Professional CEO Compensation Overview: Large Cap Companies in India

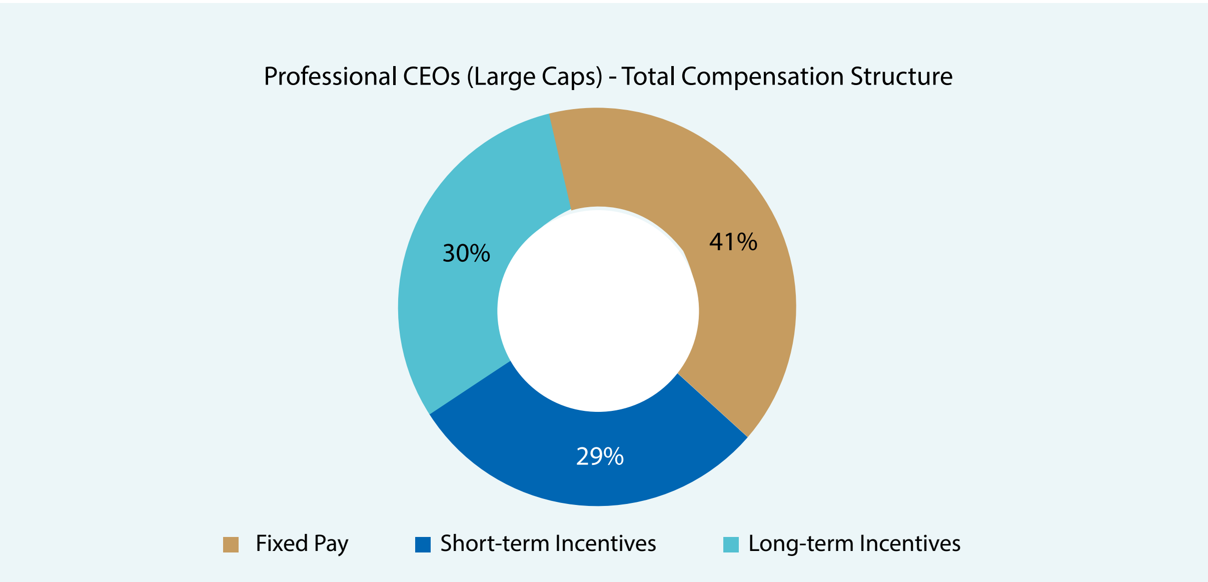
A CEO / Managing Director, who does not belong to the promoter group, is defined as a professional CEO for the purpose of this analysis. Our analysis of professional CEOs' compensation in large-cap companies in India, basis the disclosures made in FY'22, shows that the median total compensation is INR 165.4 million, and average is INR 178.2 million (see Table 1). A break-up of the compensation reveals that there is a balance between fixed compensation and variable compensation with the latter forming approximately 59% of the total compensation. A further analysis of variable compensation shows that it is almost equally divided between annual variable pay (49%) and long-term incentives (51%) (see Graph 1). It is important to note that the value of long-term incentives is based on the fair-value of grants made in FY'22 (i.e., cost basis) and does not include the value of exercised share-based payments that would have accrued over the years (i.e., on tax basis).

Table 1: Professional CEO Compensation – Large Caps

FY'22 Professional CEO Compensation	Fixed Compensation	Total Cost to Company without LTI	Total Cost to Company with LTI
Median	65.4	107.9	165.4
Average	72.3	124.4	178.2

All numbers in INR Millions

Graph 1: Compensation Structure – Professional CEOs



EQUITY COMPENSATION TO PROFESSIONAL CEOs

In FY'22, **55%** of the professional CEOs received share-based long term incentive grants. However, a historical analysis shows that **78%** of companies had made one or more share-based grant/s to the serving CEOs during their tenure till close of FY'22. From this, we can infer that the equity grant practices are not consistent across organizations. While annual grant structures are more commonly seen in the financial services (esp. banking) and IT services companies, a number of organizations follow structures that keeps the equity compensation outside the purview of "annual compensation." Our research shows that there are companies which grant equity biennially, once in three / four years and, some even do not have a fixed frequency.

