CompensationStandards.com

"The Top Compensation Consultants Speak"

Thursday, March 24, 2022

Course Materials

"**<u>The Top Compensation Consultants Speak</u>**"

Thursday, March 24, 2022

2:00 – 3:00 pm, Eastern [archive and transcript to follow]

Save This Webcast To Your Calendar: Outlook **|** iCalendar **|** Google Calendar

Our annual webcast focusing on what compensation committees should be learning about – and considering – including translating ESG goals into pay-for-performance programs, expanding roles for compensation committees, director compensation in an ever-competitive environment, and a look at how the 2022 proxy season is shaping up. Join these experts:

- **Blair Jones**, Managing Director, Semler Brossy
- **Ira Kay,** Managing Partner, Pay Governance LLC
- **Jan Koors**, Senior Managing Director and Western Region President, Pearl Meyer

Among other topics, this program will cover:

- Key Issues & Considerations for Compensation Committees Now
- HCM Topics Compensation Committees are Discussing Now
- Gender & Ethnicity Pay Gaps and Pay Equity
- Integrating ESG into Pay-for-Performance
- Latest Pay Ratio Practices
- Benchmarking Pay During COVID-19
- Director Compensation in Competitive Environment
- Early Proxy Season Feedback

<u>"The Top Compensation Consultants Speak"</u>

Course Outline / Notes

1. Key issues & considerations for Compensation Committees now

2. Human management capital topics Compensation Committees are discussing now

3. Gender & ethnicity pay gaps and pay equity

4. Integrating ESG into pay-for-performance

5. Latest pay ratio practices

6. Benchmarking pay during COVID-19

7. Director compensation in competitive environment

8. Early proxy season feedback

“The Top Compensation Consultants Speak”

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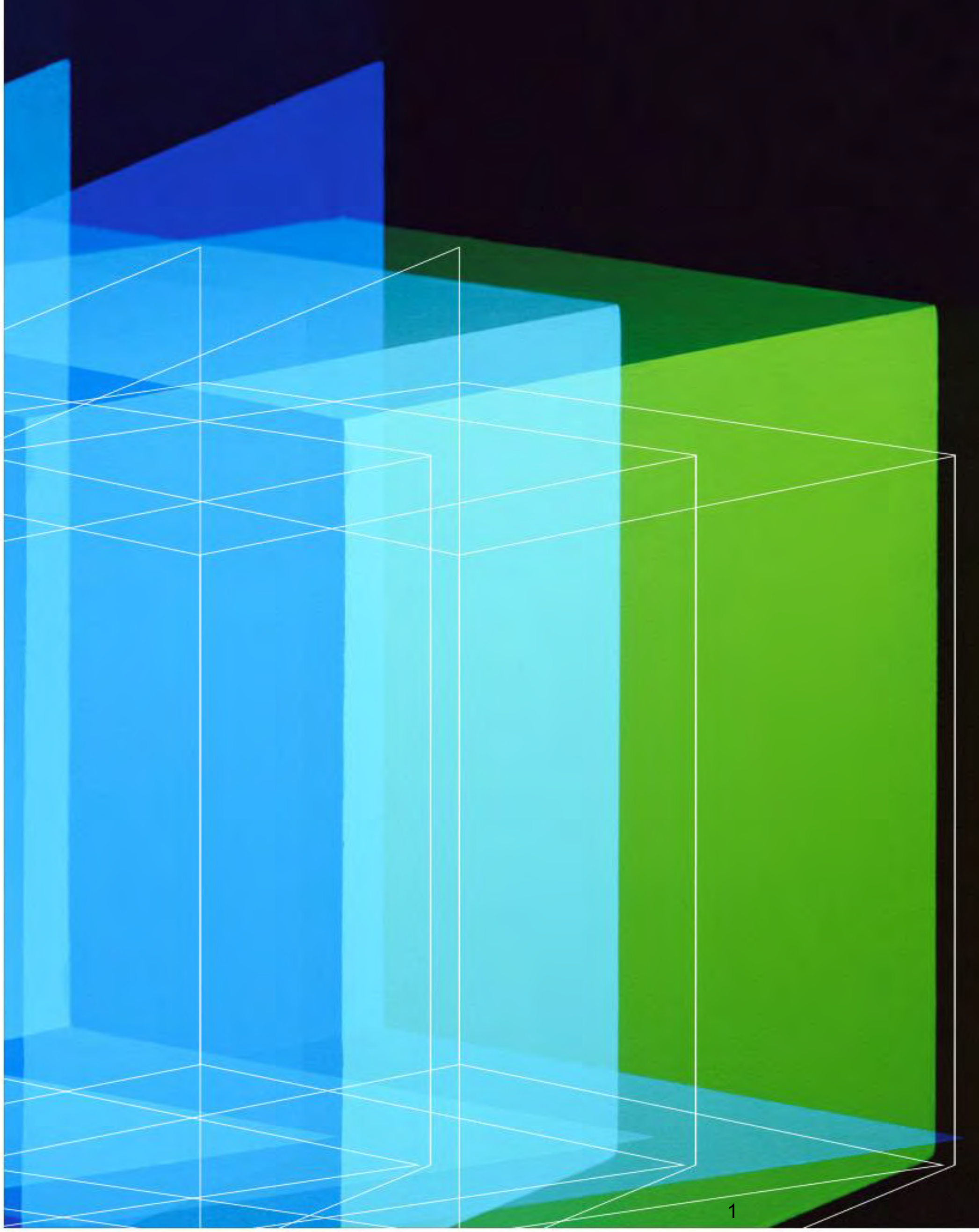
2021 **SAY ON PAY** & PROXY RESULTS

RUSSELL 3000



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JANUARY 27

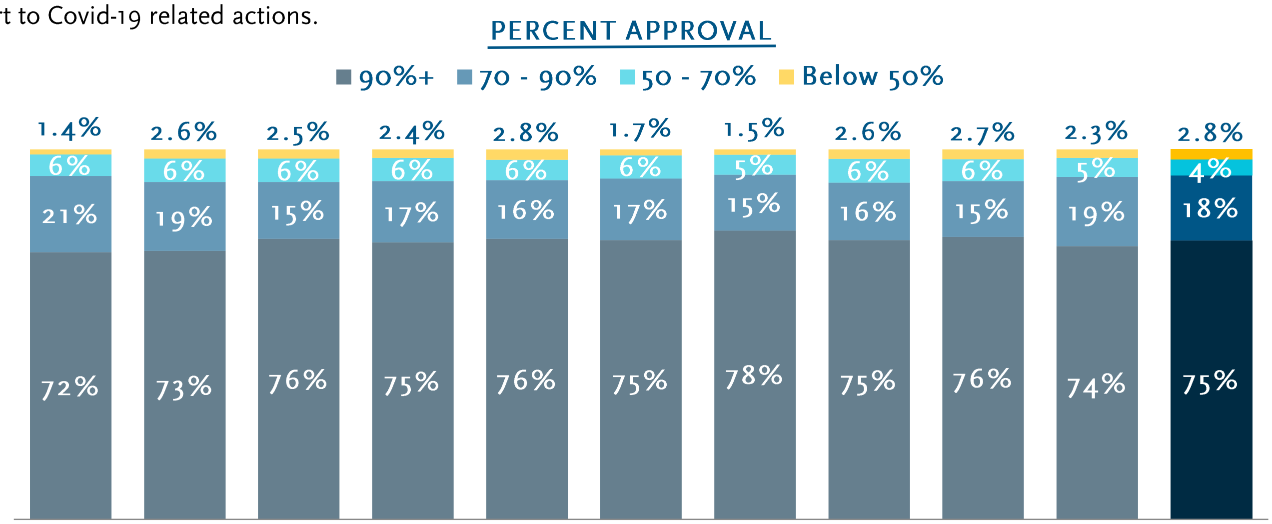
2021 **SAY ON PAY** RESULTS

1/27/2022

RUSSELL 3000
2,243 COMPANIES

BREAKDOWN OF SAY ON PAY VOTE RESULTS

63 Russell 3000 companies (2.8%) and 18 S&P 500 companies (3.9%) failed Say on Pay in 2021. Four companies failed since our last report in September. Our evaluation of the likely reasons for failure indicated that 20 of the 63 failed Say on Pay votes in 2021 were due in part to Covid-19 related actions.

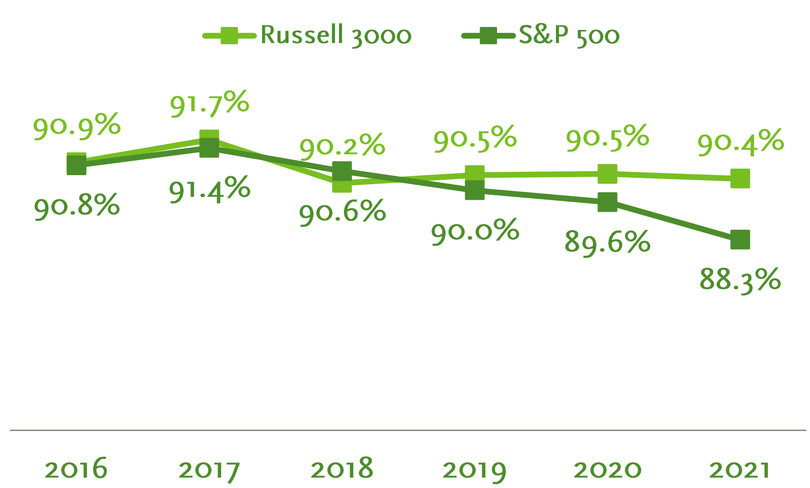


	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Avg:	90.9%	89.8%	90.6%	90.9%	90.8%	90.9%	91.7%	90.2%	90.5%	90.5%	90.4%
n:	2,660	2,226	2,253	2,545	2,157	2,116	2,356	2,153	2,236	2,396	2,243
Failures:	37	57	57	60	61	35	35	57	60	56	63

SAY ON PAY OBSERVATIONS

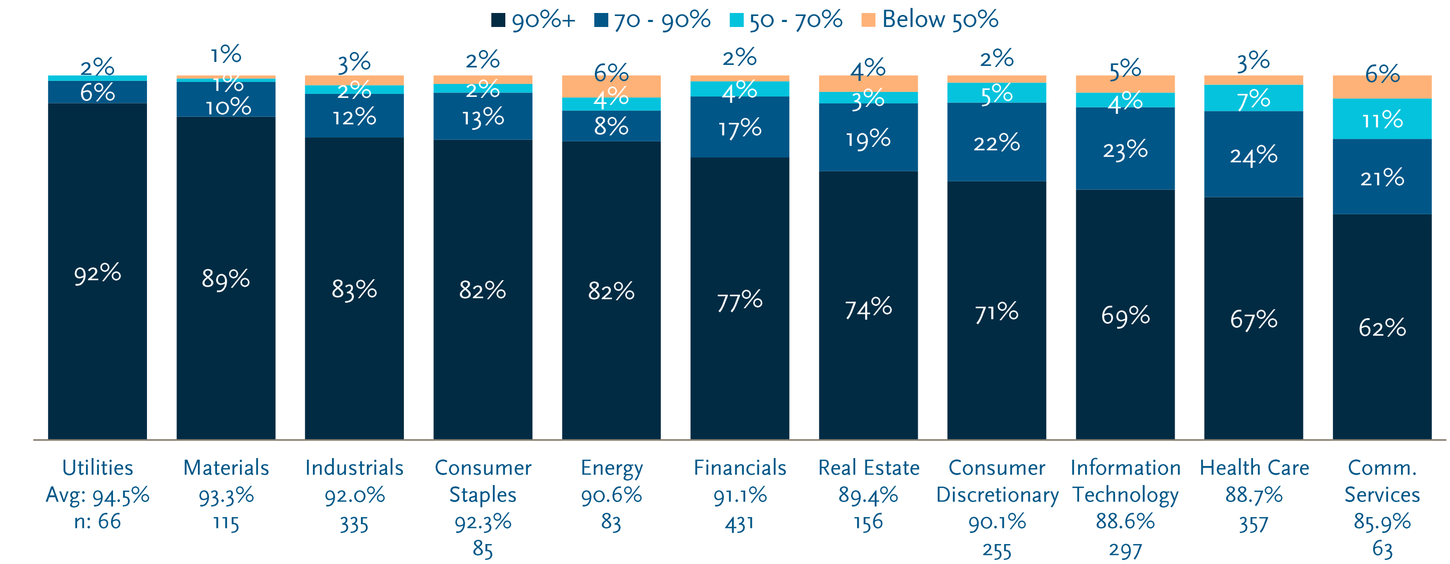
- The 2021 failure rate (2.8%) was above 2020's failure rate of (2.3%) and was unchanged from our September report
- The percentage of Russell 3000 companies receiving greater than 90% support in 2021 (75%) was higher than in 2020 (74%)
- 2021 average vote results of 90.4% for the Russell 3000 and 88.3% for the S&P 500 were below the average vote results in 2020
- The 2021 average Russell 3000 vote result was 210 basis points higher than the average S&P 500 vote result, which was 120 basis points larger than the spread in 2020

COMPARISON OF RUSSELL 3000 AND S&P 500



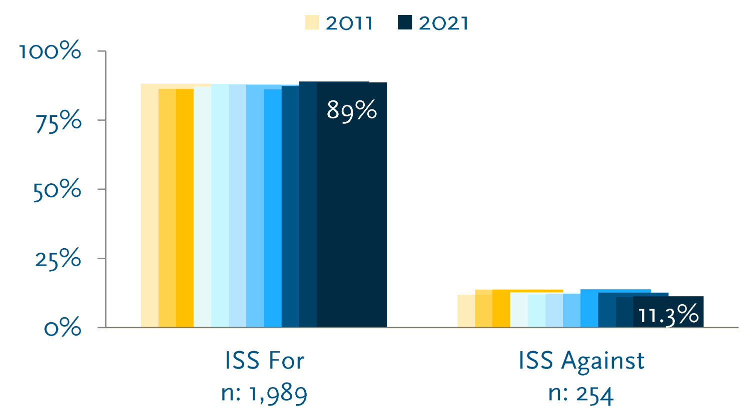
Data provided by ESGAUGE and Semler Brossy; analysis by Semler Brossy. Russell 3000 and S&P 500 sample as of March 22, 2021.

