# Fall 2022

# Director Pulse Survey

HUGESSEN CONSULTING

# Introduction

Riding the momentum from 2021, 2022 can be marked as another year of recovery. Ready to leave COVID behind, many companies picked up speed operationally. Nonetheless, economic pressures are keeping boards on their toes as they act to balance short-term financial expectations, long-term value creation and sustainability commitments made to their various stakeholders. As the business environment becomes more precarious amid heightened inflation and recessionary fears, a large proportion of directors (62%) nevertheless observed above target financial performance in 2022 and are anticipating salary budget increases to be above historical levels going into 2023. Overall, the results of this year's edition of our Director Pulse Survey are encouraging, as corporate directors expressed an optimistic tone to wrap up 2022. Other insights summarized herein relate to the use of discretion in incentive payouts, the incorporation of ESG (Environment, Social, and Governance) metrics into incentive structures and a new feature on Board Effectiveness insights.

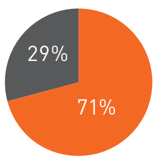
# Key Takeaways

- Directors expect 2022 performance results to be generally positive, with at (25% of respondents) or above target (52%) incentive payouts and moderate application of discretion required (29%).
- 95% of directors believe the current inflationary environment has had (or will have) a direct impact on go-forward executive pay levels. Going into 2023, close to one third of respondents are expecting above average salary budget increases (i.e., 4% or above).
- This year, once more, the 'war for talent' was identified as the preeminent board priority, followed by the effects of inflation and cybersecurity. The most challenging executive compensation issues for boards remain performance assessment & target setting and assessing pay level adjustments.
- The prevalence of ESG metrics in executive incentives continues to increase, particularly within long-term incentive programs (LTIPs).
- Over half of directors believe their boards are very well positioned in terms of diversity of skills, capabilities, and perspectives to oversee the strategy and create value for the organization.

# Methodology

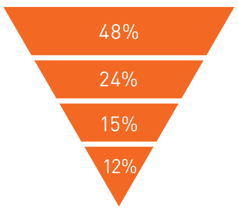
This briefing summarizes the responses of 66 director participants collected in the final two weeks of November 2022, representing directors who sit on a wide range of for-profit Canadian company boards from an ownership, industry, geography, and company size perspective. We note summary statistics may not add to 100% due to rounding.

## Company Type




- Public issuer
- Privately-held, for-profit company

## Size




Mid Cap (between $1B and $5B)

Large Cap (greater than $5B)

Small cap (between $250M and $1B)

Micro cap (less than $250M)

## Geography

36% Ontario
32% Alberta
9% Quebec
18% Other Canadian Province or Territory

5% Outside of Canada or the U.S.

## Industry

| 32% | 11% | 24% | 5% | 3% | 9% | 2% | 5% | 11% |
|---|---|---|---|---|---|---|---|---|
| Energy | Materials | Financial Services | Real Estate | Consumer Goods/ Retail | Industrials | Technology and Telecommunications | Healthcare | Other |

# 2022 Performance & Incentive Discretion

Overall sentiment on 2022 performance and corresponding incentive payouts was notably rosy (Exhibit 2), and particularly so among Energy companies. The anticipated need for discretionary STIP adjustments has levelled off at approximately 30% (consistent with 2021 and much lower than the 69% figure observed in 2020). The use of discretion is skewed towards smaller organizations, with no large-cap directors indicating the expected need to apply positive discretion this year. We suspect that the more stable conditions in 2021 and 2022, along with more 'flexible' incentive frameworks being adopted (e.g., wider performance ranges), have enabled performance assessment structures to operate as intended, and consequently reduced the need for discretion.

How has the current year's financial performance compared to estimates / expectations at the beginning of the year?

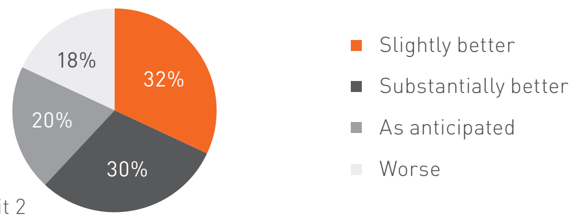



Exhibit 2

What do you expect year-end incentive payouts to be for executives of your company if no special action is taken?

