REWARDING EXECUTIVES AND EMPLOYEES IN SUSTAINABLE POWER GENERATION COMPANIES: IDEAS AND TRENDS FROM 2020 ONWARDS

REFLECTION PAPER

Giovanna Chiara, MBA (Lead Proposals Specialist Offshore Wind, GE Renewable Energy)

Mario Ceron MBA, GRP (Managing Partner, Zereon Associates GmbH)

Zurich, 2020.

– – – – – – – –

Introduction

Rewarding Executives and Employees in any modern company is indeed a science, but also an art. This is also true for Energy companies in general and within those, the Power Generation ones. However, these industries have several specifics that could 1) make the creation, implementation and ongoing deployment of Remuneration schemes not that easy or obvious and 2) conversely, those specifics could also mean an opportunity for the companies operating in that space to succeed in their respective businesses and pay their employee and executive ranks effectively at the same time.

This small study or reflection paper aims to comment on some ideas and trends regarding Remuneration schemes that can help Energy companies thrive from 2020 onwards. To do so, the present document is structured as follows:

- A brief overview on the state of the Energy and Power Generation industries worldwide.
- General requirements of a well-articulated Remuneration system in this context.
- Components of the Rewards' package, how they contribute towards company needs, and possible innovations.
- Conclusions.

We share details on the points above in the following pages.

A brief overview on the state of the Energy and Power Generation industries worldwide

As we all know, there are **major forces affecting business everywhere**:

- Geopolitical turbulences (Brexit, trade clashes, local wars, riots, refugee waves).
- China, India and Asia in general as new economic powerhouses.
- Increased Corporate Governance, Shareholder and Investors' activism.
- Demographic evolution, "baby boomers" ' retirement, welfare state challenges.
- Increasing international and local tax regulatory complexity.
- Worldwide concern and interest on sustainability issues, primary resources use and public health.
- Flatter organizations, new ways of managing performance and leading businesses.
- Changes in how projects are identified, researched into, financed and evaluated.
- Disruption of industries, new "rules of the game", emergence of unexpected players.
- New business and end consumer behaviors, social media and digital purchasing.
- Introduction of Diversity and Inclusion as corporate values in many corporations.
- Technological advancement and digital transformation.

How has all this affected the Energy businesses? Traditionally the industry, whether that was electricity, oil, carbon or natural gas, has had a long and complex value chain, ranging from raw material exploration and procurement, equipment production, energy generation and energy transformation, to storage and transportation, wholesaling, retail distribution, corporate client / end consumer sale, and auxiliary businesses (chemical, financial and others).

Companies operate in one or several different stages of the value chain, facing internationally and locally **fluctuating trade and retail prices** and, often, **government intervention or regulation and geopolitical instabilities**. Overall, there has been **long investment cycles** in large physical assets to be amortized over many years, there are companies with significant **cash flows** at their disposal, and in general, **excellence in operation**, **great engineering**, **mid-long term commercial contracts and safety** have

been priorities. Key performance indicators and Reward systems in the respective companies often reflected the above reality.

Now in concrete terms for the Energy industry[1]: "the fundamentals of what consumers want from their energy providers has shifted in the last years (...) Now they want **safe, reliable, green and efficient energy**. They want energy efficiency programs. They want information. They want choices (...) The use of **digital technologies** to capture and control operational and consumer energy usage is enabling not only new business models to deliver this, but providing the customer valuable information that they can use to make real energy decisions".

Thus, there are three items that perhaps have brought about the most significant changes to the Energy businesses in the last few decades:

- **True sustainability pursuit.** Renewable energy and 'traditional' energy prices have been equating at last (renewable has even registered lower lately), as production technologies matured, and global demand increased. Emerging countries and middle classes demand more and more energy, electric/hydrogen vehicles usage grows, cryptocurrency mining pools are requiring electricity at an astonishing rate. All of that in an increasingly polluted world with resources that are not for free, and in which public opinion and especially younger generations are more and more critical of carbon, oil and nuclear fission productions vs. solar, wind, natural gas, hydrogen or hydraulic / geothermal power.
- **Digital technologies impacting the classic operations**. The digital revolution - Artificial Intelligence, blockchain, cloud, mobile, 3D printing, IoT, smart devices, AR/VR, 5G, etc. – is transforming the way the industry operates: smart grids; automation of resource, climate and geological prospections; machinery design and prototyping;, chemical, fluid mechanics or thermodynamics analyses; operations' set-up and control; inventory management; optimization of energetic flows; real-time maintenance and self-repairs; immediate supply and demand matches; etc.
- **Digital technologies impacting the Energy business models themselves**:
    - They have allowed a myriad of new, enormously flexible players' entry into the industry, often with lightweight or no assets and innovative ideas on how to use those.
    - They have enabled the evolution towards sustainability itself and a whole range of new business opportunities (quantum physics deployment, for example).
    - They have allowed the emergence of "prosumers", or players that at times distribute the excess of energy they do not use to other players instead of to the grid, and consume directly from others when they lack enough energy, thus bypassing traditional markets and creating parallel ones, maybe creating decentralized blockchain exchanges, etc.

