COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON EMPLOYMENT, EDUCATION AND WORKPLACE RELATIONS

Reference: Employee share ownership in Australian enterprises

TUESDAY, 13 JULY 1999

SYDNEY

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON EMPLOYMENT, EDUCATION AND WORKPLACE RELATIONS

Tuesday, 13 July 1999

Members: Dr Nelson *(Chair)*, Mr Barresi, Mr Bartlett, Dr Emerson, Ms Gambaro, Mrs Gash, Ms Gillard, Mr Katter, Mr Sawford and Mr Wilkie

Members in attendance: Ms Gambaro, Ms Gillard, Dr Nelson, Mr Sawford and Mr Wilkie

Terms of reference for the inquiry:

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

(a) workplace relations and productivity in enterprises; and

(b) the economy.

WITNESSES

CAMERON, Mr Alan, Chairman, Australian Securities and Investments Commission 53

COCKBURN, Mr Richard, Executive Director, Victorian Regional Office, Australian Securities and Investments Commission 53

CUPPER, Mr Leslie Gordon, Group General Manager of Human Resources, Commonwealth Banking Corporation 111

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OXLEY, Mr Steven, Director, Policy Review Team, Department of Employment, Workplace Relations and Small Business 81

SIMPSON, Mr Neil Sidney, Secretary, Lend Lease Employee Share Acquisition Plan, Lend Lease Corporation Ltd 66

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WEBSTER, Mr William Alexander Hughes, Executive Director, Lend Lease Corporation Ltd 66

Committee met at 10.46 a.m.

CAMERON, Mr Alan, Chairman, Australian Securities and Investments Commission

COCKBURN, Mr Richard, Executive Director, Victorian Regional Office, Australian Securities and Investments Commission

TREGILLIS, Mr Shane, National Director, Regulation, Australian Securities and Investments Commission

CHAIR—I declare open these public hearings of the inquiry into employee share ownership plans and welcome the witnesses and others in attendance. We will be taking evidence today from the Australian Securities and Investments Commission, Lend Lease, the Department of Employment, Workplace Relations and Small Business, Qantas and the Commonwealth Bank. Tomorrow we will be taking evidence from Ernst and Young, Coca-Cola Amatil, Equity Strategies, QBE Insurance, the Australian Manufacturing Workers Union and MAI Services. The purpose of this inquiry is to identify the extent to which employee share ownership plans have been established in Australian enterprises and to assess the impact of those plans on workplace relations and productivity in enterprises and on the economy.

I welcome representatives of the Australian Securities and Investments Commission here today. I remind you that the proceedings here today are legal proceedings of the parliament and warrant the same respect as proceedings in the House itself. The deliberate misleading of the committee may be regarded as contempt of the parliament. The committee prefers that all evidence be given in public but if at any stage you wish to give evidence in private you may do so and the committee will consider your request.

Mr Cameron—Mr Chairman, I have arranged for Richard to make a short presentation to you in a few moments but in response to your invitation could I just confirm that the Australian Securities and Investments Commission is set up under the ASC law, as it is still called, notwithstanding our change of name, to administer the Corporations Act and the Corporations Laws of the states and the territories. Our role therefore is to promote, maintain and develop the efficiency of the Australian financial system and the entities that operate within it and to promote the confident and informed participation of consumers, including investors, in that system.

We are very much the financial regulator, the consumer protection regulator, for the whole of the financial sector. In that respect, since 1 July last year, we have taken over the consumer protection role of the ACCC with respect to consumers in the financial system, including investors. I think that, in a sense, sets the context in which we appear before you today. The offering of investments to anyone in Australia is regulated by the Corporations Law and we have a wide-ranging jurisdiction under that law, however, to grant exemptions and modifications of the law in appropriate cases.

So while the law does not specifically deal with employee share schemes, the commission has developed over the years a policy set out in policy statement 49—and there are extra copies of it available for you here today if you want to consult them—that set out

the circumstances in which we will grant modifications of the law, either by way of class order, in effect taking advantage of the class order that we have issued, or by way of specific exemptions. Richard and Shane both sit on an internal organ of the commission called the regulatory policy group, which from time to time considers specific applications that go beyond the standing policy in policy statement 49.

Paragraphs 8 to 16 of policy statement 49 set out our philosophy about all of this. I draw your attention to policy statement 49, paragraph 11:

In exercising its powers . . . the ASC—

this was written when we were still the ASC—

must strive to maintain, facilitate and improve the performance of corporations and ensure adequate protection for investors.

So we have to do both things. Paragraph 12 says:

The ASC considers it would be consistent with this if a prospectus were not required in relation to a small scale offer of shares where the primary aim of the offer is not fundraising, where the offer is intended to support the long-term mutual interdependence between the offeror and the offeree and where the issuing corporation has a history of disclosures to a well-regulated stock market . . .

So we have devised all of our policies around that underlying philosophy which, needless to say, we are very happy to debate with you because you will not find that anywhere in the law. That is our interpretation as to the way we are supposed to marry our fundamental role as the protector of investors with also ensuring that there is the opportunity to offer shares to employees.

Another change is about to occur, as I imagine the committee is aware. The government has in the parliament the Corporate Law Economic Reform Program Bill 1998 which includes significant extensions of the relief available for small-scale fundraising. That also does not specifically refer to employees but there is no reason why those provisions could not be taken advantage of with respect to employee share schemes. For example, no disclosure statement will be needed for offerings to less than 20 people raising less than $2 million in any 12-month period and that would cover a lot of small-scale employee share schemes. There is also a new quite liberal regime called ‘offer information statements’ for offerings raising less than $5 million. That also could be taken advantage of, to some extent, with respect to employee share schemes.

The issue that I would just leave with the committee before handing over to Richard is that one of the matters that the committee may wish to consider is how it deals with the unrelated—in a strict sense; nevertheless contemporaneous—issue of so-called employee entitlements. I am referring there to the debate that is going on, particularly in New South Wales but also across the country, as to how employees can be sure that they will receive their entitlements in terms of redundancy pay, termination pay and so on when companies fold. I know that is a difficult issue. It has been on the agenda now for quite a long time. The only reason I mention it today is that, in the context of what we do about employee

share schemes, one needs to remember that any money that employees put into companies ends up right at the end of the queue if that company ever goes bad.

In other words, it is all very well be to be concerned about long service leave, redundancy pay and so on, but to the extent that this is about employees putting money into their companies it becomes equity in the company and it is the very last place that they will ever get that money out from. That is one of the matters that the commission is conscious of in terms of weighing up its responsibilities for fundraising in this context. Could I ask Richard just to say a little bit more about the detail.

Mr Cockburn—Australian corporate law requires decision making by investors to be undertaken in an informed environment. Essentially when they are asked to either purchase or acquire shares they should be provided with sufficient information to be able to make an informed decision at that time. That is because there are risks associated with that investment; that is, the possibility that their money may not be repaid either in full or in part.

The other side of the coin to that is that there are costs imposed upon the organisation providing that information and the commission, and indeed the legislation, seeks to balance the benefits of providing information to investors to enable them to make an informed decision and the costs of providing that information. Offers to employees of shares in their employer company, or indeed in a holding company, have not had a privileged position under Australian corporate law; neither under the Corporations Law specifically; nor under its predecessor in the Companies Code.

The predecessor regulatory authority to us, the National Companies and Securities Commission in the 1980s, produced a policy statement for employee share schemes under which it required a prospectus but significantly reduced the content requirements of that prospectus document so that it was relatively easier and relatively cheaper to produce and provided, as we do, quite a degree of administrative relief to enable the prospectus to contain more than one document. So it is a series of documents like an employee share scheme explanatory document and perhaps a copy of the accounts of the company, rather than the strict requirements of the current law which would be that they are all in one document.

The commission, when it was formed in 1991, shortly thereafter essentially adopted an employee share policy under which it gave very similar exemptions from the strict content requirements of the prospectus provisions of the Corporations Law. That policy statement was produced in 1991. We subsequently did a major review of employee share schemes. That culminated in a policy issued in March of 1993, which is policy statement 49, which is what you have before you. Since that time the commission considers on a case-by-case basis various arguments for amendment and we have extended that policy in a number of ways.

To assist you in understanding the balancing act which we essentially go through, I thought it might be useful to remind you what the policy statement says, at paragraph 41, that the Australian Securities Commission attempts to weigh the commercial benefits and net regulatory benefit which would flow from granting the sought relief on conditions proposed; that the ASC will generally grant relief where it considers there is a net regulatory benefit or

that the regulatory detriment is minimal and is clearly outweighed by the resulting commercial benefit.

We go on to expand that in paragraph 62 by saying that we are of the view that the relief from the prospectus provisions is appropriate when the primary aim of the offer is not fundraising, when the offer is intended to support long-term mutual interdependence between the offeror and the offeree—that is the employer and the employees—and the issuing corporation has a history of disclosure to a well-regulated stock exchange which is reflected in the market price of the securities; this allows the offeree to easily compare the price of the shares with the market price.

In reality, we take comfort from those criteria for removing what would have otherwise been the relatively more onerous disclosure requirements which would be placed on a company issuing a prospectus. We derive a very significant amount of comfort from the fact that an informed market will price the securities of the employer company so that employees who are offered shares, frequently at a discount to the market, are able to make a fairly quick and easy comparison about the merits of the proposal put to them by comparing the price of the securities with the price on the market.

The commission, in doing that, has two major policy considerations. The first one is that we wish to protect the investors or employees in this particular set of circumstances and there are a number of factors that we would weigh up. An assumption we make is that employee share schemes are designed to foster the ongoing relationship between the employer and the employee and are not de facto fundraising for the employer. They are more about a bargain struck in relatively equal bargaining power so you do not have a situation where someone is trying to maximise their commercial profit vis-a-vis someone else. You actually have a sense of mutual trust where the desire is a win-win outcome. That is an assumption we make about employee share schemes. One of the ways we limit that is to say that employee share scheme relief is only available when you issue no more than five per cent of the total company’s capital over a five-year period. So it is not de facto fundraising.

We rely very heavily upon the existence of a market which will set a price for those securities. That also ensures that the employees have an option available to exit their investment. If I buy shares in an employer and those shares are not listed, then I have a quite restricted capacity to liquidate my investment and to convert it into cash. With a company that is listed on the stock market, it is relatively easy to sell. It is only really essentially a question of the price and the time.

We also want to ensure that employees will receive adequate information about the terms and conditions of the employee share plan. Employee share plans are frequently quite complex, not uncommonly designed primarily to take advantage of tax benefits. So we ensure that there is some information going to employees to provide them with an understanding of the terms and conditions on which the shares might be available.

We do not, therefore, extend class order relief to the high risk end so we do not extend to partly paid shares where not only—in a worst-case scenario—may the employees lose the amount they paid for their shares but they may be called upon in the liquidation of their employer to actually pay more money. So we generally do not allow partly paid shares to be

offered under this exemption. We also do not provide the relief for the offer of options to employees to purchase shares where the options carry a significant cost. That is, most commonly the options are issued free of charge and will entitle the employee to purchase a share or shares in the company at a predetermined price, the assumption being that the value of the option will grow as the share price and profitability of the company increase over time so the employees will have an opportunity to make money.

If the cost of the option is significant then it is quite a commercial outlay and the risks that the price might not be in the money become significant and therefore change the balance and we do not offer relief in those circumstances. The legislation, the Corporations Law, does draw a distinction between small personalised transactions—and my chairman has already identified some of those—where the benefits seen by parliament in providing information are not outweighed by the commercial benefits of allowing the transaction to occur in a small context. So under the current law I may make 20 personalised offers, which could be to employees or to non-employees in my unlisted company, in a 12-month period and I would be able to do that without a prospectus. Under the proposed bill, the CLERP Bill before parliament, that will be changed to 20 acceptances of personalised offers. So I can make, for example, offers to my 50 employees and providing only 20 accept in a 12-month period then I will not need a prospectus.

Mr Cameron—And you raise less than $2 million.

Mr Cockburn—Yes. There are some other employee share schemes which involve unit trusts which get caught under our fundraising provisions for which we also give prospectus relief. Frequently they might involve some form of salary deduction over time, either to repay the cost of shares which have already been purchased, or they might be a compulsory savings device to save up for the purchase of shares. Those moneys are normally pooled in a trust and invested until there is sufficient money there either to repay the loan or to purchase the shares and we will give relief in those circumstances as well.

The other side of the coin for employee share schemes is that we also need to protect existing shareholders. That is to say, we are concerned to balance the desirability of providing relief to enable employee share schemes to be offered but ensuring that existing equity owners do not have their percentage ownership or control of the company artificially diluted without their permission and, essentially, that is another basis for the five per cent limit in our policy.

I think the committee had indicated that it had some interest in the position of unlisted companies and I thought I would run through some of the options that are currently available in the law. At the risk of repeating myself, there is—as the law stands at the moment—20 personalised offers in a 12-month period. It is possible to offer to people who are called executive officers of the corporation without a prospectus. Executive officers are, simplistically, senior management, so the assumption in the law is that those people will have an intimate understanding of the company. They would not include people on the factory floor, for example, but would catch people like a financial controller of a company; somebody in an essentially senior position who is likely to know the ins and outs of the company. If the shares were given away for no consideration at all then, of course, there is

no prospectus required and that is because the risk is arguably not there for the person receiving the gift. The law does encourage to some—

Mr SAWFORD—Even if they had a salary sacrifice in that sort of arrangement?

Mr Cockburn—That would not be for no consideration. That would be a little bit like the NRMA—free shares.

Mr SAWFORD—Yes.

CHAIR—But you don't want to be provocative.

Mr Cockburn—The law does recognise some particular preference to employee shareholders. In the case of a proprietary company it is limited to 50 members, other than employee members, so the law places a numerical limit on the number of members of a small proprietary company to the extent that they are not also employees of the company; so the law does permit them. It also permits a proprietary company to have a prospectus for the purpose of offering shares to employees or to existing shareholders, but otherwise proprietary companies or small companies are prohibited from offering their shares to the public.

I thought I might also provide you with a brief personal view of some of the difficulties which I think have been put to you about small companies raising money. Much of the costs associated with the prospectus are, in my opinion, associated with the desire by directors, quite understandably, to minimise their personal liability. The Corporations Law imposes a liability regime on the issuers of prospectuses. That is not a part of the legislation that the commission has any capacity to exempt anyone from or to modify. So those provisions apply and we are unable to relieve anybody of those obligations. They are designed and have, in the Australian context, in my view, produced a very high level of acceptance by the marketplace of information contained in a prospectus document so that its believability is much higher for that very reason.

The problem for a small company is frequently the desire to balance the cost of the exercise with protecting one's personal position as a director from liability which might flow from either an accidental or negligent omission or misleading statement in a prospectus. In a small company many of the difficulties are associated not with doing what is called a due diligence, which is checking that the prospectus document contains all the relevant information, but with the exercise of converting what was essentially a small privately run family company into something which has systems and independent verification of its assets and its management style—to move from being a small privately run affair to something which accommodates the legitimate legal interest of third parties whose rights need to be protected and taken into account in the way you run the business and manage the company's affairs.

So much of the costs behind a prospectus are not strictly from the preparation of the prospectus but from some of the underlying preparation of converting what was a family company into something that is going public and needs new systems and new degrees of accountability. It ceases to be, as it were, 'my company and my money' and I become a

trustee, as it were, for a whole lot of people's money and I owe them obligations about being accountable and doing things in a proper and lawful manner.

In conclusion, I thought I might very briefly provide you with an indication of what occurs in some other jurisdictions. In the United Kingdom employee share schemes are exempt from the prospectus regime. In the United States of America there are, in very simplistic terms, two different arrangements. There is a simplified disclosure document for US listed companies. For non-reporting companies, which are simplistically companies that are not listed or do not have interstate offerings, there is an exemption from the prospectus regime for their employee share plan providing there is a $5 million ceiling or a 15 per cent maximum of the securities in a particular class which can be raised by the employee share scheme.

In Canada there is an exemption from the prospectus provisions, interestingly enough, provided that the employee share scheme is not offered as an inducement in the expectation of employment or as an inducement for continued employment; that is, that the employer, in effect, requires you to buy shares in the company as a condition of employment or remaining in employment. So one assumes, from that fairly unique nature, that there must have been some adverse experiences in the Canadian jurisdiction.

I have some statistics which I can give the committee but I have to put a very significant caveat on them. Under our class order you take advantage of the class order without applying to us for particular permission; that is, it does not cost you any money to avail yourself of a class order—no application fee—but we do require copies of the employee share scheme documentation to be lodged with us and I can give you the numbers between May 1993 and 30 June this year. The caveat I have to give you is that I cannot tell you how many employees have been the beneficiaries of these schemes because that is not the way we collect the information. Some companies have lodged more than one scheme because there are different schemes for different classes of employees, so it is not necessarily indicative of the number of companies which have employee share schemes either.

Regarding Australian proprietary companies which are small companies, we have 87 documents lodged during that period. Australian public companies, which include listed and unlisted but they will mainly be listeds, are 369. We have 29 foreign companies—what we call non-registered entities—which will be most commonly a foreign incorporated company that does not carry on business in this jurisdiction. A foreign company that carries on business in its own name in the jurisdiction is required to be registered.

What we found during the early nineties was quite a large number of European based and, to a lesser extent, American based parent companies would make worldwide offers to their employees in their subsidiary companies, which would include Australia, of shares in the parent, which was frequently listed on a European or US exchange. We have 179 documents under that category being lodged. For registered Australian entities, which are creatures which are not companies under the Corporations Law so they are usually incorporated under state legislation, we actually have two which together have lodged 67 documents with us. Unfortunately I cannot name them but I can give you an indication of the type of company that falls into that category and that is, for example, Westpac which is

established under its own act of parliament. It is not actually a company incorporated under the Corporations Law.

CHAIR—Thanks very much. I suspect that you have probably answered most of our prospective questions. I will just ask you a couple of things. Was it what was happening with salary sacrificing in some of the other countries that triggered your review of 49 here?

Mr Cockburn—The original development of policy statement 49 was, in reality, that we had quickly adopted the old NCSC policy which was under a totally different prospectus base, a totally different disclosure regime. The Corporations Law introduced a new regime and a new prospectus content requirement and policy statement 49 was, in effect, a recognition of that major change plus a movement that was reflected in the Corporations Law to lowering the costs associated with fundraising by companies which were subject to the continuous disclosure regime of a listed company.

