

EMPLOYEE SHARE OWNERSHIP SCHEMES: EVALUATING THE ROLE OF TAX AND OTHER FACTORS USING TWO CASE STUDIES

**Andrew Barnes, Tanya Josev, Jarrod Lenne
Shelley Marshall, Richard Mitchell, Ian Ramsay
and Cameron Rider***

* Corporate Governance and Workplace Partnerships Project, Law School, The University of Melbourne. Richard Mitchell is also at the Department of Business Law and Taxation, Monash University.

ABSTRACT

Employee share ownership (ESO) has recently been the subject of significant public policy debate in Australia and internationally. In these debates, ESO plans are usually said to be implemented for a variety of reasons including alignment of employer and employee interests, increased employee productivity, improved workplace harmony, and increased employee remuneration. This study explores, through case studies of ESO plans at two Australian companies, three key issues relevant to the implementation of ESO plans and the policy and regulation applicable to ESO plans. These issues are: (1) whether ESO plans better align the interests of employees with those of their employer, leading to better enterprise performance; (2) whether the objectives of companies in implementing ESO plans are primarily “ownership objectives”, “remuneration objectives” or “workplace change objectives”; and (3) whether the concessional taxation treatment of ESO plans provides an incentive for the implementation of plans in a way that leads to improved enterprise performance.

Sometimes it's seen as, we've got to do 'X' so you top people can get a marvellous fat bonus while we bust our butts, and that's across all companies. Lots do that. I think staff share ownership plans are one of the ways where you start to make people feel yeah, they're a part of the thing.¹

1 Introduction

As illustrated by the quote above, it is not always obvious how participation in an employee share ownership plan might make employees feel 'they're a part of the thing', such that this form of non-wage financial participation might contribute to the corporate performance and workplace culture of a business. Yet the supposedly intuitive connections between employees owning shares in the company for which they work and various corporate and public policy objectives have underpinned bipartisan support for the promotion of employee share ownership (ESO) plans in Australia since at least 1995. Even after the 1999 *Shared Endeavours* inquiry of the House of Representatives Standing Committee on Employment, Education and Workplace Relations into ESO plans in Australia, and the subsequent creation by the Liberal/National Coalition Government of a dedicated 'Employee Share Ownership Development Unit', it remains unclear what this vague objective of 'the alignment of employer and employee interests' actually means in practice, and it is thus an open question whether or not public funds should be used to support such an amorphous objective.

This study seeks to open up an examination of the reasons for implementing ESO plans at the enterprise level in Australia, through two interview-based case studies conducted at National Australia Bank Ltd and Palm Springs Ltd. By undertaking these case studies and recording these first-hand accounts of ESO plans, what is sought here is a better understanding of how such plans operate within the complex reality of day-to-day business and workplace life. While this research clearly cannot offer definitive conclusions on whether ESO plans boost workplace productivity and industrial harmony, it can provide new insights into how these supposedly critical objectives of ESO are understood by business managers and employees. Similarly, the effectiveness of the tax concession regime that has been the central mechanism through which ESO has been promoted in Australia cannot be determined on the basis of these interview-based case studies. What can be drawn from these accounts, however, is an appreciation of the role that the regulatory regime has played in these instances.

In pursuing these research objectives, this study thus explores three key issues in Australian ESO policy and regulation, namely:

¹ National Australia Bank employee, interviewed October 2004.

- whether ESO plans better align the interests of employees with those of their employer, leading to better enterprise performance and benefits to the community;
- whether the objectives of companies in implementing ESO plans are primarily ‘ownership objectives’, ‘remuneration objectives’ or ‘workplace change objectives’ (as defined later in this introduction); and
- whether the concessional taxation treatment of ESO plans provides an incentive for the implementation of plans in a way that leads to improved enterprise performance.

Our interview-based case studies reveal that in these two companies both management and employees have been relatively uncritical of a nebulous, ‘employee engagement’ rationale for the implementation of ESO plans. In practice, the plans in these companies have invariably been additions to, rather than substitutes for, other employment-related financial benefits. Along with the presence of more substantial performance-related mechanisms in these organisations, the fact that management in these companies has not sought to measure the workplace performance or industrial harmony consequences of implementing the ESO plans suggests that they have been introduced on the basis of a fairly broad conception of their value to employees and the organisation, rather than in pursuit of any more specific organisational goals.

With regard to the tax concession regime, the case-studies tend to suggest that while this regulatory incentive does not appear to prompt the introduction of ESO plans, it does shape the form that they take. While our studies do not preclude the possibility that the tax concession regime might be an incentive for some companies, it is clear from our study that a general belief in the value of aligning employer/employee interests has been a more compelling factor in the implementation of the plans than has the tax concession regime.

Structure of the Paper

In the remainder of this introduction, we briefly elaborate on the research agenda of this study. The introduction is followed by an overview of the rationale and regulation of ESO plans in Australia, and a brief explanation of the methodology employed in carrying out the National Australia Bank and Palm Springs case studies.

These two case studies are then presented separately, and are set out as follows:

- a brief history of the establishment and operation of the ESO plan at the workplace is given;
- the interviewees’ reflections on how the objectives of ‘ownership’, ‘remuneration’ and ‘workplace harmony’ are invoked is considered; and
- the impact of the tax concession regulatory regime on the establishment and structure of the plan in the company in question is discussed.

The paper then concludes with a discussion of its key findings.

Our Research Agenda

Why are Workplaces Using ESO Plans?

Faced with a paucity of qualitative research into ESO plans in Australian workplaces, particularly in relation to the nature of the link between ESO plans and enterprise performance, the Majority Report of the *Shared Endeavours* inquiry (hereinafter the Nelson Report, after its chairperson Dr Brendan Nelson MP) could only conclude that ‘intuitively it should be the case’.² The Report summarised this link as follows:

*[W]hile 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.*³

However, research on the organisational effect of ESO plans in workplaces generally concludes that any benefits this mechanism might provide cannot be obtained by simply adding a plan to an existing workplace environment.⁴ Thus, in addition to understanding ESO plans as part of a wider strategy of employee participation in corporate decision-making, an important question arising from the corporate performance and workplace harmony effects of an ESO plan is precisely *how* this form of employee ownership triggers changes in organisational and employee behaviour.⁵

The first purpose of this case study, then, is to better understand what motivates companies to initiate ESO plans, why employees participate, and, over time, whether either party perceives that the initial objectives in implementing the plan have been met. Interviewing managers and employees cannot, of course, prove the existence of a causal link between ESO and a ‘progressive workplace culture’. What it can reveal, however, is how these relationships are understood at the level of these particular companies.

² House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Shared Endeavours – an Inquiry into Employee Share Ownership in Australia* (2000) (the Nelson Report), [2.104].

³ Ibid [2.116].

⁴ For a background discussion of this issue, see Jarrod Lenne, Richard Mitchell and Ian Ramsay, *Employee Share Ownership Schemes in Australia: A Survey of Key Issues and Themes* (2005), 15-17. Available at http://cclsr.law.unimelb.edu.au/research-papers/Employee%20Share%20Ownership%20Scheme%20in%20Australia%20_08%20Apr%202005_.pdf.

⁵ Ibid, 16.

Are the Tax Incentives Warranted?

The second research question this paper explores is what role the tax concession regime has played in shaping the implementation and management of these companies' ESO plans.

Despite the bipartisan support for the present federal tax concession regime (discussed further below), there is still scepticism from some groups as to whether tax concessions should be offered for plans that apparently confer financial benefits of themselves. For instance, trade unions have typically been circumspect about the efficacy of providing publicly funded incentives for ESO plans:

The ACTU [Australian Council of Trade Unions] 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.⁶

The ACTU is concerned that concessional taxation treatment will encourage the implementation of ESO plans which simply replace fixed remuneration, but do not by themselves contribute to the progressive organisational culture which is the ultimate expressed aim of the Nelson Report. Ultimately, the question of whether tax benefits should be conferred is a policy issue, but it is hoped that this paper can reveal something of the role that these concessions played at National Australia Bank Ltd and Palm Springs Ltd when they implemented their ESO plans.

