

CORPORATE SOCIAL RESPONSIBILITY AND EXECUTIVE COMPENSATION
STRUCTURE

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Abstract

Corporate Social Responsibility has gained more traction in our modern day society than ever before. It is now a major factor for which a corporation is evaluated on. Corporate Governance, and the goals set fourth through this governance play a major role in dictating the socially responsible actions of a firm. Major facets in the context of corporate governance are Chief Executive Officers, faced with the duty of integrating these goals into every day corporate life. In order to provoke distinct action by a CEO corporations construct defined compensation structures in order to incentivize desired initiatives. This relationship highlights the importance of incentive compensation in relation to socially responsible goals of a corporation. This study takes CSR index data from CSRHub's database, and compares it to lagged executive compensation data collected from the Mergent Online database. We find that there are distinct relationships between certain forms of executive compensation and CSR rating levels, which are consistent with previous literature. We also find inverse relationships between salary compensation and various forms of CSR when compared to past investigations in the field.

KEYWORDS: (Corporate Governance, Corporate Social Responsibility, Executive Compensation)

JEL CODES: (G34, M12, M14)

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ON MY HONOR, I HAVE NEITHER GIVEN NOR RECEIVED
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Introduction

Today, more weight is being put on Corporate Social Responsibility (CSR) than ever before. In our modern day economy the shareholders of companies, the media, and the public place intense scrutiny on business decisions. In turn, firms that wish to behave responsibly must find a way to encourage responsible behavior from their managers. This has led to increased studies on the relationship between CSR and corporate governance. More specifically, these studies investigate how different forms of executive compensation influence responsible behavior. While there may be a substantial body of literature surrounding the topic, the studies have not found conclusive relationships between these various forms of compensation and levels of CSR. In order to fully understand the issue at hand we must first define Corporate Social Responsibility, as it is a very broad term.

“CSR is an action by a firm, which the firm chooses to take, that notably affects an identifiable social stakeholder’s welfare. A socially responsible corporation ought to take a step ahead and accept policies and business practices that go ahead of the minimum legal requirements and contribute to the welfare of its key stakeholders. CSR is viewed, then, as a complete set of policies, practices, and programs that are incorporated into business operations, supply chains, and decision-making processes throughout the company and usually contain issues associated with business ethics, community investment, environmental concerns, governance, human rights, the marketplace as well as the workplace” (Frooman, 1997).

Frooman's comprehensive definition allows us to see that CSR is a combination of different actions that are integrated into a company that directly benefit stakeholders. This raises the question, how can a company incentivize its management to behave in a socially responsible manner? One topic that comes to the forefront of this discussion is corporate governance and specifically executive compensation. Essentially, the CEO of a company directs its mission, and implements certain policies to lead the company to a desired end. A company is capable of compensating an executive to reward them for directing the company in a socially responsible direction (Mahoney & Thron, 2006). This problem becomes more convoluted when you realize that these CEOs are also compensated, in certain forms, due to financial performance (McGuire, Dow, & Argheyd, 2003). In this paper I will investigate the relationship between various forms of executive compensation and levels of CSR to determine if there is a definitive correlation between differing forms of executive pay and socially responsible behavior. This will help to inform corporate governance surrounding the matters of executive compensation and effective structures for incentivizing CSR goals.

In order to test the relationship between executive compensation and CSR this investigation uses a panel data model. I introduce a lagged variable association in order to create a predictive relationship between the variables. Executive compensation from the previous year is used to predict CSR levels in the following year. Moreover, each form of executive compensation is a share of the total compensation, taken as a percent. This methodology resulted in very interesting findings that were contradictory to previous studies in the field. I find a positive relationship between total CSR and salary compensation. Additionally, I find a positive relationship between the community

subsection of CSR and salary compensation. Another statistically significant relationship was that between the governance subsection and share of bonus compensation. This relationship was materially negative, and reinforces previous findings in this field of study.

My CSR metrics for this analysis were collected from CSRHub's database. CSRHub is a company, started by four original founders, that provides a web-based tool for CSR evaluation. It compiles data from nine premier socially responsible investment analysis firms and 265 more nongovernmental organizations, news feeds, social networking groups, small for profit organizations, and publishers. This comprehensive approach makes it a prominent member in the field, and draws many corporations to its services (CSRHub). CSRHub ranks companies based on four main criteria: Community, Employees, Environment, and Governance. All of these categories are weighed based on a user profile, constructed by CSRHub. These user profiles are meant to reflect the average weight users assigns to each category, and makes the rating system more dynamic, based on specific user preferences. For this analysis I will use a standardized user profile to keep categories weighted equally. The Community metric represents a company's commitment and effectiveness within a local, national, and global community, this is comprised of their citizenship, charitable giving, and volunteerism, and takes into account the companies human rights record and the impact of their services and products on the environment.

The Employees metric is comprised of, "disclosure of policies, programs, and performance in diversity, labor relations and labor rights, compensation, benefits, and employee training, health and safety. The evaluation focuses on the quality of policies

and programs, compliance with national laws and regulations, and proactive management initiatives.” (CSRHub).

The Environment metric is a comprehensive metric that measures a company’s interactions with the environment at large, including their use of natural resources, and their impact on various ecosystems. This category evaluates a companies environmental performance, compliance, footprint mitigation, leadership in climate change awareness, energy efficient operations, and various other environmental disclosure metrics.

The Governance category includes “Disclosure of policies and procedures, board independence and diversity, executive compensation, attention to stakeholder concerns, and evaluation of a company’s culture of ethical leadership and compliance.” (CSRHub).

The executive compensation data for my investigation was gathered through the Mergent Online database, and is collected on companies that are also covered in the CSRHub database. This information was gathered for the period from 2014-2016, and is categorized into salary, bonus, long-term incentives (stock/option awards), and other. Other is a combination of various forms of CEO compensation apart from salary, bonus, and stock awards.

I will control for firm size, industry, profitability, risk, year, and leverage. Following this introduction I will present a literature review section that will cover previous research in this field. This section will be followed by a theoretical discussion of stakeholder theory and corporate governance. The data and methodology section containing the description of my data sample, hypothesis, and regression equations will follow the theory section. I will then present my results section, including descriptive statistics and regression analysis. The paper will conclude with a detailed review of the

information covered, conclusions that can be drawn from them, and areas of future study and improvement.

Literature Review

While much research has gone into the topic of CSR and firm performance, the topic of corporate governance and CSR has not been focused on as closely by academics. Today, corporate activity is more scrutinized than ever before. This has led to increased attention being placed on how corporations are impacting society, and the idea of corporate social responsibility (CSR). This is largely a function of the environment that we live in today. With increased media coverage, academic research, and focus in textbooks and schools, this information is readily being transmitted through multiple means (Godos-Díez, Fernández-Gago, & Martínez-Campillo 2011; Mahoney & Thron, 2006). This is of particular concern to corporate executives who are faced with directing a company's mission, and working towards specific goals that can have both financial and social implications in the short and long term (McGuire et al., 2003). Moreover, corporate governance is used to encourage particular behavior from executives, in hopes of reaching defined objectives, which can detract from one's socially responsible goals (Zeckhauser & Pound, 1990). One important aspect of corporate governance is executive compensation, which is used as a tool to incentivize executives to behave in a certain manner. Essentially, short-term incentive structures are designed to reward CEOs for immediate financial performance metrics (accounting), while long-term incentive structures have the ability to influence consideration of CSR (Kane, 2002).

Approaching Executive Compensation

When considering how to evaluate executive compensation, previous papers take a variety of approaches to effectively capture this measure. Generally executive compensation is broken up into four categories; fixed compensation, short-term incentives, long-term incentives, and other (Murphy, 1999). In almost all cases fixed compensation is measured in the form of annual salary, short-term incentives are measured as bonuses, long-term incentives are measured in stock and option awards, and ‘other’ is a combination of non-market based incentive plans, longer term incentive structures and miscellaneous fiscal year compensation. McGuire et al. (2003), Mahoney and Thron (2006), and Jian and Lee (2015) all assume this approach for measuring executive compensation based on existing investigations, thus I will follow the same approach.

