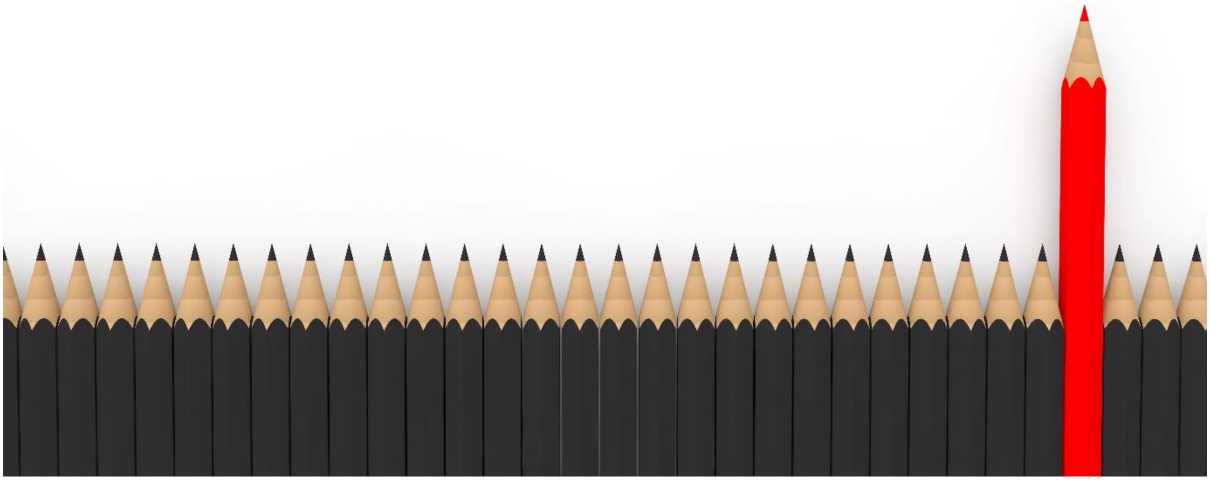
The missing 'S' in CEO compen●ation

CEO pay growth has outpaced revenue and profit growth in corporate India for several years. During the COVID-19 crisis, CEOs were expected to have some forbearance and put employees before themselves. But not all CEOs heard the clarion call. Several promoter CEOs continued to pay themselves, at the cost of lay-offs, pay cuts, and reduced profits. No amount of ESG espousing can make up for how employees in these companies have been shafted.



CEO[1] compensation has been a contentious issue in corporate India for a few years now. A separate IiAS study revealed that in 66 of the S&P BSE 100 companies, CEO pay had outpaced revenue or profit growth (or both) over a three-year period. The remuneration structure itself is of concern: in most of these companies, there is a higher component of fixed pay which is assured, with a limited share of performance-based pay, creating a weak incentive mechanism.

Universal hardships affect people differently – while some bear a higher burden, others give till it hurts, and some continue to self-preserve. Corporate India geared up to shield India from the COVID onslaught, by quickly making protective gear, to supporting the healthcare system, and of course, making vaccines. Even so, labour was hard hit. The exodus of labour, the layoffs, the furloughs, and pay cuts all impacted the average worker. While some industry leaders like Mukesh Ambani or Uday Kotak[2] led in solidarity and took pay cuts in 2021, the feudal mindset of the proverbial 'lala' became far more pronounced as well.

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[1] *For the purpose of this article, CEO is being used as a generic term. It refers to the management leader, a role that may carry different designations across companies, including Executive Chairperson and Managing Director.*

[2] *Kotak Mahindra Bank is one of IiAS' several shareholders*

Of the S&P BSE 500, there were six executive directors whose remuneration in FY21 exceeded Rs. 500 million (Exhibit 1). These Indian companies do not have the size and complexity of their global peers to justify such remuneration levels. For context, the remuneration of the highest paid board member of Toyota Motor Corporation (a company that has operations in about 200 countries and regions and revenues in excess of USD 200 bn), aggregated JPY 1.45 bn for fiscal 2021, equivalent to about Rs. 950 mn.