2 Rationale and Regulation of ESO Plans

The Rationale of ESO Plans

While the granting of shares (or options to buy shares) to executive-level employees is generally understood in corporate governance debates as a matter of providing senior managers with financial incentives based on corporate performance, this rationale has never applied quite so easily to ESO plans that are open to the majority of a company's employees.

An entire chapter of the Majority Report of the *Shared Endeavours* inquiry is dedicated to grappling with the many and varied arguments for ESO at a company level, and with the justifications for public policy support at a federal government level. While noting that government and private sector objectives are not entirely overlapping, the Majority Report recognised three broad, interrelated 'objectives' that are usually cited in favour of the

⁶ Australian Council of Trade Unions, *Submission to the Nelson Committee [Submission 1000]* (2000) 1.

implementation of ESO plans, all concerned with *aligning the interests of the employee with the employer* in some fashion.⁷ These three broad objectives are:

(a) *Ownership objectives*: This first category encompasses both *direct alignment* of interests and a more broad view of securing ‘employee engagement’.

The *direct alignment* effect of employee share ownership involves an increased perception by employees that their financial interests coincide with that of their employer. By obtaining shares in their employer, employees gain an additional financial interest in the company for which they work. For ESO proponents, this equity-holding induces employees to ‘think like owners’, thereby aligning their own interests with those of the employer, and the shareholders more generally. There is a direct link posited here: increased financial and ownership interests lead to a conscious choice to behave in ways which enhance enterprise performance – for instance, lower absenteeism, longer hours, and greater productivity. However, intuitively this link is weaker where the enterprise is larger, and the individual employee’s effect on, and capital interest in, overall corporate performance is proportionately smaller.

Running through this direct causal chain is the idea of *employee engagement* as a less direct and less quantifiable result of share ownership. It is important to recognise this less obvious component of the ‘ownership objectives’ category. Our case-studies suggest that this dimension of ESO, in contributing to a shift in employees’ mindsets and in the culture of the workplace, is often used to justify the implementation of these plans.

(b) *Remuneration objectives*: The second category, ‘remuneration objectives’, relates to the financial value of the shares conferred upon employees, both as an additional part of their remuneration and a source of ongoing wealth for employees. Employers remunerating employees at least partially by way of shares is a form of performance-based pay. The emphasis here is on providing supplementary *incentives to perform*, rather than on *ownership*.⁸ As with the direct alignment variant of the first category, however, the link being posited here is a direct one; if employees perceive that their personal financial situation will depend in part on the performance of the enterprise, they may be more willing to work harder and more productively.

Along with this incentive-based argument for ESO as an additional form of employee remuneration, it is important to note that where ESO is taxed in the hands of its recipient at a concessional rate relative to other forms of remuneration, the employer can take advantage of this disparity to confer the same financial after-tax benefit on its employees at lower cost.

⁷ The Nelson Report, [2.69]. These objectives were taken from the Australian Employee Ownership Association, *Submission to the Nelson Committee [Submission No.5]* (2000) 4.

⁸ Note the reference to ‘supplementary incentives’ in this context; sections of the union movement have previously voiced concerns that ESO might be used by an employer to replace a portion of employees’ fixed wages with a variable element, not just dependent on the performance of the employees but on economic conditions generally.

Though not a reason in itself for employees owning shares, the tax-effectiveness of ESO might be a factor in a company's decision to introduce an ESO plan.

(c) *Workplace change objectives*: This third category relies upon the supposed capability of ESO plans to reduce industrial disharmony by introducing a common interest between employees and management. In workplaces where there is no shared sense of purpose between management and employees, a broadly-based ESO plan may be implemented to break down 'class and cultural barriers' between different seniority levels.⁹ The objective is to improve industrial harmony within the workplace, and increase meaningful participation from all levels of the enterprise.¹⁰

ESO Policy and Regulation in Australia

Since 1995 the broadly bipartisan nature of support for ESO plans has been reflected in ongoing legislative change. As there is no mandated form for ESO plans in Australia beyond compliance with the general law, the primary mechanism through which they have been regulated is a modest income tax concession regime introduced by the Labor Government in 1995.¹¹ After winning the 1996 election, the Liberal/National Coalition Government, in its first Budget, increased tax concessions for employees making the tax exemption subject to the criteria contained in Division 13A of the *Income Tax Assessment Act 1936* (Cth).¹²

Despite, or perhaps because of, the non-contentious nature of support for ESO plans, during this mid-1990s period no thorough investigation of ESO plans in Australia – their operation, tax treatment and legislative foundation – was ever conducted.¹³ In March 1999 the then Minister for Employment, Workplace Relations and Small Business, Peter Reith MP, acknowledged this 'gap' in research and commissioned the Standing Committee on Employment, Education and Workplace Relations to inquire into and report on employee share ownership plans. Chaired by Dr Brendan Nelson, this Committee examined the extent to which ESO plans had been established in Australian enterprises and their effects on (a) workplace relations (b) enterprise productivity, and (c) the economy as a whole. In September 2000 the Committee produced the two papers that comprise the Nelson Report (a Majority Report and a Dissenting Report from the Australian Labor Party committee

⁹ The Nelson Report, [2.69].

¹⁰ Ibid.

¹¹ The amendments were inserted into Division 13A, Part III of the *Income Tax Assessment Act 1936* (Cth).

¹² The purpose of Division 13A is twofold: to reduce the abuse of employee share plans as tax minimisation plans and to facilitate the development of employee share plans for general employees: The Nelson Report, [2.22].

¹³ The Nelson Report, [1.1].

members).¹⁴ As stated earlier, in the course of its investigation, the Committee found ‘little accurate and detailed information was available that could provide definitive answers to the three issues it was asked to focus on’.¹⁵ Neither the Australian Securities and Investments Commission (ASIC) nor the Australian Taxation Office collects sufficient information to evaluate existing arrangements from year to year.¹⁶ The Committee could only rely upon data collected in the 1995 Australian Workplace Industrial Relations Survey (AWIRS), which had suggested that workplaces with ESO plans were 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. They were also associated with slightly higher levels of disputation. However, none of these associations established exclusive or absolute causal links. Consider, for example, the Nelson Report’s discounting of figures showing higher levels of industrial disputation, on the basis that workplaces with ESO plans are also likely to be unionised and have a union delegate in place.¹⁷

Understandably, the Committee identified the lack of information to be a serious problem given that public funds are provided to support the take up of ESO plans:

*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?*¹⁸

The Details of the Tax Concession Regime

As this tax concession regime has been the central mechanism through which ESO plans have been regulated in Australia, it is important to outline it in some detail.¹⁹ The basic position

¹⁴ Kevin Andrews, MP, *Media Release 04104 - Promoting Employee Ownership* (2004). The main recommendations of the report were not taken up by the government. However, in February 2004 the Minister for Employment and Workplace Relations, Kevin Andrews, announced a target of doubling the ESO plans in workplaces from 5.5% of employees to 11% by 2009 and the creation of the Employee Share Ownership Development Unit (ESODU) with funding of \$1.7 million over four years, demonstrating continuing support for ESO plans by governments in Australia.

¹⁵ The Nelson Report, [1.3].

¹⁶ Ibid [2.109].

¹⁷ Ibid [2.115].

¹⁸ The Nelson Report, [2.104].

