WOOLWORTHS LIMITED
ABN 88 000 014 675

1 Woolworths Way, Bella Vista
New South Wales 2153 Australia
Telephone +61 2 8885 0000
Facsimile +61 2 8885 0001
woolworthslimited.com.au

16 June 2009

Executive Remuneration Inquiry
Productivity Commission
Locked Bag 2
Collins Street East
Melbourne Vic 800 3

Dear Commissioners

Re: Productivity Commission Inquiry into Executive Remuneration

Woolworths is pleased to provide the following comments in response to the Productivity Commission's Issues Paper on Executive Remuneration.

It should be noted that the Australian publicly listed corporate sector has performed particularly well relative to the rest of the world. In particular the Australian banking sector is sound. This is due to the already robust governance framework Australia has in place.

Woolworths welcomes the inquiry into executive remuneration. However, it would be a significant retrograde step if the inquiry produced recommendations that reflect poor corporate practices that other jurisdictions have faced which have not occurred here due to our strong governance framework.

Whilst there will always be minor improvements that can be made, Woolworths believes that there is no fundamental need for significant changes in relation to the regulation and disclosure of executive remuneration.

If you have any questions regarding the matters raised in the submission, please contact me on 02 8885 3446 or nsamia@woolworths.com.au.

Yours sincerely,

Nathalie Samia
Group Manager – Government Relations
Woolworths Limited

WOOLWORTHS LIMITED

Woolworths Limited

Productivity Commission Inquiry into Executive Remuneration

16 June 2009

Definition and scope

What is an appropriate definition of 'remuneration'?

Corporation Law requires 'remuneration' to be disclosed in annual reports and this definition is acceptable. The definition captures salary and fees, short term cash bonuses, non monetary benefits (eg motor vehicles, relocation expenses, FBT etc), superannuation payments, other long term benefits such as accrued long service leave, share based payments and retirement allowances, where applicable.

However, there is some clarity required to explain the difference between accounting values and the actual value received through share based payments.

What aspects or elements of remuneration should be included?

The definition above appears adequate.

What is an appropriate definition of 'executive'? Does the remuneration report required under the Corporations Act and its coverage of key management personnel provide a suitable definition? Should the Commission's coverage of executives go beyond this, and if so, why?

The requirements for the report including the coverage of key management personnel ensures appropriate coverage of executives who significantly influence the strategic direction of the company. The definition should not be expanded due to the onerous level of information required to be disclosed and the flow on to additional compliance costs.

How should 'corporate performance' and 'individual performance' be defined? Is it possible to define them in general terms that are applicable across most businesses? Or is transparency in performance hurdles for incentive payments the more important issue?

Woolworths believes there should be alignment between corporate and individual performance however a definition is not required, more the basic principles. All incentives need to encompass both corporate and individual performance but their emphasis should differ based on the role and responsibility and targeted outcomes.

At Woolworths, short term incentives are payable upon the achievement of Woolworths' financial key result areas (KRAs), as well as a component for non-financial or individual performance. Generally the components are weighted 70% to financial KRAs and 30% to non-financial or individual performance.

The financial KRAs may be measures such as Sales, Earnings Before Interest and Tax (EBIT), Return on Funds Employed (ROFE) and Cost of Doing Business (CODB). Non-financial measures may include objectives such as reducing staff turnover rates and performance in areas such as safety, shrinkage and food safety compliance ratings. All targets are set at the beginning of the financial year for each business within the Woolworths Group and are designed to deliver improvements on the prior year's results. The measures are applied consistently from the head of each business to eligible employees within that business with the more at risk, the more senior the role.

These measures are aligned with Woolworths' business strategy and given the commercially sensitive nature of these measures, Woolworths would not support further disclosure of short term incentive plan measures as this would lead to the disclosure of commercially sensitive information to our major competitors. However a broad description of the approach should be described in the remuneration report.

In relation to long term incentive plans, the most common measures are EPS growth and relative TSR both of which are used by Woolworths. These measures are less commercially sensitive and already fully disclosed in Woolworths' annual reports.

