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

Lecture – 43
Rewarding Special Groups, rewarding directors and senior executives, sales and customer service staff, knowledge workers and manual workers (Contd.)

Welcome to the topic again on Rewarding Special Groups, rewarding directors and senior executives, sales and customers service staff, knowledge workers and manual workers.

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In the earlier session we were discussing on the executive remuneration and in the present session also we will continue our discussion and rewarding directors or senior executives elements of directors and senior executives remuneration, so let us begin.

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So, now we have to answer the question like why have the executives pay grown so much. So, the reasons explained by Dymond and Murlis are, first as we have already discussed it is the agency theory. The shareholders must structure the CEO's compensation arrangements to reward behaviors that increase shareholder wealth that is the most important reason.

Because the shareholders want return for their money and they want the agents that is the executives to function in a way that is going to inc take better make better utility of their money invest it in proper way see that it is not wasted and it is like giving profits. So, in order to do that the shareholders must structure the CEO's compensation arrangements to reward behavior that increase shareholder wealth.

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Tournament theory as described the high rewards received by CEO's have little to do with what they deserve. However, the main purpose of such rewards is to send signals to senior managers to compete for the, amongst themselves to for the number one spot. The changing nature of the companies and the increasing demands made on the chief executives are also like reasons for this tournament theory.

Like one who can withstand this pressures, one who can like take care of the multi-tasking different kinds of expectations from different stakeholders. One who can take a well balanced decision is a person who is going to like sustained in this and to make it a very highly coveted position for the senior managers who are going to like compete with each other. In order to come to that position as if it is a prize when you become a CEO, so that is the basis for the tournament theory.

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So, when we go for the agency theory you find like it is the shareholders who want the CEO's to function in the best interest of the shareholders. When you are going to the tournament theory you find like it is like we are people are competing with each other to rise up to the position which is a highly coveted position, in terms of the remuneration, in terms of the recognition and in order to achieve that they are competing with each other.

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When you are talking of the star culture it is like the creation of the celebrity CEO which who is again maybe fits into a very highly coveted position who is like the face of the organization. And who is taking leading the organization to a future with and also leading like better than the other competitors. So, creating of that celebrity kind of CEO is a star culture and of course, the talent shortage as we are already disclosed discussing. Like if there is a talent shortage to, for a person who can really fit into that position who can who is a visionary leader who motivates people by inspiration, who can who is a good strategic thinker, who is agile in nature if all these who is adaptable to change.

And who can take quick decisions who can lead through uncertain times, if all these qualities are expected from a particular person. Then there could be a talent shortage because a person needs to be good in all of these aspects who is analytical and frame of mind and who can also like who is a critical thinker. So, these talents are like all expected you know one person maybe is rare and that is why your talent shortage could be there**.** And so, to gain that talent for my organization maybe I mean I offer a huge salary for or remuneration for it.

So, another factor which may affect is that like, if there is a like when there is a pay disclosure in annual reports. So, it leads to the everybody comes to know what the other person is getting and that may lead to the demands from the CEO's to achieve a parity.

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Now, a corporate we have been time and again discussing on corporate governance and how it like affects the executive remuneration. So, what corporate governance is the internal set of processes and policies that determine the way a corporation is directed and controlled. It serves the needs of not only the shareholders, but also the other stakeholders.

But this is a very very important point to be noted, till now in agency theory or in tournament theory we were showing a like sper way of motivation which is like guided by increasing the shareholders value. Making the person showing giving more showing more reward, so that the person compete with each other to gain that reward.

But here when you are talking of corporate governance we are talking of not only the needs of the shareholders, but the other stakeholders who are connected with the business. And it comprises of a board of a company and includes how members of that board are remunerated.

