Incentivizing long-term value creation

Linking sustainability metrics to board members' pay

KPMG Luxembourg | Board Leadership Center

Contents

Foreword

Companies have made significant progress in recent years in identifying the risks and opportunities related to how sustainability is considered in a company's strategy. However, in many instances, the realization of these opportunities or risks falls outside the normal business planning cycle. Therefore, incentivizing sustainability-minded behavior is a key element of an overall governance model that supports day-to-day decision-making.

A company's strategic course is set by its management, yet it is these managers who must help ensure that this course is adhered to in their daily decisions. An effective way of providing them with further incentives to stay on course is to anchor the company's sustainability targets in their remuneration, in the same way as other strategic aims.

Consequently, linking strategic priorities to the key governance setup of a company remains an aspect of utmost importance to stakeholders, particularly investors. Remuneration is one strategic pillar of a robust governance model.

For this reason, the management board pay system is a key aspect of corporate governance for a company's shareholders. With this overview of 375 companies from 15 countries, we take stock of the integration of sustainability criteria into board members' pay, finding that an impressive 78 percent of these companies already do so. We hope this report can serve both as an inspiration and a contribution to debates within companies and between stakeholders.

Nadine-Lan Hönighaus Global ESG Governance Lead, KPMG International and Partner, KPMG in Germany

When examining the findings for Luxembourg, the picture is clear. Of the 25 companies surveyed, 15 have begun linking executive compensation to sustainability, with 8 having already achieved full alignment between boardroom pay and material sustainability topics. Momentum is clearly building across Luxembourg's sustainability landscape.

And although ESG topics seem to be less prominent in 2025, boards would do well to treat postponed sustainability reporting obligations not as an excuse for delay, but rather as an opportunity to further capitalize on the proven benefits on sustainable governance models.

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Introduction

Executive pay is a critical topic for several reasons. It aims to ensure that the **compensation of board members is aligned with the company's long-term goals and performance**, motivating executives to work towards the sustainable success of the organization. A well-structured remuneration system promotes transparency and accountability, which are essential for good corporate governance. It also maintains fairness by ensuring that the compensation is appropriate and reflective of the executive's contributions to the company. Additionally, executive remuneration plays a significant role in attracting and retaining the best people, which is crucial for the company's competitive edge and overall growth.

There are **various mechanisms through which executive pay is regulated.** In many countries, guidelines are established by government bodies and financial authorities such as through corporate governance codes. The OECD Principles of Corporate Governance serve as helpful framework and benchmark for national corporate governance codes. They provide implementation and reporting guidance for corporate governance including principles for executive compensation, emphasizing transparency and the alignment of remuneration with long-term company performance.

The European Union (EU) has implemented several directives and regulations to help ensure transparency and fairness in executive pay, with one of the key pieces of legislation being the Shareholder Rights Directive II (SRD II). These regulations often require companies to disclose detailed information about executive pay, ensure that compensation structures are designed to promote sustainable business practices and are aligned with company performance.

The design of remuneration schemes is influenced by several other factors apart from regulatory requirements. Companies also consider market practices and benchmarks when designing executive compensation structures, including analyzing compensation trends within their industry and region to help ensure competitiveness and attract top talent. Internally, companies have the discretion to design compensation structures that align with their strategic objectives and corporate culture. This includes determining the mix of fixed and variable components to incentivize desired leadership and decision-making behaviors.

Executive compensation typically includes a fixed salary supplemented with variable payments. Variable compensation depends on performance metrics and company success. Unlike fixed compensation, which covers base salary and agreed-upon benefits, variable compensation is aimed towards incentivizing executives to achieve specific goals and drive company performance through the means of short-term and long-term incentives. Companies can use various metrics, such as financial indicators including revenue growth and profit margins and non-financial indicators such as customer satisfaction and employee engagement, to be included in short-term and long-term incentives. Investors and other stakeholders prefer a balance of short-term and long-term targets in compensation schemes to help ensure both immediate results and sustainable business practices.

Frameworks such as the OECD Principles of Corporate Governance recommend that companies **disclose detailed information about executive pay**, including the criteria used to determine remuneration and the performance metrics tied to variable compensation. This transparency helps stakeholders understand how executive pay is linked to company performance and aims to ensure that remuneration practices are fair and equitable, thereby fostering trust among stakeholders. As corporate governance is one of the three pillars of corporate sustainability and responsibility referred to as ESG, executive remuneration is also the subject of sustainability reporting regulations, such as the EU Corporate Sustainability Reporting Directive (CSRD) or the disclosure requirements of the International Sustainability Standards Board (ISSB).

Key findings

Key findings

78%

of the companies included in this research consider sustainability in their senior executives' pay.

Among companies that specify the sustainability targets used in their board members' pay,

88% align these to ESG topics that are material to their businesses, although this varies widely by country.

ESG targets included in executive remuneration are most commonly linked to climate change and a company's own workforce. On climate change they typically refer to reductions in

greenhouse gas emissions,

while those on a company's own workforce often refer to employee engagement, the percentage of female managers and injury rates.

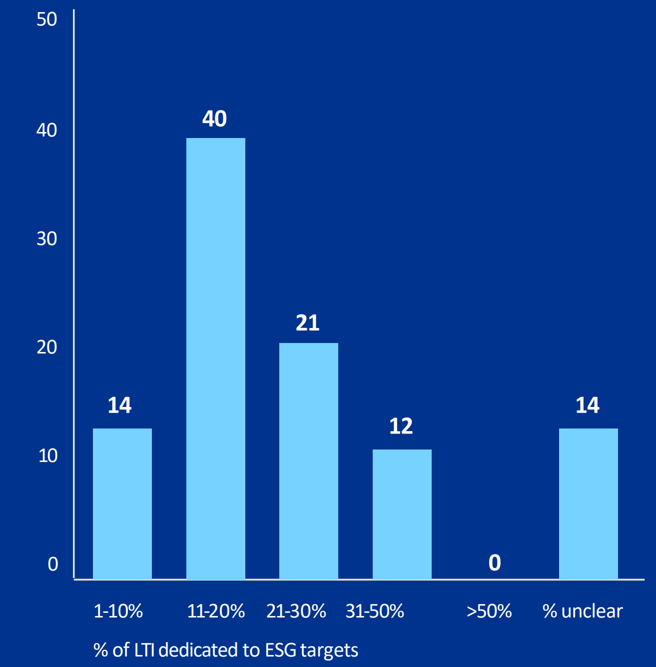
Of the 274 companies that measure board performance based on sustainability-related targets and that provide information on how these are included in variable remuneration,

40% use them only in short-term incentives,

23% include such targets only in long-term incentives and the remaining

37% include ESG targets in both short-term and long-term incentives.