Industries like automobiles, cement, and pharmaceuticals have relatively higher levels of CEO pay. "*Ours is a complex business in a difficult industry*", is the most common refrain when explaining high levels of remuneration. If that were true, at the very least, one would expect CEOs pay structures to be aligned to the company's internal pay standards. Interestingly, for some promoters, this too is not true. Some promoter CEOs are paid more than 50x the next executive director who is a professional, and more than 1000x the median employee remuneration. For context, the CEO of Rio Tinto (a natural resources company that operates in more than 35 companies and generated revenues aggregating USD 44.6bn in 2020) was paid 81x the median employee remuneration.

Boards believe competence is genetic, independent of experience, and so there are a few 20+ year-old executive directors belonging to the promoter family that are paid almost equal to the company's 50+ year-old CFOs and other whole-time directors. Promoter compensation alone accounted for more than 20% total employee benefit expenses in a few companies.

Several companies' businesses were deeply impacted by the COVID crisis – media and entertainment, hospitality, travel, and retail industries being the hardest hit. Some of these companies let go of employees and others implemented pay cuts yet the CEO's continued to be paid a high remuneration and annual raises irrespective. A company that reduced its headcount by more than 40%, gave its promoter CEO a pay raise because a fixed pay raise was baked into the remuneration structure when it was approved by shareholders. Making an exception during an exceptional year and not taking a raise was the right thing to do. Not only promoters, but professionals like Sandeep Bakshi of ICICI Bank[3] did so. Several companies reported lower employee benefit expenses in FY21, yet promoters got their pay increases.

The expectations for CEOs to deliver should not be different, whether they are promoters or professionals. Most professionals have a large proportion of their compensation linked to performance targets or through stock options – and so they are compelled to create shareholder wealth. For promoters, because their wealth (and in most cases their identity) is associated with the company, the general expectation is that they would be focussed on driving business. But in taking huge salaries, promoters are signalling that

[3] ICICI Prudential Life Insurance Company Limited, part of the ICICI Group, is one of IiAS' several shareholders

they are separating their roles as owners and managers. If so, shouldn't there be equivalent performance standards for promoters too?

In most companies where promoter remuneration is being questioned by investors, the Nomination and Remuneration Committees more often than not includes the promoter as well. While companies can extol the virtues of their conflict-of-interest policies, the practical realities are different – it is hard to ignore the promoter's presence, whether they are physically in the room or not. Boards too are happy having the promoter-in-charge: it is easy for them to delegate some of their responsibilities to the promoters. With such weak governance structures, setting performance orientation to promoter pay is a challenge. It is time for the regulator to consider putting executive remuneration of promoters to a majority of minority vote.

Promoter greed doesn't go unnoticed. As investors watch executive remuneration closely, so do employees. While employees accept that promoters are a cut above, their (promoters') behaviour during the crisis can deeply wound employee morale and loyalty. Companies describe human capital as one of their most important assets; yet its shabby treatment poses long-term risks for businesses. Boards urgently need to set greater accountability and 'professionalize' the promoters, an unenviable task by all measures.

Exhibit 1: Remuneration of executive directors in excess of Rs. 500 mn for FY21

Sr. No.	Company	Promoter's Name	FY21 Remuneration (Rs. Mn.)	Increase in FY21 promoter pay	Increase in FY21 employee benefit expenses	Multiple to FY21 median employee remuneration	Multiple to the FY21 pay of the next highest ranking professional	Share of FY21 employee benefit expenses	
								Promoter CEO	Promoter family
1	SUNTV	Kalanithi Maran	875.0	0%	-5%	Not disclosed	55x	28%	57%
2	SUNTV	Kavery Kalanithi	875.0	0%		Not disclosed	55x	28%	
3	HEROMOTOCO	Pawan Munjal	869.3	3%	3%	826x	13x	4%	4%
4	DIVISLAB	Murali Krishna Divi	808.4	54%	33%	1,868x	2x	10%	17%
5	JSWSTEEL	Sajjan Jindal	733.8	83%	-12%	1,054x	14x	3%	3%
6	RAMCOCEM	P R Venketrama Raja	597.6	46%	10%	908x	2x	14%	14%

Source: Annual reports, IiAS research

Notes:

- *FY21 remuneration includes commission and other forms of variable pay.*
- *All increases shown in the above table are annual increases; FY21 levels over FY20 levels.*
- *To assess share of promoter family remuneration as a share of employee benefit expenses, the remuneration of only those holding executive positions has been considered. Non-executive directors of the promoter family receiving commission or any other form of remuneration have been excluded.*
- *The list may not be exhaustive.*

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