Corporate governance reforms world over have brought into focus a dichotomy of performance and conformance of responsibilities. The main attention is on crucial questions about the true role and responsibility of Board of Directors in the modern organisation. Issues like how Board members are compensated and their sense of right and wrong have become topics of public debate from time to time. This article attempts to investigate whether the economic performance is the criterion for determining the director's compensation.

Corporate Governance and Directors Remuneration

It is generally believed that that the Director compensation is based on the Economic performance of the companies, for example, 'Return on Total Assets', 'Return on Equity', etc. Consistent with the recent empirical research, it is observed that there is relatively less relationship between the directors' remuneration and company performance. The results indicate that Executive directors' compensation is positively related to the shareholders funds, operating profits and company size (reflected by the sales). Pay performance link has not been established in the analysis of financial ratios such as return on total assets or return on equity and market price performance. Although corporate governance mechanisms are gaining strength, the remuneration committees have neither been formed nor are functioning in a significant manner.

Around the world, the debate of alleged excessive directors' remuneration shows no signs of abating. In the US, Peter Brown, Chairman of Top Pay research group commented recently: "Now that so many class actions are being brought against directors the danger of heightened risk premium endangers their own creditability in the corporate world".

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In Britain, the Labour party has been pressing for Institutional investors to back an independent call for companies to rethink top management pay or face action on corporate governance rules by the Government. In France, a senate Commission is reviewing the way stock options for top management are treated, in an attempt to make companies more accountable. Thus, Directors' pay became a live issue in the governance practices of the corporate sector and gained priority on the agenda of the reforms.

The educated and well aware investors of 1990's revolted to the way the corporate boards granted them extravagant pay pockets without relating it to the quantum of performance. There were instances where shareholders have blocked CEO packages leaving the companies to modify the terms to the levels accepted by them. Jack Wells, President of GE was questioned for not disclosing his pension arrangements to the shareholders. Mr. Bill. Mc. Donough, the president of New York Federal Reserve and head of the accounting oversight board, declared recently that huge US executive pay increases might have been morally reprehensible. He cited studies showing that average chief executive made 400 times as much as the average production worker compared with the ratio of 42:1 two decades ago. Mr. Mc. Donough says that there is nothing in US corporate performance any way to justify this rise in the ratio and commented that it was terribly bad social policy.

Mr. Warren Buffet, a highly regarded investor and chairman of Berkshire Hathaway Inc, pointed out that "CEOs of the companies are the only people in the economy who effectively decide what they are going to pay themselves. Excessive CEO pay is a mad disease of American boardrooms moving from company to company. The greed is good. Culture of American economy promoted the monstrosities such as Enron, Tyco and the list goes on and on". J.

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Richard, chairman of US Center for Corporate Public Governance says the excesses of US has provoked demand for a ceiling on managerial pays.

According to a study reported by K.R.S.Murthy (1998), Chief Executive Officers in USA earn 109 times the average base pay, compared to 35 times in UK and 17 times in Japan. The growing disparities in income have encouraged some economists to look for reforms in the system of Corporate Governance.

A more broad-based survey was conducted by New York-based management and human resource consulting firm called Towers Perrin. According to their survey, the average total compensation for CEO's in 2003 was:

US	—	$ 22,50,000
Mexico	—	$ 9, 61,000
Germany	—	$ 9,55,000
UK	—	$ 8,30,000
South Africa	—	$ 5, 38,000
Japan	—	$ 4, 57,000
South Korea	—	$ 3, 94, 000
India	—	$ 2, 23,000

According to the annual Asia Pacific salary increase survey by global human resources consulting firm Hewitt associates, "companies in India offered a highest average salary increase during 2003. The average hike was 10.38%, compared to much lower increase in developed world.

As India globalises, more professionals make it to top, the jargon of the west, enters the local compensation market. As per Business India's best-paid executive survey for 2000-01, Ambani's were on top. For 2004, the honour went to Hero Honda chairman Brij Mohan Lal Munjal. As per the survey, promoters dominate the list of top earners. In the top 100, more than 60% belong to business families or are representatives of foreign stakeholders.

