

Newsletter February 2018

In the current environment there is considerable discussion on modest wage growth, containment of industrial action, low inflation, improving unemployment though significant under-employment. Accordingly, our February Newsletter focuses on the prevailing challenge of wages growth with our KMP Report providing some historic context and suggested avenues for enhancing the income of the least well-paid members of Australia's workforce.

We have suggested consideration be given to sharing future increases in profit more widely, tax reform, innovation and focused education. Many of these challenges rest with our legislators though, as always, the major demands will be on the managers of our workforces and preparing them for a more productive, more competitive and more prosperous future.



KMP Report: Improved Wage Outcomes through Profit Share Innovation and Tax Reform

Our first KMP Report for 2018 follows on from our January newsletter and provides detailed comment on the workforce setting in Australia with a number of international comparisons regarding recent wage increases.



Frequently Asked Questions on LTIs

Egan Associates have been guiding privately owned and listed public companies with their incentive plan design and review for over 30 years. In this article, we summarise some of the questions that we get asked on a regular basis in relation to long term incentive design.



Australia's Minimum Wage in a Global Setting

A recent perspective offered by Bill Shorten, the leader of the Federal Opposition, has outlined an approach which Labor would consider supporting to improve the rewards available to those on the national minimum wage.



The Agenda

The Agenda is the must-read summary of issues influencing Boards of Directors and Government.

THE KMP REPORT



Improved Wage Outcomes Through Profit Share Innovation and Tax Reform

Issue 22 – February 2018

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We welcome your comments on the report and trust you will find it to be informative and thought provoking.

For Remuneration and Board Advice, please call Egan Associates on 02 9225 3225 or [email us](#).

Wages & Employment

In our January Newsletter we highlighted the workforce setting in Australia with a number of international comparisons regarding recent wage increases.

The latest Average Weekly Earnings (AWE), and Wage Price Index (WPI) figures held some good news for the economy. The Australian Bureau of Statistics revealed a 0.6% seasonally adjusted wages increase reflected in the Wage Price Index. They further reflected that the wage price index rose by 2.1% over the 2017 calendar year while concurrently revealing that wage movement in the final two quarters of the 2017 financial year recorded a rate of improvement reflecting falling unemployment and underemployment rates in parallel with increasing job vacancies.

Of some greater concern to the corporate sector would be that seasonally adjusted private sector wages increased by 1.9% compared to the public sector of 2.4% over the past 12 months. The data also revealed that wage growth in the 2017 calendar varied by sector ranging from 1.4% in the mining sector to 2.8% in the health care and social assistance sector.

The WPI data also revealed that wage growth varied across sectors with the mining industry wages increasing by 1.4% compared to 2.8% in the healthcare and social assistance sectors. It also revealed, on a regional basis, that Victoria experienced the highest annual wage growth of 2.4% with the Northern Territory reporting the lowest at 1.1%.

While there appears to be a greater propensity in the public sector for an uplift in wages, tighter reigns are being applied in the private sector which has an obvious and clear focus on obtaining an appropriate return on capital and rewarding shareholders for their investment risk.

The ABS found that in the twelve months to November 2017, Adult Average Weekly Ordinary Time Earnings rose by 2.3% to \$1,567.90. These figures are a slight increase on the previous twelve months (2.2%) and a significant increase on the 12 months before (1.7%). The full-time Adult Average Weekly Total Earnings in November 2017 were \$1,628.10, a rise of 2.2% from the same time last year. These figures also show a slight upward trend. Female average earnings rose by 2.9 per cent to \$959.50 during the period, whilst the average male weekly earnings grew 2 per cent during the same period to \$1427.80.

Table 3: Average Weekly Earnings, Australia, Original, November 2017

	Nov 2017 \$	Nov 2016 to Nov 2017 % change
Males		
Full-time adult average weekly ordinary time earnings	1 665.00	2.0
Full-time adult average weekly total earnings	1 753.50	2.0
All employees average weekly total earnings	1 427.80	2.1
Females		
Full-time adult average weekly ordinary time earnings	1 410.80	3.0
Full-time adult average weekly total earnings	1 429.80	2.9
All employees average weekly total earnings	959.50	2.9
Persons		
Full-time adult average weekly ordinary time earnings	1 569.60	2.4
Full-time adult average weekly total earnings	1 632.10	2.3
All employees average weekly total earnings	1 191.50	2.4

All employee average weekly total earnings in the public sector increased by 3% compared to 2.3% in the private sector, the national figure being 2.4%.

It is important to note that the AWE deals with a wider range of factors compared to the WPI. The ABS define these factors as those which can contribute to compositional change, and include variations in the proportion of full-time, part-time, casual and junior employees, variations in the occupational distribution within and across industries and variations in the distribution of employment between industries. The average weekly earnings differential between men and women remains significant, though much of the difference can be attributed to a higher rate of part time work amongst women. As they stand, AWE statistics cannot clarify the extent to which men and women receive equal pay for equal work, nor the reasons for any difference. It is also worthwhile bearing in mind that the AWE report is affected by the split of males and females working in different industries.

ABS Chief Economist, Bruce Hockman, stated 'The annual rate of wage growth has increased for the second consecutive quarter reflecting falling unemployment and under-employment rates and increasing job vacancy levels.

Notwithstanding the positive aspects of the recent disclosures from the ABS, the Reserve Bank's Assistant Governor, Luci Ellis, in a recent presentation indicated that the unemployment rate reveals that the labour market still retains spare capacity which, in itself, will have a dampening impact on wages growth. Spare capacity incorporates not only the unemployed by the under-employed.

The recent release of data from the ABS in relation to Average Weekly Earnings, reveals continuing differentials between States with the ACT dominated by public sector employees being the highest paying region, followed by Western Australia, with a significant resources sector.

