# Calibration of executive compensation

Board Leadership Center (India)

India as a market has undergone tremendous change in the last decade and has witnessed a significant GDP growth. It has, however, also seen its share of macroeconomic headwinds associated with the global economic fluctuations. This has had a major impact on India's talent landscape, particularly at the executive/leadership (or Key Management Positions, known as KMPs) level. The Indian market is repositioning itself with the following focus areas:

**01**

**Digital transformation:** boosting the digital economy and technology-enabled evolution

**02**

**Environmental, Social and Governance (ESG):** developing relevant strategies around energy transition and climate action

**03**

**Enhancement of global footprint:** increasing both manufacturing and exports while moving ahead on the path of development, and positioning each exported product and service as a robust brand for India in the global market

**04**

**Strengthening workforce:** building high value disruptive businesses, skilled workforce, improving workplace safety, enhancing employability of women, and creating more skilling opportunities

Focusing on technology enablement, ESG, global expansion, and skill building have become paramount for organisations across sectors. To be successful in these areas, companies must hire and retain exceptional leaders who are highly skilled, possess a visionary mindset, and a high degree of ownership. It is thus critical for organisations to hire the right fit who can adapt to these market changes and successfully navigate through macroeconomic disruptions.

Hence, it has become ever more important for organisations to consider: How should executive compensation be tailored for the risk-taking ability, market disruption, and the digital transformations that C-suite executives are expected to spearhead for organisations and industries?

# Mobility and dynamism in the skill market

In light of the growing opportunities for building future focused skills, the Indian market in general has witnessed immense mobility and dynamism in skill profiles. C-suite executives possessing niche skills often move across companies and industries for better prospects. Companies compensate these individuals well – sometimes going above the industry benchmarks. For instance, in some cases, the CFOs are paid more than CEOs due to the niche skills they possess and value they bring to the boardroom.

Career mobility has also caused a massive tussle for talent at the C-suite level. Any key change in leadership has a trickle-down effect in the entire organisation and sometimes to the larger industry. To ensure minimum disruption and changes in senior management, companies are now paying higher to ensure longevity of key positions. One of the key reasons for shortage of the right top talent is the yearning to become entrepreneurs among potential talent in the Indian market.

In light of this, organisations can leverage effective C-suite succession planning as a tool to escape the vicious cycle of skewed executive compensation.

# 'Fair' executive compensation

The disparity of executive compensation in India is a growing concern. In recent years, the gap between the salaries of top executives and the median employee has widened significantly. An analysis shows that over the last five years, CEO pay ratio to median remuneration of employees (MRE) has risen from 153 to 222 in India[1]. This trend is largely true for the entire KMP band.

There are several factors that contribute to the high level of executive compensation in India. One factor is the size of the Indian market. India is a large and growing market, which means that there is a lot of competition for top talent. This competition drives up the salaries of top executives.

Another factor is the lack of regulation on executive compensation. In India, there is no guidance on how companies should compensate its executives, what should be the KMP pay ratio to MRE, etc. This means that companies are free to set whatever salaries they see fit, which can lead to excessive compensation.

There are multiple ways to address the disparity of executive compensation in India. One way is to increase regulation on executive compensation through governance by the NRC. This would set limits on how much a company can pay its executives. Additionally, the NRCs should also aim to increase their coverage to calibrating compensation levels across the organisation rather than focusing on a few select levels. It is vital for NRCs to raise questions regarding KMP pay ratio to MRE; and drive discussions around entry level compensation, minimum wages compliance for direct, indirect and contract-based workforce.

Broad guidance range can also be given on KMP pay ratio to MRE and declared as a policy. In line with such policy, new inductions should be made within the guidance range with very few exceptions.

