



# Director Notes



## Linking Executive Compensation to Sustainability Performance

by Thomas Singer

Sustainability issues are becoming increasingly common in the boardroom, particularly as the volume of shareholder proposals regarding environmental and social policies has grown in recent proxy seasons. One area receiving attention from directors is the link between sustainability performance and executive compensation. This *Director Notes* discusses corporate directors' increasing interest in sustainability matters, progress toward a notion of performance assessment that incorporates nonfinancial elements, and companies' efforts to explain how they link incentive awards to sustainability targets in response to shareholder proposals filed on this topic since 2009.

Some high-profile companies have been public about their attempts to establish such a link (for example, with respect to energy efficiency targets or safety incident rates), reinforcing the growing acceptance of sustainability as an important driver of business value. While growing in number, these companies remain in the minority, as most executive compensation schemes continue to be tied to traditional financial performance.

### From Pay for Performance to Pay for Sustainability Performance

The link between executive compensation and corporate performance has been a common feature in U.S. companies since performance-based bonus plans and stock options surged in the 1970s and 1980s. Today, well over three-quarters of U.S. companies link employee pay to measures of financial performance.<sup>1</sup> While pay for performance is not a new phenomenon, in recent years there has been growing interest among shareholders about the inclusion of *sustainability* performance as part of the compensation formula.

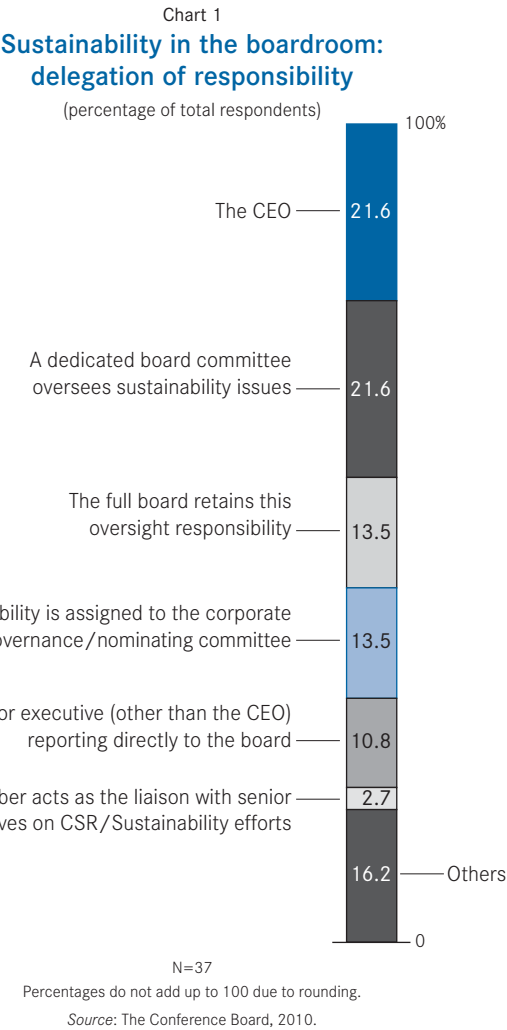
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<sup>1</sup> *Tying Pay to Performance*, Institute for Corporate Productivity, 2011.

