

# Newsletter April 2018



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## **Our Leader's Challenges and Stakeholder Expectations A Viewpoint**

Australia is facing new challenges and opportunities within the shifting patterns of international trade and the security of its commercial foothold and viability both locally and globally.



## **Incentives- Front and Centre**

What role should incentives play in rewarding senior management? What should be the relative impact of financial results, the quality of leadership, innovation, customer retention, the quality of services and products?

## **Superannuation Policy in Practice**



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# Superannuation Guarantee Increases will Strain Australia's Economy

Criticism has erupted over suggestions by Labor that the planned increases in employer superannuation contributions from the current 9.5% to a targeted 12% by July 2025 should be accelerated.

The underlying rationale of Labor's aspiration is to provide more opportunity for retirees' to achieve greater independence in retirement and mitigate the future burden and reliance on government age pensions by an increasingly aging population.

Under current legislation, employer superannuation contributions will remain at 9.5 per cent until July 2021, after which [contributions will increase steadily until reaching the targeted 12 per cent in 2025.](#)



The prospect of fast-tracking this increase has led [Financial Services Minister, Kelly O'Dwyer,](#) to come out strongly in opposition to this suggestion:

*"It would [not be] right to think that the super-guarantee particularly benefits low income earners...Far from it. In fact, many low-income earners are being forced to save for a higher standard of living in retirement than they can afford while they are working."*

Reinforcing Minister O'Dwyer's position, [the Grattan Institute](#) found that scrapping the planned increase to 12% would save the Federal Government almost \$2 billion annually – *"money that would be better spent boosting rent assistance for vulnerable retirees, mainly single women"*, the Grattan Institute Report said.

There is also a common misconception that increases to the superannuation guarantee would be paid by employers out of profit. Brendan Coates, a fellow of Grattan Institute, believes that;

["Higher compulsory super contributions are ultimately funded by lower wages, which means lower living standards for workers today. Therefore, increasing the super guarantee to 12 per cent will hurt the living standards of low-income earners, the bulk of whom are women."](#)

Similarly, the [Henry Tax Review Report](#) also found that the superannuation guarantee rate should not be increased. Given the relative taxation on income vs superannuation, pouring more money into superannuation over salary will have a significant negative impact on the Federal Government's budget.

For pre-retirement low income earners, the impact of the superannuation guarantee would be severe. According to Coates,

*“We know that home ownership is falling rapidly among the young and the poor, so raising the super guarantee to 12 per cent at a time when young Australians are already struggling to afford housing -and in particular overcoming the deposit hurdle seems like a bad idea.”*

The [table below](#) provides an outline of the effects of the income disparity:

Pre SG income	9.5% SG		12% SG		Change in take home pay	
	Income after SG	Post tax income	Income after SG	Post tax income	\$pw	%
39,000	35,295	32,047	34,320	31,257	-15.19	-2.46%
60,000	54,300	45,106	52,800	44,093	-19.47	-2.24%
80,000	72,400	57,323	70,400	55,973	-25.96	-2.36%
120,000	108,600	80,786	105,600	78,896	-36.35	-2.34%

**Notes: Tax calculation do not consider Medicare Leve, Medicare Levy Surcharge, Low Income Tax Offset and Repayment Income Thresholds. Superannuation Guarantee (SG).**

**Assumptions: The calculations provided in the table assumes one SGC increase from 9.5% to 12%, rather than a gradual increase. Our calculations do not include any Medicare levy, and Medicare surcharge.**

In reality, not all organisations would pass the super increase to their employees directly through smaller wage increases. Companies that are currently paying at or above 12% would not need to consider how to fund such increase.

However, a significant number of companies in the private sector will need to confront the reality that they must apply a proportion of budgeted salary increases to the superannuation increase.

For example, if a company has a 2.5% budget for salary increases and the superannuation guarantee moves to 10% of ordinary time earnings, they will assign a proportion of that salary budget to pay for superannuation.

