I have recently published an article in Online Opinion's web magazine which deals with this issue. I attach a copy of that article and provide the URL herewith: http://www.onlineopinion.com.au/view.asp?article=8670 . An earlier article on a similar topic appeared in December 2008: http://www.onlineopinion.com.au/view.asp?article=8230

In 1996 Nelson ITP published a book edited by me ***Business Ethics in Australia and New Zealand - Essays and Cases*** in which I had a chapter entitled

"The ethics and performance criteria of Australian executive remuneration packages" , Chapter 10. This was one of the first academic exercises of this kind. The only other academic who wrote about this, at the time, was Professor Ian Ramsay (now of the Melbourne Law School)

I have been interviewed recently a couple of times about this trend by the Rev. Bill Crewe (2GB)

I believe strongly in Government intervention and advocate the introduction of a **ratio** between the average wage and the **maximum** CEO package of 1 : 10. The reason why Australian executive salaries have not been touched at all by governments is (1) that major political parties are dependent on large corporate donations (2) the more senior politicians expect to become directors of consultants after their parliamentary careers. They would want to upset their future employers.

Yours sincerely,

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Commonsense fairness - CEO pay

By Klaas Woldring

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The issue of huge payments to CEOs has finally reached crisis proportions. For decades political leaders have called for restraint but in reality have done very little about it. In fact, they are very much part of the problem. Recently, Prime Minister Kevin Rudd condemned the excessive salary packages, even at the G20 summit.

He has delegated the task of bureaucratic oversight to APRA (Australian Prudential Regulation Authority). However, APRA only wishes to avoid excessive risk-taking in Australia's financial institutions. APRA has said that it does not intend to focus on the levels of compensation paid to executives.

The real issue is what to do about it. It certainly requires political will and intervention to set remuneration levels. Remember first of all that there is little or no correlation between CEO's compensation and organisational performance. There are numerous instances of obscenely high payments for CEOs while poor organisational performance is the norm. The "pay peanuts and you get monkeys" justification of high packages is nonsense. Other factors are relentlessly driving that spiral. What should be the guiding principle when seeking remedies and who should implement them? Above all let's be guided by common sense fairness. The average wage is about $52,000 a year. The Pacific Brand CEO’s package is $1.8 million - about 35 times the average wage. However, there are many packages that come to 75 times, or even 100 times that. The spiral is totally out of control.

Clearly this situation requires government intervention. There is no sound reason at all why governments should not mandate as to remunerations for private sector CEOs and executives.

The position taken by the Australian Institute of Company Directors (AICD), recently restated, is that only Corporate Boards can set CEO pay levels, but this has proven to be painfully self-serving and inadequate. Government intervention could be done best by legislating for a maximum ratio based on the average wage of 1:10 as the maximum base salary package for a CEO. I suggest that this is would be a very generous proposition. That cap would result in a maximum CEO base salary of $520,000.

Surely all income derives from the same common economy. An egalitarian society cannot afford double standards: democracy or plutocracy is the choice here. Quite apart from this ideological preference, the practicalities of containing unsustainable wage increases and/or workweek reductions surely demand not just brakes but serious reductions in CEO packages as well.

Disappointingly, several ALP Ministers have already said that it would be "very difficult to do something about it". Why would that be so? Well, politicians often have a life after Parliament and many join the corporate elite as directors or consultants. There are plenty examples of this. Former New South Wales Premiers Nick Greiner and Bob Carr come to mind. Both are earning far in excess of their salaries as premiers. We could also mention the former ALP Federal Minister Graham Richardson, and many others. Politicians would not be interested in upsetting possible future providers of corporate benefits.

Furthermore, both major parties are beneficiaries of very substantial corporate donations at election time, the subject of a current Parliamentary inquiry initiated by the courageous ALP Senator Faulkner. It remains to be seen if Faulkner will be successful. Public outrage is intensifying as a result of media coverage. Remarkably, it doesn't seem to occur to the political leaders that drastically tackling this issue would actually result in the approval of a great majority of voters!

There are other measures that could be introduced, either in addition or independently:

shareholders could be empowered to approve executive salaries; a very progressive income tax above a certain income level could be levied, say above $100,000; and employee share ownership schemes and workplace democratic institutions could be introduced, as done in the US and Europe for decades already. Australia is very late with this.

