Substance and symbol in ESG-linked executive compensation: evidence from Italian listed companies

Received
10th March 2022
Revised
27th May 2022
Accepted
7th June 2023

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Abstract

Framing of the research*: A very recent development in corporate governance studies concerns how to integrate environmental, social and governance (ESG) indicators in executive compensation plans. The debate is no longer about whether the use of ESG indicators in executive compensation makes sense, but about how to utilize them in the most effective way.*

Purpose of the paper: *Based on the neo-institutional theory (NIT) and on the substantive vs merely symbolic inclusion of ESG criteria in executive compensation plans, we describe the spread and frequency (of the use) of ESG indicators in chief executive officers' (CEOs') compensation plans devised by Italian listed companies, verifying, at the same time, the quantitative diversification of such indicators and the progress made by selected companies in recent years. In addition, our aim is to provide configurations that enable firms to give a higher weight to ESG indicators in their compensation plans.*

Methodology*: Our sample covers all Italian listed companies on the Financial Times Stock Exchange Milano Indice di Borsa (FTSE MIB) during the last five years (2017-2021). To analyse data and define the specific configurations mentioned above, we employed fuzzy-set qualitative comparative analysis (Fs/QCA).*

Results*: In an overall context that shows relevant progress in the adoption of ESG indicators as part of compensation plan metrics, three configurations emerged which achieve the highest ESG weights and correspond, according to our interpretation, to different levels of substantiality in ESG implementation.*

Research limitations: *First, we did not consider other conditions that could have helped to identify cases of symbolic adoption. Second, we have not examined the type of ESG indicators that firms adopt.*

Managerial implications: *Sustainability-oriented investors might look for signs in the bundle of characteristics of the remuneration policy to infer whether it corresponds to a more or less substantial implementation of the ESG activities.*

Originality of the paper: *To the best of our knowledge, our database is the first longitudinal database of ESG indicators in CEOs' compensation plans.*

Key words: ESG weight; ESG indicators; neo-institutionalism; symbolic adoption; substantial adoption; QCA analysis

1. Introduction

Recent economic and social pressures (i.e., the Covid-19 pandemic, as well as the emerging political and economic crisis) have increasingly encouraged more firms to adopt a stakeholder focus (Van Barneveld *et al.*, 2020). As a consequence, environmental, social and governance (ESG) variables have been proposed as metrics for gauging corporate efforts. As might be expected, ESG values have become increasingly popular and investment strategies driven by this sustainable perspective have gained popularity worldwide (Cornell and Damodaran, 2020; Díaz *et al.*, 2021; Zumente and Bistrova, 2021). These circumstances are also confirmed by statements published by several associations of primary company leaders and international organizations. The Business Roundtable, for example, a group of prominent chief executive officers (CEOs) of major US companies, announced that "while each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders" (2019). Therefore, they have declared that the purpose of the corporation no longer gives shareholders special consideration, but rather that corporations should serve the interests of all their stakeholders (Harrison *et al.*, 2020). Moreover, the universal purpose of the "Davos Manifesto 2020" outlined by the World Economic Forum, which states that "the purpose of a company is to engage all its stakeholders in shared and sustained value creation", clarifies the mentioned shift in companies' objectives, as well as in international public-private cooperation.

According to this perspective, the alignment between the interests of shareholders and managers (Barnea and Rubin, 2010), rather than being reduced in importance as a research theme, has gained a renewed attention and prominence, particularly in terms of designing new incentives schemes aiming at fostering firms' responsible behaviour which will result in the aforementioned legitimacy and in a "win-win" situation (Baron, 2009; Farooq *et al.*, 2017). We have recently noticed a profound shift according to which organizations are moving away from the idea of "doing good but not well" to embrace the idea of "doing good and well" (Krishnamoorthy, 2021, p. 2; Ya Ni *et al.*, 2018).

Based on this, companies have also started to incorporate ESG metrics into executive compensation (Flammer *et al.*, 2019). According to Baraibar-Diez *et al.* (2019), this represents the "response to demands of society in terms of sustainable behavior" (2019, p. 1457). As noted, companies must acquire a renewed role in the social and economic systems that leads them to reach a (new) legitimacy (Baccarani *et al.*, 2020; Matthews, 1993; Romito *et al.*, 2021). According to the organizational literature (Ashforth and Gibbs, 1990), firms may obtain this so-called "citizenship" (Melo and Garrido-Morgado, 2012) on a large scale, as well as through "coercive, mimetic and normative isomorphism" (DiMaggio and Powell 1983), that will result in a compliance with the values, norms and expectations of a greater number of community members (Perrow, 1970).

Therefore, the debate is no longer about whether the use of ESG indicators in executive compensation plans makes sense, but instead about how to utilize them in the most effective way. On this point we have

several confirmations that the inclusion of ESG indicators in executive compensation plans is also a topical theme for practitioners. The Haut Comité de Gouvernement d'Entreprise (High Committee for Corporate Governance) for instance, in its 2020 report, highlighted the necessity of including at least one environmental indicator in the determination of an executive's variable compensation.

These observations raise an interesting question: *what are the governance factors that affect the ESG weight in remuneration plans?*

In contrast to previous research on this topic, which mostly aimed at demonstrating whether implementing a sustainability-based compensation policy has a positive influence on companies' ESG and economic engagement (Baraibar-Diez *et al.*, 2019), or on long-term orientation and the firm's value (Flammer *et al.*, 2019), this paper is based on a configurational approach as part of the emerging neo-configurational direction of the study of management (Misangyi *et al.*, 2017).

