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Evaluating the Merits of ESG Metrics in Incentive Plans

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Steve Van Putten, senior managing director at Pearl Meyer, was interviewed about whether and how companies should include incentive plan metrics related to environmental, social, and governance factors.

Q: How have you seen companies implement an ESG metric in their executive incentive plan?

A: It absolutely varies by company. My clients span from smaller companies who recognize the importance of things such as diversity, equity, and inclusion, but for whom it hasn't risen to the forefront in compensation discussions. At the other end of the spectrum are very large companies with a culture that demands they be a leader in these areas.

One example is a progressive compensation committee, in partnership with the head of DE&I, that just this year implemented a scorecard with multiple elements as part of the short-term incentive program. We had discussions about what specific goals would show progress along a multi-year plan and carved out 15% of the STI.

Q: It seems the companies who are implementing incentive plans around ESG tend toward the short-term program. Is this what you're seeing?

A: That's right. In my example, we debated whether or not it should be part of the long-term incentive. I think we all recognize that ESG issues are typically multi-year objectives but it's not as easy to incorporate into a long-term incentive plan. There are exceptions, of course. Where I have seen it done as part of the long-term incentive plan is as a modifier to executive long-term incentive grant values, as opposed to a specific long-term incentive metric.

Q: What's your one piece of take-away advice for compensation committees having this and other ESG-related discussions?

A: Many companies are doing what I call "ESG Light" by incorporating ESG into an existing individual or strategic scorecard component of the annual incentive, comingled with other metrics. This is an easy and effective way to signal the importance of ESG. But they're getting some pushback and pressure from investors to be more specific and rigorous. We're advising our clients to look around the corner and anticipate what's coming next. My ultimate guidance to all clients in every situation, of course, is to focus on what makes sense for them and their circumstances.

About the Author

Steve Van Putten is a senior managing director with Pearl Meyer and leads the firm's efforts with respect to thought leadership and intellectual capital development. Steve's primary focus and expertise is on advising compensation committees and senior management on executive and director compensation matters. He has over 30 years of board-level experience consulting to Fortune 500 companies on executive pay.

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