Bonus Compensation and CSR

Previous literature discusses the relationship between Bonus compensation and CSR at length. McGuire et al. (2003) predicts that bonus will be negatively correlated with CSR strength and positively correlated with CSR weakness. Mahoney and Thron (2006) take a similar stance in their Canadian investigation and predict that bonus will be negatively correlated with total CSR, negatively correlated with CSR strength, and positively correlated with CSR weakness. Both of their conclusions suggest that there is in fact a negative relationship between bonus and differing measures of CSR. This is likely due to the fact that bonus payments are structured to reward short-term performance goals, which are almost exclusively financially based (Murphy, 2000). Thus, a major incentive to deviate from socially responsible action is to improve the “bottom

line”, which in turn results in a reward to the executive in the form of a bonus (McGuire, Sundgren & Schneeweis, 1988; McGuire et al., 2003). I intend to add value to this area of study by applying Mahoney and Thron’s (2006) advanced methodological approach to United States corporations, and juxtapose them against the findings from McGuire et. al (2003) in order to see what dynamics may have changed between CSR and executive compensation structure. I also intend to compare these results to the results presented by Mahoney and Thron (2006) in order to comment on differences internationally in the field.

Salary Compensation and CSR

When examining the relationship between salary and various measures of CSR, previous studies have found materially negative correlations between the two. For example, McGuire et al. (2003) finds in her study of the United States that there is a statistically significant positive correlation between salary and poor social performance. She also notes that there is little explanatory power in the negative relationship between strong social performance and salary. This supports the argument that corporate governance has a strong relationship with weak social performance (McGuire et al., 2003). Previous papers hypothesize that this is the case because high levels of compensation can themselves be damaging to the image of a CEO and argue that this is in fact poor social practice at its core. Although this relationship seems to be fairly strong, the argument can be made for the opposite side. Those who argue for a positive relationship maintain that fixed compensation may encourage a CEO to become more risk averse and conservative (Gray & Canella, 1997; Jensen & Murphy, 1990; Murphy, 1985). Thus, if poor social performance were considered risky, then this idea would

indicate a negative association between salary and poor social performance. Additionally, salary may also tie an executive to the company through building their firm specific human capital, making them less willing to risk the reputation of the firm and themselves (McGuire et al., 2003). While this is a compelling case, evidence from these studies points towards a negative association as opposed to a positive association. Through my investigation, I hope to provide direct insight into whether or not there is a positive or negative correlation between CSR and Salary compensation within the United States.

Long Term Incentive Compensation and CSR

The relationship between long term incentive compensation and CSR has been one of the larger points of contention relating to the study of Executive Compensation structure and CSR. This is mainly due to the conflicting results that have been produced from various studies that examine these variables. McGuire et al. (2003) finds that there is a statistically significant positive relationship between long-term incentive compensation and weak social performance. Essentially this study finds that long-term incentives result in less responsible social decision-making. After updating the methodology from McGuire et al. (2003), Mahoney and Thron (2006) find a positive relationship between long-term incentives and total CSR in Canadian firms when implementing a lagged variable association. Furthermore, they find that long-term compensation is significantly negatively related to CSR weakness. These conflicting conclusions create an interesting opportunity to examine this relationship again, under updated methodological grounds, in search for disconfirming evidence to support either claim.

Theory

Stakeholder Theory

Many studies focusing on the relationship between CSR and executive compensation structure draw from stakeholder value maximization theory. This theory examines a firm as a network of contracts between shareholders and stakeholders, both of whom supply the firm with its necessary resources in exchange for claims outlined by various contracts (Jian & Lee, 2015; Jones, 1995; Jones & Wicks, 1999; Mitchell, Agle, & Wood, 1997). Two main schools of thought emerge from previous studies. Under the first, higher levels of CSR correlate positively to greater firm specific focus on the stakeholder, leading stakeholders to support the operations of the firm, and in turn increasing shareholder value. Furthermore, if CSR is associated with increased non-financial performance, such as higher product quality and operational efficiencies, then investment in CSR benefits shareholder value because CSR is related to the retention of high quality employees, increased demand of the firm's product, more customer loyalty, and more access to valuable resources (Jian & Lee, 2015). Essentially, CSR has positive effects on the stakeholder, which have positive effects on the shareholders' value (Jian & Lee, 2015). This would imply that the CEO would be rewarded for increasing CSR, indicating a positive relationship between CSR and CEO compensation.

Under the second school of thought an issue arises with aggressive CSR investment, which transfers wealth from shareholders to stakeholders. This can stem from a managers concern for their reputation, which can incentivize them to invest in CSR for aesthetic purposes that cannot be justified on an economic performance basis (Scharfstein & Stein, 1990; Surroca & Tribó, 2008; Trueman, 1986). Assuming that a CEO would be

punished for this value destruction, this implies a negative relationship between executive compensation and CSR (Jian & Lee, 2015). There is competing evidence for both cases, thus my investigation will add value to this area of study through additional analysis of a highly debated area of study.

Corporate Governance

Another important theoretical area of discussion is corporate governance, its objectives, and how those objectives influence executive compensation methods and stakeholders themselves. It is necessary to discuss corporate governance because it can have tangible effects on corporate social responsibility and stakeholders despite there being distinct constructs (Hillman & Keim, 2001). Moreover, this idea is directly related to Agency theory. Agency theory discusses the relationship between principles and agents in business, and is often centralized around aligning the views of both in order to avoid issues that may arise. Corporate governance, in this case executive compensation structure, is used to focus executives on certain goals, which can have direct effects on CSR and stakeholders. When companies establish distinct managerial goals and incentivize those goals with particular forms of compensation, a manager may be inclined to execute certain actions that can have either positive or negative effects on social performance (Donaldson & Peterson, 1995; Jones & Wicks, 1999). Thus, it is crucial to examine the relationship between certain managerial goals and different forms of executive compensation and identify their effects on CSR. McGuire et al. (2003) provides a clear example stating that compensating a CEO in the form of a short-term bonus may incentivize them to place more scrutiny on the immediate bottom line as opposed to developing long standing stakeholder relations. This illustrates a situation in which a

CEO is incentivized to forego socially responsible action that would benefit the stakeholder for the sake immediate financial performance. Essentially, corporate governance dictates managerial goals and how managers are incentivized to reach those goals through specific forms of compensation, leading to distinct financial and social outcomes.

Data and Methodology

Executive Compensation Data

The executive compensation data for this study is gathered from the Mergent Online database. Companies were filtered by their disclosure of information pertaining to CEO compensation and were eliminated from the data set if there was not corresponding data coverage in CSRHub. Following previous studies' definitions of CEO compensation, the data is broken into four main categories: fixed compensation, short-term incentives, long-term incentives, and other (Murphy, 1999). Fixed compensation is measured in the form of annual salary, short-term incentives consist of bonus payments, long-term incentives are measured in stock awards, and other is a combination of various market and non-market compensation forms (non equity incentive plans etc.). In this study I take each section of executive compensation (Salary, Bonus, and Long term incentives) and compare that to CSR in order to compare relative changes in executive compensation structure to CSR levels. Furthermore, each form of executive compensation will be taken as a percentage (share) of total compensation. This allows me to view each piece of compensation as a share of total compensation as opposed to making an absolute comparison. It is important to note that when collecting this data, companies with a higher share of reported CEO salary compensation were found to have the most

comprehensive reporting of all compensation data. Thus, due to data availability CEOs were sorted by salary level in order to bring those with the most complete data to the top of the search. This distinction is necessary due to bias that could matriculate in the sample in regards to salary compensation. That being said there was no concrete cut off for salary level. I manually sort through company data points, incorporating them into the data set if they have complete compensation data for salary, bonus, and long-term compensation and are also covered in the CSRHub database.

