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On The Rise

Sonal Khetarpal April 29, 2019

Mith an astronomically high compensation of Rs 146 crore, CP Gurnani, CEO and Managing Director, Tech Mahindra, was India Inc's highest paid professional CEO in 2017/18. Gurnani was followed by AM Naik, Group Chairman of Larsen and Toubro (L&T), who took home a pay packet of Rs 137 crore. At a distant number three was HDFC Bank's Managing Director, Aditya Puri, who earned Rs 41.10 crore in the same year.

While Gurnani earned a massive 3,151 times more than the median pay of his company's workforce, Naik's salary was 1,725 times higher than the average salary in L&T. He surely would have never imagined that he would be among the highest paid Indian CEOs when he joined L&T as a junior engineer way back in 1965, and took home a salary of Rs 670 per month. They are outliers, and these sums are including their long-term stock options, but more on that later.

The salaries of Gurnani and Naik may seem disproportionately high, but corporate India is pampering its CEOs. The CEO/MD pay of the 500 NSE listed companies, as per a Prime Database study, increased 13.40 per cent (in 2017/18) over the previous year from Rs 2,909 crore to Rs 3,299 crore. These CEOs are not just earning a fortune, their pay is also substantially more than that of other employees in the organisation.

Research by Niti Kiran (Graphics by Amit Sharma)

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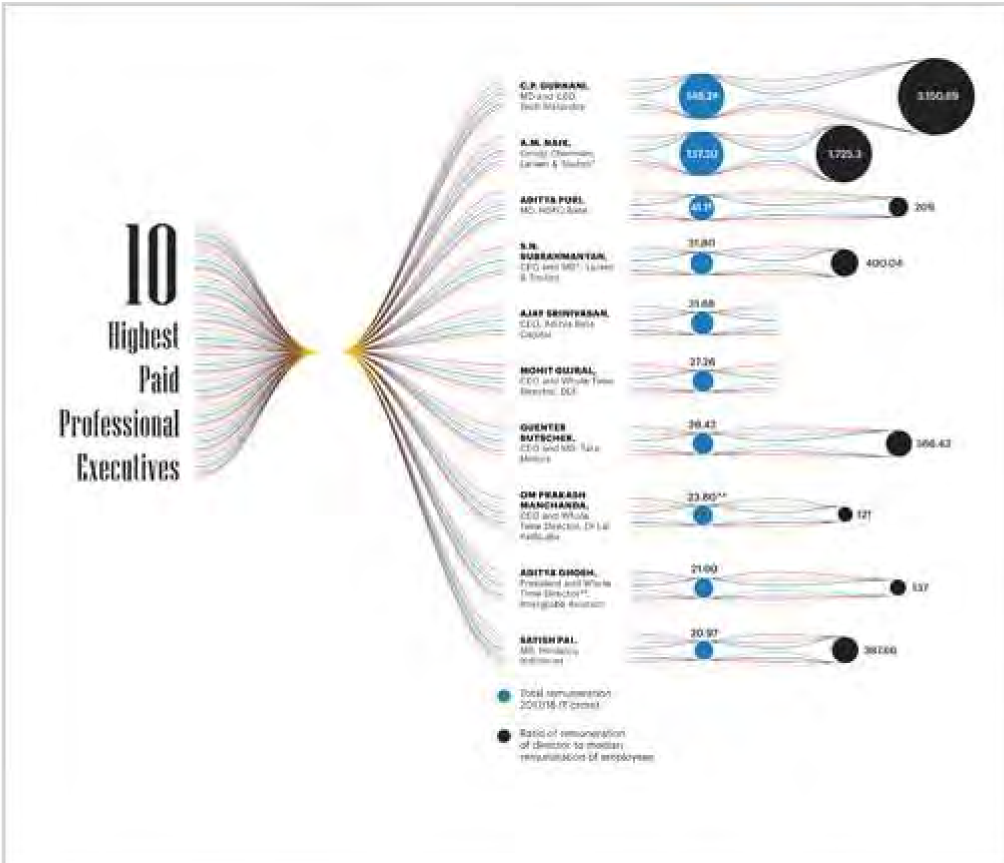
In FY18, Indian CEOs and MDs earned an average of 165 times more than the median employee pay (500 NSE listed



companies), up from 160 times in the previous year. Aditya Puri, MD, HDFC Bank, for instance, earned 209 times more than the other employees. Similarly, Aditya Ghosh, currently CEO, India and South Asia, OYO Rooms, during his stint as President of InterGlobe Aviation last year (which owns IndiGo Airlines) earned Rs 21.60 crore, which was 137 times more than the average employee salary of that company, and made him the ninth highest paid professional CEO. Ghosh quit IndiGo in November last year.