SAY ON PAY VOTE RESULTS BY GICS SECTOR



ISS RECOMMENDATION RATE

- 11.3% of companies received an "Against" recommendation from ISS in 2021, which was 30 basis points higher than the 2020 rate
- The average Say on Pay vote result for companies that received an ISS "Against" recommendation in 2021 was 31 percentage points lower than for companies that received an ISS "For" recommendation
- This was at the high end of the historical range of 24 to 32 percentage points

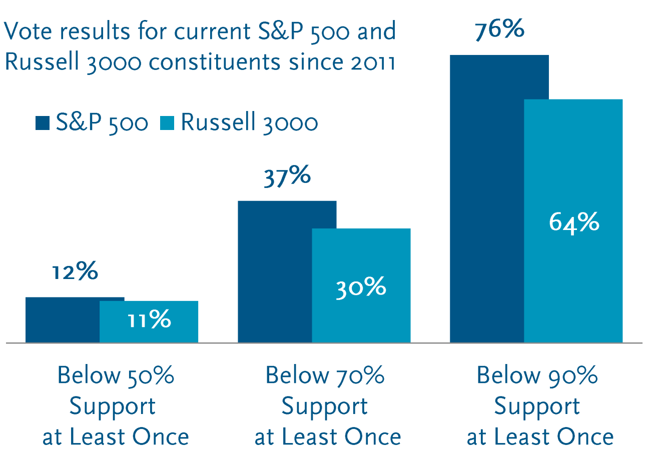


ISS "AGAINST" RATE AND VOTE IMPACT OF MULTIPLE CONSECUTIVE "AGAINSTS"

FULL 2021 SAMPLE	2,243 Companies	11% "Against" Rate	90.4% Average Vote
1 "Against"	126 Companies	33% "Against" Rate	61.0% Average Vote
2 "Againsts"	39 Companies	46% "Against" Rate	57.7% Average Vote
3 "Againsts"	15 Companies	53% "Against" Rate	52.9% Average Vote
4+ "Againsts"	5 Companies	40% "Against" Rate	49.0% Average Vote

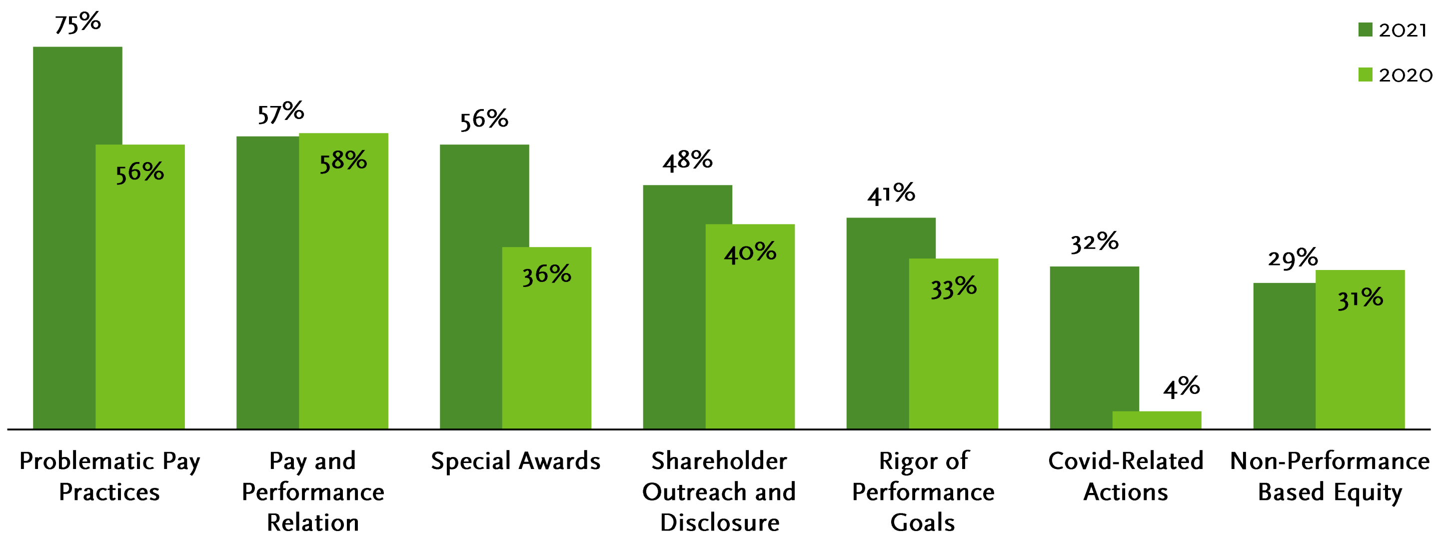
LIKELIHOOD OF A LOW SAY ON PAY VOTE

Vote results for current S&P 500 and Russell 3000 constituents since 2011



RUSSELL 3000 2021 VS. 2020 FAILURE REASONS

In 2021, a significant number of failures were due to a misalignment between pay and performance (57%), and pay practices assumed to be problematic (75%). 32% of failures were due to Covid-related actions. There was also a higher prevalence of special awards contributing to failures, though companies did not always explicitly disclose these as being related to Covid-19.



LIKELY CAUSES OF SAY ON PAY VOTES UNDER 50% IN 2021

2021 Failed Say on Pay Vote Results[1]
Russell 3000, n=63

Company	Say on Pay Vote Results 2021▼	2020	YOY	Number of Failures	Likely Causes of Votes Under 50%: Pay and Performance Relation	Problematic Pay Practices	Rigor of Performance Goals	Shareholder Outreach and Disclosure	Non-Performance Based Equity	Special Awards/ Mega-Grants	COVID-Related Actions
Phillips 66	50%	89%	-39%	1	X	X	X	X			
Prologis, Inc.	50%	84%	-34%	1	X	X	X	X			
PTC Inc.	50%	67%	-18%	2	X	X	X			X	X
The Children's Place, Inc.	49%	75%	-26%	2	X	X		X			
AT&T Inc.	49%	88%	-39%	1	X					X	
International Business Machines Corporatior	49%	86%	-38%	1	X					X	
Starbucks Corporation	47%	84%	-37%	1						X	
Vonage Holdings Corp.	47%	90%	-43%	1			X	X	X	X	
Zynga Inc.	47%	97%	-50%	1		X		X		X	
Walgreens Boots Alliance, Inc.	47%	83%	-36%	1	X		X	X			X
WEX Inc.	47%	98%	-51%	1							X
Vector Group Ltd.	46%	31%	15%	3	X	X					
Halliburton Company	46%	90%	-44%	2	X	X	X				
DXC Technology Company	46%	33%	14%	2	X	X	X		X	X	
Essent Group Ltd.	46%	98%	-52%	1				X	X		X
XPO Logistics, Inc.	45%	67%	-22%	1	X	X		X			X
Cars.com Inc.	45%	96%	-51%	1		X			X		
Tejon Ranch Co.	45%	-	-	1		X	X	X	X		
Global Blood Therapeutics, Inc.	45%	78%	-33%	1						X	
Howmet Aerospace Inc.	45%	-	-	1		X		X	X	X	
Arrowhead Pharmaceuticals, Inc.	44%	98%	-54%	1	X	X				X	
Greenlight Capital Re, Ltd.	43%	66%	-23%	1		X		X			

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LIKELY CAUSES OF SAY ON PAY VOTES UNDER 50% IN 2021 (CONTINUED)

2021 Failed Say on Pay Vote Results[1]
Russell 3000, n=63

Company	Say on Pay Vote Results 2021▼	2020	YOY	Number of Failures	Likely Causes of Votes Under 50%: Pay and Performance Relation	Problematic Pay Practices	Rigor of Performance Goals	Shareholder Outreach and Disclosure	Non-Performance Based Equity	Special Awards/ Mega-Grants	COVID-Related Actions
TransDigm Group Incorporated	43%	66%	-23%	1	X	X	X	X			
The Brink's Company	43%	90%	-47%	1	X		X		X	X	X
General Electric Company	42%	74%	-31%	1	X	X	X			X	X
Xenia Hotels & Resorts, Inc.	42%	98%	-56%	1	X			X	X	X	X
Universal Insurance Holdings, Inc.	42%	79%	-37%	3		X			X	X	
Electronic Arts Inc.	42%	26%	16%	2	X		X	X		X	
Allakos Inc.	41%	-	-	1		X		X	X		
G-III Apparel Group, Ltd.	39%	69%	-31%	3		X		X	X		X
Qualys, Inc.	38%	96%	-57%	2		X		X	X	X	X
Sterling Bancorp	38%	96%	-57%	2		X					X
Intel Corporation	38%	50%	-12%	2	X	X	X				
PacWest Bancorp	37%	81%	-44%	2		X	X	X		X	
Sabre Corporation	36%	-	-	1	X	X				X	X
Enzo Biochem, Inc.	36%	56%	-20%	1		X		X			
Invacare Corporation	35%	92%	-56%	1	X	X					X
Splunk Inc.	35%	87%	-53%	2		X	X				X
Tutor Perini Corporation	35%	34%	0%	11	X	X		X			
SL Green Realty Corp.	34%	89%	-55%	2	X	X	X		X	X	
Ladder Capital Corp	34%	-	-	1		X					
Evofem Biosciences, Inc.	34%	73%	-40%	1	X	X				X	
Acuity Brands, Inc.	33%	33%	0%	2	X	X	X		X	X	
Nabors Industries Ltd.	32%	35%	-3%	10	X	X	X	X			
Korn Ferry	**31%**	**97%**	**-66%**	**1**		**X**			**X**		**X**
Xerox Holdings Corporation	31%	66%	-36%	2	X	X		X		X	X
Paycom Software, Inc.	30%	45%	-15%	2	X	X				X	
Marathon Petroleum Corporation	30%	90%	-60%	1	X		X	X	X	X	
Premier, Inc.	**30%**	**94%**	**-63%**	**1**		**X**	**X**		**X**		**X**
NextGen Healthcare, Inc.	**28%**	**97%**	**-68%**	**1**		**X**					
Cleveland-Cliffs Inc.	26%	32%	-6%	3	X	X	X			X	
Ceridian HCM Holding Inc.	26%	54%	-28%	1	X	X		X		X	
RBC Bearings Incorporated	25%	31%	-6%	4	X		X	X			
RPT Realty	23%	98%	-75%	1	X		X			X	
LCI Industries	23%	67%	-43%	1		X				X	X
Whiting Petroleum Corporation	23%	-	-	2		X				X	X
Skyworks Solutions, Inc.	22%	89%	-67%	1	X	X	X	X		X	
Global Net Lease, Inc.	21%	-	-	1				X			
Blucora, Inc.	20%	94%	-73%	1		X		X	X	X	
Viatris Inc.	**20%**	-	-	**1**		**X**		**X**		**X**	
Park Hotels & Resorts Inc.	18%	96%	-78%	1	X		X	X		X	
Norwegian Cruise Line Holdings Ltd.	17%	87%	-70%	1	X	X				X	X
NCR Corporation	16%	85%	-69%	2	X	X	X			X	
Count (n=63)					36	47	26	30	18	35	20

[1] As of January 11, 2022

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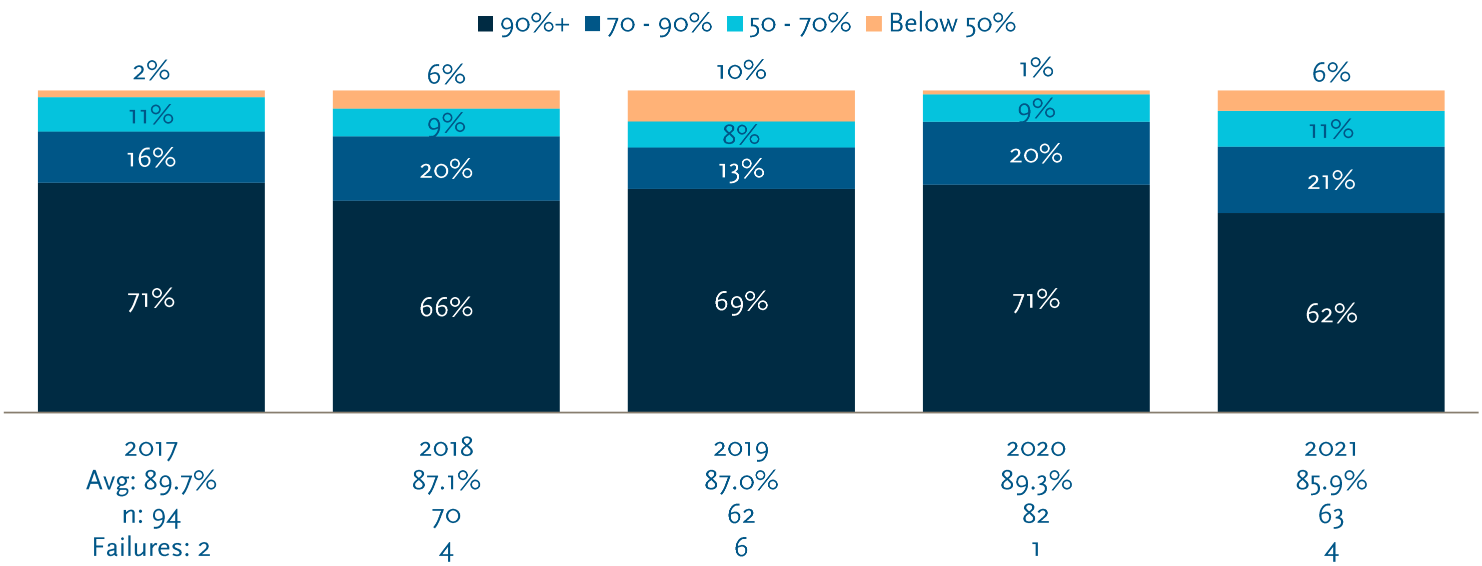
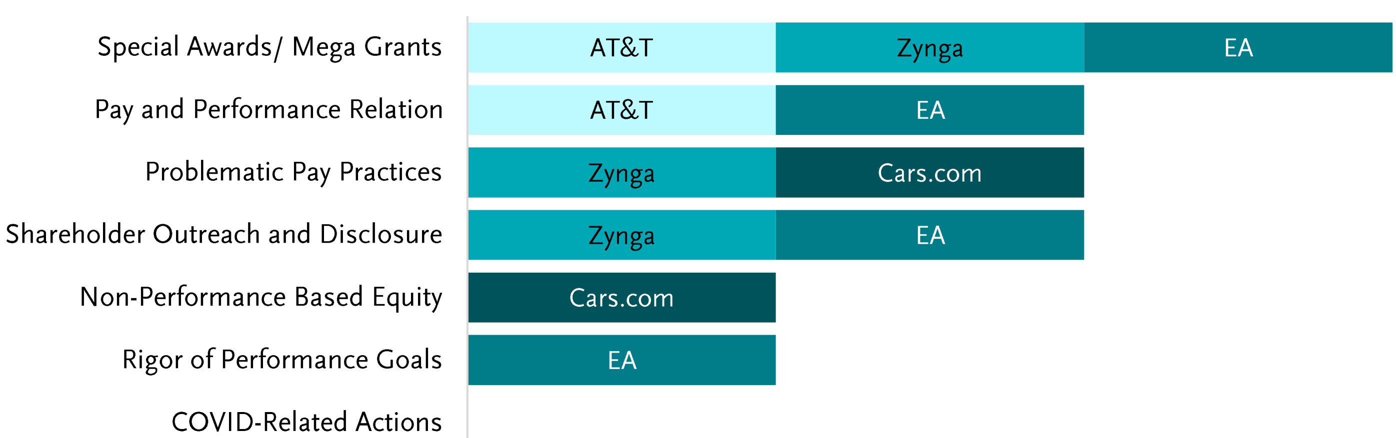
COMMUNICATION SERVICES SPOTLIGHT

Communication Services had the highest Say on Pay failure rate of any industry in 2021 (6.4%). The average vote result for the Communication Services industry has historically been lower than the Russell 3000 average in previous years; however, the industry's average vote result (85.9%) was 450 basis points lower than the Russell 3000 in 2021, compared to 120 basis points lower in 2020.



