HaRe Group newsletter: **3 February 2004**

Subject: **Executive pay update**

From time to time, there are media reports that provide worthwhile information on executive pay. This email summaries and comments on selected reports in recent months.

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NAB CEO resigns (AFR, 3 Feb.)
More media excitement about the exit packages paid to departing executives. This week, Frank Cicutto left NAB after 37 years with a package of almost $14 million. This amount includes a resignation payment of almost $3.3 million, over 18 months of Mr Cicutto's annual fixed salary. Part of this is 6 months payment in lieu of notice, but the extra amount has not been explained. There is 18 months pay stipulated in Mr Cicutto's contract as compensation for a "material change in circumstances" but NAB acknowledges that no material change exists.

The balance of the exit package includes accumulated superannuation (under $2 million), accrued annual & long-service leave ($3 million), rights to share options ($4.5 million), and half his 2003 bonus payment ($1.3 million). The other half of the bonus, paid in deferred shares, is forfeit. The board has not activated a no-compete clause in Mr Cicutto's contract, nor will it offer him a consultancy agreement.

Payday at Austar (BRW, 22-28 Jan.)
Minority shareholders are objecting to a share plan that includes $43 million in interest-free loans to 13 senior managers. Loan repayments are made via share dividends, or when sold. If the company's share price increases by 33%, the managers could own 9.7% of the company, which has yet to make a profit. (When floated in 1999, the share price was $4.70 - current trading is around 60 cents). On paper, the managers are already well ahead after buying shares last November at 16c when the market paid 38c.

However, it appears that there are some performance hurdles before vesting can occur, but these are not specified.

One minority shareholder said that, given past performance, "we cannot see how (the share plan) can be justified, we cannot see how it is in the best interests of the shareholders."

Further research reveals the company's remuneration philosophy: "Companies in which employees are significant equity holders are more focussed on creating shareholder value." The company also acknowledged market concerns about share option plans. It cancelled all existing option plans and compensated the executives for the loss, despite the fact that all options were far underwater.

Power salaries
Last November, The Age published a special report on executive remuneration trends. Once again, the theme of "public outrage and shareholder concern over soaring corporate salaries" dominated the report. Some of the constructive observations included:

- Trevor Eastwood, Wesfarmers chairman: "(the CEO, Michael Chaney's) performance is outstanding, but he's one of a team, albeit the captain, and so there should be relativity to the rest of the team."
- Don Argus, BHP Billiton chairman: "(the CEO, Chip Goodyear has) got to be on top of financial issues, legal issues....lead 38,000 people....relate to 316,000 shareholders....to relate his salary and his accountability back to a basic wage is a nonsense."

- Argus describes BHP Billiton as a huge wealth creator - but should its CEO be paid 19 times the amount paid to Peter Cosgrove, Australia's defence forces chief?
- Public sector CEO remuneration levels are generally far below company CEO levels, but several public corporation leaders are paid much more than their political masters (eg. the Australia Post CEO received $1.89 million last year)
- Proposed new laws (CLERP 9) will require remuneration disclosure on the top 5 managers, as well as the directors, and provide more shareholder muscle in discussing executive pay arrangements
- Business leaders argue that more disclosure will expose who gets what, which will fuel more pay increases
- Others argue that there is enough evidence to prove that some companies have hidden huge executive payments from shareholders (eg. Qintex) and have to be made accountable to shareholders

Comment

Shareholder concerns about executive remuneration often arise because of a confluence of variables that is seldom predictable. One powerful variable is the shareholders' (usually limited) understanding of very complex business issues. Shareholders' perceptions are also fuelled by sensational media reporting, which often fails to give a balanced view that provides a complete appreciation of relevant business conditions.

The personality mix of directors and executives is another variable that may promote unexpected decisions - including decisions to appoint a new CEO. There have been some surprising, yet very successful decisions - Paul Anderson and Bob Joss to name just two - but there have been some shockers too.

An organisation's reward philosophy is an obvious variable that should drive all executive remuneration decisions. However, it's surprising how often some companies lose sight of their business/ reward strategy when designing their pay programs. A Strategic Remuneration Framework is essential for aligning all pay programs with long term business needs.

These variables (and others, no doubt) will all impact on corporate governance and the public & shareholder perceptions of executive remuneration.

Simon Hare
HaRe Group