

HAVE NOMINATION AND REMUNERATION COMMITTEES MEASURED UP?

June 04, 2026

SUMMARY OF DISCUSSIONS

Background

It is only in the last few years that Nomination and Remuneration Committees (NRCs) have been getting the attention that they legitimately deserve. From helping to select Board members, to initiating the process of a robust Board evaluation, NRCs have a remit that is central to the health and the performance of the company. Attrition is one problem that the HR function grapples with, and the NRC's guidance is value-adding. This assumes additional significance with a large component of Gen-Z in the workforce. Compensation - how much is too much - is yet another challenging task that the NRC has to deal with. In this context, it was considered necessary for Chairs and members of NRCs to discuss the practices being followed in their companies, so that the combined experience of the participants can help to lay out a clear roadmap and address all connected issues. The discussions at this roundtable were intended to result in well considered recommendations that address common concerns, and flag the deficiencies that have come to surface.

DISCUSSIONS

ROLE, RELEVANCE AND EFFECTIVENESS OF NOMINATION AND REMUNERATION COMMITTEES (NRCs)

Role of NRCs

- The regulatory architecture comprising the Companies Act, 2013, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR), and sector-specific frameworks such as those prescribed by the RBI, envisages a framework for NRC governing appointments, remuneration, performance evaluation, succession planning and leadership oversight. While governance is not explicitly mentioned, it is an implied role of the committee.
- Over time, it has been realised that NRCs are among the most critical Board committees, given their influence over Board and senior management composition, remuneration, talent management and succession planning.
- However, the legal framework governing NRCs remains broad and principle-based, resulting in significant flexibility, but, on occasion, limited accountability. In some cases, the principle-based mandate has resulted in management persons pushing back in the event of the committee members asking for information.
- Unlike Audit Committees (ACs), where processes and accountability mechanisms are more clearly prescribed, NRCs operate within a comparatively flexible framework. This leaves space for interpretation, and company-specific processes, making measurability of outcomes difficult.
- During governance failures or corporate irregularities, attention is often directed towards Boards and ACs, whereas the effectiveness of NRCs receives comparatively less scrutiny.

Evolving Role of NRC

- NRCs are fundamentally people-centric governance committees, and their role should reflect this.
- The role of NRCs has been reshaped by evolving regulatory expectations/ recalibrations, global economic uncertainty, digital disruption, younger workforce, changing workforce aspirations, consolidation of labour laws, and technological developments, including in Artificial Intelligence.
- Covid-19 and changing workforce dynamics have significantly increased the strategic importance of NRCs, and expanded the expectations from the committee. Post Covid, a number of HR related matters, including appraisals of key employees, have started coming to the committee.
- It is felt that governance formed a part of the original intent behind the role of NRCs, as remuneration cannot be meaningfully assessed without considering performance; performance cannot be assessed without defined corporate level objectives and HR practices; HR practices would focus on succession planning; and all these aspects are intrinsically linked.
- Organisational performance and shareholder returns are ultimately driven by people, making effective human capital oversight a key responsibility. Private equity funds also tend to focus on NRCs, and their composition, because of the recognition that people will drive business, and in turn, numbers.
- Matters relating to leadership performance, appointments, remuneration, and accountability of top management should not be left solely to management or the Chairperson. These roles should be performed by the NRC.
- If governance concerns arise, NRCs should play a more active oversight role. It is believed that the remit of NRC should be expanded to include governance.
- Culture of an organisation is also an area that has increasingly started falling within the remit of the committee. Culture and behaviour cannot be mandated.
- Given different expectations from different stakeholders, and a largely principles-based mandate, it seems that a number of NRCs do not have role clarity.
- If NRCs are unable to influence leadership appointments, succession planning, performance oversight, and governance matters, they risk functioning merely as Remuneration Committees, rather than strategic governance bodies.
- NRCs should periodically assess not only their effectiveness, but also whether their composition, mandate, and practices remain adequate for evolving organisational needs.

Have NRCs Performed Well?

- The growing recognition that NRCs may not be fully measuring up to their intended purpose is itself important, as similar questions have historically been directed only to Boards and to ACs.
- Some believe that NRCs have not failed in performing their role in its entirety. However, it is also felt that they could have performed better. These include areas such as Board composition, talent management, remuneration and succession planning. Areas such as workforce capability building, leadership development, talent retention, upskilling, and attrition management too require greater focus from NRCs.

