



# Total Rewards

India • Volume 1 • Issue 2 **Q U A R T E R L Y**

04  
Compensation  
Management in India  
Comes of Age?

14  
Meeting the Total  
Rewards Challenges  
in Times of Change

17  
Make the Most  
of Long-term  
Performance Plans

## Decoding Executive Compensation



## Around the World with Total Rewards 2011

MARCH 18, 2011, GRAND HYATT, MUMBAI

### Managing Rewards in Growth Economies

The recent economic downturn has changed the rules of the game and has brought growth economies like India and China to the centre stage. There is a growing recognition of the differences in strategy, talent and employee programs that work for high growth regions like Asia Pacific vis-à-vis the more mature markets. Reward programs in particular, have been under the scanner and a lot has been said about their new 'Avatar'.

In this conference, we hope to explore and understand what's really changed, what is emerging and what that means for us as HR and Rewards professionals in India. Be a part of the conference and hear from Aon Hewitt Content Leaders and Industry Experts as they share recent research, compelling success stories and emerging practices.

For more information, write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com).

# what's *inside*



08

## COVER STORY

### Decoding Executive Compensation

The most commonly asked question about executive compensation revolves around its role in the economic downturn, and while the general belief is that it was one of the key reasons for organizations to indulge in risky behavior, it is difficult to label it as the chief culprit for all that went wrong.



14

Compensation Management in India Comes of Age? **04**

Meeting the Total Rewards Challenges in Times of Change **14**



17

Make the Most of Long-term Performance Plans **17**

Crafting Long-term Incentive Plans **22**

Management of Retiral Benefits in India **24**



24

Survey Calendar **26**

About Us **27**



Total Rewards Quarterly  
India • Volume 1 • Issue 2  
www.aonhewitt.com

#### Editors

Shilpa Khanna

shilpa.khanna@aonhewitt.com

Sushil Bhasin

sushil.bhasin@aonhewitt.com

Tel: +91 124 4155000

#### Editorial, Reprints & Syndication Offices

Aon Hewitt Tower, DLF Centre Court

Sector-42, Gurgaon, India-122002

Tel: +91 124 4155000

Fax: +91 124 4052010

#### Subscription Request

totalrewards@aonhewitt.com

#### Editorial Feedback

totalrewards@aonhewitt.com

#### Design

CREATIVE INC. (www.creative-inc.in)

Total Rewards Quarterly is published

four times a year by Aon Hewitt

Copyright © 2011 Aon Hewitt



At the outset, thank you for your feedback and the overwhelming response to our inaugural edition in October 2010.

This issue is particularly exciting owing to our merger with Aon and this being the first issue under the Aon Hewitt banner. We feel empowered as an organization to bring to you the most dominant brand in the human capital space. With McLagan, Radford and Hewitt coming together, it has significant advantages for our clients in compensation. You can look forward to better insights, information and research with an even stronger industry focus.

In this edition, our focus continues on executive compensation and on stronger performance linkage through long-term incentives. Increasingly, Indian boards are concerned about what will help them place the right accountability and deliver sustainable performance in the Indian context, rather than simply emulating practices from the west.

In addition, we bring to you our global knowledge and experience on Total Rewards Optimization (TRO). The benefit and relevance of TRO was deliberated with senior rewards professionals in India and we are glad to share the same with you. Progressively organizations have looked at market benchmarks and their talent strategy to decide the pay delivery mechanism, but owing to diversity in workforce demographics, organizations have to start understanding employee preference. Unlike the developed economies, where the purpose of TRO is to reduce cost, in growth markets like India, it is to get a better return on total rewards spends.

We hope you enjoy the read and look forward to receiving your comments and feedback.

**Sandeep Chaudhary**  
Regional Practice Leader –  
Asia Pacific Compensation Consulting  
Aon Hewitt  
For more information, please write to us  
at totalrewards@aonhewitt.com





# Compensation Management in India Comes of Age?

Salary increases in the corporate sector continue to dominate conversations on compensation management in India. With double-digit increases through two decades and an average projection of 12.3 percent for 2011, salary increases in India have held their position of being the highest in Asia Pacific (APAC) and amongst the highest across the globe.

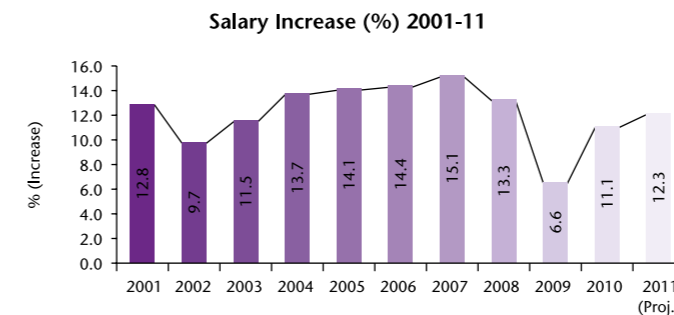
The last decade, with its share of downturns, has subjected this number to severe scrutiny. While India Inc. emerged relatively unhurt, the impact was felt on the 'average increase' number and more significantly on how it is distributed.

## Stabilizing Salary Increases

In the last decade, HR and business leaders witnessed the emergence of a highly competitive talent market. They had to quickly adapt themselves to operate in a seller's market, with more opportunities and avenues for current and potential employees.

As a result, India witnessed mostly double-digit salary increases across the decade.

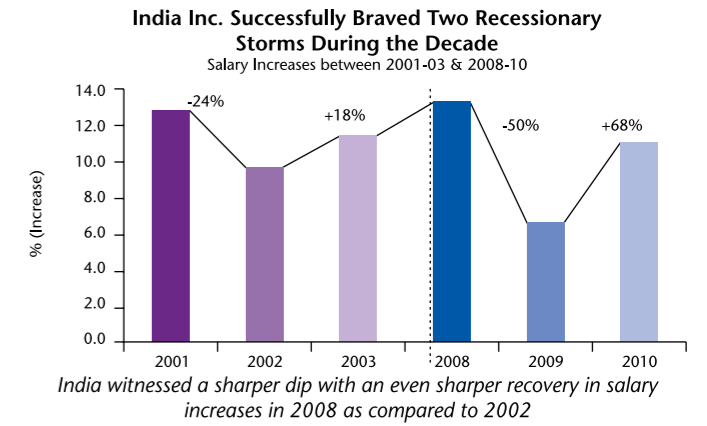
Having said that, it is interesting to note that the average increases to the tune of 13 percent across the decade (excluding 2002 and 2009) are significantly lower than the previous decade where salary increases ranged from 18 percent to 22 percent.



Source: Aon Hewitt Salary Increase Surveys (2000-10)

On the one hand, while these high increases were helping India in bridging the gap in pay levels with the developed world, on the other, these were starting to erode India's advantage due to the declining wage arbitrage.

Consequently, after several years of unprecedented growth in salary increases, the years 2004-07 witnessed some sort of 'moderation' or 'plateauing', with year-on-year increments in salary increases ranging between 0.3-0.7 percent, as compared to 1-2.5 percent in the previous years.

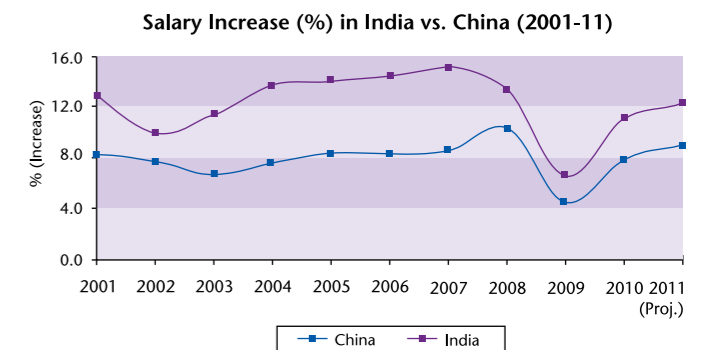


Source: Aon Hewitt Salary Increase Surveys (2000-10)

## India Vs. China

Both India and China have witnessed spectacular GDP growth rates across the decade, averaging at 7.7 percent and 9.9 percent respectively. While China has been ahead of India on GDP growth rates in the past decade, India has consistently been 2-6 percentage points ahead of China on salary increases.

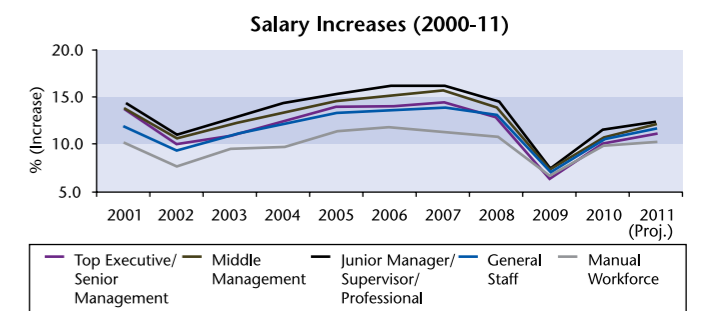
Salary increases in India have consistently been higher than the GDP growth rate across the decade.



