Perceptions of the efficacy of sustainability-related performance conditions in executive pay schemes

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This paper examines the efficacy of sustainability-related performance conditions in executive pay schemes at listed companies in the United Kingdom (UK) as perceived by the individuals involved in setting those conditions. It will be demonstrated that it is common practice in the UK for senior executives to receive part of their pay in the form of bonuses and share awards, the value of which awards will be determined by some degree of performance. The performance targets are generally related to financial performance but there is some evidence that performance conditions are increasingly being related to sustainability in some way. This paper considers a number of issues, including a key systemic issue of whether using incentive pay will have a material impact on the behaviour of UK listed companies regarding sustainability issues.

Keywords: incentive pay; performance pay; bonus; share awards

# Introduction

In UK listed companies pay for senior executives will generally consist of some or all of the following elements: basic salary; annual bonus (based on performance, sometimes with some proportion of any bonus paid deferred into shares for a period of time); long term incentive plan (conditional share awards, measuring performance over a three year period, increasingly with a further two year deferral before awards are released to participants); pension (generally in the form of a cash allowance paid with salary); and, expenses (generally immaterial, relative to the rest of the pay package) (Bender, 2007). The performance-related elements of the pay package are the annual bonus and the long term incentive plans (Bender and Porter, 2003; Bender, 2004).

Annual bonuses are generally subject to a basket of targets at each company, the precise structure of which varies from company to company and potentially from year to year. Companies may publish the performance conditions which they will be using for the annual bonus scheme, although disclosure is not mandatory.

Long-term incentive plans will vary in their precise form but current practice is generally conditional share awards measuring performance over a three year period. The performance conditions are usually financial, either measuring performance of some metric within the company's operations (for example, earnings per share, return on capital, cash flow) or some relative market-based performance (total shareholder return relative to a selected group of other companies or a share index such as the FTSE100). Performance conditions will usually be defined in advance and be published. Reward schemes measuring performance over a period of more than one year (therefore including long-term incentive plans) require explicit approval by shareholders (FCA, 2017). Generally, when seeking approval for these schemes, companies will publish the performance targets they intend to use, although disclosure is not mandatory.

With increasing economic challenges related to issues such as climate change, inequality and social inclusion there is an increased focus on how companies take long-term decisions that account for these global and local trends. Environmental sustainability can have an effect on companies in a number of ways and is a strategic issue for organisations (Goktan, 2014). Sustainability can help businesses reduce unnecessary risks, avoid waste and increase energy and material efficiency (Székely and Knirsch, 2005). Several studies have looked for links between sustainability and financial performance factors, but the evidence is mixed, including negative (López et al., 2007, Stanwick and Stanwick, 1998) and positive (Orlitzky et al., 2004; Margolis and Walsh, 2003). However, more recent research appears more confident in finding links between sustainability and financial performance (Wang and Choi, 2013; Gómez-Bezares et al., 2016). Therefore, there has been an increasing focus on how executives within companies are incentivised to include sustainability criteria in their decision making, although there is little research on whether these incentives are actually perceived to influence those decisions in any tangible way.

The remainder of this paper is structured as follows. First we review literature on executive pay, the performance of organisations that use executive pay performance measures and the use of sustainability metrics as part of those performance measures. Secondly we provide a summary of the methods used. Then we outline the data obtained through the use of interviews. Subsequently we discuss the data in relation to existing theory to create our hypothesis. Finally we provide some concluding thoughts.

# Executive pay, company performance and sustainability

Senior executive pay is a subject of public interest (Conyon, 2011). It generates press coverage and comment. The assumption is that executive pay can be used to motivate senior leaders to deliver on strong company performance (Dittmann, Yu and Zhang, 2017). The process of goal setting and monitoring of incentives within executive pay can itself be a motivational strategy (Pepper and Gore, 2012).