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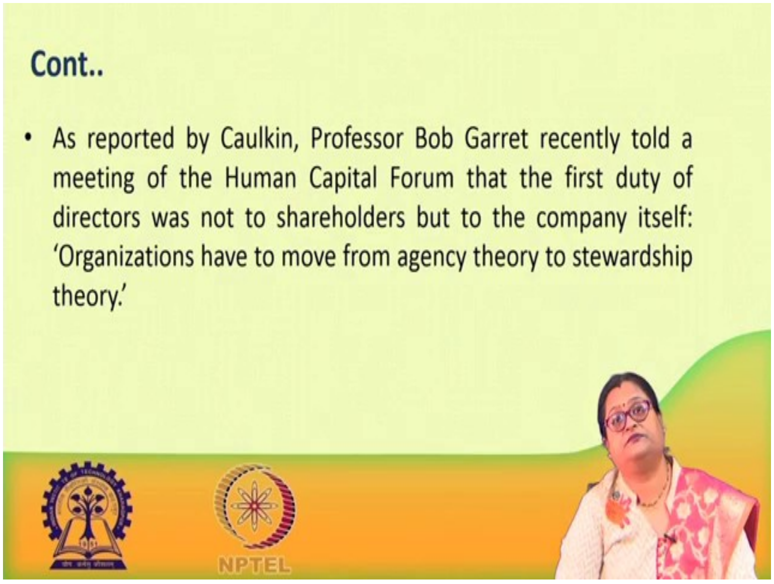

As reported by Caulkin, Professor Bob Garrett recently told the meeting of the human capital forum that the first duty of directors was not to the shareholders, but to the company itself. Organizations have to move from the agency theory to a stewardship theory, so this is a very important quote where we top of the difference like when we are responsible whether to the shareholders or to the stakeholders at large.

So, we are not like the executives are not just agents for the shareholders, but they are in the service for the company. And that means, in the stakeholders at large and they should like act in the best interest of all the stakeholders connected to the organization.

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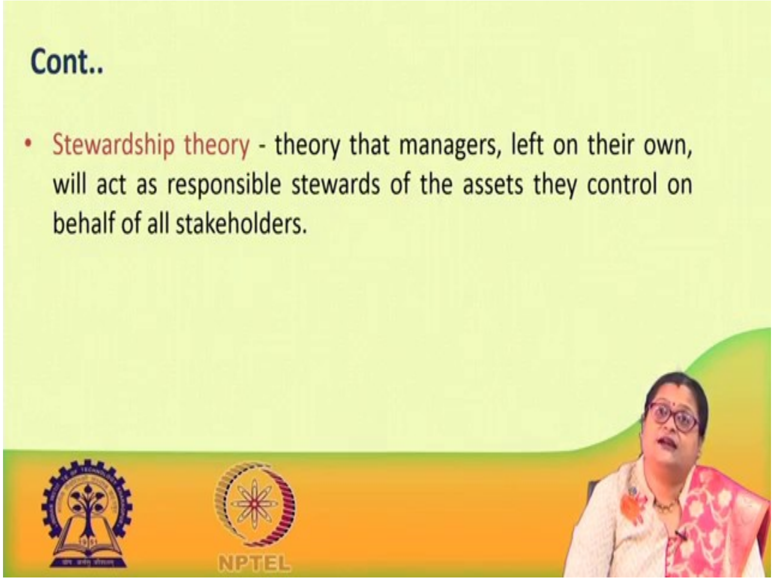

The stewardship theory tells that the managers left on their own will act as responsible stewards of the assets they control on behalf of all the stakeholders. So, it is not only the shareholders' money, but it is the assets of all the stakeholders and the managers are custodian of that. And there are stewards of the assets and it is the part of their duty to take care that they are safeguarding the assets and trying to utilize it properly in the behalf of all the stakeholders.

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The combined code on corporate governance which was produced by financial reporting council in 2008. It should it gives the principles regarding, relating to the remuneration of directors, the principles are like the levels of remuneration should be sufficient to attract.

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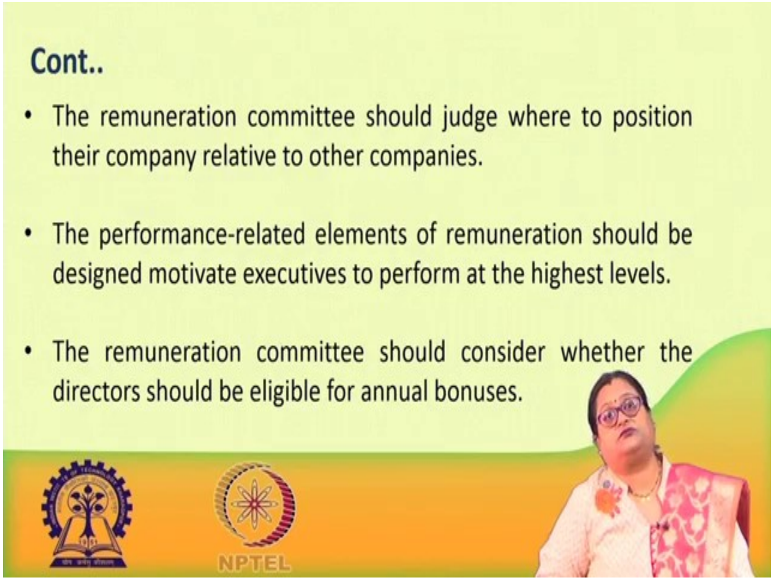