CSR Data

Mahoney and Thron's (2006) study of Canadian firms and McGuire et al.'s (2003) study of the United States note that they could have directly benefited from using a broader CSR database (apart from KLD or CSID) for the data sample. It is important to note that McGuire et al. (2003) uses the KLD as the basis for CSR ratings, and Mahoney and Thron (2006) use the CSID database, which is essentially the Canadian equivalent of the KLD. As the CSR climate is changing rapidly, it is important to evolve and use the most comprehensive metrics available. While many have used the KLD (Kinder, Lindenberg, and Domini) as the defacto measure for CSR, I will be using the CSRHub database because it is more accessible than the KLD, takes more ratings into account, and provides a broader index scale compared to the binary scale used by the KLD. The KLD database is run by the MSCI and ranks companies on a binary scale across various metrics. Essentially, the KLD looks at community, corporate governance, diversity, employee relations, environment, human rights, and product categories to compile its overall metrics. For each category it separates the company's strengths from its weaknesses and assigns each strength or weakness a value on a 0-2 scale. For instance, if

a company has strong employee strength that category would be rated 2, if it has semi strong strength 1, and no strength 0. Conversely, if it has very weak employee relation that employee weakness category would be rated 2, semi weak relation would be rated 1, and no weak relation would be rated 0.

Today, CSRHub is the world's largest sustainability intelligence database, driven by 594 industry leading CSR databases including the MSCI's KLD database. CSRHub rates each company it covers on a composite scale of 0-100 to produce a total CSR metric. This total CSR metric is comprised of four subsections; Community, Employees, Environment, and Governance. Each of these categories is rated and aggregated into the composite measure based on a user profile. For this study I will be using a standardized profile, meaning that the rating of each section will be weighted equally and there will be no variation in weights between the different categories. The Community subsection covers a company's commitment and efficacy within the local, national and global communities it does business. Moreover, the community rating covers a company's human rights record, treatment of its supply chain, environmental and social impacts of a company's products and services, and the development of sustainable products, processes, and technologies.

The employees subsection covers the disclosure of a corporation's policies, programs, and performance in diversity and labor rights, compensation, benefits, and employee training, health and safety. The evaluation in this section focuses on the quality of its programs and policies, compliance with national laws and regulations, and proactive management initiatives. Essentially, this is a comprehensive metric that takes into account diversity policies and programs, fair treatment of employees, strong labor

codes, comprehensive benefits, demonstrated training programs, employee health and safety policies, and positive safety performance.

The governance subsection is concerned with how the company is conducting itself internally and in relation to its large stakeholders. It takes into account the leadership structure and the values that drive the corporation's direction, ethics, and performance. This categories value is based on; the alignment of corporate practices and sustainable goals, transparency between the management and the stakeholders, employee engagement with management, and top down integration of sustainable goals into day-to-day operations. Essentially, this section is all things related to corporate governance.

The environment subsection covers a company's interactions with the environment at large, including their usage of natural resources and their impact on various ecosystems. Value is specifically assigned to this category based on corporate environmental performance, compliance with environmental regulations, mitigation of environmental footprint, leadership in the climate change space through implementation of policies and strategies, disclosure of sources of environmental risk and liability and actions to mitigate these risks, integration of sustainable initiatives into the upper management and board, and stakeholder engagement for environmental improvement. This is a comprehensive section that takes a wide range of environmental criteria into account to generate a subsection rating.

Control Variables

With a study of this nature there are many variables that must be controlled for to improve the quality of the model. The first necessary controls are firm size, and profitability. These are necessary because firm size and profitability have been directly

linked to social performance, and can also affect salary and incentive compensation (McGuire et al., 1988; McKendall, Sanchez, & Sicilian, 1999; McWilliams & Siegel, 2000; Waddock & Graves, 1997.) I will control for firm size by using the number of employees and will control for profitability using net income in dollars. Also, it is necessary to control for the industry, year, risk, and leverage. Industry must be controlled for because risk and opportunity for social investment can differ between industries, thus I will control for this using a dummy indicator variable for each individual SIC code (McGuire et al., 2003). This study also controls for year, using a dummy variable for each, in order to account for economic conditions that were present at that time. Risk is controlled for because it has tangible effects on the decision making of a CEO, which can affect the deployment of resources to CSR initiatives, thus it is controlled for using the beta measure of risk for the company. Also, it is possible that the availability of free cash flows has an impact on the ability of a company to deploy assets towards socially responsible initiatives, thus this study controls for leverage using the debt to equity ratio of a company (Mahoney & Thron, 2006). Control variable data is collected from a combination of Yahoo Finance, Macro Trends, and the Mergent online database.

Regression Characteristics

In order to empirically test my research question I take a similar approach to Mahoney and Thron (2006) and use panel data analyses to properly analyze the sample. A Hausman specification test is used in order to determine which model best represents the data at hand (Fixed effects vs. Random effects). Much like Mahoney and Thron (2006), I structure my regression equation using lagged variable data. This approach uses compensation data from the previous year in order to test whether or not certain

compensation structures affect the CSR ratings in the following year. Essentially, the lagged association is used in order to form a predictive relationship and capture the influencing effects of executive compensation on CSR (Mahoney & Thron, 2006). Furthermore, I control for more variables than either McGuire et al. (2003) or Mahoney and Thron (2006) in hopes of avoiding any omitted variable bias. The regression treats executive compensation as a determinant of CSR along with various control variables. This regression adds value to this area of study as it is the first time an equation of this structure has been used to test these relationships in the United States, and will provide disconfirming evidence of the relationships found in the previous study conducted by McGuire et al. (2003). My regression equations, hypothesis, and rationale behind each are stated below.

Hypotheses

H1: There will be a positive relationship between CSR and Long Term incentive compensation (stock/option compensation).

I believe that this relationship will be positive based on the findings of the previous studies conducted in this area. McGuire et al. (2003) found that this relationship was negative and significant. Alternatively, Mahoney and Thron (2006) found a statistically significant and positive relationship between these factors using their updated methodological approach. Based on this evidence, I believe that the relationship will be positive as the most modern methodology found a positive relationship. Furthermore, since Long Term incentives have been shown to enhance a CEO's long-term view for the company, and CSR benefits a company in the long run, I believe that this relationship will ultimately be positive.

H2: There will be a negative association between CSR and Bonus compensation.

This hypothesis is supported by each of the two main papers that this investigation is based on. Both McGuire et al. (2003), and Mahoney and Thron (2006) found that CSR is significantly negatively related to Bonus compensation. This is likely due to the fact that Bonus is tied directly to short-term financial performance (Murphy, 2000).

H3: There will be a negative association between CSR and Salary compensation.

McGuire et al. (2003) finds that there is a negative relationship between these two factors that is significant. Furthermore, this study also finds that there is little explanatory power in the relationship between strong social performance and salary compensation. This is likely due to the fact that high shares of salary compensation can be seen as poor corporate governance, which itself is poor social practice (McGuire et al., 2003).

Regression Equations

$$CSR_{i,t} = C + \beta_1 Stock\ Compensation_{i,t-1} + \beta_2 Firm\ Size_{i,t-1} + \beta_3 Industry_i + \beta_4 Profitability_{i,t-1} + \beta_5 Year_t + \beta_6 Risk_{i,t-1} + \beta_7 Leverage_{i,t-1} \quad (4.6.1)$$

$$CSR_{i,t} = C - \beta_1 Bonus_{i,t-1} + \beta_2 Firm\ Size_{i,t-1} + \beta_3 Industry_i + \beta_4 Profitability_{i,t-1} + \beta_5 Year_t + \beta_6 Risk_{i,t-1} + \beta_7 Leverage_{i,t-1} \quad (4.6.2)$$

$$CSR_{i,t} = C - \beta_1 Salary_{i,t-1} + \beta_2 Firm\ Size_{i,t-1} + \beta_3 Industry_i + \beta_4 Profitability_{i,t-1} + \beta_5 Year_t + \beta_6 Risk_{i,t-1} + \beta_7 Leverage_{i,t-1} \quad (4.6.3)$$

$$CSR_{i,t} = C - \beta_1 Other_{i,t-1} + \beta_2 Firm\ Size_{i,t-1} + \beta_3 Industry_i + \beta_4 Profitability_{i,t-1} + \beta_5 Year_t + \beta_6 Risk_{i,t-1} + \beta_7 Leverage_{i,t-1} \quad (4.6.4)$$

