CORPORATE GOVERNANCE AND DIRECTOR'S REMUNERATION POLICY IN INDIA: A CRITICAL ANALYSIS.

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INTRODUCTION

The issue executive remuneration has gained much importance at present, as many recent scams like Satyam scam, kingfisher's fraud draws the attention towards the dark side of the Indian corporate practices in this area. Practice of top executives paying higher and unreasonable remuneration to themselves is increasing day by day at the sake of interest of other stake holders be it creditors, share holders or employees of the company in the absence of clear policy in this regard to regulate the discretion of the company affairs of which is governed by the top executive themselves. This needs to be curbed and check and balance has to be maintained between the interest of the top executive and the other stake holders. There is no question that the top executives should be pay higher remuneration but it should be reasonable and performance based. It should not be such as to create huge gape between the income of the top executive and other sake holders so as to prevent other stake holder from economic injustice which is against the objectives our constitution. This practice may also lead to creation of new affluent class at the sake of the larger interest of the society as a result of concentration of wealth in the hands of few corporate people. This practice is also great set back to the interest of the share holders as they invest the money in the company to earn the profit or invest their money to do some fruitful business consequently it may lead to bad corporate Governance and agency problem.

This paper will focus its study on the following three major issues with regard to the remuneration policy adopted by the Indian Corporate world, which are as follows :-

1. Most of the companies in India are not following performance based remuneration policy of top executives but they adopts generally arbitrary scheme of remuneration and increases remuneration even if the company is not performing well and share value of the company is constantly diminishing.
2. A huge gape of income is created between the income of the top executive and the other middle level employees because of no clear policy on remuneration of top executive.

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3. Non promoter Directors are getting much lesser remuneration in comparison to the Promoter Directors because of their influence from the very inception of the incorporation of the company.

   This paper will try to find out the basic reasons behind such state of problem of remuneration policy and further study would explore the efficacy of the present legal regime to curb this problem of remuneration policy and role of other stake holders whose interest are thereby affected. This paper would also try to put forward the possible suggestions to improve the present situation which is detrimental to the good corporate governance practices.

1. Legal Frame work of Director's remuneration Policy

Meaning of Remuneration - Under The Companies Act 2013, Remuneration has been defined as "any money or its equivalent given or passed to any person for services rendered by him and would also include be include perquisites as defined under the Income tax Act, 1961.[2]It shall also include the reimbursement of any direct taxes to the managerial person.[3]

Remuneration can therefore be in various forms which is either money or equivalent to money like cash, medical benefits, retirement benefits, share options, shares, sitting fee and perks and allowances like contribution to provident fund, rent free accommodation, travelling expenses, car etc. It is usually a combination of various forms. Certain perquisites and compensations are explicitly exempted from being counted as a part of remuneration.

Key Provisions with regard to Director's Remunerations- In order to ensure just and equitable compensation to executives, leaving no space for unnecessary dissipation of profits, the law intervenes to balance the conflicting interests. Remuneration of executives is governed by the -

- Companies Act, 2013,
- Schedule V of Companies Act 2013,
- Clause 49 of Listing Agreement, SEBI and Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

[2] Section 2 (78) of the Companies Act 2003.
[3] Explanation B to schedule V of The Companies Act 2013.

The remuneration payable to the directors of a company, including any managing or whole-time director, shall be determined, in accordance the provisions given below either by the articles of the company, or by a resolution (special resolution if the articles so require), passed by the company in general meeting[4] and the remuneration payable to any such director determined as per the said provisions shall be inclusive of the remuneration payable to such director for services rendered by him in any other capacity. However, any remuneration for services will not be so included if the services are of a professional nature and in the opinion of the Central Government, the director possesses the requisite qualifications.[5]

Director's Remunerations- A Public Company can pay remuneration to its directors including Managing Director s and Whole-time Directors, and its managers which shall not exceed 11% of the net profit as calculated in a manner laid down in section 198 of the Companies Act, 2013. Wherein a Company in which there is one Managing Director; Whole-time Director or manager the remuneration to be payable shall not exceed 5% of net profits and where there are more than one of such Directors remuneration payable shall not exceed 11 % of the net profit.[6]

Maximum Ceiling on Director's Remunerations- If a Company wants to pay remuneration in excess of the above limit payable then a Company shall have to follow Schedule V of the Companies Act, 2013. Part II of Schedule V[7] – Remuneration Payable by a company in case where no profit or inadequacy of profit without central government is is detailed below:-

Where the effective capital of a company is-	**Limit of payable remuneration payablr shall not exceed in rupees-**
A. Negative or less than 5 crore	60 lakhs
B. 5 crores and above but less than 100 crores	84 lakhs
C. 100 crores and above but less than 250 crores	120 lakhs
D. 250 crores and above	120 lakhs plus 0.01% of the effective capital in excess of Rs.250 crores.