The remuneration committee should judge where to position their company relate relative to other companies. The performance related elements of remuneration should be designed to motivate executives to perform at the highest levels. The remuneration committee should consider whether the director should be eligible for annual bonuses or not.

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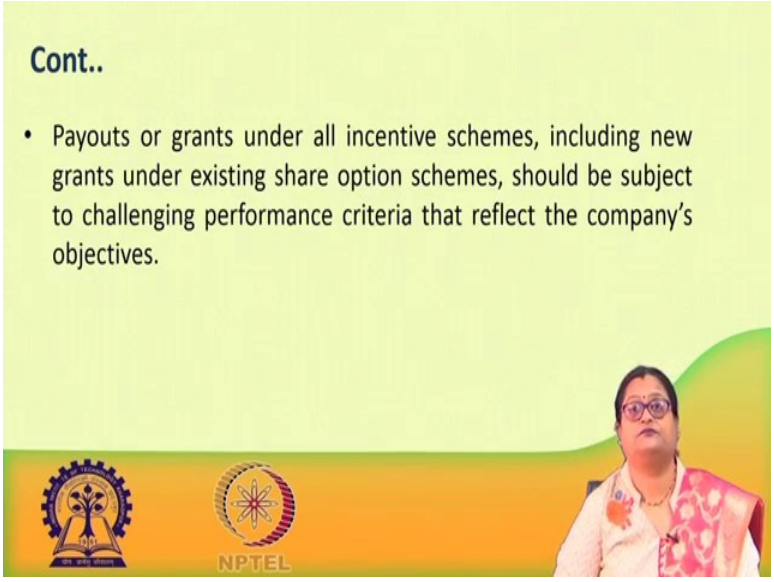

The payouts or grants under all it is incentive schemes including new grant under existing share option schemes should be subject to challenging performance criteria that reflect the company's objectives.

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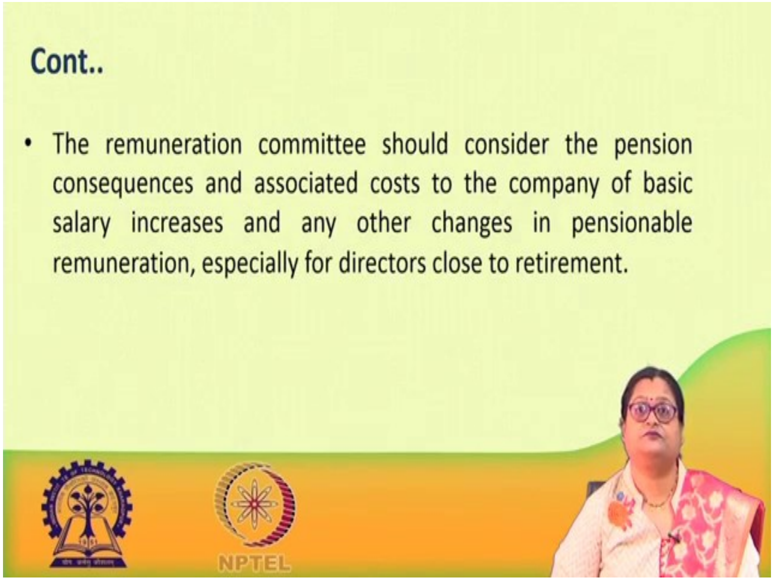

The remuneration committee should look consider the pension consequences and associated costs to the company of basic salary increases and any other changes in pensionable remuneration specially for directors close to retirement. So, if you go through this, so what is the basic thing is that the levels of remuneration should be sufficient to attract people to apply.

However, if you go again through this, so if you see that decision will be guided by these decisions of the second point is really very important where you find like the remuneration committee should judge where to position their company relative to other companies. And this is this could be based on their capacity to pay and this could be based on the strategies that they take for their organization.

