Paying for good for all

Global research into ESG and reward beyond the boardroom

pwc

London Business School

Leadership Institute

Foreword

It has become a given that ESG considerations need to be integrated into corporate strategy in order for a business to create sustainable value.

Moving increasingly into focus is the follow-on question of pay: how should ESG be integrated into reward strategy for a global workforce?

This report is a collaboration between PwC territories across the globe and the Leadership Institute at London Business School. It is a follow-on to PwC UK's 2021 report, Paying well by paying for good, which addressed the question of whether and how to link the pay of board-level executives to ESG targets. In this report we consider how ESG should be integrated into reward strategy throughout a company.

The public debate often focuses on executive pay in listed companies, and how CEOs can be held accountable for delivery of shareholder returns in a responsible manner that also benefits stakeholders. But for many companies, the more interesting question is how to use all-employee reward strategy to reinforce focus on a business strategy that now more explicitly incorporates ESG factors.

Although there are some common themes for the senior executive and wider management and employee population, there are also important differences. To draw out the key themes we have conducted global surveys of investors and senior leaders about their expectations and experiences of linking pay to ESG. We have also surveyed a set of senior HR leaders and board members in global organisations, who are responsible for making this happen.

The momentum towards integrating ESG into reward strategy seems unstoppable. In this report we outline findings and recommendations to help you do it well.

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Executive summary

The practice of linking pay to ESG is already widespread

ESG targets in pay are widely used around the world

- 82% of senior leaders have ESG targets in their pay
- Although there are country variations, prevalence is over 72% in all countries and regions covered, with US (92%) highest and the Netherlands (76%) and UK (72%) lower
- Listed companies are most likely to adopt ESG measures (89%) but the practice is also widespread in other ownership forms
- In particular, despite their owners' focus on financial value, 85% of senior leaders in private-equity-backed firms have ESG targets in their pay
- The prevalence of ESG targets in pay is increasing rapidly, rising from 45% two years ago to 86% today in the largest 100 UK companies

Targets are more common in bonus than LTIP

- Where Senior Leaders have ESG targets, for 75% they are in the bonus plan
- For 50% the targets are in the Long-Term Incentive Plan (LTIP)

ESG targets have a typical total weighting of 10% to 15%, but investors want more

- The median weighting for ESG targets is between 10% and 15%
- Senior leaders believe this is about right, on average
- Investors would prefer a higher weighting with a median in the range of 15% to 20% and with nearly one in five investors favouring a weighting of 30% or more to ESG targets

Targets tend to focus on a company's strategic priorities directly linked to value creation

- ESG targets in pay tend to be drawn from ESG targets that are prominent in the company's strategy
- The most common ESG targets relate to employee engagement or health and safety (56% in each case)
- Pay targets relating to decarbonisation (35% of targets) and diversity and inclusion (41%) are less prevalent

> We have been ahead of the curve regarding ESG, and even back in 2013 had emissions metrics in the LTIP
>
> **SVP Total Rewards, Food Processing**

> We will have ESG metrics in the new bonus scheme
>
> **Chief Business Development Director, Food Ingredients Supplier**

The ESG environment is evolving rapidly

Drivers for integrating ESG into strategy

While good treatment of stakeholders has long been a cornerstone of good business, many companies are going through a process of more explicitly integrating a broader range of ESG issues into strategy. This is in response to changing expectations about the role of companies in addressing societal problems, but also the growing recognition of the link between good ESG practices and value.

A significant driver for this increased focus is the younger generation of employees, who have entered the workplace over the last decade. These employees want to see evidence that the companies they work for share their values.

ESG means different things to different people

Given the rapid development of ESG and its role in strategy, methods for identifying and measuring ESG factors are developing rapidly. Indeed even the definition of ESG is evolving. ESG is spoken about as if it's a well-defined and homogeneous category. However, it is anything but. The 'E' can include pollution, climate impact and biodiversity. The 'S' can include employee welfare, human rights in the supply chain and diversity. And the 'G' can include financial risk remediation, ethics and compliance, and climate governance. Different dimensions will vary in importance depending on the company and stakeholder concerned.

Attitudes to ESG, and prioritisation of issues, can vary around the world. Global organisations in particular need to be sensitive to local needs and flexible to ensure the right issues are addressed.

> Our demographic promotes a sense of urgency because we have a lot of young people who are concerned with this
>
> **Group Reward Director, Retail**

> Attitudes and expectations do differ by geography so for example, social fairness is a bigger theme than environmental concerns in some geographies
>
> **Group Reward Director, Natural Resources**

Overall investors and senior leaders support linking pay to ESG

A majority of investors and senior leaders believe that pay should be linked to ESG

Two thirds of investors believe that pay should be linked to ESG. 55% of senior leader respondents agree that this should be the case in most companies. And the market has voted with its feet: over 80% of participants in our survey said their pay is linked to ESG goals in some form.

But senior leaders are more circumspect than investors

Senior leaders are more cautious than investors about linking pay to ESG: over one-third believe that pay should only be linked to ESG in the minority of companies facing the most material ESG issues. Perhaps this is because, being at the sharp end, they are more aware than investors of the risks and difficulties that can arise. Moreover, a strong theme coming through our interviews was that pay is, at best, just one element in how behaviour is aligned with strategy.

There is also some concern amongst HR professionals we interviewed that linking pay to ESG may be another example of a temporary pay 'fad'. But undoubtedly the momentum has been strong. In large UK companies surveyed the proportion including ESG targets in pay has increased from 45% just two years ago to 86% today. Our research identified three main motivations for including ESG targets in pay, which were supported by both companies and investors.

Reference: Paying well by paying for good
PwC UK 2021, AGM Mid Season Update

> Incentives are not top of the list. Most of the focus is on clearly articulating our strategy, embedding ESG into our mainstream activities, and then incentives follow on from that
>
> **Group Reward Director, Electrical Equipment**

Investors and senior leaders largely agree on the reasons for linking ESG to pay

ESG targets focus attention on non-financial goals that lead to long-term value

First and foremost, ESG targets in pay are viewed as stepping stones to long-term value creation. Most senior leaders (78%) and investors (86%) surveyed believe that a focus on ESG in company strategy supports enhanced shareholder value.

However, ESG initiatives can conflict with profit in the short-term. Including ESG targets in pay helps to overcome this problem, with 86% of shareholders saying it encourages a focus on non-financial priorities that contribute to long-term value, even where these may conflict with profit in the short-term. 86% of senior leaders believe that inclusion of ESG targets in pay does indeed contribute at least somewhat to that aim.

ESG targets signal the importance to the company of a broader set of priorities

Second, senior leaders and shareholders see a communication role for pay. Including ESG targets in pay signals the importance the organisation attaches to these objectives, internally to employees and externally to the company's stakeholders, so that tangible change actually happens.

This motivation to make senior leaders 'put their money where their mouth is' was cited by 86% of investors as the reason they wanted to see ESG targets in pay. The same proportion of senior leaders agreed that having ESG targets in their pay played this role.

> We have recently publicly announced our new strategy which involves really embedding the ESG component to a deeper degree
>
> **Chief HR Officer, Financial Services**

> ESG in pay does have important symbolism
>
> **Head of Reward, Retailing**

Including ESG targets in pay encourages companies to set short-term targets to meet long-term goals, especially for sustainability areas like net-zero

Third, there is increasing interest in how long-term net-zero goals are being translated into targets for the short-term. 85% of investors believe that putting ESG targets into pay plans forces the process of setting short-term targets to meet long-term aims. Senior leaders don't disagree: 85% of senior leaders said that having ESG targets in their pay helped with setting short-term targets towards long-term goals.

Owners matter

Senior leaders emphasised the important role played by investors (and in turn asset owners) in driving an ESG focus in particular priority areas. This is at least as true in private as listed businesses. In some cases the values of investors can cause companies to pursue ESG priorities on a broader basis than would be justified purely by shareholder value.

> The trust takes ESG matters very seriously and does influence our thinking. We have 25% weighting on ESG in the LTIP and 20% in the annual bonus
>
> **Group Head of Reward, Alcoholic Beverages**

But they differ in their views on ESG priorities

Our data shows some distinct differences between senior leaders and investors on ESG priorities. In the push to link pay to ESG, we cannot assume that everyone agrees on what ESG should mean in this context or how it should be adopted. This will require careful dialogue between a company and its investors.

Senior leaders focus on ESG goals directly aligned to value

Senior leaders believe the most important ESG goals to include in pay are those most directly related to the business strategy and the process of creating value, particularly relating to internal areas such as employee satisfaction (56% of leaders) and health and safety (56%). Diversity goals (41%) and decarbonisation (35%) or other environmental goals (36%) are important, but less so.

Pay metrics follow strategy, they do not drive strategy

The presence of an ESG metric in pay is strongly related to its presence as a target integrated into strategy. For example, companies with an externally accredited science-aligned net-zero target are four times more likely (34% of companies) to link this to pay than if they have only made a general net-zero commitment (8% of companies).

Reference: PwC Global 25th CEO Survey 2021

> Further down in the business ESG is mainly reflected through a focus on safety and wellbeing as these are things team members can directly relate to
>
> **Head of Executive Remuneration, Conglomerate**

> We are now moving to introduce environmental measures that must be aligned with the 2030 goals stated in the annual report and can be operationalised, such as emissions
>
> **Group Reward Director, Electrical Equipment**

Investors focus on broader systemic risks

Investors attach greater importance to prominent, market-wide and so-called 'systemic' factors such as climate change (72%) and other environmental priorities (62%). In part, this might reflect different motivations and perspectives: universal diversified owners care about systemic impacts on their portfolio as well as on individual constituent companies. In this context, climate change is front of mind on a portfolio basis, even if each company can only make a small impact at the margin.

But there's also a concern that investors are adopting a one-size-fits-all approach to ESG based on issues that are most in the public eye – an approach that can be disconnected from individual business priorities. By contrast, the senior leaders we spoke to see it as vital to have a targeted approach focusing on why and how a specific ESG priority is linked to the company's specific strategy.

> "
>
> The investor influence is huge and there is no doubt that has influenced us a lot
>
> **Remuneration Committee Chair, Consumer Products**

Pay is only part of the picture

Senior leaders we spoke to see pay as being an enabler of, and secondary to, developing the right culture when adopting ESG strategies. And they prioritise their efforts accordingly.

Senior leaders see culture as the key determinant of a successful approach to ESG

Senior leaders do not see pay as the most important part of achieving change in their organisation. This may explain why fewer senior leaders (55%) than investors (68%) believe it is important to link ESG to pay in most companies. Instead they see the most important task to be the development of a culture where ESG considerations are integrated into decision making (e.g. through training and education, leadership development and behaviour).

Senior leaders do not always see pay as the answer

The Netherlands is widely recognised as having a strongly stakeholder-oriented corporate governance model. Yet this is the country where there is least support amongst senior leaders for linking pay to ESG. Only around one-third of senior leaders surveyed that pay should be linked to ESG in most companies, while 44% believe this should be the case only in the companies with the most material ESG priorities. Pay can play a supporting role in developing the right culture but it is unlikely to be the key role.

“

It needs to be in the DNA – it must go way beyond incentives

Remuneration Committee Chair, Consumer Products

“

There has been some demand to roll out ESG metrics in pay to the wider organisation, but a lot of work is going into culture change and education first

SVP Global Rewards, Metals and Mining

In many cases ESG targets are linked to senior management pay in the first instance

Our interviews suggest ESG goals in pay are still generally restricted to senior management and they often follow a process of incorporating ESG into strategy, rather than leading it. Views are split as to whether pay targets provide an ex-ante incentive to drive ESG activity or a general ex-post reward (which employees come to expect and which gives them assurance that they will be treated fairly for doing the right thing).

There are cases of ESG being linked to pay throughout companies. These appear to be the exception rather than the rule but this is perhaps an area where practice will increasingly lead.

> "
> It is in the annual incentive across all levels of employee… obviously quantum varies but bonus is based on exactly the same measures
>
> **Chief HR Officer, Utilities**

Engagement is key in developing ESG strategies

80% of senior leaders say that ESG forms an important part of the business strategy in their company. And ESG strategy must of course support the overarching business strategy. But our interviewees emphasised the importance of engagement when developing an ESG strategy so that employees felt a sense of ownership of, connection with, and ability to influence that ESG strategy.

> "
> In retrospect, I would engage the business more to determine what the incentive measures should be. I am not sure going top down gets the right result
>
> **Group HR Director, Public Services**

That sense of ownership then needs to be supported by communication to enable employees to understand how their actions contribute to the company's success. The good news is that 81% of senior leaders believe they have a strong understanding of the ESG issues facing their company.

