

Financial Executives International of Australia**Tuesday 13th July 2010****Recent Changes on Board Composition & Remuneration Disclosure****Annette Kimmitt, Managing Partner, Ernst & Young Melbourne**

In December 2009 the ASX Corporate Governance Council (CGC) issued proposals that would require listed companies to adopt and disclose a diversity policy, with that diversity policy having to include measurable objectives related to gender. The proposals look set to have effect from 1 July 2010, and when coupled with the imminent reporting of a major review by the Equal Opportunity for Women in Work Agency, make this year one of heightened focus on how companies are performing in the representation of women at board and executive levels and in gender pay parity.

On the remuneration front, the Government commissioned a report from the Productivity Commission on the director and executive remuneration framework in Australia. The report was commissioned as part of the Governments response to community concerns over remuneration practices in Australia. The PC issued a discussion draft of recommendations last September, and the ASX CGC after reviewing those recommendations, has now also weighed in with recommendations for extending its *Corporate Governance Principles and Recommendations* in the area of director and executive remuneration. These CGC proposals would also have effect from 1 July 2010

SESSION OUTLINE

1. Executive remuneration
 - Productivity Commission discussion draft and next steps
 - ASX CGC recommendations

2. Diversity
 - ASX CGC recommendations
 - The case for change and potential inhibitors
 - The reactions and responses so far
 - Where to from here?

EXECUTIVE REMUNERATION

Productivity Commission discussion draft and next steps

- Discussion draft concluded that the usefulness of remuneration reports has been diminished by their complexity, placing a significant burden on companies and also causing investors to find it impenetrable and even misleading
 - Recommended including a plain English summary statement of remuneration policies as well as actual levels of remuneration and individual shareholdings of those listed in the report
 - But is not recommending any reduction to disclosure requirements, arguing that reductions to disclosure requirements would not significantly reduce the compliance burden on companies.
- Also recommended implementing a two-strike policy on the remuneration report vote. If a company receives a 'no-vote' of $\geq 25\%$ at the AGM for two consecutive years, the company must, at that second AGM, put a resolution to the shareholders for the re-election of the directors who signed the directors' report. If the resolution is passed by a majority shareholder vote, the directors must individually submit for re-election within 90 days
 - During the round of AGMs at the end of 2009, approximately 16% (18/114) companies received a 'no-vote' of $\geq 25\%$
- Government recently announced its support for these recommendations, but the final positions will be clarified through legislation expected to take effect from 1 July 2011.
 - PC currently has a working party looking at submissions on the discussion draft and will report back by to Government in October/November this year on changes that should be adopted (so after the 2010 reporting and AGM seasons)
 - Government has asked Corporations and Markets Advisory Committee (CAMAC) to advise on how best to revise the legislation (S300A) on remuneration reports
 - Has also asked CAMAC for recommendation on how the incentive components of executive pay arrangements could be simplified to improve transparency and strengthen the correlation between the interest of a company's executives and the interests of its shareholders
 - Has insisted that CAMAC consult with Treasury, AICD, major accounting firms and remuneration advisers in formulating its recommendations

ASX CGC recommendations on executive remuneration (issued Dec 2009)

- ASX CGC looking to extend its *Corporate Governance Principles and Recommendations* to address some of the issues raised by the Productivity Commission (in Sept 2009 discussion draft on *Executive Remuneration in Australia*).
- *Principles and Recommendations* currently recommend that the remuneration committee should be made up of a majority of independent directors, be chaired by an independent director and have at least 3 members. CGC is proposing to elevate this recommendation to an “if not, why not?” disclosure
- ASX is also proposing to introduce a listing rule that will mandate this as the composition of the remuneration committee for ASX 300 companies
- Final changes will depend on final recommendations of the Productivity Commission and extent to which they are adopted by Government.

DIVERSITY

ASX CGC recommendations on diversity (issued Dec 2009)

- ASX CGC looking to extend its *Corporate Governance Principles and Recommendations* to address issues raised by Corporations and Markets Advisory Committee (CAMAC – in March 2009 report *Diversity on Boards of Directors* and June 2009 report *Aspects of Market Integrity*).
- *Principles and Recommendations* to be expanded to recommend requiring each listed entity, on an “if not, why not?” basis, to establish a diversity policy that includes measurable objectives relating to gender, as set by the board.
 - Policy must be disclosed to the market in full or in summary
 - Each listed entity to disclose in its annual report, on an “if not, why not?” basis:
 - achievement against gender objectives set by the board
 - proportion of women employees in the whole organisation, in senior management and on the board
 - Nominations committee has responsibility for addressing strategies on gender diversity for board and company in general.
 - Should include in their charters a requirement to continuously review the proportion of women at all levels in the company
 - Board performance review required to include consideration of diversity criteria in addition to skills
 - Boards required to disclose what skills and diversity criteria used for any new board appointment

Diversity: the case for change and potential inhibitors

The case for change

A growing and extensive body of research is showing that women make significant and proven contributions to business and economic growth, but that in both emerging and developed markets, including in Australia, they are not enjoying the full benefits of workforce participation. This includes experiencing wage and occupational disparities and little or no visibility in corporate board rooms and executive ranks. The research shows that this is occurring even in situations where women are equally or even better educated than men.

