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SETTING THE DOUBLE STANDARD: CHIEF EXECUTIVE PAY THE BCA WAY

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The Business Council of Australia (BCA) aggressively champions the cause of greater labour market 'flexibility' and labour cost 'competitiveness', but its pronouncements on corporate executives' own pay have been uncharacteristically coy. As this paper seeks to demonstrate, while BCA members have consistently decried Australia's 'uncompetitive' wage cost structure, they have simultaneously been beneficiaries of an unprecedented explosion in the income and equity wealth of Chief Executive Officers (CEOs). Whatever their public rhetoric about improved workplace productivity leading inevitably to higher total wage and salary earnings, the intent of BCA pronouncements in relation to wages, standard hours and penalty rates is quite the opposite, namely downward 'flexibility' in unit labour costs and pay rates for ordinary wage and salary earners. In relation to pay restraint, then, the stance of the executives and boards of BCA member firms has been one of 'doing as we say' rather than 'doing as we do'.

The BCA was formed in 1983 'to provide a forum for Australian business leadership to contribute directly to public policy debates in order to build a better and more prosperous Australian society'. It is an association of CEOs from one hundred of the largest Australian corporations, boasting 'a combined national workforce of almost one million people' and accounting for one-fifth of the nation's economic activity (BCA, 2005a, 2005b). At present, just over half of the firms represented by BCA CEOs are Australian listed companies, with the remainder consisting mainly of multinational subsidiaries, along with several large locally-domiciled private companies and one statutory authority (Australia Post). The CEOs who constitute the current BCA

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board have day-to-day control of some of the most significant firms in the national economy – including Wesfarmers, IBM Australia, Qantas, Zinifex,ABN AMRO,Rio Tinto, and Boral - as well as the entity charged with the voluntary regulation of Australian listed companies, the Australian Stock Exchange (ASX) (BCA, 2005a). As such, the BCA comprises a powerful and exclusive elite of salaried executives – the 'chief executives' union', as one prominent economics writer has wryly observed (Gittins, 2005).

The BCA is also now widely acknowledged as the nation's premier big business lobby group. Since the election of the Liberal-National Coalition government in 1996, the BCA has enjoyed unparalleled access to the corridors of political power, and past and serving members of the BCA board have been amongst the most aggressive and influential critics of 'over-regulation' in the Australian economy and labour market. The BCA has been especially outspoken in its attacks on the existing systems of industrial relations and wage determination which, it is argued, have been a major cause of low workplace productivity (BCA 2005c, 2005d). More than this, the BCA has had a major influence on the Howard government's 'reform' agenda, particularly the successive rounds of legislative change to the industrial relations system, the latest and by far the most radical instalment of which - the '*WorkChoices*' Bill – has just completed its rushed passage through the Commonwealth Parliament. So a study of how well the chief executives of the companies in the BCA are being rewarded is timely.

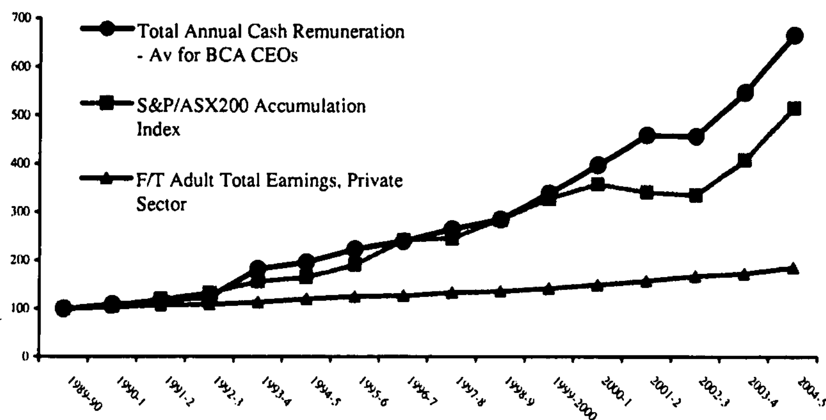
Drawing on information available as a matter of statutory requirement in listed company annual reports, this paper provides a descriptive analysis of absolute and comparative trends since 1990 in the level and composition of CEO remuneration in the 51 ASX-listed companies whose CEOs are current BCA members. It forms part of a larger study of the sensitivity of CEO remuneration to company market and financial performance in S&P/ASX500 companies over the past 16 years. The next two sections describe the trends in CEO cash remuneration and equity-based remuneration, followed by an examination of the data on termination payments to departing CEOs. These findings are then set against recent BCA policy pronouncements regarding executive remuneration, and a final section summarises the study's central findings

and conclusions. An appendix describes the methodology used to select the study sample and the associated database.

Cash Remuneration

Present and past CEOs of current BCA member listed companies have enjoyed an exponential and nearly unbroken rise in pre-tax recurrent pay over the past 16 years.

Figure 1: Growth Indices for Average Total Cash Remuneration of BCA CEOs, Total Shareholder Return and Private Sector Average Ordinary Time Total Adult Earnings, 1990-2005 (1990 = 100)



Sources: Company Annual Reports; *Connect4* Database; S&P/ASX200 Accumulation Index, Reserve Bank of Australia; Australian Bureau of Statistics: Average Weekly Earnings, Australia (6302.0).

As Table 1 shows, between 1990 and 2005, the average annual total regular cash remuneration of CEOs in the BCA sample rose by 564 percent, from $514,000 to $3.4 million, or to a notional weekly average of $65,700.

