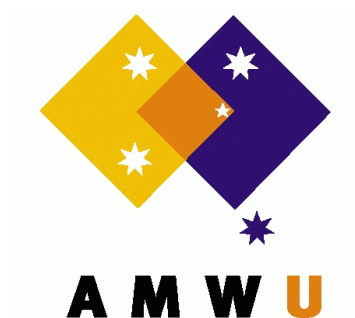


AUSTRALIAN MANUFACTURING WORKERS' UNION



**Submission to Productivity Commission Inquiry into
Executive Remuneration in Australia**

Further Comment on Discussion Draft

November 2009

1. The Australian Manufacturing Workers' Union (the AMWU) welcomes the opportunity to make a further submission in response to the Discussion Draft titled "*Executive Remuneration in Australia*", released by the Productivity Commission in September 2009.
2. The full name of the AMWU is the Automotive, Food, Metals, Engineering, Printing and Kindred Industries Union. The AMWU represents approximately 120,000 members working across major sectors of the Australian economy. AMWU members are throughout Australia's manufacturing industry, including metal manufacturing, printing and graphic arts, food and vehicle building, repair and service. They also comprise a significant proportion of workers in Australian mining, building and construction, aircraft and airline operations, laboratory, technical, supervisory and public sector employment. AMWU members are unskilled, semi skilled, tradespersons and professionals, and the vast majority of them are employed by private corporations.
3. The AMWU and its members have long rejected the *lassiez-faire* attitude to corporate regulation which has caused a disjunction between executive and non-executive remuneration to grow exponentially in recent years. We have recently submitted to the inquiry of the Senate Standing Committee on economics into the *Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009* that we welcomed any legislative attempt to impose some accountability on corporations for the retirement remuneration paid to directors and executives. The Productivity Commission inquiry into executive remuneration, of course, goes beyond simply remuneration on termination. However, that question of scope aside, we remain strongly of the view that the draft proposals of the Commission suffer from a similar failure to that Bill, a failure to comprehend that the social consequences of excessive executive remuneration extend beyond the interests of the shareholders of a particular corporation.
4. The AMWU does not disagree that methods to curtail disproportionate self-reward by directors and executives should include the empowerment of shareholders. However, when concerns about excessive executive remuneration are about the wider social and economic impact of such excess – not just its effect on a particular executive's corporation - an attempt to resolve such concerns solely through the device of shareholder empowerment is, with

respect, bound to fail. Such a mechanism would ostensibly place a weighty responsibility on shareholders to solve social problems through the exercise of their shareholder voting rights. At the same time, in obvious respects, the burden of solving society's inequities would either conflict or be simply irrelevant to the economic self-interest of considerations made by such shareholders.

5. Despite this, the thrust of the discussion draft recommendations is described at chapter 11:

“The Commission’s draft recommendations are directed at improving alignment between the interests of executives, shareholders and the boards that represent them, thereby achieving better remuneration (and other) outcomes over time.”¹

6. In the light of this premise, and given that the Commission has clearly had the benefit of numerous submissions prior to the publication of its Discussion Draft, an obvious question arises – is it the case that the Commission has found no merit in concerns about wider social implications of excessive remuneration, or has the Commission simply not addressed those concerns? A third possibility: that improved executive and board accountability to shareholders will actually solve wider social and economic concerns appears, in our submission, a courageous answer at best.
7. The AMWU is of the view that when the scale of the social inequities of executive remuneration are assessed, the social issues actually addressed by the Commission in its Discussion Draft are overwhelmingly limited. In Chapter 1 of the Draft, there is some discussion of social issues under the subheading *“What role for community expectations and societal norms?”* There are four examples given of shareholders’ and the wider community’s interests diverging. The Draft then proceeds to discuss the virtue of “creative destruction” as a force for “efficient markets” leading to material wellbeing. There is a suggestion that high pay is accepted by society generally when it is gained by “fair means”. There is an admission though that there has actually been very little input to the inquiry from “individual citizens”. The Draft then identifies that there is a potential danger is the wider community loss confidence in corporate governance. Four instances of community concerns

¹ *Discussion Draft*, at 322.

about excessive executive pay are identified at Box 1.6, following which are two comments: one from an individual who questions whether “the wider community’s perceptions” are coextensive with the “public interest generally”, and then the view of RiskMetrics that the quantum of executive remuneration is a question for shareholders *alone* ends the description of submissions on community expectations and social norms.

