A Critical Review of Executive Compensation Policies Grounded in ESG Principles

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High executive salaries often lead executives to prioritize short-term gains over long-term ESG benefits. This review explores how reducing executive compensation, influenced by environmental regulations, impacts innovation in sustainable technologies. As shareholders demand more ESG-focused models, the traditional compensation model is shifting to link compensation with environmental and social goals. The literature focuses on greenhouse gas emissions, employee satisfaction, and regulatory compliance. This review covers global ESG-based incentives, followed by country-specific approaches in China, France, Germany, India, Italy, South Africa, Sweden, and the United States. It concludes with alternative frameworks from financial institutions. Executives are more likely to engage in environmental initiatives when personal gains are tied to these goals. Equity-based incentives are favored over salary-based bonuses. Concepts like the parity pill aim to increase investor trust and transparency. As investors become more environmentally conscious, they expect companies to align with these values. Executives are encouraged to prioritize long-term sustainability over short-term personal gains.

Keywords: executive compensation, sustainability, ESG, incentives, shareholders, accounting and finance

INTRODUCTION

High executive salaries often lead executives to prioritize short-term gains over long-term goals, emphasizing personal benefits rather than considering the company's long-term environmental, social, and governance (ESG) benefits. The reduction in executive compensation, influenced by environmental regulation, is recognized as a key factor affecting an enterprise's ability to innovate in environmentally sustainable technologies. This discussion inherently involves governance aspects and aligns with the broader ESG framework, where environmental considerations are intricately linked with executive compensation and corporate innovation strategies (Ali et al., 2023; Li et al.,2023).

The traditional executive compensation model is starting to drift away now that shareholders are demanding more ESG-based models from companies. The original model is an executive appropriately compensating by generating the maximum value for the company's shareholders. A more modern approach is being taken by linking this compensation to the shareholders' goals of a healthier environment and improvements in social welfare from companies (Li et al., 2023). When discussing the link between compensation and ESG goals most literature defines it as general or overall performance, but the specifics are greenhouse gas emissions, employee satisfaction and turnover, as well as any regulations set by the government of individual countries (Flammer et al., 2019).

This review is organized by first looking at the ESG-based incentive literature that examines the world, not just a specific country. The following sections examine how individual countries approach the connection ESG goals and executive compensation, going alphabetically with China first followed by France, Germany, India, Italy, South Africa, Sweden, and finally the United States. Lastly, other frameworks take different approaches to the concept, specifically those of financial institutions.

ESG-BASED INCENTIVES AROUND THE WORLD

ESG goals are not localized to specific countries or continents but rather a practice being adopted worldwide. In 2015, the United Nations Framework Convention on Climate Change held a convention in France. At this convention, 196 countries agreed to limit their gas emissions so that the global temperature would not rise above 2°C from where it was before the industrial revolution (*UNFCCC*, 2015). All countries that attended this conference are trying to reduce their greenhouse gas emissions. Numerous studies conducted in various nations have explored the link between reducing emissions and executive compensation.

One such study was conducted by Crichton et al. (2022), who took a global look at fossil fuel companies to see their connections to executive compensation. The examination revealed that tying executive rewards to specific ESG goal achievements is highly ineffective in fostering the eventual sustainability of a green company as there was a positive correlation of 0.26 between the amount of greenhouse gases and total executive compensation. The executives demonstrated a narrow focus, prioritizing immediate gains rather than adopting a long-term perspective (Crichton et al., 2022). Crichton et al. (2022) decided that having an equity bonus that took three years to collect was sufficient in incentivizing executives to not only work towards the personal gains of the bonus but also foster the idea of green innovation within the company. The researchers also concluded that the tone at the top was one of the most defining parts of the company and the directions the company takes regarding ESG-based goals (Crichton et al., 2022).

In contrast to positive equity incentives, an investigation by Chen et al. (2023) explores how a general manager's leadership influences company ESG performance. The research findings underscore the positive contribution of responsible leadership to higher organizational ESG scores, with a correlation of 0.665. Monetary incentives were found to play a critical role, exhibiting a correlation of 0.528, whereas equity-based compensation was found to be less impactful, displaying a correlation of 0.371. Overall, the research found that companies seeking to increase their sustainability efforts had increased trust from investors and positively impacted their environments and communities (Chen et al., 2023).

