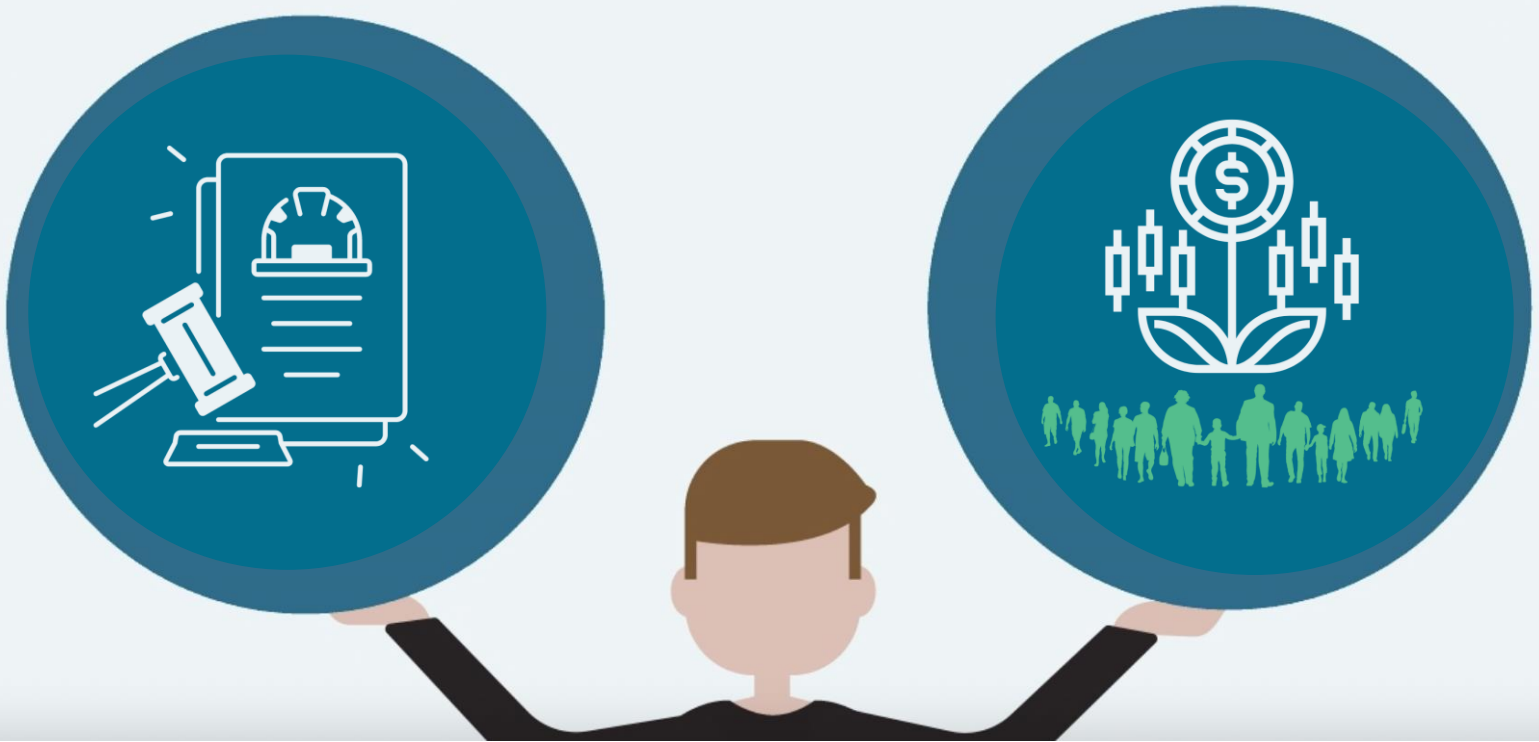
REWARD VALUE

Biennial Conference 2022

EXTERNAL DYNAMICS



ESG-related requirements and expectations continue to increase across a broad range of stakeholders

CURRENT STATE

Powered by REWARD VALUE

STRUCTURING REMUNERATION

CLOSE PURPOSE-TO-PAY GAP:

