Performance And Reward Management

Prof. Susmita Mukhopadhyay
Vinod Gupta School of Management
Indian Institute of Technology, Kharagpur

Lecture – 42
Rewarding Special Groups, rewarding directors and senior executives, sales and customer service staff, knowledge workers and manual workers

Welcome to the course on Performance And Reward Management. The topic for today's discussion are Rewarding Special Groups, rewarding directors and senior executives, sales and customer service staff knowledge workers and manual workers. Why we are focusing on these special groups of people are, like if you have followed the discussion throughout when we are discussing on performance management and reward management.

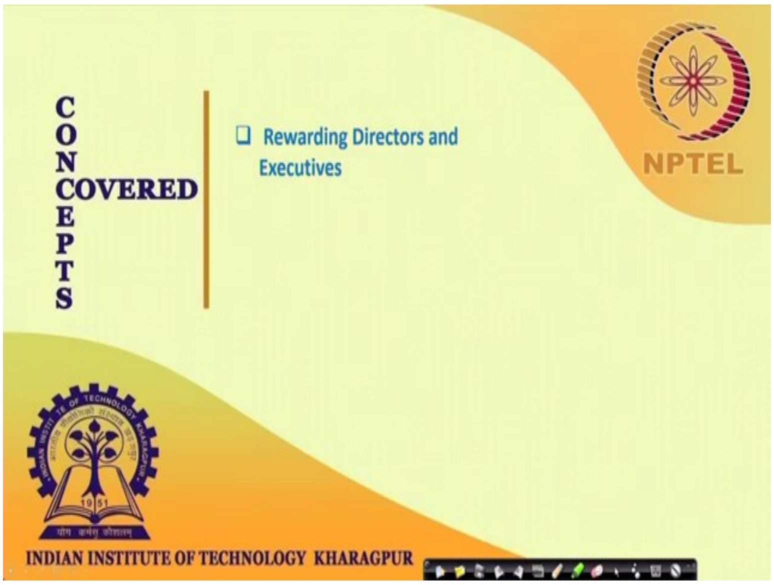
We have from the start itself discussed like the performance management is a process, is a system where the goals of the organization needs to be aligned with the goals of the department and also the goals of the individual and the roles of the individual given in a particular organization. And the function of the reward management is to help and facilitate the person performing the role in a better way, to motivate the person performing the role in a better way.

So, we can understand from here as the roles in the organization played by different nature of employees who are there based on different hierarchies who were there worked in different roles in the organizations. There are different expectations of performance from the organization from these employees about their roles. And that is their roles are different from each other the expectations, the performance expectations of these roles are different from each other.

So, in order to design a reward system for the different roles played by different employees in the organization. We have to see what kind of roles that the employees are playing, what are the expectations from these roles and then we have to map the reward in such a way it helps to facilitate the performance in the role. And it helps the person to like be more effective and efficient in that role, so to do that we have to design it separately, differently for the different kind of roles.

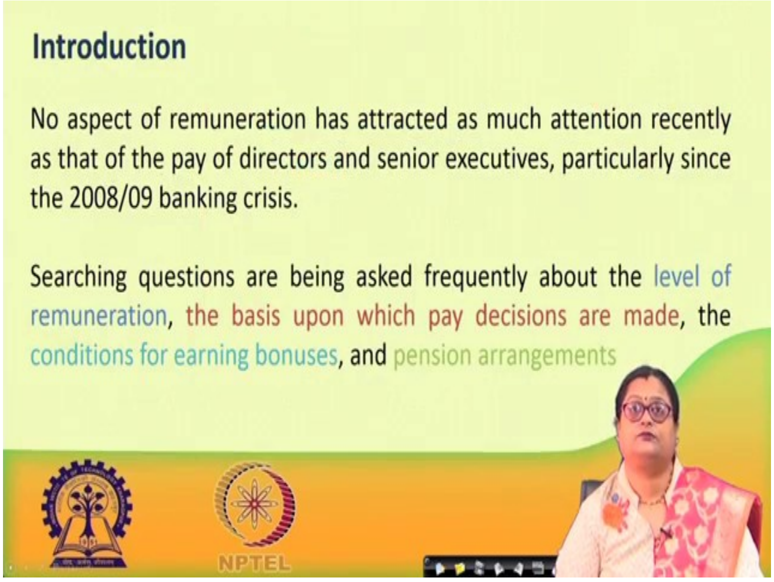
Here in this topic in this module we are going to focus on some of those special roles which are there in the organization, which are very vital roles which are there in the organizations the expectations of which are different from each other. We are going to define and describe those roles and then we have to see what are the expectations of from those roles. And then we were going to map it to the rewarded design which is going to motivate them and facilitate their performance in the organization.