LIKELY CAUSES OF FAILURE FOR THE COMMUNICATION SERVICES INDUSTRY IN 2021

- AT&T, Cars.com, Electronic Arts (EA), and Zynga were the four Communication Services companies that failed Say on Pay in 2021, and Electronic Arts was the only Communication Services company that failed Say on Pay in 2020
- Our evaluation indicated that three of the four failures were primarily due to the company making special awards and mega grants, which have historically been scrutinized by proxy advisors
- Pay and performance misalignment, shareholder outreach, or problematic pay practice issues contributed to the failure at two of the companies
- Cars.com grants large annual equity awards to its NEOs that are purely time-based, and Zynga's 2020 LTI awards have a one-year performance period along with its CEO receiving a high base salary, all of which are considered problematic pay practices
- EA and Zynga recently announced their acquisitions by Microsoft and Take-Two, respectively



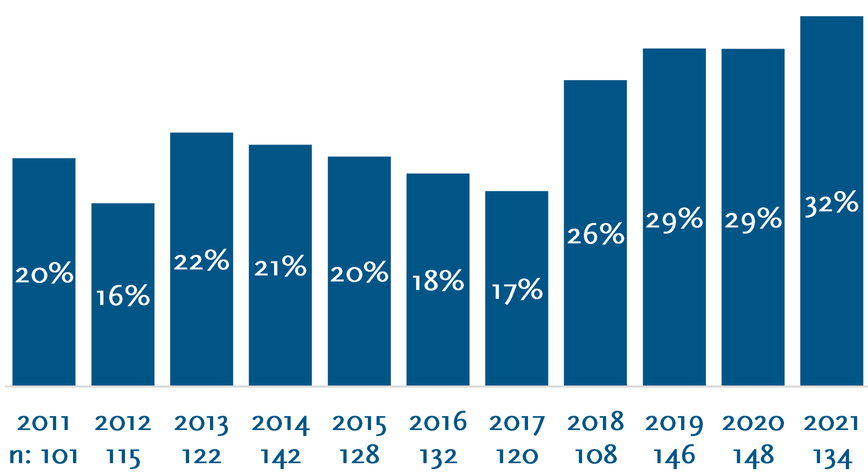
2021 **E&S PROPOSAL** RESULTS

1/27/2022

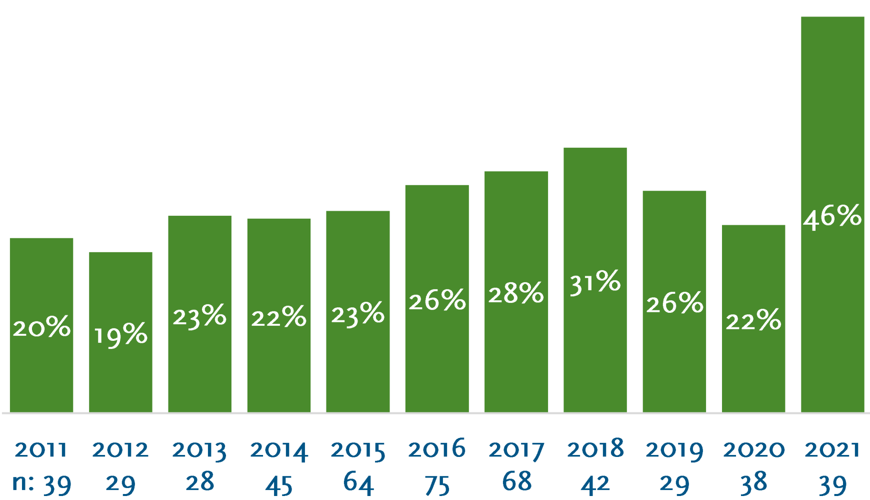
RUSSELL 3000
173 PROPOSALS

- During the 2021 proxy season, shareholders voted on 134 social proposals and 39 environmental proposals – median support for social proposals was three percentage points higher than last year and median support for environmental proposals was 24 percentage points higher than last year
- Twenty-three social proposals (17%) and sixteen environmental proposals (41%) received greater than 50% support in 2021; both rates were significantly higher than any previous year (9% of social proposals and 16% of environmental proposals received greater than 50% support in 2020)
- We observed significantly higher support (often above 70%) for proposals that requested reporting on EEO-1 statistics, diversity and inclusion efforts, Board diversity, lobbying payments, climate impact reporting, and emission reduction target disclosure

SOCIAL PROPOSALS MEDIAN VOTE RESULT



ENVIRONMENTAL PROPOSALS MEDIAN VOTE RESULT



SPOTLIGHT: TESLA

A shareholder submitted a proposal requesting that Tesla publish an annual report assessing the company's diversity and inclusion (D&I) efforts.

The proposal received 55% vote support

- The proponent cites corporate benefits of a diverse workforce, including empirical data that links D&I with higher financial and stock performance
- The proponent argues that despite Tesla's public statement to recruit, develop, and retain employees from a diverse background, it has not released meaningful quantitative data for shareholders despite previous requests from shareholders
- Tesla's Board recommended "Against" the proposal and noted that it already provides appropriate metrics for shareholders to track D&I efforts, including the company's first Diversity, Equity and Inclusion Report published in December 2020; the Board asserts these are appropriate metrics, compared to EEO-1 report data
- ISS recommended "For" the proposal due to Tesla providing broadly stated D&I goals and strategy and not providing sufficient data for shareholders to track year-over-year trends and progress towards stated goals

2021 E&S PROPOSALS THAT RECEIVED GREATER THAN 50% VOTE SUPPORT

Company	Proposal	Recommendation ISS	Recommendation Management	Support ▼
Environmental Proposals (n=16)				
Bunge Limited	Report on the Soy Supply Chain	For	For	99%
S&P Global	Approve Greenhouse Gas (GHG) Emissions Reduciton Plan	For	For	99%
General Electric Company	Report on Meeting the Criteria of the Net Zero Indicator	For	For	98%
Sysco Corporation	Report on GHG Emissions Reduction Targets	For	None	92%
DuPont de Nemours, Inc.	Report on Plastic Pollution	For	Against	81%
Phillips 66	Adopt GHG Emissions Reduction Targets	For	Against	79%
Norfolk Southern Corporation	Report on Corporate Climate Lobbying Aligned with Paris Agreement	For	Against	76%
Bloomin' Brands, Inc.	Report on Climate Change	For	Against	76%
AutoZone, Inc.	Report on Annual Climate Transition	For	Against	70%
United Airlines Holdings, Inc.	Report on Global Warming-Related Lobbying Activities	For	Against	65%
Exxon Mobil Corporation	Report on Corporate Climate Lobbying Aligned with Paris Agreement	For	Against	64%
Delta Air Lines, Inc.	Report on Climate Lobbying	For	Against	63%
Phillips 66	Report on Climate Lobbying	For	Against	62%
Chevron Corporation	Reduce Scope 3 Emissions	For	Against	61%
Conoco Phillips	Emission Reduction Targets	For	Against	59%
Booking Holdings Inc.	Report on Annual Climate Transition	For	Against	56%
Social Proposals (n=23)				
The Wendy's Company	Report on Human Rights Risks in Operations and Supply Chain	For	For	94%
International Business Machines Corp.	Publish Annually a Report Assessing Diversity, Equity, and Inclusion Efforts	For	For	94%
Paycom Software, Inc.	Report on Plans to Improve Diversity of Executive Leadership	For	None	75%
First Solar, Inc.	Report on Board Diversity	For	Against	91%
Union Pacific Corporation	Report on EEO	For	Against	86%
Badger Meter, Inc.	Report on Board Diversity	For	Against	85%
DuPont de Nemours, Inc.	Adopt Policy to Annually Disclose EEO-1 Data	For	Against	84%
Union Pacific Corporation	Publish Annually a Report Assessing Diversity and Inclusion Efforts	For	Against	81%
Netflix, Inc.	Report on Political Contributions	For	Against	80%
Chemed Corporation	Report on Political Contributions	For	Against	79%
Microsoft Corporation	Report on Effectiveness of Workplace Sexual Harassment Policies	For	Against	78%
First Community Bancshares, Inc.	Report on Board Diversity	For	None	71%
United Airlines Holdings, Inc.	Report on Political Contributions and Expenditures	For	Against	68%
The GEO Group, Inc.	Report on Lobbying Payments and Policy	Against	Against	66%
FedEx Corporation	Report on Lobbying Payments and Policy	For	Against	62%
American Express Company	Publish Annually a Report Assessing Diversity, Equity, and Inclusion Efforts	For	Against	60%
SunRun Inc.	Report on Impact of Mandatory Arbitration on Employees and Workplace Culture	For	Against	58%
Tesla, Inc.	Report on Diversity and Inclusion Efforts	For	Against	55%
Exxon Mobil Corporation	Report on Lobbying Payments and Policy	For	Against	56%
AECOM	Report on Lobbying Payments and Policy	For	Against	54%
Royal Caribbean Group	Report on Political Contributions Disclosure	For	Against	53%
Duke Energy Corporation	Report on Political Contributions and Expenditures	For	Against	51%
Omnicom Group, Inc.	Report on Political Contributions and Expenditures	For	Against	51%

2021
DIRECTOR ELECTION RESULTS

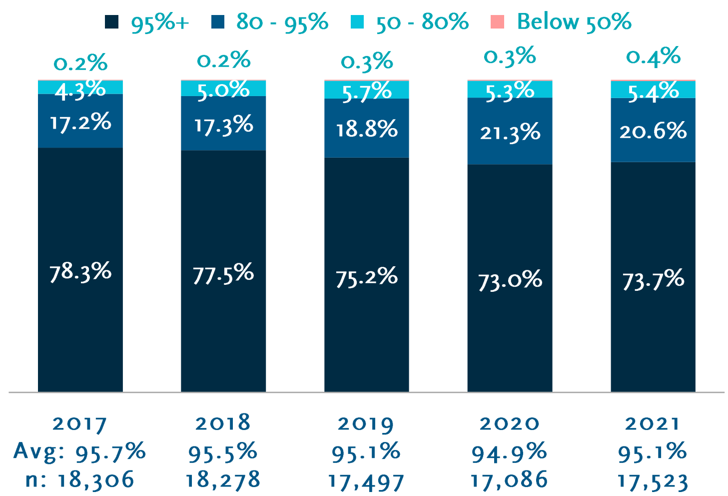
1/27/2022

RUSSELL 3000
17,523 DIRECTORS

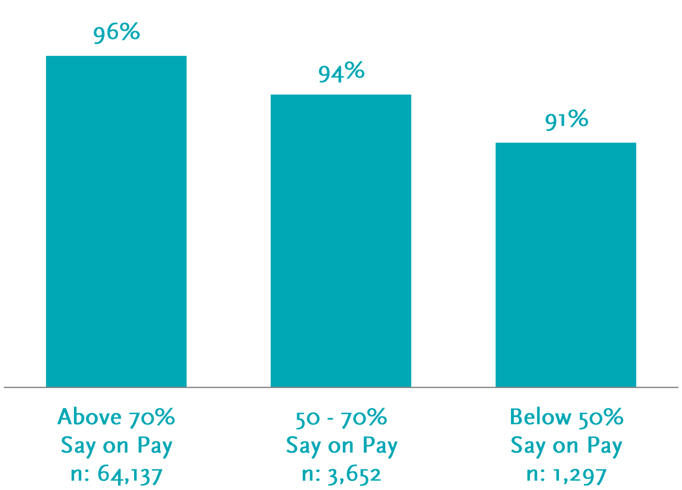
DIRECTOR ELECTION OBSERVATIONS

- Average vote support for Director nominees of 95.1% was 20 basis points higher than the average vote support in 2020 and equal to the average vote support in 2019
- The percentage of Director nominees that received vote support over 95% declined from 78% of nominees in 2017 to 74% of nominees in 2021
- Over the past five years, average Director election vote support at companies that received a Say on Pay vote below 50% in the prior year is five percentage points lower than at companies that received above 70% support
- Average vote support for female Director nominees was 160 basis points higher than average support for male nominees, which was slightly lower than the difference observed in the last two years

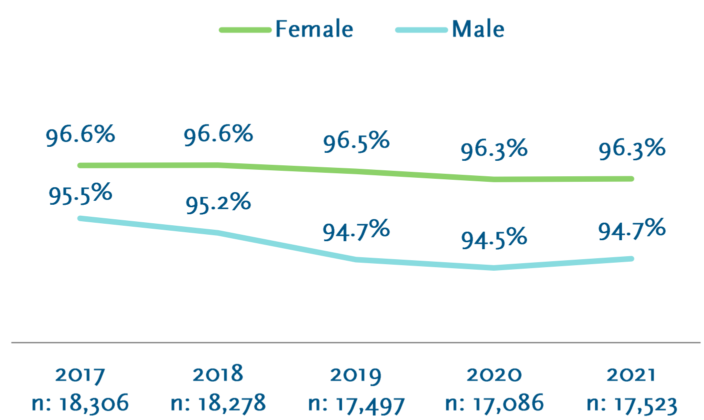
BREAKDOWN OF DIRECTOR ELECTION RESULTS



AVERAGE DIRECTOR ELECTION RESULTS IN YEAR FOLLOWING SAY ON PAY (2017-2021)