Table 1: BCA CEO Cash Remuneration, Shareholder Return and Adult Earnings: Trend Comparisons, 1990-2005

Year	Number of BCA firms in annual sample	Average BCA CEO total cash remuneration ($AU million, unadjusted)	Full time adult total earnings, private sector, (May Quarter, seasonally adjusted & annualised) ($AU, unadjusted)	Ratio of CEO remuneration to average earnings
1989-90	30	514,433	29,198	18:1
1990-91	30	560,667	30,040	19:1
1991-92	35	597,857	31,184	19:1
1992-93	33	631,364	31,798	20:1
1993-94	31	934,355	33,067	28:1
1994-95	34	1,008,735	34,928	29:1
1995-96	34	1,148,421	36,494	31:1
1996-97	38	1,234,625	37,170	33:1
1997-98	39	1,363,144	38,745	35:1
1998-99	47	1,464,324	39,816	37:1
1999-00	45	1,744,988	41,371	42:1
2000-01	42	2,041,921	43,414	47:1
2001-02	46	2,363,594	45,087	52:1
2002-03	45	2,343,796	48,896	48:1
2003-04	46	2,813,377	50,393	56:1
2004-05	49	3,420,507	54,080	63:1
Gross increase (non-inflation-adjusted) 1990-2005		564%	85%	
Average annual growth (non-inflation-adjusted) 1990-2005		13.5%	4.2%	

Sources: Company Annual Reports; *Connect4* Database; S&P/ASX200 Accumulation Index, Reserve Bank of Australia; Australian Bureau of Statistics: Average Weekly Earnings, Australia (6302.0).

With the exception of a small one-year decline in 2002-3, the growth has been continuous, equating to an annual compound growth rate (inflation-unadjusted) of 13.5 percent, with the steepest annual increase occurring in 1994 (48 per cent). For the reporting year 2004-5, the average increase was 21.5 percent, although it should be noted that the 2005 average is inflated by two extraordinarily high levels of cash payout to two BCA executives: $18.1 million to Macquarie Bank CEO Allan Moss, and $12.7 million to Leighton Holdings' Wal King, amounting to annual increases of 108 percent and 115 per cent, respectively.

Comparison of these CEO incomes with ordinary wage and salary earnings presents a contrast of extreme proportions. As Table 1 indicates, taking private sector full time adult total earnings as the comparator, we find that over the period 1990-2005 CEO cash earnings grew at more than three times the rate of increase in average employee earnings, with the latter increasing overall by just 85 percent in inflation-unadjusted terms - from an annual total of $29,198 to $54,080 – while the average annual compound growth rate was just 4.2 percent. Put another way, between 1990 and 2005, the pre-tax cash earnings gap between BCA CEOs and full-time wage and salary earners generally (including other managerial employees) widened from a ratio of 18:1 to 63:1. The trend lines in Figure 1 highlight clearly the widening earnings gap between BCA CEOs and other employees.

In overall terms CEOs have also enjoyed income growth far in excess of company shareholders. Figure 1 compares the trend in BCA CEO pay with the returns to shareholders in the top 200 ASX-listed companies, as measured by the S&P/ASX200 accumulation index. This index measures growth in share prices and dividends across 200 large- and mid-capitalisation companies, including all of the ASX-listed BCA firms, and currently represents 78 per cent of the market capitalisation of the Australian share market (Standard and Poors, 2005). As such, the index provides a reliable approximation for the average long-term trends in the returns received by ordinary shareholders in these firms. As the trend lines in Figure 2 indicate, while the growth in average CEO cash remuneration correlated closely with shareholder returns in the period to 1998, since then growth in CEO pay has far outstripped that of shareholder returns. While it may be the case that CEO pay has shown

some sensitivity to prior movements in shareholder returns (*cf.* Merhebi, Swan and Zhou, 2003), since 1999 the changes in CEO pay have been disproportionately large on the upside. Since 1999, average BCA CEO pay has doubled, whereas shareholder returns as measured by the S&P/ASX200 accumulation index have increase by just under 60 percent. Figure 1 also illustrates the long term disparity between both CEO and shareholder earnings and the earnings of ordinary employees.

Table 2: Components of Cash Remuneration of BCA CEOs, 2000-2005 (Annual Averages in $AU million, Unadjusted)

Year[1]	Number of BCA firms in annual sample	Base salary	Cash bonuses/ incentives[2]	Total cash remuneration[3]	Bonuses as a proportion of total
1999-00	45	878,192	733,335	1,744,988	42%
2000-01	42	1,074,956	1,041,293	2,041,921	51%
2001-02	46	1,107,661	1,182,325	2,363,594	50%
2002-03	45	1,111,009	1,130,961	2,343,796	48%
2003-04	46	1,218,859	1,324,742	2,813,377	47%
2004-05	49	1,363,769	2,056,738	3,420,507	60%

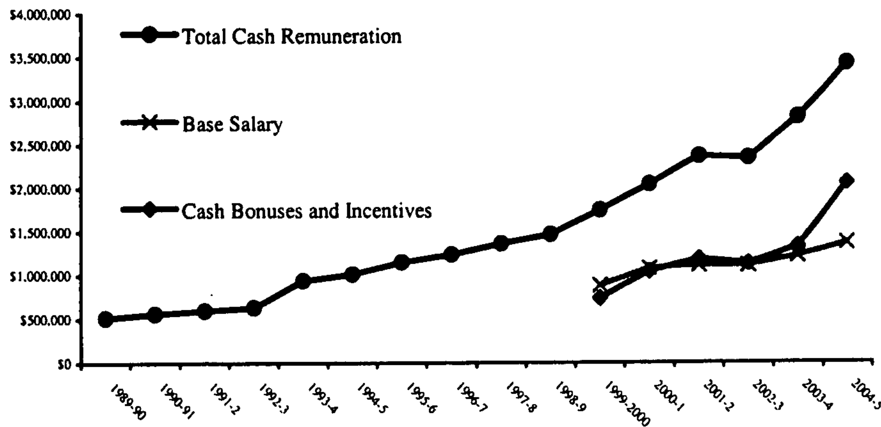
Notes: 1.Components of cash remuneration were not reported prior to 1999.
2.Includes cash payments/bonuses under short-term incentive plans.
3.Includes base salary, cash bonuses/incentives, company superannuation contributions, cash allowances, cash value of non-cash benefits, directors and other fees, and other accrued benefits paid, but excludes designated termination payments.