Average Weekly Ordinary Time Earnings, Full Time Adults by State, Original, Nov 2017



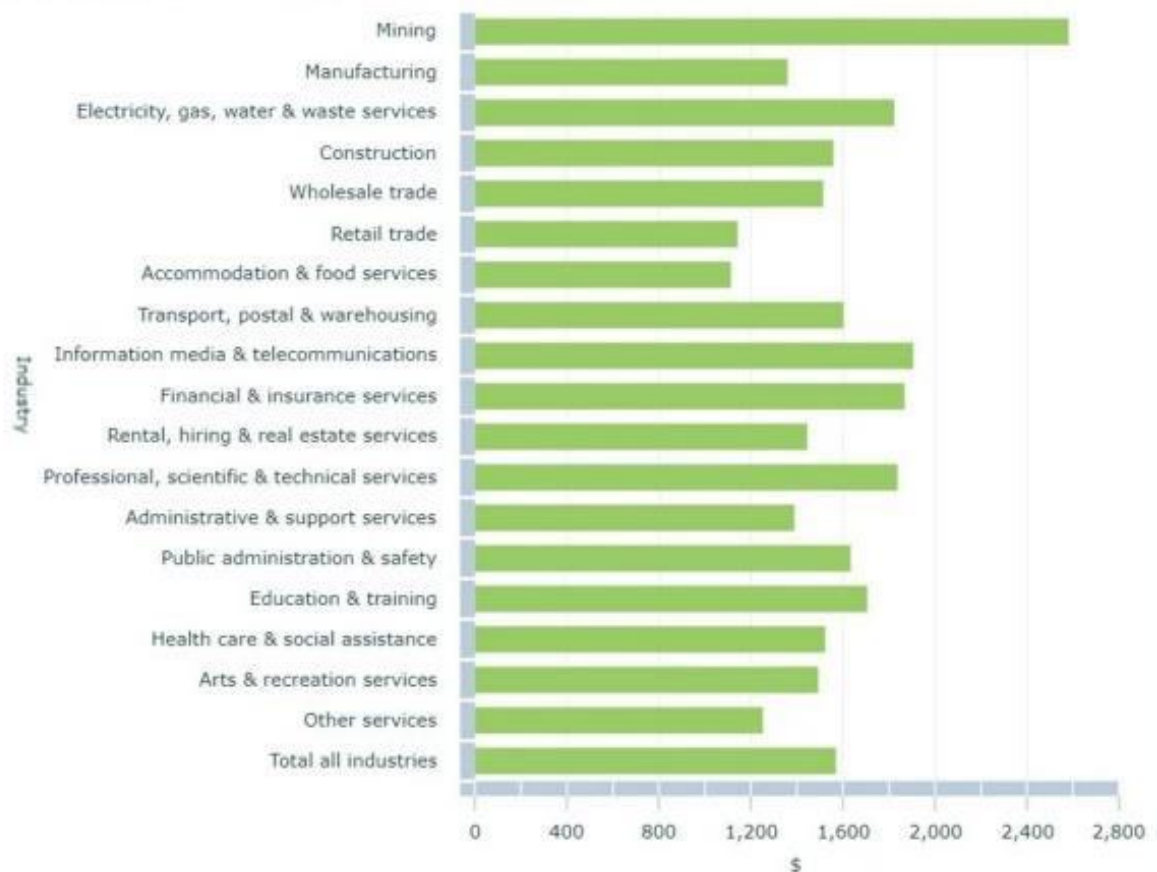
Source: Australian Bureau of Statistics

The rate of increase by region, as reflected above, differs from full time adult average earnings with the highest paid regions being the Australian Capital Territory and Western Australia with the figures being \$1,803.10 and \$1,742.80.

Notwithstanding differentials in the annual movement of average weekly earnings in the 12 months ending November 2017 or the adjustments to the wage price index, there remains a conservative outlook in relation to future growth.

The table below highlights the current earnings differentials between industry sectors, as distinct from regions.

Average Weekly Ordinary Time Earnings, Full Time Adults by Industry, Original, Nov 2017



Source: Australian Bureau of Statistics

Average weekly earnings in the mining industry stood at \$2,580.70 whereas earnings in the accommodation and food services sector stood at \$1,112.90. All employee average weekly total earnings in the public sector increased by 3% compared to 2.3% in the private sector, the national figure being 2.4%.

The government is suggesting that as unemployment falls, wage growth will start to rise. They also believe that proposed company tax cuts will increase wage growth.

Concurrently, the Unions are lobbying to raise the minimum wage, after the Fair Work Commission awarded a 3.3 per cent increase in mid 2017.

James Pearson, the Chief Executive Officer of the Australian Chamber of Commerce and Industry said, "It's early stages, but this could be the start of a gradual pick-up following recent strong jobs growth." He also added that if the economy continues to strengthen then wages growth will increase.

The Governor of the Reserve Bank, in a [recent presentation](#), indicated that unemployment will fall faster than previously forecast, but the bank does not expect core inflation will increase to levels in its target range of 2% to 3% before the middle of the 2019 calendar year though anticipates that unemployment will fall from its present 5.5% level (December 2017) to 5.25% by mid 2018 and remain broadly aligned to that figure until 2020. These

observations were reported in the bank's most recent quarterly statement published in early February.

In forecasting unemployment and inflation, as tempered by prevailing economic conditions, the Reserve Bank reported that they believed that wages growth would also remain subdued. Their expectation is that wage growth will pick up gradually over the 2018 calendar year as spare capacity declines and the adjustment following the mining boom ends.

Implicit in the bank's observations is the key uncertainty in relation to the labour market outlook. In this context, the bank states that it is not clear how much spare capacity there is in the labour market and how quickly it might decline. Further, they indicate that spare capacity will translate into building wage pressures which might reflect in Enterprise Agreements offering wage adjustments above the inflation rate.

Movement in the labour market's capacity would be influenced by entry of those currently unemployed or by current participants in the work force working more hours. In this context, participation rate outcomes will depend on a number of factors including the retirement decisions of older workers, the participation decisions of women and labour market conditions for younger workers.

The bank's view is that if participation rates do not increase as expected, employment growth is likely to be moderated. In this context, it is their judgement that the sources of expected growth in total hours worked, including a rise in participation, a decline in unemployment or an increase in average hours worked, may each impact on spare capacity in the labour market which could well increase wage growth pressures.

