

Controlling Shareholders' Networks and Related Party Transactions: Moderating Role of Director Remuneration in Malaysia

(Pemegang Saham yang Mengawal Jaringan dan Urusniaga Pihak Berkaitan: Pengaruh Moderasi Ganjaran Pengarah di Malaysia)

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ABSTRACT

Past research argued that controlling shareholders can use their power of control to influence their networks via proxy (CSProxy) and multiple-directorship (CSMulti) to engage in related party transactions (RPT). Thus, we examine the associations between CSProxy and CSMulti, and RPTs. Additionally, directors are rewarded with remunerations, and therefore, director remuneration may be effective in minimizing agency conflict. Thus, we examine the impact of director remuneration as a moderator of the relationships between CSProxy and CSMulti, and RPT. The hypotheses are tested using a sample that consists of 622 listed companies in Malaysia over the period 2012-2014 with a total of 1,866 observations. CSProxy and CSMulti are found to have positive associations with RPTs. We also find that director remuneration is significant in moderating the CSProxy and CSMulti, and RPT relationships. This evidence suggests that director remuneration is an effective monitoring cost to minimize the abuse of RPTs by opportunistic controlling shareholders via their networking, CSProxy and CSMulti. It raises the concerns of the regulators and policy makers that controlling shareholders may utilize their posts, power, position and networks to opportunistically expropriate firm resources. Firm's remuneration committee has to understand the importance of determining attractive remuneration that fulfils directors' expectation and satisfaction.

Keywords: Controlling shareholder; proxy; multiple directorship; related party transactions; director remuneration

ABSTRAK

Penyelidikan lepas mendakwa bahawa pemegang saham yang mengawal boleh menggunakan kuasa kawalan mereka untuk mempengaruhi rangkaian mereka melalui proksi (CSProxy) dan berbilang pengarah (CSMulti) untuk melaksanakan urusniaga pihak berkaitan (RPT). Kami mengkaji perhubungan antara CSProxy dan CSMulti, dan RPT. Di samping itu, pengarah diberi ganjaran, dan oleh itu, ganjaran pengarah mungkin efektif dalam meminimumkan konflik agensi. Oleh itu, kami mengkaji kesan ganjaran pengarah sebagai penyederhana terhadap hubungan antara CSProxy dan CSMulti, dan RPT. Hipotesis diuji menggunakan sampel 622 syarikat tersenarai di Malaysia sepanjang tempoh 2012-2014 yang berjumlah 1,866 pemerhatian. CSProxy dan CSMulti didapati mempunyai hubungan yang positif dengan RPT. Kami juga mendapati bahawa ganjaran pengarah adalah penting untuk menyederhanakan hubungan antara CSProxy dan CSMulti, dan RPT. Bukti ini menunjukkan bahawa ganjaran pengarah adalah kos pemantauan yang berkesan untuk meminimumkan penyalahgunaan RPT oleh pemegang saham yang mengawal melalui rangkaian mereka, CSProxy dan CSMulti. Ia menimbulkan kebimbangan kepada pengawal selia dan pembuat dasar bahawa pemegang saham yang mengawal boleh menggunakan jawatan, kuasa, kedudukan dan rangkaian mereka untuk mengaut sumber yang dimiliki oleh syarikat. Jawatankuasa ganjaran firma perlu memahami kepentingan untuk menentukan rekabentuk ganjaran yang menarik yang dapat memenuhi harapan dan kepuasan para pengarah.

Kata kunci: Pemegang saham yang mengawal; proksi; berbilang pengarah; urusniaga pihak berkaitan; ganjaran pengarah

INTRODUCTION

Related-party transactions (RPTs) are legal and normal course of business and are frequently executed through subsidiaries, associates or affiliates (Thomas, Herrmann & Inoue 2004). RPTs can be used efficiently to improve operation and reduce operating costs (Jian & Wong 2010), assist in financial resource allocation (Khanna & Palepu 1997), and help firms to meet economic and financial

goals (Gordon et al. 2007). However, RPTs have also been used as expropriation tools as seen in many corporate accounting scandals (Munir et al. 2013). Controlling shareholders can manipulate the term of transactions and disclosure due to information asymmetry. Additionally, RPTs may appear and sound efficient to the company but opportunistic controlling shareholders may hide their conflict of interest behind the practice. Thus, they can be either efficient or conflict of interest. Prior studies have

found evidence to support the use of RPTs as tunneling tools for the benefit of the related parties (Cheung, Rau & Stouraitis 2006; Gordon, Henry & Palia 2004).

RPTs are prominent in Malaysia due to concentrated ownership structure that dominates majority of firms (Claessens, Djankov & Lang 2000; Munir et al. 2013). The weak implementation of corporate governance practice and poor enforcement of minority shareholders' protection create a conducive landscape for controlling shareholders to enter into a contract with related parties (Rahmat & Ali 2016; Wahab et al. 2011). As a result, RPTs in Malaysia have frequently been used to increase private wealth rather than to increase a company's efficiency, specifically among family businesses (Ariff & Hashim 2013).