Are these astronomically high pay-outs justified? In an era of cut-throat competition, the stakes are far higher for a CEO and are hence justified, say senior HR professionals. A CEO today not only needs to ensure that his company is profitable quarter on quarter, but also ensure creation of long-term value, which is of utmost importance. Long-term value creation needs a massive risk taking appetite as well as the ability to think out of the box. When Ghosh took over the reins of IndiGo Airlines, there were a host of other low-cost airlines, all vying for the same price-sensitive Indian consumers.

The low-cost bets of the likes of Kingfisher Airlines and Jet Airways did not work. By focussing on offering a good quality value service, on-time arrivals and a great customer experience, IndiGo became profitable at a time when most airlines were bleeding. It also substantially increased its market share from 27.7 per cent in January 2014 to 39.7 per cent in January 2018. Its total revenue increased by 23.7 per cent in FY18. The airline also reported a 35 per cent increase in profitable operations in 2018. IndiGo's market cap went up 30 per cent from Rs 37,978 crore in FY17 to Rs 49,454 crore in FY18.

Shailja Dutt, Founder, Stellar Search

"The focus today is more on creating value and sharing wealth rather than the obsession with the biggest pay cheque," says Shailja Dutt, Founder of executive search firm, Stellar Search. The new norm is to create long-term value for the organisation and in the process create value and wealth for the leader and the entire team. A case in point is the Rs 21 crore salary of Ghosh, of which around Rs 16 crore was ESOPs. Becoming a key stakeholder himself in the value creation process makes the CEO answerable to the external stakeholders as well as the employees. "You share equally whether it's roses or brickbats. The CEO who shares in wealth and value creation takes responsibility for not just the company's performance but also each and every employee," says Dutt.

If one were to look at some of the new-age companies such as Swiggy, Flipkart or Ola, the CEOs earn anywhere between Rs 15 crore and Rs 20 crore per annum. One could argue that technically these CEOs don't justify the pay packet they get as the companies are still far away from profitability. But these are companies that have created a lot of wealth for shareholders. They are being paid for the valuations they are creating. Also, the variable component of the salaries could be as high as 50 per cent as they are part of the growth story and are not merely running the business.

Whether there is justification in these CEOs getting a pay packet that is several notches above that of the average employee, is certainly debatable.

The case of the top three CEOs on the highest paid CEO list is an aberration. In the twilight of their respective professional careers, the extremely high salaries of Gurnani, Naik and Puri are a reflection not so much of their respective companies' performance in the recent years, but has more to do with their accomplishments in the last few decades. Gurnani's fixed salary, for instance, is Rs 2.6 crore; a sizeable chunk - Rs 142 crore - was from the stock options that were granted to him over the years which he encashed during the year. Similarly, out of the Rs 41 crore compensation, Puri of HDFC Bank got Rs 31.4 crore as stock options over several previous years, which he exercised during 2017/18. Naik of L&T got a whopping 74 per cent pay hike last fiscal, but Rs 48 crore was through ESOPs, and Rs 78 crore was retirement benefits. He has been the Non-executive Chairman of L&T since October 1, 2017.

These three veterans are the Hercules of corporate India. They joined their organisations when they were relatively fledgling entities and turned them into powerhouses. "Their career growth is synonymous with the firm's successful journey. They are brands in themselves," explains Dutt.

Gurnani, now 60, joined Tech Mahindra in 2004 as President and is credited with the firm's successful merger with Satyam, turning what was a telecom company into a services firm with interests across BFSI, manufacturing, healthcare, and media among others. Naik is virtually synonymous with the $17 billion-L&T. Similarly, 69-year-old Puri of HDFC Bank joined as Managing Director in 1994 and built it from scratch into India's largest private sector bank by market capitalisation. As of March 29, 2019, the market cap of HDFC Bank stood at Rs 6.3 lakh crore, making it the third Indian company to achieve the milestone of Rs 6 lakh crore, after Tata Consultancy Services and Reliance Industries.