The research

1. At a macro level, economic analysis and research by the World Bank, the United Nations, Goldman Sachs and a range of other organisations is showing a significant statistical correlation between gender equality and economic development – the evidence is compelling that women are powerful drivers of economic development
 - Since 2006, the World Economic Forum (WEF) has issued a *Global Gender Gap Index*, which captures and tracks the magnitude and scope of gender disparities. The WEF also publishes a *Global Competitive Index*, which measures the set of institutions, policies and factors that define a country's productivity level. When the WEF compared its Gender Gap scores with its Competitive Index scores, and also measured the Gender Gap scores against GDP, it found that both comparisons statistically confirm the correlation between gender equality and national competitiveness
 - When it comes to this region, the UN Economic and Social Commission for Asia and the Pacific has come out saying the restriction in senior opportunities for women that exists across the region is costing the region more than US\$40billion a year in GDP growth.
 - The OECD has followed up this research by citing Australia as one of the worse performing of the developed countries when it comes to gender parity in board and executive ranks – as of six months ago, only 8.2% of board positions were held by women and more than half of our listed companies have no female representation at all. Of the 110 members of the Business Council of Australia, only 4 are women (Gail Kelly of Westpac, Tracey Fellows of Microsoft, Anne Pickard of Shell and Catriona Noble of McDonalds). The OECD is citing these issues as inhibitors to Australia's ongoing competitiveness on the international stage.
 - The Productivity Commission thus sat up and paid attention to the issue.
 - Because a nation's competitiveness depends significantly on whether and how it educates and then utilises its female talent, women's participation is being regarded as an opportunity for Australia to make competitive headway.
 - The challenge: in Australia the number of women on boards and in executive positions has been steadily declining since 2004

2. There is also a wealth of research from a broad spectrum of organisations, including Catalyst, McKinsey, Goldman Sachs and Columbia University, that examines the relationship between corporate financial performance and women in leadership roles. Their undisputed conclusion is that having more women at the top improves financial performance.

- For example, a 2007 *Catalyst* report (*The Bottom Line: Corporate Performance and Women's representation on Boards*) found that on average, Fortune 500 companies with more women on their boards turned in better financial performances than those with fewer women on boards. And three seems to be the magic number: performance was notably stronger than average at companies with three or more women on the board.
 - On measures of return on equity, return on sales and return on invested capital, the companies with the highest representation of women outperformed those with the least by 53%, 42% and 66% respectively
 - The correlation between gender diversity and corporate performance also held up across industries from healthcare to information technology.
- Likewise a 2007 McKinsey study (*Women matter*), which surveyed 101 large corporations across Europe, America and Asia across a spectrum of industries, showed that companies with three or more women in senior management scored higher than companies with no women at the top on nine criteria of organisational excellence: leadership, direction, accountability, coordination and control, innovation, external orientation, capability, motivation and work environment and values.
 - Performance increased significantly once a certain critical mass was achieved – namely at least three women on management committees for an average membership of ten people
 - Below this threshold there was no significant difference in company performance.
- McKinsey tested these findings by undertaking a second study and comparing the financial performance of 89 European listed companies, each with high levels of executive gender diversity in their respective sectors, with the average performance for their sectors. Each of these companies outperformed their sector in terms of return on equity, EBIT and share-price growth.

The market-place and policy makers are now paying attention to this research. In Australia, labour force growth is forecast to slow dramatically over the next decade, which is expected to result in a period characterised by chronic labour pressure, particularly for critical skills. This means we must make optimal use of the available talent pool, including the cohort of highly skilled and qualified women participating in the labour market.

