

**Taking ESG criteria (Environmental, Social, Governance) into account in compensation can help incorporate sustainability aspects in a company. An analysis performed by Inrate revealed that 11 % of companies in the MSCI All Country World Index (MSCI ACWI) include ESG in their remuneration systems.**

*by Martina Wengle and Christophe Volonté*

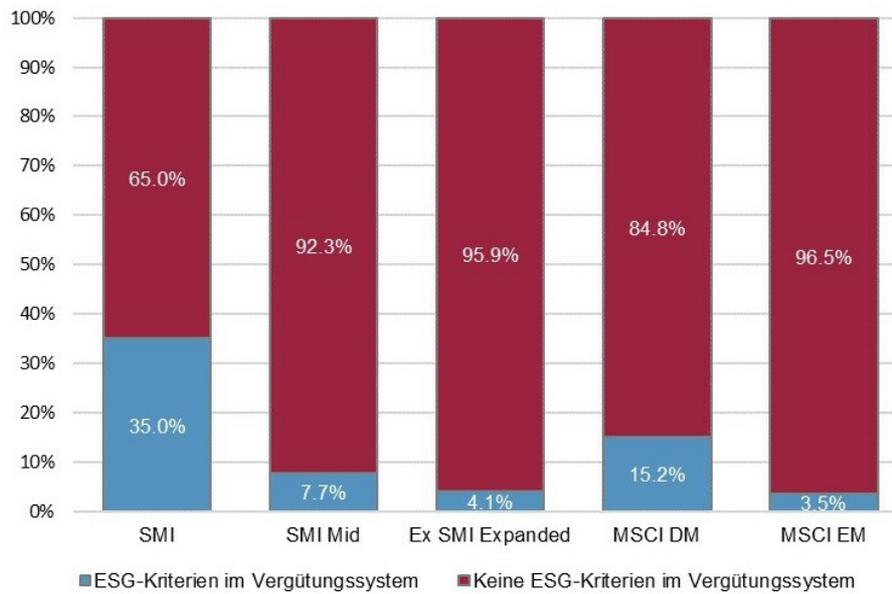
Considering sustainability in investment decisions is becoming more important for investors. That is why companies are implementing sustainability strategies. Impacts on the environment, society and corporate management (ESG: Environmental, Social, Governance) should be part of corporate decision-making (e.g. reducing the CO2 footprint, fostering employee health, strengthening diversity at the management level). An effective tool for the implementation of such strategies is the design of compensation systems. Incentives can influence the behavior of employees, and in particular, executive management.

To analyze the inclusion of ESG criteria in remuneration models Inrate evaluated data from 169 Swiss companies and 2,320 companies (ca. 80 % of MSCI ACWI) worldwide. The analysis is based on information published by companies in their annual, remuneration and sustainability reports, as well as information disclosed in voluntary databases such as the Carbon Disclosure Project (CDP). A potential distortion cannot be ruled out with respect to companies that have incorporated ESG criteria in their remuneration systems, but do not report on it. The application of ESG criteria in Switzerland, worldwide and in industry comparison is analyzed below. Furthermore, the topical areas of ESG criteria in remuneration systems that companies currently incorporate in their respective remuneration systems are depicted.

## **More than one third of all SMI companies consider sustainability aspects in compensation**

---

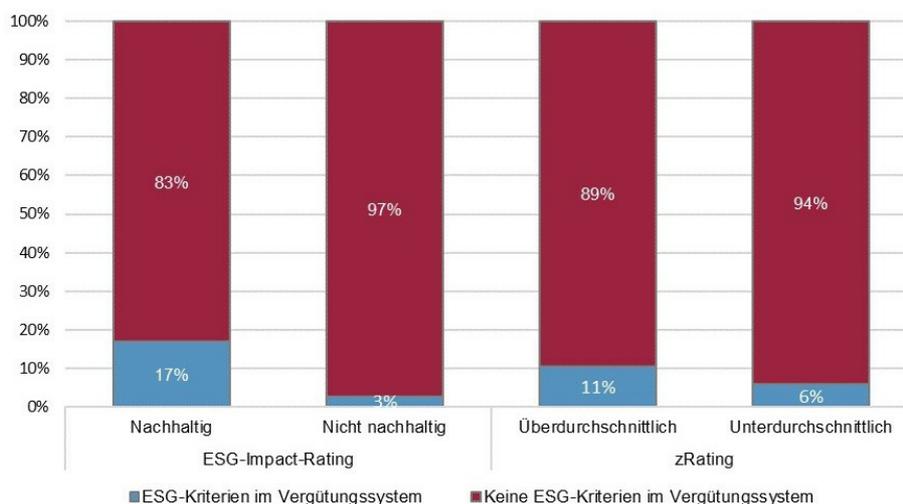
On the whole, companies with high market capitalization take sustainability into account in determining variable compensation in Switzerland. 35 % of SMI companies, but just 7.7 % of companies in SMI Mid and 4.1 % of companies outside the SMI Expanded have ESG criteria in their remuneration systems. In comparison, SMI companies perform better than companies in the MSCI Developed Markets or Emerging Markets.