The Australian Shareholders' Association (ASA), in a recent draft for consultation purposes, while supporting the view of AICD on Board prerogatives, do want to give shareholders a much stronger voice in approving or disapproving remuneration reports and recommendations. At present they can only voice an opinion. Moreover, mostly even the big institutional shareholders have gone along with recommendation by Corporate Boards. Clearly, empowering shareholders would also require new legislation - therefore government intervention.

Similarly, any increase in marginal tax for high-income earners would require political will and action.

Finally, the government could develop legislation to facilitate broad-based Employee Share Ownership Plans, as in the US, as well as legislation to introduce participation by employees in decision-making, as exists in most European countries. Involvement by employee representatives on Corporate Boards, plus permanent Employee Enterprise Councils, would achieve much greater workplace democracy. This would ensure transparency, advance knowledge of strategic plans for the business and break down the "them and us" culture. The government draft industrial legislation package now going to the Senate should include such measures rather than sticking with the old adversarial context. There is really nothing innovative in this package.

In the US, where the incidence of obscenely high executive salary packages is greatest, there is evidence that ESOPs (employee stock ownership plans), covering 10 per cent of all employees, act as a brake on executive remuneration.

The National Center for Employee Ownership (NCEO) has conducted a survey on this topic *Executive Compensation in ESOP Companies*, November 2005. The results strongly suggest that ESOP companies have a much more restrained approach to executive remuneration than many of their non-ESOP peers. Executives in ESOP companies earn less than their peers in similar non-ESOP companies, both in current and deferred compensation.

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Overpaid and under performing
By Klaas Woldring
Posted Monday, 1 December 2008

This is an interesting and important question. The first thing one can say about it that a search on Google yields little on this specific subject except relevant information provided by the National Committee on Employee Ownership (NCEO) in the US, discussed briefly below and, of course, the Mondragon experience. For information on this successful group of cooperatives in the Basque province of Spain see here. In recent weeks the widespread disenchantment with grossly excessive executive salaries has finally resulted in a flurry of opinions as to how this has happened and what to do about it. Indeed there has been much more criticism from senior politicians than is customary with such episodes in the past. Just recently it was discussed also at the G20 meeting where PM Kevin Rudd specifically described the trend as an untenable situation.

While it is argued that greed is the principal cause there are also other causes as well and plenty of justifications like the usual "Performance Pay" argument and "if you pay peanuts you get monkeys".

Early critics of the trend were Professor Ian Ramsay and myself in the early 1990s (Woldring, 1995). We both found that there is only a weak or, more often, no correlation between high executive pay and performance. Other researchers in the US and Australia have basically reached the same conclusion.

A justification within Australia has always been, "if we don't pay for talent it leaves the country". Where to? The US presumably. Not anymore perhaps, as many finance industry high fliers are actually coming back. However, that justification for spiralling salaries has never been very convincing. People migrate for many other reasons than just for doubling or tripling their pay elsewhere.

The causes of high executive salaries are many and varied. The "infinite wisdom" of the market place riding high in a time of economic rationalism; lack of preparedness by both major political parties to curb excessive salaries, probably preferring not to upset their corporate donors; weak boards; and lack of shareholder power are some of the explanations.

The endless, pious criticism from and moral exhortations by PMs and Treasurers has been singularly ineffectual in remedying the situation The recruitment head hunters have of course been great beneficiaries of the ever-higher packages in the shape of their own spiralling commissions.

Disconcertingly, there is little doubt that in Australia, as in the US, the Reward For Failure (RFF) principle can often be demonstrated as well as the amazing associated principle the Promotion of Proven Duds (PPD), both in the private and public sectors. We can be sure then that the highest paid are not necessarily the best at all.

With the growing financial crisis - and in Australia the superannuation crisis as well - finally the spotlight is on executive salaries and PM Rudd has even outlined some rather bureaucratic, regulatory ways to deal with it. No doubt there are still other ways that could effectively deal with the problem, like progressive taxes, greater power for the shareholders and more transparency.

In the UK *ESOP News* (The ESOP Centre, November 2008) reports that a "claw back" regime is being prepared "on both sides of the Atlantic" suggesting that foreshadowed performance bonuses will not be paid or may have to be repaid. This is also expected from the Obama Presidency as well as from European Commission.