AVERAGE DIRECTOR ELECTION RESULTS BY GENDER



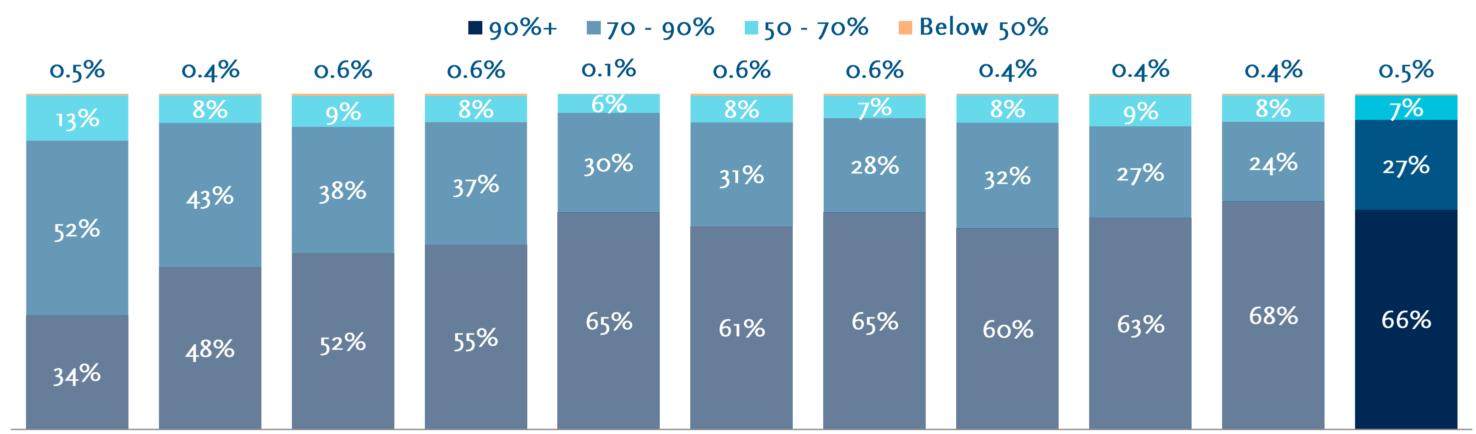
2021 EQUITY PROPOSAL RESULTS

1/27/2022

RUSSELL 3000
635 PROPOSALS

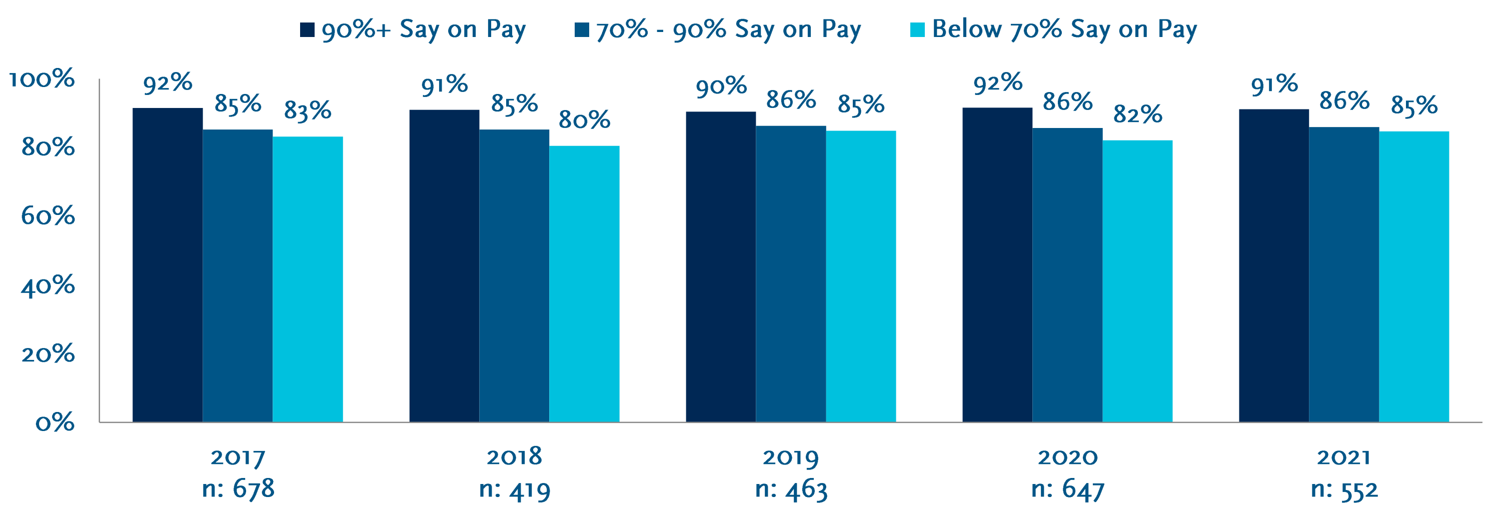
- Average vote support for equity proposals (89.1%) was 30 basis points lower than the average vote support observed last year
- Three proposals (Penumbra, Simulations Plus, and Cassava Sciences) received vote support below 50% in 2021, the same number of proposals that received vote support below 50% in 2020
- Companies that received less than 70% Say on Pay vote support had slightly higher average equity plan proposal vote support in 2021 (85%) than in previous years

BREAKDOWN OF EQUITY PLAN PROPOSAL VOTES



2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Avg: 83.2%	86.3%	86.9%	87.6%	89.5%	88.2%	89.3%	88.3%	88.3%	89.4%	89.1%
n: 632	689	781	805	786	785	829	558	565	697	635
Failures: 3	3	5	5	1	5	5	2	2	3	3

SAY ON PAY IMPACT ON EQUITY PLAN PROPOSAL VOTES



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MORE

DIRECTORS, PREPARE FOR MORE:

TRACKING, REPORTING, AND INCENTIVIZING DE&I

WomenCorporateDirectors
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Pearl Meyer

INTRODUCTION

> "Boards play an important role to ensure management attention is placed on DE&I so the leadership see it as part of their job to challenge measures and actions when they aren't aggressive enough and reinforce the long-term value and feasibility of high DE&I standards."
>
> **- Evelyn D'An,** Director, Summer Infant, GHD Group and Backblaze

Over the last decade, diversity, equity and inclusion (DE&I) has been elevated as a critical issue for boards and management teams. Several catalysts have accelerated this focus, including new pay equity laws in the US at the state level; the #MeToo movement; media attention on the gender pay gap and broader income inequality; and waves of social unrest. As this topic takes center stage now in the boardroom, Women Corporate Directors Foundation (WCD) and executive compensation consulting firm Pearl Meyer set out to understand the extent to which directors are engaging in discussions about DE&I and tracking various relevant measures.

A recent survey conducted by WCD and Pearl Meyer shows a consistent theme: **more.** Directors are more involved than they've been in the past when it comes to DE&I discussions. Companies are measuring more metrics related to DE&I and communicating more about their progress across additional channels in a sophisticated way. Directors and management teams are playing a greater role in integrating DE&I into the entire organization. It should be noted these findings also show that DE&I is not simply a hot-button topic that boards are reacting to as a result of external pressures, such as media coverage or social unrest. Rather, it is a critical topic that directors and corporate leaders have been discussing for years, and they are now taking greater strides to measure and accelerate progress.

The data show DE&I practices are evolving rapidly; yet, companies are at different maturity points in their DE&I journey. Organizations will be developing more sophisticated measures and tracking systems, improving communication, and reporting and holding executives accountable for progress on DE&I. These survey findings, complemented by perspectives from WCD members and Pearl Meyer senior consultants, can help inform, guide and accelerate action as boards and management teams look more holistically across the organization to address DE&I and build cultural norms and operational structures to help achieve their goals.

DE&I DISCUSSIONS ARE NOT NEW

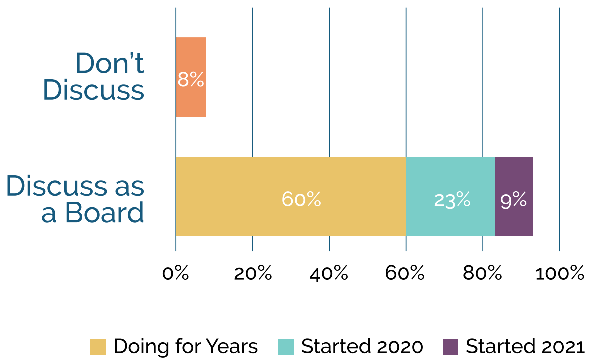
"The pandemic may have played a part in accelerating the DE&I discussion, but there is also plenty of pre-pandemic research proving the link between diversity and company performance, so it is clear that focusing on DE&I is the smart thing to do."

- Deborah Ellinger, Director, Women Corporate Directors, Covetrus, iRobot and Tupperware Brands

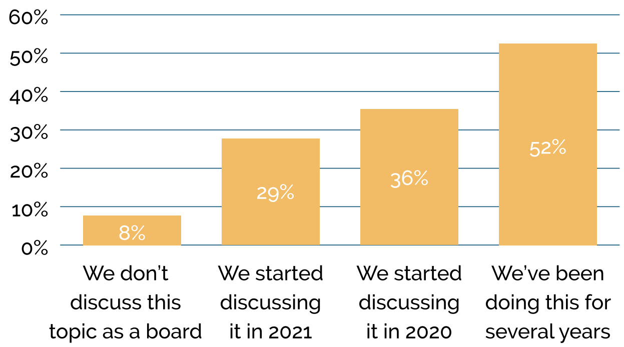
1. **Directors are involved in DE&I discussions and this is not new.**

It is abundantly clear that directors are engaging in DE&I discussions at the board level (92%), and many (60%) have been for years. The continued focus on DE&I shows these discussions are not a knee-jerk reaction to the events of the past 18 months, but rather an important trend that follows a culmination of decades-long societal pressures.

How Long has the Board Been Involved in Discussing DE&I Matters?



Percent that Rated Gender Representation as Better Than Peers



Boards are expanding the depth and breadth to which they discuss these matters. Successful organizations will see their board taking an active role which may include asking the management team more detailed questions about their DE&I programs, talking through issues that may arise or setting up DE&I councils.

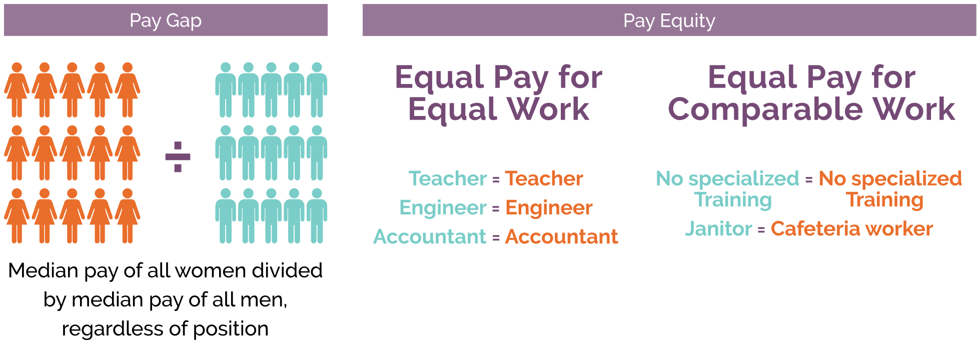
Beth Florin, Managing Director at Pearl Meyer, points out in her analysis that directors who stated they have been involved in DE&I conversations for the past several years, are also those who are asking management to be involved. She states "The organizations that are making progress are the ones where the leadership team is invested in creating change." This is supported by the data which show that firms that have been engaged in DE&I discussions for multiple years are also the firms that believe they do better than peers in terms of gender representation (52%).

Pay Gap and Pay Equity

Recent legislation in the US on pay equity and in the UK on pay gap has raised the prominence of the need to assess an organization’s current state. While the terms are often used interchangeably in the media, they are two very different perspectives of gender pay equality. Pay gap refers to the difference between the median or mean pay for men and women (regardless of other factors), whereas pay equity refers to equal pay for comparable work regardless of gender.

In a 2020 Pearl Meyer survey of Human Resources practitioners, respondents indicated that 91% of their organizations had completed a pay equity assessment or plan to do so within the next year, and 75% have measured their pay gap. In contrast, in the WCD and Pearl Meyer survey, directors indicated that 54% have assessed pay equity and only 40% have examined pay gap. This suggests that these topics are not rising to the level of the board, missing the opportunity for meaningful discussion on the implications of the results for the organization.

How Are Gender Pay Issues Defined?
Clarity on the Nomenclature is Critical



> The pay gap in the US is driven by a number of factors, the most prominent being fewer women in leadership positions; more women in low paying occupations; and societal norms on childcare and home care. As a result, ‘closing the gap’ is typically beyond the control of an individual organization. Pay equity—paying people fairly given the job they perform, the experience they bring to the position and their performance—is absolutely under the control of an individual organization and we believe should be an imperative for all firms to achieve.

- Beth Florin, Managing Director, Pearl Meyer

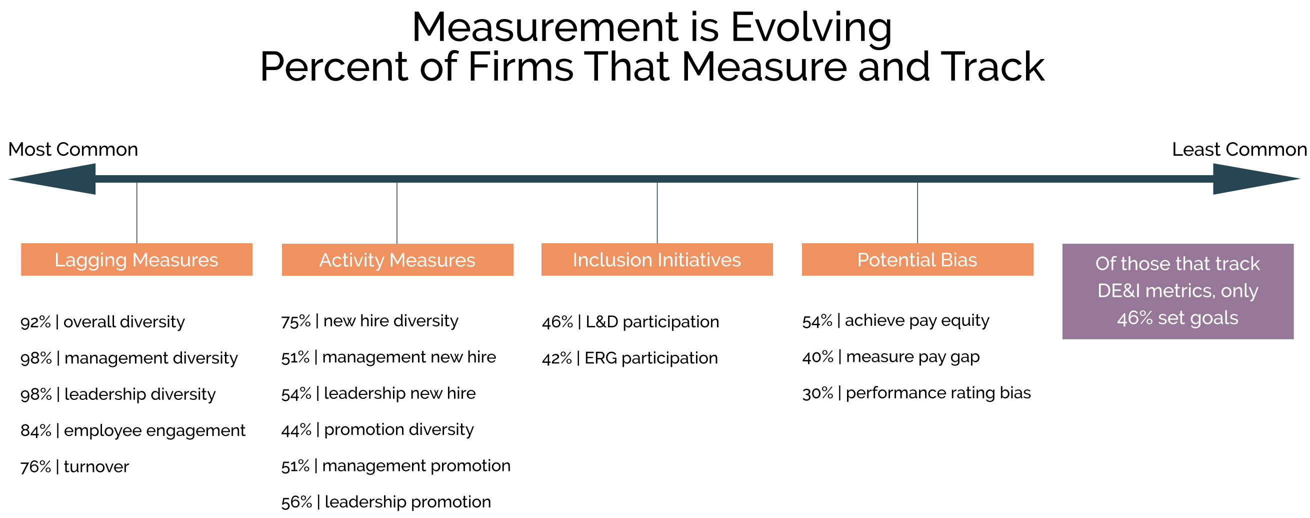
METRICS ARE EXPANDING

> "At a mature organization, this is an annual discussion using tracked lagging, activity, potential and bias metrics. For less mature organizations, lagging measures, some activity measures and potential bias measures are being developed."
>
> **- Evelyn Dilsaver,** Director, Health Equity, Tempur Sealy, Ortho Clinical Diagnostics, Blue Shield, Protiviti and Bailard Real Estate Fund

2. Organizations are expanding the metrics they use to track DE&I.

Organizations are using a range of DE&I measurements to track their progress. Lagging measures such as end-of-year reporting on diversity in the overall workforce and in management and leadership positions, workforce engagement scores and turnover rates were cited as the most common, likely because they are more readily available and have been tracked previously.