And they have to decide like whether this incentive should be only financial incentives or non financial incentives also and how they are going to attract people to their organization. So, at the performance related elements of the remuneration so should be so designed that they will be performing at the highest level.

So, again, but whether the executives will be eligible for bonuses or not which needs to be decided, because they are already getting a very huge salary, so whether they will be getting annual bonuses or not this decision to be taken. And if you see like the incentives should be given only based on challenging performance criteria and so that also reflects the company's objectives.

It is very important to discuss about the pension consequences also, because if a person is close to retirement and then the cost of the company on the terms of basic salary increases and pension needs to be taken as a decision point.

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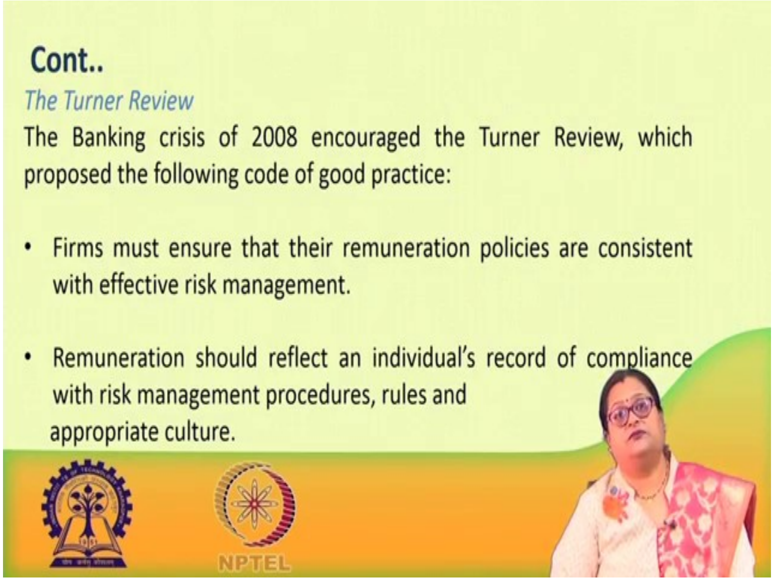

The Turner review, the banking crisis of 2008 encouraged the Turner review which proposed the following code of good practices. Firms must ensure that the remuneration policies are consistent with effective risk management. Remuneration should reflect an individual's record of compliance with risk management procedures rules and appropriate culture. So, how the person deals with risk and the strategies taken in the in order to face risk, so how risks have been like mitigated by the company with the help of the CEO.

And these are the what was the participation in the risk management, these are going to like decide on the remuneration policies of effective remuneration policies. So, and also is it is importance of compliance to risk management procedures rules and the appropriate culture of the organization.

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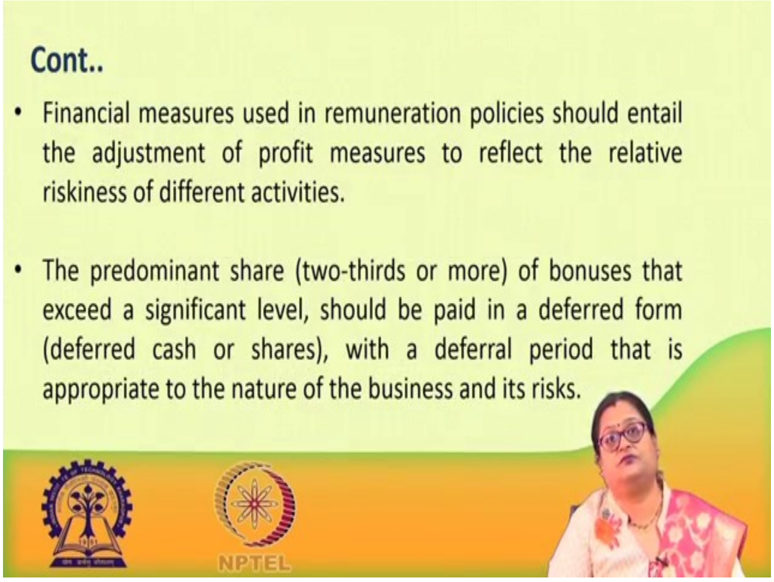

Financial measures used in remuneration policies should entail the adjustment of profit measures to reflect the relative riskiness of different activities. So, this is a very very important step that we may take a decision like which is a we understand the profit is small, but also the risk is more. So, how do you take care of that risk and what are your capabilities to answer to that risk, what is the responsibility is taken by the CEO for the risky decisions these are important things to be decided.

