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PRODUCTIVITY COMMISSION

INQUIRY INTO REGULATION OF DIRECTOR AND EXECUTIVE REMUNERATION IN AUSTRALIA

MR G. BANKS, Chairman
MR R. FITZGERALD, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT BRISBANE ON FRIDAY, 10 JULY 2009, AT 9.27 AM

Continued from 25/6/09 in Melbourne

INDEX

	Page
IN TEMPORE ADVISORY: MARK CHRISTENSEN	403-412
AUSTRALIAN INSTITUTE OF MANAGEMENT: VIVIENNE ANTHON	413-421
EFFECTIVE GOVERNANCE: JAMES BECK	422-427

MR BANKS: Good morning, ladies and gentlemen, welcome to this concluding day of initial round of public hearings for the Productivity Commission's national inquiry into executive and director remuneration in Australia. My name's Gary Banks, I'm chairman of the Productivity Commission and presiding on the inquiry. On my right is Robert Fitzgerald who is a commissioner also with the Productivity Commission. Our associate commissioner Allan Fels was unable to attend today.

The purpose of the hearings is to give interested parties the opportunity to discuss their views and their submissions on the public record and this will help the Productivity Commission in its task of understanding the drivers and trends in executive remuneration and any systemic problems warranting changes in regulation or governance frameworks. After the hearings we will be working towards completing a draft report for public scrutiny in late September. We'll hold another round of hearings in November to allow people to respond to that draft report. The feedback we get will be taken into account in producing a final report which is due to be submitted to government before Christmas. Copies of the draft report and indeed the final report will be circulated to all those who have made submissions or who appear at hearings or indeed registered an interest in the inquiry.

The hearings, notwithstanding this formality, are conducted as informally as possible, although a transcript is made to provide a public record of discussion. There is no formal oath taking required but the Productivity Commission Act does require participants to be truthful in their remarks. Transcripts of the hearings and submissions themselves are public documents and can be obtained from the commission's web site and copies can also be purchased. I think there might be order forms available from staff here today or by contacting the commission. To comply with the requirements of the Commonwealth Occupational Healthy Safety legislation you're advised that in the unlikely event of an emergency requiring evacuation of the building the exits are that way and the staff can assist you with that.

With those formalities out of the way, could I welcome our first participants in Brisbane in tempore Advisory. Welcome to the hearings. Could I ask you please to give your name and your position.

MR CHRISTENSEN (ITA): Thank you, chairman. My name's Mark Christensen. I'm the director of In Tempore Advisory which is a Brisbane based consultancy with - it's basically a one-man band, myself and I have a few subcontractors now and then. Essentially my background is economics. As you may know, chairman, I was formally with the commission many years ago and then worked up here with Queensland Treasury and for the last eight years I have been an independent consultant. Most of my background is in the area of regulation and my submission that I have prepared is essentially around the idea of regulation and the philosophy and its effectiveness in general and obviously in particular how it applies to executive remuneration.

MR BANKS: Thanks very much for attending today and for the submission. We have read it and we have some questions. We will give you the opportunity to make the main points.

MR CHRISTENSEN (ITA): Okay. Essentially my main point is that the response to the global financial crisis has been largely emotional and notwithstanding it's caused significant damage, I think the response to it within the community is leading to an expectation that regulation can solve it and indeed avoid it happening again and I believe that that is a dangerous expectation and I think governments in general have not sought to address and rather have pandered to it, if you like, in terms of stating that they can rally around with their regulators and avoid these situations happening again. I believe that the commission is the kind of institution that could put forward an opposing view on that or address that expectation within the community which I think is flawed and I think this inquiry is obviously an opportunity to do that given that I think a lot of the opposition that has led to it being put into practice with the inquiry happening is due to that sort - I don't want to use the word "irrational" but it's a very emotive issue and I think without being addressed it will continue to provide government with an opportunity to regulate and do things which I don't think are in the public interest in the long term.

I suppose the crux of my arguments in the submission are that the decisions made by a company are a combination of what you might call a scientific, measurable assessment of their business and what they need to do, but there is also what I have called an artistic or unquantifiable component in the decision-making process that they undertake in a day-to-day sense. If you like, the appointment of the CEO for a company is undertaken in that process. So it's a combination of assessing the quantifiable aspects of what they want in a CEO but at the end of the day a decision made by a board about who to get in as their CEO and how much to pay them is an intuitive assessment of what needs to happen, given a number of factors.

If we accept that as the basis for how things are in reality, then I think the idea of regulation can be put into perspective and that is if you try and have someone trying to make that decision or controlling that decision or trying to second-guess the process that a board goes through, is inherently dangerous and ultimately counterproductive. So that is, I suppose, the core theme of my submission and, as I was saying earlier, it is an opportunity for the commission to address some of those high level, big picture, philosophical issues, if you like, around regulation and how it is supposed to work and whether it does.

MR BANKS: Maybe that is a good place to start on those high level, philosophical positions. It would probably be fair to say that your submission was more at the libertarian end of the range of submissions we have received. Would you see yourself as an extreme libertarian in your attitude to government intervention?

MR CHRISTENSEN (ITA): Extreme is a loaded word, but I look at it as practical, I don't see it as some sort of political statement or philosophical statement. I think it's a practical way of addressing the issues that we confront in terms of trying to achieve economic security and trying to achieve a marketplace where people do the right thing. I just don't believe that the idea of regulation and control is going to produce the outcomes that people want. It is certainly libertarian in terms of giving it a tag, but I think fundamentally it's about being pragmatic.

MR BANKS: Do we need a Corporations Act in this country?

MR CHRISTENSEN (ITA): I think there is a role for government, I just think that they systematically overreach it. There are certainly requirements for transparency and again, going back to that analogy that things are a combination of science and art, I think to the extent that the government can facilitate that science side of things in terms of people having the information and understanding why boards make certain decisions is helpful, but if it's not also presented with a recognition that there are other factors which the government can never try and pin down or regulators can ever pin down, then it's okay. But I think we're lacking that other contextual recognition.