The process of setting executive pay has been a subject of interest to UK governments for some years, leading to regular changes of law, particularly where it is perceived that pay levels for senior executives are unwarranted or simply at very high levels (Bender and Porter, 2003). Compensation schemes that are overly influenced by managers can lead to a reduction in long-term firm value (Bebchuk and Fried, 2005; Pepper and Gore, 2012) and a decoupling of pay from performance. Compensation is most often used to encourage risk taking (Dittmann, Yu and Zhang, 2017) which allows firms to grow. However, incentive schemes rarely include a downside measure linked to performance other than the threat of dismissal.

Significant levels of performance-related pay may lead to behaviour which damages the interests of the company (Frey and Osterloh, 2005; Bender and Moir, 2006). Targets might encourage behaviour which satisfies only performance of those targets but is to the detriment of the company generally and to stakeholders (Bender and Moir, 2006).

Linking executive pay solely to share price has been shown to encourage excessive risk while including other measures, such as the cost of debt to the organisation (Bolton, Mehran and Shapiro, 2015) or linking the granting of share options to some performance measures (Bettis et al., 2016), has mitigated some of this risk taking. The introduction of regulation is needed to ensure longer term risk is considered (Bolton, Mehran and Shapiro, 2015) or to introduce measures such as requiring shareholder approval of executive pay which has been shown to have a positive impact on better linking chief executive officer pay to firm performance (Correa and Lel, 2016). However, some standard theories of compensation fail to account for longer term incentives or incentives with different maturity times which could include performance measures over different time periods (Dittmann, Yu and Zhang, 2017).

Major companies, including those listed on markets, are subject to agency: the distinction between the individuals running the companies (the executives who are the agents) and the owners of the company (the shareholders). There is a separation of ownership and control (Shleifer and Vishny, 1997) and the executives face a conflict of interest between pursuing their own interests and pursuing the interests of their employers.

One method of addressing this separation is to align the interests of the principals (shareholders/owners) and the agents (directors, managers). Thus, incentive pay in theory rewards the directors/managers for good performance which benefits the shareholders/owners (Jensen and Murphy, 1990). It is in pursuit of aligning, or attempting to align the interests of owners (shareholders) and agents (managers, executives), that remuneration is used (Arora and Alam, 2005).

A key question is whether incentives in a principal-agent situation can work. Literature appears mixed with a wide range of opinion on whether incentive pay is effective, motivates executives, improves performance or aligns interests: much of the literature is sceptical on all (Bebchuk and Fried, 2003; Bender, 2004; Edmans et al., 2016). However, it is the practice of UK companies to use incentive pay for senior executives (Bender, 2007). Of course, for the pay plans which have been used in research, there may be a selection bias in that only the pay plans which have survived are researched (Gerhart and Fang, 2014).

The UK Corporate Governance Code (2016) recommends that pay within companies is determined by a committee of independent non-executive directors. The recommendations in the code do not mandate a committee of non-executive directors but it is recommended practice and is expected by many institutional shareholders. Remuneration committees will generally use consultants to advise them. The consultants may be employed by the committee or the company, although this may partly depend on the size of the company. There are examples where the company and the remuneration committee (which, technically, is a sub-committee of the board of the company) both hire remuneration consultants. The remuneration committee will determine the company's pay policy in practice (Bender, 2011) notwithstanding that the board is ultimately responsible for the company’s pay policy.

Every three years, companies must obtain the approval of shareholders in a general meeting for their pay policy. The vote is binding: if the company is defeated on the vote, the policy does not stand (Companies Act, 2006, S.439A). Annually, companies must submit a report on implementation of the pay policy to shareholders in general meeting. The vote is advisory: if defeated, the report stands despite the vote defeat (Companies Act, 2006, S.439). Accordingly, there is a practice of engagement between shareholders and the institutional shareholders which have a larger percentage shareholding in the company's ordinary shares ahead of the shareholder general meetings to allow the company the opportunity to obtain the approval of shareholders for the pay policy and practice. This engagement practice also occurs on other business and strategic issues (Chiu, 2014).

