



# Aligning Pay, People and Planet

Executive Compensation and Sustainable Value Creation

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**Diligent Institute**

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# Executive Summary

Environmental, social and governance (ESG) factors have gained traction and visibility over the years not only among investors and stakeholders but also governments and regulators. This has led to increased pressure for companies to incorporate ESG policies and measures into various parts of their businesses. The paper evaluates the current state of inclusion of ESG key performance indicators (KPIs) in executive remuneration policies across companies in various sectors in the European Union.

In this paper, we analyse implementation of ESG KPIs in the remuneration policies, look at which metrics are more popular and whether the companies prefer to implement ESG measures as part of short-term or long-term awards.

## Methodology

To better understand current practices, we worked with the research team at [CGLytics, a Diligent Brand](#), to analyse data on the ESG KPIs in executive remuneration, mainly focused on the EU companies in the CGLytics database — namely, Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom (UK). Data from 1,914 companies was analysed for this report.

# Key Takeaways

- The percentage of companies incorporating ESG metrics in executive compensation plans in the EU has increased from 4% in 2008 to 34% in 2020.
- The sectors with the highest percentage of companies incorporating ESG metrics in executive compensation are the energy and utilities sectors, with 59% and 64% of companies incorporating ESG metrics. The health care sector has the least representation, with 22% of companies incorporating ESG metrics.
- In the EU, our data suggests that companies are far more likely to incorporate environmental (E) and social (S) metrics over governance (G) metrics.
- ESG metrics are more frequently prevalent in the short-term incentive (STI) annual bonus component of variable compensation, relative to long-term incentives (LTI).

# Introduction

2020 was a landmark year for the proliferation of environmental, social and governance (ESG) matters and the need for companies to pledge to ESG issues while integrating them into their core values. The pressure from various stakeholders has risen as a result of the COVID-19 pandemic and increased attention to social injustice. Due to this, companies are focusing on their remuneration policies as a tool to incentivise their executives to achieve better results on sustainability.

With focus and discussions around ESG ramping up in recent years, institutional investors are also formulating opinions and requests on how companies can improve their ESG strategies and bring them in-line with regional and international standards. Now that we see mounting [evidence](#) showing that positive ESG results can drive long-term value for shareholders, more companies are expected to include ESG metrics in their remuneration policies<sup>1</sup>.

Choosing appropriate ESG metrics to include in executive remuneration is a challenging task and requires deep understanding of which metrics matter the most for each company, depending on location, industry, size and a host of other factors. To help the company drive long-term value, such measures should reflect ESG topics that are relevant for the company and have the greatest impact on the business. Furthermore, the company should consider how measurable and reliable the indicators it chooses are and whether short- or long-term plans are the most appropriate solution.<sup>2</sup>

Even with the challenges associated with creation of remuneration policy tied to ESG factors, many companies in the EU have already included environmental (E), social (S) and governance (G) performance indicators in executive remuneration plans, and expansion of this trend is expected in the future.

1. The link between ESG and performance, ROBECO, September 1, 2019, [robeco.com/en/insights/2019/01/the-link-between-esg-and-performance.html](https://robeco.com/en/insights/2019/01/the-link-between-esg-and-performance.html).

2. Sullivan, Kristen and Maureen Bujno, Incorporating ESG Measures Into Executive Compensation Plans, May 24, 2021, [corpgov.law.harvard.edu/2021/05/24/incorporating-esg-measures-into-executive-compensation-plans/](https://corpgov.law.harvard.edu/2021/05/24/incorporating-esg-measures-into-executive-compensation-plans/).

# ESG Performance Measures in Executive Compensation

Increasing pressure to implement ESG KPIs in executive compensation comes from various external sources — shareholders, regulators and proxy advisors, among others. In the European Union, implementation of the [Shareholder Rights Directive II](#) increased transparency of remuneration policies and mandated say-on-pay votes. Such development of the Union-wide regulation allowed investors to intensify expectations for alignment of executive pay and ESG matters and express such expectations with a vote.<sup>3</sup>

