# 2023 Global Trends in Stakeholder Incentives:

# The Staying Power of ESG

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**Farient Advisors LLC** is an independent premier executive compensation, performance, and corporate governance consultancy. Farient provides a full array of services, linking business strategy to compensation through a tailored, analytically rigorous, and collaborative approach. Farient has locations in Los Angeles, New York, Louisville, and Dallas and works with clients globally through its partnership in the GECN Group. Farient is a certified diverse company and is recognized by the Women's Business Enterprise National Council.

**The Global Governance and Executive Compensation (GECN) Group** is comprised of leading independent firms around the world specializing in executive compensation, performance management, and governance. The GECN serves hundreds of clients in more than 35 countries across five continents, working with boards of directors, C-suite executives, investors, heads of public authorities, and other decision-makers to enhance stakeholder value.

# About This Report

Longer-term trends are becoming evident as companies continue their environmental, social, and governance (ESG) journeys. This year's sixth annual research report by the Global Governance and Executive Compensation Group (GECN) is titled ***2023 Global Trends in Stakeholder Incentives: The Staying Power of ESG***. It explores how companies around the world seek to incorporate ESG measures and other value drivers into their executive compensation plans. This year's research picks up from last year and details the three-year global and regional trends in the use of stakeholder incentives. We find the regional differences among companies' use of stakeholder incentives striking, and hope that you do too.


| Client Service Collaboration | Knowledge Sharing | Employee Exchanges | Data Exchange (pay, practices) | Client Publications |
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# Study Methodology

This report deliberately refers to "stakeholders." While we acknowledge that ESG is the most frequently used name for interests that extend beyond those of immediate shareholders, we use the all-inclusive term "stakeholder incentives."

This year's research is again global in scope, covering companies in Australia, Canada, continental Europe, Singapore, South Africa, the U.K., and the U.S. We researched and analyzed data on stakeholder incentives from the most recent public disclosures of all companies listed in the following indexes:

- Australia - ASX 100
- Canada - TSX 60
- Continental Europe
  - France - CAC 40
  - Germany - DAX 30
  - Switzerland - SMI 20
- Singapore - STI 30
- South Africa - JSE Top 40
- United Kingdom - FTSE 100
- United States - S&P 100

To discern the bigger picture and the trends and details revealed therein, we grouped all stakeholder measures into the following categories:

## Categorization of Stakeholder Incentive Measures

### SOCIAL

- Fatalities
- Injuries
- Illnesses
- Exposure to Harmful Substances
- Workplace Policies
- Gender Balance
- Diversity & Inclusion
- Employee Engagement
- Training and Development
- Behaviors, Ethics, Values, and/or Culture
- Other

### ENVIRONMENTAL

- Scope 1, 2, and 3 GHG Emissions
- GHG Emissions (scope not specified)
- Non-Renewable Energy
- Renewable Energy
- Environmental Incidents
- Air Quality
- Land Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Sustainability
- Other

### CUSTOMER

- Customer Satisfaction
- Customer Net Promoter Score
- Customer Complaints and Resolutions
- Product Quality and Safety
- Other

### GOVERNANCE

- Governance at the Board of Directors' Level
- Governance at the Executive Level
- Risk Management
- Compliance
- Behaviors, Ethics, Values, and Culture
- Other

### COMMUNITY

- Community Incidents
- Community Complaints
- Community Investments
- Other

# Executive Summary

While the global pandemic focused attention on the health and wellbeing of the workforce, the recent conflict in Ukraine causing both humanitarian and economic crises raised serious geopolitical questions. As this report was going to press, the ramifications of the war were evident in the rate of inflation growth, increased energy prices, and the decline of global stock markets. Recession looms in Europe, the U.S., and Britain. The stakeholder capitalism movement that had given rise to a steady embrace of environmental, social, and governance (ESG) initiatives does not appear to be slowing down despite the economic headwinds and decline of shareholder returns.

Many investors and company boards consider ESG initiatives in terms of "value," while a significant proportion of other stakeholders consider ESG initiatives in terms of "values." Some detractors question the moral authority of private enterprise to weigh in on the "values" issues that ESG initiatives encompass, while others, including activists, weigh in against companies that only consider ESG matters in terms of "value."

**"It may well be in the long-run interest of a corporation that is a major employer in a small community to devote resources to providing amenities to that community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects."**

**– Milton Friedman**
American economist, writing in *The New York Times*, Sept. 13, 1970

Within this context, the Global Governance and Executive Compensation Group (GECN) undertook its third consecutive annual survey of stakeholder trends in executive incentives. The larger trends, highlighted in this report, show an ongoing commitment to stakeholder incentives despite uncertainty and pushback.

We provide a description of each trend's "context," followed by an assessment of the "current state," and a forward look at what each trend portends in "predictions."

**CONTEXT**

- Investor and issuer priorities are evolving with longer-term perspectives and with greater consideration of stakeholders.

**CURRENT STATE**

- Issuers continue to focus on and refine their ESG measures in executive incentives for either value," "values," or a bet each way.

**PREDICTIONS**

- Companies will continue to move toward better-defined and articulated alignment between stakeholder and shareholder value. That is, the focus on "value" will overcome a focus on "values."

The GECN Group's reporting on this global research over consecutive years reveals a pattern in the use of stakeholder measures. This pattern allows us to relate trends and predictions within four primary categories that represent the common stages of a corporation's ESG journey. These four categories are **Adopt**, **Select**, **Incorporate**, and **Verify**.

## Stages of the Stakeholder Incentives Journey

| | |
|---|---|
| **ADOPT** | • Companies have spent considerable time and resources weaving stakeholder interests into their long-term business strategies. As a result, companies and their boards are discussing and debating whether stakeholder measures should be adopted in their incentive plans to reinforce those strategies. |
| **SELECT** | • Most companies have big ambitions for their contributions to a more sustainable future. The decision to use stakeholder measures often hinges on whether companies can identify and set valid goals on stakeholder measures that reinforce the strategy. |
| **INCORPORATE** | • Stakeholder measures are increasingly being used in short- and long-term incentives.<br>• How companies incorporate stakeholder measures in their incentives is evolving, reflecting measurement capabilities.<br>• Stakeholder measures are most often incorporated into incentives using scorecards or weighted measures. Either way, quantification is trending, overtaking milestone setting. |
| **VERIFY** | • Many countries and their regulatory agencies are requiring more robust reporting from corporations on their progress around stakeholder initiatives. Although companies must comply with minimum standards, many also choose to go above minimum requirements to provide a more complete picture and "showcase" their efforts. There is now a clear expectation that all representations and claims around stakeholder measures and goals be rigorous, supportable, and verifiable. |

**To augment our research, GECN Group partners reached out to directors, investors, and corporate governance experts to gauge their reaction to this year's findings. One example is Yale University's Jeffrey Sonnenfeld, who provided a historical perspective: "I have thought about the role of businesses in society for almost five decades. In 1977, George Weyerhaeuser, a lumber baron, told me how he viewed his firm's position: 'We have a license to operate from society, when we violate its terms, it can be revoked.' In 1985 Johnson & Johnson's CEO, James Burke, told me that 'our most powerful tool is institutional trust, which is real, palpable, and bankable. Every act that builds that trust enhances the value long-term of the business.' "Stakeholder capitalism" is not new. But the backlash against it is." Others, who have shared their perspectives, are featured throughout this report.**

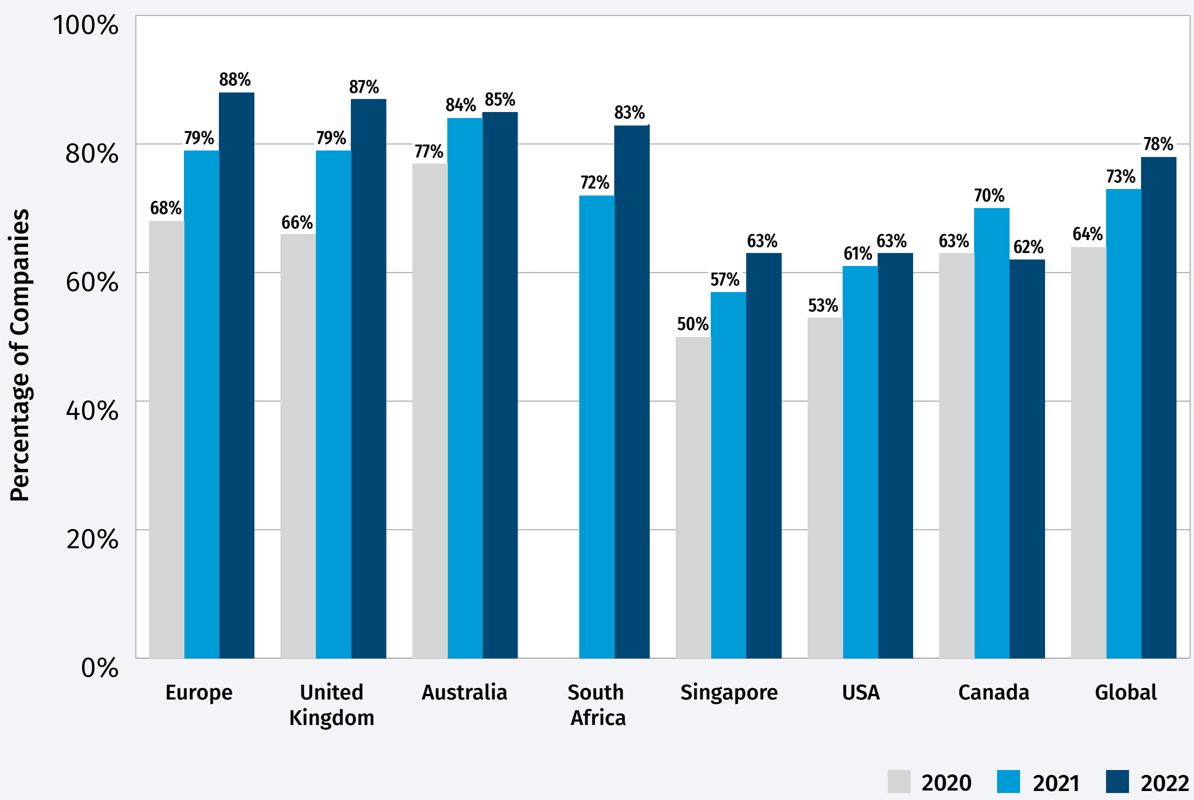
# ADOPT: The adoption of stakeholder measures continues to increase, but the rate of growth is slowing