- This is largely owing to their performance being greatly dependent on the promoter of the company/Chair of the Board. Nearly 75% of listed entities are promoter-driven, making NRCs balance promoter interests with broader stakeholder expectations. Further, with the promoter block having voting rights, decisions of NRCs require promoter support.
- Experience from certain sectors, including banking, suggests that NRCs have generally discharged several of their responsibilities effectively.
- The requirement under LODR for at least one NRC meeting in a financial year, has resulted in a number of committees meeting only once during the year, and this has resulted in limited meaningful oversight by the committee.
- The Board too needs to understand the role being performed by the NRC. For this, it is also important for the NRC Chair to brief the Board about committee discussions and decisions.

Composition of NRC

- The composition of NRCs, and the selection of the NRC Chairpersons, require careful consideration, given the breadth of responsibilities entrusted to the committee. Independent Directors (IDs) should play a very important role in choosing the members of NRC.
- The presence of IDs on NRCs provides an objective and independent perspective in committee deliberations.
- There is also a need to consciously opine on the competence that NRC members should possess. Law and regulations are quiet about this. Managements can benefit from having a sounding board. NRCs should therefore comprise individuals with calibre, depth of knowledge and experience to help the CEO and top management.
- Effective NRC leadership requires independence, judgement, maturity, and an awareness of the limits of one's own expertise. The Chair of NRC has to be a mentor to the CEO in times of major change or on matters relating to the workforce. Therefore, the Chair of NRC should have the right aptitude. He/she should also not insist that everything be necessarily run past him/her.

EXPERIENCE OF NRC WHILE PERFORMING ITS MAJOR ROLES

Board Nominations

- In several organisations, nominations at the Board-level continue to be influenced by informal networks and personal recommendations, rather than structured assessments of skills, competencies, and Board requirements.
- In promoter-driven entities, Board composition is often influenced by promoters and his/her established networks, which may limit the effectiveness of formal nomination processes. At best, names of 1-2 prospective Directors are sent to the NRC, to formalise the process of appointment.
- In such companies, even where NRCs make recommendations, the ultimate decision often rests with the majority shareholders. If NRC recommendations can be routinely overridden, the effectiveness of the nomination process will be diminished.

- However, even in professional-led entities, NRCs do not have complete freedom. They are frequently presented with a limited pool of candidates, reducing the scope for meaningful selection.
- Nomination processes should start with identifying missing skillsets at the Board level. While individuals proposed for Board positions are often accomplished professionals, questions may remain regarding whether their skills and perspectives align with the evolving needs of the Board.
- Boards should comprise individuals with diverse skills, experiences, and perspectives, rather than only domain expertise. Excessive concentration of domain experts on a Board may be counterproductive, as Directors are expected to contribute as Board members, and not merely as subject-matter specialists. Some promoters are also not comfortable with too many domain experts on the Board.
- Greater use of external search firms, objective assessment criteria, and skills-based evaluation may strengthen nomination processes.

Conflict of Interest

- There is very little conversation on conflict of interest. For example, Directors serving simultaneously on the Boards of Regulators and regulated entities may face significant conflicts of interest. Directors bear the primary responsibility for assessing potential conflicts before accepting new appointments, and should decline appointments where conflicts cannot be appropriately managed.
- NRCs and Boards should carefully review declarations and disclosures submitted by Directors before their appointment to identify actual or potential conflicts of interest.
- Directors may consider obtaining appropriate clearances from their existing Boards before accepting appointments to additional Boards.
- Concerns regarding overboarding and multiple directorships, with no time for preparation for meetings, also require greater attention.
- While recusal may mitigate direct conflicts, it may not completely eliminate the possibility of indirect influence.
- NRCs are expected to play a more active role in overseeing governance-related concerns, including conflicts of interest involving Directors and senior management.

CEO Appointment, Oversight and Accountability

- In most promoter-driven organisations, appointment of CEO is decided by the promoter. This limits the role of NRC towards holding the CEO accountable.
- While NRCs generally review the Key Result Areas (KRAs) of CEOs, meaningful CEO evaluation is often lacking, even if there is weak organisational performance, since this is handled by the promoter.
- Boards in India rarely remove CEOs solely on the basis of performance concerns, making leadership accountability a challenging area. NRCs should play a more active role in assessing leadership effectiveness, and addressing situations where CEOs or senior executives are not performing as expected, especially since they constitute the committee which recommends their appointment.

