

THE USE OF SUSTAINABILITY METRICS IN
EXECUTIVE COMPENSATION PLANS
AND THEIR EFFECT ON CORPORATIONS

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ABSTRACT

This paper serves to explore the background behind executive compensation packages as well as corporate social responsibility and specifically sustainability. After exploring the background behind these two areas of business, this paper examines the motivation behind each and identifies how companies have recently used sustainability metrics when designing compensation packages. Finally, this study serves to explore the strengths and shortcomings of using sustainability metrics while providing recommendations and insights on the approach companies should take when considering sustainability and its use in compensation.

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INTRODUCTION

Executive compensation plans vary by more than just a dollar amount. They range from cash compensation packages to total compensation including stock options and other non-traditional privileges such as debt forgiveness. In addition, the stipulations and metrics that are utilized to determine levels of compensation within any of these plans are even more diversified. While programs may vary from firm to firm, general goals of executive compensation include producing positive shareholder wealth, maintaining good corporate governance by incentivizing value-added decisions and punishing mistakes or risky behavior, and providing benefits that will attract, motivate, and retain top talent in the workplace.

As firms continue to explore the importance of accommodating all stakeholders as opposed to just shareholders, new metrics have been introduced to measure the way a company performs in addition to bottom line figures. One of these explorations addresses increased regulations over the years regarding the environment and how important stakeholders regard this factor when deciding whether or not a company is a worthwhile investment. With corporate social responsibility (CSR) and sustainability becoming increasingly important in the corporate workplace, studies have been conducted to see just what kind of impact they have on different areas of the firm. Increasingly, shareholders look for trustworthy and socially responsible (SR) firms which explains the growing relevance of CSR in the corporate world. Furthermore, SR firms are more likely to have CEO turnover due to poor performance and do not typically see an increase of risky behavior due to stock options like their non-SR counterparts (Frye, 2006). These characteristics align with the goals of good corporate governance and risk aversion. Studies have also looked into how CSR can impact executive compensation plans, with

one study concluding that CEOs in SR firms receive significantly lower pay than those in non-SR firms. While lower pay proposes it could be tough to keep top talent, it demonstrates that those in “top management of the US socially responsible firms, on average, care more for their employees and have better self-control rather than follow the path of greed” (Cai, 2011).

While different areas of CSR and the impact it has on firms have been explored more heavily in recent years, there is still significantly less attention on how adding CSR as a metric for executive compensation will affect a firm. This study seeks to use case studies on Intel, Xcel Energy and the Hershey Company in order to explore what kind of impact sustainability based compensation plans have on a firm’s ability to be socially responsible by analyzing the compensation plans of each and comparing both firms to a non-CSR based compensation package. Through these case studies, it can be concluded that while sustainability metrics can improve a company’s CSR performance, success is driven from the intrinsic value that these initiatives create for the company. Because the initiatives that the companies in the case studies adopt bring value to the company, the company is poised to perform better and attract investors. Due to the prospect of better performance, executives are motivated to ensure the success of these CSR projects. Adding CSR metrics in executive compensation packages simply enhance the speed and quality of these social responsibility projects. In order to be successful in CSR, the related projects must first be rooted in bringing long-term value for any given organization.

A Foundation of Executive Compensation Plans

While a hot topic among investors, upper level management, and finance scholars, executive compensation can often be vague and confusing to many. In order to fully understand the literature available regarding compensation, it is important to review the typical purpose, structure, and outcome of executive compensation plans.

Purpose of Executive Compensation

Regardless of industry, firm structure, or company size, executive compensation serves to incentivize upper level management to make decisions and perform in accordance with the interests of shareholders in the areas of company strategy, decision-making, and value creation. In addition, executive compensation serves as a method of executive retention. These plans tie rewards to performance in a number of areas from achieving short-term financial and strategic objectives to completing long-term value-added goals (Chaudhri, 2003). While existing literature explores a variety of plans and has long debated which general objectives plans should be based on, pay-for-performance has been among the most common while plans tied to metrics such as corporate social responsibility, including sustainability, have been less common. In 2010, less than ten “published studies present[ed] empirical findings related to executive compensation and CSR” (Callan, 2010).

After looking at the composition of different programs offered by a variety of firms as stated on their websites and SEC Filings, it can be noted that the specific goals of

these plans vary from company to company and especially from industry to industry. For example, Prudential, a financial services firm, has programs in place that seek to reward executives based on their ability to meet earnings per share (EPS) targets, their ability to achieve long-term return on equity (ROE) goals, or increase the market value of their common stock. They are not the only firm to have programs and plans in place that reward company leaders through these specific metrics; however, a company like Microsoft, a provider of technology software and hardware, focuses their compensation on increasing revenue in specific product groups or on the release and success of newly introduced products in addition to some of the aforementioned metrics (Kostiuk, 1990). While there may be specific differences in what is measured, these are all influences of a company's overall performance. Simply put, the better a company performs year over year, the more compensation an executive receives.

This paper seeks to explore plans that serve another purpose in addition to pure bottom line performance. In recent years, companies have explored other ways executive compensation can influence management to lead in line with stakeholder values, and many of the trending metrics are ones that serve to increase levels of CSR, such as sustainability.

Structure and Characteristics of Compensation Plans

Once specific goals have been set for senior executives, compensation packages are developed by negotiation between executives and board members who represent internal and external shareholders. According to the Center on Executive Compensation, executive compensation has four distinct characteristics:

1. Pay Package Design – These arrangements consist of six components: salary, annual incentives, long-term incentives, benefits, perquisites and severance/change-in-control agreements.
2. Equity Compensation – Compensation in the form of company stock. This form of compensation typically accounts for a majority of the pay package.
3. Performance-Contingent Pay – The criteria a company must meet in order for an executive to qualify for compensation such as specific financial results or strategic objectives. This is typically determined by percentage amounts with a minimum balance that is not tied to the stated criteria.
4. Vesting Schedules – Full ownership of the equity award is often attached to other conditions that require executives to comply with specific covenants.

