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The Effects of CEO Pay Structure on Corporate Social Performance[†]

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Corporate social performance (CSP) is increasingly viewed as an important business outcome by researchers, investors, and society as a whole. Furthermore, empirical research indicates that CSP is positively related to corporate financial performance. These considerations lead to the question of whether CEO pay is properly structured to provide incentive to the CEO to improve firm CSP. In a sample of 313 firms, the authors found that a short-term CEO pay focus was negatively related to CSP, whereas a long-term focus was positively related to CSP. Implications of these results for future research and CEO pay design are presented.

Keywords: *corporate social performance; compensation; incentives; stakeholder theory; agency theory*

Today's business environment calls for both profitable and socially responsible management. Firms are under increasing pressure to embrace social responsibility in part because of emerging standards related to social performance (e.g., the United Nations Global Compact, the Organization for Economic Cooperation and Development Guidelines for Multinational

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Enterprises, and the International Organization for Standardization 9000 and 14000) and also because of the proliferation of independent evaluations and rankings that make social performance more transparent. These range from the research databases such as the Kinder, Lydenberg, Domini, and Company (KLD) corporate social performance database and its associated Domini Social Fund for investors to *Business Ethics* magazine's "Best 100 Corporate Citizens" to the Social Investment Forum, an umbrella organization that provides resources, contacts, and information about socially responsible organizations and investing (Waddock, 2003).

No doubt, much of this attention has been caused by business scandals involving top corporate executives. The role of the CEO in the firm has been particularly scrutinized, especially in the context of a stakeholder view of decision making and corporate strategy (Kochan, 2002). A stakeholder view acknowledges concern for varied stakeholders, not just the firm's shareholders. It is a failure to consider multiple stakeholders, or in some cases anyone but the CEO himself or herself, that has provoked so much interest (Child, 2002).

The construct of corporate social performance (CSP) reflects a broader orientation to CEO and corporate decision making. Defined as "a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate(d) to the firm's societal relationships" (Wood 1991: 693), CSP has been advanced as an indicator of corporate performance more aligned with a stakeholder perspective. In this view, a firm has an ethical responsibility to maximize CSP, with corporate financial performance (CFP) only one, and perhaps an indirect, aspect of this.

There has also been a significant amount of empirical research attention devoted to the relationship between CSP and CFP. Available evidence suggests that CSP is positively related to firm performance (Orlitzky, Schmidt, & Rynes, 2003). This result, consistent with an "instrumental perspective" (Jones, 1995) suggests that not only may CSP be considered a business objective in and of itself but that it serves as a means to the end of CFP.

The importance of CSP raises the question of whether CEOs are given incentive through pay to improve the firm's CSP. Despite the recent scandals and all the attention focused on stakeholder theory in the academic and practitioner literatures, CEO pay packages rarely contain direct and explicit incentives to focus on CSP. Instead, CEO pay packages usually contain performance criteria that focus on accounting and stock-based measures of performance (Jensen, Murphy, & Wruck, 2004).

In this study, we examine the following questions: Do CEO pay packages provide financial incentive to CEOs to improve the firm's CSP, and if so, how? If they do provide an incentive, it suggests that CEO incentives are properly aligned, because of the importance of CSP as a social and business objective. If not, it suggests that firms are not properly providing incentive to increase CSP. In particular, we focus on short- versus long-term incentives of CEOs and their relationship to CSP.

Theory

Corporate Social Performance and Corporate Financial Performance

Corporate social performance is essentially an organization's response to expectations and demands of social responsibility (Wood, 1991). The extent of a corporation's social responsibility has been conceptualized in varied ways reflecting different degrees of responsibility beyond the role of economic institution to one that includes social duties (Hemphill, 1997). Definitions range from (see Carroll, 1999, for a review) a wide view of CSP "as actions that appear to further some social good, beyond the interests of the firm and that which is required by law" (McWilliams & Siegel, 2001: 117) to one that is narrowly focused on maximizing shareholder wealth (Friedman, 1970). For this research, we define CSP in keeping with Carroll's encompassing perspective that states that "the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time" (1979: 500).