Sources: Company Annual Reports; *Connect4* Database.

The more detailed reporting requirements prevailing since 1999 allow us to identify the main elements of the growth in total cash remuneration in recent years, and the relevant data are presented in Table 2 and Figure 2. The results show that between 1999 and 2004, base salary contributed around half of total cash remuneration of BCA CEOs, with nominally performance-contingent cash bonuses and incentives contributing the remainder. However, in 2004-5 the latter overtook base pay for the first time, rising by 55 percent to account for 60 percent of total cash payments, or $2.06 million of the average cash total of $3.42 million. While this sharp increase is attributable in part to bonus payments of

unprecedented proportions to several serving BCA CEOs (most notably $17.4 million to Allan Moss of Macquarie Bank and $7.9 million to Wal King of Leighton Holdings), 18 other BCA CEOs also received annual bonus/inventive payments in excess of $1.4 million.[1] As such, the switch to cash bonuses is both pronounced and broad based.

Figure 2: Average Reported Total Cash Remuneration of CEOs of ASX-listed BCA Member Companies, 1989/90 to 2004-5 ($AU million)



Sources: Company Annual Reports, *Connect4* Database

At first glance, payments of this type and magnitude may appear to be justifiable in that they are linked in some way to company performance, for example by being contingent on the achievement of pre-set performance targets or hurdles. However, neither the labelling of a remuneration component as being performance-based nor the existence of pre-conditions in the form of performance targets (or 'hurdles') mean

1 The BCA-affiliated companies involved were BHP-Billiton, Brambles, Bluescope Steel, the Commonwealth Bank, Coles Myer, Lend Lease, Mayne Group, Suncorp-Metway Bank, Qantas, St George Bank, Telstra, Westpac, WorleyParsons, Woolworths, ANZ Bank, Rio Tinto, National Australia Bank, and David Jones.

that payments of this type and magnitude are necessarily justified in terms of organisational efficiency, let alone distributive fairness. As we have seen, while the results indicate a degree of long-term correlation between shareholder returns and average CEO pay, since the late 1990s the rise in average BCA CEO pay has substantially outstripped overall growth in shareholder returns in BCA-affiliated and other large public companies. In short, in recent years, pay practices that are supposedly contingent on performance have, on average, generated earnings disproportionate to underlying improvements in shareholder value.

Equity-based Remuneration

So far we have considered only the cash component of total executive remuneration packages. Until the early 1990s, cash comprised the major element of executive remuneration in most Australian organisations. However, during the 1990s share market boom, and in emulation of the trend in the United States (Jensen & Murphy, 2004), the composition of senior executive remuneration in large Australian companies shifted away from cash remuneration and towards company equity. The remuneration consulting firm, the HayGroup, estimates that the contribution of 'long-term incentives' (i.e. equity-based plans) to large cap CEO pay in Australia has risen progressively from 13 percent in 1990 to 39 percent in 2004. The HayGroup data also suggests that over the same period the contribution of 'short term incentives (i.e. cash bonuses) grew from 5 percent to 21 percent, while that of 'fixed pay' has declined from 82 percent to just 40 percent (Neuhold, 2005).

Table 3 and Figure 3 detail the long-term trends in equity holdings by the CEOs in the BCA CEO sample. The results reveal a fluctuating level of average shareholdings prior to 1998, followed by a sharp upward trend between 1999 and 2003, to the point where in the latter year the average CEO held 2.8 million shares in the employing company, or almost three times as many shares as five years before.

Table 3: Equity Holdings of BCA CEOs, 1990-2005 (Annual Average Holdings)

Year	Number of BCA firms in annual sample	Total number of shares held at end of year[1]	Number of options and share rights held at end of year[1]	Number of new options and share rights granted during year[2]
1989-90	30	1,013,602	219,926	
1990-91	30	798,872	514,359	
1991-92	35	947,860	488,395	
1992-93	33	1,039,860	412,021	
1993-94	31	1,080,276	1,038,733	
1994-95	34	967,371	1,426,875	
1995-96	34	865,567	1,178,433	
1996-97	38	946,943	1,059,986	
1997-98	39	1,165,750	1,200,583	
1998-99	47	971,944	1,365,446	
1999-00	45	1,822,729	1,490,366	1,628,289
2000-01	42	2,112,930	1,642,414	1,135,440
2001-02	46	2,033,071	1,610,975	1,084,629
2002-03	45	2,842,125	1,652,911	863,564
2003-04	46	2,896,534	1,778,399	689,597
2004-05	49	2,577,152	1,076,775	361,379

Notes: 1. Figures relate to those CEOs reported as holding some shares/options...

2. Volumes of new option and rights grants were not reported prior to 1999. Figures relate to those CEOs reported as receiving some options during year..

Sources: Company Annual Reports; *Connect4* Database.