[4] Section 197 (4) of the Companies Act 2003.
[5] Section 197 (4) of the Companies Act 2003.
[6] Section 197 of the Companies Act 2003.
[7] Earlier Schedule viii of the companies act 1956.

A company with inadequate profit may pay to its managing director or whole-time director 200% of the above mentioned managerial remuneration if shareholders have given their approval through a special resolution. Where the managerial person who is not holding Rs 5 lacs worth of shares or more or an employee or a director of the company not related to any director or promoter at any time during the two years prior to his appointment as a managerial person, In such cases, the company can pay to him up to maximum of 2.5% of the "current relevant profits" and up to 5% with the approval of shareholders by a special resolution. For the purpose of this section, "current relevant profit" means profit calculated under section 198 but without deducting the excess of expenditure over income as defined in section 4(1) of section 198 relating to all usual working charges in respect of those years during which the managerial person was not an employee, director or shareholder of the company or its holding and subsidiary companies.

However, Section IV Part II of Schedule V states that a managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III:—

(a) Contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961 (43 of 1961);

(b) Gratuity payable at a rate not exceeding half a month's salary for each completed year of service; and

(c) Encashment of leave at the end of the tenure. Looking at clause (a) above, it is clear that any contribution made to provident fund, superannuation fund or annuity fund in excess of taxable limits under IT Act, 1961 shall not be included for the purpose of calculation of managerial remuneration in the event of inadequate profits or nil profits.

The law herein clearly prescribes what value of perquisites shall not be considered as part of remuneration in cases of inadequate profits. Further, had the intent of law been to include only taxable amount of perquisites in the definition of 'remuneration' under section 2(78), then this clause would have been rendered meaningless. Thus, one can safely presume that where the intent was to specifically cover taxable value of perquisites law has been drafted clearly.

Therefore, to conclude, for the purpose of calculation of remuneration:

i. In the event of adequacy of profits – the entire value of perquisites as per IT Act, 1961 will have to be considered.

ii. in the event of inadequacy of profits of nil profits - only the taxable amount of perquisites should be considered. This is relevant only in case of managerial person. While an expatriate managerial person shall be eligible for the following which shall not be considered in the definition of remuneration under Schedule V: a) Children's education allowance b) Holiday package studying outside India or family staying outside India c) Leave travel concession If any of such directors receive any amount in excess of limits mentioned under the provisions of the Act, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company. Further, if a Company wants to pay remuneration exceeding Schedule V of the Act then it shall require a Central Government approval. Section 197 of the Company Act 2013 also does not bar a managing or whole-time director of a company to receive compensation from its holding company or subsidiary provided the same should be disclosed in the director's report.

It may be concluded that, currently, there is no SEBI rule on remuneration of independent directors in listed firms and companies adhere to norms laid down in Companies Act, main provisions of which has been discussed above.

2. Impact of policy on Director's remuneration on Corporate Governance.

Director's remuneration policy in Indian corporate governance has two fold impacts *firstly*, it is necessary to pay high packages of remunerations to the top executives in order to attract and retain talented executive which is very necessary in the interest of the company itself. *Secondly,* increasing arbitrarily remunerations of the top executive has led to the emergence of new problem of huge gape of income between the income of the top managers and other stakeholders of the company.

It is the second aspect of remuneration policy that is most concerned of our study. Increasing gape of income between top executives and other stakeholders may be further divided in to the gape of the income between the income of the Promoter directors and non-promoter directors, executive directors and Non-Executive Directors, Directors and

the middle level employees and lastly Directors and investors which include shareholders and creditors.

At this point it is important to cite a relevant part of a news article published in the news paper 'The Hindu', which is reproduced as it is as follows- "High executive pay was at the centre of the recent standoff between the founders and the management of Infosys Technologies. To middle-income earners who are also shareholders in listed firms, any nine-digit pay packet may appear sky high. But how do they gauge if the CEO of their company is overpaid in relation to his peers? What are the benchmarks?