(Refer Slide Time: 03:31)



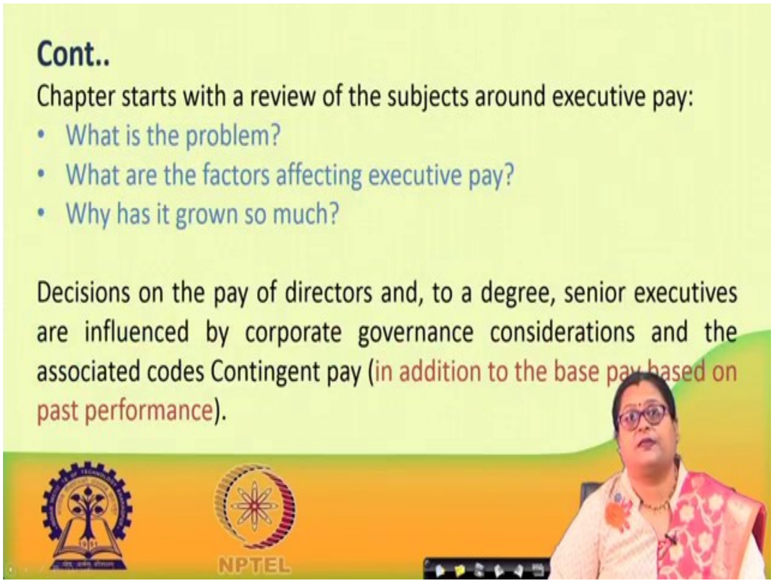
So, now, we will start with one of those special groups, the today's concept is going to cover rewarding directors and executives.

(Refer Slide Time: 03:38)



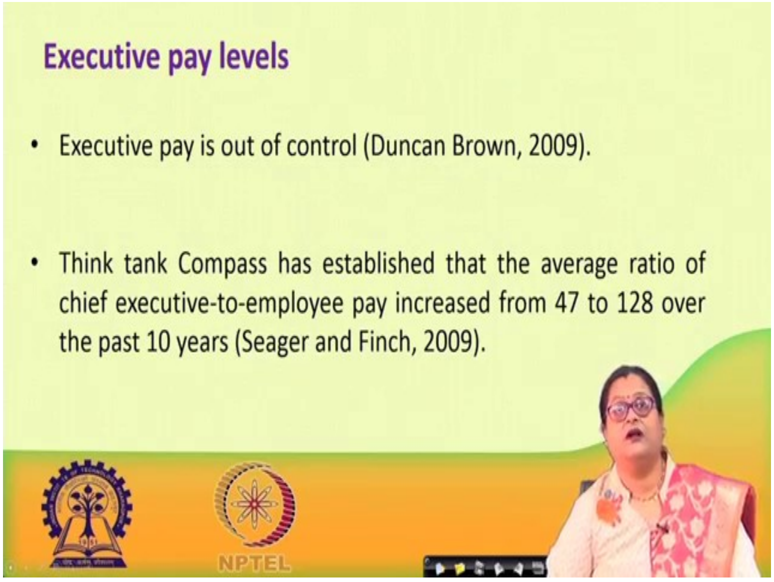
So, this is a very highly discussed topic, a topic which is of much which has gained much attention or drawn much attraction is that of the pay of the directors and the senior executives in the organization and since the banking crisis in 2008 and 9. So, some of the questions that are asked with respect to this discussion at the level of remuneration basis upon which pay decisions are made, the conditions for earning bonus and pension arrangements. These are the questions which are generally asked while we are discussing on the remunerations of the senior executives and the pay of directors.