Finally, employees also need to be empowered to do the right thing to enable the strategy to come to life. Engagement of this sort is always good practice when setting goals and objectives. But it is particularly important in development of ESG strategies, where engagement and retention of talent is in itself often a key objective of introducing the ESG strategy.

> "
> Good storytelling is a key enabler and important
>
> **Chief HR Officer, Banking**

Governance, capability, and organisational design need to adapt when ESG targets are included in pay

Doing all this well requires companies to build new capability and to collaborate between HR and sustainability functions in ways they have not done before. Governance and oversight processes must evolve in tandem as boards determine how remuneration and sustainability committees need to interact. For this reason we can expect a process of evolution and iteration, as the linkage of pay to ESG follows on behind the development of ESG strategy and its measurement.

> "
> Ensure the ESG team and reward team work closely – at first we didn't speak the same language
>
> **SVP Global Rewards, Consumer Healthcare**

The challenge is increased by the fact that many organisations are in a phase of building capability in ESG itself, and in the process of integrating this into strategy.

> "
> We have recently appointed a Head of Climate Change and created a new function to focus on social responsibility
>
> **Chief People Officer, Manufacturing**

Here to stay – how to do it well

Our view is that ESG targets in pay are here to stay, at least for the medium term: the momentum seems unstoppable. But it must be done well. To be credible, companies need to play their own game, and show how ESG targets link to the strategy by which they create value.

This can be easier said than done. Our interviews with senior leaders highlighted the challenges that arise when implementing the seemingly simple goal of linking pay to ESG. Based on these interviews, and our own practical experience, we offer five main recommendations.

> The biggest enabler is company culture… that is also the most difficult one to change
>
> **Chief HR Officer, Financial Services**

> It takes time to design this well. You don't want to risk badly designed incentives that will have unintended consequences
>
> **Group HR Director, Public Services**

Tell the story, linking to strategy. Employees and other stakeholders need to understand how ESG goals link to the company's strategy and priorities. Without this alignment, goals will lack credibility

Lead with culture, support with pay. It is culture, not pay, that drives sustainable behaviour in support of ESG strategies. Pay must be seen as the enabler of culture, not the sole driver of it

Engage, communicate, empower. Engaging employees in the development of the ESG strategy increases ownership of the goals. Employees need to understand how they can influence ESG goals and must be given the tools and freedom required to do so

Build capability and collaboration. Integrating ESG into pay requires, at least, close collaboration between HR and sustainability functions – and it might also require new capabilities in both. Governance oversight of target setting and measurement might need to evolve to enable appropriate input from sustainability committees into the remuneration process

Maintain a focus on value. Good ESG performance can't be an excuse for not creating value. The best organisations capture the symbiosis between ESG and long-term financial performance specific to their company, and pay arrangements need to reflect that.

Experience from early adopters shows that pay targets can be a useful management tool. But they also give rise to risks and unintended consequences, which must be acknowledged and addressed. By following these recommendations you can integrate ESG into reward strategy in a way that reinforces an ESG culture and supports the long-term creation of value

> When considering how to incentivise people, use reward as a strategic tool to enable employees to align with the company culture and values, to understand the behaviours required and results expected to deliver the business strategy
>
> **Group Reward Director, Oil and Gas**

1. Introduction

Growth of interest in ESG

In recent years, the prominence of Environmental, Social and Governance (ESG) issues has grown rapidly, a trend only accelerated by the COVID-19 pandemic.

Ethical consumerism has changed buying habits as people look to avoid purchases that come at a cost to the environment, workers in supply chains, and local communities. Employees now demand to work for companies that demonstrate by their actions that they put people and planet first and offer fairness and equality at work. Companies that anticipate these trends in consumer and employee attitudes open up new commercial opportunities. Those that do not face increasing reputational risks.

> It has supercharged our focus on ESG…what COVID has done is shine a light on some of the divisions that exist
>
> **Chief HR Officer, Utilities**

> Employees join us because of our ESG credentials – it is part of the value proposition. The fact we reward people against it is important to them
>
> **Chief HR Officer, Utilities**

Reflecting these shifting attitudes, political pressure around the globe has led the regulatory landscape to change at pace, and businesses are being asked to disclose more than ever before. Regulators are seeing an ever wider range of issues as falling within their remit – as demonstrated by the new International Sustainability Standards Board's exposure draft on climate disclosure standards, Nasdaq's Board Diversity Rule, the UK Financial Conduct Authority's new diversity disclosure rules, and the draft EU Directive on corporate sustainability due diligence.

This increased disclosure is helping to create a growing market for ESG investing. Pension funds are putting pressure on asset managers, reflecting the wishes of their beneficiaries to have their money invested in a way that aligns with their values and has positive impact. Investors also increasingly recognise the value implications of ESG factors, and the risks and opportunities these create as stakeholder attitudes and regulation evolve. ESG is therefore being integrated into investment decision making as a source of returns as well as to reflect asset owner preferences.

Evolving business strategies

This new landscape is prompting increased focus within business on how to integrate ESG risks and opportunities into business strategy. Indeed nearly 81% of the respondents in our study said that ESG forms an important part of their company's strategy. Companies are seeking to balance the demands of different stakeholders while also, or even as a route to, creating shareholder value. As a result, over half the companies interviewed had recently revamped their strategy to incorporate ESG and to take better account of stakeholder impacts.

> It is remarkable how far we have come on ESG in the last two to three years
>
> **Remuneration Committee Chair, Consumer Products**

Given the importance of ESG to strategy, an obvious follow-on question is whether pay should be linked to ESG targets, reflecting this strategic repositioning. With leadership so critical in setting the right tone for sustainable value creation, the role of reward in reinforcing ESG priorities must be considered.

Integrating ESG into reward strategy

In 2021, we considered this topic in relation to board executives. In Paying well by paying for good, a collaboration between PwC UK and London Business School, we studied in detail the motivations and considerations for including ESG targets in board executive pay and analysed the trends in practice in the UK market.

We developed decision tools, guiding principles and design choices to enable boards to decide whether and how to include ESG targets in board pay.

But interest in linking ESG to pay extends beyond the boardroom. Our practical experience with clients shows that the integration of ESG into reward strategy through the business is viewed as at least as, if not more, important than how board executives are paid – and raises its own set of challenges and opportunities.

Therefore, we undertook this study to look more broadly: at how senior leaders are thinking about using ESG targets as part of wider reward strategy, and at how practice and attitudes vary globally and in different company ownership models.

Our study

In this report, a collaboration between PwC and London Business School's Leadership Institute, we focus on this broader integration of ESG into reward strategy. Specifically we sought to address the following questions:

- What is current practice globally in linking pay to ESG targets beyond board executives, and how does this vary internationally and across company ownership models?
- What are the motivations for linking ESG to pay?
- What do senior leaders and investors mean by ESG, and what targets do they prioritise?
- What are the challenges and opportunities that arise from integrating ESG into reward strategy and how are companies addressing these?

To address these questions, we surveyed over 600 Senior leaders globally, covering participants from 9 countries and regions, 28 sectors, drawn from listed companies, family-run companies, companies backed by private equity, partnerships and owner managed companies.

We supplemented this data with insight from interviews with leaders from 24 companies across a range of geographies, industries, sizes, ownership models and at varying points in their ESG journey. The interviews were predominantly with Remuneration Committee Chairs, Chief HR Officers, and Heads of Reward. There was also participation from other senior roles such as a Head of Sustainability and Chief Business Development Officer. We've combined these insights with findings from PwC's 2022 global investor survey and 2022 global CEO Survey and the FTSE 100 mid-AGM season update.

Global Survey of Senior Leaders

- **632 Participants**
- **9 countries and regions**
- **28 sectors**
- **Across listed companies, family-run companies, companies backed by private equity, partnerships and owner-managed companies.**

PwC and London Business School would like to thank all of the individuals who contributed to our study, both through the Senior Leaders Survey and the interview process for their contributions and insights. By combining the insights from these different data sources we've been able to provide a comprehensive guide to best practices in linking pay to ESG in global organisations. This is something that is easy to talk about but harder to do.

There are arguments for and against including ESG targets in pay, and we cover them in this report. But the market momentum towards this practice seems unstoppable. Our insights and recommendations will help you integrate ESG into reward strategy in an effective way that reinforces a culture of sustainability and supports the long-term creation of value.

2. ESG and pay across the world

ESG: an evolving landscape

The focus on ESG has rapidly evolved in recent years

The survey data paints a picture of a world in which acknowledgement of the importance of ESG is already widespread, as is the practice of incorporating ESG factors into pay. But our interviews with senior leaders painted a picture of a fast-changing landscape with ESG considerations coming to the fore only recently.

ESG has, of course, always been with us. Great businesses have long recognised that treating key stakeholders well is an essential component of shareholder value creation. Customer satisfaction and employee welfare have therefore been central to the operation of great businesses for decades. What is changing is the extent that businesses are expected to take on board a wider range of ESG factors, which in the past may not have been considered central to their own responsibilities: the environment, diversity, human rights, equality. In many cases companies are in the early stages of implementing refreshed strategies taking into account this heightened awareness, and broadened framing, of ESG.

A combination of the COVID-19 pandemic and the interest around the 2021 United Nations Climate Change Conference (COP-26) has increased the focus on social and environmental factors. This has resulted in the incorporation of environmental, diversity, and other ESG targets into corporate strategies.

> I observe the sheer acceleration of focus on ESG in recent years. Two years ago, I never thought companies would be so focused on it
>
> **Group Reward Director, Natural Resources**

> Last year we rearticulated our ambitions and strategy around ESG measures and communicated them externally
>
> **Group Reward Director, Consumer Goods**

> COVID has offered opportunities for a more connected workforce that supports its communities
>
> **Chief People Officer, Manufacturing**

As a result the focus on ESG metrics in pay is relatively new

Although there were exceptions, most companies we interviewed have only introduced ESG metrics as separate components into pay in the last year or two or are only just doing so now, with one third of interviewees implementing ESG measures for the first time this year (2022).

As a result many companies are in a stage of trial and error, deciding what to prioritise, finding out what works, and overcoming measurement challenges. We can expect practices to evolve rapidly with learning in the coming years.

> For us, ESG in pay is something new and we are just launching it for the first time this year
>
> **Head of Executive Compensation, Soft Drinks**

Younger generations are driving the focus on ESG

Also notable was the extent to which younger generations are driving the focus on ESG. Several companies commented that they are experiencing more questions, expectations, and pressure from their younger generation of employees on the topic of ESG generally. They highlighted the importance of purpose, values, and commitment to ESG as a key element of the employer brand and value proposition.

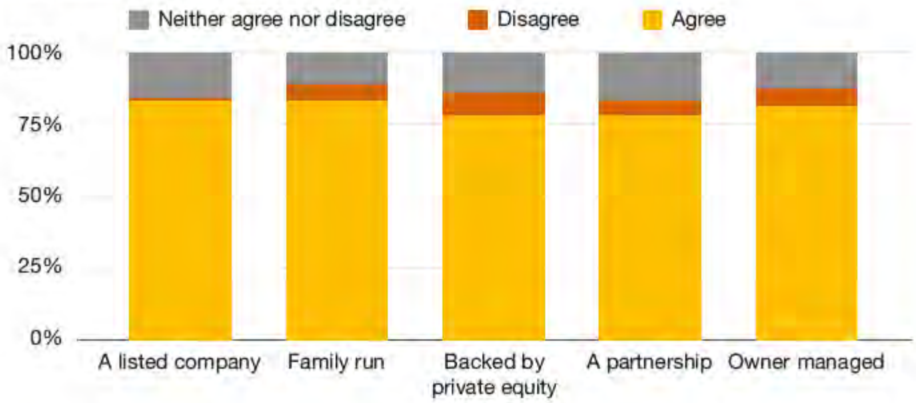
> We are seeing our younger employees becoming much more interested in ESG. They are proactively raising the topic and asking questions about what we are doing
>
> **Head of Executive Compensation, Soft Drinks**

ESG matters to private as well as public companies

It is often said that public companies are placed at a disadvantage in relation to ESG and reporting obligations placed upon them. But, as we've seen, ESG is vital for any company that deals with employees and customers for whom ESG factors are of high concern.

Overall, the extent to which ESG is viewed as important to company strategy is broadly comparable across different ownership models.