The net result is lower increases for the employees in an environment where cost of living is rising faster than salaries, thus reducing the standard of living for low-wage earners even further.

[Zoe Lockyer, a Principal](#) at [Egan Associates](#) comments,

*“When the amount was increased from 9% to 9.5% between 2012 and 2014, many companies used a portion of their annual salary increase budgets to absorb the difference. In the current environment where annual salary increases are already at subdued levels, any increase would add further pressure to annual salary review budgets”.*

The reality for pre-retirement low income earners is that they need income *in their hands* to pay for day-to-day essentials, such as housing, energy and school fees.

An increase in the superannuation guarantee will negatively impact the financial capacity of many in this demographic, reducing disposable income and having a knock-on effect across society and the economy.

Overall, the likely negative effects of superannuation guarantee increases will be to decrease living standards in Australia and place further strain on an already challenged economy.

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# Our Leader's Challenges and Stakeholder Expectations

Australia is facing new challenges and opportunities within the shifting patterns of international trade and the security of its commercial foothold and viability both locally and globally.

Australia's continuing success depends on its constituents being both aligned with, and supportive of, Government policy and related initiatives.

It requires the prudent use of tax payers' funds by Government and well informed commercial decisions by private and publicly held enterprises.

Our success is also contingent upon prudent decisions being made by employers in relation to their enterprise's leadership.



One element of this includes training, nurturing, developing and rewarding employees, being mindful also of the prevailing tax regime which governs disposable income and expenditure.

Another element involves employers' attentiveness to ensuring standards are met in relation to the competencies and capabilities of key personnel. This includes executives in leadership positions and Boards with mentoring and governance obligations and responsibilities for representing the expectations of shareholders and stakeholders.

## **Government and Enterprise Responsiveness and Accountabilities**

All levels of Government within Australia carry significant responsibility in prescribing and influencing the policies and operational programs of our communities, regularly drawing upon the expertise of the private sector. Sound strategic direction and policy initiatives, effective design and resourcing of major projects and the appointment of appropriate local and overseas contractors to deliver those projects on budget and on time are underpinned by the assumption that high quality preparatory work will ensure the former is achieved.

Listed public companies have similar obligations in relation to the development of their enterprises. In many instances, these businesses are subject to local and international uncertainties, changing supply chains and patterns of consumption. Consistently maximising returns to all stakeholders through deploying qualified labour, appropriate financial resources and intellectual inputs is critical to retaining a competitive foothold locally and internationally.

Australian Governments and private sector enterprises must effectively respond to international influences which impact their global competitiveness and their capacity to service a domestic economy and its consumers in a continually changing world.

Overlaying these “conventional” challenges is the sudden and dramatic emergence of the redefinition of “traditional” fairness and equity in the context of commercial policy and community expectation and the requirement for Governments and enterprises to rewrite and amend policies and practices accordingly. This places stress on both private and public resources already struggling to constrain expenditure and remain on-target in achieving pre-determined performance outcomes.

A substantial proportion of the Australian workforce is either approaching, or has reached, retirement age. These individuals have worked for forty, fifty or more years, many being mindful of the likelihood that advances in medicine and health sciences will extend their longevity post-retirement. Consequently, over their working life, many have sought to ensure that their superannuation and retirement strategies provide sufficient income to live independently of Government support. However, over the past two years, both retrospective and prospective revisions in Australian Government tax policies have begun to impact those approaching or reaching retirement age, creating degrees of uncertainty and disadvantage for this cohort which were neither foreseeable or, in the case of retrospectivity, avoidable. So far, some Government employees appear isolated from a number of these changes.

### **Expectations and Aspirations of our Workforce, Boards and Government**

Against this unsettled corporate and political backdrop, aspirations and expectations of our Australian workforce are similarly varied. Many opt for continuing education or training while others simply change careers in an increasingly fluid employment market. Many of our most talented graduates and employees continue to seek opportunities and experience overseas, while at the same time we broaden our net to tap into an expanding pool of skilled migrants to fill roles where either local talent is absent or uninterested.

