



Industry overview — as it relates to executive compensation

Retail

The retail industry by nature has a distinct focus on brand and the need to appeal to the consumer. Consumer demand for green products is the most compelling driver for companies in the industry to articulate and execute their climate strategies. That is not to say there aren't additional drivers, but the consumer voice is particularly prominent. This means that, at the company level, many retail companies are publishing their sustainability reports, often with a focus on the sustainability of their supply chains, managing waste, promoting energy efficiency and reducing emissions.

The textile industry globally generates around 10% of all greenhouse gas GHG emissions and 20% of global wastewater. Brands can improve their material mix (e.g. greater use of recycled fiber), move toward sustainable transport, improve packaging (with recycled materials), decarbonize their retail operations, improve waste and water management and reduce overproduction and overconsumption.

The food and grocery segment alone accounts for 26% of global GHG emissions; and 24% of the segment's emissions come from food that is lost in supply chains or wasted. 78% of U.K. retailers and supermarkets have already or will soon commit a science-based emissions reduction target; continental European companies are also heading in this direction. Carrefour is one example. Additionally, all U.K. major grocery retailers have voluntarily signed up to an industry-led "Meat in a Net Zero World" initiative, with the goal of improving productivity, tackling deforestation, cutting emissions and reducing the £3 billion of meat wasted in the U.K. every year.

Notwithstanding the continued consumer and government pressure for brands to be more transparent about their impact, there is a perceived lag in the retail industry's measures to combat climate compared to other industries. This is thought to be due to the immediate strategic focus being on mere survival through the pandemic and on the shift in business models from traditional high street to e-commerce and delivering seamless omnichannel experiences for consumers. Retail, particularly food retail, is a low-margin business area, with less discretionary cash to spend on sustainability and climate-related initiatives.



Climate challenges and responses

A challenge for retailers in acting against climate change is the prominence and impact of indirect factors such as supplier (upstream) and consumer behavior and decision making (downstream) on operations. Carbon emissions from indirect factors such as these, categorized as 'Scope 3' emissions, have notoriously been the greatest but are also the hardest for a company, or specifically an executive of a company, to directly and quickly impact.

As part of their commitments, major retailers that are leading the way in this space are working with their supply chains to ensure climate and sustainability goals are met. For example, Tesco requires suppliers to follow their agricultural standards, such as having soil and water management plans in place to ensure products are grown with minimal environmental impact. Tesco works with key

suppliers to measure their GHG emissions from agriculture and establish a baseline from which future reductions can be monitored. The company also provided 800 farms with individual assessments from an expert consulting firm to identify emissions hotspots.



What are companies measuring and reporting?

Many companies in the sector have not yet established final scientific targets, but they are measuring and tracking the following when they are within the company's control:

- Emissions and plastic usage
- Energy and water consumption
- Waste management
- Renewables, recycling and reusing

A minority are measuring and tracking their suppliers at present.



Aligning climate goals and targets with executive compensation

The slight lag in action of the industry at the company level subsequently translates to a lag and disconnect with retail companies not having yet embedded climate within executive remuneration. Of the U.K.'s top retailers in the FTSE 350, around half have implemented at least one ESG metric into their incentive arrangements.

However, we are seeing more metrics in executive incentive plans that focus on social factors (for example, employee wages, employee engagement, safety, rights and interaction with consumers), which is unsurprising given the high proportion of National Living and minimum wage employees and, in some cases, use of overseas factory workers. COVID-19 has elevated investors' focus on social factors that can have a significant impact on companies' resilience through such a crisis. As of yet, there are fewer examples of environment-related metrics.

Having said that, we know companies are considering introducing bonus metrics next year around recycling and reusing (metrics the company has more control over) and, in the last U.K. annual general meeting (AGM) season, there has been an emerging trend of companies including the ability to add environmental metrics into remuneration policies. We expect by 2023 AGMs to see more metrics relating to carbon emissions in long-term incentive plans, once companies have developed and articulated their scientific targets and the paths for achieving them.

With regards to practice of retailers in other regions, companies are typically at early stages of considering embedding climate within their executive compensation framework. It's likely that vertically integrated retailers are further ahead with this thinking, given their greater control over manufacturing and production.



Challenges aligning climate goals and executive compensation

The COVID-19 pandemic has had a significant impact, shifting retail companies' attention to more immediate survival and business strategy needs, including developing robust digital capabilities. There is also the challenge of the impact on emissions of long, complex supply chains across the industry, which executives participating in incentive plans are less able to influence, at least in the short term.

The attention on ESG in executive compensation has largely been focused on the 'S' – the social dimension, rather than environmental factors.

Focus by region

1. In the U.K., retail is not a leading sector when it comes to emerging trends such as ESG and climate in executive compensation plans, but the passion and ambition is evident. We expect to see a growing prevalence of climate, environmental and/or sustainability factors in executive incentive plans in coming years.
2. In North America, retail companies tend to be very financial growth-orientated and, as such, use metrics that incentivize and pay for financial growth and market share. Diluting the focus on traditional financial metrics by introducing climate-related metrics is understood to be a challenge.



Leading company example — Kingfisher

- **Metric name and description:** Climate Change: Deliver annual carbon reductions in line with current Kingfisher Group 2025 target which is to reduce own scope 1 and 2 carbon emissions by 22% by 2025 from a 2016 baseline
 - **Weight in vehicle:** 2% in annual bonus plan
- **Metric name and description:** Planet: 99.5%-100% responsibly sourced wood and paper by end of 2020 for all Goods for Resale (GFR) & catalogue paper
 - **Weight in vehicle:** 2% in annual bonus plan
- **Metric name and description:** Greener, Healthier Homes: 50% of Group sales to come from products that help create a more sustainable home
 - **Weight in vehicle:** 2% in annual bonus plan