Prior studies have argued that controlling shareholders opportunistically use RPTs as tools to expropriate wealth (Berkman, Cole & Fu 2009; Cheung et al. 2006). The impact of RPTs is said to be more harmful to family controlled companies (Munir et al. 2013; Villalonga & Amit 2006). The dominant voting rights provide controlling shareholders, as a related party, the privilege and opportunity to dominate and influence any decisions made by the entities (Chen et al. 2006). For example, the controlling shareholder can maintain control over a chain of firms by positioning themselves, family members and other proxies in the top management or executive board (Villalonga & Amit 2006). Alternatively, the controlling shareholder may also use their multiple directorships in other companies to execute the RPTs.

As controlling shareholders' engagement in RPTs increases the potential of RPTs being abused. Similarly it is thus crucial to ensure that the RPTs be free from any potential conflict of interest. Abdul Wahab and Abdul Rahman (2009) and Wahab et al. (2011) emphasized that director remuneration could be effective at preventing firms' engagement in RPTs. This argument aligned with Fama and Jensen (1983) in which companies can use attractive director remuneration to minimize agency conflicts. Remuneration is a monitoring cost and incentive given to top management and directors as a reward for their roles and responsibilities. The attractive remuneration can accelerate and increase directors' satisfaction and reduce opportunistic behavior (Gordon et al. 2004), specifically in the engagement of RPTs. In contrast, directors who are also controlling shareholders may utilize RPT to compensate for the unattractive remuneration. As the evidence of prior study is limited, this gap requires further investigation on the mitigating role of remuneration to minimize the magnitude of RPTs engaged by CSProxy and CSMulti.

We examine the ability of controlling shareholders in using or influencing their networks to engage in related-party transactions (RPTs). We focus on two types of controlling shareholders' networks; which are 1) the appointment of controlling shareholder's proxy (CSProxy), including family members, as the executive board; and 2) controlling shareholder's multiple directorship (CSMulti) in other firms. The first objective is to examine the

association between CSProxy and RPTs while the second objective is to examine the association between CSMulti and RPTs. We argue that the magnitude of RPTs is expected to be higher when the controlling shareholders have multiple directorships and appoint their proxies or family members to the executive board or top management. The third objective is to examine the moderating effect of director remuneration on the relationships between controlling shareholders' networking (CSProxy and CSMulti) and RPTs in Malaysia.

We select 622 of the listed firms in Malaysia over the period from 2012 to 2014 with a total of 1,866 observations to examine the hypotheses. We find that the presence of CSProxy and CSMulti in executive board increases firm's engagement in RPTs. The engagement increases the risk that RPTs may be utilized to fulfil personal interests. This evidence supports the argument that the controlling shareholders use their networks to influence firms' decision to engage with them, which is formed through CSProxy and CSMulti in other firms. On the other hand, the findings show that director remuneration is effective in moderating the CSProxy and CSMulti, and RPTs relationships.

We contribute to the literature of agency conflict type II by examining the ability of controlling shareholders to utilize their networks (CSProxy and CSMulti) to enter into contracts with subsidiaries or other entities related to controlling shareholders. Generally, prior studies use an assumption to dispute the relationship between controlling shareholders and RPTs. The basis of the argument is that the controlling shareholders can use their voting rights to dominate and influence any decisions to be made. However, we argue that it is not so easy for the controlling shareholders to abuse RPTs, particularly after the corporate governance reform and specific regulations on RPTs have been strengthened. Therefore, the controlling shareholders may create an environment and surrounding that will exclusively facilitate the transactions by positioning their proxies including family members or establish a network through directorship in other firms. The established network is conducive for controlling shareholders to engage in RPTs.

We also contribute to the literature by examining the notion that director remuneration can be used as a monitoring tool to reduce the magnitude of RPTs engaged by controlling shareholders and their networks. Specifically, we extend the work of Wahab et al. (2011) in which director remuneration is used as a moderating mechanism in the relationships between CSProxy and CSMulti, and RPTs. Incentives are important monitoring costs in motivating directors to perform their role effectively and avoid any harmful activities. The directors should be rewarded based on their accountability, fairness, and competitiveness. Each of the components of the remuneration should sufficiently be combined so that the benefits are attractive (Barkema & Gomez-Mejia 1998; Fama & Jensen 1983). The suitable combination of reward components such as salary, bonuses, fees and in-kinds that

are linked to the executive director's performance, will motivate him/her to achieve firm's objectives (Carter & Zamora 2009; Hartzell & Starks 2003). In contrast, the executive director may be induced to engage in RPTs as a substitution to unattractive remunerations. Additionally, we switch the focus of prior studies on corporate governance structure (board independence, board size, frequency of meetings and financial literacy) as RPTs' determinants (Gordon et al. 2004; Wahab et al. 2011) to the role of director's remuneration.

The next section of this article is organized as follows: Section 2 discusses background, literature, theories and development of hypotheses. Section 3 describes the research design and Section 4 reports the empirical results. The last section discusses the findings and conclusion.