Source: Aon Hewitt Salary Increase Surveys (2000-10)

## Salary Increases Across Employee Levels

Through the past decade, junior management has been receiving the highest salary increases. This set was followed by middle management, owing to the vulnerability and mobility of talent in these groups.



Source: Aon Hewitt Salary Increase Surveys (2000-10)

*We are increasingly seeing more 'customization' of increases with a high focus on 'hot' functions, 'niche skills', 'high potentials' and 'senior/top leaders'.*

The trend is different from what we saw in the previous decade, where senior/top management commanded the highest salary increase. This was primarily driven by the intense demand for leadership talent (with the influx of MNCs) and the low base pay as compared to developed nations.

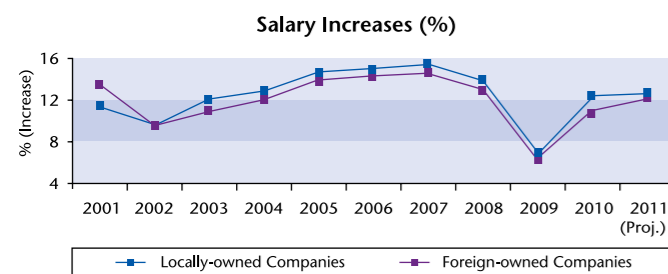
Today in India, the ratio of the CEO's salary to that of the entry level graduate, has gone up from an average of 1:90 to about 1:150 as compared to the previous decade. Additionally, the structure of senior management salaries has evolved with greater emphasis on short and long-term incentives, thereby reducing the reliance on fixed pay increases.

### Indian Companies Dominate With Higher Increases

The decade of the 1990s and early years of the last decade were clearly marked by the dominance of foreign-owned companies, which typically provided 2-3 percent higher salary increases as compared to locally-owned companies. During this period, absolute Indian salaries lagged behind multinational organizations by a significant margin (ranging between 15-20 percent).

This trend reversed from 2002. Indian companies, though marginally, but consistently, over-shadowed the foreign-owned companies by providing 0.6-0.8 percent higher salary increases. This has helped in the gradual bridging of the gap in salary levels across organizations of different ownerships, especially at the senior/top management levels.

Indian companies are increasingly coupling higher salary increases along with other factors such as greater empowerment, local innovation, increased access to top management and better career opportunities as means to lure away quality talent from established multinational giants.



Source: Aon Hewitt Salary Increase Surveys (2000-10)

### Changing Sectoral Patterns – Manufacturing vs. Services

India's growth, especially in the post 1991 reform period, has been led by dynamism in the services sector – particularly high-end, knowledge-intensive service exports.

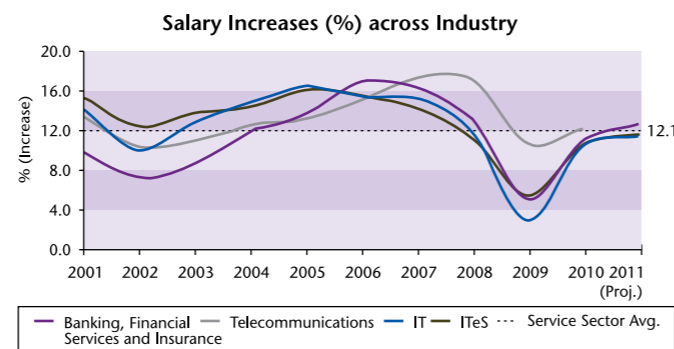
A fragmented analysis suggests that sub-sectors such as Finance, Insurance, Real Estate, Business Process Outsourcing and Technology Services have been riding the growth wave up until 2008.

The unrelenting growth of this sector has also been reflected in the growing & continuing dominance in salary increase trends. The average salary increase for this sector across the decade (excluding 2002 and 2009) has been 13 percent, typically 1-2 percent higher than the manufacturing sector in any particular year. Among other factors, rising demand for 'niche', 'technical skills', especially in the Financial Services and IT/ITeS industries has contributed to this bullish trend in salary increases.

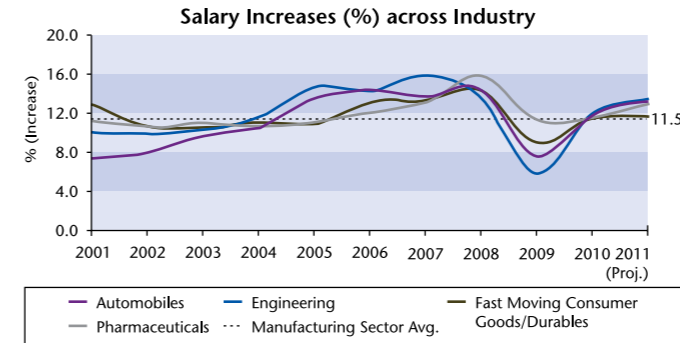
However, the year 2008 was an inflexion point in this trend; with the manufacturing sector on a stronger footing post the economic downturn. Sectors such as Consumer Goods, Automobile, Construction and Engineering were primary engines of India's economic growth during 2008-10 and thus, organizations in these sectors reported higher salary increases as compared to the export-oriented sectors.

A similar trend is expected to continue in 2011.

### Industrial Trends on Salary Increases



Source: Aon Hewitt Salary Increase Surveys (2000-10)



Source: Aon Hewitt Salary Increase Surveys (2000-10)

### Pay-for-Performance Moves into the Mainstream

Almost throughout the decade of 1990s, 'Pay-for-Performance' was a theoretical notion in India, and factors such as seniority, age and title were influencing pay decisions. This situation has been changing since the last decade and 'performance' now plays a key role in pay decisions, along with other factors such as 'scope & size', 'skill' and 'market'.

'Top performers' have been receiving pay increases that are typically 30 percent higher than those 'often exceeding



Source: Aon Hewitt Salary Increase Surveys (2000-10)

expectations' or 'good performers' and 80-85 percent higher than those 'meeting expectations' or 'average performers'. It is interesting to note that the 'bell curve' has also become significantly sharper in the period post 2007 as compared to the earlier half of the decade, with organizations laying greater emphasis on employee performance and productivity against the backdrop of limited pay budgets with continuously rising employee costs.

### Looking Ahead

India has the unique advantage of significantly higher, double-digit salary increases which, for now, are here to stay.

Merit increases therefore still have merit.

In other countries, shrinking budgets have forced compensation professionals to question the relevance of

driving merit pay through salary increases and thus shift their reliance to variable pay and other aspects of total rewards.

With enough in our kitty, the challenge is not about the budget, but about being able to show enough bang for the buck. Compensation professionals are under tremendous pressure to ensure effective utilization and measurable outcomes from this investment.

We are increasingly seeing more 'customization' of increases with a high focus on 'hot' functions, 'niche skills', 'high potentials' and 'senior/top leaders'. Additionally, 'top performers' continue to command top rewards and increases continue to be sharply differentiated. The question no longer is on whether to differentiate but how much and for whom.

While we continue to focus on salary increases, it will be wrong to deduce that this lever alone will help us to drive performance and retain our talent. Variable pay has consistently gained prominence across the decade both in terms of quantum of payout and effectiveness of the pay metrics, and will continue to evolve as the primary vehicle for rewarding performance.

With the workplace dominated by GenX and now the influx of GenY (Millennials), we have seen organizations beginning to customize and design rewards to cater to employee preferences across generations. Work-life balance, flexibility, time off, individual recognition, peer recognition, professional development, respect and pride in work are some of the 'rewards' that this generation values, and organizations are weaving these into their total rewards strategies.

The focus has shifted from how technically sound the compensation programs are, to how well they align to the internal strategy and context, and how they stack up against employee aspirations.

Clearly, as the Indian economy continues to dominate, salaries continue to increase and compensation management begins to mature.



#### Shilpa Khanna

Lead – Research & Insights, Compensation Consulting, Aon Hewitt, India



#### Poonam Chopra

Project Lead – Salary Increase Survey (India), Aon Hewitt, India

For more information, please write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com)



# Decoding Executive Compensation

*Insights from the First Aon Hewitt Executive Compensation Study in India*

Executive Compensation as a subject has always been fairly opaque and inscrutable in India and also in most parts of Asia. Organizations have rarely, if ever, been open to sharing and discussing Executive Compensation data and trends outside of whatever is mandated by regulators. Valid and reliable Executive Compensation data, however, has always been a critical requirement for organizations. Consequently we, as service providers, have always been in the interesting Catch 22 situation of not being able to effectively collect Executive Compensation data from the market, while at the same time having organizations constantly request us for this information. To respond to this situation and to effectively create a reliable platform for data sharing, Aon Hewitt launched the first-of-its-kind Executive Compensation Survey in India in 2010. Much of this report is based on the results of the survey, which was conducted across more than 60 leading organizations spread across a variety of industries. While these companies span different ownership types, industry clusters, years of existence, and so on, two common factors bind all of them – firstly, almost all of them are more than ₹ 500 crore in net worth, and secondly, they are progressive in their approach and practices towards Executive Compensation. We work closely with a number of these organizations and, in our opinion, many of them lead the thinking in this field in the country.