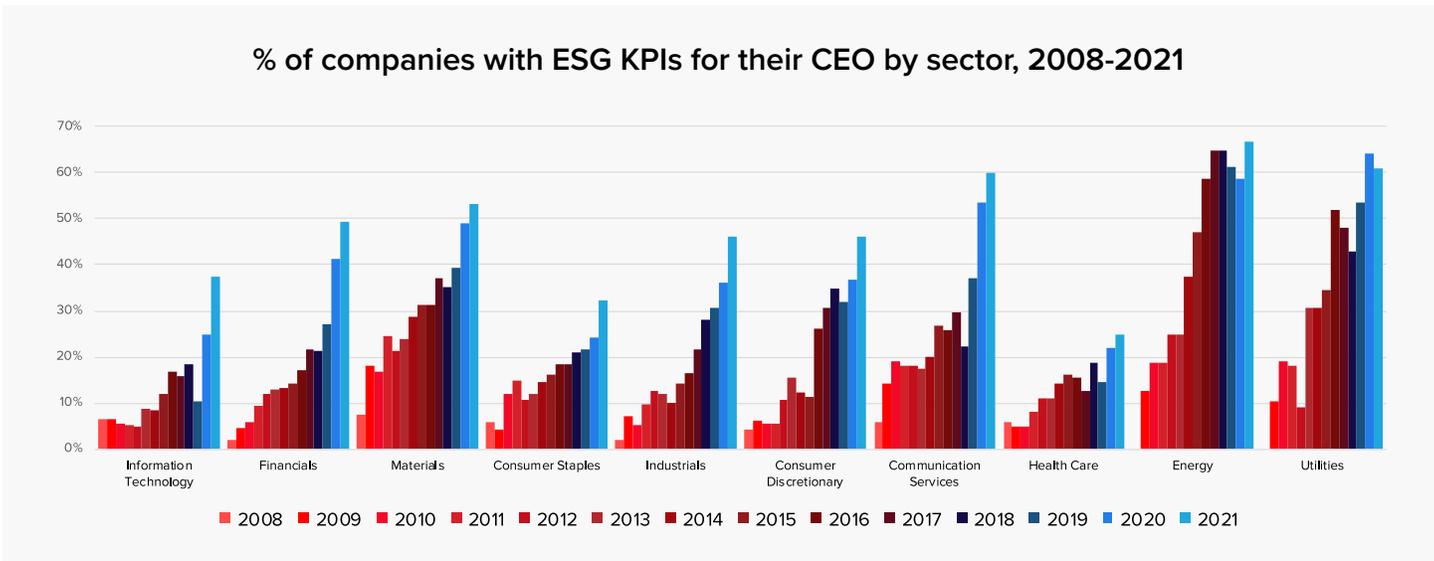
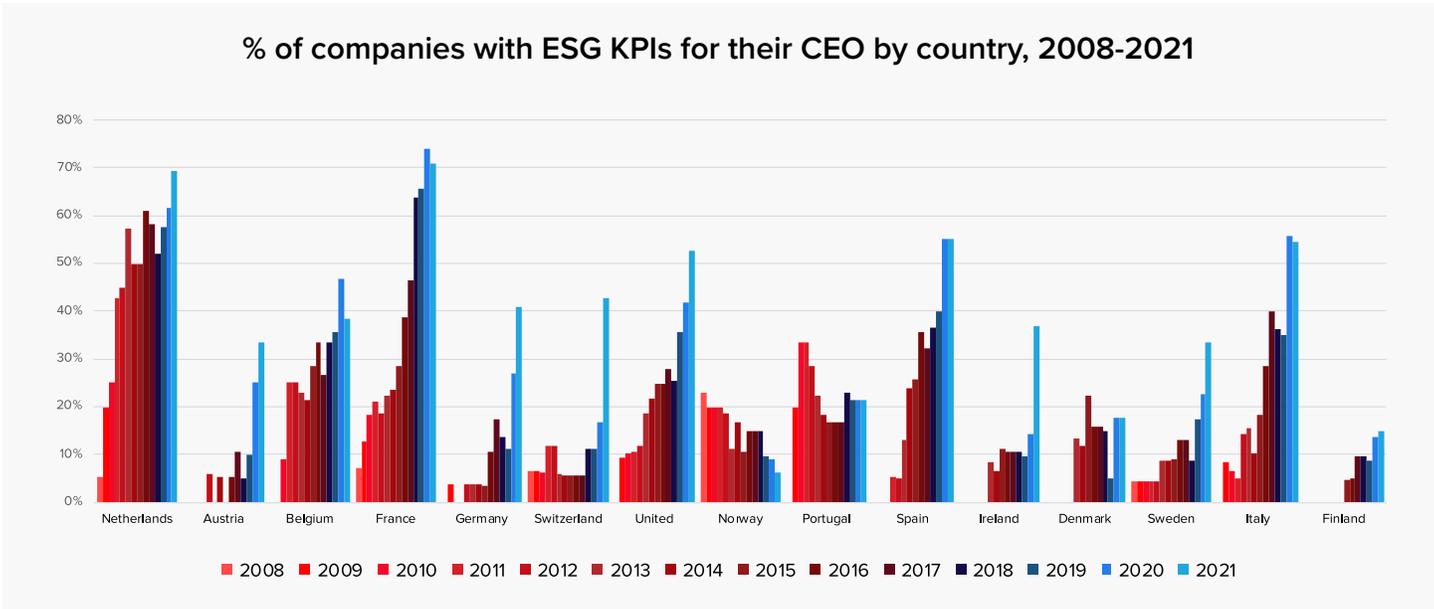
We have explored how European companies have incorporated ESG metrics into their remuneration KPIs from 2008 to 2021. Our findings suggest that the number of companies that have introduced ESG performance metrics has increased significantly. Overall, we see that the percentage of companies incorporating ESG metrics in executive compensation plans has increased from 4% in 2008 to 34% in 2020, on average across Europe. In 2021, 39% of companies in our sample are expected to implement ESG KPIs.

