



VBDO

HayGroup

Sustainable remuneration

A guide for linking sustainable goals to executive incentives

"Remuneration reveals true mission"

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Giuseppe van der Helm, Executive Director of the VBDO, to the Dutch Secretary
of State for Economic Affairs, Drs. F. Heemsker
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Foreword



A gentleman approached me following a shareholders' meeting last year. The question I had asked about whether executive compensation could be linked to sustainability targets had received a negative response for the second year in a row. This gentleman introduced himself as the chair of the company's compensation commission. He told me that this commission had discussed this issue, even though I had received a negative response at the previous year's shareholders' meeting. It turned out that everyone in the commission supported the idea! Yet the initiative fell apart when the compensation consultancy was asked to implement it: the consultancy did not know how to do this. The gentleman suggested that we make a handbook on this topic. His suggestion came a little too late: just one week earlier the VBDO had submitted a proposal for such a handbook at the Dutch Ministry of Economic Affairs.

What lies in front of you is the end result of this project. To bring this project to a successful conclusion, experts in the field of executive compensation (unfamiliar with sustainability issues) had to collaborate with sustainability experts who knew next to nothing about executive compensation. And we had recognized experts: Hay Group is, of course, one of the largest global compensation consultants and DHV is a distinguished consultant in (among other things) the area of corporate social responsibility.

The VBDO has been asking questions about linking sustainability targets to executive compensation for years, long before the commotion surrounding the level of compensation began. We pose these questions at shareholders' meetings, the place where shareholders are asked to approve the executive compensation policy. Why do we do this? Because a bonus is not necessarily bad, as long as it is linked to the right targets. These targets can be increased energy efficiency, lower CO₂ emissions, increased board diversity or improved customer or employee satisfaction. A sustainable bonus has at least three results:



- *The company is forced to formulate clear and quantifiable goals;*
- *The entire organisation must be used to attain these goals, with the result that these goals are embraced by the entire organisation;*
- *A reporting system has to be implemented that provides regular updates for managers to make necessary changes.*

Those of you who think this speaks for itself: currently some sustainability targets are only measured once a year, and the results are published after the year has ended. Difficult to make changes this way...

Four years ago, three of the companies that the VBDO tracks linked variable executive compensation to sustainability targets. Last year the total was up to seven, still not an impressive total. At the same time, a large number of companies were forced, as a result of societal pressure, to postpone improvements to their executive compensation policies until 2010. This provides opportunities!

The VBDO calls on all companies to:

- *Make at least 60% of the bonus based on long term goals;*
- *Link at least 1/3 of the bonus to sustainability targets.*

To assist with the implementation, the VBDO offers this handbook to companies, with thanks going out to the Dutch Ministry of Economic Affairs, Hay Group and DHV.

We encourage you to make use of it!

1. Introduction: why this guide?

In 2006, under the auspices of VBDO, Hay Group and DHV Sustainability Consultants investigated whether sustainability indicators were included in the performance indicators within incentive schemes of executives of Dutch listed companies. The 2006 study pointed out that sustainability indicators were still hardly linked to incentive schemes:

- The by far most popular performance indicators were profit and personal goals for short term incentives and TSR, total shareholder return, for long term incentives.
- Only a very limited number of organisations linked sustainability related indicators with remuneration. In these cases sustainability was mostly marked by employees' safety and health and rarely marked by environmental issues like carbon emission. This conclusion did not only apply to Dutch organisations but to foreign organisations as well.
- Although sustainability relates to the longer term, almost all organisations with a linkage connected these sustainability indicators to short term incentives. These sustainability indicators made up 10-30% of the short term bonus.
- Most supervisory boards recognised the importance of sustainability and the relevance to include sustainability indicators in executive remuneration schemes. Social organisations and institutional investors support supervisory boards on this view.
- Supervisory directors indicated that sustainability indicators should focus on sustainability issues that are relevant to the core business and future organisation.
- To a limited extent, sustainability issues were found on the supervisory agenda. Most supervisory directors found it difficult to give sustainability issues higher priority. They indicated that priority could be increased when a systematic approach to linking sustainability indicators to executive remuneration would be available.

After the study of 2006 many developments took place, accelerated by the 2008-2009 financial and economical crisis, that made organisations 'rethink' the performance areas relevant to executive remuneration. As a result, sustainability is now bound to enter the supervisory board and executive board agendas. In response to the supervisory directors' request for a systematic approach to linking sustainability and remuneration, this guide was initiated by the VBDO, executed by DHV and Hay Group, and sponsored by the Ministry of Economic Affairs. This guide aims to support supervisory directors, executives and staff to:

- get started by answering key questions, dealing with considerations and giving examples
- get to grips with designing and implementing the linkage of sustainability indicators to executive remuneration

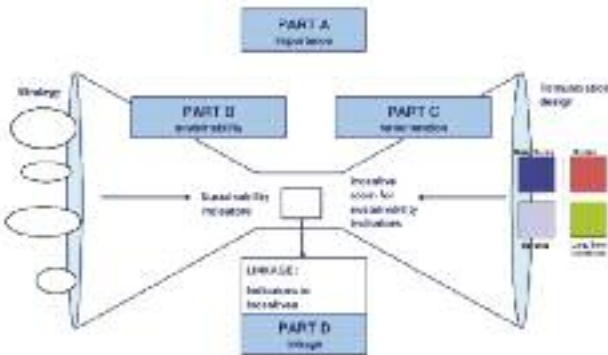
This guide is not a full thesis on sustainability or executive remuneration. It does not offer an optimal solution, nor is it a complete summary of all possible alternatives. Establishing company goals and remuneration design remains a tailor-made process. This guide tries to provide a practical handle for effectively linking sustainability and executive remuneration. It is intended to support the process of 'rethinking' the short term and long term company goals and how to include sustainability indicators. Although this guide is intended in first instance for Dutch listed companies, we also hope that other companies may find elements to include in their executive remuneration policy.

“Remuneration reveals the organisation’s true mission”



1.1. How to use this guide?

The main goal of this guide is to provide arguments, content, techniques and examples to be used in the process of linking sustainability and executive remuneration. Therefore the book is split in 4 parts. Parts A to D set out the road to linkage, the other chapters provide assistance on the way, by giving examples and further reference.



- **Part A: *The importance of sustainability and the linkage with remuneration.*** This part focuses on the relevance of sustainability for the organisation. The degree of relevance determines the need to focus on sustainability areas and indicators.
- **Part B: *Sustainability.*** This part deals with the definition of sustainability and the sustainability phase of the organisation and considerations in defining organisation-specific sustainability areas. This part ends with suggestions for sustainability areas and indicators.
- **Part C: *Remuneration.*** In this part the design of remuneration will be discussed on the basis of which the organisation can establish the required executive remuneration profile. Steps are provided to establish the volume of sustainability related incentives in both short term and long term incentives.
- **Part D: *Linking sustainability with remuneration.*** In this part the results from parts B and C are linked by allocating sustainability indicators to short or long term incentives. Target setting will result in performance factors reflecting under- and over-performance. The performance commitment can be laid down in an agreement.

The final chapters consist of:

- national and international examples, illustrating the present status of remuneration schemes that include sustainability performance indicators,
- relevant references and links and
- information about the guide initiating organisations and authors

1.2. What are the basic steps to get to linkage?

The next table represents a full overview of the considerations that need to be tackled in order to re-align an effective linkage between sustainability and remuneration. These steps may be followed in the order given, or any other order if an organisation has already made specific choices and taken certain steps previously. The final column in the table illustrates possible outcomes for each consideration.

The Road To Linkage (in 12 steps):

Linkage Step	Part	Result (illustrative)
1. Establish whether and to what extent sustainability is important to the organisation and establish why it is required that sustainability indicators are linked to executive remuneration.	A	Environmental developments force the organisation to rethink future production facilities. These are crucial goals and by consequence should trigger executive incentives.
2. Establish the phase of sustainability of the organisation.	B	Semi-advanced phase of sustainability
3. Establish the importance of sustainability within the relevant business sector.	B	The sector has to focus on product responsibility and emissions, effluents and waste.
4. Establish performance indicators appropriate for the sector and the sustainability phase of the organisation.	B	<ul style="list-style-type: none"> Client satisfaction Innovation of new products (based on new raw materials and ingredients) Ecological footprint
5. Establish the most adequate remuneration profile for the Board members	C	<ul style="list-style-type: none"> Remuneration profile is 'Performance Driven' Target performance income is set at 80% of Base Salary.
6. Establish the performance areas that are relevant to the organisation	C	Profit, shareholder value, discretionary appraisal, innovation, sustainability
7. Establish the balance between Short term and Long term incentives	C	<ul style="list-style-type: none"> Target STI is set at 30% of Base Salary Target LTI is set at 50% of Base Salary
8. Establish the volume of Performance Income related to sustainability goals	C	<ul style="list-style-type: none"> 20% of STI and 30% of LTI
9. Establish which sustainability indicators will be linked to STI and which sustainability indicators will be linked to LTI	D	<ul style="list-style-type: none"> Client satisfaction is linked to STI Innovation of new products (based on new raw materials and ingredients) and ecological footprint is linked to LTI
10. Match the sustainability goals to target levels of STI and LTI	D	<ul style="list-style-type: none"> Client satisfaction = 20% of STI Innovation = 20% of LTI Ecological footprint = 10% of LTI
11. Establish target levels for each sustainability indicator and define the leverage that applies to under - and over performance	D	<ul style="list-style-type: none"> Client satisfaction = 7 Innovation(new products in turnover) = 20% Environmental footprint = 3.5
12. Establish the pay-out vehicle for the STI and LTI	D	<ul style="list-style-type: none"> STI paid out in cash LTI paid out in 50% cash and 50% in shares

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2. Part A: The importance of linking

In this chapter we focus on Linkage Step 1:

At the end of this chapter it may be decided that:

Linkage Step	Result (illustrative)
1. Establish whether and to what extent sustainability is important to the organisation and establish why it is required that sustainability indicators are linked to executive remuneration.	Environmental developments force the organisation to rethink future production facilities. These are crucial goals and by consequence should trigger executive incentives.

This chapter provides input for motivating the linkage of sustainability indicators with executive remuneration. The chapter will focus on the definition of sustainability, the business relevance and recent developments.

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2.1. What do we mean with sustainability?

When it comes to linking remuneration with sustainability, the term needs to be defined. Many definitions of sustainability are available. For the purpose of linking sustainability with remuneration we rely on the most globally accepted definitions.

The United Nation Brundtland Commission described sustainable development: *“A Development that meets the needs of the present without compromising the ability of future generations to meet their own needs”*.

For a more business-oriented interpretation, the International Standardization Organization ISO translated this concept into a more operational definition:

“The responsibility of an organisation for the impacts of its decisions and activities on society and the environment, through transparent and ethical behaviour that:

- *contributes to sustainable development, including health and welfare of society,*
- *takes into account the expectations of stakeholders,*
- *is in compliance with applicable law and consistent with international norms of behaviour, and is integrated throughout the organisation and practiced in its relationships”*

In the late nineties of the 20th century, sustainability (or corporate social responsibility) is also defined by John Elkington's triple bottom line concept: People, Planet and Profit.

