



The background of the slide features a complex financial market visualization. It includes multiple overlapping candlestick charts in green and red, indicating price movements. Several moving average lines in various colors (pink, orange, blue) are plotted across the charts. Numerical data points and percentages are visible in the upper left, such as -0.33%, -0.36%, and -0.50%. A diagonal black band cuts across the middle of the image, serving as a backdrop for the title. Two thick red vertical bars are positioned on the left side of the slide.

DIMENSIONALITY OF INCENTIVE METRICS

ESGAUGE
INTANGIBLES AI

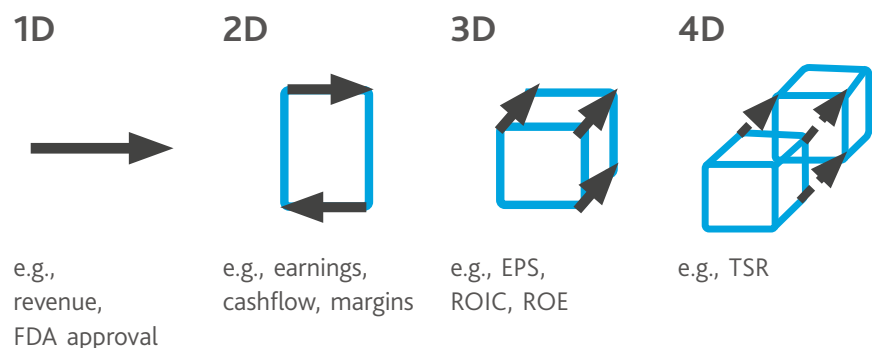
BDO



An ongoing challenge for compensation committees lies in aligning the interests of executives with shareholders and other stakeholders. Incentive pay, including both short-term incentives (STI) and long-term incentives (LTI), is generally considered an effective approach for linking the financial interests of the top executives to that of the company and other stakeholders. However, the development of metrics and the goal setting process can be incredibly challenging. There are hundreds of potential metrics for both STI and LTI programs to choose from, and some are much more challenging than others. To help our clients understand and visualize incentive plans, BDO has categorized performance metrics into five potential dimensions:

- ▶ **1st Dimension:** Represents metrics that focus on top line revenue, sales, or market share.
- ▶ **2nd Dimension:** Represents metrics that focus on not only top line, but also includes the consideration of expenses. The most prevalent **2nd Dimension** metrics are EBITDA, cashflow, net income, or operating margin.
- ▶ **3rd Dimension:** Represents metrics that focus on top and bottom line, but also includes finance, investment, and capital funding metrics. The most prevalent **3rd Dimension** metrics are earnings per share (EPS) growth, return on invested capital (ROIC), return on equity (ROE), and return on assets (ROA).
- ▶ **4th Dimension:** Represents the prior dimensions (top line, bottom line, and financing activity), but also includes future expectations. By future expectations, we mean that the metric measures what the future expected growth will be, and that the company maintains or grows investors' multiples. Largely, the only measure that incorporates future expectations is the fair market value of the stock, and therefore total shareholder return (TSR) is the most prevalent **4th Dimension** measure.
- ▶ **Strategic:** As a final catch-all, there are some other KPIs or strategic goals that don't focus on the financials or stock prices. These important measures are sometimes seen with environmental, social, and governance (ESG) goals, discretion, and other specific business outcomes.

DIMENSIONS OF PERFORMANCE METRICS



In the research for the BDO 600 Study, we collected and analyzed the short and long-term metrics for companies that comprise the eight industries included in the study.

[ESGAUGE](#) has supplied the data of performance metrics to BDO for analysis.