## Executive Compensation – A Basic Overview

Compensation for the set of employees who, theoretically, have the highest impact on the effective definition and implementation of an organization's strategy, is usually classified as Executive Compensation. Typically, these end up being the top two layers within an organization's management hierarchy. Given the nature of these roles and the decisions that these individuals are involved in, how compensation is structured for this group has been a topic of great interest and analysis for all stakeholders. The two critical areas of discourse around Executive Compensation have been the structure of the compensation package and the quantum of pay being delivered to these executives (many times with a specific focus on how it compares with pay at other levels in the organization). Consequently, a discussion around Executive Compensation more often than not also becomes a discussion around the structure of long-term incentive plans, which almost always forms the bulk of the total pay earned by an executive.

Our study, therefore, focuses on analyzing these aspects for a set of 19 typical executive roles spanning the role of the Chairperson, Chief Executive and Chiefs of Functions or Businesses. The study collected their compensation data along with detailed submissions of the structure of compensation across incentive plans, benefit plans and perquisites that organizations provide to this group.

## In the Eye of the Storm

There has virtually been an explosion in the volume of research and analysis that Executive Compensation has been subjected to in the last few years. This is partially on account of the increasingly larger paychecks that have been awarded at executive levels and partially due to the linkage that has consistently been drawn between Executive Compensation and the global recession. (And, finally, who doesn't want to know and complain about how much the boss might be getting paid!)

Evidence of discussion around Executive Compensation can be traced back to the days of Plato when he suggested that a community's highest wage should not exceed five times its lowest. By the early years of the 20<sup>th</sup> century, the banking community globally had pushed up this number to at least 20 times. The first evidence of public scrutiny of Executive Compensation was seen in the post First World War era when railroad companies were nationalized in the US – the process exposing the huge compensation that was being paid to senior executives. The Great Depression and its aftermath drove the creation of the Securities and Exchange Commission in the US (established largely to enforce the Securities Exchange Act, 1934) and this organization wrote the guidelines on disclosure of executive pay through annual filings, which today form the basis of all disclosure norms the world over.

The early discourse on Executive Compensation in India can be found in Kautilya's *Arthashastra* where the governance of compensation decisions for top officials and avoidance of greed at that level is clearly prescribed. With its socialist underpinnings, most of the post Independence era saw companies in India place moderate premiums on top professional jobs. Oppressive tax structures, benefits and perquisites were often more important than the actual pay. Since the early 1990s, the concept of differentiated Executive Compensation grew in prominence and over the last 5-7 years the focus and discussion around executive compensation has become a prominent part of the business management and governance landscape.

*The country has undergone a rapid transition from an era of moderate differentiation in compensation in the socialistic economy model to a huge disparity in compensation across levels in an organization.*

The most commonly asked question about Executive Compensation revolves around its role in the economic downturn, and while the general belief is that it was one of the key reasons for organizations to indulge in risky behavior, it is difficult to label it as the chief culprit for all that went wrong. While it is true that pay delivery and governance across the world was being driven by the pursuit of growth (in the process overlooking the risks inherent in such growth), this misalignment of pay was more prominent in certain industries and countries, and was never a global phenomenon.

The late recognition of the role of Executive Compensation in India is probably one of the key reasons why Indian companies could not be blamed for misaligned pay levels in the last couple of years. Both on account of regulatory and behavioral reasons, companies in India have rarely been as aggressive as their western counterparts in terms of pay structure. What is interesting, however, is that with increased globalization of the workforce, pay levels in India have shown a steady march northwards along with more and more aggressive structures of compensation.

The following sections highlight some of the key trends in Executive Compensation in India and attempt to analyze how organizations in India are aligning themselves to global practices while retaining their individuality, which has been critical to the success of the 'Indian way' of doing things.

### Current Perspective on Executive Compensation in India

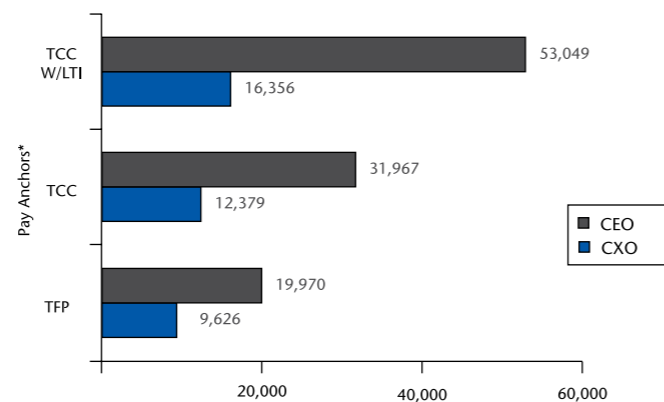
A moderately free economy, competitive organizations, rapid economic growth and a constant need for talent to manage key roles has led to a significant change in thinking about executive pay in India. The country has undergone a rapid transition from an era of moderate differentiation in compensation in the socialistic economy model to a huge disparity in compensation (even prompting the Prime Minister to comment on this) across levels in

an organization. A quick analysis of our data shows that the ratio of the total salary paid to a graduate entering the corporate world to the CEO's total pay is about 1:156. Similarly, the ratio of the pay for an entry level manager to that of the CEO is approximately 1:63.

#### Pay Levels in India

The study depicts interesting trends on total pay levels across the executive population in India. As the chart below shows, pay for professional CEOs in India is very frequently above the USD 1 million range per year. Interestingly, however, the pay at the CXO level (individuals who head functions or business and report to the CEO) is remarkably lower compared to CEO compensation. This broadly follows the same pattern as the US and other Western economies where CEO pay is usually a multiple of about five times the CXO levels.

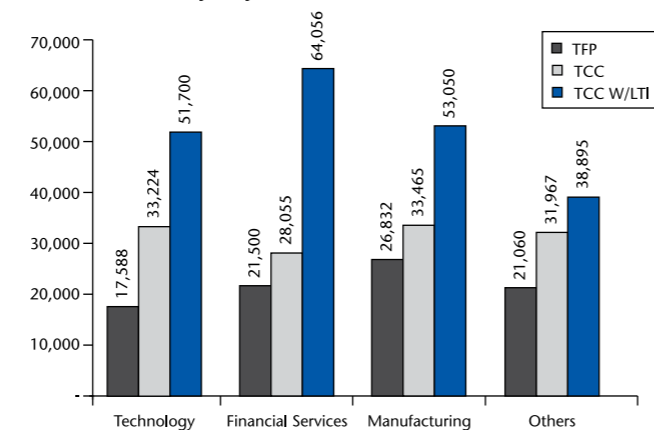
Pay Levels – Median Data – CEO & CXO



(All figures are in ₹ 000s per annum)

Source: Aon Hewitt Executive Compensation Study 2010, \*TFP – Total Fixed Pay, TCC – Total Cost to Company, TCC W/LTI – Total Cost to Company with LTI

Industry Pay Levels – Median Data – CEO



(All figures are in ₹ 000s per annum)

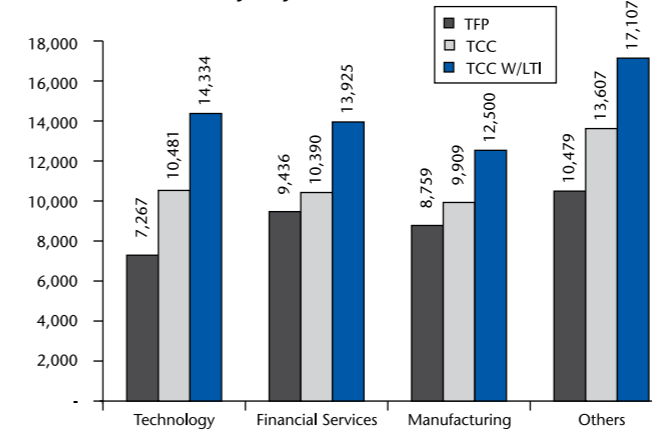
Source: Aon Hewitt Executive Compensation Study 2010, \*TFP – Total Fixed Pay, TCC – Total Cost to Company, TCC W/LTI – Total Cost to Company with LTI

#### Variation in Pay Levels by Industry

There are two schools of thought when it comes to defining whether benchmarking of pay at the CXO levels should be based on sector definitions or be industry agnostic. The first and more traditional argument suggests that regardless of levels, pay benchmarking is best conducted within industry definitions as more often than not executives move to senior positions from within the same industry. The more modern argument suggests that at senior levels the skill sets required are broadly the same and are usually independent of the industry. Therefore the best benchmarking is the one based on evaluating compensation for CXOs across companies of similar size and complexity. The data from our study seems to support the second argument more on account of the lack of significant differentiation in pay data across different industry clusters. While some level of differentiation in pay structures naturally gets built in on account of regulatory restrictions (e.g., in the banking industry) and some on account of the basic talent model in those industries (e.g. in IT/ITeS), at a broader level the distinction does not seem to be very strong.