- “People” (human capital) refers to a wide spectrum of social issues, focusing on fair and beneficial business practices toward labour and the community and region.
- “Planet” (natural capital) refers to sustainable environmental practices.
- “Profit” in the sustainability context differs from traditional accounting definitions and refers to the real economic benefit enjoyed by the host society.

Key elements of these globally accepted definitions are:

- Organisations’ responsibility for the interests of all of its stakeholders.
- A long term care for natural resources and human capital.
- An organisation-specific approach with respect to its social and environmental issues which goes beyond just legal compliance with social and environmental regulations.

Based on the above, we define sustainability in this guide as:

Organisation-specific issues with an ethical, environmental and/or social character that impact the interest of the organisation or the stakeholders.

Issues are regarded to be sustainable when they clearly relate to the social responsibility of the organisation, by focusing on the interests of a wider group of stakeholders than just shareholders and customers. In this respect an organisation focusing, next to financial targets, solely on business performance indicators like client satisfaction is regarded as having a limited sustainability perspective, whereas an organisation that also focuses on employee satisfaction, health and safety or its carbon footprint is regarded as being more sustainable.

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2.2. Is sustainability important to my organisation?

Many organisations currently have a strong interest in incorporating sustainability issues and focus in their strategy and management systems. As the world currently faces serious challenges, such as climate change, food and raw material scarcity and a huge increase in world population, the business community is finding it increasingly important to prepare itself for long term continuity. It seems inevitable that in the long run the impact of climate change and the scarcity of energy resources will be translated in financial incentives, benefiting energy efficient and low carbon organisations.

But also on the short term, a well defined sustainability strategy adds value to organisations:

- **Costs savings** are realised due to more energy efficient processes or supply chains.
- **Corporate reputation** strengthens as the risk of negative publicity is mitigated.
- **Organisation's attractiveness** on the labour market is enhanced due to a sustainability focus, as many surveys show that high potential recruits take into account the sustainability focus of potential employers.
- **Market propositions** improve as the demand for green and fair trade products is strongly emerging.
- **Minerals and base materials** are becoming more scarce, and are thus more expensive.
- **Suppliers**, who do not comply to a minimum level of sustainability, may risk their own continuity, by not meeting environmental or social legal requirements.
- **Institutional investors** have started to take organisations' sustainability strategies into account when making investment choices, as the more 'sustainable organisations' have proven to deliver better shareholder value in the long run. Organisations' sustainability performances are assessed by several sustainability indexes (e.g. the Dow Jones Sustainability Index, the Carbon Disclosure Leadership Index).

The impact of sustainability on an organisation's market value becomes visible by comparing the performance of the Dow Jones Sustainability Index to other indexes, as shown in the graph below.



Development of Dow Jones Sustainability World Index and S&P 500 index

To conclude, integrating sustainability in strategy and operations may lead to long term cost-reduction, increases company value and supports the long term continuity of the organisation. In fact, organisations do not only affect sustainability, but will themselves increasingly be affected by sustainability issues.

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2.3. Where are recent developments leading to?

In the current economic landscape developments indicate that the winning organisations of the 21st century will be those that focus not only on shareholder value. These organisations also take into consideration a broader set of responsibilities and integrate these into their core strategies, including environmental, social and socio-political issues. The economical crisis of 2008-2009 has accelerated this trend by strengthening public expectations towards the role of organisations in society. As a consequence of this changing role of organisations, sustainability has become more integrated into core strategies, processes and products of organisations and thus has become part of the scope of remuneration committees.

Sustainability developments	Remuneration developments
<ul style="list-style-type: none"> • General belief of executive managers that sustainability creates company value. A global survey by McKinsey(2009) among almost 1,200 executives around the world, shows that executives believe sustainability creates a variety of benefits to organisations, including improved operational efficiency, access to new markets, higher brand loyalty and development of new products. • Sustainability is not a hype or trend any longer, but is here to stay, because it affects the overall company performance and thus shareholder value. It is not that organisations affect sustainability; organisations will be increasingly affected by sustainability itself. • Sustainability related pressures are changing the competitive landscape of organisations in many industries: a switch to more regulation with regard to sustainability issues, an increase in unexpected resource shortages, an increase in consumer interest in sustainable products, competitors that influence industry standards by launching green products and services etc. • In order to protect company value and create additional value for its stakeholders, organisations need to respond to these pressures by developing corporate strategies that take into consideration these sustainability-related issues. Sustainability is increasingly becoming part of the overall strategy of organisations and along these lines meets remuneration policy. 	<ul style="list-style-type: none"> • The 2008-2009 financial and economical crisis has been analysed in many ways. One of the most discussed potential perpetrators causing this crisis is the executive bonus. This suggests that executive bonuses are a very effective management tool. In that respect defining indicators that establish the bonus volume needs much attention. • The same crisis analysis shows that the performance indicators many times enclose too much risk. Executives were bound to go for activities that contained big economic risks. This risk did not return in the executive remuneration. • The fall of previous respected organisations forces organisations to rethink the true mission and goals of the organisation. • Institutional shareholders, in contrast to short term oriented shareholders, conclude from this situation that organisations should focus more on long term objectives. Governance codes subscribe that in executive remuneration it is preferred that long term incentives should overrule short term incentives. For a better assessment of future return on investment institutional shareholders are becoming more interested in the way organisations intend to realise their ambitions, anticipate to changing environments and maintain sustainable market positions.
<p>Conclusion: Sustainability meets remuneration</p>	<p>Conclusion: Remuneration meets sustainability</p>



2.4. Why link sustainability to executive remuneration?

Linking sustainability with executive remuneration reveals the way an organisation considers the added value of sustainability to the organisation. Financial indicators reflect company performance over the past, sustainability indicators reflect the preparation for the future. By linking sustainability indicators with executive remuneration:

- Executives deploy resources and efforts towards sustainability initiatives and are less reserved to invest seriously in sustainability programmes
- Organisations are able to hold their top managers explicitly accountable for the organisation's sustainability performance.
- Executives are encouraged to monitor sustainable behaviour at lower levels within their organisation.
- Organisations act according to requests from rating agencies and indexes, such as the Dow Jones Sustainability Index and the FTSE4Good Index.

In viewing the basic purposes for organisations to make such a link we identified three possible motivations:

A: We create value (to stay up front)

Organisations may link sustainability and executive remuneration to improve corporate performance and shareholder value. Executives of these organisations view social, political and environmental issues not as potential risks, but more as business opportunities such as access to new markets and improved operational and workforce efficiency. Sustainability then becomes a competitive advantage. Sustainability creates new corporate value and leads to increased shareholder value.

B: We do the right thing

Organisations may see it as their duty to do the right thing. These organisations have defined corporate responsibility or stewardship as part of their mission, core values and principles. Sustainability is part of corporate culture and the way of business; not because of moral reasons, but because of enlightened self-interest. It helps them to secure their license to operate and legitimacy, which makes it easier to attract and retain better employees and business partners and run less risk of stakeholder scrutiny and consumer boycotts.

C: We have to follow others (defensive position)

Organisations may experience potential risks in socio-political and environmental issues, reputation damage and implementation of new governmental regulation. These organisations regard the sustainability-remuneration link as an additional instrument to deal with these risk issues and thus improve the overall risk management. The primary goal of the link is to protect the current value of the organisation. These organisations might also consider such a link as a response to the decreased public trust and legitimacy of new regulatory codes and rules due to recent remuneration discussions.

The motivations mentioned above are not mutually exclusive. An organisation may have a mixture of both defensive and value building motivations. However, all these motivations lead to pay attention to sustainability and will enforce the requirement of linking sustainability and remuneration.

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3. Part B: The quest for sustainability indicators

In this chapter we focus on Linkage Steps 2 to 4:

At the end of this chapter it may be decided that:

Linkage Step	Result (illustrative)
2. Establish the phase of sustainability of the organisation.	Semi-advanced phase of sustainability
3. Establish the importance of sustainability within the relevant business sector.	The sector has to focus on product responsibility and emissions, effluents and waste.
4. Establish performance indicators appropriate for the sector and the sustainability phase of the organisation.	<ul style="list-style-type: none"> • Client satisfaction • Innovation of new products (based on new raw materials and ingredients) • Ecological footprint

This chapter provides input for selecting relevant sustainability indicators. The chapter will focus on the sustainability phase and the type of industry of the organisation, the relevant sustainability performance areas and the sustainability indicators that may be included in the executive remuneration.





3.1. What's the role of corporate strategy?

One of the main purposes of executive remuneration schemes is that it consists of those performance indicators that 'deliver' information about the contribution of executives to the value of the organisation. As a consequence the performance indicators have to match strategy and business model.

In generic terms, sustainability strategy or Corporate Social Responsibility (CSR) strategy should be aligned with and fully integrated into the overall corporate strategy. A geographical strategy directed to penetrate Asian markets brings along new CSR issues, such as overtime or new cultural dilemmas. Strategic positioning also plays a role; a branding strategy directed on A-level portfolio and luxury markets raises similar expectations in terms of CSR: aligning CSR with corporate strategy means a leading position in terms of CSR as well.

Every organisation has its own unique set of capabilities, depending for instance on the size of the organisation, position in the value chain, its product portfolio or geographical presence. It is important that the sustainability areas and indicators selected for the executive remuneration scheme reflect these impacts as well as the organisation's core capabilities. An organisation can choose to select an indicator that aims to *minimise the negative* impacts of its core activities, or it can choose to develop indicators that help capitalise sustainability *opportunities*. It is key to select those performance areas and indicators that the biggest impact.

Some examples of implementing strategy into sustainability areas:

- **United Utilities:** The sustainability approach of the largest listed water company of the UK is to balance economic, social and environmental considerations in business. UU aims to integrate these considerations in every aspect of their business and selected six key areas. Because of this broad approach UU uses the organisation's performance in the Dow Jones European and World Sustainability Index as a performance measure for each executive director's annual bonus payment.
- **Panasonic:** In 2008 Panasonic developed a three-year strategic plan called GP3, with reduction of environmental impact of every business activity as the core element. One of the strategic objectives of the second year of GP3 was to reduce CO₂-emissions by 10,000 tonnes or more. Panasonic developed an "Eco ideas strategy" to achieve this goal. In order to monitor and control the progress towards objective and implementation of the Eco strategy, Panasonic linked the amount of CO₂-emissions reduction to the individual annual bonuses of all executive directors
- **McDonald's:** The highest impact fast food chains like McDonald's have on society is obesity. Many NGO's accuse fast food chains of stimulating obesity and force these organisations to take actions. In order to manage this negative impact, McDonald's incorporated the extent to which the organisation stimulates active lifestyles within societies as a performance factor into their executive remuneration schemes.

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3.2. What’s the impact of the sustainability phase?

A key consideration to take into account when it comes to establishing sustainability performance indicators, is the sustainability phase of an organisation. Organisations that have never focused on sustainability before may not have any relevant performance data and will need to select other sustainability areas and indicators than organisations that have been active in this area for some time.