## Context

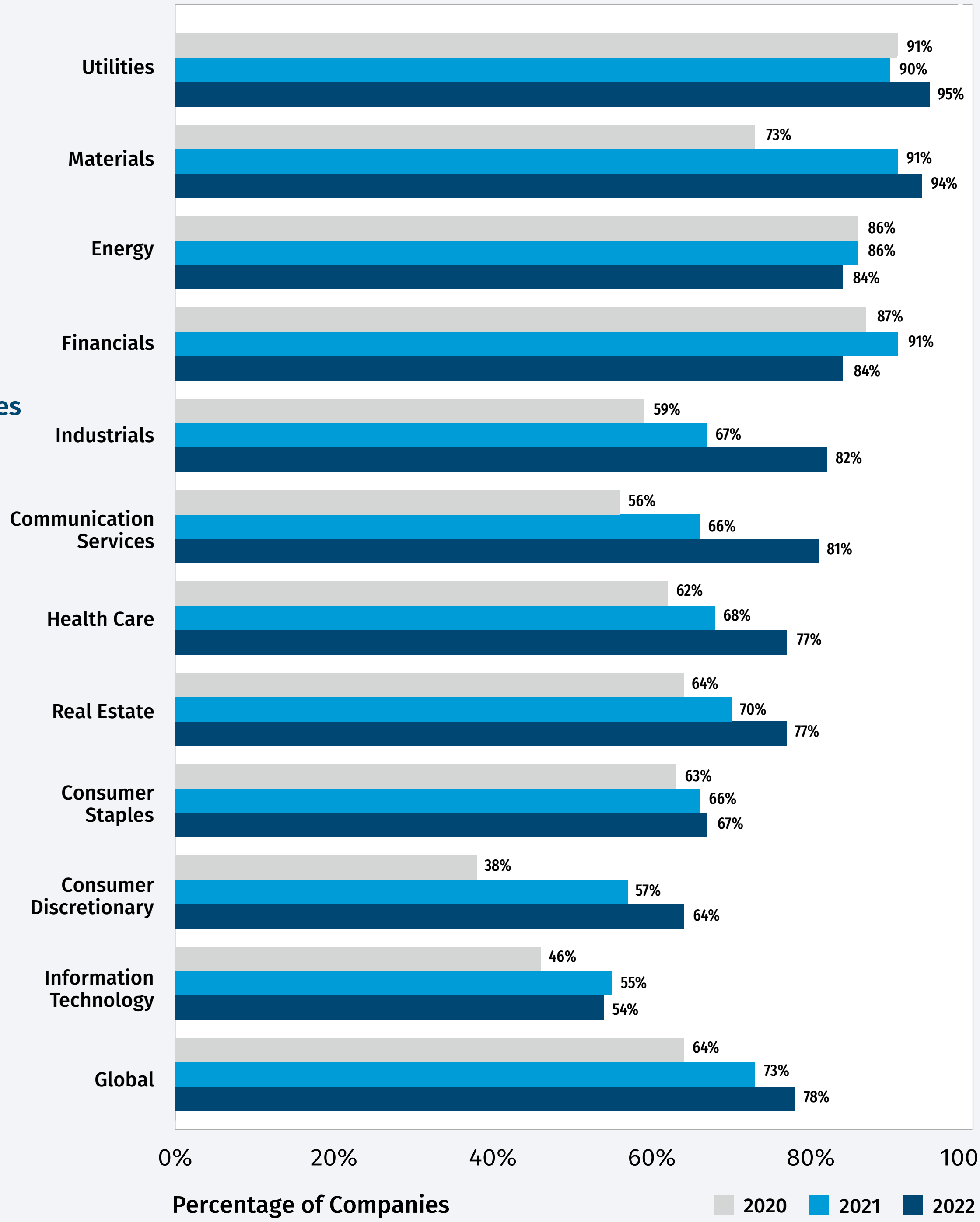
Institutional investor policies have evolved, shaped by the dominance of index investing and increasing pressure to "invest with a conscience." As investors take longer-term perspectives on their holdings, they are engaging directly with issuers around their ESG and sustainability strategies to gauge the strength, longevity, and riskiness of corporate cash flows and profits. However, there continue to be many instances of shareholder activism on ESG matters supported by hedge funds, long- and short-term investors, and specialist ESG fund managers, among others, seeking to make fast returns. Stakeholder measures in compensation have been used as part of an effective defense strategy as many investors consider stakeholder-related incentives to be a sign that companies take sustainability seriously. Moreover, companies want to communicate their ESG intentions both internally and externally. These forces have contributed to a rapid increase in the adoption of stakeholder measures in executive incentives.

The importance of stakeholders to a company's financial health over the long term is borne in the notion that shareholders and other stakeholders win together. They are interdependent. Yet some directors, executives, activist investors, and regulators believe that the attention placed on the interests of non-shareholder stakeholders will detract from the interests of shareholders, and therefore, companies should not divide their attention between shareholder and stakeholder interests.

**Prevalence of Stakeholder Incentive Measures by Region**



## Prevalence of Stakeholder Incentive Measures by Sector




## Current State

- More than three-fourths of large companies now incorporate stakeholder measures into their incentive plans
- This prevalence is up by 5 percentage points compared to 2021 and 14 percentage points compared to 2020
- Differences between regions are reflective of each region's industrial base, cultural norms, and local regulations. However, all regions but Canada are moving in the same direction—up
- Europe, the U.K., Australia, and South Africa lead the market with over 80% of large companies incorporating stakeholder measures into their incentive plans
- The other regions—the U.S., and Singapore—are increasing their use of stakeholder measures in compensation, but not to the same extent
- By sector, Utilities and Materials lead the market with more than 90% of companies using stakeholder measures in compensation, which has not changed materially from last year
- Companies in the Information Technology, Consumer Discretionary, and Consumer Staples sectors have the lowest (albeit still significant) use of stakeholder incentive measures with less than 70% prevalence, with Consumer Discretionary companies demonstrating the steepest uptake in stakeholder measures among all sectors over the past three years

## Predictions

- The increase in the use of stakeholder measures in incentives among large-cap companies may not rise significantly further as it appears to be hitting a plateau
- However, companies in regions and industry sectors with a lower use today will continue to experience growth in the use of such measures
- Because the adoption of stakeholder measures in incentives among small- to mid-size companies has been slower, the growth in the use of such measures will be higher among these companies

## Arguments For vs. Against Including Stakeholder Measures in Incentives

### ARGUMENTS FOR

✓ Shows that the company is “walking the talk”

✓ Aligns incentives with a company’s ESG strategy and commitments

✓ Focuses participants on areas requiring improvement

✓ Most investors view ESG metrics favorably

✓ Some investors are expecting companies to consider ESG and stakeholders in compensation decisions

✓ Responds to valid risk factors previously unrecognized

✓ Adds value through customer and/or investor demand, and community and regulator support

✓ Addresses value sustainability beyond typical incentive period

### ARGUMENTS AGAINST

✗ ESG metrics can contribute to incentive plan complexity

✗ Incentives may not be the most effective way to mobilize the organization around ESG initiatives

✗ It is a challenge internally to agree on which ESG measures to use

✗ Some ESG goals may not be easily quantifiable and it can be costly to ensure what is promised is actually delivered

✗ There is a perception among some investors that ESG measures are being used to augment incentive payouts

✗ Some ESG measures do not add value and there is an unnecessary cost to them

✗ Effectiveness cannot be measured within a reasonable timeframe

**“It is challenging, yet important to distinguish realistic and pragmatic targets from (very) long-term aspirations. The former can be integrated into short-term or long-term incentives; the latter should not make their way into incentives.”**

**– Jean-Christophe Deslarzes**
Chair of the Board of Adecco Group, Zurich, and of Constellium, Paris

## Stakeholder Compensation Policies Among Select Global Investors

### NO POLICY

- AustralianSuper
- Charles Schwab Asset Management
- Fidelity
- Norges
- Nuveen (TIAA)
- State Street

### POLICY DOES NOT REQUIRE ESG

**Allianz**

- Companies identified as top $CO_2$ emitters are engaged on climate strategies, and may be encouraged to tie executive compensation to metrics relating to climate change, such as GHG emissions

**BlackRock**

- If ESG measures are used, they should be:
  - Directly relevant to the company's business model
  - Aligned with its long-term strategy
  - As rigorous as other targets

**T. Rowe Price**

- Companies electing to include ESG metrics in their compensation plans should demonstrate that such metrics are:
  - Material to the company's results
  - Quantifiable

**Vanguard**

- If ESG measure is used, it should be:
  - A real metric, not simply a signal
  - As rigorous as other targets
  - Aligned with the company's long-term strategy

### POLICY EXPECTS/REQUIRES ESG

**AllianceBernstein**

- Companies should incorporate ESG measures into executive compensation plans, and they should be appropriate and well-implemented, meaning they are:
  - Material
  - Measurable
  - Disclosed with rationale
  - Disclosed with performance against goals

**Amundi**

- Companies from sectors highly exposed to climate change and its mitigation (e.g., Oil & Gas, Industrials, etc.) should use a climate-related metric in incentives

**Hermes EOS Global**

- Engagement strategy expects to see executive pay programs aligned to delivering net-zero goals

**Legal & General**

- Companies exposed to high levels of ESG risks should include relevant and measurable targets focused on mitigating those risks. ESG metrics should be:
  - Meaningful
  - Measurable
  - Aligned with company strategy
  - Subject to third-party verification

**Northern Trust**

- APAC and EMEA companies are expected to use company-specific performance measures that consider environmental and social risks

**UBS Group**

- Large companies that are a part of Oil & Gas, Materials, Chemicals, and Automotive sectors are expected to link compensation to climate change targets

## Investor expectations on ESG and compensation are being formalized into policies

Large investors have been one of the main drivers in companies adopting sustainability strategies and targets, diversifying their boards, and disclosing ESG information. A more recent development has been investors' role in driving the integration of stakeholder measures in incentive plans.

While many investors do not have a formal policy on ESG in compensation, some of the largest asset managers have released specific policies on their expectations. BlackRock and Vanguard, for example, are not pushing for companies to use stakeholder measures in pay, but if companies use such measures, they expect the same level of goal rigor as that used for other financial or non-financial metrics. Meanwhile, AllianceBernstein, Legal and General, Allianz, Amundi, and UBS, among others, have engagement policies that encourage the adoption of stakeholder incentive measures, and particularly climate measures for companies in certain industries. It should be noted, however, that some of these actors are not asking for a pay connection to all of ESG, or even all of the "E." And some actors are making the linkage only to a part of the "E," such as climate targets.

# **SELECT:** Companies are coalescing around climate and diversity measures in incentive plans

**"Organizations have no choice but to ensure that their commitment towards ESG is more than words. They must translate their commitment into meaningful actions. Variable pay plans provide this opportunity."**

**– Dr. Ronel Nienaber**
Vice President, Global Reward, Benefits, and HRIS, Sasol, Sandton, South Africa

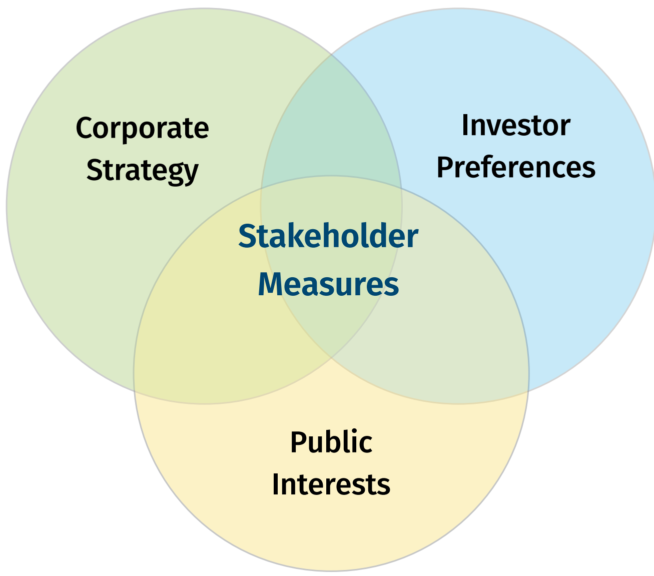
## Context

The full spectrum of stakeholder-related measures is virtually unlimited. However, as companies integrate stakeholder interests into their business strategies, determine which measures are most important to the execution of those strategies, develop baseline measurements on their starting points, and set near- and longer-term goals, they are in a better position to determine which measures may be the most important to use for incentive purposes.