The width in CEO pay across four broad clusters – financial services, technology, manufacturing and others (primarily constituted of services industries and consumer goods) ranges from 50-65 percent on fixed pay and total pay respectively. The data gap for the CXO population is even narrower and ranges from 35-45 percent on the two anchors of pay. The banking sector seems clearly to be leading the pack in terms of pay levels followed by IT/ITeS and telecom. The counter-intuitive result here though seems to be in the fact that CEO pay levels in the manufacturing sector seem to be higher than those of more modern businesses such as consumer goods or pharmaceuticals.

Industry Pay Levels – Median Data – CXO



(All figures are in ₹ 000s per annum)

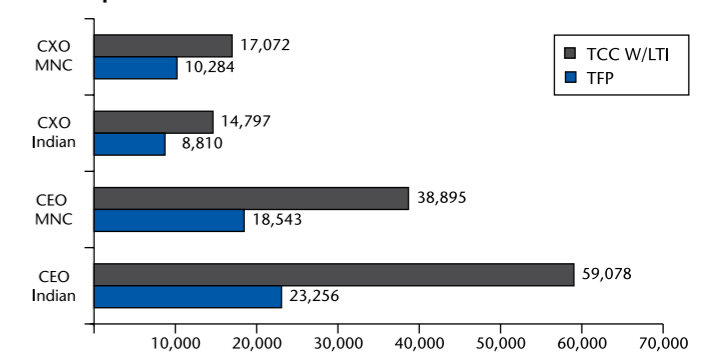
Source: Aon Hewitt Executive Compensation Study 2010, \*TFP – Total Fixed Pay, TCC – Total Cost to Company, TCC W/LTI – Total Cost to Company with LTI



#### Variations in Compensation Levels Across Indian and Multi-National Companies

Traditionally MNCs have been considered to be the better paymasters in India and the proverbial 'MNC job' considered the best career choice. Over little more than a decade, Indian companies have progressively developed their compensation levels to ensure that they attract and retain the best talent in the market. Analysis of data across home-grown companies and MNCs interestingly reveal a significant premium paid to CEOs of Indian companies vis-à-vis their global counterparts while the CXO pay remains broadly equal. While there are enough examples of Indian CEOs earning as much if not more than their global peers, one of the main reasons why our data set shows this difference is perhaps because of the nature of companies in this analysis – while the CEOs for the Indian companies manage global businesses, most MNC CEOs primarily focus on managing the India or South Asian businesses for their company.

Comparison Indian to MNC – Median Data – CEO/CXO

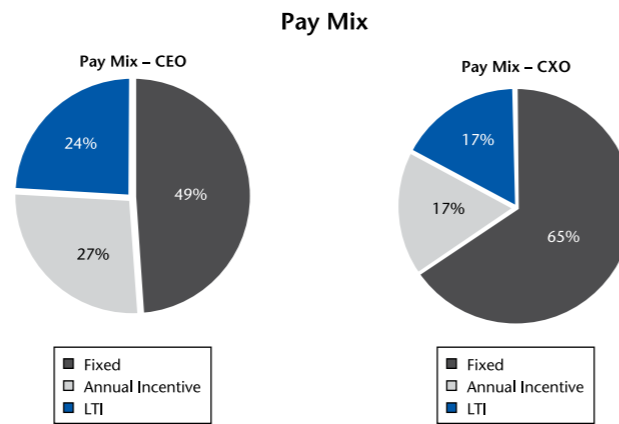


(All figures are in ₹ 000s per annum)

Source: Aon Hewitt Executive Compensation Study 2010, \*TFP – Total Fixed Pay, TCC – Total Cost to Company, TCC W/LTI – Total Cost to Company with LTI

Across most of the western world, the pay mix is very aggressively tilted towards long-term compensation – in the US, long-term incentives usually constitute 65 percent of the total CEO compensation and only about 12 percent is delivered through fixed pay.

about 65 percent of total pay being delivered through fixed compensation. While the Indian model on the face of it does not necessarily promote risky behavior, what the right mix of compensation should be at these levels still remains an area of debate and research.



Source: Aon Hewitt Executive Compensation Study 2010

In the Indian context, it is also interesting to find that there exists a wide range of organizations – modern and competitive in their outlook towards business – who have consciously or otherwise chosen not to incorporate long-term incentives into their compensation structure. Within these organizations, the element of fixed pay therefore becomes much more prominent than incentives, with about 80 percent of total pay being delivered through fixed salary. The success of some of these organizations sometimes raises the interesting question (albeit one that Executive Compensation consultants should not ask) of whether long-term incentives really are an important tool for organizations to drive managers to work for long-term success of businesses!

### Nature of Long-Term Incentive Vehicles

The vehicle or mix of vehicles that organizations use to deliver long-term incentives has been constantly changing in the last few years. This change is driven on account of a variety of reasons including stock market performance, steadily increasing dilution levels, and accounting requirements. Our research across companies globally show a strong move towards performance share plans (share grants to executives at zero cost subject to business/organization level performance conditions being met) and away from the more traditional vehicles such as ESOPs. The trend, in our opinion, reflects the need

within organizations to move away from plans that are based on entitlement to ones that reward performance.

Like the rest of the world, Indian companies are also making a transition to such performance-based structures, although the prevalence or change is much slower than seen in their western counterparts. Given the regulatory structure and the extent of understanding of different vehicles and what they can drive, Indian companies tend to rely more on the traditional ESOP plan structures than explore new or innovative vehicles.

In addition, Indian companies typically rely on a single plan structure to deliver long-term incentives, while global organizations tend to rely on a basket of vehicles – usually two or more. This portfolio approach stems from the belief that different vehicles reward different kinds of performance and therefore drive different behaviors.

Nature of LTI Vehicles – India			
	2010	2009	2008
ESOP	65%	66%	69%
Performance Shares/Units	23%	19%	18%
Restricted Stock	38%	29%	33%
Others	26%	22%	22%

Source: Aon Hewitt Executive Compensation Study 2010

### Gazing at the Crystal Ball

Around the time when the world was realizing the extent of the economic mess, a Chinese leader commented about western practices, saying: ‘The teachers have some problems.’ Our models for economic growth and business management have traditionally been structured around the capitalistic model promoted by the western world. Compensation models have also been based on learnings from the west. This world order has changed, and the realization of this change is widespread across policymakers and businessmen. In our role as compensation consultants, we have seen this transition, as companies increasingly want to know less about western data or structures and more about how leading local companies are thinking about this.

Companies have realized that they need to think about what is right in their context when it comes to structuring compensation for their executives. But some common principles will remain true around the

Compensation levels will only go up in future – it is the natural course of things; however, what needs to be closely watched and managed is the way in which organizations decide on the means to deliver that compensation to their executives.

world and we would like to close our analysis with some headlines on what we feel businesses should not forget when thinking about executive pay:

- Pay data cannot just be based on peer benchmarks but should be based on the organization’s financial and business fundamentals
- There cannot and should not be any cap on pay levels. But all stakeholders should have complete access to compensation data
- The definition of metrics that guide incentive payouts need to be the most important activity in defining Executive Compensation structures
- Incentives will always drive a certain level of risk taking and, in moderation, businesses need to take risks. It is critical to ensure that the risk mitigation framework incorporates clarity on the penalty for wrong behavior
- The governance of pay decisions need to be appropriately managed – independence in the process will be critical in driving shareholder confidence on pay decisions

Compensation levels will only go up in future – it is the natural course of things; however, what needs to be closely watched and managed is the way in which organizations decide on the means to deliver that compensation to their executives. So, as long as that process is managed honestly and is in line with the fundamentals of the business, Executive Compensation will remain a critical driver of managers’ commitment to long-term business success.



### Anandorup Ghose

Solution Lead – Executive Compensation and Governance, Aon Hewitt, India

For more information, please write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com)



# Meeting the Total Rewards Challenges

in Times of Change

As the global economy recovers, competition for critical talent remains a pressing problem for many organizations, and this is especially true in many parts of Asia. A scan of headlines from the business press supports this claim:

- “Labor shortages in and around Shanghai and Beijing are widespread” – Wall Street Journal, July 29, 2010
- “Pay war broke out as India’s tech firms vie for talent” – Wall Street Journal, April 27, 2010
- “As the economy recovers, companies will return to the challenge of winning over enough highly capable professionals to drive growth” – Harvard Business Review, July – August 2009
- “Firms poach top talent from recession-weary rivals” – Wall Street Journal, February 7, 2010

In India, we continue to see organizations challenged by high attrition rates across many sectors, along with rising salary costs, as firms compete to attract and retain talent. To address this, organizations must focus on their rewards and employee engagement strategies to meet the shifting needs of the talent market.

