Dos and don'ts of ESG-linked executive rewards

As environmental, social and governance (ESG) transformation becomes increasingly important, the trend towards rewarding executives for achieving ESG goals gains momentum in the corporate world.

Image source: Tanarat Kongchuenjit – 123RF.com

"South Africa is following suit with 93% of our Top 40 JSE-listed companies reporting they use ESG metrics for their shorter-term incentives (STIs) and 88% for their long-term incentives (LTIs)," says Martin Hopkins, executive committee member at the South African Reward Association (Sara).

This is according to a PwC publication titled *Executive directors: Practices and remuneration trends reportx, August 2022*.

ESG in South Africa

ESG is a framework for measuring the sustainability and responsibility of organisations in their quest for profit.

While the movement is not officially regulated in South Africa, it is supported by existing regulations and standards, like the King IV governance code and institutional investor requirements.

Corporate social responsibility has been around for decades, but ESG is getting an extra push from younger millennial shareholders, employees and other stakeholders who want to see real change in return for their investment and engagement with companies.

Most stakeholders currently want 15-20% of an executive's reward package to be contingent on ESG progress. According to PwC, although global ESG targets have a typical rating of 10-15%, South African companies trend closer to the upper 20% mark.

"Even so, if local businesses want to win future investment, the move towards formal ESG-based rewards, although not a legal requirement, is inevitable," says Hopkins.

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Dos and don’ts

Hopkins says there are several commitments organisations must make to ensure their ESG-linked reward structures are effective:

- DO make metrics quantifiable. Vague, qualitative measures are neither reliable nor convincing to stakeholders. Rather, they value concrete targets, milestones, timelines and progression, and a logical methodology to link such variables to performance.
- DO make metrics independently verifiable. Organisations should not only be able to articulate their ESG goals and rewards in real terms. They must also give assurance on their stated claims and chosen metrics through an independent body that is professionally qualified to validate both.
- DO ensure metrics are credible. Any rewards attributable to ESG transformation goals and metrics must be reasonably balanced with suitably stretching targets for their achievement. Overly generous bonuses for success and, likewise, overly lenient penalties for underperformance are easily detected by stakeholders.
- DO ensure metrics are proximate to the business. Rewardable ESG targets and associated measures must be important and relevant to the type of business. Cherry picking generic ESG goals, like reducing carbon emissions, simply because they are popularised in the media or preferred by stakeholders is less appreciated than selecting a goal that is more closely related to the business of the company.
- DO make ESG contribute economically. While it's good to reward executives for doing good, it's better when they are making money for their shareholders at the same time. ESG does not call on businesses to forego profits but to innovate around how to turn a profit responsibly, something which may also be woven into reward structures.
- DON’T "greenwash" or "bluewash". Never fabricate ESG outcomes by making false or unverified claims around environmental (greenwashing) or social (bluewashing) aspects of a given initiative. And certainly don't structure executive rewards around them.
- DON’T make it too easy. Relabelling normal business goals that would be achieved anyway as ESG initiatives and rewarding executives on their accomplishment is not a convincing strategy. Nor will it win the hearts and minds of

stakeholders. Make ESG authentic and progressive, challenging the business to do better rather than building a facade.

The reward professional

Hopkins says South African reward professionals have an important role to play in ESG-based incentives.

"Although they are not ESG specialists, reward practitioners will need to become familiar with any chosen methodologies, provide support on their correct use, and develop reward packages that are consistent with their purpose," he says.

As ESG becomes a standard for corporate responsibility, reward professionals can help organisations demonstrate their commitment to it through well-aligned remuneration packages.