### ESG criteria in remuneration systems by index (SPI and MSCI ACWI)

## Sustainable companies take ESG criteria into account more often than non-sustainable companies

There are also noticeable differences among companies that include ESG criteria with respect to their valuation in the ESG Impact Rating and zRating (see box). Our analysis illustrates that sustainable companies (ESG Impact Rating A or B) employ ESG criteria more often than non-sustainable companies (17 % versus 3 % of companies). When compared to Corporate Governance valuation the above average companies (zRating over 60) fare better (11 % compared with 6 %).



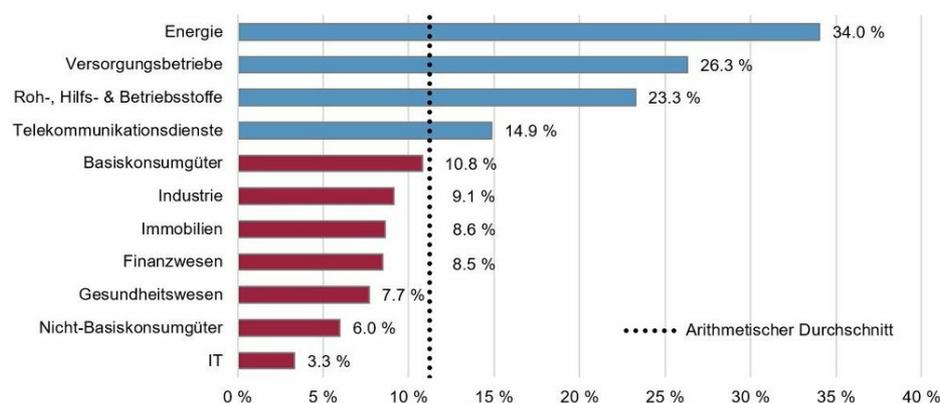
### ESG criteria in remuneration systems compared with ESG Impact Rating and zRating (MSCI ACWI and SPI)

**ESG-Impact-Ratings:** ESG Impact Ratings: The ESG Impact Ratings of Inrate measure sustainability of companies. “ESG” stands for “Environmental”, “Social” and “Governance”. In addition to the common practice analysis of sustainability and annual reports in the context of a CSR rating, this methodology takes into account the impact on the environment and society of production and products along the entire product life cycle (i.e. including supply chains, service life and waste disposal). The companies are analyzed and assessed according to the following categories: A (“sustainable or shifting toward sustainability”), B (“on the road to sustainability”), C (“non-sustainable, but with little effect on society and environment”) or D (“non-sustainable”).

**zRating:** zRating: zRating is the evaluation of Corporate Governance in companies in Switzerland. Corporate Governance is assessed using 59 qualitative and quantitative criteria. The criteria are split into four categories: 1) shareholder base and capital structure 2) shareholder participation rights 3) composition of the board/management and information policy, as well as 4) remuneration and profit-sharing schemes of board and management. Furthermore, voting recommendations for annual general meetings are also published.

## Resource intensive industries out front

11.3 % of companies worldwide include ESG incentives in their remuneration systems. But there are considerable differences among the various industries. Surprisingly, the rankings are led by resource-intensive and therefore ecologically less sustainable industries in the areas of energy, public utilities and raw, additive and operating materials. One reason for this could be that environmental incidents or occupational accidents in these particular industries are cost drivers and therefore economically relevant. Companies in the financial, real estate, health care, discretionary consumer goods, consumer staples and IT sectors are below average. As a sub-group in the health care sector only 6.5 % of pharmaceutical companies integrate ESG criteria in their remuneration systems. But it is interesting to note that these companies are above-average in Corporate Social Responsibility (CSR) Reporting. Incentives relate primarily to corporate financial objectives and individual performance goals.