¹⁹ It has been recognised that the benefits of the tax concession regime are more easily accessed by listed companies, than by privately held companies and start-up companies: see Cameron Rider, Lillian Hong, Ann O’Connell, Miranda Stewart and Michelle Herring, *Taxation Problems in the Commercialisation of Intellectual Property*, Intellectual Property Research Institute of Australia Report No 01/06 (ISSN 1449-8804 January 2006), Chapter 9 and Cameron Rider, *Sellers of Labour or Investors of Intellectual Capital?*, Intellectual Property Research Institute of Australia Working Paper No 19/05 (ISSN 1447-2317 October 2005).

taken in this regime is that when an employee is issued a share under an ESO plan, the share is treated as a form of employment income for tax purposes. The employee thus has to include in their taxable income an amount equal to the ‘acquisition discount’ – that is, the difference between the market value of the share at the date of issue and the amount of money (if any) the employee pays to the company as the issue price for the share. So, for example, if the company issued the employee a share with a market value of \$1.01, and the employee paid one cent as the issue price for the share, the employee would include the \$1.00 acquisition discount in their taxable income. This is treated as in the nature of employment income, so the employee would pay tax on that \$1.00 at their ordinary marginal income tax rate.

Division 13A then offers two ‘concessions’ which modify the basic rule. Only one of the two concessions can apply to shares issued to an employee in any financial year. To be eligible for either of the concessions, the employee share plan has to meet certain conditions relevant to the concession.

(a) *Deferral concession*: One concession is a ‘deferral concession’. To attract the deferral concession, it is first necessary, but not sufficient, that the share be a ‘qualifying share’. This requires, among other things, that the share be an ordinary share in the employer, or a holding company of the employer, and that shares under the employee share plan must have also been offered to at least 75% of the permanent employees of the employer. In addition, the share must be acquired on terms which defer the point at which the employee can have unfettered ownership of the share – for example, there must be restrictions which prevent the employee disposing of it for a period, or which make the employee liable to forfeit ownership on certain conditions.

When the deferral concession applies, the employee is not taxed on the difference between the market value of the shares at the date of issue and the money (if any) paid as the issue price for the share. Rather, the taxing point is generally deferred until the time at which the employee has unfettered ownership of the share – i.e. when the restrictions on disposal or forfeiture conditions cease (the ‘cessation time’) – or, if the conditions have not so ceased within 10 years, at the expiry of 10 years (also a ‘cessation time’). Then, at the cessation time, the employee is taxed on the difference between the market value of the shares *at the cessation time* and the money (if any) originally paid as the issue price for the shares at the time of acquiring the shares. So, for example, if the company issued the employee a share with a market value of \$1.01, and the employee paid one cent as the issue price for the share, and then *at the cessation time* the market value of the shares had increased to \$3.01, the employee would include \$3.00 in their taxable income. This would again be treated as in the nature of employment income, so they would pay tax on that \$3.00 at their ordinary marginal income tax rate.

Thus, it can be seen that the deferral concession does not ‘avoid’ tax on the employee shares, but only defers the time of payment of the tax. In addition, it works so that any appreciation in value between acquisition date and cessation time is treated as ordinary employment income taxed at normal marginal tax rates. This tends to undermine the value of the deferral concession when regard is had to the ‘CGT discount’ which the government introduced for share and property investors in 1999. This provides that, for individuals, if they make a capital gain on a share held for at least 12 months, only 50% of the gain is taxable – i.e. in effect, they only pay tax on discounted capital gains at half the ordinary marginal tax rate. Hence, in the example given, the employee is worse off for having elected to take advantage of the deferral concession, because it has meant that the \$2.00 appreciation in the value of the share between the acquisition date and the cessation time has been taxed as ordinary employment income rather than as a discounted capital gain. If they had not opted for the deferral concession, this appreciation in value would have been taxed as a discounted capital gain.

As a result, many employee share arrangements do not use the deferral concession. Instead, they use option plans to issue employees with options to acquire shares at an exercise price set slightly higher than the market value of the relevant shares at the date the option is issued. Because of the exercise price, the options have a nominal market value, so there is no significant ‘acquisition discount’ which can be taxed under Division 13A. Then, if the options appreciate in value due to the underlying shares appreciating in value, that value appreciation is treated as eligible for the CGT discount treatment.

(b) Exemption concession: As an alternative to the deferral concession, employees can elect the other concession – which is the ‘exemption concession’. To attract this exemption concession, as well as the shares needing to be ‘qualifying shares’ (see above), the employee share plan must also meet certain additional conditions. These include requirements that the shares must be acquired subject to no forfeiture conditions; the employee must be prohibited from disposing of the shares for 3 years (or until employment ceases, if earlier); and the employee share plan must operate on a ‘non-discriminatory’ basis, which requires that shares must be offered to at least 75% of permanent employees on terms which are the same in their essential features.

Where an employee elects for the exemption concession to apply, up to a maximum of \$1,000 per annum of the ‘acquisition discount’ on employee shares is treated as exempt income of the employee, and so not subject to tax. So, for example, if a company’s shares had a market value of \$1.01, it could issue in one financial year up to 1,000 shares to an employee at an issue price of one cent (meaning that the total difference between the market value and the issue price of the shares was \$1,000), and the employee would be exempt from tax on that total acquisition discount of \$1,000.

As noted, the exemption operates on a per annum basis – the maximum amount is limited to \$1,000 per annum. Further, the \$1,000 exemption is only an exemption as to the amount of the acquisition discount being included in the employee’s taxable income – it is not a tax saving of \$1,000. Hence the value of the \$1,000 exemption to an individual employee in turn depends on the marginal tax rate of the employee. If they are on the top marginal rate of 48.5%, it is worth \$485 per annum. If they are on a 20% marginal rate, it is only worth \$200 per annum.

It can be seen that the exemption concession would not be regarded as a major tax saving for most employees. The exemption concession does, however, have the advantage that any subsequent appreciation in the value of the shares will be eligible for the CGT discount treatment, so long as the employee holds the shares for at least 12 months.

Other Regulatory Factors

In terms of the direct legal regulation of ESO plans in Australia, it is worth noting Australian Securities and Investments Commission (ASIC) Class Order 184, and accompanying Policy Statement 49. As the relevant corporate law regulatory agency, ASIC provides conditional relief from some of the rules contained in the *Corporations Act 2001* (Cth) relating to the normal disclosure requirements for the sale of shares. Other sources of regulatory constraint on ESO plans also include the general role of trade practices, contract and property law in shaping ESO plan transactions, and the potential interactions between an ESO plan and employment and labour relations law.²⁰

While these other regulatory factors clearly contribute to the regulatory context of ESO plans in Australia, much of the post-*Shared Endeavours* interest in the regulation of ESO plans has centred on the merits of expanding or tightening the tax concession regime. This is perhaps unsurprising, given that the tax concession regime involves a financial cost to public funds (in tax forgone) and potentially reduces the business costs of Australian companies (in enabling them to give their employees additional financial rewards in a tax-effective manner).

3 Methodology

The case study research reported in this paper focuses on the interviewees’ perceptions of the purposes of ESO plans and the role of the tax concessions regime. Without in any way implying that the other regulatory influences noted above are not worthy of further consideration, as a question of research scope it was decided for feasibility reasons that this study of ESO plans and their regulation would limit itself to the tax concession regime.

²⁰ These regulatory factors are examined in Lenne, Mitchell and Ramsay, above n 4.

The two companies that are the subjects of this investigation are the National Australia Bank Ltd, one of the 'Big Four' Australian banks, and Palm Springs Ltd, a much smaller company, engaged in the sourcing and distribution of bottled water. The subjects were selected for their contrasting size, complexity, history of ESO plan utilisation, and industries.

Each case study consisted of semi-structured interviews with management and employees. The findings are therefore primarily based on the perceptions of interviewees concerning the motivations behind implementing the ESO plans and their effects once implemented. The findings gathered through interviews were augmented where possible with materials such as policies and procedures provided by the companies.