The typical return on total reward spending is abysmal. USD 7.5 trillion is spent annually on total rewards, yet:

- 1 out of 2 workers disengaged
- 1 out of 8 actively disengaged
- 1 out of 5 or 6 chooses to leave each year
  - 10 percent of high performers since the downturn
  - 25 percent planning to go

This is surprising, especially considering that for many organizations, the annual investment made in total rewards is one of the top three expenses. Given the size of this investment, executive

management is beginning to require HR executives to provide a more rigorous way to determine if the spending is appropriately sized and appropriately allocated to specific areas like base pay, bonus, benefits, and work environment, to get the best results in retention and productivity.

## Questions Clients are Asking

By understanding the preferences of employees, we can address many of the questions that organizations are struggling with:

- What is the optimal reward structure for our employees to maximize retention and preferences within appropriate cost structures for the business?
- What is most important to our employees, and how does this differ by segment (however, we define segment)?
- How does our brand impact reward preferences and trade-offs?

- What are the key opportunities for change, and how might employees react to a change?
- Are flexible compensation programs appropriate for our organization and, if so, where would choice be most effective?

Total rewards strategy and optimization helps answer these questions and provides quantitative insights to align rewards with the overall business and talent strategy for high-performing companies.

## Determining the Appropriate Total Rewards Strategy

The ideal total rewards strategy delivers on an employee value proposition that is attractive to both current and prospective employees. This strategy has four key perspectives to address:

- External competitiveness: Is the total rewards package competitive with the external market, including both direct and indirect competitors



- Financial considerations: What can the business afford to spend?
- Talent strategy: Do our rewards fully align with our talent strategy? What do we want to be known for in our rewards that differentiates us effectively?
- Employee preferences: What do employees value and by how much?

An effective total rewards strategy is forward-looking and aspirational, yet grounded and aligned to data on competitiveness, cost, talent requirements, and what employees truly value. Most successful organizations avoid “me too” features, and design their rewards program to ensure it is unique and different from what employees can get from other companies, addresses key needs of employees, is delivered in a financially responsible way, and is consistent with most employees and talent strategy of the organization.

### Introducing Total Rewards Optimization (TRO)

Total Rewards Optimization (TRO) uses conjoint analysis – a methodology to understand what trade-offs people are willing to make, and identify what is most important to them. In fact, an academic from the University of California, Dr. McFadden, won the Nobel Prize in Economics in 2000 for his pioneering work in using conjoint to understand how consumers make purchase decisions. Conjoint analysis provides a way to infer what is most important to people, by giving them a series of trade-offs, and asking them to make choices. This way, we can infer what is truly most important and how sensitive and receptive to change they might be in a more realistic way.

- The process for conducting a TRO study is straightforward:
- We measure employee preferences for different rewards features using a short, engaging, game-like survey. This survey typically takes employees 10-15 minutes to complete, and doesn’t look or feel like a normal survey (to see an example, visit [www.totalrewardsdemo.com](http://www.totalrewardsdemo.com))
  - By modeling employee preferences, we can learn what is most important to them, and identify the critical value drivers. This helps us learn what is nice to have, versus what is a must have, and how sensitive or receptive to change employees are
- Putting employee preferences together with cost data (along with the broader talent strategy and external competitiveness), we can then design, deliver and communicate new or existing rewards programs that maximize the balance between the needs of the organization and its employees.

### Compelling Insights from Recent Studies

Across Asia, Europe and North America, we have consistently been able to identify alternative total rewards programs that deliver significantly greater value to the employee, at a significantly lower cost to the organization. For example, an Asian division of a global financial services company wanted to ensure they were spending their rewards budget in ways that maximized value to the employees and drove retention. We were able to identify a rewards package that 85 percent of employees preferred to what they currently had, and also saved the company

*An effective total rewards strategy is forward-looking and aspirational, yet grounded and aligned to data on competitiveness, cost, talent requirements, and what employees truly value.*

USD 1,800 per employee annually (or about USD 5,000/employee discounted over three years).

While it is important to look at the results in aggregate, it is also just as important to examine findings by segment. Who are the 15 percent who don’t find this new total rewards package as attractive? If that minority is critical talent or high performers, then perhaps this new total rewards package isn’t ideal. The ability to analyze by segment of employee however, that is defined, is critical.

Crafting and executing effective total rewards strategy will always be a challenging effort for HR in organizations. This is especially true in India with its very dynamic labor and business environment. Using reliable, well-balanced, quantitative-based approaches and insights, like total rewards optimization, can make the task clearer, more defensible, and less likely to fail compared to ad-hoc trial-and-error approaches of the past.



**Ray Baumruk**  
Principal and Leader –  
Research & Insights Practice,  
Aon Hewitt



**Tim Glowa**  
Lead Consultant –  
Employee Research,  
Aon Hewitt

For more information, please write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com)

Make the Most of Long-term

# Performance Plans

*By definition, Long-Term Performance Plans (LTTP) align the level of pay-to-performance and reward long-term success.*

*An LTTP that is too simple may not address enough of the nuance and complexity in the business, which may lead to sub-optimal results.*

*If financial performance metrics are used, carefully evaluate the threshold, target and superior performance goals.*

Recent and very public events have brought a high level of scrutiny to executive pay practices – scrutiny that will likely continue into the foreseeable future. In general, most of the criticism directed towards executive pay seems to fall into one of the three categories:

- The level of pay is not aligned (read ‘too high’) with the level of performance
- The pay program motivates short-term behaviors rather than long-term value creation
- It causes excessive risk-taking. What most people can agree on, however, is the need to find better ways to have executive pay based on longer timeframes and greater performance variability

There are many ways to provide executive rewards opportunities when designing Executive Compensation plans, including:

- Base salary
- Annual incentive plans
- Stock options/SARs
- Time-vested restricted shares/units
- Long-Term Performance Plans (LTPP)
- Retirement/SERPs
- Perquisites
- Contractual guarantees

At a 30,000-foot level, LTPPs seem to have the best opportunity of these choices to address all three categories

**LTPPs align the level of pay-to-performance and reward long-term success. In addition, they can contribute to mitigating excessive risk taking.**

of criticism. LTPPs are commonly used as a part of a portfolio approach to total equity as opposed to being the sole element. Their use has been growing as companies reduce, but not eliminate, reliance on options and time-vested restricted stock to meet overall compensation goals. However, by definition, LTPPs align the level of pay to performance and reward long-term success. In addition, they can contribute to mitigating excessive risk taking by shifting more of the total rewards opportunity to performance over the long-term, thereby reducing the incentive and overall value to the executives of taking short-term risks. Still, there is a sense in the Executive Compensation community that LTPPs have been a challenge to execute effectively and that they have fallen short of expectations. So while other forms of Executive Compensation have their roles in achieving an effective executive total rewards program, this article focuses on how to make LTPPs deliver on their compelling promise. This requires moving through the layers from the ‘30,000-foot concept’ to on-the-ground execution.

### Defining Long-Term Performance Plans

First, what do we mean by the term Long-Term Performance Plans? LTPPs are any plan having the following characteristics:

- The amounts earned are contingent on and vary with achieving or exceeding defined performance goals
- Failure to perform to at least a minimum threshold performance level leads to a USD 0 payout
- The performance period is at least three years in length. (While some companies have implemented shorter-time periods, this author

suggests that anything less than three years should not be considered long-term)

This definition encompasses plans that pay out either in cash or shares; use financial, operating and/or stock return (i.e., total shareholder return) metrics; and define the performance hurdles either relative to a peer group or against absolute company-specific goals. Common names include performance shares, performance units and performance-restricted stock.

### A Six-Step Process

To help LTPPs live up to their promise, the author recommends going through a six-step process.

#### Step One: Make the Promise

The first step in making the promise is defining the LTPP goals. What do you want the plan to do? Assuming that the common total rewards objectives to attract and retain quality executives are principally addressed by other executive pay components, LTPP goals can be more specific. Appropriate goals for LTPPs include the following:

- Align executives with the long-term strategic direction
- Align the interests of executives and shareholders
- Provide a long-term orientation
- Align the levels of pay to the levels of long-term performance
- Help mitigate excessive risk taking

The design of the LTPP will determine which of these potential promises can be supported. For example, a plan based on relative Total Shareholder Return (TSR) may align executives and shareholder interests but does not directly align executives with strategic direction. Similarly, a plan based on financial metrics could align with the strategic direction

**LTPP is a reward system designed to improve employees’ long-term performance by providing rewards that may not be tied to the company’s share price. LTPPs are commonly used as part of a portfolio approach to total equity as opposed to being the sole element.**

but could pay out in a year – the shareholder returns are low because the overall stock market is down.

