FARIENT ADVISORS

a GECN GROUP company

2024 Global Trends in Stakeholder Incentives: What’s Next?

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Farient Advisors LLC

Farient Advisors is an independent premier executive compensation, performance, and corporate governance consultancy. Farient provides various services, linking business strategy to compensation through a tailored, analytically rigorous, and collaborative approach. Farient has offices in Los Angeles, New York, Louisville, and London and works with clients globally through its partnership in the Global Governance and Executive Compensation (GECN) Group. Farient is a certified diverse company and is recognized by the Women's Business Enterprise National Council (WBENC).

The Global Governance and Executive Compensation (GECN) Group is comprised of leading independent firms in the U.S., Canada, the U.K., Continental Europe, South Africa, Singapore, and Australia. We specialize in executive compensation, performance management, governance, and related topics. The GECN Group serves companies and other organizations in more than 35 countries, working with boards of directors, C-suite executives, investors, heads of public authorities, and other decision-makers to enhance stakeholder value.

FOREWORD

A Note from Robin A. Ferracone CEO of Farient Advisors

This report is the culmination of our seventh annual global research and fourth consecutive report focused on ESG incentives.

Amid an avalanche of existing content related to ESG and executive compensation, our focus in this report is to provide analysis and insights to better inform the decisions directors will be making in their boardrooms in the months ahead.

Pushback on ESG initiatives, particularly in the U.S., against a backdrop of political polarization, economic concerns, and geopolitical tensions creates unprecedented challenges. Our 2024 report captures these dynamics and tackles the essential question: What's next?

In short, our analysis reveals there is no evidence that companies and their boards are turning back—ESG has established itself as a strategic value driver for companies in all industries, of all sizes, and around the globe. Companies are stepping up to navigate these crosscurrents and amplify performance and the value of their sustainability efforts.

On behalf of our leaders and staff in North America, Europe, Africa, Asia, and Australia—five continents represented by firms in the Global Governance and Executive Compensation (GECN) Group—I invite you to read our report and encourage you to reach out to us with your own observations, experiences, and challenges.

About This Report

Having long-term trend data is essential to formulating strategies. This year's annual research by the Global Governance and Executive Compensation (GECN) Group—***2024 Global Trends in ESG Incentives: What's Next?***—provides just that. As ESG initiatives have become the focus of investor and regulatory scrutiny, we ask: How is this affecting pay practices? What specific choices are companies making on targets and metrics? How do size, industry, and geography affect decision-making? Our research details stakeholder incentive and ESG trends across regions, industries, and company size. We are confident it provides timely insights and data useful for corporate decision-makers as they design their ESG and compensation strategies.

Client Service Collaboration

Knowledge Sharing

Employee Exchanges

Data Exchange (pay, practices)

Client Publications

Study Methodology

Global in scope, this year's research covers Australia, Canada, continental Europe, Singapore, South Africa, the U.K., and the U.S.* The GECN Group analyzed data on ESG incentives from the most recent public disclosures of all 500+ 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

This year, we've expanded coverage to the U.S. S&P 1500 Index to analyze differences among large-, mid-, and small-cap companies

The tabular data for this report are sourced from ESGAUGE.

** Collectively, these companies are referred to as "large companies" in the charts that follow.*

For our analysis, all ESG-related measures were grouped into the following categories:

Categorization of Incentive Measures

SOCIAL

- Diversity, Equity & Inclusion (DEI)
- Workplace Safety (e.g., fatalities, injuries, exposure to harmful substances)
- Employee Engagement
- Employee Voluntary Turnover
- Workplace Policies
- Other Social Issues (e.g., training and development)

CUSTOMER

- Customer Satisfaction (e.g., Net Promoter Score)
- Product Quality and Safety
- Responsible Sourcing
- Other Customer Issues

GOVERNANCE

- Compliance
- Behaviors, Ethics, Values, and Culture
- Cyber Risk/Data Governance and Privacy
- Other Governance Issues

ENVIRONMENTAL

- GHG Emissions (e.g., Scope 1, 2, and 3)
- Renewable or Non-Renewable Energy Use
- Environmental Incidents/Hazardous Materials
- Air, Land, and Water Management
- Other Environmental Issues

COMMUNITY

- Philanthropy
- Human Rights
- Stakeholder/Community Engagement
- Other Community Issues

Executive Summary

Last year, Farient and the GECN Group highlighted the growing use of stakeholder or environmental, social, and governance (ESG) incentives among companies globally. Given this research, we made several predictions, among them that there would be: (1) a continued rise in the use of climate-related and workforce diversity measures; (2) an increase in the adoption of ESG measures in long-term incentive (LTI) plans; and (3) a continued push from stakeholders (e.g., investors, employees, customers, and governments) for companies to address their ESG concerns. As you will see from the data contained in this report, our predictions are proving out.

This year, we identified five major insights in the use of ESG incentive measures:

1. Companies globally continue to tie incentives to their ESG strategies and goals—a trend evident across large-, mid-, and small-cap companies
2. Companies are aware of an ESG backlash in the U.S., but maintain their focus on long-term value drivers, which often are inextricably tied to ESG factors
3. The climate crisis has led to an urgent need to reduce greenhouse gas (GHG) emissions, as evidenced by a steep increase in incentives tied to emissions reductions
4. The long-term nature of ESG strategies is manifesting in the increasing use of ESG measures in LTI plans
5. While most ESG goals are currently benchmarked against internal objectives, relative goals could be on the horizon amidst better comparability and transparency of ESG data

Companies have to carefully balance competing perspectives and tensions. And yet, our 2024 findings suggest that enterprises continue to pursue their efforts to incorporate sustainability into their purpose and business activities. They are refining their ESG strategies in an ongoing pursuit of longer-term stakeholder value. These trends are playing out to varying degrees among large, mid, and small companies alike.

Boards and management, in turn, are becoming even more thoughtful about the use of ESG-based incentives. They are revisiting measures and goals to ensure alignment with their strategies, and they are increasingly focusing on the measures that they consider to be true long-term value drivers, such as greater workforce diversity and emissions reduction. To augment their efforts, companies also are investing time and resources into quantifying the financial and social value of meeting their ESG goals.

Ultimately, some companies walk a tightrope to fulfill the expectations of stakeholders and shareholders. They have to demonstrate upfront the link between their ESG strategy and shareholder value—an effort that takes time and investment. A strong ESG proposition should address the concerns of stakeholders and prove its case to shareholders, and a well-designed incentive plan can be part of an impactful ESG strategy that drives and demonstrates meaningful progress.

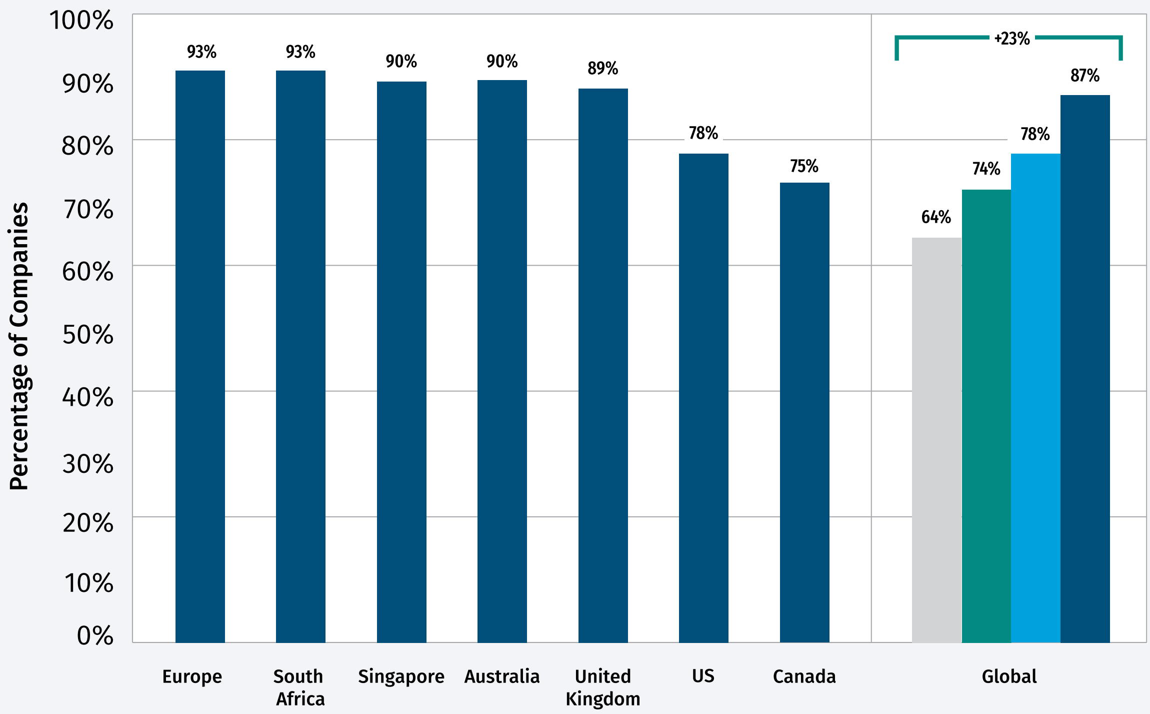
INSIGHT 1: Companies globally continue to tie incentives to their ESG strategies and goals—a trend evident across large-, mid-, and small-cap companies

Close to 90% of large companies globally now incorporate ESG measures into their incentive plans, reflecting a continued increase from the prior year. In fact, the steepest increases in ESG incentive adoption are in Canada, Singapore, South Africa, and the U.S. In the U.S., 78% of S&P 100 (mega-cap) companies now use at least one ESG incentive measure in either their short-term or long-term plan, representing a steep jump in one year.

Additionally, sectors with previously low use of ESG incentives (e.g., IT and Consumer Staples) also are catching up to the early adopters (e.g., Energy and Utilities).