For each regression equation I treat the composite metric of CSR or the CSR subsection as the dependent variable. The regression equations specified above are a

combination of different approaches to measuring CSR and executive compensation. I use a specification similar to that of McGuire et al. (2003) in the sense that CSR is my dependent variable and my independent variables consist of various forms of executive compensation and necessary control variables. Furthermore, I use a similar empirical model to Mahoney & Thron (2006), who introduce the lagged association between CSR and executive compensation into the equation. Like my equation, Mahoney and Thron (2006) use CSR as the dependent variable and focus on compensation, ownership structure, size, and financial slack (leverage) as their independent variables and controls. The third source that I base my equations on is the model used in the by Jian and Lee (2015) in their study of optimal CSR investment and executive compensation. They use a comprehensive model that incorporates all of the factors discussed in the previous two studies identified in this section, and introduce more control variables to ensure that there is minimal omitted variable bias (Jian & Lee, 2015). This model contributed to my own regression equation as I decided to incorporate a risk measure of beta, and a profitability measure of net income not previously used in the studies of McGuire et al. (2003) and Mahoney and Thron (2006). Another point of differentiation between my model and previous investigations is the exclusion of activist institutional ownership as a control. After reviewing the results of the previous studies this variable did not have any significant impact on their regression results, thus I have not included it in my own equation. The regression equations I employ for these investigations are similar, but distinct from those previously used in the two main studies of interest (McGuire et al., 2003; Mahoney & Thron, 2006) and will provide interesting insight into the relationship between CSR, executive compensation, and corporate governance.

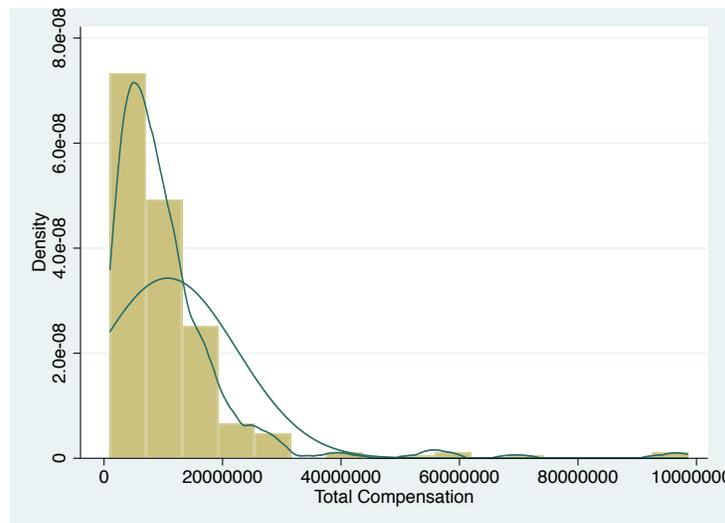
Results

Descriptive Statistics

In the data sample there are 273 firm level observations, containing 91 firms spanning 61 distinct industries. This amount of distinct industries diversifies the sample set and allows for a more comprehensive view of CSR and executive compensation throughout different areas of business. Of these 61 distinct industries, 48 contain one firm, five contain two firms, four contain three firms, two contain four firms, one contains six firms, and one contains seven firms. The industry containing the most data points is a combination of finance, insurance, and real estate companies. Table 4 containing the summary statistics is pictured in the appendix.

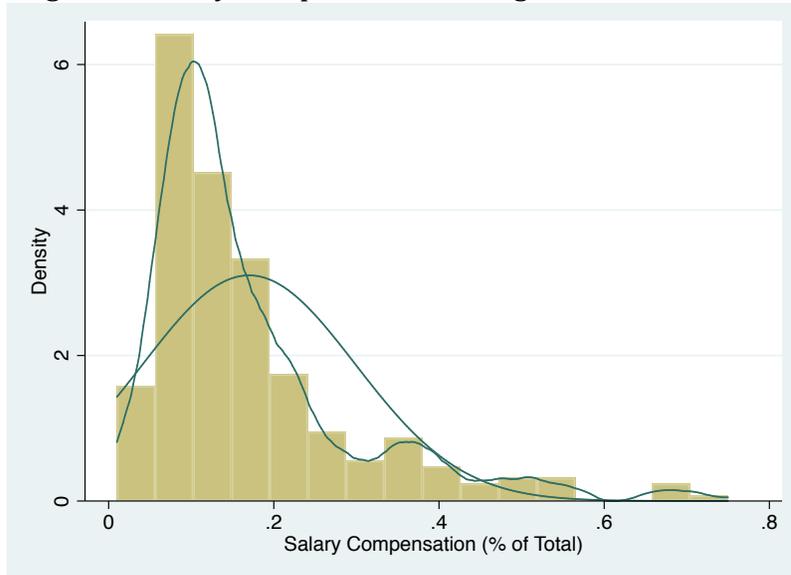
Total compensation refers to the total amount of compensation a CEO received in a given year. Total compensation ranges anywhere from \$1,000,240 to \$98,000,000, with a mean value of about \$10,000,000 and a standard deviation of \$11,600,000. The distribution of this variable can be seen in figure 1 below.

Figure 1: Total Compensation Histogram



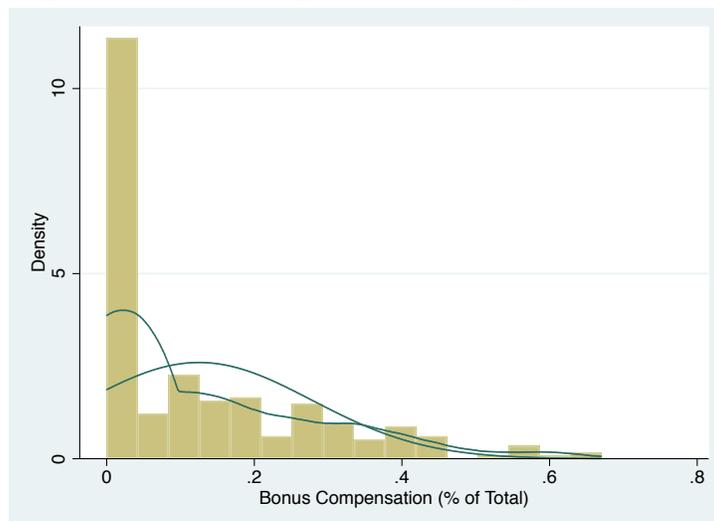
Salary percent represents the share of total compensation that is in the form of salary. Salary ranges anywhere from 1 percent to 75 percent of total compensation, with a mean value of 17 percent, and a standard deviation of 12.85 percent. The distribution is shown in Figure 2 below

Figure 2: Salary Compensation Histogram



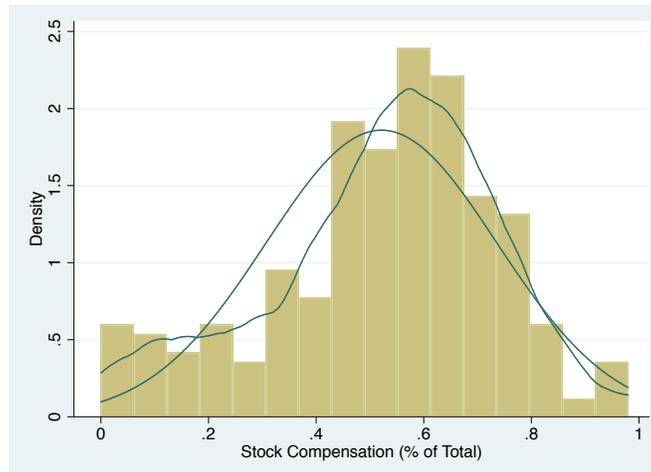
Similarly, bonus percent is the share of total compensation in the form of bonus payment. Bonus comprises between 0 and 67 percent of a CEO's compensation, with an average value of 12.5 percent, and a standard deviation of 15.3 percent.