These qualities are key to making sure these packages offer an attractive incentive to executives while also holding conditions that will keep the integrity of the package's purpose and provide positive results for a firm's standing.

The Effect of Compensation Plans

In best case scenarios, companies are able to achieve the aforementioned purposes and goals through their proposed compensation packages and programs offered to their executives. However, incentives are offered in order to achieve certain outlined goals because these objectives are not easily accomplished, with each contingency having its own set of obstacles and challenges. Therefore, the effectiveness of a compensation package is dependent on a measure of motivation. The plan must motivate an executive

to stay in a firm but it must also stimulate executives and encourage them to work to achieve the outlined goals (Chaudhri, 2003).

Several studies have analyzed what forms of compensation have proven to be the most effective. Mehran (1991) distinguished the importance of looking beyond just the level or amount of compensation that is being offered to executives, establishing that effectiveness can also increase or decrease depending on the type of compensation being offered to executives. In addition to distinguishing the importance of examining the form of compensation, Mehran recalls the works of Jensen and Murphy (1990) who concluded that equity-based compensation is more effective than cash-based compensation due to the increased ownership managers are rewarded with. While there are many literary conclusions that support Jensen and Murphy, it is noted that empirical evidence that such companies perform better is lacking. Regardless, a majority of compensation schemes offer equity rewards as the largest part of compensation package.

Corporate Social Responsibility

Executive compensation aside, it is important to explore the role of CSR in a firm and understand how companies practice CSR, why companies engage in CSR initiatives, and what kinds of initiatives currently exist. By understanding the role of CSR as a corporate initiative, one will understand why such initiatives would be included in a compensation package. While many studies cover the costs and effects of CSR on a firm, there are much fewer studies that tie CSR to executive compensation and whether or not such initiatives can produce meaningful and lasting results.

Corporate Social Responsibility Defined

According to Archie B. Carroll from the University of Georgia, CSR has evolved greatly since its prominence primarily in the 20th century. Despite being a topic of discussion for centuries, the later evolutions of the concept are more relevant to this particular study of executive compensation (Carroll, 1999). One of the earliest definitions of CSR came from Howard R. Bowen's book *Social Responsibilities of the Businessman* where Bowen wrote that CSR "refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society" (Bowen, 1953). This recognized that the responsibilities of businessmen extended beyond the consequences of company performance as identified by their bottom line. They were responsible for the consequences of their actions on society. In the 1970s, the scope of CSR specifically addressed the importance of acknowledging and caring for stakeholders, most notably outlined by Harold Johnson (1971) who stated that "a socially responsible firm is one whose managerial staff balances a multiplicity of interests. Instead of striving only for larger profits for its stockholders, a responsible enterprise also takes into account employees, suppliers, dealers, local communities, and the nation." The scope of CSR was expanded even further a decade later when Thomas M. Jones wrote that there were "two facets" of CSR. The first facet stated that "the obligation must be voluntarily adopted" free from the coercion of the law, and the second stated that the obligation "extend[ed] beyond the traditional duty to shareholders and to other societal groups such as customers, employees, suppliers, and neighboring communities" (Jones, 1980). By the

1990s, CSR grew not only as an area that more businesses considered seriously as a part of their operations and goals, but the definition itself was complex with companies operating under their own unique CSR terms. Carroll stated that there are four major CSR domains: economic, legal, ethical, and discretionary, and each domain relates to the three principles of “social legitimacy (institutional level), public responsibility (organizational level), and managerial discretion (individual level)” in different ways (Carroll, 1999). In addition, Carroll outlined that CSR is a pyramid with economic obligations at the base, followed by the other three domains. Overall, a CSR firm should strive to “make a profit, obey the law, be ethical, and be a good corporate citizen” (Carroll, 1991).

Sustainability as a Function of CSR

While the terms “sustainability” and “CSR” have been increasingly used interchangeably, sustainability is better depicted as a function or branch of CSR because it is only one measure of how well the firm is supporting an external cause other than increasing their bottom line. The growth of recognition for sustainability as CSR is indicative of environmental responsibility’s increasing importance in the corporate space.

Why Do Companies Participate in CSR

Much of the available literature considers the cost of CSR and seeks to identify if the costs outweigh the benefits (Konar, 2001). Because CSR is voluntary, it is important to explore why a firm would choose to bear these additional costs. In the last decade, there have been a slew of scandals and news stories regarding the irresponsibility and lack of care exhibited by various corporations. As such, many stakeholders have

identified CSR as an important element of corporate success. According to Keeble, Topiol, and Berkeley (2003), “investors are looking for evidence of good corporate governance, particularly sound business strategy and effective management of risk, customers are asking about the origins of products, employees are looking to work for companies that visibly account for their responsibilities to society and the environment, and governments and civil society are increasingly placing pressure on businesses to report on social and environmental performance.” Not only is CSR providing a competitive edge for corporations, it is becoming a norm and necessity of corporate culture. In fact, many studies consider CSR as a part of the inherent valuation of a firm.

Types of CSR Initiatives

As mentioned, sustainability is one type of CSR initiative that is growing in relevance. However, sustainability is not the only type of initiative available to firms. Different industries value different ways to contribute to society, playing off their strengths and opportunities to not only improve and preserve society, but to appease and win over stakeholders. The list of ways to contribute is endless, and as such, this paper will focus on a broader overview in order to establish a good idea of how CSR initiatives can be embedded into compensation packages. To remain consistent with the definition of CSR, initiatives fall into four main categories: economic, legal, ethical, and philanthropic. Sustainability falls under the ethical domain. Other examples of ethical initiatives include paying fair wages or refusing to conduct business with firms who do not practice good CSR standards.

