CEO EMOLUMENTS DETERMINATION OF NON GOVERNMENTAL ORGANISATIONS (NGO) IN MELAKA: A CONCEPT PAPER

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ABSTRACT

Non-governmental organisations (NGOs) are formed by mutual members in conducting activities to enhance social welfare of its members and public. The issue of governance of NGO arises when such social welfare fail to be achieved. Principal-agent theory explains that agent (elected CEO or key committees) is responsible to carry out NGO activities aligned with principal's interest (which described in NGO missions and goals). If CEO or key committees are being paid to govern NGO, emolument is primarily perceived as a signal to level of governance of NGO. This study objectively to determine factors that influence the decision of emoluments paid to elected CEO or key committees. Subsequently, this study is to analyze the level of governance of NGO. NGO registered in Melaka will be selected from Registrar of Societies (ROS) in Melaka. Therefore, data for this study will be collected using data from ROS Melaka. 594 registered NGO that located in Melaka will be contacted and interviewed to complete structured questionnaire. Data collected will be analyzed using SPSS software to determine the factors that influences emolument decision. Subsequently, data will be analyzed to determine the level of governance of NGOs in Malaysia, which related to emoluments decision making.

Keywords: NGO, CEO Emoluments, Organisation Categories, Board Composition Indicators And Board Individual Characteristics

INTRODUCTION

Non-governmental organisations (NGOs) are definitely important in filling the gap that government and private companies offering to public. NGOs are non-profit orientated organizations normally would not make any profit. Any access of funds generated from its activities, it will be ploughed back into the organisation. Source of funds (also known as revenues) for NGO are from donors and voluntary contribution to individual, other organisations or government agencies. Revenues and profit generated are then will be used to finance NGO activities including the payment of emoluments to its Board of directors (BOD) or its committee members.

It is common practice that emoluments are given to the Board of directors or its committee members. There is no legal statement in Malaysia that prevents such practice because emoluments given are as incentives and appreciation to the Board of directors (BOD) or its committee members in spending their time to manage NGO. An emolument is accepted as an alignment of "principle-agent relationship between managers and stakeholders" (Barros & Nunes, 2007). "Agent" would be the Chief Executive Officer (CEO) or managing director of the NGO and "principal" is NGO members or stakeholders. Large and medium sizes of NGOs need skilful managers and competent support staff to ensure its efficiency in management and strive to achieve the NGO's vision and mission. Nevertheless, it is a normal assumption of public that emoluments are the easiest way for villains to divert charitable funds into their own pockets (Abigail Barr & Owens, 2005)

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In Malaysia, there are cases of irregularities on the financial management of NGO including disappearance of funds that amounting to millions of Ringgit. For example, the case of Malaysian Indian Education Development (MIED) involving missing of funds amounted to RM4 million (Anonymous, 2010, May 12). Members of the organisation and also the public will definitely doubt the ability of organisations' board in managing the organisation fund and governing the organisation towards its mission. Thus, it is essential to study Board of directors (BOD) or its committee members' emoluments in order to justify the management ability to run the activities. Hence, the study can conclude the level of good governance of the NGO. To fill up the gap, two objectives are set for this study. First, to document the determinant factors of the NGO's Board of Directors (BOD) or key committees' emoluments and the second objective is to analyse relationship of BOD or key committees' emoluments to the governance of the NGO.

The Society Act 1966 does not provide guideline on how to determine emoluments to their BOD or key committees. The absence of such guideline is giving out an opportunity to the NGO's BOD or key committees to commit an act of conflict of interest. The BOD or key committees are tended to follows their personal interest rather than the organisational goals. The example of Malaysian Islamic Economic Development Foundation's (YAPEIM) scandal (Anonymous, 2015, Nov 23) that claims the NGO has paid excessive allowances to its top management personnel arise doubt on ability of NGO determining the appropriate emoluments.

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LITERATURE REVIEW

Emoluments and Management of NGO

An emolument is formally used to define money or another form of payment for the work done. Emoluments are inclusive salary, allowances, profit, salary, or fees from office or employment; compensation for services. Compensation to the BOD or committee members is a debatable issue which is reflecting the corporate governance. As founded by Alregab (2015), the higher the compensation that is paid to CEOs, the poorer the market performance expected and she confirms that most powerful CEOs may intervene in setting their compensation contracts, which contradicts corporate governance requirements.

Allowances for example, are inclusive food allowances and travel allowances remitted for BOD or committee members' expenses to carry out their duties or tasks. However, as explained in the problem statement, emoluments expenditure is the easiest way for dishonest BOD or committee members to divert NGO funds into their own pockets (Abigail Barr & Owens, 2005). Consequently, emolument is should be the first item to be audited in order to verify its integrity and good governance. It is fundamental to ensure good governance practiced in an organisation. However, it will be difficult to differentiate dishonest behaviour or incompetence staff or BOD or committee members if NGO has poor accounting record keeping. Logically, BOD or committee members should not be paid any emoluments, if there are appalling accounting records.