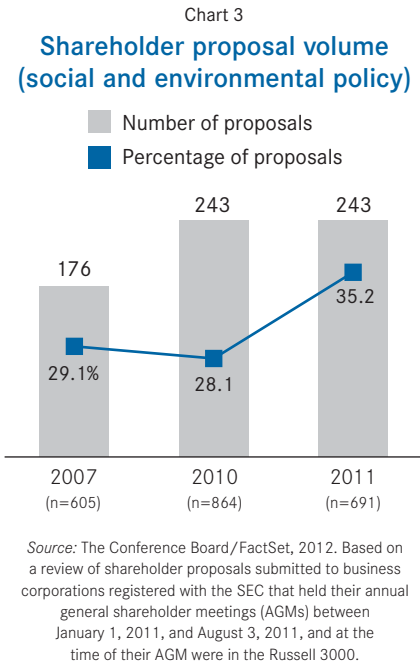
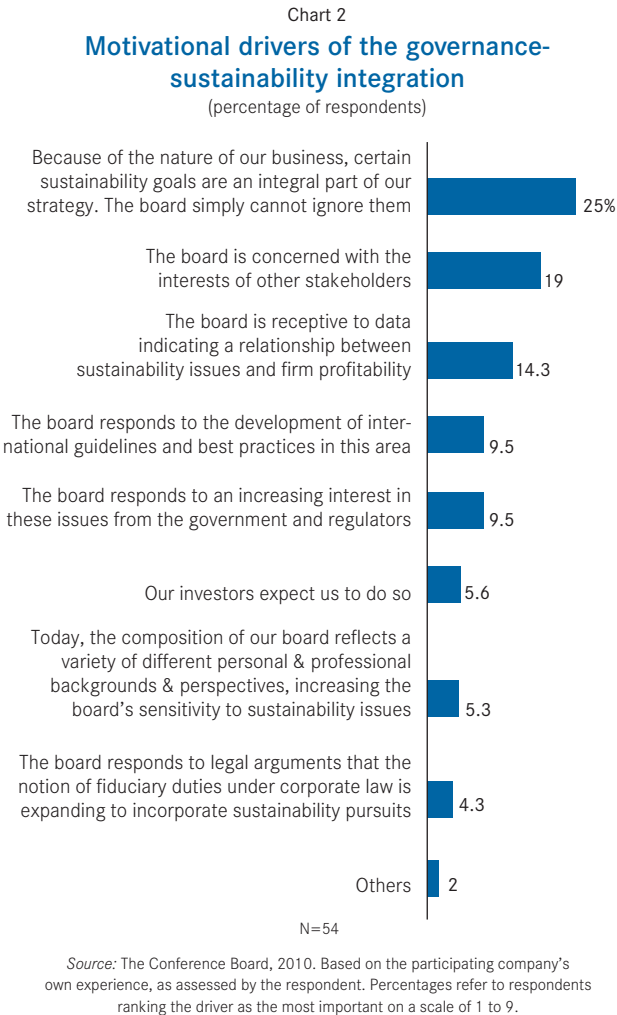


Sustainability issues are increasingly making their way into the boardroom. A survey of corporate secretaries and general counsels of U.S. public companies conducted by The Conference Board in 2010 showed that approximately half of the researched sample of business organizations assigned ultimate responsibility for oversight of sustainability to the board of directors or one of its committees (Chart 1).<sup>2</sup>

Shareholders are becoming an important driver of this phenomenon (Chart 2). According to “Shareholder Proposals: Trends from Recent Proxy Seasons (2007–2011)” by Matteo Tonello and Melissa Aguilar of The Conference Board, 243 proposals related to matters of social and environmental policy were submitted at companies holding annual meetings between January 1 and August 3, 2011, constituting 35 percent of the total. This is a significant increase from 29 percent in 2007 and the 28 percent in 2010 (Chart 3).



2 Matteo Tonello, “Emerging Sustainability Practices,” in *Sustainability Matters: Why and How Corporate Boards Should Become Involved*, The Conference Board, Research Report 1481, 2011, p. 38.



The same paper shows that shareholder support for sustainability proposals is also growing. In 2010, the share of sustainability proposals supported by a majority of shareholder votes was 0.6 percent, compared to 1.3 percent in 2011. Sustainability issues now account for a significant portion of shareholder proposals, and thus deserve serious consideration.<sup>3</sup>

According to a 2010 report by Glass Lewis, which studied publicly traded companies in the United States, the United Kingdom, Australia, France, Germany, and the Netherlands, 29 percent of companies disclosed a link between compensation and sustainability.<sup>4</sup> Results from a 2010 survey by The Conference Board of U.S. public companies revealed that 11.1 percent of respondents integrated sustainability objectives into business operations by linking compensation and sustainability.<sup>5</sup> Furthermore, a recent report by Ceres found that only 39 out of 600 companies have formally tied sustainability performance to executive compensation, while an additional 53 companies are making such linkages without explicitly disclosing related targets.<sup>6</sup>

The exact manner in which the links are made differs significantly from one company to another. Linking sustainability performance to executive compensation entails developing a system to track corporate performance on specific sustainability metrics, which can include environmental, social, and governance metrics. Some companies track sustainability performance against internally defined criteria and targets, whereas others track performance against available third-party standards, such as the Dow Jones Sustainability Index (DJSI). In the best of cases, a specific percentage of compensation is linked to performance on specific sustainability metrics. In less-defined cases, no specific percentage is assigned, but overall sustainability performance is used to help inform total executive compensation.