- **Event-Based Grants:** Event-based or one-time equity and/or cash grants have become more common now than in the past. These grants could be for varied reasons e.g., a one-off retention grant, M&A, special grant pre-IPO. etc. During the Covid-19 pandemic, some companies made equity grants to executives including the CEO in FY2020-21, seemingly to conserve cash. The bounce back from Covid-19 has been significant in many industries and so has been the payoffs from these equity grants.
- **Special Arrangement Grants:** These arrangements may be for various reasons and may take many shapes and forms. Most commonly, these are large hire-on (sign-on) grants where the vesting is contingent on continued employment and / or achievement of performance milestones over the years. For these CEOs, very often one may not see any other annual (or fixed frequency) equity compensation. In one instance, we found that while the CEO did not get any grants from the listed holding company, equity grants were made from IPO-bound subsidiary companies, the intrinsic value of which is quite considerable today. In another instance, we found that there were no equity grants for CEO since the incumbent came on board. However, years later, significant equity grants were made at the time of IPO to reward for value created in the past and to link compensation with future performance.

IMPLICATIONS WHILE DETERMINING COMPETITIVENESS OF CEO PAY

When companies analyse the competitiveness of CEO compensation for their organization, a 'comparator group' is often selected basis multiple factors including where the company competes for business, capital, talent, business size metrics like revenue, market capitalization, geographical span, etc. However, the history of how the CEOs in comparator companies have been rewarded in the past is often ignored. This may not be right given past compensation decisions taken by the companies may impact how the CEO is being compensated in the current year, especially on equity compensation.

Secondly, if the market analysis is based on current year compensation only, compensation decisions may be based on part / fraction of information. If some of the cases like the ones highlighted above, are part of the comparator group, there is a fair chance of under or overestimating the market compensation levels depending on when the analysis is being done. While the future cannot be ascertained, an analysis of historical data gets us closer to reality and gives Nomination & Remuneration Committees (NRCs) a holistic picture of the CEO compensation landscape. These one-off grants in many cases are extremely material in size and hence, must be appropriately included in the compensation analysis to assess how CEOs in the comparator organizations have been compensated over the years. The size of these grants may have a material impact on how a CEO is compensated in the current year and may alter the perception of competitiveness.

To put things in perspective, we analysed the historical grants of large cap CEOs over their tenure considering only those CEOs who have served for three or more years as on FY'22 (see Table 2).

Table 2: Intrinsic Value of Grants during Tenure

Professional CEOs – Large Cap (3+ Years Tenure)	Median
CEO Tenure	5.7 Years
Total Cost of Grants during Tenure (INR Mn)	369.0
Ratio of Intrinsic Value* of Grants to Total Cost of Grants	1.96
Intrinsic Value as a % of Increase in Market Capitalization during Tenure	0.10%

**Intrinsic Value = Share Price at the end of FY'22 less Exercise Price of Grants*

According to our analyses, the payoff from equity-based compensation at median levels is 1.96 times of the cost incurred. The positive aspect is that anything above the cost incurred is proverbially "funded by the market", but at the same time it also raises questions on the efficacy of models used to calculate the fair value of long-term incentive instruments especially in a growing market like India.

IN CONCLUSION:

A one-size –fits-all approach to CEO compensation may not work in many cases. Accordingly, it should be tailored basis the context of the organization, strategy and what is expected of the CEO in the short, medium, and long term. The market compensation for CEOs should also be understood in that context to take informed decisions on CEO pay.

If compensation of currently serving CEO is being reviewed, a historical analysis gives a longer-term view on how the CEOs have been rewarded in your comparator group. This should also have an overlay of how the comparator companies have performed over the tenure of respective CEOs. This longer-term pay and performance context will help NRCs to have a nuanced view of CEO compensation in the company vis-à-vis the market. This will provide insights on how the NRC should plan both cash and equity compensation for the future, if any one-time interventions are required to make the compensation competitive vis-à-vis the industry, etc.

If a new CEO is being hired, the NRC can plan to understand the CEO compensation nuances in the industry the company operates in. A review of compensation in the industry, together with current year peer group CEO compensation as well as history of compensation of currently serving CEOs can help the NRC start laying down the guidelines and potential structure of compensation for the in-coming CEO. While there may be changes to this preliminary structure basis negotiations, this exercise will give NRC a fair idea on soft boundaries and help them avoid either over- or underestimating the market compensation. This also gives an opportunity to the NRC to evaluate the art of possible from compensation structure standpoint e.g., a company may be following an annual grant structure but the company and/or industry situation may find a one-time multiyear grant to be more apt (or vice-versa).

Exec-Rem

Office #1103, Regus, Level 11, Platina, G Block, C-59, Bandra Kurla Complex (BKC),
Bandra (East),Mumbai – 400051, India

www.exec-rem.com
info@exec-rem.com