SHORT-TERM OR LONG-TERM: CONSIDERATIONS FOR METRIC SELECTION

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The decision of whether a performance metric should be used in the short-term incentive plan or long-term incentive plan may impact its efficacy and ability to motivate plan participants. **This article outlines considerations in determining whether the selected ESG metrics may be more appropriate for the short-term or long-term incentive program.** The preceding article of our series addressed the different considerations when selecting what ESG metrics could be included in a compensation program, and the following article will discuss key considerations when determining the weightings of the selected metrics. While the focus of this series is on ESG metrics, we note that many of these principles can be applied to other types of metrics that companies may wish to implement in their incentive programs.

The decision of whether to include ESG metrics in the short-term or long-term incentive design depends on a company's specific goals and priorities. However, there are some general factors to consider when making this decision.

- Short-term incentives are typically tied to annual performance goals, while long-term incentives are designed to reward performance over a multi-year period.
- Companies must balance including ESG metrics in short and long-term incentive design with their respective priorities over those periods

Key Assessment Considerations

Key considerations in determining whether an ESG metric should be included in the short or long-term plans include feasibility and comfort in forecasting, and the purpose and philosophy of the metric. We outline further commentary on each consideration below.

Feasibility and Comfort in Forecasting

Organizations should consider their ability to accurately forecast the selected ESG metrics over a multi-year period, as well as their ability to appropriately track performance over that time. Internal capacity to gather and analyze the ESG data, as well as ability to report performance to internal and external stakeholders should also be considered.

When determining the feasibility of predicting metrics over the long-term, answering the following questions can often provide additional insight:

Key Questions	Insights
Have the metrics been tracked for multiple years?	Experience with multi-year tracking can increase confidence that the selected metric can be accurately forecasted and adjudicated over the long-term.
How volatile / unpredictable are the metrics?	Generally, more predictable and controllable metrics may be preferred as incentive plan metrics, specifically in the long term where one negative (or positive) outcome in any given year could impact the entire multi-year grant’s outcome.
Would long-term targets be vague or focused?	While focused goals set clear expectations, early misses may lead to disincentivized participants over the course of the performance period.

Generally, if there is less comfort in forecasting and tracking a metric, it may be better suited for the STIP rather than the LTIP as the ability to accurately forecast and assess performance over a multi-year period is paramount in building a strong long-term plan.

Additionally, we acknowledge that some metrics may be inherently short or long term in nature, and while the organization may be able to reliably track and forecast the metric over a 3-year period, it may still be most suitable in the STIP.

- E.g., more "social" metrics (e.g., customer satisfaction) can often be effectively calibrated over one year, while environmental metrics (e.g., GHG emissions intensity) are usually better-suited to an LTIP given the longer-term nature of the metrics.

Purpose and Philosophy

Companies should consider the purpose and philosophy of the compensation program, and whether an STIP or LTIP is better suited to accomplish these goals. The guidelines below illustrate "typical" areas of considerations, and where an STIP or LTIP may be more favourable.

Rationale for Inclusion in STIP	Rationale for Inclusion in LTIP
Greater **ability to exercise discretion**	**Greater complexity** in calibrating and integrating metrics
More **year-over-year flexibility** in program design	More significant overall **impact on payout**
Larger **number of employees** eligible for the award	Stronger **alignment with the long-term** nature of ESG metrics

Summary & Next Steps

It is important to note that the successful incorporation of ESG metrics into the STIP and LTIP is usually an iterative process, and few companies "get it right" on the first try. For companies new to incorporating ESG metrics into their incentive programs, the first step is often to incorporate the metrics into the STIP to gain comfort and experience with the metric, and to later incorporate into the LTIP. Additionally, both short-term and long-term ESG metrics should not be used in isolation, but should be part of a broader, long-term ESG strategy. By using relevant and meaningful ESG metrics in executive compensation plans, companies can incentivize and reward sustainable business practices in the short-term while also driving positive impact over the long-term.

Ultimately, the decision of whether to include ESG metrics in short-term or long-term incentive design should be carefully considered and aligned with a company's overall strategy and priorities. It's important to strike a balance between incentivizing quick action and ensuring long-term sustainability.

In the next article, we will provide a more in-depth discussion on how much weight ESG metrics warrant in compensation design.

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