HaRe Group newsletter: **2 June 2005**

Subject: **Talent retention strategy, or a pay bonanza?**

Australian employers are continually challenged by the need to attract and retain the best people. For example:

- How should a Board weigh and balance the interests of shareholders, corporate governance and public opinion, with the very competitive market for talented executives?
- What does a marking leading company require of its executives?
- Where will the company find talented people with the right skills & experience?
- Are the best candidates already employees? If not, can the Australian market supply a sufficient number of quality candidates, or is it necessary to look globally?
- What part should remuneration play in attracting and retaining key people?

There are no off-the-shelf solutions for employers. Every organisation needs to establish its own unique strategy for managing (and competing for) talent, just like it must establish its market competition (business) strategy. In fact, the company's business strategy should drive its talent management strategy.

To help identify the right talent management strategy, consider a simple model of business strategy based on research by Treacy & Wiersema (*The Discipline of Market Leaders*). A (very brief) summary of T&W's model describes three styles of strategy for market dominance: Operational Excellence, Product Leadership and Customer Intimacy. Additional research by Ed Gubman (*The Talent Solution*) shows that market leaders of each dominant style tend to share a common approach to remuneration management.

Many Australian companies would benefit from benchmarking their business strategy to the T&W model (or similar). This alignment will inform the organisation on its best talent management options and the most suitable remuneration strategy.

Until recently, most Australian remuneration practices have not been driven by strategy. Companies did plenty of benchmarking, but generally they followed (copied?) the practices of their competitors, regardless of their differing business strategies. The proliferation of share option plans during the 1990s is testament to this trend.

Today, more Australian companies are integrating the strategic interests of the business, its stakeholders and its executives. New remuneration strategies are emerging that reflect longer term business needs. For example, if sustainable growth is a dominant objective, then executives are given more focus (and motivated?) by having long term rewards tied to increases in market capitalisation. Share option plans are still a favoured vehicle, but they nearly always include performance hurdles based on peer company performance.

Equity based plans, however, are still not delivering predictable rewards. On 19 May, the AFR reported on a "stock options bonanza" that arose from a disparity of certain executive options valued at grant (required by accounting rules) and the actual value of the vested options when exercised by the executive. One example of this mismatch was the $1.6 million value given to David Morgan's share options at grant in 1999; by 2004, the Westpac share price had risen 80% and the bank's chief had exercised his options for $11.9 million.

There are numerous examples of this situation in many companies; however, employers are well justified in arguing that the recent acceleration in share markets could not be predicted in the at-grant option valuations. When share markets cycle downwards, executives may see the at-grant valuation higher than the vested options' worth.

…/2

The Australian Shareholders Association says the exercised value should be reconciled with the at-grant estimate in each company's accounts. Others argue that a share options grant is remuneration for past service – any windfall gains after the grant date should not be remuneration for accounting purposes.

From any point of view, the potential value of an executive's unvested shares or options remains a powerful executive retention weapon. Where business strategies include high growth objectives, or in speculative commodity markets, equity based plans will continue to be attractive to executive candidates and will continue to engage people for the longer term. A challenge for some companies, however, will be the desire of less talented employees to stick around until their shares or options are fully vested.

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