The Determinants of Managerial Remuneration in the Indian Corporate Sector

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Abstract

The study tries to find economic justification for the apparently high earnings of corporate managers. In order to survive in the competitive environment after liberalization, firms have to derive the best performance from their managers. The managerial remuneration structure needs to be so designed that managers have proper incentives for directing managerial decision-making at improving the performance of their firm. The regression-based pay determination gives a fair idea as to how the executive pay structure of a firm is designed. In addition to this, the regression-based pay determination helps in knowing the executive pay structure that will help in aligning executives' interests to firm's objectives. Data for 157 managers in 8 companies for the period 1977-97 have been used for the study. In order to find the determinants of managerial remuneration, econometric modeling is done based on various theories of managerial compensation. These theories have been categorized into the following four models in this dissertation.

? The first model, the Firm Performance Model has two approaches. According to the corporate-growth approach, the size of the firm has a significant effect on managerial remuneration. According to the profit-maximization approach, the profits earned by the firms are the significant determinants of managerial remuneration.

? The second model, the Managerial Discretion Model, suggests that managers have a lot of discretionary power in running the corporation and this discretionary power affects their remuneration. This discretionary power is influenced by factors like, the percentage of executives in the BoD and the nomination of an individual to the BoD.

? The third model, the Human Capitol Model, suggests that there is a positive relationship between managerial remuneration and human capital variables like type of qualification, designation and total labour market experience.

? The fourth model, the Tournament-Based pay Structure model, tries to explain the disproportionate inter-level salary differentials at the top level of hierarchical ladder. Increasing inter-level differences in managerial remuneration towards the higher levels of hierarchy maintain incentives through all levels upto the top.

Based on these theories and the scenario in India, ten testable hypotheses have been developed. The earning equations are developed for testing the hypotheses and Kmenta's method using generalized linear regression model for pooling cross-sectional and time-series data was used for analysing the data. The study considered two angles: firstly, taking the level of inflation-adjusted remuneration of managers and secondly, taking the percentage change over the previous year in inflation-adjusted remuneration.