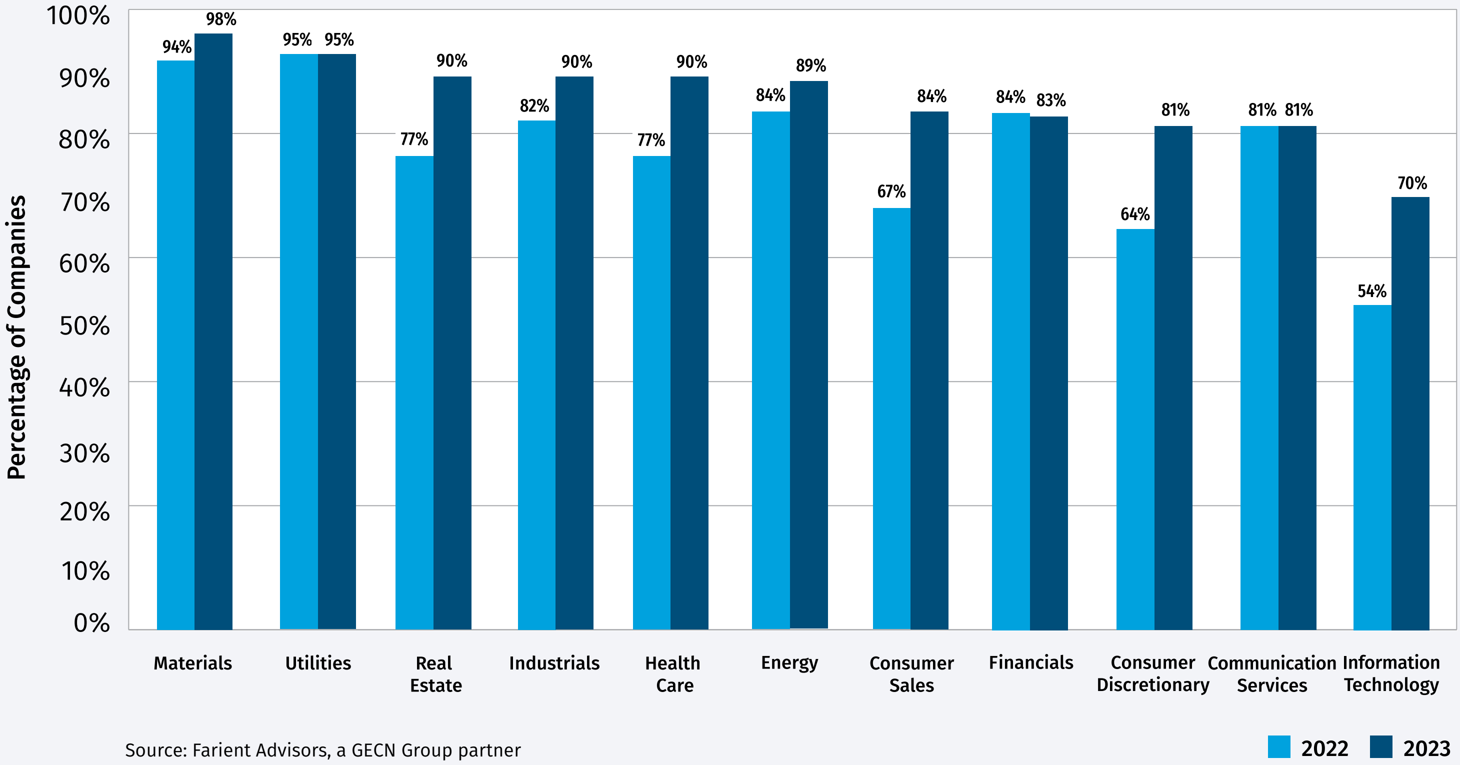
Backlash in the U.S. has not dissuaded companies from advancing their ESG efforts. Globally, concerns about "greenwashing" have encouraged more rigorous and verifiable ESG implementation, rather than slowing down those efforts.

Prevalence of ESG Incentives Among Large Companies Globally



Source: Farient Advisors, a GECN Group partner

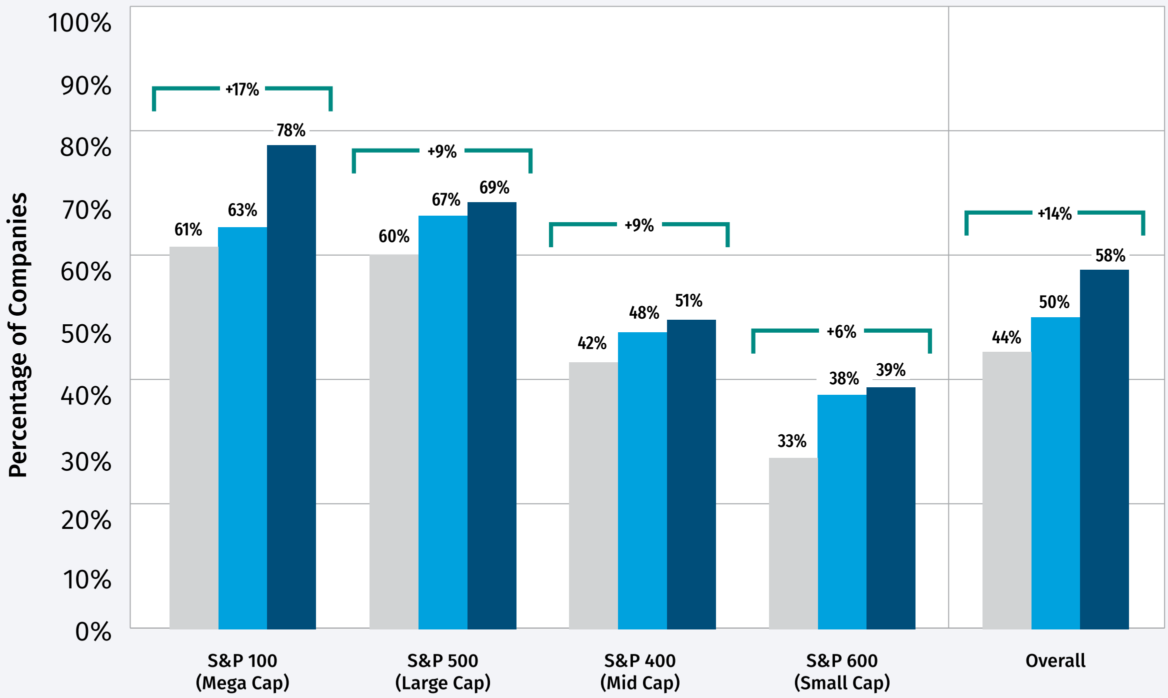
Prevalence of ESG Incentives Among Large Companies by Sector



Source: Farient Advisors, a GECN Group partner

In addition, Farient and the GECN Group expanded our coverage this year to include the full S&P 1500 Index. The prevalence of ESG measures differs significantly by company size, with a 69%, 51%, and 39% prevalence among large-, mid-, and small-cap companies, respectively. Notably, the largest companies demonstrate the most significant increase in the use of ESG, while smaller companies are marking a more gradual adoption of ESG in their incentive plans.

Prevalence of ESG Incentives Among U.S. Companies by Size



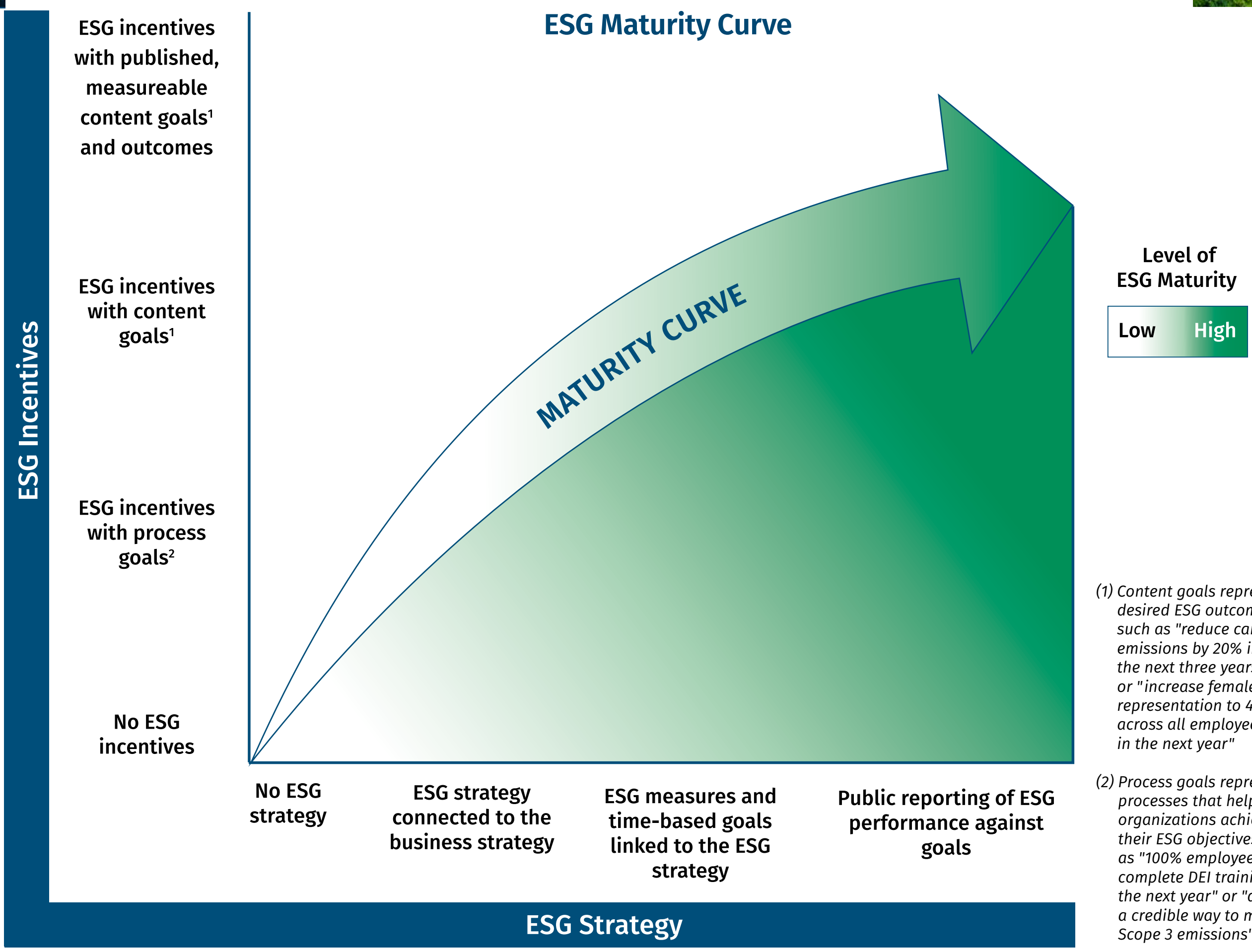
Source: Farient Advisors, a GECN Group partner

Differences in the prevalence and adoption rates of ESG measures between companies of different sizes are due to a number of factors, including: (1) greater pressure from external sources; (2) greater availability of internal resources; and (3) company maturity.