MR BANKS: I had difficulty in reading your submission and seeing what areas of regulation you think would be consistent with the approach that you take. Could you describe perhaps the kind of areas where you think regulation is justified in relation to executive remuneration and the role of boards.

MR CHRISTENSEN (ITA): I suppose I haven't thought through the exact elements of what legislation will need to offer up. Again, my pitch is at the high level in terms of recognising some of those high level issues and constraints. But if you can recognise that then I think you can then work through what that means in a practical sense of what government can and cannot mandate.

MR FITZGERALD: Just a couple of questions about that. If you take the view that the executive salaries are in fact simply meeting the market in one sense, one of the things that is very clear is that many people would view the market as having been grossly distorted in two ways, both in design and quantum. All of the submissions seem to indicate that at a particular point in recent history the regulatory changes in the USA in terms of capping the $1 million tax deductibility of CEOs' salary spawned an almost automatic response to use equity and the complexity we now have in the system is largely driven from that, not from some design feature but a reaction to a regulatory change. That might support the view that regulatory intervention you can have for these outcomes.

The second thing is the quantum. Suddenly we start to have executives from overseas, only at the very top end of the market, but that became the new benchmark which had spill-over and flow-on effects right through the market. So even if you took a market or a position, which you obviously do, what's the response if the market is in fact grossly distorted by factors external to our own but now influence us? Do you simply say, "Well, that's life," and we keep going or are there things that can start to moderate those distortions without actually putting statutory caps on quantum, for example?

MR CHRISTENSEN (ITA): Yes, I think you have to be philosophical about it but I think the question you need to ask is, are those distortions a result of initial attempts to try and control things in terms of telling executives or telling boards what they need to do? My view is that it is difficult to separate what we have now in terms of the complexity and the outcomes you get, whether they're hight or not. I think it is sort of like a self-fulfilling prophecy, the regulatory intent and the idea that the government can control these things actually drives peoples psychologies and response to that. I think the executives and the boards are in a situation where there is a sense of the government can control it and make it work and their response to that could well be, "We'll up the ante and pay our executives more."

MR FITZGERALD: But even if you took that view, one of the things that has been very clear in the inquiry so far is people have indicated that the government's arrangements in Australia are significantly different from - many would say better than - in America and that is in fact one of the reasons why we haven't suffered much greater consequences of the global financial system and our governance arrangements in companies is different. But when you actually look at that, a lot of that is underpinned by regulation, the ability of the shareholders to vote out directors in a much more robust way here than overseas, the requirement for remuneration packages to actually be disclosed and voted on. A number of the things that people now say have stood us in good stead have in fact an underpinning either in black letter regulation or fairly substantial grey letter regulation such as the ASX listing requirements.

So one of the things I struggle with is the people have said, "We don't want a regulatory response," and very shortly thereafter all of the reasons they think we stand apart from, particularly America, has a regulatory underpinning. I'm trying to work out where that comes together in a coherent thesis.

MR CHRISTENSEN (ITA): I suppose you've made a presumption that in the absence of that people will do the wrong thing, so can be sure that is the case. I mean, if those laws weren't in existence and companies self-regulated, do you believe they would run off the rails?

MR FITZGERALD: If you looked at the American and Australian market would you see that the governance arrangements we have in Australia has in any way allowed us to handle the situation better than perhaps in the American marketplace?

MR CHRISTENSEN (ITA): I think it's a cultural thing that there is a greater expectation that companies will do the right thing and they have. I don't know whether you can put it down to regulation per se because at the end of the day it's still up to - the contrary argument there, that is to say regulation has been in existence, so why hasn't it worked? At the end of the day executives and directors still have to make their own decision. It still comes down to the individual within the constraints and the perceived constraints that they face and so if they decide to the do the right think or wrong thing, then ultimately it's about them not the regulation, because if it was about regulation per se, why have things gone off the rails?

MR FITZGERALD: Within the corporate structures themselves what's the role of the shareholder then? If you've seen any of the submissions you will see that most of the shareholder groups are not proposing dramatic and radical solutions but they want refinements, including some voting powers, some have gone to the extreme of binding votes but others have simply indicated they want more say. There seems to have been a movement in Australia where shareholders are showing some discontent about the way in which companies are governed and they have shown that in some senses by voting increasingly in relation to the remuneration packages with a negative vote, although the vast majority get through. Yet those very people are saying to us we need to improve the arrangements. Would we be not prudent to listen to the investors who themselves have got the money there who are not absolutely happy with the governance arrangements?

MR CHRISTENSEN (ITA): I think this comes back to asking yourself some of these high level questions. Shareholders presumably put directors in there to make those decisions and if it was distilled down to that, I think most of them agree, yes, that's what we do. But then there's a equivocation and a bit of hedging and they go, "Well, look, that's probably true but we don't like some of the decisions they make so we want to compromise that original principle," and start fiddling with things and I don't think that serves themselves any good either. I think again that principle is where you need to argue it at but people don't like that principle because it does give them control, it doesn't give them ability - well, they presume it doesn't give them that ability. They still have an ability to take their capital and put it elsewhere. But they may like the returns they're getting from that investment, but they don't like the fact they're paying their executive too much so they say, "I don't want to move my capital because I'm making a good return, but I'm unhappy with some of these decisions." You know, if they stood by that principle, then they would take their money elsewhere. But I think part of the problem with the market is that investors aren't willing to do that, and hence they end up wanting it both ways, in terms of getting returns but also wanting particular aspects of the package carved out and dealt with on their terms.

MR FITZGERALD: You put in your paper sort of a notion which I think many of us agree with, that in some senses some investors want unconstrained up-sides and very constrained down-sides - - -

MR CHRISTENSEN (ITA): Yes.

MR FITZGERALD: - - - and we're going through a period where there are down-sides. But whilst I think there's some element of truth in that, do you think the concerns of shareholder groups at the moment is in fact deeper and more sophisticated than that, that they're actually not happy with the way in which some elements of corporations are being run, and in a sense the executive remuneration has become a proxy for that. It's one of the few things you can actually vote on directly.