Much of the growth in direct share holdings since 1998 is attributable to the growth in the popularity of executive option plans in the 1990s. [2] Indeed, the results presented in Table 3 indicate a surge in the average

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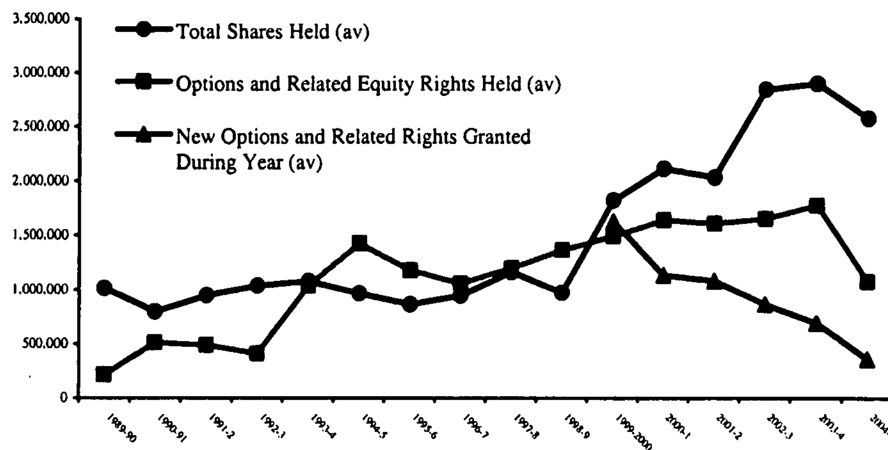
2 Share option plans give the executive the right to buy a specified number of company shares at a predetermined price at some point in the future. Options to purchase shares are granted to employees at 'nil cost'. The price payable to convert the option to a share – the 'strike price'- is usually set at the market value of the shares at the time the option is granted. If the market price increases after the option is granted the executive stands to make a net gain by exercising the option to acquire the shares, then selling some or all of them on the general market. If the executive expects a further rise in the share price, she/he may retain some or all of the shares acquired. In theory, the incentive is to improve organisational performance so as to drive share price up.

volume of share options held between 1992 and 1995, and a longer though more gradual increase between 1996 and 2004, by which time option holdings averaged just under 1.8 million.

Figure 3: Average Total Number of Share and Option Holdings of CEOs of ASX-listed BCA Member Companies, 1989/90 to 2004-5



Source: Company Annual Reports; *Connect4* Datebase.

As Figure 3 also reveals, over the last two years the growth in shareholdings has actually stalled and even declined marginally. Again, this seems to be attributable to a sharp decline in the average number of new options granted to BCA CEOs each year since the share market downturn of 2001-2.[3] Since that time, the average number of options held has also fallen. Despite the sharp recovery in share prices since 2002, then, it is clear that straight option plans have lost much of their

3 The decline in average shareholdings in 2004-5 is also attributable partly to the retirement of several particularly wealthy members of the BCA group, most notably R.J. Hamilton, longstanding CEO of the Mirvac Group. In 2004 his final full year in the post, Hamilton was reported has holding 13.2 million Mirvac shares, with a gross worth of approximately $57 million as at 30 June 2004.

appeal to executives and company boards alike. The absence of downside risk to executives, the lack of transparency in option grants, and the refusal by many companies to cost executive options has aroused considerable anger among individual and institutional shareholders. Shareholder pressure and closer media scrutiny have forced company boards to reconsider the practice. At the height of the 2002 share slump, several leading BCA companies, including the Commonwealth Bank, Telstra, Western Mining Corporation and Qantas, suspended further issues of executive options and one outspoken BCA CEO, David Murray from the Commonwealth Bank, even appeared to undergo a change of heart regarding the worth of such plans (Murray, 2002: 49).

To be sure, the concurrent rise in cash bonuses does suggest that there has been something of a 'flight to cash' since 2001. However, it would be wrong to infer that equity has lost its centrality in executive salary packaging. Based on the relevant company share price at the close of the 2004-5 financial year, the three CEOs with the greatest equity wealth in the BCA sample for 2004-5 were: C.J. Morris, Computershare ($327.4 million); J. Grill, WorleyParsons ($255.6 million); and R.T. Pearse, Boral ($191.9 million). Equity wealth on this scale dwarfs even the unprecedented levels of cash remuneration now paid to these and other BCA CEOs.

The chief change under way here is the displacement of traditional option plans by more sophisticated equity participation plans. These include supposedly more exacting equity instruments, such as restricted share grants[4], share appreciation rights[5], zero exercise price option plans, also known as 'performance share' plans[6], and 'rights' plans.[7] Renewed

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4 A restricted share grant plan is one where shares are awarded subject to forfeiture if the employee leaves employment with the company before the expiry of a specified period and / or subject to the satisfaction of a performance hurdle within that period.

5 Share appreciation rights are intended to link executive earnings more closely to those of ordinary shareholders. The executive stands to receive a cash payment geared to the total returns to shareholders over a specified period in the form of share price appreciation plus dividends, whereas rewards flowing from an option plan will reflect share price movements only.

6 With zero exercise price option plans, the executive is allowed to exercise the options at no cost to himself or herself but a performance hurdle is typically applied which must be satisfied before the options are exercised.

interest is also being shown in the older practice of part- or fully-funded share purchase plans. The heightened public scrutiny of equity plans has also led to wider application of specific performance hurdles to such plans, a development reinforced by the more stringent reporting and accountability requirements introduced under the 2004 *CLERP9* legislation. One of the most commonly used hurdles in executive incentive plans is the achievement of total shareholder returns (TSR) in excess of the 50th (i.e. median) percentile of returns achieved by a specified group of peer companies; with a larger reward, frequently the 'full' potential reward, made available where TSR performance exceeds the 75th percentile of average peer performance. Amongst the BCA sample firms, virtually all CEO equity plans now incorporate market and/or financial performance hurdles. As shall be argued below, though, these may be less exacting than appearances would suggest.

Termination Payments

Even more controversial than the trends in recurrent income and equity wealth has been the provision of large termination payments to departing CEOs, particularly those seen as failed leaders. Such payments, typically referred to by critics as 'golden handshakes', are additional to the payment of superannuation entitlements and other accrued benefits. Table 4 details termination payments made to 35 CEOs who have departed from BCA sample firms since 1991.

