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Executive Remuneration Inquiry
Productivity Commission
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To the General Manager

Submission to Productivity Commission Inquiry on Executive Remuneration

1. Introduction

Wesfarmers is one of Australia's largest publicly-listed companies with a significant business, community and shareholder footprint. Its diverse business operations cover supermarkets, department stores, home improvement and office supplies; coal mining; energy; insurance; chemicals and fertilisers; and industrial and safety products. Wesfarmers is one of Australia's largest employers, with around 200,000 Australians employed across the Group and has a shareholder base of more than 500,000 investors, many of whom are retail shareholders.

Wesfarmers has a strong interest in the current executive remuneration debate, particularly in seeing that outcomes from this debate as well as the Productivity Commission review address community concerns, while at the same time ensuring that any changes to remuneration laws and regulations do not result in outcomes that are counterproductive to company performance, and by extension the interests of shareholders and other stakeholders.

Given the complexity of the Group's operations, Wesfarmers understands the challenge in developing remuneration structures that achieve a proper balance between firstly; attracting and retaining executive talent required to lead and manage its diverse businesses, secondly; incentivising executive performance to deliver value for shareholders, thirdly; are not excessive compared to established and accepted market practices, and fourthly; are understood and supported by shareholders and other interested parties. The Group's 2008 remuneration report received a 'no' vote from shareholders after a major overhaul of its remuneration policies following the acquisition of the Coles Group in November 2007. The report introduced, for the first time, a number of new remuneration structures aimed at recognising the bigger and more complex responsibilities associated with a number of existing and new senior executive roles and responsibilities, particularly those associated with the turnaround of the Coles division.

Wesfarmers has taken the 'no' vote seriously and is addressing a number of the issues that were subject to criticism in the 2008 report, particularly around the disclosure of hurdles for the Group Managing Director's Long-Term Incentive (LTI). Wesfarmers has also moved to freeze Fixed Annual Remuneration (FAR) for its most senior executives at 2008 levels while reducing the amount of Short-Term Incentives (or annual bonuses). These reductions in individual senior executive bonuses range from $130,000 to $500,000 and approximately $1.5 million for the Group Managing director. Collectively, the potential reduction in senior executive annual bonuses for 2008/2009 as a result of this decision totals $4.5 million.

2. General Comments

Executive remuneration has regularly been the subject of criticism. Pay levels and bonuses are viewed as being out of alignment with 'average' salary and wage levels. A significant deterioration in share price levels and investment portfolios, such as that which has occurred over the past 12 months, amplifies concerns about a lack of alignment between executive performance and pay, particularly when there are high-profile examples of executive remuneration – as has been the case in the United States and the United Kingdom – is seen as facilitating 'reward for failure.'

At the same time, it is important to note the following:

- Much of the current debate is focussed on quantum, type and timing of short-term and long-term performance incentives for senior executives. In some instances, the performance of individual executives, here and overseas, has not warranted the level of incentive payments that have been received, and have been rightly criticised and in some cases rescinded. These examples have focussed much of the debate. There is a danger, however, that exceptions to the rule are viewed as standard practice and regulations aimed at curtailing outliers impede good remuneration policy-making and practices in the vast majority of listed companies. It is Wesfarmers' view that structures to incentivise performance largely work well across corporate Australia. There has been a growing trend among publicly-listed companies in Australia to ensure an increasing proportion of senior executive pay is 'at risk' – in other words, based on performance. These structures have been successful in driving value for shareholders, as evidenced by the strong performance in terms of shareholder returns achieved by many listed companies prior to the global recession. Regulation that limits performance-linked remuneration risks unintended consequences, particularly in dislocating or limiting the very important link between performance and pay.