MR CHRISTENSEN (ITA): Well, yes, but again I would question that whole intent. Why is that particular aspect something to be voted on? Presumably there's more material decisions made by boards about shareholder returns than that. Investments, operating decisions, a whole range of things which, you know, commonsense would tell you, "If you're concerned about this, why aren't you concerned about these other issues?"

I think, as you were saying, it comes back to perception of risk. I don't think they have realistic expectations about that, and risk is something that they defined as constrained; and, you know, "Risk is okay as long as it's a reasonable risk or something that I understand or something that I've foreshadowed in my decisions to invest in" in this company or that company, and I just think that's unrealistic.

The governments and regulators don't seem to be willing to disabuse people of that, because they don't want to then be seen to not have control themselves, or not be a major contributor to solutions for the community. They're there on the basis that they can do something. So if they tell the community, "Well, no we can't, because risk is innately risky," then it looks like they don't have a role to play, and that's what I have a problem with.

MR BANKS: If we move away from the role of government to the role of the directions and the board - you know, what you see as central, then who are ultimately responsible to and how do you think those governance arrangements are working, in terms of, well, the traditional issues, the principal agent problems and so on. Are the shareholders really able to ensure that the boards are doing the right thing by the mass of shareholders over time, or not? Do you have any issues in that area?

MR CHRISTENSEN (ITA): Again I think there's always going to be pragmatic constraints, and the principal agent problems have been well-documented in the literature I think, that's a realistic situation. But again I think it's the wishful thinking that people have that there's some mechanism or formula for overcoming that, other than the individual investors making decisions about where they want to put their capital and the trade-offs that they face, in terms of the returns they get versus these other things that concern them.

So if they're sitting back saying, "Well, if I invest in company A I expect to get this return, but I'm unhappy about the executive remuneration arrangements," then they have a decision to make; and it's like, Well, leave or stay." They want it both ways, they want to invest but they also want an outcome that they feel is right on remuneration.

MR BANKS: But some would say, "They own the company, so why shouldn't they have a say."

MR CHRISTENSEN (ITA): But this goes back to what is the role of the board. You know, define that role. I think if you sat them down and said that their role is to make these decisions, then they would agree with that. But after that event, after they have accepted that, they then double-back around and go, "Well, no, I don't really like that. I don't really accept that, because I'm not happy with what they have done."

MR BANKS: So in your view the only way of dealing with that is to sell your shares?

MR CHRISTENSEN (ITA): Yes.

MR BANKS: You don't see any role for shareholders having more say in relation to - - -

MR CHRISTENSEN (ITA): That is the shareholders' role. That is the competitive tension they have. If they're really concerned - - -

MR BANKS: That shareholders appoint the board.

MR CHRISTENSEN (ITA): Mm'hm.

MR BANKS: Right. You don't see any issues there, in terms of the appointment process or the ability of shareholders to express dissatisfaction through that process, short of actually selling their shares?

MR CHRISTENSEN (ITA): Yes, I would have thought they would express what they want the company to deliver in returns; whether that would just be strictly financial or there's other nonfinancial issues that they want the company to achieve, in terms of that they think it's corporate responsibility to pay an executive a reasonable amount, whatever that is. I suppose that can be expressed through the appointment process, but ultimately it's about where people want to put their money. I think that a lot of the concerns and the conspiracy theories that a lot of shareholders have about the market are due to them not being willing to really move their equity around on the basis of their concerns, these concerns about remuneration.

MR BANKS: Why don't they do that then?

MR CHRISTENSEN (ITA): As I was saying, I think because they want it both ways. They're happy with the financial returns and the performance of the company, potentially; but they have this bugbear about how much money they're paying the executive. So if they were willing to move their money around, then I think boards may then take more account of how much they're paying their executives, because that would create a market for those sort of decisions. If they actually acted on that, in terms of moving their equity around, then maybe boards would take more note of what they do on remuneration.

MR BANKS: So do you see a fundamental issue then that shareholders aren't prepared to sell shares in companies that don't meet their expectations?

MR CHRISTENSEN (ITA): Yes, well, their expectations are multi-dimensional, in terms of what they want, and their decision to invest has to reflect that package; and as I was saying, I believe they try and split that package up and try and have it in the best way they can.

MR BANKS: So in your rational world, you have to contemplate the fact that shareholders are irrational.

MR CHRISTENSEN (ITA): Sorry, that what?

MR BANKS: That what you're describing is irrational behaviour on behalf of shareholders.

MR CHRISTENSEN (ITA): Yes, that's the crux of it. I see this as an opportunity for the commission to put that on the table. I accept that it's difficult, but I still believe it's the reality. Isn't that what we're here to examine?

MR BANKS: All right. Well, you've just upped the ante on the educational role for our report. .

MR CHRISTENSEN (ITA): Good.

MR BANKS: We'll do our best.

MR FITZGERALD: Ignoring the quantum and what is reasonable, which is an issue in and of itself, there has been a lot of concern about the way in which these packages have been designed, even by directors and boards we have spoken to privately, very few are happy with the arrangements they currently have; I was wondering whether you have any views about the design features. I know you have taken a broader principle approach.

MR CHRISTENSEN (ITA): Yes.

MR FITZGERALD: One of the things that is clear is that whether design of the package actually significantly improves corporate performance is questionable. But the one thing that's absolutely sure is that if you get it wrong it can have very bad outcomes; it can direct behaviour in particular ways that are undesirable or unintended. There's no doubt at all that both in Australia and America and other places that has been demonstrated. So the design features of these are important. I was just wondering whether you have any view about those issues, or not.

MR CHRISTENSEN (ITA): Yes. I certainly don't know the ins and outs of the designs. But again, at a principle level, I think, from my limited understanding of it, it's another example of, I suppose, the culture of transparency; and the idea that we can develop a formula for how much to pay a CEO I think at the end of the day we've probably traded off some discretion that the board should rightly have on determining what the total package looks like based on their assessment of how the CEO performed.