The results incorporate three separate clusters of institutional perceptions about the ESO plans at each workplace: firstly, the *motivations* for implementing an ESO plan in general and the particular plan in question; secondly, the *operation* of each particular plan, in the light of previous ESO plans and other human resource management mechanisms; and thirdly, the *effect* of taxation concessions on the implementation and operation of the plan.

National Australia Bank

National Australia Bank Ltd (NAB) is one of the major financial institutions in the country and one of the first major Australian corporations to offer a broad based ESO plan to *all* its employees. Interviews were conducted with two senior managers in NAB's human resources department;²¹ a remuneration expert who administers the plan;²² and a Financial Sector Union (FSU) delegate who is an employee at the bank.²³ It should be noted that, while NAB has a broad-based ESO plan, it also has executive and senior executive remuneration packages which include share plans; however, the scope of this study is limited to the broad-based plan.

Palm Springs

Palm Springs Ltd (Palm Springs) was selected as the second subject of the study, as both its size and its (shorter) history of ESO plans provide a useful contrast to the NAB study. The company was established in 1988 and delivers bottled water to both the grocery and home/office sectors. Palm Springs introduced its first ESO plan in September 2002. Interviews were conducted with the General Manager of Palm Springs,²⁴ and an employee who decided to take up the shares offered in Palm Springs' ESO plan.²⁵

²¹ Hereinafter 'NAB Interviewee 1' and 'NAB Interviewee 2', both interviewed in October 2004.

²² Hereinafter 'NAB Interviewee 3' interviewed in October 2004.

²³ Hereinafter 'NAB Interviewee 4' interviewed in October 2004.

²⁴ Hereinafter 'Palm Springs Interviewee 1' interviewed in November 2004.

²⁵ Hereinafter 'Palm Springs Interviewee 2' interviewed in November 2004.

4 National Australia Bank study

A Brief Chronology of NAB ESO Plan

An employee share ownership plan was first suggested within NAB in 1982, and first implemented in 1987.²⁶ The first broad-based employee share ownership plan, open to all employees of the bank, was introduced in 1992.²⁷ Initially, the plan provided for shares to be purchased via an interest-free loan from NAB itself, which usually resulted in employees simply making repayments from the dividends of the shares.

The FSU's input was received on the structure of the plan when it was first implemented in 1987. After eight years, the bank had \$130 million tied up in interest-free loans to employees, and the 'generosity' of the plan was questioned by management. In 1995, therefore, the "Enterprise Value Added" (EVA) ESO plan was established and it remains the current plan for ESO at NAB.²⁸ Depending on the bank's performance assessed against its peers and the wider market, the EVA plan grants up to \$1000 worth of shares to each employee, as an additional reward for their existing service and at no cost to the employee. The EVA is administered by the bank, with a degree of informal input from the FSU.

Despite the fact that NAB was the first of the 'Big Four' banks to establish such a plan, one manager revealed the perception of that time that the NAB 'were not early adopters of the ESO plan; we were followers', referring to corporate remuneration trends and academic literature in the United States at the time. Factors which had influenced NAB in its original decision to implement an ESO plan include the discussion of the issue by the then Labor government and also the experience of US companies with ESO plans, as documented in 1980s academic research.²⁹ NAB senior managers understanding of this research was that it had begun to identify a possible correlation between employee share ownership and corporate growth rates and profitability.³⁰

The Three Interrelated Objectives

The three interrelated objectives noted in the Nelson Report in favour of ESO plans were all identified by interviewees at NAB as reasons for implementing the EVA. Management considered that ESO plans were beneficial in terms of 'ownership objectives', as employees went from two-fold stakeholders (as employees *and* customers) to *three*-fold stakeholders

²⁶ NAB Interviewee 3.

²⁷ NAB Interviewee 3.

²⁸ NAB Interviewee 1.

²⁹ NAB Interviewee 1.

³⁰ NAB Interviewee 1.

(employees, customers and shareholders) in the bank.³¹ Management further identified the positive ‘wealth creation’ effects of the plan.³² The plan was designed to be universal, based on equality, and easily explicable in terms of firm-wide performance³³ – all characteristics which were desirable to both employees generally and the FSU.³⁴ ‘Workplace harmony’ at the NAB was therefore considered another benefit of the plan:

*Fixed dollar amounts [as between different levels of employees] are a nice way of compensating [for] ... where you are on the scale of things. They give a better reward and more incentive to people who don't ever get all that much incentive in the way remuneration systems are structured.*³⁵

The greatest motivation behind implementing the EVA plan, however, was as part of a broader policy of *employee engagement*, one of the two categories of ‘ownership objectives’.

Ownership Objectives

NAB’s EVA plan was established in the context of a much broader bank policy entitled ‘Great Place, Great People, Great Performance’, designed to enhance employee engagement, along with learning opportunities and career development.³⁶ Those interviewed in management positions offered broad indications about the particular nature of ‘employee engagement’ as created by the EVA plan: for instance, the EVA acted as a ‘reward for effort’,³⁷ and a way to ‘make employees aware that they are part of a global group’.³⁸ Another characterisation of ‘employee engagement’ was offered by the FSU interviewee, who outlined the pressures endured by workers in modern business, and then linked ESO with the attitude required to ‘succeed’ in spite of them:

[I]n workplaces in general there's been so much pressure over so much time and [employees] have so much to do and so little numbers [sic] because everybody cost cuts it, it doesn't matter what organisation... [P]eople got fed up with that, and ... what they'll put up with is wearing off... the amount of pressure that was especially [evident] say in the last couple of years... in terms that while we must cut costs and cut this, and you'd have a great year and the Christmas notice would come out and

³¹ NAB Interviewee 1, NAB Interviewee 2.

³² NAB Interviewee 2, NAB Interviewee 3.

³³ NAB Interviewee 3.

³⁴ NAB Interviewee 3, NAB Interviewee 4.

³⁵ NAB Interviewee 4.

³⁶ NAB Interviewee 2.

³⁷ NAB Interviewee 1, NAB Interviewee 2.

³⁸ NAB Interviewee 2.

*somebody senior... would say [in it], 'There's a lot of pressure out there, a lot of competition,' and it was like, this is a Christmas notice?'*³⁹

*There is something about having shares in the company that does give people a sense of a bit more ownership, of belonging to the company, a bit more of engagement... that's what the bank is trying to do. Get you engaged, if you belong, and not just that you belong but you want to move positively... so that you'll make sacrifices, do whatever's necessary, wear the frustrations of change and all that, whenever they need to do things... people are more prepared to take the pressure of change, and having to do this and workloads and stuff, when you've got that...'*⁴⁰

Another illustration of how *employee engagement* may be affected by ESO can be discerned from employee reactions to events that negatively impact on the business as a whole. In recent years, the 'Forex' scandal (in which a discrete section of the bank lost several hundred million dollars) and subsequent board-level problems featured prominently in the Australian media. Employee responses to the Forex scandal reportedly were split between those employees that identified with the bank as a whole, regardless of the failure of discrete departments within it, and those who were disillusioned by their personal EVA shareholdings declining in value for reasons unrelated to their individual performance. On the one hand, some NAB employees were 'rather annoyed not at the bank, but at the media, because they felt that the bank was getting rather severely rubbished, when the bank was doing a lot of good things, and one process had let one thing get out of track.'⁴¹ On the other hand, some employees were disappointed at the possible personal financial impact from actions they had no control over and which were limited to a few actors; 'three or four folk – why should we carry the can?'⁴²

While 'alignment of interests' is probably an objective of any ESO plan, any *direct alignment* benefit in terms of greater worker productivity (for instance, by encouraging reduced absenteeism) as a result of NAB's EVA plan was described by management as 'drawing a long bow'⁴³ and 'at the end of the process, not the beginning'.⁴⁴ EVA payments were seen as a *result* of improved performance rather than a *direct cause* for it. The potential for directly reduced absenteeism or increased employee retention was expressly 'not a reason'⁴⁵ for the implementation of the EVA.