While this is encouraging news the latest reports in the UK suggest that although the UK Government has bailed out several major banks, the "City" bankers (the Big end of Town) have nevertheless decreed that "bonuses will be paid as usual". Critics claim that the corporate elite culture there brooks no government interference in their extravagant remuneration practices - a pretty arrogant attitude.

But what about ESOPs? Employee Share Ownership Plans provide opportunities for employees to become co-owners in the business they work in. They were started in the US by Louis Kelso in the early 1980s. About 10 per cent of US employees are members of an ESOP there.

Since 1986 the Australian Employee Ownership Association, a local advocacy group, has endeavoured to persuade governments to introduce favourable tax legislation for broad-based schemes (www.aeoa.org.au). This development is still in its infancy in Australia.

Could ESOPs be a curb on executive salaries? That would depend on many factors. If we think of co-operatives, as 100 per cent ESOPs, also typical of a high degree of industrial democracy, the directors and executives would not get away with excessive packages. Indeed the members would decide what their reward would be. In Mondragon the rule is that top managers should not earn more than six times the wage of the lowest employee. While managerial talent loss to the private sector in Spain has made this rule hard to enforce in recent years, the practice forms a stark contrast with traditional capitalist corporate culture.

In the capitalist corporation the board of directors comprises a set of like-minded corporate chiefs. Supposedly "independent", writers like Bebchuk, L and Fried, J. in (2004) Pay without Performance - The Unfulfilled Promise of Executive Compensation concentrate on the seriously flawed assumptions underpinning Agency Theory. They analyse and lament the lack of independence of boards, lack of systemic performance checks and the unquestionable weakness of shareholder power.

So, apart from an ESOP having the usual positive effects on employees' commitment, e.g. productivity, loyalty and income benefits, under what under what circumstances could an ESOP be a moderating and democratising instrument that would ensure: equitable remuneration of the senior management in relation to the entire staff; transparency of executive packages; and effective checks on executive achievement. First of all, the ESOP would have to be very broad-based. At present a high percentage of ESOPs are still executive type and generally highly lucrative. The percentage of take up would need to be increased very substantially.

Second, employee shareholders or their representatives need to be involved in the decision-making processes of the firm. There are many ways of achieving "Employee Voice", the Enterprise Councils in Europe are a good example.

Third, employees or their representatives must be able to propose the replacement of non-performing executives. After all, it their future that is at stake.

As far as Australia is concerned, where the problem of excessive remuneration exists, in large listed companies, employees own less than 2 per cent of the voting capital, without employee voice. Furthermore, all general shareholders, who in theory have control over remuneration strategy, can only comment on the remuneration plan presented at the AGM. The main shareholders are fund managers (e.g. super funds). Usually, these have either supported remuneration recommendations or have remained silent on them. Where they have voted them down boards have often taken no notice of it (E.g. Telstra), although some have. Fortunately in Small and Medium Enterprises (SMEs) excesses of executive remuneration are not common.

Encouraging broad-based ESOPs would require not only a culture shift in both management and employee attitudes in Australia but also in industrial relations. In the light of the current economic climate that is something that could happen, with Government assistance. The crisis is here and lots of things could actually change for the better as a result. The 2004 ESODU research found that overall only 4 per cent of businesses had broad-based ESOPs (meaning that it was open to at least 75 per cent of staff). There is clearly room for massive improvement.

In the US, where the incidence of obscene executive salary packages is highest, there is evidence that ESOPs, covering around 9 per cent -10 per cent of all employees, act as a break on executive remuneration. It should be remembered though that workplace democracy, European style, is not supported by legislation in the US and is not common. A combination of these two strategies would tend in the direction of the Mondragon experience, well known and admired.

The US National Centre for Employee Ownership (NCEO) has conducted a Survey on this topic Executive Compensation in ESOP Companies, November 2005 98 pp.

NCEO states: "this book includes a report on the first-ever survey of executive compensation in ESOP companies. The results strongly suggest that ESOP companies have a much more restrained approach to executive compensation than many of their non-ESOP peers. Executives in ESOP companies make less than their peers in similar non-ESOP companies, both in current and deferred compensation".