Figure 3: Bonus Compensation Histogram



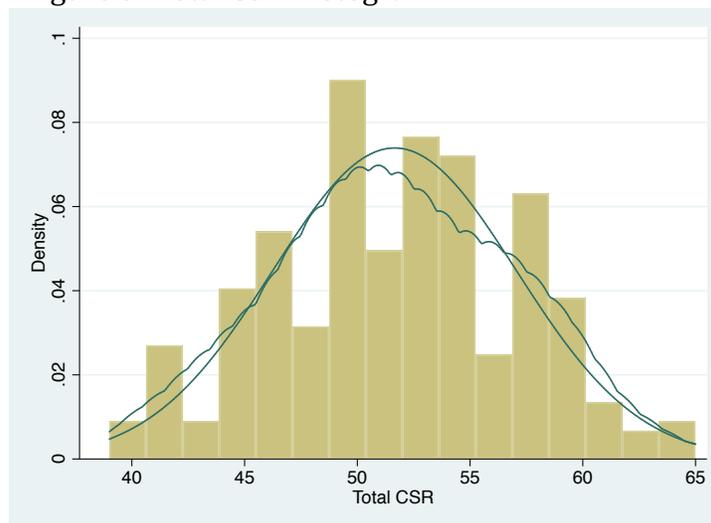
Stock compensation percent ranges from 0 to 98 percent with a mean value of 52.1 percent and a standard deviation of 21.4 percent. In summary it is clear that on average stock compensation comprises the majority of a CEO's compensation when compared to salary or bonus compensation (distribution in figure 4).

Figure 4: Stock Compensation Histogram



Total CSR, the composite metric for CSR used in my regression, ranges anywhere from 39 to 65 on the 100 point scale with a mean value of 51.65 and a standard deviation of 5.39. The distribution of this variable is relatively normal and is pictured in figure 5.

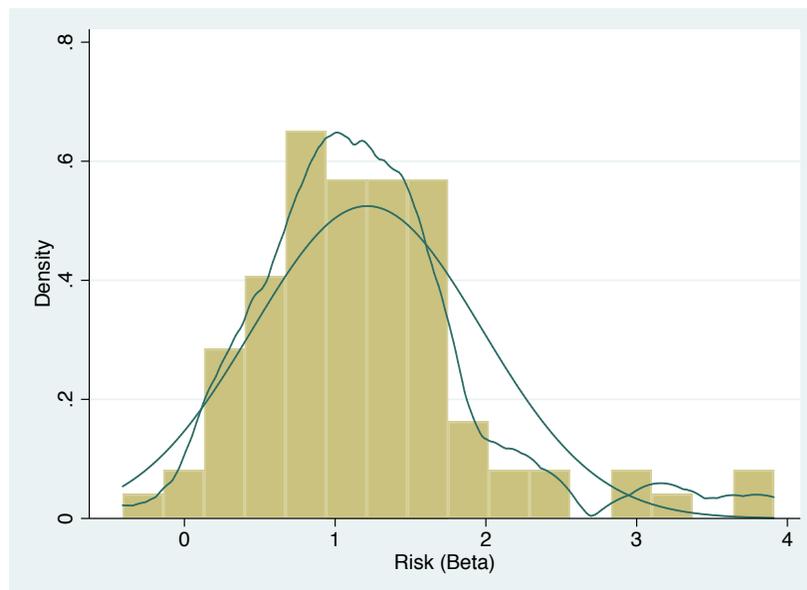
Figure 5: Total CSR Histogram



Community, a subsection of Total CSR, ranges from 35 to 69 with a mean of 51.78 and a standard deviation of 5.3. The employees subsection ranges from 29 to 73 with an average value of 55.83, and a standard deviation of 6.69. Environment varies anywhere from 35 to 82 with an average of 52.5 and a standard deviation of 8.33. Finally, governance ranges from 25 to 70, the largest of any subsection, with a mean value of 46.5 and a standard deviation of 8.1. The remaining CSR figures that accompany this section (Figures 7-10) are pictured in the appendix.

On average, sample firms are profitable with a mean net income of \$1,396,622. The firms in this sample have an average beta (risk measure) of 1.21, indicating that they are generally above market risk (Figure 6). In terms of leverage the average of the sample is .59, indicating that on average sample firms have more equity than they do debt. Additionally, the average number of employees for the sample is 28,000.

Figure 6: Risk Histogram



Regression Specification and Testing

When determining the correct specification for my regression I began by identifying that I was working with panel data, which contains multiple observations for each company over multiple years. After this step I then began a basic procedure for all of the ensuing regressions. I first ran a basic correlation matrix (Table 5 in appendix) to ensure that the independent variables I was working with were not overly correlated with one another. I found for all regressions that each independent variable was below the critical level of .6, indicating that there are likely no problems associated with multicollinearity. This issue is important to identify because it can create instable parameter estimates and make it hard to judge the relationships between variables.

The next step in my process was running each regression as both a random effects model and fixed effects and comparing both using a Hausman specification test. This test stores the estimates from each model and determines if there is a material difference between them. If the resulting value of the test is below .05 you reject the null hypothesis, meaning that the estimates are significantly different and you must use a fixed effects model for proper specification. The Hausman test for all of my regressions identified the random effects model as the proper specification. After determining the correct specification I proceeded to run the regression with standard errors that were robust to heteroskedasticity. This is done in order to effectively control for potential problems associated with heteroskedasticity, a problem that ensues when the size of an error term differs across values of an independent variable. Additionally, I proceeded to test all regressions for patterns within standard errors. The resulting figures, pictured in the appendix (Figures 11- 13, only pictured if regression was statistically significant),

indicated that the errors were relatively normally distributed and not skewed in a specific direction.

Total CSR and Executive Compensation

Table 1			
Total CSR & Executive Compensation			
	Total CSR	Total CSR	Total CSR
Lagged Salary Compensation (%)	9.402* (2.08)		
Lagged Bonus Compensation (%)		-5.049 (-1.11)	
Lagged Long Term Compensation (%)			-0.417 (-0.17)
Size	0.0000147 (1.24)	0.0000184* (2.13)	0.0000144 (1.38)
Leverage	0.000793* (1.96)	0.000457 (1.26)	0.000542 (1.50)
Profitability	7.61e-08 (0.58)	4.56e-08 (0.36)	3.79e-08 (0.31)
Risk	-0.520 (-0.48)	-0.342 (-0.35)	-0.215 (-0.21)
N	273	273	273
Note: t statistics in parentheses, * p<0.05, ** p<0.01, *** p<0.001			

Following the completion of the specification tests I determined that my model was free from major errors that could affect its validity and in proper form to analyze the results. The results of the regressions between total CSR and Executive compensation data are presented above in Table 1. The relationship between lagged bonus compensation data and Total CSR did not produce significant results. This is important to note because I hypothesized (H2) that there would be a significant, and negative

relationship between these two factors, the justification for which is discussed in the literature review section, and is revisited in the formal statement of my hypothesis in the methodology section. Moreover, the previous two studies that I am comparing my results to did find a significant relationship between these two variables, and there affects on one another, making my results materially different than both. While the results were not statistically significant the bonus variable did have a negative association with Total CSR with a correlation coefficient of -5.049 as forecasted in thy hypothesis section.

Similarly, the regression comparing lagged long-term compensation and total CSR did not produce significant results. This is also important to identify as I hypothesized that there would be a materially positive relationship between these two variables. This hypothesis was based on previous literature surrounding the topic, and was discussed in the literature review section. Furthermore, both McGuire et al. (2003) and Mahoney and Thron (2006) found materially positive relationships. Thus, based on the findings of previous studies I hypothesized that this relationship would produce similar results. Moreover, while the results were not significant the resulting relationship was slightly negative with a correlation coefficient of -0.417. This is interesting because it is the opposite of what I would have expected based on previous findings. This relationship could be do to the fact that as each form of compensation is a share of total compensation and a largely positive value in one section would imply other sections would be negative.

