2

ESOPs antipodean fables: nature and rationale

Introduction

2.1 Employee share plans have operated in Australia since the 1950s[1], and under specially enacted legislation since 1974.[2] They have enjoyed bipartisan support.

2.2 The history of employee share plans in Australia has two facets:

- Their evolving significance in business, where they undergo constant modification in response to global pressures being experienced by business and in response to the contemporary business management practice as well as changes in the taxation and corporations law;[3] and
- The gradual evolution of the legislative arrangements. Legislative changes have attempted to foster employee share plans and participation in them while at the same time limiting their use as vehicles for aggressive tax planning.

2.3 As will be revealed in this chapter, business uses employee share plans for a range of purposes, while the legislation enacted by Parliament is focused on one only. This has led, as will be seen in Chapters 3, 4 and 5, to employee share plans failing to spread amongst general employees in

---

1 RPC, *The Employee Share Handbook*, Exhibit no. 49, p. 6. The Committee was also told about two employee share schemes operating in the 1960s, with varying levels of success. In 1966 IBM Australia was operating a scheme; see P J Murray, submission no. 1. Similarly, in 1966, Ajax Fasteners in Richmond, Victoria operated a scheme; see P A Taig, submission no. 2.

2 Section 26AAC of the *Income Tax Assessment Act 1936*, enacted by *Income Tax Assessment Act (No. 2) 1974*.

3 These latter two points are specifically noted by Mr Richard Stradwick as a conclusion of his survey into employee share schemes in Australia. See submission no. 25.1, p. 3.

small, medium and unlisted enterprises as widely as hoped. Moreover, employee share plans have not commonly been used for purposes that promote other economically and socially important goals, such as to facilitate employee buyouts, to increase national savings, and to foster the development of small, medium and sunrise enterprises.

2.4 In order that employee share plans both foster economic development and provide clear social benefits, business practice and public policy must be harmonised.

2.5 In this chapter the history and rationale of employee share plans in Australia is examined. A number of conclusions are drawn about the way that employee share plans should be viewed when public policy is framed. As well, the nature and extent of employee share plans are examined, as is their potential as important elements in economic and social policy. The conclusions reached in this chapter will be the basis for the analysis and recommendations made in Chapters 3, 4 and 5.

Employee share plans in Australia

2.6 The purpose of this section is to review the nature, history and purpose of employee share plans in Australia and the extent of their use. Before doing that, it is important to set out the focus of the inquiry.

'Employee share plans' a misnomer

2.7 Throughout the inquiry, the expression, 'employee share plan' was used in many submissions and by many witnesses. This seemed to connote a single type of arrangement by which equities in a person's employing enterprise are provided on favourable terms to that person as an employee.

2.8 This expression, however, disguises an important distinction. Employee share plans are of two types, each reflecting its underlying rationale. Plans aimed at general employees are intended to align the interests of employees and employers and provide bonus income; plans aimed at executives also serve as vehicles for tax effective remuneration. As noted in academic analyses on employee share plans in Australia,

> There is no single model which adequately described all ESOPs but ESOPs generally fall into two broad categories. One category

provides benefits to executives while the other is aimed at general employees.[4]

2.9 An example of a commitment to offering employee share plans for specific purposes but aimed at general employees, is provided by Qantas. Since 1995, Qantas has offered general employees who meet certain eligibility requirements participation in successive share plans. These plans, however, are not designed merely to provide a bonus to employees, but rather as important elements in the company's strategy to increase profitability and in its employment bargaining arrangements, workplace culture and remuneration policy. As Qantas advised the Committee:

> …the Qantas employee share ownership scheme is increasingly recognised as a significant part of the remuneration package. Over the past two EBAs, Qantas has been able to negotiate wage increases lower than the prevailing EBA wage outcomes for the industry through the inclusion of the Qantas employee share ownership scheme.
>
> Staff have come to understand that productivity improvement measures achieved through enterprise bargaining and other mechanisms such as competitive tendering result in increased profit, which is then distributed to staff through the employee share ownership scheme. Qantas, submission no. 35, p. 9.

2.10 The distinction between plans open to general employees and those open to executives only was also made by the Finance Sector Union, which advised the Committee not to confuse the two types of plan.[5]

2.11 Evidence from the business press, submissions, witnesses and exhibits indicates that executive plans are flourishing. For example, the Committee was advised that the size of allocations in executive plans is increasing and that these plans are being offered to more junior executives.[6]

2.12 Moreover, the difference between the two plans is also reflected in their performance. In a recent survey it was revealed that in the year from 1 April 1999 to 31 March 2000, executive share plans increased in value by some 124 per cent while non-executive employees experienced gains of 29 per cent.[7]

---

4 R Brown and C Wah Lau, 'The extent and industrial pattern of employee share ownership plans in Australia: preliminary evidence', *Accounting Research Journal*, 10 (1997), p. 34.

5 Submission no. 29.

6 Submission no. 51.

7 B Clegg and A Hepworth, 'Hightech employees rethink pay', *The Australian Financial Review*, 16 May, 2000, p. 26.

2.13 The Committee concludes that executive plans do not require additional assistance and will continue to grow if the recommendations of this report are fully adopted.

2.14 Plans designed for general employees are a different matter, however. As will be seen,[8] the current corporate law and taxation arrangements are inhibiting the spread of these plans and action is required. As a result, the distinction between the two types of plan should form the foundation for the development of public policy. As well, these observations clearly showed that the focus of this inquiry had to be on those plans that are designed for general employees, in small, medium, unlisted companies, and in the sunrise enterprise sector of the economy.

History

2.15 Employee share plans are not a recent development in Australian business; they have a history of over four decades in Australia. The development of, and support for, employee share plans by way of specific legislative initiatives began in 1974 when section 26AAC was added to the *Income Tax Assessment Act 1936* by the Whitlam Government. The ATO advised the Committee that:

> Section 26AAC … [was] … intended to encourage employees to acquire an interest in their employer company and to allow employees some control. Employees would benefit from the increase in the value of shares if the employer were a successful company.[9]

2.16 Successive governments, irrespective of political persuasion, have supported this initiative.[10] By the early 1990s, however, it had become clear that this section of the ITAA was being abused. It was being used not only to create employee share plans, but also to create plans specifically designed for aggressive tax planning by corporate taxpayers and high wealth individuals. The Commissioner for Taxation raised the matter with the then Treasurer at the time.

---

8 In Chapters 4 and 5.

9 ATO, submission no. 24, p. 6.

10 This was noted by Mr Connolly, the then member for Bradfield, in the 1995 debate over Division 13A of the ITAA. Mr Connolly said: 'The concept of employee share ownership in terms of taxation support in this country goes back about 17 years. I think it is fair to say that, when the concept was initially developed, it had bipartisan support. Both government and opposition accepted the clear advantages which were to be found in having a mechanism by which people would be encouraged to make contributions through their income—normally by salary sacrifice type techniques—towards investing in the company which was employing them.' House of Representatives, *Debates*, 22 June, 1995, pp. 2105.

2.17 A review of employee share plans was announced in the 1993 Budget. As a result of the review, the then Treasurer, the Hon Ralph Willis MP, announced in the 1994 Budget speech that the Keating government would introduce measures to increase employee participation in employee share schemes while at the same time implementing measures to prevent schemes being used for aggressive tax planning. The Budget contained three key initiatives designed to achieve these results:

- providing for the taxation of funding arrangements that were intended to provide equities to an employee in return for their services as an employee;
- providing for the discount off the market value of a share or right to be subject to fringe benefits tax unless the share or right met certain conditions in which case it would be exempt, up to certain limits;
- providing for shares or rights that met certain conditions to be exempt from fringe benefits tax in the following way:
  - ⇒ for qualifying equities that were subject to various restrictions, up to $1,500 of the discounted value of the equities would be exempt from fringe benefits tax. Tax could be deferred up to ten years;
  - ⇒ for qualifying equities, where there were no restrictions on the sale or disposal other than that the equities had to be held for five years before sale or disposal, up to $500 of the discounted value of the equities would be exempt from fringe benefits tax[11]

2.18 The measures subsequently became part of Schedule 6, Taxation Laws Amendment Bill (No. 4) 1994. The bill passed the House of Representatives but was amended in the Senate to omit Schedule 6.[12] The Government accepted this amendment and the amended bill passed the House of Representatives on 8 December, 1994.

2.19 A number of reasons were advanced by the then Opposition for opposing the introduction of Schedule 6.[13] The most important were:

- Imposing FBT on employee share plans in the manner proposed would inhibit the growth of national savings, leading to more people being dependent on government benefits in the future;
- Existing arrangements were generally capable of dealing with the exploitation of employee share plans by people who wished to avoid tax; and even where

11 The Hon Ralph Willis, 'Employee Share Acquisition Schemes – Revised Taxation Treatment', Press Release, 10 May, 1994, attachment.

12 *Journals of the Senate*, SJ 133, p. 2768.

13 House of Representatives, *Debates*, 15 November, 1994, p. 3265, and 17 November, 1994, pp. 3663, 3670, 3677, 3681.

they were not, simple amendments to s. 26AAC would obtain the desired result;

- The proposed changes would effectively destroy employee share plans by making them less attractive for employees and more expensive for employers – taxing companies for allocating shares to employees. In effect, the proposed legislation would tax unearned income or unrealised gains and tax the wrong person: the employer rather than the employee;
- There was no evidence of widespread abuse of employee share plans; and
- The proposal would extend the purpose of FBT well beyond its original intention to tax ‘unreasonable perks’.

2.20 The Keating Government made further attempts to regulate employee share plans and as a result, Division 13A of the ITAA was subsequently enacted by Parliament in 1995.[14] In Division 13A the underlying structure of the scheme rejected by the Senate in 1994 was retained. Three important differences were:

- There was no limit on the amount of discount that could be subject to the tax-deferred concession;
- Loans and other financing arrangements provided to an employee for the purpose of acquiring equities of any sort were free of FBT liability, except if the loan was forgiven;
- FBT did not unequivocally, ie by way of specific legislative provision, apply to arrangements that provided all benefits to employees by way of employee share schemes.

2.21 The then Opposition opposed Division 13A in both the House of Representatives and the Senate.[15] The Committee makes two observations:

- The attempt to regulate abusive practices in 1994 involved the extension of the FBT system in a way that was inappropriate. As noted at the time, there were simpler and more appropriate solutions;
- The rapid growth of the use of employee share plans for remuneration purposes, or the use of those plans in ways not approved of by Parliament, could not have been anticipated at the time. Had more information been available at the time, a different conclusion could have been reached. This underscores a point made later in this report and for which recommendations are made: appropriate public policy is best created if it rests upon reliable and consistent information.

---

14 Taxation Laws Amendment Bill (No. 2) 1995, Act No. 169 of 1995. ATO submission no. 24, p. 4.

15 House of Representatives, *Votes and Proceedings*, VP 148, 22 June, 1995, p. 2214; SJ 211, 30 November, 1995, p. 4324.

2.22 The then Assistant Treasurer, the Hon George Gear MP, made it clear that the purpose of Division 13A was twofold: to reduce the abuse of employee share plans as tax minimisation schemes and to facilitate the development of employee share plans for general employees:

> The government is making these changes to reduce the exploitation of the existing legislation and to ensure that the tax concessions that are available under the new arrangements are directed at share schemes which encourage employees to own shares in the company in which they are employed or a holding company of the employer. The measures will increase the taxation benefits available to employees under these schemes.[16]

2.23 Support for employee share plans continued when, prior to the 1996 Federal Election, the then Opposition Leader, the Hon John Howard MP, delivered a policy statement, *Employee Share Ownership Plans Initiatives*.[17] In its first Budget, the Howard Government increased tax concessions for employees making the tax exemption election in plans, (discussed later in this report) subject to the criteria contained in Division 13A.[18] Subsequently, the prospectus requirements in the Corporations Law were eased, relaxing the conditions that attach to the launch of an employee share plan offer.[19] The Howard Government also provided for an employee share plan in the initial Telstra privatisation.[20]

Support for employee share plans from successive governments has a legislative history of more than a quarter of a century.