ESG forms an important part of my company's strategy



The explosive growth in linking pay to ESG

Two thirds of the senior leaders we interviewed pointed to the dramatic acceleration of interest in ESG over the last two years from their board, executives, employees, owners and other stakeholders. And they noted how this has led to recently refreshed business strategies. This, in turn, has informed a new pay strategy for executives that now incorporates ESG metrics into their pay, often as a recent development.

But if inclusion of ESG in pay seems a recent development the rate of growth has been explosive, with ESG targets in pay now a widespread phenomenon.

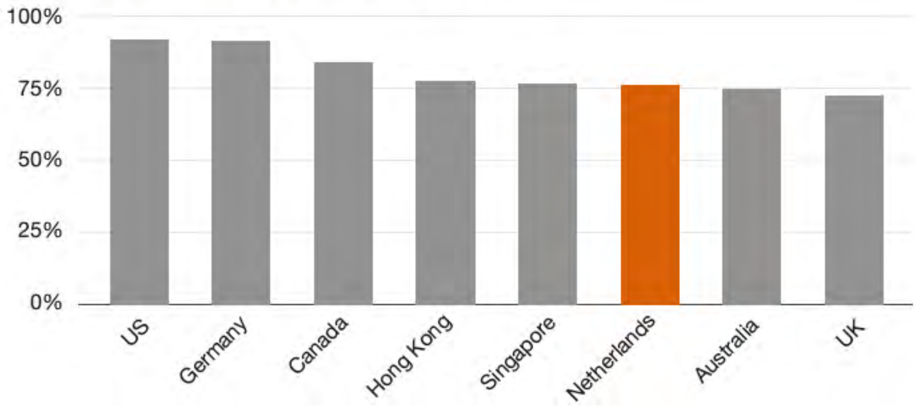
> For us, ESG in pay is something new and we are just launching it for the first time this year
>
> **Head of Executive Compensation, Soft Drinks**

The use of ESG in pay is high across countries

In each of the countries and regions we reviewed, the majority of companies use ESG – in some form – in their pay arrangements.

Interestingly, in the Netherlands, with its strong stakeholder and sustainability credentials, inclusion of ESG metrics in pay is one of the lowest among the countries and regions reviewed and, as we'll see later, senior leaders in the Netherlands are the most sceptical about whether ESG should be included. This shows that strong stakeholder orientation is about more than pay.

Is ESG incorporated into the assessment of your incentives?



ESG used in pay across company types, but especially listed companies

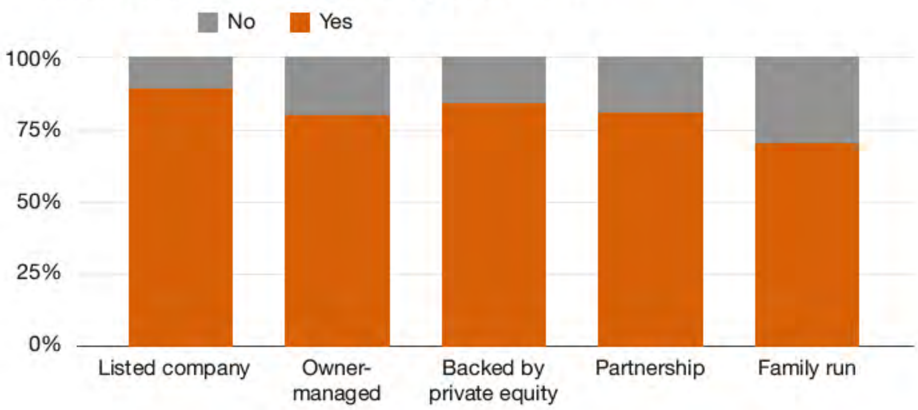
There is a significant use of ESG across different company types.

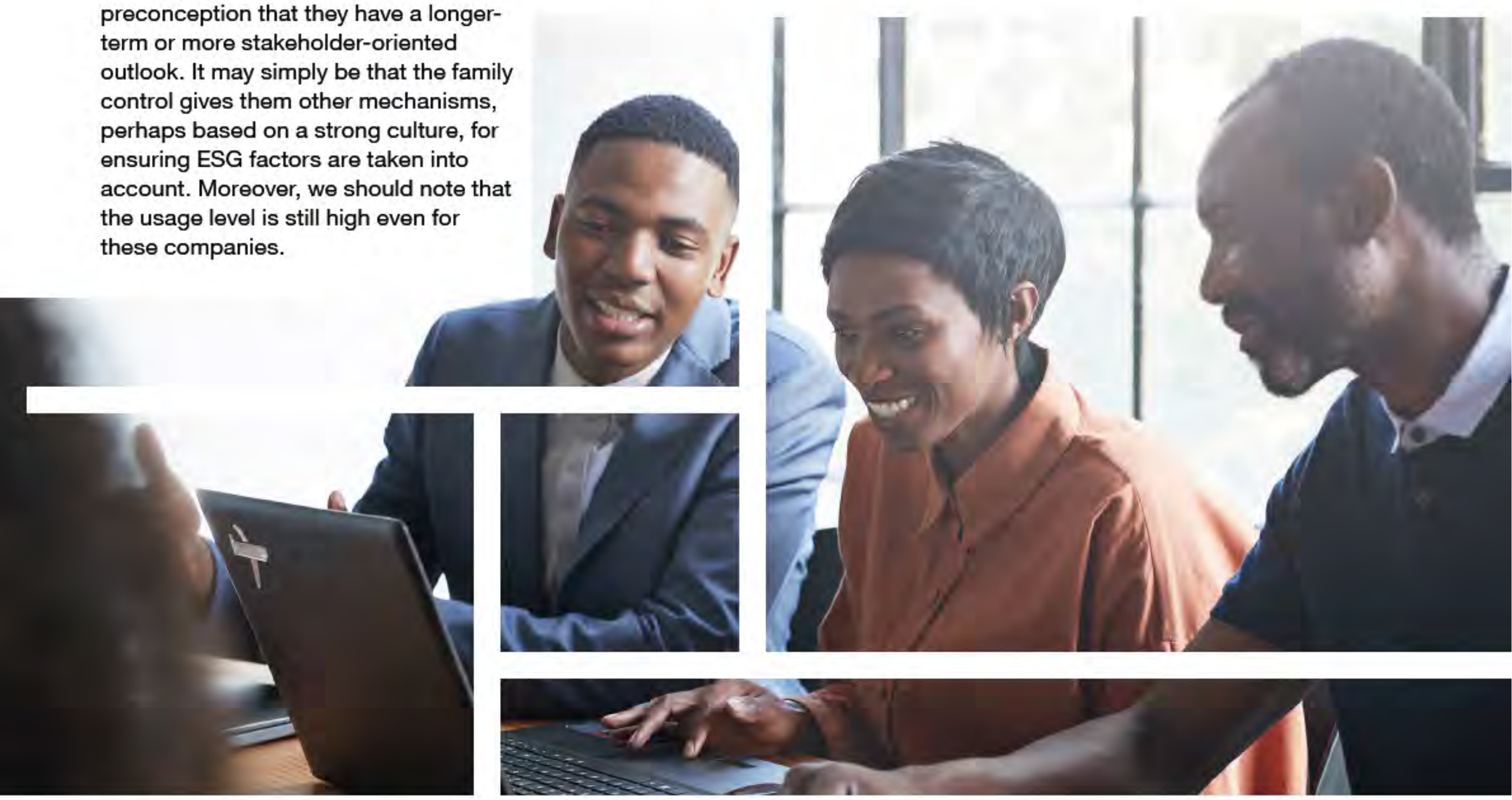
It is perhaps not a surprise, given the level of public scrutiny on listed companies, that the use of ESG is highest in these companies.

But the common view that Private Equity companies do not care about ESG is not backed up by the evidence – with 85% of PE companies using ESG measures.

It is interesting that family companies show as having the lowest use of ESG in pay, despite the common preconception that they have a longer-term or more stakeholder-oriented outlook. It may simply be that the family control gives them other mechanisms, perhaps based on a strong culture, for ensuring ESG factors are taken into account. Moreover, we should note that the usage level is still high even for these companies.

Is ESG incorporated into the assessment of your incentives?





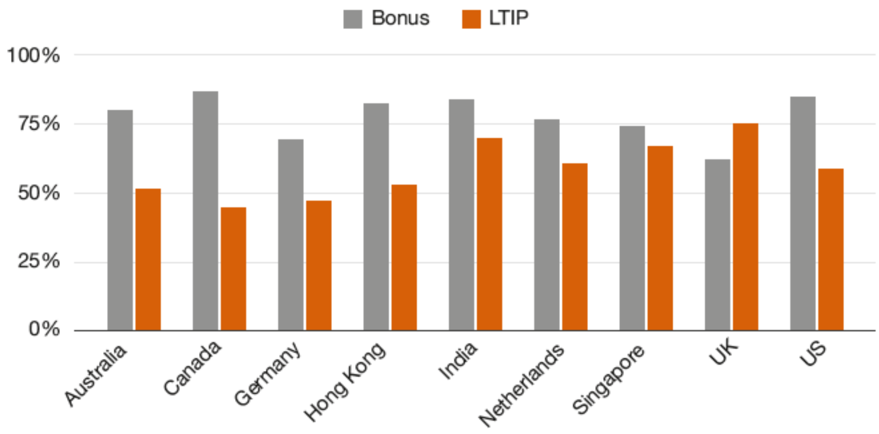
ESG typically measured in the bonus, but increasing in the long-term incentive plan (LTIP) too

The bonus has been the standard vehicle to incorporate ESG measures. There are typically a wide range of measures that can be customised to reflect the current issues of the company.

But some ESG measures are really all about long-term changes – such as carbon reduction – and so it is hard to create meaningful change through a short-term incentive.

Moving measures into the long term incentive does require companies to clearly get to grips with how they are translating 10 year plans (e.g. to get to net-zero) into defined three year targets – something which is easier said than done.

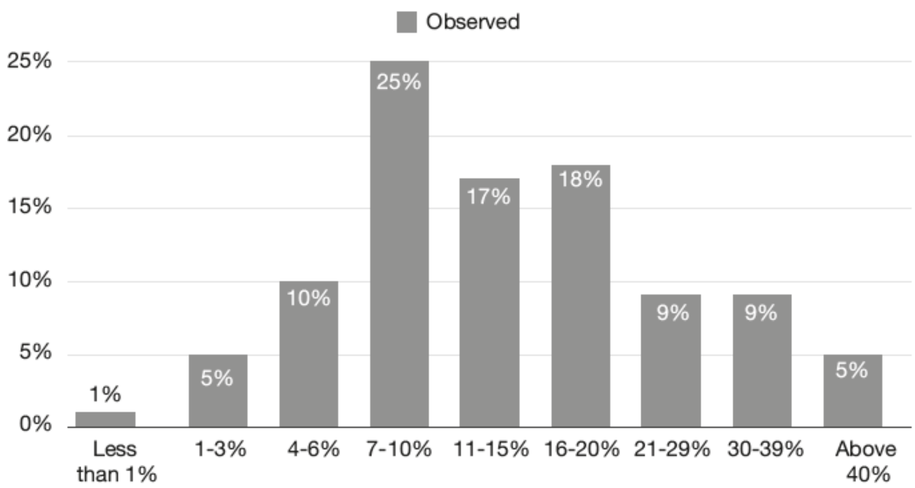
Is your organisation's performance on ESG incorporated into either of the following incentive plans?



ESG weightings are about 10% but investors want this to move to 20%

Companies typically devote about 10% of their total incentive (bonus and LTIP measures) to ESG.

When we asked senior leaders and investors how much they think should be devoted to ESG, the majority view in both groups was for this to increase, and investors seem to be pushing for even higher weightings than those preferred by management.