	CEO Short-Term Incentives Market Prevalence					CEO Long-Term Incentives Market Prevalence					CEO All Incentives Market Prevalence				
	1 st Dimension	2 nd Dimension	3 rd Dimension	4 th Dimension	Strategic	1 st Dimension	2 nd Dimension	3 rd Dimension	4 th Dimension	Strategic	1 st Dimension	2 nd Dimension	3 rd Dimension	4 th Dimension	Strategic
Banking	5%	57%	69%	0%	81%	3%	10%	87%	37%	17%	7%	54%	87%	24%	76%
Energy	38%	62%	16%	4%	84%	4%	16%	24%	78%	24%	34%	64%	30%	71%	80%
Healthcare	74%	82%	21%	0%	66%	36%	40%	24%	54%	8%	77%	80%	34%	42%	66%
Manufacturing	42%	85%	25%	3%	57%	16%	38%	36%	52%	11%	44%	91%	44%	46%	59%
Nonbanking Financial	31%	64%	31%	2%	78%	28%	33%	47%	33%	12%	37%	63%	46%	28%	65%
Retail	21%	67%	64%	3%	95%	9%	9%	20%	95%	18%	25%	62%	68%	84%	89%
Technology	45%	94%	9%	0%	53%	32%	70%	43%	23%	11%	58%	92%	40%	18%	52%
Real Estate	71%	73%	5%	0%	63%	51%	41%	12%	55%	31%	78%	78%	14%	43%	66%
All	34%	61%	23%	1%	41%	23%	33%	33%	56%	16%	47%	74%	44%	46%	68%

Note that the prevalence data above will add to more than 100%, as it is only indicative of the existence of that dimension. Most companies have multiple metrics. Further, note that the prevalent practice for STI plans is to leverage 2nd Dimension metrics, and the prevalent performance metrics for LTI plans are 4th Dimension.



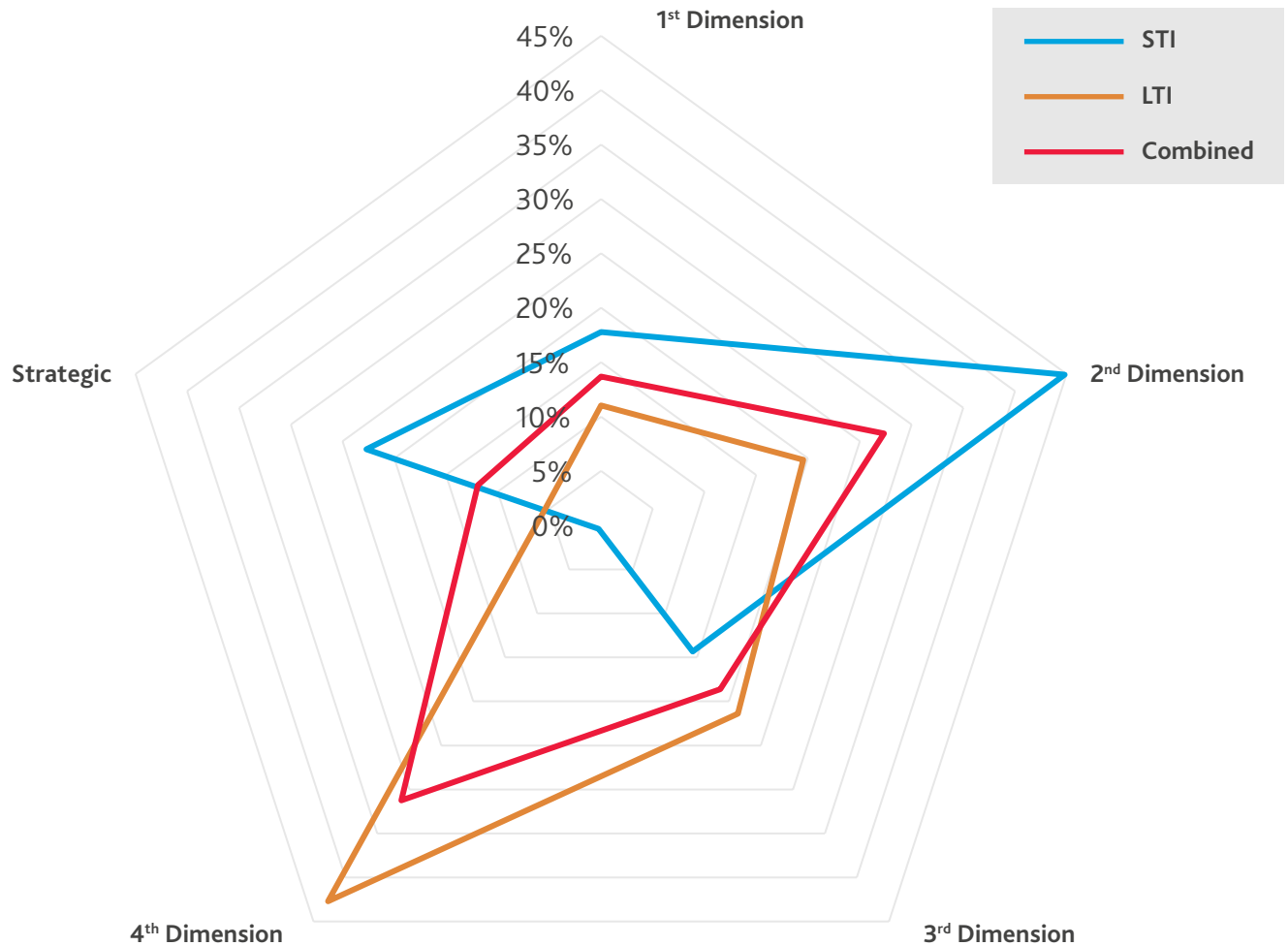
We have also summarized the incentives weighted by the percentage of base pay to understand the emphasis put on each dimension, all normalized to 100% of your total incentives.

