Textiles: Compensation

THE SUSTAINABILITY–PAY DISCONNECT

What does **'good'** look like in **SUSTAINABILITY-LINKED** pay?

What do we like / dislike?

Below we outline some of the features that we like or believe are necessary when it comes to sustainability -linked performance pay. We have also outlined some of those that we don't like.

Likes

A 'Pay for performance philosophy' – with an appropriate mix of short and long term goals and rewards and a performance benchmark that extends beyond purely financial metrics.

Pay linked to sustainability performance – these companies claim sustainability is a risk so executive pay should feature a link to addressing this risk.

Performance linked pay that is material – so NOT a 10% portion of a cash pay-out which accounts for 20% of total remuneration… an effective 2% pay for performance. Rather we would like to see a meaningful percentage of compensation (10%+) at risk based on sustainability performance.

Independently verified targets and results – independently verified targets on sustainability provide a defence against greenwashing and can allow comparison between companies. A good example is the 'Science Based Targets' initiative which requires firms to set independently verified targets for emissions reduction and report on these in a set format.

Quantitative targets where possible – financial performance accounts for the bulk of pay and links to clearly defined quantitative targets. Sustainability should align with this.

Annual targets for rewards that are granted annually – there is a tendency for longer-term direction of travel targets. We believe annual (cash) awards need annual sustainability targets.

Clear disclosure of what has and hasn't been achieved. Direction of travel targets and qualitative targets lend themselves to opaqueness. Clear delivery links are needed.

Dislikes

The need to hit financial targets first before sustainability 'top-up' occurs – this is a common feature. This structure encourages a profits over sustainability attitude.

Shareholders who don't use their holdings to support positive change when the current structure is sub-optimal. Say on pay votes give shareholders a chance to register disapproval with compensation structures and should be used as a way of engaging to drive change.

An 'Inward looking' approach, such as peer benchmarking or heavy reliance on consultants, which lends itself to greencrowding, a sub-category of greenwashing.

Adidas – best in class example

Adidas has a positive measure for all of the 'sustainability-linked-compensation' features we like to see. As such it acts as a good blueprint for others in the sector to follow. We have highlighted some of the key features of their remuneration policy using images copied from the compensation section of the 2021 annual report.

Like many companies, Adidas has a mix of shorter-term (annual) performance bonus and a long-term incentive plan (LTIP) with multi-year vesting. It also has an a-typical higher weighting towards the LTIP.

In the case of Adidas, performance against sustainability criteria can be (but isn't definitely) a feature of the short-term scheme (up to 20%, with sustainability listed as one of the 16 possible non-financial metrics).

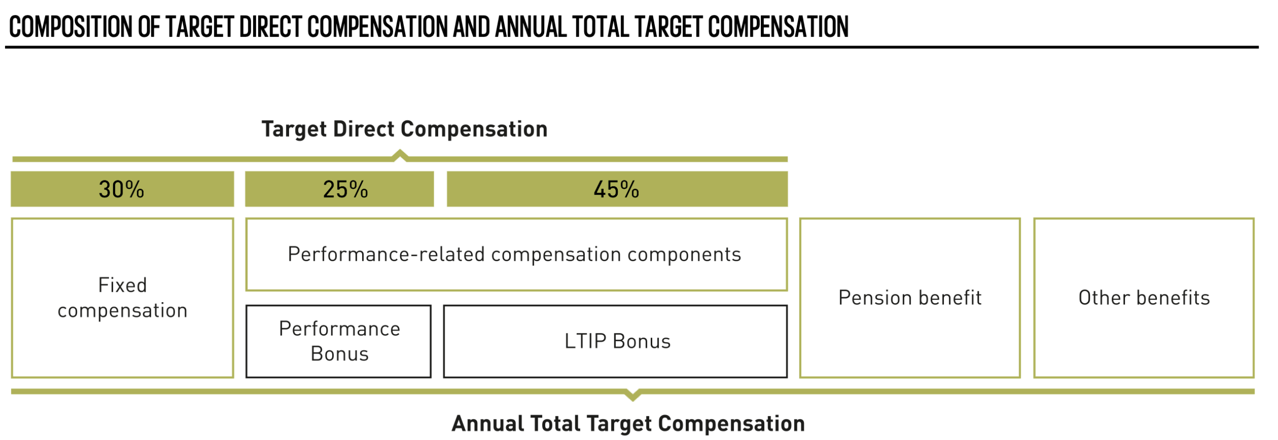

Figure 1: Adidas compensation summary. Source: Adidas 2021 annual report (page 46).

Note: LTIP = Long-term incentive plan

More importantly, it is a definitely and clearly defined feature of the LTIP bonus, accounting for 20% of the payout if targets are met. This is a material amount accounting for a material 9% of total compensation (45% LTIP x 20% sustainability) weighting.