---

[1] "Digital Transformation in the Energy and Utilities Sector", I. Wright, Risk and Compliance Magazine (Deloitte roundtable transcript), 2018.

Companies are reacting to all of this by establishing alliances (see Fig. 1 below), doing M&As or acqui-hires, and launching their own incubators, venture capital arms and platforms to create the type of disruptive ecosystems necessary to compete in the new scenarios, even becoming a totally new business in the process, coming from a well-established and conservative, traditional one.

Fig. 1: Saudi Aramco and General Electric announce joint wind turbine venture

Source: "The New Economy", E. de la Harpe, Dec. 2016.

And, obviously, companies are also investing significant amounts of time and money to organically improve parts of their back- and front-office operations, in critical investment areas overall such as [2]:

- **New Digital Cores**. Adopting a new technology base. Cloud, internal or hybrid, with strong cognitive / 'smart' computing ingredients.
- **Industry Disruption**. Accelerating own innovation and R&D.
- **Smart Utility Operations**. "The walls talk, the systems talk, data abounds (both structured and non-structured)" – there is plenty of rich information to be leveraged upon to generate, distribute and sell energy.
- **Heightened Customer Expectations**. Delivering corporate clients / end consumers alike retail-like, user-friendly experiences, especially in service phase.
- **Increasing Efficiency**. Streamlining processes.

---

[2] "Digital Transformation in Energy and Utility companies: a point of view", SAP / IBM, 2017.

All of this will need to be reflected on how the industry attracts, retains, engages and recognizes its Executives and Employees, what metrics are they rewarded by, and how to make those Rewards effective.

General requirements of a well-articulated Remuneration system in this context

The requirements of a Remuneration system for almost any company type perhaps could be summarized as shown in Fig. 2 below:

Fig. 2: Requirements of a well-articulated Remuneration system
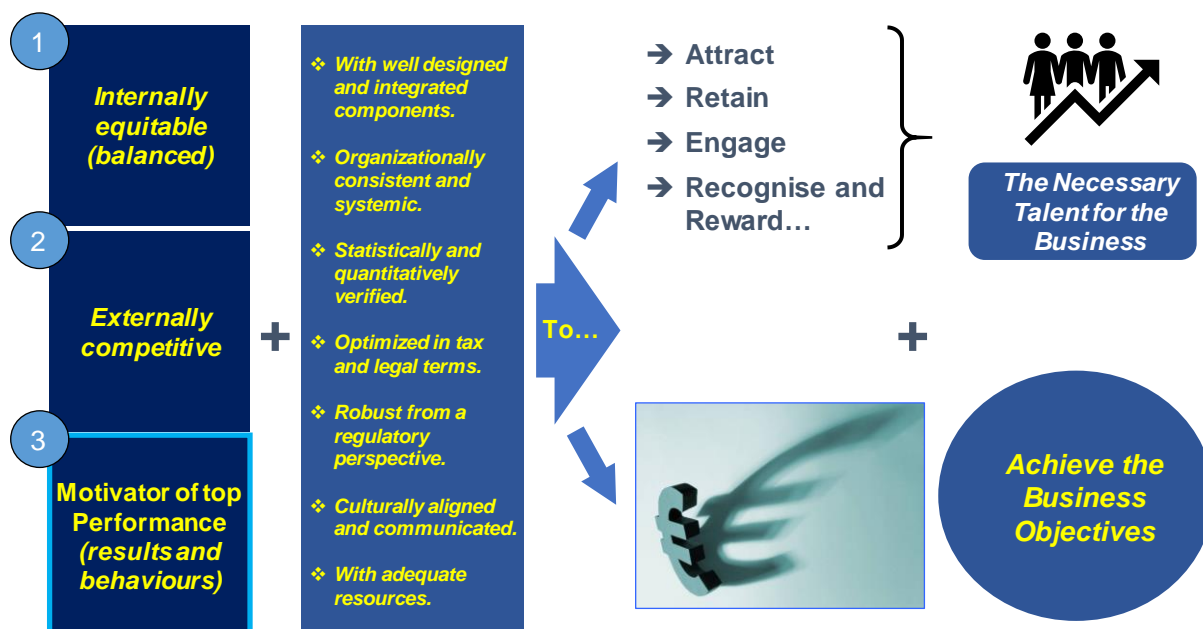
Source: "Total Rewards Management" Training Book, WorldatWork (American Compensation Association), other WorldatWork materials, and self-elaboration.

