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Executive Remuneration Inquiry
Productivity Commission
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Submission to the Productivity Commission re Executive remuneration in Australia

Introduction: As a member of the Australian Institute of Company Directors (AICD) since 1997 with diverse experience in the public and private sectors, I wish to make a short submission to the Commission based on my personal experience, research findings and community perception.

As I do not have accurate data on trends in director and executive remuneration (TOR 1) I would only make the observation that the remuneration packages for CEO's and senior Executives have been rising at a much greater rate than the wages and salaries of other workers in all sectors except the mining industry (until the recent economic downturn). The widely held perception is that these packages are totally excessive and cannot be justified.

The effectiveness of the existing framework for the oversight, accountability and transparency of director and executive remuneration practices (TOR 2)

It has become clear over recent years that the framework for the initial setting and monitoring of remuneration packages is flawed.

Rather than rewarding performance based on the role and responsibilities of executives and board members, while taking into account experience, relevant qualifications and past performance, executive remuneration is based on what other executives, both nationally and internationally are being paid, on the basis "we have to pay these packages to get the best people in a competitive market".

What this has achieved is that CEO salaries have now reached what has been described in the media as 'stratospheric', and in many cases with little relevance to performance outcomes.

Tying performance incentives to increasing the share price over the short term i.e. several years has been another flawed strategy, as this approach drives short term, expedient decisions rather than decisions which will ensure the longer term viability and sustainability of the company.

The general practice of Boards setting the remuneration package of the CEO, based on what the market is paying, and also setting their own remuneration, again based on what is the going rate for Board members of various sized companies, is fundamentally flawed. This is because the whole process is like a 'closed shop', as a majority of Board directors are former CEO's, while current CEO's see their future as Board directors.

All previous research into the composition of Boards has shown that they are made up of an homogenous group of people, predominantly male, former CEO's or business owners as well as accountants and lawyers.

Such Boards do not reflect the diversity of their stakeholders – shareholders, customers, staff and the general community.

There is clearly a vested interest in maintaining the status quo of excessively high remuneration with little accountability and transparency.

In relation to accountability and transparency, recent disregard at the A.G.M.'s of a number of prominent companies to the wishes of shareholders was obvious. Instead of listening to a majority of their 'owners' calling for restraint rather than an increase in remuneration, in most cases these calls were ignored because they cannot be enforced by law.

The fact that the general community (their customers) is also outraged by the continuing upward spiral of executive salaries is also completely ignored, as Boards and CEO's seek to justify their decisions.

It would appear that rather than be accountable and transparent to shareholders and the community in which they operate they see themselves 'above' the mores of an open, democratic society.

The role of institutional and retail shareholders in the development, setting, reporting and consideration of remuneration practices (TOR 3)

I believe there is a role for institutional and retail shareholders in developing, setting and overseeing remuneration practices.

Obviously, the logistics of how this could operate effectively and efficiently would need to be addressed.

However, while opponents of such democratisation will oppose this concept on the basis of practicality, it is possible in an age of modern technological communication to develop a model, perhaps based on electing a council of shareholders with members from both the institutional and retail shareholder groups who could then make recommendations to the Board and the broad shareholder membership.

If the Board does not accept the recommendations then they could be put to all shareholders, with a final and binding majority decision.

Any mechanisms that would better align the interests of boards and executives with those of shareholders and the wider community (TOR 4)

One mechanism, which could align the interests of both groups and be seen as independent and at arm's length, would be to establish an independent tribunal, such as that which sets the salaries of judges, parliamentarians etc.

Or alternately, an industrial relations type tribunal such as the one being established under the Fair Work legal framework would also ensure transparency and fairness.

Such a tribunal could set ranges of salaries and other benefits such as share options etc. commensurate with the size of the company, based on value and turnover.

There could be a number of bands, say 6-10, which would cover all publically listed companies and each band would have an upper and lower limit of remuneration package value.

Boards and shareholder representatives would then be responsible for determining the salary quantum and other package benefits within the externally determined limits.

While there would be much debate about what constituted 'the benefits package' eg car, super, shares, free travel etc. these benefits could be identified by the tribunal, just as the Tax office lists allowable deductions for various occupations.

Given that the current framework has failed to meet the expectations of both shareholders and the broader community for remunerative rewards to be based on results and outcomes which are seen to be earned and fair and sustainable in the medium to long term, it is time for a more independent and transparent system.

The effectiveness of the international responses to remuneration issues arising from the global financial crisis (TOR 5).

The global financial crisis has brought into stark reality the unfettered excesses of CEO and in some cases director remuneration packages of the past couple of decades.

The fact that this is a serious and challenging issue facing all Western economies should assist in finding a workable solution which provides incentive and reward to CEO's and directors while being seen as reasonable and affordable.

However, I don't think the response by some Governments to threaten to set a cap on executive salaries is the most effective long term solution. Just setting an upper limit which would apply across all companies, doesn't take into account the differing size and the particular challenges of companies in different industries etc.

Also, this would still enable Boards to give other benefits to enhance the salary with no clear and transparent processes and guidelines. Such practices as huge severance payments could still be incorporated into contracts.

It could be of great benefit for the Productivity Commission to closely monitor what other countries are proposing to address this challenging issue, as shared knowledge can lead to better solutions.

I would be pleased to be contacted for further comment.

Yours sincerely

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