- Organisations that find themselves in the first phases of integrating sustainability in strategies and operations lack sufficient insight in their sustainability performance data. Formulating specific quantitative sustainability targets is hard to do. These organisations may start with selecting qualitative sustainability indicators that reflect progress on specific areas.
- Leaders in sustainability integration are able to formulate concrete quantitative sustainability targets. In general, these organisations have reliable and complete sustainability performance data available and have a clear vision on how sustainability activities can create value for the organisation and its stakeholders.

In literature and scientific publication, many models can be found to assess the phase of sustainability integration in an organisation. The five-step model in the table below provides one of these models. The five generic sustainability phases are characterised by corresponding logical next steps and performance indicators. Indicators in the fourth column may serve as drivers in encouraging the organisation to take the next step.

Current phase	Profile description	Logical next steps	Example sustainability indicator
Starter	<ul style="list-style-type: none"> • No CSR issue analysis • No CSR data • No communication 	<ul style="list-style-type: none"> • Perform issue analysis & define CSR strategy 	<ul style="list-style-type: none"> • Publication of sustainability issues and strategy
Mover	<ul style="list-style-type: none"> • Material CSR issues & CSR strategy in place • Description strategy, limited communication 	<ul style="list-style-type: none"> • Construction and execution of CSR program and projects • Establish stakeholder dialogue 	<ul style="list-style-type: none"> • Publication of sustainability report GRI C level • Executed stakeholder dialogue
Semi-advanced	<ul style="list-style-type: none"> • CSR programs and projects in place • Sustainability report available • Reliable sustainability data available 	<ul style="list-style-type: none"> • Formulate concrete CSR targets 	<ul style="list-style-type: none"> • Publication of sustainability report GRI B level • Availability of established targets • Introduction management systems (ISO 14001, 26000)
Advanced	<ul style="list-style-type: none"> • CSR issues, strategy, programs and projects in place • Targets for CSR issues available • CSR performance disclosed • Management systems in place 	<ul style="list-style-type: none"> • Cascade targets throughout the organization • Compare with peers • Report extensively in sustainability report (at GRI A level) 	<ul style="list-style-type: none"> • Publication of sustainability report GRI A level • Identified performance external benchmark • Content criteria such as CO₂ / tonnage, lost time injury rate, employee satisfaction
Leader	<ul style="list-style-type: none"> • CSR issues, strategy, programs, reliable performance monitoring in place • External recognition in sustainability indexes and benchmarks 	<ul style="list-style-type: none"> • Sustainability performance (in terms of content indicators) • Benchmark results 	<ul style="list-style-type: none"> • Leading performance external benchmark • Content criteria such as CO₂ / tonnage, lost time injury rate, employee satisfaction



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3.3. Which external considerations are to be taken into account?

Type of industry

Next to the phase of sustainability integration, it is important to take the type of industry into consideration when selecting sustainability indicators, for example:

- Each industry has its own type of social and environmental impacts. Breweries use a lot of water in their operations, which makes water availability and scarcity a key issue for this industry.
- Each industry has its own value drivers for performance. The more supermarkets are able to meet the expectations and needs of local communities, the better their performance. Focusing sustainability activities on improving the relationship with these local societies is a strategic choice, that might create additional value for the organisation.

As each industry has its own value drivers the priorities between sustainability areas and indicators will differ per industry. Each organisation needs to, in close dialogue with its stakeholders, identify its most material sustainability issues. Banks have a stronger focus on the integration of sustainability issues, whereas for production organisations it is more crucial to focus on health & safety and emissions to the environment.

Peer group relevance

Peer group data often forms the basis for “market” comparisons, such as pay levels and company performance, but also for sustainability performance. From a sustainability point of view it is relevant to select peers that have activities with comparable social and environmental impacts. These are usually organisations operating in the same industry. For some of these organisations dedicated sustainability indexes are available, like the Dow Jones Sustainability Index performed by SAM.

Peer group comparisons can be used to identify the possible sustainability areas and indicators. Peer groups also can be used to concretise appropriate performance levels for sustainability targets

Stakeholder expectations

Greater corporate legitimacy creates value for the organisation. To improve corporate legitimacy it is required to know and meet the expectations of its key stakeholders. Do stakeholders, like investors, customers, media, or NGO’s pressurise your industry or organisation to contribute to environmental or social issues, such as climate change, poverty reduction or diversity? If so, the sustainability performance indicators for the Executive Board will need to reflect these material issues.

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3.4. Which sustainability areas are relevant?

In order to identify the most significant sustainability issues, both the Global Reporting Initiative and draft ISO 26000 Guidance on Social Responsibility provide coherent methodologies, that support organisations to identify stakeholder concerns and interests and helps them translate these into a CSR policy.

In short, the GRI provides an overview of external and internal factors to be taken into account when identifying relevant areas and corresponding KPI's. An overview of the main external and internal factors put forward by the GRI is summarised below:

External Factors

- Main sustainability interests/topics and indicators raised by stakeholders.
- The main topics and future challenges for the sector reported by peers and competitors.
- Relevant laws, regulations, international agreements, or voluntary agreements with strategic significance to the organization and its stakeholders.
- Reasonably estimable sustainability impacts, risks or opportunities (e.g., global warming, HIV-AIDS, poverty) identified through sound investigation by people with recognised expertise or by expert bodies with recognised credentials in the field.

Internal Factors

- Key organizational values, policies, strategies, operational management systems, goals, and targets.
- The interests/expectations of stakeholders specifically invested in the success of the organization (e.g., employees, shareholders, and suppliers).
- Significant risks to the organization.
- Critical factors for enabling organizational success.
- The core competencies of the organization and the manner in which they can contribute to sustainable development.

Once a long-list of areas has been identified, an organisation needs to prioritise the issues and to select only the most important ones. It is crucial to limit the number of areas and corresponding indicators when it comes to executive remuneration. Too many indicators will dilute focus.

For a detailed explanation of the sustainability report guidelines of GRI and ISO 26000 we refer to these documents.



3.5. What are the areas defined by GRI?

Based on the reporting principles GRI defines core sustainability areas, which may be of interest to most stakeholders:

Sustainability Area	Sustainability Sub-Areas	
Economic	<ul style="list-style-type: none"> Economic performance Market presence 	<ul style="list-style-type: none"> Indirect economic impacts
Product responsibility	<ul style="list-style-type: none"> Customer Health and Safety Product and service labelling Marketing communications 	<ul style="list-style-type: none"> Customer privacy Compliance
Society	<ul style="list-style-type: none"> Community Corruption Public policy 	<ul style="list-style-type: none"> Anti-competitive behaviour Compliance
Human Rights	<ul style="list-style-type: none"> Investment and procurement practice Non-discrimination Freedom of association and collective bargaining 	<ul style="list-style-type: none"> Child labour Forced and compulsory labour Security practices Indigenous rights
Labour Practices and decent work	<ul style="list-style-type: none"> Employment Labour/ management relations Occupational health and safety 	<ul style="list-style-type: none"> Training and education Diversity and equal opportunities
Environmental	<ul style="list-style-type: none"> Materials Energy Water Biodiversity Emissions, effluents and waste 	<ul style="list-style-type: none"> Products and services Compliance Transport Overall

An organisation will select its sustainability area indicators carefully, by taking into account corporate strategy, organizational characteristics and external environment. When selecting sustainability areas and indicators for the executive remuneration scheme it may be considered that performance areas and indicators should:

- lead to better sustainability performance of the organisation;
- be meaningful and relevant to the incentive scheme of the executive directors;
- be controllable and reproducible over the years and can be influenced by the executives;
- be significant to the overall performance of the organisation.

Once the most relevant sustainability areas are identified the organisation has to establish corresponding indicators, which can express the performance in those areas. Per area GRI also provides a protocol, explaining which indicators are appropriate for the sustainability areas concerned. Many listed companies report their sustainability performance by issuing an annual sustainability report, based on the GRI areas and indicators.



Part B: The quest for sustainability indicators

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3.6. What are typical indicators in an industry sector?

The following table gives insight in typical indicators for different sectors. This overview is not exhaustive nor prescriptive. Other areas and indicators may be considered to be more relevant or as having a bigger impact on company performance.

Industry sector	Social Areas (Typical indicators)	Environmental Areas (Typical indicators)
Automobiles & Parts	<ul style="list-style-type: none"> Health and safety (Accidents ratio's) 	<ul style="list-style-type: none"> Clean cars (fuel efficiency cars sold) Emission factor (carbon emissions/1,000cars) Green services / integration environmental attention in products (% green products in portfolio)
Banks & Financial services	<ul style="list-style-type: none"> Integrity (number of violations) Customer satisfaction (% customer satisfaction), Responsible investments (sustainability investment criteria) 	<ul style="list-style-type: none"> Energy use (gigajoule/ tones) Recycling (% secondary materials)
Basic Resources	<ul style="list-style-type: none"> Health and safety employees (lost time injury rates fatalities) 	<ul style="list-style-type: none"> Energy use (gigajoules/ tones) Air emissions CO2 emissions (CO2/tones production)
Chemicals	<ul style="list-style-type: none"> Health and safety employees (lost time injury rates fatalities) 	

Chapter 6 of this guide provides insight in practices of organisations which currently link their sustainability performance to remuneration.



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Part B: The quest for sustainability indicators

3.7. How to start with sustainability indicators?

Without a doubt organisations can only use indicators for remuneration purposes when robust, reliable and indisputable internal performance data are available. It is recommended to have these data externally assured, in order to enhance reliability. Many organisations, issuing sustainability reports on an annual basis, engage external accountants for external assurance on the data that is incorporated in the sustainability report.

Starting without sustainability performance data

However, even when sustainability performance data is lacking, a link between sustainability and remuneration can still be created. In these circumstances, linking qualitative indicators to the remunerations scheme can encourage executives to take the next step. Examples are:

- an incentive for the identification of the most relevant sustainability areas
- an incentive for the publication of a first sustainability report
- an incentive for the achievement of a higher GRI-application level of a sustainability report.

Incentives such as the above are aimed at integrating sustainability into company strategy and enable performance measurement in the longer run.

Enough is enough

To ensure focus on sustainability it is recommended to limit the number of indicators. The fewer indicators are involved, the more powerful they will be. The downside, however, is that other relevant indicators that are not linked to executive remuneration, are in danger of being neglected. The search for indicators is also a search for balance. If all sustainability indicators are related to long term incentives having 3 indicators may be enough. When sustainability indicators are also related to short term incentives the maximum may be set at 4 indicators in total.



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3.8. Is there a TSR equivalent for sustainability?

Based on external and internal considerations sustainability indicators should be defined that are clear, concrete and indisputable.

Sustainability index as the counterpart of TSR

Total Shareholder Return, the total of stock price increase and dividend payments, can be regarded as the valuation of the organisation through the eyes of outsiders. Specifically, (potential) shareholders transfer all information and future expectations into a present company value.

In a similar way sustainability indexes represent the sustainability value which the 'outside world' connects to the sustainability efforts of the organisation. A high score can be interpreted as a strong belief of investors that the organisation concerned takes up a constructive role towards its social context and environment, has a long term focus and is more likely to become one of the future sector leaders.