As a result, companies are evolving from putting forth a laundry list of qualitative measures contained in scorecards towards selecting a few corporate measures that bring the strategy alive and/or indicate areas of needed improvement. Moreover, these measures are regarded as important strategic differentiators for which companies are willing to pay.

In addition, investors are beginning to publish policies that are suggestive of selection criteria. Most of these policies call for measures that reflect the corporate strategy, have a material impact, and for which rigorous goals can be quantified.

Finally, public interests also are having an influence. A new generation of workers and consumers are entering the market with expectations on social and environmental factors that prior generations did not have. Additionally, various crises of the past twenty years, including the global financial crisis, the COVID-19 pandemic, and global warming have heightened public awareness of the impact—positive and negative—that companies can have on the world. Regulators too have responded to constituent demands to enact laws that move companies in a particular direction on issues like climate, labor, and diversity.

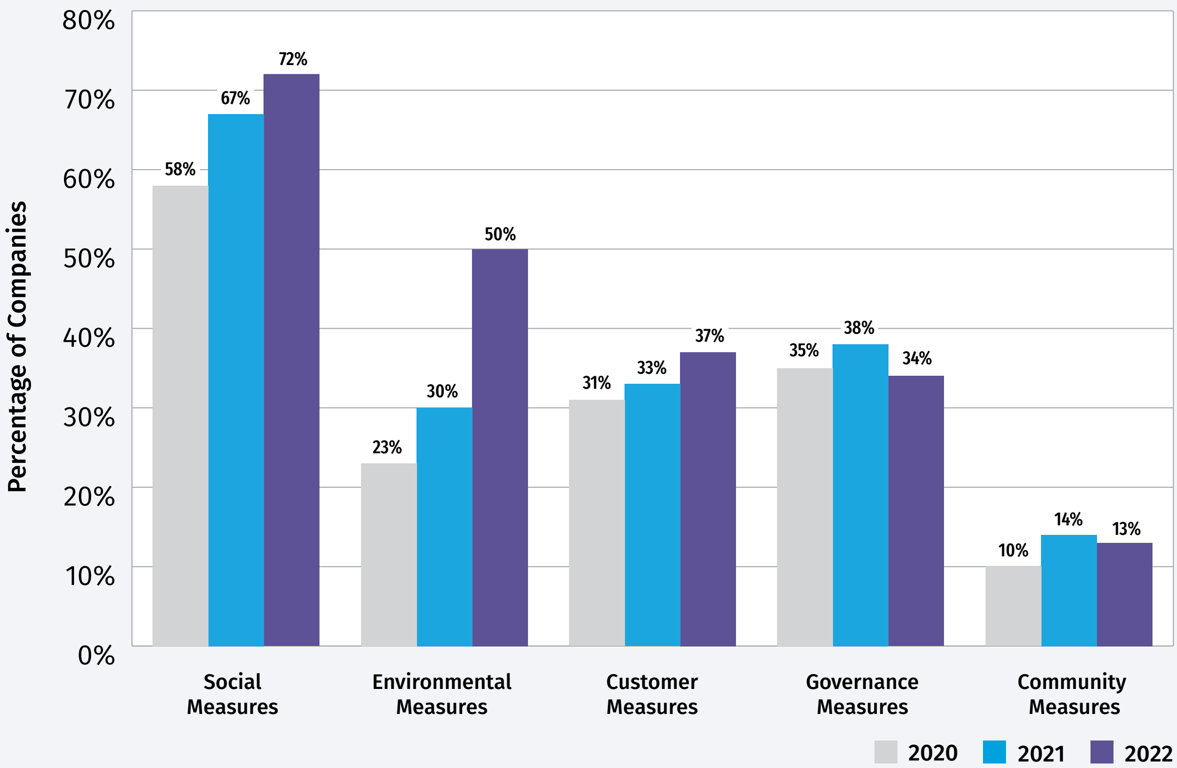


SELECT

## Current State

- Environmental measures made the most significant gains in prevalence, up by 20 percentage points in one year from 30% to 50% of companies now using environmental measures
- Social measures continue to be the most prevalent type of stakeholder measure used in incentives, gaining a further 5 percentage points since last year, from 67% to 72%
- Customer and governance measures are used by approximately one-third of companies, but have gained little in prominence
- Similarly, community-related measures are used minimally, possibly because the link back to financial materiality can be more difficult to affirm and/or investor and public pressures have focused more on environmental and employee metrics

### Prevalence of Stakeholder Incentive Measures by Type of Measure




## Predictions

- Environmental and social concerns will remain of paramount importance to society, regulators, and certain investors
- Regulations that are intended to control climate change likely will become more stringent as governments around the world aim to control emissions that are off track from the commitments of the Paris Climate Accords (aimed at limiting global warming to well below 2°C above pre-industrial levels and without exceeding 1.5°C)
- The impacts of economic inequities across society also will become more pronounced in the face of recession and climate change, thus putting greater pressure on countries to address social issues, such as pay inequity, living standards, and job attainment
- As such, increases in the use of environmental and social measures, particularly those relating to GHG emissions and DEI, will continue

# **SELECT:** The increasing use of environmental measures is a global trend across industries with a focus on GHG emission reductions

## Context

While initial discussions on stakeholder measures have been broad, there has been an increasing focus on climate from investors (such as BlackRock), regulators or standard-setters (e.g., the Taskforce on Climate-Related Financial Disclosures), and shareholder activists. "Say on Climate" initiatives have seen companies pressured to submit annual non-binding advisory resolutions on their climate transition action plans. Regulators across regions are mandating that companies disclose information about their climate risks, GHG emissions, and transition plans.

Investors also are wrestling with how best to address the climate issue. For example, should they invest in carbon-intensive industries to support their decarbonization transition efforts and engage with those companies through active stewardship or avoid investing in them entirely? And how to make this decision considering the possibility of energy shortages which could hurt particularly vulnerable communities?

Some investors have their own emissions targets related to their investment portfolio, which can be in the form of absolute GHG emissions reductions or reducing emissions intensity (i.e., emissions per unit of production), sometimes targeting high emissions sectors. These strategies in turn influence investors' policies on stakeholder incentives—for instance, Amundi and UBS Group both have policies that expect large companies in high emissions industries (e.g., Oil & Gas) or exposed to climate change mitigation (e.g., Automotive) to use climate-related measures in their incentive plans.

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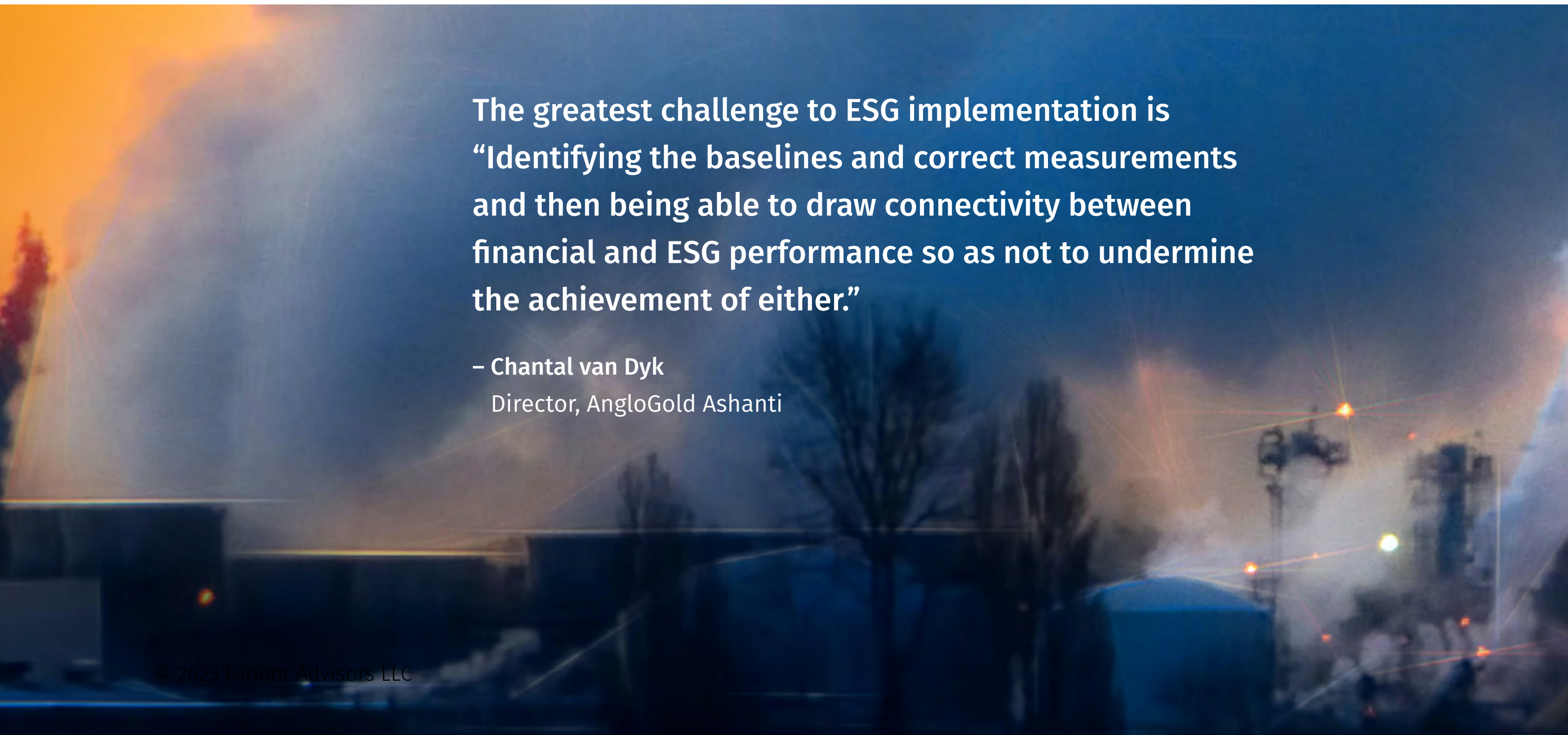


**The greatest challenge to ESG implementation is "Identifying the baselines and correct measurements and then being able to draw connectivity between financial and ESG performance so as not to undermine the achievement of either."**