**Notable cases** A few U.S. companies are already tying executive compensation to sustainability performance. Intel, for example, has linked sustainability performance to bonuses for *all* employees since 2008. Intel's bonus calculations take into account several sustainability metrics, including the energy efficiency of the company's products,

commitments to renewable energy, and the company's performance related to its carbon footprint reduction goals. Xcel Energy has also linked its annual incentive awards for executives to sustainability performance metrics, including environmental metrics (e.g., greenhouse gas [GHG] reduction goals) and social metrics (e.g., employee safety). Similarly, Alcoa included sustainability performance in its executive bonus plan in 2010, linking 20 percent of the bonus to nonfinancial metrics, such as carbon dioxide reduction, safety, and diversity. Alcoa and Xcel are good examples of sustainability transparency, as they also publish information on their sustainability compensation schemes in proxy statements (see Charts 4 and 5 on pages 4 and 5).<sup>7</sup> Other companies that have already made an explicit link between sustainability performance and compensation include ING, National Grid, Shell, and Suncor Energy.

As with any new system, there are challenges involved in creating a compensation framework that incorporates sustainability performance. Companies must have already established mechanisms for tracking sustainability metrics, and they must have developed targets to track performance against those metrics. The integrity of the compensation framework is also important—companies should ensure that the chosen sustainability targets are meaningful and sufficiently challenging. A transparent system, as in the case of Xcel Energy, helps both the company and its stakeholders align their practices according to identified sustainability priorities.

Companies should also be aware that, like any other performance system, a system of compensation based on sustainability targets is subject to changing external circumstances. For example, in early 2010, Shell had linked 10 percent of executive compensation to the company's performance in the DJSI. In September 2010, however, Shell was excluded from the DJSI, leading the company's compensation committee to set the DJSI-linked 10 percent to zero. Rather than continuing to link compensation to DJSI performance, Shell decided that, going forward, it would link compensation to a combination of internal indicators.

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3 Matteo Tonello and Melissa Aguilar, "Shareholder Proposals: Trends from Recent Proxy Seasons (2007-2011)," February 2012 ([www.ssrn.com/abstract=1998378](http://www.ssrn.com/abstract=1998378)).

4 *Greening the Green*, Glass Lewis, 2010.

5 Tonello, "Sustainability in the Boardroom," p. 40.

6 *The Road to 2020: Corporate Progress on The Ceres Roadmap for Sustainability*, Ceres and Sustainalytics, April 2012 ([www.ceres.org/roadmap-assessment/key-findings/governance-for-sustainability/executive-compensation](http://www.ceres.org/roadmap-assessment/key-findings/governance-for-sustainability/executive-compensation)).

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7 See Alcoa 2011 proxy statement, filed March 7, 2011, p. 24 ([www.alcoa.com/global/en/investment/pdfs/2011\\_Proxy\\_Statement\\_%20FINAL.pdf](http://www.alcoa.com/global/en/investment/pdfs/2011_Proxy_Statement_%20FINAL.pdf)) and Xcel Energy 2011 proxy statement, filed April 5, 2011, p. 52 (<http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9ODg1NDZ8Q2hpbGRJRDR0tMXxUeXBIPTM=&t=1>).

Chart 4

**Xcel Energy's incentive plan and sustainability targets**

The specific corporate performance measures and results for the 2010 annual incentive awards were:

2010 corporate goal	Percentage weight	Key performance indicator	Threshold performance	Target performance	Maximum performance	Actual 2010 performance	Percentage payout
<b>Enhance environmental performance</b>	10%	Renewable energy	150 MW available for commercial operation by Dec. 31, 2010	200 MW available for commercial operation by Dec. 31, 2010	Target plus the sale of 1.27 million RECs by Dec. 31, 2010	201 MW available for commercial operation on Dec. 31, 2010 plus 3.4 million RECs sold	150%
	10%	Emissions reduction	NA—no payout below 100 percent - target must be achieved	Retire 73 MW	Target plus achieve additional emissions reduction or offset projects resulting in 500,000 CO <sub>2</sub> equivalent lifetime tons reduction	73 MW retired plus 488,931 tons CO <sub>2</sub> equivalent lifetime reduction	148.9%
	10%	Energy efficiency	555 GWh	617 GWh	740 GWh	696 GWh	132.1%
	3.33%	Technology	Complete ICT Project (Cameo CSP) or complete 8 of 10 company efficiency projects	Complete ICT Project (Cameo CSP) and complete 8 of 10 company efficiency projects	Complete ICT Project (Cameo CSP) and achieve 10 of 10 company efficiency projects	Completed ICT Project (Cameo CSP) and achieved 10 of 10 company efficiency projects	150%
<b>Improve employee safety</b>	22.33%	Safety (OSHA recordable incident rate)	2.29	1.99	1.69	1.9	115%
	6.67%	Safety—DART (Days away, restricted or transferred)	1.34	1.17	0.99	1.07	127.8%
	3.33%	Behavioral Index (1)	No payout if results fall below 100 percent	Business area targets	Maximum is 100 percent	Required training completed	100%
<b>Meet earnings target</b>	33.34%	Earnings per share	\$1.55	\$1.55 – \$1.65	\$1.65	\$1.61	110

