

**SUBMISSION BY SOUTHCORP LIMITED****TO****THE INQUIRY INTO EMPLOYEE SHARE OWNERSHIP IN  
AUSTRALIAN ENTERPRISES****Index**

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**Appendices**

1998 Southcorp Limited Annual Report

1998 Australasian Employee Share Plan Kit

## **INTRODUCTION**

This submission is in response to an invitation from the Committee Secretary of the House of Representatives Standing Committee on Employment, Education and Workplace Relations for interested parties to make submissions to the Committee's inquiry into Employee Share Ownership in Australian Enterprises and, in particular:

The extent to which employee share ownership schemes have been established in Australian enterprises and the resultant effect on:

- (a) workplace relations and productivity in enterprises; and
- (b) the economy.

## **PROFILE OF SOUTHCORP LIMITED**

Southcorp Limited is a diversified company serving global markets for wine, packaging and water heaters. It is a Top 50 company on the Australian Stock Exchange with over 80,000 shareholders and 10,000 employees worldwide.

Southcorp Wines is Australia's largest producer and exporter of table, sparkling and fortified wines and one of the world's top ten wine companies.

Southcorp Packaging is one of Australia's largest packaging producers and a leader in rigid plastic packaging in North America.

Southcorp Water Heaters is a major producer of domestic and commercial water heaters in Australasia, North America and China, and a world leader in specialised pollution control technologies.

## **SOUTHCORP MISSION AND VALUES**

Southcorp's objective is to grow by generating superior shareholder value in accord with our responsibilities to the people associated with our businesses and the communities in which we operate.

Southcorp aims to achieve this objective by:

- Providing outstanding value to customers.
- Delivering world class business performance.
- Demonstrating that people are our most important resource.
- Behaving with integrity.

The employee share plan is key in engaging the support of all employees in the pursuit of Southcorp's objective and values.

## **PROFILE OF SOUTHCORP'S WORKFORCE**

Southcorp presently employs approximately 10,300 people.

Of the total workforce, 25% are full-time salaried, 65% are full-time wages and 10% are casual or part-time.

The main countries of Southcorp employment are:

- Australia      6,600
- USA              2,500
- NZ                450
- China            270
- PNG              200
- Malaysia        155

Southcorp also has employees in the UK, Italy, Germany and Vietnam.

As indicated by the above, Southcorp's workforce profile is representative of a diversified, multinational, Australian industrial company.

## **SOUTHCORP EMPLOYEE SHARE PLANS**

Southcorp has operated an employee share plan for employees in Australia since 1986. In 1991, the plan was extended to employees in New Zealand and PNG and in 1998 to employees in the USA, UK, Italy, Germany, Malaysia, China and Singapore.

Between 1986 and 1993, the main features of the plan were:

- All full time employees with at least one year's service eligible to participate.
- Eligible employees offered shares according to base salary levels.
- Shares allotted direct to employees at a discount to market price of up to 15%.
- Employees paid a deposit of 10% of the value of shares taken up and obtained an interest free company loan for the balance.
- Loans repayable by deduction from salary over a five year period.
- Dividends on shares paid direct to employees.
- No restriction period for the sale of shares.

The plan was suspended in 1994 due to the Federal Government's plans to impose Fringe Benefits Tax on employee share schemes. In 1996, a new plan was introduced, the main features of which were:

- All full and part-time employees with at least six month's continuous service eligible to participate.
- Eligible employees offered 1,000 shares.
- Shares allotted to a Trustee on behalf of employees at a discount to market price of up to 15%.

Employees obtained an interest free company loan of 100% of the value of their shares.

- Loans repayable by dividends paid on the shares.
- Minimum restriction period of three years on the sale of shares.

In 1998, the plan was restructured to include all Southcorp employees worldwide and to change the basis from shares to options. This was done to ensure that employees could participate without suffering financial penalties due to the different tax laws in each country in which the Company operates. This resulted in the participation rate increasing from 75% in 1997 to 96% of 9,872 eligible employees in 1998.

The 1998 plan was by far the most successful in the Company's history and probably one of the most successful in Australia for a company of the size of Southcorp. The Company's objective is to at least maintain the 1998 participation level in 1999.

## **TAXATION ISSUES**

Shares and options issued to Australian employees under the Southcorp share plan satisfy the exemption conditions for purposes of Division 13A of Part III of the Income Tax Assessment Act 1936.

Consequently, since 1996 employees have enjoyed the following tax advantages from participation in the plan:

- no tax payable at the time of issue of the shares or options (because the discount provided to any one employee is below \$1,000);
- no tax payable at the time any conditions restricting the ability of an employee to dispose of the shares or options are lifted (provided the employee has made the relevant election under section 139E); and
- a tax liability which arises only on the eventual sale of the Southcorp shares and only if there is a capital gain

(calculated after including any discount in the cost base).

The favourable tax consequences of participating in the plan are highlighted in the presentations and other promotional material given to employees when invitations to participate are issued.

The availability of the tax exemption on the discount and the ability to defer the payment of tax until realisation of sale proceeds has meant that participating employees have not had to bear any financial risk by acquiring shares or options under the plan. Southcorp believes that these features have been instrumental in achieving the very high participation rates currently achieved under the plan.