Considering indexes

Organisations which are in an advanced phase of sustainability integration (see part B), may consider using more integrated sustainability indicators. For some sectors and organisations, these indicators are readily available, by way of sustainability indexes. The most well-known are the Dow Jones Sustainability Indexes and the FTSE4Good Index. Organisations that comply to the eligibility criteria for these indexes can use their position or the number of points as the sustainability indicator to connect to remuneration. But it should be kept in mind that an organisation's sustainability strategy should not be guided by such indexes only, but should have its own strategic considerations as its primary basis.

Dow Jones Sustainability Index

In cooperation with Dow Jones Indexes and STOXX Limited, SAM publishes and licenses the Dow Jones Sustainability World Indexes (DJSI), a series of global sustainability benchmarks launched in September 1999. The indexes are based on SAM's corporate sustainability assessment, which identifies global sustainability sector leaders on the basis of economic, environmental and social criteria. Akzo Nobel uses the outcome of this sector benchmark as their sustainability performance indicator for their Board of Directors' remuneration.

Other indexes such as the FTS4Good index can also serve as a reliable source for an external index. However, only a relatively small part of all listed companies are part of the universes of these indexes (depending on the size of the organisation). For other organisations, a sustainability peer review can provide insight in relevant sustainability issues, performance and approach of competitors.



Part B: The quest for sustainability indicators

3.9. Is there room for discretionary judgment?

Measurable

A topic of ongoing discussion is the extent to which indicators in general and sustainability indicators in particular can or have to be formulated in a SMART way. In classical performance management theory targets for indicators are supposed to be SMART meaning:

- **S**pecific: well defined, clearly formulated
- **M**easurable: knowing how far from completion
- **A**cceptable (but Ambitious): agreement with all stakeholders
- **R**ealistic: within the availability of resources, knowledge and time
- **T**ime bound: clear understanding of timeframe for realisation

It may be desirable to fulfil all SMART requirements. However, organisations in an early phase of sustainability, might not possess such indicators.

.... or Noticeable?

It is key for an organisation to motivate why the link between remuneration and sustainability is set up. Is it to create new value for the organisation? Or just to do the right thing and align the remuneration policy with its mission and corporate value. When an organisation develops a linkage in order to manage sustainability risks or to create extra corporate value by making use of sustainability opportunities, it may be effective to formulate a clear set of sustainability indicators accompanied with measurable targets. However, when no indicators are available or the organisation wants to stimulate responsible executive behaviour in general, the organisation may decide not to formulate measurable sustainability targets. In that case the supervisory board may introduce a discretionary appraisal of hardly measurable but very noticeable issues. Discretionary judgment also makes it possible to include appraisal on unexpected and unforeseen situations. In that case the appraisal will focus on the way the executive board has dealt with the situation than the actual performance result.

In short

Yes, a more discretionary judgement of the board's approach towards sustainability may also be adequate. The only restriction relates to the supervisory board: when indicators are not set in advance the board should be able to substantiate their point of view at the end of the performance period.

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4. Part C: Remuneration room for sustainability

In this chapter we focus on Linkage Steps 5-8:

At the end of this chapter it may be decided that:

Linkage Step	Result (illustrative)
5. Establish the most adequate remuneration profile for the Board members	<ul style="list-style-type: none"> Remuneration profile is 'Performance Driven' Target performance income is set at 80% of Base Salary.
6. Establish the performance areas which are relevant to the organisation	Profit, shareholder value, discretionary appraisal, innovation, sustainability
7. Establish the balance between Short Term and Long Term incentives	<ul style="list-style-type: none"> Target STI is set at 30% of Base Salary Target LTI is set at 50% of Base Salary
8. Establish the volume of Performance Income related to Sustainability goals	<ul style="list-style-type: none"> 20% of STI and 30% of LTI

This chapter provides a “decision tree” to establish the volume of incentives that may be linked to sustainability related performance indicators. The chapter will focus on the remuneration design, the remuneration profile, the performance areas and the volume of ‘sustainability performance’.



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Part C: Remuneration room for sustainability

4.1. Who are involved in the remuneration design?

The Supervisory Board is accountable for the remuneration policy and the application of individual remuneration of executives. The decision is prepared by a remuneration committee consisting of a number of supervisory directors, while the full supervisory board makes the final decision. At the Annual General Meeting (AGM) shareholders have to approve the remuneration policy. The approved policy forms the framework within which the supervisory board can operate.

Supervisory directors generally may be assisted (or influenced) by:

- HR director
- CSR director
- External consultants
- Investors/ shareholders
- Media

More and more the strategy and opinion of shareholders and institutional investors forms the framework for decision-making. Also supervisory boards take into account the public opinions, social relevance and media attention. Especially when remuneration decisions may influence image and business performance supervisory directors are cautious. The supervisory boards' opinion, however, is a mixture of different individual opinions and attitudes, based on personal background and experiences.

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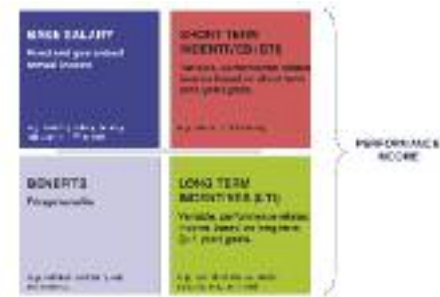
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4.2. What are the main elements of remuneration?

Executive remuneration is mainly related to company policy, individual market value and expected performance based on proven track records. Age is less important and (shown) competencies are expressed in labour market value. In contrast to other employees in the organisation the executive base salary generally leaves no room for seniority growth (merit increases). Top executives are supposed to act at a 100% level from day one, and as a consequence are paid correspondingly: no salary range.

Four Remuneration Blocks

The total executive remuneration always consists of four main categories or blocks. Two of these blocks concern fixed and guaranteed elements: Base Salary and Benefits. The two other blocks are formed by performance income and by consequence will vary during employment.



The way supervisory boards set up the separate blocks represents the remuneration philosophy of the organisation. In several cases the set up may be based on the backgrounds of the individual directors. When an executive is regarded as being an employee, in service of the organisation and taking care of a correct execution of a well defined task, the focus will be on the fixed elements with hardly any or no performance incentives. But when expected performance may be well-defined and entrepreneurial behaviour is expected, or the supervisory board wants to concretise the executive appraisal into reward, there variable blocks may be more strongly emphasised. The remuneration profile may vary from a ‘fee’ or employee remuneration profile to an entrepreneurial remuneration profile, in which there is hardly any guarantee for fixed income and incentives are mainly based on future organisational developments.

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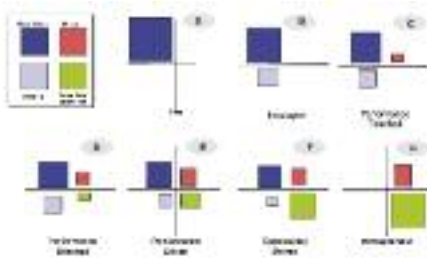
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4.3. What are relevant considerations for design?

In the following figure the main remuneration profiles are indicated.



When establishing the required profile the following considerations may be taken into account:

Internal considerations:

- **Strategy:** is there a strong and clear ambition which needs to be realised or is the organisation an ‘ongoing concern’ which needs to be managed in a routine like way?
- **Performance orientation/management style:** is there a strong result-driven management style, an atmosphere where management has to be rewarded accordingly?
- **Costs:** should remuneration costs be in line with company or personal performance and should income (highly) fluctuate with economic business developments or should income be more independent of these aspects and remain at the same level?
- **Current remuneration practice:** should the present remuneration design be continued and are only small deviations allowed?
- **Remuneration of management levels reporting to board:** should the executive remuneration package be in line with reporting levels or may it deviate?

External considerations:

- **Benchmark/ peer group:** which organisations are competitive peers in the executive market, what are common income levels within the sector and what are common performance related income volumes?
- **Type of industry:** what is common practice within the sector and is it worthwhile profiling the organisation by deviating from the usual practice, or is it unavoidable to follow the common remuneration practices?
- **Stakeholders:** what is the effect of remuneration design on client behaviour and what is the impact on shareholder or investor attitudes?
Which signals does remuneration emit towards the remuneration practice of employees in the organisation?

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Part C: Remuneration room for sustainability

4.4. Which remuneration profile fits my organisation?

After evaluating all relevant considerations as described before, the supervisory board may translate all this into the choice for one of the remuneration profiles. As the profile inclines towards the ‘entrepreneur’ profile it should be taken into account that, in general, the risk element increases as well and more attention will then exponentially be focused on the performance indicators involved. Other business relevant issues may be regarded as less relevant. Many organisations, previously opting for the opportunity driven profile, nowadays choose for ‘performance driven’ or ‘performance oriented’ profiles.

In the following table a short characterization is given for each of these profiles. In these profiles performance income is defined as the total of both short term (bonus) and long term incentives (LTI). The percentages relate to the target levels of the respective incentives. Percentages that are actually paid out may be higher or lower. For example, a ‘performance oriented’ remuneration profile will lead to a performance income of significantly more than 30% of base salary in a successful year, and to a lower percentage in an unsuccessful year.

Remuneration Profile	Description	Indicative (target) Performance Income
Fee	Usually this applies to a temporary fulfilment of the executive position.	No Performance Income
Employee	Incentives are not regarded as being motivating, the organisation needs to be managed more than to be lead into new growth and ambition or company performance areas and indicators are hard to define.	No or hardly any Performance Income
Performance Touched	Performance related income is seen as additional income which should have no big impact. It may represent a small token of appreciation by the supervisory board.	10 - 30% of Base Salary
Performance Oriented	The performance volume of remuneration is significant to focus on related indicators. On the other hand, the volume leaves room for attention of other, not included business goals.	30 - 70% of Base Salary
Performance Driven	Performance is central. The performance areas and the derived performance indicators may be regarded as the crucial success indicators. Executives are triggered to double salary.	70 - 150 % of Base Salary
Opportunity Driven	Very strong focus on performance. The main focus of the executive has to be and will be on the performance areas defined. Not included performance areas may loose attention.	150 - 300% of Base Salary

- The present major governance codes limit the performance income to a one year salary (100% of Base Salary) corresponding to a ‘performance driven’ profile. An opportunity driven profile is not seen as appropriate anymore.
- A distinction may be made for the separate positions within the Executive Board. The remuneration profile of the president of the board may differ from that of the vice-president or the other board members, determined usually by their individual accountabilities.

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4.5. Which performance areas are relevant for remuneration?

Once the (target) volume of incentives is established, the next step is to focus on the target areas which are involved with regard to payment. All relevant performance areas have to be inventoried before deciding upon the areas that will be considered to be of strategic importance to the organisation. The overview below gives an idea of performance areas that are used in short and long term incentive schemes:

- Financial goals
- Operational goals
- Personal goals
- Fitness of organisation
- Strategic plan
- Shareholder value
- Innovation

The area of sustainability performance can be added to this list. The areas are not exclusive and may overlap. Innovation can be part of the strategic plan, operational company goals can be part of personal goals. Sustainability indicators also may be placed under operational or performance areas. On behalf of establishing incentive room for sustainability it is recommended to cluster all sustainability indicators into a separate sustainability area.

