Navigating the path to maturity

Executive Remuneration in India

Trends, issues and challenges in India

pwc

Introduction

Over the last few years, the senior executive rewards landscape in India has evolved significantly. The last decade has witnessed aggressive pay practices alternating with periods of restraint and moderate hikes. We have also seen the introduction of alternative vehicles of long-term incentives, greater use of metrics to link reward with shareholder value, as well as the increasing calls for governance in senior executive pay aligned to value delivered. Equity of pay across organisational levels has also been in focus.

After a decade of experimenting with executive rewards, the Indian market has reached a stage of maturity in some aspects. However, some of the issues haunting industry have still not been addressed. The quantum of compensation has grown significantly, but the accompanying focus on governance and sophistication in how it is delivered has not kept pace. Going into the next decade, the challenges that companies will face to optimise their compensation programmes will be far tougher. They will need to make up for lost time as also respond to new business realities. The patience shown by shareholders to build businesses and the leeway provided for growth at any cost is unlikely to continue. Meanwhile, the diversity, profile and expectations of the workforce are getting more complex.

2011 India executive rewards pulse survey

To understand the changes that companies are making to their senior executive rewards practices and analyse the factors that are shaping executive pay, PwC launched the inaugural 2011 India executive rewards pulse survey. The survey conducted across 42 companies saw representation from leaders across various industries with varied ownership patterns and listing status. This paper draws upon the survey results to present an analysis of the current state of executive remuneration in India and the shape of things to come.

Trends

Coming of age of rewards of practices

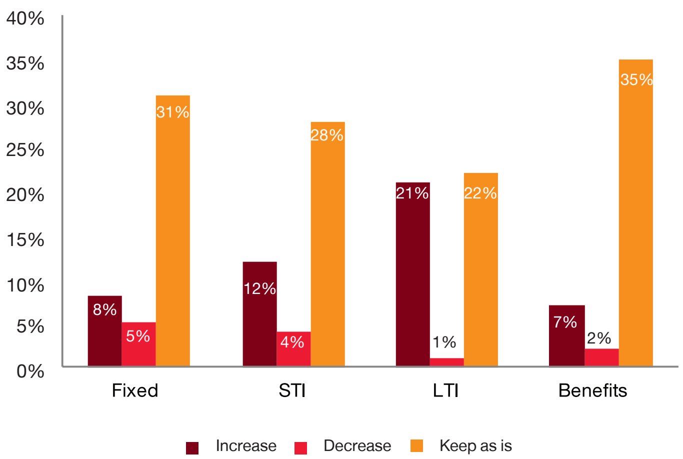
Reining in runaway compensation practices.

The executive compensation scenario in India is maturing, with more planned and measured approaches being taken now. From a compensation perspective, an important outcome of the economic crisis in 2008 was the dampener on the 'hiring at any cost' paradigm. Before the meltdown, the primary objectives of offering long-term incentive plans to executives were wealth creation and talent attraction, reflecting the immense competitive pressures on employers. Today, sustainability of compensation costs and the impact on internal parity are important factors. Design considerations are shifting and reward programmes are oriented towards driving performance and shareholder alignment. While companies still have pressures to attract and retain talent, there is a subtle shift in the economics of the talent market.

Steady increase in pay at risk.

Over the last two decades, Indian companies have continued to strengthen proportion of pay at risk at a slow but sure pace. At the executive level, pay at risk now comprises around 40% of the package at target, with an even split between short-term and long-term incentive (LTI) plans. This increase is likely to continue.

Pay mixes: Proposed changes



Long- term incentives are here to stay.

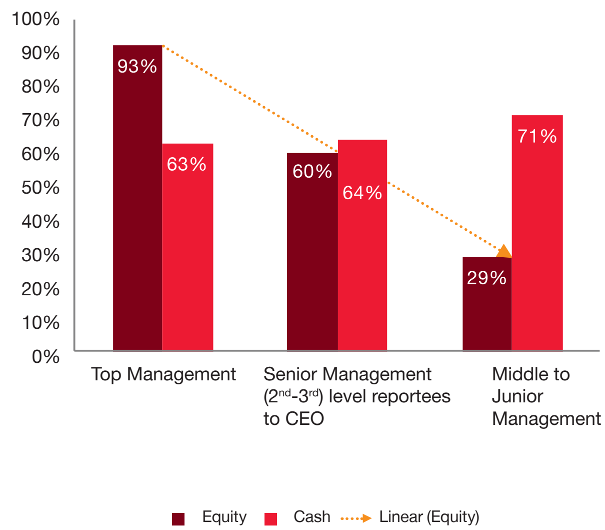
After the stock markets crash, equity awards were written off by many. The plummeting markets saw the value of grants reduce drastically and many options go underwater. However, our survey shows a high prevalence of long-term incentives at the executive level. In addition, companies without LTI have indicated a strong intent to introduce a plan in the near future. LTI has come to be accepted as an essential element in the way compensation is delivered at the executive level, with the accompanying risk and reward trade-off that it connotes. The resurgence of equity-linked LTI in a lack lustre stock market reiterates the maturity of compensation practices and signals the breaking of the short-term linkage to stock market fluctuations.