CHAIR—If there are changes, perhaps cultural and legislative changes which encourage the further development of employee share ownership plans, does the ASIC have the resources to keep track of all this? By international standards you are obviously aware it is not a major part of company behaviour at the moment but it might become so in the future. Is that an issue for you?

Mr Cockburn—The correct answer would be that what tends to happen is we have a published policy statement. We encourage people to push that at the margins as matters change. Perhaps the best example of that is that originally when policy statement 49 was introduced we restricted it to full-time employees and part-time employees. Some months ago we had an application from a very large company which had a very significant number of what we would call long-term casual staff. So that the nature of its employment arrangements with its staff had changed from having a lot of full-time and permanent part-time staff to a lot of long-term casual staff. We extended the policy statement, although it has not been revised yet, to allow them to make offers under the employee share scheme exemption to casual staff who had been employed for over 12 months where the board of directors felt that those people were equivalent to permanent part-time employees.

Mr Cameron—So the structure of our exemption and modification system is pretty flexible to deal with evolving changes in the workplace. We would expect, as the information economy gathers steam, that there will be more and more people with unusual and more modern employment relationships, whether you call them consultancies or contract employment. If that happens, the commission can, without changing the law, cause its policy statement to evolve as well. We can issue further promulgations. So we do not see it as a resource intensive process. We are not in the merit regulation business; we are in the disclosure business. This is where the two, of course, come together to some extent, but we still see that providing it genuinely falls into the category of employee encouragement and we are not wedded to the old-fashioned concepts of employment, for example. We can actually develop the policy statement and our application of it around that.

CHAIR—In terms of the employees' rights and entitlements, are you aware of how many companies in Australia which have had employee share ownership plans and have gone into insolvency?

Mr Cameron—We simply would not have that information. My comment was really directed to encouraging the committee to bear in mind, when it eventually reports, that in effect you will be reporting against a context where the public debate is in a slightly different direction. You might want to be sensitive to that. It certainly strikes us as something that needs to be borne in mind. It is consistent with our view that this is not about fundraising by the company. It is about encouraging employees to have the appropriate relationship to it. That is the way we read the earlier evidence that you have been given as well. If it is about that, we need to ensure that it does not inadvertently become a case where everybody's entitlements are all in one basket, whether it is superannuation or their equity investments. It would be a very poor investment for an individual to have everything—their employee entitlements, their superannuation and their equity investments—in one place. In a sense we are wary of that, looking at it with the wider community interest in mind.

Mr SAWFORD—Between Richard and Brendan my question has almost disappeared. You say you have no evidence or information about companies going belly up. Where will we get that information?

Mr Cameron—I do not think anybody would collect it quite in that form. Clearly there is a lot of information about companies that go insolvent but I am not sure whether anybody has done the exercise of going back to see what has happened. I am not suggesting it is a major issue at the moment. It is not as though it is a matter for public debate but that could be more related to the comparatively low penetration of employee share ownership in Australia. If you succeed for quite good reasons in encouraging it, you just need to be aware that it does not come back to bite you on the other side. That is our concern.

Mr Tregillis—In terms of the research, I presume you could think about matching a list of insolvent companies with some third party data from some consultancy or other experts. An employee may give you some feel. We would not have that information. There would be two different sets of data around that the committee could inquire into. I do not think we are saying it is a large problem but that is how you might think about the task.

Mr SAWFORD—Richard, in terms of those companies, you gave us a lot of aggregates. Can you give us some aggregates on what sorts of companies they are? Are they largely finance, retail, mining? Were there any manufacturing companies in there? What sorts of companies are they?

Mr Cockburn—Most of them are listed. To give you an example, the only one that has come close to testing the five per cent limit is in fact BHP. Its level of employee share scheme is approaching the five per cent. It is the highest we have ever had. Most of them stay below about one per cent.

Mr SAWFORD—But in terms of aggregating those other companies, in what sorts of categories do they fall?

Mr Cockburn—I am afraid I cannot be terribly helpful. To my knowledge there is not a particular predominance in any one industry.

Mr SAWFORD—I do not know which submission I read but there was some indication that it was largely in finance, retail and mining. But the submission I am referring to did not provide any evidence—it just made the statement.

CHAIR—It was a departmental submission.

Mr Cameron—The ones that do not fit within the existing policy we seek particular information about. We tend to have in our minds particular examples that would not provide an accurate snapshot. We do not have to hear from the companies at all. They lodge the documents but they are not going through any approval procedure unless they do not fit within the policy.

Ms GAMBARO—You were speaking about proprietary limited companies and if they had 50 members only 20 needed to take up the offer—and less than $2 million. Is that correct?

Mr Cockburn—I may have confused you.

Ms GAMBARO—How do proprietary limited companies work in the prospectus of things?

Mr Cockburn—A proprietary limited company, which is in very simple terms your common family company, is limited to a maximum of 50 members—that is 50 individual shareholders—who are not otherwise employees. It may have more than 50 provided only 50 or less are non-employees. It could have 100 members, 50 of whom were non-employees and 50 of whom were employees. The existing exemption in the Corporations Law from the otherwise relatively onerous requirement of producing a prospectus at the small end of the market, which is designed to accommodate small private family companies, is that I can make 20 individual or personalised offers, so I must be able to identify the person to whom I am making the offer. I cannot put an ad in the *Financial Review* and say, 'Equity investors required.' Under the current law I can make 20 offers in a 12-month period, regardless of how many are accepted.

The change proposed by the CLERP Bill would convert the 20 offers limit into 20 acceptances but unlimited offers. If I am a small family company employing about 20 people, under the proposed CLERP Bill I would in effect be able to make an offer without a prospectus to each of my 20 employees. Assuming they all accepted, I would still not need a prospectus if that was the only equity offering I made within a 12-month period, providing there was the $2 million cap.

Ms GAMBARO—There is an issue of public companies and how employees are protected but there is a trend with third generation family companies to also disintegrate. There are risks involved there. You have listed some figures on public companies. This may be difficult for you to answer, but how many proprietary limited companies, the family type companies, have these sorts of set-ups?

Mr Cockburn—There are 87 sets of documents lodged under our class order in relation to proprietary companies. That, unfortunately, is not very helpful to you because there might

have been one or two that had a number of different employee schemes over the years and a number of different classes of employees. The executives might get one bundle of offers but the scheme for the employees on the factory floor might have been different and therefore there would be another separate lodging.

Ms GAMBARO—The new bill proposes that more than one offer is able to be made?

Mr Cockburn—You can make as many personalised offers as you like within 12 months but they have to be individually addressed. It cannot be a blanket open offer and you can only have 20 acceptances with a ceiling of $2 million. That is for any sort of fundraising. It is not specifically limited to employee share schemes.

Ms GILLARD—Given your regulatory mechanisms, wouldn't it be true to say that in proprietary limited companies shares could be allocated or sold to employees without you being aware of that? If someone chose not to file, I do not see what the mechanism is that would bring that to your attention.

Mr Cockburn—If they did not wish to take advantage of a class relief or they did not comply with a condition of a class relief, we would never know. If they made offers to their shareholders in breach of the Corporations Law, in the absence of a complaint we would probably never know.

Ms GILLARD—At the listed end your ultimate protection is being able to defer to market price so people can work out whether they are getting a good or a bad deal. We have had people appear before the committee who have been advocates of these schemes and who would suggest that they have applicability right down to the very small mum and dad proprietary limited company. I am continuing to intellectually struggle with that, because in some sense the allocation of a share in a small mum and dad proprietary limited company is effectively valueless because of the ability of the predominant shareholders and directors to control almost everything to do with value and because there is no conceivable exit strategy. Am I on the right track there?

Mr Cockburn—I would agree with you. As a regulator our concern is that these smaller companies have a lower reporting obligation under the Corporations Law. It is a much easier regime, therefore the quality and amount of information in the public arena is significantly less than for a listed company. Your capacity as a lower level employee to actually understand how the business is going is very restricted, unless you happen to be given a lot of information from your employer and, even then, if it is outside the prospectus content requirement you may have limited remedies. The other problem is that the liquidity of the investment—that is your capacity to sell it, to exit it, if you cease your employment—is restricted.

The other difficulty, which you correctly identified, is that it is a very major cultural change to move from running your own small family company to running a company where you have fiduciary duties as a director to other shareholders who are not your immediate family. So it is, as I tried to identify, one of the major cost hurdles in moving from a successful small business to one which floats and has public money into it. It is not just the cost of the prospectus. It is the cost of changing the way the whole thing works—the fact

that I cannot pay my children's school fees, for example, out of the company's cheque account because it is no longer my money.

Ms GILLARD—And in terms of other jurisdictions, like the UK where you say there are sorts of blanket exemptions for employee share schemes, does that go down to the proprietary limited level as well?

Mr Cockburn—That is my understanding.

Ms GILLARD—It seems to me to make sense for a staggered retirement assumption of business transaction, where the current employees might ultimately be taking over from the owners—where you have retiring owners of a long-term business and you have a gradual move of equity across—but in the absence of that kind of transaction I really cannot see the advantage from the employees' point of view.

Mr Cockburn—Essentially, the quality of the information you get outside of a regulated prospectus environment is a function of your bargaining power. If you are buying the business from the existing owners they will be in a position where, if they do not give you adequate information, you will not purchase it so they will not be able to exit. If you are a shopfloor employee who is only being offered 10 or 20 shares, you may not have much bargaining power to get information if you feel you have not got enough.

CHAIR—Is there something that we could recommend that might help employees in that situation? Have you given any thought to that? Is there something that governments could do to assist employees in that small company environment to make sure that they are getting the information that you would otherwise get in a larger company?

Mr Cockburn—In the UK exemption they do not exempt anybody from the obligation who might be advising on the merits of the employee share scheme. They do not exempt them from the full rigours of the law related to ensuring that the advice they give is professionally appropriate and is not negligent. So, in effect, they ensure that whilst the prospectus is not required, if you actually induce someone to purchase, you have an obligation to properly advise.

Mr Cameron—It is an interesting question, though, that you raise and perhaps one that we might just take on notice and see if we can come up with something. It is a bit like the difficulty that confronts companies that are planning to float. A lot of what Richard has been saying is applicable to any company which is seeking further equity investments, not just relating to employees, and it is a major difficulty in that area.

I might just say about the UK, too, that I was a little puzzled by the information that we have that since 1986 in the UK it has been entirely free, except for this advice point that Richard makes. It has been entirely free of regulation and it is something that, if the committee is interested in, I would not mind consulting our colleagues, the Financial Services Authority, to understand whether that has been a problem. For example, since 1986, the miss-selling of pensions under the same regime has been a major problem in the United Kingdom, so much so that a former regulator had to be disbanded and reorganised and so on in order to fix it. When I look at this I am surprised that it is such a liberal regime and, if

the committee is minded to pursue that option, I would like to check with my fellow regulator whether it is an issue in the United Kingdom. We could easily do that.

Mr SAWFORD—Perhaps as a follow-up to Julia's question in terms of what Richard was saying before about what is happening in Canada and whether that has some application.

Mr Cameron—Again, we could check with our colleagues at the Ontario Securities Commission. They do not have the benefits of a national system of securities regulation but we could certainly check with Ontario and we could check with the United Kingdom Financial Services Authority as to what experience they have presently had, on a background basis.

Mr SAWFORD—That would be very useful.

Ms GILLARD—We referred in our later material to an instance where the Industrial Relations Commission approved a certified agreement that provided for a reduction in terms and conditions for employees, a reduction in pay and a pay freeze and they were provided with shares. That is referred to in the material as being part of a strategy to deal with a business crisis. That would sound an awful lot like fundraising, wouldn't it, if that has happened?

Mr Cameron—It would, but, again, I was simply trying to describe our philosophy. I suppose our philosophy is that the fundraising rules are there and apply generally, but if what the company is doing is from its point of view fundraising, we are much less inclined to give it the benefit of wide-ranging relief. Our policy statement 49 is directed to applying the fundraising regime in the context of encouraging employee participation, not encouraging fundraising by companies, hence the five per cent limit for example, which is just a proxy for saying that if companies really want to raise big money from their employees or anybody else, they should fully comply with the fundraising regime. I am not aware of the circumstances of the case you are suggesting in the Industrial Relations Commission, but it does sound a little curious.

CHAIR—The most important thing, of course, is that the employees be fully informed about what is going on.

Mr Cameron—At the end of the day it is a disclosure regime and we are encouraging people to make their own decisions. We are not trying to be a sort of nanny state regulator.

CHAIR—If you could take on notice, firstly, what we could recommend to the government that might protect employees in small companies who are wanting to acquire ownership of that company, where the advice they are currently getting is perhaps from the person who has an interest in them taking it over. Secondly, could you provide us with your comments and views on the UK legislation. You have mentioned Ontario also, so we would like any information you have from overseas about which we ought to be informed. Thank you once again for taking the time to come. We really appreciate it.

[11.36 a.m.]

HILL, Mr Kenneth Charles, Global Executive, Compensation, and Trustee, Lend Lease Employee Share Acquisition Plan, Lend Lease Corporation Ltd

MORATH, Mr Richard Louis, Chair, Lend Lease Employee Share Acquisition Plan, Lend Lease Corporation Ltd

SIMPSON, Mr Neil Sidney, Secretary, Lend Lease Employee Share Acquisition Plan, Lend Lease Corporation Ltd

WEBSTER, Mr William Alexander Hughes, Executive Director, Lend Lease Corporation Ltd

CHAIR—Good morning, and thank you to the representatives from Lend Lease for both providing us with a submission and being prepared to come along, particularly at such senior level, to speak to us about it. If someone could give us, say, a five to 10-minute overview of the submission, we can then engage in some questions. Is there anything else you would like to comment on?

Mr Webster—I have been executive director of Lend Lease since 1987. I have wide-ranging responsibilities, part of which is continuing the culture of the organisation generation after generation, communications and a number of other responsibilities.

In opening, Mr Chairman and members of the committee, I would like to say we are delighted to participate in your hearings and we hope that we make some form of positive contribution to help you in whatever conclusions you are going to come to. By way of background, I would like to talk fairly briefly about three types of stakeholders and their attitude. If you were to meet with an employee of our organisation and say, 'What does it mean to be a Lend Lease employee?' you would find that they would talk about a number of things. They would start off almost certainly talking about the culture of the group, which is something I mentioned in my introduction and which has been handed down from generation to generation of employees. It is something that is fairly clear and we think is very important that it continues.

The employee would almost certainly talk about the values of the organisation and use terminology along the lines of 'seeking a better way', 'exceeding expectations'. It captures the energy of the organisation. The employee would probably say that we are a very demanding employer. They tend not to ignore that aspect of working for the group, but they would also talk about how they were rewarded and how they were treated by the organisation—in other words, how our people are looked after—and share ownership is a fundamental component of that.

If I can just backtrack for a moment or two and give you an idea from history of what we have done in terms of looking after the interests of our people. It was in 1963—that is 36 years ago—that we provided superannuation for every employee; not a top-hat scheme, not an executive scheme—every employee was superannuated 36 years ago. In 1973 we introduced a profit share scheme, agreed to by our shareholders, by which five per cent of

our pre-tax profits are distributed to our employees but in an egalitarian way: an equal allocation to each employee irrespective of rank or period with the company. So I get exactly the same as Neil Simpson gets, Dick Morath gets or a secretary who came in gets.

In 1988 we introduced our current employee share scheme. We have had a number of them during the course but we are going to talk today about what we have in place and our aspirations for that going forward. The message I am trying to get across is that what we have put in place in terms of looking after our people are not short-term initiatives. They are not driven by tax. They are things that we very firmly believe in for very clear reasons, and they typically should last for years, decades, et cetera.

If you were to speak to one of our major investors, that is people who invest in Lend Lease shares—and particularly here I wish to talk about international investors, people who reside in other countries and are looking at Australia from far off—what they typically want to know is, 'What's your philosophy as an organisation? What do you stand for? How do you behave?' They are very interested in how we remunerate our employees and in particular, of course, senior management, and how much of our company is owned by our employees. They are interesting questions and the reason they are asking those questions is that they are looking for companies like Lend Lease to invest in for years and years, for decades, and hold that investment and have confidence in what is going on in future.

They are looking for a focus on value generation over several years. They are not focusing on how much money we are going to make next year. They are looking at what is going to happen as we pass through the current phase into the next phase and then into the next phase. They typically are looking at three to five years in terms of time horizon, and today's management decisions, of course, come out in terms of profitability some time down the track. They are particularly looking at how we retain and nurture our competitive advantage and, to put that in today's terminology, you can use words like 'intellectual capital', and how we retain that. I would have to say they like what they hear and our share ownership is very much part of that.

If you were then to speak to one of our board members, and I obviously represent the board here, I would like to quote to you from a paper presented to our board just a month ago by our chairman. This paper was looking at our culture going forward, how we will look after our people in future, protecting the interests of future generations, and initiatives that we might introduce. I do not wish to table the document, Mr Chairman, because it is a work in progress, but if I could quote—it is selective—so as to address the issues that we are talking about today. In the preamble the chairman wrote:

> Lend Lease was founded on the idea of a partnership between capital and labour.

By 'labour' we mean people. He continued:

> The assumption was always that skilled labour would be the scarce resource, not capital. Time has proved that assumption correct. Employee participation in ownership of the company has been part of the Lend Lease way since the early 1970s. An egalitarian Profit Share (paid equally to all employees either as shares or cash) and performance bonuses paid as shares have been a significant part of employee remuneration since then, as have special event share issues again given to all employees equally, regardless of their rank in the company.

. . . .

Ownership has two levels of meaning. The first one . . . refers to the number of shares owned by employees. The second meaning of ownership . . . refers to the visceral sense of ownership that employees get both from their share ownership and the way they participate in the decisions that affect them as employee/owners of the company . . . This sense of ownership results in a greater sense of pride in achievements of the company and a willingness to drive further achievement.

That is very important. The conclusion was:

Given Lend Lease's history of employee ownership, we should focus our efforts on . . . both of those aspects of ownership.