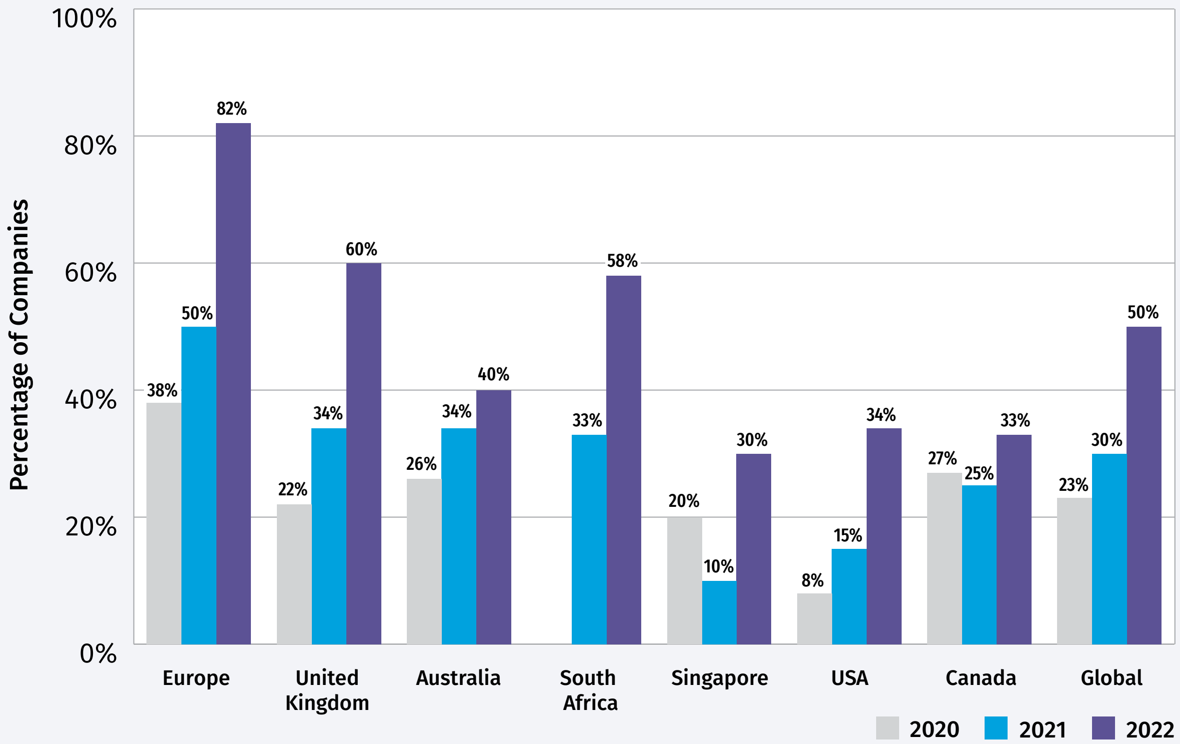
**– Chantal van Dyk**
Director, AngloGold Ashanti

SELECT

## Current State

- The use of environmental measures in incentives has increased to 50% globally with significant increases made across the various regions
  - Europe leads in its use of environmental measures, with 82% of companies in the region now using such measures, an increase of 32 percentage points from 2021
  - North America and Singapore lag the other markets in environmental metric use. Nevertheless, the U.S. has demonstrated increases, with environmental measures now used by nearly one-third of companies, up from 8% in 2020

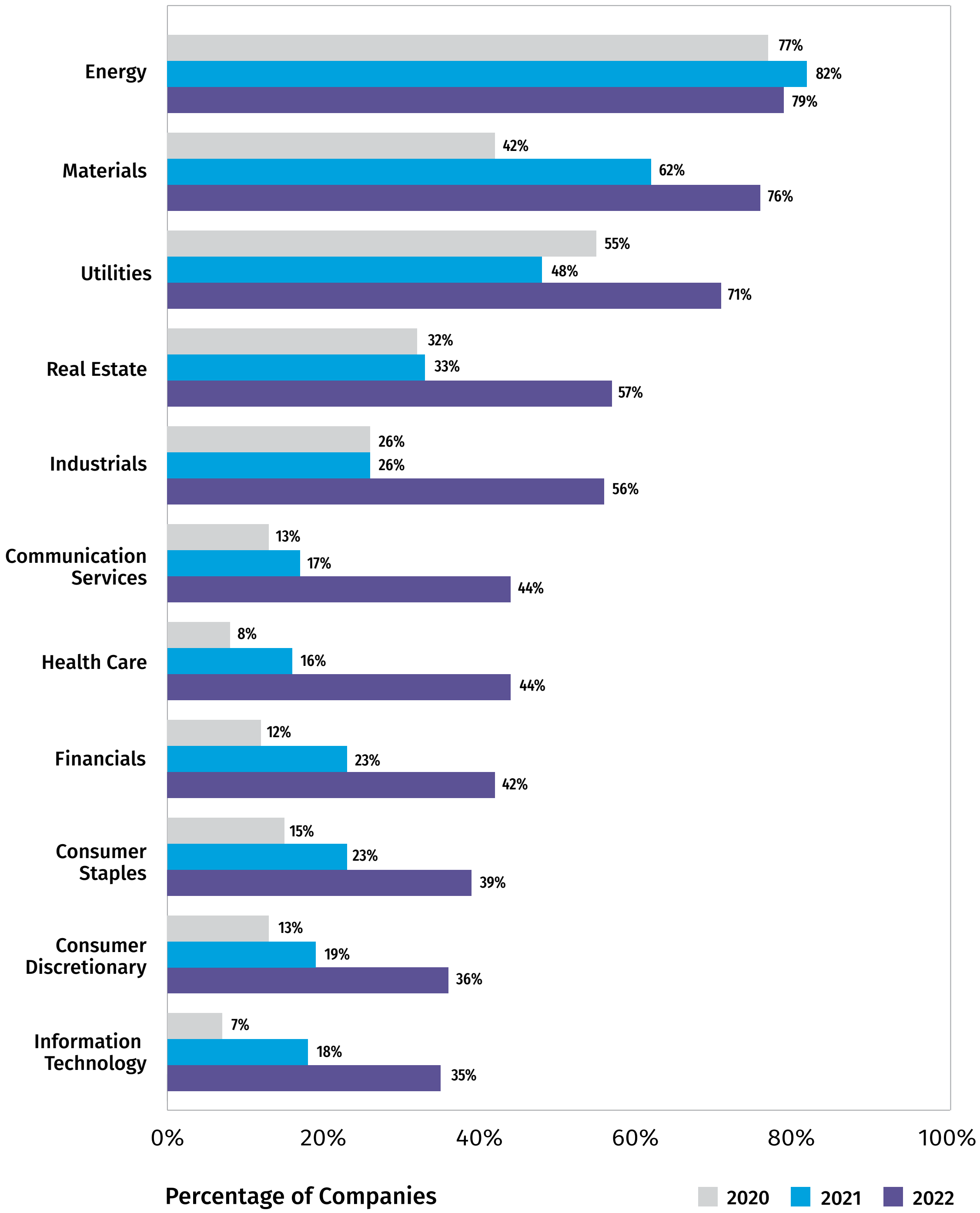
### Prevalence of Environmental Measures by Region




SELECT

- The Energy sector continues to lead in the use of environmental measures in incentives, with 79% prevalence, which has not changed much from prior years
- 2022 showed much larger gains in environmental measures used than in prior years, indicating that the prevalence of environmental measures is broad across all business types

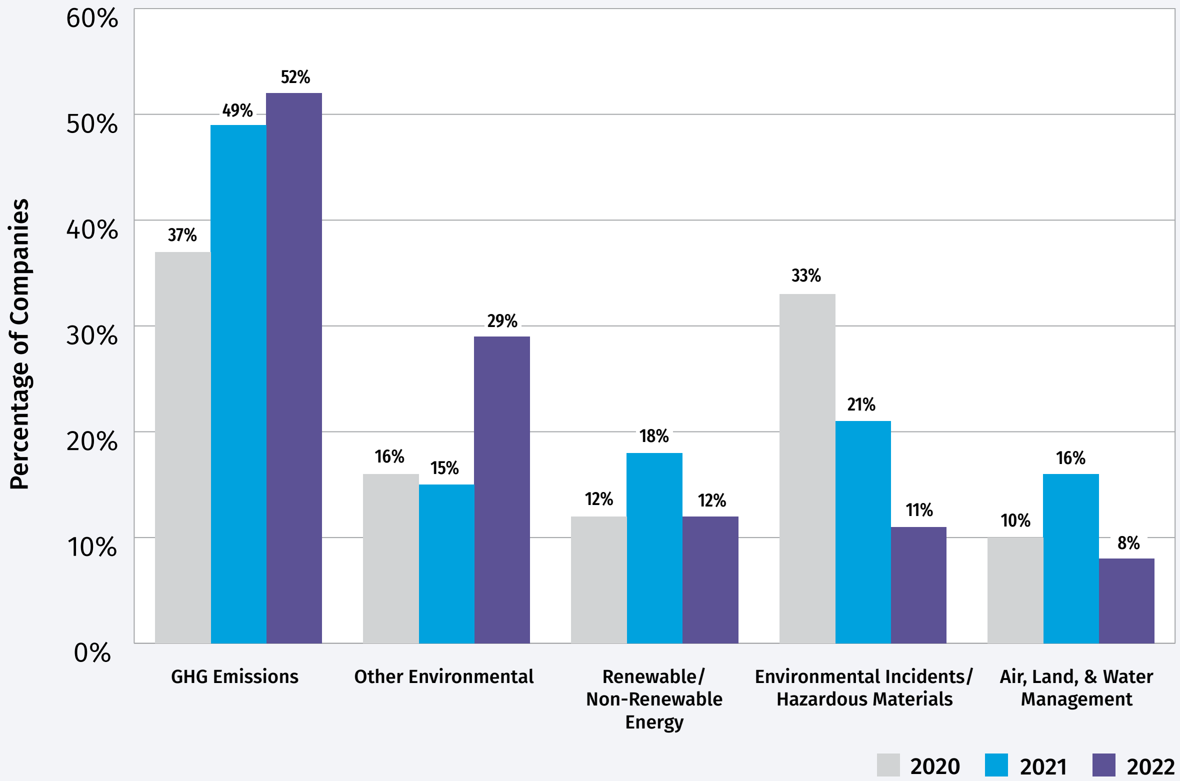
## Prevalence of Environmental Measures by Sector



SELECT

- Of those companies using environmental measures in incentives, about half are focusing on GHG emissions
  - Outside of GHG emissions, companies also are using environmental measures tied to improvements in air quality, land management, and water conservation

**Prevalence of Environmental Measures by Type Among Companies Using Environmental Measures**




## Predictions

- Regulatory developments relating to climate change will accelerate, not only in Europe and the U.K., but in other regions as well
- Investor pressure for companies to set long-term net-zero commitments and short-term emissions reduction targets will push companies to adopt measures in incentives that demonstrate their commitment to climate efforts, particularly GHG emissions
- Working groups such as the Taskforce on Nature-related Financial Disclosures (TNFD), which goes beyond climate-related risks to address broader nature-related risks (such as land use and ocean and freshwater management), has begun to gain traction among policymakers and investors, with key stakeholders beginning to develop quantifiable metrics to measure progress. As these metrics firm up, we may see a reversal of the current trend of a decrease in the use of other environment-related measures beyond GHG emissions

## Examples of Environmental Metrics

**ANGLO AMERICAN** (UK)
Anglo American's long-term incentive (LTI) award is weighted 8% on renewable energy production capacity, two additional sites above target to have execution stage approval and Latin America and Australia to have an approved Renewable Energy Ecosystem in place; and 6% weighted on reduction in abstraction of fresh water in water-stressed regions

**ASTRAZENECA** (UK)
AstraZeneca's LTI performance share plan includes a measure for "ambition zero carbon," which incentivizes the elimination of the company's Scope 1 and Scope 2 GHG emissions by 2025 with targets verified in line with the science of climate change

**DEUTSCHE BANK** (GER)
Deutsche Bank's LTI award is based one-third on an "ESG factor," comprised of generating 77 billion euros of business with environmentally sustainable finance and investments; using 80% of its own renewable energies; and lowering total building energy consumption by 10% from 2019 levels to 250 kwh/square meter

**VERIZON COMMUNICATIONS** (US)
Verizon's short-term incentive (STI) award is weighted 10% on diversity and sustainability measures, including a 10% reduction in the company's carbon emissions, calculated as [emissions divided by the terabytes of data transported over the company's networks]

> **"Companies should always assess the external environment to gain insight into the factors which may influence longer-term value. The board will then weigh these external factors in the overall assessment of future strategy."**
>
> **– Yasmin Allen**
> Greater Sydney
> Director, Australian Stock Exchange, Cochlear, QBE Insurance Group, and Santos