A broad definition of CSP is consistent with the stakeholder concept (Freeman, 1984), which suggests that organizations are accountable to a wide audience such as employees, customers, local communities, and government, in addition to shareholders. Primary areas of CSP in the KLD database that specifically address these varied stakeholders and are often acknowledged in research and by rating agencies are categorized as employee relations, product quality and safety, natural environment, human rights, diversity, and community relations. Within these categories, areas of strengths and concerns are parceled out in the KLD data.

The theoretical bases for the CSP-CFP relationship have yet to be unambiguously identified (Jawahar & McLaughlin, 2001), although a variety of causal mechanisms have been advanced (Orlitzky et al., 2003). These include forcing management to focus more clearly and directly on external demands, a fairer and more rational assessment of competing demands resulting in good management (Jones, 1995), and risk mitigation and improving business performance as a result of relying on CSP versus minimum legal standards (Bass, Simerly, & Li, 1997; Sarre, Doig, & Fiedler, 2001). In addition, CSP may affect organizational reputation, thereby improving investor perceptions of the firm (e.g., Orlitzky et al., 2003), which in turn may affect stock price.

Empirical studies have concluded that there exists an overall positive relationship between CSP and CFP, supporting the instrumental perspective of CSP. Between 1972 and 2002, 109 published studies empirically examined whether CSP predicts CFP (Margolis & Walsh, 2003). About half of these (54) showed a significant positive association, and only 7 showed a negative association (Margolis & Walsh, 2003). Orlitzky et al. (2003) conducted a more definitive meta-analysis on the population of primary studies investigating the CSP-CFP relationship and concluded that CSP and CFP are positively related. In fact, they found that some of their observed correlations between CSP and CFP were higher than those typically found between corporate strategy-structure fit and CFP.

It must also be stated that Margolis and Walsh (2003) and others have commented on methodological and conceptual problems in the CSP research. These include the reliability and validity of CSP and financial performance measures, the omission of potentially key control

variables, and the existence of potential moderators and mediators, among others. However, the vast preponderance of research clearly supports the conclusions that CSP is positively associated with corporate financial performance, that CSP acts at least in part as an antecedent of CFP, and that this positive relationship exists after controlling for a variety of contingency factors involving measurement, mediation, and moderation (Orlitzky et al., 2003). As such, it is important to understand whether the CSP-CFP relationship has implications for the design of CEO pay from an incentive standpoint.

CEO Pay Structure and CSP

Assuming that organizations value the pursuit of CSP, the next question is how CEOs as individuals consider the economic utility of CSP to the firm and to themselves, particularly to their individual remuneration. CEOs are recognized as having extensive decision-making power and the ability to significantly influence their firm's CSP (Kochan, 2002; Orlitzky & Swanson, 2002). Agency theory provides a theoretical basis with which to describe the potential divergent and convergent interests between CEOs and other stakeholders and predict how this affects CSP.

Agency theory contends that organizations can be analyzed in terms of a conflict of interest between principals and agents (Jensen & Meckling, 1976) and is commonly applied to the relationship of firm owners (principals) and managers (agents). The basis of agency theory is that agents are self-interested (i.e., they have interests that diverge from those of the principals) and may attempt to maximize their interests at the expense of the principals' (Eisenhardt, 1989). To deter self-interested behavior, a principal may closely monitor an agent and/or impose conditions that shift some of the performance risk from the principal to the agent and thus more closely align principal-agent interests. The management literature identifies pay as a primary tool to accomplish alignment. The cost of monitoring increases when an agent has more information than a principal about decisions made and actions taken (information asymmetry is present) and tasks are difficult to structure (low programmability). Decisions in the area of CSP are likely to reflect both high information asymmetry and low programmability. In situations such as this, principals should rely on pay for performance systems, including short- and long-term incentive systems.

In keeping with agency theory prescriptions, a CEO's pay is heavily dependent on the financial performance of the organization. An executive pay plan typically consists of salary, annual bonus, and long-term incentive pay (primarily stock options), with the allocation from each category varying greatly among CEOs. It is this allocation between short-term and long-term incentives that most critically defines CEO performance interests (Jensen et al., 2004).