Mr Morath—Bill asked me to give a couple of facts as a bit of background in regard to ESAP. All permanent employees in Australia and New Zealand are members of ESAP—3,200 of them. Contributions come in three ways, all from the company. The company contributions are one to five per cent of salary, depending on years of service; profit share that Bill mentioned being applied to ESAP—and 77 per cent of our employees choose profit share being applied to ESAP; the alternative is that they can take it in cash—and discretionary allocations of shares which are based on performance. About 50 per cent of employees each year participate in that. It is, obviously, a performance based allocation.

At 30 June ESAP held 23 million shares valued at around $480 million. All the income is distributed to members each year, depending on how many shares they have got in their name in their account. In the year just completed to 30 June, total dividend distributions exceeded $12.4 million. To put it in perspective, we went back and did a little case study and we chose a payroll officer whose current salary is $46,000. Ten years ago, when the scheme started, the salary would have been around the low twenties. I cannot tell you exactly what the salary was, but it is $46,000 now. The first dividend cheque that payroll officer received was for 19c and many of the employees actually framed them and said, 'This is a joke.' This year that same person has received a dividend distribution totalling $3,662—and they are not framing them. That, of course, is in addition to salary and wages.

With regard to tax, because we think you are interested in tax, all ESAPs' income, which is dividends, is distributed to the members. That income is assessable to them and is notified to the ATO. If a member withdraws shares, that is assessable income for them in that year and the tax is paid. Likewise, whenever they resign or retire, tax on the value of their holding is crystallised and it is paid. So there is no revenue leakage from ESAPs. All the tax is paid.

Under present law, tax is also payable on shares allocated after a 10-year deferral. That was, we think, a good result and both this government and the current opposition were involved in that result. However, we have been thinking about this issue and there has been recently a lot of public comment about capital gains tax. So we would actually like to propose for consideration something a little different from what we actually had in our submission and we would be very happy to write to you about this. We actually think that there should be two components to the way ESAPs are taxed. Firstly, we believe that the 10-year deferral period should remain but that what is taxed at that point should be the value at the time the share allocation was originally awarded.

Secondly, any gain in value over that original value should, we believe, be taxed as a capital gain at the time the shares are finally sold, using the original value as the cost base. Thus, the gain in value would be taxed as a capital gain but only when the shares are sold rather than at an arbitrary 10-year point. As I said, that is different from what we had in our proposal but it is based upon the discussion that is under way at present in relation to capital gains tax.

Lastly, in regard to the Ralph review, the original proposal was that share plans be taxed as companies. That was the proposal for collective investment vehicles as well, which is similar to the share plan in that all the income is distributed. For both that would have been an administrative nightmare for absolutely no gain in revenue. There is no leakage. We made submissions to that effect to the Ralph committee and received a very good hearing. We are confident that the Ralph report will recommend that the present basis remain unchanged. Thank you.

CHAIR—Thanks very much. In your submission and again what you have just told us, you have basically got 100 per cent participation. You said full-time employees or permanent ones; does that include part-timers?

Mr Hill—Yes. It includes full-time and permanent part-timers.

CHAIR—Permanent part-timers?

Mr Hill—Yes, not casuals, Mr Chairman.

CHAIR—Could you just explain: why did you go from just profit sharing to profit sharing and employee share ownership? Was that driven by the employees?

Mr Hill—The issue of employee ownership has been core to the organisation almost from its inception because, as Bill indicated, of the coming together of capital and labour. Bill talked about the 1988 share plan as being the latest generation. Prior to that there were methods applied to get employees to become shareholders way back to the early days when Bill indicated superannuation was introduced for all employees. There were share entitlements. I go back to initial share entitlements, of 100 shares per employee put into the superannuation fund for the benefit of the employees to achieve that objective. So there is a long-held core understanding of employee ownership within the organisation, going back, as Bill indicated, for 20 or 30 years.

Mr Morath—If I can add, Chairman, there was a realisation that the profit share is focusing on the result for the current year but share ownership is looking longer. As Bill has indicated with his comments, it was to get that feeling amongst our employees that we really recognised that profit share was not enough.

Mr Webster—You raised the question in the context of the plan being driven by employees. A lot of what we do relating to employee issues is very much driven by employees and we do listen. For example, our current plan is going through a little bit of a metamorphosis and we are just about to introduce the ability for employees to vote at the annual general meeting on their shares—which includes the appointment of directors or the

reappointment of directors. So this is employees saying, ‘We would like to have a bit more ownership,’ or the same impact that other shareholders would have. So we are very much an organisation that listens to our employees and what they would like. So the shape of the plan almost certainly is going to change over the next decade or two in response to that.

CHAIR—I suppose central to the whole theory of employee ownership is that you are likely to get better employee loyalty, it has been suggested, higher rates of productivity and the things that you might expect to see with employees having some share of ownership in a company. But at least in Australia there is a paucity of hard evidence to support that. In your company have you been able to demonstrate that clearly employee share acquisition has been beneficial to your company?

Mr Webster—It is not an easy question to answer because intuitively we all believe it is the case. What we have not done is to segregate that part of our characteristic or culture and try to quantify it. In fact, I do not know that we could do it. I think we would also say very clearly with total sincerity that if we did not have that as part of our culture we would not have achieved some of the things that we have achieved but we cannot quantify that.

CHAIR—Can you give us anything to illustrate that?

Mr Webster—We can give you a lot of examples. A publicly listed company has pressures on it which are different from a private company. A publicly listed company has to look after the interests of its shareholders and sometimes those are fairly short term from people who want to trade shares. But real wealth, as we have explained from our point of view, really occurs from decisions today which evolve over the next three years to five years. The privately held company can take strategic decisions and know that there is going to be no return for quite an extended period—three, four, five, eight years, whatever—so there is apparently no immediate benefit but it is worth while making the decision. A listed company has the offset of what you do when the shareholders are saying, ‘We want an increased dividend every year. We want these other things,’ and you know to be healthy and compete in the changing environment you have got to make some significant changes.

If we did not have something like a long-term share ownership plan, the people we were asking to do some of these things would be short term in terms of their thinking. They would be thinking, ‘What is the impact going to be on me? If I’m asked to do that, which I know is very unpopular and there’s change—you’re asking me to go off to this different country and create something fresh. What’s in it for me?’ or they might think, ‘When I come back to Australia, if that’s what I’m going to do, then I might actually be out of a job’—that type of thinking.

With the ownership and the way we work with our culture, that just is not an issue. They say, ‘If this is what the organisation believes is important, to create value in future—and I’m intending to be around for a long time and I want that value—then absolutely I’ve got no argument. There’s no conflict of interest there. In fact, we’re on the same team and I’m very much part of it.’ That is very much the thinking and the behaviour that goes on in the organisation so people do not question it.

CHAIR—How many employees do you have in Australia?

Mr Morath—We have 3,200.

CHAIR—As we know, if you go into the work force today you will probably have five to seven jobs by the time you retire. Is employee turnover less prevalent in your organisation than comparable companies out there?

Mr Webster—To answer that question I think you have to segregate and try to understand what an employee is and to look at the characteristics of an employee. What you find is that younger employees typically are relatively of shorter duration. The turnover I do not think is particularly different. We certainly would not claim that we have got a lower turnover from people who come in, maybe secretarial, first job, et cetera. Those people, don't forget, tend to be looking for money, for cash. They want some money to put as a deposit on a house. They are thinking of getting married, all of these other things, so their interests are quite different from those who have been there for maybe three to five years.

What we find is that people who are there after that period of time and who are really making a career path and can see all the opportunities absolutely love the idea of a joint ownership, working together, where the employees share. If you look at the people here—and we are not extraordinary people—we have all been around for in excess of 10 years, 20 years in one case—and we find, in terms of this intellectual capital retention we are talking about, that we get great loyalty from people who have been there for a significant amount of time. That tends to be three, five years plus. Those people, our senior managers, tend to have been there for quite a long time and enjoy the culture. It is a pretty tough culture to work in, I have to say. It is demanding. We do require people to turn around and take on new challenges and be accountable for those. It is quite an unusual way we do it. It is not bureaucratic; it does not have lots of layers of management. We are a relatively unusual organisation in the way we do things.

Mr Morath—There are two statistics that might help but there is nothing definitive. The first statistic is that we have had 22 years of profit increases and, for a listed company, that is a pretty unique record. That in a way is the delivery of the result. The other statistic I like is the one that I mentioned to you before, which is that 77 per cent of our employees by their choice say, 'I want to own shares in the company,' rather than, 'I'll take the cash now, thanks very much.' It is the same amount. So I think that is a vote of confidence by the employees and I think the other is the outcome of what that delivers.

Mr SAWFORD—I have just one question at the moment in terms of your actual submission. Under 'Benefits to community of interest', dot point 3, you refer to legitimately deferring tax for up to 10 years. Under 'Impacts of employee ownership,' in dot point 5 you again refer to tax deferral. Acknowledging what Richard said just a while ago, there is a reference again in dot point 2 to the 10-year limit on ultimate physical disposal of shares. What will be the impact on your ESAP if trusts were taxed as companies?

Mr Morath—In terms of the actual tax it would be the same. This was the thing with Ralph and the government. We believe they, very wisely, have recognised there is no tax leakage from this system at all. All it will be is an administrative nightmare whereby tax would be paid and then all the individuals would be then claiming it back, for not $1 of

extra revenue gained. The government recognised that with the Treasurer's statement in regard to collective investment vehicles, and share plans are exactly the same.

Mr SAWFORD—I will just ask one question about the actual share plan. It seems to me, from what Bill was saying, that in Lend Lease organisational climate is considered crucial to the success of your company. I think of one company in my electorate that changed, on their factory floor, from 12-hour shifts to eight-hour shifts. There was huge resistance in order to do this because people were receiving less money at the end of the week. At the end of 12 months, overtime in fact increased and productivity increased. In other words, the change of organisational climate, even though it was not perceived by the employees as being a plus, actually turned out to be a real plus. In fact, people who thought they were going to receive less remuneration and who needed that remuneration were actually offered overtime because of the productivity increases and the sales and all the rest of it.

Do you think sometimes—and I acknowledge what Bill said, it is hard to quantify—that really the success of Lend Lease has to do not with share ownership but more with organisational climate, regardless of share ownership?

CHAIR—Employee share acquisition seems to be a continuum of a company culture that seems to be conducive to a successful operation.

Mr Webster—There are other aspects to it. What I did not mention was that if you were to speak to an employee, one of the early things he also would say is, 'Change is the norm.' I did say we do expect people to change, to turn around, to go in a different direction and take on new responsibilities or new challenges. A lot of the change that you have seen, for example, within MLC has been very much driven by our employees. We have actually put in place a process over the last three years where employees volunteered changes they thought could make things more efficient. This is all part of the culture.

Then they volunteered to participate on components—work parties, if you will, without any management involvement—as to how to implement that change. They had to identify what they were going to change, what the benefits would be and they had to measure it after the event. We have had 150-something of these work parties working, and they have got a time frame of seven to eight weeks to do it. This is empowering employees to create the change. This is the mixture we are talking about: employees having responsibility. They can genuinely affect the behaviours in the company, but we would put to you that unless we had things like share ownership and people said, 'This is actually for the good of the company and (a) I am getting some personal satisfaction out of doing this; (b) I'm effecting a change and I'm not being told to by some manager somewhere, I'm actually doing it of my own initiative and often in my own spare time.' If that was not all a part of sharing the benefits to come out of all of that, I do not think there would be the same enthusiasm. I cannot say it would not be there but they would not have the same degree of enthusiasm. We are all on the same side of the table here.

Ms GAMBARO—There are some questions on culture I want to ask you about because people I have known in the past who have worked for your corporation have a very positive image of the company. You have answered that with questions from the deputy chair. There

are other things in place apart from the employee share ownership. That is a basis and then there are some other things. I want to ask you a question on this intellectual capital you keep speaking about and the seepage that many companies have. Kenneth, you have been with the company for 20 years. How do companies stop their top people and their brainpower from leaving? I know you have gone through some examples of that but when you lose your intellectual base it takes a considerable time to train people. I also want to ask you about job sharing. Does your company advocate job sharing? You talked about part-time employees but is job sharing widely practised in your organisation?

Mr Hill—Certainly. Bill, may want to pick up on a couple of those issues.

Mr Webster—Yes, can I lead and Kenneth can come in afterwards. I think the fundamental answer to your question in terms of intellectual capital is: are people satisfied in terms of what they are doing? For some people that mean they are really challenged and given new challenges; for other people it is actually being in a project that may take several years to come to fruition and they enjoy the creativity and then they enjoy putting it in place. Other people want to be creative and do not want to do the implementation, so it is a combination of things. There is not one answer to the question.

If you look at our annual report last year, you will see we had a number of subheadings under ‘Think more’, ‘Create more’, ‘See more.’ This was under ‘Think more’: ‘People and our investment in intellectual capital. Attracting other intellectual capital. Investing in intellectual capital. Reviewing the intellectual investment growth. Rewarding our intellectual capital. Our intellectual capital as partners and owners of the business. Return on investment from our intellectual capital partners.’ So you can see it coming all the way through this.

We do not have a magic solution. It is a combination of factors but it is all to do with people being allowed to fulfil their ambitions and stretch themselves and get their personal reward in terms of satisfaction with what they are doing combined with financial reward—combined, we think, with wealth creation as a result of their efforts. Since we do stretch our people and we ask them to do a lot more than 100 per cent, we ask them to exceed expectations—that is a norm for us—and we think people should be adequately compensated for that and recognised. This means we do lose some people early in life.

I am actually retiring early next year on my 55th birthday because I want another phase in my life. I could not have done that, I can assure you, unless we had things like a share ownership scheme. I am not saying I would be struggling but I would not have had that capacity. That is the first thing. Maybe Ken would like to pick up on the job sharing.

Mr Hill—Yes. Just to pick up on the issue of job share, we have certainly over the decades tried to take away many of the impediments to things like job share. Working off site is another aspect of that job function. Things like bringing permanent part-time people into our superannuation fund as full members and giving full benefits under the share plan to permanent part-timers removes the sorts of impediments that traditionally appear to job sharing and part-time work. It is encouraged and it is really then down to business units on how they use that facility.

Ms GAMBARO—So your company is a promoter of job sharing?

Mr Hill—Absolutely.

Ms GAMBARO—You mentioned giving voting rights to your employees under the employee share ownership. How many companies do you know of which currently offer that, or is this quite an innovative approach that you are taking? Is it widely used in the marketplace where you are assigning them an active part in the AGMs?

Mr Webster—I do not have a specific answer to that, other than to say that what we typically do in situations like this is to look at what happens in countries right around the world. The answer is that there are some jurisdictions where that is part of it. Then it comes down to the specific organisation as to whether they think that is a good thing or not such a good thing. Practical issues play a role. Sometimes there are legal impediments to it. In terms of what we are talking about, you will find that a direct vote is possible under most of our schemes. But we do have some schemes—and I think the United States is an exception to this—where the law there does not permit a direct vote.

What we have put in place there is that every employee is encouraged to lodge with the trustee in the United States how they would like their votes to be cast. The trustee, by law, does not have to vote that way. The trustee, by law, will vote the way the trustee thinks is the most appropriate. That is a legal constraint to something we obviously would like to do if we were doing it elsewhere in the world. I do not have an answer within Australia.

Mr Hill—There are a number of major companies that do have voting. We have gone to the point of saying not only will the information be gathered from the member to apply the voting philosophy but indeed the trusts will go back and inform the members of what the vote was as well. We have said that communication has to be added to bolster the concept that is being applied here.

Mr Webster—The integrity has to be there.

Ms GAMBARO—And it is a two-way thing. That is great.

Mr Simpson—That means in Australia these are binding directions by the members. The trustee has no alternative but to follow what the member says. That is a measure of how serious the company is taking this in giving that power to employees. As Ken said, the transparency of the communication is important as well to show that this is flowing in and outside of the share plan through the employees, ultimately to the company.

Ms GILLARD—Why have you chosen to operate your share plan through a trust structure, given that is not required as such? Was that a conscious decision?

Mr Morath—That is a good question. I think there are two reasons: the first reason is that the trust structure, just the same as for the collective investment vehicle, is a good structure when your objective is to get all the income out and distributed to the beneficiaries, the members who are going to pay the tax. That is the way public unit trusts work and that is a very successful investment vehicle. It is the same in the United States. They call them mutual funds over there but it is the same idea. What you want is an investment vehicle that actually is distributing all the income back to the members. They are going to pay the tax. It

then is not taxed itself. It is what we call tax transparent. That, I think, is the major reason we set it up that way, rather than having a vehicle which itself would pay tax, then the members would claim something back. That would not be a sensible idea.

The second reason is that we wanted something that was separate from the company. The trust is separate. There are trustees. Some are appointed by the companies; some are representatives for the members. The trust is not a subsidiary of the company. It is not a related party. We wanted that independence and the trust gave us that.

Mr Hill—I would endorse that. We have followed that thinking in establishing offshore arrangements with our employees in Europe, the US and Asia. That is the reason we get to that administratively efficient structure.

Ms GILLARD—There is no legal requirement to have an intermediary but I can understand the confidence building you would have by having a trust arrangement.

Mr Morath—It is like superannuation where you have a separate trust to ensure that the assets are secure. They are segregated. They are not part of the company. They are separate from the company and the company has no ownership rights or entitlements; they belong to the members.

CHAIR—Before we leave the trusts, Dick, could you tell us who pays the administrative costs of running the trust? What funds the administration of the trust itself?

Mr Morath—The cost of running the trust is paid partly out of income of the trust and partly by the company.

CHAIR—Do you know what proportion?

Mr Morath—The objective is to get it to stand on its own two feet so it is a self-funding operation. Are we there yet or not?

Mr Simpson—Not quite.

Mr Morath—What—percentage wise?

Mr Simpson—I could not estimate it. I would have to have a look for you.

CHAIR—Is the administration of the trust itself unnecessarily burdensome for the employees?

Mr Simpson—No. From the employees' point of view it is very transparent. We send statements twice a year to every employee who is a member, outlining the balances in their accounts and the tax treatment on those entitlements. We have an interactive voice response system that lets people ring up to determine their balances. It is quite transparent and easy to access from an employee point of view.