Nature and Extent

2.24 Comprehensive information on the number, nature and extent of employee share plans in Australia, and the number of employees in plans, is not available from any Government department. Limited information has been collected by the Australian Bureau of Statistics,[21] and the then Department of Industrial Relations through its 1990 and 1995 Australian Workplace Industrial Relations Survey.[22]

---

16 House of Representatives, *Debates*, 20 June, 1995, p. 2083.

17 Department of Employment, Workplace Relations and Small Business, submission no. 38, p. 3.

18 Department of Employment, Workplace Relations and Small Business, submission no. 38, p. 4.

19 *Corporate Law Economic Reform Act 1999*.

20 Department of Employment, Workplace Relations and Small Business, submission no. 38, p. iii.

21 *Employee Earnings, Benefits and Trade Union Membership*, Commonwealth of Australia, 2000. Catalogue number: 6310.0.

22 Department of Employment, Workplace Relations and Small Business, submission no. 38, pp. iv, 10.

2.25 The agencies of Government most directly concerned with the regulation of corporations and revenue issues, the ASIC and the ATO, advised the Committee that they do not collect comprehensive information about these plans. The ASIC advised the Committee that, ‘the only information in the ASIC database relates to the number of employee share plans lodged in our various regions around Australia pursuant to the class order relief that we provide under the Policy [Statement 49]’.[23] The ATO told the Committee that, ‘the office does not have details as to the precise extent to which employee share ownership plans have been established or the amount of contributions being made to either Division 13A or non-Division 13A arrangements’.[24]

2.26 The Committee finds these admissions particularly surprising, since employee share plans raise issues of corporate governance, business regulation and investor interests. As well, all employee share plans, whether they operate under Division 13A or outside, have revenue implications.

2.27 The extent of information collected by government is unlike the situation in the United States. In 1986 the United States General Accounting Office issued a report entitled ‘Employee Stock Ownership Plans: Benefits and Costs of ESOP Tax Incentives’.[25] Furthermore, the United States Department of Labour collects information concerning the number and type of employee share plans[26]. No comparable study of the revenue implications of the existing arrangements in Australia has ever been undertaken, as far as the Committee can determine; nor is the information available that would provide a reliable basis for such a study.

2.28 Various private sector organisations have conducted research directly on the incidence and nature of employee share plans, or other research on share ownership which has revealed some information about employee share plans. The organisations include the Australian Stock Exchange,[27] KPMG,[28] AEOA[29] and RPC[30]. In these cases, survey methodologies differ

23 These are not, according to the ASIC, available on the public register; submission no. 16, pp. 2-3.

24 Submission no. 24.2, p. 1.

25 Mr R Stradwick, submission no. 25, p. 15.

26 Exhibit no. 18: Mr T Hardwick, ‘Succession planning in private business and employee share ownership plans’, 1997.

27 Australian Stock Exchange, *1997 Shareowners Segmentation Study*, 2 vols.

28 KPMG, exhibit no. 13.

29 The AEOA advised the Committee that it was conducting a study of employee share schemes in the top 500 listed companies (see submission no. 5.1, p. 6). The results of the study were not available when the present report was finalised. However, Mr Richard Stradwick, who was conducting the study provided some preliminary results to the Committee, with the agreement of the AEOA. See submission no. 25.1.

and it is difficult for the Committee to evaluate the reliability of the information provided. This is especially so when different surveys reveal contradictory information. For example, a 1998 survey by KPMG indicated that only 3 per cent of private companies had employee share plans, whereas a 1992 RPC survey indicated that a little over 20 per cent of private companies and about 25 per cent of public unlisted companies had employee share plans.[31]

2.29 In sum, the comment made by the AEOA concerning the incidence of employee share plans in Australia, and research on them, is apt:

> In Australia employee ownership is still at an early developmental stage. Research into the prevalence of employee shares plans here is neither wide nor deep.[32]

2.30 The Committee sought the views of the ASIC concerning the paucity of information about employee share plans and possible remedies. The ASIC advised the Committee that:

> …while we see benefits in obtaining accurate sources of information relating to employee share schemes, this needs to be assessed in light of other considerations including: the costs of setting up another regulator, duplication of information and whether there are other existing non-regulatory bodies which could perform this task, for example, the Australian Bureau of Statistics and the Australian Taxation Office.[33]

2.31 The ATO argued that the collection of detailed information through the tax return system would have various costs:

> Details concerning deductions claimed or income returned from these arrangements are recorded by taxpayers at 'general' income or deduction labels in the return forms and cannot be separately identified from other income or deductions returned at these labels. For … detailed information … it would be necessary to include specific label fields into the return forms and to provide explanatory information in the 'Tax Pack'. This would have impacts on cost of compliance issues with regard to tax return preparation.[34]

---

30 See submission no. 30, and RPC, *The Employee Share Handbook*, exhibit no. 49, for the most recent information collected by RPC.

31 KPMG, exhibit no. 13; RPC, submission no. 30, p. 15 and exhibit no. 50: RPC, *Australian Employee Share Plan Report*, 1992, p. 28.

32 Submission no. 5.1, p. 6.

33 ASIC, submission no. 16.3, p. 13.

34 ATO, submission no. 24.2.

2.32 In contrast, one of the major remuneration consultancies in Australia, RPC, advised the Committee that it supported the collection of information about employee share plans, the only group to do so.[35]

2.33 This lack of consistent and reliable information has been a major problem facing the inquiry. It is not known, for example, to what extent the present arrangements are, or are not, attaining the goals set for them when Parliament enacted Division 13A.

2.34 In the absence of reliable, clear information a cautious approach is required. Detailed studies should be carried out to assess the present arrangements and the likely impact of the recommendations made in this report. After the recommendations are implemented their effect upon the operation of enterprises and the attainment of the goals set for employee share plans by Parliament should be monitored and reported to Parliament.

2.35 Considerable sums of money are involved in employee share plans and considerable sums of revenue are exposed. The community has a right to know whether tax concessions are producing the public policy outcomes that motivated their introduction. To do this, accurate information is required.

Recommendation 1

2.36 **The Committee recommends that the Government direct the Australian Taxation Office to conduct a study to determine:**

- **the number and type of employee share plans operating in Australia;**
- **the types of enterprise in which they operate;**
- **the number of employees in such plans;**
- **the value of holdings in those plans;**
- **the amount of revenue provided to the Commonwealth each year from the sale of employee share plan equities;**
- **revenue foregone by the Commonwealth through the operation of employee share plans; and**
- **the performance of these plans in attaining the public policy objectives set for them and in doing so, identify and report upon problem areas in plans operating both inside and outside Division 13A.**

35 RPC, submission no. 30.3, p. 12.

The Committee recommends that the Australian Taxation Office collect such information annually. The Government should consider the merit of making such information publicly available and, if so, on an annual basis.

Types of employee share plan

2.37 There are many types of employee share plans in operation in Australia. Some operate within Division 13A and others operate successfully outside it.[36] As well, the type of equity offered and the way that equities are allocated, and whether they are provided free to the employee, at a discount or at market price also affects the nature of the plan. Plans can also vary in the way that the acquisition of equities is funded in those plans where the equities are not offered gratis to the employee. Payment may be by forgivable loan or an interest-bearing loan, repaid through dividends or by after-tax salary deduction or salary sacrifice.

2.38 The RPC advised the Committee of five broad types of plan operating in Australia that are distinguished by their leverage, exposure and method of funding the entitlement to shares in an employer company by an employee. The types of plan are:

1. **Fully paid share ownership plans funded by loans from the employer company ('loan plan')**

That is, fully paid shares are either bought on market or through a new issue and paid for by loans from the company. The employee only receives a benefit if the loan is repaid and the capital value of the shares plus dividends exceeds the loan value plus accumulated interest if any.

2. **Fully paid share ownership plans ('subscription plan')**

These plans are funded by new issues or subscriptions made by the employer out of profit share, remuneration sacrifice or short and long term bonus. Subscription type plans are the style of plan contemplated under the terms of Division 13A of the ITAA, whereby taxation concessions are made available to employers and employees to encourage ownership of employer shares.

36 For example the scheme operated by Woodside Energy Limited. See submission nos. 37 and 37.1.

3. Partly paid share plans

Under partly paid share plans an employee, usually at a senior executive level, is issued with shares at a predetermined price but only paid to a small portion of their value. Fully paid shares result when the unpaid portion is paid by either the company or the employee.

4. Option plans

Options give an employee the right to acquire a share in the future at a predetermined price, subject to terms and conditions, as set down in the offer. Fully paid shares are issued on the 'exercise' of the option.

5. Replicator share plans

Replicator share plans, as the name would suggest, replicate a 'normal' ESOP and are used where the company cannot issue 'real' shares. These plans are also known as 'phantom', 'synthetic' or 'shadow' share plans.[37]

2.39 According to a 1999 RPC publication,[38] the incidence of the various types of plan amongst Australia's top 350 listed companies increased from 68.8 per cent of enterprises in 1995 to 89.4 per cent in 1998.[39] According to the 1999 RPC survey the incidence of employee share plans, by type, was:

- 54.2 per cent had an option plan;
- 14.6 per cent had a subscription plan;
- 25.6 per cent had a loan based plan;
- 5.6 per cent had a partly paid plan; and
- there appeared to be no replicator plans operating in the top 350 companies.[40]

2.40 These figures can be compared to a 1997 survey conducted by RPC,[41] which revealed that amongst Australia's top 350 companies, 74.4 per cent

37 RPC, submission no. 30, p. 2. The shares in such schemes are typically purchased on the sharemarket in enterprises other than the employer, but allocated to employees of the purchasing company.

38 I Chichton, *The Director and Executive Top 350 Report*, RPC, 1999. Reprinted in submission no. 30, p. 22. A graph of the incidence of different types of employee share schemes appears in appendix E, figure 2.

39 A 1998 survey by KPMG of 750 Australian companies, ranging from small private companies to large multinationals, revealed that 82 per cent of the listed companies in the survey had implemented at least one share or share option scheme. KPMG, *Share Scheme Survey*, exhibit no. 13. See graph reproduced in appendix E, figure 3.

40 This information appears as a graph in appendix E, figure 2.

(or 224 out of 350) had an employee share plan. Option plans were by far the dominant form of employee share plan, being offered by 71.4 per cent (or 160) of those companies with any sort of employee share plan. For 56 per cent (or about 127) of companies with an employee share plan, the option plan was the sole employee share arrangement.

2.41 There is, apparently, a dramatic fall in the number of option plans from 1997 to 1999. In 1997, 71.4 per cent of those companies with any sort of plan had an option plan and for 55.6 per cent of those companies with any sort of plan it was the *only* sort of plan. According to RPC's 1999 figures, 54.2 per cent of companies had an option plan. Possibly, this can be explained by assuming that the 54.2 per cent of companies with an option plan, as reported in the 1999 survey, had *only* an option plan. However, RPC's submission is not clear on this point. The apparent inconsistencies in the two sets of figures, presented to the Committee by the one organisation, only emphasise the Committee's general concern about the lack of consistent and reliable information regarding employee share plans.

The number of employee share plans and number of employees involved

2.42 A 1998 survey by KPMG of 750 Australian companies,[42] ranging from small private companies to large multinationals, revealed that:

- of the 86 per cent of the 750 companies with an employee share plan, 56 per cent were offered to all employees while 44 per cent were restricted only to senior employees or executives;
- less than 3 per cent of private companies surveyed had implemented a share plan;
- 25 per cent of telecommunications/IT companies had plans; and
- 26 per cent of retail and distribution companies had plans.