PURPOSE ---------- **100%** Non-financial

↓

STRATEGY ---------- **XX/yy** Financial/non-financial

↓

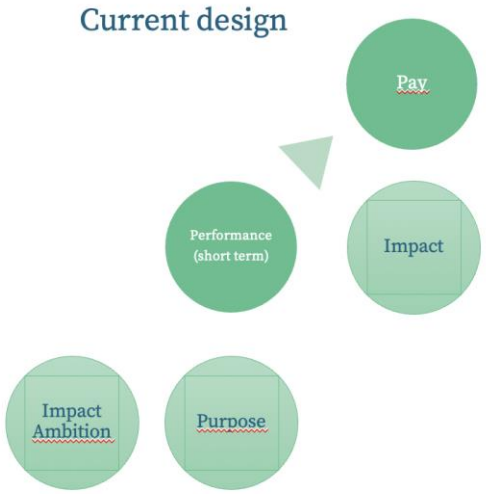
PERFORMANCE ------ **xx/YY** Financial/non-financial

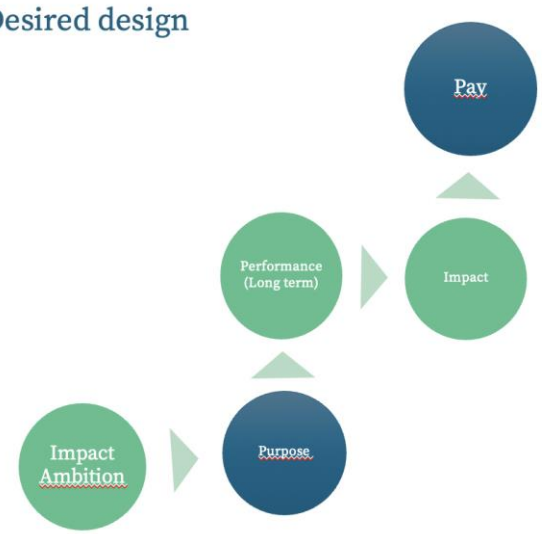
↓

PAY ---------- **100%** Financial

↓

CEO BEHAVIOR





From pay for short-term financial performance
to full alignment of purpose, performance and pay based on societal impact

DO WE NEED PERFORMANCE-BASED PAY?