% of companies including ESG targets in both STI and LTI (total: 103)

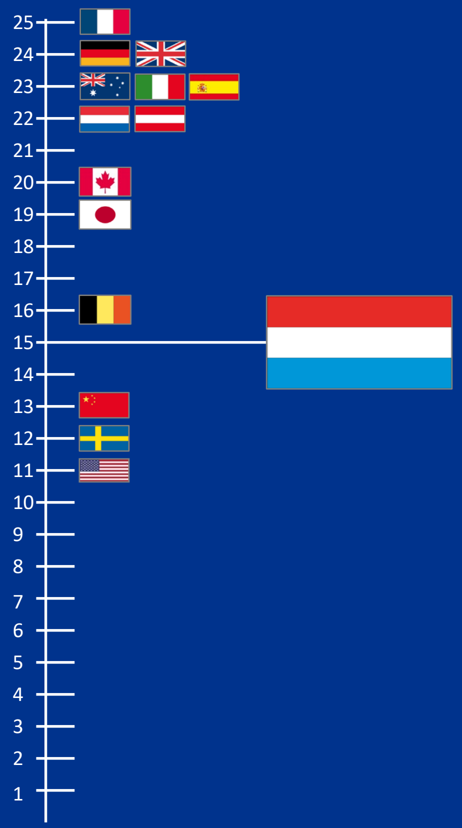


Over 40% of companies incorporating ESG targets into both short-term incentives and long-term incentives allocate 11-20% of pay to ESG-related components, while more than 20% of these companies dedicate 21-30% to such incentives.

Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

Key findings - Luxembourg

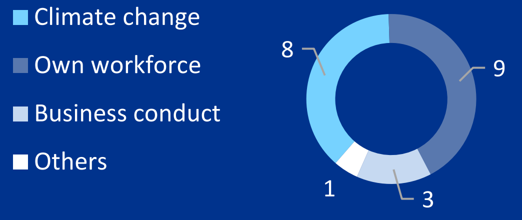
15 of the 25 companies in Luxembourg included in this research consider sustainability in their senior executives' pay



11 of the companies surveyed in Luxembourg specify that the sustainability targets linked to boardroom pay are either fully or partially aligned to topics that are material to their businesses.

Sustainability targets

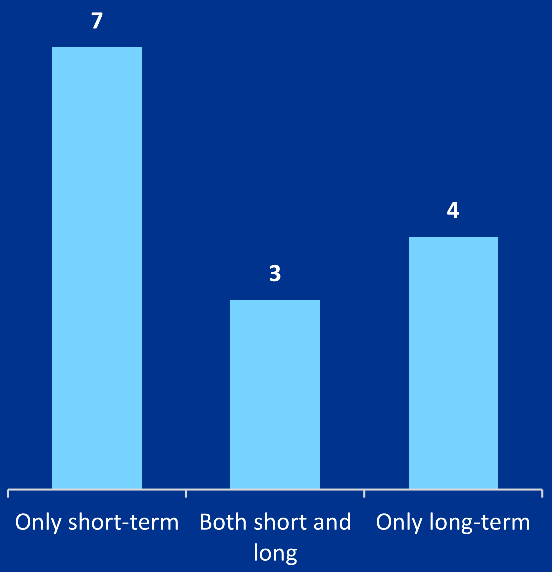
In alignment with other EU countries the most popular topics used for sustainability targets are climate change and own workforce, followed by business conduct.



The topics in this report are based on those used for the European Sustainability Reporting Standards (ESRS).

Short-term vs Long-term targets

The use of both short- and long-term sustainability targets in calculating boardroom pay is generally preferred by investors. In Luxembourg, the 21% percent of the in-scope companies are taking this approach. Nonetheless, short-term sustainability targets remain the the most widely used, employed by 50 percent of the companies analyzed.



Find further details in the following pages

Methodology

This report is based on data from 375 publicly listed companies, the 25 largest based on market capitalization in June 2024 from each of the following 15 countries: Australia, Austria, Belgium, Canada, China, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, the United Kingdom (UK) and United States (US). Nine are EU member states and the other six have significant numbers of companies that would have needed to comply with the CSRD according to its original scope before February 2025's Omnibus proposal.

For each company, KPMG professionals examined its 2023 annual report and, if required, the compensation report, sustainability report and the company's website to answer five questions:

- Is the board of management's remuneration linked to sustainability-related performance targets?
- If yes, which sustainability matters and what key performance indicators are included in the remuneration policy?
- How closely does the remuneration policy reflect the material sustainability matters identified by the company in its reporting?
- What is the balance between incentives based on short-term sustainability performance targets (one year) versus long-term targets (more than one year)?
- What is the balance in variable remuneration between financial and non-financial/sustainability performance?

KPMG carried out the research in July and August 2024. The findings are based purely on analysis of publicly available information and no information was submitted directly by companies to KPMG firms.

This report builds on 'Time to take a broader view', a report published in May 2024 by KPMG in the Netherlands, which asked the same questions of the 50 largest listed companies on the Amsterdam Stock Exchange and the 25 largest listed companies in Germany, Sweden and the UK.[1] It used annual reports published during 2023, meaning many would cover the financial year before those used in this report, and covered twice as many companies from the Netherlands. However, it produced similar results with, for example, both sets of research finding that 88 percent of companies in the Netherlands consider sustainability in working out boardroom pay.