Mr Webster—The proof of the pudding is that, if an employee owns 1,000 shares effectively, they expect to receive the dividend stream on 1,000 shares. If there is any less than that they say, 'What's going on here?'. They expect to receive the value on 1,000 shares. If there is anything less than that they say, 'What's going on here? Someone's fiddling the till.' We cannot let that happen, so by definition it has to be very efficient.

Mr Morath—Neil would have a staff of three people.

Mr Simpson—Two for the share plan.

Mr Morath—They are not large.

CHAIR—And the trust itself pays no tax?

Mr Morath—The trust pays no tax on condition that all the income is distributed.

CHAIR—To the employees, yes.

Mr Morath—If it is not, the trust pays tax at the penal rate. Our objective is to ensure that every last dollar of income goes out to the members.

Ms GILLARD—Looking at the tax proposal, just to make sure that I understand it, from the tax man's point of view you would be deferring a bit of the tax because you would pay tax on the acquired value of the shares possibly some point later than 10 years. Is that right?

Mr Morath—Let me give an example because it is hard without some numbers. Suppose someone is allocated some shares and they are worth $10,000 today. What we are proposing is that the $10,000—that value—would be taxed in 10 years time exactly as per the present arrangements. That would be taxed at income tax rates in 10 years time.

Ms GILLARD—On $10,000?

Mr Morath—On $10,000—correct. If that $10,000, which is actually in shares, has grown to $15,000 in value, we are proposing that the extra $5,000 not be taxed because we think that is more akin to capital gain. The award of the value of the money is being taxed in 10 years time as per current arrangement. But the gain, we suggest, should not be taxed until the shares are actually sold and then that gain would be taxable as a capital gain. The cost base for determining that capital gain would be the $10,000 on which the tax was being paid in 10 years time. If, later on, those shares were sold by the individual for say, $20,000, then there is $10,000 of taxable capital gain they would have to pay tax on. That is our proposal. On the $20,000 they would have paid tax on $10,000, the value of the award after 10 years time, and they would pay tax on the capital gain when they actually sell the shares.

Ms GILLARD—The $10,000 discounted for inflation. I know we are in a low inflation environment now but if we were to move back—

Mr Morath—If we still have that, yes, that would be nice. We are not sure that is going to survive Ralph. But, supposing it does, yes, you would get indexation.

Ms GILLARD—Yes, the indexation; that is right.

Mr Webster—We already said that, in accordance with the capital gains tax rules of the day. The logic is similar to normal share ownership.

Mr Morath—I want to make it clear we are not looking for some free carry here. It may well be that, if we have indexation, the indexation only commences from the time the tax is paid on the $10,000. It would not necessarily have to go right back. If that was an issue, we are not asking or proposing that. It is the principle that the gain is a capital gain and should be taxed as such. We think that is quite relevant because, with all this discussion about capital gains and encouraging share ownership and so on, this is the right time to put that proposal up. We have thought about it and we have read what the Prime Minister and others have to say. We think this is the time to put something like that up for consideration. We have varied what we have put in the submission. Are we allowed to make a supplementary submission and include that proposal?

CHAIR—Yes.

Ms GILLARD—We have some later material where a federal department has provided us with some information about employee share ownership plans and tried to correlate the incidence of those plans against a number of indicators, one of which is the incidence of unionism in a workplace. Can you give me a feel as to what degree, if any, of unionisation you have in your business?

Mr Morath—We certainly have unionisation. In terms of numbers, does anyone have a feel for that? Can we take that on board and come back to you?

Ms GILLARD—Yes, that is fine. I am not sure it is of huge relevance. There is some suggestion in the departmental material that there is a higher incidence of employee share plans in more highly unionised workplaces. I suspect the real correlation is that there is a higher incidence of them in bigger workplaces, which also correlates with a higher degree of unionism, but I am just trying to tease that through.

Mr Morath—Yes, that could well be.

Mr Simpson—We have quite clearly agreed enterprise agreements with the FSU, for instance, and a joint development agreement with the building unions. So those things are quite open and transparent from that point of view.

Mr Morath—Are you looking for the numbers of our employees who are actually members of a union?

Ms GILLARD—Just a ballpark percentage of more than 50 per cent, less than 50 per cent—something like that.

Mr Morath—We take that on board and will come back.

Mr SAWFORD—I have a more detailed request. You said you had 3,200 employees.

Mr Morath—Yes, in Australia and New Zealand.

Mr SAWFORD—Has that figure remained static over the last five or six years? Do you expect it to remain static over the next five years?

Mr Webster—You will find that our organisation has expanded quite dramatically from time to time as we have acquired things, but we also sell companies. We had a lift company called Elevators Pty Ltd which became EPL-Kone. When we sold that, the number of employees reduced by 1,500.

Mr Morath—1,200 to 1,500, yes.

Mr Webster—So the answer is that it goes up and it comes down, depending on the shape of the business and what evolves, but it is very interesting if you look back historically. The number seems to have been about 5,000 for a long time. Today, of course, you have to look at the people we have internationally. We have several hundred in Europe. We have several hundred in the United States. I think the totality comes to a bit less than 7,000.

Mr Morath—7,000 to 7,500.

Mr SAWFORD—How many 25-year-olds do you take on a year?

Mr Morath—I would have to take that on notice.

Mr SAWFORD—Or even graduates can be defined into that, if you want to. Perhaps under-25s and graduates.

Mr Morath—It is a pretty young work force.

Mr SAWFORD—That is the impression I get, too, but could you tell us.

Mr Morath—Can we take that on board?

Mr Webster—If you look at our financial services, MLC, for example, it would be a large intake. If you look at different parts of our property, we have very clearly had graduate recruitment programs, but the numbers may not be that high in the totality. We could easily take on several hundred in the financial services. Again, we have to segregate to come up with a meaningful answer, but in totality, yes, we have a big inflow of graduates.

Mr Morath—I will give you a snapshot; we will give the detailed results. I was down with Bill at our Lend Lease Projects, the old renamed Civil and Civic, which is our design and construction organisation. The man in charge of all the engineering for 88 Phillip Street

next door used consultants all around the world and he was showing us all the plans on the web. He is in charge of all of that and he is 28, so it is a young company.

Mr Hill—The average age of employees has been relatively static over the last 10 to 15 years and it is somewhere in the order of 33 to 35.

Mr SAWFORD—Average?

Mr Hill—That is the average age across the group and that has been fairly static.

Mr WILKIE—You say that you sell quite a few companies, or you buy and sell them all the time. What happens to the shares for the people in those companies when you sell a company?

CHAIR—Yes, I wanted to ask you about the tax treatment that you are proposing for the shares of the employees who are leaving the company.

Mr Morath—Will we do the two?

CHAIR—Yes, and then we will finish.

Mr Hill—That is on companies that we have sold. What occurs is the employees invariably remain in the employee share plan, so companies that we have sold in the recent past or people who have moved out of the organisation still remain as employees of the employee share plan. Depending on the commercial arrangements at the time, it may well be that they are given the opportunity to withdraw the shares and take the shares out in cash and do whatever they wish.

Mr WILKIE—And pay the tax.

Mr Hill—Or they may choose to leave them in. In fact, we have on ESAP's membership ledger substantial numbers, indeed in the hundreds, of employees that have previously worked for Lend Lease that remain employees in the employee share plan.

Mr Morath—Two examples would be Kone that Bill mentioned and IBM-GSA. But they would not be getting any fresh allocations of shares because they are no longer entitled to that, not being employees of the company. What was the second question?

CHAIR—What tax arrangements are you proposing for employees who leave the company and come out of their employee share ownership plan? I suppose it depends on how long they have been in it.

Mr Morath—Suppose, when they leave the company, it is less than the 10 years. That would still trigger the payment of tax on the value of the $20,000. If they take cash—in other words, sell their shares—they pay tax on the lot right then. If on the other hand they say, 'No, I'll take the shares,' and they have not sold their shares, they pay tax on the $20,000 as per our example and they do not pay any further tax. They do not pay the capital

gains tax component, until they actually sell the shares. That, to us, matches the treatment of the individual shareholders, who are taxed when they sell the shares.

CHAIR—Thank you very much, all of you, both for the submission and for coming along, and also running what seems to be a very successful employee share acquisition plan.

Mr Webster—Before leaving, could I say what we normally say in these situations: if we can be of assistance we are very happy to keep the lines of communication open. If you want to come back to us, ask questions or ask for our views on things, then we are very happy to help because we believe in improving things and doing what we can to assist.

CHAIR—Thank you very much. When you said you were going to say what you normally say, I thought you were going to make us a share offer!

Mr Webster—That is not part of our culture!

CHAIR—All right. Thanks.

Proceedings suspended from 12.23 p.m. to 1.56 p.m.

GOODWIN, Mr Miles Leigh, Assistant Director, Structural Reform Section, Department of Employment, Workplace Relations and Small Business

LEAHY, Mr Barry, Group Manager, Workplace Relations Policy Group, Department of Employment, Workplace Relations and Small Business

MacDERMOTT, Dr Kathy, Assistant Secretary, Framework Policy Branch, Workplace Relations Policy Group, Department of Employment, Workplace Relations and Small Business

OXLEY, Mr Steven, Director, Policy Review Team, Department of Employment, Workplace Relations and Small Business

CHAIR—Thank you very much for the submission. I know we all have jobs and then there are people going the extra mile and it is obvious from the submission you have gone the extra mile here. Thanks for putting the submission together and coming along and spending the time to talk to us about it. Perhaps you could just give us a summary of the submission and what you think are the most important points. If other members of the delegation then want to speak, that is fine, and once we have had the summary we will then have some discussion.

Mr Leahy—The reason you have four of us here today is that contributions to this submission have involved people who have a fairly deep understanding, I hope, of the policy but also we have had some extensive research undertaken, as you can see from our submission, into our major Australian workplace industrial relations survey and so we have people with us today who are technically extraordinarily adept at manipulating and using statistics, and that is the reason for it.

We have to make one minor correction to the submission we have put in. Some information we obtained from Treasury was incorrect. At page 4, line 4 of our submission you will see at the first dot point we refer to two-thirds of permanent employees. That in fact was a government proposal that I think did not get up in the Senate. It is 75 per cent of permanent employees. And that means the next sentence commencing with the two-thirds is incorrect as well. So perhaps you would just delete that sentence.

CHAIR—Right.

Mr Leahy—Our submission has attempted to address the committee's terms of reference by drawing particularly on the data the department has collected in its two major workplace relations surveys which were undertaken in 1990 and 1995. We have sought to do that in the context of government policy—and I will come back to that—about employee share ownership schemes, the role of the new workplace relations system in encouraging more flexible remuneration arrangements, the experience of several overseas countries—obviously ones which are key users of employee share ownership plans—and an overview of the empirical evidence of the schemes that are operating.

As you would be aware, the government's policy is strongly supportive of the role of employee share ownership, in particular in creating, the government thinks, more productive

workplaces and providing employees with a share in the financial gains of their enterprises. This support has been reflected since 1996 in two major policy initiatives to date—one being tax incentives that were introduced in the 1996 budget and the second major one being the provision for an employee share scheme in the sale of the first one-third of Telstra. Obviously the government believes the flexibilities being introduced through the Workplace Relations Act provide support for more flexible remuneration arrangements and we have seen some evidence of that coming through.

To talk a little bit more about the workplace relations system, the emphasis that now is placed on the enterprise and workplace level provides, the government says, a much greater focus on the role that flexible remuneration arrangements can play in developing more productive workplace cultures and, as I mentioned before, in allowing employees to benefit financially for the contribution they make to improve input performance. One of the points that is worth making is that employee share ownership, as you have probably already been informed, is only one option that is available to organisations in seeking to better align remuneration arrangements with organisational objectives. The others include performance based pay, profit sharing and productivity sharing arrangements.

In terms of the incidence of employee share ownership in Australia, the submission finds that both the incidence of employee share schemes and the number of employees who are receiving shares as a benefit have increased in recent years, albeit from a relatively low base. The most recent across-the-economy data is 1995 data. The most recent Australian Bureau of Statistics data in this area is 1994, but we do and we have presented in our submission evidence of some agreements providing for employee share of ownership options.

The AWIRS 1995 data shows that 22 per cent of private sector workplaces with 20 or more employees had employee share schemes. I should make the point here that the unit for analysis used in AWIRS is the workplace. There may, of course, be many workplaces in a particular enterprise, so while we say it is 22 per cent of workplaces that may represent, and will in fact represent, a significantly lesser number of enterprises.

The 1994 Bureau of Statistics data shows that about four per cent of employees were receiving shares as a benefit. That had increased from 1.3 per cent in 1979 and, even in the period between 1992 and 1994, I think it had gone up from 2.8 to four per cent. So there has been some increase in the number of employees receiving the benefit in the last few years. Nevertheless, the level of employee share ownership in Australia is relatively low when you compare it with, for example, the US where I think the latest figures show about 10 per cent receive employee shares as a benefit. In the UK it is up to around 15 per cent. There are some other comparable countries who have the same level as Australia. I think in Germany at the moment, for example, our submission shows that running at about four per cent of employees.

The other area of the submission we have put a fair bit of effort into is the impact of employee share ownership on organisational performance. We have in particular concentrated on the data and information you can obtain from AWIRS, but we have also obviously had a look at other empirical evidence. One of the things we have tried to do is to develop for the committee—and it is the first time we have done this with this particular data—a typology describing four different types of workplaces and then trying to use that typology to draw

out information on the impact on productivity—absenteeism and those other measures that we point to in the submission. That typology basically covers the four different types of organisations—ESOP organisations where there are no participative arrangements, ESOP organisations where there are extensive employee participative arrangements and then non-ESOP organisations with participative and non-participative arrangements. That brings out some fairly useful information about the impact or at least the relationship between the incidence of ESOPs and productivity measures that we cover.

There is undoubtedly some inconsistency in the empirical evidence on employee share ownership plans, both from within Australia and internationally. I guess the strongest consistent finding is that where there is an employee share ownership plan underpinned by or existing with strong participative arrangements then it is most likely in that sort of organisation the impact on productivity and on productivity measures will be the greatest. That is a very consistent finding that we have found. Probably that is the extent of the introductory comments and a very brief overview of our submission to you.

CHAIR—Thanks very much, Barry. Are you actually doing any research or intending to conduct research to see if we can actually measure the specific impact in the workplace of employee share ownership programs in terms of productivity and things associated with it?

Mr Leahy—Beyond what we have presented to you, no, because of the data that is available. What we are looking at here is the most recent significant data that we have. The next opportunity will be the next release of the Bureau of Statistics survey of employee benefits. Beyond that, when and if the department undertakes a further Australian workplace industrial relations survey that would be the next opportunity we would have to look in depth at the incidence of ESOPs and the impact on productivity using the same sorts of techniques we have developed in this submission. I am not sure when the next ABS—

Mr Oxley—I think actually the ABS may have discontinued that particular survey we used. They were done at fairly regular intervals, 1979 through to 1994, but I think in their rationalisation of collections they may have discontinued this particular one.

CHAIR—It just seems to me and perhaps also to my colleagues that what we need is a prospective study rather than doing a survey. Even from the last two surveys it is hard, in a scientific sense, to reach meaningful conclusions. It would be nice if we actually had a prospective study of the impact of an employee share ownership program, at least in a number of workplaces. Is it possible to design such a thing?

Mr Leahy—It would be possible, I think, to design such a study. You could do that on a case study basis and examine some of the few organisations where they do have such arrangements operating and have had them operating for some time. You would need to have capacity obviously to look at the history through an organisation. The other opportunity would be if the government decides to do another workplace relations survey. Then it would be possible to put particular questions relating to the productivity impact of employee share ownership. What we have had to do through the past surveys is to use the information available and that has meant we are actually inhibited in attributing any causality to employee share ownership programs. What we have tried to do is draw what we say are

fairly obvious and strong links, but we cannot attribute causality because we just did not ask those sorts of questions in the survey.

CHAIR—Why do you think it is the finance, insurance, mining and retail sectors that are most likely to have employee share ownership plans? To what do you attribute that?

Mr Leahy—I guess in the finance area—and my colleagues might want to comment here—it is most likely that they would be involved in this area because of the business they are in. They are obviously expert in businesses associated with share ownership. They are probably more likely to be expert in matters associated with tax. In the area of mining, I think one of the things we have drawn from our research is that the nature of organisations covered by employee share ownership often are highly unionised organisations. The mining industry, of course, is a traditionally highly organised industry, so that might be one reason, for example, that the mining industry is involved in it.

The other reasons are obvious reasons such as the owners and the managers attempting to achieve as much productivity as they possibly can. In an industry like mining, which is obviously an industry subject to extreme international competition, the employers and managers of the mines would be looking for whatever scope they can to achieve increased productivity.

CHAIR—I know some of my colleagues will ask more about this sort of thing. Do you feel that in, say, the mining sector a lot of it has been promoted by the employer as distinct from having employees actually wanting employee share ownership programs? It makes you wonder also, because of what is happening with commodity prices and so on—and some recent illustrations of employees losing all their entitlements—whether they feel inclined to have employee share ownership programs given that they would be at the bottom of the list in terms of getting money.

Mr Leahy—I do not think the evidence that we have provided enables us to draw those sorts of conclusions. I do not think there was any evidence in the surveys, Miles, was there?

Mr Goodwin—Once you start breaking down the population of ESOP workplaces, the cell sizes start to get very small when you get to industry level. We essentially stayed away from industry based analysis because there was no confidence in the findings we were getting. Essentially it is hard to break it down to that level.

Mr SAWFORD—I just raise some questions on ESOPs as almost a savings mechanism rather than one for investment or capital formation. In the US you mentioned, Barry, that it was 10 per cent and I think in the UK it was a bit higher. Is that at the expense of other savings mechanisms, like super?

Mr Oxley—We really do not have any information on that, no.

Mr Leahy—I think you are anticipating a submission from the Treasury.

Mr SAWFORD—Yes.

Mr Leahy—They may be able to address that issue better than we can.

Mr SAWFORD—What about in terms of the US and the UK, again from an international perspective? How much credence do you give to the tax regime encouraging employee share ownership rather than any other reason? It is a convenient way to defer tax, avoid tax, do what you like.

