The elements of executive remuneration business essay

Executive employees, such as chief executive officers (CEOs), chief financial officers (CFOs), company presidents, and other upper level managers are often compensated differently than those at lower levels of an organization. Executive compensation consists of base salary, bonuses, long-term incentives, benefits, and perquisites. For the higher management, salaries are influenced by the size of a company, performance of the company, by the specific industry, and in party by the contribution of the incumbent to the process of decision-making. The more profitable the organization is the firm, the better is the compensation paid to the executives.

The industries that are more highly constrained by governmental regulation (banks, life insurance, railroads, public utilities) pay relatively less than those that are more free to carry on their business (private firms).

MEANING

Executive Compensation or managerial remuneration is how top executives of business corporations are paid. Managers are very short in supply, therefore, organizations are competing with each other to attract, retain and motivate leader managers for their strategic requirement.

FEATURES OF EXECUTIVE COMPENSATION

The features of executive compensation are:

It cannot be compared to the wage and salary schemes meant for other employees in organization.

Executives are denied the privilege of having unionized strength.

Secrecy is maintained in respect of executive remuneration

Executive pay is not supposed to be based on individual performance measure but rather on unit or organizational performance.

Executive remuneration is subject to statutory ceilings in some respects.

Executive remuneration depends on competence, experience, length of service, loyalty to founders, excelling areas like M&A specialist, turnaround specialist etc.

Executive remuneration supposed to be guided by job evaluations, JDs, salary grades with ranges of pay in each grade & salary survey – but exorbitant in reality.

ELEMENTS OF EXECUTIVE REMUNERATION

Executive remuneration generally comprises four elements: –

(i) Salary and allowance

(ii) Bonus

(iii) Long term Incentives

(iv) Benefits &Perquisites

(i) Salary and allowance: Salary is the first component of executive remuneration. Salary is supposed to be determined through evaluation and serves as the basis for other types of benefits. Salary is basically determined through job evaluation and serves as the basic for other types of benefits, but in managerial compensation job evaluation plays only a part and not represents the whole truth. A manager is paid for his capabilities and for the job he performs, rather than only job demands. This is the reason why the norms of wages and salary fixation are generally not observed while fixing the salary of the manager. Salary of the managers varies by the type of job, size of organization, region of the country and type of industry. Typically, pay of CEOs and other executives is set to be competitive with other executive salaries in the market and thus may be very high in comparison to the pay of employees in their own company. Salary makes up of about 40 to 60 % of top managers annual compensation but it is not significant, as it is subject to deduction at source and is also kept by government regulation. In order to avoid such deductions and sealing, managers are offered incentives and attractive perks.

(ii) Bonus: In the base salary of executives, most receive variable pay, a compensation that fluctuates according to some level of performance. The use of compensation beyond base salary is intended to motivate executives to reach certain organizational performance goals, for example, specific profit levels, and reward them for reaching these goals. One very popular type of variable pay is the executive bonus, which is a one-time payment tied to some short-term performance goal. Bonus plays an important role in today's competitive executive payment programmes. The bonus may be based on any number of performance outcomes, ranging from judgments of executive performance by the board of directors, to levels of company profits or market share. Nearly all executives now receive some sort of bonus as a part of their compensation package. Managers deserve bonus because they have much more stakes to influence organizational success than non-managerial staff.

(iii) Long term Incentives: Incentives have become important for rewarding the performance of executives, and now make up about one half of total executive compensation. Incentives are rewards that are directly linked to specific long-term goals of the organization. The most common long-term incentive is the stock option, which either gives the executive free company stock, or allows him or her to purchase company stock at a reduced price for a period of time. If bonus is short term benefits, stock options are long term benefits offered to managers. These stocks become more valuable as the company improves financially, and therefore, ownership of stock is intended to encourage the executive to make the organization more profitable. Executives can then sell these stocks at a later time when they have appreciated in value, therefore providing compensation beyond the employee's tenure with the organization.

(iv) Benefits &Perquisites: Benefits for executive-level employees are also likely to be different than those offered to lower-level employees. Executives will often receive high levels of typical company fringe benefits, like health insurance, life insurance, and pension plans. Additionally, some executives may also have a contract for large severance packages, paying cash and stock options to a CEO fired from a company. Many executives negotiate generous severance packages at the time of hire, so that even if they are unable to deliver upon promises to the company, they can collect compensation upon exit.

