



REMUNERATION UPDATE

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SEPTEMBER 2003

*A Special Issue on Corporate Governance.
Contained in this issue:*

- *The impact of the recently released ASX 'Corporate Governance Council's 'Principles of Good Governance and Best Practice Recommendations'.*
- *An overview of executive contracts and the need for careful planning of all contract provisions.*
- *The Balanced Scorecard revisited.*

Corporate Governance and Executive Remuneration

In response to perceived excesses in the corporate sector the Australind Stock Exchange released its long awaited 'Principles of Good Corporate Governance and Best Practice Recommendations' in March 2003. Principle 9 Remunerate Fairly and Responsibly addresses the specific issue of executive remuneration and the role of the Board Remuneration Committee.

In addition to outlining policies for disclosure Principle 9 sets out specific guidelines for executive remuneration as follows:

Head Office
Suite 912, 530 Little Collins Street
Melbourne, Victoria, 3000, Australia
Tel No (03) 9629 6866
Fax No (03) 9629 6877
Website: <http://www.gna.net.au>
e-mail: gtunn@gna.net.au
ejplant@gna.net.au

Principals & Associates
Geoff Nunn, Executive Director
Elizabeth Plant, Senior Rem. & Org. Specialist
Ian Siebert, Senior Associate
Valerie Winter, Assoc. Director NSW & Qld

**Sydney Office
(Yorklon Holdings Pty Ltd)**
PO Box 614 Castle Hill
NSW, 1765, Australia
Tel No (02) 9621 2755
Fax No (02) 9837 2230
e-mail: valerie.winter@yorklon.com.au

1. Fixed Remuneration

This should be reasonable and fair, taking into account the company's legal and industrial obligations and labour market conditions, and should be relative to the scale of the business. It should reflect core performance requirements and expectations.

2. Performance-Based Remuneration

Performance-based remuneration linked to clearly specified performance targets can be an effective tool in promoting the interests of the company and shareholders.

Incentive schemes should be designed around appropriate performance benchmarks that measure relative performance and provide rewards for materially improved company performance.

3. Equity-Based Remuneration

Appropriately designed equity-based remuneration, including stock options, can be an effective form of remuneration when linked to performance objectives or hurdles.



Nonetheless equity-based remuneration has limitations and can contribute to 'short-termism' on the part of executives. Accordingly it is important to design appropriate schemes. For guidance as to principles relevant to such design refer to *Executive share and Option Scheme Guidelines, IFSA Guidance Note*, Investment and Financial Services Association, 2000.

4. Termination Payments

Termination payments for chief executive officers should be agreed in advance, including detailed provisions in case of early termination, except for removal for misconduct.

Agreements should include a clear articulation of performance expectations.

Consideration must be given to the consequences of an appointment not working out, and to the costs and other impacts of early termination.'

Principles of Good Corporate Governance and Best Practice Recommendations, 2003 pp 55-56.

Whilst these guidelines are designed specifically for listed companies they have relevance for all organisations. Perhaps the most critical impact is in terms of executive contracts of employment.

Executive Contracts

Changes in the regulatory and governance environment have a number of implications for the way we frame executive contracts:

- Shareholder approval is required for the contract of a CEO where the terms and conditions are beyond the range of what would normally be regarded as reasonable.

- The role of the executive should be clearly articulated in the contract. Note that failure to vary the contract or provide for alternative roles may invalidate the contract should the roles change materially.

- Detail performance targets in the contract or in an appendix to the contract. Note that these will be updated on a regular basis and varied should business circumstances require.

- Ensure that the quantum of fixed and variable remuneration is in accordance with market conditions. Remember that liquidators can endeavour to 'claw back' any remuneration payment deemed to be unreasonable for up to four years after a company is wound up. Should a company reduce markedly in size there is an argument for reducing executive remuneration and contracts should ensure the company has this flexibility.

- The contract need to clearly detail the operation of any performance based incentive plan, whether equity or cash based. All of the rules of operation need to be documented.

- Clearly specify the circumstances in which termination may occur and what payments might result. Think of the worst case scenario when developing your contract and should it has been adequately provided for.

- Ensure that you have covered elements such as code of conduct, restraint, anti-discrimination.

- Where the executive is also a director of the company ensure that termination as an executive also means termination as a director.



The Balanced Scorecard Revisited

The increasing level of scrutiny to which executive remuneration and executive contracts have been subject has again heightened interest in the Balanced Scorecard. We revisit some of the fundamental assumptions behind this approach and how it might assist organisations better manage the variable component of remuneration.

In the early 1990's Robert S. Kaplan and David P. Norton unveiled the Balanced Scorecard. Serious interest was generated world wide. The concept began to take off in Australia in around 1996 and 1997.

Essentially Kaplan and Norton's fundamental premise was that if companies wanted to drive performance improvement they needed to set measures across all key aspects of the business. This included financial and non-financial measures.

Performance measures could be clustered into four key groupings:

- Financial Measures;
- Internal Business Process (Operational) Measures;
- External Business Process (Customer) Measures;
- Innovation Measures.

These clusters are generic and may be adapted to suit each organisations particular operating environment.



About Geoff Nunn and Associates

Geoff Nunn & Associates was established in Melbourne, Australia in 1993. Since then, the Company has established a reputation for professionalism and quality service. Projects have been completed in over 600 organisations across Australia.

Our Services

- Remuneration Strategy Development.
- Job Evaluation
- Market Remuneration Advice.
- Remuneration Surveys.
- Remuneration Management Systems.
- Board Remuneration.
- Performance-Based Incentives.
- Remuneration Outsourcing.
- Competency Modeling and Profiling.
- Balanced Scorecard Performance System.
- Organisation Structuring and Design.
- Contracts of Employment.

Contacts

Geoff Nunn, Executive Director (03) 9629 6866.
Mobile 0418 595 107. email: gtnunn@gna.net.au

Elizabeth Plant, Senior Remuneration and Organisation Specialist (03) 9629 6866. email: ejplant@gna.net.au

Valerie Winter, Associate Director NSW & Qld
1300 880 618. email valerie.winter@yorklon.com.au

Visit our Website www.gna.net.au



GEOFF NUNN
AND ASSOCIATES PTY LTD

Independent Remuneration and Organisation Specialists

Head Office

Level 20, 114 William Street
Melbourne, Victoria, 3000, Australia
Tel No (03) 9642 5540
Fax No (03) 9642 5560
Website: <http://www.gna.net.au>
email: gtunn@gna.net.au
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PO Box 614 Castle Hill
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Tel No (02) 8850 3152
Fax No (02) 8850 3153
email: yorklon@bigpond.com.au