There is a fine line between keeping shareholders happy with high returns for their investments and keeping stakeholders, employees, vendors, and others with a non-financial interest in the company happy with actions taken to improve their well-being with ESG-related investments. Uyar et al. (2023) examined over forty-three thousand companies internationally and how they manage the connection between executive compensation and keeping the other two parties happy. The research found that there is a fine line to keeping both parties in agreement by funding projects that appeal to increasing the company's value overall with green initiatives for the shareholders as well as the environmental impact of those initiatives for the stakeholders. When these initiatives are implemented, the company recognizes the actions carried out by the executives and compensates them appropriately (Uyar et al., 2023).

Navigating the intricate balance between financial returns for shareholders and the broader well-being of stakeholders, as illuminated by Uyer et al.'s (2023) research, presents a significant challenge for companies seeking sustainable successes. ESG metric tracking is becoming increasingly more popular globally, with around 3% of companies tracking in 2010 to around 30% in 2021 (Cohen et al., 2023).

Cohen et al. (2023) explored three reasons for companies to incorporate ESG compensation plans into their organizations: incentive contracting, shareholder ideals, and ESG pledge credibility. Cohen et al. (2023) concluded that there was a positive correlation of 0.166 between ESG scores and executive compensation.

An analysis of an international dataset suggests that each of these reasons contributes to the variation in ESG compensation adoption and the firm's commitment to ESG goals (Cohen et al., 2023). Investors are becoming more concerned about their communities' environment and social well-being while executives are doing what they can to ensure their financial health. Executives use a system called share pledging to take loans out from their companies in exchange for stocks and use the stocks as collateral. This tactic leaves firms short on cash, and as Jang et al. (2022) found in their research, a company that has executives who use share pledging is also a company that tends to not have large investments in ESG initiatives. The executives utilize this compensation form to secure immediate and short-term gains, enhancing their personal wealth. Typically, these loans are taken out for alternative short-term investments, resulting in a lack of incentives for executives to pursue ESG goals within the company (Jang et al., 2022).

China

China has recently been a subject of ESG and executive compensation research. One of these studies was related to the link between executive equity compensation plans (EEIP) and ESG. Zeng et al. (2023) investigated the impact of EEIPs on ESG metrics to shed light on how internal incentives can align management's interests with the broader shareholder ESG concerns. Their findings advocate for the incorporation of flexible EEIPs as internal motivators for firms looking to enhance their ESG performance. Executives are more likely to have a positive impact on ESG initiatives if the company offers them an equity-based compensation plan over an increase in salary or non-equity bonuses (Zeng et al., 2023).

Similar research to Zeng et al. (2023) is Wu et al. (2022) who explore the same principles of EEIPs within Chinese companies with a focus on patents from those companies and their connection to EEIPs. Comparing companies over a twelve-year period for changes in value, executive compensation amounts, and a number of environmentally friendly inventions showed that companies who engage in EEIPs also have higher green inventions. However, the EEIPs had to use restricted stock, as a normal stock bonus was insufficient to motivate executives. Wu et al. (2022) found that the green companies had a greater increase in firm value with a leg up over their competition and had a greater impact on the environments over the period studied (Wu et al., 2022).

On the other side of positive equity incentives is a study performed by Zhao et al. (2023) that found the opposite true regarding executive compensation plans. The researchers examined the connection between executive compensation plans and green initiatives among China's heaviest polluting businesses. Their conclusion was when an executive was incentivized with a base salary increase then it was more likely that this executive would engage in the riskier green initiatives, with the research showing a correlation of 0.191. When incentivized with an equity-based bonus the executives were less likely to take the risks despite the long-term benefits to the company for going green (Zhao et al., 2023).

Pollution has been a concern in China for a long time, and multiple studies have been conducted on how to improve environmental conditions and how it links to executive compensation (Liu et al., 2023). Liu et al. (2023) investigated the correlation between government environmental subsidy programs and executive compensation. The research found that government subsidies had an incredibly positive effect on companies taking green initiatives, but when adding executive compensation into the mix the subsidies became less effective. The reason was that the compensation incentives were not enough to encourage executives to engage in the high risks of moving forward with environmental projects. Overall, the government subsidies positively affected companies engaging in environmental activities and slightly increased executives who wished to receive bonuses based on these initiatives (Liu et al., 2023).