Economically, companies are faced with the same task corporations have always prioritized, and that is turning a profit for the shareholders. From a legal standpoint, companies have a duty to society to operate within the standards of regulation that can range anywhere from labor law to environmental and even criminal law. While both economic and legal obligations fall under CSR initiatives, and companies are able to highlight their great success in both areas, these are both domains that have become more or less standard practice and a necessity in order for a corporation to stay alive.

Finally, philanthropic responsibilities offer a host of opportunities for a corporation to outshine competitors such as donating to community organizations valued by a company's stakeholders or heading or partnering in projects that have a specific cause. Philanthropic contributions are a great way for a company to utilize its strengths to give back to a community or to demonstrate its ability to exhibit responsibility in areas that are touched upon by its respective industry.

Because of the variety of CSR initiatives available to corporations, it becomes difficult to value a firm's level of CSR and the impact created through such actions. Therefore, when considering the full effect of CSR on a firm in a comparable way, other factors of a firm must be effectively controlled in case studies, and an important characteristic that has emerged from several studies is firm size.

Consideration for Firm Size

At the most noticeable level, firm size is a major indicator for a company's capacity to partake in CSR initiatives. From the amount of funding that is available for projects and extensive ethical measures to the resources that a firm would have to offer,

smaller companies have a capital disadvantage. However, because of the highlighted variety of initiatives available, smaller firms are also able to demonstrate creativity and the strength of partnerships in order to create an equitable contribution to society in a way that stakeholders can approve and support. Studies have found a positive relationship between firm size and managerial earnings across all major industries, and this finding has remained constant since the early 1930s (Kostiuk, 1990).

In addition to what has already been stated, it is also important to note that firm size also determines the level of responsibility that stakeholders believe a company should take. Those with more capital and resources are expected to carry a heavier emphasis on CSR, cutting deeper into the profit providing objective of CSR.

Unfortunately, when it comes to CSR initiatives, companies can no longer focus solely on the economic domain.

Firm size can also impact whether or not a company participates in CSR at all. It has been argued that due to the aforementioned “resource constraints and lower visibility, smaller firms are less likely to participate” in CSR (Udayasanker, 2008). To contrast, Udayasanker (2008) argues that regardless of these factors and of size, firms are equally motivated to participate in CSR. The motivation basis, however, tends to differ (economic vs. increased visibility). The findings of this study show that medium-sized firms are the least motivated, while small and large firms are more motivated. Medium sized firms seem to be less incentivized by increased recognition or visibility and better overall economic performance, but this does not suggest that these firms do not receive upside from CSR initiatives nor does it suggest they do not participate. Smaller firms seek increased visibility, and large firms will gain from better economic performance.

Even so, this does not suggest that one firm size performs CSR better than the other in regards to the percentage of value added vs. costs incurred despite the larger capabilities of multibillion dollar corporations. Therefore, it is important to be cautious of broadly categorizing firms into group sizes, and as stated, while firm size does significantly affect CSR participation and contribution capabilities, being a small firm does not completely bar a company from participating in CSR (Udaysanker, 2008).

Defining Value and Success in Corporations

Ultimately, the goal of a business relates to profitability, but over time, as businesses grew into multibillion dollar corporations, these entities have taken on many more responsibilities outside of their core areas of service. As these firms take on these peripheral tasks, there are measures that must be put in place in order to assess the successes and shortcomings of these activities and to consider adjustments to a firm's strategy.

Current literature has mixed findings regarding the value CSR adds or deducts from overall firm values. Many studies find that for large U.S. firms, better CSR scores are inversely correlated with the cost of equity. Investment in improving responsible employee relationships, environmental policies, and product strategies reduce firms' cost of equity (Ghoul, 2011). In addition, those who operate in "sin" industries, or those that include alcohol, gambling, tobacco, and firearms, have increased costs of equity, thereby supporting arguments in existing literature that "firms with socially responsible practices have higher valuation and lower risk" (Ghoul, 2011).

However, there are other findings that conclude that CSR activities contribute to the value of the firm only under certain conditions (Servaes, 2013). One example of a condition includes high customer awareness. Companies with high awareness as achieved through marketing have seen a positive correlation to CSR performance and firm value as found by scholars such as Ghoul. However, Servaes (2013) finds that for firms with poor awareness and poor prior reputation, CSR performance and value are inversely related due to concentrated focus on stakeholders other than the shareholders.

Due to the conflicting conclusions and lack of a universal measure for CSR success, this paper will assess case studies according to their performance on the sustainability metrics they internally set.

CSR as a Metric for Executive Compensation

CSR and executive compensation have been thoroughly explored as separate entities for many decades, but recently, CSR based compensation has become increasingly popular. While there is some literature explaining the initial belief and strengthening behavior towards this trend, there is a gap regarding the overall effectiveness of utilizing this metric.

Looking back at the purpose of executive compensation, incentives are offered in order to retain talent while meeting the goals and values of not only the firm's business but of the company's stakeholders. As CSR becomes increasingly important in a more conscientious business environment, it is not hard to believe that CSR has become a factor of evaluation for company performance nor is it difficult to understand why

stakeholders are increasingly demanding better CSR scorecards. Reasons that have been outlined include the fact that investors are seeking evidence of good corporate governance through sound business strategy and effective management of risk, that customers are increasingly emphasizing value in sustainable and socially responsible production processes, that top quality talent demands working for companies that consider their responsibilities to society and the environment, and that governments and society are increasingly pressuring businesses to report on CSR and environmental performance. This paper seeks to evaluate the effectiveness including CSR initiatives as a metric in compensation packages in relation to a company's CSR performance.