To what extent do external performance indicators 'net out' underlying market growth from entrepreneurial and managerial performance?

Market growth changes can be netted out when external hurdles such as TSR are used by comparing performance to a peer group or relevant index. Woolworths deals with this in the use of long term incentives that vest over a 3 to 5 year period so that management is incentivised to ensure their decisions enhance long term sustainable profitable growth.

TOR 1: Trends in Remuneration

How are levels of director and executive remuneration determined? What constraints exist?

The Board is responsible to the shareholders for the costs of the company. A key component impacting on a company's performance is the cost of its employees, which will therefore make it a key area of focus for the Board and management, which in its nature acts as a constraint.

Woolworths has an extensive process to determine remuneration levels. The Board of Directors, assisted by a sub committee of the Board, review all remuneration relative to the rest of the Australian workforce and on appropriate international benchmarks. Information is gathered from a range of sources to assist the decision making process, such as remuneration consultants, publicly available annual reports, benchmarking, macro economic indicators and the results of union negotiations.

It is critical companies have the absolute discretion to determine the level of remuneration it pays to all employees, including Directors and Executives to ensure it attracts and retains talent which is required to deliver shareholder value. Any regulatory intervention will undoubtedly result in negative impacts on corporate actions and will impair Australia's competitiveness.

The main constraints on executive remuneration are:

1. The Board's company governance mechanism and
2. The right of dissatisfied shareholders to not re-elect Board members if they are unhappy with their decisions
3. The shareholder votes on the aggregate cap for Directors fees.

What is the market's role in determining remuneration levels?

The employment market is no different to other markets in that supply and demand drives prices. The remuneration level for key talent is driven by the availability of key talent. Shortages in skills in certain areas in Australia have led organisations to seek talent from overseas which also drives remuneration levels in the Australian market. There is a need to understand that the Australian labour market is influenced by both local and international labour markets.

What are the major drivers of negotiated outcomes? Have they changed over time?

It is Woolworths' view that all remuneration is determined as a result of negotiated outcomes from EBA negotiations through to the CEO. In all instances, the constraints noted earlier ensure a conservative approach.

What growth in the level of director and executive remuneration has taken place over recent decades, both within Australia and internationally? What factors contributed to this growth? Has the experience differed across different industries or sectors of the economy?

Woolworths' manages their remuneration conservatively with CPI being a major determinant in the level of increases awarded. For at least the last 7 years, the total salary increases for all salaried staff, including executives has been below 4% pa and the short term incentives paid represent less than .4% of sales. Salary increases for executive directors and the heads of each of Woolworths' Australian operational business areas have averaged 3.2% for the 5 years from 2003.

We do not have a view in relation to other industries.

Is there any relationship between director and executive remuneration, and the remuneration of other company employees? Are there flow-on effects from executives to other employees? Do big disparities serve to motivate or de-motivate other employees?

There is a level of correlation between executive remuneration and remuneration of other employees due to Woolworths' remuneration structure and a cascading effect. All remuneration is determined using the same methodology discussed earlier. As previously noted, the level of remuneration is determined by the supply and demand for that particular job function and responsibility level.

There is little evidence to suggest that disparities de-motivate other employees. It is generally accepted that jobs with greater responsibility should have a greater level of remuneration.

Are current director and executive remuneration levels justified? Have increases over recent years been justified? How should the Commission determine what is 'justified' – what tests should be applied?

We believe both the level of Woolworths' directors' and executives' remuneration and the increases are justified for the reasons stated earlier.

It is inappropriate for the commission to "justify" these as:

1. It would need to assess each companies' specific reasoning at the particular point in time in regard to each decision; and
2. The commission would be attempting to second guess the corporate governance process of each publicly listed Board in Australia.

Any regulatory interference could potentially lead to a distortion of the labour market and significant competitive disadvantage. It would lead to a major issue in attracting key talent to Australia from the global market.

What relationship exists between levels of remuneration and individual and corporate performance?