# **SELECT:** The use of DEI measures continues to grow considerably and is now far ahead of other social measurement types

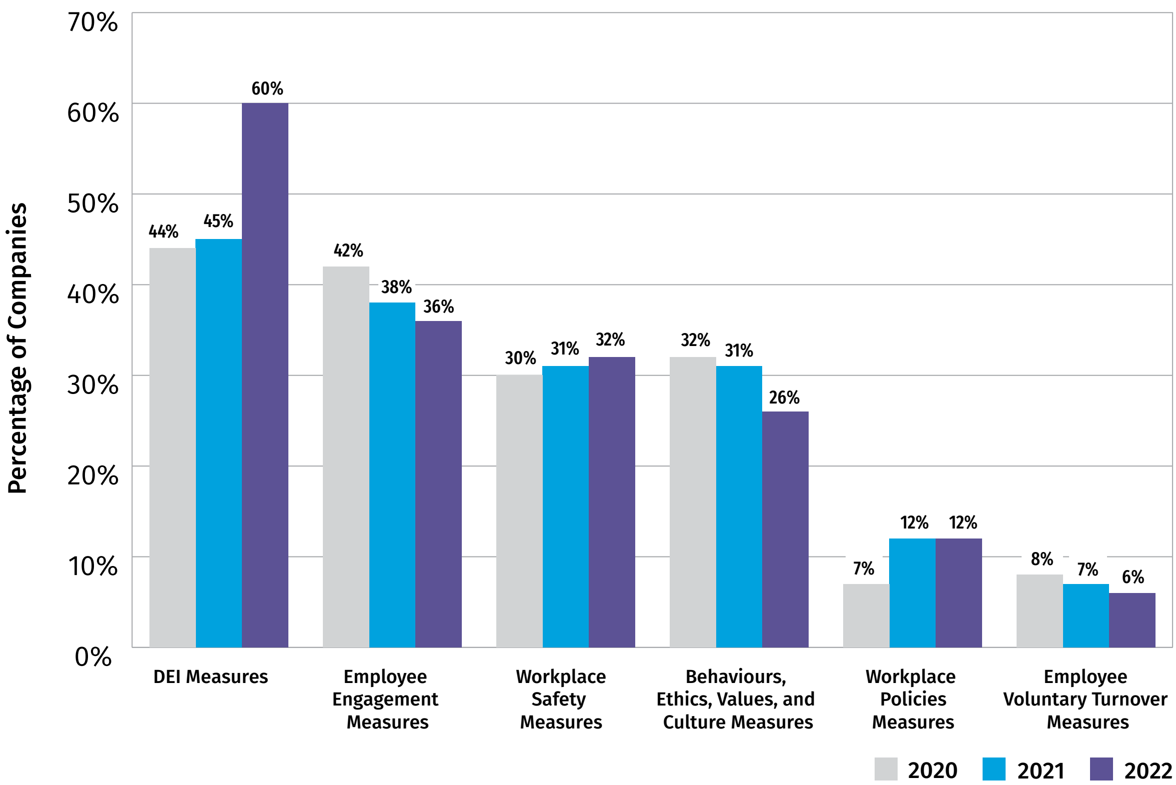
## Context

Investors continue to focus heavily on social issues, primarily workforce diversity, which has driven up the use of diversity, equity, and inclusion (DEI) measures in incentive plans. In prior years, investor pressure focused on disclosure, pushing companies to publish their diversity metrics. But now, while the pressure on disclosure remains, there are expectations for companies to demonstrate progress on their gender and/or racial and ethnic diversity, particularly for companies that may be lagging relative to others in their industry.

## Current State

- Globally, 60% of companies using social measures in incentives focus on diversity, up 15 percentage points from last year
- Other types of social measures remain flat or are falling in use, indicating a convergence towards DEI

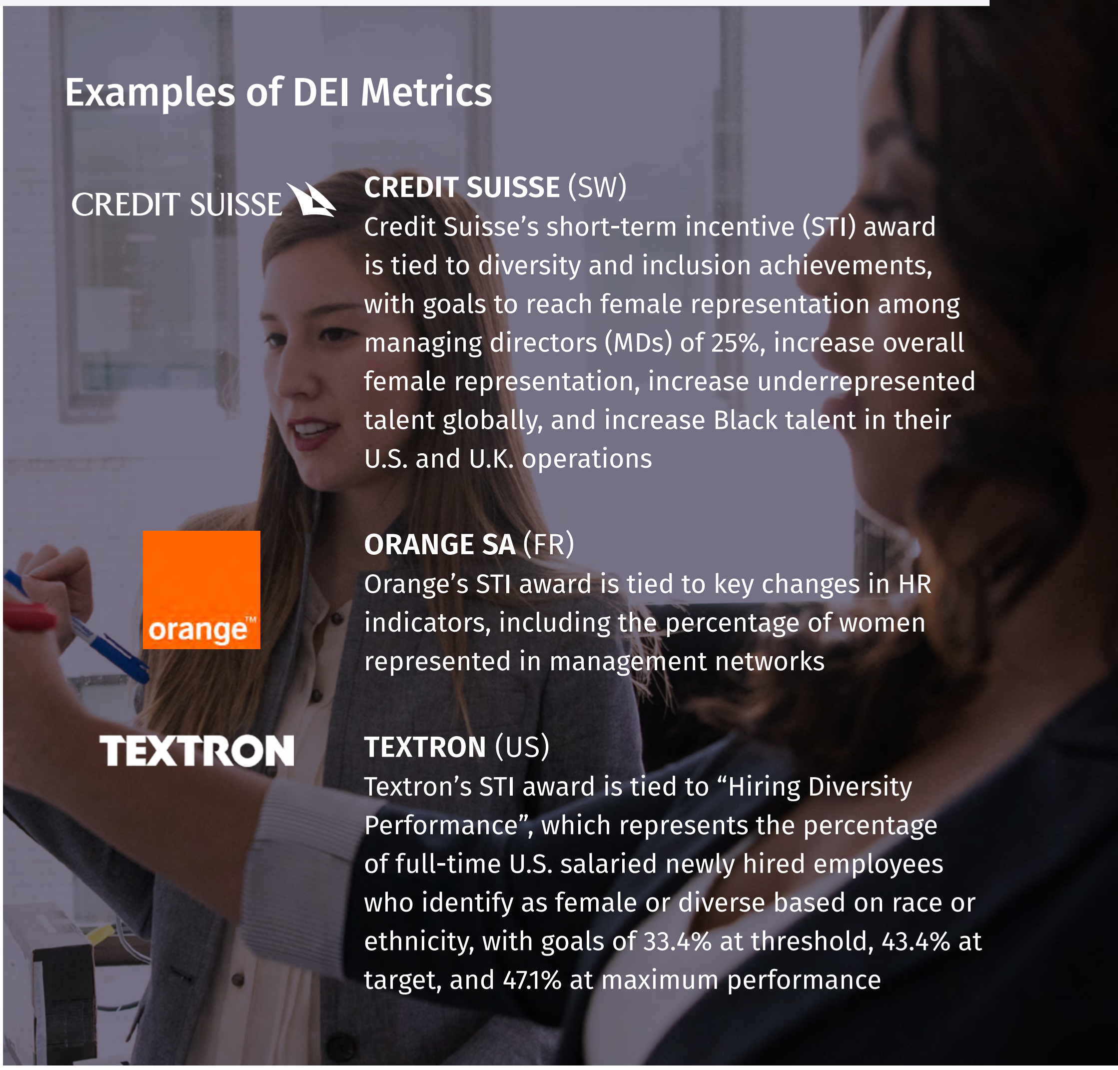
**Prevalence of Social Measures by Type Among Companies Using Social Measures**



SELECT

## Predictions

- Social measures will continue to capture needed improvements that indicate how the business is living its values, how it is achieving competitive advantage through employing a diverse workforce, and/or how it is preserving value through such measures as safety
- DEI measures will continue to be a primary social measure given the relative ease with which performance can be measured
- DEI measures will increase in prevalence as companies develop and refine their DEI strategies with more specific objectives and targets



## Examples of DEI Metrics

**CREDIT SUISSE** (SW)
Credit Suisse's short-term incentive (STI) award is tied to diversity and inclusion achievements, with goals to reach female representation among managing directors (MDs) of 25%, increase overall female representation, increase underrepresented talent globally, and increase Black talent in their U.S. and U.K. operations

**ORANGE SA** (FR)
Orange's STI award is tied to key changes in HR indicators, including the percentage of women represented in management networks

**TEXTRON** (US)
Textron's STI award is tied to "Hiring Diversity Performance", which represents the percentage of full-time U.S. salaried newly hired employees who identify as female or diverse based on race or ethnicity, with goals of 33.4% at threshold, 43.4% at target, and 47.1% at maximum performance

### "Diversity" means different things in different places. As such, stakeholder measures on DEI vary across markets

Diversity can be measured across many different variables, including age, gender, race, ethnicity, sexual orientation, language, geography, and religion. In the context of corporate board and workforce diversity, the term typically refers to gender, racial, or ethnic diversity, but can sometimes be broader as well. Moreover, the relevant diversity categories vary globally due to differences in regional demographics and cultural norms.

In recognition of these differences, when the Nasdaq stock exchange released listing standards in 2021 requiring companies to disclose board-level diversity statistics, the acceptable disclosure matrix differed among U.S. and non-U.S. issuers. For the U.S., the matrix included categories for gender, race, ethnicity, and LGBT status. Meanwhile, for non-U.S. issuers, the matrix included categories for gender, LGBT status, and a broader category for executives that identify as "underrepresented" in their home country based on national, racial, ethnic, indigenous, cultural, religious, or linguistic identity.

With myriad ways to define diversity, companies have taken different approaches when tying stakeholder incentives to diversity. In the U.S., after South Africa and, the U.K., there is an inclination to use measures of gender, racial and/or ethnic diversity, whereas in other markets, there is an inclination to put more focus on gender diversity. Additionally, some companies also use references to "underrepresented minorities" without specification to include a broader set of employees with low representation extending beyond racial or ethnic groups, like the Nasdaq rules.