There are benefits in using non-financial measures as part of remuneration as they provide information additional to that provided by only financial measures and may also assist companies which have longer term strategic objectives (Widener, 2006). Theories that try to explain how executive compensation packages are set, such as that proposed by Dittmann et al. (2017), focus on how these incentives are designed to encourage a certain level of risk taking to increase shareholder value and do not look at a firm’s performance as it relates to wider societal values such as sustainability. The drawbacks of a focus purely on the economic performance of companies were noted by Jack Welch, former CEO of General Electric who was quoted as saying: “On the face of it, shareholder value is the dumbest idea in the world. The idea that shareholder value is a strategy is insane. Shareholder value is a result, not a strategy. It is the product of your combined efforts—from the management to the employees.” (Guerrera, 2009; Hahn et al., 2010).

Goktan (2014) found a significant negative relationship between sustainability practices and Chief Executive Officer (CEO) salary but no relationship between sustainability practices and bonuses. Therefore, some have argued that pay systems should be used to change the perceptions of executives about, and incentivise behaviour towards, sustainability (Lothe and Myrtveit, 2003; Goktan 2014). The value of incentive payments may be relevant to any performance-related system with sustainability targets (Merriman and Sen, 2012). Indeed, the trend of incorporating sustainability criteria in pay has increased over the last few years (Flammer, Hong and Minor, 2017), and there are calls for this inclusion to be extended across all companies (Burchmann and Sullivan, 2017).

It may be challenging for a company to commit to sustainability measures and initiatives for several reasons including lack of knowledge, a lack of capability to see how policies and practices within the company relate to sustainability and a lack of authority (Searcy, 2011). Some companies struggle to develop and use sustainability measurement systems that cater for all stakeholders, both internal and external (Searcy, 2011). Reasons for a lack of confidence in sustainability metrics include that they may have been developed separately from business activities and have not been linked to business strategy (Székely and Knirsch, 2005). It has been claimed that it might not be possible for common metrics to be used by all industries or all companies (Székely and Knirsch, 2005) due to different cause-and-effect relationships within each company (Tanzil and Beloff, 2006). However, the introduction of sustainability related market indices such as the Dow Jones Sustainability Index, FTSE4Good or the Johannesburg Stock Exchange Responsible Investment Index (previously the SRI Index), as well as a move towards integrated reporting (Villiers, Rinaldi and Unerman, 2014), demonstrates that common practice across sectors is possible at some level.

Effective management of sustainability in a company may require the use of lagging and leading metrics: a lagging indicator is reported after an event and reflects past outcomes. Leading metrics assess activities prior to the event and affect future performance (Tanzil and Beloff, 2006). Both will be relevant to structuring a pay policy. Other issues concerning measurement include lag effects, robustness, whether management is towards sustainability or financial ends, what benchmark would be used if benchmarking is used, what variables will interact with the measure, and persistence (Dikolli and Saedatole, 2007).

The integration of sustainability criteria in executive compensation has been found to positively correlate with long term outcomes for firms (Flammer, Hong and Minor, 2017). However, others (Flammer, Hong & Minor, 2017; Maas, 2018; Huber and Hirsch, 2017) have failed to show that the use of such sustainability criteria in executive pay causes increased action on sustainability by a firm and in fact their use may just be a device to increase the levels of pay for executives (Kolk and Perego, 2013). Where those criteria include quantifiable metrics the outcomes are generally better (Flammer, Hong & Minor, 2017; Maas, 2018). If the criteria are not quantitative then their use is not linked with enhanced positive outcomes (Maas, 2018).

However, theory has also suggested that strong quantified metrics are less effective than weak incentives (Pepper and Gore, 2012) because of the changing nature of business resulting in the need to have flexibility in setting the metrics. Indeed long-term linked pay may only discourage potentially damaging actions rather than acting as a positive influence (Mahoney and Thorne, 2005) although this is not necessarily a negative. Studies have found that if external monitoring, for example by government, of sustainability reporting is low or inadequate then the measures reported are often symbolic rather than substantive (Marquis & Qian, 2014) which may explain some of the differences in the findings from other studies.