The most notable relationship is between Total CSR and lagged salary compensation, as it is the only significant regression produced from these comparisons. The overall R^2 value for the regression comparing total CSR and lagged salary

compensation data was .5469, indicating that the model explains about 54.69% of the variability of the data. Additionally, the lagged salary compensation metric was both significant, with a p-value of .038, and positive with a correlation coefficient of 9.40. Essentially, this means that a one percent increases in the share of salary in the previous year is associated with a 9.4 point increase on the index scale of total CSR in the following year. This is of particular interest because the finding contradicts hypothesis number three (H3) presented in the methodology section. Furthermore, this result contradicts the findings of McGuire et al.'s (2003) study of the United States and Mahoney and Thron's (2006) investigation of Canada.

The incongruous nature of these findings in the United States may be do to the differing methodological approach taken between this examination and that of McGuire et al. (2003). Essentially, it is possible that the primary driver behind this difference is the introduction of the lagged variable association between executive compensation and CSR. Along the same lines, the difference in these results may arise form the sources of data used in each study. McGuire et al. (2003) uses KLD data as the metric for CSR while I use CSRHub data. Moreover, I also hypothesized that this difference could have been due to the introduction of new control variables for risk and profitability and the exclusion of ownership structure as a control, which make my regression specification unique when compared to previous studies. After removing these control variables in order to make my regression equation more similar to McGuire et al. (2003) and Mahoney and Thron (2006), I found no material change in the prevailing trend identified above, confirming that this was not the root cause of the difference in the results. Alternatively, this difference could arise from the rapidly changing landscape of the

United States economy over the past fifteen years. For instance, the effects of the 2008 recession may have had significant effects on how companies view CSR and how they compensate executives to encourage them to fulfill socially responsible goals. In regard to the Mahoney and Thron's (2006) Canadian investigation, this difference may arise from differing treatment of CSR and executive compensation in Canada as compared to the United States.

Alternatively, these material differences may actually speak to the logic presented in the investigations conducted by Gray and Canella (1997), Jensen and Murphy (1990), and Murphy (1985). They argue that fixed compensation in the form of a salary may encourage a CEO to become more risk averse and conservative. These conservatory effects thereby shift the CEO's focus to long term goals, and directly benefit the stakeholders of the company through socially responsible investment in the long term. Furthermore, McGuire et al. (2003) proposes that increasing a CEO's salary may actually tie them to the company through the development of their firm specific human capital, which makes them less willing to risk the reputation of the firm, and themselves.

Community and Executive Compensation

Table 2			
Community & Executive Compensation			
	Community	Community	Community
Lagged Salary Compensation (%)	16.63** (3.14)		
Lagged Bonus Compensation (%)		-3.873 (-0.80)	
Lagged Long Term Compensation (%)			-3.039 (-0.98)
Size	0.00000410 (0.93)	0.00000706 (1.55)	0.00000348 (0.86)
Leverage	-0.00110* (-2.19)	-0.00158** (-3.24)	-0.00142** (-2.88)
Profitability	-7.22e-08 (-0.62)	- 0.000000184 (-1.55)	- 0.000000172 (-1.51)
Risk	1.062 (1.37)	1.382 (1.50)	1.419 (1.59)
N	273	273	273
Note: t statistics in parentheses, * p<0.05, ** p<0.01, *** p<0.001			

After examining the Total CSR metric as a whole compared to different forms of executive compensation, I proceeded to test each of the subsections that comprise total CSR to see if any single category was driving the overall trend that I discovered above. I began by analyzing the Community subsection of CSR against the differing forms of executive compensation. The results of these regressions are pictured above in Table 2. Similarly, the relationships between the Community subsection and shares of Bonus compensation, as well as Long-term compensation are statistically insignificant. While I did not extend formal hypothesis for each subsection this is intuitively contradictory to

what I would have expected the results to be. I would assume that a category comprising CSR would have similar underlying relationships to that of Total CSR, which I hypothesized to be materially negative for bonus, and a materially positive for long-term compensation. This rationale is the same as in the previous section and is based on the findings of previous studies, and literature surrounding the field of CSR, executive compensation, and corporate governance. The correlation coefficients for each of these relationships were -3.873 and -3.093 respectively. Similar to the total CSR regression, while not statistically significant I would have expected the relationship between this subsection and long-term incentives to be positive, not negative.

Much like the regression between total CSR and lagged salary compensation that produced significant results, the regression comparing the Community subsection of CSR and the lagged salary compensation variable was also statistically significant and positive. The overall R^2 value for this regression was .6031 indicating that it explains 60.31% of the variability of the data. This regression was significant, with a p-value of .002, and positive with a correlation coefficient of 16.63. This indicates that a one percent increase in the share of salary relative to total compensation in the previous year is associated with a 16.63 point increase on the index scale of the community subsection of CSR.

Despite not extending specific hypotheses for individual subsections, this is contradictory to what I would have expected the relationship to be. Considering that Community is a subsection of the broader CSR measure I also would have expected this to be a negative relationship, not a dramatically positive one. Following the same lines of logic introduced in the discussion of the previous regressions, this deviation from my

expectation may be due to differing data and methodology, differing control variables, and overall economic conditions that may have changed since the last investigations were conducted. In regard to the hypothesis surrounding the differing control variables, I proceeded to engage in the same procedure as I did with Total CSR regression equation, eliminating controls that made my regression specification unique from McGuire et al. (2003) and Mahoney and Thron's (2006). The results were the same as before and produced no material change, indicating that the discrepancy was not do to the introduction of the controls for profitability, and risk. These results do indicate that the community subsection is likely more sensitive to changes in the share of salary compensation, and that it could be the driving factor behind the positive relationship found between total CSR and salary compensation. Additionally, we would expect that with a large positive coefficient on this variable, the other two coefficients would be negative as they are shares that should have a sum close to one.

Furthermore, I believe this relationship may indicate that a higher level of salary provides a sense of financial security for a CEO, and may allow them to focus on socially responsible goals knowing that they have a steady stream of income. In direct relation to the community subsection, this could mean that with this added sense of security the CEO engages more strongly in their efforts to behave ethically within the local, national and global communities it does business, strengthen the companies human rights records, improve treatment of its supply chain, control the environmental and social impacts of their company's products and services, and further the development of sustainable products, processes, and technologies.

Governance and Executive Compensation

Table 3			
Governance & Executive Compensation			
	Governance	Governance	Governance
Lagged Salary Compensation (%)	2.582 (0.38)		
Lagged Bonus Compensation (%)		-11.93** (-2.88)	
Lagged Long Term Compensation (%)			2.828 (0.96)
Size	0.00000511 (0.28)	0.0000145 (1.06)	0.00000532 (0.31)
Leverage	-0.00178 (-1.75)	-0.00201* (-2.21)	-0.00197* (-2.07)
Profitability	2.88e-08 (0.18)	3.10e-08 (0.18)	2.29e-08 (0.15)
Risk	-1.592 (-0.78)	-1.860 (-0.98)	-1.375 (-0.71)
N	273	273	273
Note: t statistics in parentheses, * p<0.05, ** p<0.01, *** p<0.001			

After analyzing the community subsection I proceeded with an analysis of the governance subsection. The regression results for this variable are presented in Table 3. The results for this section were materially different from the Total CSR regressions and the community subsection regressions. These results indicate that there is no material relationship between the governance subsection and either salary compensation or long-term compensation. With the understanding that the subsections of CSR make up the Total CSR metric, I believed that they should follow the relative trends I predicted in my formal hypotheses (H1-H3). The results of this regression both contradict, and confirm

my broader hypotheses. The contradictory elements to my general hypotheses are the lack of a statistical relationship between the governance subsection and either Salary compensation or long term compensation, which I believed should have been negative and positive respectively. The correlation coefficient for long-term incentive compensation is 2.828 and the coefficient for salary compensation is 2.582. As each of the executive compensation categories is a share of total compensation, and therefore sum close to one, we would expect a balance between the negative and positive associations of each section. Thus with a largely negative coefficient on bonus compensation we would expect the other shares to have a trend in the opposite direction. The rationale behind this prediction follows the same justification introduced in the previous sections of this paper. The Confirming element to my analysis is the negative relationships identified between the governance subsection and bonus compensation, which is in direct relation to my second formal hypothesis (H2).

