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CSR Contracting, Materiality, and Their Effects on Financial and Non-financial Performance

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Abstract

Although the recent corporate governance initiative of tying environmental, social, and governance (ESG) targets to executive compensation is gaining popularity in developed economies, difficulties have been reported in their identification and selection due to a heterogeneity of stakeholder interests. Drawing on the agency and stakeholder theories, we apply the concept of materiality for the design of ESG targets in executive compensation and tests its effects on corporate financial and non-financial performance. By focusing on a unique sample of S&P 1,500 companies from 2011 to 2019, we find that material CSR contracting has a negative effect on market-based financial performance and a positive one on environmental performance. These results are robust to endogeneity and further tests suggest that this approach provide greater effects than simply adding general ESG targets in executive compensation. These findings imply a trade-off between corporate financial performance and corporate non-financial performance in the short-term which raises questions about the primary motivations of corporations and the soundness of shareholder-oriented materiality frameworks.

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