- **External pressures:** Smaller companies tend to face less pressure to address ESG concerns, such as developing climate-based targets. Some of the policies for establishing emissions targets or improving board diversity by the more prominent institutional investors specifically focus on the largest companies. Good examples are BlackRock's policy on Task Force on Climate-Related Financial Disclosures (TCFD), which targets S&P 500 companies, and the Climate Action 100+ initiatives, which targets the largest global emitters (*note, however, that in 2024 various large investors like BlackRock and State Street have pulled out of the Climate Action 100+ amidst ESG pushback and the initiative's more aggressive tactics*)
- **Internal resources:** Smaller companies tend to have fewer resources to devote to ESG efforts, such as hiring a Chief Sustainability Officer. In fact, many emerging growth companies, like those which have recently gone public are simply focusing on turning a profit and "proof of execution." Many of these companies maintain that they simply do not have the bandwidth to focus on ESG
- **Time and company maturity:** Investing in ESG takes time and resources. A certain level of company maturity is thus required before its management and board feel equipped to tie compensation to ESG goals. As a result, some of the largest companies with a long history of investing in their ESG strategies are the first-movers in incorporating ESG measures into incentives

> **"Boards need to be pragmatic and focused on doing good for the business. It takes strength to resist pressure to do everything which is difficult as everyone has different priorities. We have the duty to look after the resources that have been entrusted to us and to use them in the way we believe is best."**
>
> **- Jo Mark Zurel**, board chair, Fortis Inc.

As illustrated by the ESG Maturity Curve below, ESG incentives follow strategy. Companies must first develop an ESG strategy before they can adopt ESG incentives – i.e., they must know what they are working toward and why their ESG objectives support their overall business strategy. With a strategy, companies can work to develop specific goals and report on their progress against those goals. The area in white above the illustrated Maturity Curve reflects the fact that you cannot have measurable incentives without a strategy. ESG incentives typically also mature over time, with companies often starting with process goals, followed by content goals, and finally ESG incentives with published measurable goals and outcomes.



(1) Content goals represent desired ESG outcomes, such as "reduce carbon emissions by 20% in the next three years" or "increase female representation to 40% across all employee levels in the next year"

(2) Process goals represent processes that help organizations achieve their ESG objectives, such as "100% employees to complete DEI training in the next year" or "develop a credible way to measure Scope 3 emissions"

Source: Farient Advisors, a GECN Group partner

CASE STUDY: **HANESBRANDS**

KEY TAKEAWAY

Companies can use ESG incentive measures in ways that complement and maintain the primacy of financial performance and shareholder returns. One such way is by applying a governor on incentive payouts, so a minimum level of financial performance is required in order to pay out on ESG performance.

Company Background

- Founded in 1901, Hanesbrands (ticker: HBI) generates approximately $6B in revenue, employs over 50,000 people, and has a market capitalization of roughly $1.5B (part of the S&P SmallCap 600 Index)
- Hanesbrands describes itself as a "socially responsible leading marketer of basic innerwear and activewear apparel" with long-term success in ethical workplace practices, community building, energy and carbon emissions reduction, and environmental sustainability
- The company has significantly reduced its carbon emissions since implementing an energy management program in 2007
- It has been named one of the *World's Most Ethical Companies* in 2022 and 2021, according to Ethisphere; and named to Barron's list of 100 Most Sustainable Companies in 2021 and 2020

Case Summary

- Hanesbrands, a small-cap company, developed an ESG/sustainability strategy and launched quantitative goals across the areas of "People, Planet, and Product" that link back to its values and mission
- The company recognized the importance of improving diversity among its workforce as core to its sustainability and talent strategy; it subsequently set aggressive diversity targets for the manager level and above, which it then incorporated into its STI plan
- Despite improving the representation of People of Color in its workforce in 2022, the company chose to exercise negative discretion on the DEI measure in its STI payout, due to underachievement on financial performance

ESG Goals and Incentives

- In 2020, HBI launched its 2030 Global Sustainability Goals focused on People, Planet, and Product, as follows::
  - ***People:*** *improve the lives of at least 10 million people through health and wellness programs, diversity and inclusion initiatives, improved workplace quality, and philanthropic efforts to aid local communities*
  - ***Planet:*** *reduce greenhouse gas emissions by at least 25% to align with science-based targets, reduce water use by 25%, use 100% renewable electricity in company-owned operations, and bring landfill waste to zero*
  - ***Product:*** *eliminate all single-use plastics and reduce packaging weight by 25% while also moving to 100% recycled polyester and sustainably sourced cotton*
- In 2021, HBI announced ambitious interim targets for 2025 on its path to meeting its 2030 goals, including achieving 25% People of Color representation at the manager level and above
- In 2022, HBI launched a new global statement of purpose: "creating a more comfortable world for every body" and reinforced its commitment to being a leader in sustainability
- Also in 2022, HBI introduced ESG measures to its incentive plans for the first time, adding a DEI modifier to its STI plan based on improving representation of People of Color within its U.S. workforce at the manager level and above. The modifier can adjust the STI payout up or down by 5% depending on performance against workforce representation targets
- In 2022, despite achieving 19.1% People of Color representation in its U.S. workforce for senior manager levels and above—a 2.9% increase over 2021—the company chose to exercise negative discretion and not apply the calculated +2% modifier to its STI payout given its financial underperformance

INSIGHT 2: Companies are aware of an ESG backlash in the U.S., but maintain their focus on long-term value drivers, which often are inextricably tied to ESG factors

In the U.S., backlash to corporate ESG efforts has intensified over the past year. While pushback to the concept of stakeholder capitalism has existed for a long time, what's different is the politicization of the term "ESG" and strident efforts by its opponents to sway companies, finance titans, and even regulators from adopting sustainability strategies and targets.

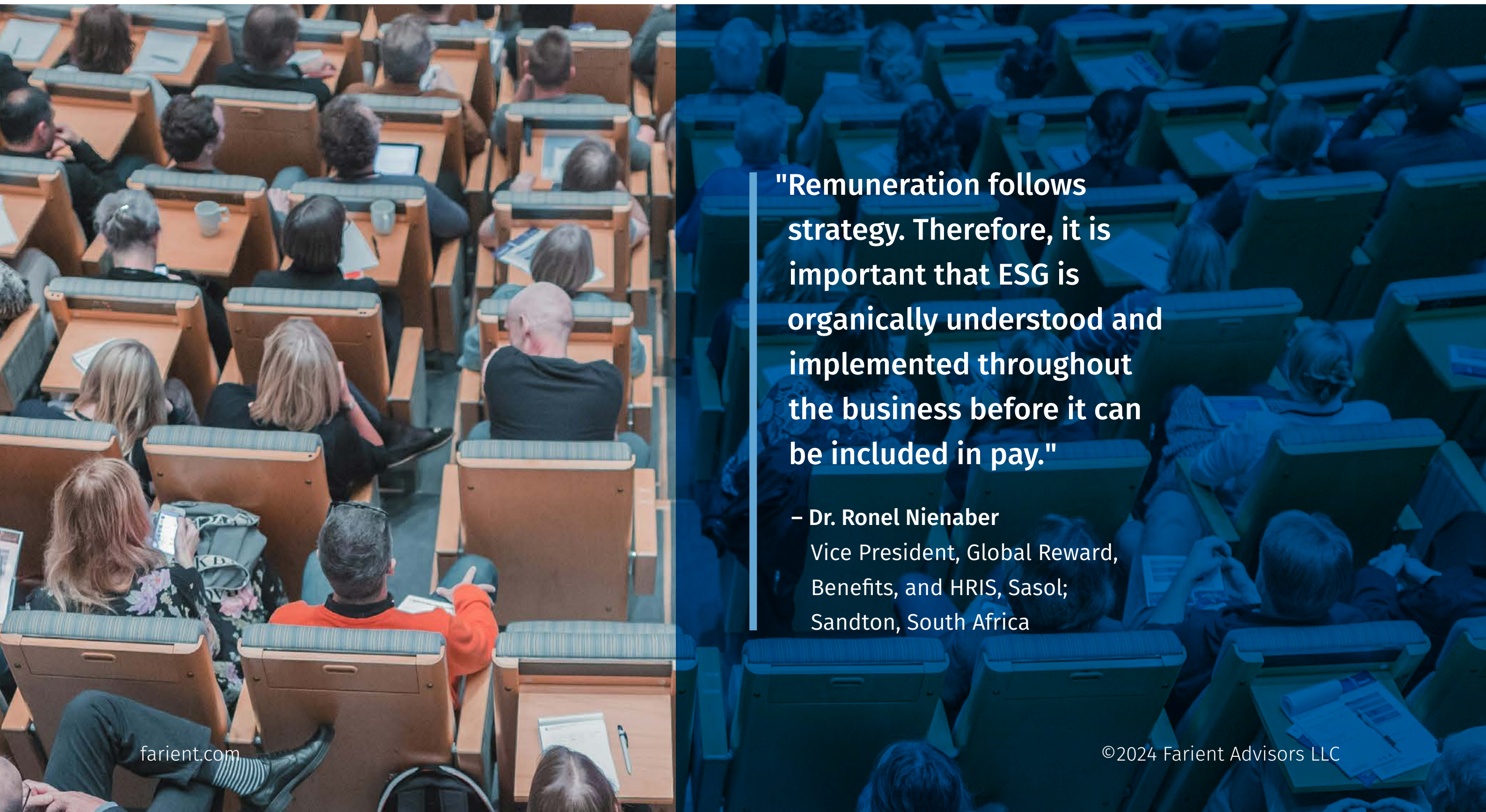
In particular, numerous U.S. states, including Texas and Florida, have enacted regulations that curb business activities aligned with companies accused of practicing "woke capitalism"—i.e., those businesses identified as receptive to addressing ESG issues such as climate change or DEI.

The 2023, U.S. Supreme Court decision outlawing the use of affirmative action in higher education turned a spotlight on DEI efforts, with many questioning whether corporate DEI programs would come under similar scrutiny. While most legal experts agree[1] that the Supreme Court affirmative action decision was limited to higher education institutions that receive federal funding, the risk of lawsuits and/or negative sentiments toward DEI initiatives among some stakeholders remain a concern for businesses.

However, companies are still adopting DEI programs and incorporating DEI goals into their incentive plans. Of the companies using social measures, 66% use a DEI metric, a continued increase from prior years. DEI incentive measures have continued to surpass other social measures, such as employee engagement or retention.

Companies globally use DEI programs to improve employee diversity, whether measured by gender, ethnicity, or other identifiers. While U.S. firms may find it wise to review their programs and/or disclosures to avoid any legal risk, DEI efforts are expected to remain an important strategic focus for many companies given the value most firms derive from employing a diverse workforce.