Fine-tuning LTI plan features based on learning.

Companies are getting 'smarter' in their use of long-term incentives. The first wave of grants in India saw indiscriminate usage across the board, with limited governance and many unintended consequences. Today, we see a more judicious use of equity, both among early adopters as well as late starters.

Companies are narrowing the eligibility of LTI plans to middle and senior management, as it has had limited success in retention at junior levels. We also see the adoption of a portfolio approach by some companies to LTI by using multiple plans in combination. This helps balance various objectives. Companies are also building a portfolio where they are using vehicles which resonate best at different levels, such as cash at junior levels and equity at senior levels.

LTI eligibility: Equity vs Cash



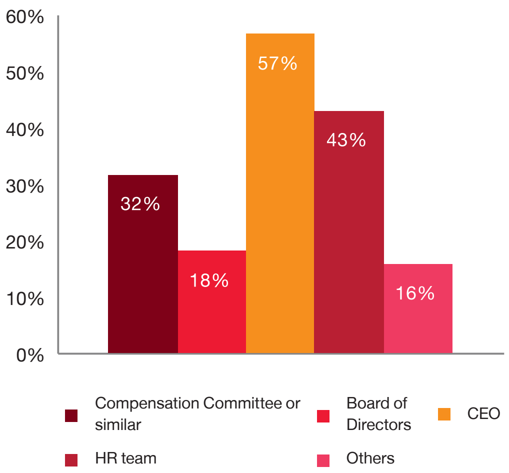
Issues

Distance to cover

Need for proactive governance.

While top executive compensation levels in India compare favorably with the west on a quantum basis, it is alarming that executive pay governance is yet to find its place sufficiently on the board agenda. Decisions on top management pay packages still rest with the CEO and the HR function in the majority of the companies surveyed. We have some way to go on the level of rigour and scrutiny applied to executive compensation decision-making, looking at factors such as market benchmarks and the applicability of the right peer group, as well as alignment to value delivered.

Who sets senior executives pay levels in your company?

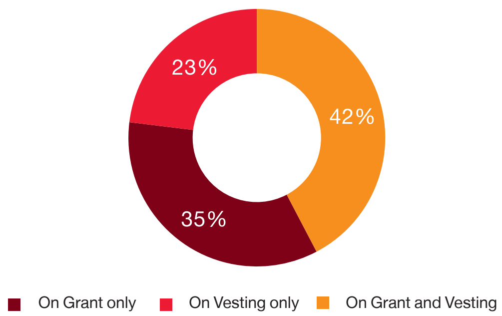


There are some areas where we see companies building upon the learning from mature markets, such as early beginnings of claw-back provisions in incentive plans which allow companies to recover bonuses in case of fraud or restatement of accounts. Indian companies are also steering clear of the controversial 'golden parachute' severance packages, though this may be by default rather than design.

Strengthening performance alignment.

The increase in proportion of pay at risk is not accompanied in most cases with robust underlying performance metrics and data. Over 40% of companies surveyed do not have a performance metric linked to the vesting of their long-term incentive plan, indicating much scope for strengthening performance linkage. Also, compensation mixes for top executives are still fixed-pay heavy, with 50 to 75% of the total being guaranteed. Companies run the risk of incurring huge compensation costs, without providing significant focus on driving desired behaviors and performance goals.

Metrics linked to LTI plans



Other aspects of strengthening the performance linkage that need to be brought in include looking beyond the traditional internally focussed absolute performance metrics and incorporating relative or market based performance metrics, as well as having metrics that are adjusted for risk.

Making better use of equity.