(Refer Slide Time: 04:35)



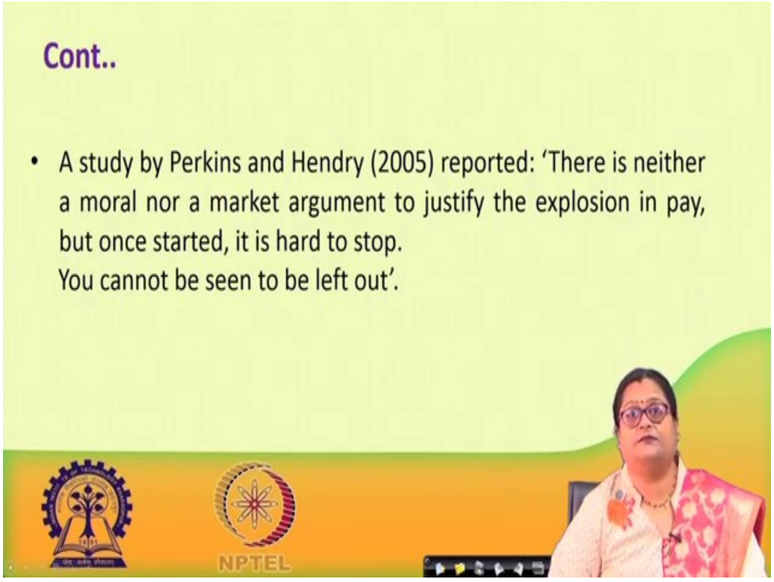
So, we will start this discussion with the topic on what is the problem? What are the factors affecting executive pay? And why has it grown so much? So, decisions on the pay of the directors and the senior executives are governed by or influenced by corporate governments, governance considerations and the associated course and the of contingent pay. So, contingent pay is the additional pay which is a base pay and which is based on past performance.

(Refer Slide Time: 05:28)



Whenever, we are talking of executive pay levels, so some of the remarks that we have over here like executive pay is out of control. The think tank Compass has established that the average ratio of chief executive to employee pay increased from 47 to 128 over the past 10 years. Now, we have to reason out whether this is ok, whether this is unjustified and unfair and if you are telling it is okay, then what are our reasons for it.

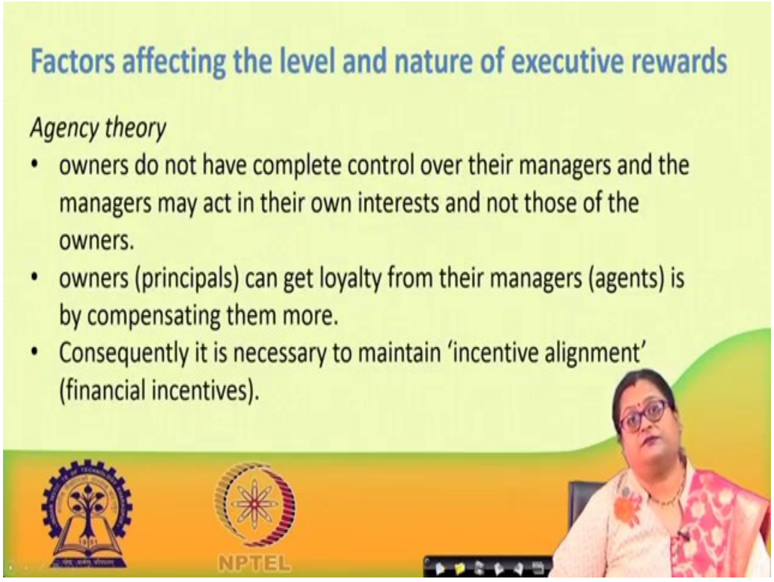
(Refer Slide Time: 06:16)