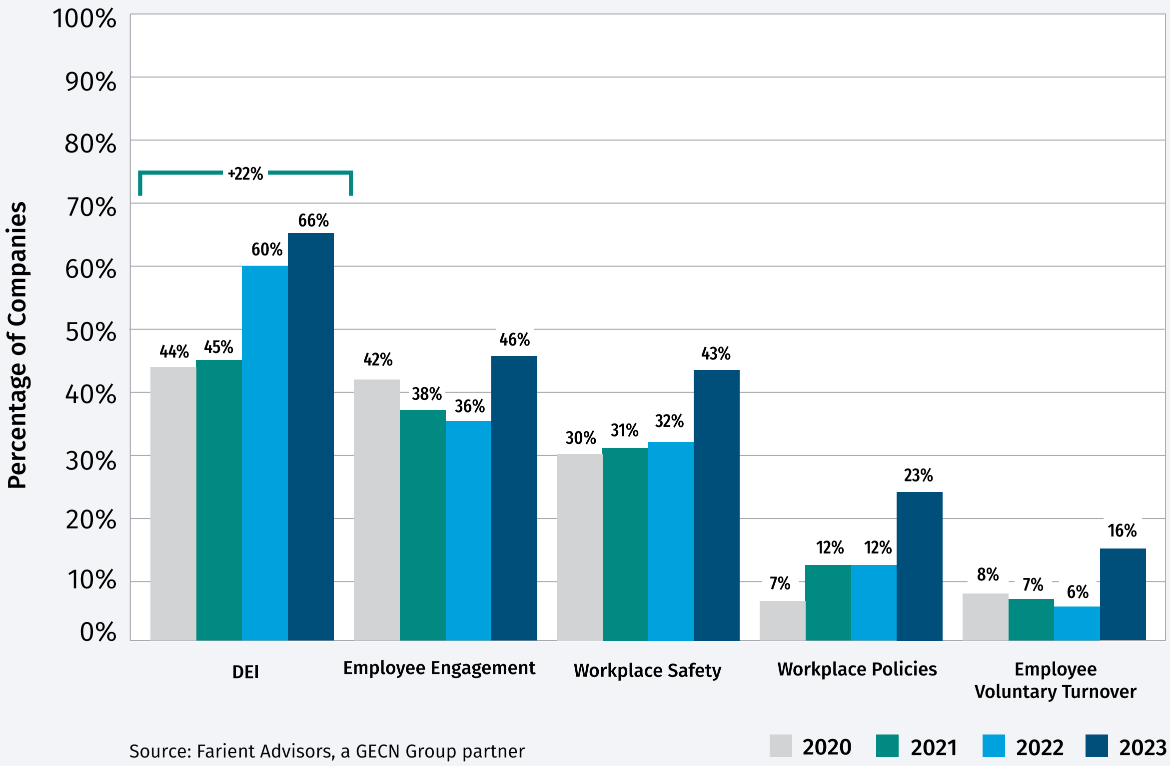
(1) *Harvard Business Review. "No, SCOTUS Did Not Make Your Company's DEI Programs Illegal." August 29, 2023*



"Remuneration follows strategy. Therefore, it is important that ESG is organically understood and implemented throughout the business before it can be included in pay."

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

Prevalence of Social Measures by Type
Among Large Companies Globally Using Social Measures



Source: Farient Advisors, a GECN Group partner

> "The world has moved from a time where ESG was only briefly mentioned in company reports to when companies created flashy ESG reports. The future lies in having auditable ESG figures, which will just become part of how one does business and reports on it."
>
> – **Jack Clemons**
> member of several
> European boards

In addition, despite some of the ESG and DEI backlash, the largest U.S. investment managers—BlackRock, Vanguard, and State Street—continue to maintain policies that require companies to consider ESG as part of their strategies and to disclose a wide array of ESG-related information, such as their climate impacts, board diversity, workforce diversity, and governance structures. More recently, large investors have retreated from initiatives such as the Climate Action 100+ and have dropped support for ESG-related shareholder proposals. They have either maintained or refined their ESG-related policies and expectations.

Similarly, most companies are not backing down on ESG. Most companies recognize that there is a business case for adopting sustainability strategies. They are responding to some of the pushback in three ways:

- **Changing how they talk about ESG:** Some companies are modifying their terminology to avoid using "ESG." Instead, they favor other words or terms that do not attract the same sort of political attention, such as "sustainability," "social responsibility," or "impact." Other companies are maintaining a focus on their ESG efforts internally and through data reporting but have shifted their public messaging. According to an analysis by Factset[2], mentions of ESG in corporate earnings calls among large U.S. companies were down 47% in the first half of 2023 compared to the same period the prior year
- **Doubling down in support:** Some companies, especially those with long-established ESG strategies and public commitments, are doubling down on their support and messaging of sustainability efforts. These efforts can serve to counter ESG opponents and send a message to stakeholders that they are not backing down from their commitments
  - Accenture, for example, continues to advance its ESG or "360 Value" strategy through investments in areas of climate, diversity, and technology. In 2023, the company purchased 100% renewable electricity in all of its offices and finalized a new science-based target for emissions reduction. In addition, Accenture continued progressing toward several ambitious targets including achieving zero waste, reaching gender parity, and increasing race/ethnicity representation in its workforce

    Accenture CEO Julie Sweet said, "*I'm a CEO who understands what brings value... Sustainability matters to our employees from a recruiting standpoint, it matters to our clients, it's part of our regulatory landscape, it matters to consumers. That's not changing because of what politicians want to call it.*" She went on to emphasize the company's success is tied to its ESG initiatives, including its commitment to DEI
- **Focusing on "material" ESG factors tied to shareholder value:** Some companies' ESG strategies are becoming more targeted. For example, they are focusing on sustainable operations like reductions in energy consumption and energy costs, and explaining how those efforts will help the company's bottom line. According to a 2023 survey of large U.S. companies by Barron's, 63% of companies say they are increasing their focus on the business case for ESG and how it connects to *shareholder* value
  - Companies also are responding to potential allegations of "greenwashing," i.e., accusations that their policies and actions are less environmentally friendly than they claim publicly. They are doing so by adopting more specific and rigorous reporting on data collection, targets, and performance

> **"Boards will need to continually improve and build their skills to deal with the increased sophistication of all aspects of ESG, including strategic oversight, risk and governance."**
>
> **– Yannick Hausmann**
> Chairman of the Board, HSBC Private Banking, Switzerland

(2) FactSet. "Lowest Number Of S&P 500 Companies Citing ESG On Earnings Calls Since Q2 2020." Sept 18, 2023

CASE STUDY: **DOW INC.**

Company Background

- Following its separation from DowDuPont in 2019, Dow Inc. updated its 2025 Sustainability Goals, which it had launched in 2015 under the former combined company as part of its ambition to be viewed as the most innovative, customer-centric, inclusive, and sustainable materials science company in the world. The goals focused on three areas for which the company believed it could have the most impact: circular economy, climate protection, and safer materials
- The company maintained a board committee focused on sustainability, a carryover from DowDuPont

KEY TAKEAWAY

It takes time to develop credible climate strategies and goals, and the LTI plan can be used to incorporate milestones towards achievements around measurements, disclosures, target-setting, and emissions reductions. Additionally, greater specificity on sustainability efforts (rather than blanket terms) provides more credibility and visibility around how those efforts link to strategy and long-term value.

Case Summary

- Dow has changed its ESG terminology multiple times, but it has maintained a consistent sustainability strategy over nearly 10 years focused on key areas of impact
- When it adopted ESG measures in its STI plan starting in FY 2020, Dow kicked off with quantitative metrics, and it disclosed goals, reflecting the company and its compensation committee's deliberate efforts to use objective and transparent measures from the outset
- Dow is at the forefront of companies adopting ESG measures in long-term incentives. It is one of less than 12% of U.S. companies with ESG measures in an LTI plan, announcing the adoption of LTI climate measures two years ago when its market prevalence was lower

ESG Goals and Incentives

- Between 2020 and 2023, Dow adopted ESG measures in its STI and LTI plans, with weights of 30% and 20% respectively
- In 2023, the company changed the name of its STI ESG measures to "Ambition" metrics and applied more specificity to the measures in its LTI plan to label them "Carbon Emissions Reduction" measure rather than "ESG"

2020

- **Introduced ESG measures into its STI Plan:**

- 40% Operating EBT
- 40% Free Cash Flow
- 20% ESG
  - ➤ Customer experience index
  - ➤ World-leading operations index (measure of environmental sustainability)
  - ➤ Global employee resource group (ERG) participation
  - ➤ U.S. ethnic minority representation

- **Began using the term "ESG"** in its proxy filings, with a total of 21 mentions

2021-2022

- **Introduced ESG to its LTI plan** by tying 20% of the payout to meeting **key long-term climate objectives (labeled as "ESG"):**

- Establishing Scope 1 and Scope 2 GHG reduction plans
- Defining Scope 3 GHG emissions exposures
- Achieving cumulative GHG emissions reductions

- **Mentioned "ESG" 112 times** in its proxy Statement

2023

- **Modified its STI plan to include "Ambition" metrics** with 20% weight, noting no change in metrics and a simple change in terminology
- **Maintained 20% carbon emissions reduction measures in its LTI plan for 2023-25 under more specific naming**
- **Mentioned "ESG" 11 times in its proxy statement**, down significantly from the prior year

INSIGHT 3: The climate crisis has led to an urgent need to reduce greenhouse gas (GHG) emissions, as evidenced by a steep increase in incentives tied to emissions reductions

Companies continue to focus on climate, perhaps influenced by the growing number of extreme weather events and the increasing stakeholder focus on these issues. These events make the long-term impacts of CO_2 emissions more tangible and motivate companies to accelerate their decarbonization efforts. Companies also are refining their environment-related ambitions by setting earlier dates and more aggressive goals around environmental initiatives.