However, organizations are also increasingly tracking activity-based measures, such as those related to hiring and promotion, with 75% citing that they track new hire diversity and 56% citing that they track diversity in leadership promotions. In her work, Florin is seeing this data play out as organizations are evolving to track activity measures. "Companies are evaluating whether the actions they're taking today—hiring and promotion diversity—are in alignment with their strategic objectives from a DE&I perspective."



METRICS ARE EXPANDING

"I think DE&I is tough to measure with numbers and that the best tool is a well-crafted, thoroughly analyzed employee survey with pulse updates to measure cultural progress in addition to counting representation at the various levels. A leading company will ensure that it does not promote leaders who create a toxic environment from a DE&I perspective, and it will celebrate those who really move the needle."

- Martha Brooks, Director, Jabil Inc., Volvo AB and Constellium SE

Inclusion initiatives and potential bias were ranked the least commonly tracked data. Inclusion initiatives, such as leadership & development programs and employee resource groups, are tracked by less than half of respondents. Measures that can point to potential bias, such as pay equity, pay gap and whether there are issues in performance rating systems, are likewise infrequently compared to lagging and activity metrics. While only between 30-54% of the organizations surveyed track within these categories, the data indicate that organizations are becoming more sophisticated in how they measure more complicated aspects of DE&I.

Despite organizations expanding their level of DE&I measurement, only 46% of organizations set DE&I goals, which in part may be attributed to the difficulty in setting quantitative goals to track against. "Setting up DE&I goals is not easy—especially for global companies. Every company I am involved in has a global workforce, and the definition of 'diversity' is different everywhere. I think it is important to pick one region at a time, show some successes, learn what works, and then continue to expand the effort from there," said Ellinger.

While progress continues to be made to capture DE&I information, collecting consistent and accurate DE&I data was cited as a continuing challenge. Varying laws and regulations complicate the data collection process. According to D'An, "The right systems [and technology] must be in place and fully integrated to ensure data consistency. Companies with disparate systems and manual interfaces run a high risk of data errors." In addition, D'An commented, "much of DE&I reporting is dependent on self-identification to capture and accurately report ethnic and under-represented groups."

COMMUNICATION IS IMPERATIVE

3. **Communication around DE&I is expanding exponentially.**

As measurement and tracking of DE&I increases, we see internal and external communication increase on a parallel path. There are many external factors that have been a driver of communication as it relates to this topic, including new SEC regulation for disclosure of material human capital management information[1], as well as calls for additional disclosures from prominent organizations like ISS, Glass Lewis, and BlackRock. "These outside stakeholders are setting the expectation that organizations need to be serious about [DE&I] which is leading companies to step up their DE&I efforts and board members to ask for more information from their management teams," said Florin.

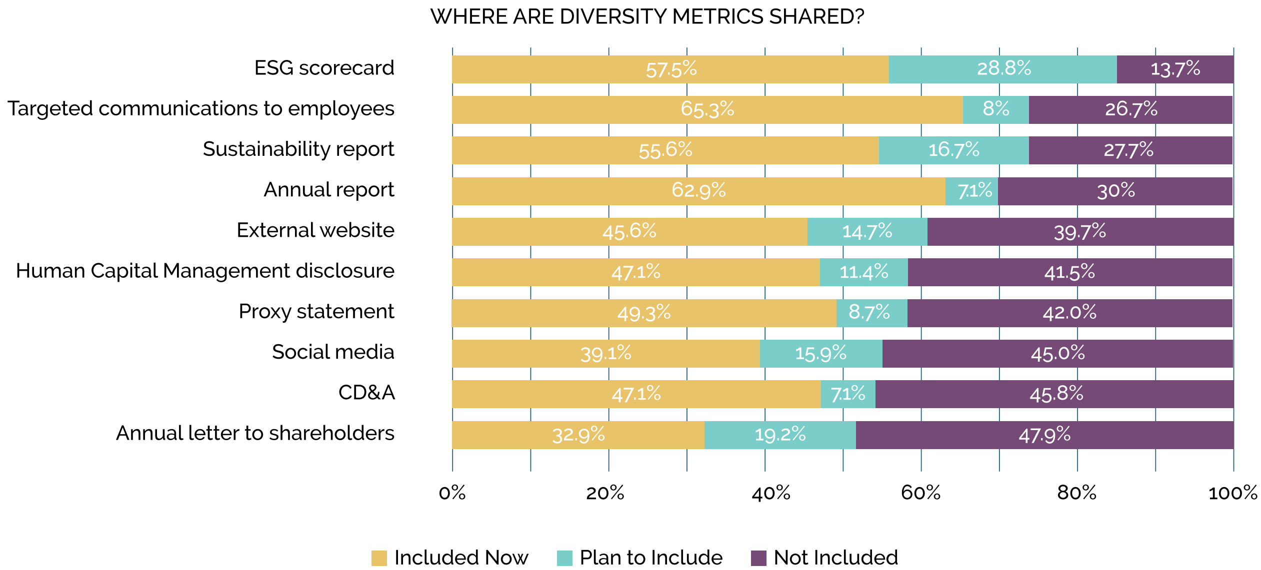
A majority of directors (65%) cited that their company's primary communication method on DE&I is through targeted communication to employees, indicating that management is being transparent and open with their workforce about their DE&I efforts. Perhaps unsurprisingly, the survey also revealed that a large percentage of directors indicated that their companies include the topic within their ESG scorecards (58%) or sustainability reports (56%). As pressure increases for companies to describe their DE&I position, ESG and sustainability reports have become the most frequently used vehicle for communicating externally on a firm's progress.

[1]**SEC Mandates Human Capital Disclosure: Nebulous Guidance Provided**
https://www.pearlmeyer.com/knowledge-share/client-alert/sec-mandates-human-capital-disclosure-nebulous-guidance-provided

COMMUNICATION IS IMPERATIVE

When looking toward the future, organizations expect to expand the methods and channels through which they're communicating about DE&I, including more companies using human capital management disclosures, social media and communication with shareholders. Communication has and will continue to become increasingly sophisticated and deeper as organizations track more metrics and as external pressures continue to rise from investors, consumers and potential employees.

Organizations Plan to Increase Communication of Diversity Metrics Across All Vehicles



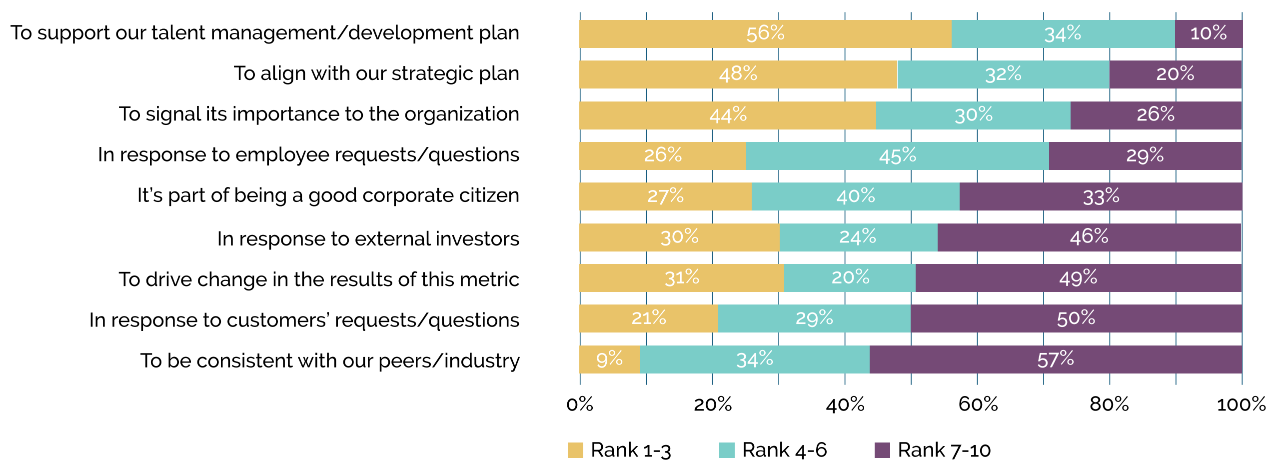
> "Focusing on a single DE&I measure in an incentive plan fails to provide a holistic view of the diversity health of an organization and can have unintended consequences. Rather than using a single measure in an incentive plan, we encourage organizations to take a broader viewpoint by using a scorecard approach."
>
> - **Beth Florin,** Managing Director, Pearl Meyer

4. **DE&I is increasingly being considered as part of annual incentive plans.**

While DE&I has been a discussion in the boardroom for many years, its inclusion in executive incentive plans is a growing trend. In fact, 39% of organizations currently include DE&I in their executive annual incentive plan and another 41% indicate they are likely or very likely to incorporate DE&I into incentive plans moving forward.

Of the organizations including DE&I in annual incentive plans, more integrate it into existing components such as individual management business objectives, the company's overall business plan, or an ESG scorecard. Less often, DE&I is included as a stand-alone metric for executives. Another way companies are holding executives accountable through their compensation is to have DE&I metrics influence the size of an annual award, either as a threshold or modifier, or to be used at the compensation committee's discretion.

Reasons to Include DE&I in Incentive Plans

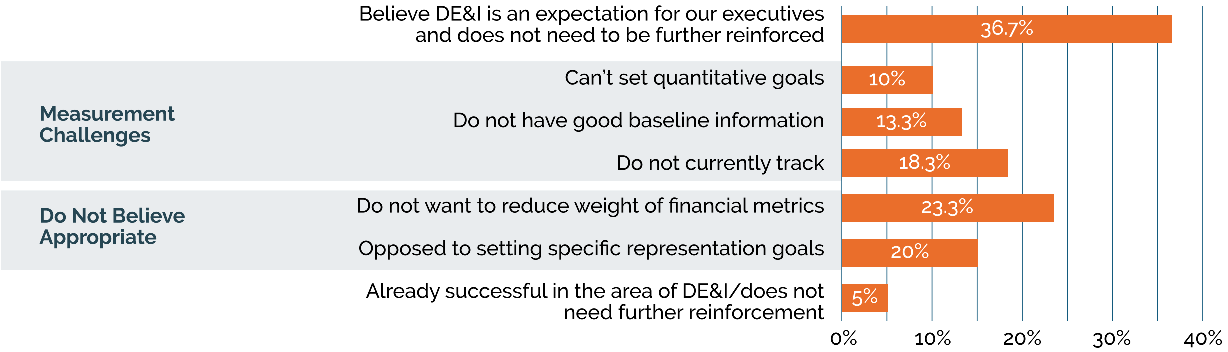


> One of my boards wanted to make sure we further developed the pipeline [of diverse candidates], to be more intentional and more transparent.
>
> **- Evelyn D'An,** Director, Summer Infant, GHD Group and Backblaze

The range of approaches that organizations are using to incorporate DE&I metrics into executive incentive plans suggests that this is an evolving practice with no one clear best practice. The most common reason cited for including this in the executive annual incentive plan was due to its "strategic importance," indicating that organizations are no longer looking at DE&I as a separate or "nice-to-have" initiative.

Further, some respondents (36.7%) said their organizations do not agree with identifying and including specific DE&I metrics in annual incentive plan because it is a baseline expectation for executives and does not need to be further reinforced. Other respondents reported they do not want to reduce the importance of financial metrics in order to include DE&I metrics.

Reasons for Not Including DE&I in Incentive Plans



The practice of how and where to account for DE&I in executive incentive plans is still emerging for some organizations. Many directors may be serving on boards that are just beginning to tackle this very topic. However, on another board, D'An has not discussed incorporating DE&I into incentive planning as their organization believes they are performing well in this area. Over the coming years, boards should expect to continue seeing organizations debate how best to create DE&I accountability and align it with their business strategy, including incentive design where appropriate.

WHAT MORE CAN DIRECTORS DO?

It is clear that the state of DE&I in corporations is evolving, and directors and companies are becoming more sophisticated in how they approach its tracking, goal setting and communication. This heightened level of activity is being driven by an increasing demand from investors, employees, regulators and consumers to address equity at all levels of an organization. However, achieving an advanced state of leadership equity is a long-range endeavor. The boards that take a methodical approach to setting diversity, equity and inclusion milestones and meeting long-term goals will be the most successful.

There are six interrelated steps that can lead to an improved DE&I environment and a more mature, human capital-oriented organization.

1. **Understand the Current State:** This includes a thorough review of the organization's current DE&I status, setting the relevant tracking systems and ensuring those systems include activity, inclusion and potential bias metrics.

2. **Build a Diverse Pipeline:** Ensure the board and management team have protocols in place for requiring diverse candidate slates and procedures that ensure diverse candidate selection when all else is equal.

3. **Develop Future Leaders:** Create formal processes to help increase diversity in leadership positions, with talent management and development programs that are specifically gender, minority, and/or identity-oriented.

4. **Engage a Diverse Workforce:** Encourage formal internal affinity and networking groups and develop programs that focus on inclusivity concepts and actions.

5. **Retain a Diverse Workforce:** Beyond compensation, companies will be forced to get creative in order to retain their diverse workforce. In addition to overall workplace and time flexibility, examples to reduce the potential for career-interruption include on-site childcare, job sharing and plans to facilitate career re-entry.

6. **Create Accountability:** The involved board can lead to an accountable management team. Tracking, reporting, and holding leaders accountable for measurable progress is key. In addition to regular formal and informal, internal and external communication, directors can influence success by incentivizing management to set and meet short- and long-term goals.

WHAT MORE CAN DIRECTORS DO?

Once board members and management teams have a thorough understanding of where their organization stands on DE&I and have a documented vision for its future state, they can build a plan for action. "Continuous follow-up from the board to management is necessary to ensure progress," said Dilsaver. There are many ways organizations are already affecting change and organizations have an opportunity to accelerate progress by prioritizing a diverse, equitable environment. Brooks commented, "DE&I will be with us for a long time. It is critical that we get a clear pulse on the employee experience to understand the barriers we need to overcome in DE&I to build the best possible culture to support the corporate strategy."