In this latter context, while over the last decade there has been a significant focus on the appropriate criteria for determining the opportunities of those leaving high school to pursue tertiary education across a diversity of disciplines and specialisations. Employers have been developing comprehensive matrices of competencies required for graduates to succeed in thousands of different occupational roles at varying levels within a job family.

In tandem, the ASX and Australian Securities Commission, with strong Government support, has demanded that Boards provide shareholders with transparency and detail of executive remuneration and the capabilities and experience of Board members. Similar disclosure at all levels in the government sector would highlight areas requiring review if Australia is to realise its potential.

Issues of diversity in respect of representation, including a greater degree of gender balance, has also been a particularly critical area for Boards to address. Boards are highly sensitive to newly elevated levels of political, media and community scrutiny of their performance, illustrative of which is the issue of remuneration, particularly the foundation for incentive payments, which has exposed many Boards to critical comment and reaction.

## **Australia or Utopia?**

As Australians, we no doubt aspire to see our Governments managing and delivering key strategic projects on time and within budget and to witness our private sector and our institutions achieving high standards of commercial integrity and prosperity, while simultaneously enjoying the support of a committed and productive workforce.

Individually and collectively, Australians are influenced by a diversity of factors including the fundamentals of cultural background, age, education, wealth and associated prospects, the cost of living, the cost of operating a business and the quality of the environment. To date, Australia has demonstrated a capacity to maintain overall high standards of living, lifestyle and longevity despite global competitive pressures and uncertainties.

However, voters are becoming progressively more sensitive to the shortcomings of Government and bureaucracies as they are also becoming aware of apparent breaches of corporate governance, such as those emerging in some of our financial institutions.

Voters vote and do so often to express a sentiment of dissatisfaction not only at local, State and Federal levels, but increasingly as corporate shareholders, as participants in change through social media, and even at the level of consumers through the products they choose to either support or boycott.

This unprecedented wave of social engagement and its impact on all models of governance should be channelled to contribute positively to our national political and corporate resilience and social sustainability.

In such a setting, over time, cost of living in relative terms should diminish, the quality of life should improve for all Australians, and adherence to the highest standards of governance should provide a clear path forward for our nation.

Is this viewpoint reflective of a future Australia or an elusive Utopia?

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# Incentives- Front and Centre

What role should incentives play in rewarding senior management?

What should be the relative impact of financial results, the quality of leadership, innovation, customer retention, the quality of services and products?

Should some elements of an organisation's performance become gateways before incentives are payable?

Would some of the factors considered as gateways or modifiers of incentive payments include the following:

Adherence to good governance and code of conduct principles

Safety and environment

Gender balance in the workforce

Employee engagement, culture and diversity

Shareholders and commentators have expressed varying views in relation to what should be the key levers for incentive payments. More recently there has also been an increased focus on employee capabilities, skills and competence as a prerequisite to appointment.

The Federal Government and the ASX have in recent years required increased transparency in relation to the capabilities of Board members and their relevance to the company at varying stages in their development and/or maturity.



The current Royal Commission into banks and financial institutions has further highlighted shortcomings in the management of incentive payments cascading either down from senior management or cascading up from less senior staff.

While we understand that a significant number of organisations regularly review the performance hurdles or criteria for payment of incentives under annual incentive plans, two core fundamental axioms of performance measurement stand out in the light of the recent events:

**"What doesn't get measured, gets forgotten."**

**"If you can't see success, you're probably rewarding failure."**

**"Good governance and ethical standards are paramount"**

While accepting the above axioms as key drivers to focus management's attention on the levers of performance improvement, if they are being rewarded for endorsing or supporting a culture which is antithesis of a sustainable business or reflects business conduct which is to the detriment of any key stakeholders, then the leadership team of



the organisation and the Board who endorse these programs are failing their shareholders.