The second aspect of the use of the word promise is the commitment to what the LTPP is intended to achieve. If pay delivery at a competitive level is the only goal, consider other forms of compensation instead of altering an LTPP design so that it no longer meets the previously outlined criteria.

#### Step Two: Accept ‘Best Imperfect’

Many senior leaders and compensation committees start with an expectation that LTPPs will achieve all of the total rewards goals. In reality, even achieving some of the LTPP promises may not be possible without over engineering the design. Over engineering often leads to such a complex plan design that participating executives do not fully understand the plan. As a result, an overly complicated plan loses its effectiveness in driving executive behavior.

When it comes to effective LTPPs, elegance of design trumps perfection. Elegant design is understandable and effective. Having said that, do

not confuse elegance with simplicity. Most executives run complex, challenging businesses. An LTPP that is too simple may not address enough of the nuances and complexity in the business, which may lead to suboptimal results. Prioritizing the promises enables a company to better select which imperfections it can live with and which it needs to avoid.

#### Step Three: Evaluate the Risks

Since the LTPP will be imperfect, it is important to manage risks as effectively as possible. Different plan designs have different risks. In this case, risks are defined not as excessive risk-taking, but as risks to the company in terms of the ability to deliver on chosen promises.

Each key LTPP design feature comes with its own risks to evaluate. Two examples include selecting performance metrics and performance goals. While these two features are closely linked, they are often measured differently. The broad categories of long-term performance metrics are financial metrics versus TSR. The broad categories of goals are absolute (company-specific) and relative (compared to a select peer group). Metrics and goals tend to be paired. TSR is mostly always measured relatively and financial goals measured absolutely.

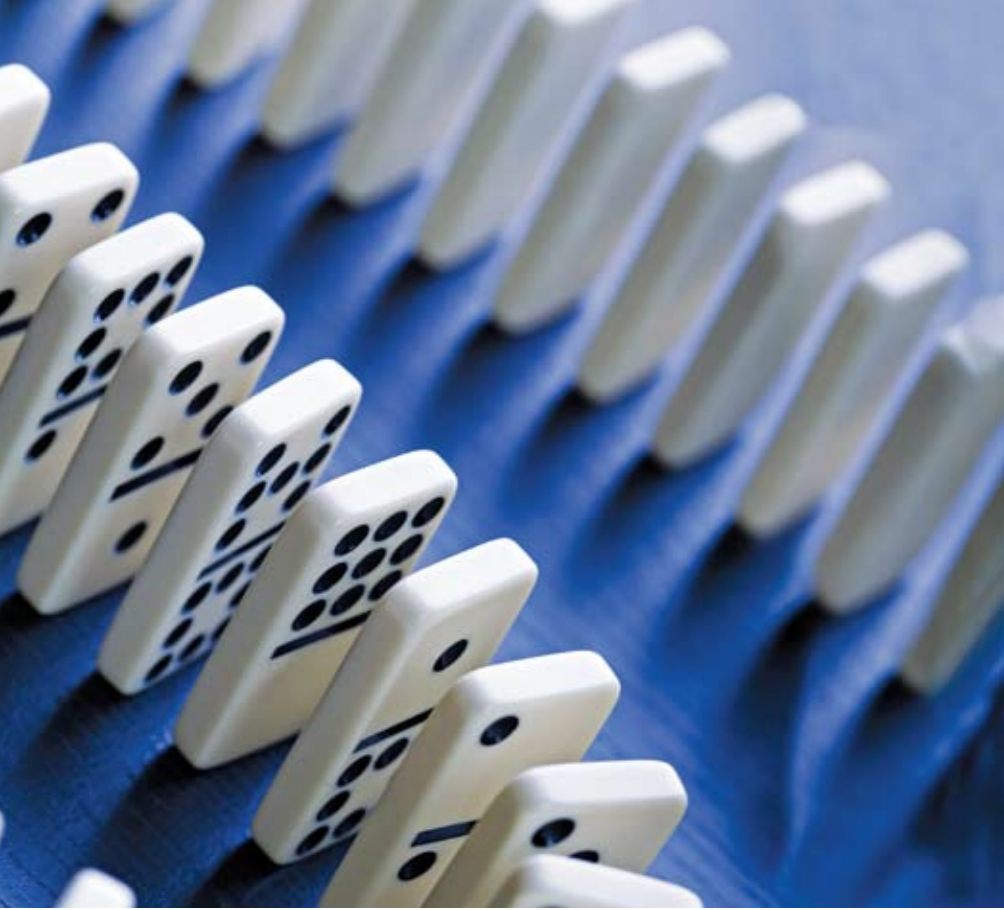
In designing an effective LTPP, selecting the appropriate performance metric is key to the program’s overall success. There is no single right metric for all companies. The first decision is to choose between financial/operating metrics and TSR. Recently, there seems to be a strong reliance on adopting TSR by default instead of going through the process of determining the right metric for an organization.

At a conceptual level, the allure of

relative TSR as a rewards mechanism is strong for three reasons. First, it requires no forecasting of the future. Second, the plan pays for outperforming peers. This feature lowers the risk of paying too much when the overall market is rising and pays something when the stock market overall is down (and the value of options and restricted stock has fallen). Third, using TSR directly aligns with shareholders, while the relative aspect mitigates the vagaries of the stock market.

Using relative TSR as the sole LTPP metric carries with it some risks. It generally does not motivate executives effectively or directly engage them to achieve the strategic plan. Executives cannot directly impact share price change through performance, let alone relative share price! Since it is a point-to-point measure, a late change in share price has greater impact than the average share price over the period. Therefore, some executives will consider relative TSR outside of their influence and implicitly discount the plan’s value below the level of its expressed compensation value. This may also lead to a greater focus on the annual incentive plan, which is typically based on more controllable measures.

Absolutely measured financial metrics are not without their own risks. The first challenge is to select the right value-creating metrics. Select poorly and you may motivate suboptimal performance. The best financial or operating metric(s) are the ones that align with creating value returns in excess of cost of capital combined with growth. The second challenge, which seems to be the concern of many companies, is that setting a multiple-year goal is difficult, especially when the world



economy is uncertain. The risk is that the goals will be perceived as too challenging, leading to low motivation. Conversely, if the goals are perceived as too low, the LTPP pays for achieving financial hurdles that do not lead to corresponding shareholder returns. Techniques for improving performance goal setting are discussed in the next section.

Still, using absolute financial measures can have substantial value. This approach can directly link to the company's strategic direction, has greater line-of-sight for executives (and therefore more incentive impact), can cause leaders to find risk-appropriate ways to achieve the goals, and can balance the short-term orientation of the annual incentive plan.

Another important area of risk involves the length and frequency of the performance cycle. The vast majority of LTPPs out there today have three-year performance cycles, with a new cycle starting each year. If a company bases its decisions primarily on competitive practice,

this becomes the clear choice. Despite broad adoption, the question remains: Is it right for your company?

The rationale for three-year overlapping cycles include:

- Future performance is too difficult to forecast beyond three years (some companies have even opted to have a plan consisting of three one-year goals)
- The overlapping cycles allow for flexibility in resetting measures and goals to adjust to a changing environment and modifying the pay-to-performance relationship
- The overlapping feature aids retention since at any moment a participant would forfeit the opportunity of two or three unfinished cycles

The risks to consider of having a three-year overlapping cycle include:

- A company's strategy may focus on a timeframe longer than three years
- Resetting goals each cycle, or each year within a cycle, provides little motivation to act in the long-term interests of the

company and take appropriate risks on new investments or markets; underperformance may be rewarded with lower goals for the next cycle

- Three years may not be enough time for investments to mature and provide the expected payouts

If these risks for a company are greater than the rewards of three-year overlapping cycles, consider an alternative plan design.

In the end, no approach is perfect. Therefore, it's important to fully understand and manage the inherent risks in the plan design. Combining relative TSR and absolute financial performance can mitigate some risks but add to the risk of complexity. The elegance/complexity dimension needs to be judged within the context of the total rewards program.

#### Step Four: Get into the Detail

At 30,000-feet, each company chooses the promises on which the LTPP is intended to deliver. Evaluating the risks bring the view to 10,000-feet, while delivering on the promise means getting into the details. Details matter, and the closer executives can get to understanding the benefits and risks of their LTPP plans, the better.

One important detail to consider is calibrating the pay and performance scale. If financial performance metrics are used, carefully evaluate the threshold, target and superior performance goals. Use multiple reference points, including the historical performance of your company, the strategic goals, forecasts of future economic conditions and the historical performance of similar companies. One tactic to mitigate the difficulty of forecasting the future is to widen the performance band from threshold to target and target to superior. This

increases the probability of getting on the pay scale – an important part of motivation. Next, carefully link pay opportunities to the performance levels. Check the incremental pay-to-performance ratios to assess their impact on excessive risk taking.