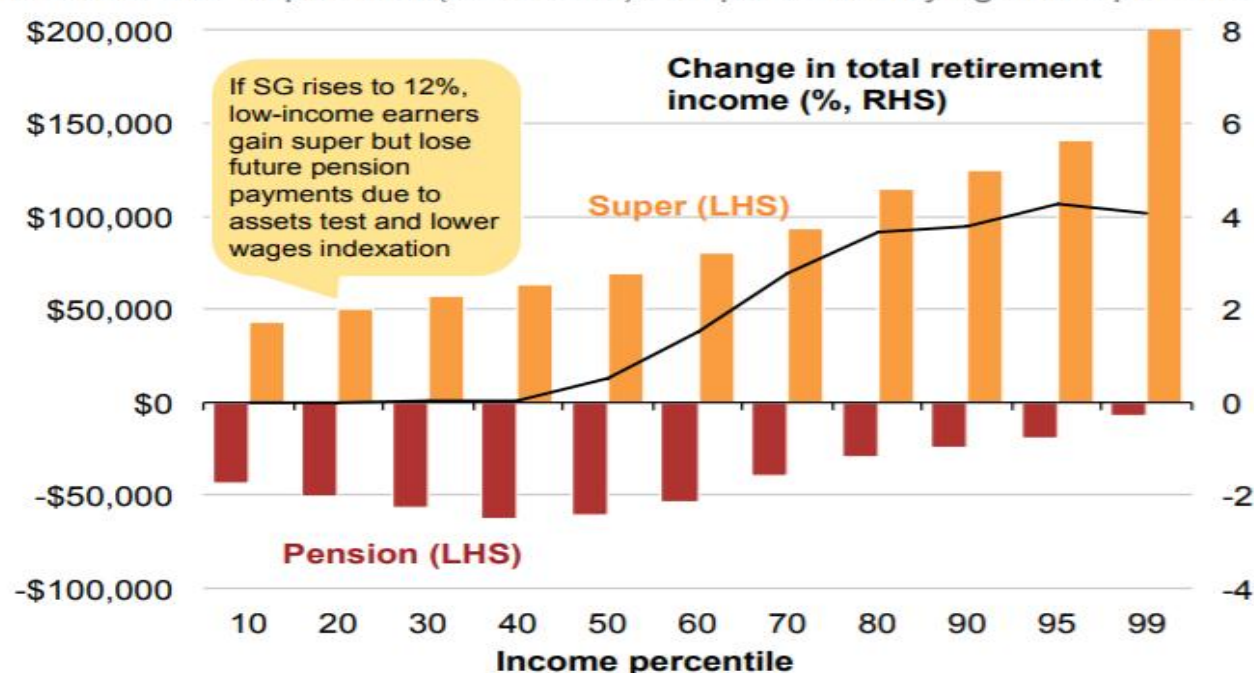
In exploring the ingredients which impact on pressure for wage increases, the bank has reflected on the high level of household debt, the medium term prospect for interest rate adjustments and the impact that this may have on consumption and therefore demand for labour.

In the context of observations made by politicians, economists, the Reserve Bank and the nation's observations about economic growth and interest rate changes among our trading partners, comment has recently emerged which reflects, among many factors, on the prospect that workers should not be forced to lock away a rise in the proportion of their wage in superannuation.

This observation arose from a recent report from the Grattan Institute which indicated that amid persistent low wages growth, the current 9.5% rate is adequate to fund a decent retirement income for the typical worker and as a consequence the demand from certain quarters to increase that rate to 12%, while increasing employment cost, may be better allocated to fund a living wage for those on modest wage levels.

The table below indicates Pension income falls for low-income earners if the Superannuation Guarantee rises to 12 per cent.

Change in retirement income (\$2015-16, CPI deflated) if the SG increases to 12 per cent (base case) compared to staying at 9.5 per cent



Notes: Results from modelling the retirement income of a person born in 1985, who works uninterrupted from age 30 to 70, and dies at age 92. Non-super savings are imputed five years before retirement, with the maximum amount of savings transferred to a superannuation pension account at retirement (so there is no change in non-super savings). Super Guarantee to rise to 12 per cent by 2025-26 (as legislated). If the pension is indexed according to wage growth with the SG increasing to 12 per cent, then pension income loss is less for percentiles 10-to-50, with change in total retirement incomes closer to 0 per cent. Voluntary superannuation contributions partially offset the fall in compulsory contributions if the SG remains at 9.5 per cent. Draw down behaviour does not change if the SG remains at 9.5 per cent. Assumes wages growth falls by the exact amount of any SG increase.

Source: Grattan analysis.

These near term observations do not reflect concerns of a number of commentators who are of the view that the superannuation funds of the majority of people retiring will not prove adequate in an environment where retiring workers are living longer and will be doing so in an environment where they will be experiencing higher living costs.

Running in parallel with this research are the economic commentators who believe that politicians and business leaders need to initiate reforms which encourage innovation and productivity which in turn will enhance income prospects over the medium term. In this context, there has also been parallel discussion in relation to the criticality of education at both university and TAFE level to prepare both today's youth and older workers for the occupations which will be in demand in future years and the coming decades.

Other comments in terms of future prosperity and capacity to pay are influenced by the employment sector including the consumer facing sector, the industrial sector, the mining sector and emerging technologies with an overlay of the capacity of those sectors to produce outcomes at competitive cost on a global footing to ensure their prosperity locally and their opportunity for generating export income.

Recent Profit Growth Sector Variability

In order to explore if there were further avenues available for the private sector while containing fixed costs Egan Associates have reviewed movement in the level of earnings before tax among the ASX 300 and within the ASX 300 by rank and industry sector.

Our research reveals in relation to listed companies reporting during the prior three calendar years (2015, 2016 & 2017) the median level of profit before tax among the top 50 companies has risen from \$738.4 million to \$1.185 billion with the average profit increasing from \$1.877 billion to \$2.618 billion.

Among the second 50 companies at the top 100 the median level of profitability has increased from \$180.7 million to \$251 million and the average profit from \$151.22 million to \$324.19 million.