Human beings resist change and try to avoid doing so whenever possible, and the same is true when it comes to executive compensation plans. A current trend has been that executives keep their compensation levels even if the company experiences economic downturns (Chen et al., 2023). An analysis performed on Chinese companies investigated the link between executive's resistance to change and how their compensation plans were being affected by ESG goals. Investors are becoming more environmentally aware and want the companies they invest in to do the same. Companies are connecting ESG goals to their executive's compensation using digital measurable means to encourage this goal. Being able to track metrics can give investors confidence that the company is upholding the claims they are making. The digital aspect of a company is critical to measuring performance and environmental impact, and linking executive compensation to these measurable sustainability efforts is important for long-term sustainability (Chen et al., 2023).

Another examination on Chinese companies explored the relationship between environmental regulations, executive compensation, and their connection to advancements in green technologies (Xiaofang & Zhuohang, 2022). This research found that when executive compensation was linked to environmental goals the executives were never given enough incentive to pursue those goals and the company suffered overall. When a company must follow more environmental regulations, they tend to invest more in technology to improve their environmental impact to meet these regulations. Xiaofang and Zhuohang (2022) argue that when an executive's compensation is reduced, they are less likely to invest in green initiatives. Executives are commonly short-sighted and can only look towards immediate gains instead of looking further at the impact that environmental changes will have on the overall financial profitability of their companies.

Tournament Incentives

One of the largest countries in need of environmental development is China. By using tournament incentive compensation plans the government is incentivizing corporations to follow ESG goals and are rewarding them for completing these goals. Promoting competition within an organization for ESG goals is believed to foster innovation. Competition motivates managers and executives to collaborate and compete against each other in pursuit of the reward goals set by the Chinese government. Ullah et al. (2023) identified a positive correlation between green activities and the wage gap among executives, reporting a Pearson correlation coefficient of 0.064, which they deemed statistically significant. Moreover, this correlation was even more pronounced in government-owned companies, with a Pearson coefficient of 0.078. The outcome of these tournament incentives was that companies were achieving better environmental results but were having trouble with the reporting of these results in their financial statements (Ali et al., 2023, Ullah et al., 2022).

Going green takes considerable time and money, and this investment's payoff may not be recognizable for years. The risks are high, and most executives do not wish to take these risks without the proper incentives to do so (Ullah et al., 2022). Using tournament theory, Ullah et al. (2022) researched the effects of linking environmental goals to executive compensation. The researchers found that when these incentives were properly applied a sense of competition was generated among the executives and they were achieving both social and economic goals. The mindset has always been to put the value of the shareholders first, but when that focus is shifted to customer and employees, then the company has a more versatile range of what it can do to help these other groups (Ullah et al., 2022).

These incentives encourage executives to engage in more risk-taking behavior as there is a reward in doing so. The executives set a tone at the top for the corporation and imposing limitations on them could negatively impact the company's environmental goals. Executives who are limited might only be looking at the short-term personal gains instead of the long-term environmental goals. Applying the tournament theory encourages competitiveness of executives to reach these environmental goals for short-term personal gains and long-term ESG goals (Ali et al., 2023; Li et al., 2023). Li et al. (2023) uses this tournament theory in their research into how the Chinese government has implemented a say-on-pay (SOP) compensation system for executives.

Under the SOP system, the shareholders are given the right to vote on executive compensation plans during shareholder meetings. The goal is to link compensation plans to the shareholders environmentally friendly goals. The Chinese government took a similar approach and limited executive compensation to be a factor of average employee wages and improved retirement benefits (Li et al., 2023). Li et al. (2023) concludes that when the government imposes these limitations, the corporations are not incentivized to engage in environmental activities. This was true for executive incentives that were very monetarily based. Still, when the compensation was equity-based, the opposite was true, and executives were environmentally motivated to increase the firm's, and therefore their own, value (Li et al., 2023).