2.43 An earlier survey conducted in 1992 by RPC indicated that about 20 per cent of private companies had employee share plans and 25 per cent of public unlisted companies operated plans.[43]

2.44 What is clear from both the KPMG survey and the RPC survey is that employee share plans are most common in publicly listed companies and far less common in unlisted companies, whether they are public

41 RPC, *The Employee Share plan Handbook*, 1997; reprinted in submission no. 30, p. 20. The RPC 1999 survey reaffirmed option plans as the dominant form of employee share scheme. See submission no. 30, p. 3.

42 KPMG, *Share Scheme Survey*, exhibit no. 13.

43 RPC, submission no. 30, p. 15.

companies or private. This coincides with evidence provided to the Committee by the ATO which stated that:

> From our observations Division 13A with its $1,000 concessional treatment and up to ten years deferral of tax has been successful in achieving its aim of encouraging employee participation in taking up share offers in their employer's share schemes.[44] However, it is acknowledged that in the small to medium enterprise segment, which is predominantly privately owned, the take-up has not occurred to the same extent. Employee share schemes in this segment may not be looked favourably upon as they would dilute the 'Controller's' interest in the company.[45]

2.45 Employee share plans are not spread evenly across all sectors. According to witnesses, they are concentrated in the banking and finance, leisure and entertainment, and research and development sectors of the economy.[46] A similar distribution of employee share plans across different sectors of the economy is revealed in a 1999 survey conducted by the Australian Bureau of Statistics.[47] Information concerning shares received as a component of employee benefits, by industry and occupation are reproduced in the tables opposite. (See also Figures 7 and 8 in Appendix E.)

---

44 However, on this point RPC advised the Committee that they estimated that 'less than 25 per cent of all public companies have taken advantage of the taxation concessions embodied in the legislation [ie Division 13A] affecting employee share plans introduced in December 1995'. Submission no. 30, p. 3.

45 ATO, submission no. 24.2, p. 8.

46 See, KPMG, *Share Scheme Survey*, exhibit no. 13; and RPC, submission no. 30, pp. 17-18. The RPC figures are from their 1997 survey. See also the incidence table, by sector of the economy, that appears in appendix 6, figures 4 and 5.

47 Australian Bureau of Statistics, *Employee earnings, benefits and trade union membership*, Canberra: Commonwealth of Australia, August 1999; Catalogue no. 6310.0; Fig. 17 and 18.

Table 1 Employees receiving shares as a benefit, by industry

Industry	Number ('000s) of employees receiving shares	Total ('000s) of employees in industry	Percentage of employees who have shares
Agriculture, forestry and fishing	6	160.8	4%
Mining	9.9	67.2	15%
Manufacturing	75.8	993.6	8%
Electricity, gas and water supply	4	69.8	6%
Construction	10.7	429.8	2%
Wholesale trade	30	475.2	6%
Retail-trade	53.7	1106.2	5%
Accommodation, cafes and restaurants	2.9	345	1%
Transport and storage	27.6	331.1	8%
Communication services	40.5	133.9	30%
Finance and insurance	86.6	296.2	29%
Property and business services	39.4	773.8	5%
Government administration and defence	0.1	340.7	0%
Education	0	609.7	0%
Health and community services	6.8	738.2	1%
Cultural and recreational services	9.9	174.1	6%
Personal and other services	0.5	258.8	0%
Total	**404.3**	**7304.2**	**6%**

Source Extracted from Australian Bureau of Statistics, *Employee Earning, Benefits and Trade Union Membership*, Commonwealth of Australian, 1999, Catalogue no. 6310.0, p. 36

Table 2 Employees receiving shares as a benefit of employment, by occupation

Occupation	Number of employees receiving shares ('000s)	Total number of employees in occupation ('000s)	Percentage of employees in occupation receiving shares
Managers and administrators	47.3	3776.2	1%
Professionals	67.0	1369.5	5%
Associate professionals	58.8	772.4	8%
Trades-persons and related workers	45.0	907.2	5%
Advanced clerical and service workers	28.8	302.9	10%
Intermediate clerical sales and service workers	84.8	1392.3	6%
Intermediate production and transport workers	35.7	656.7	5%
Elementary clerical sales and service workers	24.1	792.0	3%
Labourers and related workers	12.8	735.0	2%
Total	**404.3**	**7304.2**	**6%**

Source Extracted from Australian Bureau of Statistics, *Employee Earning, Benefits and Trade Union Membership*, Commonwealth of Australian, 1999, Catalogue no. 6310.0, p. 37

2.46 RPC's evidence confirmed this pattern of penetration:

> Meaningful employee equity participation practices in Australia are still effectively restricted to the banks, insurance companies, the major industrial companies and a handful of others.
>
> Australia's ESP participation is well behind most of the other OECD countries and it could be argued, up to 30 years behind Japan.[48]

2.47 Not only is access to employee share plans concentrated in certain enterprise sectors but also certain types of employee are more likely to have access to employee share plans in those enterprises that have these plans. As already noted, option plans are the dominant form of equity participation. RPC advised the Committee that 'in almost every case the option plan was only available to directors and / or a relatively small number of senior executives'.[49]

2.48 Of the top 350 companies in the 1997 RPC survey, only 65 or 18.5 per cent had 'meaningful' employee share plans. RPC defined 'meaningful' as, 'greater than 50 employee participants and / or representing more than 2 per cent of the capital of the company'.[50] Of those companies, 34 were in the first 50 companies in the list of top 350 companies, and 31 were in the bottom 51-350 of the top 350 list.[51] RPC also advised the Committee that, 'Of those public companies with an employee share plan, more than 80 per cent would only offer participation to senior executives, and less than 10 per cent would have meaningful, all employee plans in place'.[52]

2.49 The AEOA provided this analysis of the current situation:

> The first thing to notice is that 55 per cent of these plans are option plans. In Australian terms that normally means an executives-only share plan. Another 24 per cent are loan plans that, once again, mostly benefit executives.... Much the same can be said for partly paid plans representing 13 per cent. Subscription plans, which are funded out of a company's total remuneration budget and which tend more often to be aimed at rank-and-file employees, rate only 8 per cent.

---

48 RPC, submission no. 30, p. 17.

49 RPC, *The Employee Share plan Handbook*, 1997, p. 26; RPC, submission no. 30, p. 20. A notable exception is Southcorp; see submission no. 34, pp. 11-13.

50 Submission no. 30, p. 21.

51 RPC, *The Employee Share Plan Handbook*, 1997, p. 26; RPC, submission no. 30, p. 21.

52 RPC, submission no. 30, p. 4. It should be noted that the 1998 KPMG survey of 750 businesses, referred to already, revealed that 44 per cent of employee share schemes were restricted to senior employees or executives.

> Another way of looking at the spread of share plans is to examine the incidence of plans according to their size. Out of the Top 350 companies only 65 (or 18 per cent) had a 'substantial' share plan, i.e. a plan with greater than 50 employee participants and / or holding more than 2 per cent of the company's capital.
>
> In summary, this evidence highlights that even among the Top 350 companies share plans tend to benefit the few rather than the many.[53]
>
> For all intents and purposes, therefore, employee share ownership is limited to the 13 per cent of employees who work for listed companies. Out of this group of employees only a minority can presently claim, thanks to an ESOP, to be shareholders of the companies which employ them.[54]

2.50 The lesson that the Committee draws from this information is that public policy development in this area must be concentrated on promoting employee share plans amongst general employees.

2.51 The number of Australians involved in employee share plans is uncertain. Evidence indicated that the number of employees participating in employee share plans had increased markedly since 1991. A 1994 ABS survey, referred to by the Department of Employment, Workplace Relations and Small Business indicated that 247,800 employees were receiving shares as an employee benefit.[55] This represented 3.9 per cent of the workforce. A survey the previous year (1993) indicated that some 2.8 per cent of employees were receiving shares. Assuming that in the twelve month period there was not a substantial variation in the size of the Australian workforce, this would indicate that in 1991 some 178,000 people were employee share plan participants.

2.52 According to a 1997 survey by the Australian Stock Exchange, there were 'in excess of 500,000 shareowners with shares held via employee share plans'.[56] A survey conducted in August, 1999, by the Australian Bureau of Statistics indicated that 6.9 per cent of full-time and 2.2 per cent of part-time employees, giving a combined total of 5.5 per cent of full and part time employees, received share-based benefits. This represented some

---

53 This conclusion is supported by the submission from the Department of Employment, Workplace Relations and Small Business, which advised the Committee that the evidence available to the Department indicated that ownership of employee shares was concentrated in the hands of managers and administrators. See submission no. 38, p. 13.

54 AEOA, submission no. 5, p. 6.

55 Department of Employment, Workplace Relations and Small Business, submission no. 38, p. 13.

56 The Australian Stock Exchange *Share in Australia: 1997 Shareowners Segmentation Study*, p. 157. A source for this figure was not provided.

404,300 employees out of a total workforce of 7,304,200 employees. The ABS survey also revealed that males are almost twice as likely to participate in employee share plans as females.[57]

2.53 The Committee concludes that on the evidence available over 5 per cent of the Australian workforce, or some 400,000 employees, hold equities under employee share plans.

Value of employee share plans

2.54 There are no reliable estimates of the value of employee share plans. Such information is not collected by Government and no systematic study has been done by any other organisation. The movement of the stock market also makes precise measurement impossible. From evidence available to the Committee, it is possible, however, to develop an estimation of the value of the holdings.

2.55 A 1991 report, *Saving through the Firm*,[58] written by Dr Vince Fitzgerald estimated that employee share plans then held between $1 billion and $3 billion in assets and that no more than $100 million was saved through them each year. In 1992, RPC reported that in 1991 about $225 million worth of equities were issued under plans open to all employees and the total value of equities issued was approximately $275 million. In this study, which covered the years 1985 to 1991, the value of equities issued peaked in 1987 in which a little over $400 million in equities was issued, (with about $300 million issued to all employees and $100 million issued to a specific group or executives only). This was followed by about $400 million issued in 1989 (with a little over $300 million issued to all employees).[59]

2.56 In 1999 *The Australian Financial Review* conducted a survey of Australia's top 100 companies. It revealed that executive employees of the top 100 listed companies collectively held shares and options exceeding $975 million.[60] A survey conducted by *The Australian Financial Review* in

57 Australian Bureau of Statistics, *Employee Earnings, Benefits and Trade Union Membership*, Commonwealth of Australia, Canberra, catalogue no. 6310.0, pp. 33-34. The distribution of employees participation in employee share schemes by employment type is revealed in a 1999 survey conducted by the Australian Bureau of Statistics and reproduced in Table 2 of this chapter.

58 The Allen Consulting Group, December, 1993, p. viii; exhibit no. 28, and provided by RPC.

59 Exhibit no. 50: RPC, *Australian Share Plan Detailed Report*, 1992, p. 31.

60 D Kitney and B Clegg, 'CEO pay increases 22 pc', 1 November, 1999, p. 1. This survey excluded certain individuals, who as company founders and continuing executives held considerable numbers of shares in their now publicly listed companies.

2000[61] revealed that the value of employee share plans had increased by $752 million in the financial year to March, 2000.

2.57 In its submission dated 10 May, 1999, the ATO advised the Committee that:

> The tax aggressive employee share, welfare and incentive trust schemes detected and on which we have ascertained contribution levels, to date, have involved over $400,000,000 in contributions.
>
> …
>
> The ATO is currently reviewing the products of over 40 promoters involved in the 'employee benefit arrangements' described above. On the data we have to date, we would estimate that the total contributions made by the clients of these identified promoters will, on a conservative measure, amount to approximately $1.5 billion.[62]

2.58 The ATO advised that the problems mostly occur with the small to medium sized companies, most of which are private and unlisted, rather than with listed companies.[63]

2.59 It should be emphasised that the figures provided by the ATO apply to all types of employee benefit arrangements, and not only employee share plans, mostly with the unlisted companies. These figures provide an indication of the overall size of the funds being channelled through various forms of employee benefit plans in that sector.