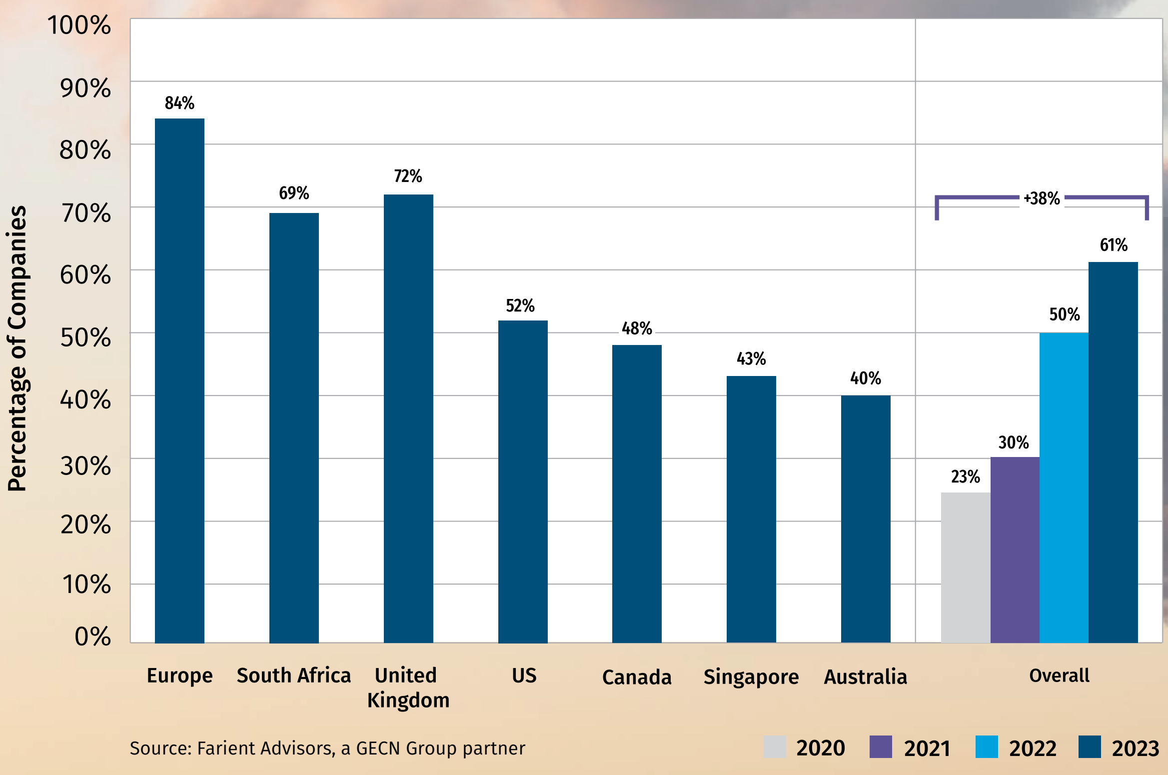
Favorable governmental policies and the geopolitical risks associated with oil and gas also are accelerating the move to renewable energy. However, companies are still facing challenges in managing this transition given that the intermediate-term returns from renewable energy investments tend to be lower than continuing to use fossil-based energy sources, likely requiring significant government investment and support.

Companies with better access to more data are also refining their emissions measurement approaches, which can have implications for incentives. More companies are now disclosing their emissions across Scopes 1, 2, and 3. Research from Institutional Shareholder Services (ISS)[3] shows a relationship between the prevalence of public emissions reduction targets and the incorporation of emissions within incentive plans.

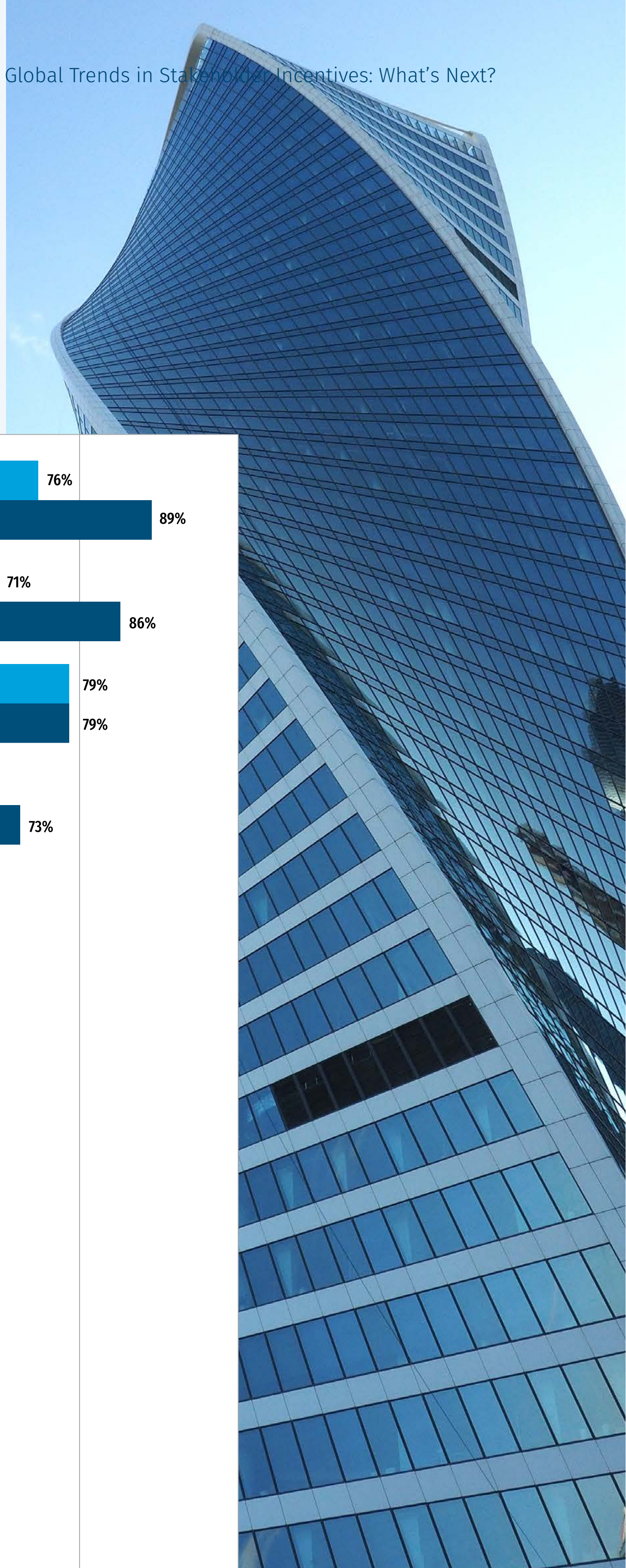
The use of environmental measures in incentives has increased to 61% globally, with significant increases across the various regions. For example, in the U.S., 52% of large-cap companies now use environmental incentive measures, up significantly from 34% in 2021 and 8% in 2020.

(3) ISS Corporate Solutions. ICS Report on GHG Reduction Targets. September 2023

Prevalence of Environmental Measures by Region Among Large Companies Globally

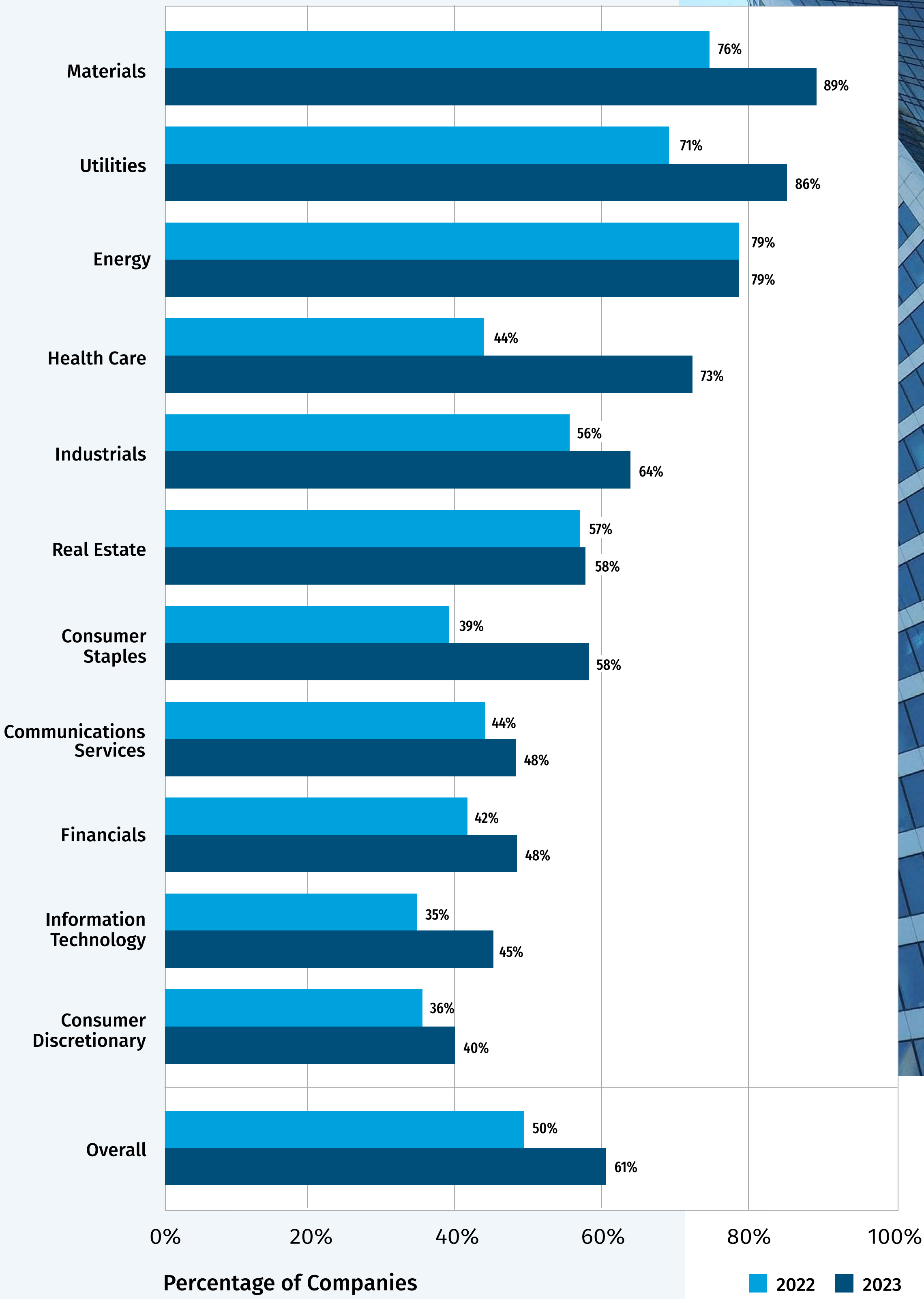


Source: Farient Advisors, a GECN Group partner



The use of environmental measures has increased across sectors, especially in Health Care.