- 2009 Goldman Sachs JBWere report (*Australia's Hidden Resource: The economic case for increasing female participation*) concludes that unleashing Australia's ready-made pool of talent would significantly increase Australia's GDP

Potential inhibitors to progress – why haven't we made any progress

- Notwithstanding the research supporting the case for diversity, the experience of recent decades highlights that realising the full potential of women to business and the economy continues to be a complex and elusive challenge
- Many employers are now experiencing 'gender fatigue', which stems from their inability to identify and remediate whatever it is that's at the heart of gender bias
 - Employers are perplexed about what to do next: they can see that women are under-represented at senior levels yet workplace policies and initiatives are having a neutral effect and their colleagues don't generally exhibit overtly biased behaviours
- But we cannot claim that Australian companies have in the past been meritocracies when it comes to this issue – leadership capability is more evenly dispersed across the genders than the current executive and board ranks imply!
- Some clues from the research
 - Talent management systems are vulnerable to gender biases and therefore contribute to and compound differences in advancement rates between men and women
 - Research suggests that gender bias is typically embedded in talent management systems by prioritising and looking for stereotypically masculine traits. For example, being 'action oriented' is a stereotypically masculine trait embedded in > 80% of talent management systems
 - Gender bias is embedded in the design of executive roles, but is latent and therefore difficult to identify. For example, excessive networking and unpredictability of work are typically regarded as critical features of an executive role, but can be particularly problematic for women (especially when combined with caring responsibilities)

Diversity: the reactions and responses so far

In addition to the ASX CGC recommendations on diversity, and in response to the overwhelming research linking company performance to gender diversity at leadership levels and on boards, the Australian Institute of Company Directors (AICD) and the Business Council of Australia (BCA) have put in place initiatives for progressing the number of women on boards and in executive roles.

- AICD launched its female executive mentor program. 56 Chairmen and senior directors (mix of male and female but predominantly male) working with 63 'up and coming' female executives in a mentoring relationship over 12 months to get the women 'board ready'
 - AICD has also been proactive in challenging recruitment firms to more proactively find suitably qualified female candidates for board roles (rather than consistently putting forward candidates from existing or long-standing talent pools)
 - Already signs that the AICD program is producing results
 - So far in 2010, 24% of all ASX 200 board appointees were female, compared to just 5% in 2009 and 8% in 2007 and 2008.
 - In less than six months this year, 24 women have been appointed to ASX 200 boards, compared to only ten for the whole of 2009. This has seen the percentage of women on ASX 200 boards increase from 8.3% at the beginning of this year to 9.2% today, with a large proportion of the increase coming from previously untapped talent entering the 'pool'
- BCA has also begun a 12-month pilot program with 11 council members who have agreed to mentor a senior woman in another BCA member company. The 11 mentors include Michael Luscombe of Woolworths, Mathew Quinn of Stockland, Ralph Norris of Commonwealth Bank and Stephen Roberts of Citibank

Also strong indications that institutional investors are paying attention to the research and getting ready to demand action

- Australian Council of Superannuation Investors (ACSI) currently exploring how to get investee companies to 'sit up and take notice' of this issue – eg encouraging investee organisations to early adopt the ASX CGC diversity disclosure recommendations and seeking to have those disclosures included in the remuneration report and subject to the non-binding shareholder vote

Diversity: where to from here and what can you do?

- As with any strategic business issue, the key is having an integrated approach that
 - Spans the short to longer term
 - Is driven from the top (must be owned by the CEO) including clear communication about how this will contribute to the business' future success
 - Is bedded in understanding and tracking the benefits to be delivered to the organisation. This includes understanding your metrics, setting targets and measures and promoting accountability
- Tools to assist: The *CEO Toolkit* is a diagnostic tool that was developed by Chief Executive Women (CEW) several years ago. It comprises a strategic framework and a pragmatic diagnostic to provide businesses with a foundation approach, method and measurement tool to build their business strategy. These issues are tackled using a company's own data to understand what the key drivers are within the company for attracting and retaining female talent
 - At the end of last year we applied the *CEO Toolkit* to one of our own lines of business at Ernst & Young. It helped us develop meaningful insights into some of the challenges and opportunities within our own organisation. We are now using those insights to help inform our strategic initiatives and actions and have applied the *Toolkit* across the broader Ernst & Young organisation to better understand our metrics, set our targets and measures and promote accountability
 - Our Advisory team has also partnered with CEW to support the *Toolkit's* deployment across the Australian corporate community, and have been working with a broad range of listed and unlisted organisations on their gender diversity challenges
 - The stage of maturity we are seeing across these organisations varies significantly in terms of both the representation of women in their business and in what the organisations are seeking to achieve
 - Seeing organisations span the divide from being purely focused on compliance with the ASX CGC gender diversity reporting requirements, to wanting to understand the gender diversity and talent sustainability outlook and investing in strategy and measures to secure a competitive advantage

To sum up:

- ASX CGC proposals look set to have effect from 1 July 2010.
 - ASX CGC, Government, Productivity Commission, Equal Opportunity for Women in Work Agency, institutional investors, AICD, BCA all agree the research is unequivocal on three fronts
 1. having more women at the top improves a company's financial performance
 2. having more women at the top is also a powerful driver of economic development and GDP growth
 3. Cannot rest on the assumption that time will correct current inequities
- So doing nothing in the hope it self-corrects won't be an option – try putting that in your disclosures!