For relative TSR plans, carefully choosing the peer group is paramount. The key is to balance the validity and reliability of the total group. Validity refers to the objective of selecting a peer group that most resembles one's own company (in terms of business characteristics and therefore TSR performance). Ideally the peers are influenced in similar ways by similar economic factors so that the impact on TSR is generally consistent. Reliability refers to the goal of having enough companies in the peer group to support statistically valid results over long periods of time (through the statistical concept known as the law of large numbers).

Also determine the best pay-for-TSR-performance formula. The most common approach is to pay more for achieving a higher percentile ranking among the peers. Analyze the historical TSR for the peers. On the surface, it may seem as though every incremental performance improvement should have the same incremental increase in compensation. However, for many peer groups, there is relatively greater change in TSR below the 30<sup>th</sup> percentile and above the 70<sup>th</sup> percentile than between these points. This analysis informs whether a straight line or graduated scale is more appropriate.

Attention to the details help to properly calibrate pay and performance.

#### Step Five: The Stress Test

Why risk the motivation of your senior team and potentially millions of

dollars of compensation without taking your design for a test flight? What-if analyses on ranges of potential performance and back-testing against historical performance can identify strengths and weaknesses of the LTPP and allow for course correction. This step should not only be conducted before the first performance cycle, but also periodically thereafter as a new performance cycle begins.

#### Step Six: Communicate, Communicate, Communicate

Communication is an important, yet often overlooked, step when it comes to developing successful LTPP programs. Today, more than ever it's essential to communicate not only to internal audiences but also to external ones.

Internally, the impact and perceived value of the LTPP will be enhanced if the participants understand:

- How it works, what the pay potential is and what has to be achieved
- Why the specific plan design features are right for them and their company
- How the LTPP fits into the total rewards program
- How the programs will be managed by the compensation committee

Externally, clear and straightforward communication about executive long-term performance plans could go a long way towards creating transparency and helping external audiences gain better clarity around how executives are compensated. External audiences include other

employees of the company and current and potential investors, as well as shareholder watchdog groups, such as RiskMetrics Group, that evaluate Executive Compensation practices in their development of shareholder proposal recommendations.

### The Difference between Promises Made and Promises Kept

While organizations often start out with the right idea when developing LTPPs, too many stop at the 30,000-foot or 10,000-foot level, making assumptions about the details or how the details impact the effectiveness of the design. Examining the details of a plan and then putting the plan through different scenarios (steps four and five) can often make a significant difference between a plan that delivers on its promise and one that fails to perform.

The appetite for LTPPs temporarily fell in 2008 as the economy fell sharply, making forecasting more difficult. As the economy recovers, the appetite for LTPPs should come back as well. Going through the six-step process can help organizations determine if what they're designing will deliver the intended results, as well as better understand the risks of not paying for true long-term performance.



**Richard Harris**  
Principal and Senior Consultant –  
Aon Hewitt, Compensation  
Consulting Practice,  
Lincolnshire, Ill

For more information, please write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com)

Contents © 2010. Reprinted with permission from WorldatWork. Content is licensed for use by purchaser only. No part of this article may be reproduced, excerpted or redistributed in any form without express written permission from WorldatWork.



## Richard Harris

Principal and Senior Consultant, Aon Hewitt

**Q.** *What are the kinds of LTI vehicles that are becoming more popular in the US?*

**ANS.** Over the past five years there has been a significant shift in the mix of LTI vehicles. 10 years ago the vast majority of companies used only stock options. For several reasons, including the introduction of a charge to earnings for stock options, in the past few years the shift has been to more time-based and performance-based shares. Contrary to some media headlines, stock options are not dead! They continue to provide the greatest award opportunity for growth companies or any company that performs well. However, their value is highly volatile and subject to shifts in the overall stock market even when these shifts are not correlated to a company's underlying financial performance. We were reminded

of this in late 2008 and 2009 during the world-wide recession. Therefore, the percentage of total LTI value delivered has fallen.

Initially, time-vested share grants filled the gap. This form of LTI provides for retention. However, in an increasingly strong governance environment, the lack of a strong performance element has led to a decrease in the use of this form of LTI for executives (however, for mid-level employees that receive stock grants, time-vested stock grants are rapidly replacing options as the LTI vehicle of choice).

For executives, this has led to a rise in the use of performance plans. As importantly, the trend has been to using a mix of LTI vehicles rather than a single one. This is because no one vehicle can meet all of the key objectives for an LTI plan by itself.

*Richard has more than 25 years of experience in Executive Compensation and is based in Lincolnshire, IL. His clients include senior management and compensation committees of publicly held companies. He is the Midwest Practice Leader for Executive Compensation and also leads the Executive Compensation Practices Performance Pay unit. In this interview, he shares with us some key trends and insights from the US and his perspective on long-term incentive design principles.*

These objectives typically include:

- Alignment of the financial interests of executives and shareholders
- Paying for performance
- Retention
- Ensuring that the LTI plan does not motivate or reward excessive risk taking

**Q.** *What are the three things that you would suggest people should remember when structuring an LTI plan in the current regulatory and business scenario?*

**ANS.** The first thing would be to set goals for the total rewards system and clearly identify the objectives for how the LTI program will support the goals

of the total rewards approach. These goals should be based on the business needs and goals of the company and not some theoretical outcome. The reason that this is so important is that no one LTI vehicle is good or bad. However, as indicated in the response to question 1, they achieve different objectives.

The current business and regulatory scenario is much more focused on the alignment of executive pay with long-term performance, than with retention or with providing the opportunity for short-term gain. Therefore, while not only LTI vehicles, but policies addressing share ownership or holding periods have also grown in importance and prevalence.

Share usage rates are very important. Shareholders have gotten companies to realize that shares are a valued and limited resource. Companies must think carefully about who and how many people receive them and the quantities delivered. Shareholder advisory services such as Institutional Shareholder Services (ISS), base their recommendations on approving new share pool requests in part on how the stewards

of the past pools have used them, as measured by run rates, overall dilution and other measures.

**Q.** *Clearly, performance is definitely a larger element than what it used to be when defining incentive plans. How would you suggest HR/Boards think about metrics which will drive LTI plans?*

**ANS.** My bias is to use financial metrics in performance plans. Doing so has several advantages such as, rewarding consistent good performance over time, balancing the motivation to achieve short-term performance at the expense of long-term performance, and better matches the plan to the companies business strategies. Determining which metrics can be challenging. While knowing what other similar companies do is an interesting reference point, the key is to choose metrics that align with how each company creates value. Typically, this means some combination of measures of earnings growth and returns on capital or free cash flow.

Using relative TSR can be a good mix with companies using stock options. This metric moderates

rewards when share price is rising more due to general factors than a company's financial performance. It also provides some reward opportunities when the overall stock market is down but your company is outperforming its peers.

**Q.** *What changes did you find in US plans post FASB (Financial Accounting Standards Board) expensing requirements for LTI plans?*

**ANS.** Initially, the expensing of stock options contributed to the shift away from stock options to time-vested share grants and performance plans. However, now that has been settled, few companies make their decisions about the proper LTI vehicles based on the accounting practices.

**Q.** *What metrics should organizations use to test the effectiveness of their LTI plans?*

**ANS.** Some people like to believe that the success of a plan is based on how much it paid out. This is incorrect. Instead, the metrics for determining the effectiveness of an LTI plan will depend somewhat on the relative importance of the objectives set for the plan. In terms of pay and performance, companies should periodically test how the pay delivered from these plans, relative to the pay delivered by plans in its peer group, and compare its performance relative to the same peers. If retention was particularly important, then trends in involuntary turnover should be the measure.

An often forgotten metric is to measure how participants perceive effectiveness. Do they fully understand the plans, how they work, and why they delivered the level of value that they did?

For more information, please write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com)

# Crafting Long-term Incentive Plans



We bring to you our expert, A P Sugathan Nair, Retiral and Financial Management Lead at Aon Hewitt.

Mr Nair has over 30 years of experience of which 13 years have been spent consulting across different aspects of employee benefits, particularly Mandated Plans, Plan Design and Structuring, Legal Drafting & Set Up and facilitates actuarial valuations and liability assessments under various accounting standards.

In this section, Mr Nair takes a deep dive into the frequently asked questions on management of retiral benefits in India.

**Q. What is the implication of reducing an employee's basic salary?**

**ANS.** Section 12 of the Employees Provident Funds (EPF) and Misc. Provisions Act, 1952 indicate that for reasons of only the employers' liability for payment of contribution, there cannot be a reduction in basic wages nor can there be any reduction in the retirement benefits. This implies that a reduction in basic wage is not possible.