This report is based on data from 375 publicly listed companies, the 25 largest based on market capitalization in June 2024 from 15 countries.

[1] 'Time to take a broader view: Why sustainability-linked executive pay is a work in progress', KPMG in the Netherlands, May 2024. https://kpmg.com/nl/en/home/insights/2024/05/why-sustainability-linked-executive-pay-is-a-work-in-progress.html

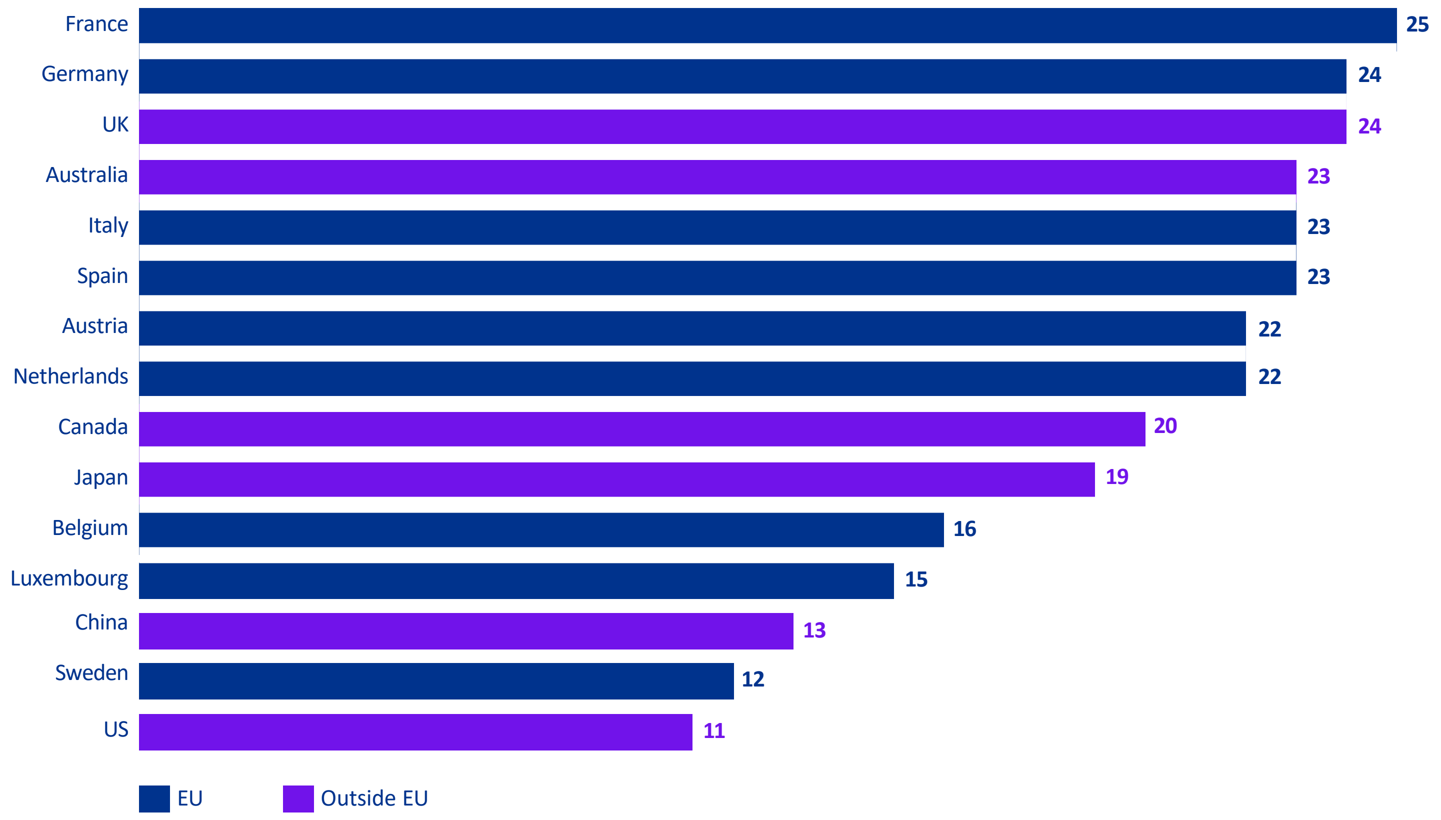
Adoption of sustainability in boardroom pay

Companies in France, Germany and the UK most likely to link boardroom pay to sustainability

Most companies in this research, 292 (78 percent), consider sustainability in calculating their senior executives' pay. This includes all of the French companies, all but one of those from both Germany and the UK and at least 80 percent of those in Austria, Australia, Canada, Italy, the Netherlands and Spain. Even in the US, the lowest placed country, 11 of the top 25 listed companies consider sustainability in boardroom pay.

There is a small difference between the average level of consideration by companies in EU member states, where an average of 20.2 of 25 companies link boardroom pay with sustainability, and countries outside the EU, where 18.3 of 25 do so. There are far wider differences within both groups, with the highest and second-lowest rates of consideration both within the EU and the joint second- highest and the lowest outside the bloc.