³⁹ NAB Interviewee 4.

⁴⁰ NAB Interviewee 4.

⁴¹ NAB Interviewee 4.

⁴² NAB Interviewee 3.

⁴³ NAB Interviewee 3.

⁴⁴ NAB Interviewee 3.

⁴⁵ NAB Interviewee 1.

This claim – that while ownership objectives were an intended purpose of the EVA plan these objectives related only to the amorphous *employee engagement* goal and not the *direct alignment of interests* — appears to be substantiated by the historical evolution of ESO plans at the bank. For instance, it was perceived that the former capital-guaranteed ESO plan (under which NAB financed the employees’ acquisition of shares if required) provided a direct benefit to employee retention, according to the FSU interviewee:

*I do think at the end of the day people think about their shares before they leave the company, because if they want to keep the shares, they have to finance the loan, because they don’t really want to necessarily sell them.*⁴⁶

This financing structure was not retained in the EVA plan. In contrast, the EVA contains a perceived disincentive to employee retention ‘because if you walk away today, then the shares that are in trust for you for three years, you immediately own. You actually get them sooner.’⁴⁷

Further, the evidence indicates that the importance of directly securing loyalty from employees via share ownership has in fact weakened over time. When queried about whether he perceived a connection between securing productivity/loyalty and the current plan, the FSU delegate said that in the EVA there was an ‘indirect’⁴⁸ connection, and that the connection had previously been much stronger:

*I get... comments... from people, about what happens to their share plan. I can tell that they are thinking about ‘how can I hang onto my shares’ – and well, with the free shares they have now, that’s not such an issue.*⁴⁹

The contention that the direct alignment effects of its ESO plans are considered by NAB to be of subsidiary importance, compared with employee engagement effects, is also supported by the apparent absence of systematic efforts to track any relationship between levels of share ownership and productivity. Establishing a specific, measurable connection between employee share ownership and employee or corporate performance was described as ‘the golden fleece’ by management. Yet, ‘[w]e haven’t invested enough time to determine whether there is a correlation yet.’⁵⁰ Another interviewee stated, ‘I’m not familiar with any methods of how they judge [the EVA’s] value. I don’t think they do anything really

⁴⁶ NAB Interviewee 4.

⁴⁷ NAB Interviewee 4.

⁴⁸ NAB Interviewee 4.

⁴⁹ NAB Interviewee 4.

⁵⁰ NAB Interviewee 3.

objective.⁵¹ The absence of testing of the human resource management effects of the ESO plan is striking given the investigations which NAB commissioned from prominent consulting groups in the information technology and human relations fields to validate the correlation between human resource *management* processes (for instance, NAB's '3 Greats' policy) and corporate performance.⁵² The lack of EVA-related benchmarking is consistent with the interviewees' general insistence that the benefits of EVA payments are viewed as a *result* of improved performance rather than as a direct cause for it.

The continued absence of direct benchmarking appears to imply a judgment or assumption on NAB's part that the nature of such a connection is at most of subsidiary importance, or that the benefits are primarily indirect. The only evaluation that occurs in relation to the EVA plan is gaining feedback from employees on *their* perceptions of its success.⁵³ The value of NAB's ESO plan according to senior managers in NAB's human resources department is that it is an 'across the board reward, based upon firm-wide performance, encouraging all to contribute'.⁵⁴ Rather than be concerned with the potential for employees to 'free-ride' on firm-wide performance improvements in this context, it is a significant finding of this study that senior management at this large, profitable company have a long-term commitment to the almost nebulous goal of *employee engagement*, while placing less emphasis on the more quantifiable, *direct alignment* effects of employee share ownership.

Remuneration: Wealth Creation and Reward for Performance

While the overarching focus of the NAB EVA plan is employee engagement, employee 'wealth creation' was also identified by management as a significant reason for its implementation.⁵⁵ However, the 'wealth creation' objective, rather than simply being a desirable outcome in itself, was seen as a means to the same end – namely, that it would secure employee engagement. The fact that employee engagement is the main priority rather than employee wealth creation is evident in the structure of the EVA plan. For instance, the value of shares granted under the EVA plan cannot be taken in cash, for the employee to invest how they choose, or as a balanced portfolio of shares in the market.⁵⁶ Further, employees cannot leverage their exposure, contributing their own money to obtain a greater parcel of shares, other than on the open market.⁵⁷ Finally, the generosity of the current plan has declined compared with the bank's previous ESO plans (although it is still at least

⁵¹ NAB Interviewee 4.

⁵² NAB Interviewee 3.

⁵³ NAB Interviewee 1, 2, NAB Interviewee 4.

⁵⁴ NAB Interviewee 1.

⁵⁵ NAB Interviewee 2.

⁵⁶ NAB Interviewee 2.

⁵⁷ NAB Interviewee 4.

competitive in these terms with the other ‘Big Four’ Australian banks), indicating that a commitment to wealth creation in employees for its own sake has declined or been recognised as impracticably expensive. ‘CBA [Commonwealth Bank of Australia] and others have implemented the thousand dollar plan ... from my understanding, but NAB staff have gone a bit backwards.’⁵⁸ The plan prior to the EVA granted 25 free shares per year to employees, and thus had greater potential than the EVA to transfer increasing amounts of wealth to employees if the NAB’s share price continued to rise. That plan was discontinued because of its expense but it was more generous in terms of employee wealth creation.⁵⁹ As the union delegate speculated: ‘it may be that [the take-up of the interest-free loan plan with a capital guarantee] was so successful that they [the bank] got bitten by the cost. Subsequent to that there seemed to be a desire not to have that sort of a plan.’⁶⁰

Further, there are some features which indicate that, where fully satisfying the wealth creation objectives of the EVA would be in conflict with employee engagement, it is the latter which takes precedence. As already noted, employees do not have the option of taking their EVA plan entitlement in the form of cash or as a diversified investment. Some of the employees who view their EVA shares as ‘something nice in addition to super for retirement’⁶¹ may not want to rely on the solvency of their employer for both their employment and part of their investments other than superannuation, but this is not accommodated by the EVA plan, or any of NAB’s prior ESO plans. The employees can sell their shares and reinvest in other investments, of course, but this involves transaction costs and possible capital gains tax implications. The financial interests of employees that are served by diversification are clearly secondary to NAB’s desire to have employees own shares in their employer.

On the other hand, management and the union delegate both agreed that NAB’s ESO plans have never been regarded as *replacing* fixed-wage remuneration. Instead, the EVA sits ‘above’ fixed-wages as an additional form of remuneration. Management expressed a consistent sentiment that ESO plans should not be ‘a part of basic pay rates’.⁶² The FSU does not exhibit concern that the NAB’s ‘remuneration objective’ is anything other than a bona fide attempt to recompense employees fairly.⁶³

It should be noted that the EVA plan sits alongside performance related bonuses, also known as the ‘at-risk reward system’, which take the form of cash rather than shares. In this sense,

⁵⁸ NAB Interviewee 4.

⁵⁹ NAB Interviewee 1, NAB Interviewee 3.

⁶⁰ NAB Interviewee 4.

⁶¹ NAB Interviewee 1.

⁶² NAB Interviewee 1.

⁶³ NAB Interviewee 4.

there is a distinction between individuals' remuneration for their performance and financial benefits conferred under the EVA. As one interviewee identified, the time lag between performance and the reward differentiates the EVA plan from other forms of performance related bonuses.