A study by Perkins and Hendry reported, there is neither a moral nor a market argument to justify the explosion in pay, but once started it is hard to stop. You cannot be seen to be left out. So, this is often guided with efficiency wages theory, if you remember when we discussed on the theories of pay like the company is willing to pay maybe much above market rate in the hope in the expectations.

Like the if there if paying above market rate much above market rate they will be able to attract a highly talented employee who is going to be become more productive in the organization and help in the competitive edge of the organization. So, what we see over here by the study of Perkins and Hendry actually there is no a moral or market argument to justify the explosion. But once started it is hard to stop, because everybody out of the fear that I will not be able to attract a high value talent is going on increasing and paying more.

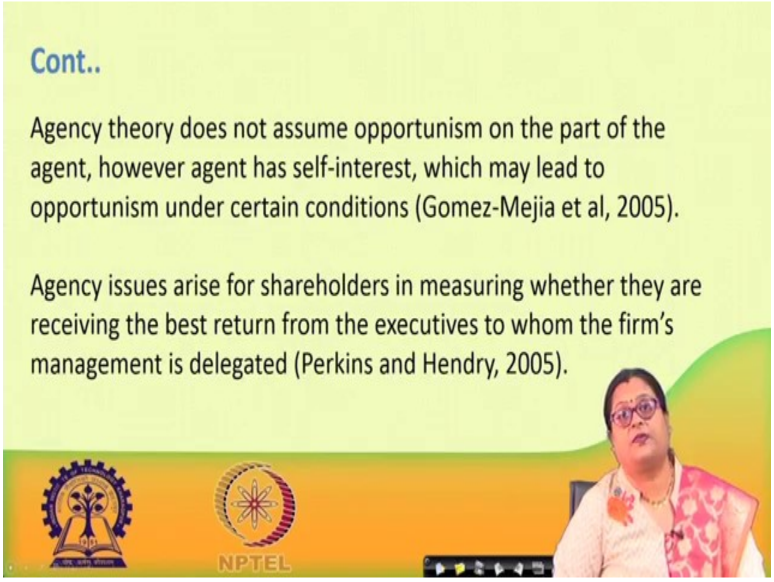
(Refer Slide Time: 07:46)



The factors which are affecting the level and nature of executive rewards are, if you are going by the agency theory; owners do not have complete control over their managers and the managers may act in their own interest and not on those of their owners. So, because the owners are separate from that of the managers and the owners are not directly running the firm. But they are running it through the managers, but because there is no ownership for the managers like they are not the owners of the company.

So, it is assumed like the owners do not have any control over their managers and the managers may act in their own interest and not those of the owners. So, one of the ways that the owners have thought that they can get loyalty from their managers that the agents is by compensating them more. So, consequently, like it is necessary to maintain an incentive alignment that is in terms of financial incentives. Alignment with the expectations of loyalty, alignment with what other organizations are paying also.

