Executive performance and rewards: Keeping up with changing global trends

Rising regulatory pressures and stakeholder scrutiny are forcing firms to re-examine what they stand for and how their values translate into meaningful actions.

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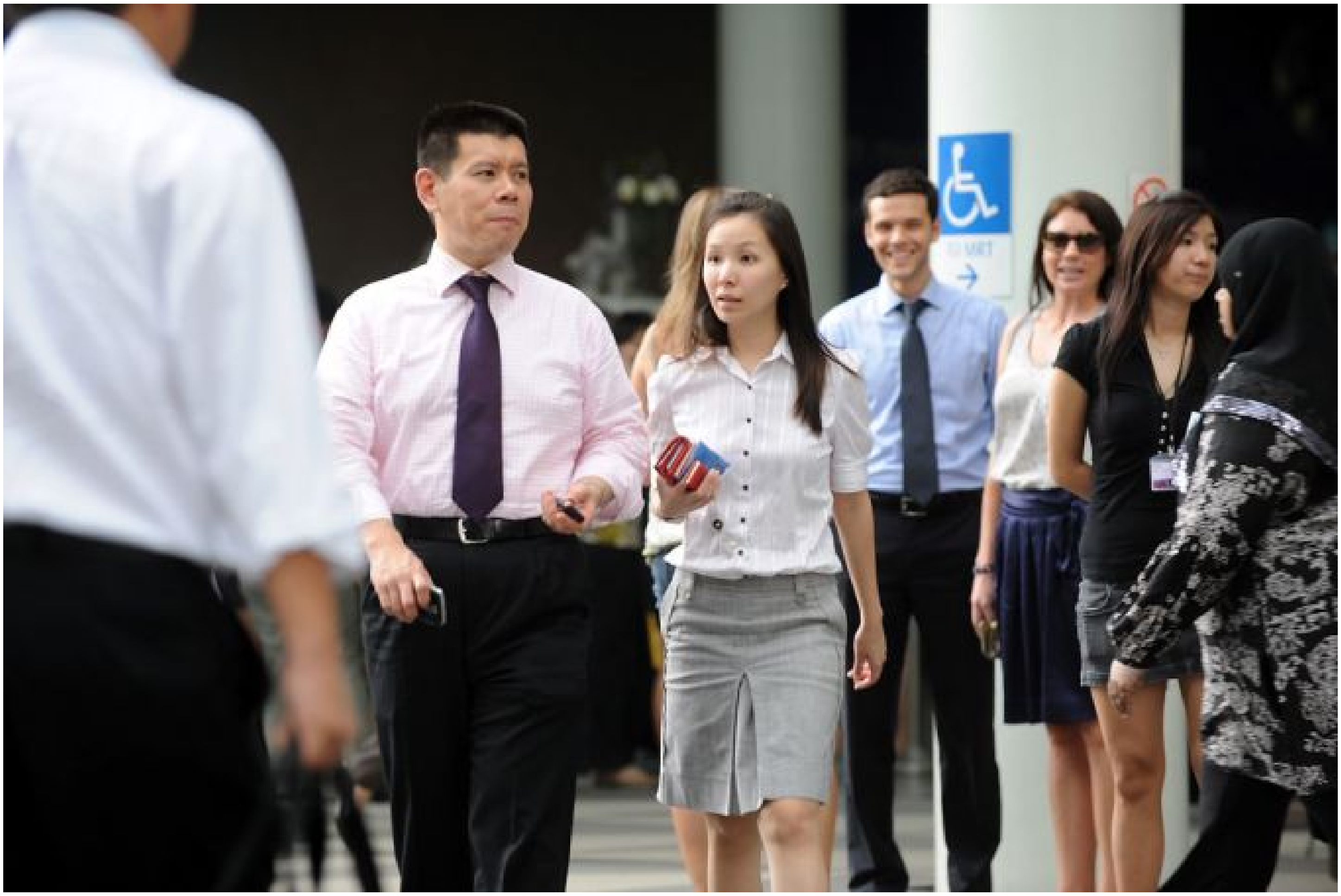

The long-term focus of stewardship is a global trend, and how company executives are assessed and rewarded needs to keep up with that. BT FILE PHOTO

A GROWING demand for transparency on the social impact of business is driving companies to focus on responsible investing - an approach that incorporates integrating environmental, social and governance (ESG) factors into investment decisions.