The difficulty from the bank's point of view, and I understand some of this because I talked to some of the negotiators from the union side... and I've got a reasonable sort of understanding... is that with... remuneration [via an ESO plan] there's ongoing, ongoing, ongoing, ongoing [employee financial interest through share-ownership] ... Even though you might say that you are trying to reward performance, well any performance related to it happened a long time ago now and the bank has tried to shift all of its performance remuneration to make it in the current year, and more immediate.⁶⁴

So, in assessing the relative importance of remuneration objectives in the context of NAB's ESO plan, three broad conclusions can be reached:

- First, the existence of the at-risk reward plan, and the absence of a link between performance and payment under the EVA, supports the proposition that the EVA's main *remunerative* purpose is 'wealth creation' for employees.
- Second, remuneration objectives appear to have been accorded less importance than ownership objectives, at least in circumstances where they may conflict.
- Third, and perhaps most importantly from a public policy perspective, these findings would appear to indicate that the least desirable potential outcome of subsidising ESO plans by means of taxation concessions has not occurred at NAB. If fixed remuneration of NAB employees had simply been replaced by equivalent after-tax remuneration in the form of entitlement to NAB shares, then an argument could be made that taxpayer dollars were being spent merely to subsidise NAB's labour costs. The findings above – that ESO shares are offered in *addition* to ordinary remuneration, and that the value of the shares conferred is less important to NAB than employees' status as shareholders in the NAB – show that, at the NAB at least, this fear has not been realised.

Workplace Harmony

While the EVA is apparently popular with both employees and the union, there was at least some initial employee scepticism about the receipt of additional remuneration in the form of equity rather than cash. One former FSU delegate was critical of the plan, due in part to a concern that the EVA might in time replace rather than add to fixed remuneration.⁶⁵

⁶⁴ NAB Interviewee 4.

⁶⁵ NAB Interviewee 1.

The EVA plan is perceived by the management and FSU interviewees as having had a modest positive influence on workplace harmony, at least in the limited sense that it is popular both among employees and with the union.⁶⁶ While employees were said to be ‘disappointed’⁶⁷ at the change from previous, more generous plans to the current plan, equally it is understood that they ‘would jump up if you actually took it [the current plan] away’.⁶⁸ Focus groups, employee feedback forms and employee queries all indicate that people are interested in the EVA and the entitlements which accrue from it, and had generally positive perceptions of the plan.⁶⁹ According to one of the managers interviewed, FSU members and other employees who were initially suspicious of non-cash, profit-based remuneration have been convinced of the benefits of the EVA plan and now ‘quite like it’.⁷⁰

Nevertheless, there is no evidence to suggest that the EVA plan has resulted in employees or the FSU becoming more integrated in the administration or strategic direction of NAB. Employee participation in the decision-making processes of the bank is limited to consultation in the form of surveys and other feedback.⁷¹ The EVA plan, for instance, was formulated and implemented in a ‘top-down’⁷² fashion, and indeed the union has not ‘agitat[ed] for more involvement’,⁷³ probably because it was ‘just something everyone was comfortable with’.⁷⁴ The EVA plan is administered in a consultative but non-participatory way, but again this is uncontroversial because the system is seen as fair. In the most recent period prior to the interviews, for example, the EVA plan paid out 120% of the base-line 1000 amount, in accordance with the plan.⁷⁵ As the union delegate commented, ‘that’s the formula. Nobody can really argue with it.’⁷⁶

Regulatory Regime Impact: Tax Legislation

The relative importance at NAB of the three interrelated objectives of ESO plans is further illustrated by the way the concessional taxation treatment of ESO plans is viewed within the bank. According to one of the managers interviewed, the tax concessions are an important

⁶⁶ NAB Interviewee 1, NAB Interviewee 4.

⁶⁷ NAB Interviewee 4.

⁶⁸ NAB Interviewee 4.

⁶⁹ NAB Interviewee 2.

⁷⁰ NAB Interviewee 2.

⁷¹ NAB Interviewee 2.

⁷² NAB Interviewee 1.

⁷³ NAB Interviewee 1.

⁷⁴ NAB Interviewee 4.

⁷⁵ NAB Interviewee 2.

⁷⁶ NAB Interviewee 4.

component of the employees' acceptance of shares as a wealth creation initiative.⁷⁷ If the shares were fully taxed as income, the shares would have the same after-tax value as wages, but in a relatively illiquid form. This would result in a preference for cash.⁷⁸

By contrast, from NAB's point of view the tax concessions were explicitly 'not a consideration'⁷⁹ in deciding to implement the EVA plan. The fact that NAB established an ESO plan before the Government contemplated tax concessions supports this assertion. In NAB's case, tax concessions would appear to have been a bonus that enhances the after-tax benefit to employees (to the benefit of both wealth creation and workplace relations) at no cost to NAB, when they would have implemented an ESO in some form anyway.

However, while an ESO plan may have been implemented absent concessional taxation treatment, the impact of those concessions on the *structure* of the EVA is readily apparent. The plan is structured so as to comply with the requirements of the relevant legislation, and the benefits conferred, while dependent on the firm's performance, have (like the plans of the other big four banks) a baseline value equal to the maximum tax-free amount: \$1000.

In summary, after-tax *value* is more important to employees than share ownership per se or liquidity of reward; whereas employee share ownership and engagement is more important for NAB than the after-tax financial benefit conferred by the plan. Tax concessions appear to allow these two preferences to coincide, in this case.

However, given that NAB's justifications for implementing an ESO plan do not depend on this after-tax value, and that its implementation was initiated by management, it would appear that the existence of tax concessions did not have a significant impact on NAB's decision to implement an ESO plan. Absent this causal link, the employees' strong preference for greater after-tax value of their ESO plan shares does not in itself justify tax concessional treatment – most (if not all) employees would prefer greater after-tax value of all of their remuneration.

Concluding Remarks

The broad concept of securing 'employee engagement' appears to have been the motivating factor in implementing various ESO plans at NAB over the past two decades, above and beyond the more pragmatic aims of creating wealth for employees or securing (measurable) performance improvements in the workplace. There is no doubt that the ESO plans implemented by NAB over the years have had a positive effect on employee wealth. At all levels, employees have benefited from the steady accumulation of shares over time. 'In hindsight, it was a great thing for the company to do ... even though at the time I wanted

⁷⁷ NAB Interviewee 2.

⁷⁸ NAB Interviewee 2, NAB Interviewee 4.

⁷⁹ NAB Interviewee 1.

control over how I invested my money.’⁸⁰ The early scepticism of risky and illiquid remuneration also appears to have abated in the light of consistently strong wealth creation. As one long-term employee stated:

*I viewed it as profit share but I was taking the risk so I didn't do it... a lot of people... who've been in the bank for a long time, a lot of them have kept those [shares] and... they would be smiling greatly... I've got egg on my face.*⁸¹

On the whole, this case study of management and employee attitudes towards ESO at NAB suggests a mixed assessment of the current regulatory approach, and its reliance on the modest tax concessions regime. On the one hand, NAB provides an example of a prominent employer utilising ESO plans in accordance with the interrelated objectives and motivations identified in the Nelson Report. On the other hand, however, this case study also suggests that the present tax concessions regime played little or no significant part in either the original implementation or ongoing operation of NAB's ESO plans – other than influencing the structure of its plan so as to take advantage of what tax benefits are available, to the benefit of its employees. To get a better sense of the implications of this case study of NAB, this paper now considers the same issues at a very different type of company, Palm Springs Ltd.

5 The Palm Springs ESO Plan

A Brief Chronology of the Palm Springs ESO Plan

In September 2002, Palm Springs introduced the company's first ESO plan – the Employee Share Plan (ESP). The eligibility criteria of the ESP were broad and non-discriminatory. The ESP was made available to all employees with more than twelve months' continuous service (full time or part time) with the company. There was no discrimination between eligible employees in terms of available share benefits.