Another way is to increase transparency around discretionary performance linked executive compensation. This would make it easier for employees to see how much their top executives are earning vis-à-vis the impact created within the organisation and the industry, in terms of market share, business growth, expansion etc. Ultimately, independence of the boards and independent directors can have a vital role to play in managing this issue and building compensation structures which are fair, just and competitive. This is crucial as reducing income inequalities is not just a hallmark of good governance but also one of the Sustainable Development Goals (SDGs).

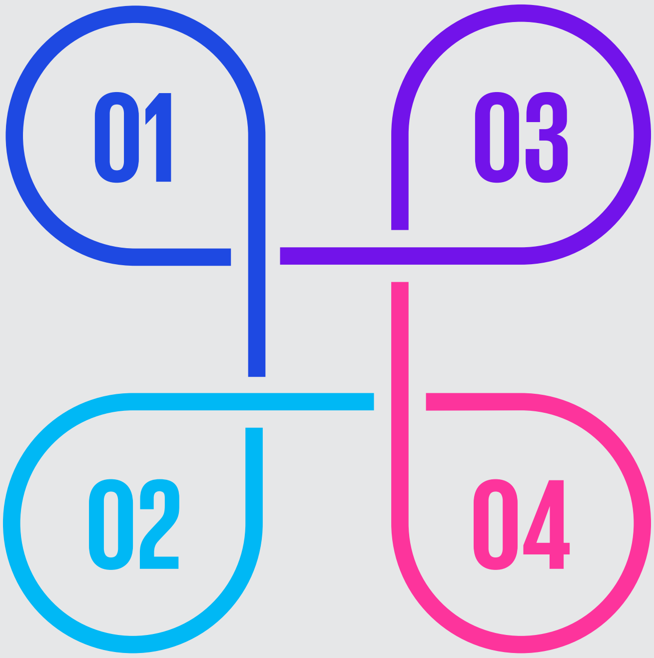
1. "Are Indian CEOs' salaries too high?", May 2023, The Hindu Business Line

# Striking the right balance between risk and reward

Striking the right balance around executive compensation with respect to risk and reward is a delicate task. On one hand, executives need to be compensated fairly for their high-level of responsibilities and the risks they take. On the other hand, executive compensation should not create a sense of unfairness among other employees or shareholders.

NRC has a critical role to play in the calibration of executive compensation keeping in mind the career mobility, reward for risk, and the fairness of this reward.

There are several factors that can be considered when striking the right balance between risk and reward in executive compensation. These factors include the following:




01 The level of responsibility, business impact and authority held by the executive

02 The performance of the company under the executive's leadership

03 The risk on company's business and the executive's portfolio

04 The compensation of other executives in similar positions in the market

It is important to note that there is no single mantra for striking the right balance between risk and reward in executive compensation. The best approach will vary from company to company. However, by carefully considering the factors listed above and leveraging the right long-term incentive plans, companies can strike a balance that is fair to both executives and shareholders.

To sum up, the calibration of executive compensation is a complex process that should account for factors like pay parity, fair compensation for job risk, disruptive market trends and business impact. By carefully considering these factors, organisations can ensure that they are paying their executives fairly and in a way that is aligned with their long-term goals.

# Questions for consideration for the NRC

1. How can NRC ensure fairness in executive compensation?
2. How can NRC help in striking the right balance between compensating the CEOs and other Key Management Personnel (KMP) for the 'risk' they take and the 'reward' they earn in terms of compensation?
3. How can NRC ensure that the right KPIs and metrics are well defined for the C-suite employees?
4. How can NRC play a role in reviewing and developing 'Compensation Philosophy' of the company which is based on Economic Value Add (EVA)?
5. How can NRC influence the organisation to build a robust executive succession pipeline?
6. How can NRC enhance robustness of the executive evaluation and its linkage to compensation?
7. What steps can NRC take to increase transparency around discretionary performance linked executive compensation?
8. What role can NRC play in evaluation and balancing of 'riskiness' of the company's business and the executive's portfolio?

We would like to thank our NRC Council Members for their time in providing us with their valuable insights and perspectives that have contributed to building this point of view document.

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