The payout for maximizing short-term earnings is more salient for CEOs when their pay plan offers substantial rewards based on short-term performance and/or a lack of disincentive to focus on the short term. Empirical research shows that managers are more likely to manipulate earnings to show larger short-term gains when bonuses are based on annual earnings (Healy, 1985), and this tendency decreases under pay plans tied to long-term performance (Richardson & Waagelein, 2002).

Attention to both strength and concern areas of CSP are more likely to have longer term positive payouts and consequences and less likely to have positive short-term financial effects. Although investment in CSP can have short-term firm reputational effects (Orlitzky et al., 2003) and thus affect stock price, short-term CEO pay is based heavily on firm accounting performance as opposed to stock price (McGuire, Dow, & Argheyd, 2003; Murphy, 2000). Thus, an instrumental CEO with a pay package focused on short-term performance has little incentive, all else equal, to engage in CSP. In the one previous empirical study (to our knowledge) on the short-term incentive, CSP relationship, bonus percentage was found to be statistically unrelated to CSP (McGuire et al., 2003).

We contend further, however, that executives have a particular financial *disincentive* to engage in CSP when their pay focuses on short-term incentives. Strength aspects of CSP involve taking positive action in the areas of community relations, human rights, the safety of the firm's product or service, the environment, diversity and fairness in hiring, and other aspects of employee relations. Attention to these may not only have a direct negative effect on the firm's short-term financial performance; it further may represent an opportunity cost for the CEO, in that resources spent on improving the firm's CSP strengths represent resources not spent in maximizing short-term performance (Margolis & Walsh, 2003). More broadly, a focus on short-term incentives may signal to the CEO a numbers-driven corporate orientation (McGuire et al., 2003). Failure to hit these short-term numbers may not only affect CEO pay but also affect the job security of the CEO.

Similarly, the negative financial effect of actions that result in CSP concerns, such as problems in areas of environmental neglect, financial mismanagement, employee safety, and product safety, are not likely to be caught immediately (Short, 2004) and are unlikely to show up in short-term financial performance. In contrast, actions of commission or omission represented by CSP concerns are more clearly likely to affect the firm in the long run (Short, 2004) and thus provide little disincentive to the CEO in the short term. Problems in these areas are likely the result of a failure to make financial and/or human capital investments and in general take a proactive stance to CSP (Jawahar & Mclaughlin, 2001). This suggests that lack of attention to CSP concerns can have positive short-term financial effects, in addition to negative long-term effects.

Hypothesis 1: A short-term focus in CEO pay will be negatively related to CSP.

Empirical evidence indicates that pay focused on long-term performance promotes management decisions that are more aligned with shareholders' interests when it comes to capital investments and merger and divestitures (Larcker, 1983; Tehranian, Travlos, & Waagelein, 1987). This relationship may extend beyond shareholders to a broader group of stakeholders, as suggested by Johnson and Greening's (1999) finding of a positive relationship between top management teams' percentage of equity ownership and certain dimensions of CSP. However, a recent study found no significant relationship between CEO long-term incentives and an aggregated measure of CSP strengths, and a positive relationship with CSP concerns (McGuire et al., 2003).

We contend, in contrast, that a long-term pay focus provides incentive for CEOs to engage in CSP. A pay plan that emphasizes long-term performance reduces pressure to maximize

short-term earnings, which is at odds with CSP, and provides a longer term time frame wherein effects of CSP are more likely to occur (Mahapatra, 1984; Short, 2004; Spicer, 1978). Reputational effects associated with CSP are likely to take a number of years to develop, and from a competitive standpoint, the reputational effects of CSP are also difficult to imitate in the short term (Short, 2004). Thus, a long-term focus may have the dual effects of minimizing the disincentive to engage in CSP present in a short-term focus and increasing the incentive because of a longer term CSP-CFP relationship.

Hypothesis 2: A long-term focus in CEO pay will be positively related to CSP.