LITERATURE REVIEW

DEFINITION OF RPT AND DISCLOSURE REQUIREMENT

MFRS124 *Related Party Disclosure*, defined RPT as a transaction between related parties that often includes special features in which RPTs stand to be performed at no cost. A related party is defined as a person or entity connected to other entities through either direct or indirect interests or shareholding. Subsequently, the related party is eligible to influence any decisions to be made by those related firms. RPTs in Malaysia are governed by the Listing Requirements of Bursa Malaysia and Companies Act 1965 (revamped as Companies Act 2016). The Bursa Malaysia Listing Requirements requires that RPT be declared immediately and in detail. Additionally, Practice Note 12 on Recurrent RPTs requires that a disclosure be made on any recurring RPT. This should be declared once in every three years. The Companies Act 1965 stipulates that any substantial property transaction with individual related party must be attached with shareholder approval prior to the commencement of the transaction. MFRS124 also requires firms to disclose RPTs by showing the related parties involved (for example individuals, associates, subsidiaries, or subsidiaries in presence of individual interest, including, directors or controlling shareholders). However, there is no specific rule requiring firms to disclose the actual market price of the RPTs.

Generally, RPTs are legal contracts which are used to facilitate the firms' operations by sharing a pool of resources and obligations (Khanna & Palepu 1997). However, the RPTs may deviate from the norm. For example, the contract can be approved either at a lower or higher price than the market price such deviation allows the opportunistic related parties to design the RPTs to align with their personal interests. Thus, RPTs have been debated from two different points of view, either to represent efficient contract or personal conflict of interest (Cheung et al. 2006; Gordon et al. 2007). We posit that RPT involving the interest of an individual related-party may signal the possibility of wealth expropriation; but

RPT among business entities indicates efficient use of resources (Di Carlo 2014). However, RPT among business entities may also hinder expropriation of wealth, and is considered conflicting if it is committed by the controlling shareholders (Wong, Kim & Lo 2015). It would harm the minority shareholder's wealth.

Past studies in Malaysia show that RPTs have frequently been used to increase private wealth, specifically among family business entities (Ariff & Hashim 2013; Munir et al. 2013; Wahab et al. 2011). In addition, RPTs can also be used to manipulate a company's earnings (Gordon et al. 2007), and perpetuate fraud (Beasley et al. 2000). Schultz and Tang (2004) also emphasized that firms will only disclose RPTs after considering the benefits and costs associated with the disclosure. Since disclosing RPT-conflict invites negative market perception (Kohlbeck & Mayhew 2010; Nekhili & Cherif 2011), management may hide any committed RPT-conflict. Otherwise, the controlling shareholders may expropriate RPTs for personal wealth but legitimize the transaction as if it is executed for business purposes. This unique landscape provides greater opportunities for the controlling shareholders to expropriate the minority shareholders' wealth through RPTs, in which the impact is more severe and prominent in a developing country such as Malaysia (Villalonga & Amit 2006).

CONTROLLING SHAREHOLDERS, PROXY AND MULTIPLE DIRECTORSHIP

Malaysia is an emerging economy, in which concentration of ownership is pronounced among business firms (Munir et al. 2013; Peng & Jiang 2010). Controlling shareholders dominate majority of listed firms in Malaysia (Claessens et al. 2000). Similar as with many other East Asian countries, most firms in Malaysia are controlled by a single shareholder, particularly among family businesses (Bertrand et al. 2008). Family controlling shareholders controlled more than 67% of listed firms in Malaysia, in which 28% of market capitalization is controlled by 15 families only (Claessens et al. 2000). Generally, most listed firms in Malaysia are of family businesses, and the concentrated ownership implies the families' dominant power (Lim, How & Verhoeven 2014; Sulong & Nor 2010).

The ownership structure becomes complex when the controlling shareholders exercise their control through pyramidal structures or cross holdings due to a divergence between controlling and voting rights (Mindzak & Zeng 2018; Sarkar, Sarkar & Sen 2008). As a result, the number of shares does not necessarily represent the voting rights held by the controlling shareholders. In most cases, the controlling shareholders minimize their direct holding in another controlled entity through pyramidal structure ownership to avoid receiving unfavorable response from investors. Consequently, the controlling shareholders of a holding company have substantial power to influence the subsidiaries' activities through the use of their

voting rights, although the number of direct ownership in subsidiaries may not be substantial. Bursa Malaysia defines a controlling shareholder as the one who exercises control over more than 33% of the voting rights. However, prior studies indicate that the control over 23-25% of voting rights is sufficient for an entrenchment effect (Lim et al. 2014; Loh 1997; Sulong & Nor 2010).

Despite holding a substantial shareholding in these firms, the controlling shareholders also often participate in management activities by holding top positions in the company such as chief executive officer or director (Villalonga & Amit 2006). The controlling shareholders may also sit as a director in other firms, including the subsidiaries and affiliates' firms. Alternatively, the founder or the controlling shareholder may appoint executive directors among their family members or connections to act as proxies (Munir et al. 2013; Villalonga & Amit 2006). The appointment of proxies in related-party entities, enhances the controlling shareholder's ability to influence the entities' activities. Hence, any business contracts with the related parties are easier to be approved. However, the real ability of controlling shareholders in utilizing their networks via CSProxy and CSMulti is not sufficiently explored and thus requires further attention.