Palm Springs engaged Trinity Management Group (Trinity) to develop and compile the package offered to employees, which involved Trinity purchasing Palm Springs shares on the market and then holding those shares on behalf of employees as a trustee. Trinity operates the trust on an ongoing basis, leaving Palm Springs with minimal involvement in the administration of the plan. This contrasts with the NAB's EVA plan, which was developed with significant input from NAB management as well as external consultants, and is administered internally.

The package requires that an employee pay \$100 to receive \$1000 of further shares in the company (roughly 4000 shares per employee), for a total value of \$1,100 in shares held in

⁸⁰ NAB Interviewee 3.

⁸¹ NAB Interviewee 4.

trust for a fully participating employee. The shares are scheduled to be distributed from the trust in 2007.

In 2002, an explanatory booklet regarding the plan was approved by management and forwarded to all eligible employees, of whom 80% subsequently chose to participate in the plan.⁸² This rate is lower than that of NAB's EVA plan, estimated to be over 95% by senior management interviewed at the bank. This may reflect the fact that the Palm Springs ESP required a nominal financial outlay, whereas the EVA requires no such commitment from employees. It may also reflect a lower degree of familiarity with listed investments amongst non-bank employees.

Three Interrelated Objectives

Ownership Objectives

Intuitively, one would expect that a *direct* alignment of financial interests would be a greater motivating factor behind Palm Springs implementing an ESO plan, in contrast with the NAB, simply because any direct alignment effects could be expected to be proportionately stronger at Palm Springs. Palm Springs is a much smaller company than NAB, both in terms of market capitalisation and employee numbers. The smaller market capitalisation of Palm Springs means that employees with \$1000 worth of shares have a greater percentage stake in the company. The smaller employee numbers at Palm Springs compared with NAB means that the average employee has a greater personal influence on the performance of the company as a whole, in theory at least.

However, while the Palm Springs' interviewees did not demonstrate as much knowledge about the objectives behind their ESO plan as did the NAB interviewees – which perhaps is expected, considering NAB has one of the most extensive histories of ESO plan utilisation among Australian companies – the objectives cited by the interviewees were similar for both companies. Palm Springs' General Manager summarised the motivations behind the plan as being 'to get employees to feel part of the company, [and] enjoy the success of the company'.⁸³ It was hoped that employees would be able to feel like 'owners' and get involved in the business of the corporation. The General Manager suggested that board papers indicated that 'employee involvement' was a predominant motivating factor.⁸⁴

An employee stated that the overall effect of the ESO plan was to garner 'a sense of belonging to the organisation'. Furthermore, the employee believed that it was a goal of management to get all personnel to feel like they were 'linked to head office more'

⁸² Palm Springs, *Employee Share Plan – [Information Booklet]* (2002).

⁸³ Palm Springs Interviewee 1.

⁸⁴ Palm Springs Interviewee 1.

considering that the company had various offices across the states – the ESO plan could possibly bring various groups of personnel together to ‘get a cohesive national unit’.⁸⁵

Notably, neither the manager nor employee interviewed cited direct behavioural outcomes – such as harder work or reduced absenteeism – as the primary goal of the ESO plan. This is consistent with NAB’s approach, even though direct alignment of interests is far more plausible at a small company such as Palm Springs than at NAB. This may be because, despite the greater relative value of \$1000 of shares in a smaller company than in a larger one, that value is still perceived as insignificant. At Palm Springs specifically, a further consideration is that directors of the company own some 70% of the company’s shares between them, commanding a majority vote. This block shareholding by management impairs even the theoretical possibility that employee shareholders could have more influence over management as employee shareholders than as employees.

This may explain why, at Palm Springs, the degree of interest in shareholder rights appears to be limited. Under the rules of the plan a trust structure is employed, such that a trust holds the shares on behalf of employees for either three years or until they leave the company (whichever is the shorter time period). The trustee of that trust thus votes the voting rights attached to the shares on behalf of the employee shareholders.⁸⁶ When asked in the interview, the employee revealed that Trinity had not once asked the employee for any voting instructions. She noted that at the upcoming Annual General Meeting, one of the issues to be raised was giving options to a certain person. While she expressed concern about this as a shareholder, she said she would still be concerned even if she did not participate in the ESO plan, as she regarded the issue as important as an employee with an interest in the solvency and profitability of her employer. Nevertheless, considering that her portfolio is small, she realised that her voice would be of limited influence: ‘I’d just be a drop in the ocean’.⁸⁷

The employee believed that employees with shares probably do not have a ‘higher interest’ in the company than those without shares. The number of shares offered in the ESO plan was not so large as to affect people’s views on ‘the issues’ in the workplace. She also believed that her status as owner of the company as well as employee had not affected her behaviour, as compared against being ‘only’ an employee.⁸⁸

⁸⁵ Palm Springs Interviewee 2.

⁸⁶ Palm Springs Interviewee 1. The ESO was and is still largely administered by Trinity, and there has been no input from employees into either the proposed or continuing structure of the ESO. Only the Human Resources Manager was heavily involved in the process. The only significant cost to the company in establishing the ESO (other than Trinity’s fees) was the printing of the brochures: the plan itself was not seen to be costly to the company.

⁸⁷ Palm Springs Interviewee 2.

⁸⁸ Palm Springs Interviewee 2.

Palm Springs, like NAB, invoked the ‘employee involvement’ and ‘linked to management’ arguments to explain the objectives of their plan, in accordance with the purpose of aligning interests between employer and employee, but notably there still appears to be no assessment of how these objectives are being met in terms of measurable standards. However, it would not be appropriate in the case of Palm Springs to conclude that this equates to a commitment to the nebulous goal of ‘employee engagement’ rather than securing direct benefits, as the disinterest in direct benefits may also be due to Palm Springs’ ongoing financial difficulties. Palm Springs’ profits dropped significantly in early 2004, leading to a clean-out of the board in March 2004 and the appointment of a new CEO. According to the General Manager, there was ‘genuine concern’ from employees about the company’s economic situation, but particularly in relation to how this would affect job security, rather than how it would affect the value of their shares. Employees felt that it was largely up to management to remedy the situation.

Further, it is even possible in this case that, from the employees’ perspective, the Palm Springs’ ESP could have led to reduced ‘employee engagement’. Given the range of share options issued to management, the employee interviewed expressed the concern that senior management might be more likely to succumb to the inherent conflict between their roles as employee and shareholder than ‘ordinary’ employee shareholders. This employee’s awareness of the potential for general employees with ESO plan shares to have different and conflicting interests to those of their share-holding managers is interesting, but it should be stressed that there is no evidence of wider concern among employees or any actual conflict between these staff levels.

At the time of the establishment of the ESP, the board had envisaged that ‘the Employee Share Plan [would] be a continuing Plan with share offers made, at the discretion of the Board, every twelve months’.⁸⁹ At the time, Palm Springs’ shares were trading at 25 cents each.⁹⁰ As of March 2005, the share price had declined by approximately 40% and although the share price has since increased, it is still below 25 cents.⁹¹ While the shares remain in trust for the employees who took up the offer, the plan was discontinued and no further shares offered to employees other than the initial \$1000 offering.

According to the General Manager interviewed for this research the poor share price reduced the relevance of the ESP to employees.⁹² He explained that both the share price performance and the subsequent discontinuance of the ESP were not ‘a big topic of conversation’ in the

⁸⁹ See above n 82.

⁹⁰ Palm Springs Interviewee 2.

⁹¹ Market price of shares as at 4 March 2005. As at 13 July 2006, the share price was 18 cents: see www.asx.com.au.