Method

Sample and Data

The sample was drawn from the 2001 Standard & Poor's 500 list. A total of 318 of these firms had not changed status across the years under study and were also present in the three databases used for data collection: the KLD CSP database, the Compustat database, and the Corporate Library board composition database. Deletion of firms due to missing data resulted in a final sample of 313 firms. The 313 firms vary significantly in terms of size, industry, and financial standing.

The board composition database is a custom compilation provided by the Corporate Library, recognized as a highly reliable independent rating agency that monitors corporate governance proceedings for publicly traded U.S. corporations. The KLD database is the largest multidimensional CSP database available to the public and is used extensively in research on CSP (Harrison & Freeman, 1999).

Measures

Corporate social performance. We measured CSP using six dimensions from the KLD 2002 CSP audit: employee relations, product quality and safety, community relations, natural environment, human rights, and diversity. We chose these dimensions because they are believed to reflect the stakeholder orientation toward CSP, were judged most important by ratings panels, and have demonstrated validity (Agle, Mitchell, & Sonnenfeld, 1999). The KLD audit further divides CSP into areas of strength and concerns. Strengths include those activities that reflect a focus on positive CSP within each of the above categories, whereas concerns cover areas in which a firm may exhibit poor CSP.

Within each of the KLD dimensions are several subcategories of social performance. Each of these categories receives a rating in the KLD audit from 0 (neutral) to 1 (strength/concern present). We aggregated ratings on each category within dimensions to arrive at a total strength and total concern score for each dimension. To calculate our final CSP measure, we calculated a net score for each dimension by subtracting total concerns from total strengths and then summed the net scores from each dimension for a grand total.

We used an aggregate measure of CSP because we are neither aware of a strong theoretical basis for making differential predictions for the separate dimensions of CSP nor for strengths versus concerns within dimension. In fact, we argue that strengths and concerns need to be considered in conjunction with one another because a firm that has concerns in a particular area may attempt to make up for them by developing strengths in that or other areas. As such, strengths and concerns may be somewhat interdependent measures and thus should not be specified independently.

Short-term pay focus. We computed short-term pay focus for CEOs by dividing the dollar value of bonuses earned by the CEO during the year by the total dollar value of pay including salary, bonus, and long-term income with stock options valued using the Black-Scholes method. The Black-Scholes method determines the current fair market value of stock options based on the standard deviation of the stock's rate of return. Essentially, fair market value is modeled as the present value of the stock option's exercise price less the expected benefit from acquiring the stock outright. Black-Scholes is the most common method used by firms to value stock options for pro forma disclosures. To smooth the data, we averaged data for years 2000 and 2001. The data were obtained from COMPUSTAT.

Long-term pay focus. We computed long-term pay focus for CEOs by dividing the dollar value of restricted stocks and stock options (valued using Black-Scholes method) granted to the CEO during the year by the total dollar value of pay including salary, bonus, and long-term income including stock options. Data from COMPUSTAT were again averaged for years 2000 and 2001. We specify short-term and long-term focus in separate equations, as our theorization does not suggest that either will be related to CSP after controlling for the other.

Control variables. We control for firm size, financial performance, percentage of outside representation on the board of directors, and industry because all have potential links to CSP and CEO pay and have been commonly specified in previous studies of CSP. Firm size was measured by the logarithm of total employees in 2001. Financial performance was measured by return on assets in 2001. Our performance and size controls are the same as those specified in a previous study on the CEO pay–CSP relationship (McGuire et al., 2003). Percentage of outside directors in 2001 was obtained through the Corporate Library database. Industry effects were controlled for by specifying dummy variables based on first-level Standard Industrial Classification (SIC) divisional classifications. Industries include mining, construction and manufacturing (these categories were combined because of the very small number of construction firms in our sample), transportation and related services, wholesale trade, retail trade, finance and related industries, and services. A finer grained specification based on a two-digit SIC classification was impractical given it would have entailed a significant loss of degrees of freedom. However, similar to Sanders and Carpenter (2003), we conducted a sensitivity analysis where we used two-digit SIC codes to calculate industry means for firm size and financial performance. We then specified, instead of industry dummy variables, firm size and financial performance divided by their respective industry means. Results were similar to those reported here, although the effects of pay focus were even greater in magnitude and statistical significance.