The purpose of this paper is therefore threefold. First, we will provide, following other authors (Aguilera *et al.*, 2006; Cucari, 2019b), a response to the calls for alternative theories in corporate governance studies by adopting a multi-dimensional and all-encompassing one, as suggested by Haque and Ntim (2020), based on the neo-institutional theory (NIT) and on the substantive vs merely symbolic inclusion of ESG criteria in executive compensation plans (Adu *et al.*, 2022).

Second, our study will describe the spread and frequency (of the use) of ESG indicators in the CEOs' compensation plans outlined by Italian listed companies, verifying, at the same time, the quantitative diversification of such indicators and the progress made by selected companies in recent years.

Finally, we will provide three specific configurations of key governance and social performance variables that enable firms to give a higher weight to ESG indicators in their executive compensation plans.

To accomplish these objectives, after gathering data from companies' compensation reports, we build a novel database that compiles information on the composition of compensation plans with reference to ESG indicators. Our sample covers all Italian listed companies on the Financial Times Stock Exchange Milano Indice di Borsa (FTSE MIB) during the last five years (2017-2021) and, to the best of our knowledge, this database is the first longitudinal database of ESG indicators in CEOs' compensation plans. To analyse the data and define the specific configurations mentioned above, which is the main contribution of this paper, we employ fuzzy-set qualitative comparative analysis (fs/QCA), which is broadly recognized as an appropriate method in social science for defining different combinations indicating a specific outcome (Cucari, 2019b; Misangyi *et al.*, 2017; Pappas and Woodside, 2021).

Our study is structured as follows: Section 2 illustrates the theoretical background; Section 3 describes the fs/QCA methodology and Section 4 reports the descriptive statistics and fs/QCA results. Lastly, Section 5 includes the discussion and concluding remarks.

2. Theoretical background

2.1 *Corporate governance and social responsibility in the neo-institutional perspective*

According to the Cadbury Report (1992), corporate governance refers to the system by which firms are controlled and managed (MacMillan *et al.*, 2004). The European Commission (2011) states that firms can be viewed as responsible if they are able to go beyond the compulsory law requirements when integrating social and environmental concerns into their strategies and operations. These two mentioned definitions would apparently deny a direct relationship between corporate governance and corporate social responsibility (CSR), leading to the so-called "separation thesis" (Harris and Freeman, 2008). However, the broader approach to CSR indirectly encompasses corporate governance mechanisms, while ESG even explicitly includes corporate governance as one of the pillars of firms' socially responsible business models and behaviour (Gillan *et al.*, 2021), reaffirming that corporate governance is in any case viewed as a topical theme in social responsibility.

On this point, scholars have long debated whether social and environmental concerns should or not be a managerial objective. The well-known Friedmanian position, according to which the only social responsibility of business is to increase its profits (Friedman, 1970), has indeed been opposed by the stakeholder approach (Freeman, 1984; Freeman and Velamuri, 2006), according to which companies should be managed in the interest of a wider range of parties, including their macro-environment (Clarkson, 1995).

This latter vision, which is consistent with the communitarian position (Lashgari, 2004) has, over time, gained a higher consensus that has become even more evident in the last two years because of the Covid-19 pandemic and its effects on the community. According to this wider perspective, corporate governance and CSR have several points of contact (Aguilera *et al.*, 2006) and together contribute to sustainability and best business practices, laying the foundation for a new way of sustainable competitive advantage (Ho, 2005) and long-term wealth creation (Beltratti, 2005). In this way, managers can fulfil their moral, ethical and social duties, while also targeting corporate goals for their shareholders (Jo and Harjoto, 2012).

Therefore, unlike the agency model (Jensen and Meckling, 1976), the synergistic relationship between CSR and corporate governance, rather than being illusory (Bebchuk *et al.*, 2022; Bebchuk and Tallarita, 2021), leads to a "win-win" situation for shareholders and other stakeholders (Edmans, 2021).

The recognition of a synergistic relationship between corporate governance and CSR is further reinforced according to the theoretical perspective that places both along the so-called corporate responsibility continuum (Bhimani and Soonawalla, 2005; Jamali, 2008), as corporate governance, social and environmental concerns can all be viewed as elements that contribute, in an integrated way, to the sustainable growth of firms (Van den Berghe and Louche, 2005).

From this viewpoint, the needed new measures of value creation should include ESG goals as a complement to standard financial metrics (Schwab, 2019). Moreover, ESG objectives are not only a supplement to financial information, but also a driver of companies' overperformance, since many scholars have found a positive relationship between ESG and financial performance that means that short-term ESG investments lead to long-term higher value creation (Friede *et al.*, 2015; Henisz *et al.*, 2019; Mishra, 2020), resolving the debate on different forms of capitalism (Stiglitz, 2019) and, in particular, on responsible capitalism (Stulz, 2022).