# INCORPORATE: Stakeholder incentives are increasingly being incorporated into long-term incentives

## Context

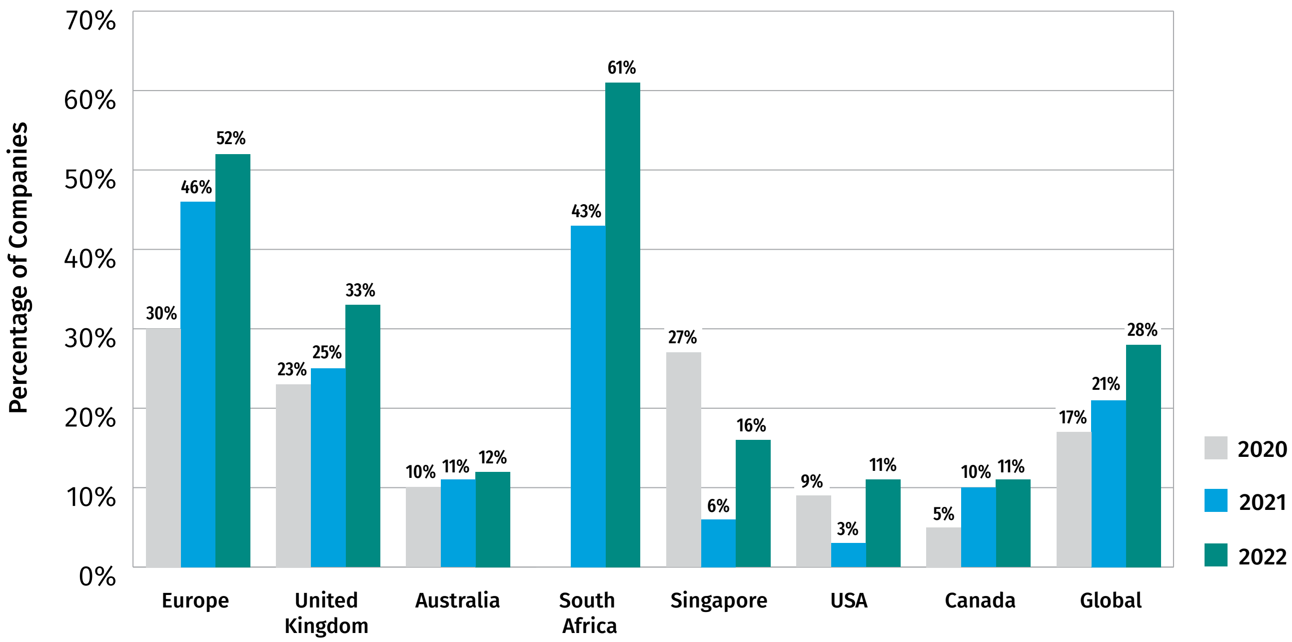
Stakeholder measures in compensation have typically been adopted in short-term incentive (STI) plans because these plans have traditionally been the "home" for other non-financial measures (e.g., strategic, operational, and individual). In addition, since many stakeholder strategies and the underlying measures are in development, it remains difficult for many companies to define measures and set goals over the longer term, making it helpful to "pilot" stakeholder measures and goals in the short-term plan.

Nevertheless, given the long-term time frame of many stakeholder measures and targets (e.g., net zero by 2050), it can be appropriate to consider these measures for long-term incentive (LTI) plans. Long-term sustainability plans can span decades, so companies often break down long-term aspirations into interim milestones to capture progress on stakeholder measures. Given the architecture of most LTI plans, this break-down most often comes in the form of three-year goals, though some may use four or five years.

## Current State

- More than one-quarter (28%) of global companies with stakeholder measures now use those measures in their long-term incentive plans, an increase of 11 percentage points from 2020
- South Africa (61%), Europe (52%), and the U.K. (33%) have the highest prevalence of ESG measures in their LTI plans
- The increasing use of ESG measures in LTI plans in Europe and the U.K. likely coincides with regulatory pressures in the region aiming to address environmental matters, and a recognition that environmental plans are typically long term
- Companies in countries such as the U.S., Canada, and Australia have demonstrated a slower uptake in the use of ESG measures in their LTI plans
- The slower uptake might be due to differences in investor expectations, regulations and/or cultural norms across regions

**Prevalence of Stakeholder Measures in Long-Term Incentive Plans Among Companies Using Stakeholder Measures**



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## Predictions

- As more companies develop climate strategies and gain greater confidence in measuring ESG performance, stakeholder measures will become more prevalent in long-term incentive plans
- Regional and sector dynamics may accelerate or provide a brake to adoption of stakeholder measures in long-term incentive plans (e.g., heavy emitters will have higher adoption rates reflecting regulatory pressure, where U.S. companies will have lower adoption rates reflecting political and cultural pressure)

## Examples of Stakeholder Metrics in LTIs

**AGL ENERGY** (AU)
AGL Energy uses a Carbon Transition (CT) measure, weighted 25%, in its LTI plan. This measure comprises three sub-metrics with quantitative goals, all measured over a four-year performance period ending in 2025. The sub-metrics are emissions intensity, percentage of renewable and storage electric capacity, and percentage of revenue derived from green energy and carbon-neutral products and services

**AVIVA PLC** (UK)
Aviva's LTI plan includes measures for reduction in $CO_2$ intensity of shareholder assets (weighted 5%), females in senior leadership roles (weighted 2.5%), and ethnically diverse employees in senior leadership roles (weighted 2.5%). The measures include a threshold to maximum range of specific quantitative targets and are measured over a three-year performance period

**GOLD FIELDS LTD.** (SA)
Gold Fields' LTI plan includes an ESG component, weighted 25%, split evenly between measures for decarbonization and gender diversity and inclusion across the group, each measured over a three-year performance period

**"While investors have long preferred financial metrics in remuneration, we are seeing that view change dramatically and hence it's inevitable that ESG-linked remuneration targets will become more prevalent."**

**– Holly Kramer**
Sydney, Australia
Non-Executive Director, Woolworths Group, Endeavour Group, Fonterra Co-operative Group

# **INCORPORATE:** Stakeholder incentive measures are becoming increasingly quantified

## Context

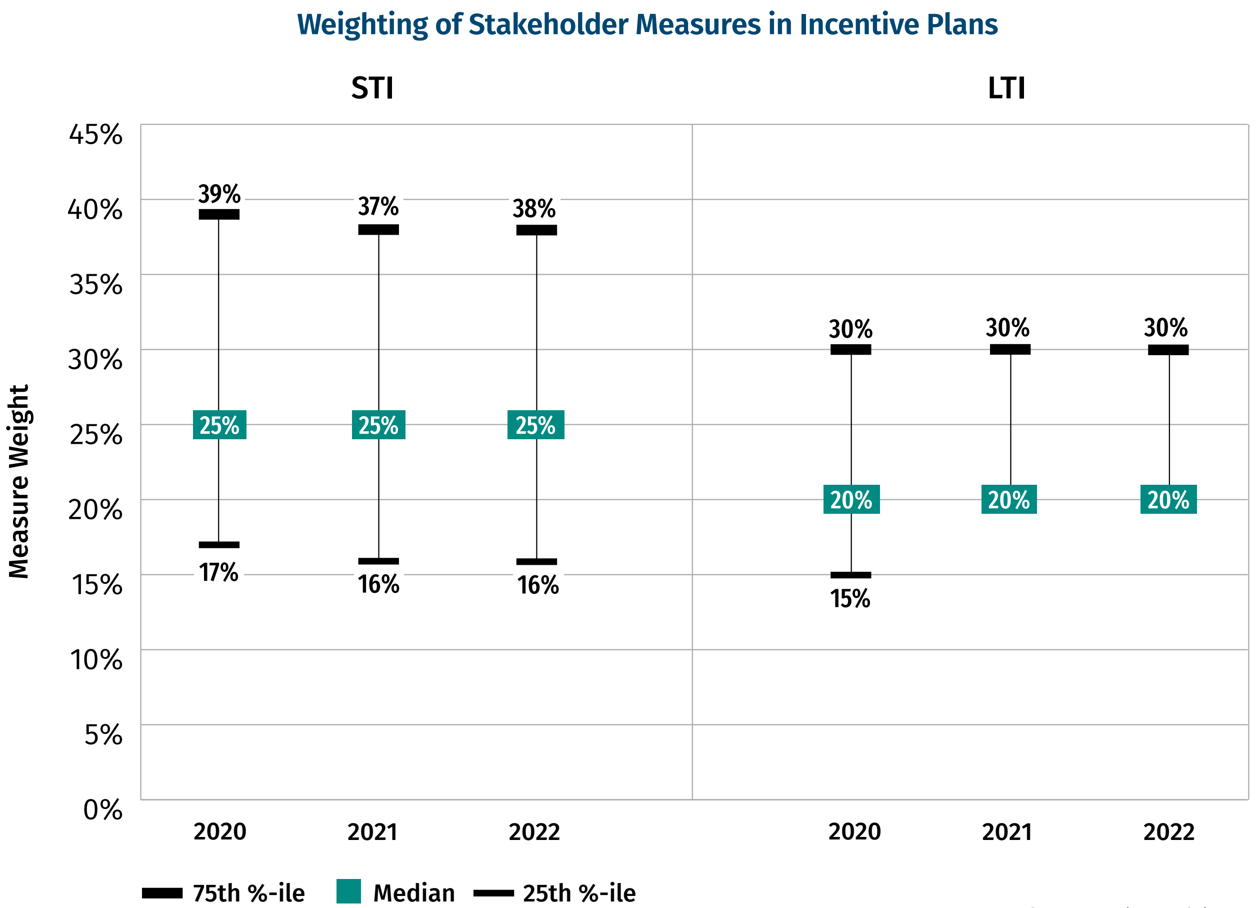
There continues to be an evolution in the emphasis and rigor of stakeholder measures within the incentive structure. In the early stages of ESG strategy development, many companies incorporated general and more qualitative sustainability measures into stakeholder incentives to demonstrate their importance, while also recognizing that specific measures and targets were sometimes not fully established.

Investor pressure has forced more companies to migrate from only qualitative or "soft" measures to more quantitative goals. For example, a company that may have used disclosure of GHG emissions as an activity-based goal in a prior year may be switching to a quantitative GHG emissions reduction goal in its new incentive plan design, which builds upon prior efforts to disclose its data and establish baselines.

Additionally, many boards and their directors have become more comfortable with stakeholder measures as their companies invest in data tracking and auditing mechanisms. This in turn, provides greater confidence in setting longer-term quantitative targets and to agree on specific weighting for these targets.

## Current State

- When used, stakeholder measures in aggregate continue to be weighted about 25% in short-term and 20% in long-term incentive plans