Observed ESG weightings

	Senior leaders
Lower quartile	7-10%
Median	11-15%
Upper quartile	16-20%

Desired ESG weightings

	Senior leaders	Investors
Lower quartile	7-10%	7-10%
Median	11-15%	16-20%
Upper quartile	21-29%	21-29%

"

40% of the bonus is based on a scorecard which includes ESG metrics relating to diversity and inclusion and the environment

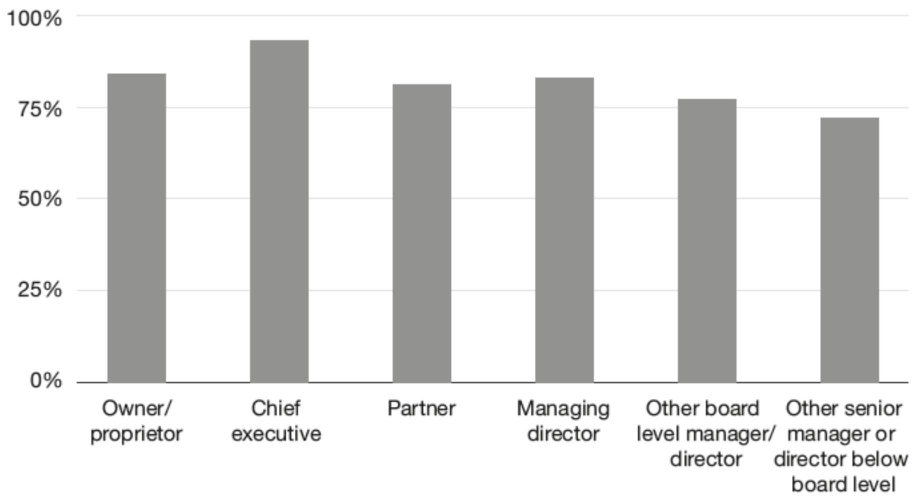
Remuneration Committee Chair, Consumer Products

ESG measures typically used for most senior levels, although emerging use throughout organisations

Most companies interviewed said that ESG metrics in pay only apply to the executive directors, executive committee, and their direct reports. This is either because the metrics only apply to the LTIP which already has a small eligible population, and/or because companies say there is insufficient line of sight and ability to influence results deeper in the organisation. The typical weighting is 10% to 20% in the annual and/or long-term incentive.

For the minority of companies interviewed that incorporate ESG metrics in pay across the wider workforce, it is typically in the annual incentive. Several companies commented that ESG-related objectives may still feature in an individual's personal objectives across the wider workforce, and this may influence decisions on their own annual pay awards and/or bonus.

Prevalence of ESG in incentives by role



> ESG is now front and center… everyone is coming at it with more energy than before
>
> **Group Reward Director, Retailing**

Case studies of linking pay to ESG

Case Study: Embedding ESG into incentives throughout the organisation

In 2021, Mastercard introduced a new compensation model for employees at the executive vice president level and above. Their bonus was determined in part by the company's performance on three Environmental, Social and Corporate Governance priorities: carbon neutrality, financial inclusion and gender pay parity.

The company has now extended that model to their annual corporate score and all employees globally, taking their shared accountability and progress to the next level. The corporate score rewards employees for going above and beyond to deliver strong results for the company. Beginning in 2022, achieving the company's ESG goals will now factor into bonus calculations for all employees.

Case Study: Take time to do it well

A consumer healthcare company commented that ESG has been highlighted in their reporting and day-to-day work for the past five years, but they are only now ready to launch their strategy to employees and the external market. They wanted to be ready with a compelling and joined-up view of how ESG is a fundamental lever to deliver on business objectives. They believe it is right to be thoughtful as in their sector, 'the way in which we manufacture our products still needs to be safe'. ESG metrics are being introduced for the first time this year in the annual and long-term incentive with a 10% weighting and will apply to the more senior roles. As part of delivery of this strategy, they have recently created dedicated roles focused on ESG who have been engaging with employees across the business.

Case Study: Make ESG integral to the employer brand and value proposition

Natural resources companies we spoke to have faced some challenges in attracting, particularly younger, workers who want to work for responsible companies. A global Oil & Gas company commented, 'we have to make a compelling case for why they should work for us as an energy company'. Another Metals and Mining company emphasised the importance of ESG being integral to the employer brand and value proposition to attract and retain the talent and skills needed. For them, this has included an emphasis on building the right culture through training and education as this is considered a critical lever of sustainable change. They have ESG metrics in pay for the senior leaders with a 35% weighting in the annual incentive and consider this to be largely about the symbolism, 'ESG metrics in pay helps the narrative with why ESG matters…culture is what turns things around and not pay'. The metrics are group-based rather than individual.

Case Study: The argument for not including ESG metrics in pay plans

As part of their recent remuneration policy review, a multinational Consumer Staples company spent considerable time determining whether to incorporate ESG metrics in pay, and concluded they can best serve their ESG agenda through metrics in the annual and long-term incentive for executives that accelerate growth in business lines that are more sustainable. Their approach was to first clearly articulate what ESG means to them, and took the view it should be in the category of, 'what we need to do anyway'. In addition, they were concerned including it in pay risked complexity, issues with line of sight and potential unintended consequences. This approach has bucked the trend of competitors and so has required a compelling business case and significant shareholder engagement. In fact, the shareholder reaction has generally been positive, 'albeit it wasn't an intuitive starting point for them'.

3. Should pay be linked to ESG, and, if so, why?

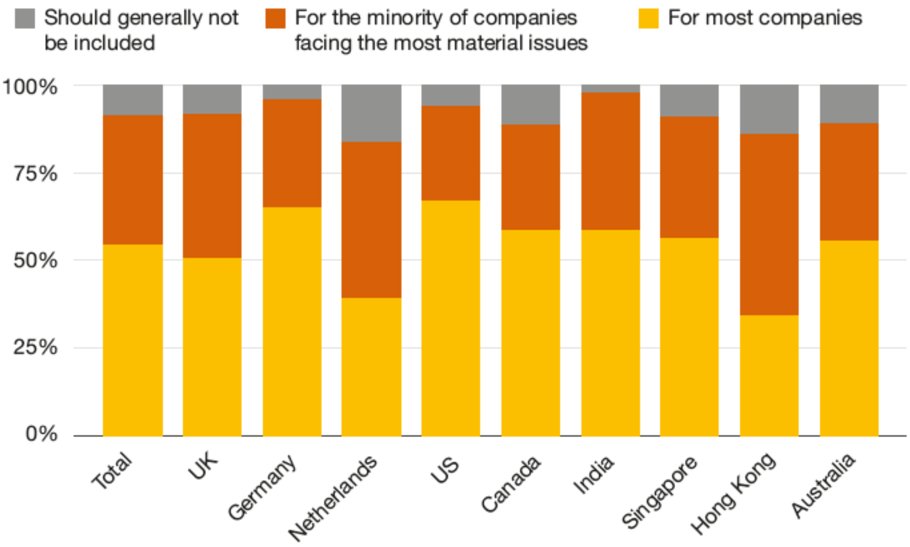
Should pay be linked to ESG?

The majority of both investors and senior leaders are in favour of linking pay to ESG, but senior leaders are more circumspect

Over two-thirds of investors (68%) are in favour of linking pay to ESG targets.

Senior leaders are more circumspect. While just over half (55%) of senior leaders believe that pay should be linked to ESG in most companies, a third believe that this link should only be made in the minority of companies that face the most material ESG issues.

A surprising finding from the survey is that the Netherlands, known for its stakeholder-oriented corporate governance system, is the most sceptical of the territories in our survey. Here the most popular view (40% of senior leaders) is that ESG should be linked to pay only in the minority of companies facing the most material ESG issues.



Why?

Investors and senior leaders agree on the reasons for including ESG targets in pay

There is, nonetheless, strong agreement between investors and senior leaders on the reasons for including ESG targets in pay:

	'Investors: Somewhat to strongly agree that having ESG in pay can'…	Senior leaders: Having ESG in their pay helps somewhat to a great deal to…
Help focus on non-financial factors that drive long-term shareholder value.	86%	86%
Signal to employees and external stakeholders the importance of ESG factors.	86%	87%
Force companies to set shorter term targets towards their ESG aspirations.	85%	85%

First and foremost, ESG is viewed as contributing to long-term value

78% of senior leaders and 86% of investors believe that a focus on ESG helps to drive long-term value.

These findings were consistent across ownership types, other than, unexpectedly, for family-owned businesses where only 63% of senior leaders believe a focus on ESG will lead to higher long-term financial returns.

Even if ESG drives long-term value, ESG initiatives can conflict with profit maximisation in the short term. Including ESG targets in pay can help ensure leaders focus on non-financial factors that create value in the long-term. 86% of investors and 86% of senior leaders cited this as a benefit of including ESG targets in pay.

> “
> We have recently publicly announced our new strategy, which involves really embedding the ESG component to a deeper degree
>
> **Chief HR Officer, Financial Services**

> “
> We developed a business case for including ESG in pay by presenting ESG as a fundamental lever to deliver on business objectives. Rather than approach it piece meal, we have taken a joined-up view which reflects how we have communicated it to our shareholders and employees
>
> **SVP Global Rewards, Consumer Healthcare**

Including ESG in pay plays an important signalling role

Although making commitments and setting targets on ESG is in itself important, there is no doubt that including ESG targets in pay can have a powerful signalling effect. Companies use this as a way of reinforcing purpose and values.

This benefit of including ESG targets in pay was emphasised by 86% of investors and 86% of senior leaders. Indeed when asked whether individual and/or team behaviours have changed as a result of having ESG metrics in pay, many companies have observed greater discussion and challenge on the topic in the last couple of years, although it cannot be stated with certainty whether this is due to having ESG targets in pay, or due to a more general societal awareness.

> “
> We have had these goals already in place for some time and putting them in pay is a way of elevating their importance
>
> **Head of Executive Compensation, Soft Drinks**

The interest of younger generations in ESG means that talent attraction and retention is a key channel through which a focus on ESG drives value for companies. Including ESG in pay can act as a signal to those employees of the importance that the company attaches to priorities that align with the values of this demographic. As we shall see, this places a premium on engagement with employees when developing ESG strategies and pay plans.

Many companies use employee engagement surveys and one-to-one conversations to hear what employees feel about their pay. Overall, senior leaders we interviewed confirmed that employees are positive about having their pay linked to ESG. In part this reflects the alignment with personal values that can result from pay being linked to ESG. The fact that ESG targets generally pay out at a higher-than-average level is unlikely to change their minds.

> The change is that employees now recognise we have a role to play in society and communities that is broader than just our financial results
>
> **Chief HR Officer, Banking**

> The new generation of employees want to work for companies that have strong values, purpose and do business responsibly
>
> **Chief People Officer, Manufacturing**

> The workforce is generally happy having pay linked to ESG metrics. They have also experienced good outcomes with this
>
> **Group Reward Director, Natural Resources**

Including ESG targets in pay encourages companies to set short-term targets to meet long-term sustainability goals

In November 2021 it was reported[1] that around 30% of the world's largest 2,000 companies had made net-zero pledges. However, only a small minority of these have set specific, and science-based, short-term targets to put them on a trajectory to those longer-term goals.

There is now increasing interest in how long-term net-zero goals are being translated into targets for the short-term. 84% of investors believe that putting ESG targets into pay plans forces the process of setting short-term targets to meet long-term aims. Senior leaders don't disagree: 85% of senior leaders said that having ESG targets in their pay helped with setting short-term targets towards long-term goals.

Influence of the owners

Shareholder influence is a significant driver for companies adopting ESG targets into pay, whether for listed or private companies. For family businesses, ESG considerations are often integral to the intergenerational philosophy and mindset.

For listed companies, institutional investor influence is strong, driven by the wishes of their own clients for a responsible approach to investment. Our interviewees had mixed views on this. Many welcomed shareholder engagement on strategic ESG issues. However, some were concerned that institutional investors adopted too much of a box-ticking approach and that this in turn led to undue influence for ratings and proxy agencies.

Furthermore, the opportunity for shareholders to have a vote on policy and its implementation through say-on-pay is seen as an opportunity to engage with companies and hold them accountable for clarifying their pathway towards longer-term goals. This is behind the insistence from investors such as Cevian and Allianz that pay should include ESG targets.

These investors also see the say-on-pay voting process as a tangible and practical way to hold boards to account for the strength of their ESG targets.

> Significant, measurable and transparent ESG targets should form part of senior management compensation plans for all European public companies
>
> **Cevian Capital**
>
> **Press release March 2021**

[1] Reference: Time.com (2021). As More Companies Make Net-Zero Pledges, Some Aren't as Good as They Sound

> The family influence is tremendous…they have their fingerprints on the design
>
> **SVP Total Rewards, Food Processing**

> Proxy agencies have too much of a role, and often adopt a box ticking approach – this doesn't help wise decisions to be made
>
> **Remuneration Committee Chair, Financial Services**

But remember, ESG is not always the most important thing

While ESG is viewed as important, not all investors view it as the most central issue for value creation. 42% of investors believe that ESG factors have only a minimal impact overall on revenue and 37% believe they have a minimal impact on margin. This is consistent with the overall body of academic research, which finds a mixed picture on the link between ESG and value, with few unambiguous findings.