Thus the determination of executive compensation has emerged as an issue of considerable academic interest. A central theme in the debate is whether director's pay is adequately tied to measures of corporate performance. Much of evidence assembled so far indicates that if a link between pay and performance can be established then its magnitude is quantitatively quite small relative to the effect of company size. The recent studies also examined the link between directors pay and stock market performance of the companies. The role of Board of Directors in general and that of compensation committees in particular is highly criticized in this context. The greed of CEO's and other directors to target share prices and stock options linked to such prices are the reasons behind corporate scams.

Now, let's consider a descriptive analysis of the relation between directors' compensation schemes and financial performance of the sample companies.

Selection of sample companies

The analysis in the article is based on the fifty listed companies (see box) on the Bombay stock Exchange selected on the basis of convenient sampling. The listed companies were chosen, as the Corporate Governance regulations are applicable and enforceable to them as per the clause 49 of the listing agreement.

Sources of Data: The annual reports of the sample companies for the accounting year 2003 were collected in which a special report on corporate governance has been

included. The report on corporate governance discloses the information regarding director's remuneration, split up details, Composition of Executive and Non-executive directors, constitution of remuneration committees and membership.

1. Governance of directors' compensation

The company must have a credible and transparent policy in determining and accounting for the remuneration of the directors. The policy should avoid potential conflicts of interest between the shareholders, the directors, and the management. The overriding principle in the governance of directors' remuneration is that of openness. Shareholders are entitled to a full and clear statement of benefits available to the directors.

Agency considerations (theory) also suggest that internal corporate governance arrangements are important in shaping executive pay in contracts. The company board is uniquely bound up with the issue of director pay-setting. The absence of a remuneration committee suggests an opportunity for executives to

award themselves pay raises, which are not congruent with shareholder interest (e.g. Healy, 1985). In essence, then, an agency cost arises.

Companies without remuneration committees may not have the appropriate mechanisms to determine, appraise and check the contribution of directors. Remuneration committees potentially have an important monitoring and arbiter function in the setting of top pay.

An experiment in salary Cap has been tried out in Poland recently. "Cap Act" in 2000 had set a ceiling in managerial salaries in all organizations in which Government had a holding. The maximum allowed salary was 6 times the average salary in the industrial sector. Despite all this there are compensation specialists who are busy finding innovative ways to make payments.

Infosys chairman and chief mentor N.R. Narayana Murthy, for instance says that the CEO of a company, should not have a salary more than 20 times that of lowest paid employee. For the year 2003-04 his remuneration was only 22 lakhs. He does not figure in the highest paid list. He earned a huge amount of 229 crore in the form of dividend and bonus shares.

2. Statutory Provisions and Limitations

According to the Companies Act, an undertaking may pay around 11% of its profits as director's remuneration. The actual break up in each case is decided by the board of directors or the remuneration committee and has to be okayed by AGM.

The Companies Act has revised the minimum sitting fees payable from Rs. 2000 to Rs. 5000. Section 309(4) provides that a director who is neither in a whole time employment of the company nor a managing director can be paid remuneration either by way of a monthly, quarterly, or annual payment or by way of commission, if the company by special resolution authorizes the same. Keeping these rules into account a proper system can be devised to reward non-executive directors for their overall contribution.

The changes made in Indian Corporate laws regarding managerial remuneration and their effect were evaluated by Ram Kumar Kakani and Prabesh Ray of XLRI, June (2003). They concluded that the changes fatter pay pockets of directors. Based on the comparison of corporate performance data of 16 large firms, they explained that managerial remuneration has significantly increased over the last two decades in sharp contrast to corporate financial performance (both from efficiency and growth point of view). Such research studies questions whether these increases in managerial remuneration was justified.