The evidence shows a correlation between company performance and executive remuneration. Table 1, details a number of performance indicators over 2006 to 2008 compared to the total increase in salary from 2006 to 2008. It is obvious that the growth in remuneration levels, whilst conservative, has been consistent with these growth rates.

Table 1: Correlation Woolworths' financial performance vs. average remuneration increases

	2006	2007	2008
Sales	12.0%	12.6%	10.7%
EBIT	32.3%	22.6%	19.8%
CODB	-1.3%	-.6%	-2.2%
EPS	14.8%	19.7%	24.0%
Rem increase pa	3.17%	3.73%	3.51%

To what extent are remuneration levels required to generate an adequate supply of suitable directors and executives; that is, are they primarily aimed at hiring and retaining the right person, rather than influencing their performance?

Remuneration levels are an important factor in attracting and retaining as well as influencing performance.

All employees generally know their 'market value' and will seek to be paid accordingly.

Remuneration structures and incentives

What are the key drivers of performance for directors and executives? Are there factors other than remuneration that influence their performance?

Woolworths recognises that remuneration is an important factor in attracting, motivating and retaining talented employees however it is not the sole influence on performance. Other factors include the individuals passion, drive and motivation to be successful, the culture of the organisation, the responsibility of achieving positive outcomes for all shareholders.

What changes have taken place in the type and structure of remuneration over recent decades? What has driven these changes?

At Woolworths there have been several changes that have occurred in the type and structure of remuneration over recent decades such as:

1. The move to a performance based culture

Ten years ago, Woolworths did not have the same structure around short and long term incentives with very few employees participating in either.

Since then, short term incentives have been aligned to key business drivers, standardised and now apply to approximately 20,000 Woolworths' employees

Long term incentives eligibility has been broadened and currently applies to in excess of 2,000 employees including store managers, buyers and other key personnel as well as our executives.

In addition, our preference for redeployment over redundancy reinforces the culture of performance improvement at the individual level.

Woolworths believes there is a direct link to our improved business performance over the last decade through these changes.

2. A change in approach to EBA negotiations.

The manner in which Woolworths negotiates agreements, including award increases, has shifted from an adversarial industrial relations approach to a consultative approach based on improving productivity. This has lead to a dramatic reduction in time lost due to industrial disputes. (10-20 days approximately 7 years ago to virtually none in the last 4 years.)

3. The introduction of paid maternity leave.

Woolworths introduced paid maternity leave in June 2008 that provides for up to 8 weeks paid leave. This was introduced as an attraction and retention initiative.

4. The emergence of flexible packaging
The ability for executives to salary sacrifice for novated lease vehicles was introduced in 2008 to attract and retain as well as counter a change to the company car policy.

Have changes to the structure of remuneration resulted in inappropriate risk-taking or other forms of director behaviour inconsistent with the interests of the company? Has the experience differed across sectors (for example, the finance sector relative to other areas of business)? Who should determine what is an appropriate level of risk-taking or an appropriate corporate strategy, and how should this be done?

Woolworths view is that the changes to remuneration have not resulted in inappropriate risk-taking or other behaviour inconsistent with the interests of the company to achieve long term sustainable profitable growth. Both Woolworths long and short term incentives use accounting and market based measures that ensure an appropriate risk balance. We have no view on other sectors. We believe that risk management is a Board responsibility

Why and/or when are the dealings between shareholders and companies on remuneration issues a matter of public interest?

Whilst public interest on remuneration levels is heightened due to disclosure requirements we believe that remuneration issues should be dealt with by the Board and shareholders and the company. As noted earlier it is shareholders that elect directors to act in their interests. If shareholders are dissatisfied a mechanism exists for them to exercise choice and not re-elect a director

What relationship exists between the structure of remuneration and individual and corporate performance? What are the key drivers of performance for directors and executives? What arguments, for and against, are there for linking remuneration and the share price?

The relationship between structure and individual and corporate performance as well as key drivers for executives have been discussed earlier.

Director fees are disclosed in the remuneration report and are subject to an aggregate cap that can only be increased with shareholder approval. For Woolworths' Board of directors it is a requirement to hold a minimum number of Woolworths' shares so that their interests are directly aligned to those of shareholders.

