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Managerial Remuneration should be classified as a Related Party Transaction to curb Promoter Influence

Abstract This article critiques the self-regulatory approach to managerial remuneration in Indian companies, arguing that allowing directors to vote on their own remuneration creates an apparent conflict of interest. It contends that the existing safeguards—statutory limits, special resolutions, and National Remuneration Commission ('NRC')—fail to curb the influence of controlling shareholders in the Indian concentrated environment, [...]

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October 11, 2025

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Abstract

This article critiques the self-regulatory approach to managerial remuneration in Indian companies, arguing that allowing directors to vote on their own remuneration creates an apparent conflict of interest. It contends that the existing safeguards—statutory limits,

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remuneration in public companies as a Related Party Transaction ('**RPT**') under Section 188.

I. Introduction

The recent controversy surrounding Starbucks' CEO 'super commuting' daily to the headquarters via corporate jet has reignited global discussions on managerial remuneration. Remuneration, particularly for top executives and promoters, has long been a contentious issue in corporate governance. In India, it takes on unique characteristics due to the country's concentrated corporate structure. The predominance of family-owned businesses and promoter-driven companies has created a corporate environment where controlling shareholders often occupy key management roles, raising specific challenges in establishing equitable compensation structures.

India's regulatory approach to managerial remuneration has evolved alongside its economic liberalization. Historically, the Indian government maintained a stringent, 'statutory-regulatory' approach. Under the Companies Act (1956), remuneration for directors in both public and private companies was tightly controlled and any payment beyond the prescribed limit required government approval, which was a cumbersome process. Post-1991, India eased remuneration controls. The Companies Act, 2013 ('**the Act**') adopted a self-regulatory approach, allowing greater autonomy for companies in determining managerial pay. While providing flexibility, these changes also raised governance concerns regarding potential misuse, particularly in promoter-driven companies where dominant shareholders could influence managerial remuneration.

These evolving governance concerns have been the subject of significant academic attention. Existing literature on managerial remuneration in India has focused on key themes, including the determinants of managerial remuneration (examining the influence of company financial performance, ownership structure, and corporate governance mechanisms), and the relationship between managerial pay and firm performance, which studies suggest is complex and influenced by factors such as controlling shareholders. These studies also

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of interest arising from promoter voting on their own remuneration, and the inadequacy of existing safeguards to prevent potential abuse, remains an area requiring further examination. This article contributes to addressing this gap.

To understand these governance concerns better, it is essential to consider the corporate landscape in India. Different scholars, time and again, have discussed the concentrated shareholding structure prevalent in India. Indian listed companies follow a 'family capitalism' system, demonstrated by concentrated shareholdings of a few wealthy families in large corporations. Various scholars refer to an early study (2002) to note that "*the average shareholding of promoters in all Indian companies was as high as 48.1 per cent*." Another study later confirms such a structure for listed companies in particular. It analyses the shareholding pattern of around 600 companies listed with the Bombay Stock Exchange to conclude that in BSE 100 companies, promoters own over 48 per cent on average, and in the broader BSE 500, promoters hold nearly 49 per cent, with only a small percentage of companies having promoter stakes below 25 per cent. Furthermore, promoter control is further entrenched through "*mechanisms such as cross-holdings, pyramid structures, and tunnelling*," making the second agency problem an acute issue in India's corporate governance framework.

Given this context, determining managerial remuneration, particularly for promoter-managers, becomes a focal point where conflicts of interest are most evident. The Act seeks to balance competing interests through remuneration limits and approval mechanisms, but its effectiveness in promoter-driven companies remains debated. This article argues that a major issue is that managerial remuneration is not classified as a related party transaction (**'RPT'**) under Section 188 of the Act. As a result, directors can vote on their own pay, raising serious conflict-of-interest concerns. By not treating it as an RPT, the Act fails to subject these transactions to the additional scrutiny and safeguards required for other RPTs. This article proposes explicit inclusion of managerial remuneration under Section 188 for public companies, adding a layer of scrutiny to make it harder for promoters to unilaterally determine their pay without any control.