⁹² Palm Springs Interviewee 1.

workplace. Employees had ‘just thrown the shares in their drawer and [hadn’t] given them much thought’.⁹³ Similarly, employees perceived that the management decision not to continue with the ESO plan had stemmed from a similar attitude: ‘The directors haven’t considered it a major issue, or something to be followed up on’.⁹⁴ It is therefore difficult to draw solid conclusions on whether the ongoing operation of the ESP was intended to secure the benefits supposedly associated with either the indirect or direct alignment of interests. We can tentatively conclude, however, that during the time in which the ESP was still made available to employees, there was no evidence that ‘direct’ alignment objectives were sought to be achieved by management considering the lack of benchmarking or even articulated standards in place. This conclusion is strengthened by the use of benchmarking in relation to performance based pay (in the form of cash) at Palm Springs, discussed below.

Remuneration: Wealth Creation and Reward for Performance

Like NAB, Palm Springs has its performance-based rewards remunerated in cash, although those ‘bonus’ plans were also not operating at the time of the interviews due to financial constraints. Those plans depended on KPIs, and were tailored to various groups of employees such as management, drivers, and salespeople (for instance, payment dependent on the number of bottles delivered in a certain time period, rather than the payment of a flat wage). Considering that individual performance-based bonuses exist *alongside* the ESP, and that there is no link between individual or group performance and payments under the ESP, it would seem that the ESP’s main remunerative purpose is simply to create ‘wealth’ for employees.

This conclusion is supported by the fact that the ESP is not regarded as a major part of employees’ remuneration package, by either management or employees. It acts only as a benefit to those who were present at the time of the sole offer, and is not considered when evaluating the remuneration level for each employee. The employee interviewed regarded the ESO plan not as part of her salary, but a ‘bonus’, and feels the company has ‘put money into her’.⁹⁵ This employee regarded the plan as ‘good value ... we [the employees] thought they [the shares] would increase in value ... also an incentive for the company to become a cohesive unit with all its employees ... and you can achieve a benefit out of it too’.⁹⁶ It is interesting to note that, despite the decline in share price since shares were issued to employees under the ESP, the fact that the offer was not continued, as discussed below, was seen as a ‘disappointment’. This may reflect the fact that even where the shares issued drop in

⁹³ Palm Springs Interviewee 2.

⁹⁴ Palm Springs Interviewee 2.

⁹⁵ Palm Springs Interviewee 2.

⁹⁶ Palm Springs Interviewee 2.

value, they still represent a positive wealth outcome for employees (who, in this case, received the shares at a discount of more than 90%).

Workplace Harmony

The effect of the ESO plan on ‘workplace harmony’ is hard to ascertain. Considering the limited nature of the ESP, and the fact that share offers were only made once before the plan was discontinued, any effect the ESP had on workplace culture would seem to be limited.

From the interviews conducted during this research, there was no indication that the ESP has resulted in employees becoming more interested in the operation or strategic direction of Palm Springs. As stated above, due to the share price drop and other concerns, interest in the ESP has fallen for both management and employees, although comments above also suggest that some employees are disappointed that the ESP only issued shares once, and has not been available to new employees since 2002.

Regulatory Regime Impact: Tax Legislation

Like the NAB management, Palm Springs management was keen to state that the tax concessions that went along with the adoption of the plan were not major considerations in its implementation – merely that it was important that employees did not incur further tax liability if they decided to join the plan. The General Manager was unsure as to whether particular literature, or government publicity, had had any effect in encouraging the board to take up the plan in the first place, let alone consider the tax implications of its establishment. It seems nothing more than a happy coincidence, then, for Palm Springs that the tax concessions provide after-tax benefits for employees.

However, management did feel compelled to ‘take account’⁹⁷ of the regulatory regime when *designing* the plan, as a poorly executed ESO plan would lead to employees incurring tax disadvantages. The General Manager explained the decision to offer \$1000 worth of shares simply as: ‘That’s what was available under tax regulations, so that’s what we offered’.⁹⁸ The employee interviewed broadly agreed with management’s view that tax considerations were not significant in the decision to implement the ESO plan. However, if the tax liability was immediate and significant, the employee emphasised that she would have reconsidered the value of the ESO plan.⁹⁹

Like the NAB case study, the Palm Springs case study provides no evidence as to the effectiveness of tax concessions in providing an incentive for the implementation of ESO plans, at least on the part of management.

⁹⁷ Palm Springs Interviewee 1.

⁹⁸ Palm Springs Interviewee 1.

⁹⁹ Palm Springs Interviewee 2.

Concluding Remarks

Consistent with management's claim that the ESP plan was intended to strengthen employees' sense of involvement in the company, rather than directly affect employee behaviours, Palm Springs does not measure potential indicators such as staff absenteeism in the context of the ESO plan – although management 'hopes' to measure productivity at some stage. To quote the General Manager, the aim was to achieve the employee mindset that "I'm a shareholder, let's try and do the right thing" ... rather than "I don't care". Thus, like NAB, this broad concept of securing 'employee engagement' appears to have been the motivating factor in implementing the ESP, while the tax concessions offered by the government played no significant part in the establishment or ongoing operation of the plan.

6 Conclusion

This study has used two interview-based case studies to explore several important questions about ESO plans in practice. In seeking to better understand what attitudes management and employees have towards these plans, and what role the current tax concession regulatory regime plays in practice, the study has explored two contrasting companies with quite different ESO plan histories.

In doing so, the study has sought to open up an examination of three key issues in Australian ESO policy and regulation, namely:

- whether ESO plans better align the interests of employees with those of their employer, leading to better enterprise performance and benefits to the community;
- whether the objectives of companies, in implementing ESO plans, are primarily 'ownership objectives', 'remuneration objectives' or 'workplace change objectives'; and
- whether the concessional taxation treatment of ESO plans provides an incentive for the implementation of plans in a way that leads to improved enterprise performance.

While only tentative conclusions about the nature and motivations behind ESO plans in Australia may be drawn from a limited study such as this, in the two companies considered it would certainly seem that the ESO plans were implemented on the basis of an indirect and quite broad 'alignment of interests' rationale. Management at both NAB and at Palm Springs appear to have sought to foster personal engagement between employee and employer, in the hope that this brings about a *general* amenability amongst employees to the pressures and dynamism of the workplace. This should be contrasted with other plans which might provide incentives for *specific* kinds of behaviour, such as reduced absenteeism or higher productivity.

Fears that ESO plans might be implemented to replace fixed remuneration with performance-based remuneration appear to be unfounded in the case of these two companies. Both NAB and Palm Springs have used 'bonus' and KPI-related mechanisms to provide employees with

a portion of performance-based pay. ESO plans operate separately from these programs. The lack of measuring ‘tools’ at either workplace to assess the effect of ESO plans on performance generally is also telling; the ESO plan is seen as a necessary part of a progressive workplace, rather than securing bottom-line results of itself. As a result, it can be observed that the ‘remuneration’ and ‘workplace change’ objectives behind both the NAB and Palm Springs’ ESO plans were both genuine and significant, although perhaps not of as high importance to management as the overarching ‘ownership/employee engagement’ motivation.

Finally, in these companies the tax concessions regime did not operate as a significant incentive when they adopted their ESO plans. NAB had been operating general ESO plans before the existing regime was introduced, while Palm Springs interviewees reported only a passing interest in this regulatory framework. In one sense, this is reassuring, as it indicates that some employers seeking to establish ESO plans are doing so for reasons other than simply to secure taxation benefits for their employees. Alternatively, however, the concerns of the ACTU – that scarce taxpayers’ funds are being utilised to promote plans which should inherently be of value to the workplace even *without* such incentives – may be well-founded, given that the tax concessions regime has apparently played such a minor role in the deliberations of management at NAB and Palm Springs.

These studies do not, of course, preclude the possibility that the tax concession regime might be an incentive for some companies to establish ESO plans – but what they do show, however, is that a general belief in the value of aligning employer/employee interests through an ESO plan has in these cases been a more compelling factor than the current tax concession regime.