Woolworths uses relative TSR rather than share price to ensure executives' interests are also aligned with the interests of the shareholders.

Data sources

Are there other useful data sources on director and executive remuneration over time in addition to those noted above (i.e. RiskMetrics, Towers Perrin and Fairfax Business Research)?

This has been noted earlier.

TOR 2: Effectiveness of regulatory arrangements

Given that it is ultimately the responsibility of the board to engage a managing director and other key executives, including associated terms and conditions,

what changes would assist the board in fulfilling this role, consistent with shareholder interests?

Woolworths believe the Board already has absolute discretion in dealing with key appointments.

How effective are arrangements for director and executive remuneration under the Corporations Act and ASX Listing rules and guidelines? Do arrangements provide sufficient transparency and accountability on remuneration arrangements and practices? How might transparency be increased, and what might be the impacts of this? Are the current disclosure requirements in the remuneration report too complex?

Woolworths believes the current arrangements are effective however the disclosure requirements in the remuneration report could be simplified. Woolworths' latest remuneration report is 19 pages long and includes 9 pages of remuneration tables. We believe, the important information that a shareholder wants to understand often gets lost in the detailed requirements.

We also believe that there is an issue related to the disclosed (accounting) value of equity. This valuation often leads to confusion because many shareholders believe that the disclosed value is the amount of remuneration that the executive actually received during the year. The actual value to an employee would be the value realised at the end of the vesting period which could potentially be higher or lower, even zero if rigorous performance hurdles have not been met.

In addition, whilst it is not current Woolworths practice to allow employees to retain unvested equity upon termination we believe there is another issue that needs to be addressed. Where an employee terminates, under the current rules, termination triggers a taxing event even though the equity has not vested and is still at risk. To be consistent with the federal government's most recent publicly announced stance on the taxation of equity, specifically the ability to retain the deferred tax option where the instruments are 'at risk', we believe the unvested portion of equity that an employee retains upon termination should have the same taxation treatment as it remains at risk until it vests.

Is the coverage of executives in the remuneration report appropriate? Would shareholders benefit from access to readily accessible, consolidated information, on director and executive remuneration?

Coverage of executives in the remuneration report is appropriate. We see no evidence that shareholders and the broader community are seeking information on executive remuneration that goes further than already provided.

The better suggestion would be to simplify the remuneration report requirements resulting in them being user-friendly.

Is there an appropriate balance between legislated requirements and voluntary guidelines? What is the role of voluntary guidelines in governance of director and executive remuneration?

There needs to be both legislated requirements and voluntary guidelines. The legislated requirements should contain the minimum that needs to be disclosed to ensure that shareholders understand the:

1. Remuneration policy and governance structure;
2. Remuneration levels of directors and senior management team; and

3. Remuneration structure including the underlying philosophy to support components of remuneration.

This also ensures that there is a level of consistency of remuneration requirements across companies.

Voluntary guidelines should then be positioned as “best-practice principles” that companies take into account if they believe it is appropriate to do so.

Is the case for regulation stronger where government is an active participant in company activities, for example through the use of taxpayer’s funds to bail out companies in financial difficulty or through other ongoing support activities?

There is a stronger case for Government intervention in commercial decision making if the Government is a full owner of a company or making a substantial contribution to “bail” out companies.

Are there any voluntary, good practice guidelines or codes applying internationally that may be of interest in an Australian context? Should Australia consider the adoption of a code of practice?

There are currently numerous good practice guidelines within the Australian context such as those from the ASX, the Australian Institute of Company Directors, the Australian Council of Superannuation Investors and the Australian Shareholders’ Association. There are numerous similar guidelines used in other major jurisdictions around the world and Australia’s guidelines are generally robust and not dissimilar.

To what extent have remuneration committees been used in Australia? What effect have these had on the linkages between remuneration levels and individual corporate performance?