Prevalence of Environmental Measures by Sector Among Large Companies Globally

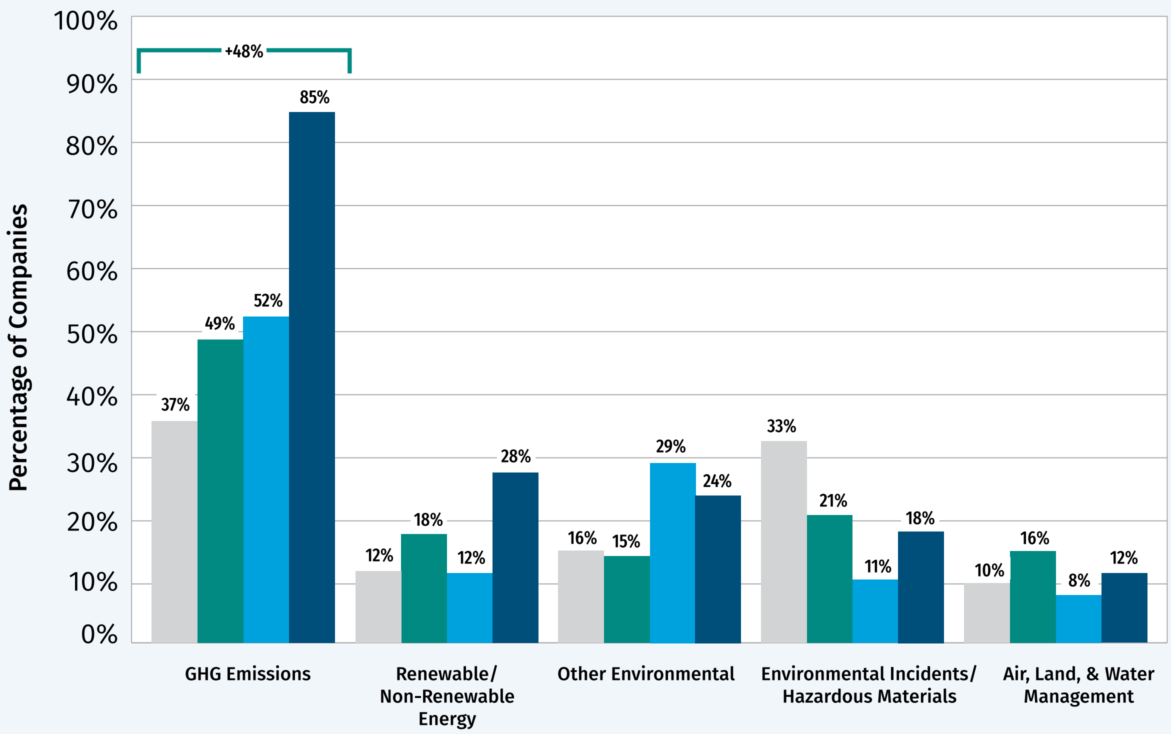


Source: Farient Advisors, a GECN Group partner

The adoption of environmental measures remained flat in the Energy sector at 79%, suggesting the adoption rate may have topped out. Meanwhile, the relatively modest use of environmental measures among Financials likely reflects its focus on factors that are more material and actionable such as social and governance considerations. Nevertheless, banks are increasingly acknowledging the influence they can have on the environment, with many large banks setting targets for reducing financed emissions (i.e., downstream carbon emissions financed by commercial lending). We may see these efforts translate into incentive plans in the future.

GHG emissions are by far the most common environmental measure, increasing by 33 percentage points over last year. This considerable jump coincides with increases in companies setting emission reduction targets and disclosing them publicly. In fact, 63% of S&P 500 and STOXX Europe 600 companies have publicly disclosed Scope 1 and 2 emissions reduction goals for 2030. Other environmental measures are generally increasing in prevalence but remain a minority practice.

Prevalence of Environmental Measures by Type
Among Large Companies Globally Using Environmental Measures



Source: Farient Advisors, a GECN Group partner

CASE STUDY: MASTERCARD

KEY TAKEAWAY

ESG incentive measures are not only for the C-suite. ESG incentives can be deployed across the broad employee population, thus encouraging everyone to work together toward a common set of goals.

Company Background

- Founded in 1966, Mastercard (ticker: MA) is one of the largest payment processing companies globally, with revenue of roughly $25B, market capitalization over $350B, and an employee population of nearly 30,000
- In 2017, MA became a signatory of the U.N. Global Compact, thus committing to sustainability and responsible business practices in the areas of human rights, labor, the environment, and corruption
- In 2018, MA appointed its first Chief Sustainability Officer, responsible for leading the company's sustainability initiatives, which included achieving a 38% reduction in GHG emissions for Scope 1 and 2 and 20% for Scope 3 by 2025

Case Summary

- Mastercard, in recognition of its global impact and potential for positive influence, became a signatory of the U.N. Global Compact in 2017. It also hired a Chief Sustainability Officer in 2018 to lead its ESG efforts
- The company introduced ESG incentive measures in 2021 and refined its environmental measures in 2022 to focus on emissions reduction, with targets for reducing Scope 1 and 2 emissions
- Mastercard expanded its ESG incentives to all employees globally in recognition of its shared responsibilities toward achieving ESG objectives

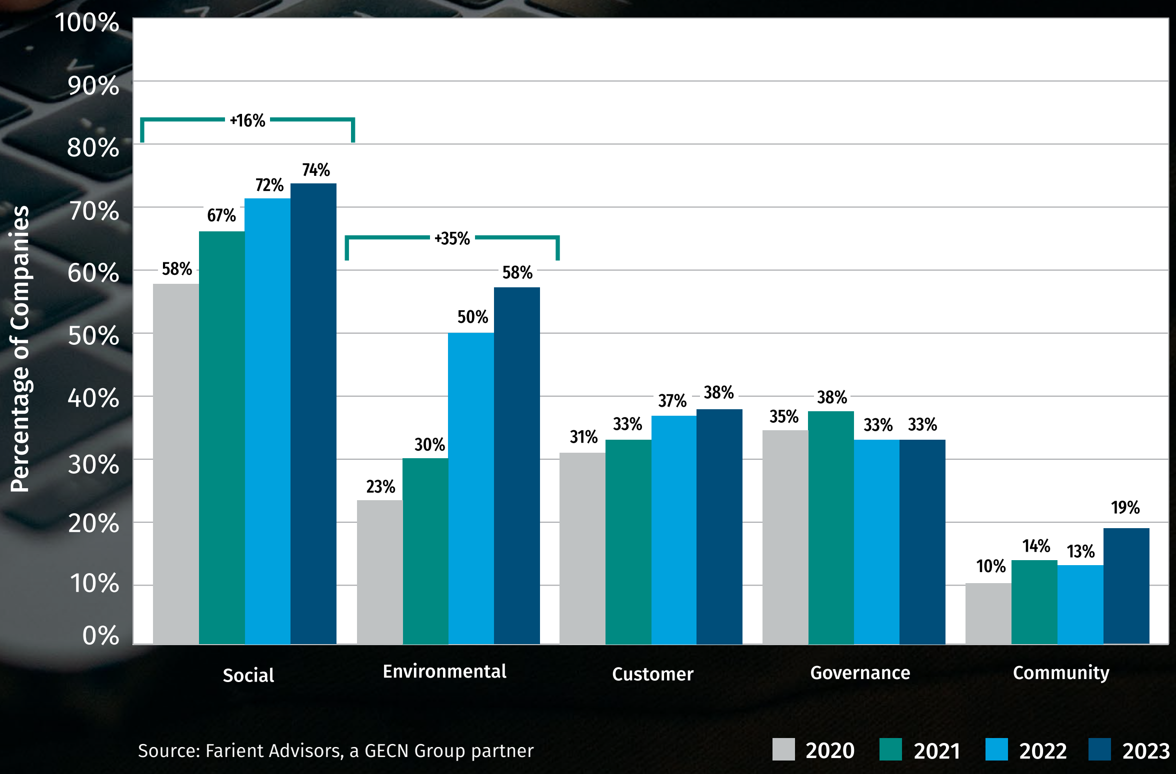
ESG Goals and Incentives

- In 2021, the company introduced an ESG modifier to its STI plan for senior executives to reinforce the importance of sustainability. The modifier could increase or decrease its STI payout by up to 10% based on performance against three measures:
  - Operational carbon neutrality (i.e., neutralizing the company's own released emissions, typically done through carbon offsets) [20% weight]
  - New entrants to the digital economy (i.e., adding new customers to digital finance products with a focus on underbanked communities) [40% weight]
  - Closing the gender pay gap (40% weight)
- After achieving its carbon neutrality target for 2021, MA modified the measures in its STI plan in 2022 to aim for more rigorous emissions reductions and to focus its ESG modifier on a new set of metrics that were more clearly defined:
  - Percent reduction in Scope 1 and 2 emissions (10% weight)
  - Percent response by top-tier suppliers to carbon disclosure survey and who set a near-term science-based carbon reduction target or net zero target (10% weight)
  - Number of individuals newly connected to the digital economy (40% weight)
  - Percent improvement in median female pay as a percent of median male pay (40% weight)
- In 2022, MA also announced the expansion of the ESG modifier to all employee bonus plans globally, noting that "our responsibility, and our success, is shared. And now we're ensuring the recognition is too"

The Priorities of Stakeholders Can Shift

The range of ESG measures being pursued by companies today is wide. While we highlight the increasing adoption of environmental measures, social measures remain the most common, with 74% prevalence, most often tied to workforce diversity, employee engagement, and retention.

Prevalence of ESG Incentive Measures by Type of Measure Among Large Companies Globally