(1) Payout is for target only, no threshold or maximum

MW: Megawatt

REC: Renewable energy credit

GWh: Gigawatt hour which relates to the Customer Demand Side Management goal.

ICT: Innovative clean technology. ICT project and efficiency projects include 10 projects approved by the committee that support our environmental leadership strategy.

CSP: Concentrating Solar Photovoltaic

Source: Xcel Energy 2011 proxy statement, filed April 5, 2011, p. 55 (<http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9ODg1NDZ8Q2hpbGRJRjRD0tMxUeXBjPTM=&t=1>).

Chart 5

### Alcoa's incentive plan and sustainability targets

2010 annual cash incentive compensation plan design, targets, and results at the corporate level (\$ in millions)

	Metric	2009 actual	Target 2010	Result 2010	IC result	Weighting	Payout
Financial measures	Adjusted free cash flow <sup>1</sup>	(\$257)	\$1,018	\$1,345	148.5%	40%	59.4%
	Profit <sup>2</sup>	(\$685)	\$440	\$538	116%	40%	46.4%
Nonfinancial measures	Safety <sup>3</sup>	1.39	1.22	1.35	0%	5%	0%
	Environment <sup>4</sup> CO <sub>2</sub> tons reduction	N/A	400,000	505,000	184%	5%	9.2%
	Diversity <sup>5</sup>				TOTAL	10%	9.0%
	Executive women, global	16.8%	17.3%	16.9%	60%	2.5%	1.5%
	Executive minorities, United States	13.3%	13.9%	12.9%	0%	2.5%	0.0%
	Professional women, global	22.8%	23.3%	23.8%	200%	2.5%	5.0%
	Professional minorities, United States	14.7%	15.2%	15.2%	100%	2.5%	5.0%
TOTAL						100%	124% <sup>6</sup>

Currency rates and the price of aluminum, which is traded as a commodity on the London Metal Exchange (LME), were kept constant at the LME price and currency assumptions used when the targets were established to eliminate the effect of price and currency fluctuations, which are not influenced by management's actions.

1 Adjusted free cash flow is calculated on an after-tax basis and defined as cash from operations less capital expenditures. See Attachment E for Reconciliations to GAAP, page 89.

2 The measure of profit at the corporate level is Income from Continuing Operations excluding discrete items (positive and negative) generally not taken into account by analysts in their evaluation of earnings from operations. See Attachment E for Reconciliations to GAAP, page 89.

3 The safety target was a reduction of the Total Recordable Rate to 1.22. We chose this metric because we have achieved benchmark performance on most other safety measures. Our total recordable rate, while good, is not the best in the world. The 2009 actual rate was calculated without businesses that were divested and were not part of the 2010 rate calculation.

4 The environmental target was to reduce CO<sub>2</sub> emissions by 400,000 tons in 2010, to make progress against our 2030 environmental goals. Although the company has pursued carbon reduction goals previously, 2010 was the first year such goals have been applied to all business groups and tied to incentive compensation targets.

5 The diversity targets were designed to increase the representation of executive and professional women on a global basis and to increase the representation of minority executives and professionals in the U.S.

6 Expressed as a percentage of the target award for the position. The target award for the CEO is 150% of salary and for the other named executive officers, 100% of salary.