Woolworths’ People Policy Committee (“PPC”) is a working sub committee of the full board that makes recommendations to the Board to assist the Board in their decision making. Woolworths’ PPC is actively involved in influencing performance through the following activities:

1. Reviewing and approving overall remuneration policy;
2. Reviewing and approving the structure of STIs annually as well as the outcomes to ensure they are aligned to objectives, reward fairly and equitably and are within company cost parameters;
3. Reviewing the design of LTIs as well as the outcomes to ensure they are aligned to objectives, compliant, reward fairly and equitably and are cost effective;
4. Review and approve the CEO recommendations in relation to the senior management group remuneration, including reviewing performance of senior management group; and
5. Reviewing and recommending to the Board, the remuneration structure for non executive directors.

Do conflicts of interest arise in the arrangements by which remuneration consultants advise on director and executive remuneration? If so, how significant and how might they be addressed?

Woolworths is prudent in their choice of consultants, choosing to use different consultants for non executive directors and senior executives. Woolworths has a rigorous review process to determine the appropriateness of consultants used for providing this type of information and have noted no conflict of interest.

TOR 3: The role of institutional and retail shareholders

What degree of influence should shareholders have in their own right in determining remuneration practices? Do current regulatory reporting arrangements enable shareholders to be adequately involved? If not, why?

The Corporations Act and the ASX Listing Rules currently provide a framework of matters for which a company is required to obtain shareholder approval Remuneration, whilst emotive, is not considered to fall within that framework.

It is our view that shareholders are adequately involved in determining remuneration practices. Shareholders elect non-executive directors to act in their interests. Given Boards are accountable for executive remuneration; shareholders will hold them accountable for their decisions as they stand for re-elections and the non binding vote on the remuneration report.

Does the current non-binding vote require strengthening? Is it appropriate for directors and executives that are named in the remuneration report, and who hold shares in the company, to be able to participate in the non-binding vote?

Woolworths does not believe that the current non-binding vote requires strengthening.

To what extent have large institutional investors used their voting rights to influence remuneration practices and other areas where they have voting powers? Are there areas where the rights of institutional investors should be strengthened? Does institutional voting typically align with the broader interests of shareholders?

Woolworths does not believe that institutional investor voting rights need to be strengthened. They currently have a non-binding vote on the remuneration report and also have a binding vote on the election of directors.

In Woolworths experience we view that institutional voting typically aligns with the broader interests of shareholders.

In what aspects of remuneration practices and setting remuneration levels would it be appropriate to increase shareholder involvement? How would this be best achieved – without, for example, diluting the intended function of the board in engaging the managing director/chief executive officer?

Woolworths sees no additional value in increasing shareholder involvement without diluting the function of the Board.

TOR 4: Aligning interests

What evidence or examples indicate that the interests of boards and executives may not be adequately aligned with those of shareholders and the wider community? What factors have contributed to any misalignment?

Woolworths does not believe there is evidence to suggest a misalignment between the interest of its Board and executives to that of shareholders and the wider community.

What are the interests of the wider community in relation to director and executive remuneration within a company? To what extent do the interests of shareholders and the wider community align? In what circumstances will they not be aligned? Can cost cutting by companies, including sacking workers, align with the public interest? Is it reasonable to reward executives for actions that promote shareholder interests but which may not align with the public interest?

Boards need to ensure they take stakeholder interests into account, namely, shareholders, suppliers, employees and the community. However the Board needs to balance the objectives and must be free to take the necessary action to ensure the sustainable long term profitability of the company.

What types of performance measures/hurdles could be used to accurately measure performance and align interests of executives and shareholders?

This has been answered earlier.

How can opportunities for executives to 'game' incentives be minimised?

To minimise the chance of gaming, there needs to be transparency through disclosure in the annual report. Woolworths' Securities Dealing Policy provides that executives are not permitted to use derivatives in relation to invested securities, and further requires both Directors and Executives to declare their use of derivatives. The Policy also provides that the use of derivatives by a Director may be disclosed to the ASX by the Company if the Company believes it is appropriate to do so.