8. At the end of page 15 of the Discussion Draft, the Commission outlines:

“While there may be some contention about the role of the community as a stakeholder on matters of executive remuneration, addressing any dysfunction within current governance and regulatory arrangements could deliver a broader public benefit. This holds even if the main impact of such dysfunction is internalised to shareholders and managers.”

9. It may be inferred from this paragraph, then, that the Commission:

1. has not accepted that there is necessarily a role for the community in general in addressing the issue of executive remuneration; but
2. hypothesises that addressing governance and regulation could deliver a “broader public benefit”;
3. but is prepared to consider that the main impact of dysfunctional remuneration is on shareholders and managers.

What follows from these conclusions is that the rest of the Discussion Draft addresses questions of the accountability of executives to shareholders. There is little if any further discussion of the wider social implications of dysfunctional executive remuneration, or any recommendations to address such social considerations. The Commission earlier (as noted above) did refer to community concerns. Later, it describes various relationships between executive remuneration and average earnings, company earnings and company wealth and the like. However, there is no analysis of those community concerns – no attempt to ascertain whether the concerns are borne out. The Commission turns inwards into the relationship between executives and shareholders and addresses that relationship. If improving the equity and accountability in that relationship has some beneficial wider social effects, then that may be a happy coincidence. But beyond such potential side effects, in

respect of social and economic concerns, it is the view of the AMWU that the Commission has simply ducked the question.

10. The Commission did identify that there was only a limited number of submissions received from individuals – perhaps it is unfair to criticise too strongly a Commission that may have been reluctant to draw conclusions about social concerns in the absence of extensive evidence. However, the Commission did receive several submissions from unions and the ACTU, it did receive submission such as that by Professor David Peetz from Griffith University, which identified significant wider economic and social concern which should be addressed. In the least, the Commission should honestly admit that an examination of the social impact of executive remuneration levels is neither attempted nor achieved in the Discussion Draft. Whether this was because of a relative dearth of relevant submissions, or because it was simply too hard to achieve with the time and resources available,² the Commission should at a minimum recommend to Government that a further examination of the broader social and economic impact of executive remuneration levels be conducted – if not by the Commission then by someone else. This Discussion Draft has not done this work.
11. This work needs to be done. In the least, the following issues need to be properly considered:
 1. general principles of social and economic equity, harmony and cohesion;
 2. the relationship between employee remuneration and executive remuneration – both have the potential to generate productivity for a corporation, but it is only executive remuneration which has skyrocketed since the early 1990s, as compared with average ordinary earnings, or with real productivity growth.³ The Draft discounts the efforts made by Dr Peetz to produce such data,⁴ but does not, or cannot, produce any data which does not suffer from the same alleged weaknesses.

² see, for example, the discussion about creating reliable data about remuneration practices at non ASX-300 companies, *Discussion Draft* at 40-41.

³ see, for example, Baker, Dean, *The Productivity to Paycheck Gap: What the Data Show*, Center for Economic and Policy Research, Washington April 2007.

⁴ Box 3.6 “Splicing the data will distort underlying trends”, *Discussion Draft* at 50.

3. the impact that unbalanced corporate rewards have had on recent devastating global economic events, by promoting excessive risk taking and corporate greed, producing unsustainable corporate structures. When companies such as Macquarie Group had a 225 per cent turnover of its share register in the past 12 months and Origin Energy a 92 per cent turnover,⁵ it is again plain that empowering shareholders alone will not lead to executives turning away from chasing short-term reward, and risking the long-term wealth, sustainability and well-being of the corporation, society and economy to do that – the shareholders themselves are often only shareholders in the short term! As is noted:

*All of this serves to reinforce the concept of shareholders as company owners only in a collective (average) sense and over time.*⁶

4. power disjunctions which see shareholders feel the need to please the executive market by increasing wages – a corollary of a limited pool of executives being thought to be available to do the job;
 5. institutional shareholders whose decision-makers have an interest not in limiting executive and management remuneration but pushing it up further – because those decision makers are either in the same job market as other corporate executives, or at least have aspirations of entering that market;
 6. barriers to entry into the pool of available senior executives – as has been noted by the ACTU, amongst others, the overwhelming gender bias of the members of boards and at senior executive level means that when the wages of such men increase exponentially, as they have done, this is a further dagger in the heart of aspirations for pay equity in this country. Further ethnic homogeneity in the membership of such boards and at senior executive level has further implications for broader social harmony and equity, beyond gender issues.
12. Broader social and economic implications of dysfunctional executive remuneration need to be considered, if not by this Commission, then by some

⁵ *Discussion Draft* at 25.

