

Newsletter June - July 2018



Criticality of Board Capability

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CEO Pay increases Over the Past Decade

This article was triggered by an enquiry from [Patrick Durkin of the Australian Financial Review](#), responding to comments by the former Treasurer, Wayne Swan, that Chief Executive pay is “out of control”.



Governance: Front and Centre

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Personal Income Tax Cuts

The Commonwealth Parliamentary Budget Office has released information on the financial implications, with distributions by gender, of the outcomes of the personal income tax changes announced in the May 2018 Commonwealth Budget.

Criticality of Board Capability

Having reviewed the statement prepared by the ASX 200 Boards in relation to Director capability, incorporating skills and experience, we have noted indicatively two approaches.

One reflecting a comprehensive matrix of relevant Director capabilities and the number of Directors possessing that relevant capability, and the other primarily offering a simple list of capabilities with limited reference to individual Director capability.



In the latter approach, the statement of Directors' capabilities was summarised in a simple list revealing that Board members collectively possessed the identified capabilities and experience. In the more comprehensive statement of Board capabilities and the incorporation of a matrix, companies nominated and described the capability and then indicated the number of Directors possessing that capability.

The latter, from our perspective and from a governance perspective, would be the only acceptable approach. Indicatively, Director's skills and experience published across the ASX 200 companies provided information on specific industry and international work experience possessed by Directors as relevant. The broad headings that were incorporated in disclosures included the following:

- Stakeholder management
- Board experience
- Experience as a Board Chair
- Experience as a senior executive including that of a CEO
- Knowledge of a specific industry sector
- International experience
- Knowledge of global markets and trade protocols
- Experience in business planning and strategy development
- Financial acumen, audit and financial reporting experience
- Risk management and compliance experience
- Knowledge of remuneration, people and workplace culture issues
- Knowledge of talent development, succession planning and nominations
- Knowledge of health and safety policy and practice
- Knowledge of the environment regulations
- Experience in mergers and acquisitions and capital markets
- Experience in supply chain and logistics
- Knowledge of specific customer segments
- Knowledge of ICT and the digital environment including cybersecurity
- Experience in sales and marketing
- Experience in corporate communications and investor relations
- Experience in social media
- Engagement in research and development and innovation
- Experience as an entrepreneur
- Knowledge of the public sector including public policy
- Experience in engaging with Government officials
- Possession of relevant personal qualities

Comment by academics, business leaders and journalists reviewing various reports have revealed a number of key obligations which Boards need to meet in forming a Board, in the first instance, and managing renewal.

Among the primary tasks which are essential in establishing and maintaining an effective Board with an appropriate spread of relevant capabilities, the following are likely to be included:

- Align Director capability to the organisation's strategic imperatives
- Avoid a focus on generic skills which add little value and represent threshold capabilities
- Differentiate capability requirements for Board members and the Chair
- Focus on the capabilities essential to lead Committees of the Board and deal with special subject matter issues
- Explore avenues in the nominations process which will build on core key capabilities
- Allocate resources to the continuous development of Directors' knowhow. This may also incorporate rotating Directors across Committees to build knowledge and understanding
- Review the Board's capability matrix and continually assess its relevance as the needs of the organisation change

[Back to Title Page](#)

CEO Pay Increases Over the Past Decade

This article was triggered by an enquiry from [Patrick Durkin of the Australian Financial Review](#), responding to comments by the former Treasurer, Wayne Swan, that Chief Executive pay is “out of control”.

In undertaking research for our article focusing on the top 100 listed companies, our research revealed that in fact CEO fixed remuneration has declined since the period immediately prior to the Global Financial Crisis, while at the same time the average market value of the enterprises under their stewardship has increased from \$11.6 billion to marginally less than \$17 billion, or 46%.