Table 1
Pearson Correlations and Descriptive Statistics

Variable	<i>M</i>	<i>SD</i>	1	2	3	4	5
1. Corporate social performance	0.55	2.94					
2. Short-term focus	0.13	0.10	-.12				
3. Long-term focus	0.63	0.24	.15	-.60			
4. Size	3.08	1.31	.05	.03	.07		
5. Financial performance	1.77	29.74	.06	.15	-.11	.07	
6. Outside board percentage	0.75	0.17	-.10	.04	.09	.15	-.00

N = 313

> .09, *p* < .05

> .12, *p* < .01

Results

Table 1 reports the means, standard deviations, and Pearson correlation coefficients of variables used in the analyses. In our sample, 13% of a CEO's pay package on average is made up of short-term pay, whereas a much larger percentage (63%) is devoted to long-term pay on average. However, the standard deviation of short-term focus (.10) is much larger compared to its mean, suggesting that there is more variation in how firms approach short-term pay compared with long-term pay. As expected, the intercorrelation between short-term and long-term pay focus, two of the independent variables, is significant ($r = -.60$). Multicollinearity also exists between certain control variables and independent variables. However, the problem is not considered serious because the variance inflation factors were all less than 1.3, well below the conventional cutoff of 10 (Neter, Wasserman, & Kutner, 1985).

Results in Table 1 provide initial support for both hypotheses, as the correlations between CSP and both short-term and long-term focus are statistically significant ($p < .01$). In the case of short-term focus, the correlation is negative, and in the case of long-term performance, the correlation is positive. Both study hypotheses are supported as well upon the inclusion of the control variables (see Table 2). Hypothesis 1 predicts a negative relationship between short-term pay focus and CSP. Results indicate that a short-term focus is significantly negatively related to CSP ($p < .05$) and that a long-term focus is positively related to CSP ($p < .05$). The total R^2 s for the equations are .08 and .09, respectively. Although statistically significant, the effects of pay focus on CSP are modest, as the inclusion of short-term focus results in an incremental increase of approximately .01 to R^2 , whereas the inclusion of long-term focus results in an increase of approximately .02.

Interestingly, the percentage of outside board membership is negatively related to CSP and approaches statistical significance in both equations. Results for industry indicate that the inclusion of the industry dummy variables results in a statistically significant increase in R^2 of .06 ($p < .01$) in both equations, which is sizable given the magnitude of the other effects in the study (for detailed results, please contact the first author).

Previous empirical research (Berman, Wicks, Kotha, & Jones, 1999) has found that some dimensions of CSP are more related to CFP than others. Employee relations and product qual-

Table 2
Regression Results: Effects of Pay Focus on Corporate Social Performance

Independent variable	Dependent Variable			
	Corporate Social Performance		Corporate Social Performance	
	<i>B</i>	<i>SE</i>	<i>B</i>	<i>SE</i>
Constant	2.09*	.81	0.91	.86
Control variables				
Size	0.15	.14	0.12	.14
Financial performance	0.01 [†]	.01	0.01 [†]	.01
Outside board percentage	-1.50 [†]	.97	-1.75*	.98
Short-term focus	-2.88*	1.69		
Long-term focus			1.59*	.69
Model <i>F</i>	2.66**		2.92**	
Model <i>R</i> ²	.08		.09	
ΔR^2 attributed to short-term and long-term focus	.01		.02	

Note: *N* = 313.

[†]*p* < .10

**p* < .05

***p* < .01

ity/safety were statistically related to CFP, but diversity, community relations, and natural environment were not (they did not include human rights in their study). By extension, based on the reasoning in this study, it is possible that CEO pay structure is more related to employee relations and product quality/safety than the other dimensions. We investigated the issue empirically by conducting regression analyses on each of the CSP dimensions separately, specifying the same control variables as in our models predicting total CSP. The results are summarized in Table 3. Pay focus is statistically or marginally statistically related to the dimensions of natural environment, human rights, and diversity, and not statistically related to the others. Thus, these results are inconsistent with implications of the Berman et al. (1999) study.