However, employers contributing in excess of the statutory PF wage of ₹ 6,500 per month, do it out of their own accord, and hence, any reduction in wages and consequent reduction in contribution is a withdrawal of a concession by the employer and cannot be treated as a right by the employees as per certain High Court judgments. Therefore, in these situations, reduction of contribution arising out of reduced wage is possible.

As and when such wage reductions come to the notice of the authority, RPF (Regional Provident Fund Commissioner), as a matter of process can issue a notice to the employer indicating violation of section 12 of the Act. It is therefore advisable, for the sake of good order, to inform concerned RPFs before implementing any wage reduction.

**Q. Should an employer value gratuity as a part of TCC (Total Cost to Company)?**

**ANS.** First, let us understand how gratuity value is

determined as a part of TCC and then examine its relevance. If an annual salary is assumed to be ₹ 100, then monthly salary reckoned for gratuity is 8.33 and hence, yearly cost (contribution) towards gratuity is 4.81 (8.33 x 15/26).

Placing a value of 4.81, as above, for gratuity may be considered incorrect. This is because gratuity is a defined benefit plan and determination of gratuity is based on last drawn salary and number of years of service. The right of gratuity (as per the Act) arises when an employee leaves the organization after a continuous service of five years. If 4.81 is shown as a gratuity component in the TCC, it may be argued, that an employee is eligible for gratuity on separation from service irrespective of whether he/she has completed the vesting period.

Contribution of 4.81 is a mathematical calculation and could be used for estimating employee cost at the budgeting stage. The actual contributions from the company will be determined actuarially for the employees as a group and will under normal circumstances be lesser than 4.81. Hence, considering that gratuity is a DB Plan and employer contribution is variable depending on actuarial techniques, it is advisable not to include gratuity cost as a component of TCC.

**Q. What have been the amendments to Provident Fund for international workers?**

**ANS.** There are two amendments; one in November 2008, and the other in September 2010.

The first one was to enroll international workers from non-SSTA countries into the EPF (those from SSTA countries could avail exclusion on the basis of 'detachment'

certificate). It also stated contributions and benefits in respect of international workers (Expats) on similar lines with Indian employees, except EPS (Employees Pension Scheme) benefits, which were on the basis of eligibility available to Indian employees in the respective host countries.

The second amendment brought in changes to contributions and benefits of Expats from non-SSTA countries. The change is that the contribution at a capped salary of ₹ 6,500 for EPS is not available. Hence, in respect of Expats, employer contribution to PF will be 3.67 percent and EPS at 8.33 percent of actual salary. Two eligibility conditions for withdrawal of PF, namely, resignation and migration out of the country applicable to Indian employees will stand withdrawn. Hence, in a majority of the cases, withdrawals by Expats will be possible on retirement after the age of 58, and the payout will be made only to a bank account in India. As regards EPS, the notification states that there will not be any benefit payout to an Expat from a non-SSTA country.

**Q. What is the rationale for introducing the second amendment?**

**ANS.** This is to encourage certain countries to formulate and implement a Social Security Totalization Arrangement (SSTA)\* on reciprocity basis. Currently there is a large portion of Indian population that contributes to social security in other countries without any pay-back when they return to India. Hence, through SSTA arrangement, it is intended to provide social security cover for Indians working abroad and likewise reckon the services of Expatriates for social security through their respective countries.

**Q. Can the PF contributions of Indian Expatriates be continued in India without payment of salaries? If yes, how?**

**ANS.** To answer this question, we will have to examine the following situations:

- **On Deputation:** Salary can continue in India with additional living allowance paid by the host country. In this situation, since the salary is paid in India, PF contributions and other retirement benefits continue without a break
- **On Secondment:** Salary in India is discontinued and can be treated as break-in-service, until the time the employee returns to the parent company in India. PF contributions can discontinue and, in all likelihood, the employee will contribute to the social security plans in the host country
- **New Employment:** It is also a practice that such employees tender their resignation from the Indian company and take up the overseas assignment on the basis of a fresh employment provided by the company in their host country. In this situation, all contributions will stop in India
- **Employment in SSTA Countries:** Can be excluded from the social security plans of the host country, provided a 'detachment certificate' is issued by the home country's social security, or benefits exportability on the basis of totalization agreement

\*The SSTA, also referred to as a Totalization Agreement is a reciprocal arrangement between the governments of two countries whereby, subject to certain conditions, the members of one country working in the other country are required to make payments to the social security systems of only one of the two countries.



**A P Sugathan Nair**  
Retiral and Financial Management Lead – Aon Hewitt  
For more information, please write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com)

# Upcoming Insights

**Salary Increase Survey, Phase 1: June-September  
Phase 2: November-March**

One of the most exhaustive studies in the area of performance and rewards in India. The study measures actual and projected salary increases, variable pay, and performance data across employee categories.

**Aon Hewitt India TCM Survey, March-August**

Aon Hewitt's Total Compensation Measurement™ (TCM) survey serves more than 7,000 organizations in over 40 international markets globally. The survey provides access to competitive pay data, as well as plan design features for base salary, bonus, long-term incentives, benefits and perquisites.

**Variable Compensation Measurement Study, May-August**

Launched for the first time in India in 2010, Aon Hewitt's Variable Compensation Measurement survey, is the only annual broad-based study capturing unique plan characteristics for cash and special recognition.

**Executive Compensation Study, July-October**

A first-of-its-kind study launched in India by Aon Hewitt. The study provides organizations with access to rich analysis of data and practices in executive compensation.

**International Assignee Policies and Practices Study, December-February**

A comprehensive study capturing details of international assignment policies and practices. The study is the first-of-its-kind in India to focus on different types of compensation approaches and their application.

**India Banking Study, May-October**

A study for all major Indian and MNC banks to come together to share and benchmark their positions and levels across the industry.

**Investment Banking Study, May-September**

A benchmark study conducted for large MNC and Indian investment banks covering 120+ positions across investment banking, institutional equities, research, debt and fixed income.

**Asset Management Forum, July-October**

A flagship study in the AMC sector covering 100+ positions across fund management, sales & other functions.

**Private Banking Forum, June-September**

A study covering large Indian & MNC private wealth management organizations to benchmark key roles across functions.

**Microfinance Compensation Survey, December-March**

A study that measures and analyzes salary benchmarks for MFIs across India.

**Life Insurance Forum, September-January**

A study of large Indian and MNC life insurance organizations covering 100+ positions across sales & distribution, actuarial services and other functions.

**Retail Broking Forum, November-February**

A study covering Indian & MNC retail brokerage organizations to benchmark 100+ positions across sales, PMS and other functions.

**Private Equity Forum, September-December**

A study of private equity players covering key positions across fund management roles.

**NBFC Forum, December-March**

A study of large NBFCs covering cash and benefits data across 100+ positions.

**Aon Hewitt India Telecom Forum, November-March**

One of the flagship studies in the telecom sector that captures cash and benefits information across 170 positions.

**SIAM Automobile Forum Compensation Survey, October-January**

The annual study looks at compensation data across levels of management and also serves as a platform for sharing best practices.

**Aon Hewitt India FMCG Forum, June-December**

The forum brings together all major MNC & Indian FMCG organizations to benchmark their positions, levels and benefits across the industry.

**Clinical Research Forum, August-December**

The study covers leading clinical research organizations providing robust and comprehensive information on cash compensation, benefits and industry trends.

**IT Industry Study, June-September**

Launched in 2001, this study provides robust and comprehensive information on cash compensation, benefits and industry trends.

**ITeS Industry Study, July-October**

A comprehensive study that covers 500+ positions across 60+ job families. The study also includes detailed benefits and compensation best practices benchmarking across the ITeS industry.

**Indian Semiconductor & EDA Forum (ISEF), July-October**

Rewards/HR managers of leading semiconductor & EDA organizations have come together to form a rewards forum for conducting a comprehensive, co-sponsored reward benchmarking survey.

For more information, please write to us at [totalrewards@aonhewitt.com](mailto:totalrewards@aonhewitt.com)



## Aon Hewitt Our New Avatar

Aon Consulting & Hewitt Associates have joined together to form a global leader in human capital consulting & outsourcing solutions. Together, we have the resources, expertise, and global reach to effectively address today's evolving human resource issues.

We partner with organizations to solve their most complex benefits, talent and related financial

challenges, and improve business performance. We design, implement, communicate and administer a wide range of human capital, retirement, investment management, healthcare, compensation and talent management strategies.

With more than 29,000 professionals in 90 countries, Aon Hewitt makes the world a better place to work for clients and their employees.

**KEY FACTS**

- **No. 1** human capital consulting and outsourcing firm in the world  
-----
- **29,000** employees  
-----
- **90** countries  
-----
- **\$4.3 billion** combined revenue  
-----
- Serving more than half of the  
**Fortune 500**  
-----

For more information on Aon Hewitt, please visit [www.aonhewitt.com](http://www.aonhewitt.com)