## **SHARE PLAN OBJECTIVES**

The objectives of the Southcorp share plan are to:

- Assist in enlisting the support of employees for the Company's Mission and Values.
- Provide an incentive for employees to contribute to the Company's success.
- Promote employee awareness of the connection between business performance and shareholder expectations.
- Provide a mechanism whereby employees can share in the financial rewards of superior Company performance, without the need to deal with this issue in the bargaining environment of an Enterprise Agreement.
- Create a community of interest between Southcorp employees and Southcorp shareholders.
- Create a community of interest, and common purpose, across Southcorp's organisational and regional boundaries.
- Promote a culture of goodwill between the Company and our employees.
- Provide an on-going frame of reference for communication on business performance between managers and the workforce, including acquisitions, divestments and restructures.
- Enable an integrated suite of HR programs, all aimed at positively motivating employee performance, to be more tangibly relevant to all employees and, through the combined operation of these HR programs (including the employee share plan) generate increased shareholder value.

- Assist to maintain low employee turnover rates.

## **EVALUATION OF PLANS AGAINST OBJECTIVES**

The objectives outlined in the preceding section cannot be achieved without majority employee participation in the plan.

Therefore, with an employee take-up rate generally below 25%, the plan that operated between 1986 and 1993 was of very limited benefit in achieving the objectives. This was compounded by the fact that only employees in Australia and New Zealand were able to participate. The main reasons for the low participation rate were:

- The need for employees to contribute funds up-front, and the loan repayments causing a reduction in take-home pay.
- Participants had to have enough personal financial security to accept the downside risk associated with share ownership.
- Insufficient investment by the Company in promoting the benefits of participation.

As a result, employees who participated in this early scheme were generally those who already understood and aligned with shareholder objectives. Therefore, the plan did not effectively promote broad employee support for the plan objectives.

The barriers to the success of the initial employee share plan, with the exception of participation outside Australia and New Zealand, were addressed with the new scheme in 1996. The removal of downside risk for employees and repayment of share loans through dividends instead of payroll deductions were the main contributing factors to the increased participation rate. Also an important factor was the investment by Southcorp in a comprehensive employee communication and awareness program. A successful participation rate of 75% of eligible employees was achieved.

The 1996 plan was run again in 1997. However, employee participation increased only marginally. This surprised the Company because all those who had participated in the previous year had benefited from both the discounted issue price and the strong improvement in Southcorp's share price. A review of the plan design uncovered the following reasons for the plan's failure to generate 100% participation:

- Even though the share plan loan is risk free and non-recourse to the employee, the existence of any kind of loan facility over the shares represented a debt in the minds of many employees which either they, or their spouses, were not willing to commit to.
- The payment of dividends on the shares, which were retained by the share plan Trustee for re-payment of the loan, still created the need for employees to declare the dividends as

income in their tax return. For some employees, this complicated an otherwise straight-forward tax return and discouraged their participation.

- The Company needed to do more to overcome language problems in communicating the plan to employees from diverse ethnic backgrounds.
- In some locations employee morale was low due to employee relations issues or job security concerns.
- Employees who planned to leave the Company generally did not take up the offer.

The first three items were addressed in the design of the 1998 plan, which was also extended to include employees in all countries included in Southcorp's operations.

In addressing the issues, a key change was the substitution of options for shares which had the following benefits:

- The same plan structure could be promoted to employees on a global basis.
- The granting of options does not involve a loan, removing a psychological concern for some employees.
- As no dividends are paid against options, there is no added complexity in relation to an employee's tax declarations.

Also, the plan was communicated in five languages to enable the broadest possible comprehension of the benefits and objectives of participation. Approximately \$500,000 was invested by Southcorp in the communication of the plan.

The result of these changes was an increase in the participation rate of eligible employees to 96%. The main factor in holding back full participation was uncertainty about job security in the Southcorp Whitegoods business, which was subsequently sold to Email Ltd. When adjusted for Whitegoods, employee participation is an outstanding 99% of those eligible.

With an extremely high participation rate, the Southcorp plan is well placed in achieving the plan objectives. For those who participated in the 1996 plan, the shares will become unrestricted on 1 July 1999. At current share market prices, those who accepted the full offer of 1,000 shares will have accrued a benefit of approximately \$3,500 at the end of the holding period. This 'bonus', which is an addition to normal salaries and wages, provides employees with a financial reward generated by share price appreciation. An employee who fully participated in 1996, 1997 and 1998 holds an accrued benefit of approximately \$ 7,200 on the current share price of \$6.15.

While there is a confident belief by Southcorp that the objectives of the employee share plan are being achieved, a

number of measures closely aligned with the objectives of the plan reinforce this belief.

- The employee resignation rate in Australia has fallen from 7.7% at the end of 1996 (which was already quite stable) to 6.7% today. The rate for New Zealand has fallen from 18.9% to 10.7% over the same period. The resignation rate in the US, which was steadily increasing before the introduction of the worldwide plan last year, has begun to trend down.
- Southcorp has approximately 50 site based unionised enterprise bargaining agreements across the Company's Australian operations. All show a record of successful renegotiation with outcomes at industry norms, even though Southcorp's overall financial performance is significantly better than the industry average. Levels of industrial disputation were of significant concern in 1994 and 1995. Today, lost-time due to industrial disputes is negligible.
- The average days lost per employee due to a workplace injury has fallen from 0.59 in 1995 to 0.21 today.
- Southcorp's earnings per share has grown at an average compound rate of 8% since 1995, compared to 1.7% rate of CPI growth.

## **CONCLUSION**

Southcorp strongly believes that its employee share plan is integral to achieving a positive, performance oriented employee relations culture. This culture enables individual employees to focus their work energy, and work ethic, in favour of Southcorp's business objectives, thereby supporting growth in shareholder value.

The use of options, instead of the provision of loans to employees for the purchase of shares, is rare in large Australian companies. However, coupled with a committed approach to, and investment in, the communication strategy, the use of options to facilitate participation by employees in the Company's share market performance has delivered outstanding results for Southcorp.

The approach in Southcorp has been appropriately assisted by the present taxation regime.