Creating Value

When a potential CEO candidate goes for an interview today, the obvious question that the employer asks would not be about his quarter on quarter approach, but his larger vision for the company. A key criterion for the candidate also will be the kind of opportunities he will get to build a valuable organisation. The candidate's compensation structuring is largely dependent on this value quotient.

"Compensation is now leaning more towards ESOPs and profit shares. So, if the company grows, there is an enormous payback for professionals. It not only aligns their wealth creating opportunities with the company's growth but also puts their skin in the game," says Sanjay R. Shastry, CEO and Managing Director of RGF Executive Search India.

A profit-share model is also making rapid progress, says Shastry, wherein the executive gets a share of the profits. "A fixed percentage of the profit growth is put in an escrow account which the executive can encash after a certain predefined timeframe, usually three to five years. This prevents the executive from being poached as any other opportunity that comes elsewhere fails in front of this end of the rainbow offer," he adds.

Variable pay constitutes almost 50 per cent of a CEO's compensation package today, against just 20-30 per cent a decade ago. "Of late, it is around 50 per cent of the total pay in the form of short- or long-term incentives," says Anubhav Gupta, Director, Executive Compensation, Aon Consulting. It could even go up to 60 per cent in some sectors such as IT and financial services. However, manufacturing and old economy sectors still have to catch up to this trend.

The component of fixed pay is even lower in mature markets. As per an Equilar study, the fixed component in S&P 500 companies constitutes only 12.3 per cent with the remainder being in the form of cash bonus, stock and ESOPs.

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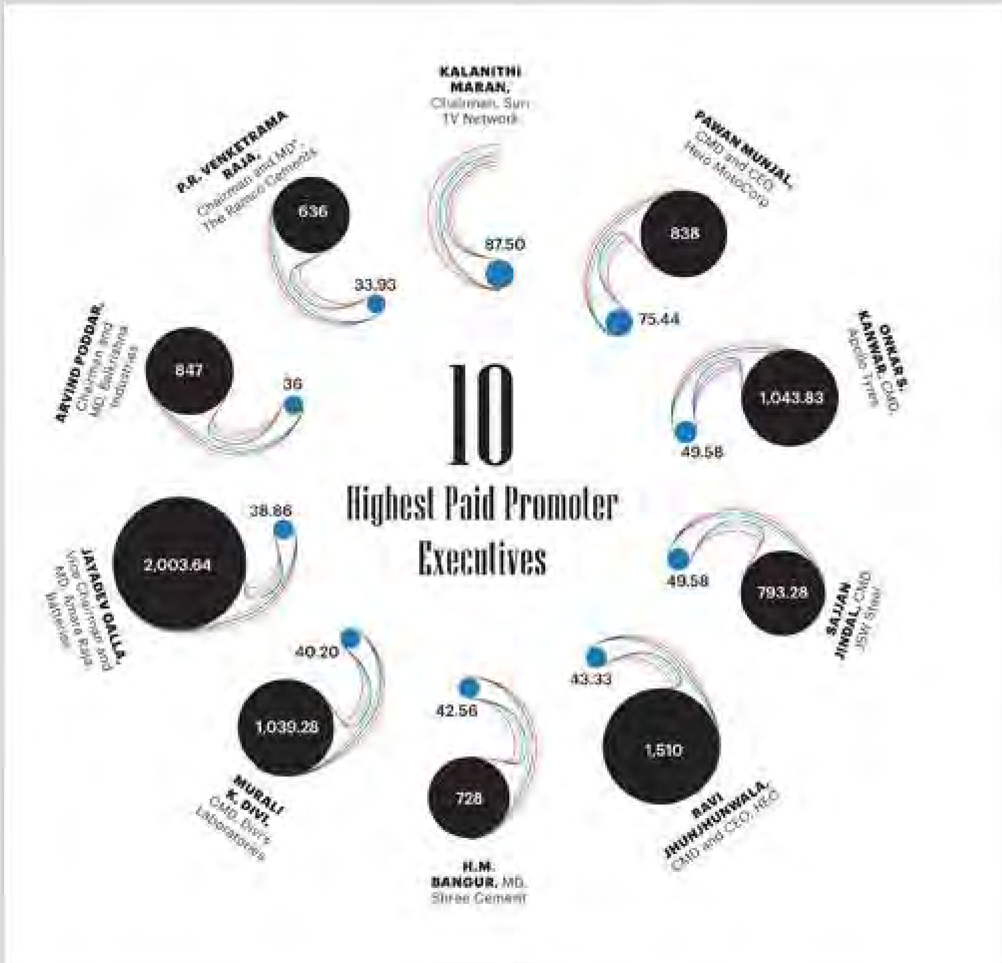
Promoter Mindset

