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The Impact of CEO Salary on Company Sustainable Development

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Abstract

There is a general agreement that extensive remuneration gaps may cause pressing environmental, social, and economic problems. Thus, a critical question to be answered is what is the effect of being at the forefront of corporate sustainability on the CEO–employee pay gap. This paper addresses the question by examining empirical evidence from 415 constituents of the S&P 1500 index over the years 2006–2016. For the above period, we found a positive relationship between a strong commitment to sustainable development at the firm level and the CEO–employee pay differential. Additionally, firms characterized by higher performance, growth potential, and financial robustness constituted more dispersed salary distribution environments. The findings also suggest that CEO gender has a significant effect on the pay gap with a moderating influence of female CEOs. The paper contributes to the literature by shedding additional light on the urgent need for the implementation of a limit capping the CEO–worker pay ratio at a certain, responsible level as one of screening criteria used by sustainability ranking providers. Furthermore, it also shows that leading corporations in the area of sustainability do not implement any serious solutions in the above area on their own accord.

Keywords

Corporate Sustainability; Executive Compensation; Fairness; Pay Gap; Corporate Governance.

1. Introduction

Excessive CEO pay becomes one of the central issues in the current corporate governance debate.

The CEO-to-worker compensation ratio in the S&P 500 index firms increased from around 42:1 back in 1980 to an astonishing 347:1 in 2013. It is much more difficult to justify on the basis of the most important economic rationales, like increased value for shareholders, proper performance, and productivity incentives or the greater complexity and the risk of an executive working environment .Furthermore, it is also exacerbated by the urgent need to address the increasing economic inequality in general, where the share of total income earned by the top one percent in the United States has been rising stably from around 7.8 percent in the early 1970s to around 20 percent in 2016. Finally, extensive pay inequality stands in contradiction to the general concept of sustainable development, as it constitutes a state that might no longer have the potential to serve human needs in the properly balanced fashion in the long run. Equity issues are inextricably linked to economic, social, and environmental quality-three main objectives of the idea of sustainable development. As such, justice in the distribution of income is one of the central themes of sustainability. Thus, under the sustainability umbrella, remuneration decisions should be subject to detailed ethical and environmental considerations. Furthermore, being at the forefront of corporate sustainability should have a profound impact on executive compensation and the pay differential between the CEO and the average worker.

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2. Organization of the Text

2.1. The Throughput Model Framework on Executive Compensation

There are quite a few channels of corporate governance. For example, Giroud and Mueller found that weak governance firms have lower equity returns, worse operating performance, and lower firm value, but only in non-competitive industries. As a function of CEO tournament as governance, Coles, et al found that firm performance, firm risk, and the riskiness of firm investment and financial policies are positively associated with the external industry pay gap. Regarding compensation incentives as governance, Core and Guay found that grants of new incentives from options and restricted stock are negatively related to these deviations. Finally, on the issue of mutual monitoring among the executives as governance, Li found strong evidence that suggests mutual monitoring provides important checks and balances on CEO power.

2.2. The Terminology of Corporate Sustainability

In addition to company responsibility and disclosure of information about activities,the board of directors' size, etc., can also affect stakeholders' evaluations of a company's reputation. Based on the studies conducted, the number of meetings held by the board of directors of companies can be used as a criterion for evaluating their activity level. The board of directors' level of activity can be used as a tool to monitor their performance and be a sign of corporate market responsibility , highlighting the relationship between the board of directors' activity and the company's performance. It is stated thatthe number of meetings held can cause the members of the board to meet with each othermore often and increase their compliance with the interests of shareholders, who create and maintain the company's reputation in the community.

The terms of corporate sustainability (CS) and corporate social responsibility (CSR) have many concepts and definitions in the literature. There is no standard definition that emerges as the companies consensus. Many studies consider corporate sustainability by following The Brundtland Report definition as "the ultimate goal that meets the needs of the present generation without compromising the ability of future generations to meet their own needs" . However, this study uses the terms CS and CSR synonymously as two sides of a coin, to refer to a wide range of business processes that voluntarily deal with triple bottom line performance (i.e, profit, people, and planet) in order to remain undamentally sustainable in long-term value creation. CS and CSR refer to a company's voluntarily activities, which demonstrate the involvement of social and environmental concerns into their business operations and in interactions with stakeholders .Companies invest substantially in their corporate reputation as a way to influence consumers . Given the background of studies on the NFSR, it can be argued that the procedures adopted by companies can help them achieve and maintain a good reputation. For example, companies' non-financial activities can affect their reputation by distinguishing their products and the services they provide. Companies' adherence to ethical principles can protect them against stakeholders' negative evaluations and increase their standing. The disclosure of information about non-executive directors can be achieved by reducing information asymmetry, providing appropriate information to stakeholders, attracting investors to companies, and preventing fraud in their reputation and growth. Companies' large shareholders can also positively impact companies' reputations by applying pressure to managers, creating appropriate procedures for transmitting information, and providing proper solutions to prevent fraud . Generally, previous research findingsregarding the relationship between reputation and sustainability demonstrate that in most cases, sustainability appears to be an antecedent of corporate reputation and a tool to enhance stakeholders' acceptance and perceptions of companies' activities. However, voluntary disclosure and the lack of a mandatory reporting framework for sustainability have led to the