Case Study: Intel Corporation

Company Background

Intel Corporation is the world's largest semiconductor chip maker in regards to revenue. This company primarily serves the computing and communications industries. Over the years, Intel began focusing on more than just the design and manufacturing of semiconductor chips for PCs and servers. The company now delivers complete computing solutions which includes hardware, software, and supporting services (Intel, n.d.).

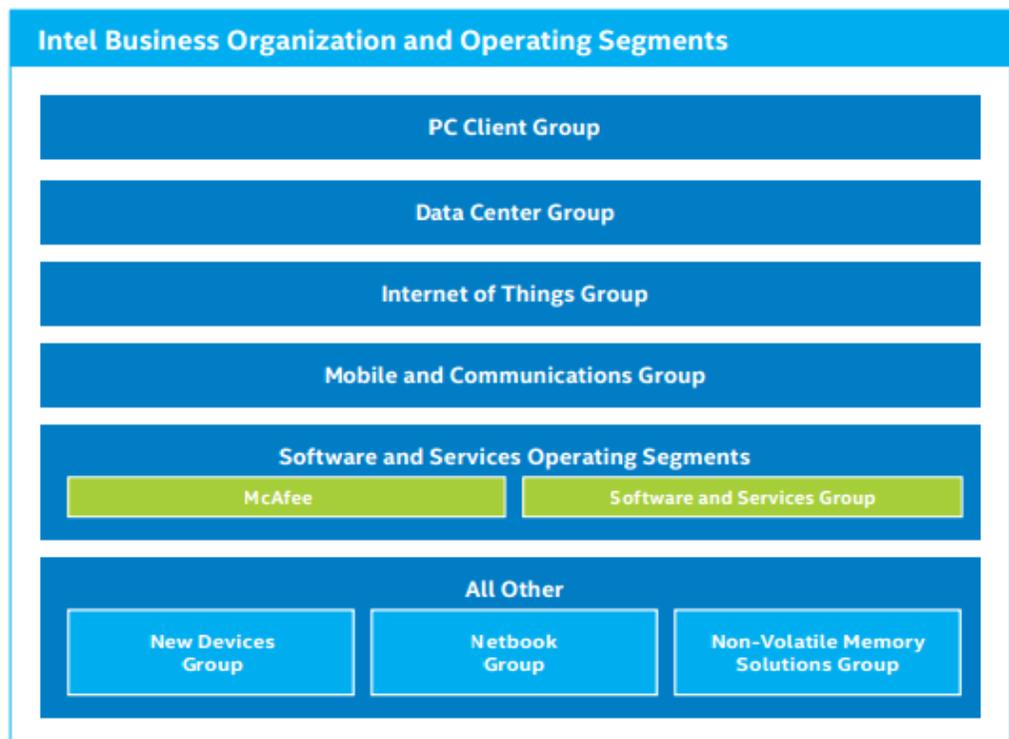


Figure 1: Intel Business Structure

Approach to Corporate Social Responsibility

Regarding corporate social responsibility, Intel believes that CSR creates value for both the company and its stakeholders by increasing effectiveness and benefiting the environment and society. Byproducts include lower risks, reduced costs, a protected brand value, and the ability to identify market opportunities. Specifically, Intel addresses challenges like climate change, access to education, and education quality. Energy efficiency leads to reduced emissions and energy costs. While Intel also invests in training, diversity, benefits programs, and education for employees in order to attract and retain a talented workforce in addition to other initiatives that fall under CSR, this study focuses primarily on the company's efforts in environmental sustainability as it relates to their compensation plan (Intel, 2013). However, briefly examining Intel's overall approach and image regarding CSR will create an understanding of the company's motives in tying sustainability to executive compensation.

Intel approaches CSR by embedding responsibility within specific business groups rather than having one CSR team head all CSR efforts though it does utilize Cross-functional Management Review Committees with senior executives who manage the corporate responsibility and sustainability activities across the organization. Additionally, Intel has a Global Corporate Responsibility Office which acts as an internal advisor to business groups.