- The current executive pay debate in Australia focuses on 1,500 publicly-listed companies. Potential regulations and restrictions on executive salaries for this relatively small number of companies carry the risk that these companies lose out to private firms in recruiting the best executive talent. Given the investments of many Australians are dependent on the long-term, consistent performance of a number of these companies, distorting the market for executive talent for listed companies with regulations that apply only to the senior executive market for listed companies runs the risk of putting these companies at a disadvantage in attracting the best talent to drive company performance, and by extension shareholder returns.

- Australia's publicly-listed companies are subject to stringent legislation governing the structure and disclosure of executive pay. These laws have been supplemented by self-regulation and codes of conduct developed and adopted by business, as well as the recently introduced non-binding shareholder vote. The processes involved with developing appropriate remuneration and oversight have improved significantly in recent years. Most Boards have dedicated remuneration committees chaired by an independent, non-executive Director. The growing reputational focus on executive pay means there is not a Board in Australia that is not conscious of the significant reputational issues associated with managing this issue in a transparent and robust way while ensuring their structures continue attract and retain the best executive talent.

- Factors determining remuneration of senior executives are complex and do not lend themselves to one-size-fits-all regulation. There is a risk that any heavy-handed regulation may be insufficiently nuanced to take account of the varying particular requirements of listed companies in structuring executive remuneration. The diversification inherent in the Wesfarmers Group, which operates major businesses in different sectors of the economy, means there is a strong imperative to structure, remuneration and reward our senior executives according to the market and sector in which they operate. In short, companies must retain a sufficient level of flexibility in structuring remuneration to reflect the realities of their individual circumstances.

3. Remuneration and Performance

- The remuneration arrangements for Coles management, which is leading the turnaround of the Coles supermarket, liquor and convenience division, is an example of how Wesfarmers' philosophy and structuring of remuneration to attract and retain the best executive talent and incentivising executive performance to deliver value for shareholders is achieved. As noted above, a good deal of community wealth and prosperity is directly linked to performance of Australia's largest publicly-listed companies. Robust remuneration incentives play an important role in driving this performance. With 500,000 shareholders and 200,000 employees, Wesfarmers has a significant responsibility to ensure it achieves consistent business performance and shareholder returns, particularly in the current difficult economic environment, and has the appropriate remuneration structures to attract and incentivise the best management team to achieve this objective.

- A good deal of the company's effort is currently focussed on ensuring the success of the Coles turnaround. The success of this turnaround is not just important to Wesfarmers and its shareholders. Ensuring Coles returns to a strong competitive position will inject a more competitive and innovative dynamic into Australia's food retailing industry and benefit consumers in terms of improved range, value and choice. The task of driving and sustaining the turnaround, which is one of the largest turnarounds currently underway in global retailing should therefore not be under-estimated. It requires world-class executive talent. In identifying and selecting fresh Coles management from a global talent pool , Wesfarmers was very mindful of the need to attract and retain the best retailing talent, particularly given the past poor performance of the business and the significant task of rebuilding the business to return it to sustainable growth.

- As a result, the remuneration of Coles senior management has been structured to reflect the risks associated with taking on what is a very challenging role while at the same time providing incentives that reward potential outperformance achieved at sustainable levels. As Wesfarmers noted in its 2008 Remuneration Report, it is designed to link executive rewards with both the strategic long term goals and performance of the Coles division and the maximisation of Wesfarmers shareholders' wealth and that for (LTI) payments to vest, a very strong improvement in the financial performance of Coles in areas such as EBIT, revenue, return on capital and customer satisfaction, will be required. Falling short of these targets will result in no long term payment for Coles management at all.

4. Conclusion

In summary, Wesfarmers supports the Productivity Commission's review of executive remuneration and supports its objective to maximise alignment between executive remuneration and shareholder value. However, it cautions that outcomes or recommendations from the review need to recognise firstly, the complexity of the issues involved which do not lend themselves to a blanket response and secondly; the imperative of achieving a balance between flexibility, self-regulation and compliance as listed companies seek to structure competitive remuneration in a global market to attract the best executive talent to manage and grow shareholder value.

Yours sincerely

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