Although all (and maybe more) areas may be regarded as relevant, this does not mean that all these areas are also shown in executive remuneration. Up to and including 2009 it is common practice to base performance indicators on three performance areas:

- Short term incentives are 70% based on financial goals and 30% on (diverse) personal goals,
- Long term incentives are 100% based on shareholder value.

The relevant performance areas also have to be linked to the short and long term horizons. Therefore it is necessary to indicate which performance areas contribute significantly to performance on the short term or the long term and by consequence are fit to be linked to the executive short or to the long term incentive schemes. Defining the performance indicators (also indicated as 'key performance indicators') per performance area will be helpful in establishing the weighing factors of the performance areas.

Below an illustration of the configuration of the performance areas in the incentive schemes:

Short term incentives	Long term incentives
60% Financial goals	40% Shareholder value
20% Personal goals	20% Strategic plan
20% Sustainability	40% Sustainability

Evaluating all performance areas will put the establishment of the volume of sustainability incentives into a wider perspective. The final weighing of the sustainability performance area reveals its importance and impact.

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4.6. How much remuneration room for sustainability?

Impact on present incentive schemes

Introducing sustainability areas and indicators will influence the existing executive incentive scheme. When the present incentive target volumes are not changed, new indicators have to take the place of existing indicators or a reshuffle of weighing factors for all indicators involved will take place.

Breaking up performance income

During the process of deciding which performance areas are relevant for executive incentives the focus on the short and/or long term generally becomes clear. The total performance income may be split up in a short term/long term ratio. A 40-60 split indicates a focus on the long term, while a 80-20 split indicates a strong focus on short term results.

Establishment of sustainability part in STI and LTI

Once the split of STI and LTI is made and the weighing in the performance areas has been set the proportion of sustainability in STI and LTI is established.

Performance Income (target) = ... % of Base Salary			
STI .. % of Base Salary		LTI ... % of Base Salary	
Performance Areas STI ... % of Base Salary	Sustainability STI ... % of Base Salary	Performance Areas LTI ... % of Base Salary	Sustainability LTI ... % of Base Salary

The resulting volume of sustainability, together with the sustainability indicators, leads to the linkage of sustainability indicators with executive remuneration.

As an illustration the following result for the sustainability room may be established:

- The supervisory board decides to divide the total performance income of 70% of Base Salary in an STI of 30% of Base Salary and an LTI of 40% of Base Salary.
- For the short term incentive the sustainability performance indicators make up 20% of the STI and for the long term incentive 40% is based on sustainability performance indicators.
- As a consequence the target STI sustainability indicators may result in 6% of Base Salary (20% of 30%) and the target LTI sustainability indicator in 16% of Base Salary (40% of 40%)

.. or put in the scheme:

Performance Income (target) = 70% of Base Salary			
STI 30% of Base Salary		LTI 40% of Base Salary	
(80% of STI) Performance Areas STI 24% of Base Salary	(20% of STI) Sustainability STI 6% of Base Salary	(60% of LTI) Performance Areas LTI 24% of Base Salary	(40% of LTI) Sustainability LTI 16% of Base Salary

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Part D: Linking sustainability to remuneration

5.Part D: Linking sustainability to remuneration

In this chapter we focus on Linkage Steps 9-12:

At the end of this chapter it may be decided that:

Linkage Step	Result (illustrative)
9. Establish which sustainability indicators will be linked to STI and which sustainability indicators will be linked to LTI	<ul style="list-style-type: none"> • Client satisfaction is linked to STI • Innovation of new products (based on new raw materials and ingredients) and ecological footprint is linked to LTI
10. Match the sustainability goals to target levels of STI and LTI	<ul style="list-style-type: none"> • Client satisfaction = 20% of STI • Innovation = 20% of LTI • Ecological footprint = 10% of LTI
11. Establish target levels for each sustainability indicator and define the leverage that applies to under - and over performance	<ul style="list-style-type: none"> • Client satisfaction = 7 • Innovation(new products in turnover) = 20% • Environmental footprint = 3.5
12. Establish the pay-out vehicle for the STI and LTI	<ul style="list-style-type: none"> • STI paid out in cash • LTI paid out in 50% cash and 50% in shares

In this part the sustainability indicators (result of part B) will be linked to the room for the ST and LT incentives (result of part C). When these indicators are linked to remuneration, it may turn out that these indicators do not match with short term and long term room for incentives.

The balance will be recovered by exchanging short term and long term incentive volumes. Finally, a Performance Commitment will summarise all relevant decisions and will formalise performance agreements for the coming years.

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5.1. Are sustainability indicators linked to short or long term?

Once sustainability indicators have been established it is necessary to define whether they are related to the short term or the long term. Short term incentives (STI) are regarded as related to a ‘one year’ performance. Long term incentives (LTI) are related to performance over multiple years. Typically, nowadays LTI refers to a three-year period, but it can be considered to relate LTI to an even longer term (four or five years). In principle sustainability indicators are long term related. However, some indicators also may have effect within a shorter period. Publishing a sustainability report may be set as a target for one year, reducing significant carbon emission may cover more than one year.

Each sustainability indicator has to be characterised in terms of time horizon and is then linked to STI or LTI. When there are four indicators this may lead to the scheme below, in which two indicators are related to STI and two indicators to LTI. An indicator which is regarded as very relevant for both short term and long term can be linked to both incentives. The target however may differ: for example reduction of carbon emission in the coming year with 10%, reduction in the coming three years with 40%.

STI	Target payout	LTI	Target payout
Indicator 1	... %	Indicator 3	... %
Indicator 2	... %	Indicator 4	... %
	20 % of STI (or ... % of Base Salary)		30 % of LTI (or ... % of Base Salary)

It may turn out that an imbalance is perceived regarding indicators. For example, when all indicators are linked with LTI and none are linked to STI. Then the ratio STI and LTI can simply be reshuffled. The sustainability room in the STI may be fully transferred and added to the sustainability room in the LTI. An original set up of 20% on STI and 30% on LTI may be transferred into 0% on STI and 50% on LTI.

Equivalent remuneration

A reshuffle between STI and LTI can be perceived as unfair. A payout opportunity in the coming year (STI) may not be perceived as having the same value as the same payout opportunity after three years (LTI). As the time horizon (and uncertainty) increases, a short term opportunity may be perceived as more valuable. When exchanging STI and LTI a ‘transfer rate’ may be introduced, e.g.:

- € 1 STI = € 1,50 or € 2 LTI

When, for example, the room in STI leads to 20% of Base Salary and no STI indicators are established, 30 or 40% of Base Salary should be added to sustainability room in LTI in order to achieve fairness.



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5.2. How can sustainability targets be set?

Once appropriate and relevant sustainability indicators have been formulated (part B), targets need to be defined for each indicator. For those organisations that are unable to select or just have not defined quantitative indicators, the target can be the realization of a well defined deliverable. For instance, when the sustainability indicator concerns the in time publication of a B+ level sustainability report, the target is clear and easy to check. When the report has been realised the target has been met, when the report is not realised the target has not been met. Of course, the quality of the report may also be included to define the performance factor (see 5.3).

When an organisation has defined quantitative indicators, such as a specific performance score in a sustainability index or a specific quantitative sustainability issue (CO₂ / ton production, client satisfaction or the lost time injury ratio), it is possible to measure the extent to which the targets are met.

For setting targets on the chosen sustainability indicators, several sources can be used, e.g.:

- peer review: what was the average progress in the selected areas of competitors on an annual basis?
- sector average for the chosen indicator and determining how the organisation should perform compared to this average within a certain time horizon
- what do executives themselves consider as a challenging but feasible target?

The weighting of the sustainability performance of the chosen indicators can be approached exactly the same way as financial indicators (see 4.5). Once these targets are set, these can be incorporated in the performance commitment, as illustrated in 5.4

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5.3. What will happen when targets are exceeded?

For every indicator a target level has to be set. This target level may be ambitious or 'easy to achieve'. In general it is advisable to correspond the target level to a level which is 'realistic' to achieve and which may relate to business plans and/or budgets.

Actual STI and LTI performance results may not be equal to target levels. In case the target level is exceeded the payout may be above the target payout. When the target level is not met, the payout will be less or can even be zero. A performance factor will express the payout level in case of under- and over-performance. Beforehand this performance factor and the corresponding range of performance results has to be defined, as illustrated in the following table.

Indicative performance factor

Performance Factor	Appraisal
2,0	<ul style="list-style-type: none"> Excellent, fantastic performance
1,5	<ul style="list-style-type: none"> Very good performance
1,25	<ul style="list-style-type: none"> Significant more than expected
1,0	<ul style="list-style-type: none"> At target, conform budget/ realistic expectation
0,5	<ul style="list-style-type: none"> Moderate, but just acceptable
0,0	<ul style="list-style-type: none"> Insufficient

The actual STI is a factor of the 'target' payout. In case all targets are met (performance factor = 1) the actual payout equals the target payout. Over-performance results in a (significant) higher payout.

The following table is an illustration of the consequences of over- and underperformance when the sustainability indicator (the rank in the Dow Jones Sustainability Index) is the position in a 20 company peer-group.

Indicative performance factor

Performance Factor	Ranking in DJSI (20 companies)	Appraisal
2,0	<ul style="list-style-type: none"> Position 1 	<ul style="list-style-type: none"> Excellent, fantastic performance
1,5	<ul style="list-style-type: none"> Position 2 	<ul style="list-style-type: none"> Very good performance
1,25	<ul style="list-style-type: none"> Position 3 	<ul style="list-style-type: none"> Significant more than expected
1,0	<ul style="list-style-type: none"> Position 6 	<ul style="list-style-type: none"> At target, conform budget/realistic expectation
0,5	<ul style="list-style-type: none"> Position 10 	<ul style="list-style-type: none"> Moderate, but just acceptable
0,0	<ul style="list-style-type: none"> Position 11-20 	<ul style="list-style-type: none"> Insufficient

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5.4. Can all this be laid down in an agreement?

The annual performance agreement may be written down in a ‘performance commitment’, in which the performance areas, performance indicators and the remuneration consequences are recorded. Such a performance commitment covers the agreements regarding short term performance (STI) as well as long term performance (LTI).

In the following scheme, all previous steps are summarised. The scheme lays down the personal commitment for the years 2010-2012.