## France leads with the highest number of companies incorporating ESG metrics in executive compensation

Individual EU member states have been developing ESG-related regulations. For example, [the Corporate Governance Code of Listed Corporations in France](#) suggests executive remuneration policy include “one or more criteria related to social and environmental responsibility.”<sup>4</sup> Unsurprisingly, our data suggests that the country with the highest percentage of companies with ESG measures incorporated in the remuneration policy is France, where 74% of companies have incorporated ESG metrics in executive pay in 2020. The country with the least representation is Norway.

3. Human, Tim, Making it meaningful: How European companies are linking ESG and executive pay, March 30, 2021, [irmagazine.com/esg/making-it-meaningful-how-european-companies-are-linking-esg-and-executive-pay](https://irmagazine.com/esg/making-it-meaningful-how-european-companies-are-linking-esg-and-executive-pay).

4. Corporate Governance Code of Listed Corporations, AFEP-MEDEF, January 2020. Accessed on [ecgi.global/node/8445](https://ecgi.global/node/8445).



Our analysis shows that the sectors with the highest percentage of companies incorporating ESG metrics in executive compensation are the energy and utilities sectors. In the 2020 financial year, 64% of companies in the utilities sector and 59% of companies in the energy sector had incorporated ESG metrics in their compensation policies. The health care sector had the least representation, with about 22% of companies with ESG metrics in 2020 reports.

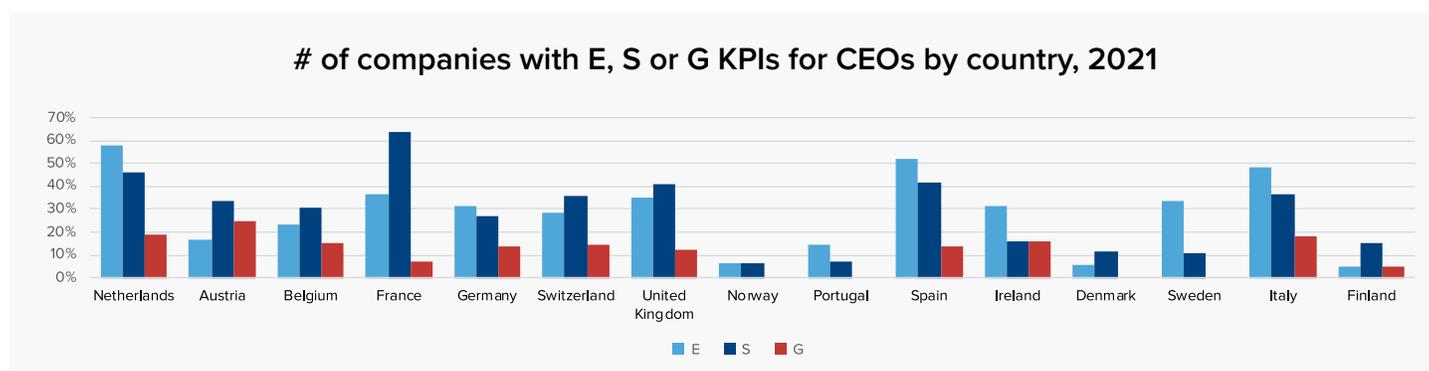
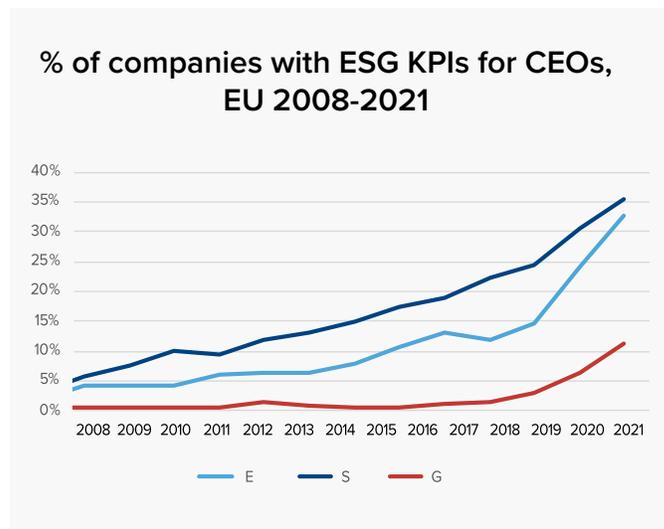
Historically, energy and utilities sectors have been incorporating ESG and health and safety measures into executive pay due to higher environmental impacts on company operations and stronger pressure from stakeholders. Greater focus on ESG matters is used by industrial companies to manage risk and increase shareholders' trust.<sup>5</sup>