2.60 The ATO advised the Committee that of the $1.5 billion invested in aggressive schemes, about one quarter, or $375 million, was contributed by employee share plans.[64] Assuming that the $375 million represents the amount on which tax has yet to be paid at the highest marginal rate, the grossed-up value of at risk plans would be in the order of $775 million. If one assumes a delinquency rate amongst these plans of between 15 per cent and 25 per cent, then the value of all employee share plans in the unlisted sector may be estimated to be between about $3 billion and $5 billion.

2.61 In the 1996 Budget, the government increased the income tax exemption available to employee share plans operating under Division 13A from $500 to $1,000 for employee and employer. The cost of this change was

61 B Clegg and A Hepworth, 'Hightech employees rethink pay', *The Australian Financial Review*, 16 May, 2000, p. 1.

62 ATO, submission no. 24, p. 16.

63 ATO, submission no. 24, pp. 12, 18.

64 *Transcript of Evidence*, p. 360.

estimated to be $15 million.[65] This would indicate that about 30,000 employees were expected to receive this benefit. The information upon which this estimation was based has not been made available to the Committee.

2.62 Submissions from BHP and Lend Lease revealed considerable employee share holdings. BHP, for example, advised the Committee that some 7.6 per cent of the company's capital was held by employees.[66] This would represent about $2.28 billion at the May 2000 market capitalisation of the company. Lend Lease advised the Committee that employees held some $1.3 billion.[67] Employees in just these two companies hold about $3.5 billon of stock in their respective employers. Recalling that about 18 per cent of listed enterprises have meaningful employee share plans, and that there are substantial holdings held by employees of other large, listed enterprises, such as Qantas, Telstra and elements of the finance sector, the aggregated level of equity holdings by employees through share plans would be at least double this figure.

2.63 Further, since 1991, as indicated in the information reviewed, there has been considerable growth in the number of plans and number of participants. Australia has also been experiencing continuing economic growth for the best part of a decade. High levels of employee share plan allocations are associated with economic prosperity. Taking this into account, and considering the reported value of employee share plans in 1991 and executive only plans in 1999, it would appear that there is in excess of $1.5 billion in plans open only to a small number of executives, in listed and unlisted enterprises.

2.64 Given these sorts of figures, it is estimated that general employees and executive employees in listed companies hold equities through employee share plans of between $6 billion and $8 billion. In unlisted companies it is estimated that between $3 billion and $4 billion is held through one sort of employee share plan or another. The Committee estimates that overall, between $9 billion and $12 billion is held in employee share plans in listed and unlisted companies. It is also estimated that annually, contributions in listed and unlisted companies amount to about $400 million. It is estimated that, owing to stock market appreciation, the annual increase in value would run into the billions of dollars.

2.65 It must be stressed that these figures are estimates only. They are based upon information gathered from a variety of sources, which have used methodologies untested by this inquiry.

65 House of Representatives, *Debates*, 12 December, 1996, pp. 8427-8428.

66 BHP, submission no. 31, p. 1.

67 Lend Lease, submission no. 26, p. 4.

Potential for growth

2.66 Given the lack of certainty in the number of employees currently involved in employee share plans, it is not surprising that there are few confident predictions of the likely extent of future growth. Two estimates received by the Committee put the possible future involvement at between 15 per cent and 20 per cent of employees. Dr Vince Fitzgerald, writing in 1991,[68] suggested that it was a 'conservative scenario' that employee share plans could, if grounded upon secure and sympathetic policy, lead to 15 per cent of employees participating. This would lead, Dr Fitzgerald estimated, to about $15 billion (in 1991 dollars) of investment.

2.67 Executive remuneration consultants John V Egan Associates Pty Ltd, advised the Committee that in their view the role of employee share plans in remuneration:

> … will increase in relative importance for executives, though I doubt that the level of participation of the average employee will significantly increase.
>
> … employee participation in the majority of organisations would be capped at 2 per cent to 3 per cent of the market capitalisation of the company and extend to 5 per cent in more progressive organisations. It would however, be my view that the traditional capping of executive participation at around 1.5 per cent to 2.5 per cent will be substantially extended and that the top team in many large companies, over the next generation of managers, will more than double their current participation rights.
>
> … only a small (though well publicised) proportion of the workforce are employed in entities which offer their employees equity in the company; as the majority of the workforce are not employed by listed companies, but rather private companies, international subsidiaries or the government sector. As a consequence, it would be my view that less that one in five employees will benefit from equity-based remuneration over the next two generations.[69]

Rationale

2.68 The history of employee share plans in Australia shows that over the past quarter of a century successive Parliaments have been supportive of employee share plans, as has the listed private sector in the past decade or

68 *Saving Through the Firm*, The Allen Consulting Group, December, 1993; exhibit no. 28, and provided by RPC, pp. viii-ix.

69 John V Egan Associates Pty Ltd, submission no. 52, pp. 4, 5.

so, though not consistently across all types of employee or enterprise. The reasons for support from government, and the reasons that employee share plans are supported by the private sector are not entirely overlapping.

2.69 The phrase 'employee share ownership plan' refers to a diverse range of practices, and as Ms Sarah Turberville reminded the Committee, they are 'informed by a variety of ideologies and intentions'.[70] It is hardly surprising then, that the Committee was confronted with a number of inter-related objectives for plans:

> **Ownership objectives:** They can be used to transfer ownership of part, or of the whole of a company to the employees. ESOPs can be used by employees to increase the existing capital of a company. This way employees secure a stake in a business in return for their contribution to its capital expansion.
>
> **Remuneration objectives**: ESOPs can be used as a remuneration and employee-incentive vehicle. In this case, shares in the employer's company are used as a performance-related supplement to existing salary and wages and as a means of enabling employees to share in the long term growth of a business.
>
> **Workplace change objectives**: Shares delivered through an ESOP can also be used to 'change the culture' of a company. In this case share ownership is used as a means of breaking down perceived 'class barriers' in the work place, as a way of attempting to solve problems posed by the sometimes apparent mutual detachment of employers, managers, and owners from each others' interests.[71]

2.70 Contrasting the reasons for establishing an employee share plan in the United States with the reasons that motivate Australian enterprises, the AEOA advised the Committee that:

> Each of the three major purposes of employee ownership can co-exist though, at particular times and in particular cases, one of the major purposes will tend to dominate. In the USA, for example, where employee ownership is quite advanced, all three factors are in evidence. However, ownership considerations are very powerful in the US and often predominate.

70 Exhibit 40: 'Mapping employee financial participation in Australia: Evidence from AWIRS 90 & 95', Department of Management, Monash University, 1999, p. 12.

71 AEOA, submission no. 5, p. 4.

> In Australia, where employee ownership is at an embryonic stage, and where management has taken the lead in promoting ESOPs, remuneration and cultural change motives hold sway.[72]

Share plans open to all employees

2.71 A number of reasons were provided to the Committee in justification of governmental support for employee share plans. One reason was that such plans would lead to a closer alignment between the interests of employers and employees,[73] which in turn may lead to an increase in productivity.[74] On this justification, an employee's personal benefit would be tangibly related to the success of their employer,[75] leading to an increase in productivity[76] as well as an improvement in Australia's industrial relations, leading to still further increases in enterprise performance.[77] In effect, employee share plans are justified by their effect upon the motivation of employees.

2.72 Owning shares in their employer, on this view, induces employees to 'think like an owner' because their own property and prosperity is at risk as they work. Such a justification appeals to employees' own self-interest, and by promoting their own self-interest employees will promote the interest of their employer, and thereby all the other shareholders. In other words, the employees promote their self-interest through harder work and increased productivity.

2.73 The motivational linkage between harder work and greater productivity on the one hand, and increased personal benefit on the other, is the reason why employee share plans are often based around ordinary shares. This type of share confers upon employees a voice in the operation of their employer and some degree of control over the enterprise. Not only can employees see the effect of their harder work and increased productivity in an increase in share value, but through ordinary shares employees have a personal investment in the governance of the corporation. This provides a further psychological foundation that ensures that their behaviour promotes the interest of their employer.

---

72 AEOA, submission no. 5, p. 4.

73 Many submissions provided alignment of employee and employer interests as a major motivation for employee share schemes. See submission nos. 3, 6, 8, 9, 11, 14, 17, 18, 23, 32, 33, 34, 35, 37, 42, 47.

74 The Treasurer, submission no. 46.2, p. 6.

75 ATO, submission no. 24, p. 6.

76 ATO, submission no. 24.1; Department of Employment, Workplace Relations and Small Business, submission no. 38.

77 ATO, submission no. 24, p. 2.

2.74 Through holding shares in their employer, employee shareholders become active participants in the share market and can come to understand the factors that influence the performance and prosperity of their enterprise. Employee share plans provide the opportunity to educate employees about those factors that affect an enterprise's share price and its success in the market place. This provides an additional incentive to work efficiently, and as a result, employees who are owners are more likely to care about the wellbeing of their employer. They think like owners as well as employees.

2.75 As noted by the AEOA, another use of employee share plans is in promoting cultural change in the workplace, with the ultimate aim of enhancing productivity.[78] The term 'cultural change' can refer to a number of inter-related goals. For example, it may involve simply aligning the interests of employees with those of their employer, so that the employee is focused on the employer's interests as they carry out their duties. It may refer to the creation of a harmonious workplace culture, in which trust and good workplace relations are promoted, leading to higher productivity - for example, through reduced industrial action or lower salary increases. 'Cultural change' may also refer to the practice of enhancing the skills of a workplace by attracting and retaining highly skilled staff. All these goals change the nature of an enterprise, its culture, so that it promotes productivity.

2.76 'Cultural change' may also refer to the evolution of a workplace from a public sector employer to a privatised employer. For example, CSL advised the Committee that an employee share plan was introduced when the formerly publicly-owned Commonwealth Serum Laboratories was privatised in 1994. The primary reason was to facilitate a cultural change, from the former public service orientation of the employees and management to that of a for-profit enterprise:

> The essence of that shift was to ensure a strong focus on the company's responsibility to shareholders, and a need for it to be profitable, competitive and efficient in order to meet the needs of both the shareholders and the market.
>
> The introduction of employee share ownership within CSL, was a major tool in providing that cultural shift.[79]

2.77 Another argument rests upon the 'democratisation' of capital: spreading ownership and thereby control more widely in the community.[80] This too,

78 AEOA, submission no. 5, p. 4.

79 CSL, submission no. 6, p. 2.

80 ATO, submission no. 24, p. 6.

the Treasurer suggested, may lead to an improvement in productivity.[81] This was reiterated by the ATO: 'One of the primary purposes of Division 13A', the ATO advised the Committee, 'is to strengthen employee participation in Australian businesses (in particular, their own employer's business), with the aim of achieving increased employee productivity.' [82]

2.78 A further distinct argument was provided by the Treasurer. Mr Costello advised the Committee that employee share plans were 'consistent with Government policy of allowing employees and employers greater flexibility and choice in their working arrangements'.[83] This justification places employee share plans within the context of increasingly flexible labour market arrangements. Employee share plans provide, on this line of thinking, additional elements of choice available to employers and employees when negotiating workplace arrangements.

