Compensate on Your Realities[1]

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The 1990s had been a tumultuous period for managerial compensation in India. In the decades leading to 1990, managerial salaries were stable, low and predictable. There were legal ceilings on the remuneration for company directors, both in terns of salaries and commissions. Ceilings were defined in the relation to those prevailing for government officials, and the managerial compensation therefore had a bureaucratic hue and structure. As the ceilings were low, compensation varied very little across companies and the relationship with performance of business was virtually non-existent. JRD Tata often bemoaned his inability to pay deserving compensation to outstanding managers in the group. Companies tried to cope with the situation, some by being liberal on the perquisites and some by being ingenious and using often not above board ways.

The turning point for managerial compensation was the onset of economic reforms in 1991, both directly and indirectly. Ceiling on directors' salaries was increased many folds and limits on share of profits were modified in 1991-92, and the regulations were further relaxed in following years. Equally strong impact was that of the forces unleashed by the process of liberalisation and globalisation of Indian economy, which dramatically changed the business environment in 1990s, with concomitant impact on managerial compensation. As a result, the level and structure of managerial compensation in Indian businesses has been transformed. Design of compensation system has emerged as a powerful organising mechanism, for setting corporate direction and for ensuring superior performance.

The decade of 1990s was a period of transition for Indian corporations, and managerial compensation too witnessed varied responses and experimentation.

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Patterns that have emerged hold important lessons, for designing robust and sustainable compensation systems.

New reality of wide differences in compensation across industries and companies. Unlike pre-1990s, when there was near uniformity or almost socialistic pattern in compensation, the emergent reality is of disparity. The disparities are rooted in the demand – supply situation for various skills and capabilities, size of organisation, profitability levels, etc. Companies need to internalise new realities, and design unique and innovative compensation system, depending on various industry and company specific factors. Companies will have to devise new ways to compete for and retain managerial talent. Companies in traditional sectors like steel and textiles may need to cross psychological and self-image barriers to look for new avenues for attracting and growing talent, in ways similar to WalMart, which has decided to stay away from top business schools.

Respond to fast changing job market with dynamic compensation systems. The job market from entry to the top management levels are undergoing rapid and cyclical changes, for a large number of industries. Emergence of new industries has seen rapid rise in compensation levels and an exodus from related industries, to be followed by sharp declines and redundancies. It was the finance sector in early 90's, marketing skills and basic industries in mid'90s, information technology in late'90s, and telecom and banking & insurance from turn of the century. Arvind, Coca Cola and Whirlpool gathered large number of personnel with very high salaries, to found the situation unsustainable soon after. New opportunities carry an element of risk, and the managerial compensation should also adequately reflect it. Compensation cannot be governed by pre-reform mindset, and the company can apportion higher risk – return nature of activity by having high variable component. ESOP tried out extensively by IT companies, is relatively long term in nature and it suffers from many deformities of the inefficient Indian stock markets. Companies should avoid impatience, fads and short cuts, to retain holistic focus on building business, which is full of uncertainties, arduous and long drawn. For a majority of levels and companies, an optimised combination of fixed, variable and ESOP compensation system is appropriate.

Align compensation norms with functional, divisional and company strategies. The compensation system needs to have adequate internal variety, as different parts of a corporate entity face different challenges and requirements. The motivational mechanisms, managerial orientation and result horizons are very different for R&D and marketing, within a company. Very few companies have implemented different compensation norms across functional areas, though there is wider prevalence for inter-divisional differences. The guiding factor can be strategy, and a compensation system should be based around a balance of financial and strategic parameters. A well-linked pyramid around functional, divisional and corporate strategies can provide the optimum and logical basis for compensation system. The system will have higher levels of accountability, fairness and openness. However, the attempt to retain coherence while institutionalising variety is a fine balancing act. The experiments of Tata and Aditya Birla group may provide two relevant models in the coming years.

Avoid managerial excesses. The governance mechanism for a corporation, acting through the board or the stock market, is often knee jerk and delayed. Whereas building superior business and long lasting organisation is a sensitive and complex process. Managerial authority often suffers from effective counter balance, and there have been many examples of self-seeking and highly biased management who did organisational damage. The long run difficulties and deformities could result from inappropriate compensation system and unbalanced hiring. The recent trends of one foreign bank tripling salary offered in campus interviews, and of one middle level executive in an Indian financial institution having seven fold salary increases in five years, are unsustainable. Many MNC subsidiaries during the last few years, found themselves in difficulty with 'dollar' salaries, whereas they should have at best gone for purchasing power parity based compensation levels i.e. Mckinsey. Managerial talent is indeed the most valuable resource, but it needs to be nurtured through balanced and long-term approaches.

Root compensation system on core corporate values and competencies. At a fundamental level, compensation system with its impact on managerial attitudes and profile, get synchronised with the basic concepts of a socio-economic organisation. It relates to its reasons for existence in terms of business it is in, core belief about self and the competencies that enable it to survive. Core values extend from one end of 'individual machismo' prevalent for American investment banking firms to 'subsuming collective process' of some of the outstanding Japanese corporations. It is often a simple difference between offering a job versus a career. High individual salaries may undermine the corporation, when the success depends not on individual brilliance but collective deployment of knowledge over the years. Indian companies need to clearly define where they stand, and stake themselves out on the required path and hold fast against short-term trends and pressures. India fortunately has a huge manpower base, which perhaps needs to be worked upon to an extent, to create world class and global enterprises.

Indian corporations, that were earlier denied flexibility, can now deploy the full force of compensation system as a key organising mechanism, for creating world class corporations. They need to see and understand their realities, and design innovative compensation mechanism to best meet their unique requirements. The system when infused with sufficient conviction will enable them to hold steadfast and not to be lead astray by passing fashions.