It is clear that the implementation of sustainability-related performance conditions in performance-related remuneration schemes is a new and emerging practice within business. While research in this area is increasing and evidence is being gathered as to the efficacy of sustainability related performance measures being included in executive pay schemes through large empirical studies of companies there is a clear gap in knowledge relating to how such performance related schemes are viewed by the individuals who are involved in setting them within business. In fact while theory has attempted to propose methods to set performance related compensation and others have gathered empirical evidence of the use of sustainability linked metrics and firm outcomes we have found no previous study that explores whether this application of theory is causal to those firm outcomes. Therefore, the motivations behind their use may have been misrepresented or lost within these larger empirical studies or theories. This paper is a first attempt to address that gap.

# Methods

An inductive interpretivism approach (Crowther and Lancaster, 2009) to investigate the implementation of sustainability related performance measures in executive pay was adopted. Key to this was to interview participants involved in the remuneration process at companies. Given the different context and regulatory environment across different countries this investigation was limited to participants in the UK in the first instance. The use of semi-structured interviews was chosen in order to provide some practical expertise and to allow data to emerge through the discussion.

Two categories of individuals were selected, as described below:

* Representatives of institutional shareholders: most listed companies in the UK must obtain the approval of shareholders, by a simple majority, in a binding vote at a general meeting of the company’s shareholders at least once every three years. In the case of the representatives of shareholders, the individuals invited to participate were those with experience of engaging between shareholders and UK companies on the pay structures of senior executives at the companies.
* Remuneration consultants: firms or individuals providing advice to companies on pay (howsoever described, other terms including remuneration and compensation) policies and implementation of those policies (Bender, 2011). The consultants provide, amongst other things, advice to remuneration committees on the detail of pay markets and the design and implementation of pay policies (Bender, 2011).

Individuals working in each of these categories were known to the lead author, following professional business conducted with individuals from each category for several years. Therefore, selection of participants for the survey was not random but those approached to participate were known to have some years of experience of remuneration practice at UK listed companies (Perkins and Hendry, 2005; Bender, 2007). Availability and willingness to participate resulted in interviews with 9 individuals; of these nine, five were representatives of institutional shareholders, four were remuneration consultants. Interviews took place between June and August 2017. Ethics approval for the interviews was obtained through the University departmental ethics panel. As part of the interview protocol interviewees were told that their responses, both their identify and that of their organisation, would be kept anonymous to ensure as open and transparent a response to the questions as possible.

During the interviews points for discussion were used rather than formal questions because of the breadth of the potential issues that might arise. The structured points for discussion were as follows:

• General view on effectiveness of performance-related pay.

• Should companies use sustainability, environmental & social measures in pay plans?

• How can sustainability be measured? What metrics? How are representative targets chosen? Use of expertise on setting targets? Credibility of targets?

• How would it relate to other metrics, for example potential for conflict with general performance of business? How to avoid trade-offs between components of a basket of measures?

• Over what period should sustainability targets be measured? Can annual bonuses measuring performance for a year be effective?

The interviews were held at the offices of the participants. Each interview was recorded and transcribed. Each interview was analysed and coded using NVivo Pro for Windows version 11. Further analysis and organisation of the findings was undertaken using DevonThink Pro Office version 2.9 and Tinderbox 7.

The participants in the survey might be subject to some bias in that they are all employed, at least to some degree, to work in the field of executive remuneration. For the consultants, this is patently their function. For the representatives of institutional shareholders, discussions on remuneration with companies are now part of the general engagement with companies and, at the very least, the institutional shareholder representatives will also be making voting decisions on behalf of their clients at the general meetings of shareholders of the companies in which they are invested. However, all of these individuals are experienced in the field and are under some professional obligation to act in the best interests of their clients. The interests of the participants must be taken into account when analysing answers discussed during interviews and which are reported in the following section.