Powered by REWARD VALUE

NO INCENTIVES

- Simple
- Intrinsic Motivation should suffice

PAY FOR PERFORMANCE

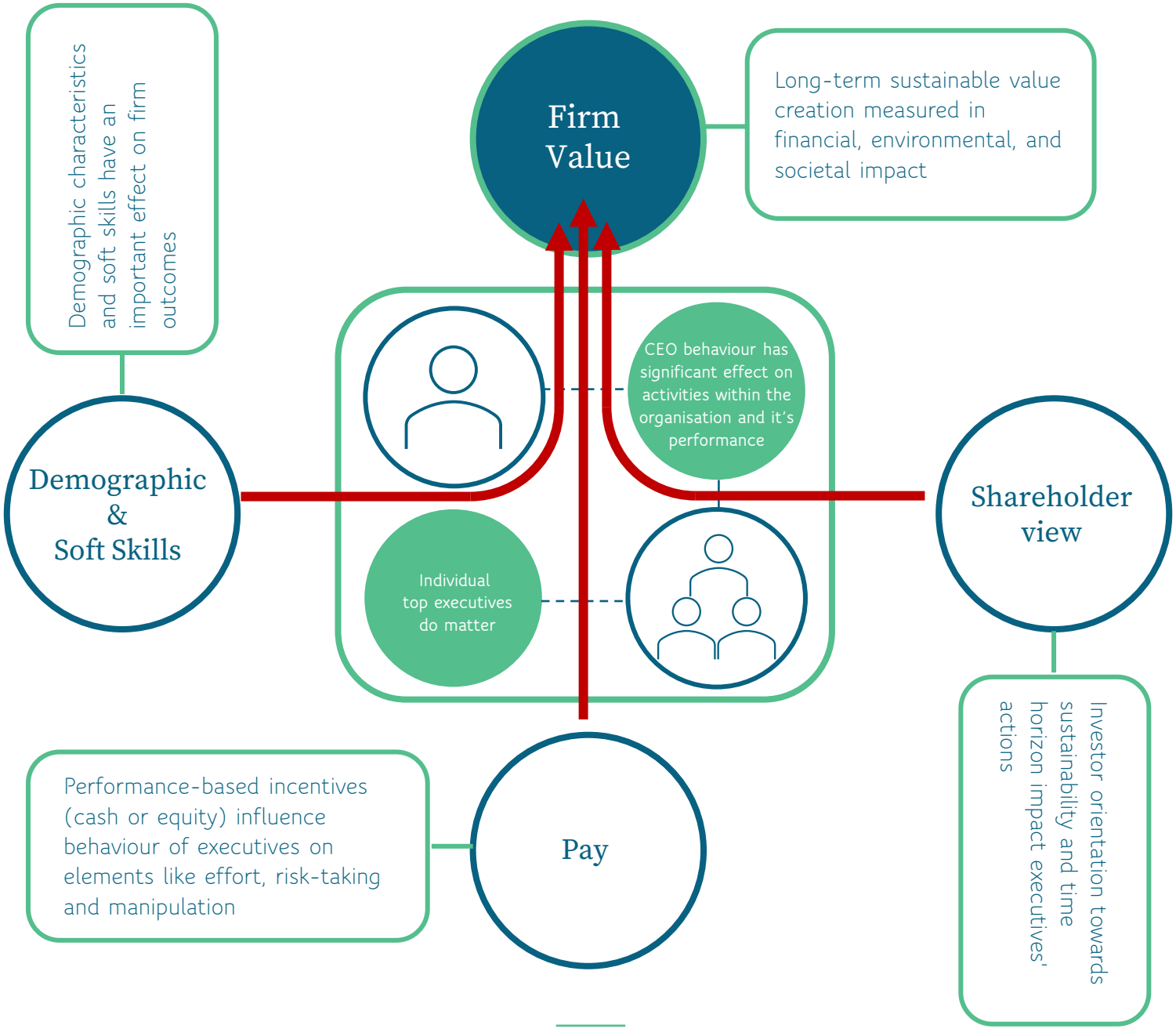
- Complex
- But transitionally relevant

RESTRICTED STOCK

- Simple
- Market reflects true value

IMPACTING FIRM VALUE

A behavioral approach



Powered by REWARD VALUE

REWARD VALUE
seo • amsterdam economics
GOLDSCHMEDING FOUNDATION
SUPPORTED BY

PAY, PRESSURE AND PREFERENCE

Powered by REWARD VALUE

seo • amsterdam economics

The goal of this research is to estimate the (combined) effect of incentives, shareholder pressure and personality on executive behaviour

RESEARCH QUESTIONS

1. How do compensation incentives affect executive behaviour with respect to
   a. investments in R&D for long-term value creation; and
   b. production of environmentally friendly goods (ESG)?
2. What is the impact of shareholder pressure and personal preferences on executive behaviour?

LAB EXPERIMENT

- Allows to test compensation models currently not used in the real world
- Makes possible causal analysis in a controlled environment (no outside influence)
- Delivers results on a large sample of individuals (*n*=3,000) who are representative of possible future CEOs (highly educated and management experience)

OVERALL RESULT

Powered by REWARD VALUE

seo • amsterdam economics

The combined effect of changing pay, selecting a long-termist and pro-social executive, and pressure by shareholders for long-term and ESG-outcomes is significant

The analysis shows that:

- **Pay, preferences and pressure all affect decisions** for R&D-expenditure and clean production.
- The effects of pay, preference and pressure **compound into a significant total effect**.

