Role of NRC in executive compensation

Boardroom Leadership Center (India)

Executive compensation in India has seen an exponential increase over the past two decades, vis-à-vis employee compensation. To understand this growing gap better, Ritesh Tiwari, Partner, Board Leadership Centre, KPMG in India had an insightful conversation with board veteran Mr. Pradeep Bhargava, Independent Director on multiple boards. The conversation revolved around the evolving scope of NRC, the factors considered by it, and the adequacy of the process followed to set the executive compensation.

How has the scope of Nomination and Remuneration Committee (NRC) evolved in recent times? In relation to executive compensation, what is the emerging ask of NRC from stakeholders?

The charter/scope of NRC is well established and regular updates by SEBI/MCA make it a live document. In recent years, the evolution is towards a greater focus on diversity (beyond gender), health and wellness of employees (work-life balance) and imbibing organisational culture and values. In short, the evolution is towards making the organisation a 'great place to work'.

Some of the key emerging asks of NRC relate to:

- Fair opportunity for inhouse talent before looking for lateral talent
- Ensure severance with reverence, with equity in the departure
- Restrict the growing inequalities in compensation between different levels
- Encourage the 'pay for performance' mechanism across the organisation.

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Independent Director on multiple boards

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How do you view the adequacy of the template and rigour followed by NRC in execution? Is there any observed shift in the process followed by NRC to set the executive compensation?

NRCs often get unfairly judged on the parameters beyond their charter. Audit Committee for instance has the ownership of accounts/ compliance/governance extending up to policies and processes. On the other hand, NRC is supposed to oversee the induction and compensation of a very small, yet critical, section of employees. And even there, they step in where most of the recommendations/ choices have been made by the executive management.

On executive compensation, the Management, and the HR update the NRC on the overall status, the process followed, the rewards policies etc., making it more of a 'good to be aware of' item. Although, NRCs get a bit deeper on the compensation of KMPs/ CXOs since it is in their template, the recommendations of leadership (who supervise and manage them) are largely followed with marginal tweaks by NRC/ board. This distant and minimal engagement dilutes the rigour of the template followed by NRC.

In your experience, have NRCs been effective in steering the equitable and consistent executive compensation regimes in organisations?

NRCs have NOT been very effective in achieving the said agenda. It is largely because NRCs perceive that their primary charter is to help induct and compensate senior leadership resources while the executive management and HR handle the rest of the organisation. This arrangement is difficult to work in reality as these two groups do not operate in sync.

Hence the NRC/ board should be asking if rewards are being equitably shared by all levels of the organisation since success is always a team effort. The ratio of CXOs compensation to the median compensation is an item that deserves discussion but is seldom held. There is some traction seen in this regard, but it is not strong enough to be impactful. Adequate overseeing of the growing divergence cannot be kept as 'out of scope' for NRC. Sadly, this exclusion is often self-imposed by independent directors / NRC to avoid conflict and unpleasantness.

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How do you view the exceptional growth in executive compensation vis-a-vis the moderate growth in compensation of employees in recent times?

In early December, the Times of India had an article with an eye-catching title “Million $ Salary CEO Club sees Membership rush in a tough year. Gets 45 new CXOs, Total Compensation of Top Executives jumps over 55%in FY 22 despite a challenging year “

The beneficiaries are promoters/professionals working for manufacturing/ tech companies. Ten of these CEOs earned in excess of INR70 cr /year, and the highest earned INR146 cr/ year (versus INR85 cr last year). This is despite every single organisation covered in this report being a publicly listed company in India. All of them having independent directors, NRC and a board who have approved these compensations after their due diligence.

The compensation increases for the general executive cadre in these companies averaged between 10-15 per cent. Simple math will show that the ratio of CEO’s salary/median salary of the executive will range from say 400 to 1000. The number will be astronomical if we were to compare it with the median including blue-collar and may go up to 5 digits.

With few exceptions, this inverted pyramid compensation structure (the higher you go, the more you get paid) is an accepted way of life in all institutions, valuing the experience/responsibilities of the CXO club. There are obvious questions about the fairness and sustainability of this trajectory.

Typically, what are the factors considered by NRC while fixing executive compensation?

It is not very different from what any diligent HR organisation would factor in while recruiting a senior leader. Since NRCs are associated with the induction/ assessment of senior management personnel, the only extra weightage will be on individuals’ dependability (stable /trusted/ integrity) and ability to work as a team player. Compensation for laterals is defined by the market forces and the only caution is the impact of the compensation on existing talent. For the senior level, a greater share of variable pay has become an accepted practice in all enterprises, duly supported by NRCs.

In your opinion, is a regulatory or stakeholder intervention desirable/essential to moderate the often-quoted growing inequalities in compensation at different levels in the organisation?

Regulatory intervention for moderating inequalities is most inappropriate at this stage of our development when the trend is towards ‘less Government’. It is not for the state to formulate or moderate individual compensation as long as the institution has the ability and resources to pay without encroaching on its other statutory financial liabilities.

However, other stakeholders like SEBI, investor advisory groups, shareholders, and even employee organisations (including trade unions) can certainly seek explanations from the NRC and Board for granting disproportionate dispensations.

Like the Audit Committee keeps an eye on the related party transactions, this is the time for NRC to be vigilant on ‘connected party compensation’ and demonstrate their independence.

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