Top 25 companies linking boardroom pay to sustainability by country

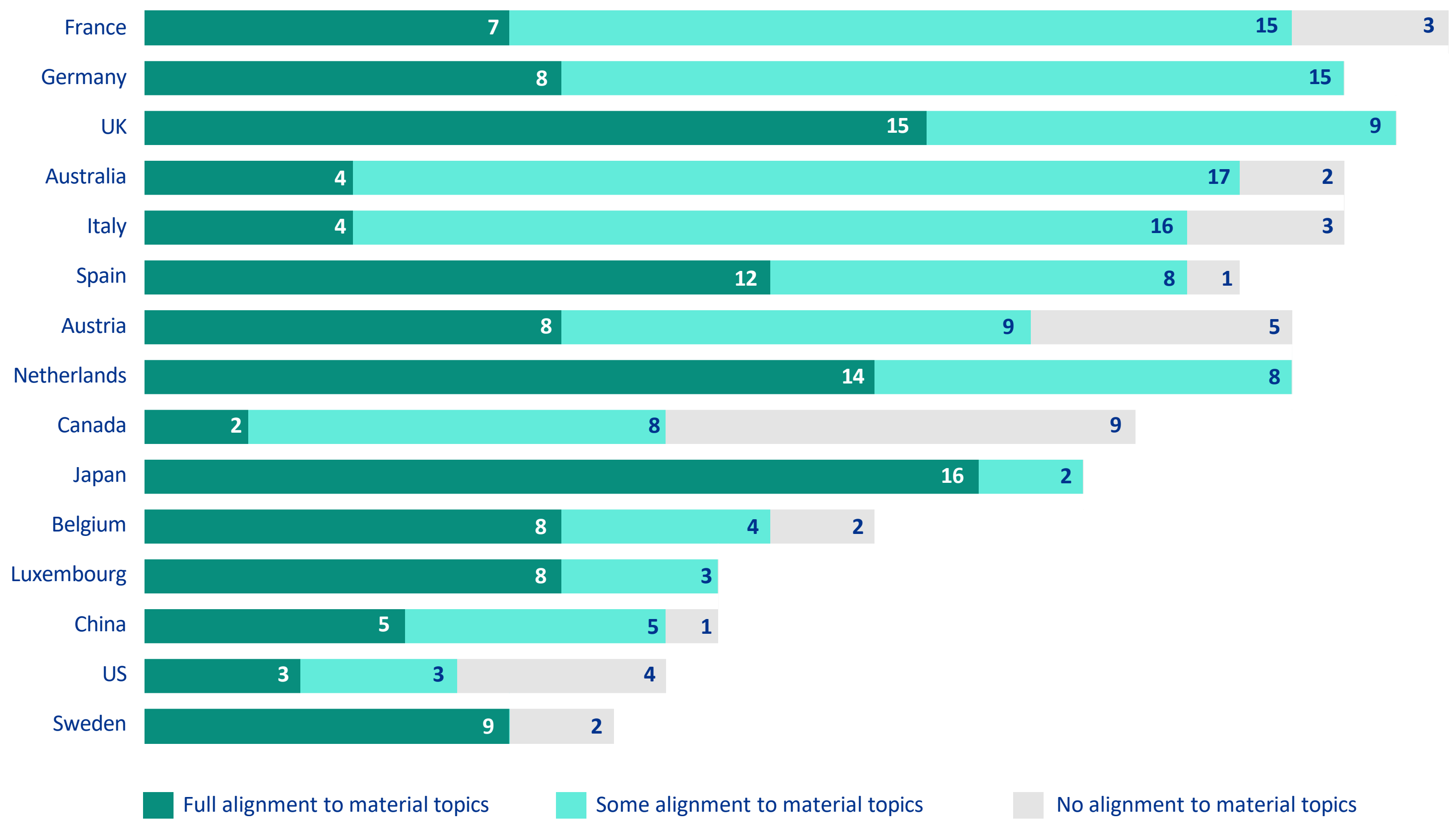


Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

The great majority, 245 of 277 (88 percent), of companies that specify the sustainability targets used in their boardroom pay align these to topics that are material to their businesses, either completely (full alignment) or partly. However, this varies widely by country. It should be noted that the report focuses on topics material to the respective business, not to the application of the principle of double materiality according to the CSRD. It is striking that Japan, rather than an EU member state, has the largest number of companies, 16 of 25, that fully align material sustainability topics and those used in pay. This is particularly notable given Japan makes less use of sustainability-linked pay than the majority of countries in this research and is not an EU member country where companies are obliged to report in line with the CSRD and have or will have to apply the principle of double materiality.

Despite strong consideration of full alignment by both Japan and the UK, on average, countries outside the EU are less aligned than those within it. An average of 7.5 companies in non-EU countries fully align material sustainability topics and boardroom pay measures, compared with 8.7 companies in EU member states. There is a similar gap on partial alignment, with an average of 7.3 companies in non-EU countries and 8.7 companies in EU ones doing this. Countries vary widely over how many companies make no alignment between material sustainability topics and boardroom pay, with five countries having no companies that do this, five having just one or two and Canada having nine.

Level of alignment to material topics of companies that link boardroom pay to sustainability



For some countries the total number of companies is lower than on the previous chart, due to a few companies providing no information on material topics. For ease of comparison this chart uses the same order as the previous chart.

Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

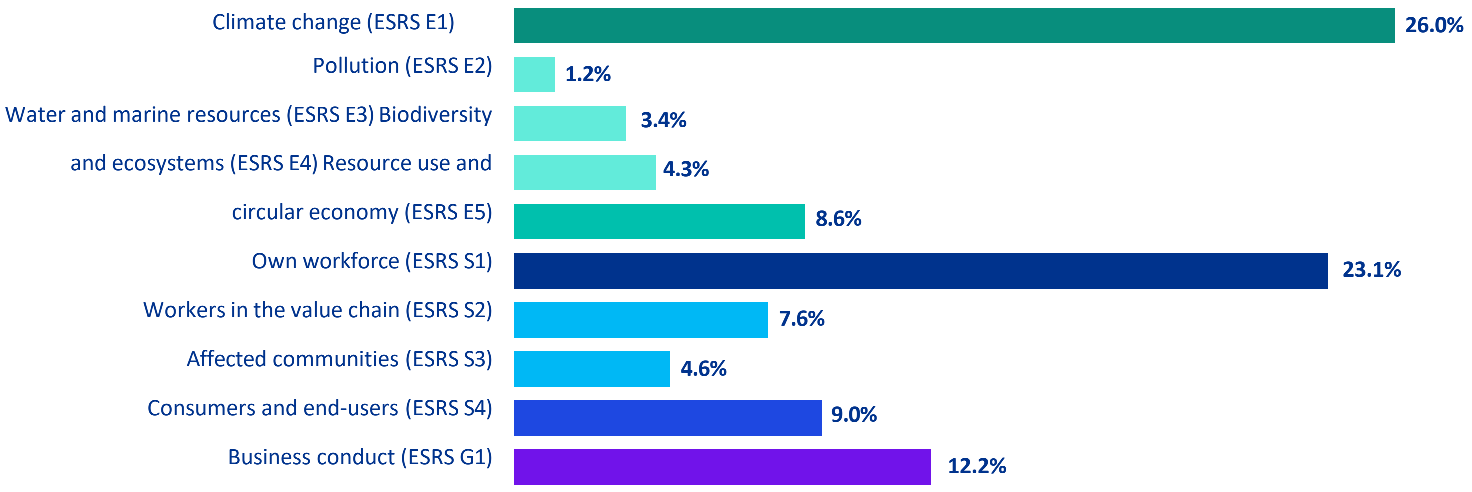
Topics used for sustainability targets

Climate change and own workforce are the most popular sustainability topics

Topics related to climate change and to a company's own workforce are by far the most popular among the companies in this research. There are several likely reasons why companies focus on these two, including that climate change and workforce are topics on which many companies have long published information voluntarily. The third most popular topic, business conduct, is a topic covered by national regulations or strong expectations from investors and banks in many countries.

The topics in this report are based on those used for the European Sustainability Reporting Standards (ESRS) — see the Background section for more information.

All topics used for sustainability targets



Percentages show each topic's share of mentions across all companies.

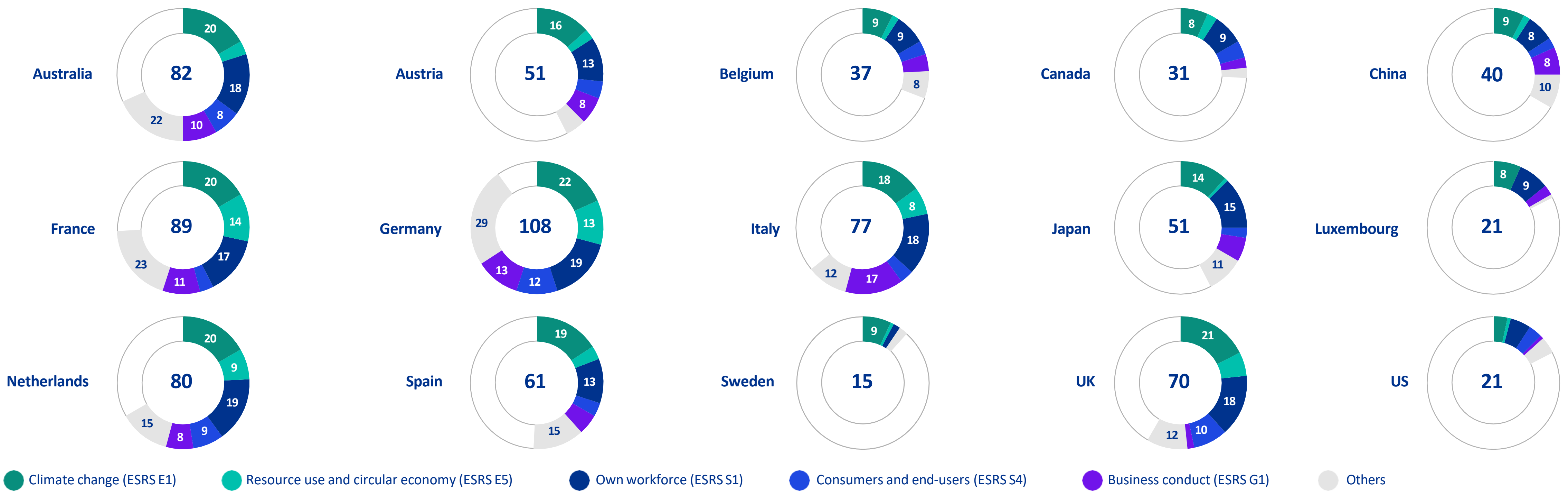
Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

Specific national data shows that German companies have the largest number of sustainability targets, 108, an average of more than four per company. France, Australia and the Netherlands all have 80 or more.

There are differences between the weight countries place on specific topics. Germany leads on adoption of targets relating to climate change (ESRS E1) with 22 of 25 companies researched using these. It is closely followed by Australia, France, the Netherlands and the UK, all of which have either 20 or 21 companies using such targets.

Italy has the most companies using ESG targets related to business conduct (ESRS G1) while France leads on targets related to resource use and circular economy (ESRS E5). The Netherlands and Germany jointly lead on use of ESG targets covering a company's own workforce (ESRS S1) and the UK is second only to Germany on adoption of ESG targets regarding consumers and end-users (ESRS S4).

Major topics used for sustainability targets by country



Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

Environment

Most commonly-used target

- Greenhouse gas emissions reduction

Other frequently-used targets

- Carbon dioxide emissions neutrality
- Greenhouse gas emissions intensity
- Net zero achievement
- Energy consumption
- Share of renewable energy
- Water consumption
- Waste reduction
- Share of recycled and reused material

Targets used by one or very few companies

- Revenue from products and services contributing to circularity
- Receipt of reclamation certificates (confirming land used by industry has been restored to meet environmental and safety standards)
- Net positive impact on biodiversity by 2025

Social

Most commonly-used targets

- Employee engagement index
- Percentage of female managers and executives
- Total recordable injury frequency rate (TRIFR)
- Training hours per employee
- Customer net promoter score

Other frequently-used targets

- Employee satisfaction
- Gender and equal pay gap
- Ethnic diversity
- Lost time injury frequency rate (LTIFR)

Targets used by one or very few companies

- Share of suppliers committed to the company's ESG standards and supplier code
- Supplier audits

Governance

Most commonly-used target

- Cyber security

Other frequently-used targets

- Incidents of corporate governance misconduct
- Internal audit practices
- Risk management
- Director performance

Unlike targets for environmental and social topics, companies typically do not disclose the specific metrics they use to assess governance issues.