Indian laws require listed companies to make elaborate disclosures on top executive pay in their annual reports. These include details of the remuneration paid to every director on the Board, and a comparative analysis of their pay against employees, in the Director's Report. The annual return (MGT 9) that follows the director's report, presents a detailed breakdown of remuneration to each of the top managers."[8]

Wide pay gap- "India was one of the earliest regimes (in 2015) to mandate listed companies to disclose pay gap ratios, a gauge of corporate income inequality. The pay gap ratio measures the ratio of a top executive's pay to that of the median (average) worker in the firm.

Management guru Peter Drucker advocated a pay gap of 20 times between the CEO and the average worker and these were indeed the pay gap ratios prevailing globally in the sixties. But global corporations have since strayed miles away from this prescription. A recent study by the Economic Policy Institute noted that CEOs of large U.S. corporations pocketed 271 times the pay of the average worker in 2016.

But recent disclosures show that many Indian companies can give U.S. firms a run for their money. In FY17, TCS disclosed a CEO-worker pay ratio of 514 times, Infosys sported a ratio of 283 times and Wipro, 259 times. However, with exercised stock options sharply bumping up CEO compensation, it was Tech Mahindra which proved the outlier, with its pay gap at more than 3,500 times this particular year.

[8] http://www.thehindu.com/business/Industry/ceo-pay-how-much-is-too-much/article19571096.ece

But high pay gap ratios weren't restricted to the tech sector. Hero Motocorp's CMD Pawan Munjal earned 731 times the compensation of the average worker and Cipla's CEO was paid 416 times the remuneration of the median worker. The 78 crore compensation to L&T's executive chairman A.M. Naik in FY17 included 38 crore in retirement benefits. But even stripping this out, the ratio exceeded 550.

But lest these numbers make you despair, there are some heartening trends too in executive compensation. One is the increasing tendency of listed firms to link their executive pay to profits or stock market performance. Pay packages for top managers are increasingly featuring a sizeable performance bonus or stock option component, with only modest base (or guaranteed) pay."[9]

As per annual report for FY17 of various companies which unearth executive compensation trends for India's leading companies are:-

"Mr. Sikka's package for FY16, for instance, included a variable component of ₹ 29 crore ($4.3 million) that was linked to the achievement of financial targets. In FY17, as the company fell short, it was slashed to $0.82 million. As much as 25 crore of the 30 crore compensation to the TCS CEO consisted of a commission pegged to the company's profits. And the Tech Mahindra CEO's 150 crore package for FY17 included enchased stock options worth 147 crore, while his base pay was just 2.4 crore. L&T's ₹ 40 crore remuneration to its chief featured 18 crore in profit-based commission. Then, there are the legal limits to Board-level compensation set out by the Companies Act. A company cannot pay more than 5% of net profits to its MD or whole time director and more than 10% of profits to all the executive directors put together. Companies which breach these limits need to obtain Central Government approval to make the payout. **In FY17, the Nifty 50 companies mentioned above, including the high-paying ones, used up only a fraction of these limits.**"[10]

From the discussion so far we may find that there is huge remunerations are provided to the top executive at the sake of other stake holders and very few companies are following norms or suggestions which is altogether against the good corporate governance practices and very demotivating to the small or medium level investors and employees.

[9] http://www.thehindu.com/business/Industry/ceo-pay-how-much-is-too-much/article19571096.ece
[10] http://www.thehindu.com/business/Industry/ceo-pay-how-much-is-too-much/article19571096.ece

3. Remedial Measures.

With the formation of corporate form of organizations, the frame work of corporate governance got wide recognition and quite peculiarly it was prevalent in various manifestations throughout the world. The theme of Corporate Governance has got recognition due to the constitution and formation of various committees and formulation of various laws throughout the world.

Various Committees and legal provisions has been laid down in this regard so far ,which has improved the position but not curbed the problem fully, however we may take note of some remedial measures suggested by the various committees and steps taken by the authorities.

Greenbury Report on Corporate Governance (1995)- During the 1990's the issue of **director's remuneration** was becoming a primary concern for investors and the public at large. Specifically, the levels of remuneration of directors in privatized industries were rising and remuneration packages were failing to provide the necessary incentives for directors to perform better. Consequently, it was recognized that corporate governance issues relating to director's remuneration needed to be addressed in a more rigorous manner. This led to the establishment of the Greenbury Committee. The Committee's findings were documented in the Greenbury Report, which incorporated a Code of Best Practice on Director's Remuneration.

Specifically, four main issues were dealt with, as follows:

- the **role of a Remuneration Committee** in setting the remuneration packages for the CEO and other directors;
- the **required level of disclosure** needed by shareholders regarding details of directors remuneration and whether there is the need to obtain shareholder approval;
- specific guidelines for determining a **remuneration policy** for directors; and
- **service contracts** and provisions binding the Company to pay compensation to a director, particularly in the event of dismissal for unsatisfactory performance.