Some investors may view ESG factors more as relating to risk and reputation than to core financial performance. As such ESG may be viewed as relevant to value preservation as much as to value creation.

So while ESG is important, it might not be the most important. Ultimately companies create value by deploying resources and motivating their employees to deliver great products and services for customers. ESG plays a role in that, but often a supporting one.

Other factors may be more important for inclusion in pay

Our interviewees also emphasised that views on the importance of ESG are highly variable across geographies and business lines. ESG is not universally accepted as necessarily a good thing or an area of critical focus for the business. Or, if important, not necessarily the most important consideration.

This is not to undermine the role of ESG integration in a resilient and effective strategy. But it is a reminder that there are other important dimensions that compete with ESG for corporate focus and hence inclusion in pay metrics. For example, 54% of CEOs include automation and digitisation goals in their long-term corporate strategy, significantly more than include targets for decarbonisation (37%) or gender representation (38%)[2].

Maintaining simplicity in pay plans may mean that these other strategic factor take priority over ESG metrics for some companies. This sentiment is reflected in the fairly widespread support (33% of senior leaders) for the notion that ESG targets should be included in pay only in the minority of companies that face the most material ESG issues.

> “
> The starting point needs to be to define what ESG really means to you as a company. We took the decision that instead of a focus on one or two discrete metrics, we can best serve our ESG agenda through targets in pay that accelerates growth in business lines that are more sustainable
>
> **Group Head of Reward, Consumer Staples**

[2] Source: PwC 25th CEO Survey

The perceived relevance of ESG varies around the world

Data from our senior leaders showed high levels of relevance for ESG around the world, although there are variations across countries and regions. For example, the proportion of senior leaders saying that ESG is important to company strategy varied from around 69% in Hong Kong to 85% in the US.

Interviewees identified differences in standards and regulations on ESG as leading to geographical variation in the approach to linking pay to ESG. Variations in consumer and employee attitudes, and local politics, also make a difference. One interviewee highlighted that environmental issues were more commonly raised by urban than rural employees.

There is a danger, sitting in a developed market headquarters, of assuming that attitudes to ESG are the same around the world as in your home country. In certain cases, other matters can be more pressing.

> It is very much a mature market focus, and yet we need our stakeholders to be more aware globally
>
> **SVP Global Rewards, Consumer Healthcare**

> In the western world it resonates. In other geographies it may not be as evolved and there are also geopolitical tensions to consider
>
> **Global Head of Reward, Banking**

And pay isn't always the answer

Our interviews revealed that senior leaders are focussed on the importance of culture in driving the change they want to see towards greater day-to-day awareness of ESG issues. Pay can influence culture, but leaders are less convinced that it is a primary driver, an issue we return to later.

There are many goals we ask managers to deliver that are not included in incentives. Just because we want managers to deliver on ESG, we should not always assume we have to pay for it.

> First you have to educate to create a genuine belief ESG is good for the company and employees can work out the connections. Yes, it flows into remuneration, but that is of secondary importance
>
> **Remuneration Committee Chair, Consumer Goods**

4. Challenges to overcome

Establishing the business case

Senior leaders we interviewed highlighted that the first step was to establish whether there is a compelling business case for including ESG metrics in pay. This includes evaluating the precise challenge or problem that needs to be solved, the range of other options that may be considered, and the extent to which this will align with the company purpose and values. Many commented that this is a time-consuming process, particularly in the face of external pressures to show commitment on any given specific issue of the day.

> Don’t expect to solve everything in a single year. It is about creating momentum and remaining committed to the topic. It needs to constantly evolve
>
> **Group Reward Director, Natural Resources**

Selecting targets

There are significant practical challenges concerning selection of metrics. The issues of interest to external stakeholders do not always align with fundamental drivers of value. ESG strategies tend to be multi-dimensional, making it difficult to know which targets to focus on. We return to this in the next section. But a common concern was to focus on issues that required a step-change as opposed to metrics that should be considered part of the ‘day job’. A common example of this latter point concerned safety metrics.

Simplicity can be a challenge. The temptation can be to include a large number of ESG measures in pay, to show to stakeholders that their issue is a priority. However, this can lead to confusion and dilution of impact, so there is an acceptance of the need to focus on the big issues. It is important to convey to stakeholders that not everything in the strategy needs to translate into pay. There is also a recognition that selection of metrics will evolve over time. Today’s big issue may be tomorrow’s business as usual.

The disparity between ESG scores from different ratings providers illustrates the challenges of finding an agreed way to assess a given ESG issue. A climate transition plan involves more than a straightforward emissions goal and includes many factors and a high degree of uncertainty. There is a danger that ESG measures can veer from the simple to the simplistic.

One financial services company we spoke to felt that market standards for environment-related metrics were insufficient and vague. The company noted that, while such metrics are receiving more focus, there is a risk to the industry of greenwashing – and that includes the risk of being accused of it. Consequently, the company is approaching the adoption of environmental metrics in its incentives with some caution although it wishes to do so.

The complexity of measuring ESG can mean that companies set out on the path of linking pay to ESG without fully anticipating the challenges that will lie ahead when it comes to measurement and assessment.

> It has taken a long time to land the measures we put in. ESG is such a broad topic, and there are plenty of things that contribute to our agenda
>
> **Head of Executive Compensation, Soft Drinks**

> Once you achieve gender balance it becomes day job, and there needs to be a plan for transitioning it out of incentives
>
> **Head of Executive Remuneration, Conglomerate**

> Ensure the board fully understands what they are signing up to. I would like to have got the broader committee deeper into the weeds on understanding the metrics and definitions
>
> **Remuneration Committee Chair, Financial Services**

Distorted incentives

In Paying well by paying for good we explained how setting pay targets for ESG can crowd out intrinsic motivation. At the same time, if a company has multiple important ESG dimensions, then including just some in pay risks distorting management focus.

An organisation we spoke to operating in healthcare said it would like to introduce metrics in pay that relate to sustainability and the environment. However, it did not want to risk a change in manufacturing that would compromise the safety of its products.

Calibration

The majority of senior leaders we interviewed highlighted difficulties with setting meaningful targets. In Paying well by paying for good we highlighted the risk of ESG targets leading to more pay, but not more ESG. It's been demonstrated that non-financial and strategic targets pay out, on average, more than their financial counterparts.

A board will not set an ESG target for executives that is not aligned with the strategy; therefore, such a target is likely to be met in any event. This means that ESG targets might result in higher pay without correspondingly greater levels of ESG achievement.

At the same time, many businesses are now just establishing baselines for those ESG metrics that have not in the past formed a part of core business reporting. Some businesses are delaying setting targets until they have a track record of measurement in place.

Listed companies were particularly concerned about the reputational considerations relating to disclosure of targets. Investors are pushing for prospective disclosure to enable them to test the level of stretch in ESG ambitions. In the absence of a track record of measurement, companies are concerned about striking the balance between targets that are achievable for executives and targets that in retrospect look too soft.

> The real difficulty is setting targets in the first place
>
> **Group Reward Director, Consumer Goods**

> We are now establishing baselines for metrics concerning energy, waste and water
>
> **VP Total Rewards, Biotechnology**

> We are very much aware of the fact this is disclosable and in the public domain so there is a reputational angle to consider
>
> **Group Reward Director, Electrical Equipment**

Measurement

Complex ESG issues do not always lend themselves to simple numerical measurement. Many companies struggle with the balance between the disclosure demands of objectivity in measures and the reality that the complexity of ESG issues means that some qualitative judgement is required. In practice it can be easier to apply such qualitative judgement for wider management and employee incentives than is the case at board level where shareholder scrutiny applies.

Many ESG issues cannot be reduced to measurement of a single metric. In Paying well by paying for good we highlighted the risk of 'hitting the target but missing the point'. We used the example of board-level diversity targets, which can be met relatively easily by companies without making progress on the more important yet challenging issue of inclusion. This risks creating a false sense of having addressed the issue, which can reduce focus on deeper issues.

In practice we found a number of companies, specifically those located in the US and Australia, were relying heavily on qualitative judgement as their experience with measurement and calibration develops.

> We haven't set specific targets and so there will be a qualitative assessment on diversity. We took time to get comfortable about that
>
> **Head of Executive Compensation, Soft Drinks**

> We work towards progress rather than hitting a particular number and then have a qualitative assessment
>
> **Head of Executive Remuneration, Conglomerate**

Implementation

A number of senior leaders we spoke to emphasised that introducing ESG into pay required the building of new relationships between HR and sustainability functions. This was often happening while those sustainability functions were themselves being stood up within the organisation.

Often these new working relationships created challenges with neither side being used to working together in the manner required for design of pay plans.

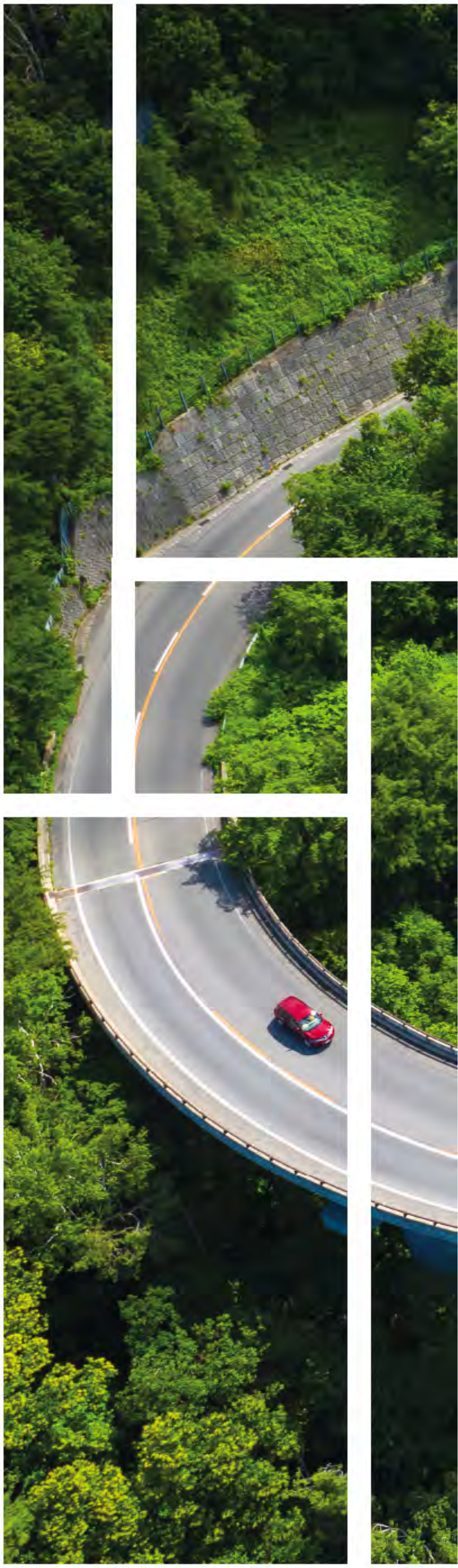
These challenges at the functional level within the organisation have their mirror image in the new working relationships required between remuneration committee and sustainability committee at board level.