3. Constitution and Functioning of Remuneration Committees

Clause 49 of the listing agreement that has legislated the code of corporate governance recommended that the board should set up a remuneration committee. This committee of the board has to determine on their behalf and on behalf of the shareholders the agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment. The remuneration package should be good enough to attract, retain and motivate the Directors of the quality required. The remuneration committee should be in a position to bring about objectivity in determining the remuneration package while striking a balance between the interest of the company and the shareholders.

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The corporate governance code suggested that to avoid conflicts of interest, the remuneration committee, which would determine the remuneration packages of the executive directors, should comprise minimum of three non-executive directors, the chairman of committee being an independent director.

The constitution of the remuneration committee is only non-mandatory requirement left to the discretionary decision of the company board. *Table A* reveals that only 22 companies have constituted this committee. Other companies have disclosed that they were yet to form this committee.

The first majority size is 3 members committee formed by 13 companies followed by the 4 members by 5 companies. The *Table A* reveals the membership pattern.

Table: A
Remuneration Committee Members

No of members	No of companies
2	1
3	13
4	5
5	3
Total No. of Companies	22

As many as 10 companies had the executive directors also as members of the committee. In other companies, all the members of the committee were non-executive directors. Chairman of the committee was executive director in respect of 4 companies and non-executive directors in case of other companies.

It would not be necessary for the committee to meet very often as remuneration is mostly fixed annually or after a specified period Meeting should be arranged on a date that suits the convenience of all the members of the committee. It is therefore recommended that all the members of the remuneration committee should be present at the meeting.

The chairman of remuneration committee should be present at Annual General Meeting to answer the shareholder queries.

Table B shows that only 20 companies, had convened the meetings during the year. 13 companies have convened only 1 meeting and 3 companies' 4 meetings.

Table : B
Remuneration Committee Meetings

No. of members	No .of companies
1	13
2	-
3	4
4	2
5	1
Total No. of companies	20

It is further recommended that the entire board of directors should decide the remuneration of non-executive directors. The recommendations of the board of directors would need to be ratified at the General Body meeting of shareholders and in case the board disagrees with the recommendations of the remuneration committee, the matter should be decided at the General body meeting of the shareholders who should be provided with sufficient information about the remuneration policy and package.

The absence of remuneration committees in the sample companies explains the lack of monitoring system, which may enable directors to award themselves unduly, causing agency costs.

4. Disclosures Of Remuneration Package

In tune with the liberalised regime of adequately compensating the best managerial personnel, limits for calculation of managerial remuneration have been liberalised. Now it is necessary as per clause 49 f the listing agreement to disclose fully to the shareholders regarding the remuneration package of all the directors.

As per corporate governance code following disclosures should be made in the section on corporate governance of the annual report:

- All elements of remuneration package of all the directors i.e. salary, benefits, bonuses, stock options, pension etc.
- Details of fixed component and performance linked incentives, along with the performance criteria.
- Service contracts, notice period, severance fees.
- Stock option details, if any - and whether issued at a discount as well as the period over which accrued and exercisable.

As per the corporate governance code prescribed by clause 49 of the listing agreement the board should have an optimum combination of executive and Non-executives with 50% comprising of Non-executive directors. Non-executive directors refer to the members of the board who are not current or former employees of the company. Executive directors refer to the directors who are in the full time employment and also members on the board. Thus for the purpose of the study the functional directors who are not the board members were not included.

TABLE : C
Composition of Directors

	Total no. in the sample companies	% of the total
No. of Executive directors	155	28%
No. of NED directors	414	72%
Total No. of directors	569	100%
No. of Promoters in Executive directors	126	22% of total directors (81% of Total ED)

TABLE : D Directors Remuneration		
Total amount paid as directors Remuneration in the sample companies.	137 crore	100%
Total amount paid to Executive directors as Remuneration	129 crore	94%
Total amount paid to Non- Executive directors as Remuneration	8 crore	6%

The information in the Tables C and D explain that 94% of the total remuneration in the sample companies is earned by the executive directors who are only 28% of the total number of directors. Further it explains that majority - 81% of the executive directors are promoters, it conforms the fact that it results in self-payments and indicates the presence of agency costs.