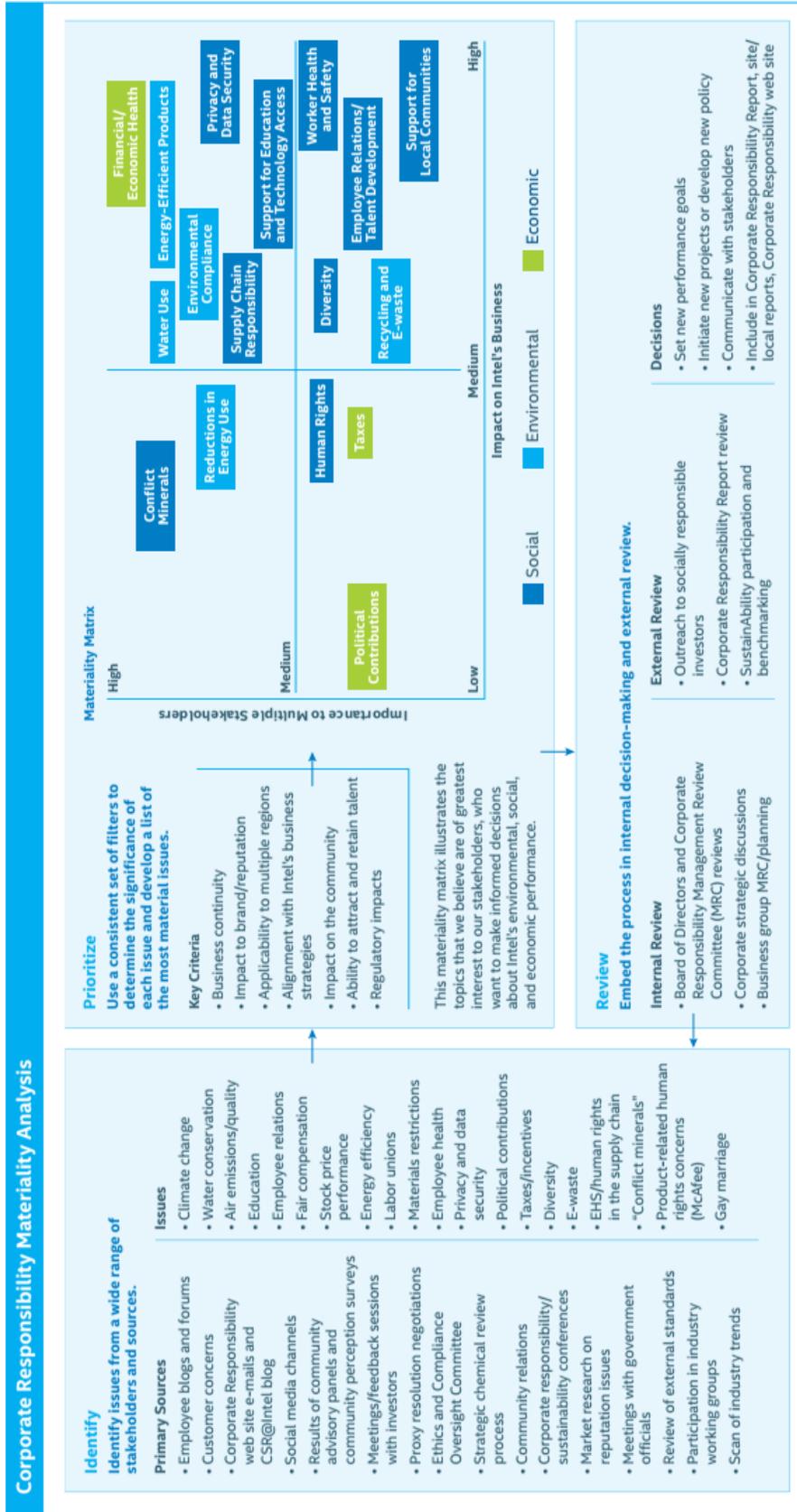
According to the company's Corporate Social Responsibility Report, Intel focuses on six areas of sustainability: energy efficiency and climate change, workforce talent and

diversity, education transformation and the digital divide, water use, waste reduction and recycling, and human rights, labor standards and supply chain responsibility.

In order to identify the areas that will be incorporated into metrics such as compensation as well as establish annual goals in CSR, Intel performs a materiality analysis where it utilizes multiple primary sources in order to identify a spectrum of relevant issues. Intel then prioritizes these issues by using filters to establish a scale of significance, creating a list of the most material issues that are placed on a materiality matrix that identifies where the issue lies in importance for the stakeholders as well as its impact on the company's business. After prioritization has been put in place, Intel embeds solutions in internal decision-making which are subject to both internal and external review.

Key Corporate Responsibility and Sustainability Issues: Challenges and Opportunities	
	Energy Efficiency and Climate Change. As impacts to climate and energy have become major focus areas for businesses and governments, we have taken steps to reduce absolute emissions from our operations and to address the climate change impact of our products. We continue to work on lowering our normalized and absolute emissions and increase the energy-efficient performance of our products. Worldwide efforts to reduce emissions and address climate change also present potential market opportunities for Intel technologies, including those for smart grids, transportation, and sensing.
	Workforce Talent and Diversity. Our ability to attract and retain top talent is key to our business success. We invest in cultivating a safe, respectful, and ethical work environment that enables employees to thrive both on the job and in their communities. We continue to work to increase the number of under-represented minorities and technical females in our workforce—especially at management and senior leadership levels—through targeted internal professional development initiatives and external education programs aimed at building the talent pipeline in engineering and technical disciplines.
	Education Transformation and the Digital Divide. Intel's success depends on young people having access to quality education and technology. As a leading technology company, we believe that we can help governments around the world achieve their economic development and educational goals by effectively integrating technology into their programs and strategies. Recognizing the lack of access to technology and education that still exists for many girls and women around the world—and the importance of enabling that access to spur economic development—we are expanding our engagement efforts and partnerships in this area.
	Water Use. Sustainable water management is a key focus at Intel, and we have invested significant resources in innovative conservation efforts. However, we face challenges in reducing our water use as our manufacturing processes become more complex. In recent years, we have expanded disclosure on our water use and conservation efforts, and continue to engage with external organizations to understand emerging best practices.
	Waste Reduction and Recycling. We recycle a significant amount of the solid and chemical waste generated in our operations. However, we continue to face challenges in reducing chemical waste generation, despite our reduction and recycling efforts. We will continue to address these challenges in support of our new 2020 environmental goals.
	Human Rights, Labor Standards, and Supply Chain Responsibility. In our industry and others, companies are taking a more active role in pushing for improvements in policies and processes for managing human rights issues, including human rights in the supply chain. We have completed an analysis and stakeholder engagement process to review our policies, processes, and potential risk areas related to human rights. We are also assessing emerging stakeholder concerns surrounding the use of technology products by governments in ways that raise censorship and human rights concerns, evaluating positive applications of technology to strengthen human rights, and working to understand how this impacts Intel's policies and management systems.