Source: Alcoa 2011 proxy statement, filed March 7, 2011, p. 24 ([www.alcoa.com/global/en/investment/pdfs/2011\\_Proxy\\_Statement\\_%20FINAL.pdf](http://www.alcoa.com/global/en/investment/pdfs/2011_Proxy_Statement_%20FINAL.pdf)).

## Empirical Research on Linking Compensation to Sustainability

Existing academic literature generally favors the adoption of an executive compensation structure that focuses on long-term performance. While research dedicated to sustainability-based compensation is fairly limited, there is a general consensus that establishing this link can improve the environmental and social performance of companies, as long as certain factors are taken into account. A 2006 article in the *Journal of Management* found an increase in the corporate social performance of companies using a long-term focus in CEO pay as indicated by the percentage value of restricted stock and stock options

in the total pay package.<sup>8</sup> A 2011 Harvard Business School study showed that companies that are considered sustainability leaders are more likely to align senior executive incentives with nonfinancial metrics, such as environmental and social performance metrics.<sup>9</sup> Furthermore, linking executive compensation to sustainability performance has been found to improve a company's environmental and social performance in other ways. A sustainability pay-for-performance system

8 John R. Deckop, Kimberly K. Merriman, and Shruti Gupta, "The Effects of CEO Pay Structure on Corporate Social Performance," *Journal of Management*, 32, no. 3, June 2006, pp. 329-342.

9 Robert G. Eccles, Ioannis Ioannou, and George Serafeim, *The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance*, Harvard Business School, 2011.



makes management explicitly accountable for the company's environmental behavior. It can even encourage CEOs to monitor environmental behaviors at lower organizational levels.<sup>10</sup> Creating a link between sustainability performance and executive compensation can also provide incentives for management to dedicate real resources toward environmental initiatives, building legitimacy in the eyes of shareholders and the public.<sup>11</sup>

## Determinants

According to the literature, the benefits of a sustainability pay-for-performance system also depend on a number of factors, and companies should be aware of the challenges associated with linking sustainability to compensation. A 2009 study in the *Academy of Management Journal* and a 2008 IESE Business School study reveal some of the issues companies should consider:

**Commitment** An effective sustainability pay-for-performance system requires that all stakeholders recognize the negative implications for the company of poor social and environmental performance.<sup>12</sup>

**Uncertainty** Companies need to recognize that a sustainability pay-for-performance system brings with it certain uncertainties, including financial uncertainties about social and environmental performance.<sup>13</sup>

**Conflicting interests** In developing performance criteria, companies and their stakeholders may often be faced with conflicting interests, particularly about the relevance and materiality of metrics.<sup>14</sup>

**Measurement** Not all companies have established robust sustainability performance measurement systems; the lack of proper measures and tracking systems can pose a significant challenge to companies beginning a sustainability pay-for-performance system.<sup>15</sup>

**Greenwashing** A weak or opportunistic sustainability pay-for-performance system can tarnish a company's reputation and be viewed by the public as little more than greenwashing (deceptively promoting a policy or product as environmentally friendly).<sup>16</sup>

## Set of sustainability metrics

The development of a sustainability pay-for-performance system requires the existence of a set of metrics a company has agreed to track. Claudia Kruse and Stefan Lundbergh indicate in "The Governance of Corporate Sustainability" that, just as with financial metrics, nonfinancial metrics should be relevant, measurable, comparable, stretching, and clearly disclosed.<sup>17</sup> Kruse and Lundbergh offer the following recommendations in setting sustainability metrics and a sustainability pay-for-performance system:

**Choose relevant and specific metrics** Companies should avoid using sustainability metrics that are too vague and generic, and instead choose metrics that are relevant to their core business. Linking pay to performance on an index, such as the Dow Jones Sustainability Index (DJSI), is generally not recommended, as indexes are not specific to companies' strategies. (Note the example on page 3 of Shell's initial decision to link executive compensation to performance on the DJSI.)

**Align with corporate strategy** Linking sustainability performance to executive compensation must be seen as strategically important to the entire corporate enterprise, not only parts of it. Sustainability metrics should contribute to the achievement of overall corporate goals.

**Make payouts conditional on financial and nonfinancial performance** In some companies, even if financial targets are not met, executives are still eligible to receive full incentive awards if they deliver good sustainability performance. Instead of this practice, companies should strive to make payouts depend on the achievement of a threshold financial/nonfinancial performance. For example, a minimum financial performance should be met for any sustainability-related bonuses to be awarded. Similarly, a minimum health and safety performance should be a prerequisite in certain industries for the award of financial-performance-related bonuses.