ESG factors include but are not limited to social impact reporting, disclosing carbon emission figures, the organisation's stand on workplace issues, how they manage their supply chains, and whether their culture builds trust and fosters innovation. In addition to being beneficial for the community, responsible investing is good for the business too. For instance, Banyan Tree defines itself as stewards of responsible tourism, and invests in "safeguarding and promoting a healthy, resilient and sustainable environment", which in turn attracts tourists to its properties.

Increasingly complex demands

The CEO's role in driving ESG factors came into perspective from as early as 2015, when Harvard Business Review started to include ESG ratings in determining its 100 Best-Performing CEOs in the World every year. Investors are voicing their concerns as well. Most recently, Larry Fink, the CEO of BlackRock, the world's largest asset management company, sent a clear message in his annual letter to CEOs that governance and social impact were his organisation's investment priorities for 2019. As he puts it, it is not "profit or purpose" but "profit and purpose".

However, CEOs are only a part of the equation when it comes to the governance of an organisation. The board of directors have a collective responsibility to manage the needs of all stakeholders - including consumers, society and shareholders. While there is no compromise to expectations from a financial standpoint, board of directors must look beyond the financials and take a comprehensive view of their company's value creation and impact over time and various dimensions.

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Shareholder capitalism started in congruence with community development. We could look to the company towns of the past era, which are testimony to this. But with rapid technological development and globalisation, shareholder capitalism today is seen to be the antithesis of the community. It is perceived to be practised solely on the premise of financial growth. On the other hand, simply doing good is not sufficient on its own. To achieve sustainability and social impact, the business needs to be successful and financially sound.

The role of the board

Boards have two key levers in driving management. First, when it comes to executive performance and rewards, paying for performance is a well-accepted tenet. The challenge is how is performance defined considering the multiple stakeholders' interests and time horizons. A 2018-19 National Association of Corporate Directors (NACD)'s Public Company Governance Survey indicates that only 15 per cent of the respondents use ESG-related measures in CEO pay. On the brighter side, as an indication of trends, the NACD study finds that companies using non-financial metrics to set CEO pay increased from 77 per cent in 2017 to 86 per cent in 2018. Investors are exerting pressure as well. A recent example is Shell, whose shareholders have insisted on including carbon footprint in the company's executive compensation plan.

The challenge in pay design goes beyond finding the right metrics or basing them on balanced scorecards. Pay design needs to support the value-creation strategy of the business considering the multiple demands, some of which are conflicting at any one point in time. Boards need to define what is considered long-term value creation for the business, set clear expectations and underline any foreseeable shortcomings. CEO and management can then articulate the vision and the related short- and long-term strategic goals. Boards and management need to ensure there are no substantial differences in their views of the company's values and the ethical framework in which it operates. The congruence should go beyond agreeing on the "official" company values and standards, and consider how their personal values and experiences will shape how they lead the company and respond to possible crises.

ESG as part of long-term strategy

Rising regulatory pressures and increased scrutiny by investors and consumers alike are forcing companies to re-examine what they stand for and how their values translate into actions that benefit society beyond the boardroom. Indeed, the best boards help their organisations maximise their potential by fuelling collaboration both among their people and with other businesses, non-profit organisations, governments and communities since many environmental and social initiatives require private-public or cross-industry collaboration.

In their capacity in overseeing management and steering the course of business, boards need to evaluate the extent of the company's social purpose strategy and related activities, challenge both, and review how they are being executed. The board must help management determine which issues and initiatives should receive investing and advocacy from the company. Once the board and management are aligned on the strategy, they need to then communicate and bring onboard the various stakeholders including institutional investors, community representatives and shareholders. Boards must articulate not only the company's long-term strategy but also how it is supported by the short-term objectives, and the specific oversight role the boards will play.

With agreement on the direction forward, key strategic milestones can be incorporated into the long-term incentives for management. These could be reviewed and reset annually on a rolling basis in order to learn from experience as well as address unforeseen changes in this volatile environment.