2.79 Another argument in support of employee share plans is that they can be used as a substitute for salary or wages when the business is not performing well. In such cases, employees forego part of their wages or salaries, in return for participation in an employee share plan, the idea being that the foregone wages and salary will be recovered when the business begins to prosper. Such alternatives, the Department of Employment, Workplace Relations and Small Business advised the Committee, 'provide scope for reducing the risk of unemployment in periods of recession by reducing an employer's overall wages bill'. [84] On this analysis, employee share plans 'offered a mechanism for wage flexibility which can be linked to employment stability'. [85]

2.80 As an illustration of such a strategy, an employee share plan was introduced by Greyhound Pioneer in 1998. Employees received free shares in return for a reduction in pay and an agreement to a pay freeze. This is somewhat unusual in Australian practice, as noted above, where the vast majority of employee share plans are introduced as additional employment benefits, rather than as substitutes for an increase in wages or as elements in an agreement that involves a reduction in wages in return for equities in the employer.[86]

2.81 The basis for legislation used by successive governments for fostering employee share plans was that they promote a better alignment of

81 The Treasurer, submission no. 46.2, p. 6.
82 ATO, submission no. 24.1; reiterated by the Treasurer. See submission no. 46.2, p. 7.
83 Submission no. 46.2, covering letter.
84 Department of Employment, Workplace Relations and Small Business, submission no. 38, p. 6.
85 Submission no. 38, pp. iii, 5.
86 Submission no. 38, pp. 6-7.

employees' actions with employer interests. This justification is also accepted by the business sector, and reflected in research conducted during 1999 by Mr Richard Stradwick for the AEOA. This research involved a survey of employee share plan arrangements in most of the Australian Stock Exchange's top 500 companies. Although Mr Stradwick's report is still being finalised, he provided the Committee with some preliminary conclusions.[87] The report suggests that enterprises introduce employee share plans for the following reasons:

- To increase employee identification with the interests of shareholders (90 per cent of respondents);
- To provide a benefit for employees (80 per cent of respondents);
- Because it is a tax effective way of rewarding employees (40 per cent of respondents);
- To improve labour productivity (29 per cent); and
- Some companies said that their plans were introduced to improve recruitment and retention. Most of these companies were in the IT and related industries (7 per cent of respondents).[88]

2.82 Noticeably absent from this list are: using an employee share plan as a trade-off against salary and wages during an economic downturn; using plans more generally in employment bargaining negotiations; and using plans as vehicles for the democratisation of capital - that is, for worker participation and control in the operation of an enterprise.

2.83 The remuneration motivation was apparent, not only in the recent research conducted by Mr Stradwick, but in submissions[89] and in frequent references in the business press.[90] In such cases, employee share plans are used to provide additional income to employees in a tax effective manner, or to substitute equities for income that would formerly have been

---

87 Submission no. 25.1.

88 Submission no. 25.1, p. 9.

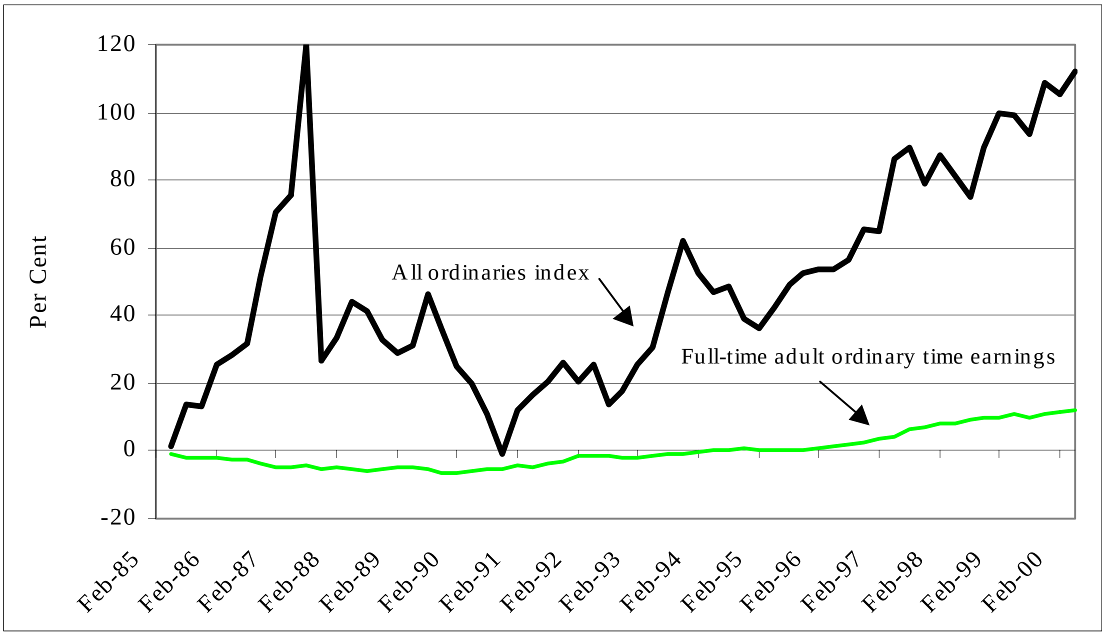
89 See submission nos. 8, 11, 31, 37, 38, 47.

90 See for example, Michael Laurence, 'Gil Levy, tax crusader', *Business Review Weekly*, 21 (1999), February 8, 1999; Michael Laurence, 'Taxation: Ralph report leaves share plans out in the cold', *Business Review Weekly*, 5 November, 1999, pp. 74-77; D Kitney and B Clegg, 'CEO pay increases 22pc: Top earners hold 975m in shares and options', *The Australian Financial Review*, 1 November, 1999, pp. 1, 25-29; B Clegg, 'Executive wealth: give me the options', *The Australian Financial Review*, 1 November, 1999, p. 27; T Sykes, 'Overpaid, male, and not always a performer', *The Australian Financial Review*, 1 November, 1999, p. 26; B Clegg, 'Drawing lines on bonuses and options', *The Australian Financial Review*, 1 November, 1999, p. 28; A Mitchell, 'Grand bouffe in the executive suite…' *The Australian Financial Review*, 15 December,1999, p. 19; M Laurence, 'Employee shares and options are coming up to harvest time', *Business Review Weekly*, 20 (1998), 22 June. 1998; A Ferguson and K de Clerq, 'Boss cocky', *Business Review Weekly*, 21 (1999), 5 November, 1999.

provided by way of salaries and wages. In this respect, the motivation for what has occurred in Australia reflects to a degree what has occurred in the United States. There, real wages for all but the top quintile of employees have been 'essentially stagnant for nearly two decades, while real stock prices have increased almost threefold'.[91]

2.84 In Australia, the disparity between real wages growth and the increasing value of the share market has not been so great, although the same trend is evident. In the eleven years to February 1996 average weekly earnings grew by 0.6 per cent in real terms, while the All Ordinaries Index grew by 53.5 per cent. In the period from February 1996 to May 2000 average weekly earnings grew by 11.5 per cent and the All Ordinaries Index by 58.4 per cent. Although the last four years have seen a significantly better wages outcome, the remuneration motive for introducing employee share plans remains considerable, as can be seen in the following graph. These figures are a compelling argument in support of employee share plans as a means of increasing the income and savings potential of general employees.

Figure 1 Real percentage increase in AWE and All Ordinaries Index since February 1985



Source *Average Weekly Earnings* (ABS 6302.0), *Consumer Price Index* (ABS 6401.0) and Datastream

2.85 Employee share plans represent an opportunity to increase a person's real income in a way unconnected with salary or wage increases. This comment from Qantas makes the point unequivocally:

91 J Gordon 'Employee Stock Ownership in Economic Transitions: The Case of United and the Airline Industry', in M Blair and M Roe (eds), *Employees and Corporate Governance*, Washington: Brookings Institution Press, 1999, p. 317.

> …the Qantas employee share ownership scheme is increasingly recognised as a significant part of the remuneration package. Over the past two EBAs [enterprise bargaining agreements], Qantas has been able to negotiate wage increases lower than the prevailing EBA wage outcomes for the industry through the inclusion of the Qantas employee share ownership scheme.[92]

2.86 The Department of Employment, Workplace Relations and Small Business, focused this point still further, advising the Committee that the direction of the Government's activities had been to provide a basis for workplaces to tailor their arrangements to their particular circumstances and requirements. This included more flexible remuneration arrangements, including employee share plans.[93] On this view, the rationale for employee share plans rests upon their use as forms of remuneration, especially remuneration that is directly related to performance,[94] that are alternatives to, or *in lieu* of, salary or wages.

2.87 However, the Department also advised the Committee that the evidence available was that:

> In the vast majority of cases in Australia, ESOPs are introduced as an additional employment benefit to employees…. They have not generally been offered as a substitute for a wage increase or as part of a package which involved a reduction in wages or as a trade off for receiving employee shares.[95]

2.88 Using equities as important elements in a remuneration package is especially common in the telecommunications, information technology and internet sectors. For example, in the wake of the fall in share prices in April 2000, it was reported in the press that it was a 'habit' in the new economy (that part of the economy based on the use of the internet and information technology) to employ staff at a lower base salary topped up by a form of share option plan.[96]

2.89 Such an approach has two benefits to an enterprise. First, it ties an employee's remuneration to the success of the enterprise, and second, it reduces the bottom line cost of wages and salaries, because the cost of

92 Submission no. 35, p. 9.

93 Submission no. 38, p. iii.

94 This should be distinguished from a reward provided to employees for exceptional performance. When an equity is provided as a component of remuneration, it is *in lieu* of salary or wages; when provided as a reward it is *additional* to salary and wages.

95 Submission no. 38, p. 6.

96 M Bachelard and A McKenzie, 'The salaries: Handcuffed to sinking ship', *The Australian*, 18 April, 2000, p. 2.

shares or options allocated does not need to be recorded as an expense in the profit and loss account, under current accounting standards.[97]

Executive-only equity plans

2.90 Executive remuneration packages, in particular, are often designed as tax effective income vehicles and also to give effect to performance incentives. Consequently, there is continual evaluation of the existing taxation arrangements and how best to use them to minimise an executive's taxation liability: 'With the new capital gains tax rules now imposing tax on only half of any capital profit,' Peter Freeman wrote in *The Bulletin*, 'the focus is on how best to devise means that legitimately convert at least part of an executive's remuneration into capital gains rather than straight income.'[98]

2.91 This motivation is apparent when equities are provided without performance hurdles. The reason is that tying allocation of equities to the performance of the enterprise, makes a clear linkage between employee performance and enterprise performance. When equities are provided simply in return for work, when no particular performance hurdles are nominated, or as a trade-off against increases in salary or changes in conditions, then the motivation of the plan is more likely to be that of remuneration rather than productivity, although of course, the two are not mutually exclusive.

Criticisms of employee share plans

2.92 A number of concerns have been raised about employee share plans. Perhaps not surprisingly, most are offered by unions. Representing the trade union movement, the ACTU advised the Committee that while it supported employee share plans in principle, and had developed guidelines for plans that it would support, it nevertheless had a number of reservations.[99]

2.93 The ACTU advised the Committee that employee share plans often involved inequities within an enterprise and between members of the community: those who had the opportunity to participate and those who did not. Moreover, there seemed little justification for tax incentives to encourage employee share plans as this would involve a misdirection of scarce public funds:

97 Submission no. 35, p. 5; see also, A Mitchell, 'Grand bouffe in the executive suite…' *The Australian Financial Review*, 15 December,1999, p. 19.

98 P Freeman, 'Executive tax relief', *The Bulletin*, 29 February, 2000, p. 70.

99 For the ACTU policy on employee share plans, see 'Employee Share Ownership Plans – Handle with Care', exhibit no. 23. Submission no. 27, p. 1.

