RSM DISCOVERY

***Management** Knowledge*

18

2nd Quarter 2014

ROTTERDAM SCHOOL OF MANAGEMENT, ERASMUS UNIVERSITY

- **Thinking smart about knowledge sharing**
  Rebecca Morris talks with Rob Zuidwijk and Bart Kuipers

- **What value ethical leadership?**
  In discussion with Marius van Dijke, Steffen Giessner and Rob van Tulder

- **A radical approach to radical innovation**
  By Dirk Deichmann and Jan van den Ende

- **Close-tie entrepreneurial inspiration and business survival**
  By Jeroen P.J. de Jong

- **Exploring the differentials between servant and transformational leadership**
  By Dirk van Dierendonck and Daan Stam

- **Politics and perceptions in the demand for movies**
  By Jason Roos

- **Sustainability bonuses: a credible sign of corporate responsibility?**
  By Paolo Perego

The business school that thinks
and lives in the future

RSM Erasmus
ERASMUS UNIVERSITY

Sustainability bonuses: a credible sign of corporate responsibility?

By ***Paolo Perego***

Companies in a range of sectors must comply with a series of minimum CSR standards as a condition of being in business, or staying in business, and rightly earn little in the way of moral credit for doing so. However, where others are making a name for themselves by going further than required, should they be regarded as somehow morally superior?

This would seem to depend very much on the motivation for being more responsible. Are they doing so because they see the enhanced behaviour as good in itself, or are they going the extra mile(s) because they see profitable consequences? These questions are interesting academically and the answers have practical implications for shareholders, other stakeholders and broader society.

> *"Some companies clearly take the issue seriously while others do little more than pay it lip service."*

The extent to which corporate social responsibility (CSR) establishes itself further will be reflected in the incorporation into the remuneration of senior management and other staff of bonuses tied to sustainability targets. In the meantime, unfortunately, a lack of disclosure on management remuneration still makes it difficult to measure and assess the importance that individual companies place on CSR.

Sustainability consultant Coro Strandberg addressed the issue in a recent article in the international press: *When I was a director of a financial institution in the 1990s, we struggled in vain to get top executives to pay attention to the board's sustainability priorities... Then we stumbled upon the idea of rewarding the CEO for long-term sustainability performance. The result? We saw a dramatic improvement in the company's sustainability practices from then on (and financial performance, too). Once we realised the impact of this simple measure, the board quickly embedded the principle in its compensation philosophy, which in turn spread the concept throughout the management ranks.*

While it remains difficult (yet) to gauge the exact figures involved in "sustainability bonus" schemes, the mere mention of them in relation to remuneration in publicly disclosed information speaks volumes. An article that I co-wrote on the subject with Ans Kolk entitled *Sustainable Bonuses: Sign of Corporate Responsibility or Window Dressing?* and which appeared in the *Journal of Business Ethics* in January 2014, addresses the subject in much greater detail than is possible here. The objective of that study is twofold. We aim at further understanding the role of sustainable bonus systems by exploring this emergent practice in more detail on initial implementation and peculiarities compared with previous quantitative analyses mainly confined to the North American context.

It goes without saying that pay-for-performance is not a new phenomenon, but in recent years there has been a growing pressure to consider CSR performance as part of the executive compensation formula. An increasing number of multinationals, such as Intel, Alcoa, Group Danone, National Grid and Xcel Energy, have reportedly incorporated CSR and sustainability into their bonus structures. On the whole, however, these programmes remain a minority. One reason is the inherent conservatism of the remuneration governance process. The complex combination of regulatory push and peer benchmarking makes executive compensation an area of conformity rather than differentiation between companies.

As outlined by Coro Strandberg: *Research shows that 64 per cent of the companies in Standard & Poor's 1500-stock index attached performance*

criteria to company shares in 2011, up from 20 per cent in 2002. The global platform of responsible investment research firm Sustainalytics reveals a modest increase, from 13 to 16 per cent, of company boards that considered environmental, social and governance (ESG) factors in executive compensation from 2010 to 2012.

Some companies clearly take the issue seriously while others do little more than pay it lip service. For example, Royal DSM is a global science-based company with its roots in the Netherlands, active in health, nutrition and materials, which visibly sets store by its sustainability credentials. In a prominent section on its website labelled "Finding sustainable solutions for a changing world", DSM notes that today's market needs are driven by a number of major global trends and challenges. *We're using our innovative strengths to address some of the most important of these trends and challenges, such as climate change, increasing energy scarcity, overstretched healthcare systems and hidden hunger,* it says.

The DSM 2013 Integrated Annual Report describes CSR and sustainability as both a core value and a business driver for the company. Sustainability falls under the responsibility of the Managing Board. The company says its view that DSM is doing well when it comes to CSR is supported by the fact that the company has been named among the leaders in the *Dow Jones Sustainability World Index* for several years in a row.

Management remuneration at DSM will be linked to a new energy efficiency improvement target, in addition to the greenhouse gas emissions reduction measure already incorporated in the company's long-term incentive plan for management. Each measure will count for 25 per cent.

Transparency and openness about sustainability bonus details will surely become more common. Specialists in compensation and benefits, remuneration committees and boards, investors and regulators should be part of the debate, demonstrating how sustainability can deliver long-term value through a better alignment of traditional incentive programmes in this area.

It might still be a bit too early for a definite assessment as to whether the introduction of sustainability bonuses is a credible sign of corporate responsibility or mere window dressing, given the emergent state of the instrument. But certain thoughts present themselves as observable fact in the business world. Customers have changed. Shareholders have changed. Employees have changed. CSR has become a moral issue. Companies must learn how to live with it, and adapt their practices accordingly. Might DSM have created a template that others will want to follow? Time will tell. ■

This article is based on the paper *Sustainable Bonuses: Sign of Corporate Responsibility or Window Dressing?*, written by Ans Kolk and Paolo Perego, and published in the *Journal of Business Ethics*, January 2014, Volume 119, Issue 1, pp 1-15. http://ssrn.com/abstract=2195023

***Paolo Perego** is Associate Professor, Department of Accounting & Control, Rotterdam School of Management, Erasmus University.* EMAIL *pperego@rsm.nl*

RSM Expertise

The Department of Accounting and Control is a compact powerhouse of international and influential faculty members. It has a very strong research orientation and an equally strong practitioner orientation. Stakeholders range from academic researchers to the business community of accountants, controllers, and financial advisors. The department's research approach is interdisciplinary, integrating both economic and behavioural aspects of accounting.

WEB ***www.rsm.nl/research/departments/accounting-control/***