As the table data discloses, the average termination payment for CEOs departing prior to 2000 was $2.3 million, while for those leaving between 2001 and 2005 the average payout was just under $3.3 million. Several of the largest payments have gone to individuals who have departed their positions in controversial circumstances, including J.B. Prescott, BHP ($8.7 million); P.D. Macdonald, James Hardie Industries ($8.4 million), and F. Cicutto, National Australia Bank ($6.6 million).

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7 A right's plan gives the holder the right to take up a share in a company. It may be necessary to pay an exercise price (usually market price at grant) but many rights plans replicate zero exercise price option plans and allow the rights to be exercised without payment.

Various justifications are offered for such payments. Defenders argue that they represent special recognition for good/long service or provide an incentive a departing executive to do so 'quietly' and not disclose corporate information to competitors.

Table 4: Termination Payments to BCA Chief Executives,1991-2005

Executive	Company	Departure date	Termination payment ($AU million)[1]
Fowler, SA	Westpac	1991	567,500
Kean, BR	Boral	1994	1,740,000
Fawcett, DR	Foodland	1994	1,220,000
Ralph, JT	CRA/Rio Tinto	1994	940,000
Murphy, BK	Caltex	1995	1,540,000
Blytheway, WT	Mayne Group	1995	1,630,000
Allen, DCK	Woodside Petroleum	1996	780,000
Mercer, DP	ANZ Bank	1997	3,210,000
Kells, GV	CSR Limited	1997	2,870,000
Tideman, CCS	David Jones Limited	1997	1,270,000
MacFarlane, DB	Amcor Limited	1998	1,570,000
Jones, M	NRMA/Insurance Group Aust	1998	2,060,000
Clairs, RJ	Woolworths	1998	2,130,000
Prescott, JB	BHP	1998	8,780,000
Argus, DR	National Australia Bank	1999	6,548,091
Blount, WF	Telstra	1999	2,290,000
Hammond, RW	Adelaide Brighton	1999	670,000
Average for 1991-1999			*2,342,094*

However, the nature and persistence of these exit payments raises questions about board accountability, including, most importantly, the habit, at least until recently, of disclosing such payments to shareholders only after the event – and with evident reluctance. Although the *CLERP9* reforms have mandated full advance disclosure of termination payment provisions in new CEO contracts, it remains to be seen what impact, if any, the new disclosure requirements will have on the magnitude such payments.

Table 4: Termination Payments to BCA Chief Executives,1991-2005 (cont.)

Executive	Company	Departure date	Termination payment ($AU million)[1]
Wright, PJ	Adelaide Brighton	2001	252,114
Bleasel, LF	AGL	2001	5,601,574
Harvey, P	Alinta	2001	1,275,210
Fletcher, J	Brambles Industries	2001	7,711,000
Weikhardt, P	ICI/Orica	2001	2,148,700
Dodd, ER	NRMA/Insurance Group Aust	2001	2,359,000
Eck, DK	Coles-Myer	2001	987,806
Anderson, P	BHP	2002	9,098,409
Crabb, J	Sims Group	2002	1,552,002
Kirby, P	CSR Limited	2003	4,792,740
Wilkinson, LP	David Jones Limited	2003	1,159,983
Jones, WS	Suncorp-Metway Mank	2003	2,052,000
Jones, RH	Amcor Limited	2004	567,399
Humphry, RJ	Australian Stock Exchange	2004	1,341,953
Macdonald, PD	James Hardie Industries	2004	8,436,896
Cicutto, F	National Australia Bank	2004	6,618,595
Whitewick, IM	Paperlinx Limited	2004	949,739
Every, RL	Onesteel Limted	2005	1,886,460
Average for 2000-2005			*3,266,199*

Notes: 1. Figures prior for 2000-2005 are based on amounts reported as termination payments in company annual reports. Figures for 1991-1999 are estimates based on net difference between mid-point figure for highest paid executive in turnover year and comparable figure for previous year.

Sources: Company Annual Reports; *Connect4* database.

The BCA Position on Executive Pay

In contrast to their outspoken support for the cause of greater 'flexibility' in ordinary workers' pay levels, on the issue of their own remuneration

levels BCA CEOs have been unusually reticent – though not entirely so. In June 2004, in the immediate context of debate over the proposed *CLERP9* legislation, and in particular the proposal to allow shareholders a non-binding vote on proposed CEO remuneration packages, the Council executive released a 'position paper' on the issue (BCA, 2004). With a view to 'framing the debate', the document's author/s[8] offered an assortment of justifications for prevailing Australian executive reward practices, the chief of which can be summarised as follows:

- The market for executive labour differs from that for 'average workers' in that the supply of executive skills is 'extremely small'.
- Critics devote undue attention to pay in a small number of large companies and overlook the lower level of remuneration paid by smaller firms.
- Australia listed companies have no choice but to offer rewards comparable to those offered by unlisted firms trading locally, yet the CEOs of unlisted firms are not subject to disclosure rules, and generally face fewer stakeholder demands, pressures and responsibilities, while the greater scrutiny applied to listed companies may serve to keep their executives' salaries 'artificially low' and hence may produce 'a lesser quality of corporate leadership'.
- Australian companies compete in the global economy and global labour markets and, to attract 'the best executive talent', must therefore align executive salaries with 'international benchmarks'.
- The level of remuneration paid to CEOs of Australian-based companies is lower than that paid in 'other countries' (*i.e.* the USA and the UK).
- The average tenure of Australian CEOs is both shorter than that of CEOs elsewhere and continuing to fall, the implication being that Australian boards are already particularly vigilant regarding CEO under-performance, while CEOs are under unusually strong pressure to deliver results quickly.

8 The paper carries no attribution of authorship.

- Unlike other employees, executives 'lack specific protections from dismissals'; hence securing contractual provision for compensation for early termination is a legitimate concern for any incoming CEO.