> The ACTU has a serious concern with the proposition that Employee Share Ownership should be promoted by way of tax concessions to the participants. If the schemes are positive to enterprise performance as their proponents claim it should be in the interests of those enterprises to encourage their use and their application should therefore not require scarce taxpayers funds. In addition it is inevitable that the share schemes will only apply to a minority of employees as those employed in the public sector, non profit sector and small to medium size private firms are generally unable to participate in a practical way - this is a further reason for questioning tax incentives for an approach which cannot be accessed by all employees.
>
> The ACTU believes that if public funds are available to encourage employees to save more and provide for their retirement they should be used to improve superannuation benefits, particularly for the low paid.[100]

2.94 The ACTU also questioned the assertions that employee share plans enhanced the performance of an enterprise. It said that the evidence for their effects on productivity and employee morale was anecdotal. Quoting from a study conducted in 1989, the ACTU reported that:

> It is unclear whether employee share ownership in itself increases productivity. It sometimes does and certainly can have that effect, but whether it does depends upon a number of factors… Of the employee share schemes, the tax-driven US ES0Ps are possibly the least effective in delivering actual improvements in economic performance.[101]

2.95 The Committee was advised by the Finance Sector Union that the Union supported employee share ownership as a positive way for employees to access long term investment strategies with the potential to be financially rewarding. However, the way that some employers provided access to a plan was arbitrary, 'inequitable and at worst discriminatory and sends out inappropriate messages to that employer's workforce'.[102]

2.96 The Australian Manufacturing Workers Union advised the Committee that a survey the union had conducted of delegates during April 1999, had revealed that 'the presence of the share scheme had not changed the dynamic of workplace relations…nor had any of the share schemes had an observable impact on productivity'. If given a choice, the union informed

100 Submission no. 27, p. 1.

101 Submission no. 27, p. 6.

102 Submission no. 29, pp. 8, 10.

the Committee, 'employees would prefer other forms of reward and benefit to participation in employee share plans.'[103]

2.97 Employee share plans have been the subject of much research and discussion in the United States for a considerable period of time. Over this time, a number of objections to employee share plans have been put forward. The most forceful criticism is that the motivational benefits that employee share plans are said to provide do not exist. Employee share ownership 'works' according to its proponents, because employees 'monitor' their performance and increase it in order to increase the value of their equity holdings. Since there is no way any individual could capture more than a small fraction of the potential gains from such activities there is no incentive to improve performance. Moreover, employees could not 'see' how their own increased individual effort translated into improved value of their equity holding. Again, the incentive for improved performance is missing.[104]

2.98 Some critics claim that firms offering employee share plans are 'inefficient because employees do not have the incentive to maintain the physical capital of the enterprise properly'.[105] Critics also claim that employees participating in employee share plans would 'prefer to maximise net revenues per worker rather than profits, which would result in inefficient levels of production and use of resources'.

2.99 Other critics argue that enterprises offering employee share plans are more democratic and therefore less efficient at processing large amounts of complex information. Other critics argue that employee share schemes may expose employees on relatively low incomes to fluctuating risks and that as a result they may shy away from taking risks in order to protect their investment. There is also the possibility that employee share plans may be used to dilute the interests of outside shareholders and help further entrench management.[106] Others argue that employee share plans may have a negative effect on firm performance because employee ownership may lead to a reduction in managerial control and lower-quality decision making.[107]

---

103 Submission no. 12, p. 3.

104 R Brown and C Wah Lau, 'The extent and industrial pattern of employee share ownership plans in Australia: preliminary evidence', *Accounting Research Journal*, 10 (1997), p. 36.

105 Except where otherwise noted, these criticisms have been raised by Margaret M Blair, *Ownership and Control: Rethinking corporate governance for the twenty-first century*, Washington: The Brookings Institution, 1995, pp. 298-301; 317.

106 In addition to Margaret M Blair, *Ownership and Control: Rethinking corporate governance for the twenty-first century*, this objection has been raised by J Gates, *The Ownership Solution: Toward a shared capitalism for the 21st Century*, Reading: Addison-Wesley, 1998, pp. 62-63.

107 R Brown and C Wah Lau, 'The extent and industrial pattern of employee share ownership plans in Australia: preliminary evidence', *Accounting Research Journal*, 10 (1997), p. 36.

2.100 On the evidence available to it,[108] and on balance, the Committee concludes that the criticisms of employee share plans are not justified.

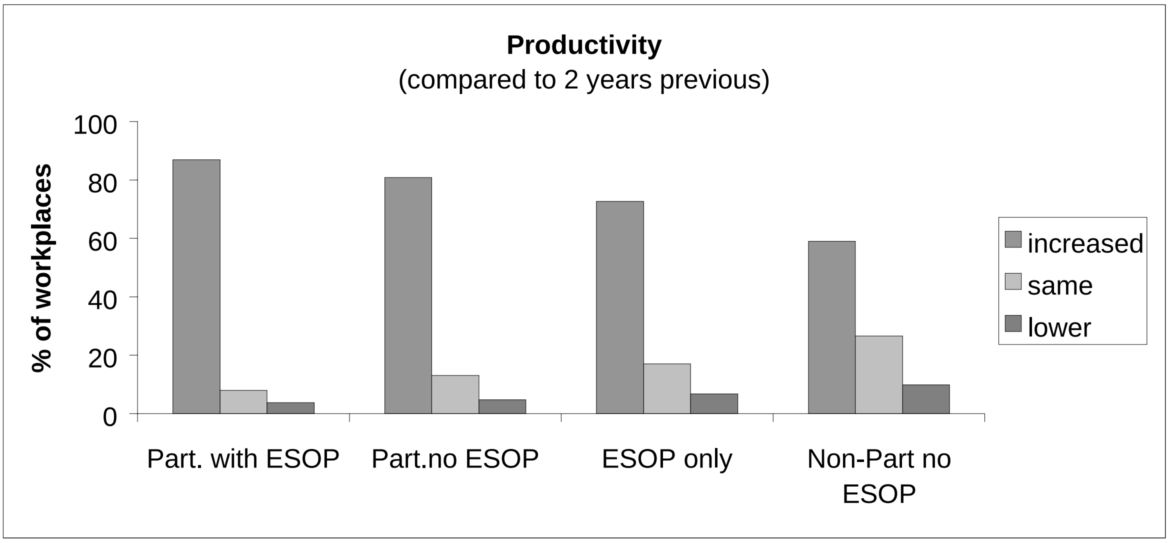
2.101 The Committee concludes that, for the most part, employee share plans in Australia have as their basis two driving ambitions:

1. Providing employees with an additional form of remuneration, or in the case of executives, remuneration that is also tax effective; and

2. Cultural change (broadly understood) within a workplace, leading to higher productivity.

2.102 The increased productivity and decreased absenteeism of workplaces with employee share plans, in particular those where employees also have a role in decision making, can be seen in the following graphs.

Figure 2 Productivity of workplaces with and without employee participation in decision making, and with and without ESOPs

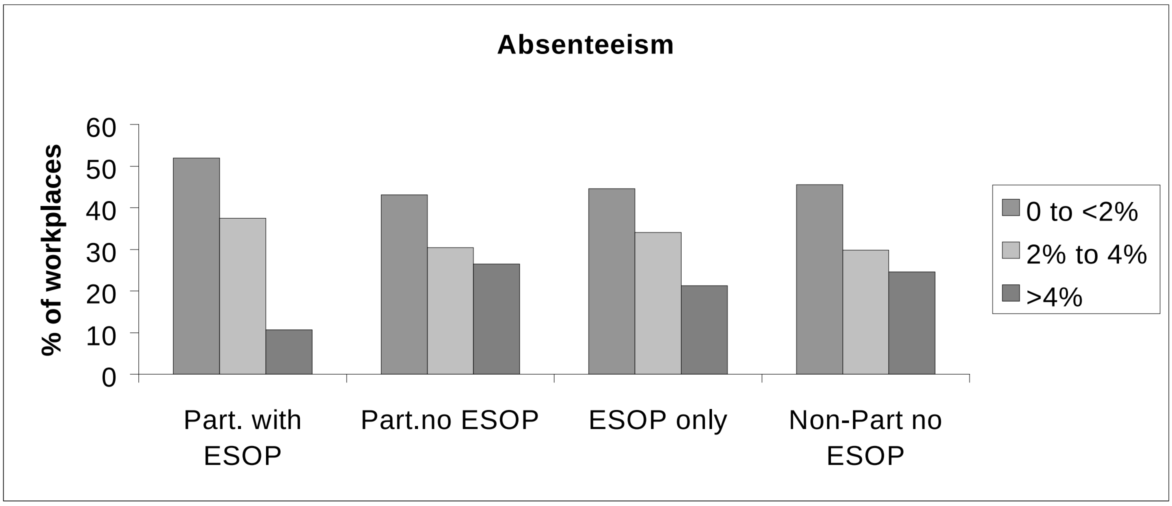


Source AWIRS 95 main survey, General Management and Employment Relations Management Questionnaires

Population: Private sector workplaces with 20 or more employees where productivity was measured. Figures are weighted and based on responses from 1024 workplaces

108 For example, M Blair, *Ownership and Control: Rethinking corporate governance for the twenty-first century*, Washington: The Brookings Institution, 1995; J Gates, *The Ownership Solution: Toward a shared capitalism for the 21st Century*, Reading: Addison-Wesley, 1998; R Brown and C Wah Lau, 'The extent and industrial pattern of employee share ownership plans in Australia: preliminary evidence', *Accounting Research Journal*, 10 (1997), p. 36.

Figure 3 **Absenteeism in workplaces with and without employee participation in decision making, and with and without ESOPs**



Source AWIRS 95 Main Survey, Workplace Characteristics Questionnaire and Employee Relations Management Questionnaire.

Population: Private sector workplaces with 20 or more employees. Figures are weighted and based on responses from 953 workplaces

Evaluating the justifications for employee share plans

2.103 Employee share plans are thought to better align the interests of employees with those of the employer. If this is true then encouraging them will produce various benefits to the community. Consequently, as a means of encouraging plans, the present arrangements provide various taxation concessions.

2.104 It is important for the community to know when it provides a taxation concession, that the concession is attaining the result desired. The major question from the point of view of public policy therefore, concerns the justification of employee share plans: do they in fact better align the interests of employees with those of their employer, leading to better enterprise performance and benefits to the community?

2.105 This is a question that cannot be answered with certainty, although intuitively it should be the case. A thorough examination of the reasons for the increase in the number of employee share plans and their effect, if any, on productivity in Australia has not been undertaken.[109] In fact, very

109 A point supported by R Brown and C Wah Lau, 'The extent and industrial pattern of employee share ownership plans in Australia: preliminary evidence', *Accounting Research Journal*, 10 (1997), p. 34.

little of a substantive nature is known about employee share plans in Australia at all.[110]

2.106 Moreover, despite the various taxation concessions provided and the possible effects of employee share plans on corporate governance,[111] neither the ASIC nor the ATO collect sufficient information to evaluate existing arrangements.[112]

2.107 This is not to say that there is no information available concerning the putative effect of employee share plans. The information that supports the extension of public policy in this area is drawn from studies conducted abroad, two studies conducted by the then Department of Industrial Relations in 1990 and 1995,[113] and also from anecdotal evidence provided by enterprises in Australia and abroad.

2.108 An analysis of this information, however, yields equivocal results. Although the evidence in support of employee share plans improving productivity is limited, it is nonetheless encouraging. This is a conclusion which is also supported in some submissions.[114] In contrast, subjective assessments of the positive impact of employee share plans were provided to the Committee by enterprises.[115]

2.109 It should be noted that the Australian Workplace Industrial Relations Surveys (AWIRS) 95 survey revealed that workplaces that had an employee share plan 'were more likely to have experienced some form of industrial action than non-ESOP workplaces (17 per cent v 13 per cent), more likely to have had strike action (2 per cent v 1 per cent) and a combination of strike and non-strike action (9 per cent v 4 per cent)'.[116] This may reflect the fact that while penetration of ESOPs is limited it tends to be confined to large, unionised workplaces.

2.110 Advocates of employee share plans claimed before the Committee that a number of benefits flow to business, and thereby the economy and the wider community, from employee share plans. In addition to the capacity to provide employees with income while minimising taxation liability, and the benefits to the apparent performance of an enterprise from

---

110 The Australian Workplace Industrial Relations Survey, 1995, is an exception.

111 See Chapter 5.

112 This omission is discussed in Chapter 3, and recommendations are made to remedy it.

113 The Australian Workplace Industrial Relations Surveys (AWIRS). The analysis of the 1995 AWIRS is presented in A Morehead, *et al*, *Changes at Work*, DWRSB, 1997. Cited in submission no. 38, p. 1, note 3.