Performance Commitment 2010-2012				
Short Term Incentive 2010				
Performance area	Weighing (a)	Performance indicator	Performance factor (b)	Result (a x b)
Short Term Performance area 1	... %	= 2,0 = 1,5 = 1,25 target level = 1,0 = 0,5 = 0 %
Short Term Performance area 2	... %	idem %
ST Sustainability	... %	idem %
100 % Total result (c)			%
Base Salary 2010 (d)				€ ...
Target STI (e)				.. % of Base Salary
STI 2010 (c x d x e)				€

Long term Incentive 2010-2012				
Performance area	Weighing (a)	Performance indicator	Performance factor (b)	Result (a x b)
Long Term Performance area 1	... %	= 2,0 = 1,5 = 1,25 target level = 1,0 = 0,5 = 0 %
Long Term Performance area 2	... %	idem %
LT Sustainability	... %	idem %
100 %			%
Base Salary 2010 (d)				€ ...
Target LTI (e)				.. % of Base Salary
LTI 2010-2012 (c x d x e)				€

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5.5. What type of payments can be used?

There are three types of payments for incentives: cash, shares and stock options.

In principle, all three types can be used. Cash payments are seen as the payment type for short term incentives (bonuses). In recent history the concept of Long term incentives was synonymous with stock options, mainly caused by the minimal tax consequences in the early nineties of the last century. Taxation has changed over the years and nowadays choices are mainly based on the character of the type of payment:

- **Stock options:** Stock options are related to stock developments, but do not need employee financing for acquiring stock. There is no financial downside risk for the employee: stock price increase leads to bonus payment, stock price decrease ('underwater' situation) does not lead to payment, but does also not lead to employee risk. The number of options to be given to an executive is mostly based on benefit value. This benefit value represents the expected future value of the options and is usually calculated with formulas such as Black-Scholes. The value is generally in the range of 25-30% of the underlying share value (number of options times stock price). Calculations like these result in a high number of options in times of decreasing stock prices, which can be capitalised when stock goes up.
- **Shares:** A common point of view is that the possession of shares aligns the interests of executives with those of the shareholders. As a rule, shareholders expect executive decisions to be in the interest of shareholders (share price). However, opposite views are also found, namely that executives may encounter situations in which short term decisions, although with long term performance in mind, may negatively affect short term share prices: executives may be focused on (short term) share prices instead of long term company performance.
- **Cash:** Money payments directly correspond with the value related to achieving targets. Unlike shares and stock options cash payments do not have to be transferred into real value, can be communicated clearly and do not need profound accounting rules. Additionally, cash payments are more simple than the complex shares and stock options e.g. with regard to exercise period.

The characteristics above have caused institutional investors to be more explicit about their preferences: stock options are history, shares are acceptable and cash payments are the preferred way forward. Obviously, this mainly applies for long term incentives as cash payments are already common for short term incentives.

Claw back and waiting period

The irregularities of recent years have led to the introduction of claw back clauses or 'waiting periods' regarding the actual payout of incentives. A claw back clause makes it possible to recall the initially paid out incentive when external circumstances give cause or when targets were not met in the end. A 'waiting period', a period after which the definite realisation of targets can be established, may also prevent undesirable payout situations.

The same applies to selling stocks. To emphasise the relevance of executive stock property and to prevent irregularities it may be desirable to state that shares will not be cashed during the active career period of the executive, but only after e.g. six months after leaving the organisation.

From a sustainability point of view we agree with the preference of institutional investors and recommend a claw back clause or a waiting period

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5.6. Is there a code for sustainability incentives?

There is no code for introducing sustainable indicators to executive incentives. Neither is there a code for the volume of sustainable indicators in the total of performance income (being the total of short term and long term incentives). On the other hand Corporate Governance Codes (CGC) have stated some 'rules' regarding executive remuneration. In summary:

- base salary and performance income should be balanced and in line with the risk profile of the organisation
- performance income should not surpass base salary (being more than 100% of base salary)
- performance income should be based on long term goals
- non-financial indicators should be included

This results in a commonly (in CGC's) accepted preference of a 'performance oriented' or 'performance driven' remuneration profile.

Another recommendation is to:

- Balancing base salary and performance income may be made concrete by means of a complementary relationship:
 - a relatively low base salary (versus peers) may be compensated with a strong performance income,
 - a relatively high base salary (versus peers) may be compensated with a moderate performance income.

The VBDO recommends:

- Performance income should not surpass base salary (being more than 100% of base salary)
- The performance income has to be divided in the target percentages for short term and long term incentives. The VBDO's preference is to focus on long term incentives, with minimal 60% of the performance income based on long term incentives.
- Regarding performance areas and indicators the VBDO prefers that sustainability areas relate to more than 30% of (short and long term) performance income.
- The payout is preferably in cash. Payout in shares is also possible. Stock options are not preferred. It is recommended that shares are not cashed until half a year after leaving the organisation.

6. Examples current practices

This chapter will summarise corporate strategy and remuneration of companies that include sustainability indicators in the executive remuneration.

Amsterdam listed companies:

- Akzo
- DSM
- Shell
- Wereldhave

International listed companies:

- National Grid
- Nokia
- Panasonic Corporation
- Tesco

AKZO (Paints, Coatings and Specialty Chemicals)

Mission Statement & Values

“We believe the future belongs to those smart enough to challenge it. We believe that real progress belongs to those who not only think with courage, but also have the courage to deliver on the thought. Tomorrow’s answers, delivered today. What drives us is knowing that what is good for our customers today is not necessarily good enough for them tomorrow. What excites us is asking the unasked question. What inspires us is seeing the opportunity others cannot. What unites us is the intelligence to deliver where others have not. This benefits our customers because we sustain their future competitiveness and meet the consumers’ unspoken needs”.

AKZO’s values are:

- Focus on our customers’ future first
- Embrace entrepreneurial thinking
- Develop the talents of our people
- The courage and curiosity to question
- Integrity and responsibility in our actions

Corporate strategy

AKZO’s mission is pursued by following the strategic agenda as formulated below:

1. Successfully integrating ICI
2. Delivering profitable growth by leveraging their strong emerging markets and technology positions, augmented by bolt-on acquisitions
3. Improving margins through enhanced pricing and procurement processes
4. Increasing operational effectiveness, partly through restructuring, particularly in mature markets
5. Embedding the AkzoNobel values
6. Creating an industry-leading Talent Factory
7. Striving for world class levels of sustainability and safety.

Sustainability strategy & objectives

AKZO’s sustainability strategy follows a three-level approach, and on each level environmental, economic and social aspects are included. The three levels focus on

- Inventing sustainability: Integrate long term value propositions
- Managing sustainability: Include sustainability in all aspects of the value chain
- Improving sustainability. Continue to comply and ensure a license to operate

As part of sustainable value creation, AKZO has formulated three overall sustainability targets:

- Remain in the top three in the Dow Jones Sustainability Indexes
- Reduce the total recordable injury rate
- Deliver a step change in people development, in part through substantively improving the diversity of the organisation

Sustainability in remuneration policy

Sustainability indicators

- all aspects of the Dow Jones Sustainability Index

Sustainability in Short term incentives:

- 30% of short term cash bonus consist of personal targets, among which sustainability targets.
- Remaining targets are linked to EVA.

Eligibility

- Board of Directors
- 64% (CEO) and 57% (Board members) of the total remuneration package is based on variable elements.

Sustainability in Long term incentives:

- Long term incentives is performance share plan.
- 50% of the conditional grant of shares is linked to the ranking of the organisation in the Dow Jones Sustainability Index. The remaining is linked to the relative TSR performance in peer group.

DSM (Life Sciences and Material Sciences)

Mission statement & values

DSM, as a Life Sciences and Material Sciences organisation, aims to improving the quality of people's lives.

DSM Values are:

- Respect for people
- Valuable partnerships
- Good corporate citizenship

Corporate Strategy

DSM has formulated a "Vision for 2010: Building on Strengths", focusing on value creation through:

- Market driven growth and innovation
- Increasing presence in emerging economies
- Operational excellence

Sustainability strategy and objectives

DSM's main aim to create value is by combining entrepreneurial drive with an awareness of the need for continuity and a strong sense of responsibility. Sustainability is in this respect one of the most important elements of DSM's Values (Respect for People, Valuable Partnerships, Good Corporate Citizenship); the organisation is continuously looking to improve the safety and health of its employees. A further reduction of DSM's eco-footprint (including the value chain) and increased utilization of renewable resources are key elements in the organisation's sustainability policy, which forms an integral part of DSM's overall strategy.

Many DSM products and innovations help reduce CO₂ and other emissions at customers. DSM furthermore takes sustainability explicitly into account in the selection and evaluation of suppliers by applying a Supplier Code of Conduct for suppliers, which is based on the organisation's own values.

Sustainability objectives

- Improve the safety and health of its Employees
- A further reduction of DSM's eco-footprint
- Increased utilization of renewable resources

Sustainability in remuneration policy

DSM strives for a high performance in the field of sustainability and aims to maintain a good balance between economic gain, respect for people and concern for the environment in accordance with the Triple P concept (People, Planet, Profit). The remuneration policy reflects a balance between the interests of DSM's main stakeholders as well as a balance between the organisation's short term and long term strategy. In the light of the remuneration policy, the structure of the remuneration package for the Managing Board is designed to balance short term operational performance with the long term objective of creating sustainable value within the organisation, while taking account of the interests of all stakeholders.

Sustainability indicators

- all aspects of the Dow Jones Sustainability Index

Sustainability in Short term incentives:

- 30% of short term cash bonus consist of personal targets, among which sustainability targets.
- Remaining targets are linked to EVA.

Eligibility

- Board of Directors
- 64% (CEO) and 57% (Board members) of the total remuneration package is based on variable elements.

Sustainability in Long term incentives:

- Long term incentives is performance share plan.
- 50% of the conditional grant of shares is linked to the ranking of the organisation in the Dow Jones Sustainability Index. The remaining is linked to the relative TSR performance in peer group.

SHELL (Oil and Gas)

Mission Statement & Values

The objectives of the Shell group are to engage efficiently, responsibly and profitably in oil, oil products, gas, chemicals and other selected businesses and to participate in the search for and development of other sources of energy to meet evolving customer needs and the world's growing demand for energy.

Shell's values are:

- Economic: Long term profitability is essential to achieve business goals and continued growth.
- Competition: Free enterprise is supported.
- Business Integrity: Honesty, integrity and fairness in all aspects of our business and expecting the same in the relationships with all business partners.
- Political: Shell does not interfere with political activities in countries Shell operates in, or with employees' political activities.
- Health, Safety, Security and the Environment: through a systematic approach in order to achieve continuous performance improvement.
- Local communities: Aiming to be good neighbours by continuously improving the ways in which is contributed to the general wellbeing of the communities within which Shell works.
- Communication and engagement: Regular, honest and responsible dialogue and engagement with all of its stakeholders is seen as essential.
- Compliance: Shell complies with all applicable laws and regulations of the countries in which Shell operates.

Corporate strategy

Shell's strategy is "More Upstream, Profitable Downstream". Shell's long term challenge is: how to produce more energy and less CO₂. Shell is convinced that contributing to sustainable development helps create business value and reduce operational and financial risk, making Shell a more competitive and profitable organisation.

Sustainability strategy & objectives

Shell has six focus points in its approach to managing environmental and social impacts and opportunities and its performance in this area:

1. Prevention of incidents in order to operate safely.
2. Shell requires all of its operations to manage environmental and social impacts.
3. Prevention of climate change by reducing greenhouse gas.
4. Aiming to be a good neighbour in the communities and wider societies where we operate.
5. Avoidance of emissions into the air and water and the safe disposal and handling of waste from our operations are part of our business.
6. Performance in this area is measured, and methodologies are continuously improved.