Mr Leahy—I do not think there is much doubt that where there are favourable tax regimes there is more likely to be a greater participation in share ownership programs. I think that probably does come through the evidence that we have presented.

Mr Oxley—Yes. I think generally you characterise the taxation arrangements in the US and the UK as being even more favourable to employee share ownership than in Australia. That would undoubtedly be one of the factors that has led to a greater incidence of schemes in those countries.

Mr SAWFORD—Can I simply say, from a personal point of view, to the people responsible for preparing the submission: well done. It really was excellent.

Mr Leahy—Thank you.

Ms GILLARD—I think it is an excellent submission, too, but I am actually going to ask you some questions about the data, so I will be the one that you will want to kill. I understand why you do these surveys on a workplace unit, because of the philosophy driving the bargaining units in the act. But, from other information we have had before this inquiry, it seems that the pattern of difference in the development of employee share ownership schemes—and I do not know if this is going to prove to be right at the end of the inquiry, but this is my thinking now—is that you are more likely to get them with major publicly listed companies because they are used to selling their shares to the public; therefore selling them to employees is not that difficult; and for employees they have an objective benchmark as to whether or not it is a good deal for them because they can always compare what they are being offered with market price.

You have what is, in my mind, a grey area about what is happening with unlisted public companies. Then I think you have a very underdeveloped area with proprietary limited companies where there is a real question, I suppose, about the applicability of employee share ownership schemes, particularly down the small end, because you end up with a share that you cannot trade for anything, because of the nature of the company. In terms of your data is there any way of breaking it down against those classifications rather than against the workplace by workplace classification? The trouble with this data is that we might be looking at a workplace that is a Westpac bank and we might be looking at Julia Gillard's fish and chip shop, and they are, for employee share ownership plans, quite different animals, but they might still be workplaces of 20 or more employees.

Mr Leahy—I should point out that the workplace was used in both the 1990 and the 1995 surveys, so there was no political imperative driving it. I think we have some little information on the extent, for example, of single businesses, do we not, Miles?

Mr Goodwin—Yes.

Ms GILLARD—Single site businesses.

Mr Goodwin—Yes. In 1995 only three per cent of single workplace organisations had ESOPs and 29 per cent of workplaces which were part of a larger organisation. The data you are getting is essentially that of large multi-work-site organisations. The reason the AWIRS goes in at the workplace level rather than firm level is that the workplace can be defined.

Ms GILLARD—I am sure it makes sense for a whole lot of other purposes. It is just not the most convenient delineation for this one.

Mr Goodwin—Yes. As far as additional data in respect of breaking it down to company type levels and trying to do some analysis is concerned, I think it would be relatively difficult but maybe not impossible. But it would be fairly difficult to do, yes.

Ms GILLARD—Just in terms of what we have now, of those workplaces that you have analysed in these surveys that have reported they do have employee share ownership plans, given that three per cent statistic, would you say they are most likely to be multisite employers and you are looking at one workplace of that multisite employer in this survey?

Mr Goodwin—No. It is a randomly generated sample. All the workplaces are scrambled. There could be six Westpac, three Qantas, four Greyhound. It is just randomly generated. That is why it can be generalised to the whole of workplaces in Australia.

Mr Leahy—We report in here that there have been some other surveys undertaken, which may give more of a hint. For example, a 1990 survey by Cullen Egan Dell surveyed the top 1,000 companies and they recorded that 43 per cent of companies surveyed had share plans for their executives and 34 per cent had employee share plans. But you are basically correct in that I think the experience would be that the vast majority would obviously be listed companies. I think one of the things the government actually has before the parliament at the moment, the Corporate Law Economic Reform Program Bill 1998, removes one of the inhibitions to the extension of employee share ownership plans to non-listed companies by reducing or removing the prospectus requirements.

Ms GILLARD—Yes. We have had some discussion of that this morning. You refer on page 7 to a certified agreement which dealt with Greyhound Pioneer Australia. In the evidence we had before us today, we were getting different perspectives on this which raise a public policy question. From the point of view of ASIC, what they say is that they lift, or are prepared to lift, the onerous requirements of putting together a prospectus if you are offering shares to your employees. They do that on the policy basis that the main purpose of offering shares to employees is not fundraising but is the participative mutual benefit of employees feeling they have some stake in the entity they work for on an ongoing basis and that is their framework.

The framework of this agreement, by its very definition, really is a company that does need to fundraise—obviously desperately needs to fundraise—and has in part done that by getting employees to trade current pay and perhaps future pay outcomes against share issues.

I did not specifically put the Greyhound example to the people from ASIC, but if we were on that track, using their policy framework, Greyhound, or a company in the position of Greyhound, ought not to be able to avoid the full prospectus requirements because it is perhaps not a predominant purpose—but a major purpose is fundraising.

Mr Goodwin—Yes.

Ms GILLARD—Are you able to tell us with that example whether they did have the prospectus requirements lifted or not lifted?

Mr Leahy—No. The only information we have on that agreement—or at least the only information I have on the agreement; perhaps others have different information—really relates to the workplace relations arrangements, the content of the certified agreement that established the employee share ownership plan and the future workplace relations arrangements covered by it and the way in which it got through the commission. Do you have any more?

Mr Oxley—Nothing more on the prospectus.

Ms GILLARD—I do not know if you have available to you the full transcript of the commission proceedings but it might have been a matter raised. There certainly is a public policy argument there if you are going to ask employees to effectively help you with fundraising, particularly if you are in trouble as a company. The disclosure information requirements owed to those employees is perhaps at the highest possible point, much higher than when Westpac is trying to flog shares to me as an individual and they would have to put out a prospectus.

Dr MacDermott—That is always considering the company issued the shares to employees at no cost.

Ms GILLARD—Yes, but they sacrifice pay.

Dr MacDermott—They did, but they did not actually raise funds.

Ms GILLARD—Is it possible to get a copy of that agreement?

Mr Leahy—Yes, it is a public document. I can give you a quick run-through now, if you like.

Ms GILLARD—All right.

Mr Leahy—Basically, the employees agreed to a five per cent reduction in pay and a pay freeze until the company returned to specified levels of profitability. In return, the company issued five million shares—and that was basically shares equivalent to an up-front 15 per cent increase in their current ordinary weekly wage or salary excluding allowances and overtime—so the five per cent reduction in pay, the share issue, which was about 30 per cent of equity in the company, represented an up-front 15 per cent increase in their current ordinary weekly wage.

In addition to that, the agreement provides for a profit sharing scheme. There are two phases before that profit sharing scheme kicks in: firstly, there is an adjustment phase which continues until the company can demonstrate a $3 million profit over a continuous period of 12 months, and that has to keep going; then there is a consolidation phase where the company has to demonstrate a $3 million profit over a further period of 12 months beyond the initial 12 months; then at the end of the consolidation phase, 30 per cent of the company's profit over the previous 12 months will be distributed to employees. So it is a combination of both. Obviously, if the company comes out of the crisis that it was in, then they get the benefits associated with increased dividends, et cetera, or being able to sell the shares, and there is a trade-off with the wage decrease, and presumably no further wage increases during the life of the agreement. But then there is the profit sharing component as well.

Ms GILLARD—An arrangement like that is terrific if it works. If it had not worked and that company had gone into liquidation, what those employees basically did was to trade a priority entitlement in the liquidation—that is, wages and those things that depend upon wages, like annual leave calculations. They would not get a distribution as shareholders in a liquidation. If it does not work, then it is a very considerable downside in that sense, isn't it, in terms of priority in the liquidation?

Mr Leahy—But the alternative may have been for the company to close shops immediately. At least in this way the employees have continued employment.

Ms GILLARD—If it works.

Mr Leahy—It is working, at least to the extent that for the period they do not close down the employees have continued employment with the five per cent reduction in salary. What the empirical evidence would argue and what logic would tell you is that during that time the employees would do whatever they could to improve profitability, productivity, et cetera of the company.

Ms GILLARD—I suppose the problem is that at the point you are certifying the agreement and working out whether or not it is going to satisfy provisions like no disadvantage, you do not know whether or not it is going to work—by definition.

Mr Leahy—The interesting thing about this particular agreement was that it was certified under 170LT of the Workplace Relations Act.

Ms GILLARD—It will all be different soon.

Mr Leahy—This allows for the commission to certify agreements that do not meet the no disadvantage test where there is a public interest. Obviously the commission has made some assessment, presumably, of the workability of the agreement because it has had to assess the public interest component and has decided that in these circumstances the ongoing employment prospect outweighs the initial disadvantage suffered by the employees.

Mr Oxley—Regarding the prospectus issue, in certifying the agreement the commission would not have any jurisdiction to say that any prospectus requirements should be waived.

Ms GILLARD—Certainly not. I was just wondering whether it had become apparent on transcript, just in the nature of things, whether or not a prospectus was being supplied—not that the commission would be empowered to order one. This is a very different arrangement from the model ASIC has in mind when it is saying this is all about participation and common cause and not about fundraising. This is really a de facto kind of fundraising in that you are reducing your wages bill against profit share liability and a share issue.

Mr Leahy—We will get you a copy of the agreement. I imagine, although this may be different, that we may not be able to get a copy of the transcript. We will see what we can do. We will provide you with whatever documentation we can.

CHAIR—Where you have a company in trouble which offers employees this kind of arrangement, provided the employees are prepared to accept it, I gather from what you are saying that the department has no major problem with it.

Mr Leahy—No.

CHAIR—The ASIC might.

Mr Leahy—The Workplace Relations Act has been specifically designed to allow the commission to certify agreements which do not meet the no disadvantage test to cope with these sorts of incidents. There was a company in Shepparton, which was SPC, which in effect had the same sort of arrangement a number of years ago. The employees gave up entitlements to allow the company to trade its way through a difficult period.

Mr WILKIE—I see from page 11 in your report there were 700 workplaces that were part of the 1990 survey and were resurveyed in 1995. There appeared to be no real increase in the share ownership schemes that were offered to non-managerial staff. I think a third of workplaces with share schemes had discontinued them by 1995. What do you extrapolate from that data?

Mr Goodwin—The obvious conclusion is that some of them are failing in one way or another to deliver benefits from either the management's perspective or the employees' perspective and hence were discontinued. I suppose that is another way of saying they are not always successful.

Mr SAWFORD—Miles, would this indicate that some of these companies had gone belly up?

Mr Goodwin—No. If they are in the panel survey they are surviving workplaces.

Mr SAWFORD—In the process of going belly up?

Mr Goodwin—We have no way of determining that. But they are surviving workplaces.

Mr Leahy—There could be a variety of reasons. One might be the circumstances that were operating in 1990. The company or the workplace at that time might have been striving to achieve particular improvements in productivity and saw this as a vehicle for getting an

initial leg up. After a short period there might have been an alternative. They may have moved to profit sharing, for example, or productivity sharing or performance based pay arrangements. There are a variety of different sorts of mechanisms for achieving the same end, this one being obviously quite an important one. The nature of the particular tool that employees and employers will agree on will depend on the circumstances of the particular company and the particular industry at the time. There could be a whole variety of reasons which do not reflect on the pluses or minuses of the nature or type of scheme that is operating at any particular period.

Mr WILKIE—Why do you believe they have not increased for non-managerial staff? Is it just a decision of the company?

Mr Goodwin—We do not really know but essentially management has control over who they offer it to. Again, I think part of the problem there is because cell sizes were so low it was hard to get into at industry level. Without doing that we would be guessing as to why it was so.

Mr Leahy—I do not think the evidence from AWIRS is conclusive. From the panel survey you certainly get an indication, but the broader surveys, like the ABS survey of employee benefits, show that between 1992 and 1994 there was an increase from 2.8 per cent of employees receiving shares to 3.9 per cent. That would seem to indicate that more than just managers are getting access to share benefits. There have been other studies, as we indicated, which show higher figures than that. For example, I think the Australian Stock Exchange in 1991 did another survey which showed a higher percentage again of employees getting share benefits. The information available about the extent of who is getting what, and the changes, is not terribly good.

Ms GAMBARO—Do you have any information or detail as to what happens to employee share ownership plans in former government enterprises that have become privatised?

Mr Leahy—The most obvious one is the experience with Telstra. It was pretty significant. At 30 June 1998 there were about 57,000 employees. Reports are that 92 per cent of employees took up the option of the employee share ownership program that was made available when one-third of Telstra was sold off. Beyond that, I do not know.

Ms GAMBARO—Do you think these schemes should be more portable? When employees move from one company to another are there restrictions at the moment?

Mr Oxley—As far as I know, in most schemes you would be required to sell the shares back to the company on leaving employment. Obviously there would not be that link between employee motivation and performance and the company. Your return would depend on the previous company you worked for. There are those types of issues.

Ms GAMBARO—We have had various companies provide evidence about greater productivity and a greater work culture in companies that do provide these types of schemes. It is very difficult to measure things like productivity. Are there any other qualitative type measures that you can use? Could you use productivity and morale, the number of days that

people are away from the workplace, absenteeism, sick leave—all those sorts of things—as a measure, or do you have any other ideas? There does not seem to be much data that supports that. There is no hard data, if you know what I mean.

Mr Leahy—There is the innovative piece of work in this submission that we have put up—of course, it is all innovative.

Ms GAMBARO—Of course!

Mr Leahy—Particularly in appendix A, as I mentioned before, we tried to create—and Miles can take a great deal of credit for this—a typology of four different types of workplaces. We had ESOP workplace with no participative management practices, an ESOP workplace with participative management work practices, and then non-ESOP workplaces with those two distinctions, participative and non-participative. Using those four different types of workplace, in the AWIRS we asked managers and employees, but particularly managers, whether or not productivity had increased, what the level of absenteeism was, what the level of voluntary resignation was, what the level of unfair dismissals was, et cetera.

Breaking the statistics down to those four types of workplaces, we have tried to create comparisons across each of those workplaces. If you have a look at that appendix at page 34, for example, under 'A1 productivity', it shows that at workplaces where productivity was measured, participative ESOP workplaces—so that is one typology—were most likely to report an increase in productivity compared to the two previous years. That is a question we have asked managers in AWIRS. If you go over to the next page it talks about absence. Participative workplaces with ESOPs were more likely to report low levels of absenteeism.

We have tried to obtain that sort of information with five or six different measures in that appendix. Apart from in the area of industrial action, and we think there are some reasons for that, in most of those measures of productivity and productivity improvement—absenteeism, labour turnover, level of workplace change and level of job satisfaction—the organisations where an ESOP exists and is supported by a participative management culture seem to come out on top. In fact, that is a very consistent finding.

In the area of industrial action it shows, in fact, in those organisations the level of industrial action is amongst the highest of the four organisations. We think the reason for that is twofold: (1) those organisations are often highly unionised organisations, and (2) they are most likely to be the organisations that have suffered the greatest change over the period. Obviously, as you go through structural organisational technological changes, they are the sorts of circumstances where most disputation can occur. That is what we have tried to create in that typology for you.

Ms GAMBARO—I must also congratulate you on some of the data you have provided. It is very extensive.

Mr Leahy—Thank you.

Mr SAWFORD—Notwithstanding employee share ownership—put that to one side for the moment—there seems to be an international trend whereby increasing numbers of people who rely on wages and salaries seem to be realising that their wages and salaries in the future are going to remain pretty static. They have participated in the share markets around the developed world to an increasing degree, particularly over the last 10 years. There is that trend irrespective of employee share ownership. There seems to be another trend along with that of what I call 'salary substitution' rather than 'salary sacrifice'.

In other words, I go to work for you, Barry, and you offer me $150,000. You are very generous! There is $50,000 salary, a Visa card I can use to spend how much I want each month, you will pay my mortgage, you will pay my private school fees and you will pay my hospital stuff. But as far as the tax department is concerned I only get $50,000 income. That trend is around the place as well, as people try to adjust. Yet, if you go back to some of the basic principles of marketing of employee share ownership, we have a great need in this country, and of course we do, for capital formation. Yet more and more I am starting to hear that this has nothing to do with capital formation; this has to do with salary sacrifice; this has to do with better industrial relations; this has to do with everything but capital formation. It is a savings mechanism. It is a tax avoidance mechanism. Sorry, that might be a bit cruel—a tax deferral mechanism. It relies on all sorts of these different things.

Mr Leahy—But to the extent that it is a savings mechanism, then arguably at least it is a form of capital formation. At least it is providing the financial sort of wherewithal.

Ms GILLARD—You have to work out the rate of substitution through other forms of savings. That is the problem.

Mr SAWFORD—Yes, that is right. There is only a given amount of money that people have who are on wages and salaries. If they put this into that, they are not going to put it into something else. There has to be a substitution.

Mr Leahy—Yes.

Mr SAWFORD—In view of those sorts of trends that are happening, is your department in the process of conducting or contemplating conducting, or likely in the future to conduct, a whole different range of research into this sort of share ownership or share ownership generally?

Mr Leahy—As I mentioned to the chair before, it is not on our schedule at this stage. We have been working with the association to develop a booklet to promote share ownership as an option. That is about as far as we have gone on it, apart from trying to inform ourselves through the surveys that have previously been undertaken. But, if this becomes an issue of greater interest and if there is another Australian Workplace Industrial Relations Survey, it would be possible to factor into that survey, which, as you know, is the sort of seminal document on workplace relations in the country, we would be able to factor into that survey a significant amount of work on this issue. It would be possible, but it is not on our agenda at this stage.

Mr SAWFORD—We might consider as a committee a recommendation around that.

CHAIR—It seems a pity, for example, with the Telstra privatisation that there was not a prospective study set up of the attitudes, performance, productivity and all the other things of Telstra employees in the pre-ownership environment versus the post.

Dr MacDermott—That is one of the most interesting things about AWIRS. It does have an employee component so that individual employees could report.

Ms GILLARD—To which audience is the booklet directed that you have produced? Is it to employers to contemplate schemes or to employees?

Mr Leahy—I can understand the latest draft of it, so it would be something that would appeal to all levels, I think.

Mr SAWFORD—Are you talking about the share market as a whole?

Mr Leahy—No, employee share ownership.

Mr SAWFORD—Only about this?

Mr Leahy—Yes, and also the alternatives, such as profit sharing and productivity sharing.

Mr SAWFORD—What about the share market in general? There are lots of books on the market. In terms of Australians being the greatest gamblers in the world, in terms of simple information about the share market, there seems to be a great lack.