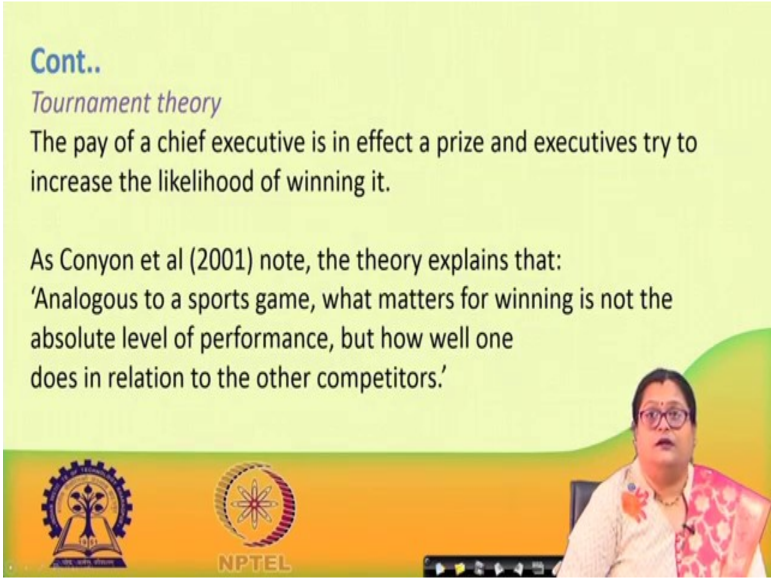
(Refer Slide Time: 09:17)



Agency theory does not assume opportunism on the part of the agent; however, agents have their own self interest, so which may lead to opportunism under certain conditions. So, it is not telling like all the managers are bad or managers will definitely try to work out their own ways throughout the organizations it is not telling it is not assuming that. But, it is assuming managers also do have their self interest of why they will function for the owners and in cases this self interest may give rise to opportunism.

So, agency issues arise for shareholders in measuring whether their return, getting the best return from the executives to whom the firm's management is delegated. So, the shareholders also expect the best return for their money and they expect like the executives runs the firm in a better way. The because, the management of the firm they have the shareholders of delegated it to the management, they were expected to function in a way which is going to give them the best return for their money.

(Refer Slide Time: 10:51)



Tournament theory, the this theory tells that the pay of the chief executive is in effect a prize that the that is given to the executive for running the organization smoothly and executives try to increase the likelihood of winning it. So, as Conyon et al note, the theory explains that analogous to a sports game, what matters for winning is not the absolute level for performance, but how well one does in relation to other competitors.

So, in this theory the how best the organization is run by the executives and how the executive is contributing to gaining the competitive edge for the organization with respect to other competitors in the environment of that particular organization, is going to define the pay for the chief executive. Like, who has been able to transform the organization well, who have been a good strategic thinker, who has been a good visionary leader. So, that the acumen that he brings into the business helps the organization to flourish with respect to other organizations and make its own place in the market.

So, that is going to determine the remuneration the reward that the chief executive gets. So, that is that this theory that is why to have talks of it as the pay of the chief executive is like a prize that the person wins and every executive would try to increase the likelihood of winning it.

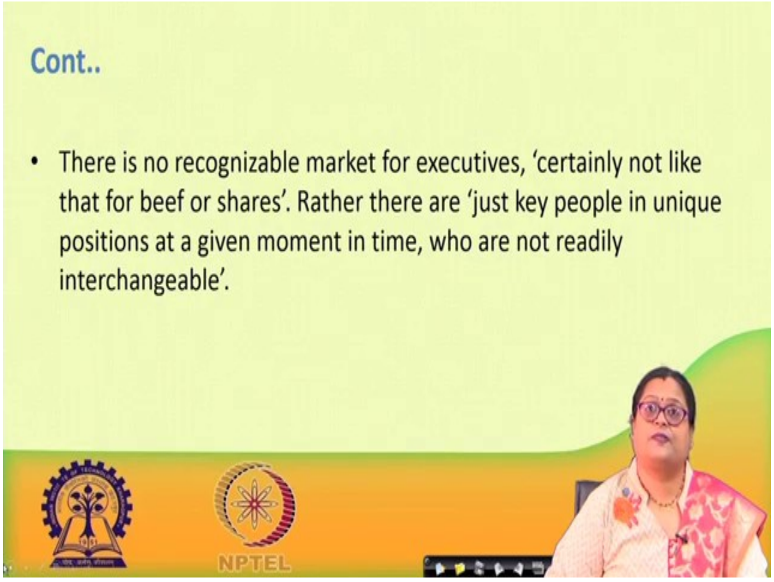
(Refer Slide Time: 13:00)

When we talking of market forces this is also like the comparisons with other executives in relevant industry labour markets is the way market forces working in executive pay. So, Hampel report in 1998 stated that the boardroom remuneration will be mostly determined by the market.