Among the second 100 company's profitability over the 3 year period has increased from \$45.85 million to \$77.63 million and the average from \$20.73 million to \$54.86 million.

Companies ranked between 200 and 300 on the ASX the median level of profitability has increased from \$12 million to \$31.77 million and the average from \$11.37 million to \$29.47 million.

The tables below highlight the average profit before tax across the ASX 300 which varies from \$339.9 million to \$513,01 million. On an industry basis the following table provides a report on results and each of the three calendar years together with the median values.

Top 300 company average Earnings Before Tax (EBT)												
	All Sectors	Financials	Materials	Tele Service	Real Estate	Consumer Staples	Utilities	Health Care	Industrials	Energy	Consumer Disc	IT
2017	513,053,675	1,167,550,466	907,148,832	678,197,394	517,952,598	414,459,110	312,668,087	227,755,211	176,945,337	164,074,952	118,625,717	69,765,522
2016	324,478,879	1,050,092,593	69,932,736	880,851,984	467,893,272	194,987,000	68,264,070	226,994,352	158,185,379	69,685,298	104,120,609	64,389,245
2015	339,911,532	1,134,994,948	249,770,105	863,485,864	364,376,129	388,734,750	230,170,831	212,533,040	115,511,346	320,755,027	24,237,560	47,979,887

There is clearly variability across industries with the average level of profitability in the financial sector being a negative 7% between the 2015 and 2016 Financial Years and a 6% uplift in the 2017 Financial Year. The materials sector revealed the most dramatic change with the increase in the first Financial Year being a negative 72% and then 1,200% in the 2017

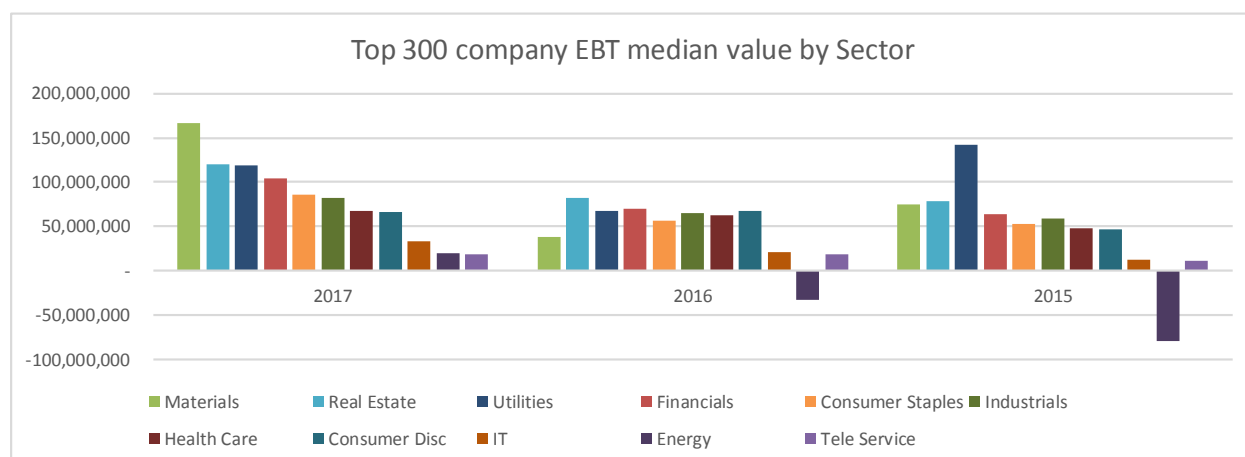
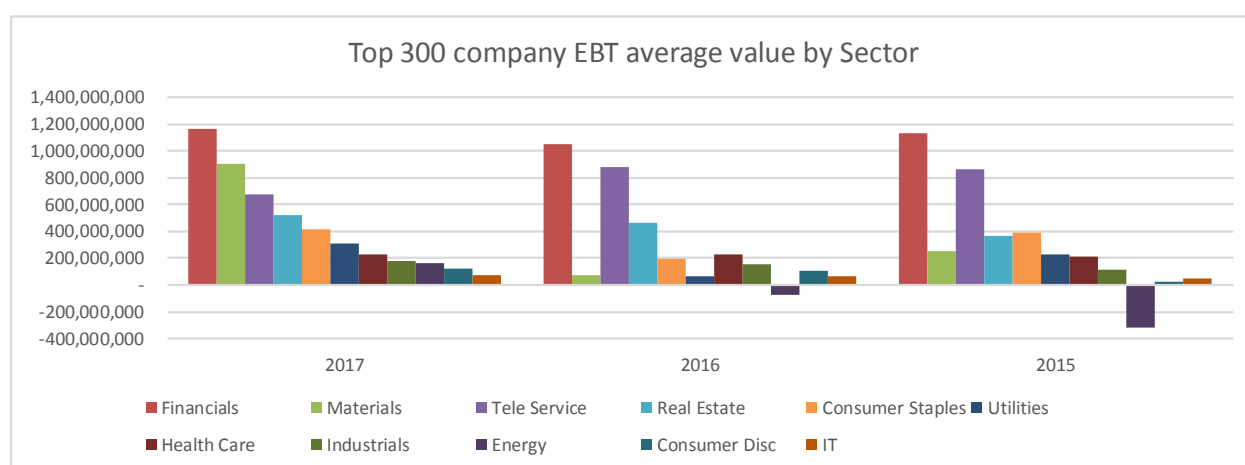
Financial Year. This reveals a significant impact of changes in commodity prices and export activity.

In telecommunications there was a significant negative outcome in profitability in the most recent Financial Year. In real estate it was positive in both years, being 28% uplift in the first and 17% in the second.

In consumer staples there was a 50% decline in the first financial period though a 94% improvement in the second. In utilities there was a negative 70% followed by a 360% uplift. Health care was relatively neutral with a 7% improvement in the 2016 Financial Year followed by a negative 7% in the 2017 Financial Year.

Industrials demonstrated a 37% adjustment on average in the first Financial Year followed by 25% in the second. The energy sector reflected a continuous negative impact with consumer discretionary revealing an average adjustment of 330% in the first period followed by a 24% adjustment in the 2017 Financial Year with the information technology sector revealing a 34% increase in the 2016 Financial Year followed by a 13% increase in the 2017 Financial Year.