10 Pascual Berrone and Luis R. Gomez-Mejia, "Environmental Performance and Executive Compensation: An Integrated Agency-Institutional Perspective," *Academy of Management Journal*, Vol. 52, No. 1, 2009, p. 120.

11 Berrone and Gomez-Mejia, "Environmental Performance and Executive Compensation."

12 Berrone and Gomez-Mejia, "Environmental Performance and Executive Compensation."

13 Pascual Berrone, *Pros and Cons of Rewarding Social Responsibility at the Top*, IESE Business School, University of Navarra, 2008.

14 Pascual Berrone, *Pros and Cons of Rewarding Social Responsibility at the Top*, IESE Business School, University of Navarra, 2008.

15 Pascual Berrone, *Pros and Cons of Rewarding Social Responsibility at the Top*, IESE Business School, University of Navarra, 2008.

16 Pascual Berrone, *Pros and Cons of Rewarding Social Responsibility at the Top*, IESE Business School, University of Navarra, 2008.

17 Claudia Kruse and Stefan Lundbergh, "The Governance of Corporate Sustainability," *Rotman International Journal of Pension Management*, 3, no. 2, 2010.

## Media Coverage

The past two years have seen a number of news articles, blog posts, and opinion pieces touching on the issue of sustainability and executive compensation. The topic is often brought up as part of a broader discussion on sustainability, although a few articles have been dedicated exclusively to the issue. Media coverage of the issue (see Exhibit 1 for examples) has centered primarily on the following:

- discussion on the growth of sustainability issues in the boardroom, including executive compensation;
- examples of how companies are currently linking sustainability performance to executive compensation; and/or
- discussion on shifting compensation structures to align with long-term sustainable performance, rather than short-term outlooks.

Exhibit 1

### Pay-for-sustainability performance in the media

Publication	Date	Title	Type
<i>GreenBiz</i>	1/11/2012	<i>The Pros &amp; Cons of Linking Sustainability Successes with Bonuses</i>	Blog
<i>Wall Street Journal</i>	12/14/2011	<i>A Manifesto for Sustainable Capitalism</i>	Opinion
<i>Forbes</i>	4/26/2011	<i>The Role of Environmental Sustainability in Executive Compensation</i>	Article
<i>The Guardian</i>	5/18/2010	<i>Bonuses can be a good thing - if they're linked to carbon emissions</i>	Article
<i>Harvard Business Review</i>	4/21/2010	<i>Compensation and Sustainability</i>	Blog
<i>Financial Times</i>	2/24/2010	<i>Drive to Link Pay to Sustainability Begins</i>	Article

## Shareholder Proposals (2009–2011)

While by no means numerous, shareholder proposals linking sustainability performance to executive compensation have grown in number in the last few years (Table 1). The 2009 proxy season saw one shareholder vote on this issue at Take-Two Interactive Software. While the 2010 season did not see any votes on shareholder resolutions related to this topic, four resolutions urging companies to link executive compensation

to sustainability performance were voted on by shareholders during the 2011 proxy season. The Laborers' International Union filed those resolutions at Sempra Energy, Chevron Corporation, Lowe's Companies, and Equity Residential. However, none of the resolutions gained much voter traction, with Sempra Energy showing the greatest support at only 6.9 percent of *for* votes as a percentage of votes cast.

Table 1

### Shareholder proposals on pay-for-sustainability performance

Company	Meeting date	Pass?	As a percentage of yes/no votes	
			For	Against
Equity Residential	6/16/2011	No	3.7%	96.3%
Lowe's Companies	5/27/2011	No	4.4	95.6
Chevron Corporation	5/25/2011	No	5.6	94.4
Sempra Energy	5/13/2011	No	6.9	93.1
Take-Two Interactive Software	4/23/2009	No	3.7	96.3

Source: The Conference Board/FactSet, 2012.

The 2011 shareholder proposal submitted to Sempra, Chevron, Lowe’s and Equity read as follows:

RESOLVED: That the shareholders of [Company] request the Board’s Compensation Committee, when setting senior executive compensation, include sustainability as one of the performance measures for senior executives under the Company’s annual and/or long-term incentive plans. Sustainability is defined as how environmental, social and financial considerations are integrated into corporate strategy over the long term.