France

Research conducted by Chouaibi et al. (2021) delved into the connection between corporate social responsibility (CSR) and executive compensation among French corporations. The focus was on how both initiatives link with the cost of equity and connected compensation and ESG (Chouaibi et al., 2021). The examination found that when companies are socially responsible and engaging in ESG activities, the cost of equity tends to be lower. However, tying executive pay to sustainability goals did not encourage ESG behaviors among executives to promote responsible business practices. In essence, the research indicates that socially conscious companies can motivate their executives to pursue ESG goals, reducing equity costs. The decision to pursue bonuses ultimately rests with the executives (Chouaibi et al., 2021).

Germany

Patrick Velte (2016) investigated this concept of ESG and executive compensation within a set of German corporations. This research explores German corporations and how their two-tier board system incorporates ESG based executive compensation. The two-tiered system splits the board of directors into two groups: one that focuses on the everyday operations within the company and a second oversight board that ensures the company is achieving shareholder and regulatory goals (Byrne, n.d.). By focusing on the two-tier board system, the research reveals how incorporating ESG considerations in compensation frameworks reflects a commitment to long-term value creation.

The management board is concerned with the everyday operations of the company and as such handles the implementation of environmental activities. The oversight board can focus on the regulations being set in place by the government on environmental standards. They can also consider the requests of ESG orientated shareholders, thus allowing the company to have plans in place to ensure financial and environmental responsibility (Velte, 2016). Velte (2016) emphasizes that having a section of the oversight board dedicated to compensation planning ensures positive ESG performance from the company.

India

India has long been plagued by high unemployment rates and great wealth disparity (Rath et al., 2020). A recent analysis by Rath et al. (2020) examined executives opting for a lower compensation package to focus on their corporation's ESG activities. The researchers found that when executives made this personal sacrifice towards improved ESG the company overall had greater returns. Rath et al. (2020) found that companies who didn't incorporate ESG metrics into executive compensation plans correlated -0.462 for return on assets (ROA), and a -0.013 correlation with stock returns for investors. When ESG and executive compensation were connected the findings were -0.727 for the ROA and stock return on investment correlation of -0.011. This implies that companies transparent with ESG initiatives typically offer lower executive compensation plans than companies not focused on ESG (Rath et al., 2020).

Pareek and Sahu (2023) examine companies listed on India's National Stock Exchange to see the connection between executive compensation and ESG goals. The researchers found that the two are positively correlated until a certain point, beyond which increasing compensation has a negative effect on ESG (Pareek & Sahu, 2023). Pareek and Sahu (2023) additionally observe that executives are tasked with serving as intermediaries between stakeholders and shareholders. While stakeholders often prioritize ESG considerations, shareholders focus on increasing the company's value. Overall, there is a positive connection between executive compensation and ESG initiatives (Pareek & Sahu, 2023).

Italy

Cucari et al. (2023) research explores integrating ESG indicators into executive compensation plans for Italian companies. Within the research three different options stood out from the rest; first was that ESG disclosures in the company were just for show to appease shareholders without any substantial change, second showed few ESG changes, and the third showed more significant ESG changes (Cucari et al., 2023). The researchers argue that there should be independence within the group deciding executive compensation so that ESG goals align with the organization's goals. Cucari et al. (2023) recommend this independence so that there is a balance between ESG goals and the organization so that sustainability can be achieved as well as proper executive compensations.

Building upon the concept of say-on-pay is the notion of ESG focused mutual funds exercising voting rights on behalf of its shareholders in matters related to executive compensation. ESG funds can signal their commitment to investors' ESG objectives by actively voting on proposals. ESG focused mutual funds can hold firms with higher ESG metrics and vote on executive compensation plans that directly signal efforts to align management with their investors' interests. When shareholders themselves propose such ideas, they typically do not get much traction and are set aside, but when a larger group, namely a mutual fund, proposes the idea there is typically greater support (Dikolli et al., 2023).

The term "greenwashing" appears throughout the literature on this subject and is a phrase used when a company claims that they are performing green actions, but the environmental performance of the company does not reinforce those claims (Ratti et al., 2023, Velte, 2016). Ratti et al. (2023) examine a list of Italian corporations and how they link an executive's compensation to environmental goals to help prevent or end greenwashing. The ESG goals would be linked to a meaningful reward so there is an incentive to achieve these goals (Ratti et al., 2023).