- Effective performance management frameworks should provide mechanisms for addressing sustained underperformance at the leadership level.
- Feedback to the CEO remains a critical component of leadership accountability.
- Some Directors note that there is a fixed term given to the CEO/ Managing Director (MD) of the company by the shareholders. It would be a good practice to have a limited term for the CEO/ MD, to ensure accountability. Also, the company must have a retirement policy in place, to avoid giving a CEO/MD the comfort that he/she would continue indefinitely.

Leadership Development and Talent Management

- The role of NRCs extends beyond appointments, and includes ensuring the continuous development and grooming of senior executives.
- Structured leadership development and capability-building initiatives can help individuals realise their full potential.
- NRCs should focus not only on CEOs and CXOs, but also on the broader leadership pipeline, and future talent pool, both of which are often ignored. There is a need for focussed efforts towards majority of the workforce, including their need of upskilling.
- Organisations should adopt a long-term talent investment approach by identifying and developing future leaders well in advance of leadership transitions. There should be a talent roadmap. Both the width of the talent (skillset) and the depth of the talent (succession planning) is important.

Remuneration and Performance

- Accountability remains one of the most overlooked considerations in remuneration decisions.
- While benchmarking studies have long been considered one of the best ways of determining compensation, they have limitations.
- Re-appointment and remuneration decisions should be linked to performance, rather than benchmarking alone. Determining remuneration without adequately assessing performance and the value contributed by an individual reflects weak governance. Assessing intellectual contribution is another area which remains one of the more challenging aspects of remuneration evaluation. While benchmarking serves as a useful reference point in some cases, it should not replace a meaningful performance evaluation.
- Benchmarking may not always provide an appropriate basis for remuneration decisions, particularly where organisational performance is significantly dependent on the contribution of a specific individual. It may also work differently in the case of a promoter running the business versus a professional CEO running it.
- In certain circumstances, retaining exceptional leadership talent may require remuneration decisions that cannot be directly benchmarked against peer organisations.
- Executive remuneration should be assessed in the context of organisational circumstances, leadership requirements, value creation, and long-term sustainability. Talent, role, performance, and remuneration are closely interconnected, and should be considered holistically. There are no absolutes in

compensation. It is therefore important for the NRC to create a transparent framework, to justify the compensation.

- Proxy advisory firms have, in certain instances, recommended voting against the reappointment of NRC members where remuneration recommendations for top executives were perceived to be excessive. Greater transparency may be required regarding the rationale supporting remuneration decisions.
- Disclosures relating to remuneration, including median remuneration comparisons and pay rationale, are often not sufficiently explained in annual reports or minutes of Board or committee meetings.
- Minutes relating to appointments, reappointments, and remuneration decisions should adequately record the rationale supporting such decisions.

Succession Planning

- Succession planning remains one of the most significant governance challenges across organisations, and one of the roles of NRCs, where the committees have been found to be underperforming.
- Succession planning is frequently misunderstood as a replacement exercise, whereas its primary objective is business continuity and institutional resilience. It means having a pipeline of talent, but not necessarily that a person is behind another person.
- While some efforts related to succession planning for junior levels exist, these are almost non-existent for top management positions, including those for the CEO.
- Succession planning is particularly challenging in most promoter-driven organisations, where leadership transitions are often influenced by promoter decisions, rather than formal succession frameworks. This is true even for companies where the promoter may have a very small stake.
- However, the track record of professional-led organisations is also not too good, with succession planning requiring greater discussion, oversight, and active engagement from NRCs.
- Succession planning often remains a documentation exercise, rather than a meaningful governance process. While organisations generally recognise the importance of succession planning, practical execution continues to remain a challenge. Effective succession planning requires the identification, development, and assessment of future leaders, rather than the preparation of formal succession charts alone.
- Leadership pipelines and creating a pool of potential successors may be more effective than identifying a single replacement for each position. Each critical leadership role should ideally have identified successors or “shadow” leaders capable of assuming greater responsibilities when required. This helps in planning grooming of the right persons.
- In succession planning, talent availability and leadership readiness continue to present challenges across industries.
- Succession planning should not be left to be a contingency exercise, and should be implemented both in letter and in spirit.

