HaRe Group newsletter: **3 June 2004**

Subject: **Executive pay update**

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

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The big money (BRW, 3-9 June)
"Record company profits and a shortage of talent are sending bonuses through the roof." After an austere 2003 (of few increases in base packages, limited bonuses & cuts in share-based plans), 2004 is showing a big turnaround for talented people. The stellar performers are being given special attention, rather than whole executive teams. New, sharper incentive plans will deliver "really big dollars" if executive performance matches expectations.

Fewer long-term incentive (LTI) plans are based on share options. Many companies are now offering performance shares that reflect total shareholder return (TSR) performance relative to a peer group. Progressively tougher performance hurdles must be cleared at set times before executives have the right to vest their shares. Many LTI plans have staged vesting periods that are designed to retain talented people. If an executive leaves, then s/he can lose a large chunk of LTI value.

As employers realise that market demand for great talent may exceed supply, there is potential for a bidding war. However, any premium will most likely be offered in incentives - base package increases will be moderate. Overall, base package increases for currently employed executives should trend below 6% during 2004-05.

$7.1 million p.a. for NAB chief (AFR, 28 May)
John Stewart, NAB's new CEO, has a 3 year contract worth $21.4 million, if he (and NAB) clear all performance hurdles. On top of a base package of $2.23 million p.a., Mr Stewart is entitled to a further $2.23 million if EVA growth and specified business change targets are met. (No information is given on how much is awarded if targets are exceeded - or if some targets are just missed). Half of Mr Stewart's annual incentive payment will be paid in cash, and half in NAB shares that are deferred until the end of the 3 year contract.

Subject to AGM approval, additional long term incentives worth $2.68 million p.a. are made up of 900,000 share options and 210,000 performance rights, effective 2 Feb.'04 and exercisable between 3 and 5 years later. One quarter of Mr Stewart's allocation may be exercised if the bank performs at the 51st percentile (P51) of Total Shareholder Return (TSR) performance of the top 50 in the S&P/ASX 100 - another quarter for P51 TSR of a basket of major financial services companies. The exercise rate increases up to the full allocation when NAB's performance exceeds P75 of both TSR measures. All options and rights will be forfeit if Mr Stewart resigns within the first 18 months of his contract.

The millionaires' factory (AFR, The Age, 19 May)
Macquarie Bank has reported (yet again) a stellar performance and galactic rewards for its 5,700 staff. Average remuneration was about $220,000 per employee. MD Alan Moss received $12.7 million in 2003-04; the head of investment banking & infrastructure Nick Moore collected over $8 million; head of equity markets Ottmar Weiss got $7.2 million. Are Macquarie Bank (MB) employees paid too much? Chairman David Clark says "look at the scoreboard" which refers to MB's 625% total shareholder return since listing, compared to the market's more modest 112%.

While MB justifies its high pay levels as fair compensation for being part of the ruthless and high-risk investment banking world, the Australian Shareholders Association chairman John Curry says a focus on bonuses may lead to people doing "foolish things" - "...bonuses don't make you work harder or smarter." That may be the case, but incentive plans should use measures that focus employees on what is most important to business success.

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MB is part of a global industry that offers large rewards for good performance. Talented people are scarce, so MB has to offer the best package (including non-financial benefits) to attract & retain the best employees.

Comment

The recurring theme is clear: the importance of pay for performance is growing.

The trend is to a more moderate base package and increasing opportunities in incentive pay. At all levels of management, HR performance measures are being refined by reference to the precise measures of business performance (like TSR). These measures sharpen the distinctions between levels of incentive pay, which helps to ensure that the best people are properly rewarded for their greater contribution to business success. It also means that the average performer does not receive undeserved rewards and employers can alleviate the risk of high remuneration costs.

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