(Refer Slide Time: 13:35)

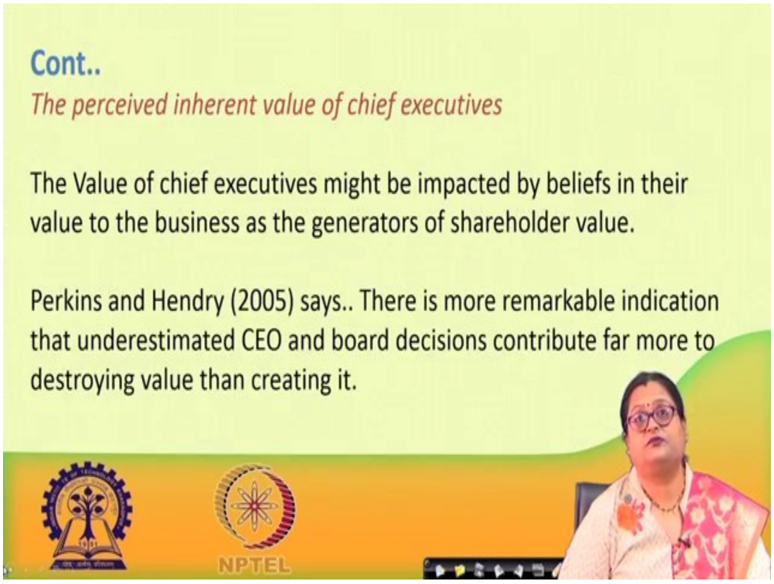
A study by Perkins and Hendry in 2005 over 10 years for 81 of the FTSE 100 companies revealed. There is a lack of intra company movement among executive directors in particularly internationally.

(Refer Slide Time: 14:00)



There is no recognizable market for executives, certainly not like that for beef or shares. Rather there are just key people in unique positions at a given moment in time, who are not readily interchangeable. So, we can understand like why they are special groups, why the competencies of a particular person in a particular position is very special. And why the organizations want to compensate more to buy the loyalty of that person or to make that person more engaged in the organization because here maybe we are talking of rare talents.

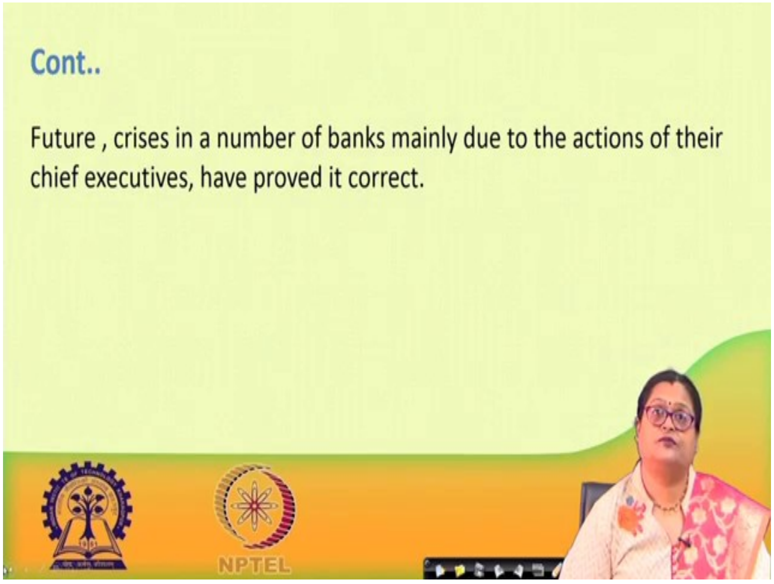
(Refer Slide Time: 14:49)



From this we look into the perceived inherent value of chief executives. The value as we were talking of , there are rare talents who can add much to the capital, human capital of the organization. So, the value of chief executives might be impacted by the beliefs in their value to the business as the generators of shareholder value.