Based on the results of this regression it is evident that lagged bonus compensation data is significantly related to the governance subsection of CSR with a p-value of .004. Moreover, this relationship is drastically negative with a correlation coefficient of -11.92. This means that a one percent increase in the share of bonus compensation in the previous year is associated with an 11.92% decrease in the governance subsection in the following year. The overall R^2 value for this regression was .6224 meaning that this model explains 62.24% of the variability of the response data around its mean, a relatively good fit to the regression line.

The negative relationship between the share of bonus compensation and the governance subsection of CSR was not directly hypothesized as it is a subsection of

CSR, but falls in line with more general hypothesis stated in the methodology section. I hypothesized that total CSR would be negatively related to bonus. This subsections relationship to bonus falls within that hypothesis, and can be justified after reviewing the nature of bonus compensation. As discussed in the literature review section, bonus is a form of compensation often related to the achievement of short term financial goals. Rewarding a CEO for attaining these immediate financial goals frequently encourages them to forego longterm CSR initiatives for the sake of profiting in the short term. In order to clarify this relationship it is important to revisit the formal definition of the governance subsection. This subsection is concerned with how the company is conducting itself internally and in relation to its stakeholders at large. It accounts for leadership structure and the values that drive the corporation's direction, ethics, and performance. The value of this category is based on the alignment of corporate practices and sustainable goals, transparency between management and the stakeholders, employee engagement with management, and top down integration of sustainable goals into day-to-day operations. Based on this definition it is clear that increasing the share of bonus in a CEO's total compensation may have detrimental effects on the sustainable goals of the corporation, and top down integration of those goals. Moreover, it may direct the CEO away from long-term social responsibility and damage overall stakeholder relations. The statistical significance of governance and bonus compensation indicates that it is a subsection that is more sensitive to changes and bonus compensation, but interestingly is not ultimately reflected significantly in the Total CSR metric analyzed previously in this section. Additionally, this relationship is also confirmed by previous studies in this field. Both McGuire et al. (2003) and Mahoney and Thron (2006) find that there is a negative

relationship between CSR and the share bonus compensation using their respective methodologies, providing theoretical and statistical evidence to that point. My study finds the same trend, and confirms that this is one of the relationships we can be most confident in when discussing executive compensation and its effects of corporate social responsibility.

Conclusions

The findings of this study present various conclusions about the interactions between executive compensation and CSR and can potentially have impacting influences on corporate governance issues for United States companies. This idea gains even more importance when we acknowledge that certain goals dictated through targeted corporate governance, and the method of compensating those goals, can have direct affects on CSR initiatives within a firm, and closely relate to the stakeholders of a company who are concerned with the long term view of a company and its wellbeing in relation to society. Specifically, the results of this paper can be of potential use to firms designing compensation plans for CEO's. Companies of all sizes can consider these results and based on their specific goals tailor a compensation plan that will most effectively lead them down a socially responsible path or not.

It is important to note that all studies in this field have not been conclusive, and often times have conflicting findings related to CSR and executive compensation. For instance when comparing the results of this study to those found by McGuire et al. (2003) we see some drastic differences. The updated methodological approach taken from Mahoney and Thron's (2006) study of Canadian firms presents a new lens in which we view firms in the United States, and is potentially responsible for the new relationships

found in this investigation. Similarly, we see distinct differences between the findings of this study and those found by Mahoney and Thron (2006). The differing results gathered using very similar models speaks to the variability of these trends globally, and the independent nature of how executive compensation is related to CSR internationally. This can make the direct application to corporate governance more convoluted, and companies should be cautious when approaching issues that have this degree of importance. It is important to take all research as a whole and not rely on one single source as basic truth for examining the relationships between various forms of executive compensation and their impacting effects on CSR.

If I had more time to work on this study I would make various improvements in order to increase the applicability of my results. The first area of possible improvement is the expansion and further diversification of my current data set. The data collection process is cumbersome for many reasons including but not limited to, time constraints, availability of data, and consistency in reporting standards throughout distinct industries. For my study specifically, I would potentially use the KLD, a more commonly used source of data in academic works, as the data source for my CSR metrics. This would allow for pure apples to apples comparison with McGuire et al.'s (2003) study of the United States, providing clear disconfirming evidence to the validity and applicability of her study to modern day firms. This evidence is necessary because we live in a world that is evolving at rates never seen before and we must constantly update our knowledge of complex corporate issues with the evolution of new macro economic events. That being said this data set is both heavily guarded and expensive to use for an application such as a senior thesis. Furthermore, I believe that an increased body of literature with CSRHub

data as the basis of the investigation would prove useful in comparison with my results. This paper has potentially opened the door for future academic works to consider this database, and use the results found here as a baseline for further study.

Additionally, I would use the Execucomp database for my CEO compensation data, as it is regarded as the most comprehensive in nature, and has been standardized over a long period of time. This was also the database used in McGuire et al. (2003) and would provide a clear platform for comparison. Unfortunately, this data also has distinct barriers to entry similar to the KLD.

Another suggestion I have is the examination of this issue in the future. It is important to revisit certain issues as they evolve, and identify that continuous work in the field is necessary to understand the current relationships that are present. This presents a distinct opportunity for academics in the future to revisit this research topic and question, and test for changes that may arise over the next few years. Additionally, new studies can form from this line of investigation, such as a direct study of one specific industry as opposed to a diversified sample. This would provide acute results that may indicate differing trends across distinct industries.

In conclusion we find significant results that must be examined further. I find a positive relationship between Total CSR ratings and the share of salary compensation. This trend holds true with the community subsection of CSR, and reinforces the general trend found in the comprehensive Total CSR metric. I also find a negative relationship between the CSR subsection of governance and the share of CEO bonus compensation. This underlying trend did not appear in the comprehensive Total CSR metric, and may speak specifically to the sensitivity of governance to bonus compensation. Finally, this

study is a good starting point for future investigation, and serves as a shingle in this developing field of academic research.

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Appendix

Table 4					
Summary Statistics					
Variable	Observations	Mean	Std. Dev.	Min	Max
Total Compensation	273	1.08E+07	1.16E+07	1000240	9.85E+07
Salary	273	1094457	442734.8	169949	3513461
Salary Percent	273	0.1700366	0.1285968	0.01	0.75
Bonus	273	1417655	3281217	0	3.20E+07
Bonus Percent	273	0.1250916	0.153446	0	0.98
Stock Compensation	273	6191100	8234984	0	9.08E+07
Stock Compensation Percent	273	0.5214286	0.2145699	0	0.98
Total CSR	273	51.65201	5.396738	39	65
Community	273	51.78022	6.399337	35	69
Employees	273	55.83883	6.697483	29	73
Environment	273	52.50916	8.336716	35	82
Governance	273	46.56777	8.172541	25	70
Profitability	273	1396622	3814040	1.21E+07	2.47E+07
Leverage	273	0.5960073	53.27493	-855.7	166.04
Risk	273	1.212857	0.7602045	-0.41	3.91
Size	273	28042.48	60660.19	27	323000