Almost 60-70 per cent



of corporate India comprises of promoter-led companies, and unlike professionally managed companies, promoter CEOs tend to prefer fixed pay: a strong fixed component along with cash handouts which are commission-based and available in the short term. "Promoter pay is a bit of an aberration. The usual perception is that the business was their idea after all and they took the risks, so taking higher pay-outs is not unreasonable. Unlike professionals, their pay is not governed by market forces," says Ronesh Puri, Managing Director of executive search firm, Executive Access.

For the large promoter-run company CEOs such as that of Reliance Industries and Mahindra & Mahindra, salary doesn't matter too much as the promoters own more than half the company and their dividends and other perks are much higher than their salary. Mukesh Ambani, for instance, is known to have capped his salary at Rs 15 crore for the last few years. However, promoters of smaller companies look at their compensation as a source of income. "It is also a matter of lifestyle for them. But, most of them get out of this mindset as their company grows," says a senior headhunter on condition of anonymity.

Taking a fixed pay is also tax efficient, points out this headhunter. "The company pays a corporate tax on its revenue to determine the dividend. There is then an additional dividend distribution tax that it has to pay. And, the promoter, too, has to pay a tax if the dividend value exceeds Rs 10 lakh whereas compensation can directly be booked as expenses."

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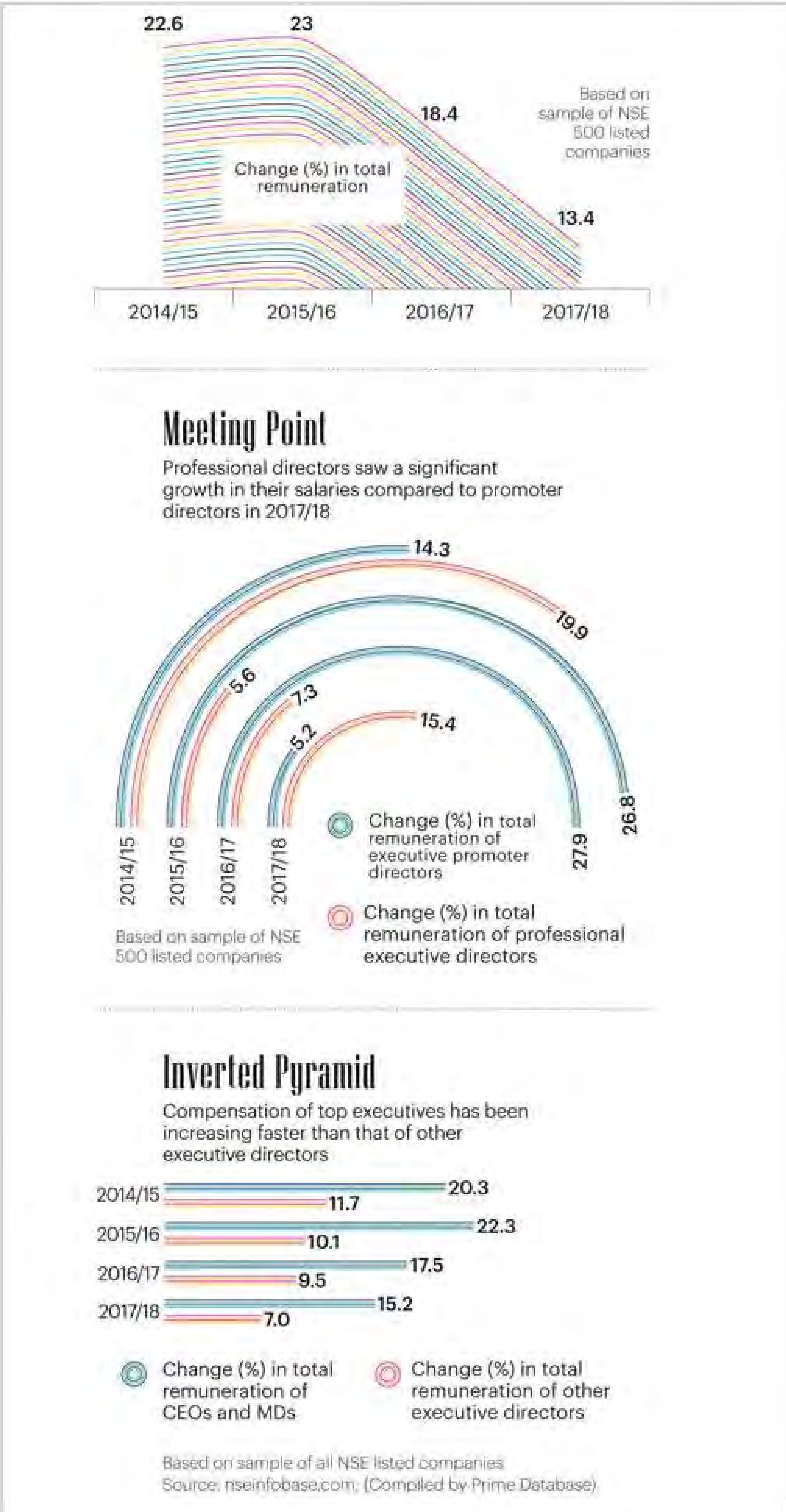


