

Remuneration Strategy Design and the Qantas Experience

Remuneration Strategy Design Issues

Most companies in the ASX 100 follow a formulaic approach to the design of executive remuneration: FAR/STI/LTI. LTIs and part of the STIs are almost always delivered in equity. Directors and executives are required to hold an amount of equity in their company (Minimum Shareholding Requirements).

The strategy is designed to align the interests of executives with those of shareholders. And it generally works quite well from that narrow perspective. The design however, cannot effectively balance the interests of all stakeholder groups. When customers, suppliers, regulators and employees rank lower on the corporate priority list the design becomes problematic.

When variable reward components are delivered primarily in equity the message is clear. It's all about profit and shareholder returns.

The Qantas Experience

In 2018 Alan Joyce, former Qantas CEO, was the highest paid executive in Australia with a package of almost \$24m.

When the pandemic hit Joyce elected to take no base pay from 1.4.2020 to 31.7.2020 and a 35% reduction from 1.8.2020 to 31.10.2020. Somewhat tokenistic when base pay is around the \$2.0m pa mark. But a gesture nonetheless.

Joyce received no STIs or LTIs 2020, 2021 and 2022. The Qantas Board's decision to freeze STI and LTI payments during the pandemic period was mirrored by many private and listed companies. This is a history of Joyce's realised remuneration for the past five years (Source Qantas Remuneration Reports 2019-2023):

Year	FAR (\$)	STI Outcome (\$)	Recovery Retention Plan (\$)	LTI Outcome (\$)	Realised Remuneration (\$)
FY 2023	2,301,000	Pending	4,327,000	14,815,000	21,443,000
FY 2022	2,272,000	0	0	0	2,272,000
FY 2021	1,979,000	0	0	0	1,979,000
FY 2020	1,744,000	0	0	0	1,744,000
FY 2019	1,910,000	1,758,000	0	6,329,000	9,997,000

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Qantas Remuneration Report- 83% No-Vote

In this Newsletter we discuss the most recent case of alleged corporate misconduct at Qantas and the linkage to executive remuneration. We have made every endeavour to avoid the hype that has surrounded Qantas over the last few months and which culminated with the tumultuous AGM on 3 November 2023.

Geoff Nunn & Associates

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Geoff Nunn
Board Advisor &
Governance Specialist
0418 595 107
gtnunn@gna.net.au
www.gna.net.au

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The Qantas Experience (Continued)

At its AGM on 3 November 2023 the Qantas Remuneration Report received an 83% No Vote from shareholders, the second largest in Australian corporate history (behind 88% for the NAB in 2018). Overwhelmingly, this was a negative response to the 2023 remuneration package for the former CEO (actual remuneration received was \$21.43m for the FY 2023). The STI component is zero at present, however the Board deferred it's decision pending further information. It has been calculated at a notional value of \$2.2m based on a 126% STI scorecard as shown below:

Source Qantas
Annual Report 2023
Pages 34

Strategic Objective	Weighting (target)	Outcome
Group Profitability	50%	●
Transformation and Growth	10%	●
Customer	20%	●
Workplace and Operational Safety	15%	●
Climate	5%	●
STIP Scorecard Outcome	100%	126%

● Target achieved or exceeded
● Partial achievement against targets
● No achievement against targets

Qantas STI KPIs have evolved in response to the pandemic. LTI KPIs have remained static during this period. This table tells the story:

STI Performance Drivers 2019-2023	2019	2020	2021	2022	2023
Key Performance Indicator	Weighting				
Underlying Profit Before Tax	50.00%	50.00%	30.00%	30.00%	50.00%
Transformation & Growth	10.00%	10.00%			10.00%
Recovery & Growth			20.00%	20.00%	
Workplace Safety	7.50%	7.50%	7.50%	7.50%	7.50%
Operational Safety	7.50%	7.50%	7.50%	7.50%	7.50%
Climate					5.00%
Net Promoter Score					
Punctuality/Reliability/Trust	15.00%	15.00%	15.00%	15.00%	20.00%
Domestic Market Position	10.00%	10.00%			
Leading Domestic Market Recovery			20.00%	20.00%	
Total	100.00%	100.00%	100.00%	100.00%	100.00%
LTI Performance Drivers 2019-2023					
Key Performance Indicator	Weighting				
Relative Total Shareholder Return	100.00%	100.00%	100.00%	100.00%	100.00%
Total	100.00%	100.00%	100.00%	100.00%	100.00%

Source Qantas Annual Reports 2019-2023

The survival of our national carrier has been a priority for the Federal Government since Qantas's financial viability collapsed in 2020/21. Despite the grief caused to customers and shareholders there are some positives during this period. Qantas ran a number of flights during the pandemic to repatriate Australians caught overseas when borders closed. It brought much needed vaccines into the country during this period. And more recently ran flights to Tel Aviv to bring Australians home when hostilities erupted in Israel.

