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**Although the company disclosed an overall 40 per cent weighting for the ESG key performance indicators (KPIs) for FY2021, it did not disclose the individual weighting for the KPIs.** PHOTO: BLOOMBERG

# Linking ESG to remuneration: The case of Top Glove

While the glove maker has done well in linking its materiality assessment of ESG issues to the KPIs, it could consider providing more information on how the ESG metrics actually affect remuneration. BY MAK YUEN TEEN

TOP Glove, the largest glove manufacturer in the world with a primary listing on Bursa Malaysia and a secondary listing on the Singapore Exchange, had a stellar financial performance when the Covid-19 pandemic hit, as it benefited from the huge surge in global demand for gloves.

Its net profit attributable to shareholders grew by 381 per cent from FY2019 to FY2020, and another 340 per cent from FY2020 to FY2021. Its return on equity over the same period increased from 14.4 per cent to 26.0 per cent, and then to 131.3 per cent. It share price surged by 454 per cent between the end of FY2019 and FY2020, and then fell back 54 per cent between the end of FY2020 and the end of FY2021.

While Top Glove's business was thriving, it came under considerable public scrutiny for its labour practices, such as poor living and working conditions of its migrant workers, forced labour practices which led to import bans of its products by the United States, and its questionable handling of a whistleblower complaint. The board was criticised by some influential institutional investors, who voted against the re-election of six independent non-executive directors (INEDs) – although they were nevertheless re-elected.

In response, the company revamped its remuneration policies for management in FY2021, seeking to link the company's environmental, social and governance (ESG) standing to executive remuneration.

**Changes in remuneration policy**

In its integrated annual report for the financial year ended Aug 31, 2021, Top Glove disclosed the following:

"Our management incentives or remuneration pay are linked to ESG metrics, ensuring management accountability for the achievement of the company's goals. In FY2021, the Group has set 40 per cent of the FY2022 key performance indicators (KPIs) tied to social and environmental pillars, which are aligned with the company's material ESG matters. To reflect the company's commitment in transitioning into a netzero carbon business, the group introduced carbon-emissions reduction as a new KPI for FY2022."

In various parts of the report, it mentioned this 40 per cent linkage of ESG metrics to management pay for FY2021, and as one of the key achievements and highlights for the year. Therefore, it would appear that it had already linked ESG to executive remuneration in FY2021.

**Governance over remuneration**

The company has a Board Nomination and Remuneration Committee (BNRC) made up of four members who are all INEDs. In FY2021, the BNRC reviewed the remuneration packages of the executive directors (EDs), non-executive directors (NEDs), key senior management and related employees. At its board meeting in June 2021, the board deliberated and approved the group's remuneration pay link to ESG metrics.

The company also has an Employee Share Grant Plan (ESGP) and Employee Share Option Scheme (ESOS) which are administered by committees other than the BNRC. Rather surprisingly, these committees are chaired by the executive chairman (EC), and have two other members of management – an ED plus the son of the EC, who is deputy general manager of marketing and a non-board member. The other four members are INEDs, three of whom are the chair and members of the BNRC.

**ESG KPIs and metrics**

The following ESG KPIs and metrics are used:

1. Product quality and safety – Customer complaint rate
2. Occupational health and safety – Occupancy accident rate
3. Human rights and labour practices – Social ethical audit scoring
4. Reduction of carbon emissions – Scope 1 and 2 emissions intensity reduction
5. Talent retention – Employee turnover rate

In the company's 2021 Integrated Report, the company disclosed its assessment of the materiality of ESG issues. The six ESG issues assessed to have the highest impact on stakeholders and greatest significance to the company's business are: (a) product quality and safety; (b) occupancy health and safety; (c) labour management relations; (d) human rights; (e) customer experience; and (f) environmental compliance.

There is a strong alignment between the company's materiality assessment and the ESG KPIs that the company has linked to management pay. While a company's materiality assessment may not necessarily reflect the ESG factors that stakeholders consider to be most important, the ESG issues identified by Top Glove through its materiality assessment do appear to be factors that would be important for the company.

For each KPI, the company has identified a metric which is measurable. This would address common concerns among investors about subjectivity of ESG KPIs.

It has also disclosed short-term and mid-term targets for the various ESG metrics.

However, while the company disclosed an overall 40 per cent weighting for the ESG KPIs, it did not disclose the individual weighting for the KPIs.

The company also did not clearly disclose whether it linked the ESG metrics to annual incentive pay or long-term incentives (which in its case comprise employee share grants and employee share options) – or to both. Most companies currently link ESG metrics to annual incentive pay, although they are being encouraged to also link them to long-term incentives.

**Where's the link?**

The company discloses the name, exact remuneration and breakdown for each individual director. For EDs, it disclosed the following remuneration components: salary, fees, bonus, ESGP, ESOS, other emolument, and benefits-in-kind. For the next six key management personnel (KMP) who are not directors, the company disclosed the name, exact total remuneration and the following components: salary, bonus, benefits-in-kind and other emoluments. It would appear that "other emoluments" for these KMP include the fair value of share and share option grants.

Although the company mentioned the linkage of ESG metrics to executive remuneration for FY2021, it is unclear how the ESG metrics have actually impacted remuneration.

Only two of the top 10 executives received a bonus in FY2021 – one of the EDs and another KMP who received a negligible bonus. Did most of the executives not achieve their ESG and other KPIs?

In FY2020, three of the four EDs received bonuses. That year, it disclosed the exact remuneration of three other KMP, with two receiving bonuses. In FY2019, only one of the four EDs – the EC – received a bonus. The three KMP who are not EDs did not receive bonuses.

Overall, there appears to be little short-term incentive pay for KMP, particularly those who are not EDs. For EDs and other KMP, it is unclear how ESG (and other) goals affected their bonuses. It is also unclear whether ESG metrics are also linked to long-term incentives, that is, to the award or vesting of shares and share options.

**Importance of good governance and transparency**

While it is now common for companies in the UK, EU and US to link ESG metrics to executive remuneration, Top Glove is one of the first Asean companies to do so. This is clearly spurred by the scrutiny it has faced, especially on social issues. It has also done well in linking its materiality assessment of ESG issues to the ESG KPIs.

The company could consider providing more information on issues such as how the ESG metrics actually affect remuneration and weightings of different ESG metrics. It may also consider linking ESG to both short-term and long-term incentive pay, if it is not already doing so.

There are many issues to be considered in deciding whether and how to link ESG to executive remuneration. If companies choose to do so, they need to be able to demonstrate that it is not just a public relations statement, with ESG metrics having little or no impact on executive remuneration. There needs to be transparency on the issues highlighted in this article.

It is also important that there is an independent and competent remuneration committee to ensure that linking ESG metrics to executive remuneration does not result in "soft" targets that are relatively easy for executives to achieve.

A forthcoming report by the author, to be published in collaboration with Sustainable Finance Institute Asia and CPA Australia, will discuss in-depth key issues and research on linking ESG to executive remuneration.

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