The histograms below reveal the industry variability and the tables above the average movement in earnings by industry sector in the ASX 300. It reveals across the entire ASX 300 there was a marginal decline between the 2015 and 2016 Financial Years though a significant uplift between the 2016 and 2017 Financial Years.



Future Profit for Sharing

Given market sentiment is that the 2018 Financial Year will reveal an indicative uplift in the range of 5% to 7%, this reveals an average improvement across each ASX300 organisation in the range of \$25.65 million and approximately \$36 million.

If between 20% and 30% of the average profit uplift were allocated for profit sharing and assuming a middle of the road outcome in relation to forecast, there would indicatively be between \$6 million and \$9 million available for distribution to employees.

If the average employee population that is currently exempt from participation in a bonus or incentive plan across all enterprises, whose employee numbers would vary from in excess of 100,000 to less than 500, were 4,000 then indicatively there would be \$1,875 per employee through profit sharing, or \$36 per week which would represent a significant uplift to the minimum wage earner and leave approximately 30% of after tax profit improvement to be retained for further investment and 25% to be distributed to shareholders.

This macro market assessment is obviously not one which will be universally available in all sectors. As will be observed above, some sectors are challenged. The data also reveals variability of profitability in each of the last three Financial Years, as reported, up until 31 December 2017. Sectors which employ very large numbers of employees would include those in both consumer staples and consumer discretionary sectors. They are clearly not the most profitable sectors in the current environment where household expenditure is under pressure.

It is acknowledged that distribution of profits to the least well-paid employees can be managed on a pre-tax basis whereas retained reserves and distributions to shareholders will be on a post-tax basis. Given the current legislative environment and the lack of universal support for a reduction in corporate tax, recent portrayed experience enjoyed in the United States where there was a significant reduction in corporate tax compared to that foreshadowed over the next decade in Australia, the challenge of managing enhanced rewards for Australian employees will be a shared burden for enterprises and legislators with key points of influence in the period ahead being the sponsorship of innovation and the broader application of technology, the alignment of educational outputs with the changing world of work and a commitment of all stakeholders to encourage increased returns from employee input through building more direct rewards for that contribution.

While the above has drawn data on the ASX 300, the principle should have universal application. There is also an implication that senior management's total reward, while not leading the world, have increased at a far greater rate than that of the average member of the nation's workforce. With continuous profit improvement in the years ahead, tax reform and an adaptive workforce every stakeholder should benefit.

Conclusion

If a construct were to be introduced where the prior incentive pools were contained for distribution to current participants in annual incentive plans for one or two years, then in principle with government tax reform, targeted investment and transformation initiatives delivering improved profitability and the adoption of strategies for containing fixed costs the general workforce could benefit through gaining a new share of improved performance.

Adopting this approach may well require further attention by management in ensuring that profit is not distributed to an unproductive segment of their workforce while acknowledging the contribution made by the least well-paid employees in their enterprise.

The funding of this enhanced annual reward would be delivered through a profit-sharing construct and not a mandatory or imposed set of wage adjustments, whether delivered through a flow-on of increases to the minimum wage, the adherence to long-established penalty rates in an environment where days of the week are not acknowledged in the same way as they were two generations ago.

Policy makers, labour leaders and corporate leaders need to explore avenues for improving the welfare of all workers without encouraging a transfer of Australia's investment into low cost economies which will not advantage Australia over the longer term.

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Frequently Asked Questions on LTIs

Egan Associates have been guiding privately owned and listed public companies with their incentive plan design and review for over 30 years. In this article, we summarise some of the questions that we get asked on a regular basis in relation to long term incentive design.

What are the most commonly used LTI plan types by privately-owned and listed companies?

Long term incentive (LTI) plans are preferred by both listed and privately-owned companies to reward and retain executives and strengthen the alignment between the performance of their business and their executives.

Share based LTIs are particularly popular by start-up companies which are often cash strapped especially in their early stages of development. Share option plans assist start-ups to retain staff who also contribute to capital upon exercising their options.

Privately owned companies offer equity based LTIs for a number of reasons including attracting and retaining high calibre staff and motivating key employees to contribute to the company's growth.

Alternate LTI plans which are commonly used by privately owned companies include:

- deferred cash incentives which are payable upon achievement of three to five year performance hurdles such as growth in company value, achievements beyond target revenue, profit or return on capital;
- share warrants which provide executives with a stake in the growth of the underlying of value of the business over a specified number of years;
- unitised profit share arrangements;
- phantom shares, and
- cash settled share appreciation rights.

The majority of the LTI vehicles used by privately owned companies are also used in the listed company environment in part arising from the intense scrutiny from shareholders, regulators and analysts.



Performance rights are the most commonly used form of LTI adopted by listed companies in Australia with a vesting period of 3 to 5 years. Performance Rights are contractual rights to receive shares in the future if certain conditions and/or performance hurdles are met.

Options provide the right but not the obligation for participants to buy a parcel of shares in the future at a price fixed at grant date. The most notable difference between a performance right and a share option plan is the lack of risk associated with the performance right. Payment is not required by an executive to gain any benefit from the performance right

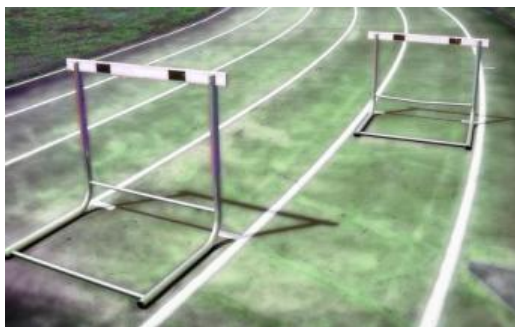
(subject to meeting performance hurdles) and as such there is no possibility of the performance right having no value when the restrictions are lifted and the share is transferred to key staff.

The dilution of capital is generally greater in case of an option plan as the number of options required to deliver comparable reward to a rights plan would be greater.