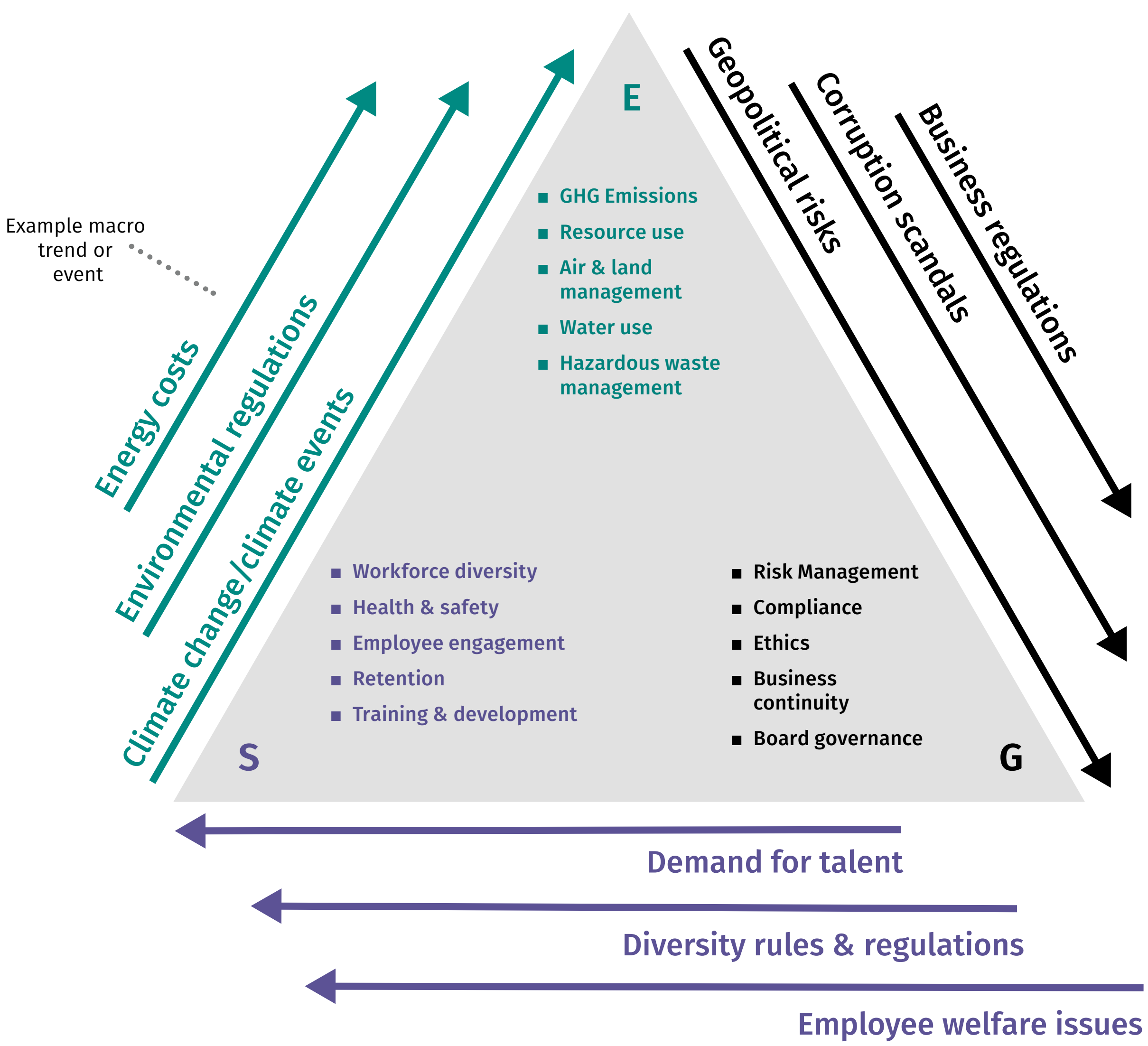


Source: Farient Advisors, a GECN Group partner

As companies continue to refine and develop their ESG strategies, they also are moving toward better prioritized, defined, and measurable indicators. Prioritization often is guided by what is most material to business strategy, value creation, or risk mitigation. Measures selected in this manner have the advantage of being more specific to the needs of the business but may not satisfy all stakeholders.

Additionally, the focus of a company's various stakeholders can shift over time, influenced by internal factors, micro factors specific to the company, or macro factors, such as climate events or social unrest. Many U.S. companies, for instance, adopted workforce diversity measures and goals in the wake of racial and gender crises (e.g., George Floyd murder and the #MeToo movement). In addition, geopolitical risks, such as wars and other conflicts, can focus attention on issues of risk management, business continuity, and proper governance. The "Stakeholder Triangle", shown below, illustrates the balancing act companies perform in reaction to shifting priories across the various areas of E, S, and G.

Stakeholder Focus Triangle



Source: Farient Advisors, a GECN Group partner

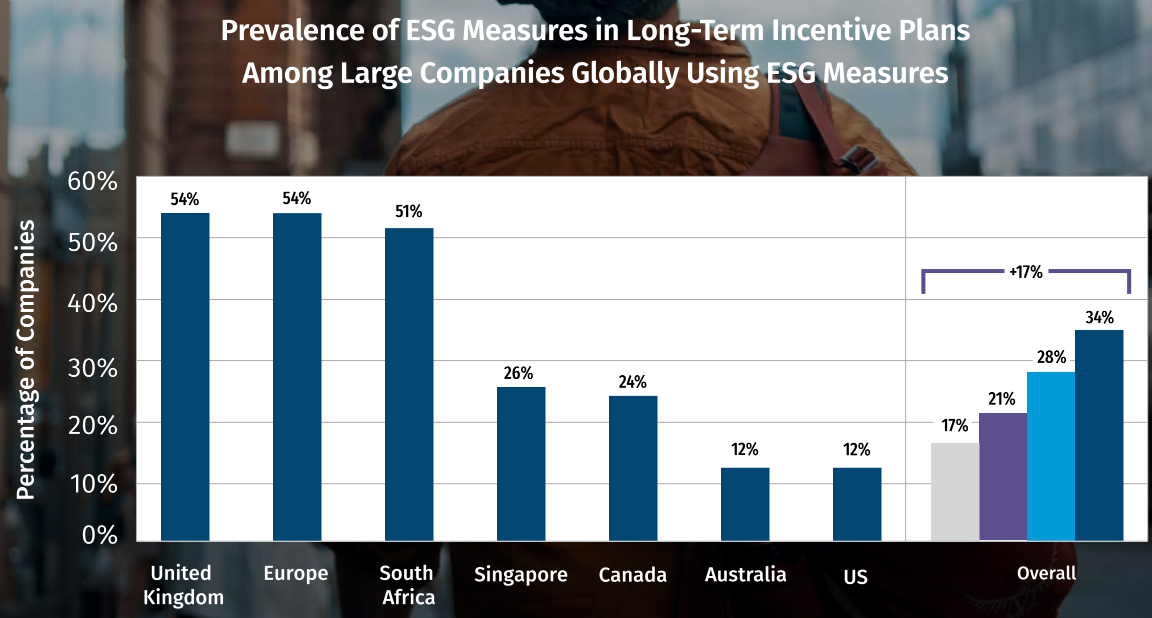
INSIGHT 4: The long-term nature of ESG strategies is manifesting itself in the use of ESG measures in LTI plans

Our earlier studies have shown that as companies add non-financial measures to their incentives, it is typically far more common to see them in short-term incentives (STIs) compared to long-term incentives (LTIs). This year, we also see companies continue to incorporate ESG measures into their LTIs.

The continuing preference for putting ESG measures into STIs is likely related to the uncertainty that remains in setting long-term targets for measures that are relatively new for management and the board. Additionally, the pace of change in measurement methodologies and technologies is so rapid that it is often easier to incorporate ESG measures into annual rather than longer-term plans, as it provides flexibility as measurements evolve. The STI can also support interim progress towards more meaningful long-term ESG outcomes.

When designing an LTI plan, however, companies tend to look for measures reflecting long-term priorities where long-term targets can be reliably set. Many LTI plans have overlapping multi-year performance periods, which can introduce added complexities if the measures and targets change regularly. Despite the challenges, putting ESG metrics into LTIs can be a constructive way to provide meaningful incentives, encouraging participants to take a longer-term view and work toward ESG progress over time.

Approximately one-third (34%) of global companies with ESG measures now use those measures in their LTI plans, up from 28% last year and 17% in 2020. South Africa, Europe, and the U.K. have the highest prevalence of ESG measures in their LTI plans, while Canada has the most significant increase in adoption. About 12% of companies in the U.S. now use ESG measures in their LTI plans.



Source: Farient Advisors, a GECN Group partner

CASE STUDY: **ALLSTATE**

KEY TAKEAWAY

Once companies have experience with ESG measures and goals in the STI plan, they are more likely to incorporate those measures into LTI plans, especially when the company's long-term strategy recognizes the value of ESG.

Company Background

- Founded in 1931 by Sears Roebuck and Co. and subsequently spun off in 1993, Allstate is one of the largest insurance companies in the U.S. with revenue of roughly $55B, market capitalization of nearly $35B, and employees numbering approximately 55,000
- Allstate manages ESG risks and opportunities to create long-term value for stockholders, customers, and employees by applying ESG principles across the enterprise and providing products and services that are mindful of environmental and social impacts
- The company manages a $61B investment portfolio and integrates ESG considerations in its investment analysis and decision-making, having established climate change and DEI as two pillars of its investment approach

Case Summary

- Allstate manages ESG risks and opportunities as a key component of its strategy. It considers ESG factors through both its operations and investment arms
- The company added ESG factors to its STI plan in 2021 with a focus on key strategic and DEI priorities to further align the compensation program with the company's overall strategy
- In recognition of the importance of ESG measures to its long-term strategy, Allstate moved the measures to its LTI plan

ESG Goals and Incentives

- In 2021, Allstate introduced ESG measures to its STI plan through a 20% strategic initiatives scorecard by measuring progress on customer initiatives ("Transformative Growth") and DEI, including:
  - Female and ethnic minority representation
  - Minimum compensation per hour for employees
  - Diverse suppliers spend
  - DEI metrics in Allstate's responsible investing
  - Cultural integration
- In 2022, the company created a Societal Engagement Framework (SEF) to prioritize engagement on issues where it has an impact, allowing it to better align its values, business priorities, and ESG actions
- In 2023, in recognition of the importance that ESG measures have to Allstate's long-term strategy, the company moved its Transformative Growth and DEI measures to its long-term incentive plan, with a total weighting of 10% for each, thus giving greater prominence to its ESG objectives. In 2022, MA also announced the expansion of the ESG modifier to all employee bonus plans globally, noting that "our responsibility, and our success, is shared. And now we're ensuring the recognition is too"
- In 2023, the company's "Nominating, Governance, and Social Responsibility Committee" increased the cash retainer paid to its Chair in recognition of its increased focus on ESG matters