Mr Leahy—That is slightly beyond our range of activity.

Mr SAWFORD—I know.

Mr Leahy—But, interestingly, the level of community ownership of shares has skyrocketed recently. I think it is up to something like 32 per cent of employees, is it, who now own shares?

Mr Oxley—I think it is more generally the population.

Mr Leahy—Yes, more generally the population. In the last few years it has gone up significantly to 32 per cent.

CHAIR—Do you intend to put in a bid to conduct another AWIR survey?

Mr Leahy—Another part of the department is currently doing an evaluation of the current survey. In due course I imagine we will be approaching the minister with a view as to it, but in the end it is a government decision, of course.

CHAIR—The 1994 survey showed a sharp increase in the number of employees owning shares. Could that have had something to do with the recession, coming back to the Pioneer Greyhound thing where you have companies trying to survive?

Mr Leahy—The first survey was reported on for 1989-1990; the second one, 1995. I would have thought the general uptake was of companies trying to develop mechanisms to improve productivity. I do not know, but there may have been some component related to the recession.

Mr Oxley—There were tax incentives introduced in 1988 which might have had an impact down the track between the two surveys.

CHAIR—Are you aware of any research that compares the rate of companies going into liquidation who have employee share ownership plans versus those who do not?

Mr Oxley—No.

CHAIR—If you are trying to market this sort of thing to employees, I would have thought employment security would have been a fairly sound thing.

Mr Leahy—I think the Greyhound type of agreement is a very unusual agreement. The most common employee share ownership programs in Australia tend to be not instead of remuneration but in addition to remuneration. They are either, as I understand it, fully funded by employers or at least through fairly cheap loans. There really has not been a great incidence, I do not think, of remuneration substitution at this stage. It is more in addition.

CHAIR—Do you have any comments? Have you seen any of the other submissions we have had to this inquiry? Have you any comments to make about what has been said by others who have come here?

Mr Leahy—We have seen some of them. Do you have any comments?

Dr MacDermott—I have no comments, no.

Mr Oxley—At this stage we have not had any chance to go through them in detail. However, over the next few weeks we will have a more detailed look at the submissions.

CHAIR—Are there changes in government legislation, whether in tax or any other area, that you would like to see? I am working on the assumption that the department basically likes the idea of employee share ownership.

Mr Leahy—Yes, obviously from our submission we are strong supporters of it and it is clearly government policy. The extent to which we can free up some of the processing associated with agreement making whilst maintaining appropriate safety net protection will help. Obviously, the proposal before the parliament at the moment—the Corporate Law Economic Reform Program Bill 1998, which removes some of those prospectus requirements—would allow an extension, to some extent anyway, of ESOPs into medium and small businesses. A combination of those two things will certainly help with the extension.

CHAIR—One of the issues that came up this morning was about employees in small companies, often family companies, where they might like to have an employee share

ownership program which is going to lead to acquisition of that company. Then you have the problem where the person giving you the advice about the ownership of the company actually has a conflict of interest, in that it is the person owning it, and it is very hard to make sure that employees are being properly protected. Is that something you have identified as a problem? Would you have any ideas on how that might be overcome?

Mr Leahy—We do not have any evidence either way on that from the information we have. Interestingly, in the US employee share ownership and the transfer of ownership from the employer to the employee is one way of an employer divesting ownership to fund retirement, which seems a rational process if the business is sound and employees are not disadvantaged by that sort of a process. It does seem to be a rational process.

CHAIR—What changes in legislation would you like to see, whether it is tax or anything else? As we have discussed, there are prospectus changes in CLERP.

Mr Leahy—One of the criticisms there has been of the workplace relations legislation is that the agreement making processes—and there are, to say the least, differing views on this—both at the individual and the collective level, are complex. To the extent that you can remove those sorts of complex processes whilst, as I said before, maintaining appropriate protection to employees in terms of the safety net—say, for example, through the no disadvantage test—then that should, we think, encourage the uptake in agreements at the individual and collective level; also it may assist with more people taking up employee share ownership programs.

Mr WILKIE—You touched before on portability. What do you think the impact would be if there was portability across all share ownership schemes? Do you think it would impact on staff turnover?

Mr Leahy—On the evidence it would appear that, as Steve mentioned before, if you adhere to the theory underpinning employee share ownership—that part-ownership of the company improves motivation, improves commitment, et cetera—if an employee with part ownership leaves the company, presumably you are losing some of that motivation commitment. The alternative, of course, is that, if an employee takes that asset with them, they are setting themselves up for, for example, retirement, so there are balances. The strong theoretical support for employee share ownership does lie in the commitment that is generated to the company in improved productivity and morale, et cetera, that flows from that.

Mr WILKIE—So you would suggest that should not be portable?

Mr Leahy—It is not something that I have thought terribly deeply about but there are at least pros and cons to it.

CHAIR—Thank you very much. It was excellent. Is it government policy that the survey be conducted and be conducted regularly?

Mr Leahy—The two previous surveys were the Australian workplace industrial relations surveys conducted under the former government but the second one was completed under

this government and released by Minister Reith. As I said, because it is a major survey and it is a major expenditure, we are doing an evaluation of AWIRS—or another area of the department is—at the moment. Once that evaluation is completed there will be, presumably, a report to the minister and if necessary a recommendation to him about the future of the survey.

CHAIR—It just seems, with all the money and effort that goes into it, there are some basic questions you are not able to answer. It is not your fault but we need some better research, a lot of which ought to be prospective.

Mr Leahy—Yes, there would be other ways of undertaking research. You could do a dedicated survey, for example. The terrific advantage of the AWIR surveys to date has been that they are so broad ranging in terms of the number of people they cover. The last survey covered four different categories. It covered employers, managers, delegates, employees, small business, big business. It covered the complete range.

Dr MacDermott—You can link employees back to workplace types. You can tell quite a lot about the relationships there to those kinds of things. It is not a national survey of employees. You can actually tell where they are coming from, so that is quite useful.

CHAIR—Thank you very much and enjoy the rest of your afternoon.

Dr MacDermott—Just briefly, you have some sense of the limitations on the data but if, within the framework of those limitations, there are any further questions you want to ask, we will be happy to get the information for you.

CHAIR—Thanks very much.

[3.05 p.m.]

GREGG, Mr Peter Allan, Deputy Chief Financial Officer, Qantas Airways Ltd

JOHNSON, Mr Brett Stuart, General Counsel and Company Secretary, Qantas Airways Ltd

KAWAMOTO, Ms Sakurako (Cherry), Business Analyst, Strategic Planning, Qantas Airways Ltd

WARDELL-JOHNSON, Mr Grant, General Manager, Taxation, Qantas Airways Ltd

CHAIR—Firstly, we welcome the Qantas representatives to the hearing today. We thank you and your employees for providing us with a submission and taking the time out, particularly at such a senior level, to come and speak to us.

Mr Gregg—Thank you. I just wanted to read the conclusion from our submission and then a brief statement about our submission. The employee share ownership scheme in Qantas has been an important component in the cultural change program which has contributed to the success of the airline since privatisation. This success can be measured in financial performance, productivity improvements, customer satisfaction and constructive industrial relations. The scheme is an effective means of communicating an understanding of shareholder value to employees and linking the performance of the airline to employee remuneration.

This is wholly consistent with the long-term objective of linking the fortunes of Qantas to an employee’s own personal remuneration and to his or her own performance. Qantas needs the additional level of commitment this will engender as customer expectations rise and the level of competition in the aviation industry increases. Government policy has an important role in encouraging greater levels of participation in employee ownership schemes by Australian companies. Specifically the tax legislation should be examined for any ambiguity with respect to employee share ownership schemes.

For example, Qantas recommends that further consideration be given to the dividend streaming issue to ensure that taxation laws and their administration by the Australian Taxation Office do not discourage the companies from implementing employee share ownership schemes. In addition, Qantas recommends further reform to the tax legislation, such as increasing the tax-free threshold which would encourage companies to participate in employee share ownership schemes. The all employee share scheme under the proposed Year 2000 UK Finance Bill provides one example of how this can be done.

Our submission can be summarised in three key areas. The first area of discussion is the role of employee share ownership schemes in Qantas. From an industry context we show that it is important for an airline to secure the commitment from its employees to strive for greater efficiency and productivity. The drive towards efficiency and productivity, however, must not undermine safety and the need to continually improve service quality. From an organisational context we discussed the implementation of a new workplace culture after

Qantas was privatised in 1995. The ideal culture was one which encouraged employees to take ownership of their performance.

Several initiatives were put in place to encourage this behaviour. One such initiative was employee share ownership schemes. In our submission we highlight our gradual progression from a simple bonus share scheme to one that requires prespecified performance benchmarks to be met for the financial year before shares can be granted. Such a scheme is in line with the company's desire to encourage employees to take ownership of their own performance.

The second area of discussion in our submission is the performance of Qantas since privatisation. To cite some of the key Qantas performance results, operating profit before tax and abnormals increased by 49 per cent and productivity by 13 per cent between 1995 and 1998. Furthermore, Qantas recorded the highest total shareholder return compared to other major international airlines since the privatisation. Our employees, who received shares under every single employee share scheme offered to date, saw their total returns hit 110 per cent this year.

In our submission we left out statements which measured the impact of employee share ownership schemes on the performance of the company. As much as we would like to establish this, it is difficult to isolate the effect of employee share ownership schemes relevant to other initiatives which were implemented at the time. Based on anecdotal evidence from employees, however, the schemes are perceived as a significant direct benefit. Such an outlook, coupled with internal communications aimed towards educating them to become share owners, leads us to believe that our employees are exposed to the interest of our external shareholders.

The third area of discussion in our submission focuses on the factors we must consider when implementing employee share ownership schemes. From an aviation specific context we discussed the implementation and success of employee share ownership schemes in other major airlines around the world. From an Australian context we discussed the issues which may affect the uptake rate of employee share ownership schemes by Australian companies. In particular we describe our experience with the widely drafted dividend streaming prohibition.

In order to encourage Australian companies to take up employee share ownership schemes we recommend an investigation into possible grey areas in the taxation legislation which may be perceived as a risk in implementing such schemes. As I said earlier, in addition we refer to the Year 2000 and UK Finance Bills as a further avenue in encouraging the uptake of employee share ownership schemes.

In conclusion, we would like to reinforce our support for employee share ownership schemes. Accordingly, we have dedicated a large proportion of our submission to inform the committee on the importance of such schemes to Qantas. In addition, we have suggested ways which may assist the uptake rate of employee share ownership schemes by other Australian companies. If you agree, I would like to hand over to Grant Wardell-Johnson who would like to address the ATO response to our submission as well, before we go into discussions.

Mr Wardell-Johnson—I would like to address some comments made by Mr Michael O'Neill at the hearing on 10 June in relation to the dividend streaming issue. I would like to preface those comments with two: one is that Qantas is a fairly conservative company in terms of taxation, so to the extent that there is a grey area it likes to go to the commissioner and seek clarification to get a private binding ruling in respect of that. The other comment I would like to make is that Qantas has a very good relationship with the ATO, and in fact Michael d'Ascenzo who spoke at your hearing has assisted Qantas in a number of complex issues. Also, the branch at which we deal with the ATO is very helpful in particular matters. We have differences of opinion and we have a difference of opinion in relation to this particular issue which we think is important.

In respect to the February issue of shares which was on 5 February, we sought a private binding ruling from the commissioner in respect of a number of issues. One of those issues concerned a series of anti-avoidance provisions in relation to dividend streaming. The basic purpose of those provisions is to stop people streaming benefits to one set of shareholders—so one set of shareholders gets, if you like, capital where the other set of shareholders gets dividends. These provisions are very widely drafted. What we wanted to do was to gain certainty that the commissioner would not apply these provisions in respect of our employee share acquisition scheme.

They considered the matter in Canberra and said, 'We can give you that if you give us a tax analysis of all your employees and all your shareholders,' which was clearly impossible for us to do. In the absence of that they were willing to say that they did not intend to make a determination against us in respect of this issue provided the circumstances would not change, but they were not willing to be bound by that. From a Qantas perspective they have the power to actually issue a private binding ruling.

In the 10 June hearings there might have been a suggestion that we were asking for a ruling in respect of the 30,000 employees or the shareholders. We were not. We were asking for a ruling only in respect of how it impacted Qantas. We believe they have the power to issue that ruling. They might want to actually make particular assumptions, if they cared to, in respect of Qantas's motivations or in respect of the tax position of the shareholders or the employees, if they choose to do so. They have the power to make those assumptions. But to the extent that they have to make any assumption they also have the power to actually decline to give a ruling and that is what they chose to do in this particular circumstance.

So from a Qantas perspective we would like to see certainty. We do not see that there should be any feasible application of these dividend streaming rules to the normal employee share acquisition scheme. From their point of view they are saying, 'We have the power not to give you a ruling,' and they choose not to give us a ruling in that regard. Whilst that is an issue we have mentioned in our submission, I want to highlight the fact that it is not the main game. The main game is really weighing up the benefits that can be derived from an increased taxation threshold under division 13A, against the cost of that, and we think those benefits are very significant.

CHAIR—Thanks very much. I realise your job is to represent the Qantas interests, but I see recently that Ansett employees are trying to develop an employee share ownership

program. I suppose in one sense, from your point of view, you would see that as justification for the program you are running yourself.

Mr Gregg—Their scheme, from what I have read, is slightly different. They are trying to encourage that a significant proportion of the shareholding of the company be held by employees to offset some of the ownership that is privately held between News Corp and Air New Zealand, but it certainly reinforces what we have been saying: ownership of the company in the hands of the work force is a beneficial thing to encourage. We have seen that in a number of airlines around the world, United Airlines being, I guess, the leading example of that.

CHAIR—You have spoken about dividend streaming and problems with that. What about capital gains tax? Do you have a view about any changes that ought to be considered or not considered there as far as employee share ownership programs go?

Mr Wardell-Johnson—I know there would be certain submissions that would say you could possibly fix certain tax anomalies using the capital gains tax provisions. I think they open up a whole new discussion in terms of capital gains tax. Possibly what I should do is get back to you to the extent that we do form a view in respect of it, but that has not been part of our submission to date.

CHAIR—Does your program run through a trust?

Mr Johnson—No, it does not.

CHAIR—Lend Lease, who were here earlier today, run through a trust structure and they think it is marvellous. Anyway, they have spoken to us strongly in support of that. Can you explain what your arrangements are and why you have not gone into a trust?

Mr Johnson—I am not sure what the Lend Lease arrangements are, but Qantas looked at how to structure the arrangement to achieve the goal, which was to ensure employee participation as shareholders, and the decision was made to issue bonus shares. The way ours is structured is today, once the company hits certain performance benchmarks set by the board, the employees are entitled to receive a bonus share. In the past we had to actually buy one share for each employee in order to be able to issue the bonus shares but, with the recent changes to the Corporations Law, the directors have the ability to issue bonus shares to employees regardless of whether they are existing shareholders.

From a simplicity perspective, what it means is that at the end of each period the board can determine whether their benchmarks have been met. At that point the employees are issued the shares. In the last grant, it was $1,000 worth of shares. The employees then own those shares, with the only limitation that they cannot sell them for the three years of the lock-up period. It is simple. It is very easy to explain to employees and they feel like they own them. They receive the dividends directly and they get the benefits of the imputation credits directly.

Mr Gregg—The only thing that I can think of with trusts is that it might make it easier for the employees to dispose of their shares. The trust might actually dispose of the shares

for the employees so they do not have to go through a series of brokers. Individual employees might have to find someone to buy and sell their shares for them.

Mr SAWFORD—It seems to me that a lot of the companies who are very favourably disposed towards employee share ownership have gone through very significant organisational structures, significant downsizing. In terms of Qantas taking on employee share ownership, how important are the industrial relations and the relationship between employees? Is the be-all and end-all just to lock them in? What is the rationale?

Mr Gregg—It was a combination of things. At the time of the privatisation when the government chose to dispose of its asset, it also wanted to send a signal to the work force there, as it did in other privatisations, that they could have access into some shares. The management and the board of Qantas also wanted to encourage the employees to be involved in the growth and the change that was about to occur in the company. The company had been through some significant change in the previous couple of years as well, so it was a combination of events to actually bring the work force along with you in a time of significant cultural change.

Mr SAWFORD—It was also fortuitous perhaps that it was in a time when the stock market was booming.

Mr Gregg—Definitely, if you look at the Qantas share price between the time it was floated and now. If this time last year you had asked me that question, I think the employees probably would not have had a huge return on their shares because the share price performance has only really taken off strongly in the last 12 months or so. The strength of the stock market certainly has been of some help, but the performance of the company has to warrant an increase in the share price as well. If we had not performed strongly as a company, I do not believe the share price would have taken off either.

Mr SAWFORD—Has Qantas given any consideration to perhaps at some time—hopefully a long time down the track, when perhaps the share market is not as propitious as it is at the moment—where you are anticipating a fall; what impact will that have on employees?

Mr Gregg—We take the view that, as long as the company continues to perform, the market should continue to reward the performance of the company and that should be through an increasing share price. If the company's price is overvalued—and the analysis that we have done and we have seen others do would indicate that it is not—you should continue to be able to get a return out of the share price while the profitability of the company continues to improve. If something happened and the share price did collapse, would we continue to reward staff with that? I believe in the current environment we would, as long as the staff were performing.

Mr Johnson—Provided the shareholders receive the benefit as well.

Mr SAWFORD—How important is salary sacrifice to the employee share ownership plans at Qantas?

Mr Gregg—Up to date it has not been significant, but I believe as we go forward it will be a bigger part of our enterprise bargaining arrangements as we try to couple more closely the performance of the company to the performance of individual staff members and reward them that way.

Mr SAWFORD—Do you anticipate any downside to that among your employees?

Mr Gregg—It will be a case by case negotiation. We certainly have not seen that to date. We have traded off certain things with employees and it becomes a lifestyle issue for a number of employees over a long period of time. I cannot predict what it will be like in the future, but certainly if it is done in conjunction with the employees' wishes it should be okay. That is what we have tried to do with nearly everything Qantas negotiates with the employees through the enterprise bargaining arrangements.