The main disadvantage of options and rights in a private company is the lack of liquidity. Unless there is a future transaction or the company enters into an agreement to buy back shares or permit their sale, employees will not be able to convert them to cash. Moreover, if the shares do not become more valuable, options may ultimately prove worthless.

In Australia, option plans are heavily used at the pre-IPO stage whereas, after an IPO, companies tend to switch to other forms of LTI plan and adopt performance hurdles reflective of market practice and/or milestones set out in a prospectus. In a listed company environment, the prevalence of option plans is higher among recently listed companies or companies with high growth potential and high share price volatility. It is our observation that the prevalence of option plans is higher for companies operating in the, mining, energy, healthcare, biotechnology and ICT sectors.

Loan backed share plans constitute another form of LTI plan. Loans granted are usually interest free and non-recourse. Here employees are protected if the value of the share falls below the loan balance. Dividends (after tax) where paid are usually applied against



repayment of the loan. Companies will often hold shares granted under a loan backed plan in a trust and apply a service based condition to ensure retention of talent.

Another instrument is share appreciation rights (SARs) which can be settled in either cash or equity at the discretion of the company. The gross financial reward resembles a share option plan and eligible employees benefit from their contribution to value creation of the company.

What is the most prevalent approach when setting up the performance period and vesting schedules?

Typically, LTI performance periods can extend from 3 to 5 years. It is not uncommon for companies to require an additional service period for up to 2 years where vested shares are subject to a holding lock to ensure further retention of LTI participants.

Vesting schedules are either in the form of overlapping awards or cliff vesting where 100% of the LTI award vests at the end of a single performance cycle. The overlapping cycle construct is the most common and reflects a “business as usual” approach allowing for LTI awards to be built up over sequential year allocations. Annual allocations also give Boards the flexibility to adjust both individual allocation values and also the participants in the LTI program from year to year.

What are the most commonly used performance hurdles?

Listed companies predominantly use performance measures which focus on earnings per share and relative total shareholder return (TSR). Both cash and equity based LTIs could be also tied to the achievement of company milestones, sector or company specific financials or an increase in the company's value. Other commonly used performance hurdles include sales revenue, EBIT or EBITDA, profit targets, return related measures (ROI, ROCE, ROE), cash flow management and customised growth measures.

In essence, these factors are driven by a company's long-term strategy, relevant accounting and tax implications of each plan type, a company's business life cycle as well as external challenges such as competition, industry and market specific dynamics and legislative requirements. It is common for companies to use performance hurdles together with service based conditions to maximise the use of LTI awards to the benefit of existing shareholders.

Dilution of shares presents itself as an ongoing pressure point for existing shareholders and is inevitable as a company issues further equity to its employees. As the LTI plan design gets more complicated, the burden of administration also increases.

Egan Associates have been guiding private and both listed and unlisted public companies with their incentive plan design and review for over 30 years. Email us at zlockyer@eganrem.com for your queries.

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Australia's Minimum Wage in a Global Setting

A recent perspective offered by Bill Shorten, the leader of the Federal Opposition, has outlined an approach which Labor would consider supporting to improve the rewards available to those on the national minimum wage. He expressed the view that the “minimum wage is no longer a living wage.” He said on Monday the 29th of January, “our goal should be a real living wage, effectively raising the pay of all Australian’s, particularly the 2.3 million who depend upon the minimum rates in the awards”.



The concern expressed by Labor’s leader was clearly sponsored by recent data revealing the challenges facing many individuals and households associated with the cost of housing, managing debt and rising energy costs. The observations from Mr Shorten might have been influenced by recent wages growth in the United States, where the corporate tax rate has been reduced to 21%, and the growth in listed company enterprise values has increased significantly over the past 12 months (despite recent market volatility), a phenomenon not reflected in Australia. These perspectives were put forward when a number of employers were concerned with wages growth in an environment where their costs of supplies

were increasing and productivity was not demonstrating significant improvement.

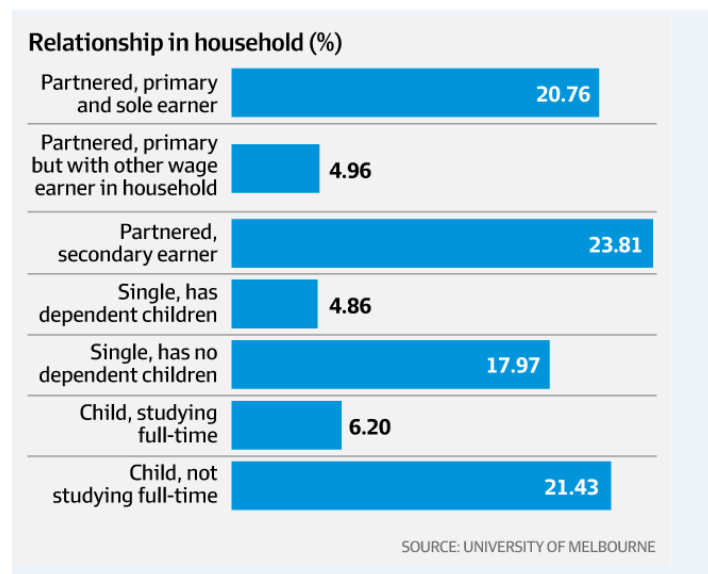
Living wages are important for workers, although, Chris Richardson at Deloitte Access Economics stated, “A higher minimum wage hurts jobs because basically it is trying to make businesses do what a better social security system could do cheaper and more efficiently.”

He added that a higher minimum wage will weigh on Australian employers more than in other countries. This is due to the fact that Australia’s minimum wage is higher than the average wage among the rest of the [Organisation for Economic Cooperation and Development](#) (OECD) member countries.

In the context of the above, research from the OECD reveals that Australia’s real minimum wage in US dollars is high by global standards - a fact implicitly revealed in initiatives by many local companies to outsource an increasing proportion of their administrative workload to low cost economies, particularly within the Asian region.