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Former Qantas CEO Alan Joyce Image The Guardian 28.9.2023

The Governance Issues

Qantas shareholders have received zero dividends since FY 2019. Late in 2022 the share price began to recover to pre-pandemic levels and closed at \$6.30 on 30 June 2023. It has since slumped to \$5.18 on 3 November 2023 on the back of recent issues which include:

1. The illegal sacking of 1700 workers during the pandemic.
2. Selling tickets for 8000 flights already cancelled.
3. Lengthy delays in processing refunds to customers for cancelled flights during the pandemic.
4. Shareholder dissatisfaction with executive remuneration levels.

When Royal Commissioner Haynes handed down his final report into misconduct in the Financial Services Sector in early 2019 the findings signaled a wake-up call to directors and CEOs across all industry sectors. He made a number of observations which are summarised here:

"Those analyses, taken together, will reveal the importance of four observations about what has been shown by the Commission's work: The connection between conduct and reward; the asymmetry of power and information between financial services entities and their customers; the effect of conflicts between duty and interest; and holding entities to account."¹

As this newsletter is primarily about the structure of Qantas's executive remuneration strategy I'll just focus on first point above (conduct and reward).

¹ Final Report: Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Sector, February 2019 pp 2-3.

Geoff Nunn
Board Advisor &
Governance Specialist
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gtnunn@gna.net.au
www.gna.net.au

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What would Royal Commissioner Hayne, make of the conduct of Qantas over the last few years? The issues are not exactly the same as those uncovered during the Banking Royal Commission. But they are of the same nature. Deceptive conduct, putting profit ahead of customers, not accepting responsibility for mistakes, avoiding regulatory obligations.

Struggling for survival can evoke the fight/flight response in an organisation. But there are no excuses for the misconduct that Qantas has been accused of.

A Review of Design is Needed

Qantas needs a comprehensive review of its executive remuneration strategy. Not one that tinkers around the edges. Institutional investors need to support innovation and rediscovery of what we once knew, but have somehow forgotten. Back to basics is the best approach. A design that includes market competitive Fixed Annual Remuneration, a moderate Short Term Incentive scheme (delivered in cash), based on an appropriately weighted balanced scorecard.

To reward sustained long term performance the company might offer an LTI based on a combination of shareholder, customer and environmental measures (with equal weighting). The LTI might be delivered in cash with the option to acquire equity on an annual basis at a discount to market if the executive chooses to do so. No mandated equity holdings or holding periods. This was common practice in the corporate sector 25 years ago.

Delivery of financial, customer and operational performance is a base line accountability for all members of the executive team. We don't need elaborate equity based incentive plans to drive performance. Just measured accountability. A deep delve into the literature performance based incentives schemes will convince the readers of the perverse outcomes that result from lop-sided plans.

"Like all extrinsic motivators, goals narrow our focus. That's one reason they're effective; they concentrate the mind. For complex or conceptual tasks offering a reward can blinker the wide-ranging thinking necessary to come up with an innovative solution. Likewise, when an extrinsic goal is paramount – particularly a short term measurable one whose achievement delivers a big payoff – its presence can restrict our view of the broader dimensions of our behaviour."

Drive. Daniel H. Pink, Canongate 2009. P 50.



Still an Australian Icon?

The Message

We need our national carrier to be the iconic leader it once was. Trusted, acting with honest and integrity and providing a world class service. Remember the Qantas advertising campaign featuring the Peter Allen song: "I still call Australia home".



Image West Australian 11.10.2023

The campaign evoked a sense of pride in Qantas which had a well deserved reputation for safety and reliability.

The Board and Executive team have ensured the survival of Qantas when Australia's other major Airline, Virgin Australia, went into administration in 2020 with \$6.8 billion of debt. This is a commendable achievement.

We'll be watching closely to see how the Qantas Board and Remuneration Committee respond to the 83% No-Vote.

Additional Information

We've included a few figures on the next page which trace some financial and operational statistics for Qantas over the last five years as further background information.

Financial and Operational Performance - Qantas 2019-2023



A Selection of Corporate KPIs Source 2023 Qantas Annual Report

Category	KPI	Year				
		2019 N	2020 N	2021 N	2022 N	2023 N
Financial Performance	Total Revenue (\$m)	17,966	14,257	5,934	9,108	19,815
	Underling Profit Before Tax (\$m)	1,326	124	-1,774	-1,859	2,472
	Statutory Earnings Per Share (Cents)	51.50	-129.60	-89.90	-45.60	96.00
	Return on Capital Invested (%)	19.20%	5.80%	-21.40%	-31.60%	103.60%
	Operating Cashflow (\$m)	3,164	1,083	-386	2,670	5,085
	Dividend per share (Cents)	25.00	0.00	0.00	0.00	0.00
Operational Performance	Available Seat Kilometres (n)	151,430	111,870	29,374	50,633	117,258
	Passengers Carried (n)	55,813	40,475	15,866	34,363	45,725
	Aircraft in Service (n)	314	314	315	322	336

Five Year Share Price History Source Google Finance 5.11.2023