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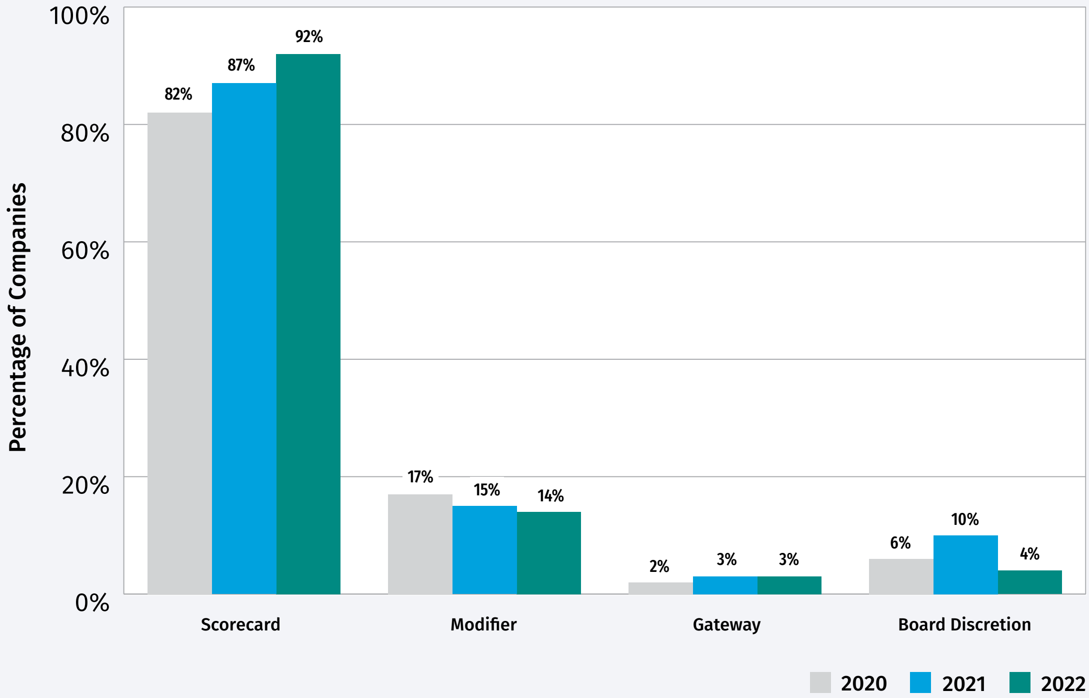
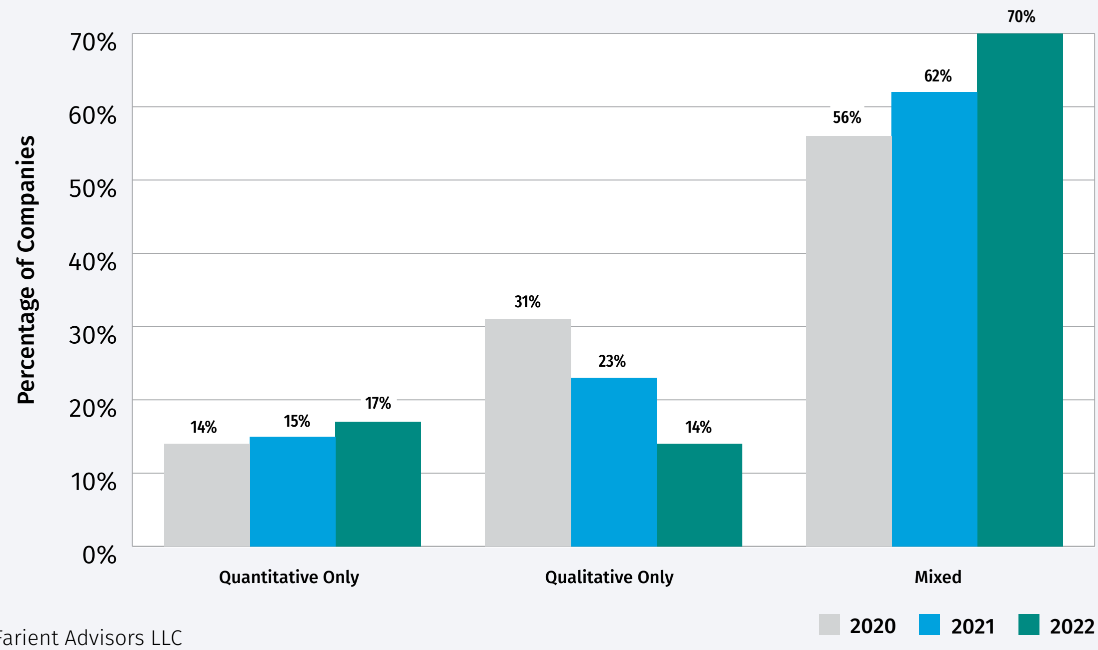
- Most companies (92%) use a scorecard through a weighted or discretionary approach to incorporate stakeholder measures into incentives
- Use of stakeholder measures as a modifier is decreasing as companies coalesce around scorecard or weighted approaches. Almost three-quarters of companies using stakeholder measures use at least one quantitative measure, an increase from prior years
- Only about 14% of companies that disclose their stakeholder measurement mechanism use strictly qualitative stakeholder measures in their incentive plans, which represents a 17 percentage point decrease from 2020, as companies move towards adopting more quantitative goals

### Mechanisms for Incorporating Stakeholder Measures Into Incentives Among Companies Using Stakeholder Measures




### Prevalence of Quantitative vs. Qualitative Measures Among Companies Using Stakeholder Measures and Disclosing Measurement Type



## Predictions

- There will be greater use of stakeholder measures in compensation with discrete weightings (within or outside of scorecards) as organizations continue to prioritize key stakeholder measures that are critical to the business
- Stakeholder measures used in long-term incentive plans likely will appear in the form of quantified weighted measures, rather than embedded with other metrics in an unweighted scorecard
- There will be increased quantification of measures with specific measurable goals disclosed
- The overall weighing of stakeholder incentives will increase in the total pay mix as they are added to LTI plans

## Examples of Quantitative/Qualitative Stakeholder Metrics

**ASCENA REIT** (SG)
Ascena REIT's STI plan uses a balanced scorecard with performance outcomes based on quantitative and qualitative targets across various dimensions including "sustainability," which relates to measures for talent retention, succession planning, and sustainable corporate practices

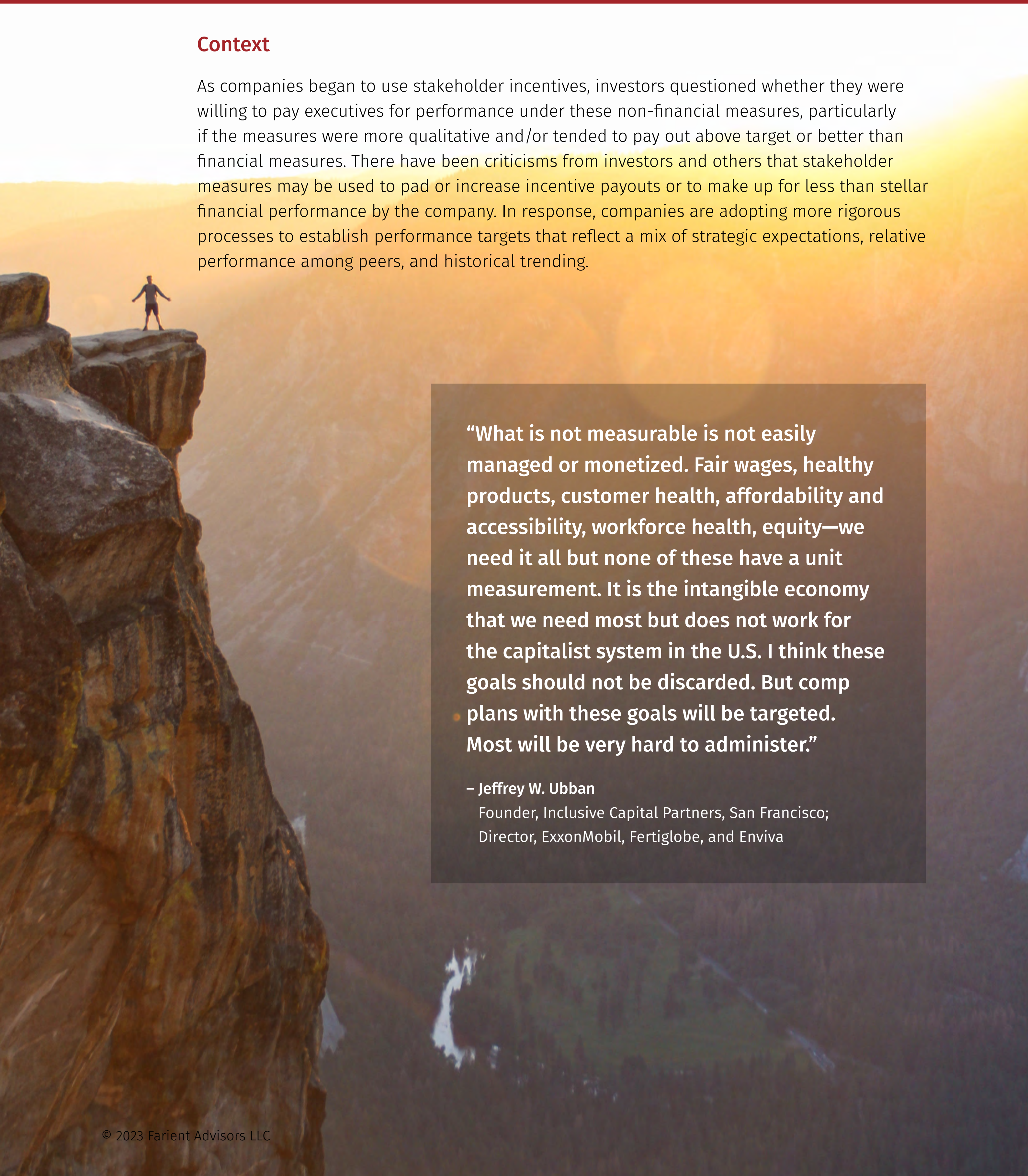
**EMERA ENERGY** (CA)
Emera Energy's STI plan includes categories for safety (weighted 10%), environment (weighted 10%), and people (weighted 10%), which in turn, encompass various qualitative and quantitative objectives, such as implementing new safety training modules, achieving a 50% employee completion rate, establishing key DEI metrics and baselines, and improving the company's employee engagement survey results

**SAP** (GER)
SAP's STI plan includes three quantified "sustainability KPIs" encompassing Customer Net Promoter Score (weighted 6.67%, target +5 to +10), employee engagement index (weighted 6.67%, target 84%), and net carbon emissions (weighted 6.67%, target 145 kt $CO_2$)

**"Stakeholder incentives need to be integrated into strategy, business, and budget planning, and into group, department, and personal goals and reviewed throughout the year just like other goals."**

– **Eric Wetlaufer,** Managing Partner, TwinRiver Capital, Toronto; Board Member of TMX Group, IMCO, Enterra Solutions, and Niyogin FinTech

# **VERIFY:** More work is needed to set rigorous targets and make stakeholder incentives a meaningful portion of overall pay



## Context

As companies began to use stakeholder incentives, investors questioned whether they were willing to pay executives for performance under these non-financial measures, particularly if the measures were more qualitative and/or tended to pay out above target or better than financial measures. There have been criticisms from investors and others that stakeholder measures may be used to pad or increase incentive payouts or to make up for less than stellar financial performance by the company. In response, companies are adopting more rigorous processes to establish performance targets that reflect a mix of strategic expectations, relative performance among peers, and historical trending.

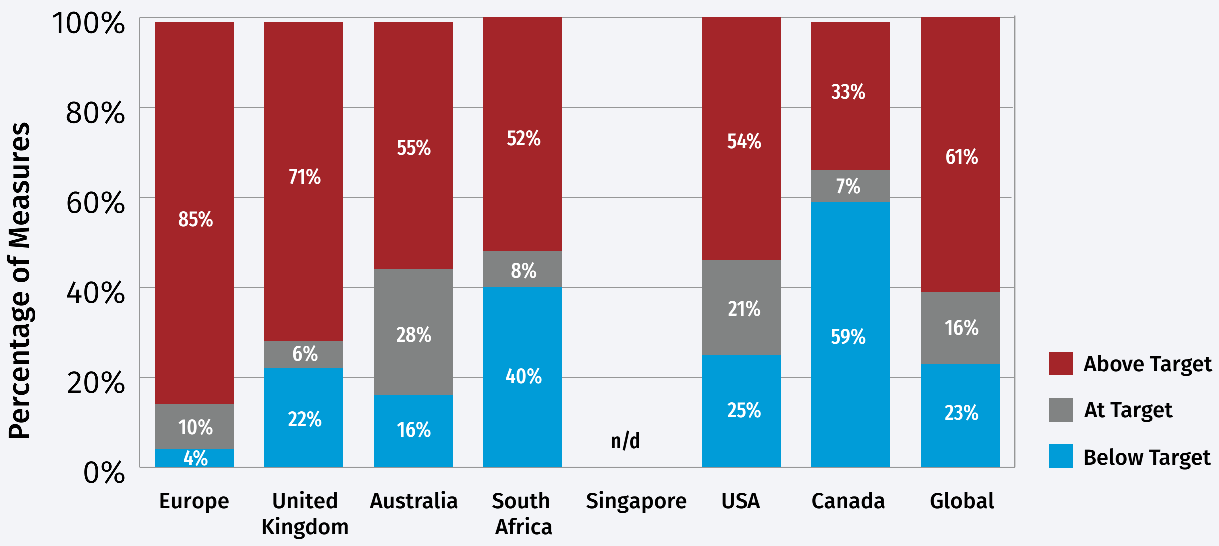
**"What is not measurable is not easily managed or monetized. Fair wages, healthy products, customer health, affordability and accessibility, workforce health, equity—we need it all but none of these have a unit measurement. It is the intangible economy that we need most but does not work for the capitalist system in the U.S. I think these goals should not be discarded. But comp plans with these goals will be targeted. Most will be very hard to administer."**