That would probably be my only comment, about how it's structured, that again we have probably gone too far down that mechanistic way. Then we turn around and end up with outcomes with which we're unhappy. But we don't question why that may have happened, or the over-reliance on transparency and formulisation of executive remuneration.

MR BANKS: Thank you very much for attending.

MR CHRISTENSEN (ITA): Thank you.

MR BANKS: We will just break for a moment, please, before our next participant.

MR BANKS: Our next participant this morning is the Australian Institute of Management. Welcome to the hearings. Could I ask you, please, to give your name and your position.

MS ANTHON (AIM): Yes, my name is Vivienne Anthon. I'm general manager, learning and research, at the Australian Institute of Management, Queensland and Northern Territory. We're the peak professional body for practising managers in Australia; 25,000 individual managers and 5000 businesses.

MR BANKS: Thank you very much for attending today. We're in your hands. We don't have a written submission, but we'll give the opportunity to make the main points you want to make.

MS ANTHON (AIM): Thank you. I'd like to make the point at the beginning that we have read a lot of the submission material that has already been presented to you, and we very much respect the different prisms, if you like, that have been represented there; so from AICD, from AHRI, from academics and from a range of people who have deep, deep expertise in particular areas. We don't set remuneration packages; that is not what we do.

However, we do believe that we have expertise in the area of managers and management and we are very much fascinated by the role that management has in governance and how that impacts in managers interacting with their board, but also how that interacts in the daily actions of the organisation, which then generate the activity which generates the financial or social outcomes of the organisation. So it's with that in mind that we come today, because we are very much interested in what managers do, what they can do better, how they contribute, and what that actually means.

A lot of the discussion is in the regulatory domain, and we understand that. It's or position that a strong regulatory framework in necessary. But, as managers, we believe that skilful managers move us past compliance and into commitment, to a better way of doing things. We conducted some research, the Australian governance survey, we conducted research in 2007. It was commissioned by the Australian Institute of Management. It explored a number of areas; it wasn't particularly about executive remuneration, that wasn't its point. But it did make an interesting finding, and that was the ability of CEOs and managing directors to influence change and to influence governance changes.

The results showed that the CEO or the managing director is in fact rated at least as important in initiating or championing governance change as the chair or other members of the board; and to us that's fascinating, because it means that person and the other senior executives that work with that person has a great deal of influence, and that is what we want to plumb and that's what we want people to be, more skilful.

We would also make the point that, because of the independence of directors, which is appropriate, the very nature of that independence means they rely on the officers of the company for their information and for their strategy and their input. Therefore, the quality of that decision-making is based on the quality of the managerial research, managerial intent to do the right thing, managerial strategy, oversight and vision. So I think what we would say is that we have knowledge that managers make a significant impact at board level, they initiate a lot of governance change through their relationship with the board.

We would also say where managers are able to clearly articulate strategy, where they're able to clearly articulate the behaviours that are expected in a company and where they can bring clarity, those things then enable people to make a decision about their worth. So if it's very clear through strategy what we are attempting to achieve in a particular given period of time and there's clarity around that, then we can't be coming out and saying "We didn't know any of this was happening" if the strategy is really, really clear.

MR BANKS: It's interesting, that perspective, I think, because what you're really underlining is the key role of management, particularly the CEO, in the fortunes of the company.

MS ANTHON (AIM): Yes.

MR BANKS: We have had a bit of debate about that. But how would you respond? You said that research that you conducted in 2007 indicated that the CEO was at least as important as anyone else, including the chair of the board, in terms of governance changes and so on.

MS ANTHON (AIM): Yes.

MR BANKS: Some would argue that the CEO was very important in terms of influencing his or her own pay and that's that part of the problem, because we're seeing CEOs essentially write their own pay ticket. How do you respond to that?

MS ANTHON (AIM): I think that's absolutely right, some would see that, and history would show that that's probably true. What we'd say is again if there is clarity about strategy, if there's clarity about key performance indicators and there's clarity about what the CEO is expected to achieve, then part of that conversation is, "Given we're going to do this, given I'm going to be measured in this way, then this is the remuneration," however packaged, "that will support that," and provided that there's clarity on that and provided that the strategy is achievable, we would see that's appropriate input.

For instance, if the strategy is to make quite remarkable growth figures, then that will also dictate what the key performance indicators are; and if that's in the public domain, then people can make a choice about whether that's an appropriate thing to be doing. If the strategy is more of the same, acquisition, changing sectors, corporate social responsibility, winding back on certain things, then that will dictate what is an appropriate package to achieve that strategy, and therefore in that case it's not inappropriate that the executive have some input on what their worth is.

MR FITZGERALD: In the notes we have in relation to the AIM's position on this there's reference to trying to create an environment of, I think it's called, commitment and transparency, as distinct from a climate or an environment of apparent compliance, and the proposition I think is put that despite the fact that we had apparent compliance we still have had what are perceived to be unacceptable outcomes in remuneration or risk and all those sorts of things. I was wondering if you could explain to me what you mean by commitment and transparency and its distinction from what we have got and what are the things that would be necessary to achieve that, particularly around the sorts of issues that we're concerned about.

MS ANTHON (AIM): I think when the previous speaker was talking you were drilling down on the difference between black letter law and grey letter law, or other terms we can use for that. We all know that as soon as you codify something you will also have those people who can work around that codification; and we also know, as practising managers, what pressures that can bring if someone says, "This is what I've got to do. Find a way around it all," or "Achieve this." What we would challenge both ourselves as managers and others who seek to have input on that is, what can be done upskill people, what can be done to bring further clarity so that people are actually motivated to do more than just comply, because they see the benefits of that.

Whereas that might sound a bit Pollyanna-ish, we would say that if we have skilful managers, if they understand the effect of behaviours and clarity, that can sit on top of the compliance. That might come down to professional development requirements. I guess that's a form of codification. But it might come down to demanding that they in fact don't just bring their technical expertise to the table but they bring some managerial, skilful expertise as well, because not everybody who sits at the top of the tree has the full range perhaps of behaviours or skills; they might be a brilliant technician, for instance.

