HaRe Group newsletter: **31 March 2005**

Subject: **Executive & professional pay update**

From time to time, there are media reports that provide worthwhile information on executive and professional remuneration. This email summarises and comments on selected articles in recent (and not so recent but relevant) business papers.

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Expats have little incentive to come home (AFR, 10 Mar.)

A Senate inquiry took 650 submissions from expatriates to understand why Australians stay overseas to work. The main reasons why they don't come back include poor financial & taxation incentives, excessive red tape and limited opportunity.

While some expats cited difficulties in transferring foreign driver's licences and bringing foreign spouses home, most said tax levels and incompatible pension & health plans were the main disincentives.

The New Zealand government has recognised the problem and is about to start a campaign to attract both Australian & NZ expats.

GE boss reaps rewards (AFR, 7 Mar.)

GE's CEO, Jeffrey Immelt, received 12% more remuneration last year because his company met financial targets. Mr Immelt's base salary of US$3 million did not change; however, his bonus rose 23% to US$5.3 million. Additional "performance units" vest in 5 years if cash-flow and share-return hurdles are cleared. GE stopped issuing share options in 2003.

About 75% of Mr Immelt's pay is tied directly to GE's performance measures. His bonuses have been going up because company performance is going up.

Incentives at BHP Billiton (The Age, Sept. 2004)

Last year, Stephen Bartholomeuz wrote about the new executive incentive scheme at BHP Billiton. In summary, he explained the key elements:

- 30% of an executive's remuneration package is guaranteed base salary (assuming all performance targets are achieved)
- The remaining 70% is a mix of cash and performance shares (again, assuming all performance targets are achieved)
- The "fair value" of performance shares granted in any year cannot exceed twice base salary
- Fair value (was then) about 29% of market value
- Share grants based on short-term performance indicators will vest in 2 years
- Share grants based on long-term performance will vest in 5 years
- Long-term performance is measured using total shareholder return (TSR)
- The company's TSR target is more than 5.5% a year better than "leading industry" peers over 5 years
- The peer group is weighted by market capitalisation and includes global oil companies
- The number of shares exercised in any year are limited to 4 times base salary divided by the market price of the shares

BHPB says market conditions and insufficient training & succession planning have left the mining industry short of experienced managers. The new executive incentive scheme will defend against competitors that would otherwise poach BHPB's best people. If BHPB can clear its performance hurdles and provide escalating wealth to a key executive, then a potential new employer may find the cost of a sufficient "golden hello" prohibitive – ie. compensating the executive for lost unexercised shares may be too expensive for another employer.

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This approach to executive remuneration is a complex but good example of best market practice. The wealth delivered to executives is fully contingent on the TSR performance of the company. Also, market expectations of good corporate governance include detailed explanations of performance-based remuneration.

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