Need to Realign, Off-track Executive Remuneration[1]

Dr. Rajnish Karki

RAJNISH KARKI & ASSOCIATES
L – 1/13, Hauz Khas Enclave
New Delhi 110016 INDIA
+(91-11) 41654982 46113750
rajnish@karkiassociates.com

The news items on the remuneration of Navin Jindal and other CEOs have created a sense of disbelief and discomfort, in the corporate India and beyond. This years' remuneration are not one-off but broadly along the lines of the past few years, so a pattern has formed and settled into. It can therefore be plausibly assessed, for the influencing forces and the efficacy of executive remuneration in India.

CEO remuneration is multi-component and multi-dimensional in implications. It comprises of broadly three components – 'fixed pay', which is payable as monthly salary, company contributions such as provident fund and pension, and imputed value of perquisites; 'performance pay', payable annually depending on company's performance and executive's contribution in a year; and, 'stock options', granted at the beginning and along the tenure in recognition of the long-term contribution. The quantum and the proportion of components have a significant impact on the short and long-run performance of a company, the ways and methods of its organisational functioning, and the image among external stakeholders and society at large.

In a review over a decade ago (Corporate Dossier, 2nd March 2001), I celebrated the freedom of setting executive remuneration. For decades and till the early-1990s, executive remuneration in India was low, uniform and tightly controlled, with ceilings defined in relation to those prevailing for government officials. The freedom brought about a welcome and healthy change, in introducing differentiation along the size of businesses and linkages with the profitability. The CEO remuneration moved-up in the 1990s, but it rose further and sharply in the

[1] Published in Corporate Dossier (The Economic Times), dated 12th December 2012, in a slightly abridged version under the title "Money for Nothing"

next decade. A look at the highest paid 300 executives reveals that the remuneration of CEOs managing large businesses is in excess of Rs. 5 crores per annum. These large businesses, over Rs. 5000 crores or $ 1billion in size and having above par profitability, currently number around 200 in India. And, they can be used for comparison with the trends overseas.

A metric is the ratio of the remuneration of highest and lowest paid employee in a company. Taking the remuneration of lowest paid worker or staff in India at Rs. 2 Lakhs per annum, the ratio works out to over 250 for large companies in the country. It was around 20 in early-1990s, and continues to be so currently for public sector units. There are wide differences – with PSUs and some old business houses bringing the 'low' end; groups such as Tatas and Mahindras that are restrained in remuneration, around the ratio of 100; many emerging business houses and multinational companies and banks over 200; and, the 'outliers', mostly promoter – managers such as Navin Jindal going all the way to many thousands. In comparison, the ratio for American companies climbed from around 20 in 1970s to 100 in early-1990s and 300 in 2000-01, and is currently over 250. While UK tends to track American trends, albeit on the lower side, the companies in continental Europe such as Germany and France are more restrained and the ratio is less than 40.

The current remuneration of Indian executive is conclusively high and in fact excessive. A ratio of 250 is being panned in America as unfair, and it's arguably more so in the Indian context where lowest paid corporate employee draws over four-times the per capita income. And, the prevailing ratio in continental Europe puts the matter beyond contention. The swiftness of rise from 20 to over 250 in barely decade and a half makes the Indian executive remuneration worrisome. There are three perspectives or criteria to assess executive remuneration – the 'economic', 'organisational' and 'institutional'.

The economic perspective relates to the opportunity costs of hiring and retaining competent managers and the executive being rightly rewarded and controlled as 'agent' of owner or 'principal'. Major demand – supply gaps in the availability of executives skilled in operating in a competitive and global business environment, spiked-up the remuneration almost every five years in the last two decades. As pay suffers from lock-up effect, much more than perhaps any transacted good or services, the remuneration remained at the spiked-up level even when the situation changed and rose from the previous high base in the next cycle. With remuneration ratio – outliers being mostly owner managers, the apprehension of principal – agent relationship getting compromised in such condition, is actually substantiated. Further support comes from the professionally run companies such as L&T and HDFC, where the CEO remuneration is distinctly higher than the comparable business or company heads in owner-managed groups, especially the component of stock options.

The organisational perspective considers CEO as a steward, who leads the company from one point of its evolution to the other. The current performance is seen as a result of all the executive decisions and actions and the developments internally and externally, from a company's founding, with the CEO taking the baton forward. A CEO has position power, but a high proportion of his effectiveness comes from the personal power – ability to command respect and carry difficult decisions and to lead members for ambitious goals that may mean pain and sacrifice early on. The personal standing will be affected if the CEO is perceived to be cornering unfair rewards, impacting company's performance and errors of commission and omission on long-term decisions. Indian organisations increasingly appear exceptionally generous at the top. The remuneration drops sharply to around a third at a level just below CEO, and the differences thereafter are small and relatively balanced.

The institutional perspective looks at a company in its larger context, of the prevailing laws and regulation and the socio-cultural norms and aspirations. Corporate India is generally respected, as embodying national aspirations and is seen as a major and distinguishing strength of the country internationally. Many of the CEOs are seen as role models of society. However, the institutional aura of corporate India has certainly diminished in the previous decade. The type of companies and CEOs that are hogging the limelight are increasingly less so for product, market and technology achievements. High executive remuneration comes in your face and causes wide-ranging consternation. India with a socialistic history and orientation, till just a couple of decades ago, and with 33% of population below $1.25 poverty line, will have no stomach for US type executive remuneration. The executive remuneration although well within the prevailing regulation, is falling foul of the larger socio-economic context of India. And in the absence of suitable realignment and self-regulatory mechanisms, corporate India could invite social and regulatory reaction, which may be unpredictable, unproductive and regressive.

The executive remuneration in India has clearly gotten off-track. While greed is universal, the excessive remuneration is an outcome of the governance infirmity as an economic entity, the misinterpretation of role and contribution of CEO in an organisation and the lack of understanding and sensitivity to institutional context. CEO is an immensely powerful position in a company, and more so when he is a principal shareholder too. That power however comes with enormous responsibility, and calls for wisdom and balance in realising the company's interests as a whole from the economic, organisational and institutional perspectives.