MR FITZGERALD: Can I just put a couple of things to you that have come up in submissions and I don't want to lock you into an AIM position if you haven't already given consideration to it but you may have some personal thoughts. One of those has been in relation to the quantum itself that once you get to a certain disconnect between the senior managers' pays, the CEO and the top few and the rest of the organisation, that can in fact have effects within the organisation. Whilst I think it's impossible for governments and others to actually cap quantum, there's no doubt at all that some have the view that what's starting to occur is such a disconnect between the very top layer of management and the rest of the organisation that it creates almost a dysfunctionality within the organisation or potentially some difficulties and I was wondering whether you have a view about that or whether you have any evidence as to whether that is a supported statement.

MS ANTHON (AIM): It would be a view rather than evidence. We haven't researched it. Certainly that disconnect is in your issues paper. What we would say is - and again while it might sound a little bit simplistic I think it's something we have striven for - there is clarity about the expectation, there is clarity about the role that people are called to but that is less of an issue in organisations. We certainly have anecdotal evidence of much-loved CEOs who are earning most considerable amounts of money and quite different from those who manage at a different level and there is no dysfunctionality about that because the strategy is clear; it is clear how that person is doing that, it is clear how that person contributes back with skill and inclusion. So there are some soft factors that come into play in that. I think where the real annoyance - and that annoyance can be organisationally or that annoyance can be from a shareholder's point of view - is when people can't see the value.

We strongly believe that where people can see the value in someone's expertise, being both soft skills and technical skills, where they can see that value, they're actually not unhappy with it. We don't see it in raw dollar terms, we see it in value and what they're contributing.

MR BANKS: Could I just ask on that, I guess on the value question any observations you'd have about whether the nature of the role of a CEO, whether the management task in itself has become more complex or difficult or the scale of the management role has changed which might part-explain what's been happening with executive remuneration.

MS ANTHON (AIM): Very much. The whole area of leadership and management has been described as many things from a black art to the saviour of the world. But what we can be sure of is that in an increasingly complex society - which is a little bit focused on short-termism, as in, "I've got to do this now because I've got to get that report in because I've got to show, we've got a reporting period dah dah dah" - that the skills that people have to bring to the table which are both governance up but management down I'm not sure we always have people who have that ability to connect both ways. I feel that there is both an up and a down connection which people don't have and I think that is part of the issue because if you're really good at connecting up, then you don't really know what's happening on the ground and if you're really good on the ground, you're actually not bringing to the board or maybe having strategy and vision upwards.

MR BANKS: I'm not getting a clear signal from when you say - I mean, you're sort of talking about deficiencies rather than people excelling and therefore deserving the remuneration packages that they're getting. Do you think our CEOs and our senior managers are better now than they used to be?

MS ANTHON (AIM): Some, and I'm not sitting on the fence on that. I'm saying some are and some most definitely are not. I think the complexity of the current environment hides some of that and I think that in dealing with this and dealing with that, dealing with this and dealing with that it can actually mask some underlying lack of skills which only show themselves when something goes wrong. So some managers definitely are, but they are not necessarily the managers who are getting, in all cases, the very high packages.

MR BANKS: What about succession planning in companies. Do you have any observations on that? Clearly the whole question of the gene pool from which you draw to choose the best CEOs has been discussed a lot and people have argued whether that is an international market or whether it is mainly domestic. But clearly an important strand of it is the international succession procession in companies. Do you have any views on that?

MS ANTHON (AIM): Two comments there, once again not researched so anecdotal, but we would say that's highly variable. We work with managers and organisations where there are very clear succession plans and we work with places for whom that isn't even a consideration. We would also find that culturally in Australia there doesn't seem to be this internal grooming of the company guy or gal but that seems to be a little bit of an American Jack Welsh GE-type thing. We would also consider it an area of further research as to whether those people who have been deliberately groomed for succession actually turn out to be a more effective person or whether they haven't and I think that that is an area that actually asks for a bit more investigation. But certainly in Australia it is not as strong in our observation that people are actually groomed for that task.

MR FITZGERALD: Somewhat related to that, the issue of the CEO and his or her motivation is central to this inquiry.

MS ANTHON (AIM): Yes.

MR FITZGERALD: It's not clear to us that there is any research at all - but there might be - that shows there is a direct link between performance and quantum, but there is a direct link between the design of the package and some performance outcomes and they're different. I was wondering whether you have any insights or research that actually demonstrates to us the relevance of remuneration and either performance or motivation of senior managers, not just the CEO, because for some there seems to be a presumption that quantum in some way or another is an important component in motivation. What we would recognise is that quantum can be very important in matching the market in attracting or retaining people. But my question is not that, it's different. It's actually saying, does quantum actually motivate senior managers beyond a certain point?

I know there has been a lot of work by human resource people at lower level management about that issue but at the senior ends I have not seen much. There might be substantial research which I am just not aware of.

MS ANTHON (AIM): We're not aware of that research, but that is not to say it doesn't exist because our focus is very much in the managerial domain rather than director domain. The second thing we would say is the jury is even out on motivator factors for managerial people down the pecking order too and there are very different schools of academic theory on that link between motivation and performance regardless of the level. So I think that there is again a little bit of gap at the senior level, I think there is a gap at the senior level in the Australian context and I think, as in most academic disciplines, there are different ways of viewing the motivation performance connection.

MR FITZGERALD: Can I just move to a couple of governance issues and again, I just want to put back some of the things that have been put in our submissions and again you may not have a view about them. One of them was put to us that there should be a move away from CEOs actually being on the boards.

MS ANTHON (AIM): Yes.

MR FITZGERALD: We are a lot different from America where often the CEO is the chairman of the board and the governance arrangements are at best murky or mushy, as somebody once described it. We have greater clarity. But I wonder whether or not again you have an insight as to whether or not, given that you see a clear distinction between management and, in a sense, the director level, the CEO sits in a very strange place, it plays both.

MS ANTHON (AIM): Absolutely.

MR FITZGERALD: Is there time coming when we actually question that or is that a given and it's an appropriate given?