All companies disclosed the details of executive directors remuneration. Out of these 50 companies, 29 companies paid only sitting fees to non-executive directors.

TABLE: E Remuneration of Executive Directors	
Average remuneration paid to Executive Directors (including all benefits) (In lacs)	**No of companies paying**
Up to 10	14
11 to 20	3
21 to 30	4
31 to 40	2
41 to 50	8
51 to 60	3
61 to 70	2
71 to 80	0
81 to 90	2
91 to 100	1
Above 100	11
Total no. of companies	50

TABLE: F Remuneration of Non-Executive Directors	
Average remuneration paid to Non-Executive Directors (including all benefits) (In lacs)	**No of companies paying**
Less than 1 lakh	28
1 to 2	11
2 to 3	5
3 to 4	2
Above 4 lakhs	4

Tables E and F show glaring differences in the payments made to executive directors and non-executive directors. In the earlier analysis it was mentioned that the percentage of non-executive directors is 72% in the sample companies. The board of directors as a whole has to shoulder the responsibility of better performance and devote considerable time for the affairs of the company. Further the corporate governance legislations placed greater statutory responsibilities on the non- executive directors. All the members and the chairmen of governance committees are required to be the non-executive directors.

5. Directors' Pay and Company Performance

One of the key hypotheses in the empirical literature on the determination of directors' pay is the supposed positive relation between compensation and company performance (Murphy, 1998; Hall and liebman, 1998).

The separation of ownership and control in large corporations has created problems of trust and accountability to managers and Board of Directors. "How could non-owner directors be counted on to maximise profits and secure the health of the companies, rather seek perquisites and power for themselves?" asks Keller (1998).

The increase in the Managerial remuneration and commission payable to directors has to be in line with the financial position of the companies. With the increase in managerial remuneration, good performance should increase proportionately. After all, one expects value for money in goods and services, why not in management.

Kose John & Lemma Senbet (1998) in "Corporate Governance and Board effectiveness" expand the definition of Agency conflicts to include those occurring among the stakeholders of the firm, viewing the firm as a nexus of contract among outside claimants, including equity holders, debt holders, employees and society at large. The purpose of Corporate Governance is to reduce the costs of Agency problems within a firm in order to attain wealth maximisation.

Andrew Benito & Martin J. Conyon (1999) examined the determination of director's compensation in UK quoted companies between 1985 and 1994.They focused on the Governance mechanisms that determine pay outcomes. Their results indicate that Directors' Compensation is positively related to pre-dated shareholders' returns. They found that the pay for performance link has become quantitatively stronger over their sample period. Further they concluded that positive adherence to the principles of the Cadbury report, and the governance variables play little statistical role in shaping the compensation of top directors.

Agency theorists identify boards as internal monitoring devices that monitor the degree to

which managers act consistently with shareholders interests. A central function of corporate boards is to oversee managers and replace them when necessary. In performing this function boards are a lower cost mechanism for replacement of managers than the market for corporate control.

Table H explains that 20 companies were not paying commission to executive directors. In case of other 20 companies, commission is a significant portion of their salary (Commission is more than 25% of their total remuneration).

Public sector companies like ONGC, IOC does not pay commission. How ever, in some companies directors are entitled to a performance-linked bonus. For example, in BHEL, six whole time directors did get such an incentive 2002-03. They each received 13,525. In private sector however commission can add up to big numbers in comparison to their emoluments.

Table: G

Directors' Remuneration/Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
total directors remuneration	56000	5024600000	136363540	710889886.7
total ED remuneration	27824	353700000	26990063	53887189.09
total salary and perks	156587	353700000	20444617	51926216.95
average total ED remuneration	27824	70740000	7076404	11351885.25
average salary and perks	22857	70740000	5302545	10708341.65

6. Commissions

If the highest paid executives have been finding there remuneration increasing these days, one reason could be due to increased profits adding up to higher amount of commission. The USA's approach to Corporate Governance is to minimize conflicts of interest between owners and managers. This is attempted by giving managers as well as directors profit related incentives such as commission shares and stock options.