Shell's sustainability KPI's are linked to:

- Environmental criteria, i.e.: Greenhouse gas emissions; Flaring; Operational spills; Energy intensity; External perception of environmental performance
- Social criteria, i.e.: Total recordable case frequency (injuries/million exposure hours); Gender diversity (% women in senior leadership positions).

Sustainability in remuneration policy

Additional measures have recently been introduced to reflect key business priorities and concerns expressed by shareholders that a single measure relying on TSR alone is not appropriate. These are a group of three relative growth measures, assessed on an annualised basis: earnings per share

(EPS), net cash from operating activities, and hydrocarbon production, using the same comparator group and vesting scale. Weights: 30% each for TSR and EPS, and 20% each for net cash from operating activities and hydrocarbon production.

Sustainability indicators

- Various indicators which evaluate Shell's contribution to sustainable development. Most important indicator is total recordable case frequency. Other criteria are greenhouse gas emissions, flaring, operational spills, energy intensity, and external perception of environmental performance.

Sustainability in Short term incentives:

- 20% of the annual bonus is based on sustainability indicators.
- Bonus is multiplied when targets are exceeded.

Eligibility

- Board of Directors

Sustainability in Long term incentives:

- 20% of LTI is based on hydrocarbon production.

WERELDHAVE (Real Estate)

Mission Statement & Values

The right accommodation at the right time and in the right place. Wereldhave's mission is to make available, when and where needed, commercial and residential property for rent. The objective is to attain an attractive investment result, combined with a low risk profile on the property portfolio.

Wereldhave's values are: With respect to the world, Wereldhave strives for:

- Environmental considerations with respect to innovation and relieving pressure on environment.
- Sustainability with respect to new investments
- No political involvement in any country Wereldhave operates in

With respect to the workforce, Wereldhave strives for:

- Equal employment opportunities, good working conditions, a maximum use of internet for business purposes
- Zero tolerance towards threats of violence, conflicts of interest and harassment
- Complete non-disclosure of confidential information

Wereldhave's profit is related to:

- Ethical and lawful behaviour expected from employees and business partners.
- Zero tolerance toward bribery, cartel agreements, and not following the organisation's accounting procedures throughout the organisation
- Following generally accepted principles of corporate governance

Corporate strategy

- *Diversification by geographical area and type of property:* In order to limit the risks of the cyclical property market.
- *Portfolio renewal:* In order to obtain a portfolio with a lower average age, with favourable letting prospects and low maintenance costs. Since the demand for newer property is higher than that for older property, portfolio renewal will also help to improve marketability.

Sustainability strategy & objectives

- Corporate sustainability is a strategic priority for Wereldhave. Corporate sustainability policy is aimed at improving the quality of the portfolio and business operations through a more efficient use of all resources, ultimately resulting in lower costs. The importance of sustainability extends further than the responsible use of energy and raw materials. Improving quality is a continuous process of initiation, implementation and evaluation, involving all stakeholders.
- Wereldhave has defined four specific focus areas: its own organisation, requirements for new investments, construction & property development and property management. Objectives and activities have been documented in a sustainability manual, which also aims to stimulate the ongoing debate on sustainability within the organisation.
- Objectives are formulated in Wereldhave's sustainability manual which is not publicly available.

Sustainability in remuneration policy

Sustainability indicators

- Share of sustainable properties in portfolio

Sustainability in Short term incentives:

- Not included in STI

Eligibility

- Board of Directors
- Wereldhave's remuneration policy contains a claw back construction.

Sustainability in Long term incentives:

- Share of sustainable properties in portfolio is one of five indicators for LTI. Exact proportion is not mentioned in public documents.
- LTI is a long term cash bonus, the target level is 33% of annual income and will be allocated in cash after agreed period.
- 70% of LTI is based on strategic objectives, 30% based on long term personal targets.

NATIONAL GRID (Utilities)

Mission statement & Values:

- National Grid is an international electricity and gas company and one of the largest investor-owned energy companies in the world. They play a vital role in delivering gas and electricity to many millions of people across Great Britain and north-eastern US in a safe, reliable and efficient manner.
- National Grid’s vision is to be “the foremost international electricity and gas company, delivering unparalleled safety, reliability and efficiency, vital to the well-being of our customers and communities. We are committed to being an innovative leader in energy management and to safeguarding our global environment for future generations”.

Corporate strategy:

- Corporate strategy is to build on core UK and US, electricity and gas, regulated business base and financial discipline to deliver sustainable growth and superior financial performance;
- Corporate objectives e.g. positively shaping the energy and climate change agenda with external stakeholders, driving improvements in safety performance and building trust, transparency and an inclusive and engaged workforce.
- National Grid considers, amongst others, reputation, relationships and responsibility as their principal business drivers that affect the financial performance of the organisation.
- National Grid developed a “Framework for Responsible Business”, that defines the principles by which it manages the business and makes sure the environmental and social factors are incorporated into their decision making. The Framework is based on three business goals: sustainable growth, profits with responsibility and investing in the future.

Sustainability strategy and objectives:

- National Grid identified and manages, amongst others, the following impact areas: climate change, environmental management, business ethics and compliance and occupational, public and process safety and occupational health.
- National Grid has set itself a challenging target of reducing organisation-wide greenhouse gas emissions by 80% by 2050. This goal has been set at a mid term reduction target of 45% by 2020

Sustainability in remuneration policy

Sustainability indicators

- Carbon emissions reductions
- Safety

Sustainability in Short term incentives:

- Carbon reduction and safety targets are part of cash bonus
- Carbon reduction targets are given equal weight in relation to other targets like operational delivery and financial targets
- Carbon targets account for 5% of performance package
- Reduction of carbon budget of 1-1,5% per year until 2050

Eligibility

- Board of Directors
- Annual performance plan maximum 150% of base salary

Sustainability in Long term incentives:

- Not included in LTI deferred share plan



NOKIA (Mobile Communication Technology)

Mission statement & Values:

- Nokia's vision is a world where everyone is connected. They believe that their business benefits people, communities and the environment in new and exciting ways.
- Nokia's corporate values are "being very human" (encompasses how Nokia does business and manages its impact on people and environment), passion for innovation, achieving together and engaging you.

Corporate strategy:

- Nokia's strategy is to build trusted consumer relationships by offering compelling and valued consumer solutions that combine beautiful devices with context enriched services;
- Nokia defined environmental regulations as a material risk factor that could adversely affect their business, sales and results of operations.

Sustainability strategy and objectives:

- Nokia's sustainability strategy is to further unleash the potential of mobility to bring social and economic benefits, boosting economic development and improving quality of life, by extending access to mobile communications
- Nokia's key sustainability issues are: Environment (e.g. energy efficiency, materials and substance management, recycling), Accessibility/Universal access, Supply chain and Human Rights;
- Environmental issues are Nokia's main priorities.

Sustainability in remuneration policy

- Sustainability or corporate responsibility is not explicitly part of the objectives or guiding principles of Nokia's remuneration policy.

Sustainability indicators

- Environmental achievements (no specific environmental issues disclosed)

Eligibility

- Board of Directors

Sustainability in Short term incentives:

- Individual strategic objectives
- Each executive officer has its own predefined individual strategic objectives, which might include environmental targets.
- STI is cash incentive (75% - 170% of base salary)

Sustainability in Long term incentives:

- Not included

PANASONIC CORPORATION (Personal and Household goods)

Mission statement & Values:

- Panasonic Corporation is a worldwide leader in the development and manufacture of electronic products for a wide range of consumer, business, and industrial needs.
- Panasonic's basic management philosophy and mission is to contribute to the progress and development of society and the wellbeing of people through its business activities. Their principle is that an organisation is a public entity of society.
- Panasonic aims to make sustained growth to satisfy not only shareholders, but a larger group of stakeholders.

Corporate strategy:

- Panasonic's developed a three year management plan GP3, aims to deliver steady growth with profitability. Part of the GP3 plan is to reduce the environmental impact of every business activities while pursuing steady growth with profitability.
- Also other elements of the GP3 reflects the strategic importance of sustainability for Panasonic. For instance, one of the core elements of the GP3 is to gain a top reputation in terms of sustainability and a globally trusted brand and to vitalise the organisation as a public entity. In addition, Panasonic sees reducing its environmental impact of all business activities as being equally important as growth and profitability and it would like to nurture corporate culture with diversity.
- One of the company objectives of the second year of GP3 (2009), is to reduce the CO₂-emissions by 10,000 tonnes or more. In order to achieve this and other objectives Panasonic formulated an "Eco ideas strategy" as one of the four strategic businesses of the organisation.

Sustainability strategy and objectives:

- CSR is part of Panasonic's basic management philosophy. One element of this vision is that an organisation is a public entity of society.
- CSR is also a central theme in the business strategy of Panasonic and in its the brand slogan (Panasonic ideas for life) and brand promise (Through innovative thinking, we are committed to enriching people's lives around the world).
- Panasonic's main focus is on environmental management. Their environmental initiatives should reduce the environmental impact of their activities and improve the competitiveness of their products.

Sustainability in remuneration policy

- The amounts of remuneration and bonuses of executive directors is linked to the individual performance of the directors, based on Capital Cost Management, Sales and CO₂-emissions. With these performance evaluation criteria, Panasonic intends to promote continuous growth and enhance profitability on a long term basis.

Sustainability indicators

- CO₂-emissions

Sustainability in Short term incentives:

- Individual performance is based on Capital cost management, sales and CO₂-emission, Panasonic is not transparent about corresponding weights in STI cash bonus.

Eligibility

- Executive Directors

Sustainability in Long term incentives:

- Not included in LTI



TESCO (Food and Drug Retail)

Mission statement & Values:

Tesco is about creating value for customers to earn their lifetime loyalty. Tesco's values are:

- No-one tries harder for customers, e.g. act responsibly for our communities;
- Treat people as we like to be treated

Tesco strongly believes that fulfilling the needs of their customers - not just in their homes but in their communities and in broader society - they will repay Tesco with their custom and their loyalty.

Corporate strategy:

Tesco's strategy consists of five elements, reflecting their four established areas of focus, and Tesco's long term commitments on community and environment.

The objectives of the strategy are:

Being a successful retailer; grow the core UK business; be as strong in non-food as in food; develop retailing services (e.g. personal finance, telecoms); put community at the heart of what we do;

Tesco operate a "balanced scorecard approach" to managing the business that is known as the "Steering Wheel". This instrument helps Tesco implementing their strategy.

Sustainability strategy & objectives:

Each country in which Tesco operates develops a Community Plan to develop the following sustainability objectives:

- actively supporting local communities;
- Buying and selling products responsibly;
- Caring for the environment;
- Giving customers healthy choices;
- Creating good jobs and careers for local people

These sustainability objectives are all part of Tesco's Steering Wheel., emphasising that sustainability is part of the daily activities.