> We are getting more coordinated with ESG, and have hired a Head of ESG. Building capabilities is critical and we underestimated that in the past

Head of Sustainability, Aerospace

> There were challenges in working with the sustainability team to determine appropriate targets for an LTIP

Group Reward Director, Consumer Goods



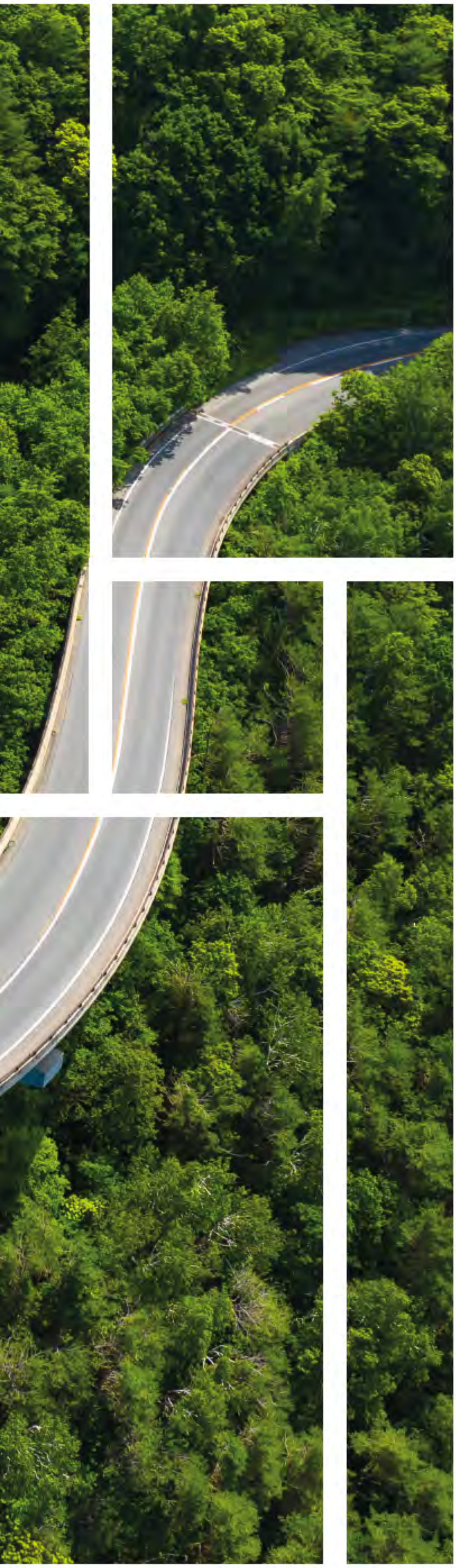
Balancing financial and non-financial outcomes

The narrative of 'doing well by doing good' can be taken to mean that anything that benefits stakeholders also benefits shareholders. But this is not always true. There are trade-offs. Indeed regulation and shareholder activism are already pushing companies to consider wider ESG goals regardless of shareholder value. This is particularly the case in relation to climate change and diversity. Remarkably, our research finds that 50% of investors and 82% of senior leaders agree that ESG goals should be pursued regardless of shareholder value.

But if these trade-offs become a reality, and some ESG goals prove to be costly for companies to pursue, clear thinking will be required regarding the motivations for ESG actions, and which actions to pursue. History suggests that companies cannot pursue ESG without regard for value: both are needed. The senior leaders we interviewed were aware of this and recognised that ESG goal achievement must be combined with strong financial results.

> We now face issues in needing to protect a craft industry while at the same time protecting the local environment

Group Head of Reward, Alcoholic Beverages



Assessing effectiveness

Measuring success

Senior leaders we spoke to struggled with measuring the effectiveness of including ESG targets in pay. Overall there was scepticism about the role that pay played by itself. Instead it was viewed as much more significant as a reinforcer of culture.

Therefore separating out the role of pay is challenging, although one approach identified was simply to track progress against the desired ESG goals, whether qualitative or quantitative in nature. In the case of diversity, for example, this might include progress on balanced short-lists.

More sophisticated approaches tended to build up dashboards of external and internal data, although the ability of these to isolate the impact of pay design choices is extremely limited.

> Impact and effectiveness of having ESG metrics in pay will be evaluated by getting to the numbers and targets that need to be achieved
>
> **Remuneration Committee Chair, Financial Services**

> We shall consider informal factors. For example, in diversity and inclusion we shall consider the extent to which search firms and others are saying that our managers are demanding a more diverse selection pool of candidates
>
> **SVP Global Rewards, Consumer Healthcare**

> We take a multi-faceted approach to evaluate impact and effectiveness that includes tracking our reputation and patterns in employee engagement
>
> **Chief People Officer, Manufacturing**

It's good to talk

When asked whether individual and team behaviours have changed as a result of having ESG metrics in pay, many companies have observed greater discussion and challenge on the topic in the last couple of years. However, it cannot be said for certain whether this is directly attributable to having ESG in pay, or a more general and societal market trend. Nor do we know if talk translates into action on an ESG issue or on creating value for the company.

> At an operational level it is hard to determine whether there has been change. Either people think about it in their day-to-day work, or they don't
>
> **Group HR Director, Public Services**

> I would say the behavioural change is that our associates are talking about these things more – the topic is out there
>
> **SVP Total Rewards, Food Processing**

Not easy

Linking pay to ESG sounds easy, but is far from straightforward. There are potential benefits in linking pay to ESG, as we outlined in Section 3, and will assess again in Section 5. But in Paying well by paying for good we identified a number of risks with linking board executive pay to ESG:

- ESG can be difficult to measure reliably
- There is a risk of hitting the target but missing the point
- ESG incentives can distort behaviour
- ESG targets may lead to more pay, not more ESG

Our interviews with senior leaders at the cutting edge of implementing reward strategies reinforced these same challenges. For these reasons the assumption that linking pay to ESG is always the right thing to do is a lazy one. Sometimes the costs will outweigh the benefits.

These challenges might explain why senior leaders are less likely to see inclusion of targets in pay as being automatically the right answer. The idea that executive pay should always be linked to ESG is a view that is far from universally held.

Being at the sharp end of implementation, senior leaders are well aware of the risks and difficulties of including ESG targets. They are also aware that driving change through an organisation is about culture as much as it is about pay. We will return to this point in Section 6. But first, we turn to the significant problem of deciding which ESG factors to prioritise, when a typical business strategy will incorporate many ESG dimensions.

5. Selecting ESG measures

The multi-dimensional nature of ESG

ESG is spoken about as if it's a well-defined and homogeneous category. However, it is anything but. The 'E' can include pollution, climate impact and biodiversity. The 'S' can include employee welfare, human rights in the supply chain and diversity. And the 'G' can include financial risk remediation, ethics and compliance, and climate governance.

Definitions of materiality

One view of ESG focuses on financially material stakeholders: these are stakeholders that affect the financial prospects of the company. The work of the Sustainability Accounting Standards Board (SASB) focuses on this definition of materiality. That is now being enshrined in the proposed Sustainability Disclosure Standard[2].

[2] ISSB® Sustainability Disclosure Standard (March 2022). Exposure Draft

The SASB framework is reasonably well-evidenced as identifying those ESG issues, for each sector, that are aligned with long-term performance.

But materiality is increasingly being viewed through the broader lens of impact material stakeholders: these are stakeholders on which the company has a material impact, regardless of whether there is a reciprocal financial impact for the company[3].

[3] The Investor Forum and London Business School (January 2022). What does stakeholder capitalism mean for investors?

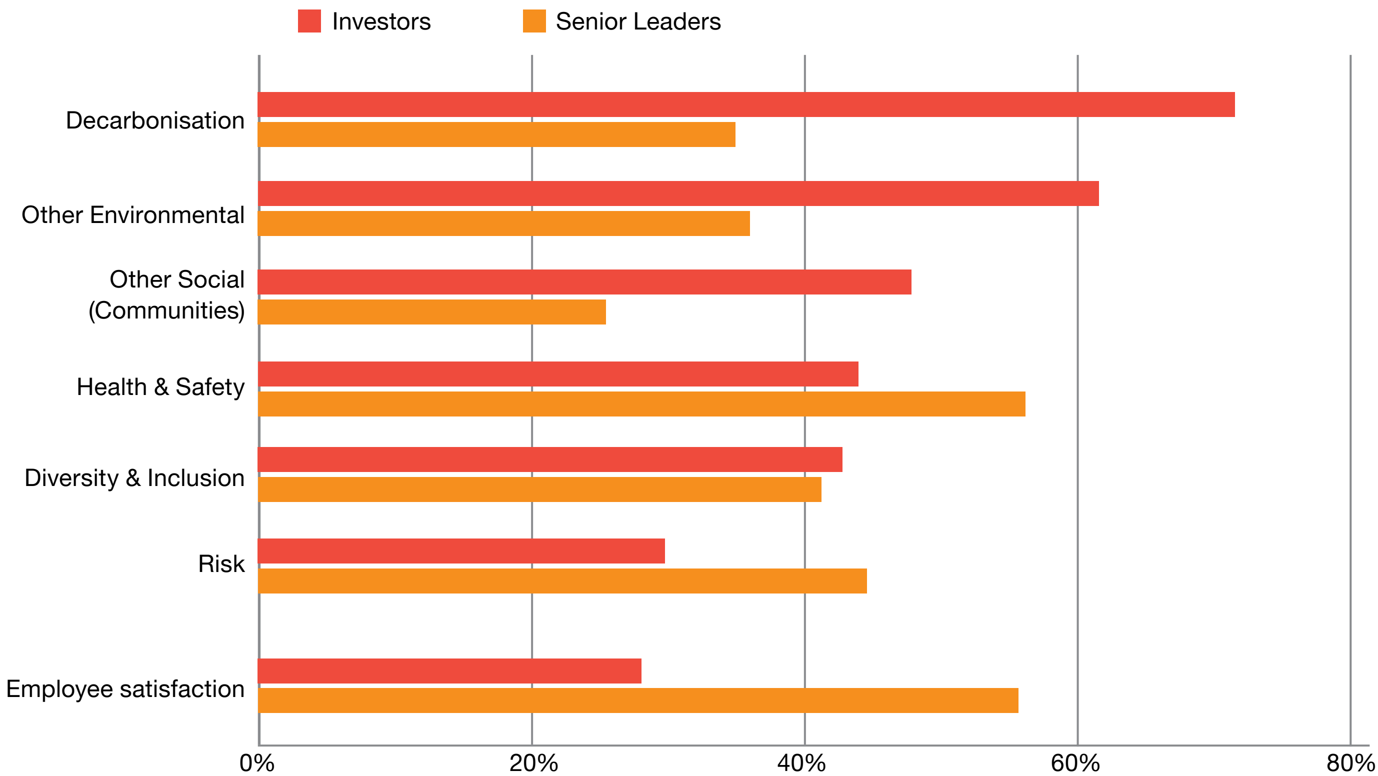
Impact material stakeholders have a way of becoming financially material over time. If a company has a major stakeholder impact, it is quite likely that the stakeholder ends up in due course having a financially material impact on the company, whether through consumer or employee preferences or through changing regulation. Climate change is a great example of an issue that went from being viewed as irrelevant for companies, to being viewed as impact material as knowledge of climate science spread, but which is now seen as financially material for some companies because of transition and physical risks.

A final nuance is that ESG issues can be material at the individual company level or at a systemic level that affects the value of markets overall. Climate change is often viewed this way. Action to align with carbon reduction targets might be viewed as costly for an individual heavy emitter, but – from an investor's perspective – the positive spillover from controlling climate change on the rest of the investor's portfolio can outweigh these costs. This is an example of investors looking for action on a systemic risk.

Differing priorities

Our survey data shows interesting differences between the ESG issues that companies and investors see as a priority.

What ESG issues should be part of pay plans?



By breaking down ESG into focus areas, we begin to see differences in priorities for each stakeholder group.

Companies prioritise those issues that are most directly financially material, with a clear link to shareholder value creation. Senior leaders, still in the middle of the ongoing Great Resignation, are prioritising employee satisfaction. Our senior manager survey found that this is the joint most popular measure, one that over 55% include as part of current incentive plans. Closely following that is employee health and safety.

By contrast, investors are more inclined to focus on measures that are either impact material or systemically material. Those who invest across multiple companies and face demands from asset owners and the public are conscious of the system-wide issues they are being lobbied to act on.

PwC's 2021 Investor Survey found their top priority (65%) was reducing Scope 1 and 2 greenhouse gas emissions. Their next priority after that was one of the more traditional concerns: ensuring worker health and safety (44%).

In part this simply reflects the fact that investor and senior leader priorities differ. Investors who are 'universal owners' have a strong interest in systemic risks as well as company-specific factors. But investors also have clients – asset owners, retail clients, etc. – who have preferences about how they want their money managed. These preferences might not all be financial in nature.

There are good reasons for these differences, but some bad reasons too. Resource-constrained investors might be more likely to focus on one-size-fits-all ESG issues across the market as a whole, as opposed to engaging individual companies on the issues that are specifically relevant to them.

ESG measures are changing

Increase in measures linked to societal concerns

The nature of measures included in company incentives is changing. In Paying well by paying for good, we identified the growing prevalence of 'new' ESG measures, predominantly linked to climate and diversity. These are replacing or complementing more traditional ESG measures relating to issues such as employee health and safety. Our interviews with senior leaders highlighted the growth in use of environmental metrics to align with targets and ambitions that have recently been communicated to employees and externally.

> We have recently published a 2030 ambition on water and packaging and so are introducing plastic and water targets to the executives' compensation
>
> **Head of Executive Compensation, Soft Drinks**

> 40% of the bonus is based on a scorecard which includes ESG metrics relating to diversity and inclusion and the environment
>
> **Remuneration Committee Chair, Consumer Products**

Decarbonisation targets to align with net-zero commitments frequently came up in discussions. Although currently focussed on Scope 1 and 2 emissions, there is increasing pressure from shareholders and other stakeholders also to consider indirect emissions in the supply chain and from use of products (Scope 3).