# Results

It was no surprise that the interviewees broadly agreed that performance-related pay can work but answers were nuanced. An effective design and implementation of the performance pay system was important but it was questioned whether it is anything more than an important messaging tool. Of the five shareholders, three viewed the concept as working but not a perfect system. For these shareholders, the comment of one that the system was not broken but cracked appeared to summarise their views. One also observed that performance-related pay is not as precise or targeted as market participants might think. One of the shareholders was particularly concerned about complexity in pay practices and that any additional complication of using further metrics (or series of further metrics) would not be welcome although there may be an opportunity to use new metrics to reduce complexity.

For two of the five shareholders, the pay system did not work. For one, targets set as the "performance" part of the system were ineffective. Where metrics are measured over a period of several years, it was the view of a participant that: "*the situation of the company, the economic environment, laws can change overnight, all kinds of things can happen which makes the performance conditions that you set three years ago a bit of a lottery*". Another was "*woefully disappointed*” with the system of performance-related pay in the UK, criticising the level of rewards, and an absence of considering the complexity involved.

A shareholder noted that a survey undertaken within the firm for which they worked identified that, at UK companies, the level of payment awarded in annual bonuses was between 60% and 70% of the maximum permitted per year. In the view of that shareholder firm, this level of consistent payment was not justified by performance at companies.

For one shareholder, performance measures should be objective, visible externally and audit-able. A remuneration consultant also noted that there is scepticism about the use of non-financial targets amongst shareholders. That consultant thought shareholders struggled with any targets other than earnings per share or total shareholder return.

Two of the shareholders, having voiced scepticism about how senior executive pay practice in the UK works, did note that pay does influence some behaviour and that they wanted to reward good performance in management. These shareholders were in agreement with three consultants who expressed a view that executives should want to do their work to the best of their efforts.

In principle, all participants in the interviews agreed with the concept of companies pursuing sustainable, environmental or social measures. A shareholder described the idea of using remuneration to lead to a change of strategy - that sustainability-related performance targets are adopted before it formally becomes part of a company's core strategy - was “*cart before horse*”, although one of the consultants thought that remuneration could be used as a step towards changing strategy. For three of the shareholders, some non-financial, sustainability-related performance would be acceptable within pay arrangements but the for majority of pay at least 75% of the measures (and, in the case of one of those shareholders, all long-term performance measures) applying to performance-related pay schemes must be financial. However, one consultant and a shareholder also noted that it was very difficult to set sustainability related targets that were actually challenging. The example given was of a 3 year target to reduce carbon emissions. The challenge for the shareholder is to understand whether this is a “good” target. Certainly, a certain level of reduction could be positive in a wider sense but in the circumstances of the company it is difficult for external stakeholders to assess the complexity and challenge of the target. This is an important point to consider if sustainability-related metrics are to have credibility.

All those interviewed had been exposed to companies (either advising the companies or investing in the companies) which had used sustainability metrics. However, the practice was not dominant enough for all to remember even which company undertook a sustainability focused practice in their remuneration schemes. The number of companies using these metrics is "*a small proportion*", "*a small number, in bonuses*" although one shareholder observed that they could not think of any company using sustainability-related metrics in long term performance plans but "*plenty*" were using it in annual bonus arrangements. Another shareholder struggled to recall any companies using sustainability-related metrics observing that the failure to recall any examples was "*germane*".

Strong views were held on the period over which sustainability, or any performance, targets should be measured. One shareholder held the view that sustainability related targets should only be used in an annual bonus scheme and that long-term plans should only use financial metrics. Other shareholders varied in approach: one agreed with the current practice evolving in the UK whereby performance was measured over 3 years but any shares vesting would be retained for a further 2 year period. Another shareholder was particularly keen on environmental and social performance measures and considered 3 years to be a minimum period. One shareholder agreed with the concept of restricted shares (whereby, the only primary condition is continued employment) with terms of 5 or 7 years, depending on the business and the business strategy.

The view of the remuneration consultants was different to that of shareholders. Whilst one of the consultants was broadly supportive of the three year performance and two-year retention periods in current practice, other consultants noted the personal motivation for executives: one referred to there being a "*personal horizon*". This view reflected a difference between the remuneration consultants and at least two of the shareholders who expressed frustration about the rate at which executives and companies discounted the value of future awards.