Subsequent analysis provided by the Melbourne Institute of Applied Economic and Social Research, revealed that the purchasing power of Australia's minimum wage in an environment of rising domestic costs has been curtailed. It also revealed that 13% of workers effectively on minimum wages live in households that enjoy the top 20% of incomes in the nation. These wage earners being young adults in study, potentially living at home and primarily aged between 21 and 34 years as well as many women with a secondary household income.

The research from the Institute reveals that only 21% of those on minimum wages might be termed "harvester workers" or those supporting a household on a single minimum wage.



Further analysis and consideration needs to be given to the appropriateness of the minimum wage, as a living wage given the Opposition Leader's statement that 2.3 million Australian's who are dependent on minimum rates in awards are significantly influenced by Australia's minimum wage.

Many of Australia's leading service providers manage their wages productivity through **offshoring** key administrative and data management roles.

We know that in the services sector, where a significant number of participants are global organisations, their work is undertaken by a global hub, often not based in Australia. We also note as revealed in the financial press that a leading advisory firm is testing the use of virtual Executive Assistants based in the Philippines to contain costs.

With local remuneration for Executive Assistants in Australia nominally being in the range of \$60,000 to \$100,000 it was revealed that similarly qualified staff in the Philippines received between a \$5,000 and \$20,000 a year.

Enterprises of all scales will have increased capacity to pay higher wages if corporate taxes are reduced and profits improve. The latter will be influenced substantially by input costs, which at present in Australia, are increasing, not reducing. The euphoria expressed by some in relation to the United States improvement in wages needs to be considered in the context of more moderate basic living costs and their historic low minimum wage compared to Australia as observed in the table above.

In the Australian Financial Review an article, "Half of Bill Shorten's Minimum Wage Workers are in the Top 50 pc" published on the 7th of February, revealed that official figures show that the relative share of national income won by employees and companies have been little

changed for decades, with labour capturing 58 cents of each dollar of income in 2016-2017 according to the Australian Bureau of Statistics. Similarly, profit share has stayed remarkably steady, fluctuating between 41 cents and 44 cents over the past 30 years.

Deloitte Economist Chris Richardson, commented that significant swings in the profit and wages share during the 30-year period was influenced when the commodity and resources boom took off at which stage wages growth galloped ahead of productivity growth. At the end of this era, in 2012, wages growth slowed. Although wages growth in the past 12 months in Australia appears to be contained below 2%, over the 2017 calendar year average hourly earnings grew by the equivalent of 2.9% in the United States being the best year on year wage increase in that country since 2009.

In exploring the ingredients which impact on pressure for wage increases, the Reserve Bank in its recent quarterly report (February 2018) reflects on the high level of household debt, the medium-term prospect for interest rate adjustments and the impact that this may have on consumption and therefore demand for labour.

In further commenting on wages growth, the bank's quarterly report reveals that the average Enterprise Bargaining Agreement signed in the 2017 calendar year will lead to lower wages growth over the next two to three years than experienced in prior periods. They also reveal that Australia's average earnings per hour growth is about half the wage price index and while revealing that the outcome of the Minimum Wage Case in 2017 contributed to average award wage increases above trend, this circumstance appeared to have minimal impact on overall wages movement.

In the context of observations made by politicians, economists and the Reserve Bank comment has recently emerged which reflects, among many factors, on the prospect that workers should not be forced to lock away a rise in their wages in superannuation. This observation arose from a recent report from the Grattan Institute which indicated that amid persistent low wages growth, the current 9.5% rate is adequate to fund a decent retirement income for the typical worker and as a consequence the demand from certain quarters to increase that rate to 12%, while increasing employment cost, may be better allocated to fund a living wage for those on modest wage levels.

These observations do not reflect concerns of a number of commentators who are of the view that the superannuation funds of the majority of people retiring will not prove adequate in an environment where retiring workers are living longer and will be doing so in an environment where they will be experiencing higher living costs.

These views are clearly placing pressure on legislators and those advising governments on their future financing needs to provide a quality lifestyle for retired workers while at the same time addressing a number of competing challenges in a rapidly changing workforce in relation to skills and education requirements which are impacting on the nation domestically and its economic advantage in generating export income.

While evidence can be found to support many competing perspectives, it is increasingly important to Australian businesses to ensure their sustainability through exploring the inputs to their costs and the opportunity to contain or reduce those inputs, while at the same time reviewing their operational alternatives in order to ensure both growth and longer-term sustainability in what is a high wages cost nation. Managing the future clearly requires considered input from Governments whose policy frameworks and oversight of significant expenditures impact directly on citizens' costs and Australia's international competitiveness.

Addressing these challenges will require careful consideration and planning by governments, business and the labour force with each major stakeholder having the potential to contribute positively to a prosperous and fair future as Australia explores its optimal pathway in a global setting for both the nation and its citizens.

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The Agenda

Academics divided on impact of penalty rates cut

Professor Phil Lewis* from the University of Canberra, a well-regarded and experienced economist, issued a scathing response recently to findings of an online survey purporting to refute predicted increases in employment intended to result from changes to Sunday penalty rates, describing the research as having, “a major hole”.

The research paper, “*The Short Run Employment Impact of the Fair Work Commission Penalty Rates Decisions*” written by academics** Dr O’Brien, Dr Pol and Professor Markey and presented to the Western Economic Association in early January, surveyed 1,300 workers.



The authors concluded that the number of people working in the retail industry on Sundays fell 7 percent last July (from June) following the reduction of penalty rates from 200 to 195 percent of the award hourly rate set by the [Fair Work Commission](#).

The purpose of the rates cut by the Commission was to make the cost of hiring workers cheaper, thereby increasing jobs. However, the authors of “*Short Run...*” claim their findings contradict Professor Lewis’ research which supported the rates cut, suggesting that “*labour demand may be extremely inelastic*”.

Professor Lewis represented the retail industry in hearings which led to the rate changes made by the Fair Work Commission. He found the “*Short Run...*” research had not mentioned the important fact that the hourly adult Sunday minimum wage rate increased in July 2017 from \$35.41 per hour to \$35.67.