The research by Ratti et al. (2023) emphasizes the need for a standardized and transparent corporate executive compensation plan. These plans should show the aligned incentives of environmental achievements with executive's decision-making. This approach goes beyond the common performance-based evaluation and addresses the limitations of greenwashing (Ratti et al., 2023). By emphasizing transparency and standardization, such compensation plans foster accountability and reduce the risks of misrepresentation in corporation environmental efforts. This perspective contributes to a more ethical framework for executive compensation.

South Africa

Matemane et al. (2022) used an analytical hierarchy process (AHP) to supply a ranking for the sections of ESG that companies find most important and then used that system to decide how these sections can be linked to executive compensation. The researchers found that the environmental sector was the most important, followed closely by social performance with governance at the bottom. The research concentrated on South African companies, highlighting social inequality as a significant challenge. Addressing this issue directly, companies can enhance their social initiatives to alleviate poverty and unemployment. Connecting these ESG principles to executive compensation ensures that the executives will not be compensated accordingly if the company does not promote environmental and social values (Matemane et al., 2022).

Sweden

ESG goals and its connection to executive compensation is becoming more of a worldwide trend rather than staying in a select few countries. Homroy et al. (2023) explored the link between ESG initiatives and the compensation of CEOs in Sweden. The findings indicated that ESG targets only made up a small part of the incentive for executive pay and found that the executives were not more or less likely to meet these goals than they were with other organizational goals. Shareholders want increased value from their investments and improved ESG from the company, which the researchers find contradictory (Homroy et al., 2023).

Homroy et al.'s (2023) research used James Tobin's Q valuation for companies to further explore the connection of ESG and executive compensation. The researchers also look at companies from the viewpoint of the skillsets of the executives and how Tobin's Q is affected by executives with very well-rounded skillsets. Executives with a wider range of skills that were also linked to ESG pay programs focused on governance found their Tobin's Q scores to be 7.5140, with a positive return on assets of 1.0836. If the executive wasn't ESG connected, but maintained a higher governance score, the Tobin's Q decreased to -

0.05819, with a decrease in return on assets being -0.0012. Executives associated with the company's ESG scores are inclined to make decisions that enhance the company's overall value and engagement in ESG activities (Homroy et al., 2023).

United States

Companies not only aim to maximize shareholder value but also have an interest in the ideals of all the other groups with a stake in their business, including vendors, customers, employees, the community, and the environment (Bebchuk & Tallarita, 2022). An examination conducted by Bebchuk and Tallarita (2022) delved into a group of U.S. presently incorporating ESG metrics into their executive compensation plans. The findings indicated that the relationship between these two does not benefit either group. The researchers aim for companies to prioritize attention to all external stakeholders, as ESG typically addresses only a limited portion of these stakeholders. Encouraging executives to consider the broader range of stakeholders may make them less inclined to act (Bebchuk & Tallarita, 2022).

Compensation transparency is also an issue within this ESG pay program. Under the current systems in place for executive compensation, most shareholders can understand where the money is sourced and how an executive is compensated. When using an ESG based compensation plan the disclosures become less dependable, and compensation comes from too many areas to be able to trace and understand easily. Each company also uses their own compensation system, so comparing companies becomes exceedingly difficult (Bebchuk & Tallarita, 2022).

An alternative investigation into U.S. corporations with high pollution levels employs a socio-organizational theory known as institutional theory. Under institutional theory, an organization shapes its behavior to better suit the outcomes for stakeholders, who in this case are shareholders, the environment, and society (Berrone & Gomez-Mejia, 2009). The findings indicate that having good environmental performance has an adverse effect on executive compensation. Berrone and Gomez-Mejia (2009) also found that the blame rolls downhill within most organizations, so when something goes wrong, or costs exceed budgets, the managers of those projects get blamed. Since the environmental objectives are not met the managers do not receive bonuses; they would have otherwise received their bonuses if these environmental initiatives were not taken.