Discussion

The purpose of this study was to explore the relationship between CEO pay structure and CSP in light of the growing importance of CSP as both a valued organizational outcome and a means to greater CFP. Our findings provide support for the argument that the way a CEO's pay is structured has an effect on CSP. The more firms have a short-term focus on CEO pay, as measured by the percentage value of bonus in the total pay package, the less the firm's CSP. This suggests that a short-term focus provides the CEO a disincentive to engage in CSP. Based on our theorization, this is because investment in CSP is likely to have a limited or possibly negative effect on short-term financial performance, while representing an opportunity cost for scarce corporate resources. In contrast, our results suggest that the more firms use a long-

term focus in CEO pay, measured by the percentage value of restricted stock and stock options in the total pay package, the higher the firm's CSP. Based on our theorization, this is because a long-term focus removes the disincentives to engage in CSP present in a short-term performance and because in the long term, CSP and CFP are positively related.

This study is, to our knowledge, the first to identify a significant negative relationship between a short-term pay focus and CSP, and a significant positive relationship between a long-term focus and CSP. However, the percentage of variance in CSP explained by CEO pay structure was relatively small. There are undoubtedly several explanations for this, although one obvious one is that we should expect small effect sizes given the fact that the empirical relationship between CSP and CFP, though significant, is also not large. An instrumental CEO may be aware of this, and although motivated to take actions that affect CSP, may view CSP as but one of many possible ways to influence future pay.

Our results differ to some extent from those obtained by McGuire et al. (2003), who also studied the effects of CEO pay structure on CSP. They found no significant relationship between a short-term focus and separate measures of CSP strengths and concerns, no significant relationship between a long-term focus and CSP strengths, and a significant positive relationship between long-term focus and CSP concerns. One possible explanation for the differences in results is that McGuire et al. (2003) employed significantly different model specifications. They analyzed effects of pay focus on CSP strengths and concerns separately, whereas we combined them into an aggregate measure. They also included both short- and long-term focus in the same equation. To investigate the effects of these differences, we conducted supplementary regression analyses using the same specifications of CSP and pay focus as McGuire et al. (2003). Coefficient estimates for pay focus were the same directionally as those we report in Table 2, although not statistically significant. This suggests that model specification might partially explain the differences (for full results, please contact the first author). Another difference between studies is that McGuire et al. (2003) included only four dimensions of CSP. The two additional dimensions included in our study, human rights and diversity, were relatively strongly related to pay focus as indicated in Table 3. It is possible that our inclusion of these additional dimensions also may explain the differences in results.

Limitations of the Present Research

A potential limitation relates to the use of the KLD data to measure CSP, as criticism has been advanced regarding the reliability and validity of these data (e.g., Entine, 2003). As Waddock (2003) pointed out, however, the KLD data are likely to be no less reliable than much of the other data used in academic research, including data from corporate financial statements. From a validity perspective, the KLD data conform well to the definition of CSP used in this study (i.e., from Wood, 1991), and in general the KLD data have been shown empirically to be a good summary measure of corporate social action (Mattingly & Berman, 2004). Although other definitions of CSP can be advanced, our use of KLD data is appropriate from a construct validity perspective (Waddock, 2003).

The measure of CSP used to test our hypotheses was an aggregate of six dimensions. Berman et al. (1999) argued that dimensions of CSP including employee relations, product

Table 3
Effects of Pay Focus on CSP Dimensions

CSP dimension	Pay Focus	
	Short-Term Focus	Long-Term Focus
Employee relations	.24	.15
Product quality/safety	.06	.14
Natural environment	-1.10*	.65**
Human rights	-.53*	.13 [†]
Diversity	-1.60*	.47 [†]
Community relations	.04	.05

N = 313. Values are unstandardized coefficients. CSP = corporate social performance.