Human Capital Management and Attrition

- Attrition is generally defined as the rate at which employees leave an organisation. However, acceptable attrition levels vary significantly across industries and business models, as also across different levels within the same organisation. Therefore, attrition requires industry-specific and company-specific considerations.
- In certain sectors, including insurance, workforce dynamics may require industry-specific approaches to measuring and assessing attrition. Some industries have the bad practice of the whole team moving with their superior. This poses additional challenges.
- Talent retention has become an increasingly important strategic priority, and cannot be left to chance.
- NRC discussions often focus disproportionately on senior leadership, while broader workforce issues receive comparatively less attention.
- Greater emphasis may be required on workforce capability, leadership pipelines, upskilling, talent development, and retention strategies.

Board Evaluation and Effectiveness

- Board evaluation remains effective only when undertaken with genuine intent and a commitment to improvement. When conducted in good faith, Board evaluation can become a powerful tool for improvement. Otherwise, it risks becoming a mechanical compliance exercise.
- The effectiveness of the evaluation exercise depends on its being a robust process. It not only depends on the evaluator, but also on the seriousness of the individual being evaluated, and those responsible for acting upon the feedback. It also depends on whether the promoter or the NRC is driving the process.
- Many existing evaluation exercises often result in a 100% score for every person, with limited detailed comments, which are focussed on improvement. The evaluation of Board Chairs often results in superlative comments being given. Uniformly favourable assessments limit their effectiveness as a tool for improvement.
- It is felt by most that evaluation of the Board, as a whole, is effective. But evaluation of individual Directors is not done objectively, and does not get much meaningful responses. If done well, and if feedback is provided, evaluation of individual Directors can result in considerable improvement.
- As per most evaluation results, while committees seem to be performing well, in general, the NRC is not the top scoring committee.
- In some cases, questions have been raised regarding Boards that have been receiving consistently high evaluation scores, despite weak organisational performance. Some Directors believe that an effective Board is not always responsible for a year-on-year operational performance of the company, since the performance is dependent on exogenous factors too. But if things go uncontrollably downhill, the Board would have to be held accountable.

Strengthening Evaluation Processes

- Board evaluations, led by external consultants, are generally perceived to be more objective, transparent, and independent. While choosing the firm, care must however be taken to induct an evaluator with firsthand boardroom experience, so that the process does not degenerate into a mechanical reporting

exercise. It is felt that if an external firm should be entrusted with the process of evaluation once in 3 years. External evaluations may also provide useful benchmarking against peer organisations and industry practices. However, some Boards resist external evaluators.

- Evaluation should focus on identifying what can be done differently, better, more effectively, or less frequently. This would help improve the processes.
- Evaluation frameworks should extend beyond standard questionnaires, and be supported by structured discussions, meaningful feedback, and follow-up mechanisms.
- Directors should provide objective and honest assessments, rather than uniformly favourable feedback.
- Evaluation outcomes should be appropriately minuted, and accompanied by action plans, and follow ups, wherever necessary.
- Constructive and candid feedback remains one of the most valuable outcomes of any evaluation process. The value of evaluation lies not in scores, but in feedback, follow-up, accountability, and continuous improvement.
- Board committees should take a lead on implementing suggestions that they can, so that the workload of the Board does not increase disproportionately.

INTERNATIONAL PERSPECTIVE AND SOME SUGGESTIONS FOR INDIA

- International jurisdictions increasingly separate responsibilities relating to nomination, remuneration, governance, succession planning, leadership development, and performance oversight.
- In the United Kingdom, companies commonly maintain separate Nomination Committees and Remuneration Committees, while some organisations also constitute Nomination and Governance Committees. The Nomination Committee focuses on HR aspects, including succession planning; and the Remuneration Committee focus on performance and remuneration.
- In the United States, Nomination Committees focus only on nomination of Directors, while Compensation and Leadership Development Committees are often entrusted with responsibilities relating to executive compensation, talent development, leadership succession, and performance oversight.
- The benefit of a dedicated Remuneration Committee is that it can focus on remuneration in depth.
- Such specialisation enables greater focus, accountability, and effectiveness in the discharge of committee responsibilities.
- While legislative changes required to mandate separate/ additional committees may be difficult and time-consuming, it would be possible for NRCs in India to consider having the agenda of NRCs made into 2 volumes, to focus dedicatedly on the nomination and the remuneration functions.
- In some countries, it is also mandatory to have reappointment of IDs each year. In India, however, there is resistance to this proposal.

- In some Nordic countries, to truly represent the interest of workforce, some committees also comprise non-Board members.

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