MS ANTHON (AIM): I'd like to make it very clear that I can't speak on the whole of the Australian Institute of Management but I can make it clear that I speak on behalf of the Australian Institute of Management Queensland and Northern Territory because in fact we are asked that on quite a few occasions and the view of our CEO is that in fact the CEO should not be a member of the board.

MR FITZGERALD: Could you just give me the reasons why you are of the view.

MS ANTHON (AIM): The reason for that is, as shocking as that might seem on one level, is that it makes it very difficult for that person to decide what hat they are wearing. It makes it very difficult for that person to be saying, "Okay, we're having that discussion but it relates to you" - particularly in regard to remuneration or this or that or this or that - "and therefore are you in the room as yourself or are you in the room as a director?" and there is a tension in that. I would like to make clear that we're not naive to the extent of the impact that could have, but we're just saying one of the issues is that that person fills two roles and no-one else at the table does. No-one else at the table has any lack of clarity about in whose interests they should be there, and that is the issue.

Again, I do need to say that's a view of our group here in Queensland, it's not necessarily the view of others. We haven't put that to them.

MR FITZGERALD: I wasn't aware that you had a position on that, so that's good. The second one was more obscure and I suppose in one sense a proposition put to us that if CEOs are in fact directors, they're currently exempt from being voted in or out as a director. Some have put to us that CEOs should be like all other directors and that is subject to shareholder votes.

MS ANTHON (AIM): Yes.

MR FITZGERALD: Again, not a proposition that has been put by many proponents but by some. Again, the same thing, I wonder whether you have a view about that.

MS ANTHON (AIM): No, we don't have a specific view on that but again, anecdotally we would say that we would be supporting any position that made it really clear for the CEO who is charged ultimately with the daily operations of the company to have absolute clarity about the role they play and who they are reporting to. So that would be our big prism first statement, who are they actually reporting to? Then, of course, we get into some of the philosophical discussions too.

MR FITZGERALD: Can I just ask this on that without trying to push you too far. Who do you think they should report to? If they are both a CEO and director and directors are responsible, in a sense, to the shareholders as well to the company, who is the CEO responsible to if they hold both those positions?

MS ANTHON (AIM): Therein lies the rub, if they hold both of those positions, their legislative calling is their role as a director and their role as a director is ultimately and technically back to the shareholders. But in a day-to-day landscape and remember as the Australian Institute of Management we're interested in people's day-to-day actions, CEOs take their riding instructions from the board. So again you've got that inevitable tension with potential for lack of clarity about who's actually calling the shots. No matter how much removed a shareholder is, at the end of the day, as it currently stands, they do have an impact in their ability to vote with their feet, with their money or vote for directors. I'm not being evasive on that, I'm saying it's something we're got to grapple with.

MR FITZGERALD: A last comment on that, the issue of the celebrity CEO has arisen in this inquiry. Of course, it's a nice catch-all phrase and, of course, it has no meaning other than, you know, very high profiles CEOs have come and gone with variable performance records. I was wondering whether the institute itself again has a view about this notion of the importation of the celebrity, the superstar CEO as distinct - and I think it's powerfully linked into your view about how you develop quality managers within. But it has been a central theme in this inquiry that again, to some degree, remuneration packages have been distorted by the desire of directors to find the superstar, the celebrity. I was just wondering whether you have about that sort of syndrome and have we moved through it, are we in it or does it matter?

MS ANTHON (AIM): I think we're moving through it. I think we had a good dose of it but we are hopeful that we are moving through it. We would say that in fact the cult of the celebrity CEO again is interesting culturally because I think it's borne more in another context and then in an attempt to play in the sandpit I think we've imported some of that, "Well, we've got to have this person because they are high profile," or this and that. We would say that for us it is about the skills that people bring to the table and that those are not necessarily wrapped up in a celebrity, if you like, CEO.

But I do have to make the comment that I think certain directors and certain shareholders look to that as in, "We know that name," or, "They were good somewhere else therefore," or, "They will have a magic wand," or or or, and I think we're not quite through that but I do believe it can mask what that person is actually bringing to the table and if they're a celebrity in this instance, do they have skills to transport those to another place. They answer might be yes, by the way, and the answer is their reputation may be well earned. But I think we have to go back to reputation and value rather than celebrity because I don't think celebrity helps and I think too it actually magnifies at both ends. I think it magnifies when things are going well and I think it magnifies when things aren't going well because people go, "Oh, how exciting, here's a big fish who has failed," and we Aussies do tend to be the tall poppy syndrome so I think it is magnified.

I believe through what we're hearing - and others could probably speak more fully to us - I believe we're actually moving a bit through that but I think there are still some remnants of it and I think it comes back to the short-termism and the quick fix.

MR FITZGERALD: My last comment then related to that is simply the directors. One of the issues that people have raised with us is the quality of directors.

MS ANTHON (AIM): Yes.

MR FITZGERALD: Again you represent management as distinct from directors. Again, I'm sure the answer is that it's variable, you've got good directors and you've got poor ones. But is there a concern in the AIM that the quality of directors or the pool from which we draw directors is sufficiently robust to ensure that they in fact are the best we can get for governing these particular corporations, particularly those larger complex ones?

MS ANTHON (AIM): As you flagged, we don't seek to speak on behalf of those organisations who develop and support company directors. But we are the people who have to work with the company directors and we are the people who actually see the result of that gathering of different skills at the table. Again, we would say that the situation is variable and we would also have to say, "What is the current incentive" - and I don't mean just monetary incentive - "Why would someone be a director? What would motivate them to do that?" We are just seeing that people have highly variable motivations for doing it and that can have an impact on boards, it can have an impact on the sort of people who decide they will acquire the skills or come into the pool.

So I guess our place in space is such that we are more at the receiving end of the quality of the directors at the table and we don't see that changing a lot for the better. We don't see it changing a lot for the worse either at the moment. But we don't see a significant jump either way.

MR BANKS: Thank you very much for taking the time to appear this morning.

