Chapter 1: Introduction

The former Prime Minister of India, Dr. Manmohan Singh advised restraining excessive compensation to top executives (Singh 2007). Indian scholars, policymakers, and media have raised concern over the excessive CEO compensation in Indian companies. They suggest the failure of corporate governance mechanisms in adopting efficient compensation practices and curbing rent extraction by the CEOs.

Boards use compensation and incentives to attract, hire, and retain talented CEOs. However, our understanding of CEO compensation contracting in Indian companies is rather incomplete for several reasons. First, recent methodological developments show that it is necessary for longitudinal compensation studies to control for not only the time-invariant managerial attributes in order to obtain unbiased coefficients, but also to cluster standard errors by firm in order to obtain unbiased standard errors. Longitudinal compensation studies in the Indian setting inadvertently suffer from one or both these issues. Second, compensation studies in the Indian setting argue that CEOs of Indian firms draw excess compensation and criticize the failure of corporate governance mechanism to promote efficient contracting. However, their conjecture is not based on any formal test. Third, economic theory suggests that the use of relative performance evaluation (RPE) in executive compensation enhances contracting efficiency and creates incentive to achieve both superior performance and strategic advantage. While the evidence of RPE usage in the U.S. and the U.K. and the drivers of RPE usage are well documented, we are in the dark about any RPE usage in Indian firms.

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1 The words compensation, pay, and remuneration are used synonymously in this dissertation.
In this dissertation, first, I review the literature on CEO compensation, discuss current regulatory framework for and compensation contracting practices in India, and examine the trend in CEO compensation in Indian companies. This is followed by an empirical investigation of four key research issues in three essays. First research issue is whether the boards of private sector companies in India use RPE in determining their CEO’s total compensation, and what type of performance measure do they use therein. Second research issue is about the drivers of the RPE usage in Indian private sector: what role does a firm’s operating efficiency and asset productivity play in its RPE usage in CEO compensation. Third research issue is about the role of corporate governance in CEO compensation contracting in Indian companies: how are two important governance attributes, namely ownership and board structures associated with total CEO compensation in Indian firms. The fourth research issue is about the explanation for higher CEO compensation. It seeks to answer whether CEO compensation results from an efficient contracting or a rent extraction by the CEOs.

The rest of the dissertation is organized as follows: Chapter 2 reviews the literature on CEO compensation. Chapter 3 discusses the legal framework and regulatory requirement for CEO compensation of Indian companies. Chapter 4 studies the compensation contracting during 2013-14 in the companies included in the S&P BSE Sensex index (henceforth, Sensex companies). Chapter 5 examines the trend in total CEO compensation during 2002-2013. Chapter 6 addresses the first research issue: whether Indian companies use RPE. Chapter 7 focuses on the second research issue: the role of operating profitability and asset utilization efficiency in RPE usage. Chapter 8 examines the third and fourth research issues: the role of ownership structure and board attributes in total CEO compensation and the explanation for excessive CEO pay. Finally, Chapter 9 concludes the dissertation.