The boards of directors of Sempra, Chevron, Lowe’s, and Equity all recommended voting *against* the proposed resolutions (see page 9 for the text of their recommendations). It should be noted, however, that the boards of Chevron and Equity made their recommendations based on their account that a link between sustainability performance and executive compensation was already in place at their respective companies.

Exhibit 2  
**Voting guidelines on pay-for-sustainability performance**

As shareholder resolutions on sustainability issues continue to make their way onto corporate ballots, the investment community will increasingly seek guidance on how best to respond to such resolutions. Resolutions asking for a link between executive compensation and sustainability performance are relatively new; for this reason, they lack the voting guidance available for other governance issues. While a number of organizations issue guidance on executive compensation, few specifically mention resolutions linking compensation to sustainability performance. The table below offers a summary of the voting guidelines issued on this matter by the most prominent organizations.

Organization	Guideline	Summary
Ceres	FOR	We therefore recommend voting FOR resolutions that call for incorporating social and environmental criteria, alongside financial criteria, into formulas used for determining executive compensation.
ISS	AGAINST	Generally vote AGAINST proposals to link, or report on linking, executive compensation to environmental and social criteria such as corporate downsizings, customer or employee satisfaction, community involvement, human rights, environmental performance, or predatory lending. However, the following factors will be considered: <ul style="list-style-type: none"><li>• Whether the company has significant and persistent controversies or violations regarding social and/or environmental issues;</li><li>• Whether the company has management systems and oversight mechanisms in place regarding its social and environmental performance;</li><li>• The degree to which industry peers have incorporated similar non-financial performance criteria in their executive compensation practices; and</li><li>• The company’s current level of disclosure regarding its environmental and social performance.</li></ul>
TIAA-CREF	CASE-BY-CASE	TIAA-CREF will consider on a case-by-case basis shareholder resolutions related to specific compensation practices. Generally, we believe specific practices are the purview of the board.
Florida State Board of Administration	CASE-BY-CASE	These types of resolutions ask companies to compensate executives on the basis of their progress on various social issues. Generally, the SBA does not support such proposals. While it is important for corporations to be socially responsible and ethical, shareowners should not enforce a social mandate through the manipulation of compensation levels. Shareowners have the right to address any social issue on an individual basis with their companies. The SBA believes executives should be compensated based on numerous factors and that linking pay matters with social issues is generally inappropriate.
Council of Institutional Investors (CII)	N/A	The CII has not issued specific guidelines related to resolutions calling for a link between executive compensation and sustainability performance.
International Corporate Governance Network (ICGN)	N/A	The ICGN has not issued specific guidelines related to resolutions calling for a link between executive compensation and sustainability performance.

Sources: Ceres 2011 Guidance Proxy Voting for Sustainability, p. 17 ([www.ceres.org/resources/reports/proxy-voting-for-sustainability](http://www.ceres.org/resources/reports/proxy-voting-for-sustainability)); ISS 2012 US Summary Guidelines, p. 63 ([www.issgovernance.com/files/2012USSummaryGuidelines.pdf](http://www.issgovernance.com/files/2012USSummaryGuidelines.pdf)); TIAA-CREF Policy Statement on Corporate Governance 6th Edition, p. 34 ([www.tiaa-cref.org/ucm/groups/content/@ap\\_ucm\\_p\\_tcp/documents/document/tiaa01010204.pdf](http://www.tiaa-cref.org/ucm/groups/content/@ap_ucm_p_tcp/documents/document/tiaa01010204.pdf)); Florida State Board of Administration Corporate Governance Principles and Proxy Vote Guidelines, p. 45 ([www.sbafla.com/fsb/LinkClick.aspx?fileticket=XtY-54lfidU%3D&tabid=997&mid=2799](http://www.sbafla.com/fsb/LinkClick.aspx?fileticket=XtY-54lfidU%3D&tabid=997&mid=2799)); Council of Institutional Investors Corporate Governance Policies, p. 10 ([www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2012-21-11%20FINAL%20\(2\).pdf](http://www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2012-21-11%20FINAL%20(2).pdf)); International Corporate Governance Network Remuneration Guidelines ([www.icgn.org/files/icgn\\_main/pdfs/best\\_practice/exec\\_remun/2006\\_executive\\_remuneration.pdf](http://www.icgn.org/files/icgn_main/pdfs/best_practice/exec_remun/2006_executive_remuneration.pdf)).