A fundamental imperative of enterprise sustainability is operating within a legal, moral and ethical framework.

Over the coming months we will explore the area of annual cash-based incentives and the criteria which applies and raise questions in relation to what is the purpose of fixed remuneration (an annual salary) and how critical is it to have a capable workforce and Board of Directors offering stewardship of the leadership team and ensuring, through various risk management protocols, that their governance principles are being adhered to throughout the organisation.

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# Superannuation Policy in Practice

*The Australian* on April 14, 2018 reported that Tony Shepherd, a highly respected executive with significant engagement in both private and public sectors and Chairman of the Abbot government's cost-cutting taskforce, recently questioned whether Federal public servants and politicians should enjoy a 15.4% employer superannuation contribution when most other workers receive only 9.5%.

Estimates suggest the difference between Federal public-sector superannuation contributions and the majority of Australia's employees cost taxpayers \$1.6 billion each year. Mr Shepherd was reported as saying, "*there really needs to be a review. The argument for having a higher rate of superannuation in the public sector doesn't stack up now.*"



Data from the Australian Bureau of Statistics reveals that the rate of increase in public sector salaries (full time adult average weekly earnings) in recent years exceeded that in the private sector. Tracking this movement back over the last three reporting periods is revealed in the tables below.

## **Private Sector**

<b>November 2014 - 2015</b>	<b>November 2015 - 2016</b>	<b>November 2016 - 2017</b>
1.1%	1.9%	2.3%

## **Public Sector**

<b>November 2014 - 2015</b>	<b>November 2015 - 2016</b>	<b>November 2016 - 2017</b>
3.1%	3.4%	2.8%

The above figures show a clear response by the private sector to variable prosperity and the challenges associated with private sector employers endeavouring to remain competitive regionally and internationally while surviving in both domestic and export markets.

While the anomaly of private versus public sector superannuation contributions should be addressed, it is equally important that all sectors look at pay comparisons in the context of total employment cost, not salaries and superannuation separately. It is also important that any analysis should also have regard to the average hours worked to achieve average earnings.

It would not be our view in work value terms, on a like for like position comparison, that the public sector is leading the market. Notwithstanding this observation, transparency and equality of opportunity would address the challenge.

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# About Egan Associates

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:

- **Remuneration reviews and benchmarking:** for CEOs, executives, senior management and professional positions, including specialist roles
- **Annual incentive plan structures:** advice on performance criteria, target and maximum payment levels as well as deferral and clawback provisions
- **Long term incentive plan structures:** advice on participation, performance hurdles, equity instruments, valuation and allocation, as well as provision of performance monitoring services
- **Corporate transactions / IPOs:** assistance transitioning pre-IPO reward arrangements into the listed company environment (or any other corporate transformation) considering issues including escrow provisions
- **Government pay reviews:** assistance at federal, state and local level in administrative, policy and corporatised environments on reward for senior executives, professional and administrative staff, and governing Boards
- **Board fee reviews:** benchmarking Board fee levels, including Chairman and Director retainer fees, Committee Chairman and member fees and fees for adhoc engagements.
- **Board effectiveness:** assistance with Board reviews, Board skills matrices, scenario planning and Board documentation.
- **Workforce & Governance:** *Define and evaluate positions and analyse pay the easy way!* Our new cloud-based software captures more than 30 years' knowledge, learning and experience in organisation analysis and remuneration in a suite of products which operate either as powerful, stand-alone modules or as an integrated combination. Access more than 1,000 role templates and over 13,000 accountability statements or easily create your own PDs from scratch. Organisation charts are generated automatically. Powerful analytics give you pay and workforce insights in one click. And our intuitive, user-friendly job evaluation module is designed to bring your JE process into the 21<sup>st</sup> century. And because *Workforce* is designed and hosted in Australia by Egan Associates, you know you're in great hands!



Egan Associates

Phone 02-9225 3225



