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The Spotlight

Spotlight, our regular Q&A with clients and colleagues, highlights leading viewpoints on trending topics in the world of human resources.

Photo

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ESG in Executive Compensation — A New Trend Among Listed Companies in China

Investor expectations are on the rise in China. In a recently issued guidance for listed companies issued by the China Securities Regulatory Commission (CSRC), environment, social and governance (ESG) issues have been added to investor relations communications. In addition to financial targets, companies are now being evaluated for ESG measures, which are considered key components of business performance. Increasing numbers of large-cap companies in Europe and North America are already linking executive compensation and long-term incentives to ESG performance. Yet, determining how to effectively measure ESG performance clearly and objectively remains a top priority across regions.

Chinese financial and economic media group, Yi Magazine, recently invited Bradley Ni, partner at Aon's human capital practice and head of executive compensation and corporate governance consulting in China, to sit down and discuss this growing trend. Here is an edited transcript of their conversation.

Questions and Answers

What sparked the link between ESG and executive compensation in China?

Initially, ESG was a main concern for rating agencies and investors to help evaluate companies by short-term financial performance and long-term strategy. The focus on ESG served merely as a prevention — to avoid potential risks, such as environmental violations. As time progressed, a more formal ESG rating system was introduced to investors in China.

The government issued policies and guidelines requesting that listed companies turn their attention to ESG topics. By now, more than 30 countries and regions have issued requirements on ESG disclosures, including China. In this market, the China Securities Regulatory Commission [CSRC], Shanghai Stock Exchange [SSE] and Shenzhen Stock Exchange [SZSE] have issued such requirements since 2018.

Today, more listed companies are considering ESG an integral part of their social responsibility. Elements of human capital management, such as employee wellbeing and diversity, equity and inclusion, are now being included.

The next step toward integrating ESG strategy with business strategy for some firms is linking ESG indicators in executive compensation and long-term incentive plans. However, this does come with new challenges when evaluating ESG performance clearly and objectively.

How should firms introduce ESG into executive compensation? What ESG performance indicators can be used to measure value?

The board, as well as legal and compliance requirements, should serve as a guide for determining the best way to introduce ESG into executive compensation. In this process, leaders should pinpoint how ESG will benefit the company and determine the key areas that it will impact.

It's important for the company to evaluate itself to see if the board and management have adequate resources for ESG disclosure, as well as a full understanding of potential risks. After that, firms should set up measurable indicators, plan the total schedule, set phased targets and build tracking and evaluation systems.

Is there any mature public standard to evaluate ESG performance?

So far, we haven't seen an established system or standard that is widely used by the Chinese market. However, some evaluation agencies already have their own systems in place. For example, MSCI has 10 subjects and 35 subitems in ESG evaluation, allowing it to issue results similar to a credit rating.

What are the main focus areas for executives when evaluating ESG indicators?

In China, we suggest that executives pay more attention to the link between current policies and ESG indicators. It's likely that different industries will have different focus areas. For example, resource-driven businesses should center their attention on environmental protection. However, with increasing cultural expectations, executives should think about how to integrate ESG indicators into their company's core competences holistically as well.

Is there anything in common among those who already introduced ESG indicators into their performance evaluation?

Based on our observation, there are two types of companies who are pioneers of ESG — top-listed companies who receive more attention from regulators and investors, and environment-related industries like energy and manufacturing.

But today, ESG is a widely covered topic among many industries. Where companies are on their ESG journey currently depends more on the maturity of management, governance practices and stage of development. It's not simply about environmental protection — ESG has evolved to support social responsibilities that encourage businesses to explore their true value and meaning.

For more information on the rising ESG trend in China and how to address this at your firm, please write to humancapital@aon.com.

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About Human Capital Solutions

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