Role of the business leadership

The second key lever for boards is selecting and coaching the right leaders to run the business. As guardians of the company's business and management, boards need to focus not just on measuring the quantifiable target achievements of the leaders, but also the qualitative aspects of values and culture. Independent directors can best help recruit and appoint executives that embody the values, culture and behaviours that are consistent with the company's business and social impact objectives. Assessing values and behaviours is not a straightforward quantitative exercise. Thus, the board's judgement and discretion need to be factored in when it comes to making decisions on executive performance and rewards. A passive board would not be in a position to exercise sound judgement and discretion.

In a recent speech, Singapore's Deputy Prime Minister Heng Swee Keat said stewardship is about "engaged, responsible and meaningful value creation over the long term". He added that "this focus on the long term is important, especially when change is happening ever faster. Equally, the focus is not just on the company itself, but the benefit to the larger community".

This long-term focus of stewardship is clearly a global trend. How executives are assessed and rewarded needs to keep up with that. In a public corporation, executives need to think and act like a steward, and not an agent or like an equity partner in a private professional services firm. Boards need to help define that stewardship journey and ensure that the journey is led by good leadership.

- **The writer is managing director and partner, Human Capital Solutions, South-east Asia, at Aon**

ESG

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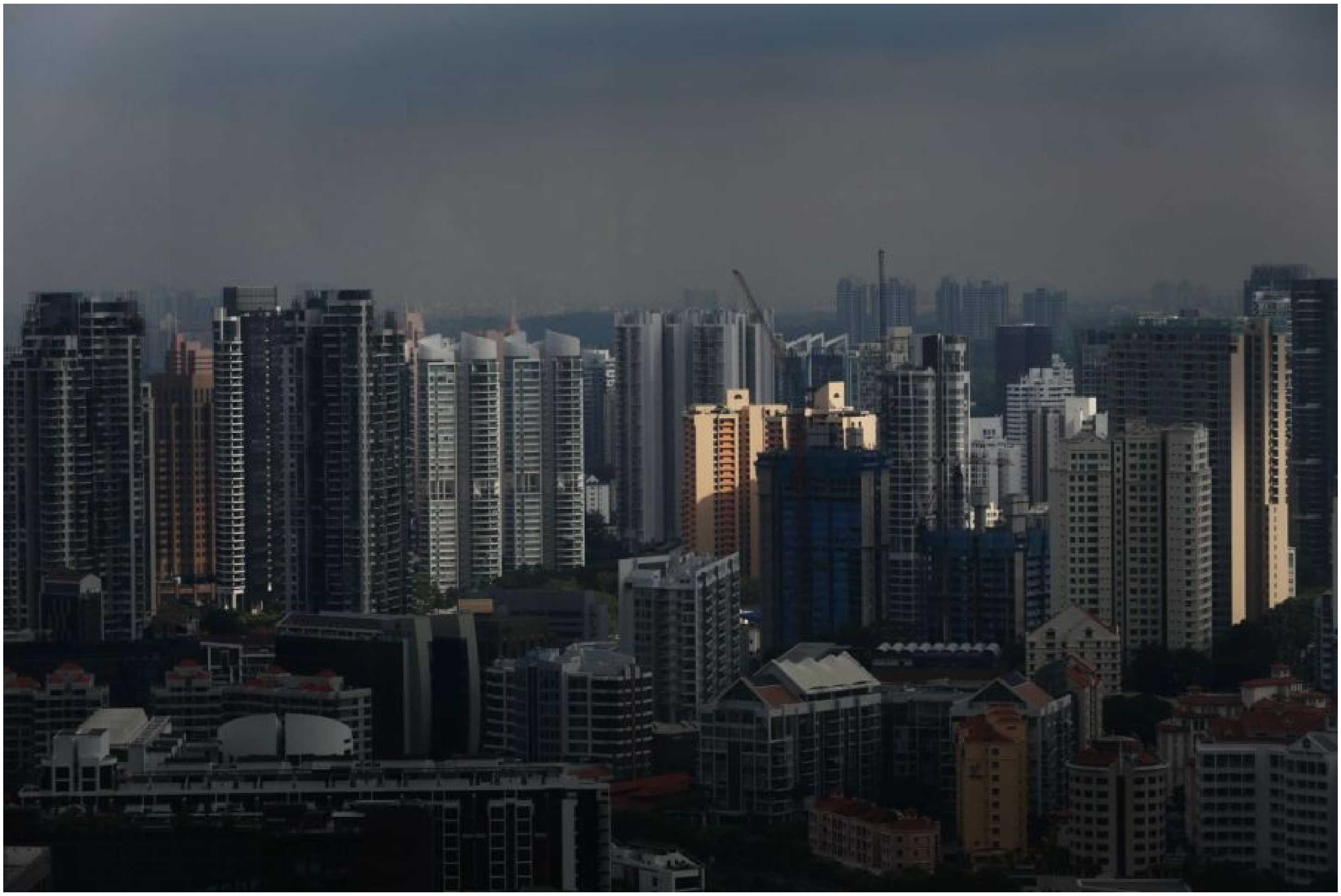