Table: H
Profit-related Commissions

% of the commission in the total ED remuneration	No. of companies
Up to 25%	7
26-50%	13
51-75%	9
76%-100%	1
Total	50

Stock options as a payment mechanism have not gained enough significance in the Indian corporate sector. Out of 50 sample companies, only 8 companies have granted stock options for the directors. Out of 8 companies only 3 companies issued stock options to the Non- Executive directors.

7. Company performance and director's remuneration

Murphy (1998) comments that CEO compensation is related to stock based measures of performance, not only because this is desired by shareholders, but because higher stock returns signal efficiency of directors. Non-stock-market based measures of performance will be useful to the extent that they convey information to the shareholders as to whether the director pursued the desired activity or not. The important point emanating from agency theory and the "informativeness principle" is that other signals of managerial effort are potentially important in designing the compensation contract. Other important signals that may be important for shareholders are the relative performance evaluation and the role of directors monitoring through remuneration committees.

Murphy (1998) reviewed the empirical literature that uses agency theory to motivate statistical analysis of relationship between executive compensation and shareholder returns. In addition, Garen (1993) argues that the link between pay and performance may not be constant over time. They present evidence for a sample of UK companies and find that there was a significant relationship between top pay and performance between 1983 and 1988, but there is no such relationship between 1988 and 1991. Overall, then, agency theory generally predicts that pay and performance should be positively correlated and it is tested in this sample study.

This paper defines the pay variable as direct emoluments and includes salary, bonus and benefits but excludes long term elements of compensation such as share options and their benefit (both in terms of dividend and Market appreciation).

The typical result, produced in many studies, is that the correlation between executive pay and stock returns is small or weakly determined. Among the sample companies, Comparison was made between closing market prices and directors pay and also between director's pay and annual average prices. This analysis confirmed the opinion that there is no positive correlation between director's pay and market prices.

The results indicate that Executive directors' compensation is positively related to the shareholders funds, operating profits and company size (reflected by the sales). Pay performance link has not been established in the analysis of financial ratios such as return on total assets or return on equity and market price performance. Although corporate governance mechanisms are gaining strength, the remuneration committees neither have been formed nor are functioning in a significant manner.

List of Sample Companies

No.	Company Name	No.	Company Name
1	Infosys Technologies Ltd.	26	HDFC.
2	Sundaram Clayton Ltd.	27	Bajaj Industries Ltd.
3	JK Synthesis Ltd.	28	Tata Teleservice Ltd.
4	Raymonds	29	SPIC Ltd.
5	Kesoram Ltd.	30	ICI Ltd.
6	Hindustan Lever Ltd.	31	Goetze India Ltd.
7	KCP Ltd.	32	Reliance Industries Ltd.
8	Gujrat Sidhee Cement Ltd.	33	ACC
9	Dhunseri tea & industries	34	Ballarpur Industries Ltd.
10	Gujarat Narmada Valley Fertilisers Ltd.	35	Sundaram Finance Ltd.
11	Ashok Leyland Ltd.	36	ITC Ltd.
12	Nicholas Pirmil India Ltd.	37	CPCL
13	Kinetic Honda Ltd.	38	Colgate Palmolive
14	Kothari Sugars & Chemicals	39	BSL Ltd.
15	Tata Yadagawa Ltd.	40	RANE Ltd.
16	Tata Power Ltd.	41	Arvind Mills Ltd.
17	The Great Eastern Shipping Co. Ltd	42	GATI
18	Glaxo Smithline Ltd.	43	Kanisk Steel Industries Ltd.
19	Ranbaxy Ltd.	44	Grasim Ltd.
20	Larsen & Toubro Ltd.	45	SAIL
21	Carborandum Universal Ltd.	46	Ahmedabad Electricity Ltd.
22	United Phosphorous Ltd.	47	BASF India
23	Gujarat Heavy Chemicals	48	GIS
24	Max India Ltd.	49	Bharat Forge Ltd.
25	UTI Ltd.	50	W.S. Industries