Industry overview — as it relates to executive compensation

Fast-moving consumer goods

The fast-moving consumer goods (FMCG) sector and climate change are deeply intertwined — the sector is a major cause of GHG emissions but is also heavily impacted by it. 26% of global GHG emissions come from food production, with food waste and deforestation also major contributors to GHG emissions. Climate change in the form of hurricanes, flooding and fires etc. presents an inherent risk to FMCG companies as it effects disrupt supply chains, reducing raw material supply and increasing prices.

Drivers of action

As with the retail industry, consumer demand is a significant driver of action against climate change for FMCG companies. For example, due to rising consumer demand, companies such as KFC, Subway and Burger King are incorporating alternative, plant-based meats into their menus. Danone, Starbucks and Budweiser, among others, are reducing their plastic use, and some major brands have committed to science-based targets and One-Plant Business for Biodiversity (OP2B) initiatives to work toward Paris-agreement goals.

Investor demand is also a strong driver. In 2020, an investor coalition representing $11.4 trillion in combined assets (over 90 investors) signed a letter to six of the largest companies in the fast-food sector to enact meaningful policies and targets to reduce the carbon footprints of their meat and dairy supply chains and to urge companies to publish quantitative, time-bound targets and commit to publicly disclose their progress. A further indicator of investor sentiment and appetite for climate-focused FMCG companies is that Oatly and Beyond were among the most valuable FMCG initial public offerings in recent years, with other plant-based food IPOs expected this year or next.

Regulatory drivers are also at play with many countries having or adopting legislation to regulate single-use plastic products such as plastic bags and straws. The European Union and U.K. are leading the way with additional measures to reduce waste. In February 2020, top producers of plastic waste, including Coca-Cola, Pepsi, Nestle, Crystal Geyser, Mars, Danone, Mondelez International and P&G, were sued by the Earth Island Institute, a California environmental group. The ongoing suit seeks to hold these companies accountable for their plastic pollution and demands they stop advertising products as “recyclable” when they are, in fact, largely not recycled.

Challenges for the industry in tackling climate change

Supply chains play a vital role in climate change given the significant amount of resources used for consumer goods production. As with the retail industry, this presents a challenge for FMCG companies to address climate change, given the indirect impact of their emissions from suppliers. There is no formal requirement to reduce emissions for FMCG supply chains, and so far we see the world's largest meat, fish and dairy producers failing to match sustainability commitments of the high-street brands they supply. In fact, more than 70% of meat and livestock companies do not have emissions targets, and the agriculture, food and forest products sector scored the lowest for coverage and quality of climate-risk disclosure across non-financial services sectors. Having said that, some major FMCG companies are taking responsibility for their supply chains by helping suppliers enhance energy efficiency, adopting soil and water management practices and prioritizing zero-deforestation.

Further, there is a challenge for the sector known as the "consumer dilemma" — this describes the extent to which a consumer is willing to pay more for environmental packaging and/or prioritize instantaneous shipping. There are thought to be broadly two types of consumers:

1. **Survivalists,** who are more income-restrained and therefore more likely to opt for cheaper goods even when the production of such goods is not environmentally-friendly

2. **Selectionists,** who have more disposable income and therefore can be more brand-loyal and allow purchasing decisions to be based more on values around sustainability, while tolerating the higher costs

Most consumer goods companies will not want to sacrifice one customer type over the other, so there would need to be some shift in certain aspects of their portfolios to maintain market share while offering some environmentally produced and packaged products.

What are companies measuring and reporting?

Many companies in the sector have joined the Science Based Targets Initiative and are setting their emissions reduction targets under one of three categories: 2°C, well-below 2°C and 1.5°C.

In addition to GHG emissions reduction targets, other metrics being measured and reported include:

- Energy and water consumption and efficiency
- Plastic usage (including single-use plastic usage)
- Waste management: recycling and reusing
- Energy sources used to power plants
- Investment in and efficiency of smart technology to optimize production, source to production (how locally are materials sourced)
- Sustainable farming and responsible sourcing

Aligning climate goals and targets with executive compensation

As in retail, there is seemingly a disconnect between the climate change strategy, actions and initiatives being taken or committed to at the company level and how it is being embedded within and driven by executive compensation. Currently, a minority of FMCG companies (11%) have an environmental-related goal in their executive compensation frameworks, typically in short-term rather than long-term incentive plans. Where these do exist, disclosure is generally weak and often describes an assessment of progress against key environmental or sustainability initiatives as opposed to tangible, quantifiable goals.

Metrics in short-term incentive plans include:

- Sustainability or recyclability initiatives
- Management of environmental risks
- Sustainability programs such as Together Towards ZERO and Sustainable Economy

Examples of metrics in long-term incentive plans include:

- Reduction of GHG emissions (Co2e)
- Carbon reduction
- Water efficiency

Interestingly, a U.S. FMCG company, one of the world's largest suppliers of fresh produce, adjusted its incentive plans for hurricanes in FY 2021 due to the financial impact extreme weather had on the company.

Challenges aligning climate goals and executive compensation

Metric selection and target setting is seen as a challenge. Companies are finding that choosing a metric or determining which metrics to use in a scorecard that sufficiently represents and measures all of what the company is doing to combat climate change is difficult. They are also finding balancing having metric(s) that are meaningful enough to drive desired behaviors and turn the dial with the company and shareholders' concern about the inclusion of a climate-related metric in the incentive plan diluting existing financial metrics challenging.

Leading company example — Unilever

- **Metric name and description:** “Sustainability Progress Index”, a scorecard that a committee uses to assess the company’s progress against the Unilever Sustainability Living Plan (USLP). The scorecard captures targets such as:
  - Reduction of carbon dioxide emissions from energy from factories per tonne of production vs 2008 baseline (%)
  - Purchasing of crude palm oil from physically certified sustainability sources (%)
  - Achieve /eader/A ratings (number) — relating to DJSI, CDP Climate, CDP Water, CDP Forests, GlobeScan rating providers.
- **Weight in vehicle:** 25% of long-term incentive plan