Suggesting that Australia's listed companies were 'already subject to some of the most stringent disclosure legislation on executive pay in the world' (BCA, 2004:1), the BCA paper also put the case for voluntary self-regulation, singling out for favourable mention the 'Principles of Good Corporate Governance and Best Practice Recommendations' issued by its own affiliate, the ASX, in March 2003 (ASX, 2003). Finally, the BCA paper challenged the 'political' proposal (adopted from the United Kingdom, and since realised by *CLERP9*) to give shareholders direct input to remuneration decision-making via a non-binding vote at company AGMs. Such a proposal, it was argued:

> Assumes [wrongly] that shareholders generally have a detailed understanding of the complex role, function and value of executive management, as well as the detail associated with the global market for executive talent and how suitable candidates for specific positions might be rewarded (BCA, 2004:15).

More recently, BCA spokespersons have also invoked the stronger reporting and accountability requirements under *CLERP9* itself as an added justification for the upward trend in CEO pay, with outgoing BCA president and Wesfarmers CEO Michael Chaney[9] reportedly offering the following rationale for the most recent round of increases:

> The growing gap between the remuneration of CEOs and of other executives reflects the growing demands on CEOs personally, and the much higher levels of public scrutiny faced by CEOs. Being the CEO of a major corporation, particularly a listed corporation, is becoming a higher-risk job, and that increased risk is reflected in increased remuneration. (Kitney and Buffini, 2005:18)

9 Chaney retired as Wesfarmers CEO in July 2005, having held the post since 1992. Between 1998 and 2004 alone, Chaney's own annual cash remuneration in this role increased more than four-fold, to $6.7 million.

While space does not permit a comprehensive assessment of these pronouncements, several counterpoints are warranted. The first regards the claimed scarcity of executive 'talent'. This contention appears to conflate market supply and market demand. Simply because the number of positions and incumbents is limited does not mean that the supply of potentially appointable candidates is necessarily similarly limited. The dismantling of internal promotion structures and the repeated rounds of middle-management de-layering in the 1990s had much the same effect. Incoming CEOs also have a well-deserved reputation for eliminating promising internal rivals. As Gideon Haigh (2003) has argued, the mantra of scarce executive talent can be viewed as being essentially a self-serving myth of incumbency.

Secondly, the claim that Australian CEOs are habitués of a global labour market is open to question on a number of grounds. Notwithstanding several high profile international appointments, most of the CEOs of Australian listed companies, including those belonging to the BCA, are domestic appointees. Further, according to the BCA's own commissioned research (Booz Allen Hamilton & BCA, 2004; Korporaal, 2004), it was not until 2003 that external recruitment – that is, recruitment external to the organisation though not necessarily external to the country - overtook internal succession as the principal source of new executive recruitment in Australian firms. So full globalisation of the Australian CEO club is still some way off.

Thirdly, the contention that the short tenure of the average Australian CEO signifies that Australian boards do exercise close and effective control over CEOs both understates the significance of voluntary departure and flies in the face of the reality of day-to-day power relations within large corporations. Notwithstanding the growing presence of independent directors on company boards, and their mandated majority presence on remuneration committees, it seems that many non-executive directors still do not feel sufficiently empowered to resist CEO demands. A large proportion also believe that CEO remuneration is excessive. According to a recent survey of 121 directors, most of them members of the boards of S&P/ASX 200 companies, 52 percent believed that the current CEO pay levels are excessive, with 70 percent of these believing

that CEOs were overpaid between 20 and 50 percent (Buffini and Pheasant, 2005).

Fourthly, and relatedly, it is still the case that many non-executive directors hold their positions at the behest of the incumbent CEO. Indeed, many are themselves ex-CEOs or executive aspirants. Despite the appearance of board independence and the existence of 'independent' remuneration committees, the balance of day-to-day boardroom power clearly continues to reside with the CEO. In this respect, it is particularly significant that the BCA itself is comprised of CEOs rather than board chairpersons (with the exception of executive chairs, of course). According to Bebchuk and Fried (2004), far from acting in shareholders' interests, and far from executive pay being determined by arms-length bargaining, executives use the power of their positions to extract an 'economic rent'[10], chiefly by influencing their own remuneration packages. The issue here is one of 'asymmetric information' - the 'agent' has greater knowledge, and hence power, than does the 'principal'. Using recent US evidence, Bebchuk and Fried argue that, despite closer scrutiny and new reporting requirements, CEOs have managed to maximise their personal returns by uncoupling pay from performance, persuading or forcing boards to renegotiate or soften performance hurdles, re-price out-of-the-money options, and offer access to disguised income in the form of generous sign-on payments (or 'golden hellos')[11], special retirement benefits, retention and long-service bonuses, no-interest company loans, special zero-cost share rights, post-termination consulting fees, and the like. As such, executive incentive plans that purport to advance shareholders interests may be little more than devices to camouflage economically unwarranted levels of income and wealth appropriation.

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10 Economic rent is the income an individual receives in excess of the amount that would be needed to retain them in the position.

11 While not investigated here, multi-million dollar sign-on payments have become a commonplace in recent executive hiring practices, particularly as a means of compensating external hires for having to forego potential additional wealth under restricted equity plans made available by the previous employer. Such payments amount to a form of disguised remuneration, are clearly an operating expense, and warrant closer investigation.

Finally, one especially curious feature of the BCA position paper is the absence of anything other than a passing reference to the application of performance hurdles to executive performance incentive plans. The presence of such hurdles would seem to offer *prima facie* justification for the growing significance of short- and long-term incentive payments in CEO packages. Why, then, does the BCA make so little of this point? One explanation may be that, from the perspective of the CEOs themselves, performance hurdles loom as an imposition and an indication of shareholder and board distrust of their underlying motives. Another, more subtle, explanation is that these hurdles may not be as solid as they seem; indeed, as the available US research makes clear, performance targets are open to considerable manipulation. A five year study of 570 US firms with executive option plans in place by Kasznik and Aboody (1998) found that the pattern of share price movements, forecast revisions, and earnings forecasts around the time of option grants differed significantly from other times. They also found that, before the grant date, executives were more likely to disclose bad news, and that they tended to withhold positive news until after the option grant date. As is well recognised, carefully timed announcements of staff cut-backs can also serve as a powerful share price stimulant and it appears to be far from coincidental that past and present BCA CEOs with the most to gain from share options and rights have also been among the most committed practitioners of workforce downsizing.