Mr SAWFORD—Perhaps one last question. It seems that the Qantas scheme is almost like a savings mechanism in terms of your employees. Has it had any impact on other aspects of savings, like superannuation, with your employees?

Mr Gregg—No.

Mr SAWFORD—None at all?

Mr Gregg—No. The great majority of superannuation at Qantas is either a defined benefit or an accumulation plan, as you would expect. The major part of the work force is a defined benefit scheme where you put in a proportion of your salary, the company matches it and you define what they get. Other parts of the work force, like the pilot work force and some of the executives, have an accumulation scheme, so you have the choice of putting more or less in as you wish as well. It really has not affected that to date, though I would say that we would probably like to make our employee share ownership scheme more extensive over time as the work force develops.

Mr Johnson—One of the questions you asked earlier was what we are trying to achieve. One of the major goals is also to link the employee interests with that of the shareholders, because, do not forget, prior to 1995 Qantas was not listed and most of the employees were long-term Qantas employees who had never worked for a public company, so they had to understand there was a major cultural change required in order to focus them on return to shareholders prior to return to employees.

Mr SAWFORD—In relation to organisational changes, whatever they be, whether it be employee share ownership or whatever, because the people who own the scheme or introduce the scheme believe in the scheme, it will always have a short-term positive impact. All organisational structures do that. I do not want to start naming them, but there are some organisations in this country that have had cyclical restructuring over the last 20 years. Some people in those organisations would argue that, yes, there was a significant improvement after the introduction of the scheme and then it went back to perhaps a more conservative evening-out level, then there was a dip, and that that perhaps institutes among management a need for another organisational structure. There are significant companies in this country, particularly in those areas where this is attractive—finance, retail, mining—who have had

significant restructures all the way along. I suppose only time will tell with Qantas because you are really just a beginner at this.

Ms GAMBARO—At page 12 of your submission, where you have the stock market performance, you then have figure 7 where you compare the airline return, float July 1995 to 14 May 1999—I think you collected the data in air by class, by routes. What was the main methodology there? Did you survey customers?

Mr Gregg—This is a total shareholder return measure. Total shareholder returns are measured by dividend plus capital appreciation. It is a calculation of the return over that period of time indexed against what other airlines have achieved in their own stock markets.

Ms GAMBARO—I saw that but when you go into the other section, other performance indicators—

Mr Gregg—Other performance, yes.

Ms GAMBARO—that is related to the stock but then other performance indicators were also married in as well. It does not relate to that graph. What methodology did you use?

Mr Gregg—A typical survey.

Ms GAMBARO—Across the board.

Mr Gregg—Yes.

Ms GILLARD—I want to make sure I understand the tax issues you are raising. I have to confess I do not know much about dividend streaming. It is a gap in my education. What vice is the antiavoidance provision directed at?

Mr Wardell-Johnson—There are a number of different provisions: sections 45, 45A, 45B, 160AQCB and 177E. They all have slightly different thrusts but the general thrust is to try to prevent companies streaming either capital or one set of dividends to one set of shareholders that can use the capital or the dividends in a 'tax-preferential' manner. That is, capital is not taxed in their hands, whereas dividends are received by other shareholders who can use the franking credits associated with the dividends. You are streaming one set of gains to one set of shareholders and another set of gains to another set of shareholders.

Ms GILLARD—Depending on what would advantage their tax positions.

Mr Wardell-Johnson—They have different tax implications according to who they are.

Ms GILLARD—What is it about an employee share issue which would raise in the ATO's mind the possibility of dividend streaming?

Mr Wardell-Johnson—The fact that you are issuing shares to only one group of shareholders, the employees.

Ms GILLARD—I understand that now.

Mr Wardell-Johnson—I think there is clearly no policy intent for these provisions to apply.

Ms GILLARD—Yes, it stands out because you are allocating to one class of shareholders. That makes sense. In terms of the general tax issues you raise, you refer to the UK experience. You talk about increasing the current employee exemption concession and company income tax deduction levels. If you had the ability tomorrow to make changes to the tax laws, what changes precisely would you make to facilitate employee share ownership plans in the way you believe they should be facilitated?

Mr Wardell-Johnson—The first thing I would do is raise the threshold, which is currently $1,000, to something significantly more substantial—whether that be $7,000, which would be in some sense in line with the UK provisions but still less concessionary than the UK provisions, because I think they have three sets of allocatable shares or a greater amount. That would be the major thrust of what I would do.

Mr SAWFORD—One of the things we asked members of the department—who were here prior to you—was what information they had in terms of the UK, where there is a much more significant rate of employee share ownership. I think it is 15 per cent. What the department could not answer, which makes it far more relevant, is how many of these people with employee share ownership in the UK do not have access to super. In other words, it is a savings mechanism for their retirement. But the department was not able to give us that information. That becomes a little bit more crucial because this is a savings mechanism. We need to know how many of those employees in the UK have access to super and in what form.

Mr Wardell-Johnson—They might be starting off with a different base. I think the UK government has looked at it very seriously and concluded that this is something that can change the work culture in the UK and have gone for it in a very significant way, because £3,000 in terms of the free shares is not a small amount. They are thinking this is a really significant thing for the future.

Mr SAWFORD—So rather than a savings issue it is a cultural issue.

Mr Wardell-Johnson—Yes. There might be a different base. I recognise what you are saying.

Mr SAWFORD—The superannuation base in Singapore could be regarded as a cultural issue, too. Whether it is super or whether it is employee ownership, it is a savings mechanism. Each has their own value but if they are both strongly present you need to know what they are and how they are balanced. I would think in terms of your arguments towards this you need to provide the data to show what is the situation with super or other savings mechanisms in terms of that, which we have been unable to find out at this stage. We do not know either

Mr WILKIE—You have said you have been able, through enterprise bargaining, to offer lower wage increases as a result of using share ownership as an incentive to employees. How did you ensure that the employees were not disadvantaged by accepting lower increases as opposed to going for shares? You touched on it before but I am a bit concerned that a lot of share ownership schemes are there to get people more interested and involved in the company, whereas it appears here it is also being used to lower wages.

Mr Gregg—I do not think it is there to lower wages. It is a choice between awarding salary increases through a straight salary increase or through a mechanism that might actually provide greater than the base salary increase. To encourage staff to be more committed towards the company and to work towards delivering that return is a positive both for the company and for the shareholders involved. Rather than look at it as a mechanism with which we are trying to trade off returns to the staff, we are actually trying to improve their return by making sure the other stakeholders in the company get a return as well.

Mr WILKIE—How did you do that? Did you do it on a dollar for dollar basis? We have heard how some companies have offered twice the value in dollar terms of shares than what they would have received as a salary increase. This has been an incentive for them to take up the share offer. Have you done anything like that?

Mr Gregg—I do not have the exact detail with me. We probably need to come back to you on that. My recollection of the matter is that enterprise arrangements in the marketplace at the time are typically what a company has to negotiate in any case. We were trying to achieve greater productivity benefits from our work force in other areas. While we gave them the base EBA increase we traded off things like 'Will you allow more part-time employees? As an offset against that will you take a share bonus scheme or a share employees scheme as an offset to the membership of the unions?'

Mr Johnson—I think that is right. The base EBA increase was not out of line with the expectation. It was give and take.

CHAIR—What is the attitude of the unions in your work force towards the employee share ownership plan you are running?

Mr Johnson—They are quite supportive today.

Mr Gregg—It is 80 per cent.

Mr Johnson—With a 99 plus per cent participation.

CHAIR—Is that participation spread evenly throughout the work force?

Mr Johnson—It is open to all employees. Every employee of Qantas is offered the opportunity to participate in this.

CHAIR—So from Mr Strong to—

Mr Johnson—From Mr Strong down.

CHAIR—The ownership is not concentrated in certain pockets of the work force?

Mr Johnson—No.

Mr WILKIE—There is no executive plan?

Mr Johnson—No, there is not.

CHAIR—So the guy or woman who is handling the bags has the same options as Mr Strong.

Mr Johnson—Absolutely. They have the same participation in our employee share scheme as executive directors.

CHAIR—Cathay are obviously going through this problem—I know you are well aware of it—the loss of profit for the first time in 35 years. With respect to these negotiations with the pilots, do they not have an employee share ownership plan? I know you would not agree with the concept that they are in crisis mode but they are trying to readjust the way they run their company. So in their case, is the employee share ownership offer a new concept for them?

Mr Gregg—I honestly could not speak for Cathay. My understanding is that they paid over the odds for staff to move to Hong Kong some years ago when it was very difficult to get technical crews. Those salaries are now up for renegotiation. With the diminution of their earning stream they have to look for savings and that was certainly one area where, on a global scale, staff were paid far in excess of most other technical crews around the world. So they looked for a mechanism in which they could try to readjust that.

Mr Johnson—Yes, my understanding is that it is a trade-off between the cash and the shares.

CHAIR—Yes. Throughout their company, though, do they run an employee share ownership program?

Mr Johnson—I do not know.

Mr Gregg—I am not aware.

CHAIR—I was going to ask you about the impact of the employee share ownership program on wage outcomes in Qantas. Have they been affected to any significant extent by the program?

Mr Gregg—I do not believe so. As per my comment before to Kim, if there is an enterprise bargaining arrangement, we go in there with what the market is really paying at the time and then we try to achieve some other productivity benefits for what we trade off on.

Mr Johnson—It is part of the negotiation process.

CHAIR—Of course, yes. So from your point of view, with dividend streaming, there needs to be some modification to tax arrangements specifically for employee share ownership programs. We need to increase the tax free threshold for companies that are involved in employee share ownership programs.

Mr Wardell-Johnson—I would put those in the other order and put the first one in last.

CHAIR—All right.

Mr Wardell-Johnson—And the tax threshold in bold.

Ms GILLARD—In terms of how share issues intercept with wages—if you did that—because of the tax advantage of shares vis-a-vis cash wages, you are going to skew decisions, are you not? I am not necessarily saying that is a bad thing but if you change the tax laws so that you can receive up to $7,000 in shares and not pay tax on it, then that is clearly a more advantageous transaction for everybody except the tax man, compared to taking that $7,000 in cash salary. So you are changing the incentives.

Mr Wardell-Johnson—Yes, and there is a trade-off there for the other benefits, in my view—the employee share acquisition scheme would give productivity benefits and work-cultural benefits.

Ms GILLARD—In terms of the cost for revenue for the Commonwealth, that is almost impossible to estimate, isn't it, given that you would expect, if you created that tax climate, to see a big spread of employee share ownership plans and big take-up rates?

Mr Johnson—We have the GST now though, don't we?

Mr Wardell-Johnson—I do not know whether it is impossible to estimate but certainly there is the trade-off.

Ms GILLARD—Yes.

CHAIR—You have not done any estimates, for example, of what the tax expenditures would be in your company if the tax free threshold went to $7,000?

Mr Wardell-Johnson—No, we have not.

Mr Gregg—Most likely you would not reduce salaries on the way there. It would be a trade-off against future increases in salaries.

Mr Johnson—I do not believe Qantas would immediately go to $7,000 in any event. It would be negotiated over a period of time. We were at a $500 grant for the first four grants even when $1,000 was available under the tax act, because the feeling was that that was the appropriate level.

Ms GILLARD—So it goes against where tax policy has been heading in the sense that it has been heading down the track of saying, 'However you remunerate, you'll get caught in the same tax basket.' The whole reason for doing FBT was that you ended up with—

Mr Johnson—The same tax.

Ms GILLARD—people in different positions getting taxed differently because of the way in which they received their benefits. So there is a policy issue there from the Commonwealth point of view, isn't there, about creating—

Mr Wardell-Johnson—One difference there, though, is that FBT type benefits generally advantage the more highly paid employees.

Ms GILLARD—Yes, absolutely.

Mr Wardell-Johnson—This is for all employees.

Mr WILKIE—Because you negotiate shares instead of salary, what sort of advice do you offer employees then about the performance of the company and its projected performance into the future, so that they know they are making a sound investment if they decide to go down that path? In actual fact, they are trading one off against the other, so it is like buying the shares in a way, and you would normally get a prospectus if you were doing that with another company. What sort of performance information do they get?

Mr Gregg—Nothing more than what the outside market gets in terms of the performance of the company. That information that is generally available to the market is all that they will have.

Mr WILKIE—They would have to go and find that out?

Mr Johnson—No, they are all shareholders. We provide them all with the annual report, half-yearly reports. The share prices are reported to them on a weekly basis. As part of the actual Qantas style share plan they receive a lot of information about what is involved in being a shareholder and where they can obtain additional information. We try to provide them with a significant amount of information but, as Peter said, we are limited by what the law allows so we can only provide them with information which is provided publicly.

Mr WILKIE—I suppose where I am coming from is that while the share price is high they are obviously going to be getting a benefit, but if the share price is going to go down and they have no way of forecasting that, then they could end up disadvantaging themselves.

Mr Johnson—It depends to what extent there is a reduction in their salary due to negotiations. Our understanding, as we said earlier, was that the actual EBA increase was what was expected. It was the additional flexibility which was provided in return for the shares.

Mr Gregg—Share prices do move and they do move without any additional information about a company being made public. Typically, a share price is valued on the performance

of the company, so if the company is performing we are trying to reward stakeholders, including staff, for that performance. If the company does not perform, then all stakeholders will not get that reward. I understand your point about trading off a salary rise for that, but in today's world where you are trying to encourage your staff to take a greater interest in their company and the future of their company, this is one of the few mechanisms available to do that and to encourage them to look towards the future.

Mr Johnson—Share the risk with the other shareholders.

Mr Gregg—And the returns.

Mr Johnson—Don't forget that they are actually getting the shares with no cost base to them. I understand what you said but—

Ms GILLARD—What happens when a staff member exits Qantas and holds a parcel of shares as a result of that agreement?

Mr Johnson—We have a policy that they should continue to hold those shares for the trading lock period. So if an employee has the shares two years into a three-year trading lock, they still have to hold them for the additional 12 months.

Ms GILLARD—And outside the lock period?

Mr Johnson—They can sell them the same as any other Qantas shareholder can. In actual fact, our first trading lock period expires in June next year.

Mr WILKIE—So they are portable. In other words, they can claim those shares?

Mr Johnson—They are their shares. Once they are granted, the employee owns them. The only restriction is the trading lock, where the tax act requires a three-year trading lock in any event.

Mr WILKIE—You are happy with that?

Mr Johnson—The trading lock?

Mr WILKIE—Some people are suggesting that shares should not be portable—that once you leave, you sell them.

Mr Johnson—As a public or listed company, we are very comfortable with that.

Ms GILLARD—That is not a problem, even in circumstances where in your industry it is possible or probable that people would move from Qantas to a competitor?

Mr Johnson—No, not when you consider the little shareholding that they have. It is a little different if Ansett is not listed, then one could understand using Dr Nelson's example. You could understand why there might be a requirement that they sell their shares but, with a listed company, I do not think it is the same.

CHAIR—If, for example, the threshold went to $7,000, what proportion of Qantas capital would that represent? Would it exceed the set five per cent rule?

Mr Wardell-Johnson—I go back to Brett's comments—that is, I do not think there would be any direct intention to go up to that limit at that particular point in time.

Mr Johnson—Yes, a flexibility.

Mr Wardell-Johnson—It is just a flexibility to do that.

CHAIR—If the threshold was increased, would you still issue them all as bonus shares or would you think about changing?

Mr Wardell-Johnson—I think that has changed now, having regard to the change in capital or corporate law rules in respect of capital. We do not issue through a premium share mechanism. We just issue the bonus shares directly now.

Mr Johnson—Not issued directly but they are issued—yes.

Mr Wardell-Johnson—Not through share premiums.

Mr Johnson—No.

CHAIR—Thanks very much. I presume you will keep an eye on the course of the inquiry and if you see people make submissions—the ATO is obviously one you are across—or say anything with which you disagree or support or anything like that, please let us know. Whilst the issue is very complex, I suspect by the end of the inquiry there will be a number of simple recommendations that we will make. Thank you.

Proceedings suspended from 3.47 p.m. to 4.19 p.m.

CUPPER, Mr Leslie Gordon, Group General Manager of Human Resources, Commonwealth Banking Corporation

LIMMER, Mrs Carolyn Ann, Chief Manager, Executive Development and Recognition, Group Human Resources, Commonwealth Banking Corporation

CHAIR—Thank you very much for providing us with the submission and, most importantly, taking the time to come and speak to us about it and about the employee share ownership plan that you run. Perhaps you could give us a 10-minute overview and then we will have some dialogue.

Mr Cupper—Thank you. What I propose to do, Mr Chairman, is to give you a brief overview of the main schemes in the bank and some of the issues that we see coming out of that and perhaps some of the wider issues that government should be looking at. Our submission is deliberately brief. It is put in the context of a very strongly held view that the critical issue we face as a country, if we are going to tap the capability of the people who work with us, is to get a very direct line of sight between customer needs, our employees' behaviour and shareholder return. That trilogy goes to the core of growth, not just from a company perspective but also from a national perspective.

The reason we are so strong on that and the reason that provides the framework for our thinking about equity participation by employees in various forms is that our customers, our employees and our shareholders share two things in common: one is choice and the other is a quest for value. When you think about that in today's world and particularly in the finance sector, we are all experiencing the question of choice. Customers do not have to come to the Commonwealth Bank to do their business. They have an increasing variety of choice. To get them to come to our bank, they have to have some value proposition which is more attractive than that offered somewhere else.

Employees, despite a high level of unemployment, have a choice as to where they spend their time and, in fact, how they work when they are at work. That is a very critical part of the equation and, obviously, shareholders have a choice as to where they spend their money. So our formula, our way of thinking, going forward and behind a lot of the changes that are occurring within the bank and in other corporations, is that if we can align customer need and employee behaviour and understanding of that customer need and differentiating us as an employer from other potential employers, we believe we will be able to attract and retain a higher calibre group of staff and, in turn, be able to produce better customer propositions than our competitors.

If we do those two things, the first two legs of the trifecta, then shareholder value often looks after itself. It is in that context that we see share schemes as being one of a number of ways of aligning the interests of employees, shareholders and customers. We would say, on the basis of our experience and personal experience in other corporations, that of itself share schemes are a necessary but not sufficient condition to make that alignment. It has to be consistent in design and application with other performance feedback and review systems which are also designed to try and align effort with output and, hopefully, link to customer behaviour and preference.

