

WHAT DETERMINES EFFECTIVE ENFORCEMENT OF CLAWBACKS IN EXECUTIVE COMPENSATION: EVIDENCE FROM INDIA

Dr Arun Kumar Tripathy and Dr Nidhi S Bisht
Management Development Institute Gurgaon
India

Clawback Policy- Why?

- Compensation given to executives has received significant criticism for being outrageous and rewarding managerial short-termism (Post 2008 crisis)
- On average, CEOs' salary has been on the rise, even when organisational performance has fallen below shareholder expectations
- Spate of corporate scandals, where executives have been accused of misfeasance, fraud or material financial restatement
- Hence, the organisation's key challenge –is to revisit executive compensation for effective risk management and reduce managerial myopia in strategic decision-making.

Clawback Policy – What is it?

- A clawback is a contractual agreement in which the executive agrees to pay back previously paid remuneration under certain circumstances.
- Clawbacks in executive compensation are to align better the interests of executives and the company's stakeholders and are intended to create more accountability among senior executives.
- It conveys that mere resignations do not exonerate executives from their fiduciary responsibilities and violations during their tenure.
- Will help companies to avert any possible monetary and reputational harm that the company may have to bear due to the wilful or negligent actions of executives.
- Various benefits of adopting clawbacks (Chan et al.; 2012):
 - improvement in financial quality reporting,
 - lower abnormal accruals,
 - reduced opportunistic managerial behaviour and,
 - more confidence of external stakeholders like shareholders and auditors in the internal control mechanism for firms.

Enforcing Clawback- Challenges

- Enabling boards to act against senior executives for violating the code of conduct and governance practices.
- Judgement is required to decide whether the executive can be held accountable for the material, reputational, and financial harm suffered by the organization.
- Complex and ambiguous responsibilities of the top executives and the broader legal framework for compensation clawbacks.
- Boards in these organizations sometimes may lack the commitment to enforce.
- Examples:

The ICICI board indicted and penalised Kochhar in January 2019 after giving her the clean chit for the same accusations in 2016.

The Board of Yes Bank, on the directions of the Reserve Bank of India (regulator), approved a clawback of 100 per cent of the performance bonus paid to Rana Kapoor (Founder & Promoter).

Case Description -ICICI Phase 1

- The regulator (RBI) conducted a probe – could not establish any conflict of Interest in loan approval.
- ICICI Board hired a law firm to conduct an investigation – provided a clean chit to the CEO.
- Denying all charges against her, Kochhar(CEO) mentioned that she was unaware of the business dealings between her husband's firm and Dhoot.
- The board accepted the CEO's argument. Chairman BOD stood by the CEO, stating that unfounded rumours were to malign the bank and its top management.

Case Description -ICICI Phase 2

- The media highlighted the story in a big way. Investigating agencies initiated a preliminary inquiry into the nexus between Kochhar's husband and Dhoot.
- Ministry of Corporate Affairs started investigations.
- SEBI (market regulator) started proceedings against Kochhar and ICICI.
- Growing pressure from shareholders, investors, and media, yet another complaint from a whistleblower –Board decided to have an independent enquiry.
- After that, the board announced Kochhar's leave until the closure of the investigation to facilitate an independent search into the charges.
- New Chairman-BOD was appointed.

Result

An Independent internal inquiry committee indicted the CEO:

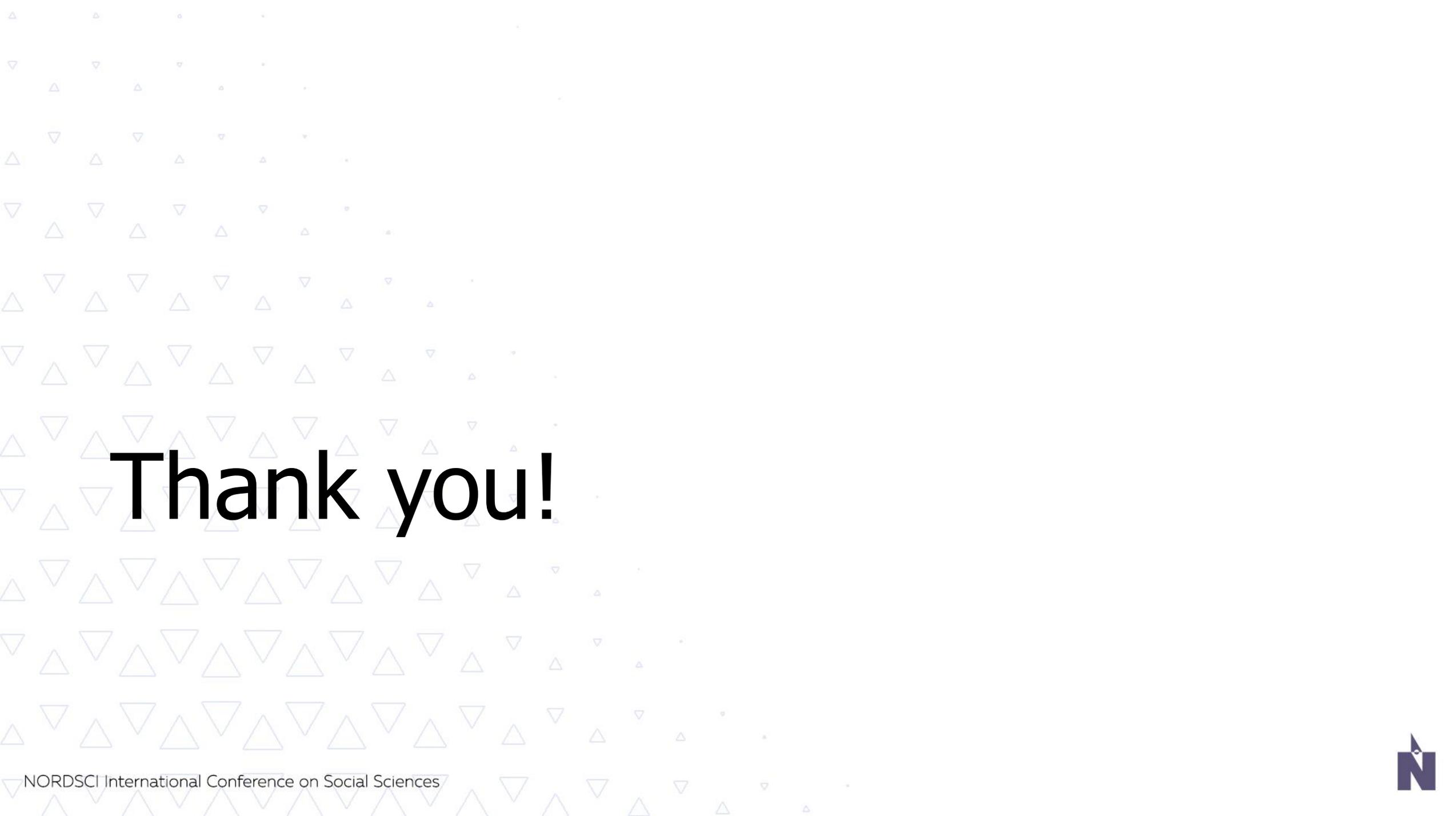
- She violated the bank's code of conduct, its framework for dealing with conflict of interest and fiduciary duties.
- She violated applicable Indian laws, rules, and regulations. And her lack of diligence concerning annual disclosures while sanctioning loans to parties related to her played a role in making the bank's processes ineffective.

Pursuant to the indictment by the enquiry committee, the ICICI board decided to:

- Retroactively treat the CEO's resignation as termination
- Board decided to claw back all performance bonuses and stock options given to her between April 2009 and March 2018 and revoke her existing and future entitlements.

Conclusion

- Understanding clawback enforcement.
- External stakeholders like media, regulatory bodies and investigating agencies have to play an active role in enforcing the clawback policy.
- Contributes to the literature on clawbacks in executive compensation and highlights its importance in reducing managerial short-termism in the corporate world.
- With an increased focus on risk management, clawback policies are likely to be a standard feature to avert potential monetary and reputational harm that the organisation may have to bear due to wilful or negligent actions of executives.
- The clawback initiated by the ICICI board is in line with the growing scrutiny of organisational performance measurements against governance practices and conduct.
- Broadly designed clawback policies can better serve as a strategic tool to focus on long-term value creation.
- Companies can tailor a well-thought-of clawback policy in alignment with the overall compensation philosophy and ensure effective enforcement through a responsible board.



Thank you!