5. ESG and Executive Compensation: Hearing from board members globally, Willis Towers Watson, 2021.

# Within ESG Metrics, Social Metrics are Popular

In the EU, our data suggests that companies are more likely to incorporate E and S metrics over G metrics. This is in-line with our recent [report on the ASX](#), in which the data suggested that social metrics are much preferred in executive compensation plans.

The average inclusion of the former metrics in 2020 was 24% and 30% respectively compared to 6% for the latter. For 2021, we expect the average percentage of companies including Environmental & Social related metrics to increase to 33% and 35% respectively. Percentage of companies linking Executive compensation to Governance related metrics will also climb to 11% in 2021.



We expect the Netherlands to have the highest percentage of companies incorporating environmental KPIs in executive compensation in 2021, with about 58% of all companies in the country having environmental metrics. In 2020, Spain had the highest share of implementation of environmental metrics, at 52% of all companies. France, on the other hand, leads with the highest percentage of companies incorporating social metrics in CEO executive pay plans and structure, with 64% of companies expected to have social metrics in 2021. Italian companies have showed the highest implementation rate for governance metrics, with 18% of companies including such measures in 2020 remuneration reports.

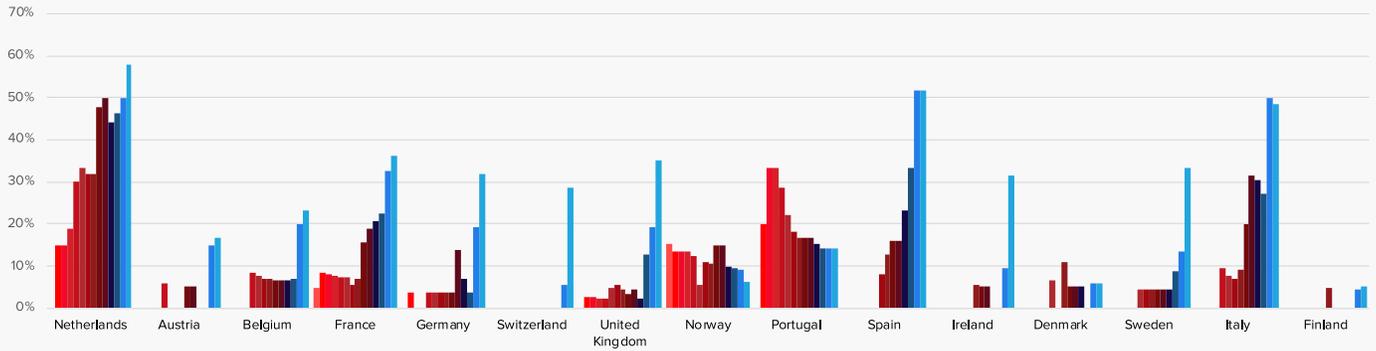
In 2020, social and environmental issues gained even more attention than usual as a result of the COVID-19 pandemic and its impact on workforces and economies around the world. According to a board member survey conveyed by Willis Towers Watson, a majority of directors believe that these developments have accelerated ESG priorities for companies.<sup>6</sup> Further research shows that metrics related to diversity, equity and inclusion are dominating the ESG performance indicators in executive compensation policies.<sup>7</sup>