The table below sets out the information which we have been progressively compiling over more than two decades on the remuneration of KMPs in Australia’s leading corporations.

| | Average Market Cap of ASX 100 Company * | Average CEO Fixed Remuneration |
|------|---|--------------------------------|
| 2007 | \$11.600 billion | \$1,739,055 |
| 2009 | \$11.276 billion | \$1,740,592 |
| 2011 | \$10.867 billion | \$1,650,925 |
| 2013 | \$13.190 billion | \$1,509,947 |
| 2015 | \$13.969 billion | \$1,670,666 |
| 2017 | \$16.999 billion | \$1,543,374 |

* 31st December in the relevant year

Over the period on which we have reported above, the Australia/US exchange rate, by way of example, has moved from around 95c to 75c, reducing the global purchasing power of Australia’s top company CEOs, one of the highest taxed in the world.

Notwithstanding these broad observations, the analysis is not a perfect “apples with apples” comparison as the constituents of the ASX 100 over that decade have varied and there have been two or more changes to the CEO of a significant number of those enterprises.

Our experience, generally, is that replacement CEOs commence their journey on fixed remuneration below that of their predecessor, often serving between 3 to 7 years in the top job, but on occasions less than 3 years.

Over that period there has been a high degree of variability in the level of incentive paid to CEOs where such incentives are strongly aligned to shareholder returns. Equity-based LTIs are even more problematic as disclosures reflect a statutory accounting value not the realised value which is subject to performance hurdles, typically, relative total shareholder return performance and a defined earnings per share performance. Our experience is that between 60% and 70% of LTI awards vest.

Acknowledging that with the growth in these enterprises the increased internationalisation and increased exposure to the digital world and emerging technologies, the demands on these positions have changed significantly whereas the demands on many of those in the workforce, fulfilling standard trades, technical, administrative or sales roles, have not changed.

We readily acknowledge that the typical CEO of an ASX 100 company receives fixed remuneration in excess of \$1.5 million or around nineteen times average weekly earnings. We also acknowledge that their work week is likely to be twice that of the indicative occupations reflected upon above and that Australia's top CEOs have oversight increasingly of multi-located international enterprises operating in a number of jurisdictions with local economic, social and financial challenges.

Total reward of CEOs in the 2017 year across the ASX200 including fixed pay, annual incentives and benefits arising from performance hurdled equity incentives under long term incentive plans on average amount to \$3,630,500.

[Back to Title Page](#)

Governance: Front and Centre

Egan Associates has received many and varied requests from clients to advise on:

- the structure of Non-Executive Directors' (NEDs') fees;
- the level of fees paid to Chairs and members of the Board and its committees; and
- the fee pools of companies regarded as comparable.

Our last research report dealing with the cost of governance was published in July 2014. Recent discussions arising from our advisory work and highlighted in Board responses from comments made by institutional investors and their advisers, together with issues recently arising in the Royal Commission into the financial services sector, have brought a number of supplementary issues front and centre.



In addition to the above notations, emerging issues include:

- the attributes and skills essential for Directors serving on an ASX 200 Board
- the time commitment essential for Directors to meet their governance and stewardship accountabilities
- the Board diversity in relation to a number of attributes including industry and international experience, gender and age
- the nature of Board immersion in key governance issues including, but not limited, to:
 - adherence to corporate values and behaviours
 - ethical conduct, particularly in relation to the management of customers' affairs
 - depth of knowledge of Directors in relation to remuneration practices well below the KMP
 - Recent published information, in part arising from the Royal Commission, APRA and AUSTRAC, reveals that many Boards have not been aware of corporate practices in relation to the structure of remuneration, the criteria for the payment of incentives and the relationship between those practices and related research revealing positive customer engagement and employee engagement.
 - Comment on and evidence being presented to the Royal Commission and observations and engagement with institutional investors and proxy advisers, further reveal that Boards have placed a significant level of trust in the KMP who prepare reports or make presentations to Directors outlining the integrity of organisation processes and the ethical conduct which is enforced throughout the organisations over which they have stewardship.
 - Boards have increasingly relied upon advice coming from management in response to questions arising or concern generally which has percolated into the community and increased awareness of shareholder expectations and, in part, the reliance in many organisations and therefore Directors on research undertaken by management's principal advisers.

