Tying executive pay to ESG: Singapore listcos see strategic role

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Environmental, social and governance-linked pay can boost sustainability efforts, but metrics must be carefully designed

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AT LOCAL telco Singtel, top executives' remuneration is not just based on hard financial metrics. Tackling issues such as climate change, digital inclusion and talent diversity also play a part in determining how they are compensated.

Singtel is part of a small but notable group of Singapore-listed companies that incorporate ESG – or environmental, social and governance – key performance indicators (KPIs) in their top executives' remuneration.

The company has used ESG-related KPIs in the incentive plans of its top executives – including chief executive Yuen Kuan Moon and management committee members – since its strategic reset in mid-2021.

The ESG targets are designed with "an appropriate degree of stretch – challenging yet realistic and achievable", said Aileen Tan, Singtel's chief people and sustainability officer.

ESG KPIs are applied to the short-term incentive plans of Singtel's top executives, and represent 10 per cent of their annual balanced scorecard performance. In these same executives' long-term incentive plans, ESG factors have a 20 per cent weightage.

These KPIs span five areas: climate change and the environment; reputation and responsible business practices; community impact in terms of digital inclusion and enablement targets; diversity; and talent retention.

The climate and environmental KPIs are measured using Singtel's rating by CDP, a non-profit that helps companies with environmental disclosures. Reputation and responsible business practices are measured by the company's ESG rating under MSCI, a ratings agency.

Other Singapore-listed companies that adopt ESG-linked remuneration include CapitaLand Investment (CLI), Keppel and Sembcorp Industries.

CLI has ESG-related targets in its group business scorecard, while its long-term incentive plan includes targets which are linked to environmental performance. One of the KPIs for its performance share plan (PSP) award is the reduction of carbon emissions intensity over a three-year performance period.

"The level of achievement for this KPI would directly affect the number of shares management receives as part of their remuneration," said CLI's chief sustainability and sustainable investments officer Vinamra Srivastava.

Keppel similarly includes sustainability targets in the performance appraisal of its senior management, in both annual remuneration and long-term incentives.

"In addition, we have a three-year Keppel PSP that is awarded to a selected group of key management personnel. Sustainability-related targets contribute up to 25 per cent of the PSP," said the company's chief sustainability officer Ho Tong Yen.

At Keppel, some ESG targets apply companywide. In FY2023, environmental sustainability targets – including for carbon emissions reduction – accounted for 7.5 per cent of the performance scorecard at the company. This scorecard determines the annual performance bonus pool for all employees.

Vinamra Srivastava, CapitaLand Investment's chief sustainability and sustainable investments officer, says the company has ESG-related targets in its group business scorecard. PHOTO: CLI

Over at Sembcorp, ESG targets tie in with the company's broader shift of its portfolio from "brown to green", and drives the transition to renewable energy.

Sembcorp has set transformation targets that include growing its gross installed renewables capacity to 25 Gigawatts by 2028, and reducing its absolute emissions and emissions intensity.

"Since 2021, we have linked these transformation targets to the compensation of our senior executives. Doing so underscores our commitment to integrate sustainability into our business," said a Sembcorp spokesperson.

Cautious approach needed

The use of ESG-linked remuneration in Singapore comes as more companies adopt the practice regionally.

In the Asia-Pacific, the proportion of companies that include ESG metrics in executive incentive plans rose to 77 per cent in 2023, from 63 per cent the year before, indicated a study by financial services company WTW.

In Singapore, however, adoption levels are not high. Last year, just 16 per cent of Singapore-listed companies linked top executive remuneration to sustainability performance, down from 26 per cent in 2021, said the *Sustainability Reporting Review 2023.* But this was still an improvement from the 8 per cent figure in 2019.

Linking remuneration to ESG factors should boost a company's sustainability efforts, by creating clear financial incentives for leaders and employees.

But there are concerns that easy-to-achieve ESG metrics are selected, or that the KPIs may not be the most important for the business nor sufficiently stretched, said corporate governance advocate Professor Mak Yuen Teen.

"There is a risk that use of ESG metrics may actually become a way to inflate executive remuneration," he noted.

To avoid the pitfalls, companies need to think carefully about their choice of ESG metrics and how it ties into their broader sustainability strategy.

ESG metrics can also be linked to not just short-term remuneration but also longer-term incentives, said Prof Mak, citing Singtel and Keppel as positive examples.

"But even for Singtel and Keppel, investors would generally want to see that the KPIs that are used are related to the most material ESG factors for the companies. Both could provide more information on the specific KPIs used and ideally, these are KPIs that can be assessed reasonably objectively," he said.

Data and measurement is another common challenge for companies embarking on ESG-linked pay, said Dr Sean Shin, senior lecturer at the National University of Singapore Business School.

"(It) takes time to develop data collection systems, and compile reliable and meaningful data to measure and report actual performance against ESG goals," he said.

"Additionally, understanding whether the measures accurately reflect executive performance and the company's climate strategies is more complex than evaluating traditional operating or financial metrics."

Dr Shin's advice to companies using ESG-linked pay is simply "transparency, transparency and transparency".

Past research indicated that many companies include ESG goals in executive pay to signal "commitment" rather than to drive performance, said Dr Shin, noting that this can lead to accusations of greenwashing.

"Explaining the rationale behind chosen ESG metrics and how they align with overall business strategy is important to avoid this issue," he said.