Methodology

This study was distributed as an online survey of WCD members, conducted from July 13 to July 30, 2021. Of 157 total respondents, 90% are directors currently serving on boards, while the remaining percentage are in the C-suite or senior management positions. Approximately 70% of respondents currently serve on the board or leadership team of a public company. A decision was made to survey board members of US-based organizations due to the varying regional definitions of diversity and regulations related to equity.

ABOUT WOMEN CORPORATE DIRECTORS EDUCATION AND DEVELOPMENT FOUNDATION, INC.

A unique global network, the Women Corporate Directors Education and Development Foundation (WCD), a not-for-profit organization, has served as the place where the most powerful and influential women in the world have convened for more than 20 years.

WCD is recognized as:

- A bold catalyst for board diversity
- A true world-wide peer community for seasoned and acclaimed female corporate directors
- A critical resource for board opportunities
- A leader in developing high-quality governance programming, thought leadership, and sharing best practices
- A valued facilitator accessing critical insights from leading authorities across a variety of industries and topics

Our Mission

As the preeminent organization for women directors globally, WCD seeks to:

- Foster a powerful, trusted, and global community of women corporate directors who meet specific and objective criteria
- Increase representation of women on public and large private company boards and in board leadership positions
- Increase the pipeline of aspiring and qualified female board candidates
- Inspire visionary boards worldwide – by providing education and tools that keep members engaged, informed, and high-performing as directors.

For More Information

To learn about the benefits of WCD membership and how to join, visit **womencorporatedirectors.org.**

ABOUT PEARL MEYER

Pearl Meyer is the leading advisor to boards and senior management on the alignment of executive compensation with business and leadership strategy, making pay programs a powerful catalyst for value creation and competitive advantage. Pearl Meyer's global clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private companies to the Fortune 500 and FTSE 350. The firm has offices in Atlanta, Boston, Charlotte, Chicago, Houston, London, Los Angeles, New York, Rochester, and San Jose.

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WomenCorporateDirectors
A Foundation *Inspiring Visionary Boards Worldwide*

Pearl Meyer

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Name: Ira T. Kay
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- **Ira**, a Managing Partner/Founder at Pay Governance, is one of the nation's foremost experts on executive compensation. He works closely with boards and management to help them develop executive compensation programs that Balance the Tension in increasing shareholder value in the current regulatory environment. His clients include premier US and global corporations ranging across various industries, including technology and financial services companies. A sample list of his major clients include: Qualcomm, Accenture, WalMart, Morgan Stanley, and Chubb. He has done special projects in the tech space for Intel, Palo Alto Networks and a subsidiary of Google.
- Ira writes and speaks regularly on executive compensation issues. He has authored and edited several prominent books on executive compensation and governance. His most recent co-edited book was written with the partners of Pay Governance: "Balancing the Tension: Current Topics in Executive Compensation". Ira is considered an expert on the relationship of CEO pay and performance and has conducted and published research on pay for performance, stock buybacks, say on pay votes, CEO pay ratio and other important topics. He is often quoted in The Wall Street Journal (WSJ), New York Times, Agenda, The Economist, and other leading Board level publications.
- Ira holds a B.S. in Industrial and Labor Relations from Cornell University and a Ph.D. In economics from Wayne State University.

Harvard Law School Forum on Corporate Governance

U.S. Corporate Journey Towards Gender Diversity

Posted by Olivia Wakefield, Ira T. Kay, and Paige Patton, Pay Governance LLC, on Monday, December 6, 2021

Tags: Board composition, Board dynamics, Boards of Directors, Diversity, ESG, Human capital
More from: Ira Kay, Olivia Wakefield, Paige Patton, Pay Governance

Editor's Note: Olivia Wakefield is Partner, **Ira T. Kay** is a Managing Partner/Founder, and **Paige Patton** is a Consultant at Pay Governance LLC. This post is based on their Pay Governance memorandum. Related research from the Program on Corporate Governance includes **Politics and Gender in the Executive Suite** by Alma Cohen, Moshe Hazan, and David Weiss (discussed on the Forum **here**); and **Will Nasdaq's Diversity Rules Harm Investors?** by Jesse M. Fried (discussed on the Forum **here**).

Executive Summary

- Over the past five years, **cultural, legislative, and governance factors** have strongly influenced board diversity resulting in an increase of women directors serving on U.S. public company boards.
- **Women now hold 30% of board seats across the S&P 500, relative to 18% held five years ago** . This increase should be considered a milestone in the journey, with expectations for continued progress over the coming years.
- During this same five-year period, **women board members have increased by a net amount of approximately 2,700 while, in contrast, men board members have declined by a net amount of approximately 1,900.** These numbers were attained by examining a broader data set consisting of thousands of companies with more than $150 million in market capitalization. This total includes the Russell 3000, plus many more companies whose data were collected by *DirectorMoves*, a weekly publication which analyzes Board changes. This vast increase in women board members demonstrates the strong commitment of U.S. corporations in regard to board gender diversity.
- **In 2021, the departure rates for men board members are projected to be over four times higher than their women colleagues,** with over 1,800 men departing boards as compared to 460 women departing during that same period (Source: DirectorMoves). This change reflects a shift in board composition that is driven by companies seeking both diversity and a broader mindset regarding the critical capabilities needed for today's boards.
- U.S. companies have made great strides towards a balance of gender diversity on boards. This is in addition to the **nascent growing success of the recruitment of underrepresented minorities.**
- **A potential challenge to meaningful board diversity may be current board governance practices** ; more ongoing evaluations in terms of board structure, succession planning, term limits, and retirement ages may be required to further facilitate continued diversification.

Overview

As executive compensation advisors to the boards of many prominent publicly traded companies, we are witnesses to the revolutionary increase of women directors in the board room. Board gender diversity remains a major corporate governance objective globally. The U.S. has achieved substantial progress on gender diversity at many large publicly traded companies. Significant progress has been made as society, investor preferences, and governance have evolved, often through the hard work of groups and leaders focused on the criticality of this issue. Many experts believe that gender diversity is essential to financial success, better decision-making and attractiveness to investors, while benefiting all stakeholders: employees, customers, vendors, and the public. [1]

While boards have made progress on gender diversity, there is more to do to increase both gender and underrepresented minority (URM) representation on boards. As we continue to strive for better board gender diversity, we suggest that the lessons learned on this front can enable broader board diversity including URM representation. We also discuss how current board governance structures may need to be reframed in the effort of advancing broader board diversity.

Women Joining Boards: By the Numbers

To understand the progress of women on boards, we have utilized unique information from the *DirectorMoves* database that contains information from thousands of companies with market capitalizations of $150 million or greater, which would include all of the Russell 3000 plus many more. These data allow us to develop real-time information, specifically focusing on the number of directors joining and departing boards by gender. The *DirectorMoves* data show a significant increase in women board members over the past five years with over 2,700 women joining boards (net of departures); 1,300 of whom joined in the last two years. In stark contrast, over 1,900 men (net of new men joining) have departed from board service during the same period (**Figure 1**). The definition of “net amount” is calculated as [net board members = total board members joining—total board members departing]. For example, if a total of 10 women joined boards in a period and 7 departed in the same period, the net increase is 3 joining. The same methodology was used to calculate the net for men.

In a 2021 annualized forecast, over 1,400 men will have been recruited to join boards, while over 1,800 men will have departed. By contrast, over 1,200 women directors will have been recruited to join boards, and 460 will have departed (**Figure 2**). While the total projected number of men joining boards remains slightly higher than women in 2021, the forecasted departure levels for men are substantially higher than that of women (1,857 men versus 460 women).

Figure 1: Five Year Cumulative Comparison

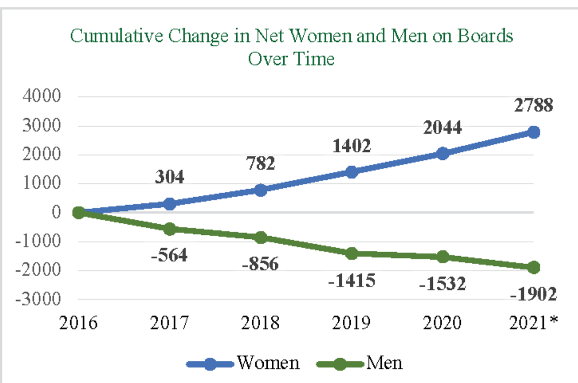
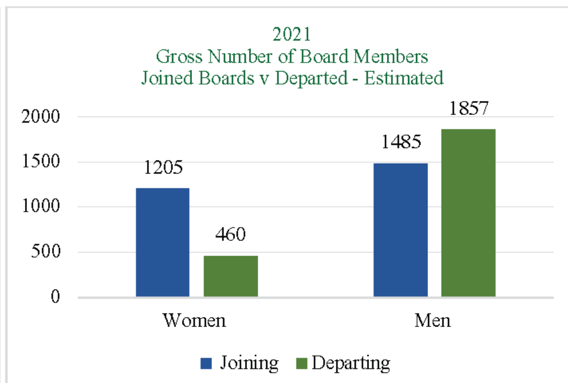


Figure 2: 2021 Board Members Joining and Departing



Source: DirectorMoves data
These data come from two DirectorMoves data sources. Cumulative change data in **Figure 1** reflects the number of board joiners less the number of board departures by gender as reported by DirectorMoves twice weekly since January 1, 2021. Full year data are forecasted based on the annualized weekly trend since January 1, 2021. The gross numbers in **Figure 2** reflect 2021 year to date data which have been interpolated. As a general matter, these are not the same people joining and departing.

The DirectorMoves data indicate a compound annual growth rate of women on boards of approximately 25% over the past four years; however, the growth of women on boards has decelerated in the past two years (**Figure 3**).

In contrast, despite the fact that we estimate that there are slightly more men than women still being recruited to boards, the number of men on boards has declined on average by almost 380 per year over the past five years (**Figure 4**).

Evolution of Board Gender Composition

Currently, 30% of the S&P 500 independent board directors are women. This shows progress when compared to 2015, when women represented approximately 18% of board composition. In 2015, there was an average of 1–2 women independent board members sitting on a board of 9–11 board members. Today, the average number of women directors is 3.3% [2] within an average board size of 10.8% [3] Further, nearly 400 women were recruited in the past two years to S&P 500 boards. Over the past five years, we have seen a 78% increase in the number of women directors of S&P 500 companies, with the percent change increasing to over 200% in the ten years from 2011–2021 (**Figure 5**). These growth rates are directionally consistent with the more expansive universe of the DirectorMoves data, which capture a broader sample of companies of varying sizes and whose progress has advanced (as outlined in **Figure 3** above), but not at the pace of the S&P 500.

While 30% was the initial target level for women board representation in 2015, it should be considered a milestone in the journey with expectations for continued progress. Certain S&P 500 organizations are leading the way with 50% or greater women board diversity in 2021. Of note, within the ten S&P 500 companies that have 50% or more women on their board, six also have women Chief Executive Officers and/or women Board Chairs, supporting recent observations that companies with women leaders tend to have more diverse board composition. [4]

This progress has been driven within the U.S. by a number of factors including legislation, regulatory efforts, and shareholder focus, as well as the hard work of groups and leaders focused on the criticality of diversity issues. For example, in 2018 California passed Senate Bill 826 into law which requires California headquartered, publicly traded companies to have at least one woman on the board. Additional states that have enacted board diversity-related measures include: Colorado, Maryland, Illinois, and New York. [5] In August 2021, the SEC approved NASDAQ's Board Diversity Rule which requires companies listed on their U.S. stock exchange to publicly disclose board-level diversity statistics annually using a standardized template, or explain why they do not have at least two diverse directors. [6] Further, Institutional Shareholder Services ("ISS") has just closed the comment period for the ISS Proposed Benchmark Policy Changes for 2022, which include proposed changes to ISS' gender, racial and ethnic policies in multiple markets. [7] These requirements will help organizations both focus on their diversity, inclusion and belonging priorities while providing shareholders and employees with increased transparency regarding board-level progress towards broader diversity.

Reframing Board Governance Norms to Accelerate Progress

The progress towards a balance of gender diversity on boards is significant. As we identify factors that may be posing challenges to diversity on boards generally, it is important to evaluate whether current board governance practices should be revised to keep pace with cultural and social changes in the broader environment. To continue diversity progress, companies should reevaluate the skills and capabilities they need from their board members as well as facilitate that evolution of skills to match strategy and culture (e.g., through board refreshment, changes in board recruiting strategy, etc.). We see this new mindset emerging as companies continue to focus on board succession planning with the same rigor as management succession planning.

Conclusion

The increased representation of women in the boardroom over the past five years is promising. Gender diversity has gained both momentum and visibility as society, investor preferences, and governance have evolved, often through the hard work of groups and leaders focused on the criticality of this issue. Further, many organizations have already begun the execution of their diversity, equity, inclusion, and belonging priorities which means that we can expect to see more change in board composition in the coming years. With the increasing requirements for consistent disclosure across U.S. publicly traded companies, and ongoing investor pressure, we expect closer attention to increased URM diversity as well. Boards must ensure that board members continue to have the skills and capabilities to best support their business strategies and meet stakeholder expectations. This will help spur progress in creating boards composed of a variety of different people and perspectives—creating a richer dialogue, enhanced decision-making, and improved company performance.

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Harvard Law School Forum on Corporate Governance

The Stakeholder Model and ESG

Posted by Ira Kay, Chris Brindisi and Blaine Martin, Pay Governance LLC, on Monday, September 14, 2020

Tags: Corporate purpose, ESG, Executive Compensation, Incentives, Stakeholders
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Editor's Note: Ira Kay is a Managing Partner, **Chris Brindisi** is a Partner, and **Blaine Martin** is a Consultant at Pay Governance LLC. This post is based on their Pay Governance memorandum. Related research from the Program on Corporate Governance includes **The Illusory Promise of Stakeholder Governance** by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum **here**); **For Whom Corporate Leaders Bargain** by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita (discussed on the Forum **here**); and **Paying for Long-Term Performance** by Lucian Bebchuk and Jesse Fried (discussed on the Forum **here**).