EFFECT	CONTROL GROUP	PAY	PREFERENCE	PRESSURE	TOTAL
		LT production	**LT focus**	**LT shareholder**	
ΔR&D	All short term	+ 14.5 %	+ 2.9 %	+ 22.7 %	**+ 40.1 %**
		Clean production	**Pro-social**	**Pro-ESG**	
ΔESG	All dirty production	+ 19.0 %	+ 8.6 %	+ 10.4 %	**+ 38.0 %**

EXTERNAL VALIDITY OF THE EXPERIMENT

Powered by REWARD VALUE

seo • amsterdam economics

Controlled lab experiment vs. the real world and follow up research to bolster external validity

Laboratory experiments yield credible causal inference in the context of the experiment. Further studies can add to our current results and bolster the external validity of the evidence base.

PRO'S	CON'S
Testing new pay models not currently implemented	Real-world strategic decisions are more complex
Causal analysis in isolated environment	No insight on how decisions are made
Large sample of 'future CEOs'	No board dynamics
Flexible to adjust and test more mechanisms	No competition between companies

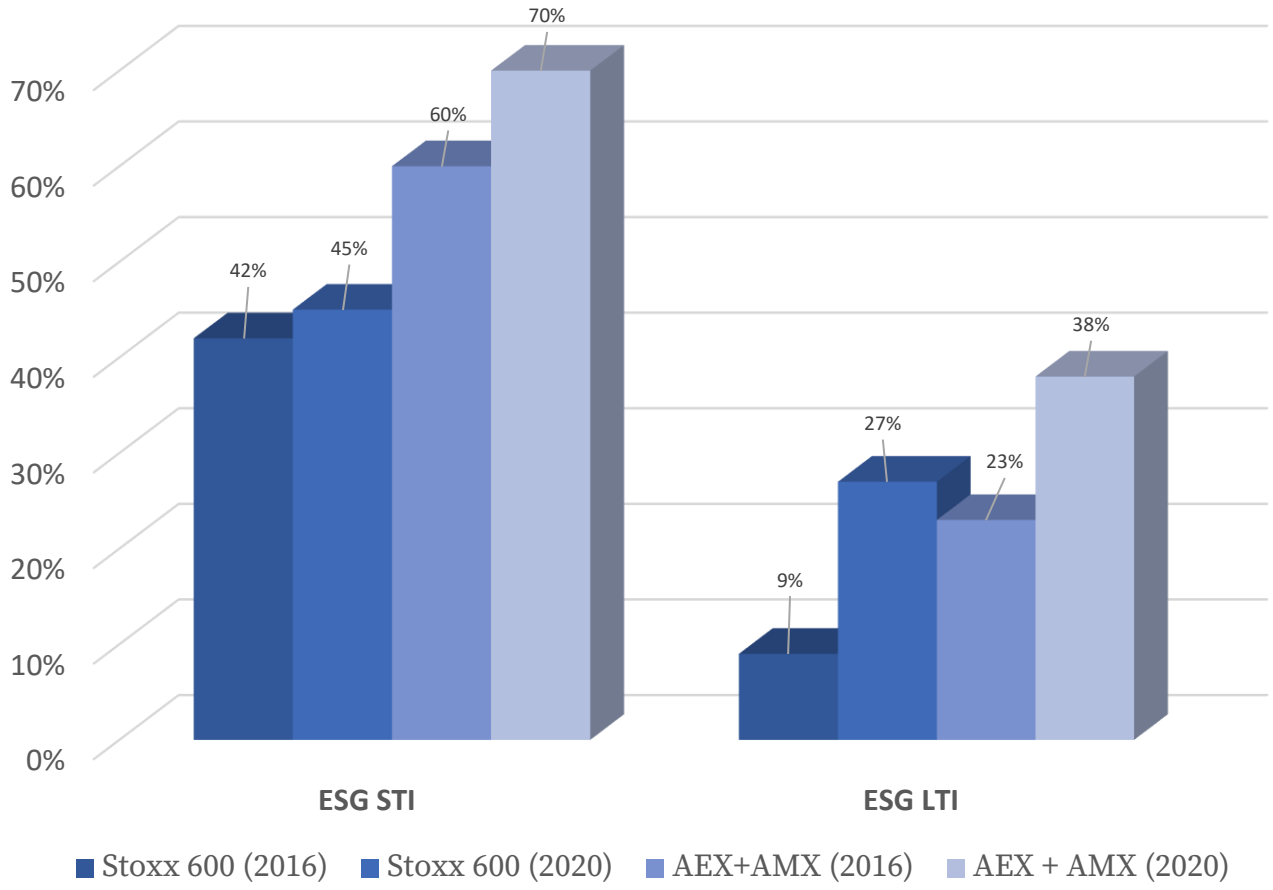
Follow-up research to improve external validity:

1. **Classroom experiment**
2. **In-company experiment**

HOW TO SUPPORT THE TRANSITION

Remuneration structure is key

MARKET DATA – *USE OF ESG KPI'S*



Use of ESG kpi's (AEX & AMX) - STI

	2016	2020
Environment	7%	9%
Customer	17%	23%
Employee	29%	45%
Innovation	17%	15%
Weight of nonfinancial KPIs	30%	27%

IMPACT OF THE DESIGN OF EXECUTIVE REWARDS ON ESG PERFORMANCE

Pay level
No impact

Pay structure
Performance shares & longer vesting (+)
Grant size (-)

Pay criteria
STI: sales (-), accounting (-), strategy (+)
LTI: TSR (-), accounting (+), customer (+)

IMPACT OF ESG MEASURES ON ESG PERFORMANCE

Positive effects in **3rd year** after adoption

sustainability committee
- Control mechanism
- Supports achievement of ESG KPIs

Environmental targets encourage environmental **innovation** (design & develop eco-friendly products & services)

SUSTAINABLE LONG-TERM VALUE CREATION

Integrated Measure of Corporate Success

DRIVERS FOR SLTVC

Powered by REWARD VALUE

KEY ELEMENTS

Impact Measures Long-term changes to human well-being that can be attributed to the company.

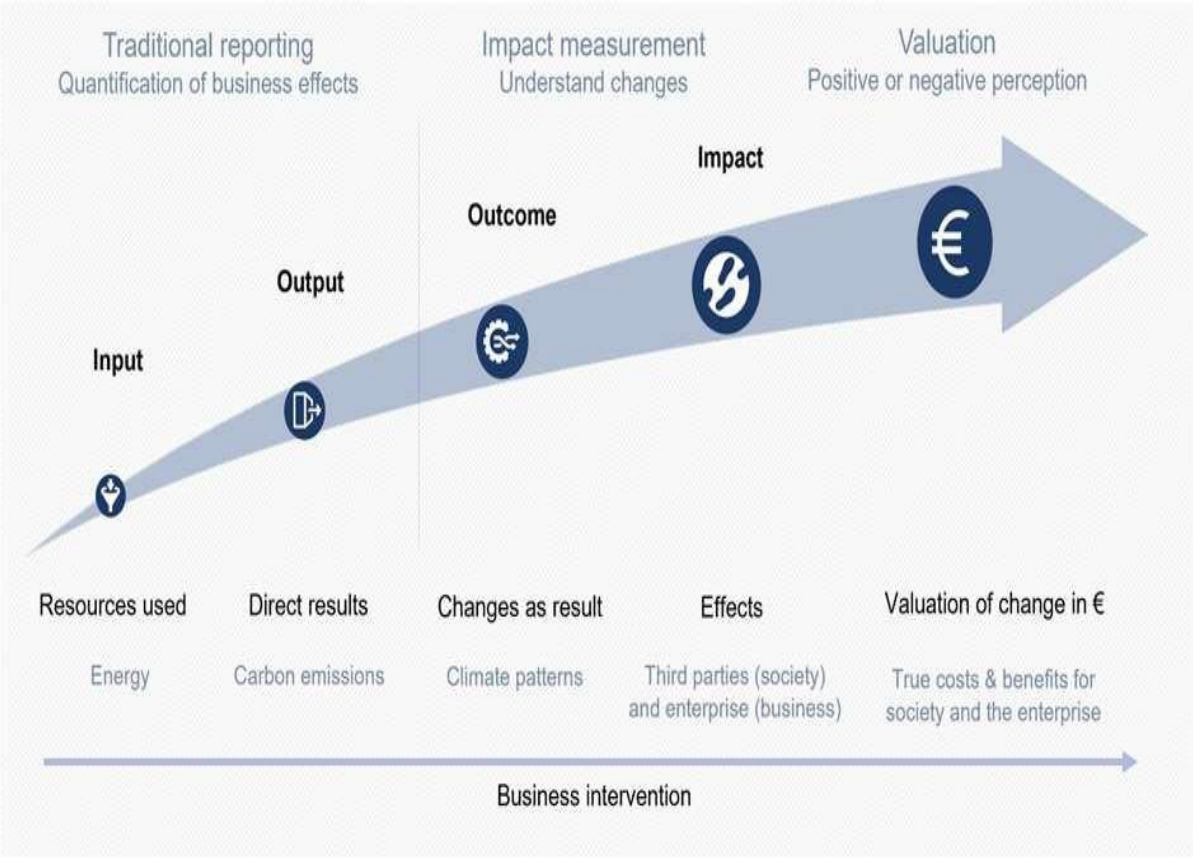
- Financial returns to shareholders / ultimate beneficiaries
- Environmental contribution – Do no harm / net positive
- Social contributions through sustainable products and services, employee, customer and community well-being.