Perkins and Hendry in 2005 says, there is more remarkable indication that under estimated CEO and board decisions contribute far more to destroying a value than creating it. So, if we do not go by the decisions of the board and decisions which are not proper to the need of the business. Then it goes for the destruction of the values of the organization rather than creating it.

(Refer Slide Time: 16:10)



So, like some of the decisions taken by the CEO's which are not very well thought of decisions with a lot of foresights given in to the vision and mission of the organization or the capability of the organization to do something or to pay something to take a new plunge. If these are not well thought over decisions by the chief executives that may have led or that has led to many crises in the organization.

(Refer Slide Time: 16:53)

When you talk of remuneration committees, the committees like the committee on corporate governance 2000 of the stock exchange and others recommended: Establishment of remuneration committees to offer an independent basis for setting the salary levels and the rules covering incentives, share options, benefit entitlements and contract provisions for executive directors.

So, this is a very important decisions and the recommendation if we understand if we unders we understand like there is a we have to prioritize the. And differentiate between people who are there in the organization based on their close match to the goals of the organization or based on the contribution to the goals of the organization in gaining a competitive advantage.

But there is also issue of maintaining internal equity, so it should not be so much the payment the incentives, the benefits, entitlements that the CEO gets. We should not be so much deviated from the other employees in the organization it should not appear to the original. The other employees should not get a feeling like the CEO of the like the pampered employees of the organization and others are like downgraded not recognized, not taken care of, the huge disparity which may be there.

So, it is very much required to establish a remuneration committee which is going to have a independent unbiased look into the actual contribution made by the CEO in bringing over the changes or in leading the organization to a higher level. And also the contributions of equal maybe the CEO thinks of it gives ideas, but also there are a lot of people at the back end who are translating those ideas into actions.

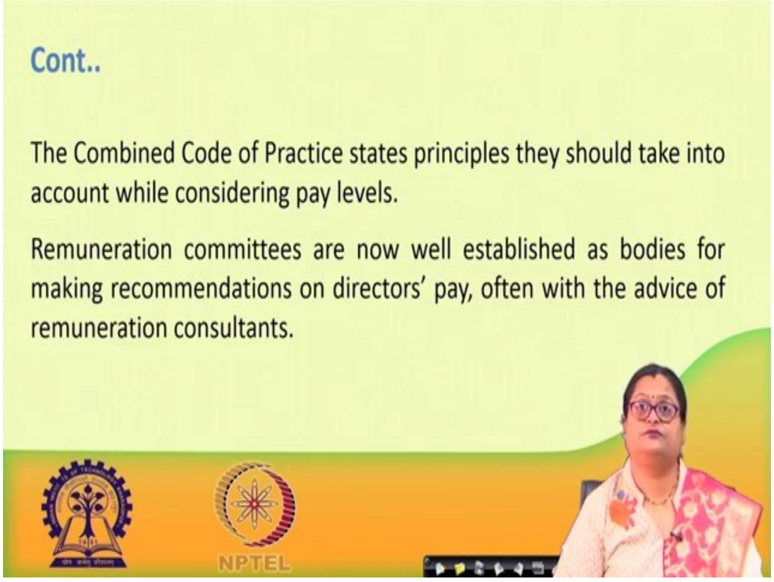
And who are also important in the organization, because if they do not execute the ideas which are shared by the CEO's, then maybe it will not be actually translated into reality. So, it is very important for the remuneration committee to have an unbiased look to have a well justified and realistic assumption of the salary levels.

