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Integrating CSR Criteria in Executive Compensation

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Research published in the *Strategic Management Journal* studied the increasing governance practice of including corporate social responsibility (CSR) based provisions in executives' compensation packages and the effects of such provisions on company outcomes. The authors note the rise of this practice, 37% of S&P 500 companies in 2013 from just 12% a decade earlier, and highlight famous examples – such as Intel tying a portion of its executives' compensation to metrics pertaining to emissions reduction and the energy efficiency of their products. The researchers studied the effects of this practice by examining proxy statements from all S&P 500 firms from 2004-2013 for the inclusion of any executive compensation provisions pertaining to social and environmental performance.

Key Takeaways:

- Increasingly, boards are including CSR-based provisions in executive compensation packages.
- Companies that adopt such provisions engage in more CSR, lower emissions, and more green-related patenting.
- These companies ultimately experience an increase in overall firm value following adoption.

The authors found companies that included such provisions, perhaps unsurprisingly, lowered emissions by 9%, increased green-related patents by 3%, and improved overall CSR ratings by 5% following the provisions' adoption. Interestingly, they also found that companies that adopted these provisions became more long-term focused in their annual reports and, ultimately, increased their overall value (Tobin's Q) by 3%. Finally, the authors found that the effects of these provisions are stronger as the percentage of executive compensation packages tied to CSR metrics increases, such as for companies that link up to 10-15% of total compensation to CSR compared to the 4% average. The authors describe this as the first study to examine this rising governance trend. They argue that their findings suggest that boards may do well to consider CSR criteria in executive compensation packages – or for those that already do, increasing the proportion tied to CSR – to not only boost company CSR efforts but also to direct managerial attention to less salient but still financially important stakeholders of the firm, thereby improving performance overall.

Source: Flammer, C., Hong, B., & Minor, D. (In press). Corporate governance and the rise of integrating corporate social responsibility criteria in executive compensation: Effectiveness and implications for firm outcomes. *Strategic Management Journal*.