Short-term and long-term sustainability targets

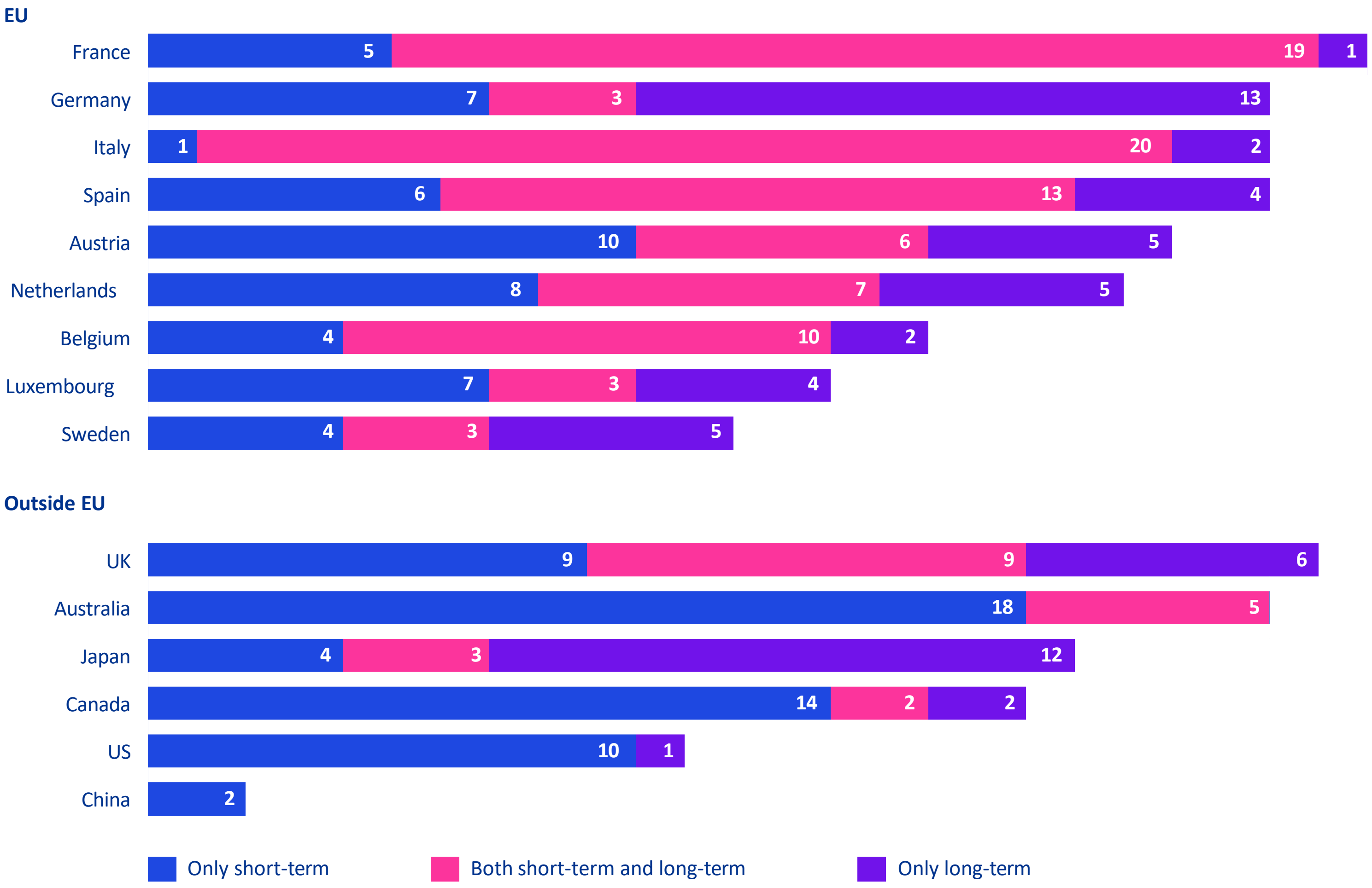
Countries vary widely in use of short-term and long-term targets

Investors generally want companies to use both short-term and long-term sustainability targets in calculating boardroom pay with 37 percent of the companies in this research taking this approach. Short-term sustainability targets alone are used by 40 percent of the companies researched with 23 percent using only long-term ones. Italy has the highest number of companies using both short-term and long-term targets, 20 of 23, followed by France with 19 of 25, while in the US and China no companies use both.

There is a significant difference between the nine EU member states, where an average of 9.3 companies use both short-term and long-term sustainability targets in boardroom pay, and the six non-EU countries, with an average of 3.2 companies using both. Among the latter group, the UK makes the greatest use of both short-term and long-term targets with nine of the researched companies doing so.