MS ANTHON (AIM): Thank you.

MR BANKS: We will just break for a moment, please.

MR BANKS: Our next participant this morning is Effective Governance. Welcome to the hearings. Could I ask you please to give your name and your position with that organisation.

MR BECK (EG): Thank you, gentlemen. My name is James Beck, I'm the managing director of Effective Governance. We're a Brisbane-based governance adviser firm. We do a lot of work throughout the nation with various boards. Our core focus is to actually help organisations to be more effective in their governance, thus the name. Over the last three years we've worked with over 200 organisations through and across not for profit through to ASX listed, through to private entities large and small. In the last five years we've conducted over 150 board evaluations. So whilst we haven't taken the time to sit down and analyse the results of all 150, we have some anecdotal observations which I'm happy to share, depending on what questions you ask.

If I may state my general observation is that Australia is adequately regulated, the earlier questions that you've asked the other participants. But I think we must continue to embrace the if not, why not approach to regulation and that, I think, has stayed steady and good during the last couple of years and if we go down to a more mandatory approach I think we're in danger of creating rules which are then broken rather than justify why they're not doing it. In our opinion the focus on levels of remuneration is not necessarily the issue. The issue is about transparency of assessment of a CEO and the board so that irrespective of what they're physically getting paid, it's about ensuring that there is a transparent and formal process in place.

Again, anecdotally we will say to you that there is a large number of organisations out there that do not have a formal CEO assessment process in place. So if they don't have a formal CEO assessment in place, how can they actually conduct and say at the end of the year, Congratulations, you've got these bonuses."

MR BANKS: Sorry, would that include ASX-listed companies?

MR BECK (EG): No. I don't have any information on that. So bearing in mind, outside the ASX, it's a fairly large - you'll also be surprised as you move down the tree, or the pecking order, if you like, of companies, a large number of CEOs don't even have contracts in place, or have contracts which are that outdated that you can drive trucks through them.

So whilst the focus is very keenly on ASX-listed entities, the reality is where do we grow these behaviours if it's in the non ASX-listed companies. So we should be starting to say to organisations, "Yes, we have got the ASX guidelines, the Corporations Act, saying, 'These are what organisations should be doing, ' and the guidelines are things that we should be following to be good ASX-listed entities." We actually advocate to non ASX companies - private, public, whatever they may be - to follow those guidelines.

Short of keeping the market informed, the guidelines all give a very good framework for organisations to follow. So as such, and this is my final comment, if you're considering regulating something, it should not be an amount of money that people are paid, both directors or CEOs, it should be regulating that there is a formal transparent assessment process that is tied to the strategy and the outcomes of the organisation; as the previous speaker, Vivienne, talked about, making sure the organisation is heading towards expansion, and, if that is achieved, then the shareholders are getting what they expected to get, so therefore the rewards should be such and put in place so it's one of assessment, not an amount of money. That's my general comment and observation. I am happy to take questions.

MR BANKS: Good. That is I think a very useful contribution. You talked about the 150 board evaluations that you conducted over time. What was the mix in relation to publicly-listed or other companies there, or size of companies?

MR BECK (EG): Just ran through those analyses only last week. About 65 per cent of them were, if I could say to you, government-funded or sometimes deemed to be not-for-profit. The remaining 35 were a mix of a handful of listed entities in there, but not significant, and the rest are mainly private organisations.

MR BANKS: This inquiry is focusing on the publicly-listed companies obviously.

MR BECK (EG): I understand.

MR BANKS: But do you have any observations, particularly at that end, from your own evaluations or any other evidence, about, I guess, the quality of boards, the ability of companies to attract the right people, and indeed whether there are any impediments to getting good people onto company boards?

MR BECK (EG): Again I build on the previous speaker's position. Many people come to us and say, "I want to be a director." I ask them, "Why?" Why would you want to take on the level of accountability and responsibility that is placed on you by the shareholders? Forgive me here, but again outside the ASX-listed entities, if you divide the number of hours that those directors spend being a director, in the interests of the shareholders or stakeholders of the organisation, divide that by the number of hours that they spend by the income, your household cleaner would probably get more than those directors get paid.

It's not money, some do it for ego. But some do it for return to the community, because they're in that position in life to do so. Some also do it for the journey to get to an ASX-listed entity as a director. So the barrier is this level of expectation of accountability. What we're seeing is a very strong trend for organisations to consider advisory boards rather than formal boards, because they get the same value out of it but without the accountability.

MR BANKS: Just going from that to I guess the name of your own company and its focus on governance, any observations you had about the state of governance in our corporations, particularly perhaps moving into the private corporations or publicly-listed ones. My colleague was saying earlier that Australia is generally seen as having far better corporate governance than the USA, and that has been reflected probably in better outcomes in a whole range of areas, including executive remuneration. But do you have any observations about that and areas where governance could be improved?

MR BECK (EG): I actually support Robert's view. I think Australian governance in general is fairly sound. My fear, as I opened with, is that we over-regulate it. That's not to say that what is in place at the moment is not. Yes, I actually believe it's appropriate, what we do have. The American system is challenged and the British system is old-school. The Australia system is looked by many other countries - I was in Singapore only recently, where they aspire towards what we actually do here. So we have a good firm base to move from. Sorry, the second part of your question, Gary, was?

MR BANKS: Notwithstanding those comments about the state of governance in Australian corporations, whether there are any areas where you think there could be improvement, particularly bearing on this question of executive remuneration.

MR BECK (EG): I think the biggest focus that governance needs to be focused on is making sure that we have got the right skills around the boardroom table. With this continual drawing from a pool of known directors, you can understand why they do that. It's like, "Well, I want somebody with the experience, and proven experience, rather than taking on board somebody who may have the attributes but hasn't got the track record," also, putting in place a process around which you bring those skills onto the board in structured manner, and transparent manner, for shareholders.

We are seeing some government-funded organisations clearly defining, based on the strategy of the organisation, the skills that they need around their boardroom table and then mapping those skills against the directors that they have; that is what I call transparency of, "We have the right skills."