Typically, with long cycles in the business and with top level safety and sustainability priorities on top of financial, commercial and operational targets, the Energy industry has been characterized by **often long-term, internal careers** and promotions, and **long-term and diverse metrics' evaluations** - it is frequent that a person has lifetime employment and many jobs inside a single company even today.

Rewards, as compared to other industries and with some improvement aspects, have normally been **high in many instances**: many companies had **1) stable, cash-plentiful** businesses, **2) a highly qualified workforce** with engineering and scientific master's

degrees or tertiary education levels to take care of, and **3) a lack of skilled talent for certain positions** such as scarce operations' professionals (Oil Prospectors, specialized Chemical Engineers, Superconductor Lab Supervisors, Nuclear Physicists, etc.), people with strong relationships with the different regulators, managers of the largest accounts, contracts or clients, etc.

In the new world that is coming, however, there will probably challenges that the company Rewards will need to address, such as the following:

- **Intensified war for talent**. Now, competition for the best people will not just be against other companies in the same industry, but with a great deal of new entrants, and indeed companies from other industries, especially for Science, Technology, Engineering and Mathematics (STEM) profiles, software developers, AI, blockchain, data analytics or IoT experts, etc.
- **Much shortened, open-sourced and sustainable projects**. People will have to be rewarded for their capability to work in "fast and agile", more entrepreneurial projects within collaborative internal and external teams, communities and alliances, in a way which is systematically caring towards the environment and the stakeholders - different from the classic industry's more stable, long term situations and purely internal team / company concerns.
- **Different work approaches and company cultures and more diversity.** Work relationships will be flatter, more informal, risk taking, and with a higher degree of variety in terms of gender, ethnicity, handicap status, age, religion, sexual orientation, etc., which will require new metrics and recognition schemes in an industry that has historically had slightly risk-averse or safety / procedure-oriented company cultures and generally "uniform" workforces.

This will probably mean that the Reward systems of old, to be well articulated today, will need to be reviewed in depth, possibly along the following lines:

- **Clear recognition of swift and effective technology learning, adoption and deployment**, and less importance of years of service / personal tenure with the company.
- More focus on **specific project achievement goals and profitability, prototype success, new business** generation, and **effective work in internal and external teams –** changing and fluid.
- Even more emphasis on **sustainability KPIs and other aspects** (corporate governance, codes of conduct, fulfillment of values, diversity and inclusion, safety) - **at all organizational levels**.
- More oriented towards **horizontal / 'mosaic'-type careers / competency acquisition**.
- More **external comparisons** of Rewards vs. rigid and often obsolete internal job grading systems.
- **Adjustment of all unjustified existing Compensation gender gaps,** now required by law in many countries and for many years neglected.

- Reward systems **administered with new technology** themselves, supported by true experts and with enough dedicated resources.
- Adequate **centralization vs. decentralization** in the Rewards' decision making.

In order to follow these lines, **new proportions of the Reward packages / pay mixes**, and a different **configuration of its individual components** across the different collectives, will be required.

Components of the Rewards' package, how they contribute towards company needs, and possible innovations

The Reward packages in most companies can be represented overall as shown below.

