

Executive Remuneration in Australia Productivity Commission Discussion Draft September 2009

Discussion Items

Submitted by Malcolm Fraser 25 November 2009

Appreciation

I thank the Commissioners for the opportunity to make this submission & also Mr Nick Hague for his administrative assistance.

I am proud & grateful to live in a country where government seeks the views of all citizens & makes it readily possible for ordinary citizens to make a submission.

I thank Mr Chris Bowen and the Government he represents for their wisdom in recognizing the need for an inquiry on this subject.

Introduction

I served as a professional engineer for 39 years with a major Australian company, leaving in March 2007.

In that time I've had the opportunity to mix with people at all levels of my company. As well, I have got to meet people in diverse areas of the community. I've maintained an interest in the wider world through many media items including thousands on varied topics via ABC Radio National.

My comments below are based on my personal experience and on impressions formed from the above sources.

I have selected a few points from the Productivity Commission Draft in which I am particularly interested, & make my input accordingly.

My Input

Draft Chapter 1 Page 12:

Large discrepancies between executive pay and average earnings might demotivate a company's employees, adversely affecting productivity and making wage restraint more difficult to achieve during economic downturns.

My Response:

I feel executives can exercise self restraint regarding their own levels of remuneration.

In his 3rd Boyer Lecture (22 November 2009), Gen Peter Cosgrove discusses leadership in an Australian context. He makes the point... "no system can ever describe the limits of obligation which must be self imposed on the behaviour of men and women of integrity"

Looking at the context I understand Gen Cosgrove to be saying that leaders, as people of integrity, should not simply comply with limits laid down by regulation. Rather they should set their own sometimes more stringent limits which I feel could include limiting their own remuneration for the sake of their organization, the shareholders and for the benefit of society as a whole.

It could be considered an important aspect of leadership and a source of pride & satisfaction to executives to set a leadership example in resisting demotivatingly large (to those led) pay levels.

Psychiatrist & journalist Dr Tanveer Ahmed said in his article for the Sydney Morning Herald 5 October 2004:

“A senior manager of a multinational company once told me that a key function of astronomical salaries for chief executives is that they cause great envy among fellow workers. This creates a huge incentive for them to aim up the corporate chain, which should translate into higher productivity gains.”

Dr Ahmed goes on to say that this type of approach “leaves staff demoralised and angry, which is unlikely to translate into productivity gains. In fact, the opposite may be true...”

“... patients I see who speak of their sense of hopelessness after being laid off or denied a promotion suggest the dubious justifications for executive salaries act to stamp out any incentives.”

According to Wikipedia, Robert Townsend (1920-1998) was an American business executive and author who is noted for transforming Avis into a rental car giant.

In his book “Up the Organization” 1971, Coronet Books, Townsend writes:

“Your key resource people may be engineers, designers, artists, city managers, accountants, mathematicians, chemist, editors, district sales managers, or some of each. But average them all out and they’re making one fifth of what the chief executive gets.

“Fair? Not in my book. And it cuts two ways.

“The salary gap makes the key people frustrated and restless. As the chief’s salary edges up out of the earth’s atmosphere, one of two reactions sets in. Subconsciously or consciously impressed by how much he is paid he either becomes:

1. Arrogant (since I’m so good, I’d better see that all important decisions get the laying on of hands in my office before they made). The company grinds to a halt and the zeal drains out.

Or

2. Timid (I’m paid this much to make sure nothing goes wrong: so I’d better have a look at everything before it happens). The company grinds to a halt and the zeal drains out.”

Townsend recounts how he refused to countenance a pay increase expected in the light of his dramatic turning around of the fortunes of Avis. He said to Gen Sarnoff one of Avis’s directors at the time:

“... since I'm now overpaid in relation to the service agents, rental agents, city managers and regional vice presidents who run this company, you will be defeating my crusade for just compensation system. And since 15% of the pre-tax profits goes into a profit-sharing fund for the top 500 people that raise will come out of their pockets, and if I were them I wouldn't stand for it”

It is interesting to note that at the time Townsend ran Avis in the early 1960s a CEO was paid around 5 times the pay of an average worker in the company. This indicates how much CEO pay has blown out in the last 40 years or so.

