Australian Government
Productivity Commission
Submission on Executive Remuneration

By

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Purpose:

To provide an input into the Public Hearings on Executive Remuneration by outlining the impact of modern and quantifiable human capital management (HCM) approaches on the valuation of roles.

Submission:

Human Capital Management has developed over the past few years to a point where Human Resources/Assets can be quantified and valued allowing them to be managed as well, if not better than other organisational assets whether Financial, Plant and Equipment, Inventory etc. The value of the HR asset can be established and placed on the balance sheet if accounting standards would allow. There are a number of features that allow human assets to be better managed than other assets, for example a HR asset appreciates while physical assets like plant depreciate. Furthermore in HCM the asset is valued on its contribution to the organisation and any deviation from the specification can also be assessed and taken into the measures, this is not the case for other physical assets like vehicles, motors etc. HR assets are purchased and must be maintained to ensure value is obtained.

This submission presents that in any organisation:

1. Roles (defined contribution points in a structure) can be sized and valued based on the defined contribution to the organisation (specification of requirements) and
2. The incumbent can also be sized and valued against the designed role (shortfalls against the specification).

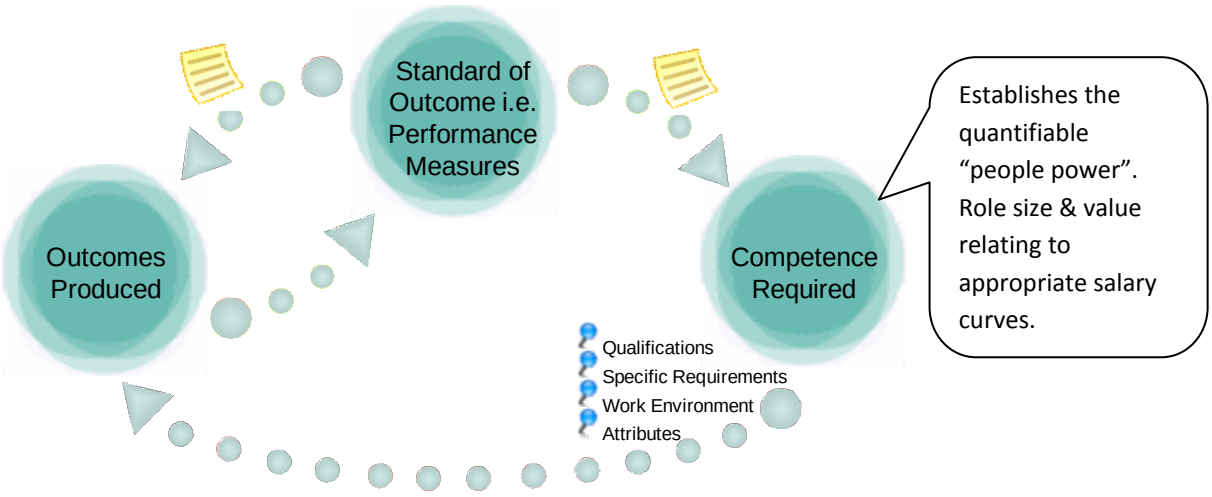
The designed role can be applied across a national or global structure as its size remains constant while the value is related to the relevant currency and salary curve positioning. This provides for responsive and appropriate decision making including international equity and competitiveness.

This quantitative sizing and valuation of the roles within a current (or even future) structure allows HR assets to be placed on the balance sheet (if accounting standards would allow it) and a new series of performance measures could be introduced including:

1. Ratio of Employment Cost (total or department) to HR Asset value
2. Return on HR Assets

The HR Asset balance sheet value is determined through a logic and robust approach which is as sound as say plant and equipment valuation. The logic and robustness is derived from the checks and balance that can be applied:

1. Outcomes produced by the role as designed;
2. Performance measures or standard of the outcomes, and then
3. The competence required to produce the outcome at the standard required.

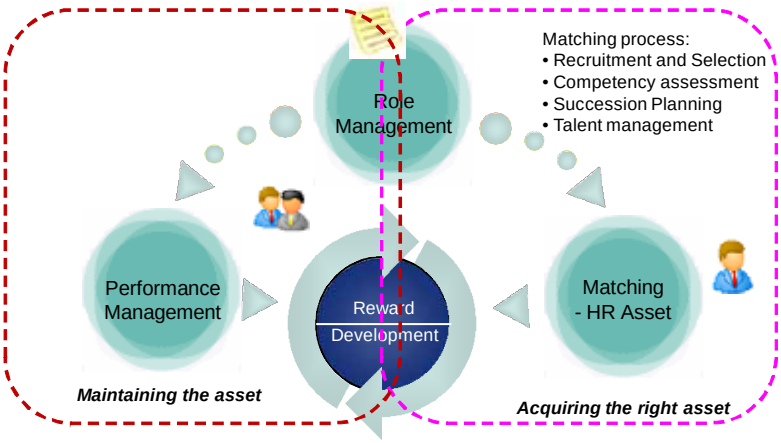


The HR Asset value is the "Base Salary" value from which the package is developed including any adjustments required in the "cash amount". The base salary and performance payment are the variable components of the package and what Board and shareholders are interested in. If the performance pay is calculated as a percentage or other relative proportion of base salary (this is a measure of relative contribution) then base salary becomes the key driver in determining the total package.