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of existing safeguards. Finally, it proposes classifying managerial remuneration as an RPT to enhance corporate governance oversight.

II. Legislative Provisions Concerning Managerial Remuneration

As discussed previously, the Act takes the subject of managerial remuneration to a 'self-regulatory' mode. This article opines that it follows a boundaries-with-loopholes approach, where it prescribes remuneration limits but simultaneously allows exceptions that can undermine these constraints. While Section 2(78) of the Act broadly defines 'remuneration' as any "*money or its equivalent given…to any person for…[their] services*," the specific provisions concerning managerial remuneration are found in Section 197 and Schedule V of the Act. Section 197 prescribes a maximum overall limit on managerial remuneration payable by a public company. The Act distinguishes between two scenarios–when the company is profit-making and when the company has inadequate profits or is loss-making.

A. When a company is profit-making

Section 197(1) of the Act provides the rule for the overall limit of managerial remuneration. As per it, "*total remuneration payable by a public company to its directors…in respect of any financial year*" cannot exceed 11 per cent of the "*net profits of that company for that financial year*." The first proviso clarifies that this limit of 11 per cent is not rigid and can be relaxed if authorized by shareholders through an ordinary resolution. After the 2017 Amendment, central government approval for exceeding this limit was also removed.

Moreover, the second proviso to this section establishes specific remuneration limits for an individual and multiple directors or managers. However, as given in the proviso, these specific limits can also be surpassed with a special resolution, with no requirement for the central government's approval. Since the overall limit cannot be surpassed without surpassing the individual limits, a special resolution becomes necessary to address these limit increases simultaneously.

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general rule is that directors cannot receive remuneration beyond sitting fees —i.e., the fee paid to directors specifically for attending Board or committee meetings. However, the executive directors can still receive their remuneration, provided that it complies with the limits specified in Schedule V. Following the same boundaries-with-loopholes approach, the Act also allows for exceeding these limits, provided that the shareholders pass a special resolution.[1]

III. Governance Issues with the Self-regulatory Approach

This shift of power into the hands of the shareholders creates serious corporate governance issues. In this section, we will focus on the issue of conflict of interest and assess the existing safeguards against these conflicts, evaluating their effectiveness.

A. The Apparent Conflict of Interest

Directors bear extensive responsibility for regulating company affairs, yet "*their duties of good faith and fair dealings are owed by each director individually*." Beyond these fundamental obligations, Section 166 of the Act imposes specific fiduciary duties on directors, including the statutory requirement to avoid conflicts of interest. The law mandates that directors "*disclose…the contracts or arrangements…*" in which they have any personal interest.[2] Such transactions constitute RPTs and necessitate additional safeguards to protect the company's interests. Certain RPTs, as specified in Section 188(1), must be confirmed with special resolutions, where the interested director can neither vote nor attend the board meetings discussing these transactions.

Interestingly, managerial remuneration is not regarded as RPT. The explanation attached to Section 188(1) clarifies that the remuneration paid to directors in their official capacity is not considered an RPT. However, compensation beyond their entitled remuneration would be classified as an RPT. This exclusion could be a deliberate legislative choice to avoid dual

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remuneration, it focused primarily on enhancing RPT safeguards with promoters rather than questioning the established exclusion of routine managerial remuneration from RPT provisions. Thus, the directors can participate and, if they are also shareholders, can vote on the resolutions, deciding their own remuneration.