A friend was telling me her brother is the CEO of an overseas statutory tribunal. He applied for the job as a matter of principle though as a lawyer his abilities could have commanded much higher remuneration in the private sector.

Though I can see benefits from executives reducing the gap between their own remuneration and that of ordinary staff, I feel it is all too easy to have ideas of how others can be generous with their money.

There may be a surprisingly large number of people in Australia – not just executives - who are in a position to reduce their remuneration for the common good.

My own experience is as follows in this regard:

In 1998 I felt I was being paid - in global terms - an amount amongst the top 10% of all the world's working population. So I wrote to my company saying that for the sake of reducing the gap between the rich and the poor in the world and for the sake of my company's sustainability I wanted to have my remuneration frozen. The company wrote back agreeing to my proposal and so my remuneration was frozen from 1 July 1998 and 30 June 2006.

I felt a great sense of satisfaction from this arrangement. We already had our house paid off and with belt tightening felt we were actually making a contribution to improving the state of my company & of the wider world – even miniscule though that contribution was in comparison with the company's costs or the global economy.

Sadly, as I tried to use my experience to influence executives to follow suit it transpired that since I was an award employee this arrangement was not legal.- and that a mistake had been made in agreeing to my request in the first place. Arrangements were made for me to be reimbursed. But all was not lost, because my wife and I decided to put the money after tax into what we call our “socially useful purposes fund”

Draft Chapter 1 Page 14

Community ‘norms’...reflect what the community at large thinks is ‘right’ or ‘fair’ For example while there is often a focus on the quantum of pay received by some executives, similar concerns are not evident for other, often more highly paid individuals such as sports stars and entertainers. This suggests that the concerns derive more from the perception that executives can influence their remuneration...That is high pay is accepted where people consider it is gained by fair means. It is apparent that many in the community who have raised concerns about executive pay do not think the status quo is delivering fair outcomes...and this underscored the importance of well functioning pay setting arrangements.

My Response:

It is not fair to them or society that sports stars and entertainers get so much. They are in a privileged position resulting from the huge amount of money that can be made as a result of large audiences whether in a stadium, on TV or through the box office.

Yes, I do have a perception that that the status quo is not delivering fair outcomes. But it goes further than that.

Sir Gerard Brennan, former Chief Justice of Australia, said (Sydney Morning Herald 15 February 1999) that the pre-eminent Australian value is egalitarianism and that great disparity of wealth erodes & ultimately undermines a society.

I once came across a person who'd had been taken off shift roster along with his colleagues back in about 2005 and lost around \$300 a fortnight. The change was because of work pattern changes including outsourcing. He said to me that if he was wanted to come in on weekends the company could think again. Some months later he told me that he had a call from overseas where work was being outsourced and asked to assist with a technical problem. He said "the answer's in the manual" and hung up.

Draft Chapter 1 Page 14:

...to date there has been very little input to this enquiry from individual citizens.

My Response:

Given that there has been outrage regarding the level of executive pay, it is significant that there has been little individual citizen input

Is this normal regardless of the degree of public interest for productivity commission inquiries?

Has the media concentrated on the obvious outliers rather than educating the public on how the general trend in executive remuneration is affecting the public good?

Is it correct only to see such high profile negative situations like Pacific Brands as outrageous (See Draft Ch 1 Box 1.1) while accepting as appropriate the high CEO remunerations of companies not seen as in especially negative situations by the media (see Box 1 below).

Box 1

Year 2008 CEO total remunerations. Taken from the September 2009 Risk Metrics study commissioned by the Australian Council of Super Investors Inc

1	Allan Moss	(MQG)	\$24,755,444
2	Wal King	(LEI)	\$16,494,758
3	Frank Lowy	(WDC)	\$16,204,760
4	Sol Trujillo	(TLS)	\$13,394,523
5	Mike Smith	(ANZ)	\$12,963,480
6	Geoff Dixon	(QAN)	\$12,171,606
7	Ralph Norris	(CBA)	\$ 8,662,920
8	John Stewart	(NAB)	\$ 8,513,608
9	Mike Tilley	(CGF)	\$ 8,108,792
10	Terry Davis	(CCL)	\$ 7,808,919

Average \$12,907,881

Draft Chapter 1 Page 16:

The draft lists parties from whom submissions have been received and with whom discussions have been held.