[†]*p* < .10

**p* < .05

***p* < .01

quality/safety, and natural environment are more likely to affect CFP and that diversity and community relations are less likely to affect CFP. Considering this, our results presented in Table 3, particularly the results related to diversity, do not provide support for our reasoning that firms align CEO incentives and CSP because of a CSP-CFP relationship. However, it should be noted that the Berman et al. (1999) data cover an earlier time period (1991-1996) than our study and that Short (2004), analyzing data through the year 2000, found that all dimensions of CSP, including diversity, were significantly related to some measures of CFP. It is also possible that much of the alignment we observe between a long-term pay focus and CSP is due to normative concerns, with CSP viewed by firms as an important goal independent of its effect on CFP.

Future Research

Future research should examine more closely the causal relationship of proven CSP predictors. This will require the use of more extensive data sets and consideration of possible lag effects of CSP antecedents. Future studies of the relationship between CEO incentives and CSP may also have to involve more detailed data, especially if the implications of a positive CSP-CFP relationship increasingly attract the attention of corporate compensation committees. One reaction to this relationship, as discussed in our Practical Implications section below, may be to tie various forms of short-term incentives (e.g., bonuses) to specific accomplishments related to CSP. To the extent firms structure incentives in this way, we can expect to observe a weaker negative, and perhaps even a positive, relationship between a short-term pay focus and CSP. It further implies that the basis for bonuses, not just the bonus amounts, should be accounted for in empirical models. As even publicly held firms are not required to report such detailed information, more intensive data collection may be necessary.

In terms of theory building, Hill and Jones (1992) suggested management-stakeholder relationships can be viewed as a nexus of “contracts between resource holders.” Their model

extends agency theory beyond the typical management-shareholder relationship to multiple stakeholders. Our research has demonstrated the relevance of agency theory in predicting management pursuit of CSP. Future research should continue to generalize the agency framework to the area of CSP, looking at both the implicit and explicit contracts that exist between management and stakeholders. Our study focused on incentives in the form of management pay, but consideration should also be given to other forms of interest-aligning incentives and external monitoring, an increasingly relevant motivation for firm CSP.

Finally, given calls to look at individual dimensions of CSP in addition to aggregated measures (e.g., Berman et al., 1999; Johnson & Greening, 1999; Short, 2004), future work should attempt to reconcile in particular the contradictory findings of Berman et al. (1999) and Short (2004) related to effects of dimensions of CSP on CFP. In the context of our study, data on this may help to shed light on the question of whether the relationship between CEO pay and particular dimensions of CSP is a result of instrumental versus normative concerns.

Practical Implications

The increasing focus on CSP has made it critical for firm owners to understand how specific governance mechanisms may accomplish or deter social performance goals. Issues surrounding executive pay and financial corporate scandal are prevalent. However, as firms seek to use pay as a control mechanism to direct executive performance, they must also consider the effect it may have beyond financial performance on social performance. Our results suggest that compensation committees of boards of directors should increase the long-term focus and decrease the short-term focus of their CEO pay packages to improve CSP.

CEO pay packages in the future can also affect CSP by providing direct and short-term incentive to improve CSP, as opposed to the indirect incentive represented by a long-term focus. This approach is currently very unusual (Jensen et al., 2004), although it is a more obvious way of addressing the agency problem related to CEO pay. Firms that have attempted this approach include Citigroup, which after being accused of predatory lending practices satisfied shareholder concerns by linking CEO pay directly to corporate social responsibility (Julavits, 2001), and Wal-Mart, which recently linked CEO bonuses to success in increasing diversity in the store-level management ranks because of several gender bias lawsuits (Chain Store Age, 2004).

Last, although we found that a long-term pay focus was associated with CSP, it is important to point out that we did not find that long-term pay *amount* was associated with CSP. Using the same control variables as in our other analyses, the effect of long-term pay amount on CSP was minimal in magnitude and statistically insignificant (for detailed results, please contact the first author). This is important because numerous concerns, ethical and otherwise, have been raised about high levels of CEO pay (Brown, 2002). It is long-term pay, most often in the form of stock options, that typically accounts for extremely high executive pay levels (Economist, 2004).

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