Using compensation to drive action on diversity, equity and inclusion

Six questions companies must consider when designing DEI goals for executive incentive plans.

The last six months have been eye-opening for many corporate stakeholders, as 2020 has brought a long-overdue change in how companies approach diversity, equity, and inclusion (DEI).

Your company is probably grappling with many of these new questions around DEI—as employees, customers, board members, and other stakeholders seek action and accountability. The dual-lens of COVID-19 and the recent murders of George Floyd, Breonna Taylor, and other Black Americans have highlighted profound social justice and economic divides in the US. As a result, companies are revisiting their records on DEI, and their responsibility to help shift a status quo stacked against Black, Indigenous, and other People of Color (BIPOC), as well as other often underrepresented populations.

A vocal commitment to addressing equality and racial justice has become critical —with leaders across all industries acknowledging the painful legacy of long-term systemic racism. "Check-the-box" DEI is no longer acceptable, with employees and society demanding tangible actions from organizations that drive long-term, sustainable change.

Many corporations around the globe have begun to actively embrace the Black Lives Matter movement and revisit DEI initiatives with a new commitment to active, accountable change, including:

- Stronger representation and development of BIPOC employees and women throughout the organization and especially in more senior, managerial, and executive positions
- Full inclusion for these populations in all company programs, plans, and practices
- Equity for all groups across company policies, programs, and practices (including pay equity)

Advancing DEI in the workplace is hardly a new idea, but past DEI initiatives have often fallen short of the real accountability needed to solve the problem. If you want to pay more than lip-service to your DEI goals, you may be considering linking DEI goals directly to executive incentive plans.

This link between compensation and DEI is still a relatively infrequent practice. Mercer estimates that only 15%-20% of S&P 500 companies include DEI metrics in their executive incentive plans. Only about 5%-10% of those companies have an objective, quantitative DEI metric, while many other companies include DEI goals and accomplishments as part of subjective individual or strategic performance metrics.

For companies looking to pursue DEI goals aggressively, this raises important questions on the best way to:

- Hold executives, boards, and companies accountable for real, long-term change
- Tie DEI goals to executive compensation and incentives
- Structure incentives for maximum efficacy
- Define the most meaningful DEI metrics to link to compensation

Every company is different, so the advice in this article is not overly prescriptive. Instead, it is intended to help companies ask the right questions about how to best track and reward DEI advancement in your organization.

1. Where is our company today on DEI? Where do we want it to be? By when?

Before you can design an effective incentive plan, you must determine and clearly communicate your organizational DEI strategy and objectives. What do you want to influence, for whom, and over what time period?

It is essential to give full attention to all aspects of DEI. Companies often focus on representation—something that is easier to see and measure—at the expense of equity and inclusion, which may be less apparent, but are critical to an effective and successful DEI strategy.

Like any other incentive metric, you need to be able to measure DEI by identifying the key outcomes you desire and understanding where you are today on these crucial issues. You need to know where you're starting from, where you want to go, and how you're going to get there. Examine your current data, benchmarks, and goals to form a level set and then define how you will quantify current state, goals, and progress along the way.

Finally, build consensus around the implications of the status quo, ultimate goals, and metrics for evaluating success. Set specific time frames to inform compensation goals and ensure accountability.

2. How will we create an environment to support real DEI change?

Metrics are not magic. Your organization won't change, and you won't achieve your DEI objectives just because you decided to add metrics to your incentive plans. You need to set your company up for success by creating a culture that will support change in DEI. This means lining up authentic support from leaders of your compensation plans, and also from your board and other stakeholders.

Effective programs, plans, and policies will help drive a more diverse workforce that feels fully included in all aspects of their work and are treated equitably for all opportunities.

3. Will we use the Short-term Incentive (STI) Plan or the Long-term Incentive (LTI) Plan?

Most companies that incorporate DEI metrics today do so in their short-term incentive plan, measuring and rewarding for annual, incremental progress in their DEI objectives. However, achieving DEI objectives is a multi-year, on-going endeavor, and so perhaps better suited for the LTI plan. Since the LTI delivers the most significant portion of compensation to US executives, it takes a brave organization to be serious about long-term change and place this part of their executives' pay at risk for DEI achievement.

4. What DEI metrics will we track?

DEI metrics will vary by company and need to be tied to the company's overall DEI objectives and strategy. If you've established a robust DEI program, you won't be able to use all of the goals you've established in your incentive plans.

Most organizations that use DEI metrics today are measuring achievement of representation. For example, BIPOC or women as a percentage of the total workforce or in leadership positions. Some companies have also taken the next step to measure inclusion for diverse employee populations through improved results on employee surveys and other feedback channels.

No organization that we are aware of uses an equity-related metric—perhaps rightfully so. While the "E" of DEI is as essential as representation and inclusion, most see treating all employees equitably in pay, promotions, and other opportunities as a requirement rather than something that should be rewarded by incentive compensation.

5. Will our measures be quantitative and objective, or qualitative and subjective?

Will you measure progress numerically against predetermined benchmarks or goals, or will you use qualitative goals that give your board compensation committee discretion to determine the ultimate level of achievement? Often quantitative DEI goals are distinct goals that measure objective results in representation or inclusion (measured by employee survey scores, for example), or both. In contrast, qualitative goals might be part of broader strategic goals, of which DEI might be just one part.

Under either approach, you will need to decide how much weight to give the DEI metrics. The average weighting for standalone DEI metrics in an STI is only about 5%, below the level typically thought to be motivational. However, some firms are increasing this to 10%-15%—recognizing that a higher weighting is necessary to affect real change.

6. Who will be held accountable?

Who will have accountability for DEI metrics in their incentive plan? C-Suite executives only? SVPs and VPs? Will you also include directors, managers, or all incentive plan participants? Acknowledging that most actions affecting DEI happen within the broader workforce, some companies prefer to start with smaller, more manageable groups of their most senior executives first, and plan to expand deeper into the organization over time.

Decide if your program will be limited to the US or North America, or extend globally. How might metrics differ by region or country to best reflect local DEI challenges, and how will you maintain parity for incentivized employees across your organization? How might you communicate differently to, and across, these groups and their stakeholders, depending on local cultural needs?

Ultimately, the success of your DEI incentive metrics will depend on how you address each of these questions and calibrate them to the needs of your business, the challenges and strengths of your culture, and your company's specific goals around DEI.

Mercer can help you at every step of your DEI journey. Draw on our expertise, whether you are evaluating your DEI strategy and determining your starting point and desired goals, or if you are introducing DEI metrics to drive an already robust DEI strategy.

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