Materiality Academic research has shown that addressing the material ESG topics positively affects long-term value creation. Materiality matters in two ways:

- ESG Materiality (relevance)
- Focus (weight)

Time Horizon Creating sustainable impact means shifting the focus to the long-term. Current remuneration policies still have short to medium time orientation and are mainly driven by financial metrics.

THINKING BEYOND OUTPUT TO UNDERSTAND A COMPANY'S TRUE VALUE



CONTEXTUALIZE THE EFFECT OF BUSINESS INTERVENTIONS ON SOCIETY AND THE ENTERPRISE VALUE

WHAT CAN BE DONE NOW

Steps to modernize executive remuneration

Powered by REWARD VALUE

FIVE STEPS TO MODERNISING REMUNERATION

STEP 1

Define the goal

What does the company aim to achieve with this remuneration plan? How do these objectives link to the company's purpose and strategy?

The outcome of this step is a statement of intent; a declaration that informs all subsequent remuneration plan choices, and against which the remuneration plan will be evaluated.

STEP 2

Decide what matters

On what topics does the company invite the world to measure its progress? What financial, social and environmental impact does the company expect to make by focusing on these topics?

Remuneration plans exist to spur meaningful change. For a plan to be credible, it must do more than allow easy rewards for the realization of generic sustainability pledges.

STEP 3

Decide weightings

What reward weighting does the company give to each topic identified in step 2?

How do these weightings reflect the company's stated purpose or mission?

This step applies focus to 'materially significant' topics, against which executives will be evaluated for remuneration purposes.

STEP 4

Set time frames

Within what time frames does the company want to achieve progress towards the 'things that matter' given the weights allocated in Step 3? How are these time frames written into the remuneration plan?

This step clarifies what the company means, exactly, by terms such as short- and long-term.

STEP 5

Set targets

What metrics will be used to evaluate progress toward the 'things that matter' given the weights allocated in Step 3?