Are boards properly exercising their functions on behalf of shareholders? Are they being unduly influenced by chief executive officers? If so, why?

Woolworths believes their Board is properly exercising their functions on behalf of shareholders and not being unduly influenced by CEOs. Ultimate accountability for executive remuneration rests with the Board.

Are some forms of remuneration more likely than others to promote a misalignment between the interests of boards and executives and those of shareholders and the wider community?

Woolworths remuneration components have been discussed earlier and we do not believe there is a misalignment due to our use of rigorous performance measures.

Are taxation considerations, either from the company's or executive's perspective driving design of remuneration packages? If so, what changes are required? How should bonuses be treated for taxation purposes – should they be an allowable tax deduction for companies? Should bonuses be subject to special/higher taxation rates?

Remuneration is structured to attract, retain and align individuals' interest with shareholders interests. Cash bonuses are designed as an incentive to deliver company and individual objectives. They are measured annually and paid in arrears. Introducing additional tax on bonuses would:

1. Act as a disincentive and as a result potentially lead to lower company performance, impacting a range of financial measures such as sales or profit;
2. Lead to increased pressure on Boards to raise base pay to compensate the executive for the lower bonus value; and

3. Lead to an increase in remuneration levels for international recruits to counter higher tax rates

Is it appropriate that there be separate treatment of financial institutions? If so, why and in what way? Are there any risks from such an approach? Are there other sectors that would require a differentiated approach?

Woolworths does not have a view on this.

If current arrangements are not serving to align the interests of the board and executives to those of shareholders and the wider community, how could regulatory arrangements and remuneration practices better secure this? For example:

1. **Should shareholder votes on remuneration be (more) binding?**

Woolworths does not believe there is a misalignment. It would reduce Board responsibility, add to complexity in the approval process and freeze decision making in that companies could no longer act quickly on these decisions. The Board should retain accountability for all executive remuneration decisions.

2. **Are the current approval processes for equity-based remuneration appropriate?**

Woolworths believes the current process is appropriate.

3. **What effect does hedging have on aligning interests, and should this practice be permitted?**

Woolworths has a hedging policy that prevents executives from entering into a hedging arrangement on unvested securities. Hedging of vested securities, if undertaken, is part of an employee's management of their personal finances.

4. **Is the current regulation of non-recourse loans appropriate?**

Woolworths has no non recourse loans.

5. **What is the role of remuneration consultants and what has been their influence on remuneration practices, including levels, growth and structures of remuneration practices? Do conflicts of interest exist?**

The Board seeks a wide range of inputs to assist their decision making as noted earlier. Remuneration consultants form part of the Board's decision making process related to remuneration.

6. **Should government have a greater role in regulating remuneration?**

There is already a significant body of law relating to remuneration. Any government interference in the free market may place Australia at a significant competitive disadvantage relative to the international labour market and would result in shareholder returns being impaired.

What are the costs and benefits of any options/mechanisms to more closely align the interests of boards and executives with those of shareholders and the wider community? What could be some unintended consequences of limiting or more closely regulating executive remuneration in Australia?

The Government could (theoretically) intervene heavily in remuneration setting by amending the Corporations Act to: (a) cap remuneration, and/or (b) set remuneration structures, such as dictating the balance between base, STI and LTI components and mandating that incentive plans operate in a particular way.

This would have the effect of removing the Board's role and accountability in remuneration decisions. It then becomes impractical as a question arises as to who will then take responsibility for the decisions.

Currently, if a Board performs badly through poor decision making, the directors can be held accountable by the shareholders for the poor decisions by voting them off the Board. If the Government makes key decisions such as remuneration, how will shareholders enforce accountability?

TOR 5: International developments

Are there any international approaches particularly applicable to Australia?

Woolworths is not aware of any.

Are there particular lessons for Australia from international approaches and experience – both successes and failures?

Woolworths believes the international experience, particularly failures, provides an opportunity for Australian Boards to examine whether remuneration policies contributed to the problems and, from that, assess their own policies. Woolworths however believes that its governance is sufficiently rigorous to protect it from such failures.