114 For example see submission nos. 25, 27, 29, 31, 38, 42.

115 Submission nos. 3, 6, 8, 9, 11, 14, 17, 18, 21, 23, 26, 31, 32, 33.

116 Submission no. 38, p. 26.

excluding the value of equity issues from annual accounts, further benefits to business nominated by witnesses include:

- increased productivity;[117]
- cultural change, which includes better workplace relations, decreased turn-over of staff and a better capacity to attract high calibre staff and lower absenteeism;[118]
- better run companies, including higher returns on assets, higher profitability;[119] and
- increases in national savings.[120]

2.111 A comprehensive study on employee share ownership was conducted by the US General Accounting Office in 1986. Its report was based on a survey of 4,174 plans covering more than seven million employees. It demonstrates well the equivocal nature of the evidence concerning the efficacy of employee share plans. However, in a sample of 3,657 of the 4,174 plans the following positive results were reported.[121]

- 66 per cent reported improved morale;
- 36 per cent reported higher productivity;
- 33 per cent reported reduced labour turnover; and
- 23 per cent reported improved profitability.

These figures are encouraging.

2.112 Mr Richard Stradwick advised the Committee that in this survey many small firms reported that productivity was difficult to measure and could not respond.[122] A sample of 3,636 of the 4,174 plans surveyed reported the following disadvantages:

- 57 per cent reported no disadvantages;
- 16 per cent reported dilution of the value of their stock;
- 16 per cent reported a repurchase liability;
- 4 per cent reported loss of control of the company;
- 3 per cent reported poor performance of their stock;

---

117 Submission nos. 5, p. 8; 25, p. 13; 30, p. 13; 38, pp. 17, 21; 35, 37.

118 Submission nos. 25, p. 13; 18, p. 4; 30, p. 13; 38, pp. 13, 21, 23ff; 33, p. 2; 34, p. 12; 35, p. 42.

119 Submission nos. 5, p. 8; 25, pp. 13-17; 30, p. 13; 38, pp. 21; 34, p. 12; 37; 42.

120 Submission no. 30, p. 13; 37.

121 This information is taken from submission no. 25, p. 15.

122 Submission no. 25, p. 15.

- 1 per cent reported difficulty in obtaining a loan to fund their plan; and
- 15 per cent reported other problems.

2.113 The equivocal nature of the evidence available in the United States was set out by Dr Margaret M Blair, who wrote that:

> The earliest empirical studies of employee ownership tended to be either isolated case studies or studies of companies that had set up ESOPs. The case studies often produced very optimistic results, suggesting that employee ownership would yield productivity improvements, but these studies were criticized because they were subject to 'selection bias'. Only the successful employee-owned companies survived to be studied, and the case studies tended to be of the most successful of those. The earliest systematic studies based on large samples provided little support for the idea that ESOPs improve company performance. Subsequent research has tended to confirm that the presence of an ESOP does not, by itself, seem to improve corporate performance.
>
> But a growing number of studies suggest that performance is significantly enhanced when ownership of equity by employees is combined with other programs that enhance employee participation and control over the company.[123]

2.114 Ms Sarah Turberville, from the Department of Management at Monash University, added weight to this assessment when she testified that employee share plans do not appear to have a significant effect on employee attitudes and whether employees come to consider themselves more like owners than employees. A major problem in this area, she suggested, was disentangling the effect of different workplace practices that affect performance, and the fact that an employee's performance may be affected by a number of different factors.[124]

2.115 The conflicting evidence and the quality of the information, as noted, makes reaching a clear conclusion exceedingly difficult. Taking all this information together, however, it appears to the Committee that the Department of Employment, Workplace Relations and Small Business, provided a worthwhile summary of the status of employee share plans in enterprise performance. The Department advised the Committee that:

> A strong theoretical argument can be made that ESOPs should lead to improvements in organisational performance through a

123 M Blair, *Ownership and Control: Rethinking corporate governance for the twenty-first century*, Washington: the Brookings Institution, 1995, p. 313-314.

124 *Transcript of Evidence*, p. 292.

number of mechanisms, in particular through increasing employee motivation and commitment to the organisation.

While often supportive of this theoretical conclusion, the empirical evidence on the impact of ESOPs is at times less clearcut. A range of studies have found that ESOPs can lead to improved productivity, profitability, growth and reduced absenteeism and labour turnover (to name but a few factors). On the other hand, some studies have come up with findings suggesting that ESOPs have little or no positive impact.

One approach which has provided more consistent results has been to consider the impact of ESOPs in a broader context of organisational change. For instance there seems to be strong evidence that more positive results ensue when ESOPs are linked to broader employee participation measures.

The AWIRS 95 data sheds light on the associations between the presence of ESOPs and various workplace characteristics related in one way or another to workplace productivity and performance. Based on the AWIRS 95 data, ESOP workplaces are associated with stronger perceptions of improved productivity, a greater propensity to measure productivity, lower levels of absenteeism, labour turnover and dismissals and higher levels of workplace change. All of these factors could be seen as related to improved organisational performance.

On the other hand ESOPs were associated with slightly higher levels of disputation and mixed results in terms of employee participation. These associations on their own do not provide conclusive evidence for establishing absolute or exclusive causal links. For example, as was noted above, the figures relating to industrial disputes are heavily influenced by the fact that ESOP workplaces are more likely to be unionised workplaces with a delegate.

Often it is the case that there are a number of different possible causes for an observed outcome, and sometimes an outcome will be linked to a number of causes, often in a complex manner. Indeed, a review of the literature surrounding topic areas such as productivity, absenteeism, labour turnover, employee satisfaction, or industrial disputation would indicate that these outcomes are potentially a function of numerous and often competing organisational, workplace, employee and environmental factors or characteristics.

> The analysis of the AWIRS 95 data does however provide strong prima facie evidence that ESOPs can lead to improvements in a range of factors related to improved workplace performance.[125]

2.116 The absence of clear data makes framing public policy especially difficult when this involves the use of public funds by way of concessional taxation treatment. However, while it is difficult to demonstrate a sustained causal link between improved productivity and the operation of an employee share plan, it does appear to be the case that the introduction and operation of an employee share plan may be related to the existence of a progressive workplace culture and related management practices, which in turn can increase enterprise performance. It may be that companies with employee share plans are better performing enterprises but that firms with such plans tend to exhibit more progressive management practices and a progressive organisational culture. On the whole, this leads to better performing enterprises.

2.117 Such information is not generally available. As a result, up to date information on effective, contemporary management practices, including the use of employee share plans in well managed enterprises, is not easily accessible within the small, medium, unlisted and sunrise enterprise sectors.

2.118 The two decade experience with employee share plans in the United Kingdom[126] has led the Blair Government to legislate for new forms of employee ownership plan. For the Blair Government there is no doubt about the economic and social effect of promoting employee share ownership. As the United Kingdom Financial Secretary, Mr Stephen Timms MP, said in a *Budget Day Press Notice*:

> This new plan is a cornerstone of the drive to tackle the productivity gap and promote a high investment Britain, a Britain where we reward enterprise and provide fairness for all. Only by pursuing both enterprise and fairness together can we equip Britain for the future and secure rising living standards for everyone.
>
> This is why employee share ownership is so important to this Government and why we have put in place a range of measures to promote employee share ownership that is unparalleled in the world.[127]

---

125 Submission no. 38, pp. 31-32.

126 See appendix F.

127 http://www.inlandrevenue.gov.uk/news/budgetreleases/rev3.doc; downloaded 1 May, 2000.

Recommendation 2

2.119 **The Committee recommends that the Government fund, on a contestable basis, independent, university-based research into best practice management in relation to employee share plans.**

Recommendation 3

2.120 **The Committee recommends that the Government develop, in conjunction with educational institutions and private sector industry groups, educational programs designed to make information about contemporary management practices available to small and medium unlisted companies, and companies in sunrise industries.**

Extending the rationale: the role of employee share plans in national savings

2.121 The first legislative initiatives for employee share plans and subsequent legislative action have, for the most part, assumed that the purpose of employee share plans is to align the interests of employees and employers. While this remains the primary purpose, others have arisen as the Australian economy has developed and various social trends have emerged. They include the role that plans may play in succession planning and in fostering sunrise enterprises. However, the most important additional justification for fostering employee share plans which was urged upon the Committee was the place of plans in a national savings program.

2.122 Despite the increasing popularity of employee share plans, their place in a national savings program has not been fully considered by Parliament nor been the subject of clear policy. Such a consideration is timely. Adopting policies that promote employee share plans because of a range of benefits to the community will provide the certainty required for the further development of employee share plans and a strong justification for continued concessional treatment.

2.123 Australians are not by habit enthusiastic savers.[128] As reported in the *OECD Economic Outlook*,[129] Australians were expected to save about 2.1 per

128 'The Measurement of Saving in Australia', *Economic Round Up*, Spring, 1999. See also V W Fitzgerald, *National Saving*, Commonwealth of Australia, Canberra, 1993.

129 'Annex Table 26: Household Savings Rates', *OECD Economic Outlook 66*, December, 1999, Paris: Organisation for Economic Co-operation and Development, p. 218.

cent of their disposable household income in 1999. This is the lowest figure in the OECD with the exception of New Zealand (1.7 per cent), and lower than Canada (2.2 per cent), Sweden (2.3 per cent) and the United States (2.5 per cent). This should be compared with other countries such as Japan (12.2 per cent), Germany (11.2 per cent), France (15.2 per cent), Italy (11.3per cent), Hungary (19 per cent), Korea (12.2 per cent), Ireland (11.3 per cent), and Belgium (12.8 per cent).

2.124 As a result, many Australians have not developed a large pool of savings that can be used for major life-time events. The only option for many Australians will be that at some time in their lives they will have to call upon the social security system to support them.

2.125 All political parties support the maintenance of a social security safety net for those in genuine need. The problem that faces Australia is funding this system. As the population profile of Australia will age substantially over the next several decades, it is important that greater reliance on private savings be encouraged.

2.126 This is seen most dramatically when the projections for the period 1995-2041 are considered. Based on research conducted by the Australian Bureau of Statistics and reported by the Australian Institute of Family Studies,[130] they provide a stark and sobering picture:

- From 1996 to 2041 there will be a steady rise in the proportion of people over the age of 65, from 12 per cent in 1995 to 22 per cent in 2041. This will result in a near doubling of the aged dependency ratio from 18.1 to 34.8.[131]
- By the year 2041, for every 100 people of workforce age there will be 36 elderly people and 29 child dependants. Overall, the dependency ratio will increase from 50.3 in 1995 to approximately 65 in 2041, an increase of 26 per cent.

2.127 This raises a number of public policy issues that need to be addressed as soon as possible. These include:

- As the pool of elderly people increases, so will the pool of middle-aged carers decline (or at least the ratio of carers to those being cared for).
- The costs of caring for a greater number of elderly people will place significant demands on public expenditure unless the rate of national saving can be significantly increased.

130 David de Vaus and Ilene Wolcott (eds), *Australian Family Profiles: Social and Demographic Patterns*, Melbourne: Australian Institute of Family Studies, 1997, p. 6.

131 The overall dependency ratio represents the number of people aged less than 15 years and more than 65 years (the dependent age groups) as a proportion of the number of people of working age. This is expressed as the number of people in the dependent age groups per 100 people in the working age group.

2.128 Apart from taxation revenue expended at the time, the primary way of funding the retirement programs for an aging population will be by a maturing superannuation system. It is of concern to the Committee that even with compulsory superannuation contributions there will not be adequate funds available for all Australians to enjoy a comfortable retirement.

