ESG and Compensation

Use Compensation to Advance ESG Initiatives

By Tracy Glassel and Jim Wolf

Directors should take a close look at how their companies can use compensation to advance an environmental, social, and governance (ESG) strategy. A key to ESG oversight is the board's examination of how compensation reflects and advances the company's commitment to ESG goals. Investors and other stakeholders package a broad range of nonfinancial topics under the collective umbrella of ESG initiatives. These topics include:

- **Environmental**: Climate change, greenhouse gas emissions, water conservation, and energy conservation.
- **Social**: Human rights standards, pay equality, diversity and inclusion, and a living wage.
- **Governance**: Board diversity, executive compensation, board declassification, and proxy access issues.

Boards typically assume broad oversight of ESG strategies and commitments, while management teams drive specific objectives. Even within their oversight function, boards and compensation committees should consider the roles pay can play when setting high-priority ESG strategies.

Compensation's Dual Roles

Compensation typically plays one of two roles in an ESG strategy:

- **Compensation as the chosen ESG cause to advance**. Some noteworthy ESG causes focus on compensation "fairness," such as pay equity among genders and ethnicities, decreasing the income gap between executives and workers, and the provision of a living wage across the entire employee base.
- **Compensation as the proof of ESG commitment**. Stakeholders may not find an ESG commitment credible unless compensation is tied to the outcome. Companies can tie almost any ESG objective to publicly disclosed executive compensation to prove commitment to the chosen goals.

What to Consider

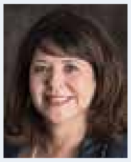
Before setting pay-related ESG strategies, boards should:

- **Select the most relevant topic(s) to your company**. Companies often start with a single issue that garners scrutiny. For instance, a retailer with a sizeable minimum-wage workforce might focus on how it provides a living wage for its workers. An energy company might focus on improving a specific environmental metric. Technology companies might focus on data privacy or gender pay equity in the workforce.
- **Understand what metrics you can measure**. Companies may not yet have the systems or processes they need to measure certain metrics. For example, in order to establish pay equity, a company might need centralized information on tenure, role history, individual performance, or past compensation. If current systems do not provide this information, the company might start with an easier comparison, such as pay for similar roles in a common location. Start with what you can measure today.
- **Set your own standards**. Many ESG areas lack commonly accepted standards to define success. The absence of a standard should not delay progress. A company should create its own standard—whether for pay equity, a living wage, or environmental performance—based on its position on these issues and the available information. Create the compelling disclosure story that demonstrates progress against your standard. An early start could even become a competitive advantage.

Outlined below are a few compelling examples of companies that have followed this road map. Each company focused on a specific ESG issue, established a standard, and used compensation to advance their ESG objective.

- **Living wage at Amazon.com.** In 2019, Amazon rolled out a new wage floor of $15 an hour to more than 250,000 full- and part-time employees. Amazon's public policy team is also advocating for an increase in the federal minimum wage.
- **Greenhouse gas emissions at Chevron Corp.** The board established greenhouse gas standards that will be a factor in determining compensation for executives and nearly all other employees beginning in 2019. Chevron will report on the annual achievement of methane and flaring performance in its 2020 proxy statement.
- **Diversity at Textron.** For the past decade, Textron has focused on improving diversity among its full-time US salaried workforce. The company proved its commitment with a specific metric in its annual bonus program that focused on greater diversity across company ranks.

As more companies formalize and communicate ESG initiatives, we expect that compensation's ties to ESG will become a more frequent discussion topic for compensation committees and the full board.

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