Fig. 3: The Rewards' package and an approach of Total Rewards
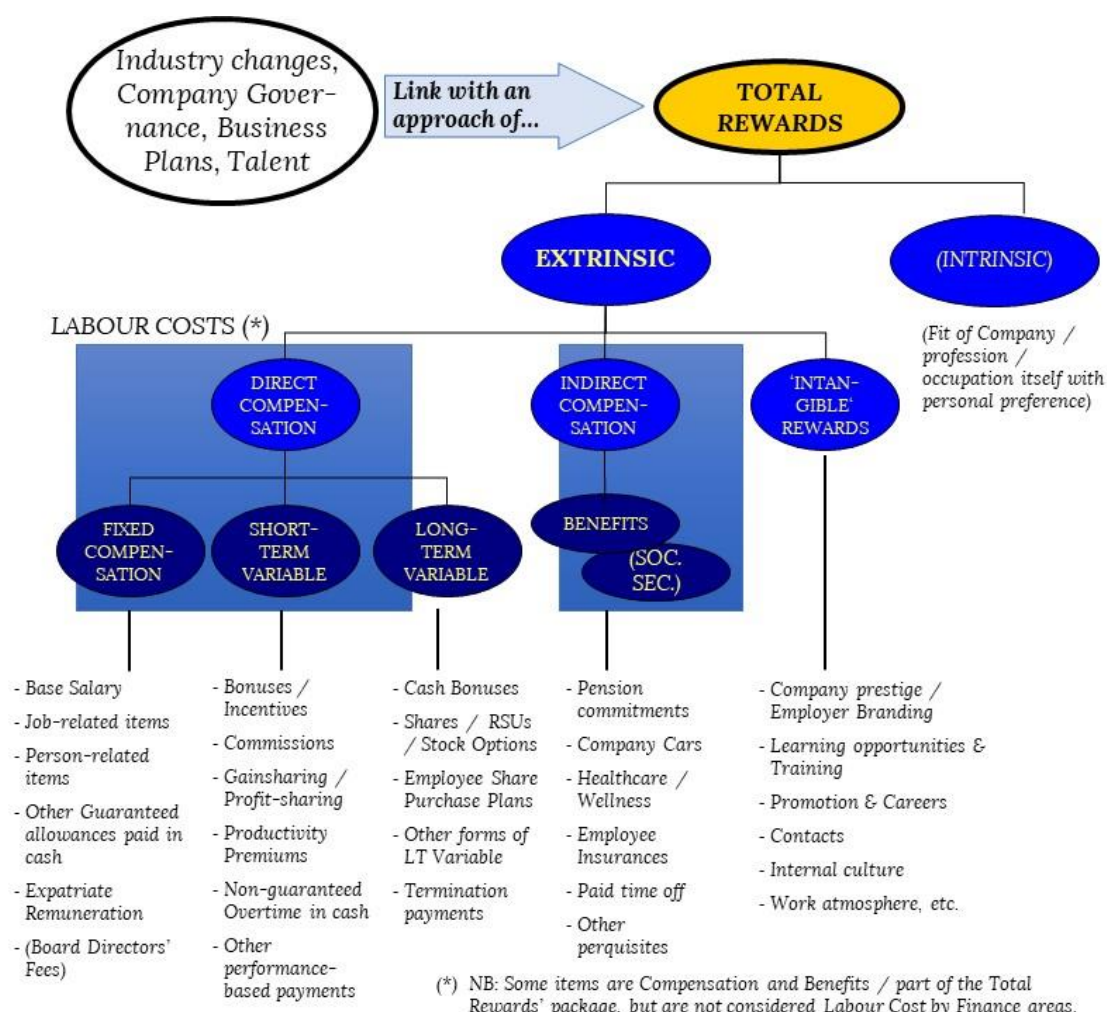
Source: "Total Rewards Management" Training Book, WorldatWork (American Compensation Association), 2018, other WorldatWork materials, and self-elaboration.

A relevant question that companies ask themselves is: **how do we modelize all this for each Company collective**, in the context of evolving business needs, technology shifts and Executive / Employee expectations, whilst simultaneously achieving the new culture and results?

A wise answer to this question often depends on adopting a **"Total Rewards" approach**, by which the corresponding Remuneration packages are considered both from a holistic perspective, and from an 'individual elements' one: the Total Reward has to consider all necessary elements, make the investment worth it, offer a **fair Value Proposition as a whole** to the professionals and be competitive, and at the same time, has to contain the **right blend of components** that will lead such professionals, teams and company in the desired direction. **Not all Total Rewards components are the same or serve the same purposes** - over-use or under-use of each does have consequences.

