Empowering shareholders on executive compensation

Recent shareholder activism and regulatory action have focused attention on the issue of executive compensation in India. The Companies Act, 2013 (act), restricts the total managerial remuneration payable by a public company to its directors and managers in a financial year to no more than 11% of its net profits for that financial year. Consistent with recent trends in shareholder empowerment and corporate governance, the Ministry of Corporate Affairs amended the act in September 2018 to permit shareholders of public companies to decide on the payment of remuneration exceeding the 11% ceiling or the limits prescribed where the company had inadequate or no profits (instead of seeking central government approval).

There are further sub-limits to the overall ceiling. Remuneration to the managing director (MD) or whole-time director (WTD) or manager exceeding 5% (individually) or 10% (collectively) of net profits, or other directors exceeding 1% (where there is MD/WTD/manager) or 3% (in all other cases) of net profits, requires a special resolution of shareholders at a general meeting. In addition, prior approval from financial institutions, non-convertible debenture holders and any other secured creditor is required where the company has defaulted in payment of its dues.

Substantial powers are given to the shareholders in matters of managerial remuneration. The public shareholders of Apollo Tyres rejected the reappointment and remuneration of Neeraj Kanwar (a member of the controlling group) as the MD in September 2018. Although the controlling shareholders held 40.81% of the company, the resolution failed without sufficient votes from public shareholders. A revised proposal reducing the overall compensation by 30% (with 70% of total compensation being performance-based) was placed before the shareholders, and then approved in December 2018.

For listed companies, with effect from 1 April 2019, a special resolution of shareholders will be required if the annual remuneration of a single non-executive director exceeds 50% of the total annual remuneration of all non-executive directors, or if the remuneration of an executive director (who is part of the promoter group) exceeds INR50 million or 2.5% of the listed company’s net profits, whichever is higher, or if the aggregate annual remuneration to such executive directors exceeds 5% of the company’s net profits.

Listed companies also need to disclose, in the board report, details of remuneration package (including the fixed component and performance-linked incentives) of individual directors, the ratio of the remuneration of each director to the median employee’s remuneration, percentage increase in the remuneration of each director, chief executive officer (CEO), chief financial officer, company secretary or manager and the percentage increase in the median remuneration of employees. The act and the listing regulations specify restrictions on remuneration only to directors and managers (defined as an individual responsible for the management of a company’s affairs) of public companies.

Companies are also taking action on executive compensation based on performance and other criteria. Recently, the board of a leading private-sector bank announced that it would clawback all bonuses paid over a nine-year period to its former MD and CEO on the basis of an inquiry report that concluded that the executive dealt with conflicts of interest and other requirements ineffectively.

The Reserve Bank of India (RBI) has also questioned the size of pay-outs by certain private sector banks citing performance issues. In February 2019, the RBI issued a discussion paper on executive compensation of private sector banks, including foreign banks in India. The proposed changes include a minimum 50% variable compensation, variable pay to include stock options and be capped at 200% of fixed pay, compulsory deferral mechanism for variable pay and imposition of penalties in case of divergence in non-performing assets.

In the US, the Dodd-Frank Act was enacted to restore public confidence following the 2008 financial crisis and imposes measures on compensation matters to promote transparency and to ensure that it does not reward excessive risk-taking. It includes provisions that offer stockholders a non-binding advisory vote on certain aspects of executive compensation and mandates pay ratio disclosure. The EU also requires member states to provide shareholders the right to hold a binding or advisory vote on the remuneration policy.

Shareholder activism and regulatory action have increased the requirements for Indian companies to review their remuneration policies, actively engage with shareholders and adopt better governance practices.

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