It was suggested that with rolling plans, measuring performance over several years might not be optimal and that strategic measures could be measured annually, a view consistent with the stated policy of one of the shareholders and also consistent with the views of the shareholder who had noted that measuring performance over three years was equivalent to a lottery.

Discussions also covered business planning. One shareholder stated that they wanted companies to plan for 10 years. Another shareholder wanted companies to state their plans for seven years. In the experience of two of the remuneration consultants, however, companies did not have very long term business plans, one noting that many companies planned for no more than three years.

Sustainability and the environment are long-term issues. The views expressed present challenges to that notion, particularly regarding the views expressed on the discounting applied to longer term metrics by executives and companies and scepticism regarding the long term planning of companies.

Despite the small number of schemes using sustainability as the basis for metrics, one consultant noted it is "*early days*" whilst a shareholder noted it “*seems to be increasing*". One remuneration consultant noted an important point of principle, namely that in their view it was a mistake to be prescriptive on this subject. In their view, companies should undertake proper behaviour, rather than define practices by linking it to pay. Another consultant noted that an incentive might be designed to have an effect but in practice the outcome may be very different, which that consultant described as the “*design effect*” and the “*in-flight effect*”.

A consultant and a shareholder both noted that the process for defining performance conditions, particularly in long term schemes, was heavily influenced by the views of shareholders but that shareholders held very different views. In the words of the consultant, companies struggled with the demands of shareholders. For both, the impact of the different views held by shareholders led to the adoption of performance conditions that were a lowest common denominator, that is conditions acceptable to shareholders but not necessarily effective or considered an optimal policy for either companies, executives or shareholders.

Therefore, there appears to be a general acceptance that performance related pay that include sustainability metrics might be useful however in practice there is less confidence that they actually change behaviour at present. In summary the following represents the main emerging themes from the interviews:

* There is doubt on the causal link between setting sustainability related performance measures and behaviour change of executives
* The setting of realistic, achievable and challenging metrics for sustainability outcomes is difficult, in particular for external stakeholders
* Views as to what issues are important to measure are not consistent across different shareholders
* Sustainability metrics make more sense when measured over a long timeframe however remuneration incentives work better over a shorter period of time.

Further three external factors were highlighted during the interviews which will be covered in the following sections, including:

* Planning for and managing societal transitions
* Government regulations and pressures
* Reputation

## Planning for and managing societal transitions

A challenge in the field of sustainability is that the business model of certain companies will be damaged if the company, or the society in which the company operates, moves to a more sustainable environment. An example is the oil industry where, if carbon emissions are to be reduced due to a warming climate, the production levels of the oil industry are likely to decline significantly. The choice then facing oil companies is to adapt to a new business model or to manage their own decline. A question which therefore arises for companies which have performance-related pay is whether they, and other stakeholders, are prepared for incentive schemes to reflect that significant change of business model or to reward the decline and ultimate obsolescence of the company.

Two of the remuneration consultants suggested that the incentives should encourage diversification, although one also added that the ultimate outcome of a sustainable future might be that all business activity would cease. For the three shareholders that commented on this subject, diversification of the businesses was favoured although one conceded that managed decline would be an option.

A shareholder noted that at a high level, there is a difference between activities and behaviours. A company might be producing oil which is damaging to the environment (the activity) but that it is doing so in a responsible manner (the behaviour). This appears a contradiction but, for the purposes of sustainability, is positive for so long as the damaging activity is permitted to continue.

## Governmental regulation and pressures

A remuneration consultant observed that government regulation to tackle sustainability challenges is needed given the systemic pressures on companies to produce returns and the lack of accounting for externalities. A shareholder also added that there is a widespread level of discontent in society with business which would add pressure for further governmental regulation. Three of the shareholder representatives noted the pressure from society, and from clients, for companies to adopt more sustainable practices, including in pay practices.