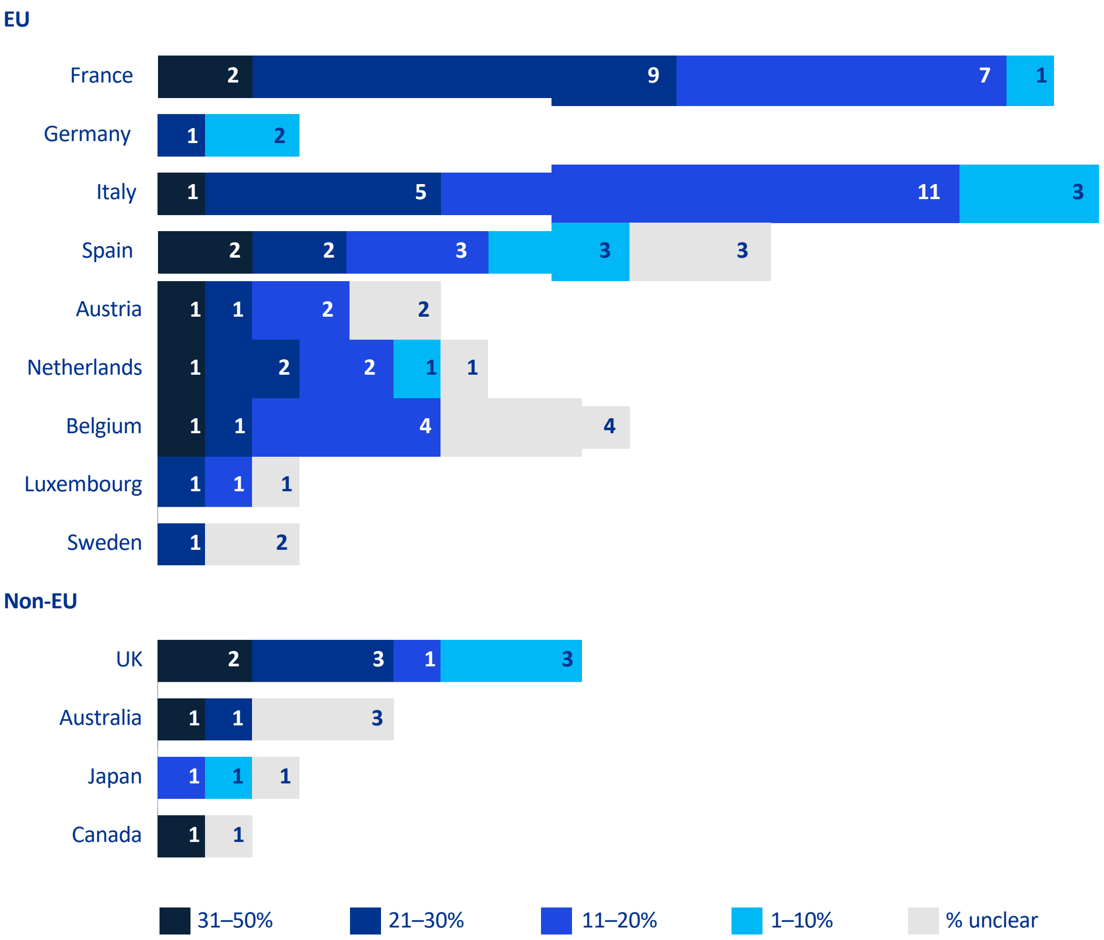
Australia has the most companies, 18, that use only short-term sustainability incentives followed by Canada with 14 and the US with 10. Germany has the most that use only long-term incentives with 13 doing so, with 12 companies in Japan doing likewise.

Use of short-term and long-term sustainability targets

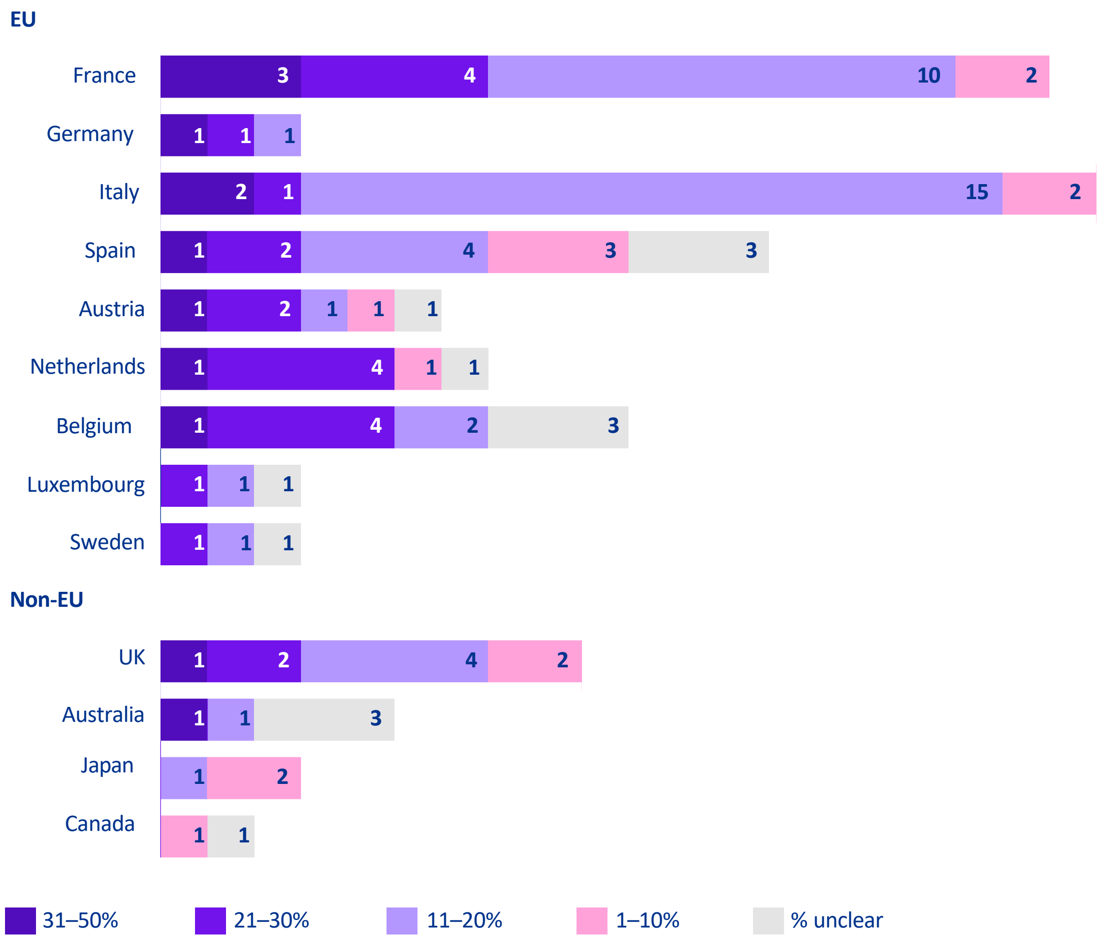


Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

Proportion of pay targets based on short-term incentives among companies using both



Proportion of pay targets based on long-term incentives among companies using both



Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

Recommendations

Recommendations on how to integrate sustainability indicators into management board remuneration

Four steps to sustainable executive remuneration

1

Derive key performance indicators from the corporate strategy

Select key sustainability indicators that are relevant and suitable to remuneration. These should be closely linked to the corporate strategy. This could be indicators that either contribute to long-term business development, reflect how managers could avoid significant risks to business success or for example also refer to aspects of particular importance to the market or industry. Indicators are supposed to help steering the company into the intended strategic direction.

