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ADVISOR BLOG | JUL 2019

Diversity Goals in Executive Compensation Plans

Deb Lifshey

MANAGING DIRECTOR

A new ESG trend or simply a reaction to reputational risk?

In the past year, we have spent a lot of time thinking about whether and if ESG measures could or should be incorporated into executive incentive plans. We've discussed with our compensation committees and done research which led us to believe that while directors wanted to be educated on matters of ESG, there was little traction or interest in hard-wiring these measures into executive compensation incentive plans.

Things may now be taking a turn. This week Uber formally announced that it will begin to factor in whether it meets specific diversity targets when it calculates bonuses for its CEO and other top executives. Uber has stated this measure is part of an ongoing effort to increase the number of women and under-represented people in managerial roles. Prior to Uber going public, executive bonuses were generally based on company and individual performance as determined by Uber's compensation committee. Beginning in 2019, Uber adopted a more official "Executive Bonus Plan" to "create a direct relationship between key business performance measurements and individual bonus amounts." While the measures and weightings to be used under the plan are not yet public, Uber has indicated that a "significant" portion of the bonus will be based on achievement of diversity goals, and it will be one of only a "limited number" of metrics that will be used to determine bonuses for Dara Khosrowshahi (CEO), Nelson Chai (CFO), Tony West (General Counsel), and Nikki Krishnamurthy (Chief People Officer).

Uber is certainly not the first company to formally incorporate diversity goals into executive compensation programs. Microsoft and Intel disclose that 50% of executive annual cash bonuses are based on operational/strategic performance goals that include (among other things) diversity metrics (although we note we cannot tell from the proxy how much the diversity goal is weighted within a scorecard of measures). Johnson & Johnson and Facebook also reward employees and executives for very specific goals tied to diversity and inclusion.

It would be nice to think by hardwiring a "softish" ESG goal into executive compensation renders these companies as governance pioneers. However, the reality is that the facts and circumstances of the past few years have likely mandated the outcome. Uber has been struggling to overcome reputational damages sustained by former executives who were pushed out in 2017 after a run of scandals including allegations of sexism, harassment, and tolerance of poor behavior (not to mention the EEOC investigation into accusations of gender discrimination). Since then, Mr. Khosrowshahi has brought in a new executive team, hired a head of diversity and inclusion, and announced a new set of corporate values in an attempt to overhaul the company's culture.

Uber commissioned a report from Eric Holder, a former US attorney-general, who also gave advice to tie executive pay to diversity and inclusion metrics. Other technology companies recently incorporating diversity goals are also doing so in the wake of troubling statistics about the number of females and minorities in leadership roles at such firms.

The impact of incorporating a diversity goal into the executive bonus plan has yet to play out, but perhaps it will move the needle on progress more quickly. According to the data in Uber's diversity report, also released on Monday, there was a modest level of progress. For example, the percentage of women in leadership roles grew from 20.9% to 28% in the past year, although the largest percentage of women in US leadership roles are white. The amount of women in tech leadership roles, however, fell from 15.6% to 13.8%.

While it's clear that Uber's incorporation of an executive compensation diversity metric seems to be reactionary, it does appear to be part of a slow trend towards inclusion of ESG measures in incentive plans. What is less clear is how heavily this measure will actually be weighted in the annual bonus program, how impactful the measure is (as historically the annual bonus is small compared to Uber's long-term compensation elements), and most importantly, how and if incorporation of the goal will actually spark accelerated improvement in Uber's next diversity report.

About the Author

Deborah Lifshey is a managing director at Pearl Meyer, where she specializes in advising clients on compensation matters from a legal perspective including securities disclosure, taxation and corporate governance issues, negotiation contracts, and reasonableness opinion letters.

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