## Board Responses to Shareholder Resolutions Urging Companies to Link Executive Compensation to Sustainability Performance

The following are the board recommendations against the 2011 shareholder resolution filed by the Laborers' International Union asking companies to link executive compensation to sustainability performance.

**Sempra Energy** The board of directors recommended voting *against* the resolution, and offered the following rationale:

"We and our executives firmly believe that the efficient and sustainable deployment and use of energy are in the best interests of our shareholders and the global community. However, we do not believe that making sustainability a distinct performance measure under our executive compensation programs is an appropriate design to drive long-term shareholder value. Although the board agrees with the proponent of this proposal that sustainability is extremely important, the board believes that this overly prescriptive shareholder proposal is not in the best interests of our shareholders."<sup>18</sup>

**Chevron Corporation** The board of directors recommended voting *against* the resolution, and offered the following rationale:

"Your Board recommends a vote AGAINST this proposal because it believes that environmental, social, financial and operational elements are already incorporated into executive compensation in the evaluation of the performance of the Company, its business units and individual executives. Chevron's executive compensation philosophy...guides the Board to reward executives whose performance furthers the Corporation's environmental, social, financial and operational objectives."<sup>19</sup>

**Equity Residential** The board of directors recommended voting *against* the resolution, and offered the following rationale:

"The Board believes this proposal is unnecessary, as prior to receipt of the proponent's proposal, the Company had already made sustainability goals a separate measure to be considered in its compensation program commencing with 2011 and adopted specific sustainability goals for each Executive Vice President. The Company's Chief Executive Officer has general responsibility for setting sustainability goals and monitoring their achievement. The satisfaction of these goals will be considered by the Chief Executive Officer and Compensation Committee when determining executive compensation (including compensation of the Chief Executive Officer), together with such executives' achievement of other company, business unit and individual goals."<sup>20</sup>

**Lowe's Companies** The board of directors recommended voting *against* the resolution, and offered the following rationale:

"The Board does not believe that including sustainability as one of the performance measures under the Company's incentive plans is necessary to create long-term, sustained value for Lowe's shareholders. Rather, Lowe's Board believes that the Company's existing executive compensation program, which has a strong pay for performance philosophy and pay programs that result in awards to executives that are sensitive to the long-term value they produce for shareholders, promotes the best interests of our shareholders over time."<sup>21</sup>

## Conclusion

The past five years have seen significant growth in the volume of shareholder proposals regarding sustainability policies. As environmental and social issues continue to make their way into the boardroom, traditional measures of corporate performance are likely to be increasingly supplemented with nonfinancial metrics. The growing value that shareholders are placing on long-term performance and corporate sustainability serves as an indicator for directors that nonfinancial performance may play a greater role in future executive compensation schemes.

18 Sempra Energy proxy statement, filed March 29, 2011, p. 30 ([www.sempra.com/pdf/financial-reports/proxy.pdf](http://www.sempra.com/pdf/financial-reports/proxy.pdf)).

19 Chevron Corporation proxy statement, filed April 14, 2011, p. 78 ([www.chevron.com/documents/pdf/Chevron2011ProxyStatement.pdf](http://www.chevron.com/documents/pdf/Chevron2011ProxyStatement.pdf)).

20 Equity Residential proxy statement, filed April 15, 2011, p. 24 (<http://investors.equityapartments.com/Cache/c11050658.html>).

21 Lowe's Companies proxy statement, filed April 11, 2011, p. 44 (<http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NDQzNzU1fENoaWxkSUQ9NDY2NDM0fFR5cGU9MQ==&t=1>).



## About the Author

**Thomas Singer** is a research associate in corporate leadership at The Conference Board. His research focuses on corporate social responsibility and sustainability issues. In addition to his work at The Conference Board, Singer serves as an independent consultant advising on corporate sustainability strategy. Prior to joining The Conference Board, Singer worked with Blu Skye Sustainability Consulting and SustainAbility, helping clients embed sustainability into their core business. Over his career, he has supported engagements with industry leaders across sectors, focusing on strategy development, opportunity assessment, competitive analysis, and stakeholder engagement. He began his career as a management consultant with Kaiser Associates, advising clients on white space opportunities, competitive analysis, and benchmarking. Singer is a graduate of Tufts University.

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## About the Series Director

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