Since companies are open systems deeply interconnected with the individuals and communities to whom they are somehow accountable (Russo and Perrini, 2010), besides the more intuitive beneficial effects in terms of efficiency (Brammer and Millington, 2005) that firms can obtain through higher ESG engagement, scholars have highlighted the relevance of responsible behaviour in responding to stakeholders' pressures, thus acquiring legitimacy and creating competitive advantage (Halkos and Piazons, 2016; Lee *et al.*, 2018). Indeed, Sen *et al.* (2006) defines CSR as the set of activities put in place by firms to fulfil their obligations to society, thus establishing and enhancing their societal relationships (Sun *et al.*, 2019). Therefore, since ESG concerns are constantly raising their importance in the worldwide community, thus improving the stakeholder pressure on firms, the relationship between companies and stakeholders can be enhanced by additional investment by firms in ESG performance. This strategic choice may result in a higher reputation for firms (De Castro *et al.*, 2006), that is, the set of expectations, perceptions and opinions that stakeholders have regarding the values and behaviours of a given organization (Fombrun *et al.*, 2000). By demonstrating that they respond to ESG pressures, firms may raise their reputation and obtain so-called citizenship (Matten and Crane, 2005) and legitimacy (Carroll, 1994).

The aforementioned reasons for which companies may consider it worth raising their ESG engagement is consistent with the NIT, which is recognized as a dominant theoretical framework in organizational studies (Alvesson and Spicer, 2019, p. 204). Indeed, the NIT suggests that a firm's response to institutional pressures is often stimulated by two reasons: efficiency (substantive/economic) and legitimization (symbolic/impression management) (Meyer and Rowan, 1977). Of course, both aspects motivating the response of firms to stakeholder pressure are driven, on a large scale, by the three well-known mechanisms of institutional isomorphism: the coercive one, that originates from political influence, the mimetic one, that stems from risks and responses to uncertainty, and the normative type, which is mainly related to education and professionalization (DiMaggio and Powell, 1983). All three forms and, at the same time, causes of isomorphism are currently strongly in place with reference to ESG issues. From a coercive point of view, the incentives for social and environmental responsibility have increased significantly over recent years (consider that about 500 of the 800 billion euros of Multiannual Financial Framework 2021-2027 and NextGenerationEU are allocated to CSR objectives), in addition to the sanctions. Similarly, from a competitive point of view, globalization and the more rapid diffusion of

information, which have increased in the last 10 years due to technological progress, have exacerbated the reputational risks for companies, leading them, in a mimetic way, to pay more attention and neutralize their gaps in terms of ESG engagement. Lastly, as Ghoshal warned in 2005, academic and managerial training has increasingly drawn from scientific research in terms of the aforementioned shift from a shareholders' view to a stakeholders' one, which is consistent with a greater ESG engagement, in order to prevent bad theories from negatively influencing good managerial practices (Ghoshal, 2005).

In order to fulfil stakeholder expectations and obtain reputation and legitimacy, companies have to accurately disclose information on their responsible behaviour (DasGupta, 2021). Indeed, scholars have highlighted that one of the main reasons why CSR activities fail to create the expected added value is that firms do not effectively communicate their socially responsible activities (Kim, 2017). Obviously, corporate social disclosure impacts differently on different companies. Firms that, because of their core activity, may more heavily and negatively impact on the community (as is the case of chemicals, food or pharmaceutical companies, for instance) are more likely to give greater attention to this topic and diffuse more information about their social and environmental engagement (Boutin-Dufresne and Savaria, 2004; Gao *et al.*, 2005). Likewise, larger companies, who typically have a larger impact on community as well as greater notoriety, usually suffer higher stakeholder pressures, to which they have to respond with an analogous level of non-financial disclosure (Carlisle and Faulkner, 2004; Graafland *et al.*, 2004). Additionally, country-specific characteristics may influence the required level of social disclosure, given that the varying forms of capitalism and governance that characterize companies in various contexts may differently affect the expected level of CSR disclosure (Aguilera *et al.*, 2006; van Der Laan Smith *et al.*, 2005). Regardless of the higher or lower need to communicate organizations' social performance, it is clear that social disclosure, like any other business communication, responds to the need to reduce information asymmetry towards stakeholders, including financial ones (Gangi *et al.*, 2019). Indeed, both debt and equity (institutional investors) holders, through this greater information disclosure, may be able to better evaluate companies' risk, thus limiting the well-known problems of adverse selection (Verrecchia, 2001).

The abovementioned considerations describe a clear theoretical and practical background, but there is still one last element missing. Since, especially in terms of improving economic efficiency, the costs associated with greater ESG engagement are more likely to turn into financial performance improvements only in the medium to long term, and managers are more typically evaluated on the basis of short-term performances, some incentive mechanism is needed to align the interest of executives with this new conceptualization of enlarged value creation, that may be fostered by institutional forces that compel firms to sustainability-based compensation (Adu *et al.*, 2022) and also result in the described enhancement of shareholder value.

2.2 ESG-linked compensation plans

Following the "pay for performance" assumption, several authors have stated the importance of ESG-based compensation policies for motivating executives to pursue sustainable objectives beyond financial performance (Haque, 2017). Moreover, the study of Flammer *et al.* (2019, p. 1099) showed that the adoption of CSR contracting - as the integration of CSR criteria in executive compensation - leads to: i) an expansion in long-term orientation); ii) growth in firm value; iii) a rise in social and environmental initiatives; iv) a reduction in emissions and v) an increase in green patents, but did not provide any evidence regarding the link between compensation plan design and corporate social performance.