This investigation also reinforces the idea that the company and the community have similar mindsets, but green projects are difficult for executives to undertake. Notably, the end of the line for wastes has no effect on the executive's pay, only the efforts to reduce pollutants before it reaches the end (Berrone & Gomez-Mejia, 2009). This idea emphasizes executives adopting environmental strategies so that they can receive their bonuses and allows them to show these actions to appease shareholders (Berrone & Gomez-Mejia, 2009).

Companies' involvement in ESG-related activities is not a recent concept; it has been ongoing for more than two decades. The decisive factor behind these initiatives lies in the actions of the CEO. (Ali et al., 2023, Crichton et al., 2022, Fabrizi et al., 2014, Li et al.,2023). Fabrizi et al. (2014) explored U.S. based companies, examining the connection between executive bonuses, encompassing both financial and non-financial aspects, and their impact on the decision-making processes regarding CSR by executives. The research finding reveals a negative correlation between equity incentives and social responsibility, so the more the executives and the shareholders think alike, the less likely the executive is to engage in ESG projects (Fabrizi et al., 2014).

Additionally, when a new executive comes into the company or an older executive closer to retirement is in charge, the more likely these executives are to promote ESG values within the company. The rationale behind this is that the incoming executive seeks to enhance their standing with the shareholders to secure their continued tenure. In contrast, the retiring executive, less impacted by the company's future, can take risks with ESG projects without bearing the consequences if they fail (Fabrizi et al., 2014).

Flammer et al. (2019) conducted research that gathered information on ESG and CSR scores from the S&P 500 in the early 2000s. Their goal was to see the connections between executive compensation and CSR ratings and how the two affected each other. Flammer et al. (2019) discovered that incorporating green goals into executive compensation led to an enhanced long-term focus. This, in turn, elevated both the company's overall value and shareholder value, while also contributing to a reduction in greenhouse gas emissions and fostering a green initiative-friendly environment within the company. Incentivizing executives to consider long-term value-enhancing actions can increase the company's overall value. The results of this research emphasize the effectiveness of CSR executive compensation, especially when it is significant (Flammer et al., 2019).

Li and Thibodeau (2019) further examine the S&P 500 and CSR related executive compensation by drilling into the relationship between monetary management and CSR. The research examined how executives' personalities influenced CSR scores and that connection between compensation plans. Li and Thibodeau (2019) found a negative connection between CSR and monetary management when CSR compensation plans were in place. A negative connection meant executives were less inclined to manipulate earnings because the bonuses instead increased with CSR scores. The research emphasizes that compensation plans like this reduce an executive's motivation to manipulate earnings, which overall benefits shareholders by creating fair financial statements and increased reputation for the company (Li & Thibodeau, 2019).

Diversity and size of the board of directors also influences the ESG scores and executive compensation of S&P 500 companies (Tamimi & Sebastianelli, 2017). The research finds that companies with larger boards of directors tend to have larger ESG scores with a Pearson correlation of 0.214. Furthermore, enhanced governance is associated with greater gender diversity on boards, with a Pearson correlation of 0.152. An increase in ESG disclosures helps show investors how the company is affecting the environment and what steps the company is taking to improve the social welfare of society and the company's employees (Tamimi & Sebastianelli, 2017).

Another recurring theme throughout the research is the effect of ESG scores and executive compensation on agency costs. These agency costs are opportunity costs of choosing between the interests of shareholders with ESG goals and executives with corporate financial goals. Hong et al. (2016) delved into whether CSR generated financial returns for shareholders and how different organizational models incentivize executives to follow CSR goals. Hong et al. (2016) found a correlation of 0.29 between CSR levels and sales, 0.122 between CSR and research and development, and 0.09 between CSR levels and CSR contracted executives. Companies that listen to their shareholders are also companies who tend to engage in ESG initiatives and are more likely to connect their executive compensation to those initiatives (Hong et al., 2016).

INTERNATIONAL FINANCIAL INSTITUTIONS

Financial institutions are also looking at the environmental and social impacts they are making on their communities. Lee et al. (2023) found that financial institutions have a massive amount of influence on the economy, with the ability to make or break certain companies or industries. The overall findings were that financial institutions compensated their executives based on ESG metrics. When an executive has a higher pay for performing ESG activities the executive is more likely to engage in those activities and vice versa (Lee et al., 2023). Lee et al., (2023) conclude that when an executive's pay is linked to ESG goals, the company is going to be ESG focused and tend to invest in ESG related businesses.