⁶ *id.*

other research and inquiry by Government. This recommendation should be made to Government by this Commission.

13. To assist, we repeat the proposals we outlined in our earlier submission to the Senate Economics Standing Committee, and to this Inquiry, or methods that can be adopted to address broader social and economic concerns:

1. Making executive pay restraint a condition of doing business with the government or receiving government subsidies. Conditions on entities who engage in the sphere government procurement are not uncommon. Indeed, there has been a very recent reissue of the “*Australian Government Implementation Guidelines for the National Code of Practice for the Construction Industry*”, which took effect from 1 August 2009. Such Guidelines in this and previous editions, have not been reluctant to regulate instruments of remuneration and negotiations for that remuneration, to a greater extent than would otherwise apply under legislation. Regulation of executive remuneration could similarly reflect Government policy, and restrain behaviour contrary to that policy;
2. Using the taxation system to curb excessive executive pay. This could apply generally, or in conjunction with the government procurement regulation noted above, as the 90% taxation of bonuses applied in the United States to banking firms who were recipients of US Federal Government bailout monies.⁷ Similarly, tax deductibility could be removed where remuneration is excessive, as is already the case where tax deductibility is constrained when relatives are involved.
3. Setting a ratio. Whether used in accompaniment with punitive taxation, as part of government procurement conditions, or as a simple cap, the AMWU’s suggested method of determining what amount is “excessive” pay, is to use a ratio of 25 times a company’s lowest paid full-time adult wage. The advantage of this is to provide revenue where executive rewards are excessive, but allow strict pay capping to be avoidable through a simple method of raising the level of the lowest wages paid by the relevant company.

⁷ C Hulse and DM Herszenhorn, “House Approves 90% Tax on Bonuses After Bailouts”, *The New York Times*, 19 March 2009, at www.nytimes.com/2009/03/20/business/20bailout.html

14. There are social implications of executive remuneration becoming dysfunctional, and such dysfunction becoming entrenched in the way corporations relate to their employees and to the society in which they operate. There need to be mechanisms to address such dysfunction which are considered not merely because they assist the “efficiency” of the particular corporation, but because they address the problem that excessive corporate remuneration is for general society.
15. In respect of the recommendations that are made by the Commission, which are in the context of shareholder empowerment, the AMWU broadly supports the array of mechanisms to ensure executives and boards are more accountable. In respect of several recommendations, the device of “comply or explain” is adopted. We agree that such a device is only effective with a coercive mechanism to address non-compliance or non-explanation, such as recommendation 15, the board election trigger on two 25% disapprovals of a remuneration report. We would maintain that 25% is an appropriate threshold for both stages of the “two-strikes” process.
16. Directors and their representative bodies have been vociferous in their objections to this idea. The AMWU, however, would concur with the view of less self-interested others that directors are “over-egging the pudding”. This is not a “two strikes and you’re out” rule, it is a “two-strikes and you go to the vote” rule. The sky will not fall in because the board has to go to an election – and an election will not be called unless the board fails to provide an adequate explanation after the first instance of disapproval of a remuneration report. A sanction must be meaningful if boards are to engage meaningfully with their obligations in respect of remuneration reports, and those obligations recommended by the Commission in the Discussion Draft in particular.
17. Raising the threshold for the second “no vote” beyond 25% introduces the ability of a board to manipulate proxies or to “capture” the votes of certain large institutional shareholders for example, to overwhelm what might be significant and meaningful dissent. The measures to restrict the use of proxies at recommendations 6 and 7 of the Discussion Draft go some way to alleviating these concerns, but not entirely. As we have noted, it is also in the self-interest of senior decision makers of certain large institutional shareholders to maintain high levels of executive remuneration generally. Creating and maintaining

accountability to those who are not so self-interested means that a lower threshold for a “no vote” must be maintained. Without a second 25% vote triggering a vote for the board, the remaining recommendations made in this Discussion Draft will ring hollow. Undermining the effectiveness of the sanctions leaves boards with the capacity to ignore the increased accountability to shareholders provided by those recommendations .