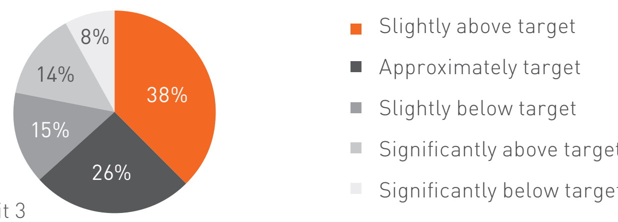
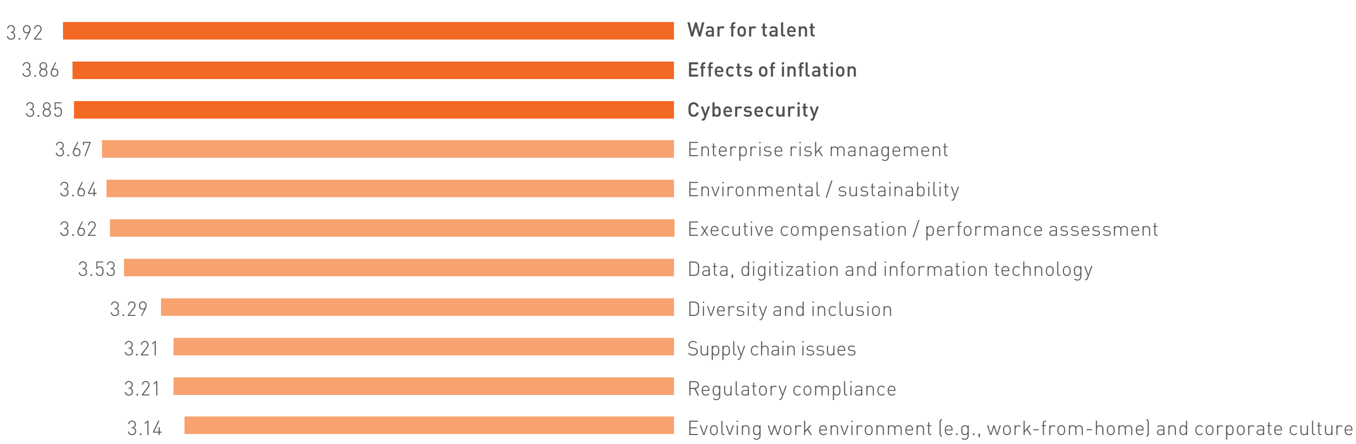



Exhibit 3

# Top Board Priorities for 2023

Building on **last year's survey**, we asked directors to identify top board priorities going into 2023 (Exhibit 4). The top board priority overall remained the 'war for talent', followed by the effects of inflation (which shot up to #2). Environmental Sustainability was identified as the top priority among Materials companies and #2 among large-cap companies. The continued focus on environmental issues for boards, along with other 'Social' matters, has fuelled the adoption of ESG-related metrics, as we detail below. Meanwhile, the most challenging human capital issues faced by boards were identified as talent acquisitions / retention, succession planning, and pay-for-performance alignment, in that order.

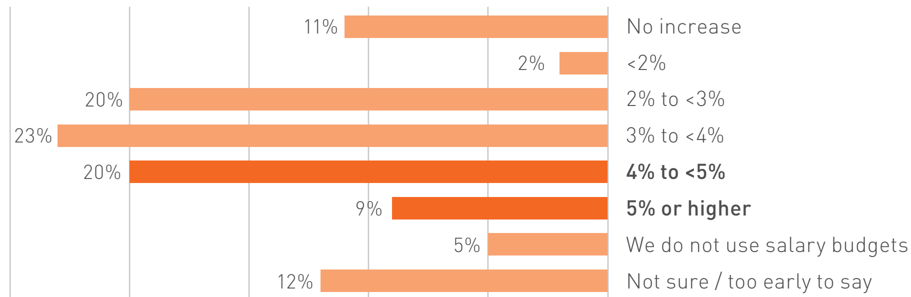
Going into 2023, on a scale of 1 to 5, please rate the importance of the following topics to your Board in the coming year. 1 signifies an issue of minimal importance, while 5 indicates an issue of very high priority. [Exhibit 4]



## Inflationary Pressures in Compensation & One-time Awards

95% of respondents recorded that the current inflationary environment has had (or will have) a direct impact on go-forward executive pay levels, with 13% expecting a significant impact. As such, compared to last year, the proportion of respondents expecting a 4%-or-above increase in the executive salary budget has more than tripled (29% vs. 9%) (Exhibit 5).