Introduction

In August 2019, the Business Roundtable (BRT) released its new stakeholder model of the revised purpose of the corporation, stating explicitly that businesses exist to serve multiple stakeholders—including customers, employees, communities, the environment, and suppliers—in addition to shareholders. **[1]** This new model was publicly supported by 181 CEOs of major corporations. It could have a substantial impact on corporate incentive designs, metrics, and other governance areas as corporations continue or begin to operationalize this stakeholder model into their long-term strategies, as incentive plans are core to reinforcing and communicating business strategy. While there are many opinions on the BRT statement, the stakeholder model is evolving in both importance and sophistication. **[2]**

Further, the COVID-19 pandemic, the associated economic impacts, and increased focus on social justice illustrate the increasing expectations on—and willingness of—corporate leaders to address social issues that may extend beyond a traditionally narrower view of the business purpose of the corporation. Given these circumstances, some companies are taking a fresh look at their impact on numerous stakeholder groups and their reinforcing impact on company success. For example: Will increased focus on employee wellness initiatives enhance the resilience of corporations? Will sustainable supply chains and real estate differentiate a company in both the consumer and talent markets, or are these practices rapidly becoming baseline expectations of employees, investors, customers, and the broader community? The answers to these questions are beyond the scope of our expertise, but these and similar questions are at the center of the discussion on ESG metrics and their applicability to incentive compensation.

If the stakeholder model represents an emerging model for the *strategic* vision of a company, ESG (Environmental, Social, and Governance) metrics can be used to assess and measure company performance and its relative positioning on a range of topics relevant to the broader set of company stakeholders in the same way that financial metrics assess company performance for shareholders. This post will address, at a “conceptual” level, key questions and guidelines for assessing a company’s *readiness* for—and potential *approach* to—implementing ESG metrics and goals in executive incentive programs. We are applying our significant expertise in the design of executive incentive programs to the emerging paradigm of ESG-focused goals in the context of the evolving stakeholder model.

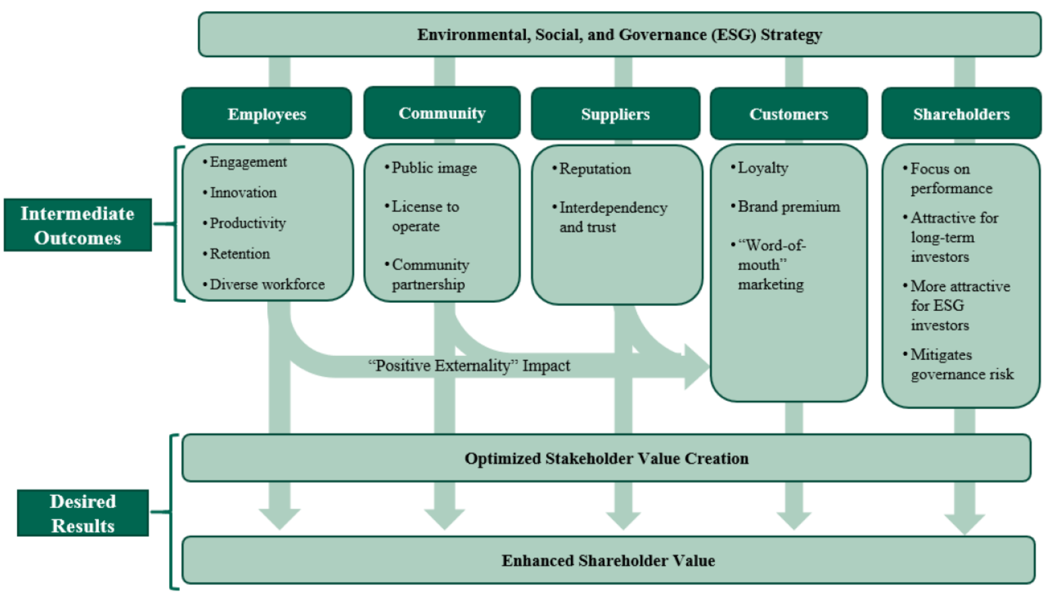
Background

The BRT statement drew significant interest from the press and corporate governance community as it was viewed by many—some investors, the media, academics, and some legal commentators **[3]**—as a social and economic enhancement to, or replacement of, the concept of “shareholder primacy” as popularized by Milton Friedman and supported by many institutional investors and their advisors. [4] Others viewed it as a contradiction to, or a distraction from, the very successful shareholder model which has created prosperity over decades for shareholders and many other stakeholders. [5]

Pragmatically, the BRT's statement may be a continued evolution of corporate culture and strategy that seeks to place more direct focus on the role that stakeholders have long played in the corporation from the corporate *governance, management, and board* perspectives. This sentiment is reflected in the member quotes included in the BRT's release as well as a recent Fortune CEO survey in which a majority of CEOs surveyed (63%) "…agree with the [BRT's] statement and believe most good companies always have operated that way." [6] In this context, the BRT's statement serves to enhance, clarify, and substantially debate the sometimes-counterproductive dichotomy of "stakeholders versus shareholders." ESG metrics, applied to this clarified purpose of the corporation, provide the quantifiable and generally accepted means to measure this more nuanced view of company performance.

The "Stakeholder Value Creation Chain" below is a model developed by Pay Governance to illustrate the intersection of ESG strategy, the stakeholder model, and the creation of firm value. The model captures the reinforcing carryover effect of stakeholders' contributions to the economic success of the company. An example of a "positive externality" is that many employees want to work for environmentally friendly companies, and the increased engagement of those employees may also increase productivity, customer satisfaction, etc. All companies need to balance their stakeholders', including shareholders', long-term interests. It may be a greater challenge for economically stressed companies to make long-term investments for other stakeholders than it is for top-performing companies to do so. However, our research and others' find that, overall, companies manage both short- and long-term performance trade-offs efficiently. [7] [8] These findings support optimistic outcomes for this Stakeholder Value Creation Chain.

The Stakeholder Value Creation Chain:
How do ESG strategies/metrics and the stakeholder model align?



These developments, and interest in this model of value creation generally, have prompted an increase in questions about whether and how to include ESG metrics in incentive plans. Below, we provide some key questions and guidelines for assessing a company's *readiness* and potential approach for *implementing* ESG metrics in executive compensation incentive programs.

Is your company ready to set or disclose ESG incentive goals?

ESG incentive metrics are like any other incentive metric: they should support and reinforce strategy rather than lead it. Companies considering ESG incentive metrics should align planning with the company's social responsibility and environmental strategies, reporting, and goals. Another essential factor in determining readiness is the *measurability/quantification* of the specific ESG issue.

Companies will generally fall along a spectrum of readiness to consider adopting and disclosing ESG incentive metrics and goals:

- **Companies Ready to Set *Quantitative* ESG Goals:** Companies with robust environmental, sustainability, and/or social responsibility strategies including quantifiable metrics and goals (e.g., carbon reduction goals, net zero carbon emissions commitments, Diversity and Inclusion metrics, employee and environmental safety metrics, customer satisfaction, etc.).
- **Companies Ready to Set *Qualitative* Goals:** Companies with evolving formalized tracking and reporting but for which ESG matters have been identified as important factors to customers, employees, or other These companies likely already have plans or goals around ESG factors (e.g., LEED [Leadership in Energy and Environmental Design]-certified office space, Diversity and Inclusion initiatives, renewable power and emissions goals, etc.).
- **Companies *Developing* an ESG Strategy:** Some companies are at an early stage of developing overall ESG/stakeholder strategies. These companies may be best served to focus on developing a strategy for environmental and social impact before considering linking incentive pay to these priorities.

We note it is critically important that these ESG/stakeholder metrics and goals be chosen and set with rigor in the same manner as financial metrics to ensure that the attainment of the ESG goals will enhance stakeholder value and not serve simply as "window dressing" or "greenwashing." **[9]** Implementing ESG metrics is a company-specific design process. For example, some companies may choose to implement qualitative ESG incentive goals even if they have rigorous ESG factor data and reporting.

Will ESG metrics and goals contribute to the company's value-creation?

The business case for using ESG incentive metrics is to provide line-of-sight for the management team to drive the implementation of initiatives that create significant differentiated value for the company or align with current or emerging stakeholder expectations. Companies must first assess which metrics or initiatives will most benefit the company's business and for which stakeholders. They must also develop challenging goals for these metrics to increase the likelihood of overall value creation. For example:

- **Employees:** Are employees and the competitive talent market driving the need for differentiated environmental or social initiatives? Will initiatives related to overall company sustainability (building sustainability, renewable energy use, net zero carbon emissions) contribute to the company being a "best in class" employer? Diversity and inclusion and pay equity initiatives have company and social benefits, such as ensuring fair and equitable opportunities to participate and thrive in the corporate system.
- **Customers:** Are customer preferences driving the need to differentiate on sustainable supply chains, social justice initiatives, and/or the product/company's environmental footprint?
- **Long-Term Sustainability:** Are long-term macro environmental factors (carbon emissions, carbon intensity of product, etc.) critical to the Company's ability to operate in the long term?
- **Brand Image:** Does a company want to be viewed by all constituencies, including those with no direct economic linkage, as a positive social and economic contributor to society?

There is no one-size-fits-all approach to ESG metrics, and companies fall across a spectrum of needs and drivers that affect the type of ESG factors that are relevant to short- and long-term business value depending on scale, industry, and stakeholder drivers. Most companies have addressed, or will need to address, how to implement ESG/stakeholder considerations in their operating strategy.

Conceptual Design Parameters for Structuring Incentive Goals

For those companies moving to implement stakeholder/ESG incentive goals for the first time, the design parameters range widely, which is not different than the design process for implementing *any* incentive metric. For these companies, considering the following questions can help move the prospect of an ESG incentive metric from an idea to a tangible goal with the potential to create value for the company:

1. **Quantitative goals versus qualitative milestones.** The availability and quality of data from sustainability or social responsibility reports will generally determine whether a company *can* set a defined quantitative goal. For other companies, lack of available ESG data/goals or the company's specific pay philosophy may mean ESG initiatives are best measured by setting annual milestones tailored to selected goals.
2. **Selecting metrics aligned with value creation.** Unlike financial metrics, for which robust statistical analyses can help guide the metric selection process (e.g., financial correlation analysis), the link between ESG metrics and company value creation is more nuanced and significantly impacted by industry, operating model, customer and employee perceptions and preferences, etc. Given this, companies should generally apply a principles-based approach to assess the most appropriate metrics for the company as a whole (e.g., assessing significance to the organization, measurability, achievability, etc.) *Appendix 1 provides a list of common ESG metrics with illustrative mapping to typical stakeholder impact.*
3. **Determining employee participation.** Generally, stakeholder/ESG-focused metrics would be implemented for officer/executive level roles, as this is the employee group that sets company-wide policy impacting the achievement of quantitative ESG goals or qualitative milestones. Alternatively, some companies may choose to implement firm-wide ESG incentive metrics to reinforce the positive employee engagement benefits of the company's ESG strategy or to drive a whole-team approach to achieving goals.
4. **Determining the range of metric weightings for stakeholder/ESG goals.** Historically, US companies with existing environmental, employee safety, and customer service goals as well as other stakeholder metrics have been concentrated in the extractive, industrial, and utility industries; metric weightings on these goals have ranged from 5% to 20% of annual incentive scorecards. We expect that this weighting range would continue to apply, with the remaining 80%+ of annual incentive weighting focused on financial metrics. Further, we expect that proxy advisors and shareholders may react adversely to non-financial metrics weighted more than 10% to 20% of annual incentive scorecards.
5. **Considering whether to implement stakeholder/ESG goals in annual versus long-term incentive plans.** As noted above, most ESG incentive goals to date have been implemented as weighted metrics in balanced scorecard annual incentive plans for several reasons. However, we have observed increased discussion of whether some goals (particularly greenhouse gas emission goals) may be better suited to long-term incentives. **[10]** There is no right answer to this question—some milestone and quantitative goals are best set on an annual basis given emerging industry, technology, and company developments; other companies may have a robust long-term plan for which longer-term incentives are a better fit.
6. **Considering how to operationalize ESG metrics into long-term plans.** For companies determining that sustainability or social responsibility goals fit best into the framework of a long-term incentive, those companies will need to consider which vehicles are best to incentivize achievement of strategically important ESG goals. While companies may choose to dedicate a portion of a 3-year performance share unit plan to an ESG metric (e.g., weighting a plan 40% relative total shareholder return [TSR], 40% revenue growth, and 20% greenhouse gas reduction), there may be concerns for shareholders and/or participants in diluting the financial and shareholder-value focus of these incentives. As an alternative, companies could grant performance restricted stock units, vesting at the end of a period of time (e.g., 3 or 4 years) contingent upon achievement of a long-term, rigorous ESG performance milestone. This approach would not "dilute" the percentage of relative TSR and financial-based long-term incentives, which will remain important to shareholders and proxy advisors.

Conclusion

As priorities of stakeholders continue to evolve, and addressing these becomes a strategic imperative, companies may look to include some stakeholder metrics in their compensation programs to emphasize these priorities. As companies and Compensation Committees discuss stakeholder and ESG-focused incentive metrics, each organization must consider its unique industry environment, business model, and cultural context. We interpret the BRT's updated statement of business purpose as a more nuanced perspective on how to create value for all stakeholders, inclusive of shareholders. While optimizing profits will remain the business purpose of corporations, the BRT's statement provides support for prioritizing the needs of all stakeholders in driving long-term, sustainable success for the business. For some companies, implementing incentive metrics aligned with this broader context can be an important tool to drive these efforts in both the short and long term. That said, appropriate timing, design, and communication will be critical to ensure effective implementation.

Appendix 1: Mapping the Intersection of ESG Metrics and Stakeholder Impact

According to a recent Bank of New York Mellon survey, some the most prevalent questions from investors fielded by corporate investor relations professionals surveyed concern board composition and structure, diversity and inclusion, climate change and carbon emissions, executive compensation, and energy efficiency. [11]

The illustrative table below provides Pay Governance's generalized perspective on the alignment between ESG initiatives and the directly impacted stakeholders. *The matrix below is illustrative and is not exhaustive of all ESG metrics and stakeholder impacts.*

Class	Category	Example Subcategories	Employees	Community	Suppliers	Customers	Shareholders
Environment	Carbon and Climate	• Energy and fuel efficiency • GHG emissions • Technology and opportunity (investments)		✔	✔		✔
	Natural Resources	• Water (use and pollution) • Land, forests, biodiversity (use and pollution) • Sustainable sourcing		✔	✔		✔
	Waste and Toxicity	• Hazardous and non-hazardous waste • Emissions and spills • Electronic waste • Packaging material	✔	✔	✔	✔	✔
	Management of Environmental Risk	• Disaster planning, response and resiliency • LEED design and certification	✔	✔	✔	✔	✔
Social	Human Rights	• Ethical sourcing • Supply chain standards	✔	✔	✔	✔	✔
	Labor, Health, and Safety	• Fair wages, benefits, training and development • Labor standards, job stability, and mobility • Employee engagement	✔	✔	✔		✔
	Diversity and Inclusion	• Equal opportunity and participation	✔	✔	✔		✔
	Product Safety, Quality, and Brand	• Customer satisfaction • Affordability and accessibility	✔	✔		✔	✔
	Community Engagement / Partnerships	• Volunteer hours • Workforce/community demographic parity • Alliances with key organizations, councils, and institutions • Corporate philanthropy	✔	✔			✔
Governance	Board Composition	• Minority representation • Gender equality	✔	✔		✔	✔
	Ethics and Compliance	• Anti-corruption • Cybersecurity and data privacy • Oversight and accountability • Management policies, systems, and disclosure (transparency) • Political contributions/lobbying	✔	✔	✔	✔	✔
	General Corporate Governance	• Executive compensation • Board leadership/structure • Share structure (multiple classes, board election)	✔				✔
	Risk Management and Mitigation	• Code of conduct • Sensitivity analysis and stress testing	✔	✔		✔	✔

Endnotes

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Harvard Law School Forum on
Corporate Governance and Financial Regulation

Are Share Buybacks a Symptom of Managerial Short-Termism?