What will be the rules covering the incentives, share options and benefit, entitlements, and contract provisions for executive directors. So, that there is a balance also, the CEO should not be feeling I am contributing so much I am not getting as desired. But, again it should maintain parity with the other employees of the organization also.

(Refer Slide Time: 20:30)

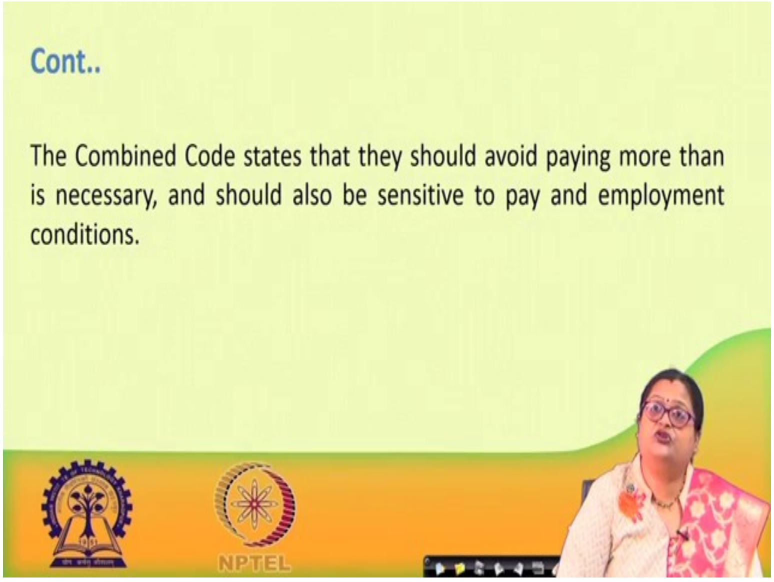
The committees will be held responsible to shareholders for the decisions they take and the non executive directors who sat on them would have no personal financial interests at stake. They will be constituted at subcommittee of company boards and board should elect both the chairman and members. The essential role is to set broad policy for executive remuneration.

(Refer Slide Time: 21:11)



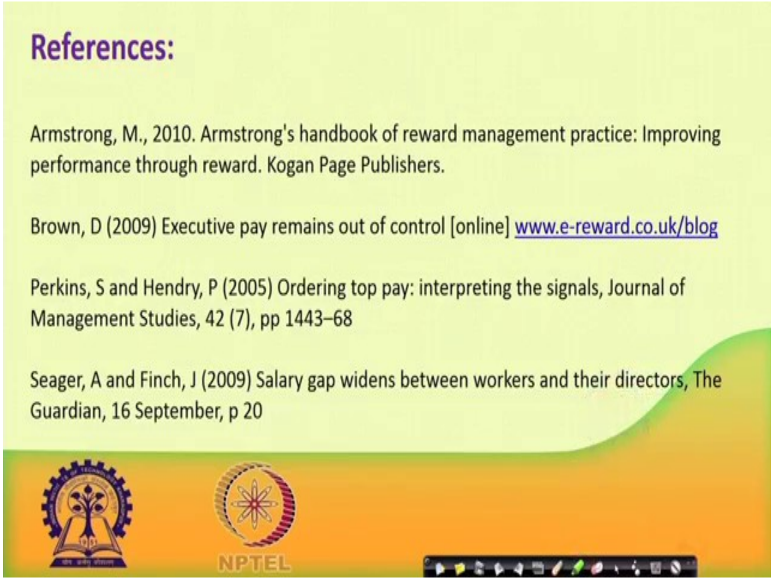
The combined code of practices states principles they should take into account while considering pay levels. Remuneration committees are now well established as bodies for making recommendations and directors' pay often with the advice of remuneration consultants.

(Refer Slide Time: 21:39)



The combined code states that they should avoid paying more than is necessary and should also be sensitive to pay and employment conditions.

(Refer Slide Time: 21:55)



These are the references from which this discussion has been developed, we will continue more on the discussions of executive pay in the next session.

Thank you.