DEVELOPMENT OF HYPOTHESES

CONTROLLING SHAREHOLDERS PROXY AND RPT

Some founders or controlling shareholders as board chairmen, have the power to appoint their proxies to the executive board of the firm. They can appoint proxies among their family members or any trusted-person to the executive board to intentionally dominate the decision making process to safeguard their interests (Moore & Craig 2008). Moore and Craig (2008) debated that the participation of the proxies in the board can influence the decision-making process and consequently, increases the prospect for opportunistic transactions. Therefore, the firm's involvement in any contract with related parties will increase the likelihood of the firm's resources being expropriated. The involvement of CSProxy in RPTs results in a more serious conflict between controlling shareholders and minority shareholders.

Prior studies provided the evidence that controlling shareholders engaged in greater frequency of RPTs (Cheung et al. 2006; Munir et al. 2013). However, the argument is driven by the assumption that the controlling shareholders can use their voting rights to manipulate and influence their proxies and family members, on their behalf, to engage in RPTs. Nevertheless, there is no evidence to date that directly demonstrate the relationship between the proxies and RPTs. In line with the Agency theory and findings from prior studies, the presence of CSProxy will enable RPTs to be engaged on behalf of the controlling shareholders. Thus, we argue that CSProxy has a positive relationship with RPTs, and therefore would like to venture the following hypothesis:

H₁ The presence of CSProxy in the executive board is positively related to RPTs.

MULTIPLE DIRECTORSHIP AND RPT

The directors in multiple directorships could benefit from extensive knowledge and experience on best board practices obtained from several firms which could enhance the decision-making process (Haniffa & Cooke 2002). CSMulti can reveal the trend of the economy and different aspects of business, and provides opportunities to compare policies and management practices (Beasley 1996); or the very least, exposes the directors to different management styles. Mohd-Saleh, Iskandar and Rahmat (2005) also stated that the multiple directorships are important governance mechanism, being able to reduce the opportunistic activities by top management such as earnings management.

However, Ferris, Jagannathan and Pritchard (2003) found that multiple directorship is less effective in monitoring top management's activities. The director who served many firms has fewer opportunities to master various business environments due to their heavy workload and this indirectly undermines their effectiveness (Bathala & Rao 1995). In fact, multi-directorship is also seen as a means to facilitate them to commit fraud between firms (Pfeffer & Salancik 1978). The controlling shareholders can utilize their directorship networking to achieve their personal goals by harming the interest of other stakeholders specifically through RPTs. Through the extensive directorship network the errant directors have the opportunity to expropriate the resources of the firms they serve such as transferring assets to firms under their control mainly for self-interest often ignoring the rights of other shareholders' rights. Hence the presence of CSMulti is expected to threaten the effectiveness of a firm's corporate governance. This aberration concurs with findings by Ali, Haniffa and Hudaib (2006) who found multiple directorships do not improve the performance of firms, while in fact they actually facilitate the mismanagement and misconduct of directors. There is however a lack of evidence to demonstrate the abuse of multiple directorships, particularly those perpetrated by the controlling shareholders involved with RPTs. This argument supports the theory that CSMulti can influence other related parties in expropriating a firm's resources after operating under condition of non-transparency. A hypothesis can be proposed here on the linkage between multiple directorship and RP RPTs Ts:

H₂ The presence of CSMulti is positively related to RPTs.

DIRECTOR REMUNERATION

Director remuneration is a reward scheme to directors. It is used in corporate governance to resolve the conflict between managers and shareholders (Dong & Ozkan 2008; Wahab et al. 2011). Its main function is to provide

incentives and to discipline the directors (Alagla & Ali 2012). Jensen and Murphy (1990) show that the director remuneration system can align those interests between owners and directors to preserve the wealth of shareholders. Attractive rewards can motivate executive directors to act in order to fulfil the firm's objectives and stakeholder interests (Andreas, Rapp & Wolff 2012; Jensen & Meckling 1976). The attractive remuneration can effectively reduce agency problems and improve the firm's performance (Fama & Jensen 1983), and also retain competent directors to contribute their skills, expertise and knowledge to the business (Anderson & Bizjak 2003).

The Malaysian Code on Corporate Governance, revised 2012, recommends that director remuneration package should be aligned with the firm's long-term business strategy and objectives. Generally, firms are free to set remuneration for their directors, but the quantum must reflect the board's responsibilities, commitment, expertise and complexity of the firm's activities. In listed firms, an independent remuneration committee is responsible to identify the appropriate procedures and criteria to be used in determining the remuneration. Bursa Malaysia also requires listed firms to disclose the details of each director's remuneration in their respective firms' annual reports. There are four primary components of remuneration for executive directors. The remuneration committee should propose remuneration such as wages, bonuses, fees, non-financial incentives and stocks options aligned with the knowledge, skills and experience of the respective executive directors (Conyon 2006).

Generally, the remuneration component involves cash such as fees, salaries, and bonuses, and non-financial incentives such as stock options or warrants, properties and other in-kinds (Jaafar & James 2013). Salaries, fees and bonuses are the main components of the remuneration package which should meet the expectation and satisfaction of the directors, failing which they may be induced towards personal conflict of interest (Abdul Wahab & Abdul Rahman 2009; Jaafar & James 2013). For example, a low component cash remuneration can cause dissatisfaction leading the director to seek compensation by utilizing RPTs (Kohlbeck & Mayhew 2010).