	CEO Short-Term Incentives Weighted					CEO Long-Term Incentives Weighted					CEO All Incentives Weighted				
	1 st Dimension	2 nd Dimension	3 rd Dimension	4 th Dimension	Strategic	1 st Dimension	2 nd Dimension	3 rd Dimension	4 th Dimension	Strategic	1 st Dimension	2 nd Dimension	3 rd Dimension	4 th Dimension	Strategic
Banking	2%	27%	35%	0%	36%	1%	2%	76%	18%	3%	2%	15%	56%	9%	19%
Energy	10%	38%	6%	0%	46%	1%	7%	14%	65%	13%	6%	22%	10%	33%	29%
Healthcare	33%	42%	12%	0%	13%	24%	27%	16%	31%	2%	28%	35%	14%	15%	8%
Manufacturing	17%	60%	13%	1%	9%	9%	31%	20%	37%	3%	13%	45%	17%	19%	6%
Nonbanking Financial	15%	39%	19%	1%	26%	9%	24%	38%	26%	4%	12%	31%	28%	13%	15%
Retail	5%	21%	31%	0%	42%	3%	3%	9%	81%	4%	4%	12%	20%	41%	23%
Technology	13%	73%	4%	0%	9%	16%	46%	23%	15%	0%	15%	59%	13%	8%	5%
Real Estate	42%	47%	1%	0%	10%	26%	18%	3%	43%	10%	34%	33%	2%	22%	10%
All	18%	45%	14%	0%	23%	11%	20%	21%	43%	5%	14%	32%	18%	22%	14%



When summarizing by weight, you can better visualize that STI tends to be 2nd Dimension, while LTI tends to be 4th Dimension. However, the BDO 600 Study does a reasonable job of incorporating all dimensions into their incentive programs when combining STI and LTI. Visually, the weights can be illustrated as follows:




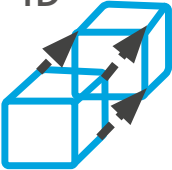
METRIC PREVALENCE



BDO Comment: BDO believes that a portfolio of incentive measures should be used to mitigate risk from any single performance measure, and that companies should strive to put some weight into all the distinct Dimensions ranging from 1D to 4D to Strategic. This ensures that CEOs do not overly focus on a single goal or outcome. The line for the combined incentives in the chart above creates a well-formed pentagon, illustrative of a balanced portfolio of metrics.

Impact to Goal Setting for Positions Beneath the CEO

Broadly speaking, incentive measures should have line of sight for the executives. When thinking about the four primary Dimensions of incentive metrics, it becomes easier to view what types of measures are most important for different executives.