Sustainability in remuneration policy

Tesco wants to develop sustainability related performance measures. Tesco views sustainability measures as

- a way to achieve durable improvements of underlying drivers of performance;
- a foundation for future performance.

Short term performance measures, and sustainability targets are part of the corporate objectives, which are based on the Steering Wheel.

Sustainability indicators

- Energy efficiency
- Reduced environmental impact
- Implementation community programmes
- Embedding new international Community Plans

Sustainability in Short term incentives:

- Targets are formulated on annual basis, not disclosed in public documents
- Corporate objectives have maximum of 55% of base salary.

Eligibility

- All executive directors

Sustainability in Long term incentives:

- Not included in deferred share bonus plan

7. References and links

7.1. Relationship with governance codes

Sustainability is slowly but surely finding its way into the executive remuneration chapters of various governance codes. Two high-profile corporate governance codes have already included some sustainability-like elements in their principles. The phrasing is generic though, focusing on the long term nature of incentives and risk containment. The Dutch Bank Code even recommends banks to for a ‘sustainable’ executive remuneration policy, but the term is not specified in the remaining text. Below you will find the ‘sustainability’ essentials of the two Corporate Governance Codes.

The Dutch Corporate Governance Code

In the principles formulated in the Dutch Corporate Governance Code of 2009 (otherwise known as the Code Frijns) the themes that are most strongly related to sustainability are focused on the long term nature and on risk containment of executive remuneration, e.g.:

- Targets linked to incentives are to be of a long term nature. In establishing performance indicators non-financial indicators have to be included. Also the remuneration should be in line with the risk profile of the organisation.
- The remuneration structure is to promote the interests of the organisation in the medium and long term
- The supervisory board has a stronger grip on executive remuneration (scenario-analyses, fairness check, claw back clause)
- The remuneration structure may not encourage management boardmembers to act in their own interests or take risks that are not in keeping with the adopted strategy

The full text of the Dutch Corporate Governance Code can be downloaded at: www.commissiecorporategovernance.nl

The Bank Code

Specifically for the banking sector, recommendations with respect to executive remuneration have been formulated in the Bank Code of 2009 (based on the Report of the Committee Maas). The starting point is that banks should develop well thought-through, controlled and sustainable executive remuneration policies. The policy should be aligned with organisational strategy, risk appetite organisational objectives and values, and takes into account the long term interests of the bank (...) as well as social acceptance.

The full text of the Bank Code can be downloaded at: www.nvb.nl

7.2. Sustainability indexes

A number of sustainability indexes have been developed in the past decade, of which the Dow Jones Sustainability Index is probably the most well-known, and used by a number of Dutch organisations to assess their sustainability performance. Only 'sustainable' organisations are included in such indexes. A profound analysis of the sustainability performance of the organisations concerned forms the basis of composing the indexes. The analyses are carried out by specialised bureaus such as SNS Asset Management and Sustainability Asset Management (SAM). The analyses are repeated periodically and organisations can be removed from the index or added to the index. Each index has its own criteria. Below please find an overview of three indexes in which Dutch organisations are represented.

Dow Jones Sustainability Index

Dow Jones Sustainability (1999) Indexes are the first global indexes tracking the financial performance of the leading sustainability-driven organisations worldwide. Based on the cooperation of Dow Jones Indexes, STOXX Limited and SAM they provide asset managers with reliable and objective benchmarks to manage sustainability portfolios.

FTSE4Good Index

The FTSE4Good Index Series (2001) is designed to measure the performance of organisations that meet globally recognised corporate responsibility standards, and to facilitate investment in those organisations. The FTSE4Good Index differentiates between sectors and for each dimension reviews policy, management and reporting criteria.

Ethibel Sustainability Index

The Ethibel Sustainability Index (ESI) (2002) has contracted Standard & Poor's to maintain and calculate the Ethibel Sustainability Indexes. The Indexes are designed to approximate the sector weights on the S&P Global 1200. They are free-float weighted indexes containing the best-in-class organisations with respect to sustainability across sectors and various regions.

The table below shows a summary of (not exhaustive) criteria of each of the above three indexes:

Criteria Dow Jones Sustainability Index	Criteria FTSE4Good Index	Criteria Ethibel Sustainability Index
<p>Economic:</p> <ul style="list-style-type: none"> Codes of Conduct Compliance Corruption & Bribery Corporate Governance Risk & Crisis Management <p>Environmental:</p> <ul style="list-style-type: none"> Environmental Reporting <p>Social:</p> <ul style="list-style-type: none"> Corporate Citizenship Labour Practice Indicators Human Capital Development Social Reporting - Talent Attraction & Retention 	<p>Environmental:</p> <ul style="list-style-type: none"> Climate change, e.g.: reduction of CO₂/GHG emission. Environmental management <p>Social:</p> <ul style="list-style-type: none"> Countering bribery Upholding human and labour rights internally and within the supply chain, e.g.: <ul style="list-style-type: none"> - Equality - Forced labour - Child labour - Worker representation 	<p>Ethical Economic, e.g.:</p> <ul style="list-style-type: none"> Strengthen economic potential Long term focus on stakeholders <p>Environmental, e.g.:</p> <ul style="list-style-type: none"> Emmission and waste Environmental impact of end product <p>Social (external), e.g.:</p> <ul style="list-style-type: none"> Societal impact of core activity Human rights Social investments <p>Social (internal), e.g.:</p> <ul style="list-style-type: none"> Employee development Equality Wage structure Employee participation

7.3. Links to relevant websites

Useful references about corporate sustainability can, amongst others, be found on the following websites:

Eumedion (www.eumedion.nl)

Eumedion operates as a representative of the interests of institutional investors in the field of maintaining and developing corporate governance. Eumedion has drawn up “11 principles for a sound remuneration policy”, in order to support Dutch and international shareholders in the listed companies with a statutory seat in the Netherlands in the supervisory task assigned to them by the law and the Dutch Corporate Governance Code with respect to the remuneration of ‘management board members’.

Global Reporting Initiative (www.globalreporting.org)

The Global Reporting Initiative (GRI), a not-for-profit organization based in Amsterdam, has developed a widely used sustainability reporting framework. The framework sets out the principles and indicators that organisations can use to measure and report their economic, environmental, and social performance. This forms a basis for organisations that are in the process of developing and reporting on sustainability indicators.

Ministry of the Environment/Dutch government (www.vrom.nl)

The Ministry of the Environment has formulated a vision on sustainability within the framework of the governmental policy programme 2007 - 2011. The goal is to encourage sustainable development by a threefold approach:

1. focus on specific sustainability themes (e.g. climate, sustainable energy, CO2 storage),
2. an active role in the dialogue with society on the topic
3. by setting an example on sustainable organisations by becoming a front runner.

Sustainable Asset Management (SAM) (www.sam-group.com)

SAM and Robeco, a member of the Dutch Rabobank Group, have formed a strategic alliance to establish the world's leading platform for sustainability investments in terms of product development, innovation, and distribution.

Sustainalytics (www.sustainalytics.com)

Sustainalytics is an international sustainability research provider to the financial sector, and is specialised in analysing the Environmental, Social, and Governance (ESG) performance of organisations, institutions, and countries. Currently, over 100 institutional and retail investors use Sustainalytics' global research solutions to implement their Responsible Investment policies.

UN-PRI (www.unpri.org)

The establishment of the Principles for Responsible Investment (PRI) was jointly coordinated by the United Nations and the PRI itself. The six interconnected Principles aim to act a framework for global best practices in responsible investment. The principles provide a menu of possible actions for incorporating ESG-issues into mainstream investment decision-making and ownership practices.

Dutch digital knowledge centre CSR (www.duurzaam-ondernemen.nl)

This website is the most complete Dutch website about corporate social responsibility. Next to a comprehensive download centre, the latest CSR news is distributed on a weekly basis.



7.4. Guide initiating organisations and authors

VBDO

The Dutch Association of Investors for Sustainable Development (VBDO) was launched in 1995. The VBDO aims at generating a more sustainable capital market by raising awareness both with multi-national corporations and investors about the contributions they can make towards a sustainable capital market.

The VBDO also formulates strong opinions on different topics related to sustainability. VBDO regularly carries out researches, visits Annual General Meetings of stock listed companies and engages in an active dialogue with banks, insurance companies, media and stock listed companies. As such VBDO is the only association in the Netherlands representing institutional as well as individual sustainable investors.

More information on: www.vbdo.nl en www.goed-geld.nl

Hay Group

Hay Group is a global management consulting firm that works with leaders to transform strategy into reality. We develop talent, organise people to be more effective and motivate them to perform at their best. Our focus is on making change happen and helping people and organisations realise their potential. Worldwide Hay Group has over 2600 employees. Our clients are from the private, public and not-for-profit sectors, across every major industry.

The Executive Reward group in the Netherlands is located in Zeist and supports supervisory boards and organisations in designing and implementing adequate remuneration schemes, based on research, data and practice.

More information on: www.haygroup.com

DHV Group

The DHV Group is a global provider of consultancy and engineering services in transportation and aviation, water, building and industry, spatial planning and environment.

DHV is active worldwide through a network of local offices in Europe, Asia, Africa, and North America. Its mission is to provide multi-disciplinary services for the sustainable development of our living environment, in a close relationship with clients, employees, and partners, based on mutual loyalty, while providing a solid return to our shareholders. Within DHV the advisory group on sustainable business and CSR is located in Amersfoort and provides consultancy activities in this field, in particular for listed companies. DHV's services range from designing CSR strategies, sustainable remuneration to implementation and sustainability reporting.

More information on: www.dhv.com

Authors:

- Helen Hol associate consultant Hay Group
- Lars Kurznack freelancer
- Edmond Logger senior consultant Hay Group
- Rob van Tilburg senior consultant DHV

Within the scope of writing this guide the authors have interviewed various parties on their ideas on sustainability and executive remuneration, such as supervisory directors, CSR directors, HR directors, rating agencies, institutional investors and investor representatives. The authors would like to express their gratitude for their views and perspectives and therefore for providing extra input and stimulus to linking sustainability indicators to executive remuneration.





An increasing number of companies recognises the importance of a well developed sustainability strategy. Incorporating sustainability into both long term strategy goals and daily business operations adds value to the company. Institutional investors experience or count upon a higher return on investment, employees are attracted to work in organisations with an innovative character, society embraces the social and environmental commitment and customers are in favour of affordable sustainable products.

Accelerated by the worldwide financial and economic crisis organisations 'rethink' the performance areas and indicators relevant to executive remuneration. More than ever "executive remuneration will reveal the organisation's true mission". With all this in mind, linking sustainability performance to executive remuneration is the logical next step. A limited number of companies already established such a link, emphasizing the value of sustainability to their organisation.

This guide, developed by a mutual initiative of VBDO, Hay Group and DHV provides support for those organisations that consider to put a leverage factor in the organisation's development and to bring extra value to their organisation by introducing sustainability indicators in executive incentives. As both sustainability and executive remuneration are tailor made processes, the guide does not provide a one-size-fits-all solution for linking. It provides food for thought and practical steps to be taken in this challenging quest. We hope you will benefit from it.