Nevertheless, as reported by Maas (2018), most of the existing studies focus on the effect of executive compensation on corporate social performance and only a few analyse whether this effect changes when corporate social performance targets are used. Furthermore, according to Stern (2020), most ESG-linked bonus plans are poorly designed, which may be the reason they achieve such mixed results. In addition, the criticisms are related to the scarce transparency and the absence of outside reviewability (Bebchuk and Tallarita, 2022). However, the inclusion of ESG metrics in compensation plans could depend on internal and external factors. As shown by Cohen *et al.* (2022), the inclusion of ESG metrics, at a macro-level, is more common in countries that are generally perceived to be ESG-sensitive; at a micro-level, it is associated with firms that have publicly issued environmental commitments, as well as those with more independent boards that have a higher percentage of female members and the presence of institutional investors.

Therefore, the debate has shifted regarding the substantive vs merely symbolic inclusion of ESG criteria in executive compensation (Adu *et al.*, 2022), since organizations, as already stated, frequently try to pursue legitimacy through both symbolic and substantive practices (Ashforth and Gibbs, 1990). In this scenario, only a few authors have focused on the substantive vs merely symbolic inclusion of ESG indicators in executive compensation plans (Adu *et al.*, 2022), although some discussion concerning whether CEOs' compensation may be driven by symbolic and substantive considerations has been developed in the less recent past (Zajac and Westphal, 1995).

From this perspective, understanding both the progress that companies are making towards a greater inclusion of ESG goals in executives' compensation plans and identifying the driver of this new form of alignment between shareholders and managers objectives is critical. In the following sections of this paper, we will contribute to the existing literature filling this gap by both describing the recent progress in terms of ESG-related compensation plans by Italian firms and investigating how some variables, such as the "say on pay", the compensation committee independence and the compensation plan structure, may lead to a higher weight of ESG goals in the CEO's compensation plan.

The compensation committee is an important element of the corporate governance structure, since it may heavily contribute to reducing agency

problems by improving the alignment of executive remuneration with shareholders' objectives (Murphy, 1985). Therefore, several studies state that to obtain this alignment and push executives to raise companies' CSR engagement, the compensation committee should tie managers' remunerations to CSR objectives (Al-Shaer and Zaman, 2019). The relevance of this choice has been verified by Hong *et al.* (2016), who provide evidence of a positive relationship between CSR-linked remuneration for CEOs and CSR performance. In this context we decided to include, as an explanatory variable of the CSR weight in the compensation structure, the independence of the remuneration committee, since this characteristic among the board members is likely to promote a higher CSR engagement (Jo and Harjoto, 2011; Jo and Harjoto, 2012).

Another corporate governance mechanism that can somehow reduce the aforementioned misalignment between shareholders and managers is the vote on the remuneration plan ("say on pay"). Through this mechanism, shareholders express their opinion on executives' compensation (Conyon and Sadler, 2010; Esposito De Falco *et al.*, 2016), showing an increased activism towards orienting managerial behaviour (Cucari, 2019a). However, even if less attention has been paid to this element in previous CSR research (Lozano-Reina and Sánchez-Marín, 2020), some authors have found that the nature and level of CEO remuneration are positively linked to CSR performances (Cullinan *et al.*, 2017).

Finally, we included in our empirical analysis two more elements: the number of ESG indicators and the total number of performance indicators used to define short-term incentives. We incorporated these two measures because, on one hand, the number of ESG indicators in the compensation structure can serve as a proxy for a broader and more diversified vision of CSR engagement, which is consistent with the legitimacy theory and with the need for an enhanced disclosure of firms' sustainable behaviour. On the other hand, we decided to take into account the overall number of indicators included in the compensation structure because it can serve as a proxy for less limited discretion regarding managerial behaviour, which is consistent with higher agency problems and, therefore, with a higher necessity of including CSR objectives as a part of the CEO's compensation in order to more effectively align their interests to shareholders' ones.

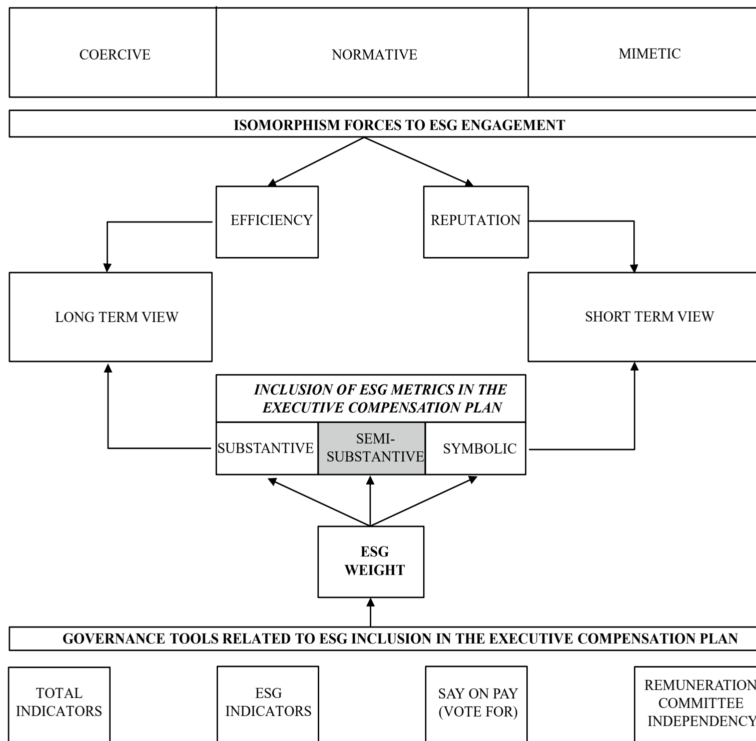
When investigating the effect of the selected variables on the relative weight assigned to ESG performance indicators in the overall compensation plan, our contribution will provide different configurations of the mentioned drivers that can lead to shaping a more symbolic or substantive inclusion of ESG scores in compensation plans. Indeed, our theoretical perspective, relying on the NIT, takes into consideration that organizations are highly concerned about social and symbolic pressures arising from their institutional environment (Suddaby *et al.*, 2013) and may adopt this kind of practices simply for legitimacy effects, while providing only an appearance of economic rationality.