One of the shareholders agreed that there should be a wider examination of the role of companies within society, including challenging the shareholder primacy model. Another shareholder referred to section 172 of the companies Act 2006 (Companies Act, 2006, S.172) which includes a duty on directors to pay due regard to the impact of the company on the wider community and the environment, in respect of which the shareholder had no issue with directors being rewarded to some degree, but not exclusively, for undertaking that duty. Another shareholder noted the government consultation on corporate governance in 2016 from the Department for Business, Energy and Industrial Strategy (Corporate Governance Reform, 2016) which included suggested reforms on the regulation of executive pay in the UK.

For the consultants there were, in the words of one, a “p*lethora of influences*” whilst another noted a changing perception at a macro level. One consultant observed that running a business should be instinctive to "*get it right*" and should not need pay to determine that behaviour.

## Reputation

Does using, or not using, environmentally and sustainably focused arrangements in pay schemes damage companies? For all respondents commenting on this, the point related to the general reputation of the company as a responsible corporate citizen, not specifically on pay arrangements being linked to the environment. A shareholder summarised it as, “*in the long run companies will be measured and approved by society, their clients, their customers and I think those companies that don’t do it won’t be rewarded by customers*”. Three other shareholders agreed with the reputational risk of poor environmental behaviour. The wider general negative reputation of business was also recognised by remuneration consultants, one of whom noted that "*most of the new generation of executives are aware of the reputation that business has got*”.

There was a divergence of views on the competitive aspects of companies undertaking sustainable activities. Two of the remuneration consultants considered there would be a competitive disadvantage with a potentially negative impact on public opinion or politicians if additional costs were incurred for members of society at a time of economic pressure. Three of the shareholders did not see a major obstacle, with no long-run costs associated with acting sustainably and indeed that those societies imposing greater obligations on companies did not appear to be materially disadvantaged (companies based in Scandinavia were mentioned as a specific example by one shareholder).

The interview participants discussed whether companies used environmental and sustainable targets merely for compliance or publicity reasons without genuinely intending to address sustainable behaviour. Four considered this to happen to some degree: two shareholders and two remuneration consultants. Amongst these four, there were divergent views on the extent to which the use of environmental or sustainable targets is used for appearance sake. For one shareholder and one remuneration consultant, it happens "*sometimes*". For one of the shareholders, there was a concern that companies set environmental targets as a means to achieve a payout rather than to genuinely improve performance whilst at the same time having a policy which might enable the company to avoid the attentions of non-governmental organisations. One of the consultants was of the view that a material proportion of environmental and social activity is “*window dressing*”. However, another consultant disagreed and had not seen any evidence of companies using environmental measures as a window dressing. The consultant added that in their experience, companies did not put new metrics into their long term incentive schemes without careful consideration.

# Discussion

Concern over sustainability issues is on the increase. There is media pressure regarding environmental behaviour (Nikolaeva and Bicho, 2010) and while consumer interest may be transient, the cultural changes which have occurred do not seem to be transient (López et al., 2007). It appears from the interview responses that the reputational challenges for companies are recognised more widely and companies appear to be adapting. Law and regulations are a widely cited driver of sustainability-related practices (Barry et al., 1993; Yen and Yen, 2012; Goktan, 2014). However, one remuneration consultant commented with regards to externalities that the absence of payment for external costs - such as pollution - may be a distortion to the social and financial worth of a company.

Sustainability is now more likely to be regarded as a good strategy leading to better management, and therefore better performance (López et al., 2007; Orlitzky et al., 2004). In particular, companies which have been involved in environmental accidents, and whose reputations have therefore suffered, are more sensitive to environmental pressures, whilst companies with assets and operations that have an environmentally greater impact will be more likely to have environmentally innovative practices (Chatterji and Toffel, 2010; Berrone et al., 2013).

The media plays an important role in reporting on corporate behaviour and the threat of exposure can act as a restraint, an incentive to behave (Margolis and Walsh, 2003; Nikolaeva and Bicho, 2010). There is a risk, however, that sustainability activities are superficial (Luo and Bhattacharya, 2009; Berrone et al., 2013) thus undermining progress towards more sustainable behaviour. Each of these issues came up during interview and appear to support these previous findings that reputation is important when setting performance targets although the actual implementation can sometimes be “*window dressing*”.