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content of such reports often being determined by senior corporate management. Managers' decisions to disclose this type of information can significantly impact companies' performance and reputation because managers' personality characteristics cause some of them to view such information as a threat and others as an opportunity. According to studies conducted in Iran, the environmental, social, corporate governance, and ethical dimensions of such matters have not been addressed. In addition, after 2015,research on the links between corporate reputation and sustainability has increased; this has coincided with the launch of the United Nations' Agenda 2030 and its sustainable development goals. For this reason, companies are more involved in sustainability issues but, although reputation plays a crucial role in maintaining competitive advantage and achieving business goals, no comprehensive study has been done on the factors affecting it in Iran. A corporate reputation is the public's general view of a company and exists independent from individual impressions ; however, people in different social groups may endorse the same values, but associate different behaviors with them and personal experiences and the socio-cultural environment exert a strong influence at the concrete level. For this reason, it is expected that people in different countries would differ in their concrete (behavior) instantiations of values. Following this argument, CEO behavior might vary across the different environments, and Iran's managerial decisions may also be different from those in other countries. The literature states that CEO powercan be classified as an opportunity for CEOs' discretion and opportunistic behavior than stakeholder demands . A body of related literature on NFSR showed that despite the many applications and benefits involved, there are also several challenges, such as the CEO's unfamiliarity with the matter and the absence of the appropriate advertisement of NFSR by Iranian firms . The limited body of research on this topic shows the low quality of reporting non-financial information in Iranian firms, representing the existing gap in meeting stakeholders' expectations and its effect on investors' decision-making.

3. Literature References

This empirical study is designed to explore internal dynamics in CBM implementation based on multiple cases. For the exploratory purpose of this study, doing interviews in multiple cases is an appropriate research set up, as they promise in-depth insights and allow comparisons among the cases (Bocken et al., 2018). Eisenhardt and Graebner(2007) find that interviews are a valid data collection method for qualitative research in particular in more complex, rare and strategic-highlevel business situations. In addition, they state, 'Interviews are a highly efficient way to gather rich, empirical data, especially when thephenomenon of interest is highly episodic and in frequent'.(Eisenhardt & Graebner, 2007, p. 28). Their findings comply with theresearch set-up of this study. A similar research set-up was used by Golev et al. (2015) to find out barriers in industrial symbiosis and their approach is adapted for this study.

The data for this study were derived from an investigation of all constituents of the Standard and Poor's 1500 index for which detailed executive compensation data for both the CEO and other executive officers were available in Standard and Poor's ExecuComp database over the years 2006-2016. The average worker salary and all the other financial data used in this paper were derived from the Compustat and Infront Analytics databases. Being at the forefront of corporate sustainability was measured by the inclusion of a given company in at least one of the following benchmarks: the Dow Jones Sustainability World Index, the Fortune 500 World's Most Admired Companies list, Newsweek's Top 100 Green Companies in the U.S. ranking, or the UN Global Compact companies list. We used the four different and very popular ratings mentioned above concurrently in order to form a complete picture of the ongoing developments in the area of corporate social and environmental responsibility as possible and to avoid omitting any possible distinctive and over-average activism. The DJSI applies the

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component selection process based on the companies' total sustainability scores resulting from the annual corporate sustainability assessment. The assessment embraces between 80–120 industry-specific questions focusing on economic, environmental, and social factors that are relevant to the companies' success but that are under-researched in the conventional financial analysis. On the above basis, since 1999, the top 10% of the ranked companies from each industry are selected for inclusion in the Dow Jones Sustainability Index as the most sustainable ones. The FT 500 list consists of firms with outstanding reputations on the basis of the admiration of their employees, clients, and business world because of, among other factors, the quality of their management, employee talent, financial soundness, and social responsibility. It was first published in 2006. The NW 100 lists the top 100 particularly notable performers in the areas of environmental impact, green policies, and reputation score among the 500 largest U.S. companies based on their revenues, market capitalization, and number of employees. It looks at factors such as greenhouse gas emissions, water use, solid waste disposal, air pollution, toxic releases, environmental management, climate change mitigation and pollution policies, and environmental commitment and communication. It was first published in 2009. The UNGCCL, which launched in 2000 by the United Nations, is the world's largest voluntary network of companies and follows ten principles related to human rights, labor rights, environmental responsibility, the diffusion of environmentally friendly technologies, environmental protection, and social transparency.

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