6. ESG and Executive Compensation: Hearing from board members globally, Willis Towers Watson, 2021.

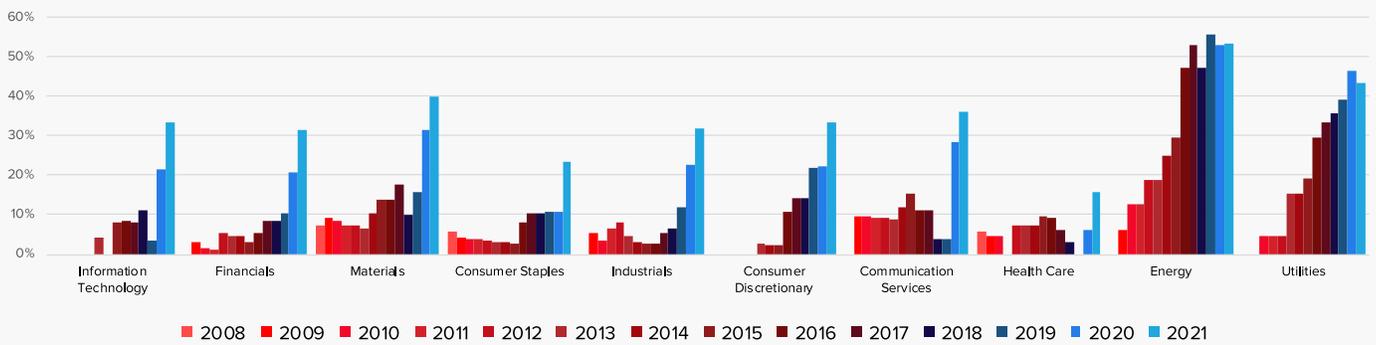
7. Sullivan, Kristen and Maureen Bujno, Incorporating ESG Measures Into Executive Compensation Plans, May 24, 2021, [corpgov.law.harvard.edu/2021/05/24/incorporating-esg-measures-into-executive-compensation-plans/](https://corpgov.law.harvard.edu/2021/05/24/incorporating-esg-measures-into-executive-compensation-plans/).