DIRECTOR REMUNERATION, CONTROLLING SHAREHOLDERS' NETWORK AND RPT RELATIONSHIPS

In line with the above view, attractive rewards can control and mitigate potential agency problems. It can satisfactorily align the interests of the executive boards and shareholders (Andreas et al. 2012) or between majority shareholders and minority shareholders (Jiang & Peng 2011). The agency and the contract theories suggest that directors are more motivated to meet the firm's objectives when they are provided with appropriate incentives (Hambrick 1988; Jensen & Meckling 1976; Jensen & Murphy 1990). Previous studies have proven that firm performance is positively associated with the quantum of rewards received (Mehran 1995) or when

the payments are increased (Jensen & Murphy 1990). We emphasize that attractive director remuneration may curb the opportunistic tendency of executive directors in abusing RPTs (Wahab et al. 2011). They will perform their responsibilities with integrity and will not seek other opportunities to misuse their positions, authorities and networks unethically to expropriate firm's resources using RPTs. If RPTs are carried out under effective monitoring and supervision, it can increase the firm's value (Gordon et al. 2004); Wahab et al. 2011).

In contrast, Chen et al. (2006) emphasized that if the rewards are less attractive or lower than expected, it may cause the firm's performance to decline. The executive directors may feel that the firms do not share mutual benefits and pay less attention to their efforts over the years. As a result, the unsatisfied executive directors may use their positions, voting rights and authorities they possess in the firm to opportunistically abuse contracts, including RPTs. The controlling shareholders may also appoint proxies to the board of directors to act on their behalf, and errantly use their networks gained through multiple directorships in other firms to facilitate RPTs.

However, there is no empirical evidence to date to prove that director's remuneration can reduce a firm's involvement in RPTs. Kohlbeck and Mayhew (2004) emphasized that the gaps are crucial, particularly, when it involves the controlling shareholders' networks either through proxy or network from multiple directorships. In line with the Agency theory and past findings, this study anticipates that attractive remunerations can motivate executive directors to achieve the firm's goal. The directors' remuneration incentives would play an important role in minimizing the involvement of controlling shareholders through their networking, either CSProxy or CSMulti to abuse RPTs. We predict that director remuneration is effective in moderating the controlling shareholders' network and RPTs relationships. With this consideration we propose the following hypotheses:

- H_{3a} The positive relationship between CSProxy and the RPTs is moderated by the magnitude of director's remuneration.
- H_{3b} The positive relationship between CSMulti and the RPTs is moderated by the magnitude of director's remuneration.

RESEARCH DESIGN

The samples for this study comprises firms listed on the Bursa Malaysia from 2012-2014. Since the revamp of corporate governance and the Malaysia Companies Act 1965 in 2007, there are no substantial changes to those regulations and policies that directly affect RPTs, director remuneration, corporate governance structure (CSProxy and multiple directorship), and firm's ownership structure in Malaysia. Therefore the data set provides relevant and new evidence on the issue of interest.

The sample firms are selected due to their propensity to engage in RPTs. Peng and Jiang (2010) emphasized that Malaysia lacks the protection for minority shareholders due to ineffective implementation of corporate governance practices and enforcement of regulations. Additionally, most firms are established with a concentrated type of ownership characterized by the single controlling shareholder or founders (Claessens et al. 2000). They often sit as board chairman or chief executive officer (Sarkar et al. 2008), and appoint their family members or proxies to dominate key top management positions (Munir et al. 2013; Villalonga & Amit 2006). This feature of business environment and landscape in Malaysia are thus likely to encourage firms to engage in RPTs.

Corporate governance practices in Malaysia have been strengthened twice, in 2007 and 2012. The reforms included the amendment to the Malaysian Companies Act 1965 in 2007, which was the banning of RPT loans to or from directors. Currently the corporate governance practice in Malaysia is more advanced compared with those of the other East Asian countries. The quality of reporting among Malaysian listed firms is better and more reliable. Bursa Malaysia also requires listed firms to disclose RPTs by documenting the existence of a director or other related party's interest in the transactions. Additionally, MFRS124 Related Party Disclosure requires that a firm shall disclose the nature of the related-party relationship as well as information of those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. While the MFRS124 allows firms to execute RPTs at a lower or higher price than the market price, the firm however is not specifically required to disclose the actual market price of the RPTs. Considering that the corporate governance reforms in other countries may be in distinctive stages, the Malaysian business settings demonstrate that Malaysia is an appropriate location to conduct this study.

Data on RPTs were collected manually from company's annual reports. An archival of non-financial data, such as previous corporate governance structures, ownership structures and audit quality levels were similarly collected manually from the annual reports. We excluded financial institutions because of their specific regulations (Saad 2010) and omitted firms with incomplete data for the four-year period. The final sample consists of 622 companies, a total of 1,866 firm-year observations. The sample includes various major industries that are classified by Bursa Malaysia, including trading and services, industrial products, consumer products, property, construction, plantation, technology and others. We define controlling shareholders as individuals, organizations or a group of individuals who have a holding of minimum 23 percent of direct ownership of the firm. The use of 23 percent as a baseline to the ownership structure aligned with the prior reviews such as Lim et al. (2014); Loh (1997), and Morck, Shleifer and Vishny (1988) who stated that an effective control occurs at around 15 percent to 25

percent of voting rights. Morck et al. (1988) specifically found that entrenchment effect of managerial ownership begins at the level of 23 percent to 25 percent.