Now, a conflict of interest is apparent when a director, who may also be a shareholder, can vote on the resolution of his own remuneration. This situation raises questions about directors' ability to fulfil their duty of "*good faith and fair dealings*" towards the company and whether they can be trusted to prioritize the company's interests over their personal financial gain. Under Section 166(3) and (4) of the Act, directors are bound by duties of no-conflict and independent judgment, which are fundamentally compromised when they vote on their own remuneration. The duty of no-conflict does not require an actual conflict; as held by the Supreme Court, the mere possibility of conflict is sufficient to trigger its application. When directors vote on their own compensation, they are inherently in a position where their personal financial interests directly conflict with their duty to act in the company's best interests, creating what courts would likely recognize as a classic case of a person acting as a "*judge in their own cause*." Such conduct contravenes Section 166(3) and constitutes a clear breach of duty of no-conflict.

This conflict is particularly pronounced in the Indian context, where promoters with controlling shareholding often function as directors. The Supreme Court in *Sangramsinh P Gaekwad v. Shantadevi P. Gaekwad* recognized that fiduciary duties are breached when directors take "*undue benefit*" or act with "*ulterior motive*" or "*mala fide*" to make "*pecuniary benefit and gain for [themselves] to the detriment*" of shareholders. In companies with inadequate profits, when promoter-directors vote for excessive compensation, they may effectively prioritize personal gain over the interests of other stakeholders including employees, creditors, minority shareholders, and the company itself. The concentration of ownership and control in Indian listed companies exacerbates this conflict, as controlling shareholders can effectively determine their own compensation without meaningful oversight from independent parties.

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voting. The no-conflict principle operates independently of procedural compliance. Even if all statutory procedures are followed, the underlying fiduciary breach remains where directors vote on matters affecting their personal financial interests. How effectively these safeguards prevent harmful self-dealing in practice remains a question of empirical inquiry, which this article will try to answer in the following section.

B. Evaluating the efficacy of available safeguards

Keeping the concentrated shareholding of Indian companies in mind, we will now evaluate the major safeguards available against the potential abuse of voting powers by directors in matters concerning their own remuneration.

1. Limits and Approval Mechanisms for Exceeding Limits

As discussed previously, the Act has set limits on the managerial remuneration of all publicly listed companies. However, the shareholders can exceed these limits by passing a special resolution. Therefore, limits alone are definitely not an effective safeguard.

Special resolutions, the approval mechanism for exceeding these limits, are also ineffective in practice. As per Section 114 of the Act, passing a special resolution requires not less than three-fourths of the total members present and voting. This may seem a tough requirement to fulfil, as you need at least 75 per cent of votes in your favour to approve your unreasonably high compensation. However, its effectiveness falls short when seen in conjunction with the concentrated shareholding pattern of Indian listed companies.

It would be illogical to assess the efficacy of a safeguard without considering the promoters. These individuals typically hold controlling stakes and often serve as directors. For such promoters, achieving the 75 per cent approval threshold is significantly easier than for a director who is a minority shareholder. Controlling promoters have two avenues to achieve this threshold:

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the other voters. In such a scenario, a special resolution would be there for the namesake, and only the promoter would have a say.

ii. Influence on other shareholders

Even if the promoters do not hold a stake as high as 75 per cent, they can influence the voting decision of other shareholders. The controlling shareholders have the primary say in the 'hiring and firing' of the directors, and they also hold the loyalty of domestic financial institutions. As a result, it becomes difficult for directors to oppose or act contrary to the interests of these controlling shareholders. Therefore, the promoter will most likely influence the director-shareholders in the company. These shareholders, in likely 'allegiance' to the promoter, will vote in favour of the promoter, leading to the passing of that resolution.

This argument is empirically supported by the study conducted in 2022 by Institutional Investor Advisory Services (IiAS), a proxy advisory firm. This assessment of "*201 remuneration resolutions for promoters presented in 2022 shows that 68 (34%) of these would have been defeated had promoters not been allowed to vote.*"

2. The Nomination and Remuneration Committee

The Act and the SEBI (LODR) Regulations of 2015 together assign a crucial role to the NRC. It has key roles in appointment, performance evaluation, succession planning, and remunerations in a company. As per Section 178 of the Act, read along with Regulations 19 and 20 of LODR, the NRC shall comprise only non-executive directors, with at least three members, of whom no less than half must be independent directors. Moreover, under Section 178(3), the NRC must set criteria ensuring director and manager remuneration is 'reasonable' and 'clearly linked' to performance.