Figure 2: Intel Areas of CSR



We have used the Sustainability Materiality Framework developed by the research firm AccountAbility to define corporate responsibility materiality, both for this report and for our strategy development. (Note that "materiality" in this context does not refer to financial materiality.)

Figure 3: Intel's CSR Materiality Analysis

Some notable highlights include the fact that Intel was one of the first companies to have public goals related to *conflict materials* and the company manufactures conflict-free microprocessors. Intel also has a Sustainability Action Grant Program which helps fund projects expected from executives and employees, giving them resources to achieve initiatives linked to their compensation plans. Intel's overall safety performance is twice as good as the US semiconductor industry average, and the company is the largest voluntary purchaser of green power in the US according to the US Environmental Protection Agency. Intel also has a program to help improve supplier corporate responsibility through more stringent requirements related to compliance, performance, and transparency (Intel, 2013).

Due to these efforts, Intel has received several awards and recognitions as listed in their annual CSR report:

2013 Selected Awards and Recognitions	
Overall Corporate Responsibility	Business/Workplace/Citizenship
<p>Dow Jones Sustainability Indices. Listed on North America and World indices (15th year)</p> <p>Fortune magazine. World's Most Admired Companies (1st in our industry) and Blue Ribbon Companies lists</p> <p>FTSE Group. Listed on the FTSE4Good Index (13th year) (global)</p> <p>United Nations Global Compact. Listed on the United Nations Global Compact 100 Index</p> <p>Corporate Responsibility magazine. 100 Best Corporate Citizens (14th year) (U.S.)</p> <p>Ethisphere® Institute. 2013 World's Most Ethical Companies</p> <p>Corporate Knights. Global 100 Most Sustainable Corporations in the World (8th year)</p> <p>Reputation Institute. 2013 CSR RepTrak® 100 Study (global)</p> <p>MAALA Corporate Responsibility Index. Platinum rating (9th year) (Israel)</p>	<p>Forbes. Most Reputable Companies in the Americas (U.S.)</p> <p>Barron's. World's Most Respected Companies</p> <p>Fortune magazine. 100 Best Companies to Work For 2013 (U.S.)</p> <p>Glassdoor. Best Places to Work Employee Choice Awards (U.S.)</p> <p>Working Mother magazine. 100 Best Companies for Working Mothers (U.S.)</p> <p>Anita Borg Institute. Top Company for Technical Women (U.S.)</p> <p>Diversity MBA Magazine. Top 50 Out-Front Companies for Diversity Leadership (U.S.)</p> <p>Human Rights Campaign. Corporate Equality Index (11th year) (U.S.)</p> <p>AMR Research. Top 25 Supply Chains (5th overall) (global)</p> <p>National Conference on Citizenship. Included in Civic 50 Ranking (U.S.)</p> <p>Center for Political Accountability. 5th in CPA-Zicklin Index (U.S.)</p>
Environment	
<p>U.S. Green Building Council. Ray Anderson Radical Industrialism Award</p> <p>U.S. EPA. "Organizational Leadership" Climate Leadership Award</p> <p>Interbrand. Best Global Green Brands 2013</p> <p>Malaysia Ministry of Energy, Green Technology, and Water. Energy Efficiency Management Excellence Award, Industry category</p> <p>Solar Energy Industries Association. Top 25 Companies Using Solar (U.S.)</p> <p>Maplecroft. 3rd in Climate Innovation Index (U.S.)</p> <p>The Green500. Several Intel-based systems ranked in the top 10 in the 2013 lists of the world's most energy-efficient supercomputers</p>	

Figure 4: Intel's CSR Awards & Recognition

Executive Compensation Structure

As with most large corporations, Intel operates on a pay for performance basis in the form of annual incentive cash plans and equity awards. The annual incentive cash plan is based on relative and absolute financial performances, company performance relative to operational goals, and individual performance. The equity awards are based on long-term interests of Intel's stockholders and are based on both absolute and relative stockholder return. The sustainability metrics relevant to this study are identified under operational goals in the incentive cash plan. While Intel provides data regarding its basic compensation structure, data about the specific measurements and calculation justifications are held confidentially. Below are the distributions as provided by the latest proxy statement issued by Intel.