We do not shy away from the fact that the primary onus for the design and implementation and carriage of share schemes and equity participation rests with the employer and the shareholder body, because often you are asking shareholders to dilute their capital in return for some expected benefit over a longer period of time. That is the primary onus. But, clearly, the extent to which the legislator is able to provide an enabling framework to be a catalyst to encourage the introduction and maintenance of these types of arrangements we see as a national benefit.

I think it is also very important, in a world where we are often confused by the attraction of short-term gain, to have legislative frameworks in place that actually recognise the need for medium- and long-term benefits. A lot of these programs are not quick fixes. They are about building wealth over time; they are about building a commitment, an alignment of employees' interests and customers' interests over a longer period of time, not by the results of any one quarter or six-month period. I say that also because I am of the view that everyone looks for ways of raising revenue, additional ways when the pressure is on in terms of budgetary pressure, and it may well be tempting to tax or to impost these types of schemes in one way or another from a short-term perspective. I think it is very important that government, in looking at the future direction of how they can support share schemes, certainly look to the medium- and long-term sustainability of these arrangements.

Quickly, in terms of the schemes that we have in place, we have given a very brief outline in our submission. We have applauded publicly the initiatives taken in 1995 to put some inducement and support through the taxation system towards, firstly, clarifying and, secondly, supporting companies to introduce and maintain employee share ownership programs. In 1996 we introduced Bankwide, a scheme whereby employees who were within the bank for two years or more could be awarded up to $1,000 worth of bank stock. We also introduced that for a three-year period only. We went to our shareholders seeking their support for three years so that we could have a look at it and over that period they could have a look at it to see whether in fact this was something they wished to continue to support.

Most of the features of that scheme are consistent with other general schemes applying in different companies. We also put a performance hurdle, or performance target into the general scheme. So, whilst the first year was a free grant, in the subsequent two years we had to achieve the greater of five per cent growth in annual profit or the CPI plus two per cent growth in annual profit, whichever was the larger. In the first year our staff collectively achieved that target; in the second year they just missed that target. We went back to the shareholders last year and they renewed the scheme for a further three years, such was their confidence in the behaviour that it was driving. We have in fact given the board more discretion in assessing the effort and contribution by staff against the target in the event that there are particular events that could be taken into account which otherwise may prevent staff from sharing in the combined rewards of the bank.

In excess of 75 per cent of our staff are shareholders in the bank under that scheme and those shares are vested for three years. In fact, for those who received the shares in 1996, there has been a 99 per cent appreciation in their value since that time. For those who received the shares in 1997, there has been a 40 per cent, to date, appreciation in the value of those shares. We have supplemented that general program by giving staff the opportunity

to acquire additional shares up to a maximum—it seems a small number—of 300 per year, but 300 at $24 or so a share is not an insignificant outlay of cash and they purchase those virtually on-market at a five per cent discount to the market price over the defined period. We have that window twice a year to a maximum of 300 shares.

Almost a million shares have been purchased by staff. These are not free shares. These are people buying into their own company in addition to what has already been provided to them and anything else they may do as individuals outside of work. Whilst there is only a two or three per cent take-up in those voluntary purchases, nonetheless in excess of 3,000 staff have chosen to purchase those shares as part of that framework. This is even though at one level it was only a five per cent discount. It is part of the culture of building wealth and equity.

We also have put in place an executive option program which is limited to 50 people who, in the view of the board, can have a considerable impact through their roles, skill and experience on shareholder value. That scheme is yet to materialise in terms of any delivery of vesting. It is spread over a three-year period and there are some very challenging performance hurdles put in place on the executive option program. Over that three-year period we have to basically outperform the relevant index, the banking and finance index, excluding the CBA's own growth in that index. As a condition we also require participants to own in their own right the prescribed number of shares. They actually have to buy into the scheme. We also have built into the price which they will pay, if we meet the hurdles, a premium to reflect the time value of money of the options they have been granted over that time. I think that is recognised in the market as one of the tougher hurdles around.

That is the point I really want to emphasise in terms of looking at the design features of the way the bank has gone about this. There is a very strong focus on the importance of performance hurdles. We recognise it is shareholder equity that we are dealing with. The fundamental principle is until the shareholder gets the benefit of our efforts first, employees come second. We are not about distributing shareholder wealth or diluting capital unless we have demonstrated through growth in the business that there is a sharing of genuine growth. This is unlike some schemes which basically are geared towards treating a limited number of people in a very favourable way.

In that context we would encourage the continuation of the legislative program that has been put in place. We have noted in our submission two examples which do give us concern, where the left hand and the right hand at federal and state levels may be going in opposite directions. We refer the committee to the Western Australian state government's decision, through its revenue and treasury departments, to charge payroll tax on the deemed employer contribution to employee share schemes. These are the same schemes that the federal regime is recognising with some form of incentive through the taxation system.

That issue is currently the subject of discussion between the bank and the Western Australian department of treasury and revenue. In our view it is very inconsistent to have the encouragement at a federal level and the deeming of payroll tax on the so-called employer contribution of the free shares. If shares are totally free, you are taxed the maximum payroll rate as if it is wages. When you put in performance hurdles and such things to try and get

this culture going, we are at a loss to understand why that state chooses to go that way. No other state is doing this.

The second issue does come back to the federal sphere. That goes to the way in which the current taxation provisions are framed in the treatment of options for people who are exiting the work force. I wanted to bring the committee's attention to this because, quite frankly, it is something we have only been able to get our minds around in very recent times. We have put a very strict performance hurdle into our schemes, so at any one time you are going to have people who have been awarded options but through normal retirement will not see the full distance of the three-year term.

The attitude we have adopted is if someone is there for two of the three years our board has said, 'Right, on either a full or a pro rata basis,' recognising their contribution, 'we will allow you to retain the options but you will only be able to exercise those options if and when the three-year performance hurdle is met. You maintain your right to hold the options in a relative proportion or the full entitlement. After you have gone, if the bank meets the performance hurdle, then you will be able to exercise those options. This is in recognition of your contribution towards that particular suite of options or that period of time.'

Unfortunately, one of the triggers as to when the tax liability will accrue is the cessation of employment. We have the situation where the tax liability is incurred by virtue of the person retiring. They are taxed in full on the perceived discount they are achieving between the price their option was issued at and the then market price. There is no guarantee that in fact they are going to get a revenue stream at some point in the future. Nor do they necessarily have a revenue stream in that tax year because they have not exercised the option. I suspect when this was introduced it was in a period in which performance hurdles and the encouragement of keeping people in a performance culture right to the end of their time with the organisation was not at the front of a lot of the design and thinking around the taxation system.

We think in those circumstances it can lead to some unfortunate behaviour. The individual gets the tax impost with no offsetting gain. If they are a participant in more than one tranche of options it is possible for them, in the year they leave, to be paying tax on options which have been allocated over two or three years. You could be talking of many thousands of dollars in tax with no revenue stream nor any guarantee that it will be realised. Our view is that it should be permissible to allow the deferral of the tax liability until the options are normally exercisable in line with meeting the performance criteria.

That is an issue which is emerging more now because of the effluxion of time since the legislation was brought in, the emphasis on three-, four- and five-year performance plans with people coming up to retirement and leaving the company during that period. I bring that to the committee's attention because whilst we are very supportive of the general philosophy and endeavour of governments over many years to try and encourage greater share and equity participation, this particular taxation principle lacks equity. In fact, it will demotivate companies from continuing to pursue share options for individuals who are approaching a likely cessation of employment; or it will encourage companies to grant the options at the point of cessation of employment ahead of the performance hurdles being met, which is not, in our view, a sensible outcome.

I have taken longer, Mr Chairman, than you suggested, but we are very positive, based on our own experience, as to the way in which share schemes of various sorts can drive behaviour positively. They have to be well designed, they have to have a performance component, in our view, because that is the thing that ties together customer preference, employee behaviour and shareholder return. And I come back to where I started—that is, the line of sight towards which we would be very supportive of further encouragement.

CHAIR—Thank you. Mrs Limmer, do you have anything to add to that?

Mrs Limmer—No, I think Les has covered it pretty well.

CHAIR—First of all, I think you said 75 per cent of Commonwealth Bank employees are involved in a share plan. Is that spread evenly across the work force?

Mr Cupper—Yes, it is.

Mrs Limmer—And part-time employees in the $1,000 share plan get the same number of shares as full-time employees.

Mr Cupper—On a full allocation.

Mrs Limmer—Full allocation, yes. Everybody gets the same number. If it is 40 shares, part-time employees and full-time employees get 40 shares and all levels in the organisation participate.

CHAIR—Have you made any attempt to quantify the benefits of the share plan to the bank? It is hard, because a part of it can depend on the behaviour—

Mr Cupper—We could sit here and say that since 1996 when the first shares were issued at around $11, the share price has gone as high as $28. We have had record profits year after year. We could make all those sorts of claims, but the critical issue is the causality between the presence of the share scheme and that type of outcome. We all know that it is a multifaceted equation. I made the comment before that when you have a work force conscious of share ownership, talking about share ownership, you are certainly either heading positively or, indeed, heading south—and I have been in organisations where people have had a look at their behaviour because of the way the share price has been heading and they had a stake in it.

It provides you with a very tangible way of focusing attention, in the same way that you are able to design your performance management systems in a way which links effort and output and reward. If the share scheme was the only thing that did that, then I think it would be seen as optional and ancillary. If it is tied together as part of a general reward and recognition system, then I think it does perform part of the momentum that you get in any organisation—going forward. But to actually de-mark it and say it is worth X or Y on the bottom line would be an act of faith.

Mr SAWFORD—In terms of your executive plan, can you give us some generalised examples of performance hurdles?

Mr Cupper—We have the same performance hurdle in the executive option plan for everybody. What we are talking about here is the use of executive option as a long-term incentive. We do not try and confuse short-term performance bonuses which are more cash based where, over a 12-month period, you have a specific set of tasks and you are judged against those tasks in relation to short-term cash bonus potential. I know some companies will use shares as part of that short-term perspective. What we are looking for, particularly at the more senior levels in the organisation, is the time frame of the decision. The likely impact of decisions that you take in more senior roles often traverses two, three, four or five years; therefore, you are looking at the calibre of the decisions being made over time and trying to recognise how that impacts on the growth of the company over time.

We see these, essentially, as part of a medium to longer term recognition system. In that case, as an investor looking at where they put their money, we believe that the test should be that our shareholders in terms of their total shareholder return, both in value and dividend, should get a greater return than other competitors that we have and where they can invest their money. So the index of performance is a relative index. We have to be the best or outperforming that particular basket of companies who are identified as our major competitors and the choice that our shareholders have of where they can invest.

That is the only—when I say ‘only’, it is very significant—hurdle that we put up. We have to outperform that index and that excludes, as I said before, our performance in that index. In a crude sense, we have to be up there and outperforming the NABs and others if we are to demonstrate to our shareholders that they are getting the best return, or amongst the very top return, having regard to where they could have been putting their money over that three years.

Mr SAWFORD—In terms of some of these performance hurdles, would the salary bill be reduced?

Mr Cupper—They would not be share scheme hurdles. They would be short-term business plan hurdles. If we were saying that we did not wish to increase in real terms our costs over the coming period, then that would be factored in and broken down, at various levels right through the organisation, by division, by teams within divisions, as to how they met their particular targets. Whilst that will impact on the bottom line directly in the short term, indirectly it may feed into the analysts’ perception of how you are travelling as a company, your ability to control costs, your ability to have new initiatives and grow the business, and that might be factored into the share price. You would hope the two things are tied together.

But the actual performance targets of the option scheme are the relative performance of the index and how we sit in that index. Clearly, in terms of the ESAP program, the one which we review annually and the possibility of $1,000 worth of Com. Bank stock, that is on growing profit year on year by a defined target or better. Obviously, all of those short-term management goals and team goals and individual goals will factor their way through as to whether we achieve that or not and will impact on whether they access the free shares. So the two things come together in that way.

Mr WILKIE—I would be interested in talking to you about the tax stuff later on, because I am a member of parliament from WA and I would like to follow that up on their behalf. You are actually operating a scheme where people buy in, so you are not negotiating wages based on people's involvement in the share scheme. You are doing it as part of the productivity increases?

Mr Cupper—No. Let me go back. We had no negotiation with our employees or unions with regard to the introduction of the employee share scheme. We believed that was a matter between the board and the shareholders because it is the shareholders who have to vote and say whether they want to see any dilution or sharing of the stock base. These are not negotiated instruments in that way. The board has set parameters within the rules approved by the shareholders.

We have not tried to put this into a collective enterprise bargaining framework where shares become a currency to be tossed around between representatives of employees and management, when in fact they are the province of the shareholders rather than someone acting generously on their behalf deciding who should be getting what.

Mr WILKIE—That is good.

CHAIR—Are there any tax problems for your overseas employees in terms of becoming a part of the plan?

Mrs Limmer—Yes, we do not have a lot of overseas employees. We have a couple of hundred but essentially, because of the small number, we have not actually involved them in the plans to date. Because of the complexities in terms of meeting various tax and securities legislation in each of the countries where we have our representative officers, to go through and actually get those sorts of approvals would be difficult. The $1,000 free grant arrangements do not apply in those other countries, of course.

Ms GILLARD—Do you have a view about the sufficiency of the $1,000 cut-off threshold? Other submitters have put to us different views about that.

Mr Cupper—When the stock was $10, it seemed more generous than it is when it is $25. That is, probably close to 100 shares seems better than 40 in terms of what that really translates into. So in a symbolic sense as well as a real sense it is still $1,000, but success sometimes works against you in terms of the positioning. I should say that a critical part of our experience to date has been the need to be constantly putting the symbolism and the reinforcement of the share ownership process before staff so that you can build on that. I sense that number, as a maximum for the benefits of the tax provision, could be considered, reviewed, with some more flexibility than there is at the moment. Obviously, our scheme says 'up to $1,000'. When we have allocated, we have allocated at the maximum.

Mr SAWFORD—Japan does not have any tax incentives, does it, for employee share ownership? You mentioned there were some countries that do not have tax incentives.

Mrs Limmer—Yes, they are all different. That is where the complexity is, and if you have, as in our case, 200 staff spread in different countries around the world, just in terms of

meeting whatever those legislative requirements are, it is just not worth going through all the legal complexities, essentially.

Mr Cupper—What you do in those circumstances is that you will look at either a cash long-term incentive process or some other form of recognition. To the extent that we get caught up in complexity and the sorts of tax issues that we have raised, that is going to encourage more phantom or shadow share schemes than real ones. So you will use the share price as an indicator of progress or growth but may not have to go through shareholder and other approval processes to mirror or track that growth.

Mr SAWFORD—Is that an argument for no tax incentive at all—tongue in cheek, of course?

Mr Cupper—I suppose you can get to a point where you have penetration and ownership where this sort of behaviour becomes a way of doing business. There would be a point where you would want to be reviewing that. At this stage, despite what we would see as the benefits, it is still an encouragement and facilitation phase. I think there is a place for some support along the taxation lines that are currently in place in terms of positioning.

Mr SAWFORD—There are various figures in terms of the share ownership and the number of people in the working population that have shares. What if 60 per cent of the population had shares in Australia—which is an incredibly high figure which may never be achieved? In that circumstance, would that go back to a point where you would not need any tax incentives? We have a very complicated tax system.

Mrs Limmer—Yes.

Mr SAWFORD—There is a need to simplify it. There are lots of ways of simplifying it: just get rid of all the deductions which means you have to do something else in terms of the tax rates paid and all the other things. There are ways you can simplify, if you have the will.

Mrs Limmer—So one thing is genuine encouragement of share ownership and then, in terms of employee share ownership, that is sometimes another issue, isn't it?

Mr Cupper—You can make the argument that if the benefits are there, then they should be fulfilling to customers and shareholders and employees in their own right. There have been, since the privatisation, some successful floats. There probably has been a change in the general community appetite for share ownership and more people getting closer to it. We see the impact of technology and direct access through the Nets and other things rather than going through the halls of the stockbrokers and some of the traditions and, again, symbolism of people saying, 'That's not for me.' You can make that line of argument. It is a question of readiness and when you wish to turn that tap off and another tap on in terms of whether it is becoming self-sustainable. I do not think as a country we are at that point yet where it is actually embedded and has become self-generating in terms of everyone looking after themselves. But the argument is there; I do not dispute that.

Mr SAWFORD—The previous group were arguing or putting forward a view that maybe the UK example of £3,000, I think in the year 2000 tax threshold, which is about

$7,000, would not be a bad idea for the government to consider. What would be your view on that?

Mr Cupper—Sorry, the $7,000 would be a threshold for—

Mrs Limmer—Concession.

Mr SAWFORD—Yes, the concession

Mr Cupper—For any type or just employee share ownership?

Mr SAWFORD—Employee share ownership.

Mr Cupper—To be truthful, I really have not given that consideration.

Mr SAWFORD—So the Commonwealth Bank is not arguing for increasing the threshold for employee share ownership?

Mr Cupper—The question raised before was whether we saw it at $1,000. I was taking that to be the particular scheme which does not include options and those sorts of things. A point I should have made before, for example, was that people who participate in our option program are ineligible to participate in free grants of shares or other things. It is not as if they can get in at all levels. I am happy to take it on notice and give it more thought.

Mr SAWFORD—We would be interested in your view.

Mr Cupper—A view around that issue and come back via the appropriate channel.

Mrs Limmer—Les was talking before about how the share price has gone up. In the 1996 issue people got 83 shares. If we had an issue today, that would be 40 shares. So the leverage has changed significantly.

Mr Cupper—The perception and things like that.

CHAIR—Thank you very much for your time and for providing us with the submission. As you follow the inquiry, if you feel there is anything else you would like to put forward or if you take exception to what someone else has said or anything like that, please let us know.

Mr Cupper—It is on the Net. We cannot put it on Share Direct yet.

CHAIR—Thank you for that.

Resolved (on motion by **Mr Sawford**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at the public hearing this day.

CHAIR—That is the end of the hearing. I thank all members, colleagues, staff, Hansard officers and, of course, those in the gallery, which reflects the level of interest there is in the inquiry.

Committee adjourned at 4.58 p.m.