

Reviewing CEO Remuneration

Remuneration Review No. 3

June 2006

INTRODUCTION

Stakeholder interest, greater transparency and corporate governance considerations have led to Boards paying greater attention to the process of reviewing CEO remuneration. While advice from independent specialist firms of remuneration advisors is important it remains incumbent upon Boards to ensure that they critically review the advice and satisfy themselves as to its appropriateness to the company's circumstances before they make decisions on CEO remuneration packages.

The time spent by Boards on executive remuneration is relatively small and many months often elapse between occasions when it is a key focus of the Board. In these circumstances and at a time when CEO remuneration has been undergoing significant change it may be helpful to briefly canvas some of the issues of which Boards should be aware when reviewing CEO remuneration.

SCOPE

This paper:

- o provides comments on changing CEOs remuneration practice,
- o outlines principles that need to be applied when benchmarking CEO remuneration,
- o presents P50 data for Base Packages by reference to company size,
- o presents percentage data on the excess of P75 TRPs over P50 Base Packages, and
- o comments on the key aspects of CEO employment contracts.

While the commentary focuses on CEO remuneration the comments in relation to market benchmarking would generally apply equally to other top executive roles in listed companies.

TERMINOLOGY

In this paper the following terms have the indicated meanings.

Base Package	The annual value of salary, superannuation, other benefits, FBT and gross-up for non-deductible benefits such as superannuation contributions in excess of the deductible limits
CEO	Chief Executive Officer
LTI	Long term incentive
P50	50 th percentile or median
STI	Short term incentive
TRP	Total remuneration package comprised of Base package, STI and LTI

GRG Remuneration Reviews are articles to assist directors and senior executives who have responsibilities in relation to Board and senior executive remuneration and other human resources issues. Their role varies between articles with some aimed at stimulating critical thinking, others updating information and others simply acting as a reminder of principles and approaches where awareness may need to be heightened.

GRG Godfrey Remuneration Group Pty Ltd
ABN: 38 096 171 247
56 Berry Street
North Sydney NSW 2060
Phone (02) 8923 5700
Facsimile (02) 8923 5706

ANNUAL MARKET BENCHMARKING

Remuneration packages for CEO roles in Australia have been undergoing significant change over recent years. In this regard the following brief comments are provided.

1. Traditionally in Australia there has been a modest gap between the remuneration of CEOs and the remuneration of their direct reports. Recently the gap has grown particularly in larger companies. The following presents a guide to the degree of change in relativity of Base Packages at the P50 between CEOs and their direct reports among top companies.
 - a. CEOs were traditionally paid about 50% more than their direct reports,
 - b. Common current practice is for CEOs to be at least 100% more than their direct reports,
 - c. In some sectors the gap has increased to around 200% and more.
2. The impact of incentives which tend to represent higher percentages of Base Package for CEOs than for their direct reports makes the spread between CEOs and direct reports even greater than indicated by the previous comments on Base Packages.
3. This change in relativities has been driven by the rate of increase in CEO total remuneration packages being significantly higher than the rates of increase that have been experienced by direct reports. This has been during a period when direct reports have received increases at rates higher than those received by the general workforce.
4. Part of the increase in CEO remuneration packages may have been attributable to shrinkage of the relevance of superannuation as a means of capital accumulation for CEOs. LTIs are now the main capital accumulation component of remuneration packages for CEOs.

During periods of rapid change in remuneration practice it is necessary for Boards to be sure that CEO remuneration packages remain competitive in terms of quantum and structure. Good corporate governance would indicate that when reviewing CEO remuneration the Board should obtain independent advice from specialists who maintain databases and have a sound understanding of contemporary practices, trends and regulatory issues. Boards should also critically review and challenge the information and advice so as to be satisfied that it is sound and appropriate for their companies' circumstances.