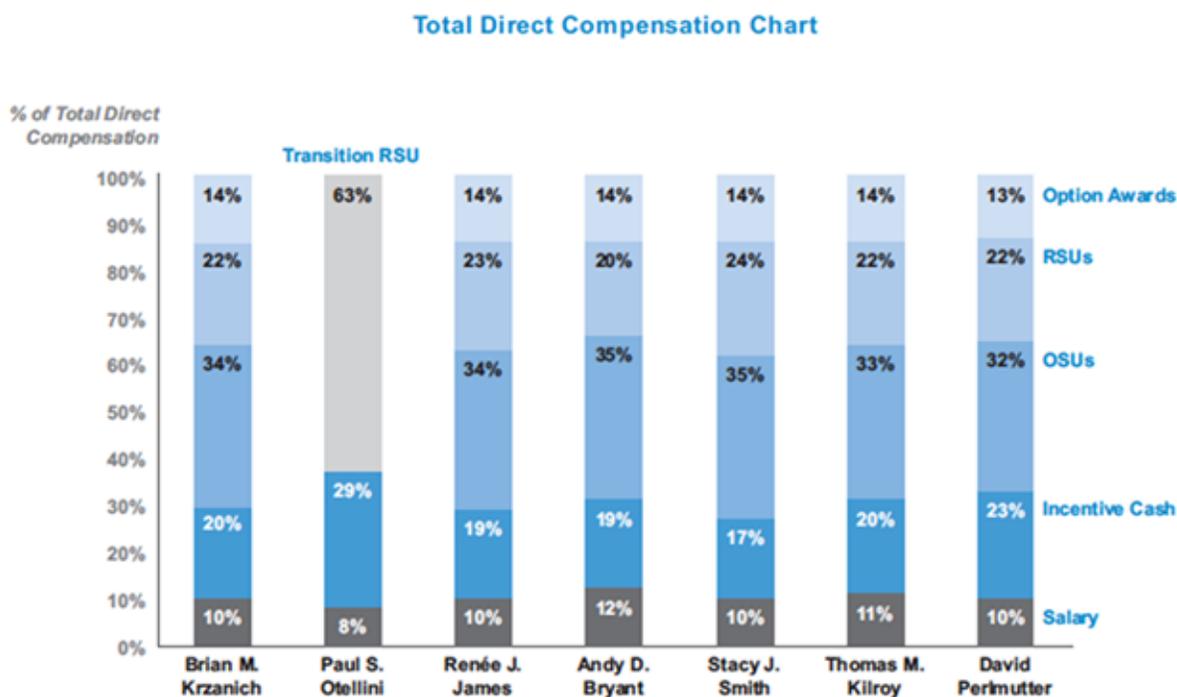


Figure 5: Intel's Executive Compensation Distribution

CEO Performance and Incentive Pay Mix



Figure 6: Intel CEO Compensation Distribution

Annual Incentive Cash Calculation

Absolute Financial Component (\$ in millions)	Intel's 2013 net income \$9,620	÷	Intel's average net income over past 3 years \$11,873	= 81.0%										
Relative Financial Component	1 + Intel's 2013 net income growth -(0.126)	÷	1 + the simple average of the annual net income growth for our technology peer group and the S&P 100 (excluding Intel) (0.185)	= 73.8%										
Operational Component <i>Goals are scored based on pre-established success measures. Each category has a different weighting.</i>	Reinvent PC $\frac{17.9}{22}$	+	Cloud & Data Center $\frac{18.0}{15}$	+	Maximize Manufacturing Lead $\frac{12.7}{12}$	+	Win Mobility $\frac{14.9}{24}$	+	Compute Continuum $\frac{12.7}{11}$	+	Path to \$100B Revenue $\frac{6.3}{9}$	+	Org Health & Environment $\frac{7.6}{7}$	= 90.1%
Payout (as a percentage of target)	$81.0\% + 73.8\% + 90.1\% = 245\% \div 3$											= 82%		

Figure 7: Intel Annual Incentive Cash Calculation

2013 Operational Goal Categories

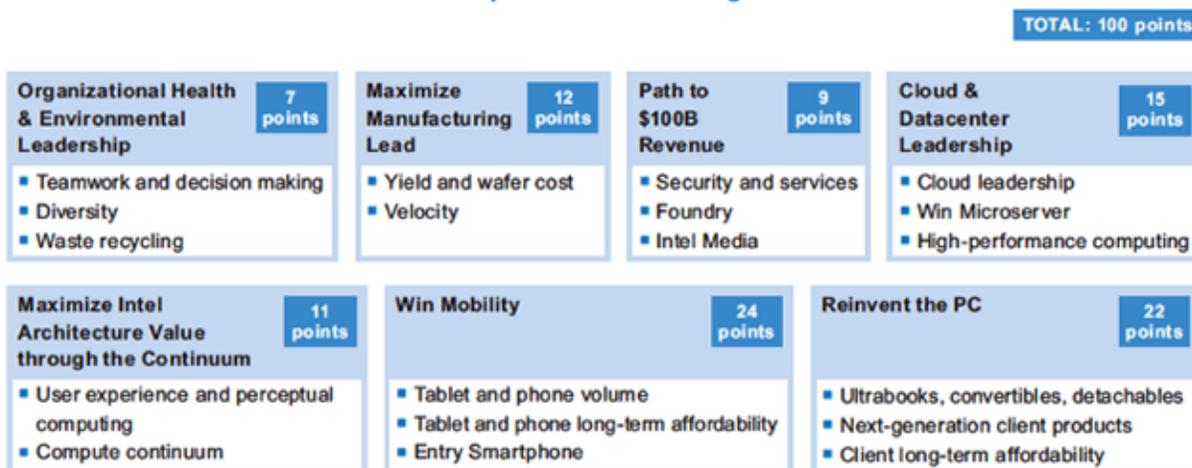


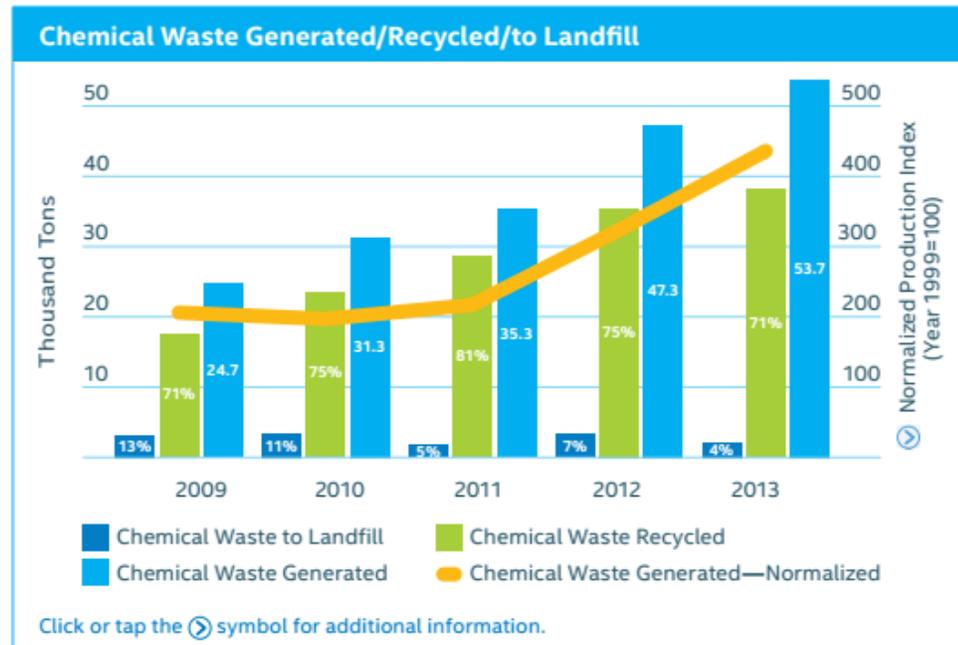
Figure 8: Intel Operational Goal Categories