My Response:

Missing from the list is specific reference to health workers including psychiatrists & psychologists.

These people may be able to give opinions on matters such as:

- For executives, how does very high pay effect their well being when they consider that the pay they get is excessive compared to most members of the community?
- Are executives experiencing health or relationship problems due to their having to work very long hours due to the workload put upon them and considered by the community justified by their high pay?
- For ordinary workers employed in a company with highly paid executives how well do they cooperate with the objectives of the company given that their own positions are far less well remunerated and their remuneration may even be reduced or their position entirely eliminated due to cost containment requirements?
- How do workers feel given that the costs of their housing may well be going up at a rate considerably greater than their pay is increasing while executives can easily afford very adequate housing?

Draft Chapter 2 Page 27:

The draft appears to contend that a CEO's function and influence on a company's performance and shareholder returns could require a remuneration far more than is applicable to public office holders including the position of prime minister or chief justice.

My Response:

A very important point.

Yes, the CEO certainly has a great influence on company performance & shareholder returns but this is the nature of his or her profession. Yet a Prime Minister or a person in high public office is also responsible in a major way for the wealth of a whole country. A professional, self disciplined approach would be for the CEO to recognise the privilege of his or her position & be prepared to set limits for themselves on their remuneration. An amount around that paid to a prime minister or a chief justice might be entirely appropriate, considering the similar degree of professionalism of these different roles.

In an article appearing in the Academy of management executive, 2002, volume 16, number three, Thomas A Kochan, Professor of Management at Massachusetts Institute of Technology addresses the crisis in confidence in corporations. He says, commenting on US trends:

“Boards likewise turned to CEOs who could best manage relations with the financial community and project an image of confidence. The era of the charismatic CEO was born. Wall Street, the business media, and press, and business School case writers alike reinforced these trends by committing a classic attribution error – they attributed the successes of organizations to the leadership and vision of the CEO and his (mostly his) top executive team. This error served to increase the perceived value of CEOs. The self-reinforcing escalation of executive compensation that ensued eventually lead to a 600 to one ratio in CEO compensation to that of the average worker.”

Draft Chapter 3 Page 73

The draft presents figures 3.15 and 3.16 comparing CEO remuneration for similar roles in various regions for 2008. Australia's is considerably below that of the US.

My Response:

Is our life style & the strength of our social fabric in Australia considered attractive enough to hold CEOs here in spite of high pay available in the US CEO market?

That said, the CEO market in the US undoubtedly influences the Australian market – as is stated in the Draft. Should not the Australian government be urged to get a degree of international agreement on the limiting of CEO remuneration?

Draft Chapter 9 Page 251

As a key point the draft states that:

voting by shareholders has increased in recent years, particularly since the introduction of the non-binding vote on the remuneration report. This has increased board accountability and encouraged greater engagement between boards and shareholders on remuneration matters.

My Response:

Section 249 P of the Corporations Act provides for 100 or more shareholders to request a company give all its members a statement relating to a resolution that is proposed to be moved at a general meeting or any other matter that may be properly considered at a general meeting. This provides a vehicle whereby shareholders may engage with a company board and other shareholders on remuneration matters at greater depth than is possible than by a vote alone.

A shareholder must be familiar with the Corporations Act to realise that the Section 249P provision is available.

Since this is such a valuable aspect of shareholder communication with the company including the Board, I would suggest that the existence of this provision be prominently highlighted in Company Annual reports.

Annual Reports should also be required to state the deadline for the following year's Section 249P statements and to summarise the conditions have to be met by Section 249P petitioners.

**End of Submission
M. Fraser 25 November 2009.**