In the Energy industry, depending on having or not long-term cycles, cash availability, company size, geographies, market positioning, share price growth stability, etc., there has usually been somehow a "classic" Energy industry Total Rewards approach, that can be compared against innovations / changes that might be required from 2020 onwards. Such a possible comparison is made herein (Fig. 4).

Fig. 4: Configuration of Energy industry's classic vs. 2020+ Total Reward packages

TOTAL REWARDS PACKAGE ELEMENT	Classic approach	Innovations from 2020 onwards
Fixed Compensation / Salaries **Pensions / Benefits**	✓ Relatively **high Salaries and Pensions and generous Benefits** (insurances, free or discounted gasoline, free electricity, etc.). ✓ **Highly correlated with tenure / years of service**, or even formally linked to those.	✓ **Proportionally less important,** and **more based on performance, internal balance** and **external market movement.** ✓ Possibly, more deployment of **sign-on bonuses** for scarce talent attraction purposes, along with other Reward elements.

(cont.)

TOTAL REWARDS PACKAGE ELEMENT	Classic approach	Innovations from 2020 onwards
Short-term Variable Pay	✓ **Not very demanding and/or relatively small target percentages.** ✓ **Commercial Incentives** oriented more toward**s client service and contract renovation ("farming")** vs. new account wins ("hunting").	✓ **Continuing importance of Client Service Incentives** – still often source of steady cash for the companies. ✓ However, at the same time, higher Variable and with larger emphasis on **short-term project success, teamwork and new business wins**. ✓ Importance of rewarding the **success of the new prototypes / ventures / milestones / tech adoptions / businesses**.
Long-term Variable Pay	✓ **High use of Rewards based on mid-term projects, long-term incentives and Share-based Remuneration**, often based on individual company Earnings per Share and Share Price.	✓ **Also very important**, but more linked to **1) comparison vs. external peer groups** (proxy advisor guides or others), and **2) modern company investor/VC valuations and ventures' financial exit criteria**.
International and Expatriate Remuneration	✓ **Significant**, depending on job. ✓ Compensation / Mobility areas aware of **international Tax and Legal considerations**.	✓ Probably, **as important as before** except in specific cases (for example, if Exploration activities decrease)**, including Rewards' tax and legal localization as necessary,**
'Intangible' Rewards	✓ Good **training** opportunities, **brand strength**, **internal careers**.	✓ Combined with **external experience**s and **'flatter', more informal and more entrepreneurial atmospheres** at work.
Performance-related pay overall	✓ **Not totally predominant**, except in large US multinationals, or companies with aggressive internal employee rankings.	✓ **Much more pervasive and flexible, technology-enabled, and with much more immediate feedback.** ✓ **Premiums** expected for **entrepreneurial employees** who bring in **innovations and new deals or ideas**.

Source: self-elaboration.

The way to design and implement the cited innovations or changes from 2020+ will require **attention to the concrete company situation** and the **necessary Rewards expertise** to lead the transition effectively. This can be as ambitious as desired: it could be that a given company decides to pay some of their employees in cryptocurrencies for a specific project success, offer tokens exchangeable in different digital or even physical marketplaces as a part of their rewards, and so on.

Conclusions

As soon as the Energy company reaches some complexity in terms of divisions/new innovations/new business lines/new areas and countries, at the same time that it fully embraces the new sustainable and digital paradigm, it will have to **make decisions as to how many Reward systems will be necessary, which ones and why**, splitting the information also by collective (job levels and special ones that may require separate treatment, such as Expats, certain Engineers, etc.). This can often be expertly shown on a specific table, and experience shows that companies are sometimes not fully aware of their current situation, nor of the possibilities available, when faced with their own actual and potential picture.

Having 2, 3, 10 or 40 Reward systems, will depend on many factors that a Remuneration professional can study to make proposals to the organization, in terms of strategy to follow; technical redesigns; packages' configuration and positioning at, below or above market; tax and legal aspects; implementation and deployment matters; administrative convenience; etc.

With that, both industry traditional and newer challenges can be tackled more effectively in the future. An **improved Remuneration system** in the corresponding Energy company can indeed foster **sustainability, speed, success of the digital transformations** and, eventually, **better business** and **greater satisfaction** by its Executives, Employees and stakeholders overall.

. . . .

For more information on this paper and our services:

Email: *contact [at] zereonassociates (dot) com*

Web: *www [dot] zereonassociates (dot) com*