I'm not talking, "We need an accountant or lawyer," I'm talking about getting down to the level of, "Our strategy is to focus on an overseas expansion," for example; "Therefore, we have got somebody with overseas expansion experience on the board." That's the level of transparency that should be in our annual reports - but sometimes, you know, we have got the nice pictures and that - a good summary of how it was formed. So I think that's probably the biggest focus that the board should be considering, and that would actually in a constructive manner draw people that are outside the current gene pool into the mix and give them the opportunity.

MR FITZGERALD: You started by your comments about how you encourage non-ASX companies to actually adopt or follow the guidelines for that. Some have said to us that if you impose any form of regulation or requirements, then they should apply to the non ASX-listed companies. Clearly those that are proposing that are those people that have ASX-listed companies. Are there dangers in that approach though? You said, for example, you endorsed the notion of an if not, why not. But the if not, why not requires you to explain either to shareholders why you have deviated or to some quasi-regulator.

In non ASX-listed companies they're generally closely held, although not exclusively so, and, apart from ASIC, there isn't anyone else who shows an interest in them. So if not, why not only works of there's somebody that you're reporting to, and, if they don't like what you've said, can act. So I'm just wondering whether or not it is a seamless space between ASX-listed and non ASX-listed, both in terms of the guidelines and, more importantly, your notion of if not, why not. Now, it's also true to say that there are some very substantial non ASX-listed companies which have quite substantial non-traded shareholders.

MR BECK (EG):   As soon as you get an organisation that has more than one owner, or more than one stakeholder, I believe the if not, why not process or considerations need to be presented back to the shareholders or the stakeholders. So the organisation has gone through the process of saying, "We have considered these factors and we have chosen not to do this, for the following reason, we're too small. We can't do the following activities," and that's an okay answer, but at least they have gone through the process and made a constructive decision and said, "This is the reasons why we can't do that." As far as should it be mandated to the non-listed entities. Definitely not. As I said, it's kind of like an if not, why not just on the principles alone.

MR FITZGERALD: Then the second thing is, if it makes good sense to assess the performance of a CEO, irrespective of the size of the company, one would think that boards would want to embrace that. Clearly what you're saying to us is they're not, and that would ring true, from what we have heard from others. So I suppose the question for me is what would change that behaviour. Acknowledging that black letter law is not often the way to go, what are the incentives for them to do that; and if the incentives are in fact totally non-regulatory, why have they not adopted those good practices anyway. In other words, what is the mechanism by which you will see improved performance in this area?

MR BECK (EG): I suppose the question you're asking me is, "Do you put such a concept about, well, what the ASX guidelines at the moment suggest the board should be reviewed?" So has that worked effectively? Some would argue that it hasn't, and they'll have an if not, why not process that they take them through. If the question is, "Do we put CEO assessment in the guidelines and make it an if not, why not process, then will it actually be effective?"

You may get the same outcome as you have with the board evaluations: only those that either have a problem and need to sort something out, will they revert to it; rather than taking a proactive approach to putting in place more effective, fair governance. The alternative is to slide it into the Corporations Act, which then moves it into black letter law. That's not my place to pass a comment on. I'd much rather see you focus on the assessment process than trying to legislate gaps, amounts of remuneration for executives. So if you're going to legislate something, don't legislate the amounts.

MR FITZGERALD: My third comment is related. Do you think the role of ASIC needs to be improved in the space of non ASX-listed companies? I'm not necessarily saying through law, but again, for example, ASX has a range of guidelines, the Institute of Company Directors have guidelines. The one player that I don't think has guidelines at all is ASIC, and yet they are the regulator to the vast majority of companies that exist in Australia. The ASX is only a small portion of the number of companies, although a very large percentage of the economic activity. So just a question: does ASIC have a role, if not in black letter law regulation, in a more supportive role, in terms of guidelines or encouragement of better behaviour or performance?

MR BECK (EG): I have never put my mind to it. So I'd probably need to consider that further. Something jumps out in that comment of, "Who regulates the regulators?"

MR FITZGERALD: I think you have the answer to that, we'd be grateful.

MR BECK (EG): You did ask another couple of questions about managing directors and CEOs.

MR FITZGERALD: Yes.

MR BECK (EG): If I may pass a comment on that. I support again what the Australian Institute of Management's observations were for Queensland, and that is the wearing of two hats is quite problematic. That's not to go to say that other directors in the boardroom do not have multiple hats. The consideration is as CEO running the organisation and leading the organisation sometimes you actually have to stand up against the board for the betterment of one of your stakeholders. and that is your people, where you are then conflicted is versus your requirement to represent the best interests of your other stakeholder, which is your shareholders. So the balancing of that puts the managing director in a very difficult position. My personal perspective is that they should not be one and the same person, they should be separated.

There has been numerous discussions in the last couple of hours about the role of the board. We'd actually advocate that there is a defined set of activities the board should be conducting. One is formulation and direction of the organisation from strategy. The second primary activity is the management of their only employee, and that's the CEO. Then there's about eight other activities they should be conducting, and there's many various observations of what they should be. But those two of strategy and CEO are the primary functions of the board. If you're a managing director sitting around the table as an equal with your other directors and you're supposed to be managing your CEO function, you are then conflicted in that process.

MR BANKS: Thank you very much for appearing, at short notice as well.

MR BECK (EG): Thank you.

MR BANKS: I think that's the last of our participants, I just confirm that, for this round of hearings. We have had very strong participation so far in the hearings. We have had a lot of submissions now, about 100 submissions; many of them of great substance. So we are very grateful for that. On behalf of my colleagues Robert Fitzgerald and Allan Fels and myself and the commission, we thank all those who have contributed to this process.

We are now going to get on with the job of producing a draft report, which will appear in late September. We will then have another round of hearings, to give people an opportunity to comment formally and discuss the draft report with us, which is an important part of our process. Others will simply make submissions. So we are expecting to get a lot more submissions in response to our preliminary findings and proposals in that draft report. So I here by declare the hearings closed. Thank you very much.

AT 10.46 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY