

Executive Remuneration Developments in Australia: Responses and Reactions

Savo Kovačević*

Abstract

Rewards for Australian executives continue to stir debate. A recent Australian government response to pay concerns was to call on the Productivity Commission (PC) to investigate the oversight, accountability and transparency of remuneration practices. At least two PC-related outcomes were controversial: the 'two strikes' and 'clawback' proposals. This article considers the reactions of two key stakeholders, namely the Australian Institute of Company Directors and the Business Council of Australia. The views of these two organisations reflect an ongoing evaluation of rules- and principles-based governance structures. Asserting the need to consider alternate analytical models when studying executive pay, the present article concludes with several questions about the intent(s) driving remuneration reforms and their possible consequences.

JEL Code: J3

Keywords

Accountability of remuneration practices; executive remuneration; governance structures; remuneration reforms.

Introduction

The annual general meetings toward the end of 2011 were unique for more than thirty listed Australian companies. Shareholders in these companies registered binding protest votes against executive remuneration reports under new rules affecting executive pay which came into force earlier that year. This new legislation formed part of ongoing reforms to the governance of executive rewards emerging from an inquiry led by the Productivity Commission (2009). Once again, arguments about the nature of rewards for the men and women managing Australia's largest companies had come into sharp focus.

At its core, the debate over the reforms appears to revolve around the efficacy of new and proposed regulatory mechanisms, countering calls for a principled approach to determining executive rewards. The executive pay inquiry articulated the complexity of this debate by identifying recurring structural problems — and possibly creating new ones. Chief amongst them are the relationships (if any)

* Department of Management, La Trobe University, Melbourne, Australia

between executive pay and corporate performance; governance matters such as the composition and function of remuneration committees; and the effects of shareholder 'voice' on board recommendations. There is a debate between those advocating the imposition of rules on board practices and those advocating reporting of conformity with best practice in terms of 'if not, why not' explanations from directors: boards and executives argue that the new rules are designed to address problems which are largely non-existent. These issues are revisited throughout this article when considering post-2007 regulatory developments for executive rewards following the election of the Rudd and Gillard Australian federal governments.

An understanding of recent responses and reactions to executive pay controversies allows researchers to frame questions around the intentions and consequences of remuneration reform. After considering Australian research findings, this article continues with a brief overview of international and Australian governance developments. Next, it considers the Australian Government's forays into addressing executive remuneration through the Productivity Commission (PC). The article then outlines the concerns and reactions of two key stakeholder organisations — the Australian Institute of Company Directors (AICD) and the Business Council of Australia (BCA) — in relation to two especially controversial recommendations from the PC. Finally, potential problems with regulatory changes are identified and questions are posed for regulators, boards, shareholders and researchers.

An Ongoing Debate

Enduring questions follow executive pay analysis in Australia. While pay-for-performance arguments persist, with largely inconclusive findings, Australian researchers also tend to focus on three other related issues: the size, composition and formulation of rewards.

The gap between executive pay and average pay has continued to climb: older research by John Shields (2005) indicates that CEO packages in BCA-affiliated firms were 18 times higher than average adult pay in 1990. By 2005, that gap had grown to 63 times. The Productivity Commission (2009) more recently reported that top 20 CEO pay averaged \$7.2 million (110 times average weekly earnings) in 2008–2009. Research commissioned by the Australian Council of Superannuation Investors (ACSI) indicates median CEO pay (excluding long-term incentives) in the top 100 listed companies has remained above \$2 million since at least the mid-2000s. Nelson, Gallery, and Reza's (2011) survey of 2009's ASX Top 150 companies indicated that short-term pay for executives shrank between 2007 and 2009. Table 1 reproduces findings of ACSI surveys between 2006 and 2010.

Table 1: Australian top 100 CEO remuneration (excluding long-term incentives) 2006–2010

Year	Average (\$A)	Median (\$A)	Minimum (\$A)	Maximum (\$A)	Change in Average (\$A)
2010	3 345 647	2 785 900	132 699	15 964 902	-59 678
2009	3 405 325	2 853 198	239 295	14 931 956	-397 905
2008	3 803 230	2 903 752	198 648	27 894 726	-26 154
2007	3 829 384	2 862 491	321 331	26 286 806	+356 893
2006	3 472 491	2 492 718	415 862	16 504 181	+640 359

Adapted from ACSI (2011).

The composition of the CEO pay packet has also contributed to the growing rewards for executives. Disclosure of long-term incentives now provides researchers with a more complete picture. As summarised in Table 2, these have become a larger part of the executive's reward package. Here, total remuneration has been growing (save for the years 2008 and 2009). An examination of 2598 firm years between 2006 and 2009 by Rankin (2010) similarly confirmed long-term incentive payments were increasing for all executives, but found no discernible trend in the proportion of long-term incentives making up total pay across the years of the study.

Table 2: Australian top 100 CEO remuneration (including long-term incentives) 2006–2010

Year	Average (\$A)	Median (\$A)	Fixed pay as per cent	Bonus as per cent	Equity value as per cent
2010	4 982 196	4 388 073	39	28	33
2009	4 932 253	4 039 748	41	27	32
2008	5 150 984	4 049 293	38	36	26
2007	5 532 515	4 168 554	33	36	31
2006	4 557 051	3 274 675	39	35	26

Adapted from ACSI (2011).

The formulation of executive rewards in Australia is shaped by the confluence of several forces. Key amongst these are the need to set globally competitive rewards, shareholder (retail and institutional) influence and regulatory mechanisms driven by government and market actors. The following sections of this article consider more closely regulations which have affected rewards for Australian executives.

Policy Developments Against a Broader Context

Developments in international and Australian corporate governance frameworks have been considerable since the early 1990s. Australian board practices continue to be shaped by a variety of government organs, market mechanisms, professional associations and interest groups. Heightened listing and disclosure requirements by regulatory bodies have placed considerable pressure on boards to modify or change their practices in order to comply with authorities. The participation of retail investors remains amongst the highest in the world (Australian Securities Exchange 2010) and this has led to increased shareholder activism and scrutiny of board decisions on pay. Moreover, the issue of company performance, especially in Australia, is of particular interest in recent times as boards are evaluated in

light of the Global Financial Crisis. A previous OECD *Economic Outlook* (OECD 2009) reported that all but one of its then-30 member countries had been in recession or experienced contractions in economic growth. Australia escaped corporate collapses on the scale of Lehmann Bros, Fannie Mae and Northern Rock and, more recently, has experienced stable Reserve Bank cash rates, with small increases introduced during the crisis.

While nations such as the UK (see Greenbury 1995; Hampel 1998) and the USA (see Faulkender, Kadyrzhanova, Prabhala, and Senbet 2010) busied themselves with significant regulatory and practical questions in relation to executive pay, Australia moved more cautiously. In the 1990s, Hilmer (1993) and Bosch (1995) released guidelines for good board practice. One of the most significant developments in the 2000s can be found in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*. The Act contained expanded requirements for the disclosure of remuneration and for the presentation of remuneration reports outlining the rationale of executive rewards, and compelled companies to hold non-binding shareholder votes on the reports. More stringent disclosure requirements initiated earlier in the late 1980s and mid-1990s had already seen greater transparency introduced to boardroom decisions, but arguably had also contributed to the accelerated growth of executive salaries (Peetz 1999: 18). The Australian Securities Exchange Corporate Governance Council (itself comprising some 20 professional associations) led the way by requiring fair and responsible remuneration practices from listed companies (ASX Corporate Governance Council 2003, 2007). Calls for remuneration committees to be staffed by non-executive directors were echoed in standards and guidelines such as those released by the Australian Accounting Standards Board (2004) and the Australian Council of Super Investors. ACSI has a history of advocacy for the tightening of Australia's corporate regulatory framework and released guidelines on good governance practice (see, for example, ACSI 2009) largely consistent with other industry and advocacy groups elsewhere in the world. This article refers to a number of organisations which have affected or been affected by changes in Australia's remuneration regulation framework. Table 3 summarises these organisations.

Table 3: Australian governance framework stakeholders referred to in this article

Acronym	Organisation
AASB	The Australian Accounting Standards Board
ACSI	The Australian Council of Super Investors
AICD	The Australian Institute of Company Directors
APRA	The Australian Prudential Regulation Authority
ASA	The Australian Shareholders' Association
ASX	The Australian Securities Exchange
BCA	The Business Council of Australia
CAMAC	The Corporations and Markets Advisory Committee
EOWA	Equal Opportunity for Women in the Workplace Agency
IFSA	Investment and Financial Services Association, now The Financial Services Council
PC	The Productivity Commission

Government Responses

The election of federal Labor governments led by Prime Ministers Kevin Rudd in 2007 and Julia Gillard in 2010 resulted in the creation of a new ministerial post in the Treasury department — Minister for Superannuation and Corporate Law — which, among other responsibilities, would concern itself with regulation of the corporate sector. Ministers in this post appeared initially to take a ‘hands off’ approach to corporate governance issues. Senator Nick Sherry (2007–2009), for instance, stated that the government did not believe in setting remuneration levels (Efrat 2008). His successor Chris Bowen (2009–2010) also declared he was ‘interested in sprucing up the house, not knocking down and rebuilding it’ (Efrat 2009: 17). These stances were contrary to public sentiment. Treasurer Wayne Swan acknowledged that the community was ‘rightly offended’ by the growing mistrust between executives and workers, and former Opposition Leader Malcolm Turnbull believed shareholders should decide the entire remuneration of executives and board members, not just their severance packages (Saulwick and Coorey 2009). Views such as these contributed to growing pressure on the government to take action on executive largesse, but how this was to be done was uncertain. At the time, Sheehan (2009) observed that the government was attempting to influence remuneration practice through indirect means. Minister Bowen’s request, however, that the Productivity Commission investigate executive salaries and Treasury Secretary David Bradbury’s (2010–2012) later release of a discussion paper on the ‘clawback’ of executive rewards (Commonwealth of Australia 2010) suggested a more interventionist posture.

The Productivity Commission

The Productivity Commission received its Terms of Reference in March 2009 for its review of director and executive regulation. Key to the present article’s account of recent events is the Term of Reference which required the PC to ‘consider the effectiveness of the existing framework for the oversight, accountability and transparency of remuneration practices in Australia’ (Productivity Commission 2009: v). The PC also considered the efficacy of non-binding shareholder votes on executive packages. This policy had been introduced by a previous government in the mid-2000s as a benign intervention in excessive payments, but did little to curb either packages or shareholder ire. In this respect, the PC would ultimately recommend that a ‘no-vote’ by 25 per cent or more investors at two annual meetings in a row should trigger a board spill.

Before it completed the final report, the PC released a *Draft Report* in September 2009. It was notable for at least three reasons: its rejection of the imposition of salary caps; the argument that binding votes (i.e. ‘say on pay’) were unworkable; and the proposition of a ‘two strikes and you’re out’ policy which would end board member terms of office if two consecutive votes rejected a reward package. Alan Fels (2010: 78, 80), Associate Commissioner of the PC, continued to assert that the introduction of caps would result in practical problems for firms and potentially disadvantage some firms in relation to others. Further, a binding vote on pay packages would also undermine the board’s authority to

negotiate with executives. It was argued that a 'two strikes' rule would overcome these problems.

Released in December 2009, the PC's *final* 17 recommendations addressed issues of board capacities, conflicts of interests, disclosure, remuneration principles, shareholder engagement and implementation issues. The Government subsequently agreed to almost all recommendations and added another — the clawback of bonuses — for consideration by lawmakers (Bowen 2010; Maiden 2010). The Corporations and Markets Advisory Committee (CAMAC) was charged with advising the Government on legislative changes flowing from the acceptance or modification of the Commission's recommendations.

Two changes between the draft and final recommendations are of particular interest to the present discussion: *remuneration committee composition in the ASX300* and a *refinement of the 'two strikes' policy*. Moving from prevailing prescriptive directions that remuneration committees be staffed with independent non-executive directors, the PC recommended an 'if-not-why-not' explanation be provided to regulators and the market when a board's understanding of independence differed from current requirements or when it was not practical for the committee to be thus staffed (Recommendations 2 and 3). This acknowledgement of the myriad challenges involved in board composition signals a turning of the tide against long-held arguments that board seats should primarily or solely be filled by independent and/or non-executive directors. Australian research into relationships between board composition and CEO pay-for-performance examined this shift. Capezio, Shields, and O'Donnell (2011) found that none of their three measures for board independence strengthened the link between CEO pay and firm performance.¹ Similarly Nelson et al. (2011: 29) found that remuneration committee independence and expertise did not have a significant influence on CEO pay.

The 'two strikes' proposal (Recommendation 15) was seen as a means of increasing shareholder signalling and power, thus pressuring boards to be more responsive to shareholder concerns (Cooper, Moule and Mason 2010). A 25 per cent vote against the remuneration report at the AGM would compel the board to reconsider reward packages. A subsequent rejection (again, from 25 per cent of shareholders) would result in all board seats being up for re-election within 90 days. Since the mid-2000s, Australian shareholders could make non-binding votes on remuneration packages. The number of 'no' votes in AGMs continued to climb during this time. Calls for full binding votes persisted in the popular media, but the former Minister for Corporate Law Chris Bowen asserted that they were unworkable (Efrat 2009). The Australian Institute of Company Directors, hitherto an energetic observer of the PC inquiry, expressed concerns about the 'two strikes' policy and argued that it would end up benefitting minority interests.

The 'two strikes' recommendation became law on 1 July 2011. The first protest vote was registered in October that year. At least fifteen companies in the ASX 200 registered a vote of at least 25 per cent against their remuneration reports (Featherstone 2012). Some smaller companies faced particularly large protests: Cryosite (81 per cent 'no' vote), Globe International (74 per cent) and Clean Global Energy (64 per cent) chief among them.

The Corporations and Markets Advisory Committee

Minister Bowen referred the PC's recommendations to the Corporations and Markets Advisory Committee to determine how best to revise legislation. An information paper was released in July 2010 considering the views of bodies such as the AICD, IFSA, ACSI and the ASA. In April 2011, the final CAMAC (2011) *Executive Remuneration Report* generally avoided advocacy for new legislation and suggested that the formulation of remuneration packages was largely a matter for boards. Further, CAMAC sought the removal of 'accounting-based' remuneration reports. With layers of disclosure and transparency requirements added during the 1990s and 2000s, remuneration reports became increasingly obfuscated with incredible amounts of detail — some of it potentially misleading to shareholders. Indeed, commentators such as Bartholomeusz (2011) called the revisions 'corporate-friendly' and noted that the introduction of the 'two strikes' law would be sufficient to keep boards on their toes.

Reactions from the AICD and the BCA

While the PC recommendations churned through the regulatory wheels of CAMAC, key players such as the Australian Institute of Company Directors and the Business Council of Australia weighed in with their views. The AICD warned that minority interests could possibly dominate deliberations on executive rewards: a case of the tail wagging the dog. With 'clawback' provisions (opposed by the AICD) seriously considered by the government and the 'two strikes' recommendations recently becoming law, the AICD found itself more vigorously urging lawmakers to reconsider tighter controls.

The AICD has consistently argued through position papers and guidelines against black letter law (Colvin 2011: 4) and has called for better self-regulation, not government intervention (Company Director 2009). It welcomed the PC draft report's rejection of salary caps and its assertion that binding shareholder votes were unworkable in practice. The Institute was less impressed, however, with the government's tightening of the screws on boards throughout 2010 and 2011. Indeed, it was 'disappointed with the excessive and fundamentally flawed executive remuneration legislation passed by the Senate on 20 June 2011' (AICD 2011a). The 'two strikes' rule, for instance, had a number of practical implications for boards. First, there was even more disclosure required in relation to explaining the ramifications of the reforms to investors and the significance of disruption to stewardship if a 'no' vote was recorded against it. Second, boards would have to disclose changes — if any — they would make to remuneration policy or packages after a 'no' vote. Third, a spill resolution would be required at the subsequent AGM if a second 'no' vote was recorded. Fourth, a greater emphasis was now placed on companies to liaise with major shareholders and proxy advisors to explain proposed remuneration structures and policies. Fifth, opportunists and raiders would require relatively little co-ordination to force a board spill and install a director (or directors) who served their interests.

Looming reforms threatened to send directors on remuneration committees into a deeper circle of 'calibration hell' (Featherstone 2010: 10). As such, *Position*

Paper No. 15 was released in June 2010 (AICD 2010). Fundamentally, the AICD promoted a principles-based approach to remuneration reports as an alternative to compliance with growing prescriptive requirements. The *Position Paper* argued that a firm could articulate this position by addressing four broad areas in the remuneration report:

- Governance structures for determining executive pay;
- Executive remuneration philosophy;
- ‘Actual pay’ outcomes for executives that year; and
- Current executive entitlements to future remuneration.

These four areas represented the AICD’s proposal to re-draft current disclosure requirements in section 300A of the *Corporations Act 2001*. Further, the AICD emphasised that it would not support calls for remuneration reports to be presented in ‘plain English’, nor would it tolerate additional regulatory requirements to those already in existence. Alterations and deletions of other parts of the regulatory framework were also put forward as part of the AICD’s agenda to ease the growing compliance burden.

Representing the chief executives of Australia’s largest companies, the Business Council of Australia was of the view that the recommendations lacked sufficient clarity and had the potential to impose unnecessary and unwarranted restrictions on the flexibility of boards (BCA 2010). Earlier, the BCA had rejected the PC’s draft recommendations 1 and 15 (‘no vacancy’ and first ‘two strikes’ proposals) and expressed concerns about the practicality of other recommendations (BCA 2009). Company constitutions include clauses outlining the minimum and maximum number of directors on a board. Further, many constitutions include an additional clause that allows the board to then set the number of directors at any one time. ‘No vacancy’ is a practice adopted by some boards to set the number of directors at a given time, within the company’s constitution. This practice can impede the election of new board members (Productivity Commission 2009: 367). Removing this clause, the BCA argued, could lead to companies having oversized boards, and make it easier for minority interests to get themselves on boards. The BCA saw the ‘no vacancy’ proposal as a matter of board diversity, not remuneration. As such, the BCA could not support the ‘no vacancy’ recommendation: it had no direct relation to improving remuneration policies or, arguably, board diversity, as organisations such as the Equal Opportunity for Women in the Workplace Agency (EOWA) were already involved in this regard.

Primarily, however, the BCA was concerned that a second ‘no’ vote would send an unclear message to boards about the specific nature of shareholder concerns. Like the AICD, the Council also feared that minority interests would hijack voting on packages to install directors who served only that group’s interests. Research conducted during the 2010 AGM season by the law firm Johnson Winter and Slattery found that ten of the Top 100 firms received ‘no’ votes of 25 per cent or more. Closer examination of the ten firms indicated that the company meetings had an average voter turnout of 55.93 per cent (Keeves 2010). In other words, a 25 per cent ‘no’ vote could be achieved with 14 per cent of shares on issue.

Claws Out Against the Clawback

In addition to the PC's recommendations, the Government introduced a company 'clawback' proposal in early 2010. The clawback would be activated in cases where bonuses were paid to directors and executives after a material misstatement in the company's financial statements (Bowen 2010). Here, the Government was aiming to send a strong message: it was mindful of the rage caused by some of the larger, more questionable bonuses paid to executives. Parliamentary Secretary to the Treasury David Bradbury released a clawback discussion paper in December 2010 to consider options for implementation (Commonwealth of Australia 2010). While the clawback initiative had support from ACSI, the AICD and the Business Council of Australia grew even more concerned.

The AICD strongly opposed the clawback provisions, arguing that they were totally unwarranted and that they would result in increased red tape and compliance costs. Further, the clawback was claimed to be uncalled-for, prescriptive, and heavy-handed and likely to have several unintended consequences as to the setting and structuring of remuneration (AICD 2011c). The BCA agreed with the basic proposition that executives should repay improperly-earned profits, but opposed the introduction of a clawback provision on two grounds. Like the AICD, the BCA saw no demonstrated need for reform. Also, they saw practical difficulties in applying a clawback in a meaningful and pragmatic way: the BCA questioned whether legislation could be successfully drafted to cover a multitude of remuneration practices, what might constitute a misstatement and how to determine the appropriate clawback if required (BCA 2011). Indeed, of the 28 submissions made to the clawback discussion paper, the majority did not appear to support enshrining clawback into law, leaving it instead to boards or the ASX to resolve rare cases of improper executive rewards.²

In February 2012, David Bradbury's office announced that the Government would proceed with amendments to the *Corporations Act 2001*. Listed companies would be required to disclose steps taken to claw back bonuses and other remuneration where there had been a material misstatement in financial statements (Bradbury 2012). While CAMAC had ultimately decided against progressing towards a principles-based framework for reporting, Bradbury commented that regulators 'should not rule out moving towards a principles-based legislative architecture at some point in the future' (AICD 2012: 4).

Complex Compliance Architecture

The 'two strikes' and 'no vacancy' reforms have attracted most of this article's attention. Other parts of the Australian reform agenda relating to remuneration consultants, hedging of incentive rewards, voting rights of key management personnel in board spills, disclosure and so-called 'cherry picking' of proxies have not been discussed, but certainly add to the complexity of remuneration questions faced by boards. It would be remiss to suggest that other issues are subordinate in the remuneration debate, but the ones discussed are amongst the most urgent of board considerations. At this stage it is perhaps worthwhile to briefly reflect on events from the narrow remit of this review and, more

importantly, to consider the implications of these developments for regulators, boards, shareholders and researchers. Table 1 provides a chronological outline of key events referred to in this article before attention is turned to how prior research can assist with developing a more rounded understanding of continuing executive pay reforms.

Table 1: Chronology of key events relating to the regulation of executive remuneration in Australia, 2007–2012

2007	NOV	<ul style="list-style-type: none"> Rudd-Gillard government elected.
2008	OCT	<ul style="list-style-type: none"> Australian Prudential Regulation Authority to examine executive remuneration policies appropriate for avoiding excessive risk-taking in Australia's financial institutions.
	MAR	<ul style="list-style-type: none"> Treasurer Wayne Swan asks Productivity Commission to head inquiry into executive pay. Terms of Reference issued by Assistant Treasurer Chris Bowen.
2009	MAY	<ul style="list-style-type: none"> Australian Institute of Company Directors submission to the Productivity Commission inquiry.
	JUL	<ul style="list-style-type: none"> Business Council of Australia submission to the Productivity Commission inquiry.
	SEP	<ul style="list-style-type: none"> Draft Productivity Commission report released.
	NOV	<ul style="list-style-type: none"> Australian Institute of Company Directors post-draft submission to the Productivity Commission inquiry. Business Council of Australia post-draft submission to the Productivity Commission inquiry.
	DEC	<ul style="list-style-type: none"> Final Productivity Commission report <i>Executive Remuneration in Australia</i> released.
2010	APR	<ul style="list-style-type: none"> Chris Bowen responds to Productivity Commission report. Most recommendations accepted and clawback proposal is added. The Australian Securities Exchange releases an exposure draft calling for remuneration committees in the ASX300 to be solely composed of non-executives.
	JUN	<ul style="list-style-type: none"> Australian Institute of Company Directors <i>Position Paper No. 15</i> released.
	JUL	<ul style="list-style-type: none"> Corporations and Markets Advisory Committee releases <i>Executive Remuneration: Information Paper</i>.
	AUG	<ul style="list-style-type: none"> Gillard-Swan government elected. Australian Institute of Company Directors submission to the CAMAC <i>Information Paper</i>. Business Council of Australia submission to the CAMAC <i>Information Paper</i>.
	DEC	<ul style="list-style-type: none"> David Bradbury, Parliamentary Secretary to the Treasurer, releases clawback discussion paper. The Australian Prudential Regulation Authority releases a draft on board composition.
2011	FEB	<ul style="list-style-type: none"> Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011 introduced.
	APR	<ul style="list-style-type: none"> Corporations and Markets Advisory Committee releases <i>Executive Remuneration: Report</i>.
	JUL	<ul style="list-style-type: none"> 'Two strikes' recommendation becomes law.
	OCT	<ul style="list-style-type: none"> First 'no-votes' under new 'two strikes' law recorded at annual general meetings.
2012	FEB	<ul style="list-style-type: none"> Several recommendations made by CAMAC review adopted by the Government.

The need for sound and transparent executive remuneration practices is clear given continued public interest in corporate activity, growing levels of share ownership and shareholder activism, changes to regulation and globalising business activity. Regulators and developers of best practice need to be more sensitive to the nature of governance problems they seek to address, as well as the short-, medium- and long-term outcomes of their responses. The 'ratcheting-up' of executive pay (Kovacevic 2009), for instance, was a perverse outcome of 1990s legislation which was apparently intended to keep rewards modest through disclosure of executive and director rewards. Arguably, this has not been the case. Similarly, the drive for increasing reward transparency and shareholder say on pay (Sheehan 2010), which may be founded on the sound principle of keeping largesse in check, needs careful consideration before uncritical implementation in order to avoid the potential of introducing a new form of remuneration pain in place of present grievances. Indeed, one has to question what the actual intention behind executive pay reform is: do regulators seek to introduce best practice (where excessive risk-taking and underperformance is not tolerated) or do they seek to halt unseemly displays of greed? In essence, Sheehan (2009) describes this as a choice between a carrot and a stick.

When considering the various organisations identified in this discussion, it is readily apparent how fluid, fractious and asymmetric the relationships between some players can be and how others will act with consistency and predictability. As such, a re-evaluation of the utility of one or several theoretical frameworks is required. In building an understanding of governance complexities, Daily, Dalton, and Cannella (2003: 372) earlier concluded that 'a multi-theoretic approach to corporate governance is essential for recognising the mechanisms and structures that might reasonably enhance organizational functioning'. Multiple lenses through which to view board relationships (and resulting pay decisions) are necessary. In this vein, van Ees, Gabriellson, and Huse (2009) suggested adopting a behavioural approach to understanding actual board problems and responses. Pepper and Gore's (2011) recent recasting of the agency model reconsidering behavioural aspects suggested that the role and utility of agency perspectives is far from determined. Bender's (2004) U.K. research has considered institutional theory explanations for director and executive rewards and has also discussed the role of legitimacy in pay. Bebchuk and Fried (2005) have enlivened the executive pay argument with their managerial power perspective. Barringer and Harrison (2000: 369) argued that the drivers of inter-organisational relationships and alliances are often simplified and glossed over in research.

This paper stops short of deriding Australia's extended corporate governance framework as an 'alphabet soup' of stakeholders with conflicting and/or base interests, but does pose the question of what concerted efforts are required to ensure that executive pay is, in essence, *fair*. The question is deceptively simple. However, a number of conundrums are identified when the question is considered in light of the present discussion and the implications of executive pay reforms. Namely:

- i) Many studies have suggested and continue to suggest that the relationship between pay and performance is weak, at best. Firm size may be a better

predictor (Capezio et al. 2011; Fels 2010). Despite this, popular sentiment continues to ponder the relationship between pay and performance and remuneration reports are still called upon to explain how an executive's reward reflects the company's fortunes that particular year. This supposed relationship potentially mis-directs pay debates. Recent observations reported by the AICD (2011d) indicate ASX300 companies have been increasing short-term incentives for executives and reducing long-term incentives as a proportion of fixed pay. It appears that the appropriate metrics for performance can still vary.

- ii) Codes of conduct, statements of best practice and, sometimes, regulators often stipulate that remuneration committees should be composed of independent directors. The Australian Prudential Regulation Authority (APRA 2010), for instance, mandates only independent directors on the remuneration committees of companies in the financial services industry. Research suggests, however, that the composition of remuneration committees may not affect the size of executive packages (Capezio, et al. 2011; Nelson et al. 2011). Bhagat and Black's (1999) study of American companies similarly could not find a strong correlation between board composition and firm performance. Perhaps it is extreme to exclude insider directors from boards. Also, will the second rejection of a reward package and the resulting board spill guarantee a superior board composition and ultimately lead to the design of better remuneration packages? This remains to be seen.
- iii) Legislation has increasingly sought to empower shareholders through non-binding votes (previously) and (currently) 'two strikes' mechanisms, while directors (i.e. the AICD) and executives (i.e. the BCA) are concerned about being beholden to minority shareholder interests. The BCA (2009: 8), for instance, is concerned that boards may be intimidated from performing their fiduciary duties in the interests of the company as a whole and will instead satisfy the interests of minority shareholders who have the potential to replace directors. Further, as boards will need to engage early and more often with investors in order to avoid 'no' votes, will directors have legitimate claims to increased compensation given a heavier compliance burden? Are higher-paid directors more sympathetic to executives negotiating larger salary packages? Research by Main, O'Reilly, and Wade (1995) and O'Reilly and Main (2010) suggest that reciprocity effects between directors and executives cannot be ignored.
- iv) Shareholder and like-minded stakeholders seek *regulation* which provides them with greater influence and protection, while boards seek to avoid one-size-fits-all solutions and instead operate under sound governance *principles*. Gordon (2005: 679–680) points out that executive pay straddles at least two worlds: one where shareholder returns are paramount, the other responsive to concerns about the social implications of wealth and power. Strategies apt for one world may not suit the other. The AICD (2011b) reported that remuneration packages are expected to become more 'con-

vergent' as boards move to safer 'vanilla' reward options to satisfy investors. Non-financial performance measures (e.g. customer satisfaction) may be perceived as tempting shareholder rejection (Featherstone 2012). This appears to be a conflict between rigidity and flexibility and tests the durability of 'if not, why not' Australian governance arrangements.

- v) Can regulators justify proposing legislation which does not appear to be evidence-based, such as pay clawbacks (Commonwealth of Australia 2010)? While some fraudulent financial reports have been uncovered, the incidence of these acts is relatively infrequent. What assumptions and strongly-held beliefs drive current governance policy? The study by Larcker, Richardson and Tuna (2007) of 2126 firms found little corroborating evidence for a link between better governance and managerial choices. With clawbacks in use in the UK, the USA and the EU, it may be more appropriate for researchers to fully examine the efficacy of those structures before they are evaluated in Australia.

Conclusion

Executive rewards in Australia have attracted much interest in recent years, and recommendations from the 2009 Productivity Commission inquiry have moved the debate into sharper focus. The Federal Government adopted almost all of the 17 recommendations put forward by the PC. One of the more controversial recommendations was the 'two strikes' rule which could trigger a board re-election. A 'strike' is registered when there is a 'no' vote of 25 per cent or more against a resolution calling for adoption of the remuneration report. The 'two strikes' recommendation became law in 2011 and several companies received their first 'no' votes during the AGM season later that year. In addition to the PC inquiry, the Government also introduced rules for the 'clawback' of bonuses and other pay where there had been a material misstatement in the company's financial statements.

The responses and reactions of two high-profile stakeholders such as the AICD and the BCA have been considered here as they are among the most influential organisations in executive reward discussions. While generally supportive of the need to review pay rules, their concerns and objections around the Government's subsequent adoption of PC recommendations have raised questions around the consequences arising from resulting legislation. Are the new rules warranted? Do they ensure fair rewards for executives? Will the threat of a board spill as early as 2012 create unnecessary instability for companies?

In addition to providing an insight into pay reform processes since the election of the Rudd-Gillard Labor governments, this analysis has also considered the consequences of reforms for boards and shareholders and calls for researchers to study critically the factors that shape executive rewards. Do legislative processes reflect a managerial power thesis or are they the product of (classical or behavioural) agency perspectives? How do remuneration committees ensure that reward packages are not rejected by shareholders? How do regulators and boards determine when rules-based governance mechanisms are more appropri-

ate than principles-based processes (and vice versa)? In the Australian executive pay debate, new answers appear to be quickly followed by new questions.

Notes

1. Three conditions of board independence as described by Capezio et al. (2011): (i) presence of a non-executive chair; (ii) proportion of non-executives on the board; (iii) remuneration committee dominated by non-executives.
2. This conclusion is based on responses to the discussion paper question: 'Do you believe that a reform to clawback director and executive remuneration when financial statements are materially misstated is needed to further enhance Australia's executive remuneration framework?' (Commonwealth of Australia 2010).

References

- ACSI (Australian Council of Superannuation Investors) (2009) *A Guide for Superannuation Trustees to Monitor Listed Australian Companies*, Australian Council of Super Investors, Melbourne.
- ACSI (2011) *CEO Pay in the Top 100 Companies: 2010*, Australian Council of Super Investors, Melbourne.
- AICD (Australian Institute of Company Directors) (2010) *Position Paper No. 15: Remuneration Reports*, Australian Institute of Company Directors, Sydney.
- AICD (2011a) Flawed executive pay laws passed by Parliament (media release) from <http://www.companydirectors.com.au/General/Header/Media/Media-Releases/2011/Flawed-executive-pay-laws-passed-by-Parliament> [accessed 23 April 2012].
- AICD (2011b) 'Getting ready for the new pay laws', *The Boardroom Report*, 9(16), p. 5.
- AICD (2011c) *Submission to Federal Treasury on Discussion Paper 'The Clawback of Executive Remuneration where Financial Statements are Materially Misstated'*, Australian Institute of Company Directors, Sydney.
- AICD (2011d) 'The sway in executive pay', *The Boardroom Report*, 9(20), p. 3.
- AICD (2012) 'Government to implement more executive pay changes', *The Boardroom Report*, 7 March, 10(4), p. 4.
- APRA (Australian Prudential Regulation Authority) (2010) *Prudential Standard CPS 510: Governance* (No. CPS 510), Australian Prudential Regulation Authority, Canberra.
- ASX (Australian Stock Exchange) Corporate Governance Council (2003) *Principles of Good Corporate Governance and Best Practice Recommendations*, Australian Stock Exchange.
- ASX Corporate Governance Council (2007) *Corporate Governance Principles and Recommendations*, Second edition, Australian Securities Exchange.
- Australian Accounting Standards Board (2004) AASB 1046: Director and executive disclosures by disclosing entities, Melbourne.

- Australian Securities Exchange (2010) *2010 Australian Share Ownership Study*, Australian Securities Exchange.
- Barringer, B. R. and Harrison, J. S. (2000) 'Walking a tightrope: Creating value through interorganisational relationships', *Journal of Management*, 26(3), pp. 367–403.
- Bartholomeusz, S. (2011) 'Executive pay report on the money', *Business Spectator* 25 May 2011, available: <http://www.businessspectator.com.au/bs.nsf/Article/Executive-pay-report-on-the-money-pd20110525-H7A-NW?OpenDocument&src=sph> [accessed 27 May 2011].
- BCA (Business Council of Australia) (2009) *Submission to the Productivity Commission Discussion Draft on Executive Remuneration in Australia*, Business Council of Australia, Melbourne.
- BCA (2010) 'Government response pays sound attention to executive remuneration recommendations', (media release 16 April), available: <http://www.bca.com.au/Content/101673.aspx> [accessed 23 April 2012].
- BCA (2011) *Submission to the Treasury regarding the Clawback of Executive Remuneration where Financial Statements Are Materially Misstated*, Business Council of Australia, Melbourne.
- Bebchuk, L. A. and Fried, J. M. (2005) 'Pay without performance: Overview of the issues', *Journal of Corporation Law*, 30(4), pp. 647–672.
- Bender, R. (2004) 'Why do companies use performance-related pay for their executive directors?', *Corporate Governance: An International Review*, 12(4), pp. 521–533.
- Bhagat, S. and Black, B. (1999) 'The uncertain relationship between board composition and firm performance', *The Business Lawyer*, 54(3), pp. 921–963.
- Bosch, H. (1995) *Corporate Practices and Conduct*, Third edition, FT Pitman Publishing, Melbourne.
- Bowen, C. (2010) 'Government responds to the Productivity Commission report on executive remuneration', (media release 16 April), available: <http://www.chrisbowen.net/media-centre/media-releases.do?newsId=3060> [accessed 23 April 2012].
- Bradbury, D. (2012) 'Reforms to further enhance Australia's executive remuneration framework' (media release 21 February), available: <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/007.htm&pageID=003&min=djbandYear=andDocType> [accessed 23 April 2012].
- CAMAC (2011) *Executive Remuneration: Report*, Corporations and Markets Advisory Committee, Canberra.
- Capezio, A., Shields, J. and O'Donnell, M. (2011) 'Too good to be true: Board structural independence as a moderator of CEO pay-for-firm-performance', *Journal of Management Studies*, 48(3), pp. 487–513.
- Colvin, J. H. C. (2011) 'More red tape for directors', *Company Director*, 27, May, p. 4.
- Commonwealth of Australia (2010) *The Clawback of Executive Remuneration where Financial Statements are Materially Misstated*, Federal Treasury, Australia, Canberra.

- Company Director (2009) 'Q and A with John H. C. Colvin', *Company Director*, 25, December, pp. 20–23.
- Cooper, J., Moule, A. and Mason, R. (2010) 'Final Productivity Commission Report released', 12 January, available: <http://www.freehills.com/5694.aspx> [accessed 20 January 2010].
- Daily, C. M., Dalton, D. R. and Cannella, A. A. (2003) 'Corporate governance: Decades of dialogue and data', *Academy of Management Review*, 28(3), pp. 371–383.
- Efrat, Z. (2008) 'Picking the next trifecta', *Company Director*, 24, April, pp. 26–28.
- Efrat, Z. (2009) 'Q and A with Chris Bowen', *Company Director*, 25, December, pp. 14–17.
- Faulkender, M., Kadyrzhanova, D., Prabhala, N. and Senbet, L. (2010) 'Executive compensation: An overview of research on corporate practices and proposed reforms', *Journal of Applied Corporate Finance*, 22(1), pp. 107–118.
- Featherstone, T. (2010) 'The growing Rem headache', *Company Director*, 26, May, p. 10.
- Featherstone, T. (2012) 'Two strikes health check', *Company Director*, 28, February, pp. 18–23.
- Fels, A. (2010) 'Executive remuneration in Australia', *Australian Accounting Review*, 20(1), pp. 76–82.
- Gordon, J. N. (2005) 'Executive compensation: If there's a problem, what's the remedy — The case for compensation discussion and analysis', *Journal of Corporation Law*, 30(4), pp. 675–702.
- Greenbury, R. (1995) *Directors' Remuneration: Report of a Study Group Chaired by Sir Richard Greenbury*, Gee Publishing, London.
- Hampel, R. (1998) *Committee on Corporate Governance — Final Report*, Gee Publishing, London.
- Hilmer, F. G. (1993) *Strictly Boardroom: Improving Governance to Enhance Company Performance*, The Business Library, Melbourne.
- Keeves, J. (2010) *2010 JWS AGM Season Survey Results*, Johnson Winter and Slatery, Sydney.
- Kovacevic, S. (2009) 'Disclosed: An exploration of board remuneration committee challenges', *Asia Pacific Journal of Human Resources*, 47(2), pp. 201–218.
- Larcker, D., Richardson, S. A. and Tuna, I. (2007) 'Corporate governance, accounting outcomes, and organizational performance', *The Accounting Review*, 82(4), pp. 963–1008.
- Maiden, S. (2010) 'Kevin Rudd's crackdown on executive pay watered down', *The Australian*, 4 January, available: <http://www.theaustralian.com.au/business/kevin-rudds-crackdown-on-executive-pay-watered-down/story-e6frg8zx-1225815764009> [accessed 23 April 2012].
- Main, B. G. M., O'Reilly, C. A. I. and Wade, J. (1995) 'The CEO, the board of directors and executive compensation: Economic and psychological perspectives', *Industrial and Corporate Change*, 4(2), pp. 293–332.
- Nelson, J., Gallery, G. and Reza, P. (2011) The impact of corporate governance on CEO remuneration structures in the aftermath of the GFC, Paper presented at

- the 2011 Accounting and Finance Association of Australia and New Zealand Conference, available: http://www.afaanz.org/openconf/2011/modules/request.php?module=oc_proceedings&action=view.php&anda=Accept+as+Paper&andid=220 [accessed 23 April 2012].
- O'Reilly, C. A., III and Main, B. G. M. (2010) 'Economic and psychological perspectives on CEO compensation: A review and synthesis', *Industrial and Corporate Change*, 19(3), pp. 675–712.
- OECD (2009) Annual Projections for OECD Countries, *Economic Outlook* No 85, available: http://stats.oecd.org/Index.aspx?DataSetCode=EO85_MAIN [accessed 12 September 2009].
- Petz, D. (1999) 'Nearly the year of living dangerously: In the emerging worlds of Australian industrial relations', *Asia Pacific Journal of Human Resources*, 37(2), pp. 3–23.
- Pepper, A., and Gore, J. (2011) Towards a behavioural agency theory: New micro-foundations for theorising about senior executive reward, Paper presented at the Third European Reward Management Conference.
- Productivity Commission (2009) *Executive Remuneration in Australia*, Productivity Commission, Melbourne.
- Rankin, M. (2010) 'Structure and level of remuneration across the top executive Team', *Australian Accounting Review*, 20(3), pp. 241–255.
- Saulwick, J., and Coorey, P. (2009) 'Rudd takes action on bosses' pay', *The Sydney Morning Herald*, 19 March, p. 1.
- Sheehan, K. M. (2009) 'The regulatory framework for executive remuneration in Australia', *Sydney Law Review*, 31(2), pp. 273–308.
- Sheehan, K. M. (2010) 'Say on pay and the outrage constraint', *SSRN Working Paper Series*, 20 September, available: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1679622 [accessed 1 March 2011].
- Shields, J. (2005) 'Setting the double standard: Chief executive pay the BCA way', *Journal of Australian Political Economy*, (56), pp. 299–325.
- van Ees, H., Gabrielsson, J. and Huse, M. (2009) 'Toward a behavioral theory of boards and corporate governance', *Corporate Governance: An International Review*, 17(3), pp. 307–319.

About the Author

» **Dr. Savo ('Sam') Kovačević** is a Lecturer in Management and HRM in La Trobe University's Department of Management. His research interests primarily revolve around corporate governance issues. Current research involves the examination of board composition and practices, as well as the impacts of regulatory change on executive rewards. He can be reached at s.kovacevic@latrobe.edu.au.