BASIC PRINCIPLES OF REMUNERATION BENCHMARKING

Irrespective of whether traditional surveys or public domain data is used there are some basic principles that should be applied when benchmarking remuneration against market practice for CEOs of public listed companies. These include:

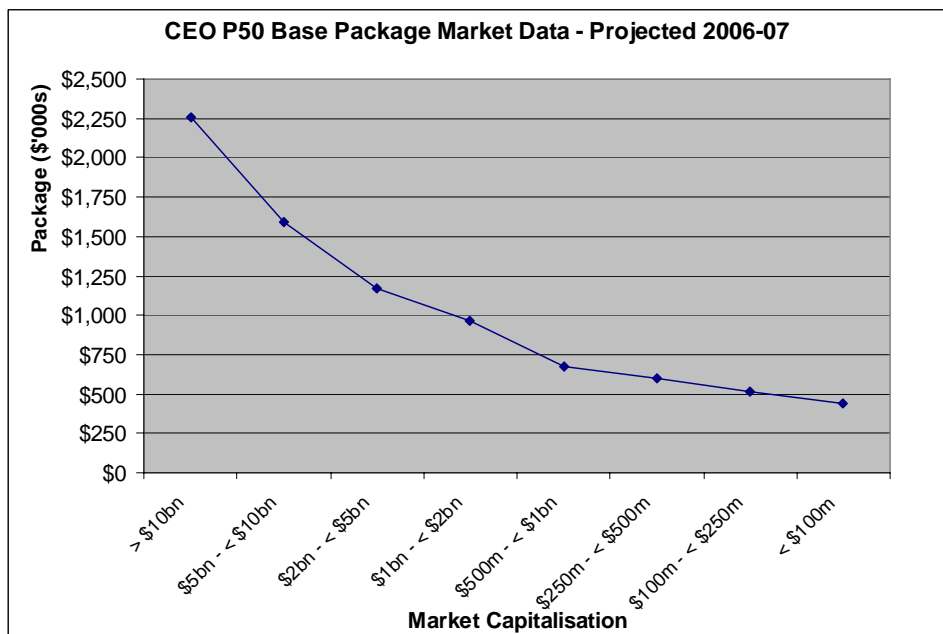
1. **The benchmark should include only CEO roles.** CEOs' remuneration packages are different from those of other executives in terms of both quantum and structure.
2. **The CEO roles should only be in public listed companies.** Remuneration packages of CEOs of listed companies are different from those of CEOs of other organisations such as government enterprises, co-operatives, private companies and subsidiaries of overseas companies.
3. **The listed public companies should only be Australian companies** except in the small number of cases where the company is genuinely competing for CEO talent on the international market. Remuneration packages of CEOs of Australian listed companies tend to be different from those of CEOs of overseas listed companies.
4. **The companies in the benchmark sample should be those with similar dimensions because the dimensions will reflect the accountabilities and complexity of the CEO roles.** Company dimensions tend to be analysed in terms of a size e.g. market capitalisation and industry sector. Other factors relating to the complexity of the business may also be taken into account. An analysis of the top 350 ASX listed companies by

reference to size as measured by market capitalisation and industry sector indicates that great care needs to be exercised when selecting a sample of ASX listed companies that are similar to your company in terms of both size and industry sector. The matrix provided in Appendix A verifies this situation. Hence, qualitative judgements and compromises generally need to be made in order to arrive at an acceptable sample of companies. For years Boards have been sceptical about data provided from surveys conducted by remuneration consulting houses. This scepticism arose from market experience which suggested that practice was different to that being portrayed in the survey data. That scepticism was not adequately addressed because the underlying data could not be revealed and discussed due to confidentiality restrictions. With a better understanding of the market in Australia it now seems evident that the scepticism may have been justified because the data would have been too thin as only a few of the relevant companies would have contributed data to the survey and/or the data was polluted by data in respect of senior executives who were not CEOs or were CEOs of organisation that were not listed companies.

