Pearl Meyer

ADVISOR BLOG

ESG and Executive Compensation: Four Discussion Points for Boards

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In April, Aalap Shah and I were invited to serve as panelists in the latest installment of Sloane & Company and Innisfree M&A's "Mind Your ESG" webinar series. Together, Sloane and Innisfree have been holding monthly webinars to discuss the growing role of ESG in company communications, shareholder engagement, and proxy solicitation strategies.

We were asked to talk about the evolving role of ESG in executive compensation plans. Certainly 2020 had a strong influence on many companies' ESG stance. The immediacy of employee health and safety (among many other issues), and the growing insistence from institutional investors that ESG be taken seriously, has most boards and management teams at least talking about what they are going to do and how. Aalap and I shared these four key points to consider.

Social metrics lead the way – for now

The "S" of "ESG"(i.e. social metrics) appears to be the most prevalent ESG measures in incentive programs. In many cases, this reflects measures like safety and customer satisfaction, which have been at play in incentive plans for some time. It should be noted they are often core to a company's business. Coming out of the pandemic, we are still observing social metrics as the most common, but fueled more by diversity, equity, and inclusion than in prior years, and also by the growing corporate attention being paid to larger social justice issues.

Think about incorporating ESG metrics into long-term programs

ESG metrics are most commonly found in annual incentive programs. This approach makes a lot of sense for certain metrics (like employee health and safety), but for other measures that are tracked over longer periods of time, such as DE&I or environmental goals, companies should also consider the impact of long-term incentive programs. ESG measures are often long-term by their very nature, so why not incorporate them into these plans?

Be thoughtful when implementing ESG metrics/targets

When it comes to implementing any incentive metric, it’s important for executives to feel like they have agency over the outcome that’s being incentivized. Once that hurdle is cleared, compensation committees must then ensure that ESG goals have significant stretch, are metric-driven, and are meaningful to the future health of the company. If companies are considering implementing an ESG metric, it should be more than just window dressing. ESG measures in incentive programs should be material to the company and to the executive’s pay outcome.

“Qualitative” ESG metrics is a misnomer

Any ESG metric can be distilled down to something quantifiable. Start with a baseline goal and then take actions to make it measurable. To measure progress, use quantitative actions to assess qualitative metrics. Companies may also find it helpful to tie ESG goals to part of a larger initiative. For example, if a company has a greenhouse gas emissions goal that has a 10-year reduction target, committees should work with management to consider how that long-term goal can be incentivized in increments to align with typical incentive compensation cycles.

About the Author

Stephen Huber, vice president in Pearl Meyer's New York office, joined the firm in 2012. He provides compensation advisory services to public and privately-held companies, specializing in compensation market benchmarking, proxy analysis, incentive plan design, peer group development, performance goal calibration, and pay-for-performance alignment. He has worked with clients in a variety of industries, including industrials, energy, construction, chemicals, technology, consumer goods, and pharmaceuticals.

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