The median pay of the top 10 promoters was Rs 43 crore in 2018/19, as against Rs 29.47 crore of the professional CEOs of India Inc. The highest paid promoter CEO was Kalanithi Maran, Chairman, Sun TV Network, who took home Rs 87.50 crore last year. Next is Pawan Munjal, CMD of Hero MotoCorp, whose total pay was Rs 75.44 crore (out of which the basic pay was Rs 9 crore and fixed commission Rs 51.72 crore).

All the top nine promoter CEOs (after excluding Kalanithi Maran, for whom the data is not available) earned more than 500 times the median employee salary in their firm; four of them earned more than 1,000 times - Jayadev Galla, Vice Chairman and Managing Director of Amara Raja Batteries (2,004 times at Rs 39 crore); Ravi Jhunjhunwala, CMD and CEO of HEG (1,510 times at Rs 43 crore); Onkar S. Kanwar, CMD of Apollo Tyres (1,044 times at Rs 49.60 crore); and Murali K. Divi, CMD of Divi's Laboratories (1,039 times at Rs 40 crore).

Four of top 10 promoter CEOs are from the auto and auto ancillary sector: Automotive batteries manufacturer Amara Raja, tyre manufacturers Apollo Tyres and Balkrishna Industries, and two-wheeler manufacturer Hero MotoCorp.

"Auto and manufacturing sector were not the flag bearers of top salaries but that is changing as most of these companies have strong international presence, and as they grow their business in foreign markets, they bring in stronger governance and world-class processes into their boardroom," explains Shastry of RGF.

HeroMotoCorp, for instance, is present in 37 countries across Asia, Africa and South and Central America, and plans to expand its footprint further. In fact, it reported a 12 per cent increase in international sales in FY18 at 204,484 units. Apollo Tyres, too, has gradually expanded its international footprint since 2009 and has six global manufacturing plants. Similarly, 85 per cent of Balkrishna Industries' revenue comes from overseas markets for supplying overhead hoist transport systems to replacement markets and vehicle manufacturers. This could be the reason why the annual increments are in line with their company's growth.

The median increase in promoter pay over 2016/17 was 11.3 per cent as the turnover of these companies increased by 13.25 per cent and shareholder value by 29.25 per cent in 2017/18. There were instances of dips in emoluments too. For instance, Divi's Murali saw his pay fall 13 per cent to Rs 40.20 crore as the company's turnover reduced by 4.6 per cent.