As described in the following image (Fig. 1), our theoretical framework first considers the forces of organizational isomorphism that drive greater corporate engagement in social responsibility. These forces orient a firm towards greater social responsibility primarily to achieve

efficiency goals (in the long term) or to improve the company's reputation and citizenship (in the short term) Similarly, there are governance variables, such as the say on pay vote and remuneration committee independence, that push companies towards a greater adoption of ESG metrics (ESG weight) in structuring executive compensation plans.

The result of the varying incidence of these variables across firms ends up determining a substantive, semi-substantial (grey zone) or symbolic approach to the inclusion of ESG metrics in the structuring of compensation plans. Ultimately, an essentially substantive approach to the inclusion of ESG metrics turns into a more short- or medium- to long-term view of the topic.

Fig. 1: Conceptual model



Source: Own elaboration

3. Methodology

3.1 Sample

The dataset consists of all Italian firms listed on the FTSE MIB during the period from 2017 to 2021. This time frame was chosen to allow for an investigation of the impact of ESG indicators during the recent Covid-19 pandemic. ESG compensation in the Italian context has received

scant attention, and to the best of our knowledge, no other studies have addressed the variations in ESG indicators in executive plans. Given the normative and political pressures they normally bear, listed companies are particularly interesting to examine within a neo-institutional framework, whose aim is to make sense of the institutionalization of organizational practices under the effects of contextual influences. By the same token, listed companies are more likely to carry out a merely symbolic and formal application of new practices, such as ESG implementation, simply to comply with the dominant institutional context. Appendix 1 provides the final list of companies (26) we have included in the sample according to the availability of data.

3.2 Qualitative comparative analysis

Recently, different authors have suggested a more pluralistic range of theory building and methods for studying corporate governance (Boyd *et al.*, 2017; Cucari, 2019b; Filatotchev and Wright, 2017; Tihanyi *et al.*, 2014). One of these is certainly the introduction of qualitative comparative analysis (QCA) in corporate governance studies (Cucari, 2019b; Garcia-Castro *et al.*, 2013).

QCA has led to a new wave of "neo-configurational" studies that explicitly embrace causal complexity (Greckhamer *et al.*, 2018; Misangyi *et al.*, 2017). For a deeper review concerning different approaches and tools in QCA design, see Thomann and Maggetti (2020). Briefly, QCA aids in the identification of causal structures (Fiss *et al.*, 2013; Ragin, 1987) and it is an instrumentation of generic analytical approaches for which qualitative methodologists advocate (Kan *et al.*, 2016). Specifically, Filatotchev and Wright (2017, p. 459) prescribed a "qualitative research… based on using rich research and governance-related documents at the firm's level" and other recent contributions suggest that the literature requires a much richer empirical base.

In this sense, QCA has been adopted in corporate governance research to empirically help tackle the complexity implied by the bundle perspective on corporate governance (Cucari, 2018; Khlif *et al.*, 2019). Specifically, we adopted the fs/QCA that allows researchers to define the value of conditions not only in a dichotomous way, but also in gradual variations. The use of fs/QCA requires the selection of a calibration method to transform the original values into fuzzy set values for both the causal and outcome conditions (Ragin, 2009), as discussed in the next section.

3.3 Data and operationalization of outcome and causal conditions

Since we adopted the Fs/QCA, we needed to express variables into sets and subsets according to their degree of membership in a specific condition (the calibration process). Our analytical model comprised one outcome, which measures the relative weight assigned to ESG performance indicators in short-term incentive plans and four causal conditions in line with the literature above (Tab. 1).

Tab. 1: Outcome and conditions

Outcome/conditions	Data source	Description
ESG weight (outcome)	Report on remuneration policy and payments	Relative weight (%) assigned to ESG performance indicators used to define short-term incentives
ESG Indicators (condition)	Report on remuneration policy and payments	Number of ESG indicators used to define short-term incentives
Total indicators (condition)	Report on remuneration policy and payments	Total number of performance goals used to define short-term incentives.
"For" votes (condition)	Elaboration of the meeting minutes and of the summary report of the votes	Percentage of favourable votes over the total of the votes expressed by investors for the first section of the remuneration report (remuneration policy).
Degree of independence of the remuneration committee (condition)	Report on corporate governance and ownership structure	Percentage of independent directors (according to the criteria of the corporate governance code) over the total of directors composing the remuneration committee.

Source: our elaboration

The calibration process can be based on theoretical criteria when available. Unfortunately, in this case, we were not able to use any theoretical criteria and consequently, based on other studies, we followed the practice of relying on sample statistics such as percentile scores (Greckhamer, 2016; Paolone *et al.*, 2021). In this study, the values of the 95th, 50th and 5th percentiles correspond to full membership, the crossover point and full non-membership, respectively: full membership (fuzzy score = 0.95); the crossover point (fuzzy score = 0.5); and the threshold for full non-membership (fuzzy score = 0.05).

Tab. 2 shows the calibration process and indicates the transformation of both the outcome and the conditions into fuzzy terms.

