excellence enablers CORPORATE GOVERNANCE SPECIALISTS
[AN M. DAMODARAN INITIATIVE]

Expert Expressions
Corporate Governance Demystified

Excellence Enablers Private Limited June|2016

A series of interfaces with the entire range of stakeholders of Corporate Governance, has given rise to a number of questions, issues, concerns and, happily, some suggestions and solutions. In each issue of this monthly newsletter, we will be getting two experts to articulate their thoughts on a specific topic. The third issue is now with you. Needless to add, we welcome your feedback.

Editor

IDs COMPENSATION- HOW MUCH IS TOO MUCH?

M. Damodaran
Chairperson,
Excellence Enablers
Former Chairman,
SEBI, UTI and IDBI

"For him light labour spread her wholesome store;
Just gave what life required, but gave no more."

(Oliver Goldsmith)

How much, and in what manner, should Independent Directors (IDs) be compensated, is a question that continues to occupy corporate mindspace. Pay too little and you end up with Directors who are willing but not able. Pay too much and you possibly impact independence adversely. Stock options allegedly promote short-termism. On the other hand, some investors perceive disinterest or non-involvement on the part of Directors who do not own shares. Loss-making companies cannot pay commission to IDs, and hence find it difficult to get the good IDs, that they need. Is there a mismatch between the statutory expectations from IDs and their compensation?

Deepak Satwalekar and Somasekhar Sundaresan shed light on the vexed question, "How much is too much?"

Deepak Satwalekar
Independent
Non-Executive
Director on Boards

Somasekhar Sundaresan
Partner,
J. Sagar Associates

With the largely critical discussions on the Companies Act, 2013, it would seem that, earlier, IDs did not have any responsibilities. Saying that the workload of IDs has increased significantly is insulting those who earlier took their role seriously. The change now is that more onerous and specific responsibilities have been cast on IDs, requiring greater engagement. Possible liabilities faced by them too have changed.

What is appropriate (not adequate) compensation for IDs? At what level would independence get compromised? How can compensation of IDs help align their interests to those they represent?

With a higher time commitment, risk taking ability and

When the role of directors in the governance by the board develops into a fundamental tool of regulatory policy, what directors should be paid becomes a key question.

Directors are humans whose risk-reward appreciation is the same as any other normal human. The increasing regulatory focus on making the buck stop at the doorstep of the directors is a good thing. It has made directors think about what makes it worth their while to join a board. Equally, it reminds the system that paying peanuts would fetch only monkeys.

Directors cannot be expected to be on business corporate boards for altru istic purposes. Yet, when the shorter tenures, the number of potential IDs has shrunk. However, the basic law of Economics which requires price to adjust when supply shrinks and demand increases has been negated by legal stipulations.

The developed world is moving away from "per meeting" compensation. A crude indicator would be based on the expected role of IDs. Directors on Committees, depending on their workloads, should be paid additionally. Evaluation can address issues of non-attendance and non-participation, but should not lead to differentiated compensation.

Listed companies should pay a part of IDs' compensation with stocks bought at the prevailing market price on the day the compensation is paid. However, these shares should be permitted to be sold only after ninety days (or more) of the exit of the Director from the Board. This will prevent short termism and insider trading concerns.

It is time that the views of IDs on this subject are heard, by those that matter.

payments from a company inflate their earnings unreasonably it begs the question if their judgement would remain uninfluenced by a largesse – particularly for independent directors. Sitting fees, regulated by law, are a pittance. Stock options pose a moral hazard – independence from ownership mingling with promoting value of ownership does jar with each other. Commissions by percentage can bloat the remuneration.

Simple ways to see how much is too much:

* proportion of remuneration paid to a director in her total income

* time and attention on hand for the director to seriously attend to meetings

* assessment of contribution to the board