Equity is the preferred vehicle at senior executive level. However we see limited use of equity vehicles beyond employee stock options or ESOPs. Vehicles such as performance shares and restricted stock can be effective in a well designed LTI portfolio to balance multiple plan objectives such as retention, performance and reward. Most first time users of equity tend to stick with options without realizing that it may not be best suited in their context. Although options have a high alignment with shareholder value delivered, they require the highest dilution and have the least retention based on appreciation potential. In the last couple of years, companies that have limited their LTI plans to options have been unable to optimize their value despite incurring costs on these programmes. Tailoring of plans to the stage in life cycle, talent context and primary objective will need to be increased.

Challenges

The task for this decade

Segmentation of rewards.

Workforce diversity is on the rise in India, with an increasing proportion of millennials and greater hiring from Tier 3 and 4 locations[1]. We see workforce segmentation getting more complex over the next decade, with the accompanying challenge to build appropriate reward programmes relevant to each segment. At the same time, this complexity will need to be balanced with administrative costs and ease of implementation. We see glimpses of segmentation in various reward plans, however these are typically reactive outcomes based on cost pressures rather than proactive strategies. Companies will need to take a structured and proactive approach to segment their workforce and a customized approach could improve the alignment between executive motivation, reward and business performance and keep the employer's value proposition relevant and competitive.

[1]Source: PwC NASSCOM Diversity Study for the NASSCOM Corporate Awards for Excellence in Diversity and Inclusion 2011.

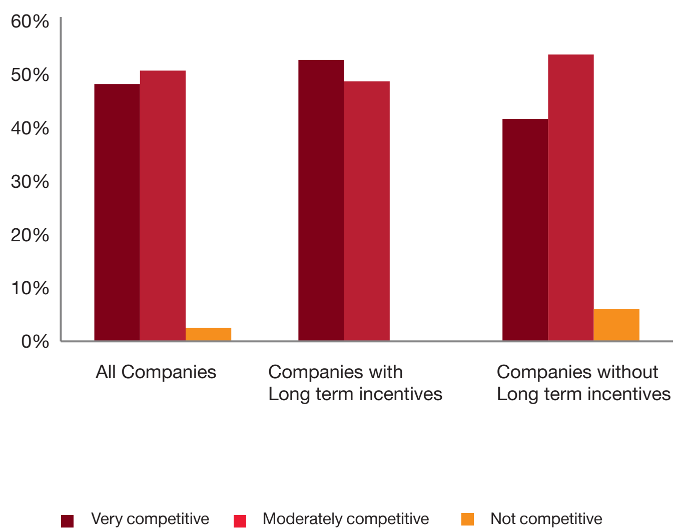
Holding steady through good and bad times.

The external environment is dynamic and there will inevitably be ups and downs. Often, a market downturn or upturn, a new management team or new rules and regulations lead to accompanying changes in the remuneration framework. However, too much flux in pay frameworks through times of such change is not a good thing. Executives will 'switch off' when they have little understanding of what they need to do year on year to earn their incentive. Shareholders too, become sceptical of regular change, perhaps suggesting that it is occurring simply because previous arrangements were not paying out. A considered and stated compensation strategy may not yield positive returns for executives and stakeholders each and every year; however standing by it can yield sustainable returns over the long term. The goal for companies and compensation committees should be a reward strategy and framework that can endure, and will stand the test of changes in positive as well as adverse talent and market conditions.

Balancing act between talent pressures and good governance.

The maturing of growth rates may be applying the brakes on runaway compensation inflation. However the executive talent market is likely to remain buoyant given the imbalance between supply and demand for executive talent in India. Retention, particularly of top and critical talent, continues to be key and hiring targeted at areas critical to company strategy continues. Talent mobility across industries is the norm, and hiring and benchmarking executive compensation across industries and business models will continue. This will further put an inflationary pressure on executive compensation across the board and be at odds with the need for restraint and adherence to budgetary considerations derived from the economic model. In our survey, only half of the respondents felt confident of the positioning of their executive compensation packages. This reflects the underlying competitive pressures being imposed by a mobile and buoyant executive talent market.

Pay positioning: Do you feel your executive pay package is competitive?



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To find out more about executive rewards or to discuss the challenges and issues raised, please contact any of the following members of the People & Change Consulting team at PwC.

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Acknowledgements

We thank all the companies that participated in PwC's 2011 India Executive Rewards Pulse Survey. For a copy of the survey report, please contact any of the members of the People & Change team at PwC.

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AK 276 January 2012 Navigating the path to maturity.indd
Designed by: PwC Brand and Communications, India