Tab. 2. Calibration process

Outcome/conditions	Calibration values		
	Full non-membership	Crossover point	Full membership
ESG weight	0.05	0.13	0.24
ESG Indicators	0.63	1	2
Total indicators	3.7	6.25	15.7
"For" votes	0.75	0.92	0.97
Rem committee independence	0.67	0.83	1

Source: our elaboration

We considered the value average both for the outcome and for the causal conditions over a period of five years. Finally, we set our consistency threshold at a minimum of 0.80 (Ragin, 2008).

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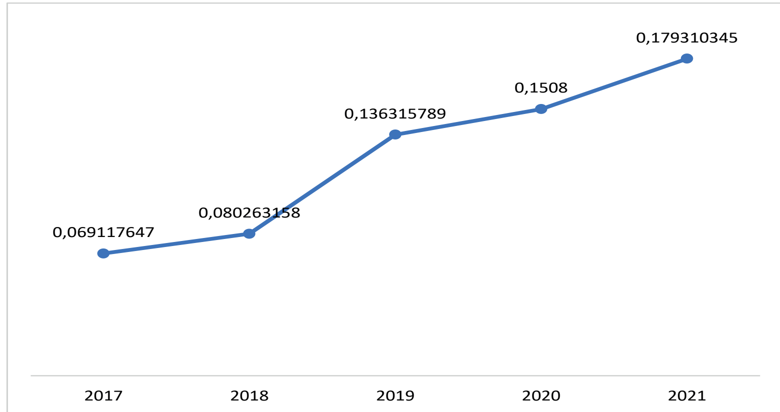
italian journal of management
Vol. 41, Issue 2, 2023

4. Results

4.1 Descriptive statistics

The following figures and tables show the descriptive statistics for all the variables used in the analysis.

Fig. 2: Average ESG weight over time



Source: our elaboration

The average ESG weight, for firms in our sample, has been growing quickly in recent years (Fig 2). This trend seems to have started even before the Covid-19 pandemic, so that it is hard to tell whether the virus-related crisis has had any impact on the employment of ESG indicators as part of executive remuneration. The average number of ESG indicators and of total indicators across the five years, as well as the relative percentage of ESG indicators over the total, are shown in Tab. 3. It is worth noticing that the ESG weight does not equal the percentage of ESG indicators, and that the latter has been generally higher and has been growing more slowing than the former across the years.

Tab. 3. Average ESG indicators and total number of indicators over time

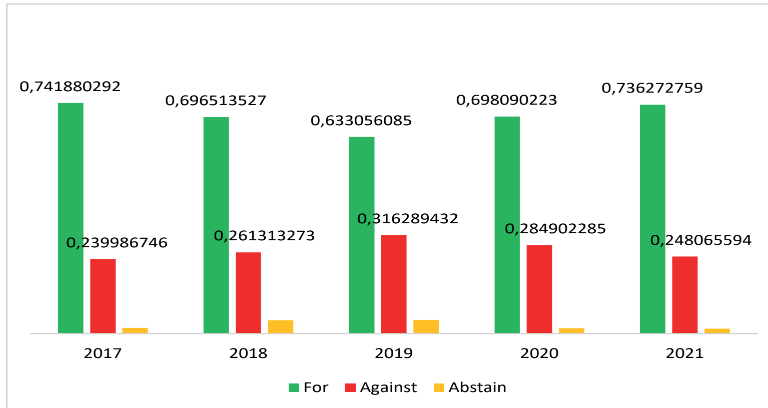
	2017	2018	2019	2020	2021
Number of ESG indicators	0.65	0.70	1.15	1.42	1.76
Total number of indicators	6.65	6.16	6.62	7.88	7.97
Percentage of ESG indicators over total number of indicators	18.54%	19.67%	22.34%	25.14%	25.51%

Source: our elaboration

The percentage of "for" votes over total votes is relatively high (always greater than 60%) in all the years considered (Fig. 3), with a relevant minimum in 2019 (63.31%). However, it should be considered that these votes include the ones from block holders and majority shareholders, who

tend to approve executive decisions and to increase the percentage of "for" votes. Therefore, even a small fraction of voting dissent is indicative of shareholders' satisfaction, and especially of minority shareholders.

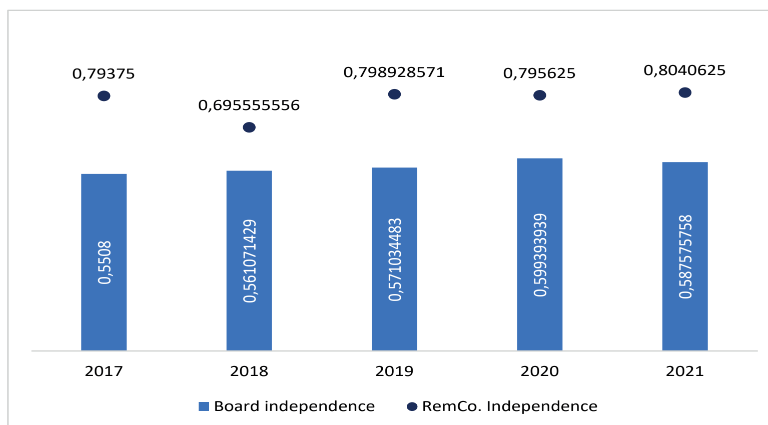
Fig. 3: Percentage of "for" votes over total votes



Source: our elaboration

Fig. 4 shows the average percentage of independence of both the board and the remuneration committee of the firms in our sample. It is immediately evident that there is an abrupt drop in board independence in 2018, even if there are no dramatic changes in remuneration committee independence in this year as compared to the other four years.