When we are talking of like the financial measures used in remuneration policies should entail the adjustment of profit measures to reflect the relative riskiness of the different activities. The predominant share two thirds or more of bonuses that exceed a significant level should be paid in deferred form, deferred cash or shares with a deferred period that is appropriate to the nature of business and it is risk.

This is again very important like you take a decision which is a risky decision which may appear to be successful in the short run. But as time passes on it may appear to be risky and maybe you need to really question your decision taken at a point of time. So, whenever we are talking of bonus and a predominant share of that bonus which is beyond a significant level should be paid in a deferred form in terms of deferred cash or shares for a deal with a deferred period that is appropriate. So, that we can observe how that the decision is working is it really helping the organization in the long run or it is becoming riskier in the long run.

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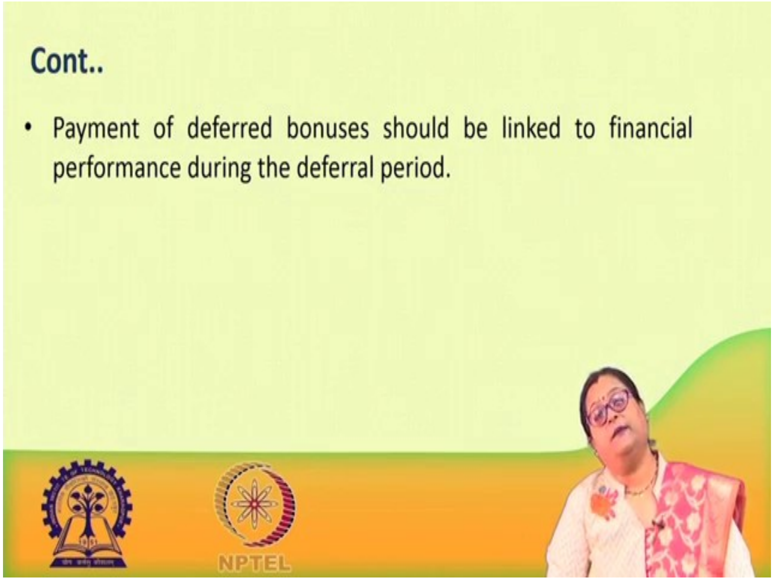

Payment of deferred bonuses should be linked to financial performance during the deferred period. So, if it is performing well then maybe you just get your bonuses accordingly, but if the result of the decision shows like it has not been a very good decision. And performance financial performance is going down then your deferred bonuses should be linked to that financial performance during the deferral period.

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The main elements of the directors and the executive's remunerations are basic pay and short and long term bonus or incentive schemes, share options and share ownership schemes, benefits and service contracts.

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Now, what is basic pay? And how it is fixed? Basic pay will be fixed based on the market worth of the individual's concerned. So, that is again determined by high how high price high value talent you are, what are your past performances, past experiences, how many companies maybe you have made the organization sail through. And that is how that is your experience you are getting paid for.

So, this basic pay is generally like remuneration and joining the company is commonly settled by negotiation often subject to the approval of a remuneration committee. So, if you are getting paid something in a x in a particular organization to what I should we give x_2 x_3 x or whatever depends on the negotiation and approval of the remuneration committee.

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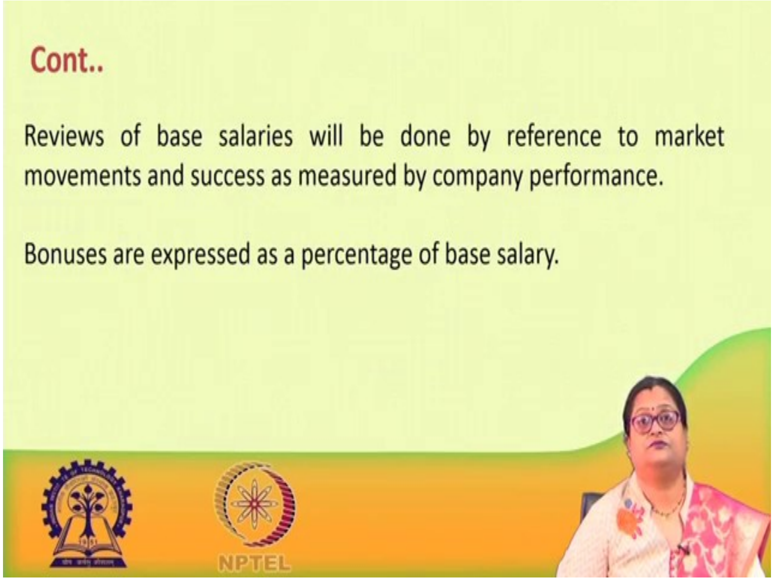

