Attachment 2

Author: **PETER WILSON - Peter Wilson is president of the Australian Human Resources Institute and chairman of Yarra Valley Water. This article will appear in the May issue of hrmonthly magazine.**
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As the sharemarket slumps, it's high time to rethink executive pay

Government and industry must co-operate on this, writes Peter Wilson.

WITH much political fanfare, the Prime Minister, Kevin Rudd, recently announced a pay double-whammy. First, his Government would legislate to cap chief executive termination payments to one year's pay unless a shareholder vote agreed to more. The second was a Productivity Commission inquiry into executive remuneration, with former trust buster Alan Fels in the main seat. There was not much of a business-friendly look about any of this.

We have all been waiting for something to happen, and the sense within governments is that executive remuneration will rise no more. In fact, the reverse is openly canvassed.

So what has happened over the past 20 years? My own experience is instructive. In 1990, I moved to the ANZ Bank from a permanent secretary position in charge of a government department. My government job paid me $130,000: base pay, superannuation and a Ford.

At ANZ, I reported to the group CEO on a package of salary, superannuation and a Holden, totalling $133,000. I remember feeling a little indignant. Weren't the new foreign banks supposed to have pushed up competition and pay? Apparently not. As it turned out I was paid fairly in both sectors, which weren't much different in remuneration relativities.

In 1992, after a recession that threatened the existence of both ANZ and Westpac, a new ANZ CEO was installed on a package of $400,000, along with two other executive directors at around $230,000 to $240,000. I was still sitting fairly at the next level in the pay pack, on about $150,000. At that time, there were only discretionary short-term cash bonuses and no shares or options. Fixed pay represented 90 per cent of the total, on average.

Currently the head of a federal or state government department receives about $500,000, and up to $600,000 in the case of the federal Treasury boss. In contrast, the CEO of a major bank or a Telco earns between $4 million and $6 million, depending on how you work out the increments to personal wealth from bonuses and incentives.

So public sector heads' incomes have gone up three or four times over 20 years, and for their counterparts in leading private-sector companies about 10 to 15 times. The 1990s relativity is now well and truly broken.

Reputable business commentators regularly tell us that it all makes sense, as many top companies are now world market leaders with share capitalisations valued at 10 to 20-plus times what they were worth 20 years ago. The risks of being in these top jobs are also high, with average CEO tenure being four to five years. And when the CEOs move out, so do

many at the next level. I have done this twice in my career. It's expected that next-generation executives will manage at least four or five unplanned moves.

The r eal change in private-sector pay relativities came in the early 1990s when the US and European investment banks really hit our shores. As world markets globalised and capital became more freely available, high premiums were paid to investment bankers who could pull companies apart and put them back together for major improvements in shareholder value, or at least expected ones.

Their remuneration structure had a base cash salary comparable to other industry executives, but it represented only 20 per cent of their total income, and 80 per cent sat within target incentives.

Our largest organisations lost many top people to Credit Suisse, UBS, Merrill Lynch and Goldman Sachs, among others. Malcolm Turnbull is an example, as is former Victorian treasurer Alan Stockdale, who moved to Macquarie Bank.

Local banks responded with pay structures with tougher performance objectives and much bigger payouts for short- and long-term results.

In one year during the 1990s my pay at ANZ doubled. At the beginning of that year I received a letter advising me of the pre-tax and post-tax value of my fixed remuneration and how I could flex and salary-sacrifice the components of it in interesting ways. In addition, I was given a set of demanding performance objectives, and some further out-performance targets, against which higher short-term cash bonuses could be paid. On top of all that, there were share options issued with retention and effective personal performance hurdles.

As an up-and-coming senior bank executive I decided to super-stretch myself to deliver as much as possible. It worked. My wealth doubled from more pay gains. The bank thereafter ratcheted up my targets, and attached more demanding qualifying conditions to my longer-term incentives. But the formula still worked to give me 20-50 per cent pay increases annually.

Later the effect moved across from commercial banking to retail with the arrival of smarter credit cards and other electronic banking wizardry. Retail bankers had their day in the sun, joining the corporate lenders in pay status. Other corporations had to keep up with the banks, or lose their best people.

Until 2008.

That's when share prices of finance houses dropped at least 50 per cent to 80 per cent in a few months, but executive pay did not seem to reciprocate. When US taxpayer bail-outs were used by AIG to pay retention bonuses for top executives, all sympathy and patience within government was lost. The political sabres began rattling with menace.

Our world still has the potential to be an open and astonishingly competitive marketplace, and in the end that's unlikely to change. But if poor policy choices in future eventuate in the here and now, the consequences for our economic recovery will resonate for a long time. Without doubt, a more co-operative government-industry approach can help prevent that.

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