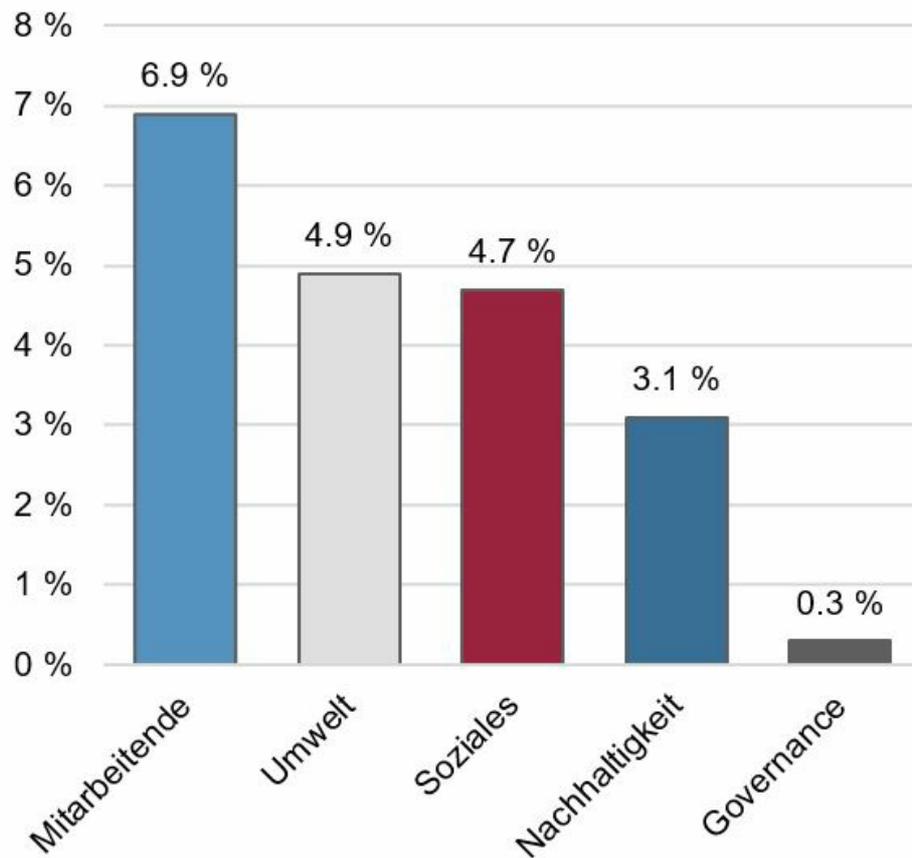


Percentage of companies with ESG criteria in remuneration systems by industry (MSCI ACWI)

## Focus on occupational safety and health protection for employees

The most widely applied topics relate to employees: 6.9 % of companies mention this type

of performance criteria with regard to remuneration. Occupational safety and health protection, but also fostering talent, talent management and employee satisfaction are primarily noted in that context. 4.9 % of companies address the environment. In general, environment-related topics, energy conservation, emission reduction and water are cited. Thereafter, with regard to social issues (4.7 %) customer satisfaction, quality criteria, ethics and corporate values, as well as stakeholder engagement and social programs are incorporated into variable compensation. 3.1 % of companies generally reference a link to sustainability or CSR in performance-related pay.



ESG criteria topics (MSCI ACWI)

## ESG criteria in remuneration systems as potential leverage for sustainability

Monetary incentives help align the interests of managers and shareholders. Because investors are paying more attention to sustainability performance in their investment decisions it makes perfect sense to include ESG criteria in remuneration systems. The integration of ESG criteria in remuneration systems generates potential clout for the sustainability of a company. The analysis by Inrate concluded that ESG criteria are undeniably incorporated in remuneration systems. 11.3 % of companies worldwide employ such incentives. Highly capitalized companies are the current trendsetters in this area. There are considerable distinctions in industry comparisons. They primarily encompass criteria relating to employees.

## About the authors



Martina Wengle is a Senior Analyst at Inrate. She has a wealth of professional experience in the areas of sustainability and governance.



Christophe Volonté is Head of Corporate Governance at Inrate. At the same time, he teaches and conducts research at the Universities of Basel and Constance. Since 2007 Christophe Volonté has focused on Corporate Governance.