Linked to this appears to be a growing tendency to include measures relating to broader societal concerns rather than issues that are immediately financially material to the company. This again reflects the different priorities of companies and investors highlighted above. This is also reflected in the fact that we recorded, in Paying well by paying for good, that fully 45% of ESG measures used in large UK companies are not material under the SASB framework.

So boards need a clear rationale for the measure they are selecting, with careful consideration for its motivation, and the nature of its materiality. The need for measures that support long-term value creation in the company must be balanced with investor wishes for measures that address systemic risks or the preferences of their beneficiaries or society. This is no easy task.

Picking the right measures

Although it is not possible to generalise which measures are most appropriate for a company to adopt – this will depend on what is material to the strategy for that company – it is possible to identify some general features of a good ESG measure. In Paying well by paying for good, we identified the following qualities as being most relevant for selecting measures for board-level targets:

Measures aligned to strategy

Big issues requiring a step change

Shared internal and external understanding of what constitutes a stretching target

Clear and assured criteria

For measures for wider employees, the same considerations apply, but with some nuance. A key concern with board-level metrics is providing a level of transparency and accountability that satisfies external investors. Within the company, the process of senior management oversight can provide for more qualitative assessment and discretion. For a wider population, the targets, as we have discussed, can be viewed as much as a communication or signalling device as an accountability mechanism – in which case, the telling of a story linked to strategy is particularly critical.

> "Explain the alignment with the business strategy. You should start pay plan design from the business strategy, and not because it is a trend
>
> **Chief HR Officer, Financial Services**

Design considerations

As well as selecting which ESG measures to focus on in pay, there's also a need to decide how to incorporate them into specific incentive plans. In Paying well by paying for good we identified four key decision points of how to include ESG metrics in pay, which are summarised below. Please refer to that previous report for further detail and examples.

Input vs Output

Quantitative ESG goals like reducing emissions or improving health and safety can lend themselves well to objective output goals, which are generally favoured by investors. However, early stage or complex ESG goals, such as creating an inclusive culture as a building block to increasing diversity, may better lend themselves to input goals. However, this should still be as objective as possible.

Individual KPI vs Scorecard

Sometimes an organisation will have a small number of critical ESG issues that are clearly first amongst equals when it comes to inclusion in pay. In other cases, companies may have many different objectives spanning the environmental, social, and governance domains. In these cases, a scorecard may work better.

Annual Bonus vs LTIP

Goals requiring longer-term action, like environmental goals, are often put into the LTIP, given that it can take several years to make material progress.

But multi-year target setting can be challenging and can be disrupted by changing priorities and circumstances. Annual bonus allows more flexibility for adaptation over time. And it is better to set well-calibrated one-year targets than vague long-term ones.

Underpin vs Scale Target

In most cases, ESG metric will work most effectively as scaled targets with a threshold, target and maximum performance level.

However, some issues will have pass or fail performance standards or been seen as an underpinning expectation below which reductions in payout are appropriate. Health & Safety can be an example of this in some cases.

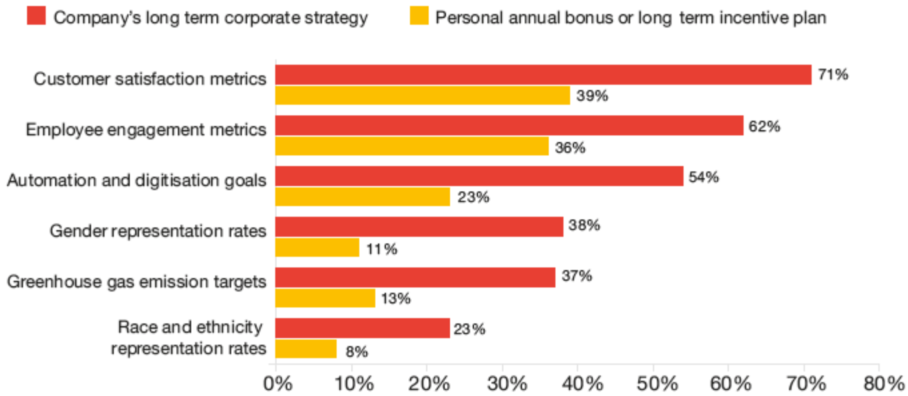
Pay follows strategy

Linked to this, senior leaders emphasised the importance of selecting metrics that supported a clear narrative linked to the strategy of the company. They often emphasised these intangible components over and above technical incentive design.

PwC's 25th Annual CEO survey shows how pay follows rather than leads strategy. ESG measures were much more likely to appear in a CEO's incentives if they featured as a specific metric in the business strategy.

On the specific issue of climate change, companies that had introduced science-based targets linked to a specific net-zero commitment were 4x as likely to have carbon reduction targets in pay than companies that had simply made generic net-zero commitments.

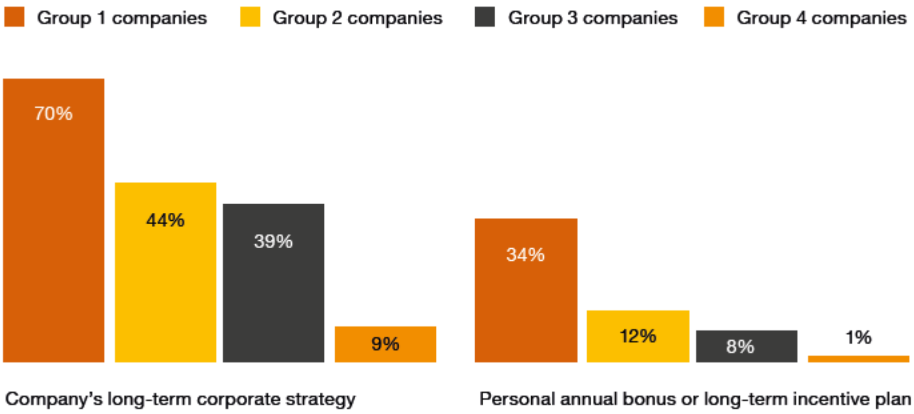
Alignment of incentives with business strategy



Source: PwC 25th Annual Global CEO Survey

> The narrative is really important – the ESG vision must be bespoke, clear and tailored to the company
>
> **Remuneration Committee Chair, Winemaking**

Companies with serious decarbonisation commitments often embed targets into strategy



Questions: Which metrics are included in:

a. Your company's long-term corporate strategy,

b. Your personal annual bonus or long-term incentive plan?

Source: PwC 25th Annual Global CEO Survey

Notes:

Group 1 companies = science-aligned net-zero commitment;

Group 2 companies = non-science-aligned net-zero commitment;

Group 3 companies = carbon-neutral commitment;

Group 4 companies = no net-zero/carbon-neutral commitment

6. It's about far more than pay

Culture eats pay for breakfast

There tends to be a focus on the mechanistic aspects of 'putting your money where your mouth is' and 'you get what you pay for'. For senior leaders, experienced in the realities of bringing about organisational change, it is much more subtle.

Company culture was widely cited as the key enabler to engaging employees in ESG, and in influencing employee behaviour and business results.

Many organisations interviewed said that having ESG in pay was symbolic and primarily concerned with signalling, and stressed the criticality of messaging from the CEO.

> "
>
> Having it run through our culture and DNA is far more important than building it into incentives
>
> **Remuneration Committee Chair, Winemaking**

> "
>
> I think the biggest enabler is company culture…that is also the most difficult one to change
>
> **Chief HR Officer, Financial Services**

> "
>
> Yes, it is in pay, but incentives are not a panacea, rather a reinforcer. It is key the CEO talks about it and reinforces the necessary messages
>
> **Group Reward Director, Oil & Gas**

Mixed views on the role of pay

There are mixed opinions on the relative impact of incentives. Some senior leaders do see them as a critical driver of culture change alongside other interventions such as clear communication from senior leadership.

> It ranks pretty high. However, this comes with the caveat that you won't get any traction at all with incentives unless you have the education first
>
> **SVP Global Rewards, Consumer Healthcare**

This tends to be aligned with a view that sees inclusion of ESG metrics as providing a strong incentive for undertaking particular actions that employees may not have carried out otherwise.

> Philosophically it is an incentive and about motivating people to hit stretching targets
>
> **Group Head of Reward, Alcoholic Beverages**

But it was more common for pay to be seen as second order compared with other interventions to develop the right culture relating to ESG.

> It ranks pretty low down. Good employees will deliver similar results regardless of what is in their incentives
>
> **Remuneration Committee Chair, Winemaking**

> A bit of both…a bit of stretch may help persuade our leaders go the extra mile, but in the end, they will always do the right thing
>
> **Head of Reward, Retailing**

These interventions include training and education, town hall meetings, building line manager capabilities, podcasts, newsletters, leadership blogs, trade union forums, face to face leadership briefings and team meetings. Some use an engagement survey incorporating specific questions on ESG.

Virtually all ensure that it is part of business as usual. This includes incorporating ESG into wider business performance processes that go beyond pay. If the CEO is challenging business unit leaders on their performance of ESG goals alongside the financials, then the message quickly gets home.

> We ensure it is part of our normal business performance processes. ESG is a core component of our business planning cycle
>
> **Group Reward Director, Electrical Equipment**

Ensuring strategic alignment

The incentive arrangements must be aligned with the company's purpose, values and business strategy. Incentives are part of the company's organisation design, which covers tangible aspects of life at work such as remuneration, hierarchy, and job design, together with intangible or informal aspects, such as the psychological contract and sources of pride. Companies need to ensure that how they use incentives is aligned with what they value as a company, the behaviours expected and their business strategy.

> "
>
> Ensure there is alignment between the company's purpose and how people are paid. You also need to hire people with the right mindset that aligns with your company culture
>
> **Chief Business Development Officer, Food Ingredients Supplier**

An example of this practice may be considered through how companies responded to the question of whether ESG metrics in pay form a reward or incentive. Those considering it a reward (i.e. an ex-post discretionary payment for good performance) tended to emphasise values such as collaboration and teamwork, which translated to having the same ESG metric in bonuses across the organisation.

> "
>
> We have the enterprise-wide ESG measures across the global leadership team, and they have really rallied around this
>
> **Chief People Officer, Manufacturing**

Those considering it an incentive (i.e. an ex-ante commitment to a payment if certain performance is achieved) tended to emphasise innovation, agility, and entrepreneurialism. This translated into more individual incentives and pay-for-performance at a senior level.

> "
>
> Critical really is creating the culture where all this matters and showing the ROI from focusing on it
>
> **SVP Total Rewards, Food Processing**

The importance of engagement

Many of the senior leaders we spoke to emphasised the importance of engaging with employees on the development of ESG strategy and associated pay strategies. But few had done it, and many spoke with regret that they had not done more.

> In retrospect, I would have done more engagement with employees to understand what matters to them and engage them in the incentive design
>
> **Chief People Officer, Manufacturing**

The lack of engagement perhaps arises from an overly technical approach to reward design, focussing on the specific features of the pay plan rather than the context in which it will be introduced. Without understanding of how the plan and metrics work, and how these link to strategy, the impact of linking pay to ESG will be limited. Engagement and communication are critical.

> Insufficient participant understanding is a massive barrier to achieving what we want from having ESG metrics in incentives
>
> **Group Head of Reward, Alcoholic Beverages**

By contrast, those that viewed incentives as a trigger for extensive engagement were more likely to trigger a virtuous circle of improved understanding, motivation, and action.

> It is vital to have clarity on the direction of travel and what we want to achieve. We encourage dialogue as we don't want employees to just focus on getting the numbers as that is tactical and misses the strategic intent
>
> **Group HR Director, Public Services**

7. Doing it well

The rich insight we have gained from our surveys and interviews reinforces our practical experience working with organisations looking to link pay to ESG: it is much easier said than done. We are, however, able to draw lessons from our study, identifying five key recommendations for companies wanting to integrate ESG into reward strategy in an effective way.

Tell the story, linking to strategy

Employees and other stakeholders need to understand how ESG goals link to the company's strategy and priorities. Without this alignment, goals will lack credibility internally and externally.

> We start with education because everyone starts from a different place
>
> **Head of Sustainability, Aerospace**

Pay design must follow development of the strategy rather than seek to lead it. Accordingly, the incentive arrangements must be aligned with the company's purpose, values, and business strategy rather than with the latest demands of external stakeholders.

The story-telling aspect of successful integration of ESG into reward strategy was a distinctive theme of our discussions with senior leaders.