- These circumstances may well have highlighted the necessity in a number of major corporate entities for Boards to have a small cadre of highly skilled staff, independent of management and the KMPs in the organisation, undertaking investigations on behalf of the Board. Such initiatives should ensure that there is no prejudice which either advantages or disadvantages KMP and senior management in relation to their reward and their continuing employment. This approach may not be entirely dissimilar to the intent of the support provided by Ministers' staff in Government where they are not employees of the organisations or the Departments reporting through to the Minister and Cabinet/the Parliament, but rather undertake an independent assessment of matters of concern to the Cabinet.
- As we reflect on discussions with a select number of major company Boards over 20 or more years , I recall both positive and negative feedback from management in relation to what I would have then described as deep hands engagement in the operation and stewardship of leading enterprises by Directors who wished to have a first-hand understanding of the organisation's contractual obligations, the nurturing and mentoring of talent in order to ensure succession and the oversight of either unintended or unidentified weaknesses in contracts entered into with third parties.
- There appears to be emerging evidence that issues of this nature which have in part arisen from Board commitments to not interfere and therefore not engage in a forensic manner have led to concerns expressed by both customers and shareholders.
- As a consequence detailed oversight among Australia's ASX 200, and certainly the ASX 100, may involve the establishment of an Office of the Board (OTB) which is modest in scale though appropriately staffed by individuals with the relevant authority to investigate matters on behalf of the Board and as a consequence shareholders, customers and suppliers in ensuring that a company's operations were being conducted in accordance with directions, in accordance with appropriate practice and absent of conflict of interest, particularly third party interests.
- OTB staff would need to be highly skilled, absolutely independent of management and have the necessary authority to undertake any enquiry on behalf of the Board and to report to the Board independently of management, though in the spirit of transparency inform management of the outcome of their enquiries or investigations.
- The cost of establishing an Office of the Board would represent a cost of governance. Our next KMP Report will address the relative cost of an ASX200 Board and CEO.

[Back to Title Page](#)

Personal Income Tax Cuts

The Commonwealth Parliamentary Budget Office has released information on the financial implications, with distributions by gender, of the outcomes of the personal income tax changes announced in the May 2018 Commonwealth Budget.



The following tables reveal that the schedule of income tax changes flow through for a period of 10 years reflecting the forward estimates. The estimates do not consider the implication of the Government's policy to constrain the tax to a GDP ratio at or below 23.9%.

The Parliamentary Budget Office has also assumed that the timing of tax collections would not differ by gender. The Parliamentary Budget Office disclosed, as set out below, their data sources.

Data sources:

- 16 per cent samples of de-identified personal income tax and superannuation returns for the 2014-15 financial year from the ATO
- Treasury provided the model for the 2018-19 Budget measure *Personal Income Tax Plan* and Economic and policy parameters as of the 2018-19 Budget
- Morrison, S 2018, *House of Representatives Hansard – Wednesday, 23 May 2018*, page 81, Commonwealth of Australia
- Fraser, J 2018, Secretary to the Treasury, *Opening statement – May 2018 Senate Estimates* (including the tabled document *Personal Income Tax Plan – further information*), 29 May 2018

While there has been recent comment in some sectors that the tax imposition, under the Government's plans, is more generous to males than females, subsequent commentary and evidence has revealed that the estimates incorporate both male and female earnings which vary, being influenced by both hours worked and the differential occupational weightings between male and female.

As indicated by the Government, gender has no impact on the tax rate applying to disclosed income.

Table A1: Personal Income Tax Plan – Components commencing from 1 July 2018 – Overall financial implications and distribution by gender (\$m)^{(a)(b)(c)}