Figure 7

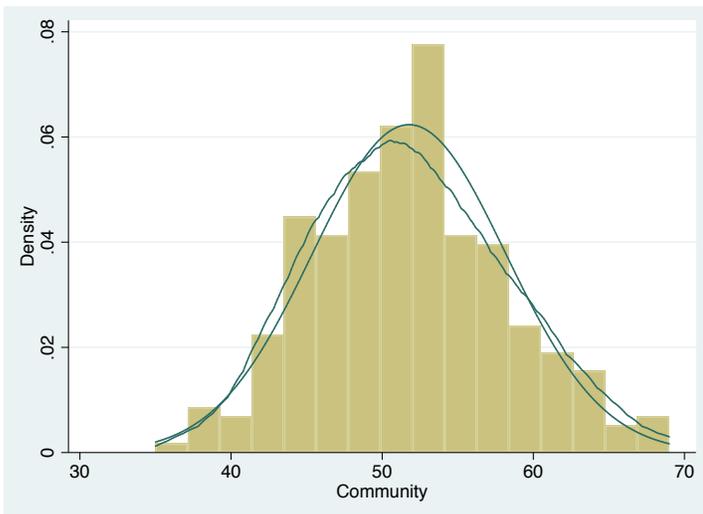


Figure 8

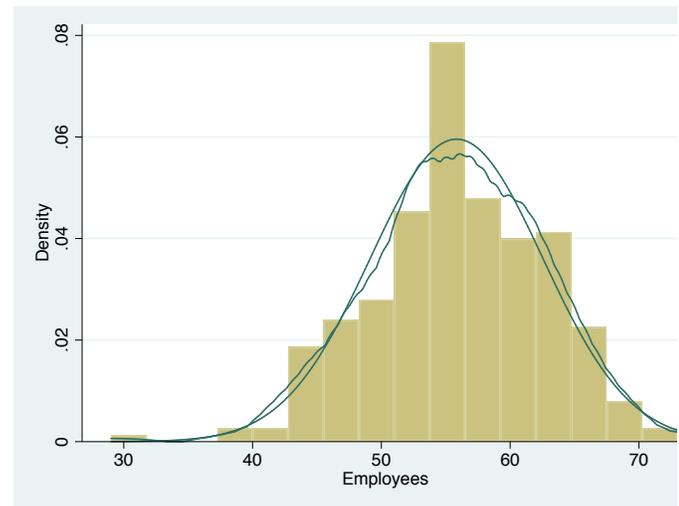


Figure 9

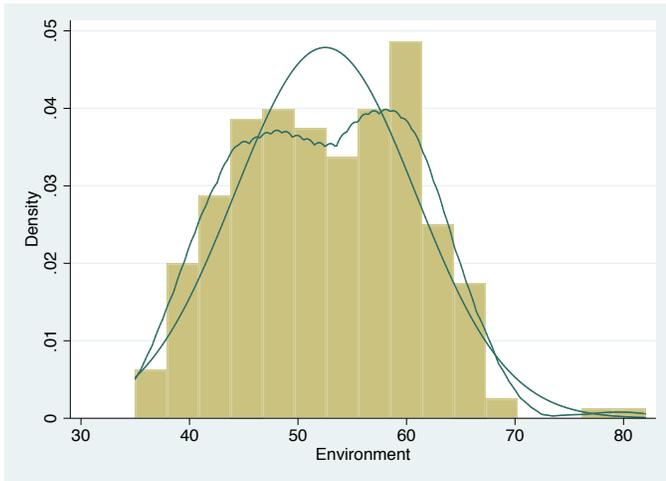


Figure 10

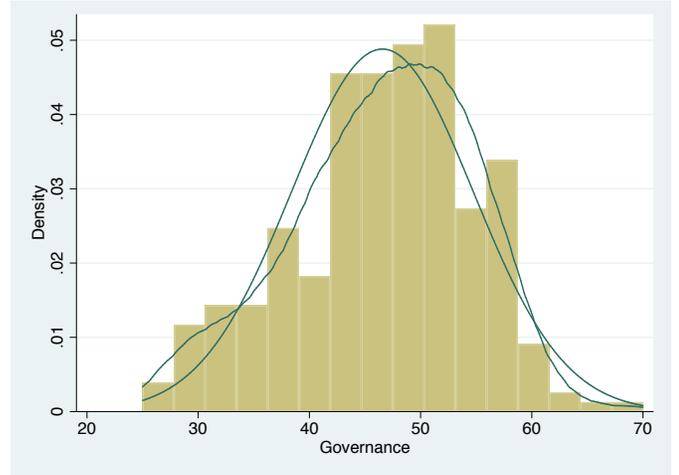


Figure 11: Total CSR and Salary

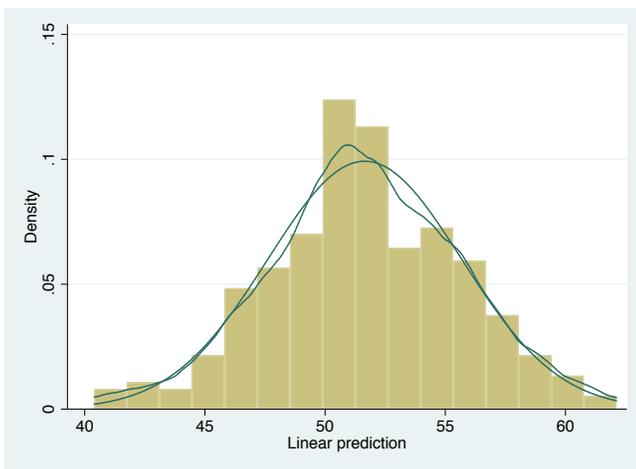


Figure 12: Community and Salary

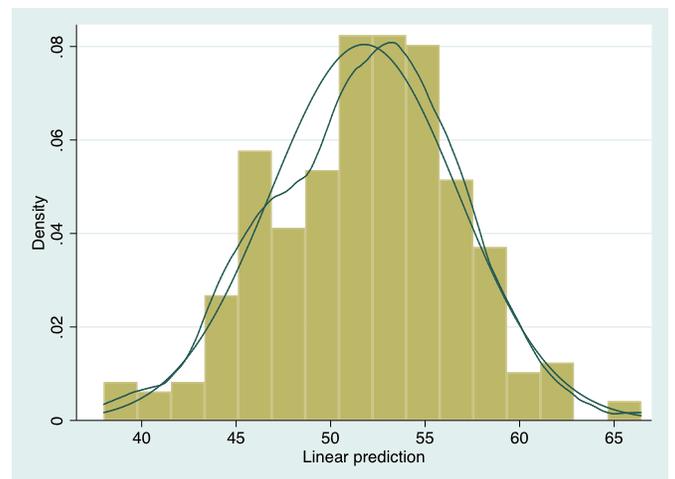


Figure 13: Governance and Salary

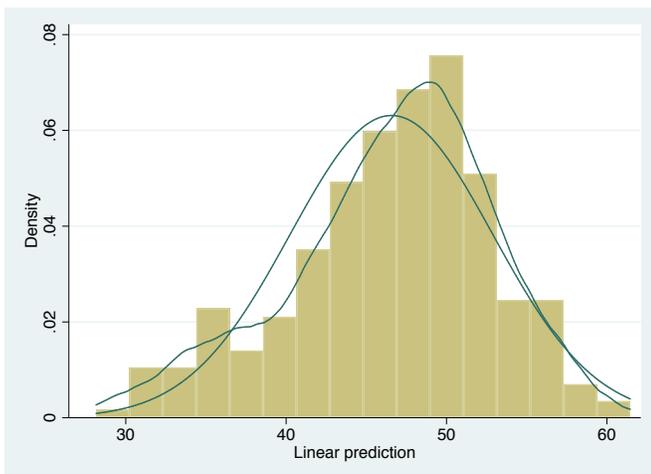


Table 5

Correlation Matrix								
	Total CSR	Lagged Bonus Compensation	Lagged Stock Compensation	Lagged Salary Compensation	Size	Risk	Leverage	Profitability
Total CSR	1.00							
Lagged Bonus Compensation	-0.0961	1.00						
Lagged Stock Compensation	0.1479	-0.4140	1.00					
Lagged Salary Compensation	-0.1174	0.1244	-0.6198	1.00				
Size	0.2693	0.0912	-0.0131	-0.1134	1.00			
Risk	-0.0759	-0.1127	0.0672	0.0860	-0.1069	1.00		
Leverage	0.0422	0.0503	0.0940	0.0275	-0.0531	0.0242	1.00	
Profitability	0.2329	0.1391	0.1272	-0.2271	0.2639	-0.1890	0.0358	1.00