1D	2D	3D	4D
 e.g., revenue, FDA approval	 e.g., earnings, cashflow, margins	 e.g., EPS, ROIC, ROE	 e.g., TSR
Includes:	Includes:	Includes:	Includes:
<ul style="list-style-type: none"> ▶ A single actionable item (typically top line) 	<ul style="list-style-type: none"> ▶ Top line ▶ Bottom line 	<ul style="list-style-type: none"> ▶ Top line ▶ Bottom line ▶ Financing activities 	<ul style="list-style-type: none"> ▶ Top line ▶ Bottom line ▶ Financing activities ▶ Investor multiples
<ul style="list-style-type: none"> ▶ Targeted towards head of sales 	<ul style="list-style-type: none"> ▶ Targeted for operating unit heads 	<ul style="list-style-type: none"> ▶ Best targeted for NEOs and above 	<ul style="list-style-type: none"> ▶ Best targeted for CFO and CEO

Leveraging data from [ESGAUGE](#), we have also analyzed the prevalence and weighting of each Dimension for the other Named Executive Officers (NEOs).

	Prevalence (sums to greater than 100%)		Weighted	
	CEOs	Other NEOs	CEOs	Other NEOs
1 st Dimension	47%	68%	14%	14%
2 nd Dimension	74%	84%	32%	28%
3 rd Dimension	44%	63%	18%	17%
4 th Dimension	46%	58%	22%	16%
Strategic	68%	92%	14%	25%

As expected, CEOs have a greater weighting on the 4th Dimension while other NEOs have a higher weighting on Strategic, which includes strategic and other non-financial metrics.

ESGAUGE Comment: The ability for an executive to influence a performance outcome (line of sight) is crucial when selecting performance metrics for both specific job roles and across different performance periods. The data show that, generally, compensation committees of companies in the BDO 600 Study select lower dimension metrics predominantly for short-term incentives and favor them for roles beneath the CEO. The addition of higher dimension performance measures for CEOs and long-term incentives rounds out a diversified group of metrics within these plans.

BDO Comment: BDO is not inferring that other executives should have totally distinct performance measures from the CEO, as that can create other challenges optically. However, in a portfolio or basket of performance measures, different weightings can be applied for different roles that optimize the line of sight.

Conclusion

The determination of incentive metrics can be very challenging, as it is critical that they meet several objectives for the employee, the company, the investor, and other stakeholders. When designing incentive plans, each measure should be viewed in the dimension that it is serving, ranging from the 1st Dimension to the 4th Dimension, and the total dimensional weighting should be balanced. Some closing thoughts are summarized below:

- ▶ Short-term incentive plans should have an emphasis on 2D metrics, with support from 1D, 3D, and other strategic metrics that help drive a companies' short and long-term goals.
- ▶ Long-term incentive plans should have a focus on 4D metrics with support from 3D metrics and potentially 2D metrics.
- ▶ The portfolio of incentive metrics should be balanced, ranging from 1D to 4D to other strategic goals.
- ▶ To optimize line of sight for your employees, lower dimensionality metrics should be leveraged as you move lower in the organization. Similarly, higher dimensionality metrics should be applied for the most senior executives.

ABOUT ESGAUGE

ESGAUGE is a data mining and analytics firm uniquely designed for the corporate practitioner and the professional service firm seeking customized information on U.S. public companies. It focuses on disclosure of environmental, social, and governance (ESG) practices such as executive and director compensation, board practices, CEO and NEO profiles, proxy voting and shareholder activism, and CSR/sustainability disclosure. Our clients include business corporations, asset management firms, compensation consultants, law firms, accounting and audit firms, and investment companies. We also partner on research projects with think tanks, academic institutions, and the media. ESGAUGE's artificial intelligence (AI) and machine learning platform, ESGAUGE Analytics, is tailored to specific empirical information needs, with analyses by custom peer groups, business sector, company size, and other measures.

ABOUT BDO

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, and advisory services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through more than 65 offices and over 700 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of more than 88,000 people working out of more than 1,600 offices across 167 countries and territories.

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