| | 2018–19 | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | 2024–25 | 2025–26 | 2026–27 | 2027–28 | 2028–29 | Total to 2021–22 | Total to 2028–29 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|------------------|------------------|
| Revenue | | | | | | | | | | | | | |
| Low and Middle Income Tax Offset of up to \$530 for individuals with taxable income up to \$125,333 for the 2018-19, 2019-20, 2020-21 and 2021-22 financial years | | | | | | | | | | | | | |
| <i>Males</i> | - | -1,950 | -2,050 | -2,050 | -2,050 | -100 | - | - | - | - | - | -6,050 | -8,200 |
| <i>Females</i> | - | -1,750 | -1,900 | -1,950 | -2,000 | -100 | - | - | - | - | - | -5,600 | -7,700 |
| Total | - | -3,700 | -3,950 | -4,000 | -4,050 | -200 | - | - | - | - | - | -11,650 | -15,900 |
| Increase the upper threshold for the 32.5 per cent marginal tax rate from \$87,000 to \$90,000 | | | | | | | | | | | | | |
| <i>Males</i> | -260 | -300 | -320 | -350 | -350 | -400 | -400 | -450 | -450 | -500 | -550 | -1,230 | -4,330 |
| <i>Females</i> | -100 | -120 | -150 | -150 | -200 | -200 | -250 | -200 | -250 | -250 | -250 | -520 | -2,120 |
| Total | -360 | -420 | -470 | -500 | -550 | -600 | -650 | -650 | -700 | -750 | -800 | -1,750 | -6,450 |
| Total revenue – Components commencing from 1 July 2018 | | | | | | | | | | | | | |
| <i>Males</i> | -260 | -2,250 | -2,370 | -2,400 | -2,400 | -500 | -400 | -450 | -450 | -500 | -550 | -7,280 | -12,530 |
| <i>Females</i> | -100 | -1,870 | -2,050 | -2,100 | -2,200 | -300 | -250 | -200 | -250 | -250 | -250 | -6,120 | -9,820 |
| Total | -360 | -4,120 | -4,420 | -4,500 | -4,600 | -800 | -650 | -650 | -700 | -750 | -800 | -13,400 | -22,350 |

- (a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.
- (b) Figures may not sum to totals due to rounding.
- (c) Total estimates over the 2018-19 Budget forward estimates period are set equal to those detailed in the 2018-19 Budget and information subsequently released at Senate Estimates on 29 May 2018. PBO estimates from 2022-23 to 2028-29. All estimates by gender are PBO estimates.
- Indicates nil.

Table A2: Personal Income Tax Plan – Components commencing from 1 July 2022 – Overall financial implications and distribution by gender (\$m)^{(a)(b)(c)}

| | 2018–19 | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | 2024–25 | 2025–26 | 2026–27 | 2027–28 | 2028–29 | Total to 2021–22 | Total to 2028–29 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|------------------|------------------|
| Revenue | | | | | | | | | | | | | |
| Increase the upper threshold for the 32.5 per cent marginal tax rate from \$90,000 to \$120,000 | | | | | | | | | | | | | |
| <i>Males</i> | - | - | - | - | -2,650 | -3,050 | -3,300 | -3,500 | -3,800 | -4,100 | -4,400 | - | -24,800 |
| <i>Females</i> | - | - | - | - | -1,100 | -1,350 | -1,500 | -1,650 | -1,800 | -2,050 | -2,250 | - | -11,700 |
| Total | - | - | - | - | -3,750 | -4,400 | -4,800 | -5,150 | -5,600 | -6,150 | -6,650 | - | -36,500 |
| Increase the upper threshold for the 19 per cent marginal tax rate from \$37,000 to \$41,000 | | | | | | | | | | | | | |
| <i>Males</i> | - | - | - | - | -2,800 | -3,100 | -3,250 | -3,300 | -3,400 | -3,450 | -3,550 | - | -22,850 |
| <i>Females</i> | - | - | - | - | -2,150 | -2,400 | -2,450 | -2,600 | -2,650 | -2,800 | -2,850 | - | -17,900 |
| Total | - | - | - | - | -4,950 | -5,500 | -5,700 | -5,900 | -6,050 | -6,250 | -6,400 | - | -40,750 |
| Increase the Low Income Tax Offset to up to \$645 for taxable incomes up to \$66,667 | | | | | | | | | | | | | |
| <i>Males</i> | - | - | - | - | -50 | -200 | -200 | -200 | -200 | -200 | -200 | - | -1,250 |
| <i>Females</i> | - | - | - | - | -50 | -250 | -250 | -250 | -250 | -250 | -200 | - | -1,500 |
| Total | - | - | - | - | -100 | -450 | -450 | -450 | -450 | -450 | -400 | - | -2,750 |
| Total revenue – Components commencing from 1 July 2022 | | | | | | | | | | | | | |
| <i>Males</i> | - | - | - | - | -5,500 | -6,350 | -6,750 | -7,000 | -7,400 | -7,750 | -8,150 | - | -48,900 |
| <i>Females</i> | - | - | - | - | -3,300 | -4,000 | -4,200 | -4,500 | -4,700 | -5,100 | -5,300 | - | -31,100 |
| Total | - | - | - | - | -8,800 | -10,350 | -10,950 | -11,500 | -12,100 | -12,850 | -13,450 | - | -80,000 |