2

Select relevant, suitable and reliable data

It is advisable to focus remuneration on a small number of suitable sustainability indicators that are truly decisive for business success. Suitable key data must be controllable and it should be possible to determine them for shorter intervals than a year. They should be part of continuous reporting for the management board in order to enable performance to be managed in the first place. However, the availability of data during the year is often a challenge, particularly in the case of sustainability indicators. It is therefore advisable to start small, with one or two key pieces of data, and at the same time, develop data availability and internal reporting to increase this.

3

Define the shares of the remuneration system and scope

We recommend determining the relative share of sustainability-related targets in the short-term and long-term variable remuneration components. It is relevant to determine the target group for which the targets are designed. In this report we have focused on the remuneration of the management board, but it is widespread practice that the performance indicators relevant to this board are also taken into account in an adjusted form in the remuneration of top executives.

4

Provide transparency and aim to ensure reliability of data

For capital markets in particular, information on financial incentives for the management board is a decisive valuation criterion for companies, as it has an influence on the opportunities and risks that board members take into account in their operational activities. For this reason, public reporting on management board remuneration is required by law for listed companies in many countries and is also recommended for smaller companies and organizations. The reliability of remuneration-related sustainability indicators is often ensured by external auditing. Due to the impact on the executive board and capital markets, remuneration-relevant key figures are often also those that are voluntarily audited with a higher level of assurance (reasonable assurance).

How KPMG can help

High-performing companies are realizing that good and robust governance drives environmental and social responsibility. As organizations continue to adapt to an ever-changing landscape, boards and management must prepare to address the new dynamics affecting their oversight roles and the governance of their organizations.

Boards have responsibilities to steer their organization towards sustainability and ensure the ESG information under their oversight is appropriate, reliable and compliant.

While plenty of guidance and information exists, standards and regulations addressing specific areas of responsibility and reporting continue to evolve. Governance covers a wide variety of issues including risk management and internal controls, data harvesting and data breaches, executive remuneration, board diversity and competences as well as shareholder rights.

KPMG understands that a focus on governance can underpin the success of the broader ESG strategy by helping ensure that both the people and policies are fit for purpose. Member firms offer a suite of services designed to review your governance structures so that they are effective and efficient — to help remove inadequacies, and help ensure your board and leadership has the required expertise.

How you run your company is the foundation of strong ESG and without it, your license to operate could be at risk. By reviewing your ESG policies and practices along key financial and societal performance measures, KPMG professionals can help you ensure greater accountability, more effective decision making, and stronger compliance throughout your entire organization.

Learn more

KPMG professionals know how the intrinsic power of ESG can transform your business. We can show you how to enhance trust, mitigate risk and unlock new value as you transform to build a sustainable future.

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Background

References to the CSRD and ESRS in this report

This report refers to the EU Corporate Sustainability Reporting Directive (CSRD) and the topical logic of the European Sustainability Reporting Standards (ESRS) to structure the topics referred to in boardroom pay. Originally, the CSRD was planned to affect around 50,000 companies both headquartered inside and outside the EU. However, due to the February 2025 Omnibus proposal, the CSRD reporting requirements for large EU companies might be postponed by two years and may only be mandatory for companies with more than 1,000 employees. Additionally, the proposal aims to reduce the amount of data companies have to report by revising the ESRS. The proposals will be reviewed by the European Parliament and member states and, if approved, will then need to be transposed into national laws.

ISSB standards

The ISSB standards managed by the International Sustainability Standards Board provide a global baseline for financial disclosures related to sustainability. As well as being voluntary rather than mandatory, ISSB standards differ from CSRD in that users take a specifically financial view, with the aim of ensuring that companies publish comparable, reliable and consistent information on sustainability risks and opportunities. However, ISSB S1 takes a similar approach to CSRD's governance standards in requiring companies to disclose whether and how metrics related to sustainability are included in pay policies.

The 10 topical ESRS standards	
ESRS E1:	Climate change
ESRS E2:	Pollution
ESRS E3:	Water and marine resources
ESRS E4:	Biodiversity and ecosystems
ESRS E5:	Resource use and circular economy
ESRS S1:	Own workforce
ESRS S2:	Workers in the value chain
ESRS S3:	Affected communities
ESRS S4:	Consumers and end-users
ESRS G1:	Business conduct

Omnibus proposal

On 26 February 2025, the European Commission announced its so-called Omnibus proposal, through which it plans to reduce the bureaucratic burden on companies resulting from four existing political initiatives: the CSRD (see above), the EU Taxonomy, the Corporate Sustainability Due Diligence Directive (CSDDD) and Carbon Border Adjustment Mechanism (CBAM).[2] The new proposal aims to save companies around EUR6.3 billion annually in administrative costs, including by simplifying reporting requirements. This includes reducing the number of companies covered by the CSRD by four-fifths and reducing the amount of data companies have to report under ESRS.

2. 'Commission simplifies rules on sustainability and EU investments, delivering over EUR6 billion in administrative relief', European Commission, 26 February 2025. https://ec.europa.eu/commission/presscorner/detail/en/ip_25_614

Appendix

Companies in research by sector

Number of companies	Percentage of total	Sector
6	2%	Aerospace and defense
7	2%	Construction and infrastructure
28	7%	Industrial goods and services
35	9%	Technology and IT services
16	4%	Automotive
49	13%	Consumer products and retail
14	4%	Insurance
15	4%	Telecommunications
76	20%	Banking and financial services
36	10%	Energy
12	3%	Media and entertainment
12	3%	Transportation and logistics
7	2%	Chemicals
3	1%	Environmental services
14	4%	Mining and materials
10	3%	Conglomerates
26	7%	Healthcare and pharmaceuticals
9	2%	Real estate

Number of companies   Percentage of total

Source: Incentivizing long-term value creation: Linking sustainability metrics to board members' pay, KPMG International, March 2025

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