Similarly when an individual is appointed to a position (specific role), they are sized and valued on the same basis as the role. The appointment of the employee may be an external recruitment, internal promotion/movement or an assessment for succession planning, role changes etc. The individual assessments not only ensure the individual is remunerated correctly (contribution against this role) but the gaps are identified and development planning can be put in place prior to appointment.

Salary curves have been used within sectors and organisations for many years providing approximate "job" worth in very generic terms. These salary curves can now be produced much more accurately utilising the same role sizing methodology described above (reverse engineer the existing role design). While these curves already exist and can be enhanced, it is only in recent years that the value of the contribution at the top 2 to 4 levels has being ignored and become distorted in some organisations. This distortion has largely been the result of a combination of the role contribution value (base salary) with the perceived "Market Adjustment" within the package. Protocols or guides for establishing "upper" points have been proposed and adopted throughout the world for many years. An example is the article in the Financial Review 1st June 2009 which proposed 10x the average as the maximum. While existing contribution curves can be enhanced significantly, they have operated with reasonable effectiveness for the majority of the hierarchy in organisations for many years. The extension of this contribution curve, as a mathematical formula, to the upper levels involves a combination of commercial reality and acceptability just like managing any other asset. There will always be "*Holden*" organisations and "*Mercedes*" organisations but this has been, and will continue to be, catered for in the statistical distribution 1st Quartile, Median and 3rd Quartile (percentiles). The systems in use for many years to establish salary curves have, in principle, been relatively effective but lacked methodology and quantitative rigour which is now available.

While the acquisition of the HR asset is normally a one-off (diagram RHS), the maintenance is an on-going process and can be addressed through a quantitative performance management system shown in the following diagram (LHS).



A true performance management system is definitive and the employee themself knows how they are performing and can utilise the system for performance management and reporting (exception and interventions actioning).

Conclusion

It is possible utilising modern human capital management to size and value human assets and manage these as well as, if not better, than other assets whether financial, plant and equipment, inventory, buildings.

The question of Base Salary value is a factor of determining the role size and relating this to the appropriate salary curve which is determined by location, currency and competitive market positioning (not adjustments).

Salary curves have been in use for many years and while the principle is sound it has been the lack of quantitative rigour that is now available through HCM methodology that has exacerbated the executive salary issue. This includes extending the contribution curves to the upper "Executive" levels.

Base Salary or contribution value forms the basis for developing the package including the "Performance Pay".

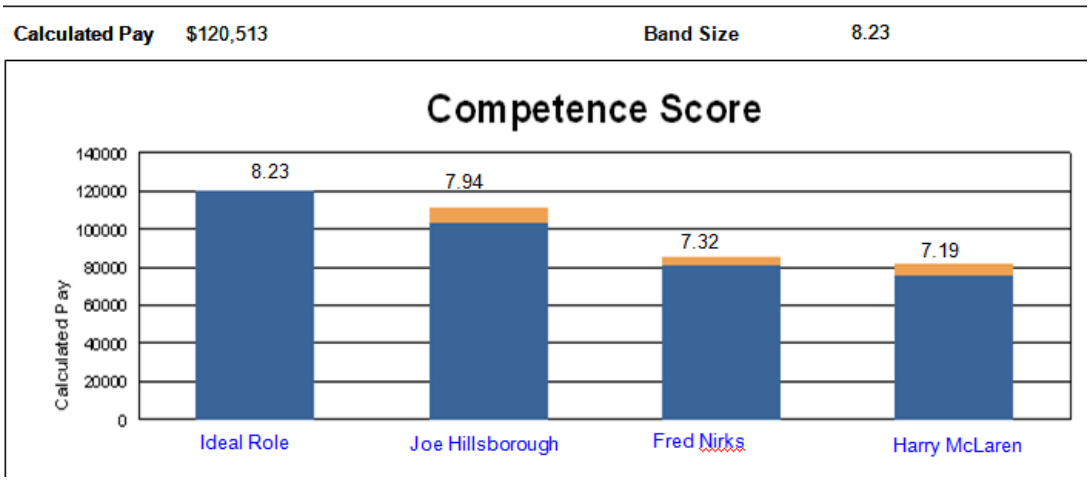
Structures and role are not static and change over time. A strategic approach to HCM will address both current and future structures. Human asset must be maintained to ensure that they:

1. Appreciate and develop in the current role (which will be dynamic)
2. Contribute in a measurable way and within a predetermined envelope of performance
3. Are developed for new and future roles where economically viable (succession planning – assets available for existing role in current structure as well as future roles).