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

(c) PBO estimates from 2022-23 to 2028-29. All estimates by gender are PBO estimates.

- Indicates nil.

Table A3: Personal Income Tax Plan – Components commencing from 1 July 2024 – Overall financial implications and distribution by gender (\$m)^{(a)(b)(c)}

| | 2018–19 | 2019–20 | 2020–21 | 2021–22 | 2022–23 | 2023–24 | 2024–25 | 2025–26 | 2026–27 | 2027–28 | 2028–29 | Total to 2021–22 | Total to 2028–29 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|------------------|------------------|
| Revenue | | | | | | | | | | | | | |
| Increase the lower threshold for the 45 per cent marginal tax rate from \$180,001 to \$200,001 | | | | | | | | | | | | | |
| <i>Males</i> | - | - | - | - | - | - | -1,000 | -1,200 | -1,350 | -1,500 | -1,700 | - | -6,750 |
| <i>Females</i> | - | - | - | - | - | - | -350 | -400 | -450 | -550 | -550 | - | -2,300 |
| Total | - | - | - | - | - | - | -1,350 | -1,600 | -1,800 | -2,050 | -2,250 | - | -9,050 |
| Remove the 37 per cent marginal tax rate, so that all income from \$41,001 to \$200,000 is taxed at a marginal rate of 32.5 per cent | | | | | | | | | | | | | |
| <i>Males</i> | - | - | - | - | - | - | -3,600 | -4,250 | -4,700 | -5,250 | -5,800 | - | -23,600 |
| <i>Females</i> | - | - | - | - | - | - | -1,300 | -1,550 | -1,800 | -2,000 | -2,300 | - | -8,950 |
| Total | - | - | - | - | - | - | -4,900 | -5,800 | -6,500 | -7,250 | -8,100 | - | -32,550 |
| Total revenue – Components commencing from 1 July 2024 | | | | | | | | | | | | | |
| <i>Males</i> | - | - | - | - | - | - | -4,600 | -5,450 | -6,050 | -6,750 | -7,500 | - | -30,350 |
| <i>Females</i> | - | - | - | - | - | - | -1,650 | -1,950 | -2,250 | -2,550 | -2,850 | - | -11,250 |
| Total | - | - | - | - | - | - | -6,250 | -7,400 | -8,300 | -9,300 | -10,350 | - | -41,600 |

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

(c) PBO estimates from 2024-25 to 2028-29. All estimates by gender are PBO estimates.

- Indicates nil.

The reason for the differential between male and female relates to the average level of income earned by males working longer hours. The research by the Parliamentary Budget Office reveals the final stages of the personal income tax plan will give an aggregate benefit in excess of \$40 billion to Australian tax payers over the 10 year planning period. Approximately 75% of that benefit will flow to males and marginally more than 25% to females.

On the basis of our observations, the proposed taxing methodology is gender neutral. Notwithstanding, due to the average earnings of males compared to females, the benefit flowing to males will be greater in dollar terms. The analyses undertaken by the PBO have not taken into account total household earnings and have relied on the tax returns of individual tax payers.

At a political level, we are observing continuing discussion in relation to the equity of the proposal, albeit it is gender neutral in its structure.

[Back to Title Page](#)

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 21st century. And because *Workforce is* designed and hosted in Australia by Egan Associates, you know you're in great hands!



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