Reviews of base salaries will be done by reference to market movements and success as measured by company's performance. So, whatever is a base salary decided will be decided like in the markets what are the movements happening and what are the market rate. And the success like what the company can pay also and the bonuses are expressed as a percentage of the base salary.

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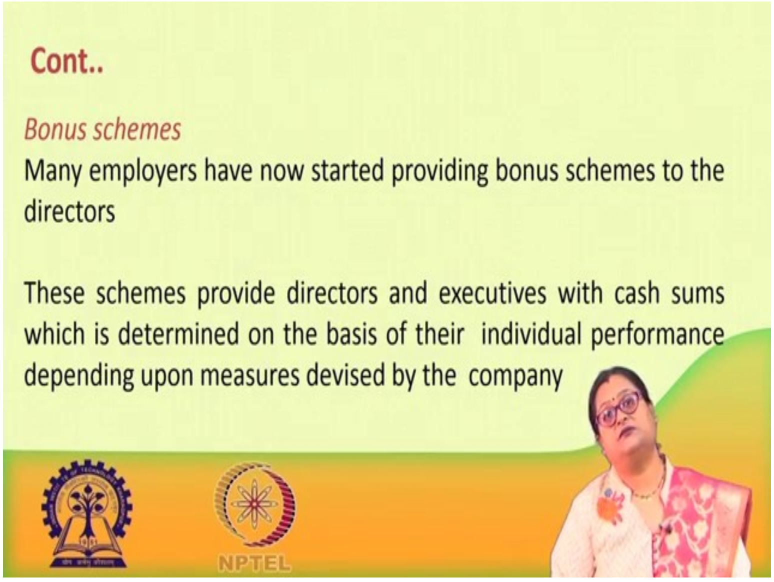

Now, what are the bonus schemes? Many employers have now started paying bonus schemes to the directors. So, these schemes provide directors and executives with cash sums which is determined based on their levels of individual performance depending on the measures depending on the measures devised by the company.

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Now, the benefits of the bonus scheme is that; they increase commitment, they serve as a source of motivation and they promote organizational citizenship behavior.

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Now, what is organizational citizenship behavior? Organizational citizenship behavior is a type of behavior in which the employee starts thinking of the organization as their own. Starts identifying with the organization and feels a level of ownership from for the organization. So, this is more developed from the affective commitment the organization develops towards the organization.

Affective commitment and the signs of engagement that employee develops towards the organization tries to get more involved in the job and gets more identified with the organization its purpose, its values. And starts thinking of the organization as their own as their like the process of ownership and becomes committed to the purpose of the organization, and gives better performance from this organizational citizenship behavior.

So, this is a positive aspect of the organizational citizenship behavior, but sometimes organizational citizenship behavior may be detrimental for introducing new changes in the organization. Because when I start thinking of this organization is my organization and I have contributed much to the growth of the organization this is my organization it is going to listen to what I am telling and I have a reasonable contribution to make, so that my voice should always be heard.

This kind of like ownership when develops, it sometimes reduces the flexibility of the person of the CEO's or the executives to take in fresh suggestions from new members at adapt to the changing time. It may give to the situations I have thought it in this way that is why it is a correct solution and the organization needs to be running this way only because this is my organization. So, these are on the flip sides of too much of organizational citizenship behavior.