REGRESSION MODEL AND VARIABLE MEASUREMENTS

We use a pooled regression to examine the hypotheses using the regression model as follows:

$$RPT_{it} = \alpha + \beta_1 CSProxy_{it} + \beta_2 CSMulti_{it} + \beta_3 DRem_{it} + \beta_4 CSProxy_{it} * DRem_{it} + \beta_5 CSMulti_{it} * DRem_{it} + \beta_6 ROA_{it} + \beta_7 Lev_{it} + \beta_8 Growth_{it} + \beta_9 FSize_{it} + \beta_{10} BInd_{it} + \beta_{11} RCom_{it} + \beta_{12} CFirm_{it} + \beta_{13} \sum Ind_{it} + \beta_{14} \sum Year_{it} + e$$

Where, RPT is a total magnitude of RPTs disclosed in the financial statement in year t , scaled by the beginning of total assets of year t . This measurement is consistent with that of Kohlbeck and Mayhew (2010) and Rahmat and Ali (2016). We define all RPTs involved with the controlled firms as representing opportunistic transactions, which have high possibility to be used as tools to maximize personal benefits. The nature of the RPTs is unique; the firms are allowed to execute RPTs at a non-arm length transaction. Thus, the RPTs could be agreed at a price below or higher than the market rate. Nevertheless, the firms often do not disclose the market price in the financial report, resulting in the difficulty to determine either the tunneling or propping of RPTs as related to the firm's wealth expropriation.

The model also includes control variables to represent firm-specific characteristics, performance, corporate governance patterns, and audit quality levels that may affect a company's engagement in RPTs. Firm's return on assets (ROA), leverage (Lev), growth ($Growth$), sizes ($FSize$) and controlled firms ($CFirm$) are included to control cross-sectional firm characteristics and performance differences. Differences in corporate governance practices are also controlled by including board independence ($BInd$) and remuneration committee ($RCom$). Summaries of the variables' definitions and measurements are shown in Table 1.

RESULTS

DESCRIPTIVE ANALYSIS

Panel A of Table 2 shows results of the descriptive analysis of 622 firms listed on Bursa Malaysia with total observations of 1,866. The result shows that the mean value of RPTs is 0.09; indicating the average total number of RPTs engaged by Malaysian listed firms over the three year is about 9% of the firm's total assets. Meanwhile, the mean value of director remuneration ($DRem$) is 0.04 with a maximum score of 0.01. The statistics show, on average

TABLE 1. Definition and measurement of the variables

Variable	Description
RPT	RPT is a total magnitude of RPTs disclosed in the financial statement in year <i>t</i> , scaled by the beginning of total assets of year <i>t</i> .
CSProxy	Proxy of the controlling shareholders in the executive board. It is measured as a dummy, equal to one if there are family members related to the controlling shareholder on the board, otherwise 0.
CSMulti	The controlling shareholders' multiple directorships, measured as a dummy variable, equal to 1 when the controlling shareholders have directorships in other firms, including the subsidiaries or affiliate firms, and coded as 0 if otherwise.
DRem	Director remuneration, measured as a total magnitude of director remuneration in year <i>t</i> , scaled by the beginning of total assets of year <i>t</i> .
ROA	Return on asset, measured as earnings after tax of year <i>t</i> divided by the year-end total assets of year <i>t</i> .
Lev	Firm leverage, measured based on total debt of year <i>t</i> divided by total assets of year <i>t</i> .
Growth	Firm growth, measured based on the market value of a firm divided by the beginning book value of total assets for the year.
FSize	Firm size, measured using the natural logarithm for the book value of the beginning total assets of year <i>t</i> .
BInd	Board independence, measured as the ratio of independent non-executive directors to total board members.
RCom	Remuneration committee, which is measured as the ratio of independent non-executive directors to total remuneration committee members. It represents the independence of remuneration committee.
CFirm	Controlled firms, measured as a dummy variable and coded as 1 if the firm is a controlled firm, and coded as 0 if otherwise. The firm is categorized as a controlled firm when its largest shareholders hold the firm's ownership in excess of 23% or above.
Industry	A vector of industry indicator variables based on Bursa Malaysia's industry classification.
Year	A vector of year indicator variables (2011, 2012, 2013 and 2014)

the listed firms in Malaysia have paid their directors' remuneration at about 4% of the firm's total assets within the three-year period. However, there are firms paying rewards up to 10% of the total assets.

Panel B of Table 2 shows the descriptive statistics for dummy variables, namely *CSProxy*, *CSMulti* and *CFirm*. The statistic shows that 1,259 (67.5%) listed firms have *CSProxy* on their executive boards. This illustrates that the majority of the firms' controlling shareholders appoint proxies, especially among their family members

or trusted persons. In the meantime, only 428 (22.9%) of listed firms reported about *CSMulti*, indicating only about 22.9% of the controlling shareholders have other directorships in other firms, including the subsidiaries or affiliates. The statistic also shows that about 1,395 (74.8%) of listed firms in the sample are controlled firms. Other results for controlling variables can be referred to in Table 2. Overall, the data do not have any critical normality problem where the highest Skewness value is 8.72, and the lowest value is -0.99.