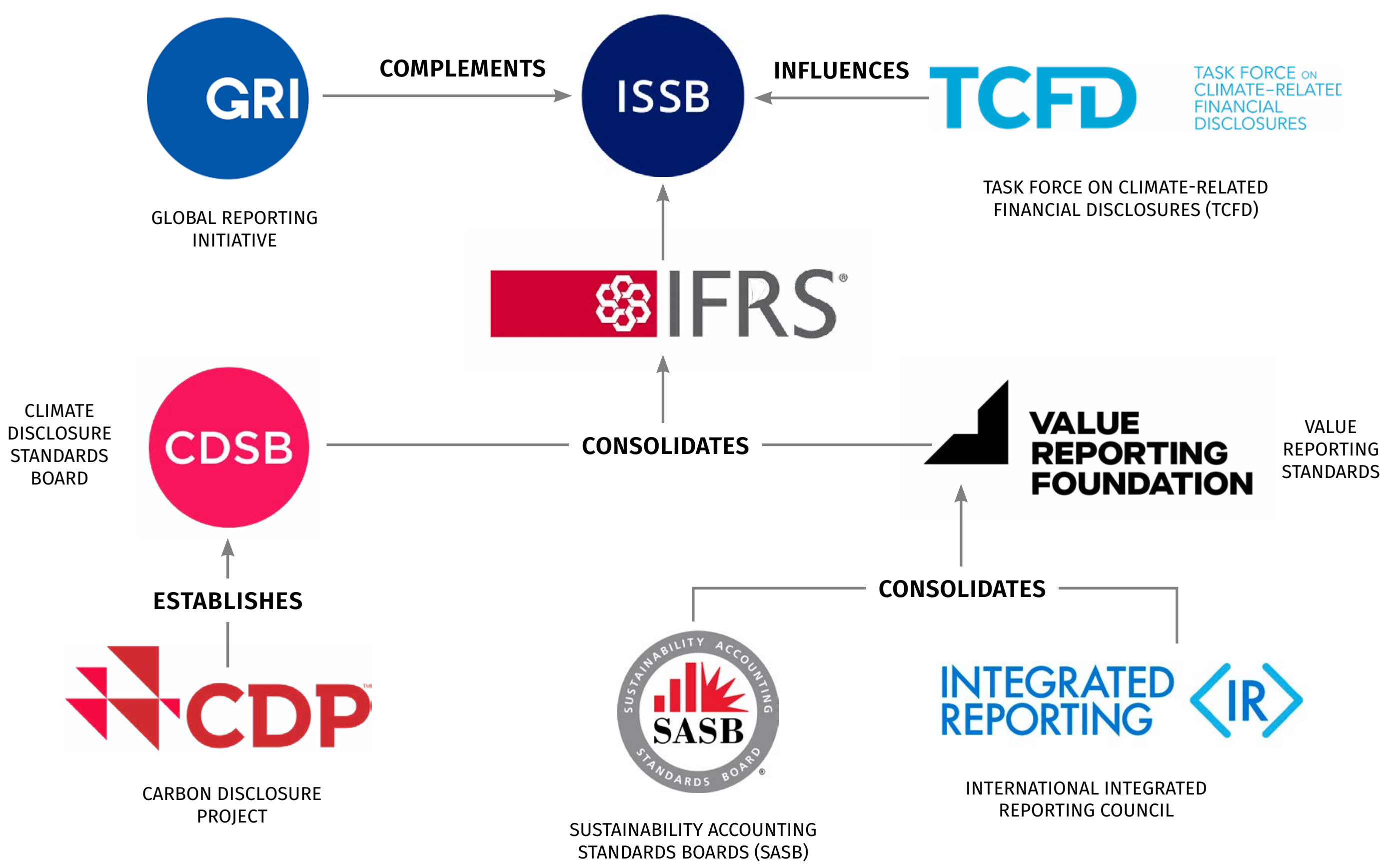
INSIGHT 5: While most ESG goals are currently benchmarked against internal objectives, relative goals could be on the horizon amidst better comparability and transparency of ESG data

When using ESG incentive measures, the overwhelming majority (99%) of U.S. companies use only absolute, or internal, goals. Nevertheless, relative benchmarks may become more common going forward due to changes in the ESG data reporting landscape in the coming years.

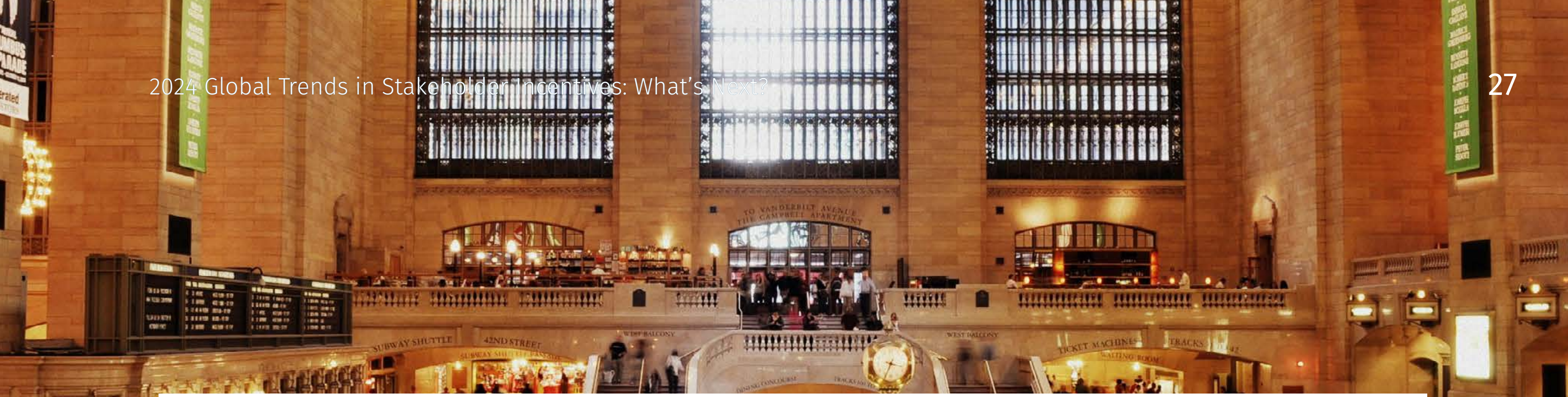
- **Standardized ESG data reporting**: ESG reporting standards are consolidating, which will encourage companies to disclose the same data and use the same methodologies more consistently over time. Consolidation is coming from voluntary standard-setters, such as the International Sustainability Standards Board (ISSB), which builds on the work of market- and investor-led initiatives, including the Task Force for Climate-Related Financial Disclosures (TCFD) and SASB, and complements the Global Reporting Initiative (GRI). Additionally, ESG reporting regulations, including those in Europe and new climate reporting rules by the U.S. Securities and Exchange Commission (SEC), will similarly compel companies to disclose ESG data more consistently for use by regulators and investors alike

In addition, the proliferation of ESG data tracking and database platforms—platforms that themselves have shown signs of consolidation—provides greater data consistency. For instance, Nasdaq acquired ESG data management

Consolidation Among ESG Reporting Standards



Source: AuditBoard, Inc.



company, Metrio, in 2022 and subsequently released an expanded suite of ESG tools to help its listed companies collect, measure, and disclose investor-grade audited ESG data. The growing availability of these tools, which typically use these standards, is expected to raise data quality and comparability

When companies and their peers can report ESG data in a similar fashion, it arms them and their stakeholders, including investors, with better and more reliable information for decision-making

- **Growth in third-party assurance of ESG data**: Another recent development has been the rapid rise in the share of companies gaining third-party assurance for reported ESG information. According to a study by the International Federation of Accountants (IFAC), approximately two-thirds of large global companies reporting ESG information now have at least some of their data audited(4). Certain regulations, including the SEC's climate disclosure proposal, include rules to require third-party assurance. In the U.S., some of the largest accounting and audit firms have expanded their audit offerings to ESG. Ultimately, we expect this will result in higher-quality data reporting for use by companies and stakeholders
- **Pressure on companies to perform and show progress**: More transparent data will inevitably lead to better performance assessments, both the reporting company itself by and external parties. Moreover, the ability to assess historical performance on ESG factors, such as GHG emissions, gives companies the information they need to help make projections and set performance goals

One of the primary challenges of developing and reporting on ESG strategies has been target-setting. Companies face intense pressures from investors and other stakeholders to set long-term ESG goals, especially around emissions. Without sufficient information, however, these long-term goals can be difficult to determine, and breaking them down into shorter one- or two-year targets can be even more challenging when relevant data inputs are unavailable or changing

In addition, companies are facing pressure to show positive performance on their ESG strategies, especially if ESG factors form part of executive compensation. To meet the challenges of setting ESG goals for incentives, better relative data is expected to become a more common tool for making comparisons and setting goals

While absolute progress on ESG performance is important, there remains an untapped opportunity for companies to measure ESG performance on a relative basis. For example, some companies struggle with diversifying the gender composition of their workforce as the pool of potential candidates entering their sector may be limited and they are competing against peer companies for the same candidates. In such cases, analyzing performance on a relative basis may be a valid comparison to mark progress on DEI in a broader context, even if progress may move more slowly on an absolute basis

(4) International Federation of Accountants (IFAC). "State of Play: Sustainability Disclosure & Assurance." February 2023

Action Steps for Directors

Most large companies globally have already embarked on their ESG journey and have incorporated ESG measures into their incentive plans. Mid- and small-cap companies, while less developed on our ESG Maturity Curve, are following suit. Companies appear to be undeterred in their pursuit of credible ESG measures and goals for their incentive plans; however, they also now must navigate competing perspectives among those who question the value of ESG.

Companies can continue to move forward in a thoughtful and balanced way by pursuing the following actions in evolving their ESG incentive plans:

1. **Develop a compelling case for how ESG objectives link to long-term shareholder value.**

   If companies identify ESG measures that demonstrably benefit shareholders in addition to other stakeholders, everyone wins, and objections based on shareholder primacy can be diffused

2. **Consider new opportunities to address environmental factors.**

   Reporting requirements on climate risks are increasing, while rating agencies are becoming better at comparing environmental progress across organizations, and companies themselves are working hard to enhance their ability to measure impact. As a result, companies will have better opportunities to move further along the ESG Maturity Curve by quantifying important environmental measures to incorporate into their incentive plans

3. **Focus on measures that link to the company's core business strategies, values, and identity.**

   Measures that link back to these business fundamentals can deliver powerful messages both internally and externally and can support and reinforce the company's mission

4. Consider using relative ESG benchmarks.

As environmental and human capital disclosures improve, more comparative data is becoming available. As a result, companies have an opportunity to establish relative, not just absolute, benchmarks for assessing performance

5. Consider putting ESG measures into long-term, not just short-term incentive plans.

The ESG journey is inherently long term in nature. As companies make progress in establishing quantifiable content goals, they also are better equipped to determine the relevance of ESG for long-term incentive plans

All companies have an opportunity to assess where they are on the ESG Maturity Curve. As companies evolve in developing their ESG strategies, measures, goals, and reporting, so too can they mature in their use of ESG measures in their incentive plans. In addition, small- to mid-cap companies have an opportunity to "go to school" on the examples set by their larger counterparts.

As evidenced by the long-term trends shown in our research, the ESG journey is long, characterized by both progress and setbacks. Despite the hard work and challenges, it's clear that the journey continues.

Contact Us

We hope this research contributes to the advancement of ESG and stakeholder engagement.

We invite your questions and comments. Feel free to directly contact any of the firms in the GECN Group or write to info@farient.com

United States

Farient Advisors LLC
Robin A. Ferracone (robin.ferracone@farient.com)
Brian Bueno (brian.bueno@farient.com)

United Kingdom

Farient Advisors LLC
Simon Patterson (Simon.patterson@farient.com)
Stephen Cahill (Stephen.cahill@farient.com)

Australia and New Zealand

Guerdon Associates
Michael Robinson (michael.robinson@guerdonassociates.com)

Canada

Southlea
Amanda Voegeli (amanda@southlea.com)
Ryan Resch (ryan@southlea.com)

South Africa

21st Century
Mark Bussin (drbussin@21century.co.za)
Chris Blair (CBlair@21century.co.za)

Switzerland

HCM International
Stephan Hostettler (stephan.hostettler@hcm.com)
Gabe Shawn Varges (gabe.shawn.varges@hcm.com)