D'Apolito et al. (2019) offer a unique perspective with their research performed on European financial institutions and how they incorporate ESG goals into executive compensation plans. Linking executive compensation and ESG goals incentivizes executives to not engage in such risky, but highly rewarding, actions and instead turn their attention towards the long-term environmentally sustainable actions that the company stakeholders are requesting. The research found that linking these two ideas was beneficial for 170 of the 200 companies examined; when ESG goals became the focus for the company, risk-taking behaviors lessened (D'Apolito et al., 2019). D'Apolito et al. (2019) reach the conclusions that when incorporating ESG goals into an executive compensation plan the executives start to look toward the horizon and not be short-sighted with their goals.

Heavily polluting companies have already incorporated the idea of linking environmental goals to executive compensation. Ritz (2022) explored the reasons large oil companies in the United States and

Europe had for this connection. Ritz (2022) found differences in how the companies formed these incentives, but the overall goal was to cut emissions and reduce waste. The largest reason for creating these incentives was growing pressure from investors and financial institutions that are becoming more concerned with ESG goals and protecting the planet. The idea of linking ESG goals and executive compensation is still a new concept for most companies, it will take time to implement and refine (Ritz, 2022).

Equator Principles Framework

Expanding upon focusing on financial institutions, Abudy et al., (2023) conducted research investigating the connection between ESG and executive compensation. Abudy et al. (2023) investigate ESG goals from the perspective of financial institutions using the Equator Principles framework for ESG focusing on the executive compensation of these companies. The research revealed a significant increase in total executive compensation, driven particularly by larger amounts of equity-based compensation, suggesting a positive influence of ESG standards on aligning executive pay with shareholder interests. The opposite was true when looking at non-equity-based compensation as there was a negative influence on ESG standards (Abudy et al., 2023).

Parity Pill Concept

Companies can focus on any part of the ESG acronym to better aid their communities and nations. While the environmental aspect is the most discussed, the social aspect might be the most impactful to individuals within a community. Skladany (2022) explored the aspect of something he calls a "parity pill". The parity pill would be a stipulation in an executive's contract that would become effective in case of economic hardships, so that the executive's excessive pay would be distributed to the lower-level employees (Skladany, 2022).

The idea behind this would be to ensure the lower-level employees would be able to keep their jobs should times become more difficult. This concept would allow the executives to keep high pay during the high points but allow them to hold onto their employees during the low ones. Unlike the idea of executives who voluntarily take this approach, the idea of the parity pill would be written in as part of the executive's contract. This idea focuses solely on the social aspects of ESG and helps to show the ethics and responsibility of the company's leadership, as well as improve the overall reputation of the company (Skladany, 2022).

CONCLUSION

In conclusion, when executives are given a choice between personal gains and environmental goals, the choice is to go with the immediate personal gain (e.g. Ali et al., 2023; Crichton et al., 2022; Jang et al., 2022; Li et al.,2023). However, when a connection is made tying the two together, then the executives are more likely to engage in environmental initiatives (Lee et al., 2023; Zeng et al., 2023; Zhao et al., 2023). The literature is torn between whether offering equity-based or salary-based bonuses tied to ESG goals, with the literature favoring equity bonuses (Abudy et al., 2023; Crichton et al., 2022; Li et al., 2023; Wu et al., 2022; Zeng et al., 2023) over literature that does not encourage equity incentives (Chen et al., 2023; Zhao et al., 2023).

Other ideas, such as the parity pill (Skladany, 2022), offer different perspectives on connecting ESG goals and executive compensation. The overall idea is to increase investor's faith in the company and to give more transparency to financial statements (Chen et al., 2023). Investors are becoming more environmentally friendly and want the companies they invest in to do the same. In the end, executives need to look to the future and the sustainability of the environment rather than being so short-sighted and selfish with their personal financial goals (Ali et al., 2023; Crichton et al., 2022; Li et al.,2023; Jang et al., 2022).

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