According to the [Australian Financial Review](#), Professor Lewis said the “*Short Run...*” paper seemed “*designed to reach a predetermined conclusion... that the awards have not had any positive effect on employment*” and would not be considered worthy of journal publication. In response to Professor Lewis, Dr. O’Brien acknowledged that, “*true, the minimum wage increased on the same date negating the penalty rate decrease to an extent...however it is a fact that Sundays still became relatively less costly than previously because of the penalty rate decrease compared to other days.*”

According to the *Financial Review*, disagreement prevails between certain business groups and Labor as to whether reducing penalty rates will have the effect of increasing jobs or will reduce employment by giving workers less money to spend.

**Professor Phil Lewis is a Professor of Economics and Director of the Centre for Labour Market Research at the University of Canberra. Professor Lewis has researched and produced widely*

acknowledged work on the labour market and was awarded Life membership of the [Economic Society of Australia](#) in 2001.

***Dr O'Brian is a Lecturer in Economics at the University of Wollongong; Dr Pol is a Senior lecturer at the Centre for Small Business and Regional Research at Wollongong University; and Professor Markey is a Director of the Centre for Workforce Futures at Macquarie University.*

Labour Shortage

In the most recent **National Australia Bank Business Survey**, it was revealed that labour shortages are the highest they have been since the GFC. The report revealed a sharp **increase in labour unavailability** as a constraint on output at the end of the 2017 calendar year, rising from about 45% in the June Quarter to above 55%.

Around 17% of survey participants indicated that labour unavailability was a significant constraint on output in the final quarter of the 2017 year. The research reflected the highest level of labour shortage since September 2008.



Following the publication of the survey, we note that the Reserve Bank forecast that unemployment would fall further than their estimates in late 2017, from the present level of 5.5%. Notwithstanding, we note that the NAB survey found that wage cost pressures would not grow in the near term and had fallen back to previous lows of below 2%.

The bank's **research** however **forecast enterprise agreements would see average wage growth of 2.6% over the coming 12 months** which is higher than the 2.25% reported at the end of June 2017

Decline in Industrial Disruption a factor in slow wages growth

It is understood that the Fair Work Commission's decision recently, to stop Sydney train workers from taking industrial action, arose in part because of the impact such initiatives would have on the economy.

We further note that recent analysis by the Australian Institute's Centre for Future Work, authored by Jim Stanford, has revealed there has been a 97% decline in industrial action from the 1970s to the present decade.

They revealed that in the first 9 months of 2017 the number of industrial disputes was close to a post-war era low. They further indicated that there is a close statistical relationship between the reduction in industrial activity and low wages growth. Their research also revealed that **frequent industrial action has traditionally been associated with faster wage growth.**

The CEO, Innes Willox, of the **Australian Industry Group**, in responding to the research, revealed that the level of industrial action in Australia has fallen significantly since 2006 when secret ballots for industrial action were introduced, though also **revealed that over the past decade there have been periods of high wages growth and low wages growth with no apparent link to the level of industrial action.**

We note that the Chief Executive of the **Australian Chamber of Commerce**, James Pearson, commented that wages growth is a function of more factors than workplace relations with rising business competitiveness and confidence to invest as well as consumer confidence being key factors.



We understand that the Secretary of the **ACTU**, Sally McManus, commented that the recent research provided evidence that onerous industrial relations laws needed to change if workers are to benefit.

It is also understood that the **Reserve Bank** has acknowledged that **slow wage growth may reflect an erosion of workers' bargaining power** in order to achieve improved working conditions.

Jobs Growth in December

The unemployment level rose to 5.5% at the end of the 2017 calendar year after a third quarter with an unemployment rate of 5.4%. This was despite job gains of 34,700, seasonally adjusted, in December which was significantly above that predicted though well below the 61,000 new jobs that were created in November. Full time employment grew by 15,100 in December but was surpassed by part time increases of 19,500 on a seasonally adjusted basis.

Over the 2017 calendar year full time employment rose by 322,000 with trend employment increasing 3.3% above the average yearly growth over the past two decades of 1.9% and the highest since September 2005.



The participation rate also increased from 65.5% to 65.7% though monthly hours worked per employee fell by 0.5%.

The jobs growth outcome at the end of the 2017 calendar year reflected a likely growth in employment to September 2018 of 1 million additional jobs as promised by the coalition when they came to government in 2013.

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About us

For more than 25 years, Egan Associates has advised leading organisations and emerging enterprises in Australia and New Zealand on the remuneration of Board Directors, executives and key staff members, as well as performance management, corporate governance and Board effectiveness.

Our Services include:

- **Workforce & Governance:** an online resource to assist organisations manage position documentation; job evaluation; and internal pay relativity and market competitiveness.
- **Remuneration reviews and benchmarking:** for Boards, CEOs, executives, senior management and professional positions, including specialist roles
- **Corporate transactions / IPOs:** assistance transitioning pre-IPO reward arrangements into the listed company environment with considerations including escrow provisions
- Advice on **annual incentive plan structures**, performance criteria, target and maximum payment levels including deferral and clawback provisions
- Advice on **long term incentive plan structures**, participation, performance hurdles, equity instruments, valuation and allocation, as well as monitoring
- **Government pay reviews:** assistance at both Federal, State and local level in administrative, policy and corporatised environments on reward for senior executives, professional and administrative staff and governing Boards
- **Board effectiveness:** assistance with Board reviews, Board skills matrices, scenario planning and Board documentation.

John Egan



John's early career was with Cullen Egan Dell (now Mercer Human Capital), which he chaired from 1983 to 1989, when he formed Egan Associates. John has been an advisor to Boards and senior executives on organisation, governance and reward issues over many years. He has assisted a significant majority of Australia's top 200 companies as well as a myriad of entrepreneurial organisations and government entities across a wide range of industries.

John has been actively involved with Universities, chairing Sydney University's Board of Advice for its Faculty of Economics & Business (2001 – 2010). John is an Honorary Fellow of the University and an Adjunct Professor in the School of Business.

His personal interests are business education and training, as well as cool climate gardens – www.thebraesgarden.com. He served as a Trustee of the Sydney Royal Botanic Gardens & Domain Trust from May 2010 to June 2014.