Literature finds varying credibility in practice regarding the use of sustainability goals in corporate incentive schemes (Kolk and Perego, 2013) and that measures may be unreliable (Gerhart and Fang, 2014), views which came across from at least one of the consultants interviewed. Interviewees discussed aligning the interests of executives and shareholders when using sustainability metrics. The discussion covered important issues concerning the role of companies and the effect that sustainability related metrics may have on company behaviour. In addition, the potential value of payments from sustainability-related performance pay schemes may be relevant to the sustainability targets which are set (Merriman and Sen, 2012, although this paper was focused on mid-level managers rather than senior managers). However, the majority agreed that the actual quantification of these metrics was complex and they may not have the skills to judge their appropriateness for the company in question.

The remuneration consultants all stated that financial returns were important for companies and that therefore, sustainability-focused remuneration would continue to be dependent upon a company generating profits. One consultant observed that a company requires profits to pay bonuses: the consultant also agreed that there was too much of a focus on shareholder returns but, it nonetheless remained the case, in the opinion of the consultant, that rewards for sustainability-related behaviour required financial performance stating “*if making a loss, regardless of how they are doing against the non-financial metrics, I think it is difficult to justify a payout*." Another consultant stated “*We’ve got to have profits, we’ve got to have revenue. I think we’re never going to be in a world where we say health and safety comes before profit. We might say that but actually?*” Another consultant observed that when designing a pay policy or implementing any form of non-financial objective, a common response from executives at a company is to ask "*how much is that going to cost me? What's the return on that?*”. The other consultant noted that companies were expected to maximise financial return, to achieve “*financial delivery*”.

One shareholder was particularly sceptical, being concerned that non-financial measures allowed executives to be paid bonuses or share awards notwithstanding that the company had failed on financial measures. The shareholder noted that an investment decision was made on the quality of a company's management, the quality of the financial performance and expectations of future financial performance. Another shareholder, who had expressed very supportive views of sustainable behaviour by companies, noted that as a shareholder, the firm for which that shareholder worked “*has pensions to pay*". Due to this systems pressure, the scope for using sustainability extensively within pay arrangements for companies will be limited.

We therefore propose the following hypothesis as a result of our findings.

Hypothesis A: *individuals within the executive compensation industry view the scope for using sustainability performance targets within pay arrangements for executives as limited by the short term need for financial returns and the complexity involved in setting those targets*.

Given the above we additionally propose the following hypothesis and would welcome further testing on the robustness of this hypothesis in other studies.

Hypothesis B: *the use of sustainability related performance measures in executive pay schemes does not causally drive sustainability measures within companies, rather external drivers, including government regulation of sustainability measures, are the drivers.*

# Conclusions

This paper explored the efficacy of sustainability-related performance conditions at UK listed companies as perceived by the individuals involved in setting those conditions. We found that it remains early days for the implementation and use of these schemes; and, perhaps the most important finding, in the view of the participants, there is a continuing focus on financial performance by companies even where companies, their advisers or their shareholders are sympathetic to sustainability issues and would wish to adopt sustainability-related performance metrics (and, potentially, greater sustainability across all of the company). To address this issue, may require further examination of the role and purpose of companies.

This paper looked at listed companies. Companies listed on a stock exchange generally wish to attract investors. The generation of profits is a factor in determining demand for a company's shares. In addition to the question of whether undertaking corporate sustainability by a company is profitable and/or generates returns, there is a question whether investors attribute a value to the sustainability activities of the company. Privately held companies including co-operatives or family owned companies may find it easier to adopt a wider set of performance metrics.

The topic of sustainability-related pay is a subject which deserves further research. Here we found that those involved in setting the conditions related to this pay are sceptical that it drives real change however further research is needed to test out hypothesis and in particular to explore the perceptions of the executives themselves and whether they are truly motivated into alternative behaviours through their usage.

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