Sanjay R Shastry, CEO and Managing Director, RGF Executive Search India

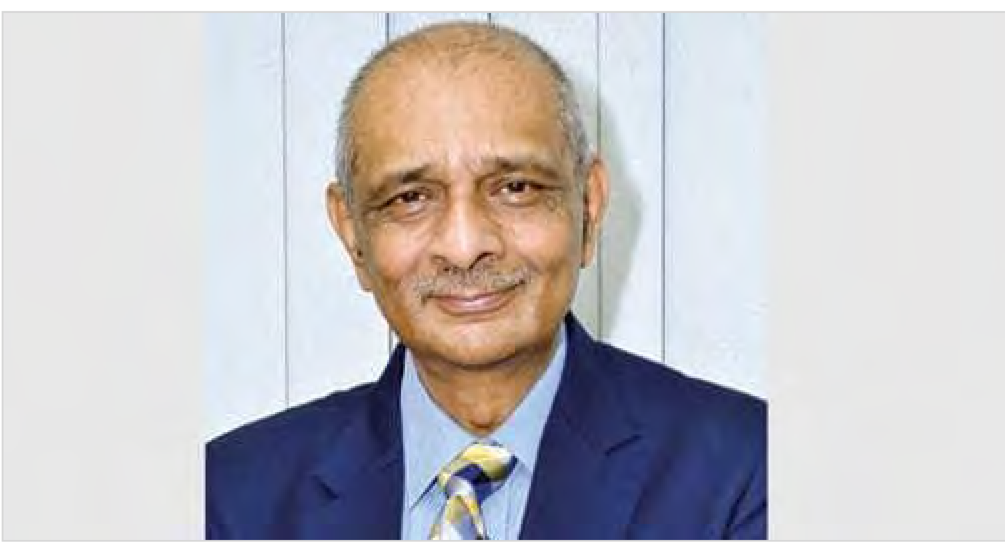
Lack of Transparency

Bob Iger, CEO of The Walt Disney Company, got a $65.6 million compensation in fiscal 2018. Shareholders didn't take to it kindly, despite the company's stock price being on a five-year high post the announcement of its new streaming service, Disney Plus. Iger's salary hike meant a CEO-to-median employee pay ratio of 1,424 to 1. In fact, Abigail Disney, grandniece of founder Walt Disney, tweeted that the pay hike was "insane".

Indian CEOs are not used to being questioned by their shareholders. While the norm for CEOs is not to be too worried about quarter on quarter growth, but have a vision for the future and work towards it, how long can the person be forgiven if the company doesn't perform in the short term?

In an ideal world, the risk and reward should align. But that doesn't really happen. There are also questions on how much reward justifies the growth. There are several instances when the company hasn't done well but there is no impact on CEO compensation. Often, the owner takes a lot more than the professional CEO of the company or places too many family members on the Board. All of these are cases of lack of good governance in companies where the owner wants to retain decision making in his own hands. In such cases, wealth will not be tied up objectively to the appreciation of share value.

There are only a few instances of shareholder activism in India. In 2014, shareholders of Tata Motors rejected an increase in remuneration of three key executives. However, when put to vote for a second time in January 2015, shareholders voted in favour of the increase. More recently, in November 2018, minority shareholders at Apollo Tyres rejected Neeraj Kanwar's reappointment as Managing Director amid claims of high salary and moderating financial performance, following which Onkar and Neeraj Kanwar agreed to take a 30 per cent salary cut.



Ronesh Puri, Managing Director, Executive Access

We still do not have cases where the founders have been removed when the company didn't perform (think Steve Jobs, Travis Kalanick). Neither the Jet Airways Board nor the shareholders could get founder Naresh Goyal to exit, until the company reached the brink of bankruptcy. What we have are spectacular issues of non-performing assets (NPAs) due to non-performance of Boards at IL&FS and Jet. "The company can't go down just like that. It is strange to think that the Board didn't or couldn't see the signals before, but kept their heads turned away," says Ronesh Puri.