In view of profit oriented organisations, poor governance (such as fraud its own funds or resources) will lead to losses. In the end, the organisations will cease to exist because competitors will take over its customers. Subsequently, only profit orientated organisations that practice good governance will continue their business. Contradictory, inefficient NGO is rarely (or never) being punished. Nevertheless, whenever there is a bad governance of any NGO reported in the press or media, it will eventually affect incoming donors for NGO, even the NGO with very good governance.

Principal-agent relationship model has been widely use in evaluate management of profit-orientated organisation (Mayston, 1993). The model was developed by Jensen and Meckling (1976) presents the most influential framework that transforms the principal-agent relationship. As agency theory describes the conflict relationship between principal and an agent, where the agent (e.g. a manager) has to behave

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on behalf of the principal (e.g. a shareholder). This model explains the mutual agreement between the principal and agent which is giving agent responsibility managing business assets (principally owned the business assets) in order to get profit. The agent (CEO or manager) elected by the principal (NGO members or BOD) to manage NGO assets towards achieving NGO missions and goals. The model will align the interest of principal and agents. Consequently, any discrepancy between the agent's and principal's interest will then create malfunction of NGO governance. In addition, if NGO agent (CEO or manager) is being paid to carry out their duties in managing NGO, their emoluments is the first signal of governance malfunction (Barros & Nunes, 2007). Jensen and Meckling (1976) add that, "If both parties to the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principle".

Variables of Emolument Determinants

Barros and Nunes (2007), highlights that "board compositions, individual characteristics, organization type" and accounting indicators are positively related to CEO emoluments. Accounting indicator such as Return on Assets (ROA) is easily tested for profit orientated organization (Davila & Venkatachalam, 2004). However, NGO donors' collection is more appropriate to be used in this study. Another element that can be used as accounting performance indicators is number of NGO members. Members usually required to pay annual fees, thus could be considered as income to NGO in funding their activities including emoluments to its key committees. Ghosh and Sirmans (2005) have explored the impact of board characteristic on CEO compensation in Real Estate Investment Trusts (REITs) and found that CEO compensation is depends significantly on the usual economic measures of performance including firm size and return on assets. More important, CEO compensation is higher in REITs where the board is weak in monitoring due to large size, and older directors.

ROS in Malaysia categorized NGO into 14 categories. The categories are Religion, Youth, Mutual Beneficiary, Cultural, Occupation, Education, Commercial, Politics, Social & Recreational, Sport, Women, Community Welfare, general and others category. Profit orientated firms' characteristics are positively related to CEO compensations. Ashley & Yang (2004) reviewed that company stability influence compensation. Company size also does matter (Benito & Conyon, 1999). Therefore, it will be relevant to study whether NGO category influences the emolument payment. A study by Fiador (2013) on the other hand, found that the size of the NGOs is most positively influential factor in explaining an NGO's adoption of a governance framework. Another organizational characteristic which is age has received some attention in the governance literature. According to Loderer and Waelchli (2011), as organizations aged, their governance structure deteriorates because the complexity of expansion cause in weaker monitoring and ultimately poorer governance.

The compensation of a CEO receives also will depends, in part, on the types of programs and services offered by the charitable mission. Most of the charity taken place by the NGOs or NPOs. According to www.charitablenavigator.org, the median CEO pay at an educational institution is nearly $88,000 more than paid to the typical religious leader in the year 2013. Balsam and Harris (2015) found that the bonuses are positively associated with profitability, competition, firm size, available cash and the use of compensation consultants and committees, while negatively related to board oversight and charitable nature. The evidence consistent with the payment of bonuses incentivizing non-profit executives as, despite reduce contributions, future performance is positively associated with bonus compensation.

Board composition indicators that are studied by Barros & Nunes, (2007) include political alliance, duration served by the CEO and formal acquaintance of CEO with Board of Directors (BOD). Board composition is also known as a board structure and study by Roshayani et al. (2013) found that an optimum mix of board members matters in ensuring efficient resource strategy and consequently enhance the level of accountability in NPOs. Rose (2006), conducts a multivariate analysis using a sample of listed Danish firms found that the higher proportion of insider ownership increases the lawyer oriented, whereas a higher remuneration increases the business person oriented of the board. If the firm size increases, the international dimension of the board increases and if a firm's experiences less growth board structure becomes more traditional. Nevertheless, Kyereboah and Biekpe (2007) found a negative

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relationship between firm age and the size of the board and the proportion of outside directors. The negative relationship with outside directors imply poor governance while the negative relationship between firm age and board size can be construed as ambiguous since the literature has not yet reached a consensus on which is best for good governance in terms of the larger or small board. However, a study by de Andres-Alonso et al. (2010) based on a sample of Spanish foundations, showed that the board size (board composition) and independence do not have a definitive effect on the entity's efficiency. Instead, the knowledge, diversity inside the boardroom and the active character of trustees has a positive influence on resource allocation.