As in the Cadbury Code, the Greenbury Code recommended the establishment of a Remuneration Committee, comprising entirely of nonexecutive directors, to determine the remuneration of the executive directors. However, in terms of service contracts, Greenbury

recommended a **maximum notice period of 12 months** rather than three years as suggested by Cadbury.

Following publication, the recommendations of Greenbury were also taken on board by the **London Stock Exchange** and incorporated into the UK Listing Rules. However, unlike the Cadbury Code it was not widely accepted as many believed that the recommendations made did not sufficiently deal with the issue of linking directors pay to the Company's performance in the interests of shareholders

With respect to India, after the economic initiatives in 1991, the Govt. of India thought it fit to respond to the developments taking placing the world over and accordingly the initiatives recommended by Cadbury Committee Report got prominence. In order to give due prominence Confederation of Indian Industry (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and, the Securities and Exchange Board of India (SEBI) constituted committees to recommend initiatives in Corporate Governance.

In India, the recommendations of Naresh Chandra Committee, Dr. J. J. Irani Committee constituted by Ministry of Corporate Affairs, the Kumar Mangalam Birla Committee and N. R. Narayana Murthy Committee constituted by SEBI are more prominent. Apart from these committees, there are OECD principles and reviews by various other corporate bodies like FICCI, KPMG, and ICSI etc. on the corporate governance practices in India.

Kumara Managalam Birla Committee Report on Corporate Governance- This committee interalia recommended, forming of remuneration committee for deciding Director's remuneration policy of the company, under its mandatory recommendations head.

SEBI Committee-Uday Kotak Committee Report on Corporate Governance- Most recent committee on Corporate Governance is Uday Kotak Committee Report[11] constituted under the chairmanship Mr. Uday Kotak ,vice CEO and MD of Kotak Mahindra Bank limited on 2 June 2017 by SEBI with the aim of improving standards of corporate Governance of listed companies. The committee filed its report on 5 October, 2017 and interalia recommended with regard to the Director's remunerations as follows:-

[11] Committee Reort on Corporate Governance, on 5/OCT/2017 constituted by SEBI.

i. The Committee noted various cases of disproportionate payments made to executive promoter directors as compared to other executive directors. It is felt that this issue should be subjected to greater shareholders scrutiny. The Committee recommends that shareholders approval by special resolution should be required if the total remuneration paid;

   a) To a single executive promoter-director exceeds Rs.5 crore or 2.5% of the net profit ,whichever is higher : or
   b) To all executive promoter-Director exceed 5% of the net profits. It is clarified that net profit should be calculated under section 198 of the companies Act. The committee also recommends that SEBI could review the status in future based on experience gained. The committee further recommended Insertion of new sub clause (e) under sub regulation (6) of regulation 17 to the SEBI's LODR Regulations.

4. Conclusion and Suggestions

From the discussion so far in this paper it may be concluded that Overall review and reform of remuneration policy of Director's remuneration is the need of the hour. Disparity in remuneration policy in Indian corporate world has led to the huge gape of income between Director's remuneration and the income of other stake holders of the company and present policy of our Government is nor sufficient to curb the problem. SEBI has not provided any provisions with regard to regulating the increasing remuneration of top executives however some help may be taken from the regulation no. 17 of the SEBI's LODR regulations in this regard. However it is not sufficient and SEBI should come forward and lay down very clear cut regulations to regulate the Director's remuneration policy and should provide penal provisions to implement it strictly.

Recommendations of Uday Kotak[12] report on corporate governance constituted by SEBI ON 2 June 2017 should be implemented in toto which interalia recommends inserting provisions in LODR Regulations of SEBI. There must be provision in Companies act[13] stipulating provisions to uphold the say of share holders on Director's remunerations.

[12] Committee Reort on Corporate Governance, on 5/OCT/2017 constituted by SEBI.
[13] The Companies act,2013.

Similar recommendation may be find under Uday report on Corporate Governance.[14] Director's remuneration exceeding ceilings or even touching the ceiling should be sent for the approval of shareholders.

Institutional Investors should play an active role in director's remuneration policy; provisions may be laid down in this regard. Constitution of remuneration committee should be constituted in each and every company regardless the nature of the company which is not small companies as welfare provisions which should even look after the remuneration of middle level employees. Constitution of the remuneration committee should be made mandatory.

[14] Committee Reort on Corporate Governance, on 5/OCT/2017 constituted by SEBI.