TABLE 2. Descriptive statistic (n = 1,866)

Variable	Minimum	Maximum	Mean	Std. Dev.	Skewness	Kurtosis
Panel A						
RPTs	0.00	7.10	0.09	0.28	8.72	89.69
DRem	0.00	0.01	0.04	2.58	0.76	2.41
ROA	-45.12	94.92	3.90	9.57	1.77	21.06
LEV	0.10	9.90	0.14	1.87	2.99	11.34
GROWTH	0.10	9.87	0.71	0.75	4.45	35.53
FSIZE	13.20	25.62	19.81	1.55	0.22	4.46
BIND	0.00	0.88	0.46	0.12	0.51	3.12
RCom	0.00	1.00	0.69	0.23	-0.99	4.60
Panel B						
	Yes	%	No	%		
CSProxy	1,259	67.5	607	32.5		
CSMulti	428	22.9	1,438	77.1		
CFirm	1,395	74.8	471	25.2		

Notes: Please refer to Table 1 for variable's definition and measurement. Year and Industry are not reported for brevity. We report t-statistics based on White's (1980) consistent estimator. ***significant level $p < 0.01$, **significant level $p < 0.05$, *significant level $p < 0.10$.

CORRELATION AND MULTICOLLINEARITY

Table 3 tabulates the result of Pearson's correlation test, which shows that no variables are highly correlated with each other. The results indicate that there is no severe multicollinearity problem. The highest correlation is between *BInd* and *RCom* at 0.282 and correlations with other explanatory variables fall well below 0.282, suggesting that the variables do not have multicollinearity issues (Neter, Wasserman & Kutner 1983). We also run Variance Inflation Factor (VIF) analysis and the findings (not tabulated) confirmed that there is no multicollinearity problem in the regression model. The maximum VIF value is only 3.38, which is lower than the maximum VIF value, 10 (Neter et al. 1983).

MULTIVARIATE REGRESSIONS

Table 4 shows the results of the multivariate regression for the relationship between controlling shareholder's network variables (*CSProxy* and *CSMulti*), director remuneration and RPTs. The regression results show that the adjusted R^2 is about 11%, and the F-test value is 10.67 and significant at $p < 0.00$. These values indicate that the model is fit enough to explain about 11% changes in the tested relationships. Based on Table 4, the results indicate that there is a significant positive relationship between *CSProxy* and RPTs, with a coefficient of 0.04 (t-statistic = 3.77) and significant at $p < 0.01$. The result supports H_1 that states the presence of *CSProxy* in the executive board increases the engagement of RPTs by listed firm. The finding suggests that the appointment of *CSProxy*, either among family members or trusted-persons could facilitate controlling shareholders' execution of RPTs; leading to increased likelihood of minority shareholders' wealth expropriation. The controlling shareholders may use their proxies in the executive board to cooperate in the execution of RPTs. The findings show that controlling shareholders have a great opportunity exposing the firm's resources to risks by manipulating or concealing RPTs in the firm's financial statements.

Table 4 also exhibits that there is a significant positive relationship between *CSMulti* and RPTs. The coefficient is 0.02 (t-statistic = 2.14) and significant at $p < 0.05$ to support hypothesis H_2 . The finding indicates that *CSMulti* increases firm's engagement in RPTs. The presence of *CSMulti* in other firms, including subsidiaries or other affiliates will enable them to influence the entities to engage with related parties. *CSMulti* creates a conducive opportunity for the controlling shareholders to engage in RPTs, and they may intent to abuse the RPTs for personal gain. This evidence is in line with the finding of the study Haniffa and Hudaib (2006) which finds *CSMulti* facilitates the mismanagement and misconduct of directors rather than improving the performance of firms.

TABLE 4. Multivariate regression results (n=1,866)

Variable	Coefficient	t-statistic	p
Constant	0.38	8.44	0.00
CSProxy	0.04	3.77	0.00
CSMulti	0.02	2.14	0.03
DRem	0.01	4.11	0.00
CSProxy*DRem	-0.01	-2.43	0.01
CSMulti*DRem	-0.01	-2.38	0.01
ROA	0.00	5.57	0.00
Lev	0.01	1.18	0.23
Growth	0.00	1.47	0.14
FSize	-0.01	-10.37	0.00
Bind	-0.02	-0.96	0.33
RCom	0.00	0.75	0.45
CFirm	0.01	4.53	0.00
Industry	Included	Included	Included
Year	Included	Included	Included
R-squared	12%		
Adjusted R-squared	11%		
F-statistic	10.67		
Prob (F-statistic)	0.000		

Notes: Please refer to Table 1 for variable's definition and measurement. Year and Industry are not reported for brevity. We report t-statistics based on White's (1980) consistent estimator. ***significant level $p < 0.01$, **significant level $p < 0.05$, *significant level $p < 0.10$.