Salary differential would firstly be determined by the size or contribution to the organisation. Secondly it would be driven by the competitive components in the package, variable performance pay being a significant contributor to this.

Appendix A – Examples of Executive Officer Recruitment – Size and Dollar Differential

The following graph and table shows an example three (3) applicants who were interviewed (not real names) for a senior position. One applicant was clearly the more competent applicant. However while relative to the other applicants Joe was outstanding he did have significant shortfalls in competence. In fact 3.65% under in size (approx half a band) and if he had been paid the full salary (which was the initial tendency) he would have been over paid by 12.26%. Also he would have been appointed not knowing his own shortfalls or have a personal development plan in place to correct these.



	Band	Salary	*Diff Band*	*Diff $'s*
Ideal	**8.33**	**$120,513**	*"Power"*	*"Value"*
Joe Hillsborough	7.94	$107,353	*-3.65%*	*-12.26%*
Fred Nirks	7.32	$83,229	*-12.43%*	*-44.80%*
Harry McLaren	7.19	$78,743	*-14.46%*	*-53.05%*

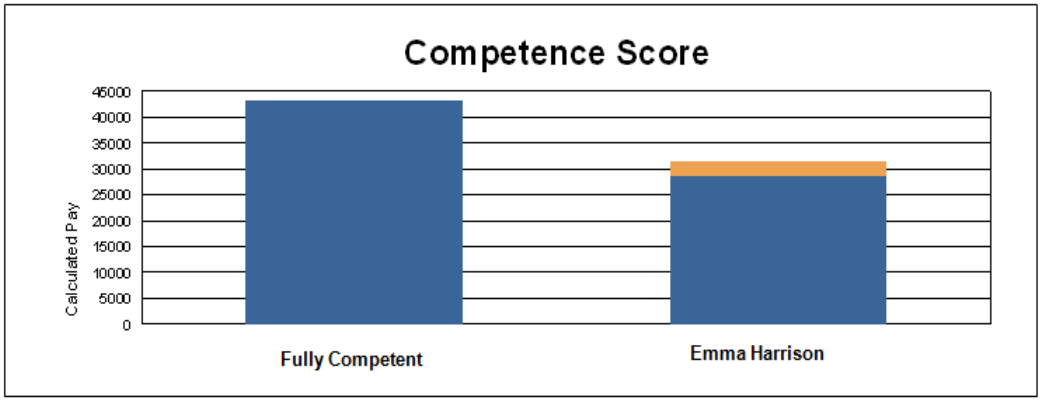
The gap between the designed Role and Applicant in Hierarchical terms is shown in this diagram:

Appendix B – Examples of Assessment of an Incumbent against a Role

This assessment could have been for: 1 x applicant recruitment; assessment against a current role or assessment against a future role (succession planning). The graph and first table show the gap from a size and value perspective. The second table Competency Profile shows the gap between designed or ideal and actual competence.

Regional Retail Operations Manager

Calculated Pay $43,320 **Band Size** 5.71



Role	Role Design	Incumbent Emma H.	Difference
Size	5.71	4.72	-21.0%
Salary	$43,320	$31,341	-38.2%

Competence Profile – Required/designed versus Assessed Competence

Emma Harrison		Required Level	Assessment Score
Applicants Calculated Pay		$43,320	$31,341
Applicants Band Size			4.72
A 2	Business Performance	D	B
A 3	Risk Management	D	B
A 5	Planning	D	C
A 6	Resource Management	D	D
A 7	Systems and Procedures	C	B
A10	Communication	D	C
B 1	Customer Commitment	D	B
B 3	Commercial Focus	C	B
C 1	Leadership	C	B
C 3	Facilitation	C	C
D 7	Technology Application	D	B
E 3	Health and Safety	D	B

Comparison with Other Asset Management

It is unlikely management would accept the above differential in other asset management such as equipment/plant or financial management. The following diagram shows the 21% size and 38% value differential applied to a physical asset, say a motor, and Return on Investment or margin:

	Specification/ Requirements	Delivered
Power (hp)	35	27.65
RoI (%)	20%	12%