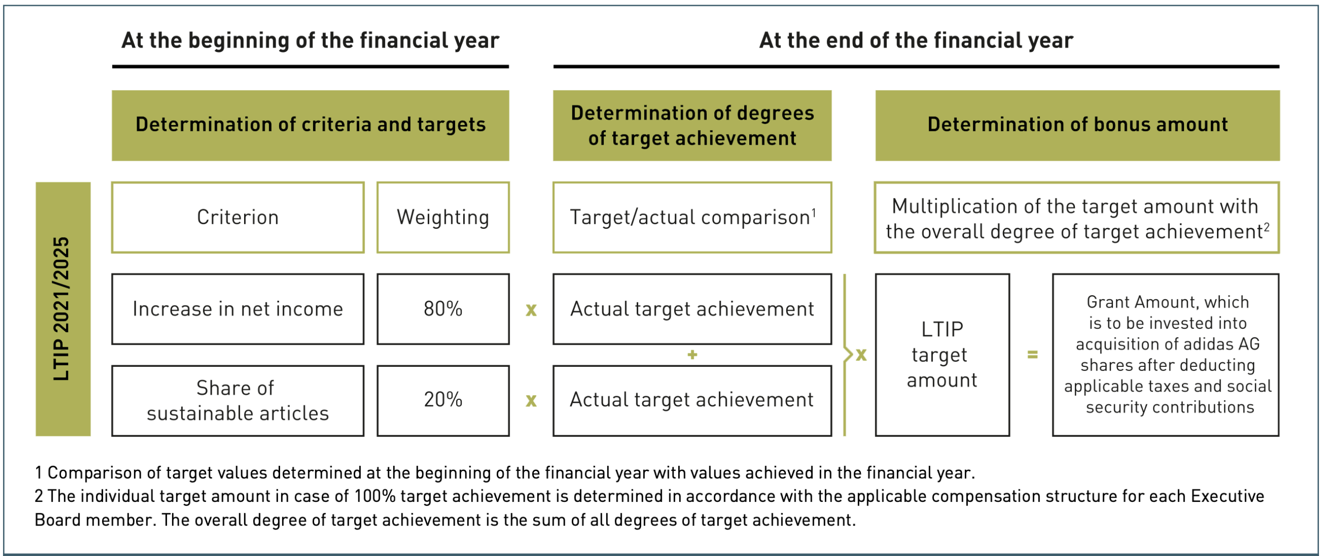

Figure 2: Adidas Long-Term Incentive Plan (LTIP) structure. Source: Adidas annual report (page 54).

As importantly, it is based on a clear sustainability goal, 'share of sustainable articles' with clearly defined and communicated annual targets. Delivery also has clear positive implications for upstream (scope 3 emissions) where a signficicant amount of the climate impact happens.

Furthermore, these targets align with the company's five year goal. This timeframe element (both goals and LTIP scheme) aligns well with the ongoing journey that is sustainability.

LTIP 2021/2025: ESG CRITERION

Performance year	Share of sustainable articles offered
2021[1]	+8pp
2022[2]	70%
2023[2]	78%
2024[2]	84%
2025[2]	90%

1 Percentage point increase in the share of sustainable articles (by count) offered at the points-of-sale compared with respective previous season (comparison of Spring/Summer 2021 with Spring/Summer 2022). The percentage of sustainable articles (by count) offered at the points-of-sale in Spring/Summer 2021 amounted to 60.6%. The definition of sustainable articles is based on the proportion of environmentally preferred material content. For apparel and accessories/gear, the environmentally preferred material content is based on article weight (at least 25% recycled content or 50% sustainable cotton; excluding trims), for footwear (only upper part) it is based on material components (at least 25% of the components used contain 50% or more recycled content) or article weight (at least 25%). Only articles with verified environmentally preferred material contents are included. Licensed articles are excluded. Without Reebok.
2 Percentage of sustainable articles (by count) offered at the points-of-sale (average of Fall/Winter season of the current financial year and Spring/Summer season of the following financial year). The definition of sustainable articles is based on the proportion of environmentally preferred material of the article weight. For apparel (excluding trims), the environmentally preferred material content is required to amount to at least 70%, for accessories/gear (excluding trims) at least 50% and for footwear (full shoe) at least 20% of the article weight. Only articles with verified environmentally preferred material contents are included. Licensed articles are excluded. Without Reebok.

Figure 3: Adidas LTIP ESG Criteria. Source: Adidas 2021 annual report (page 53).

We note that although Adidas is a leader, we wouldn't class its compensation scheme as perfect. For instance, the sustainability link to the annual pay award could be clearer. The sustainability targets used in the LTIP (share of sustainable articles) is also somewhat narrow. We would encourage broader ambition, for instance adding targets related to emissions or biodiversity impact.

Planet Tracker

For further information please contact:
Nicole Kozlowski, Head of Engagement, Planet Tracker
nicole@planet-tracker.org

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