Executive perquisites, or " perks," are special benefits and services for executives and other top employees of companies. Perks may be things such as a car service, an executive dining room, special parking, membership in clubs, and other such amenities. Some of these perks, like car service or a company airplane, may serve to improve an executive’s ability to do his or her job. Additionally, some perks bring with them a certain level of status, for example company-paid membership to an exclusive country club that is appealing to executive employees. Executive compensation may include other benefits which other employee do not receive. Moreover, executives are compensated for the various expenses incurred by them, for taxation takes away a major portion of their salary. Such payments are in the form of –

(a) Medical care;

(b) Counsel and accountants to assist in legal, tax and financial problems;

(c) Facilities for entertaining customers and for dining out;

(d) Company recreational area (swimming pool and gymnasium);

(e) The cost of the education and training of executives, scholarships for their children, and allowances for business magazines and books; and

(f) Free well-furnished accommodation, conveyance and servants.

WHY MANAGERS SHOULD BE PAID MORE?

Managers have intensive worth and hence command hefty premiums.

The managers drive himself to success in his or her role is creating the mean by which certain organizational goal is achieved. The financial reward is a symbol of managers role itself , its power , its dignity and its freedom

The class of people called manager is always in short supply. One must pay heavenly if one has to attract and retain talented and competent individual

Having succeeded in retaining them, the manager must be motivated for better performance and it is the money which motivates employees and managers are no exceptions.

The lifestyle that fits his status and job requires considerable amount of money. To a worker, the wage is a mean of living but for a manager financial reward is a symbol of social prestige and position.

It is to eliminate or at least minimum corruption. The best of satisfying greed is to pay well scans and scandals cost the organization irreparably.

GUIDELINES FOR CEO COMPENSATION

Corporate Governance

A corporate governance aspect to CEO-pay

Revolves around the decision process involved in fixing a CEO's compensation; In some, corporate Head Quarters lays down the broad guidelines while the actual compensation is a function of local market conditions

In the Indian context it is the board of directors that decides the compensation of CEOs

Since most CEOs also chair the board, this means they write their own pay-cheques. However, some companies (especially the progressive ones) have compensation committees in place

Company's Act 1956

In India the Companies Act is the legislation that primarily shapes the remuneration of top managerial personnel.

Until 1993, the Act provided for an upper limit in the amount of compensation to be paid.

It had been pointed out that the " regulation of director's remuneration becomes necessary for several reasons, prominent among them being the prevention of diversion of corporate funds for personal use and the impact which an unduly high executive reward has upon the rest of society."

However, over the years, with the shift in India's economic policy towards a market-oriented capitalistic economy, this particular legislation has been amended to increase the maximum pay package limits that are payable to the managerial personnel. While other reforms have taken their time to be incorporated in to the Act, the maximum pay ceiling for CEOs has been increased systematically and more frequently.

One of the main reasons put forward for this regular increase has been the need to attract and retain talent at the senior level.

Additionally, it has been argued that the risk and responsibility at the senior level needs to be compensated by a sufficient increase in the pay packet. Needless to mention the risk and responsibilities at the CEO's level pertain to the uncertainty associated in fulfilling organizational objectives. This automatically indicates a strong relationship between the CEO's compensation and organizational performance.

Logically the CEO’s job should be at stake if the organizational objectives are not fulfilled.

Indian law does not require that the compensation committee have a charter. The scope of the Company’s remuneration committee includes determination of the Board’s compensation and the Company’s policy on specific remuneration packages for executive directors including pension rights and any other compensation payments.

RECOMMENDATIONS

Companies should have completely independent compensation committees that decide CEO pay

In the absence of such committees, there should at least be a special sub-committee that decides CEO pay

Whichever form the committee takes, CEO pay should always be aligned with the performance of the company’s stock

The usage of more sophisticated measures of financial performance, like Total Shareholder Returns (TSR) or Economic Value Added (EVA)

To use a balanced measurement matrix that includes non-financial parameters like customer satisfaction and employee engagement

Some companies could even split the variable pay component into two parts:

One of these is related to a company’s performance in the short-term (typically sales and profits)

Another to its performance in the long-term (Market Value Added or Market Capitalization). The short-term bonus is typically capped as a percentage of the CEO's salary, while the long-term reward takes the form of stock options.

QUESTIONS:-

Q1. What do you mean by executive compensation? Explain the features of executive compensation.

Q2. Briefly explain the major components or elements of executive compensation.

Q3. Differentiate between Salary and Bonus.

Q4. Explain the guidelines for executive compensation?