Accounting-based hurdles are also open to manipulation. For instance, with profit-based targets, the executive may artificially inflate paper profits by postponing infrastructure investment or cutting back on research and development. Hurdles based on peer company benchmarking may also still provide rewards for mediocre performance, especially where the pay-out target is set only at the 50th percentile. By the same token, the use of more onerous hurdles, say a pay-out set at the 75th percentile, may also encourage executives to demand and receive a much higher potential reward. Of course, the use of relative performance measures of this type may also result in a substantial payout to the CEO in circumstances where company performance is actually declining, albeit at a lower rate than that of comparator firms. One outcome of hurdle malleability and manipulation would be a tendency for incentive payments to outstrip performance and shareholder returns. As noted

above, this is precisely what has occurred since the late 1990s in firms in the BCA sample.

Conclusions

The 100 CEOs who comprise the membership the BCA represent the elite of Australian big business. Individually and collectively, they have also been in the forefront of the employer campaign for greater flexibility in Australian employment relations, as well as for increased labour productivity and labour cost competitiveness. Their advocacy of more thoroughgoing 'reform' of the Australian wages system inevitably invites consideration of their own remuneration as salaried employees, and of how their pay has changed over time. Drawing on data from company annual reports, the paper details trends over the past 16 years in the level and composition of CEO remuneration in the 51 ASX-listed companies whose CEOs are current BCA members. The study's findings point to five main conclusions.

First, the blow-out in CEO pay levels is difficult to reconcile with the BCA CEO's persistent advocacy of a more competitive labour cost structure for the Australian economy. Current BCA CEOs and their predecessors have enjoyed long term cash earnings growth far in excess of that of ordinary Australian wage and salary earners. Over the past 16 years, their average total cash earnings has risen at an average compound annual growth rate of 13.5 percent (or 10.7 percent in inflation-adjusted terms[12]), compared to just 4.2 percent (or approximately 1.4 percent in real terms) for other employees generally. The gross cash earnings gap between the two groups has widened from 18:1 to 63:1. In relation to pay restraint, the stance of the executives and boards of BCA member firms remains one of 'doing as we say' rather than 'doing as we do'.

Second, in composite terms, changes in CEO pay since 2000 have become less sensitive to changes in total shareholder returns. While increases in CEO cash remuneration correlated quite closely with growth

12 Based on an average annual inflation rate of 2.8 percent between June 1989 and June 2005.

in returns to ordinary shareholders during the 1990s, over the past five years CEOs have enjoyed earnings increases disproportionate to those of investors in S&P/ASX200 companies. Notwithstanding the greater application of performance hurdles to CEO incentive payments, the evidence presented here suggests that the earlier coupling between CEO pay and 'shareholder value' is, if anything, breaking down. Performance hurdles, it would seem, are not all that they purport to be. Indeed, it is possible that their chief effect is to disguise additional 'rent extraction'. It is also curious that the BCA's defence of CEO remuneration levels makes hardly a mention of these devices.

Third, there is some evidence of a 'flight to cash' since the share market slide of 2001-2. Cash incentive payments have now overtaken fixed pay as the principal component of BCA CEO cash earnings, now accounting for 60 percent of the total. This year, BCA CEOs received average cash bonuses of $2.06 million, an increase of 55 percent on the previous year's average. Again, the gap that opened between levels of bonus payment and returns to shareholders during the recession of 2001-2 shows no sign of being corrected.

Fourth, while the late 1990s surge in option grants and share shareholdings has evidently come to end, equity plans continue to overshadow cash as the major source of CEO wealth acquisition. In 2005-4, BCA CEOs held, on average, 2.6 million shares in the employing company, with a majority having from $10-$30 million in company equity. What is clear is that traditional option plans have fallen from favour since 2000, and greater emphasis is now being placed on most sophisticated instruments, such as share appreciation rights and zero exercise price options, which closely resemble restricted share grants.

Finally, the multi-million dollar termination payments made to departing BCA CEOs - averaging $3.3 million over the past five years - are further indication of the continuing bargaining power of incoming and incumbent CEOs relative to their notional employers, the board of directors. Like the more recent practice of the 'golden hello' and the 'long-service bonus, such payments, which are generally additional to standard superannuation benefits, amount to a form of disguised income supplementation. The BCA's aggressive support for the gutting of unfair dismissal laws makes a mockery of its contention that seven-figure

termination payments are justified on the grounds that CEOs lack specific protections from early dismissal. Here, as in other aspects of the debate on pay, the highly paid employees who comprise the BCA have elevated the policy double standard to something of an art form.