On sight, NRC may appear to be an effective solution to the concerns discussed in the previous safeguard. With its membership consisting entirely of non-executive directors, half

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One key issue is that, under Section 197 read with Schedule V of the Act, shareholders retain the *final* say in directors' remuneration. The recommendations given by the NRC are not binding on the shareholders and must be approved through a shareholder resolution. Since the promoters have dominant shareholding and influence, such resolutions are likely to pass in their favour, undermining the NRC's effectiveness in curbing promoter control.

Another possible issue could be the 'board dynamics' of the NRC. This refers to the behavioural influence that senior management may exert on the NRC. While legal provisions can regulate formal processes, they cannot control the interpersonal pressures that may arise within a company. For instance, directors might insist on attending NRC meetings where their own performance and remuneration are being discussed. In such cases, NRC members may find it difficult to ask them to leave, as doing so could strain relationships at the board level and impact overall dynamics. Reports also highlight that in "*a handful of instances, promoters are [also] members of the NRC.*" Here, the NRC members may be influenced to be non-critical or nice towards the promoter.

IV. The Way Forward

As analyzed, despite existing regulations, promoters may circumvent available safeguards, leveraging their controlling stakes to secure disproportionate compensation. This highlights the need for more robust solutions to mitigate the problem of promoters' inherent conflict of interest.

A key solution would be to classify managerial remuneration in public companies as an RPT under Section 188. The exclusion of remuneration from RPT scrutiny allows promoter-directors to participate in and vote on resolutions determining their own pay, even when they hold controlling stakes. By treating it as an RPT, such decisions would come under the purview of Section 188 read with Regulation 23 of SEBI (LODR) Regulations (2015), which already mandates the approval of the 'majority of minority' shareholders for material RPTs. This approach ensures that remuneration decisions are subject to the same level of scrutiny

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over institutional investors and directors who owe their positions to them. This could dilute the independence of minority shareholder approval, making it an imperfect safeguard. Moreover, the policy implications of classifying managerial remuneration as an RPT also require careful consideration. This change would alter the governance framework, introducing additional compliance costs and procedural complexities that companies would need to navigate.

Singapore's regulatory approach provides a compelling precedent for this reform. It already incorporates certain aspects of managerial remuneration within RPT frameworks, particularly for interested person transactions involving directors. These transactions are subject to stringent approval and disclosure requirements. Singapore also maintains separate governance mechanisms through independent committees and enhanced disclosure requirements, creating a dual-layered protection. The Singapore model is particularly relevant for India because both jurisdictions share similar corporate governance challenges stemming from concentrated ownership structures.

Therefore, despite the limitation of the 'majority of minority' system, classifying managerial remuneration as an RPT still introduces an additional layer of scrutiny that currently does not exist. Unlike the present framework, where promoters have unchecked control, requiring minority shareholder approval at least imposes a procedural hurdle that could deter egregious abuses. The implementation would need to address practical concerns, including defining materiality thresholds for remuneration that would trigger RPT approval requirements, establishing clear timelines for approval processes, and ensuring that routine compensation adjustments don't become unduly burdensome.

V. Conclusion

In this article, we discussed how managerial remuneration in India reflects an interplay of regulatory frameworks, concentrated ownership structures, and corporate governance challenges. While the self-regulatory approach offers flexibility, it also opens avenues for

as an RPT. While not a perfect solution, this approach adds an essential layer of oversight, making it harder for promoters to determine their pay without external scrutiny. By addressing these conflicts of interest, the second agency problem could be mitigated, and Indian corporate governance can better align with global standards, ensuring equity for all stakeholders, especially minority shareholders.

About the Authors

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[1] Proviso to Section II of the Schedule V (Part II).

[2] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, Clause 49.

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