What do you anticipate the executive salary budget increase to be for the upcoming year? [Exhibit 5]

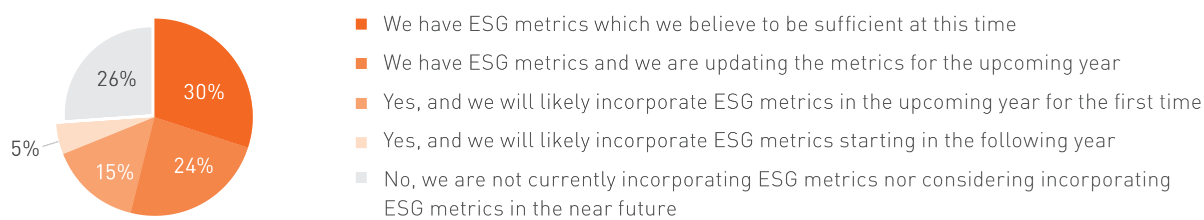



On the topic of one-time awards, which we have not asked about in a few years, we observed their usage decreasing materially since 2018 (58% in 2018 vs. 36% in 2022). Where they were used in 2022, they most commonly took the form of retention awards (58%), followed by on-hire awards (33%). One-time awards can be appropriate in exceptional circumstances but, as the name suggests, are not intended to be perpetuated. Investors and proxy advisors regard the repeated use of one-time awards as a signal of poorly functioning incentive programs.

## Environmental Social & Governance ("ESG") in Compensation

Since our 2018 survey, respondents who have or are expecting to implement ESG metrics in incentive plans soon have increased from the number of 40% to 74% (Exhibit 6). While the number who indicate their companies currently have ESG metrics (55%) is up versus last year's review (46%), the percentage who are expecting to introduce metrics this year or next (20%) is down materially year-over-year (37%). This could be a result of the survey sample demographics or an indication that the pace actual of adoption is slower than anticipated. For those companies who are introducing ESG new metrics, the most common categories are Climate / Environment and Human Capital (e.g., Diversity & Inclusion, Employee Engagement). Historically, ESG metrics have been more commonly included in annual bonus plans, however they are increasingly showing up in LTIPs (22% of respondents, skewed towards large and mid-cap companies). Overall, larger companies face more internal and external expectations to play a leading role in the integration of ESG into compensation and have the resources to do so. In contrast, we observe that smaller organizations are less likely to implement ESG metrics into their incentive programs (e.g., 75% of respondents at micro-cap companies are not considering implementing ESG incentive metrics).

Is your board considering the use of environmental, social, and governance (ESG) metrics in any incentive program for executives? ESG encompasses many topics, including climate, sustainability, diversity & inclusion, etc. If your company incorporates standard safety metrics such as total recordable injury rate (TRIF), please note that we are excluding those from "ESG" metrics for the purposes of this survey. [Exhibit 6]



# Board Effectiveness & Compensation

Board Effectiveness evaluations help boards diagnose the areas where they can make adjustments to better their odds at making choices that drive sustainable value. 72% of respondents indicated that evaluations are conducted annually on the boards they serve (Exhibit 7), with nearly 87% of large-cap directors valuing the use of a 3rd party to support the effort.

Board composition, as one of the most direct levers of board effectiveness, continues to be one of the most discussed topics, particularly as it relates to changing skills and perspectives warranted to oversee strategy. 61% of directors believe their boards are very well positioned in terms of skills and capabilities (Exhibit 8). At the same time, only 56% believe that their boards are very well positioned in terms of having the diversity of perspectives warranted to adequately oversee strategy and support value creation (Exhibit 9).

How frequently does your Board conduct a Board Effectiveness evaluation (or similar intervention)?

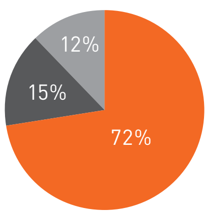



Exhibit 7



Does your Board have the skills and capabilities warranted to appropriately oversee the strategy and create value for the organization?

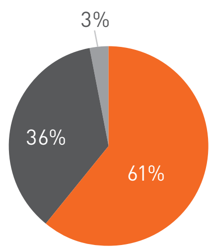



Exhibit 8



Does your Board include the diversity of perspective warranted to appropriately oversee the strategy and create value for the organization?

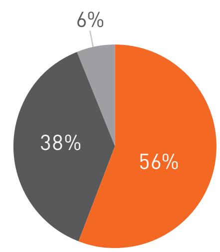



Exhibit 9



# Conclusion

The 2022 edition of our Director Pulse Survey indicates a positive tone as companies have been able to steer further away from COVID crisis management and bring focus back to strategic initiatives. The 'war for talent' remains the top concern in boardrooms, and as heightened levels of inflation persist amid economic softening, boards must tackle complex decisions around retaining top talent and setting performance expectations. Although ESG detractors are having their time in the spotlight, Canadian boards are steadfast in maintaining momentum in these areas. The balancing of financial performance and sustainability commitments is making its way into incentive design decisions more than ever, an indication that a real shift in prioritization is upon us.

**For those with questions or who are interested in more in-depth and customized analysis, please contact John Skinner—jskinner@hugessen.com, Michael Small—msmall@hugessen.com or Solomon Coupal—scoupal@hugessen.com**

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