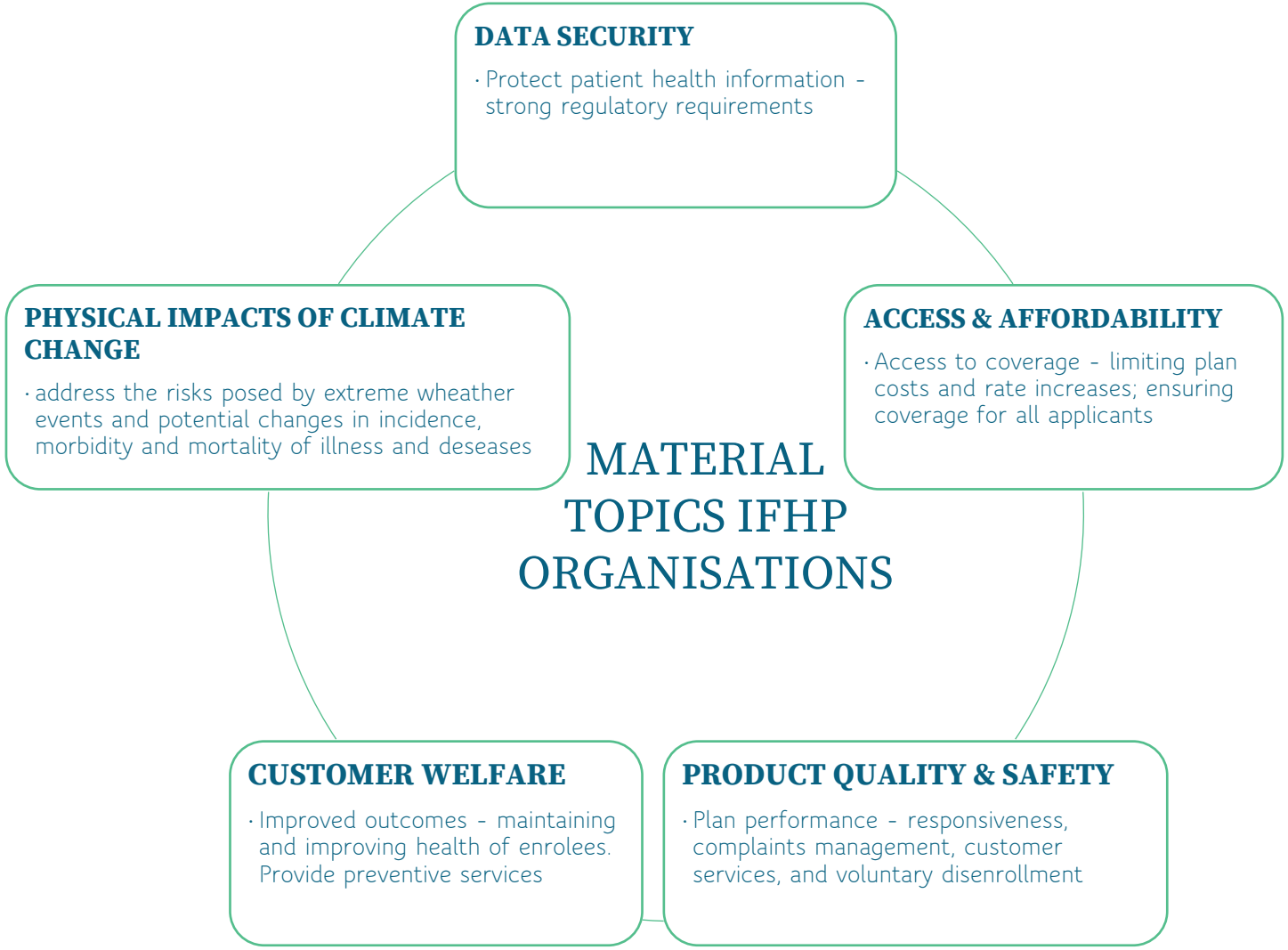
Incentives are credible and effective when they are given for achieving results beyond those that would have been achieved without executive intervention.

MATERIALITY IFHP ORGANISATIONS

ENVIRONMENT	SOCIAL CAPITAL	HUMAN CAPITAL	BUSINESS MODEL & INNOVATION	LEADERSHIP & GOVERNANCE
GHG Emissions	Human Rights & Community Relations	Labour Practices Employee Health & Safety	Product Design & Lifecycle Management	Business Ethics
Air Quality	Customer Privacy	Employee Health & Safety	Business Model Resilience	Competitive Behaviour
Energy Management	Data Security	Employee Engagement, Diversity & Inclusion	Supply Chain Management	Management of the Legal & Regulatory Environment
Water & Wastewater Management	Access & Affordability		Materials Sourcing & Efficiency	Critical Incident Risk Management
Waste & Hazardous Materials Management	Product Quality & Safety		Physical Impacts of Climate Change	Systemic Risk Management
Ecological Impacts	Customer Welfare			
	Selling Practices & Product Labelling			