Information available through Remuneration Reports, related documents such as notices of meeting and other disclosure documents now enables the most appropriate benchmark sample of comparable CEO roles to be compiled and for the data to be presented and analysed with transparency not available from traditional survey data. For example when GRG benchmarks CEO remuneration we show for each company CEO role the incumbent's name, Base Package, STI, LTI and total remuneration package. The data is then analysed with percentiles presented and then the data is extrapolated forward to the remuneration period relevant to the remuneration review being undertaken. Being able to sight particular individuals' remuneration packages provides comfort as to the accuracy of the data which may be independently validated and allows the percentiles to be assessed against individual reference points which may be significant in a particular company's circumstances.

OVERVIEW OF BASE PACKAGE DATA

The following relates to Base Package data only. The data relates to the P50 of market practice only. The data has been analysed by reference to company size categories as shown in the graph. The data is useful as a reference point to gain assurance of the validity of more specific and tailored data. Deviations should be explainable by reference to the characteristics of the sample selection criteria. While the following graph is a useful guide it is not a substitute for a specifically tailor market benchmarking of a CEO's total remuneration package by an independent specialist professional firm.



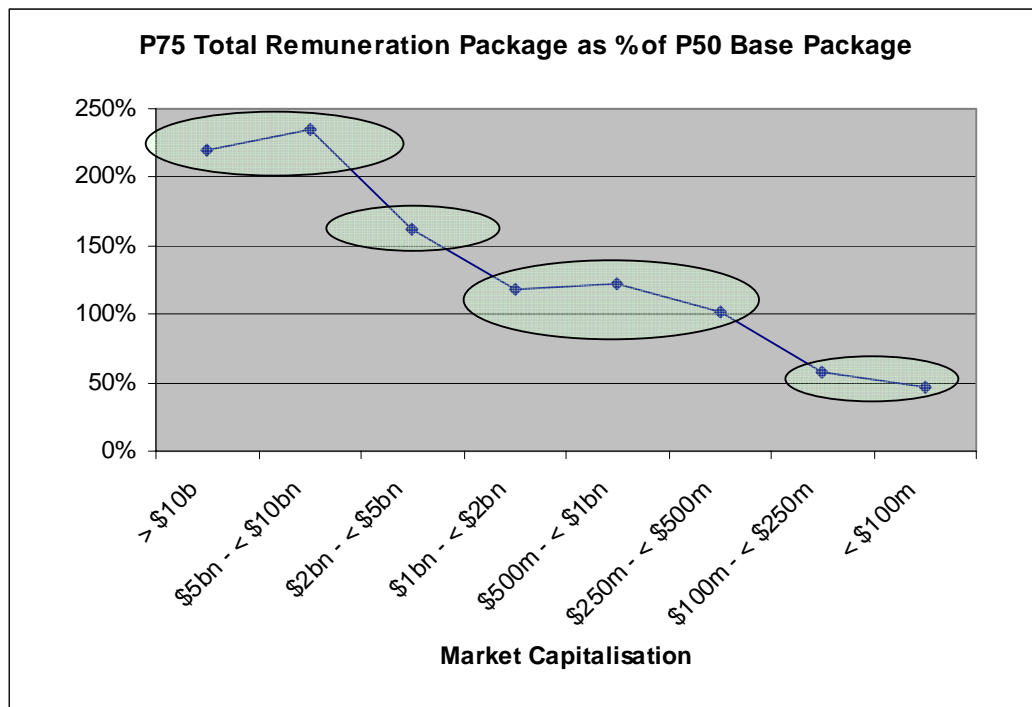
A PERSPECTIVE ON INCENTIVES

A percentage that is frequently used for remuneration planning purposes is the excess of the P75 of total remuneration packages over the P50 of Base Packages for comparable roles. These reference points have become important because:

- Many companies align their Base Package policies with the P50 of market practice for Base Packages. Such a policy position is clearly neither excessive which would be likely to attract criticism from various stakeholders nor too low to undermine the company's competitive position in terms of attracting and retaining CEO talent.
- Many companies align the target levels of their total remuneration packages with the P75 of market practice for total remuneration packages. This positioning assumes that the company is aiming to achieve superior performance and needs high calibre talent to achieve its aims.
- Target award opportunities for STI and LTI combined would then be set to deliver P75 TRP when planned performance is achieved.