Posted by Ira Kay and Blaine Martin, Pay Governance LLC, on Saturday, May 18, 2019

Tags: Executive Compensation, Firm performance, Incentives, Management, Pay for performance, Repurchases, Shareholder value, Short-termism
More from: Blaine Martin, Ira Kay, Pay Governance

Editor's Note: Ira Kay is a Managing Partner and **Blaine Martin** is a Consultant at Pay Governance LLC. This post is based on their Pay Governance memorandum. Related research from the Program on Corporate Governance includes **Share Repurchases, Equity Issuances, and the Optimal Design of Executive Pay**, by Jesse Fried (discussed on the Forum **here**), and **Short-Termism and Capital Flows** by Jesse Fried and Charles C. Y. Wang (discussed on the Forum **here**).

Introduction

Corporate share buybacks (also known as repurchases) have been somewhat controversial for many years, but have taken on even greater significance following the corporate tax cuts passed in 2017 and implemented in 2018. It is estimated that buybacks reached $1 trillion in 2018, likely fueled by extra cash resulting from the tax cuts. Buybacks are also gaining attention across a broader cross-section of the political arena, as three U.S. Senators and an SEC Commissioner have recently criticized share buybacks, with each commentary citing different criticism and potential solutions. [1] [2] [3] However, the common charge is that U.S. public companies are returning money to shareholders instead of investing in productive projects, equipment, workers, and long-term growth. Many buyback critics state the use of earnings per share (EPS) as an incentive metric and stock options inappropriately rewards executives for short-term decisions that reduce long-term value. Specifically, buybacks are criticized for mechanically increasing short-term EPS and “popping” the stock price to generate executive payouts at the expense of long-term performance.

Key Findings

- Many corporate critics believe that excessive share buybacks are an example of harmful executive short-term behavior that creates long-term damage via underinvesting in the core business.
- To evaluate buybacks, we split a sample of the S&P 500 into companies that engaged in small and large buyback activity from 2010 to 2014. We then evaluated TSR and other corporate performance metrics after the buyback period (2014-2018).
- Four-year post-buyback performance on TSR and CapEx growth was higher for the companies in the large buyback sample than for the companies with smaller buybacks. This indicates that share buybacks likely did not damage long-term performance or investment.
- Higher short-term (one-year) TSR is associated with higher long-term subsequent (three-year) TSR and CapEx investment. This finding suggests that companies generally do not sacrifice long-term returns or investments for short-term gains.
- The use of stock options and EPS-based incentive plans, rather than encouraging short-term gains at the expense of long-term performance, are correlated with higher long-term TSR.

- Our research shows that buybacks do not appear to be harmful to long term corporate performance. Companies need to continue to align executive incentives with capital decisions to continue their success.

This is an important and charged topic, as many large companies conduct share buybacks that are approved by their boards and typically discussed with large shareholders. Despite solid governance and shareholder support, critics of buybacks include some governance and shareholder groups, politicians, the business media, and academics who are opposed to the alleged short-term implications of a buyback or the "shareholder primacy" model in general.

To bring some important facts to the debate regarding the reality of corporate capital allocation and investment, Pay Governance has updated and expanded our original research on the relationship among share buybacks, long- term growth, and executive compensation for S&P 500 companies. This new study builds on the findings from our prior analysis; importantly, it adds total shareholder return (TSR) and other metrics evaluated not only during, but *after*, the buyback period.

The Relationship Among Share Buybacks, TSR, CapEx Growth, and Revenue Growth

We examined buybacks (2010-2014) and key financial metrics *after* the buyback period (2014-2018). We measure share buyback activity by calculating the change in common shares outstanding (CSO). [4] Using a sample split into groups of companies with above- and below-median change in common shares outstanding, we examined the effect of buybacks on TSR and financial growth data for the subsequent four-year period following the buyback period. Our analysis was based on the same sample as our 2014 research on share buybacks but excluded companies that were acquired or merged. With the benefit of an expanded post-buyback time frame, we were able to compare the long-term performance and prospects for companies with and without share buyback capital allocation strategies.

TABLE 1: SHARE BUYBACKS, TSR, AND CAPEX

		Post Buyback Period Performance (4-Year)				
Group	Median Change in CSO (2010-2014)	Median TSR (12/31/2014-12/31/2018) (Annualized)	Median CapEx Growth (2014-2018) (CAGR)	Median Employee Count Growth (2014-2018) (CAGR)	Median Revenue Growth (2014-2018) (CAGR)	Median EPS Growth (2014-2018) (CAGR)
Small (or Zero) Buyback Companies	5.0%	4.2%	3.5%	1.7%	4.2%	9.15%
Large Buyback Companies	-12.8%	5.4%	4.1%	2.6%	3.8%	9.14%
Total Sample	-4.4%	4.8%	3.7%	2.3%	3.9%	9.14%

n=404
CAGR: compound annual growth rate; CapEx: capital expenditure; CSO: common shares outstanding; TSR: total shareholder return

Contrary to the common assertion that share buybacks damage long-term growth and investment, we found (Table 1) that companies conducting larger share buybacks (-12.8% change in common shares outstanding over four years) showed higher TSR, higher CapEx growth, and higher employee count growth over the subsequent four-year period. Additionally, the companies conducting large buybacks continued to grow revenue in the subsequent period at a pace nearly as fast as the group with smaller buybacks (3.8% annualized revenue growth versus 4.2%). Earnings growth was equal between the two groups (9.15%).

While buybacks are explicitly intended to optimize EPS and potentially increase stock prices, we make no claim that the large buybacks are *causing* the subsequent favorable TSR and CapEx growth. However, the TSR and other data in a "post-buyback" period appear to demonstrate no long-term damage or obvious cannibalization of CapEx investment. This is confirmed in the following sections.

While it is *possible* a company could have grown revenues even further through investing or hiring, it is also not clear that incremental investment would have resulted in higher revenue growth or, more importantly, earnings growth that shareholders would have valued on par with a share buyback. The equal bottom-line EPS growth (9.15% annualized growth) between the two buyback groups suggests that both appear to be optimizing earnings growth.

The Relationship Between Short-Term TSR and Long-Term Performance

The argument of corporate myopia, or short-termism, hinges on the claim that short- and long-term corporate financial success are frequently antithetical and present an excessive trade-off. Examples of such commentary include arguments stating that buybacks damage future results and that companies reduce other investments to attain short-term profits at the expense of long-term growth and profitability.

To examine this, we expanded our investigation into how companies' strong short-term performance affected long- term performance as measured by TSR and CapEx growth. If the corporate sector is broadly myopic, we would expect companies with higher short-term TSR to have lower subsequent long-term TSR and lower CapEx growth. It seems reasonable to test whether companies that are making short-term cost savings decisions (e.g., reducing CapEx growth) to increase the short-term stock price are consequently damaging their long- term value.

TABLE 2: SHORT-TERM TSR AND SUBSEQUENT LONG-TERM TSR AND CAPEX GROWTH

		Short-Term (1-Year) TSR		Long-Term (3-Year) Subsequent TSR (Annualized) and CapEx (CAGR)				
Period	Group	Period	TSR	Period	TSR	TSR Change	Capex	CapEx Change
1	High Short-Term TSR	2008	-18.4%	2009-2011	14.7%	Lower	0.0%	Higher
	Low Short-Term TSR		-50.6%		22.1%	Higher	-0.6%	Lower
2	High Short-Term TSR	2009	61.3%	2010-2012	14.8%	Higher	15.7%	Higher
	Low Short-Term TSR		13.1%		11.6%	Lower	8.0%	Lower
3	High Short-Term TSR	2010	39.2%	2011-2013	17.9%	Higher	17.0%	Higher
	Low Short-Term TSR		6.1%		16.7%	Lower	7.1%	Lower
4	High Short-Term TSR	2011	18.3%	2012-2014	21.9%	Equal	9.9%	Higher
	Low Short-Term TSR		-11.4%		22.0%	Equal	4.5%	Lower
5	High Short-Term TSR	2012	29.7%	2013-2015	16.9%	Higher	7.7%	Higher
	Low Short-Term TSR		5.7%		13.8%	Lower	1.5%	Lower
6	High Short-Term TSR	2013	57.0%	2014-2016	9.7%	Higher	5.8%	Higher
	Low Short-Term TSR		19.3%		7.8%	Lower	1.3%	Lower
7	High Short-Term TSR	2014	27.4%	2015-2017	10.3%	Higher	6.3%	Higher
	Low Short-Term TSR		1.6%		9.1%	Lower	-0.9%	Lower
8	High Short-Term TSR	2015	13.6%	2016-2018	8.3%	Higher	7.9%	Higher
	Low Short-Term TSR		-17.1%		6.4%	Lower	0.6%	Lower

CAGR: compound annual growth rate; CapEx: capital expenditure; TSR: total shareholder return

To test this (Table 2), we reviewed and compared S&P 500 companies with low and high short-term TSR (below and above sample median, respectively) to the subsequent long-term TSR and Cap-Ex growth over eight discrete periods. We found that, with the exception of 2008 (probably due to the financial crisis [5]), each period reviewed showed that companies with higher short-term TSR had equa l or higher subsequent long-term TSR a nd CapEx growth relative to companies with lower short-term TSR.

While this test was not definitive, companies appear to be buying stock *without* suffering long-term repercussions or cutting expenses/investments to increase short-term share prices. Rather, the market appears to recognize and reward in the short-term those companies that optimize for the long-term (as illustrated by the correlation between short-and long-term TSR and CapEx growth). While we do not claim that strong short-term performance *causes* strong long-term performance, it appears that companies are optimizing their capital allocation strategies.

The Relationship Between Executive Compensation Design and Share Buybacks

Much of the criticism of share buybacks focuses on the assertion that executive incentive programs encourage short-term focus on increasing their annual compensation and that this myopia has resulted in share buybacks that are otherwise an inefficient allocation of capital. We examined the relationship between executive compensation design and share buybacks by reviewing the use of EPS as a metric in annual bonus plans as well as the use of stock options in long-term incentive (LTI) plans. Table 3 below presents the results of our findings.

TABLE 3: EXECUTIVE COMPENSATION DESIGN, SHARE BUYBACKS, AND TSR

Incentive Design Characteristics	Sample Size	Median Change in CSO 2010-2014	Annualized Median TSR 2010-2014	Annualized Median TSR 2015-2018
Grants Stock Options	248	-5.4%	18.2%	5.0%
Does Not Grant Stock Options	149	-1.3%	16.1%	4.8%
Uses EPS as Annual Bonus Metric	123	-4.9%	17.9%	6.4%
Does Not Use EPS as Annual Bonus Metric	274	-3.9%	17.7%	3.6%
Grants Stock Options and Uses EPS Bonus Metric	80	-6.5%	18.2%	7.0%
Does Not Grant Stock Options or Use EPS Bonus Metric	113	-2.2%	17.2%	4.8%
Total Sample	397	-4.4%	17.9%	4.8%

CSO: common shares outstanding; EPS: earnings per share; TSR: total shareholder return

We found that EPS use in annual incentive plans and the use of stock options were indeed associated with increased share buybacks. Contrary to the short-term criticism, companies that granted stock options and used EPS in bonus plans had higher TSR in the period contemporaneous with share buybacks **(**2010-2014**)** a nd the subsequent period (2015-2018**)**.

These findings stress the impact of executive compensation design decisions, including the mix of LTI vehicles and metrics, on company performance. [6] Incentives must appropriately motivate executives to optimize not just a company's operating performance but also its efficient allocation of capital. These findings are not intended to prescribe a particular LTI mix or incentive metric; rather, they demonstrate the importance of selecting the right LTI vehicles and metrics given a company's current and future business outlook.

Conclusion

Following up on Pay Governance's original research into the relationship among executive compensation, share buybacks, and shareholder value creation, we found even stronger evidence that certain executive compensation structures (granting stock options and using EPS bonus metrics) are correlated with share buybacks. We also debunked two common myths: that share buybacks damage long-term corporate investment and that there is an excessive trade-off between short-term and long-term shareholder returns.

Taken together, these findings suggest an alternate narrative about the relationships between executive pay, share buybacks, shareholder value, and company growth. The contemporary fact-driven story of share buybacks is not one of managers shirking investment and long-term stewardship of corporate capital but one of disciplined capital allocation. Companies conducting the largest share buybacks are not just rewarding shareholders with higher long- term returns; they also appear to be investing in the long-term through capital expenditures.

Executive compensation programs are an important part of the strategic structure ensuring this efficient capital allocation and long-term corporate financial sustainability. The use of short- and long-term financial metrics and share-based incentives remains a proven approach for focusing executive teams on long-term value drivers and aligning executive pay with shareholder interests.

Endnotes

[1] Chuck Schumer and Bernie Sanders. "Schumer and Sanders: Limit Corporate Stock Buybacks." The New York Times. February 3, 2019. https://www.nytimes.com/2019/02/03/opinion/chuck-schumer-bernie-sanders.html. (go back)

[2] David Morgan et al. "U.S. Republican Senator Rubio Pushes Plan to Tax Stock Buybacks." Reuters. February 13, 2019. https://www.reuters.com/article/us-usa-tax- buybacks/us-republican-senator-rubio-pushes-plan-to-tax-stock-

buybacks-idUSKCN1Q22WY.
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[3] Commissioner Robert J. Jackson Jr. "Stock Buybacks and Corporate Cashouts." The U.S. Securities and Exchange Commission. June 11, 2018. **https://www.sec.gov/news/speech/speech-jackson-061118#_ftn23.**
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[4] Companies in our "Small (or Zero) Buyback Companies" subset include companies that conducted no buybacks and companies that were net share issuers.
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[5] 2008's -50% TSR appears to have generated a substantial and unique bounce-back. The companies in this group, however, on the average did not get back to their 2007 stock prices even after 3 years of subsequent +22% TSR CAGR.
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[6] The large amount of executive stock ownership would also serve to balance the pressures in trading off short- and long-term performance.
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