MATERIAL TOPICS IFHP ORGANISATIONS

REWARD VALUE

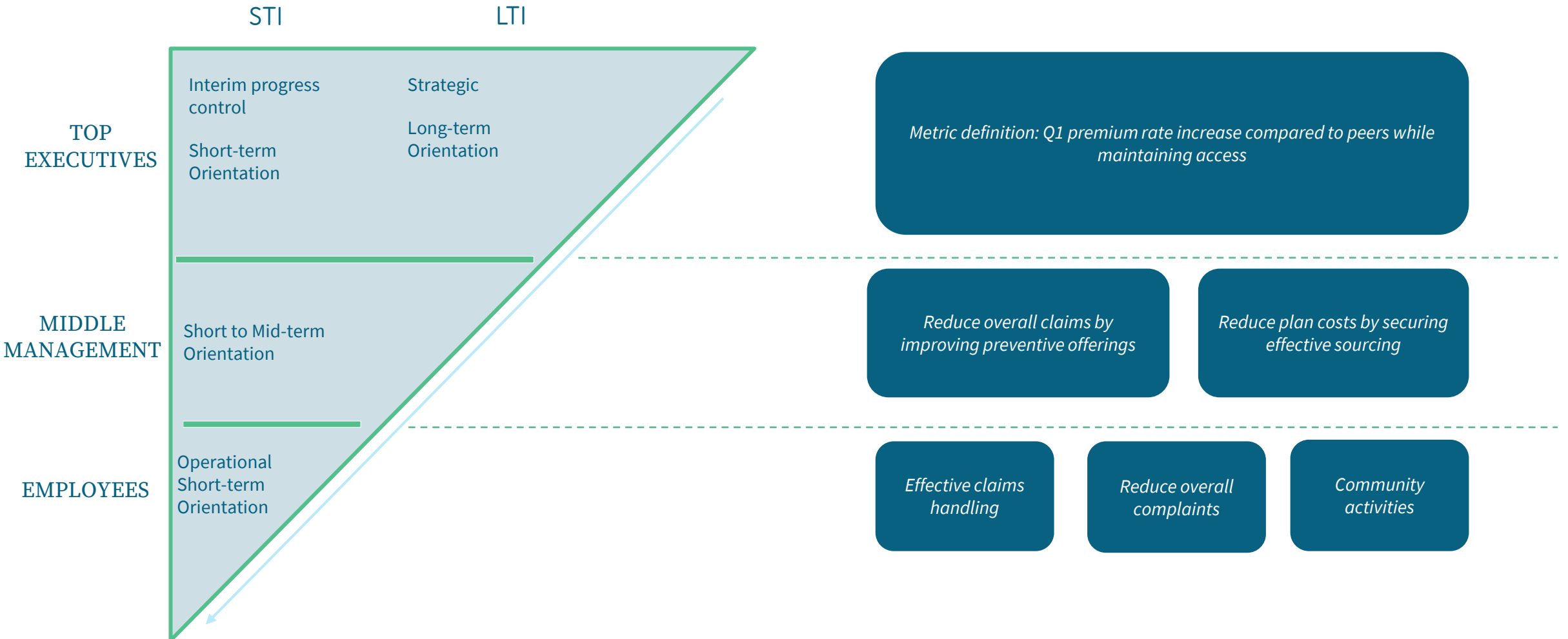


ESG METRIC SELECTION AND REMUNERATION ALIGNMENT

Cascading ESG metrics in variable pay plans to enhance line of site and alignment

Powered by REWARD VALUE

Sample Illustration – Cascading STI and LTI ESG metrics



REWARD VALUE

THANK YOU

DATE HERE

OTHER INFO EG; CONTACT INFO