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Appendix: Data and Methodology

The full study sample comprises the 51 ASX-listed companies whose CEOs are currently BCA members.[13] Data on the remuneration of current CEOs was obtained from the annual reports of the companies concerned available via the *Connect4* and *FinAnalysis* e-databases. Wherever available, annual remuneration data was also collected on predecessor CEOs (or Managing Directors) in the sample companies back to the financial year 1989-90, the earliest year for which such data

13 The 51 ASX-listed firms represented in the sample are: Adelaide Brighton Limited; Alinta Limited; Alumina Limited; Amcor Limited; ANZ Banking Group Limited; Australian Gas Light Company; Australian Stock Exchange; AWB Limited; Bendigo Bank Group; BHP Billiton; BlueScope Steel Limited; Boral Limited; Brambles; Caltex Australia Limited; Coca-Cola Amatil Limited; Coles Myer Ltd; Commonwealth Bank of Australia; Computershare Limited; Crane Group Limited; CSR Limited; David Jones Limited; Foodland Associated Limited; Insurance Australia Group; James Hardie Industries NV; Leighton Holdings Limited; Lend Lease; Macquarie Bank Limited; Mayne Group Limited; Mirvac Group; National Australia Bank Group; OneSteel Limited; Orica Limited; Origin Energy Limited; PaperlinX Limited; Perpetual Trustees Australia Limited; Promina Group Limited; Qantas Airways Ltd; Ramsay Health Care Limited; Rio Tinto; Sims Group Limited; St George Bank Limited; Stockland; Suncorp-Metway Ltd; Telecom New Zealand Limited; Telstra Corporation Limited; Transurban Limited; Wesfarmers Limited; Westpac Banking Corporation; Woodside Energy; Woolworths Limited; WorleyParsons Limited. Zinifex, which is also a BCA listed company, has been excluded from the sample because of the recency of its listing. Historical changes in company listing mean that not all present BCA affiliates are represented in all years of the 16 year sample pool.

is generally available via these e-databases.[14] While the sample is not fully representative of the pool of firms whose CEOs have belonged to the BCA for some or all of the past 16 years, and while annual data on some of the firms is incomplete, what the data set does provide is a solid time series on CEO remuneration in these firms that is amenable to annual descriptive analysis. The preliminary database included a total of 673 annual observations. Of these, 51 were identified as being affected by a CEO turnover episode (involving part year remuneration data only and/or the inclusion of a one-off termination payment to a departing CEO) and were therefore excluded from the data set used to analyse year-on-year trends in recurrent remuneration. The final sample data set therefore comprised a total of 621 annual observations, or an average of just on 12 years of data per company, covering a total of 138 individual CEOs, or an average of 2.7 CEOs per company. These data were then used to calculate mean annual levels of recurrent remuneration[15], while the data relating to turnover years was analysed to ascertain mean levels of termination payment.

Data collection had to accommodate several distinct regimes of mandatory annual reporting. Prior to the 1998-99 financial year, the annual director's reports of listed companies were required to report only the total annual 'emoluments' (i.e. combined cash and 'non-cash' remuneration) received by or due to executives in bands of $10,000 commencing at $100,000. Companies were not required to identify individual executives, nor to detail the elements of each remuneration package, only the number of executives in each $10,000 band. However, under the *Company Law Review Act, 1998* company annual reports were required to identify each of the five most highly paid executives and all directors by name, to indicate the specific amount of remuneration per individual, and to provide a breakdown of this amount as between fixed remuneration (including superannuation) and other major cash

14 The earliest year for which such data is available in any form is 1989. Prior to that year, there was no mandatory reporting requirement relating to executive remuneration under Australian corporations law.

15 Since the sample size is necessarily limited, and since all firms in the sample are concentrated in the top range of market capitalisation (with no outliers), it is appropriate for descriptive analysis to focus on range mean rather than on the range median.

components, such as bonuses and incentives, fees, other benefits, and termination payments. These requirements have now been extended by the 2004 *CLERP9* legislation, which requires reporting, *inter alia*, of the estimated value of new share option grants and of remuneration in the form of equity-based 'long-term incentives'.

To increase the degree of compatibility between the earlier banded data and the more detailed data available for more recent years, it has been necessary to make a number of assumptions in relation to the data for 1990-99. The individual occupying the highest pay band in either the 'director' or 'executive' categories has been assumed to be the company's CEO (or equivalent). The midpoint of the relevant $10,000 pay band has been treated as the actual amount paid.[16] Further, it has been assumed that, while this nominal amount encompasses all components of total cash remuneration, it does not register any equity-based contribution to total remuneration. The results for all years are also reported in current year dollar terms[17] and have not been inflation-adjusted, but this is quite appropriate given the nature of the exercise.

Turning to equity-based remuneration, for the whole 16 year period studied, it has been obligatory for companies to report the total number of company shares held at the end of the reporting year by each company director and executive board member, as well as the total number of share options held by each. Until this decade, it had been rare for companies to place a dollar value to these holdings. Accordingly, this analysis concentrates on the volume rather than the value of equity held. While this precludes estimation of trends in the total monetary wealth accruing to CEOs, and takes no account of differential share price levels and movements between the sample companies, it does have the benefit of allowing us to gauge trends in the mean volume of company equity made available to CEOs.

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16 My thanks to my colleague Rachel Merhebi for her assistance in compiling and analysing the banded data.

17 Where remuneration is reported in a foreign currency, the values have been converted into Australian dollars using the the relevant foreign currency exchange rate as at the company report date.

Since 1999, firms have been required to specify the number *new* share options and related equity rights granted to each of the five highest paid executives each year. However, while reporting the estimated value of new option grants to the recipient has been a feature of international accounting standards guidelines for some years, it is only this year (following the passage of the *CLERP9* changes to corporations law in 2004) that it has been incumbent on companies to do so. However, a survey of these estimates indicates significant inconsistencies in the modelling used to arrive at these valuations. Accordingly, given the recency of these data and the level in inconsistency in reporting practices, reported valuations of new option grants and other equity-based remuneration have been excluded from the present study.

Thus, while not permitting a comprehensive analysis of long-term income trends by remuneration type, the sample database nevertheless does offer some revealing insights into the executive remuneration practices of BCA member companies over the long-term. The key point to note here is that the exclusion of new equity-based remuneration from the calculation of average annual total remuneration means that for the later half of the period studied the reported growth trend estimates significantly *understate* the actual increase in CEO income and wealth acquisition. In reality, the double standard has almost certainly been more pronounced than reported here.

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