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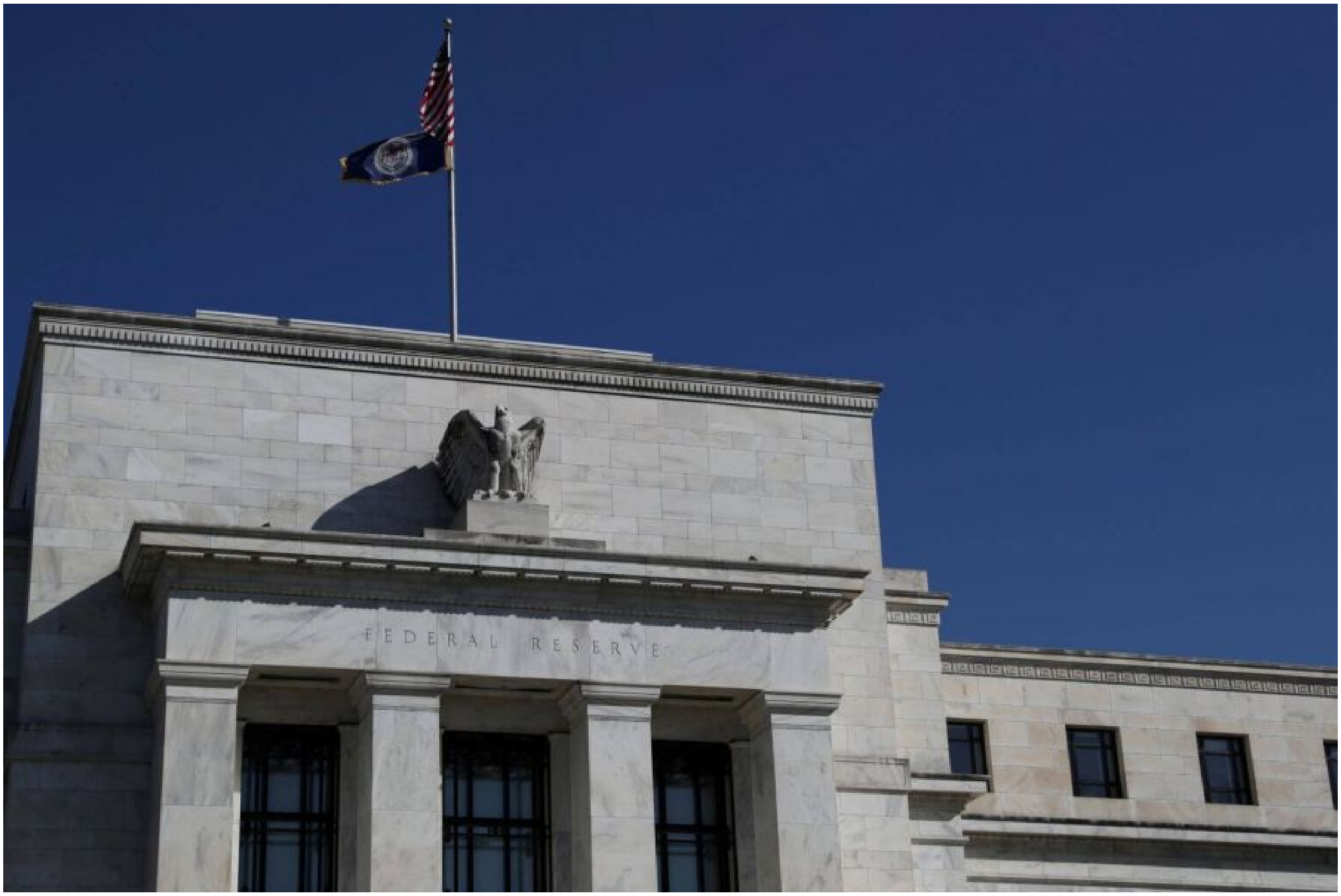