ESG

% of companies with Environmental KPIs for CEOs by country, 2008-2021

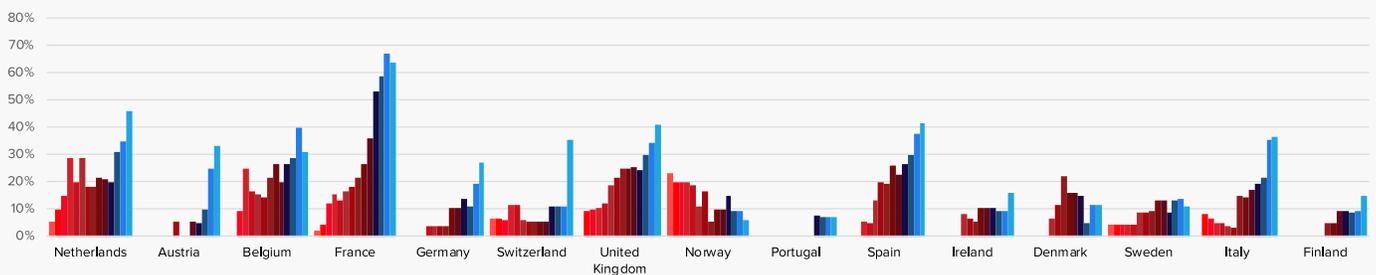


% of companies with Environmental KPIs for CEOs by sector, 2008-2021

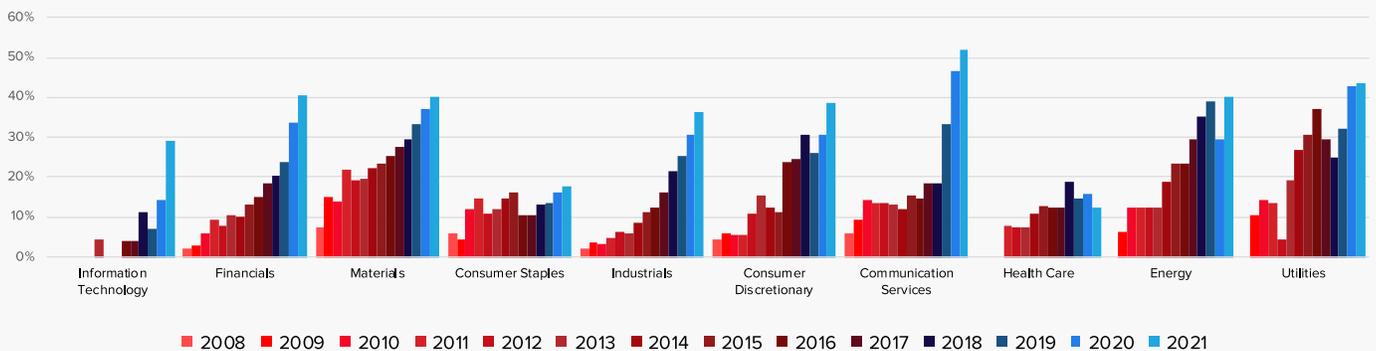


ESG

% of companies with Social KPIs for CEOs by country, 2008-2021

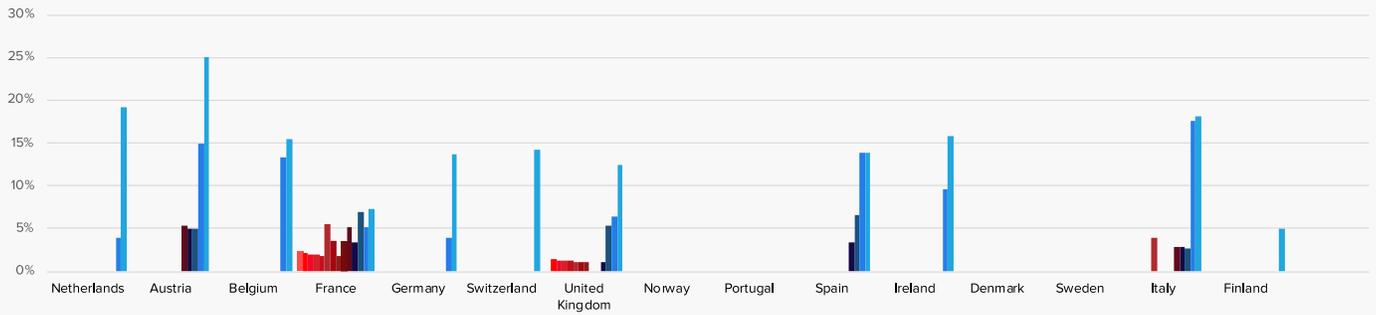


% of companies with Social KPIs for CEOs by sector, 2008-2021

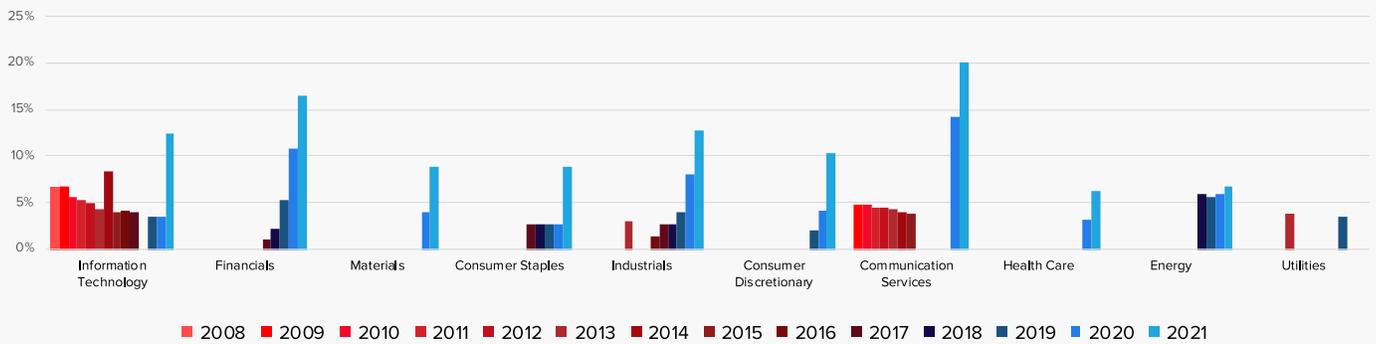


ESG

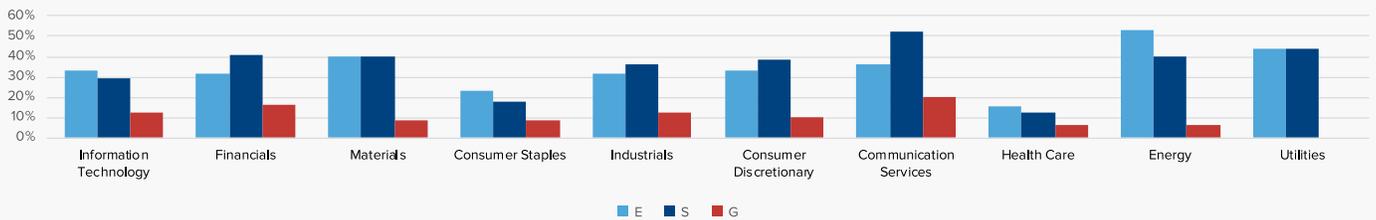
**% of companies with Governance KPIs for CEOs by country, 2008-2021**



**% of companies with Governance KPIs for CEOs by sector, 2008-2021**



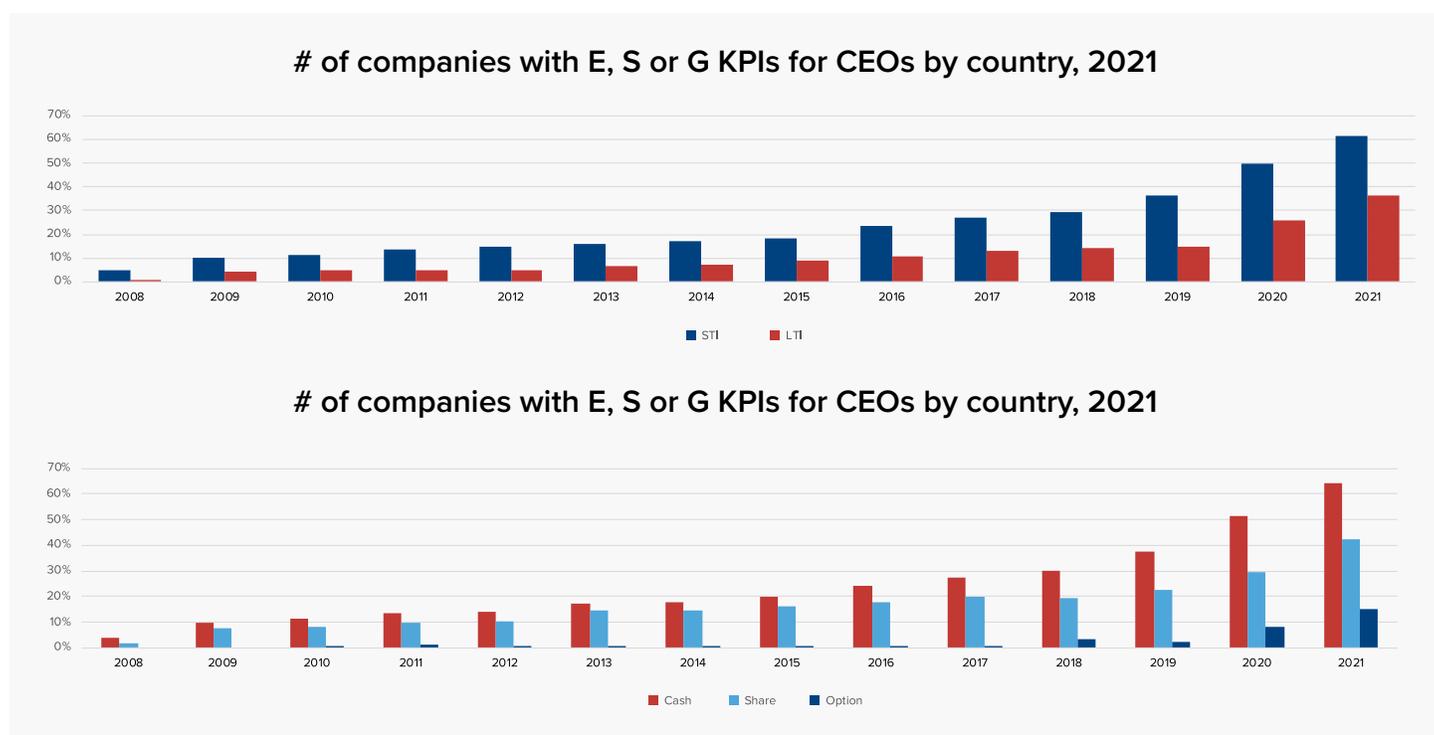
**# of companies with E, S or G KPIs for CEOs by sector, 2021**



Unsurprisingly, our data suggests that the sector with the highest representation of companies incorporating environmental metrics is the energy sector. 53% of companies in the sector have environmental KPIs in their remuneration policies. We also find that the communication services sector leads the incorporation of social and governance metrics. 52% of the companies in the sector have social metrics in their KPIs, and 20% of companies in the sector have governance metrics. The health care sector has the least representation of companies with both E and S measures. The utilities sector also has no companies incorporating G metrics in pay plans. The health care sector has 6% of companies incorporating G metrics in their pay plans.