Governance isn't just about following rules and regulations but it is also a function of how professionally the company is run, says K. Sudarshan, Regional Managing Partner, Asia, EMA Partners. "What is happening in India is companies are growing fast and systems and processes always play catch up to growth. In high growth markets, growth comes first and processes follow."

In a 2019 survey conducted by Institutional Investor Advisory Services (IiAS) 70 per cent of the respondents believed that executive remuneration practices of corporate India were opaque and 56 per cent believed that in less than 25 per cent of companies, CEO remuneration was aligned to company performance.

The Nomination and Remuneration Committees (NRCs) play a crucial role in ensuring parity between performance and rewards. However, Amit Tandon, Founder, IiAS, claims that in some promoter-driven companies, a person from the family is also a member of the NRC. "This leads to potential conflict of interest and limits the ability of the committee to look at compensation objectively."

Recently, the Reserve Bank of India (RBI) introduced guidelines for the banking sector executives. There were also disclosures pertaining to declaring CEO pay ratio. An important change is that ESOPs have been included in the pay matrix, which the RBI will review. The Securities and Exchange Board of India (Sebi) has also mandated that the chairperson of the top 500 listed companies by market cap will not be executive directors or related to the managing director or CEO from April 2020. In the top 10 highest paid promoter companies, except for Sun TV, The Ramco Cements (as on March 31, 2018) and Amara Raja Batteries, no other company has a separate CEO.

There are many grey areas and Business Today's analysis shows that some companies have their own set of exclusions to calculate CEO pay ratio and percentage change in remuneration. There is a need for more detailed disclosures on perquisites, bonus, commission and dividend income.

The current disclosures make it difficult to identify fixed and variable components, and draw trends at a national level. What we need is a standard format on disclosure norms for directors' compensation for better transparency. Regulation can only improve disclosures but better governance will happen when Boards take it up vigorously. "They need to create thought-through pay structures that align pay and performance, considering the size and industry," says Tandon of IiAS. Boards have a responsibility to ensure that CEOs play their part in the larger corporate story and don't become larger than life themselves.

"It is the organisation that is the lead actor, and the CEO plays a supporting role. If we keep creating a cult of CEOs, it will not be healthy for the organisation. They are there to do the job and the focus should be to formulate strategy and execute with the buy-in of major shareholders and Boards have a responsibility to ensure they get paid to do just that," says Sudarshan of EMA Partners.

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Second in command

One of the key measures of professionalism in a company is how succession is planned. Shailja Dutt, Founder of Stellar Search, says compensation at the second level is a good indicator of the potential successor.

BT deep dived into finding the second highest paid executives. In the overall top 10 companies, there are three family members and seven professionals. The three family members are: Neeraj Kanwar (son of Apollo Tyres' CMD Onkar S. Kanwar), Prashant Bangur (son of Shree Cement's MD H.M. Bangur), and N.V. Ramana (immediate family member of Murali K. Divi, CMD of Divis Laboratories).

In Sun TV, after Kalanithi Maran and his spouse Kavery Kalanithi, who both took home Rs 87.50 crore each, was the company's CEO and MD, K. Vijaykumar, at Rs 1.30 crore (he resigned on March 31, 2019). At Tech Mahindra, following Gurnani is the firm's CFO Milind Kulkarni at Rs 1.26 crore. Vice Chairman (non-executive) Vineet Nayar took home more than Kulkarni (Rs 40 crore). In JSW Steel, founded by Sajjan Jindal, the second highest paid isn't his spouse or children but a professional executive, Seshagiri Rao, who is the Joint MD and Group CFO. Similarly, at HDFC Bank, it was Deputy MD Paresh Sukthankar who was with the bank since its inception in 1994. He resigned in August 2018. "This speaks volumes about the company that it is professionally run," says the head of a search firm who didn't want to be named.

A.M. Naik of L&T might have broken all records of cash emoluments in India but he has also mentored S.N. Subrahmanyan, MD and CEO, to carry forward the baton at L&T.

Dutt says it is common in old economy companies to not have clear succession plans in spite of ageing CEOs. "I have seen companies where the CEO is already way past retirement and there is no successor within his second line and then there are rumblings in the Boardroom. My question is, what were you waiting for? Identifying succession early, especially when you have a strong CEO at the helm, is not just a responsibility but a necessity."