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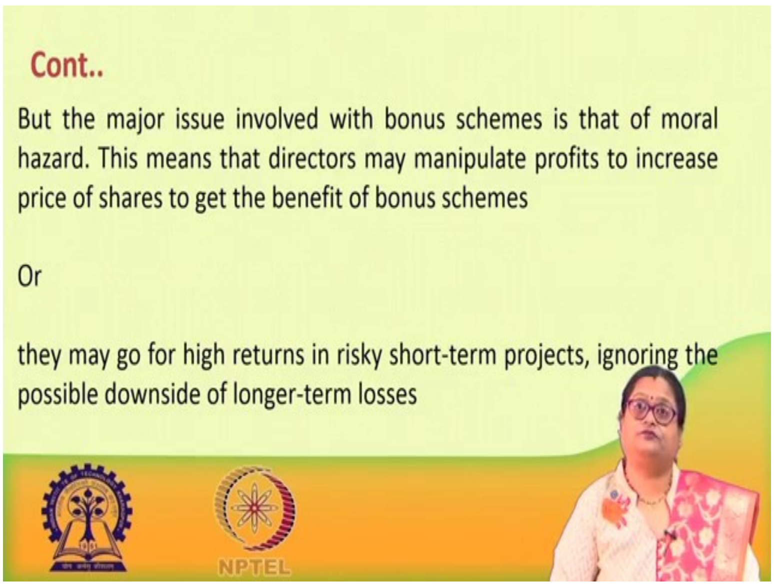

So, but the major drawback the issue involved with the bonus game is that because it is linked with the base pay and the percentage of base pay which is again linked to the performance of the organizations. So, people may use it in the purpose of self interest, so it gives rise to moral hazards. So, they may manipulate profit to increase price or shares to get the benefits of bonus schemes.

Or they may go for as we are telling high returns in risky, short term, projects increase in sometimes in ignoring the possible downside of longer term losses. So, that is why we were talking of the deferred payments of bonuses, so because in like in the greed for bonus and more bonus it may try to show a short term project with like a risky short term projects. So, which may give high return, but in the long run which may be detrimental to the organization, so the bonuses paid should also be deferred in nature.

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Long term bonuses, so these are like cash bonus schemes that can be extended over periods of more than one year on the grounds that annual bonuses focus too much on the short term results. The most common approach in providing long term rewards is through share ownership scheme which we will discuss later.

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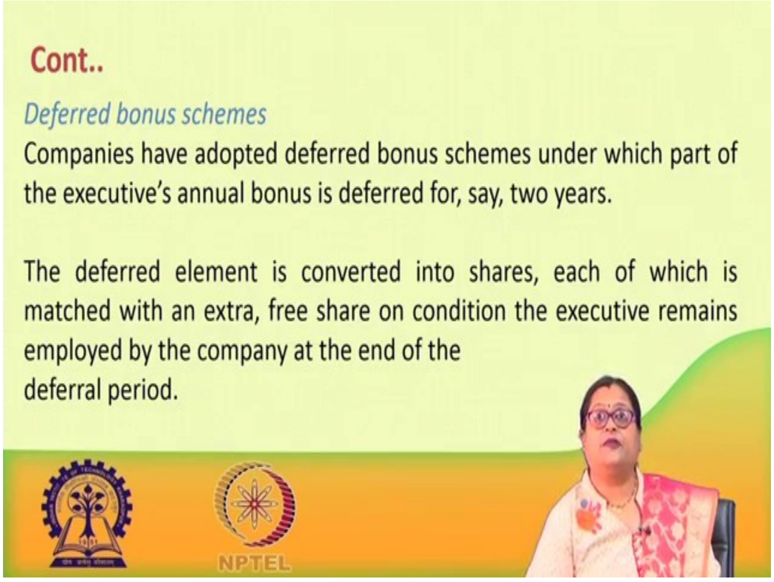

The deferred bonus schemes are the organizations have adopted deferred bonus schemes under which part of the executive bonus is deferred for say two years. So, the deferred element is converted into shares each of which is matched with an extra free share on condition that the executive remains employed by the company at the end of the deferred period.

So, this is another way also to make you retain the person in the organization, because we see like if people are attractant more by short term incentives and the organizations have the tendency to pay above market rate in order to gain the best of the talent. That could like attract the executives to work for other organizations maybe competing organizations also.

But here when we have a deferred long term bonus schemes in terms of like shares of the company matched with an extra free share. So, if which like if the executive gets if he or she still remains with the company at the end of the deferral period could be again a reinforcer, a motivator for the executive to stay back in a particular organization.

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And thus such a scheme is designed to reward performance and loyalty to the company. So, if you stay back in the organization as a loyal employee that loyalty is going to be in terms of like these deferred bonuses.

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These are the references that again we based on which we have developed this discussion; we will continue more on this in our next session stay tuned.