# ESG Metrics in Executive Compensation Likely to Be Short-Term Focused

Our data and findings suggest that ESG metrics are more prevalent in the short-term incentive (STI) annual bonus component of variable compensation, relative to long-term incentives (LTI). While ESG metrics in both components are growing, the growth in LTI is expected to be faster in 2021. Currently, 50% of companies in the EU have ESG metrics in the STI (annual bonus), and this is expected to grow to 62% in 2021. From the sample space, 26% of companies also have ESG metrics in their LTI pay plan, which is also expected to grow to 36% in 2021.



When examining payment instruments, we also found that cash plans are likely to have more ESG metrics compared to shares and options. Sixty-four percent of cash instrument–settled plans have ESG metrics, compared to 42% and 15% of shares and options, respectively.

Prevalence of inclusion of ESG metrics in the short-term plans can be explained in several ways. Formation of long-term performance indicators based on ESG metrics can be challenging for companies. Such goals should be tied to the company’s sustainability vision while not being too vague. Some ESG targets, for example related to employee health and safety, can be successfully implemented as part of the annual bonus. Nevertheless, inclusion of ESG metrics in long-term plans is expected to increase in the near future, reflecting companies’ commitments to sustainable development and social justice.<sup>8,9</sup>

8. O’Connor, Phillippa, Lawrence Harris, and Tom Gosling, Linking executive pay to ESG goals, June 29, 2021, [pwc.com/gx/en/issues/reinventing-the-future/take-on-tomorrow/download/Linking-exec-pay-ESG.pdf](https://www.pwc.com/gx/en/issues/reinventing-the-future/take-on-tomorrow/download/Linking-exec-pay-ESG.pdf).

9. ESG and Executive Compensation: Hearing from board members globally, Willis Towers Watson, 2021.

# Conclusion

Continuous public debate on ESG is leading to countries worldwide addressing the issue on the legislation level, investors and regulators applying pressure, and companies themselves developing internal policies and incentives for higher management to follow businesses into a more sustainable direction.

The data and analysis performed in this paper show that the number of companies across the EU including ESG metrics in their remuneration policies has been growing, and accounted for around a third of all companies in Europe in 2020. Such trends are expected to further develop, with more companies adding environmental, social and governance measures as incentives for executives to lead the company into doing business more responsibly. We have seen some countries in Europe developing corporate governance regulations that focus on ESG indicators in remuneration. Similarly, EU-level regulations relating to say-on-pay and remuneration policy transparency help to develop compensation policies with better focus on sustainability.

Environmental and social indicators have been used by companies more often than governance measures. Global events that shape the development of economy and society can also influence which ESG measures companies decide to emphasise in their policies. With the global COVID-19 pandemic, social measures have been especially important, which is reflected by the inclusion of indicators related to human capital by many companies. Discussions and pressure from stakeholders around environmental topics, such as carbon neutrality and achievement of Paris Agreement goals, are likely to develop further and lead to more environmental measures in executive remuneration policies.

Finally, the paper discussed the difference between incorporation of ESG metrics into short- or long-term plans. Most of the companies in our analysis have chosen to add such indicators to annual bonuses. However, with the development of a better understanding of ESG measures and their design and impact on companies' value, long-term plans could include more ESG indicators. Inclusion of sustainability indicators in annual bonus or long-term incentive plans shows increasing awareness of ESG matters and development of related commitments from businesses.

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## Areas for Future Investigation

- What is the correlation between incorporation of ESG factors into executive pay and the sustainability development of companies? Are increases in ESG KPIs pushing the acceleration of responsible business development, or are such measures not enough?
  - Is incorporation of ESG factors into long-term awards leading to increased responsibility of businesses and growth of shareholder value? Does inclusion of ESG metrics in short-term awards have a similar effect?
  - How will future evolutions in the global market and society as a whole affect the development of ESG metrics?
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