**– Jeffrey W. Ubban**
Founder, Inclusive Capital Partners, San Francisco;
Director, ExxonMobil, Fertiglobe, and Enviva

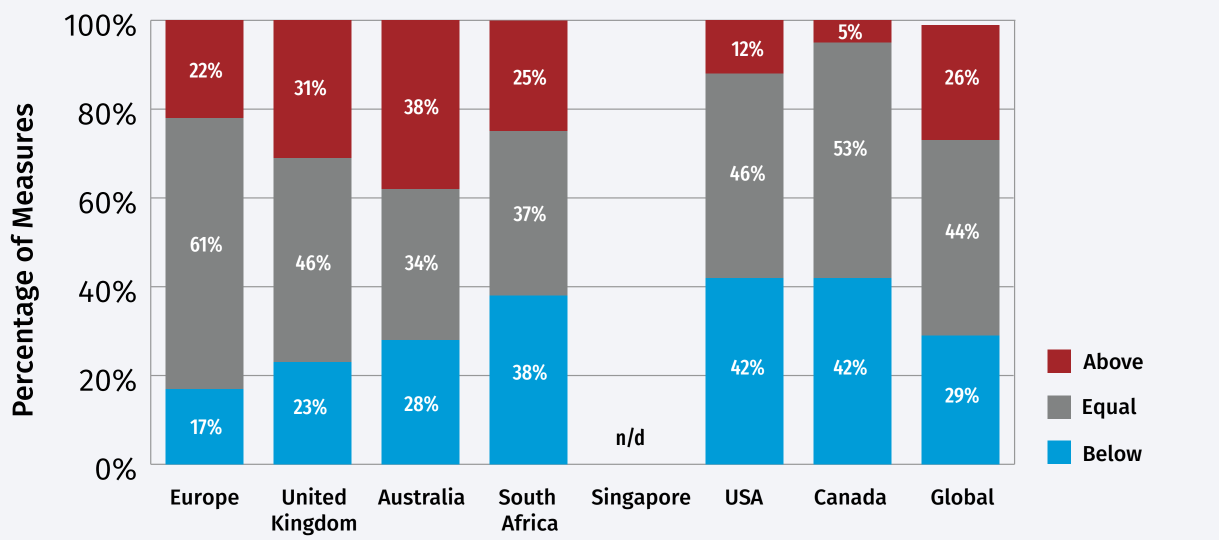
## Current State

- Overall, 61% of stakeholder measures pay out above target, 23% pay out below target, and 16% pay out at target
- However, payout levels vary considerably by region. For example, most measures used by European companies (85%) pay out above target, while most used by Canadian companies (59%) pay out below target
- When comparing how stakeholder measures pay out relative to overall STI payouts, nearly half of the measures (44%) pay out at the same rate, while a similar portion pay out at above (26%) and below (29%) the overall rate

### Payouts as a Percentage of Target For Stakeholder Measures In Short-Term Incentive Plans By Region



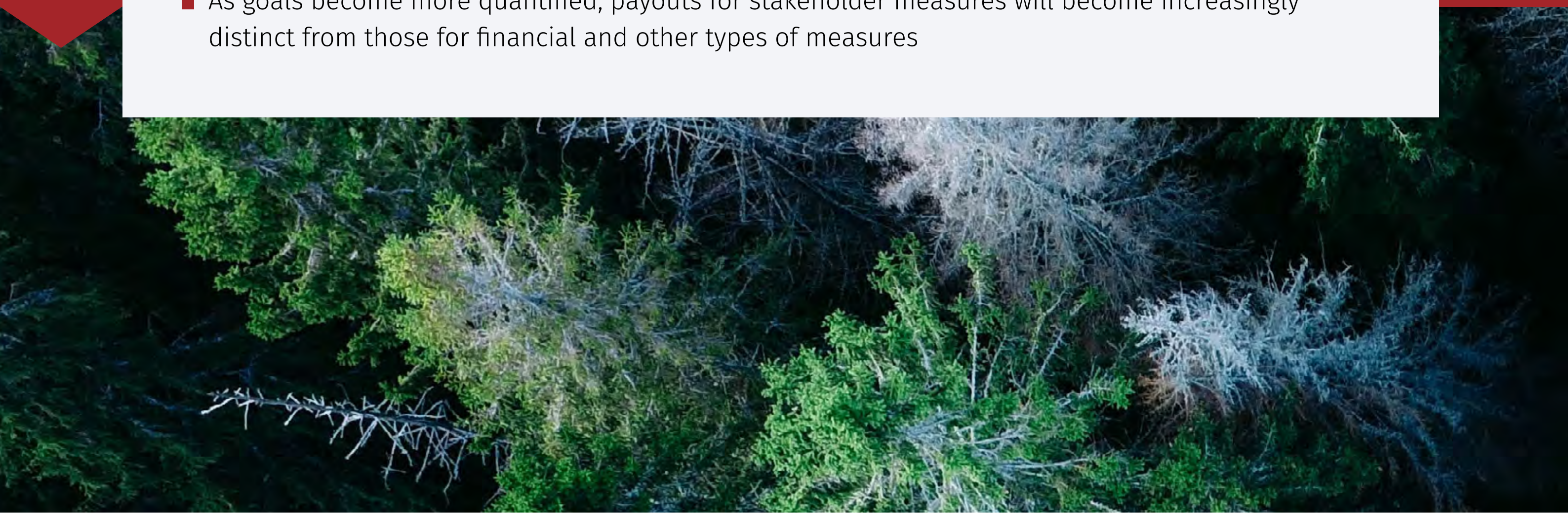

### Payouts For Stakeholder Measures Relative to Total Payouts for Corresponding Short-Term Incentive Plan By Region



VERIFY

## Predictions

- Companies will increasingly face investor scrutiny to explain their stakeholder measures, justify their goals, and warrant their results
- As goals become more quantified, payouts for stakeholder measures will become increasingly distinct from those for financial and other types of measures



## Examples of Disclosures on Payouts for Stakeholder Performance

**AFRICAN RAINBOW MINERALS** (SA)
African Rainbow Minerals' LTI plan includes sustainable business measures for improved safety performance, improvement in Broad-Based Black Economic Empowerment (B-BBEE) score, and environmental compliance based on various climate change performance targets for reductions in Scopes 1 and 2 GHG emissions. The payouts achieved on these metrics in 2021 were between target and maximum performance levels

**DEXUS** (AU)
Dexus' STI plan weights ESG measures 25%. The plan paid out at varying levels for different metrics. Its Customer Net Promoter Score (NPS) paid out above target for outperformance (target of +41 to +45, with actual achievement of +46); its safety audit score paid out above target for outperformance; its employee NPS paid out at target (target of +41 to +45, with actual achievement of +43); and its performance against four ESG benchmarks (PRI, GRESB, DJSI and CDP)[1] paid out above target

**IBM** (US)
IBM uses a diversity modifier in its annual incentive plan based on improvement in the representation of executive women globally and of Black and Hispanic executives in the U.S. Due to improvement in representation across all targeted groups, the diversity modifier increased the incentive payout by five percentage points

(1) Principles for Responsible Investment (PRI); Global Real Estate Sustainability Benchmark (GRESB); Dow Jones Sustainability Index (DJSI); Carbon Disclosure Project (CDP)

## Canadian Companies Have High-Performance Expectations

Canada stands out with respect to relative payouts of stakeholder incentives in short-term incentive plans with close to 70% paying out at or below target (versus less than 40% globally). Canada’s industry representation includes many natural resource companies that have long embedded stakeholder incentives such as employee health and safety within their incentives which means that they have significant experience and good data (both historical and relative) to set robust targets. Given the ultimate importance of employee health and safety, Canadian companies are focused on ensuring meaningful improvements are made over time that align with their underlying safety culture.

**To effectively oversee stakeholder interests, boards and compensation committees can consider the following questions at the four different stages of the ESG journey:**

**ADOPT**

- Does the company have a credible strategy that includes stakeholder interests?
- Does the company have measures and goals that indicate real progress and corporate sustainability?
- What do your investors and other stakeholders think about the company's commitments, measures, and goals?
- Are we making any direct or implied ESG promises we can't keep?

**SELECT**

- Do the stakeholder measures align with the company's business strategy?
- Which measures have the greatest impact on sustainable performance and culture?

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- Has the company established credible ways for delivering on and measuring performance?
- Have baseline performance levels been developed?
- Over what time period can meaningful progress be made?
- How should stakeholder incentives be structured (e.g., scorecards vs. weightings, quantitative vs. qualitative, short- vs. long-term, activity- vs. outcomes-based)?

**VERIFY**

- Who on the board has responsibility for setting stakeholder goals and verifying performance? What role for other functions exist within the company to verify?
- Does the compensation committee have the information it needs to effectively determine achievement levels and translate achievements into payouts?



# Action Steps for Directors

Boards have a critical role to play in all four stages of the stakeholder incentive journey, i.e., determining whether to **adopt** stakeholder incentives, and if so, which measures to **select**, how best to **incorporate** such measures into the plans, and how to establish goals and **verify** results. The last stage in particular contributes to stakeholder trust by showing that stakeholder measures are being taken seriously. To help strengthen the board's role, consider the following actions and recap:

## FIVE ACTIONS FOR BOARDS TO CONSIDER

1. Ask the right questions (see sidebar)
2. Identify measures that are derived from the strategy and can move the needle on sustainable performance
3. Consider the use of stakeholder measures not only in short-term but also in long-term incentive plans
4. Take a broad perspective in considering the use of stakeholder measures, e.g., use of measures inside as well as outside of incentives, alignment up and down the organization, messaging in all types of company communications (internally and externally), impact on culture, and comparisons with peer and most-admired companies
5. Review board governance of stakeholder matters to provide effective oversight. Ensure that governance responsibilities are assigned and overlapping, as needed, to avoid gaps or lapses in oversight

## RECAP

- Environmental and diversity measures will continue to gain traction as definitions around these measures improve
- Companies will continue to gain confidence in measuring stakeholder performance, which will open the door to greater use of stakeholder measures in LTI plans
- As regulators put greater pressure on companies to report on their stakeholder plans, goals, and achievements, companies will face greater scrutiny for quantification and verification of results
- As investors sharpen their stance on the use of stakeholder measures in executive incentives, companies will face greater scrutiny on the extent to which their measures reflect their strategies and their payouts reflect real, quantifiable achievements

# Contact Us

We hope you find our research illuminating and that it contributes to the continuous improvement of corporate and stakeholder engagement.

We invite your questions and comments. Please direct all inquiries to GECN Group leadership.

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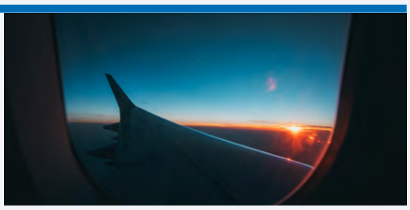

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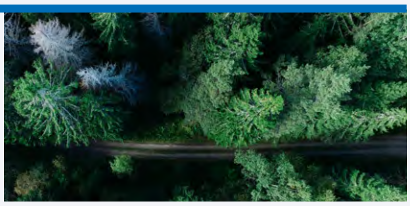

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