The foregoing is mainly adopted by companies that wish to have a strong performance focus in their remuneration structures.

The following graph shows for various companies categorised by market capitalisation size the gap between P50 Base Package and P75 total remuneration package expressed as a percentage of Base Package.



The foregoing table is consistent with the policy position that is typically adopted by Boards in relation to CEO incentives which is to set LTI target awards at 50% higher than STI target awards. This higher weighting reflects the fact that CEOs are expected to take a longer term perspective in relation to the company and its businesses.

These relationships are shown in the following table.

Market Capitalisation	Typical Policy Positions			P50 Base and P75 TRP Gap (from foregoing table)
	Target STI as % of Base Package	Target LTI as % of Base Package	Target Total of STI & LTI	
<\$250m	*	*	50%	50% - 60%
>\$250m to <\$2b	50%	75%	125%	100% - 130%
>\$2b to <\$5b	60%	90%	150%	160%
>\$5b	100%	150%	250%	220% - 240%

*NB: Below the \$250 million market capitalisation range it may well be that LTI plans are less well established and that the majority of incentives are provided via STI plans.

The significant increase in incentive amounts in companies above the \$5 billion market capitalisation group may be attributable to several factors including:

- o Influence of the financial services sector via the major banks which tends to offer total remuneration packages which contain relatively higher incentive opportunities in both STI and LTI,
- o Overseas practice where the incumbent may have been hired from overseas or potential replacements may be sourced from outside Australia or the incumbent may be marketable internationally. Large Australian companies are more likely to have significant overseas operations.

EMPLOYMENT CONTRACT TERMS

When reviewing remuneration arrangements it may also be timely to review the terms of the CEO's employment contract. Current thinking seems to be that the contract should be open ended as opposed to being for a specific period of time, the notice period should be 6 months from the executive and 12 months from the company, and the severance payment should be equal to 12 months Base Package or Base Package plus target STI and should be inclusive of any payment in lieu of notice.

0000oooo0000

GRG Contacts

GRG is well positioned to assist boards in reviewing their company's remuneration strategies, incentive plans and employment contract terms. Many of the top Australian listed companies are among our growing number of clients.

GRG maintains data bases on director and executive remuneration. We will be capturing all the aspects required to be covered in Remuneration Reports and therefore will provide an authoritative source of advice in relation to market practices and emerging trends.

Please feel free to call any of the following consultants.

Sydney 02 8923 5700

- ◆ Denis Godfrey
- ◆ Jeff Smith

More information on GRG may be obtained from our website:

www.godfreyremuneration.com

APPENDIX A – MATRIX OF TOP 350 ASX LISTED COMPANIES

		Top 350 Companies Sector and Size Analysis																					
		Sector													Totals	%							
Market Capitalisation	>\$5bn	0	1	2	2	12	2	2	1	2	5	3	3	0	3	4	2	2	2	2	41	12%	
	\$2bn - <\$5bn	0	3	2	3	8	1	3	3	1	3	0	3	0	3	0	2	2	2	2	32	9%	
	\$1bn - <\$2bn	3	4	1	5	7	1	4	13	2	4	0	0	4	4	3	4	3	3	5	53	15%	
	\$500m - <\$1bn	2	0	1	1	4	0	2	4	4	4	1	2	4	4	1	4	1	3	3	30	9%	
	\$250m - <\$500m	3	0	3	7	7	3	2	8	1	2	2	2	4	4	4	4	4	5	5	53	15%	
	\$100m - <\$250m	3	2	1	6	11	0	7	24	0	9	2	2	15	2	9	3	3	3	3	95	27%	
	\$0 - <\$100m	2	0	5	7	2	2	8	12	0	2	0	0	1	4	4	1	4	1	0	46	13%	
	Totals	13	10	15	31	51	9	27	69	11	15	11	11	32	25	21	10	10	21	10	350	100%	
	%																						