Brickley, Horn, & Wedig (2010) also highlights board composition regarding emoluments decision making. This only can be established if BOD has the power to elect the CEO. A political alliance does not necessarily means a relationship with politicians. However, it includes the external support received by CEO in determining his/her emoluments (Elhagrasey, Harrison, & Buchholz, 1999). External support could be members of an NGO or high profile stakeholders. Nonetheless, some NGO's patron could influence management of the NGO because members of NGO highly valued patron's advices. Thus, it should be included in the study.

According to Hearn (2013), director's self-reward or compensation is measured through fixed base salary as well as total remuneration which provide a conservative estimate of the full private benefits of control of the directors. Hence, the study found that the larger board sizes have less effective governance mechanisms while enhanced expropriation of private benefits of control is closely associated with lower government promotion of private sector policies, media and analyst freedom and corruption control.

Individual characteristics are also influenced emolument payment to CEO. Public or NGO members' perceptions on CEO experiences, educations and capabilities could influence in determining CEO emoluments (Marchetti & Stefanelli, 2009). While study by Brick et al. (2006) found that relating future firm performance to the portions of a CEO and director compensation that are not related to firm characteristics, CEO characteristics or other governance variables. Logically, those who posses higher qualification are deemed perceived as more capable in managing the organisation compared to lower qualified personnel.

Moreover, Peni (2014) examines the association between the characteristics of the CEO and the Chairperson of the board and the firm performance and found that the age of the CEO or the Chair are mixed, while their experience and quality appear positively related to firm performance. Duc Vo and Thuy Phan (2013) also underlined that the elements of working experience of the board members and the compensation of board members have positive effects on the performance of the firms, while board size has a negative effect on the performance of the firms. In addition, the relationship between other board's characteristics such as educational level of board's members and firm's performance cannot be concluded from their study. Whilst Roberts and Zamora (2014) found that the board members who play both oversight and operational roles, is significantly impacted non-profit executive pay practices. This is consistent with Harris, Petrovits, and Yetman (2013), who profess that boards that actively oversee incentive compensation represent good governance. Contrary with Yetman and Yetman (2012), find that although boards can provide good governance, their effectiveness diminishes as board size increases. In fact, Aggarwal et al. (2012) found that the larger the board, the weaker the financials based pay for performance sensitivities.

RESEARCH DESIGN AND DATA COLLECTION

Researchers assumed that NGO registered in Melaka is more likely to fit our study. There are probability that NGO do not give any sort of payment to its key committees. In addition, there will be inactive NGOs but still registered with ROS and appeared in ROS listings. Researchers believe that inactive NGO should not be valid for this study. According to ROS statistics in December 2009, there are 1983

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registered headquarter-NGO in Melaka. Therefore, researchers decided to determine the number of sample to be used in the study is based on rule of thumb principle as suggested by Newman (2003). Consequently, the study will be based on sample of 594 registered NGOs (30% x 1983).

Registered NGO are required to send its annual financial statements and report to ROS. Therefore, data such as board size, total revenue, funding details, and other financial data will be collected from ROS office based in Melaka. However, registered NGO could have delayed meeting ROS deadline in sending their report to ROS. Some details such on remuneration payment details and individual characteristics may not available at ROS office. Hence, second collection data will be conducted through telephone survey using structured questionnaires. Face to face interview will deemed as highly in cost to get such data. On the other hand, posted questionnaires are deemed to have low responses. Thus, telephone interview session is more appropriate to ensure NGOs responses and keeping cost of survey to minimum.

The questionnaire design will be based on the studies by Barros & Nunes (2007). The questionnaires will be divided into few sections including data on background of the NGO selected, board composition indicators and board individual characteristics.

The collected data from the questionnaires will be analyzed to determine whether emoluments paid to CEO or key committees are influenced by organisations categories, board composition indicators and board individual characteristics. Subsequently, data will be analyzed to establish the relationship between governance of NGO in terms of emoluments decision making.

CONCLUSION

The effectiveness operation of an NGO depends on how well the NGO is governed. Since the management primarily depends on CEO directives, it is assumed CEO is compensated according to his/her performance. The CEO individual missions should be aligned with NGO's mission. This study will provide results that vital in assisting NGO to improve its governance especially related to determining emoluments for its BOD and key committee members. Further results would highlight the necessity to develop code of governance of NGO in Malaysia.

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