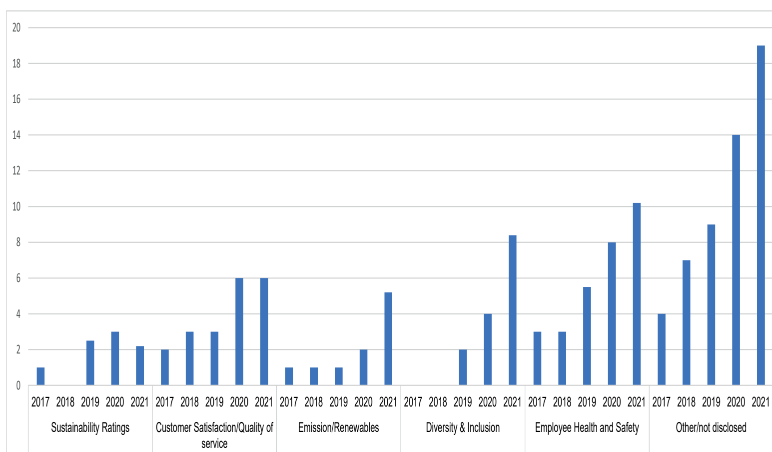
Fig. 4: Percentage of "for" votes over total votes



Source: our elaboration

Finally, Fig. 5 shows the evolution of the number of ESG indicators over the five years, divided by category. It emerges that, even if all categories have been growing over time, most of the indicators are in the category "other/not disclosed".

Fig. 5: The number of ESG indicators divided by category



Source: our elaboration

4.2 fs/QCA results

The results of the fs/QCA are shown in Tab. 4. Following the notation introduced by Ragin and Fiss (2008), we have reported consistency and coverage values for each configuration, as well as for the overall solution for each outcome. The coverage value indicates how much of the outcome is explained by a given configuration and therefore reflects the empirical importance (Ragin, 2008). The consistency signifies how closely a perfect subset relationship is approximated. In our study, we obtain an overall coverage value of 0.51 and an overall consistency value of 0.95, which are suitable scores for the analysis.

Coverage indicates empirical relevance, so greater coverage implies that the solution has a greater empirical relevance (Ragin, 2009), which means that a greater number of empirical cases are covered.

Tab. 4: fs/QCA results

	Configurations		
Conditions	1	2	3
ESG indicators	•		•
Total indicators	ᵒ	ᵒ	
'For' votes	ᵒ	ᵒ	ᵒ
Remuneration committee independence		•	•
Note: Black circles ("•") signify the "presence" of a condition, circles with a cross-out ("ᵒ") represent its "negation", and blank spaces in the solutions indicate "don't care".			
Raw coverage	0.38	0.37	0.35
Consistency	0.96	0.05	0.97
Solution coverage	0.51		
Solution consistency	0.95		

Source: our elaboration

The findings reveal three "equifinal" configurations that lead to higher ESG weights:

- solution #1: a high number of ESG indicators, with a low number of total indicators, associated with a low percentage of "vote for" and "don't care situation" regarding the level of independence of the remuneration committee. We define this configuration as a *symbolic ESG inclusion*;
- solution #2: a low number of ESG indicators, with a low number of total indicators, associated with a low percentage of "vote for" and a highly independent remuneration committee. We define this configuration as a *semi-substantive ESG inclusion*;
- solution #3: a high number of ESG indicators, with a "don't care situation" for the total indicators, associated with a low percentage of "vote for" and a highly independent remuneration committee. We define this configuration as a *substantive ESG inclusion*.

5. Discussions and conclusion

As suggested by some authors (Furnari *et al.*, 2021), we adopt "configurational thinking and theorizing" that are well suited for explaining causally complex phenomena. According to our results, we find that some variables/conditions are conducive to higher ESG weights in compensation plans. Although all three configurations are associated with a higher ESG weight, they nonetheless correspond to different "bundles of values" that allow us to interpret the outcome ESG weight as more or less "substantial" or "symbolic".

In other words, even if the outcome is the same (i.e., a higher ESG weight) it can be interpreted differently (e.g., a symbolic ESG implementation), depending on the background conditions (i.e., configurations) from which the output arose. From the perspective of neo-institutionalism, in some configurations, the formal application of ESG standards, as proved by a high ESG weight, is decoupled from the actual practices carried out by organizations (Boxenbaum and Jonsson, 2017).

Specifically, based on our theoretical framework, the configuration that can be associated with the highest degree of substantiality is Solution #3. In this case, we consider that the larger the number of ESG indicators are present in a remuneration plan, the greater the awareness of the company decision-makers of their importance for keeping track of ESG performance. In addition, a truly independent remuneration committee ensures that ESG implementation is not simply a matter of appearance but that it is truly embedded into the organizational culture (Abdelmotaal and Abdel-Kader, 2016). The total number of indicators used in a compensation plan is irrelevant.

The other two configurations present lower levels of substantiality in ESG-linked compensation plans. Both these configurations include a lower number of total indicators, which might be an indication of insufficient attention towards fine-tuning the system of incentives or even towards transparency regarding the internal processes of the firm. More specifically, Solution #2 appears to be in the middle in the substantial-symbolic

continuum. The high ESG weight is achieved in this case when there is a low number of total indicators in the remuneration plan. Therefore, even if the remuneration committee is highly independent, it might be that the remuneration plan is not sensitive enough in taking into account all the nuances in performance goals (both financial and non-financial ones) that can be linked to incentives for executives. As a result, the ESG weight might result from a more contingent and less thoughtful evaluation.