TABLE 3. Pearson correlation (n = 1866)

	RPTs	CSProxy	CSMulti	DRem	ROA	Lev	Growth	FSize	BInd	RCom	CFirm
RPTs	1										
CSProxy	.026										
CSMulti	-.016	.045									
DRem	.008	.032	.017								
ROA	.325**	.027	.025	-.020							
Lev	.261**	.025	-.019	-.044	.198**						
Growth	.182**	.017	-.018	-.036	.278**	.057*					
Fsize	-.180**	.079**	.081**	.036	-.142**	-.129**	-.081**				
Bind	-.013	.254**	-.028	-.001	.023	.009	.004	-.025			
RCom	.022	.089**	-.046	-.005	.023	.044	.026	-.059*	.282**		
CFirm	.025	.129**	-.084**	.009	.016	-.056*	-.035	.056*	-.025	.007	1

Notes: Please refer to Table 1 for variable's definition and measurement. Year and Industry are not reported for brevity. We report t-statistics based on White's (1980) consistent estimator. ***significant level $p < 0.01$, **significant level $p < 0.05$, *significant level $p < 0.10$.

Table 4 shows that the result of $CSProxy * DRem$ is negative; the coefficient is -0.01 ($t = -2.43$) and significant at $p < 0.05$. This evidence supports hypothesis H_{3a} that suggests the magnitude of director remuneration can moderate or reduce the $CSProxy$ engagement with RPTs. We also find a similar result for $CSMulti * DRem$. The coefficient is negative, -0.01 ($t = -2.38$) and significant at $p < 0.05$. The hypothesis H_{3b} is supported; namely the tendency of controlling shareholders with $CSMulti$ to engage with RPTs can be reduced when they are sufficiently rewarded with remunerations. These findings confirmed that director remunerations are important monitoring costs in which the attractive incentives could increase director's satisfaction. As a result, the executive directors are motivated to play their roles effectively, and at the same time, it avoids or minimizes the execution of contracts that could harm other stakeholders. This is consistent with the assumption in agency theory, which postulates that incentives are needed to improve performance and reduce agency problems. It is also supported by Dong and Ozkan (2008), who found reward schemes as an important corporate governance tool in solving agency conflicts that exist within a firm.

DISCUSSION AND CONCLUSION

The ownership structure of the majority of Malaysian listed firms is concentrated on single controlling shareholders. This phenomenon creates agency conflict between controlling and minority shareholders. This situation provides an opportunity for the controlling shareholder to expropriate a firm's resources for personal gain, specifically through RPTs which is one of the main causes of conflict of interest between related parties (controlling shareholders or executive directors) and other stakeholders (Gordon et al. 2004). Based on the views of conflict of interest, the opportunistic controlling shareholders can use their power to engage in RPTs which thus increases the firm's costs and the attendant risk of expropriation will reduce the wealth of other stakeholders.

Our study gives a broader picture of the ability of controlling shareholder in manipulating their networking via $CSProxy$ and $CSMulti$ to expropriate firm resources through RPTs. Additionally, Brickley and James (1987) and Wahab et al. (2011) suggested that the reward system is a mechanism that can reduce conflict of interest through the alignment of the interests of all parties. This study uses the director reward system as a 'watchdog' in mitigating $CSProxy$ and $CSMulti$ engagement in RPTs.

We found that the presence of $CSProxy$ and $CSMulti$ in Malaysian listed the firm's increases firm's engagement in RPTs. The findings support hypotheses H_1 and H_2 . The evidence contributes to the knowledge by exhibiting that controlling shareholders can appoint their proxies or use their multiple directorships' positions in other firms to execute RPTs. We focus on the view of conflict of interest,

in which the presence of $CSProxy$ and $CSMulti$ enhances the ability of the controlling shareholders to sign a contract involving related parties. This circumstance will increase expropriation potential of firm resources through RPTs.

This study also contributes to director remuneration literature by examining the effect of reward system as a moderator in the relationship between $CSProxy$ and $CSMulti$, and RPTs. The documented evidence confirms that attractive director remuneration could effectively reduce the tendencies of using $CSProxy$ and $CSMulti$ to misuse RPTs for personal or controlling shareholders' gains. These findings aligned with the recommendation of Fama and Jensen (1983) and Wahab et al. (2011) that attractive remuneration offered to directors could moderate opportunistic RPTs.

Our study also have some limitations that should be taken into consideration when assessing and interpreting the results. First, we examine the firms listed on Bursa Malaysia for the years 2012, 2013 and 2014. The findings from this period should not necessarily be generalized to other contexts and settings. In addition, there are two different views toward RPTs; either they represent "conflict of interest" or "efficient transaction." However, our study only focuses on the view of conflict of interest with regard to RPTs being perceived as opportunistic contracts that can be used by related parties to maximize personal gains. Additionally, we include the cash and in-kinds rewards such as fees and salaries, and non-monetary benefits in determining director remuneration, but we exclude stock options and warrants. The results could be distinct if the determination of director remuneration considers different combinations of cash, salary and non-monetary benefits. This limitation may narrow down the scope of review on the remuneration of directors.

The findings from our study provide some implications for practices and future research. Concentrating ownership by controlling shareholders through pyramidal structure is complex and cannot be identified easily. Although the controlling shareholders may not sit in the board, their appointed proxies can help them to realize their personal goals. They can also utilize their multiple directorship networks in various firms, including subsidiaries or affiliates to engage in RPTs. The regulators and shareholder activists must seriously examine and be aware of the potential consequences, and take the right steps to minimize risk. The remuneration committee must understand the type of incentives that could encourage the directors to perform their duties, in line with the firm's goals.

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