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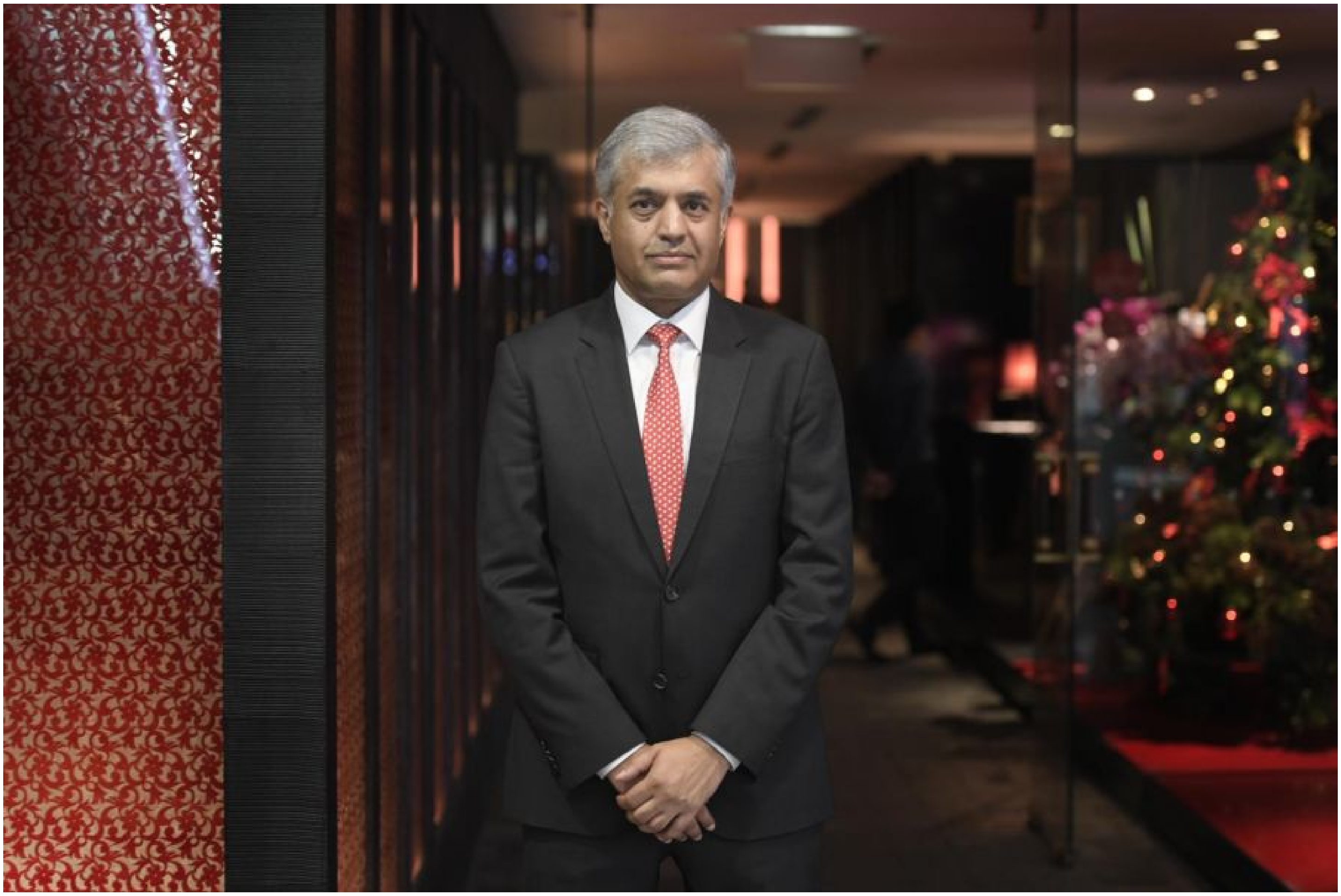

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