Executive Remuneration Briefing Part 3: Middle management: What price an ethical company?

Posted by Ben Schiller [1] on Mar 5, 2012

When it comes to motivating for sustainability – from boardroom to shop floor – leading companies are learning that money isn't everything

Companies with the most advanced sustainable pay schemes not only incentivise senior managers, but also include lower-down employees as well.

While companies do not yet appear to be looking at specific sustainability metrics for section and units heads – possibly out of wariness of slicing up pay package metrics too thinly – they are beginning to incentivise for corporate responsibility well beyond the boardroom and executive suite.

Intel is a good example. Since 2008, all its employees have received bonuses based on three criteria: absolute financial performance, relative financial performance, and operational goals.

Within the last category, it includes measures such as product and facility energy efficiency, the success of renewable energy projects, carbon emission reductions, and the company's environmental reputation. Bonuses are dictated by how well the overall company does in meeting its targets, with employees paid in multiples depending on their salary. Senior staff, with direct responsibility for business units, are also incentivised personally to reach targets.

"The plan is about everyone understanding the strategic importance of sustainability, and it's something everyone can affect," says Suzanne Fallender, Intel's director of CSR strategy.

"If someone works in a factory, it is something they can really affect. But everyone [else] can turn off the lights and use power management systems on their computers."

Fallender says the employee bonus plan was key to reducing energy use by 6% a couple of years ago. And, such is the reach of the plan, every unit wants its initiative to be included in the scheme's goals, which shift a little every year.

Fallender describes pay as a "key component of our overall push" in integrating sustainability, alongside "vision and strategy", and board-level involvement. Intel has had a dedicated CSR board committee since 2003, so its commitment to rewarding sustainability is perhaps less surprising.

As well as direct financial bonuses, Intel has a Sustainability in Action programme, where employees can apply for grants for research, internal, or community projects. For example, employees recently built an algae farm on the roof of a building, producing a mixture that could be turned into biofuel. Another project saw a team build a garden maximising water-conservation. Fallender says the projects are not only valuable in themselves, but also help develop teamwork and build morale.

Carbon bonuses

Other companies are also incentivising sustainability measures in unusual ways. For example, WSP, a UK engineering consulting firm, has set up a personal carbon trading system for its employees. Staff voluntarily agree to a personal carbon limit set annually by the company. They enter values on a website for their travel to and from work, their home energy use, carbon output, and so on. If they come in under the limit for the year, they are rewarded with a bonus at the end of the year – about £100 last year.

Since setting up the scheme in 2007, WSP has opened it to other companies around the world. About 2,200 employees from 15 organisations now participate.

David Symons, director of WSP's environmental practice, says the scheme is a good way of engaging staff on environmental issues, with knock-on business benefits.

"We've found that this is a good way to increase staff understanding and awareness of environmental issues, and that it does it in a subtle way, rather than it being a formal training course," Symons says.

As well as tracking their carbon output, participants swap tips about sustainable living on a Facebook page, celebrate green "heroes", and challenge each other to do better.

"The core premise is to demonstrate that sustainable living is easy, interesting, and can save you money, which is in contrast to many sustainability programmes, where life is a bit greyer and meaner and people are told they have to stop doing things," Symons says.

Swiss Re, the reinsurer, has something similar. Under its COyou2 programme, it matches employees' investments in CO_2-reducing technologies, such as hybrid cars, solar panels and heat pumps. Staff can get up to CHF5,000 (about £3,500).

All about money?

The big question about incentivisation and sustainability, whatever the management level, is whether money is the best way to motivate.

Some human resources experts argue that companies tend to over-play financial rewards. Nadine Exter, manager of the Doughty centre for corporate responsibility at Cranfield School of Management, argues that staff are driven by three types of rewards – "extrinsic" (material), "intrinsic" (psychological), and "social" (how individuals relate in the workplace).

To get the most out of staff, companies have to think about all three types. Exter says employees respond to everything from "social identity" and "desire to be part of a collective", to their "desired levels of self expression" and "discretion to control their destiny in the organisation".

Intrinsic and social rewards are important to motivating sustainability, Exter believes, because the issues are often value-laden, beyond the scope of formal codes and official contracts. Conversely, Exter says employee motivation on sustainability can be shaken by perceived unfairness (such as unequal top-to-bottom pay ratios), or where the actions of senior staff diverge from professed principles.

Companies cannot rely purely on financial motivation – especially as such incentives have been the very thing that led to the recent financial crisis. Two Wharton management professors, Adam Grant and Jitendra Singh, wrote a paper in 2011 arguing that recent financial scandals, from Enron to the 2007-8 meltdown, were caused by "excessive reliance on financial incentives". The researchers argue that such inducements can have "unintended consequences", including unethical behaviour, jealousy, and a loss of intrinsic interest in work.

They note that between the early 1990s and 2003, the proportion of compensation contingent on share prices rose from less than 10%, to more than 70%, as shareholders took steps to tie business performance to their own financial interests. The trouble, the researchers point out, is that the incentives tended to lead to short-term decision-making, and, in several cases, financial calamity.

When it comes to incentive mechanisms, perhaps companies should be thinking more laterally. Financial incentives have their place, but they are not a silver bullet for sustainability performance, as for any area of company performance. There are many ways to incentivise, and the financial path may not always, in every situation, be the best one.

National Grid: sectorised incentives

London-listed National Grid, which operates **electricity** and **gas** networks in the **UK** and the **US** north-east, is using both "carbon budgeting" and financial incentives to meet its carbon targets.

Its goal is to reduce emissions by **80%** by 2050 (from 1990 levels) and **45%** by 2020.

The **budgeting** process, adopted in 2008, sets five-year goals, requiring business units to account for how they are going to **reduce carbon** annually. Their success is measured alongside other performance measures, such as customer service, reliability, and safety.

Executives are incentivised directly, with **30%** of bonuses based on individual targets, which include cutting carbon. Ian Gearing, head of corporate responsibility, says the exact amount at stake related to carbon varies with sector or business unit.

Aside from the chief executive and executive directors, staff in the safety and environmental team, or those operating plants or working in construction could all see their **bonuses** affected by National Grid’s **environmental performance**, according to Gearing.

“It was important to link it to remuneration to make sure everyone has a bit of skin in the game, and to recognise it is an important part of our business,” he says.

But Gearing reckons the carbon budgeting has been more important. “It has really allowed us to understand where emissions are coming from, to identify areas of innovation, and have a sense of **ownership** in the units.”

National Grid has financial and regulatory incentives for reducing carbon – including that it would have to pay for additional carbon **emissions permits** if it went over its national allocation.

But group head of sustainability Stuart Bailey says those are not the main motivations. “We’re not driven by financial returns. We are driven by the fact that we need to be doing our part in the overall **decarbonisation** of the UK.”

Gearing adds: “To be taken seriously, we need to demonstrate we are managing our emissions effectively. While there is a financial aspect, the other part is being able to show regulators and the government that we are serious, and can contribute to the debate on energy policy.”

Links:
[1] http://www.ethicalcorp.com/users/ben-schiller