Finally, Solution #1 is the one that, among the three, seems to correspond to the least substantial, and so the most symbolic, ESG implementation. In fact, this configuration includes those organizations that generally obtain a low percentage of "for" votes, while having a remuneration plan that includes fewer total indicators and several ESG indicators. At the same time, in this case it is therefore irrelevant whether the remuneration committee is essentially independent. Furthermore, the low number of total indicators, coupled with the relatively high number of ESG indicators, might indicate that the ESG weight is artificially inflated by using too many ESG indicators that have little relation to the firm's operations.

Several theoretical and practical implications can be drawn. First, an important result is that one of the variables presenting the same value in all three configurations is the low percentage of "for" vote percentage. This is not surprising, since higher voting dissent is often intended almost as a synonym of shareholder activism (Stathopoulos and Voulgaris, 2016) and so it can be interpreted as a sign of the attention of investors towards the corporate strategy issues, including sustainability concerns (Grewal *et al.*, 2016; Esposito De Falco *et al.*, 2018). However, it must be considered that the "for" vote relates to the remuneration plan as a whole, so that investors have no way of approving or rejecting a single component (e.g., financial indicators, ESG indicators) of the remuneration plan. Therefore, lower percentages of "for" votes are intended as general dissent regarding the remuneration plan, but not ESG weights specifically. This result is in line with the growing number of companies that are linking executive pay to sustainability metrics. Therefore, it emerges that the "say on sustainability", like the "say on pay", could govern the votes at the upcoming shareholder meetings. Consequently, examining the configuration of variables could help investors to vote more conscientiously. Sustainability-oriented investors might look for signs in the bundle of characteristics of the remuneration policy to infer whether it corresponds to a more or less substantial implementation of ESG engagement.

Second, another important result is represented by the percentage of independent directors within remuneration committees, which have the responsibility of designing the remuneration plan and defining the remuneration policy (Kuo and Yu, 2014). This governance variable should be free of burdensome ties with the other decisional tiers of the organization, so that it can best design incentive systems that truly align the interests of owners, managers and other stakeholders. The presence of directors who are not independent can undermine the functionality of the remuneration committee, which ends up being dominated by the interests of executives and top managers and being unable to defend the interests of all other stakeholders, including society. Independent directors safeguard

the interest of all stakeholders and ensure that the implementation of ESG goals is embedded within the organizational culture and not decoupled from the actual organizational practices (Park and Zhang, 2020).

Third, the number and the type of ESG indicators adopted can be an indication for investors of how symbolic or substantial the adoption of the ESG logic within the firm is, as emerged from the descriptive analysis. Too few or vague, general, or poorly measurable indicators may indicate a purely formal compliance with sustainability, which allows the firm to define themselves as socially and environmentally friendly, without having to transform their internal processes.

Therefore, from the point of view of organizational design, our results suggest that firms should aim for highly independent remuneration committees and for remuneration plans that are linked to a comprehensive set of ESG indicators. This not only creates a basis for aligning managers' behaviour to long-term sustainability goals, but also sends signals to investors regarding the authenticity and substantiveness of the firm's intent. In designing the remuneration plans, firms should also ensure there is balance between the number of ESG indicators and the total number of indicators, since a low proportion of ESG indicators over the total can be read as a sign that little attention is paid towards sustainability performance.

Some limitations of this study need to be addressed through additional investigation and future research. In the first place, we looked at only a subset of the possible signs of substantial or symbolic ESG adoption. For instance, we did not consider other conditions - such as the absolute number of independent directors, or CEO duality - that could have helped to identify cases of symbolic adoption. Second, since institutional pressures are context-dependent, our research may suffer from the specificities of the industries that the firms in our sample belong to. Therefore, further analysis is needed to verify the extent of symbolic adoption in different industries, as well as the profiles of symbolic adopters in these domains. We have also not thoroughly examined the type of ESG indicators that firms adopt, especially in the fs/QCA results. Subsequent papers could try to identify the profiles of symbolic adopters of specific (ESG) indicators.

Further investigation is needed regarding how ESG-based compensation plans affect firm performance. While it is commonly believed that using variable remuneration components can contribute to orienting top management towards the long-term viability of the firm and boosting firm performance, less is known about how firm performance is affected when compensation is linked to sustainability goals. Investigation on this topic could certainly also draw insights from the literature examining the link between sustainability and economic performance.

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Appendix 1. List of companies included in the sample

1. A2A
2. Assicurazioni Generali
3. Atlantia
4. Banca Generali
5. Bper Banca
6. Buzzi Unicem
7. Enel
8. Eni
9. Finecobank
10. Hera
11. Intesa Sanpaolo
12. Inwit
13. Italgas
14. Leonardo
15. Mediobanca
16. Moncler
17. Nexi
18. Pirelli & C.
19. Poste Italiane
20. Prysmian
21. Recordati
22. Saipem
23. Snam
24. Telecom Italia
25. Terna
26. Unipol Gruppo

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italian journal of management

ISSN print 0393-5108
ISSN online 2785-549X
DOI 10.7433/s121.2023.06
pp. 101-125

Italian Society of
MANAGEMENT