18. We note with approval the requirements to reveal the existence of remuneration consultants. We remain concerned, however, that the independence of the remuneration consultants interests from that of executives is not assured by recommendations 10 and 11. We note the canvassing of international models of regulation of remuneration consultants at Box 6.10 of the Discussion Draft,⁸ and the canvassing of suggestions for improving disclosure at Box 6.11.⁹ The independence of any remuneration consultants from the interests of boards and executives must be paramount – the mere disclosure of the use of such consultants is not enough.
19. We are attracted to the suggestion at Box 6.11 that remuneration consultants should be characterised as akin to auditors in terms of the independence of their engagement and disclosure requirements. Such independence should reduce the effect of remuneration consultants seeking to please management and executives by constantly recommending greater largesse in executive remuneration.¹⁰ In addition, when such independence is established, requiring board members to disclose when they have not adopted the recommendations of the consultants they have engaged will be more effective in constraining board members from self-rewarding remuneration beyond that which has been independently assessed.
19. Independence of setting remuneration from those receiving remuneration is integral to credibility being restored to levels of executive remuneration in Australia. Without independence, the urge to excessively self-reward is understandably overwhelming. We would remind the Commission of the discussion by Professor Peetz, in his submission, of the 1992 survey conducted by Noble Lowndes Cullen Egan Dell:

⁸ *Discussion Draft* at 161.

⁹ *Discussion Draft* at 163.

¹⁰ see *Discussion Draft* at 159.

“Nearly two thirds of companies had a policy of 'positioning' their executives' pay above the median and 92 per cent claimed to set them around or above the median. Only 2 per cent aimed to position their pay below the median. Of course, it is mathematically impossible for all companies to achieve the position they are seeking. By definition, 50 per cent of firms will be paying below the median, not 2 per cent. As virtually all firms attempt to position themselves at or above the median, senior executive remuneration will increase even in an environment of zero inflation and zero productivity gains. A similar pattern was seen in the USA at that time (Crystal 1991).”¹¹

There is little to suggest that this “*Lake Wobegon effect*”¹² has diminished over time, although another recommendation by the Commission could be for a similar survey to be conducted as was commissioned by the then Department of Industrial Relations. If remuneration consultants are not independent, if they are too willing to please those who engaged them, if they have become too intertwined with the operations of a corporation generally (ie they are consultants on more matters than just remuneration), then the risk of their recommending to a corporation’s board that he board and executives are repeatedly “above average” is simply too great a risk to take. Just as executives and board members will excessively self-reward, a compliant remuneration consultant will provide a remuneration report to facilitate such reward.

20. As a whole, the recommendations of this Discussion Draft are useful first steps in empowering shareholders to be able to have control over the remuneration of boards and executives of the corporations in which they share ownership. The AMWU maintains concerns, however, that even these recommendations are insufficient to resist manipulation by self interested boards and executives. Moreover, however, there is a general need to question, whether this method – empowering shareholders - is sufficient to address the mischief of executive excess. When there remain wider social concerns about excessive corporate remuneration, it is inappropriate to leave control of this excess to shareholders alone. It is most unlikely that broader social interests will coincide with the individual self-interest of shareholders to an extent that those social interests

¹¹ Peetz, D, “*Submission to Productivity Commission Inquiry into Regulation of Director and Executive Remuneration in Australia*”, May 2009 at 8.

¹² From the tales of Garrison Keilor of the fictional town of Lake Wobegon where “*all the women are strong, all the men are good looking and all the children are above average*”, <http://prairiehome.publicradio.org/about/podcast/>

will be addressed. Indeed, whilst a company is rewarding its shareholders with higher profits, shareholders are unlikely to be overly concerned about corporate social responsibility, or about executive salaries, wages or termination payments which are disproportionate to those received by other employees of a corporation or other workers in the economy at large – despite the social consequences of such excess which exist whether or not a particular company is profitable. If such social equity is a concern, then some further regulation or constraint must be placed on the ability of the directors or executives to influence their own remuneration

21. Whether the Commission has been unable or unwilling to address the social and economic impact of excessive executive remuneration, it has not done so. No recommendation extends outside the relationship between shareholders and the boards and management of the individual corporation. Concern shown by Australians about corporate excess goes beyond these immediate particular relationships. That concern must be addressed. This Commission should recommend that Government investigate the wider impact of executive remuneration on Australian society, not simply the effect of executive remuneration on the operation of a corporation. Until this is done, the interests of non-executive employees, and on Australians generally who do not have an interests in the wealth generation of those corporations, are simply externalities to the relationships between the owners and managers of corporation. This work need to be done.