

# Governing executive remuneration

Board Leadership Center



**While the linkage between executive remuneration and business performance is well established, balancing the expectations of executives and shareholders is easier said than done. There is a need, and a desire, to maintain stability at the leadership levels which often results in a tight rope walk for the Nomination and Remuneration Committee (NRC) when determining executive pay. A talent crunch, and the great resignation, further compounds the problem in an environment where the market shapes compensation trends and the NRC often ends up playing catchup.**



## Pay for performance

With the NRC's composition being dominated by Independent Directors, ascertaining 'real' performance, which goes beyond financial performance and outcomes, is not as simple and straightforward. Change in executive remuneration in scenarios where organisations fail to meet their performance targets is not proportional to scenarios where organisations perform. The Company's Act also provides no guidelines to the NRC for these specific scenarios. Additionally, targets are set at the beginning of the year while performance and remuneration are looked at, at the end of the year with limited to no discussions on remuneration in between. Even the current set of metrics used for evaluating performance and determining remuneration show limited diversity, with majority of the metrics being tied to financial performance. Executive performance needs to look at metrics holistically such as ESG metrics, digitalisation, diversity and inclusion etc. rather than focusing on metrics such as market capitalisation and share price growth.



## Company structure matters

How organisations are structured often dictates the process of determining executive remuneration. At one end of the spectrum multinational organisations follow a disciplined and regimented compensation philosophy

driven by their corporate head quarters, leaving the NRC with little legroom beyond reviewing the proposed philosophy. On the other hand, promoter driven organisations offer limited flexibility for the NRC, with the promoters wanting to control the overall process. The NRC in these cases can show the mirror to promoter group and voice their concerns, however the company's legal entity structure and the proximity to power centres can complicate fair assessment of executive remuneration.

## Maintaining the pay mix and balancing pay elements



Executive remuneration across organisations is a mix of fixed, short-term incentives and/or long-term rewards. The NRC is dependent on the HR team in the organisation to provide market benchmark reports, however these reports are often dated which provide little elbow room to manage pay, especially when the report indicates a lower compensation positioning compared to the market. The committee may choose to focus on more performance driven long term incentives such as performance shares, performance driven ESOPs (Employee Stock Option Plans), performance linked RSUs (Restricted Stock Units) and/or SARs (Stock Appreciation Rights), however, it is important that the targets set for vesting of options/units are at a stretch to align long-term organisational performance and pay.

## Maintaining internal parity



With the market dynamics, there has been a disproportionate increase in compensation for technology roles and niche skills even at the CXO levels. The increases have led to certain key positions in the organisation like senior data scientists etc. commanding a higher compensation than the key managerial personnel (KMPs) despite being at a lower rung within the hierarchy. These market dynamics are compelling the NRC to look at steeper increases in remuneration at the executive levels to maintain parity. In scenarios like these, the NRC can focus on the total compensation and use variable pay

components to drive parity rather than increasing fixed costs for the organisation. Additionally, the NRC needs to counsel the HR team especially on managing compensation for senior management hires and niche roles, where the market premiums can adversely affect internal parity.



## Governing executive remuneration

As the NRCs represent the entire organisation and its stakeholders, it is important for them to gain a wider perspective on compensation from the stakeholders, such as the executives, their direct reports, and external consultants. The NRC needs to protect interests of stakeholders not involved in the process of determining executive remuneration by preventing practices such as deep discounting of options, widening the gap between median worker pay and the executive pay etc. With instances in the market where organisational expenses on executive pay and long-term incentives run into hundreds of millions of rupees for organisations which haven't broken even, the NRC needs to balance the organisation's ability to pay and executive remuneration. Governing executive pay becomes even more challenging when the CEO, chairperson or the MD control a large percentage of equity and it may be difficult for the NRC to push back. Finally, the NRC can look towards indexing compensation to the market, subsidiaries as well as global compensation trends to help organisations and all its stakeholders unlock value.

## Questions for the NRC to consider:

1. How does the NRC effectively link compensation to company performance?
2. How can the NRC address performance-pay correlations for other KMPs like CMO, CTO etc. considering NRC's interactions are limited compared to CEO and CFO?
3. How does the NRC create a culture of open and honest conversation on pay and performance?
4. In organisations with dominating shareholders (promoters), how does NRC maintain independence in the executive remuneration process?
5. How does NRC prevent value erosion for other stakeholders through practices like deep discounting, absence of performance shares etc.?
6. How can the NRC align executive remuneration practices with the compensation practices of the wider organisation?

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