> It all boils down to the messaging…the key thing is for the organisation to be really clear on why they have ESG metrics in the first place and how they can influence the outcome. There are still frustrations our pay practices are too complex
>
> **Global Head of Reward, Banking**

A clear narrative that aligns incentive arrangements with the company's values, purpose, and strategy helps to secure employee buy-in and understanding. But it is just as relevant to external stakeholders, such as investors, who are keen to understand how ESG goals align with strategy and financial performance.

Lead with culture, support with pay

Our interviewees were unanimous that it is culture, not pay, that drives sustainable behaviour in support of ESG strategies. Pay must be seen as the enabler of culture, not the sole driver of it.

> Culture is what turns things around, not pay
>
> **SVP Global Rewards, Metals and Mining**

Culture can be destroyed by incentives, but is rarely made by them. Instead, culture is reinforced by a range of initiatives such as training, performance management, recruitment and promotion, all of which must be carefully designed to support the desired outcomes.

> There needs to be alignment between the incentive arrangements and related HR processes, such as resourcing, talent management and performance management
>
> **Group Head of Reward, Consumer Staples**

And of course leadership is vital, with the CEO standing up as a role model for the right behaviours.

> “
>
> Key to gaining traction is that the CEO is engaged and pushing the topic
>
> **Chief HR Officer, Financial Services**

Pay is an emotive topic and navigating through multiple stakeholders can feel overwhelming. It is a complex topic with different views, and so businesses must play their own game to be credible – there is no silver bullet. Ultimately what many senior leaders said they want to see is their employees behaving responsibly and empowered to do the right thing. ESG metrics in pay may support that goal, but also may not be the best, or only, solution. This is where effective sponsorship and a fully engaged board can help ensure the right decision is made for the business, and not simply to satisfy a dominant stakeholder or follow a trend.

> “
>
> You cannot satisfy everyone and shouldn’t try to
>
> **Chief HR Officer, Financial Services**

Engage, communicate, empower

Engaging employees in development of the strategy increases ownership of the goals. Employees need to understand how they can influence ESG goals and must be given the tools and freedom required to do so.

A lesson from our interviews with senior leaders is that you cannot engage or communicate too much. Almost uniformly the organisations we spoke to regretted that they had not communicated more.

> In an ideal world you would engage employees on the incentive plan design as it helps with buy-in. It is good to use employees as a sounding board, but we have not done that very successfully in the past
>
> **SVP Global Rewards, Consumer Goods**

A minority of companies directly ask their employees what ESG issues matter most to them, and similarly only a small number engage employees in the development or design of incentive plans. Those that do engage, see the value of linking delivery on the ESG agenda with their corporate purpose.

> We have done a lot of work on our purpose with focus groups, and employees are empowered to ensure they do the right thing
>
> **Group Reward Director, Consumer Goods**

One senior leader spoke about extensive involvement that included a series of 8 to 10 panels comprising employees and board members in which feedback was requested on the proposals and what they wanted from their own pay.

Another company uses a dedicated intranet platform on which employees can raise issues or concerns on ESG.

Engaging the wider workforce in pay plan design

A major Retailer adopted an inclusive approach to determining the appropriate design for linking ESG to pay for executives. This included asking for feedback from both executives themselves and employees across the organisation (who would not be personally impacted). Board members hosted around eight to ten listen and learn sessions in which employees gave feedback on proposals and articulated what they wanted from their own pay. There were also one-to-one meetings with executives and group sessions when there was a strawman to evaluate. The engagement from employees was very strong, and in particular the large demographic of young people in the firm helped promote a sense of urgency to the exercise as they are particularly concerned with the environment and society. ESG metrics are being introduced to executive pay for the first time this year in the annual incentive with a 25% weighting.

Build capability and collaboration

Integrating ESG into pay requires, at least, close collaboration between HR and sustainability functions – and it might also require new capabilities in both.

> We have recently created and hired a new role of VP ESG
>
> **VP Total Rewards, Biotechnology**

Many senior leaders spoke to the need for developing close collaboration and engagement with colleagues in other functions and departments. In particular, close working with the sustainability team is required to develop appropriate targets for incentives (analogous to well-established collaboration with finance on financial targets).

More generally, when considering the implementation of any new pay practice linking to ESG, companies may find it beneficial to develop a cross-functional advisory group comprising representatives from major functions who can provide feedback on proposals, offer an ear to the ground on what employees are thinking, and act as advocates for change.

> Sustainability colleagues need to be in the camp and the conversation from the beginning
>
> **Group Reward Director, Electrical Equipment**

Governance oversight of target setting and measurement might need to evolve to enable appropriate input from sustainability committees into the remuneration process.

Maintain a focus on value

History tells us that good ESG performance can't be an excuse for not creating value. The best organisations capture the symbiosis between ESG and long-term financial performance, and pay arrangements need to reflect that.

Investors do care about ESG objectives, but mostly as a route to creation of long-term value, and they expect ESG performance to be combined with strong financial results.

> We are at a stage where we believe ESG drives shareholder value, but investors will still want to see we are hitting our numbers
>
> **Remuneration Committee Chair, Consumer Products**

A number of senior leaders commented on tensions between needing to be commercially successful while at the same time protecting the environment and other stakeholder issues.

> At the end of the day, we still need to make commercial decisions but focus on how to empower our leaders and teams to do the right thing. Employees recognise we have a role to play in society and communities that is broader than just our financial results
>
> **Chief HR Officer, Banking**

A senior leader in the Utilities sector quoted analysts who said that having ESG metrics in incentives doesn't provide much upside, but perhaps helps with value preservation through enhancement of reputation.

Given these trade-offs, most people we spoke to were realistic on the need to temper pay-outs on ESG goals when financial performance was weak.

> It seems that it is only ok to pay for ESG when the financials are strong. If you have a bad year financially then there will be an expectation you do not pay for non-financial aspects
>
> **Chief HR Officer, Banking**

8. Conclusion

Our study of the views of investors and senior leaders globally on the topic of linking pay to ESG has revealed rich insights.

Widespread support for linking pay to ESG

The momentum towards the practice seems unstoppable. Over three quarters of senior leaders who participated in our survey said that their pay is already linked to ESG targets in some form. And most investors and senior leaders believe this is how it should be: that pay should be linked to ESG in most companies. There are reasons not to link pay to ESG, which we have covered in this report. But increasingly it seems that the relevant question is moving from whether to do it, to how to do it well.

The prevalence of, and support for, linking pay to ESG varies a bit by geography and ownership structure, but not a lot. Indeed, the extent to which the practice is uniform is probably more interesting than the differences. Senior leaders in the US, often portrayed as a laggard when it comes to ESG, were just as likely to report having ESG targets in pay as were senior leaders in more 'progressive' European countries. The ideas that private equity doesn't care about ESG or that family-owned businesses care about it more than anyone were similarly debunked. The importance of ESG, and the practice of linking it to pay, was reflected fairly uniformly across the board.

Areas of agreement suggest the practice is here to stay

Investors and senior leaders agree on quite a lot.

They agree that a focus on ESG factors will generally lead to long-term improvement in financial performance and shareholder value.

Perhaps as a consequence, majorities of both agree that pay should be linked to ESG in most companies. They also agree on the reasons for doing this. It helps executives focus on short-term and non-financial factors that lead to long-term shareholder value but may conflict with short-term profit. It signals to employees and external stakeholders the importance of ESG factors to the company. And it imposes discipline by forcing companies to set short-term targets towards longer-term ESG aspirations, for example net-zero commitments made for decades into the future.

Investors and senior leaders are also broadly aligned on what weighting should be applied to ESG targets in incentives: 10% to 20%. Although investors are more likely to push for the higher than lower end of the range.

These areas of strong agreement suggest that linking ESG to pay is not a flash in the pan or a passing fad. It looks like it's here to stay, at least for the medium term.

Areas of disagreement provide insight on some key issues

But investors and senior leaders don't agree on everything, and the areas of disagreement yield important insights.

First of all, they seem to prioritise different ESG metrics. Senior leaders are focussed on the metrics most directly linked to business performance and value creation. These are metrics relating to employees, customers, or innovation. By contrast, investors are more focused on metrics relating to big societal issues of the day like climate change and diversity.

Some of this difference may simply be explained by different perspectives. Senior leaders are accountable for individual company performance, and often receive the strongest feedback on their responsible business practices from customers and employees. By contrast, investors have to consider overall portfolio returns not just what is best for individual companies. And they are under pressure from asset owners and regulators who are trying to use the finance system to fix society's ills.

But there's also a concern that investor focus on so-called systemic issues is a cover for a one-size-fits-all and box-ticking approach to ESG that helps with the asset manager's reputation and asset gathering but pays insufficient regard to company-specific issues and strategies. This tension certainly came out in our interviews.

There is also disagreement on how incentives act to enhance integration of ESG into strategy. Investors believe that ESG metrics act like any other: you get what you pay for. Pay is therefore seen as an important primary driver of ESG. Including ESG targets in a bonus acts as a necessary counterbalance to profit and other short-term financial targets.

By contrast, senior leaders see pay as one part of a complex network of interventions to create the right culture; and it is the culture, not the pay, which will be the primary driver of successful integration of the ESG strategy into business operations. Pay therefore needs to follow strategy, and at the right time. Premature linkage of pay to ESG, when metrics and measurement are immature, can be counterproductive. Poorly designed incentives can also undermine a broader culture. In some companies, the culture around ESG may be viewed as sufficiently well engaged to render the link to pay redundant or even counter-productive.

This understanding of the nuances of driving change in complex organisations, and the potential unintended consequences of linking pay to ESG, may explain why senior leaders are more circumspect than investors about the practice. While support for the practice in most companies amongst the investor community is, at over two-thirds, very strong, nearly half of senior leaders disagree. More than one-third would prefer that the practice of linking pay to ESG is focussed on the minority of companies with the most material ESG issues.

Doing it well means focussing on much more than pay

Our interviews with senior leaders, who have grappled with how to integrate ESG into strategy, suggest five important lessons if pay is to support the integration of ESG strategies into the day-to-day operation of the business.

Tell the story, linking to strategy. Employees and other stakeholders need to understand how ESG goals link to the company's strategy and priorities. Without this alignment, goals will lack credibility.

Lead with culture, support with pay. It is culture, not pay, that drives sustainable behaviour in support of ESG strategies. Pay must be seen as the enabler of culture, not the sole driver of it.

Engage, communicate, empower. Engaging employees in development of the ESG strategy increases ownership of the goals. Employees need to understand how they can influence ESG goals and must be given the tools and freedom required to do so.

Build capability and collaboration. Integrating ESG into pay requires, at least, close collaboration between HR and sustainability functions – and it might also require new capabilities in both. Governance oversight of target setting and measurement might need to evolve to enable appropriate input from sustainability committees into the remuneration process.

Maintain a focus on value. Good ESG performance can't be an excuse for not creating value. The best organisations capture the symbiosis between ESG and long-term financial performance specific to their company, and pay arrangements need to reflect that.

If there's a common theme across these recommendations it is this: that integrating ESG into the business is about much more than pay. Pay design, and making the right choices of metric, pay vehicle, weighting, and performance scale is important. But as a tool for influencing culture and behaviour it will fail unless placed within a broader context of change and building of the appropriate capability to execute.

While some of this is applied common sense, it is often disregarded, to the regret, we found, of some of the senior leaders we interviewed. Perhaps the most commonly cited, but least implemented, recommendation related to the importance of employee engagement and communication relating to the choice of ESG goals. Engagement and communication are always important. But they are particularly so in the area of ESG strategy. This is because implementation of an ESG strategy is often seen as adding value through enabling talent acquisition and retention by addressing employee desires to work for a company that is seen to 'do the right thing'. Disregarding employee views on how the strategy is designed and implemented is therefore to fall at the first hurdle.

Remember why you're doing it

Underpinning successful linkage of ESG to pay is being clear on why you are doing it. What is the purpose of the ESG strategy, how does it create value, and how does the link to pay support its execution? The world of ESG is populated by special interests with loud voices, which can create an environment of corporate reactivity rather than proactivity. While this can't be entirely ignored, it is important to retain a strong focus on what you, as a leader in your organisation, are trying to achieve. Ultimately, this is the long-term sustainable success of your business.

There is continuing debate about the extent to which ESG and long-term value is aligned. But what is clear, is that it is difficult for a business to be sustainably successful without treating its stakeholders and the environment with respect. And equally so without creating long-term value for its shareholders.

The linkage of ESG to pay must reflect both.

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