2.129 This concern has been reinforced recently by comments from Ms Philippa Smith AM, the chief executive officer of the Association of Superannuation Funds. Ms Smith was reported in the press to have said that:

> …present super levels would not allow for adequate retirement income for the estimated 20 per cent of the population that will be over 65 and eligible for retirement by 2031.
>
> …this would mean the cost of health care and the aged pension would rise from 10 per cent to 22 per cent of GDP, resulting in a $60 billion annual cost to the community.
>
> Taxes would then need to be increased to cover this 'black hole' in the economy.[132]

2.130 One submission assessed the problem this way:

> As our population ages so too will the need for an absolute dependence upon national savings. … based on research undertaken by the Australian Institute of Family Studies, by the year 2041 for every 100 workers there will be 65 dependents. … ESPs as a 'second' savings platform to superannuation will assist in alleviating this potential crisis.[133]

2.131 This problem is one being faced in all the developed, industrialised economies.[134] This pressure on the capacity of superannuation to provide a reasonable retirement is heightened when the 'mechanics' of superannuation are considered. For example, Mr Arthur Levitt, the Chairman of the United States of America Securities Exchange Commission said:

> There is another word every investor in America needs to understand: cost. Investing in our markets costs money. Executing transactions, sending account statements, even switching

132 J Stensholt, 'Call to boost super payments', *The Australian Financial Review,* 7 March, 2000, p. 10.

133 The Kenneths Group, submission no. 7, p. 3.

134 United Nations Research from *World Population Prospects 1992* (New York: United Nations, 1992), reported in: David de Vaus and Ilene Wolcott (eds), *Australian Family Profiles: Social and Demographic Patterns,* Melbourne: Australian Institute of Family Studies, 1997, p. 8.

> investment managers entail expenses that are paid by the investor. And, fees matter to an investor's bottom line. A one percent annual fee will reduce an ending account balance by 17 percent after 20 years.[135]

> With this in mind, the Committee agrees with an assessment of compulsory superannuation made in 1993: ‘The hoped for positive effects of superannuation policies on national saving, however, depend critically on maintaining a strongly positive regime for voluntary financial saving in other forms’.[136] The Committee considers that employee share plans may also have a vital role to play as part of a system of national savings and retirement planning.[137]

2.132 At present, the major source of retirement income is via the social security system, the central elements of which are a taxpayer funded national pension scheme and compulsory superannuation.

2.133 As noted, the level of savings by individuals in Australia is low compared to other developed economies. The Committee considers that employee share ownership plans should have as a policy objective, increasing the pool of national savings.

2.134 The current social security arrangements are supported by the overwhelming majority in the Australian community. In terms of prudent retirement planning, employees express a clear preference for superannuation and generally regard shares as a supplement to income and more secure retirement investment options, such as superannuation.[138] The Committee believes this should be reflected in public policy, as it reflects an obvious fact: Australians are prepared to trade some degree of return and choice for security and certainty.

2.135 The Committee believes that a retirement planning policy must provide for clear gains with minimal risk. Employee share plans are, on this view, supplementary and additional. Consequently, the Committee agrees with RPC that:

> ESOPs should never be …viewed as an alternative to superannuation. In certain circumstances ESOPs can be applied as

135 Arthur Levitt, *The SEC Perspective on Investing Social Security in the Stock Market*, speech delivered to the John F. Kennedy School of government Forum, Harvard University, 19 October, 1998. Downloaded from: http://www.sec.gov/news/speeches/spch223.htm on 22 February, 2000.

136 V W Fitzgerald, *Saving Through the Firm*, The Allen Consulting Group, 1993, p. vii.

137 A view supported in many submissions, including submission nos. 5, 7, 10, 30.3, 36; 31; 28; 26.

138 Australian Manufacturing Workers’ Union, submission no. 12.

a medium and long-term supplement to superannuation, which is entirely appropriate.[139]

2.136 Taking into account these considerations, the Committee concludes that share plans should be added to the list of investments available for retirement planning. At present, share plans are additional investments to superannuation, rather than alternative or competing investments. The Committee concludes that the *status quo* should be maintained, but that incentives should be provided to convert employee share plan participation into preserved superannuation investments.

2.137 Compulsory superannuation should remain and where possible, taxation concessions available in this area should be applied as equitably as possible.

Recommendation 4

2.138 **The Committee recommends that legislative measures should ensure that employee share plans are not used as an alternative to mandatory superannuation for general employees.**

2.139 If a concession can be made to an employer to establish an employee share plan open to all employees, and which even the lowest paid will elect to join, and the benefits of that plan can be transferred to a preserved superannuation plan, then it would be appropriate for the Government to offer some incentives to do so. Such an approach may lift national savings levels and also enhance retirement planning. The Committee therefore supports tax concessions to encourage participants in employee share plans to convert their at-risk equity holdings into preserved superannuation investments.

2.140 Nevertheless, apart from maintaining the compulsory nature of superannuation and allowing employee share plans to be additional forms of savings, the exact role of employee share plans within a national savings and retirement program remains to be determined. The Committee agrees with a sentiment expressed by the Business Council of Australia, that 'the potential for operating ESOPs as a tool to increase the level of long term savings and investment in Australia should be further examined (and also include analysis of the interface between ESOPs and superannuation arrangements)'.[140]

139 RPC, submission no. 30.3.

140 Business Council of Australia, submission no. 36.

2.141 These conclusions raise a general matter upon which the Committee wishes to make some observations. The recommendations in this report are designed to foster the growth of employee share plans and in particular, incorporate them into a national savings strategy. However, key elements of that strategy and an overall plan are outside the ambit of the present inquiry. Nevertheless, the Committee recommends that solutions be found to what is an emerging problem in retirement planning and commends a foreshadowed review of national savings policy.[141]

2.142 What must be developed in this country is an integrated suite of retirement planning measures. Such measures will succeed only if they provide an appropriate mix of low risk, certainty and compulsion, as superannuation does, and higher risk, choice, and inducements to invest, as employee share plan participation should. The Committee believes that public policy settings in respect of employee share plans should be framed with this in mind. In this respect, the Committee agrees with the suggestion of the Business Council of Australia that, 'If increased savings or long term commitment to an enterprise are intended outcomes of ESOP operation, the structure should reflect this and offer incentives to ensure that these results are obtained'.[142] The recommendations in Chapters 3, 4 and 5 are designed, in part ,to produce these results.

2.143 The Committee draws several conclusions from this. First, as noted, public policy seeks to foster plans because it is hoped that there will be a benefit to the community in terms of increased productivity. While this motivation for the current arrangements still remains, in order to justify promoting still further employee share plans in any sector, additional benefits to the community must be obtained. Principally, these benefits must be in terms of fostering national savings while ensuring that employee share plans are not used to avoid tax.

2.144 As a result, the Committee concludes that employee share plans should continue to be promoted, not only because they may be part of a raft of initiatives that can improve productivity but because they have the potential to be used to further other socially desirable goals. One of these is the objective of increasing national savings. Other reasons, such as assisting in succession planning and transferring ownership of small businesses when the existing owners wish to retire, and fostering the development of enterprises in sunrise industries, are important to promoting national prosperity and are considered in Chapter 5. When these considerations are taken together, a compelling case can be made for

141 B Pragnell and M Rice, 'Next cab off Howard's rank', *The Australian*, 16 March, 2000'; B Dunstan, 'Super review the next cab off the rank', *The Australian Financial Review*, 11 May 2000.

142 Business Council of Australia, submission no. 36.

supporting general employee share plans. Public policy should be framed with these goals in mind.

2.145 Second, despite the purpose attributed to employee share plans by Parliament, the motivation and purpose that they have in practice will, ultimately, be determined by the market. Public policy should be framed so as to ensure that the community benefits from the operation of such plans. Legislation and practice should be harmonised so as to maximise public benefit.

2.146 Third, the potential that employee share plans have to reduce the call upon social security assistance by retirees should be clearly recognised by appropriate and sympathetic public policy.

2.147 Fourth, the Committee was also made aware of the importance of employee share plans in the development of sunrise enterprises.[143] The Committee notes that the use of share and share-option plans to attract and retain high calibre staff is increasing amongst technology-oriented businesses in Australia. Some venture capitalists regard it as an essential condition in order to be a viable candidate for venture capital investment.[144]

2.148 Finally, the issues of employee buyouts and succession planning were raised with the Committee. Accounting firm Ernst & Young advised the Committee that employee buyouts are rarely seen in Australia although they were common in the United States and Canada.[145]

2.149 Unlike Australia, where employee share plans are mostly confined to publicly listed companies, the situation was the opposite in the United States. According to the AEOA, in the United States the overwhelming majority are in unlisted businesses; by some estimates 90 per cent of employee share plans. The AEOA also advised the Committee that by the year 2000 in the United States a quarter of all public companies would be more than 15 per cent owned by employees and that 25 per cent of all private companies would have an employee share plan of some kind.[146] The Committee concludes that facilitating employee buyouts or 'buy-ins' would greatly increase the level of employee share ownership in Australia and that this should be an aim of share plan policy.

---

143 David Gaul, CEA Technologies, submission no. 9; Australian Venture Capital Association, submission no. 45.1 and Mr Andrew Green, *Transcript of Evidence*, p. 377ff; Australian Information Industry Association submission no. 48.

144 L Caruana, 'Drug money: science's bitter pill', *The Australian* 15 October, 1999, p. 26.

145 Submission no. 20.1, p. 3.

146 AEOA, submission no. 5, p. 7.

2.150 In a paper written by Mr Tom Hardwick and provided as an exhibit to the Committee by the author, it was stated that a 1997 survey conducted by the Monash University Family and Private Business Research Unit revealed that over the ensuing decade 60 per cent of private business owners planned to retire. This would involve a transfer of ownership of business and assets worth approximately $607 billion. Only 30 per cent of owners had succession plans in place.[147] Owing to the structure of Australian taxation and corporate law, sale of the enterprise to employees would be difficult and costly. As Mr Hardwick notes in his paper, the AEOA is unaware of any widespread use of employee share schemes in privately owned companies and both the Family Business Council and the Foundation for Family and Private Business are also unaware of any use of employee share schemes by privately owned companies for succession planning purposes.[148] It is clear to the Committee that using employee share plans as vehicles in succession planning would greatly expand the number of Australians who would have access to share ownership.

2.151 The Committee concludes that the potential that employee share plans have to foster the development of sunrise industries, employee buyouts and succession planning should be clearly recognised by appropriate and sympathetic public policy.

Recommendation 5

2.152 **The Committee recommends that public policy should be formulated so as to promote employee share plans for the following purposes:**

- **to better align the interests of employees and employers;**
- **to develop national savings;**
- **to facilitate the development of sunrise enterprises; and**
- **to facilitate employee buyouts and succession planning.**

147 T Hardwick, 'Succession planning in private business and employee share ownership plans', exhibit no. 18, p. 3.

148 T Hardwick, 'Succession planning in private business and employee share ownership plans', exhibit no. 18, p. 14.

Recommendation 6

2.153 **The Committee recommends that the Government introduce a concessional taxation rate on up to 50 per cent of the proceeds of the sale of any equities acquired under an employee share plan that operates under Division 13A of the *Income Tax Assessment Act 1936*, and which is open to 75 per cent of a company's employees, where the taxpayer:**

- **invests, as a preserved contribution, up to 50 per cent of the proceeds of the sale of any equities acquired under such a plan in an approved superannuation fund in the participant's name; or**
- **invests in an approved trust structure established to provide income for a dependant, for the term of their legal dependency; or**
- **has reached retirement age or after, and uses the proceeds to fund retirement.**

The Committee recommends that a maximum allowable limit should be applied in any one tax year. That limit should be set to advantage general employee share plans. The concessional tax treatment will apply only to that qualifying portion of the proceeds invested in the terms described. The nature and level of taxation concessions provided should be determined by the Government after consultation with appropriate industry bodies, the Employee Share Plan Advisory Board (see recommendation 9) and the Australian Taxation Office.

Recommendation 7

2.154 **The Committee recommends that a national review be conducted on the possible investment options, that could be encouraged in addition to compulsory superannuation, that would:**

- **increase national savings, and in the longer term,**
- **promote greater self-reliance in retirement.**