Specifically looking at the calculation of these goals, scoring ranges from 0% to 125% based on the level of achievement, which is also confidential. The results are added together and divided by 100. The final operational score always falls between 0% and 155%, and over the last five years, Intel has fallen between 90.1% and 103.1%, averaging at 96.8%. The scores are calculated by senior management with approval from the compensation committee. Regarding operational goal categories, each category is scored out of a 100 point system with emphasis on areas of higher significance. It is important to note that while Intel outperformed in the area of organizational health and environment leadership, this category was allocated the least amount of points. The specific goals within this category included teamwork and decision making, diversity, and waste recycling.

Analysis

From an absolute perspective, Intel has established itself as a steward of the environment and social responsibility. It has also made progress towards sustainability goals set for 2020. Intel intends to drive reductions in greenhouse gas emissions, energy use, water use, and waste generation while increasing recycling and product energy efficiency. The company did not list a quantitative look at these goals, but both water and solid waste generation have decreased according to the company's annual report.

While there is much progress, Intel has also disclosed its shortcomings regarding sustainability. Chemical waste generation rose due to its complex manufacturing process and product design.



Chemical waste generated was up 14% on an absolute basis and up 35% on a per chip basis in 2013 compared to 2012.

Figure 9: Intel Chemical Waste Generation

Even so, since 2008, when Intel initiated the use of sustainability as a metric in compensation plans, there has been significant improvement in the reduction of greenhouse gas emissions. While it is expected that a company will reduce emissions regardless of the compensation metric as long as it has an emphasis on CSR, there is a large decrease from 2007 to 2008 when the metric was put in place as demonstrated by a chart pulled from Intel's 2011 CSR report. Intel had set a goal to reduce the absolute global-warming gas footprint from Intel operations by 20% of the 2007 levels and by 2011 had decreased it by more than 60%.

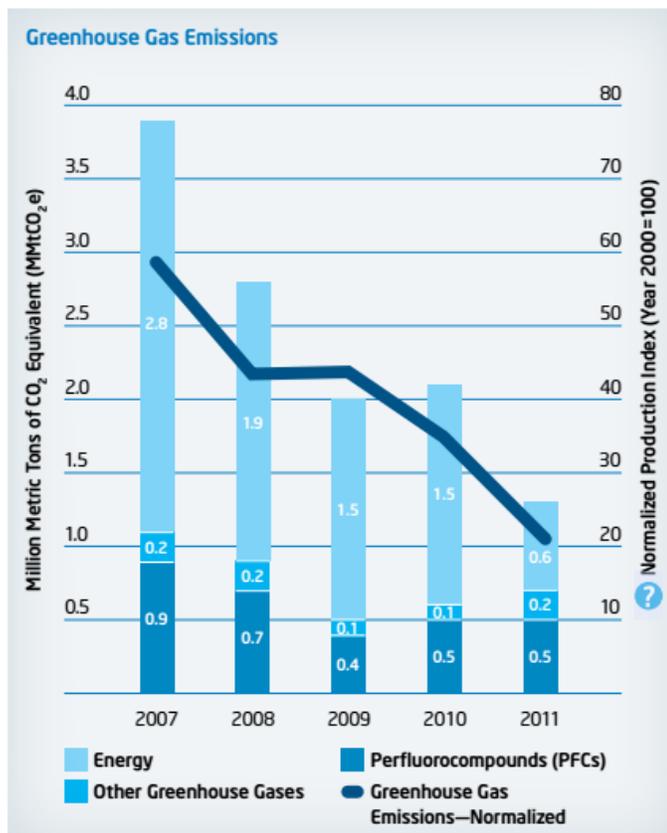


Figure 10: Intel's Greenhouse Gas Emissions

While there may be many factors that play into Intel's decrease in greenhouse gas emissions and other sustainability achievements, aside from the recession, the most notable difference between 2007 and 2008 in operational decisions was the establishment of the compensation metric in order to achieve this goal. This case study demonstrates that while it is effective to include sustainability metrics in executive compensation, it may not be enough to completely improve sustainability efforts. In fact, prior to these metrics, levels were already improving but not by nearly as much. Therefore, these metrics help accelerate the timeline and effectiveness of sustainability efforts, but the overall desire to be sustainable or socially responsible must stem from the organization's core values or be demonstrated in the demands and values of its shareholders.

Case Study: Xcel Energy

Company Background

Xcel Energy is a utilities provider that generates, purchases, transmits, distributes, and sells electricity in the US through its four subsidiaries: Northern States Power-Minnesota, Northern States Power – Wisconsin, Public Service Company of Colorado, and Southwestern Public Service Co. Xcel operates through Regulated Electric Utility, Regulated Natural Gas Utility, and All other segments. Serving residential, commercial, and industrial customers along with public authorities, the company generates a variety of energy sources, is involved in the purchase, transportation, distribution, and sale of natural gas, is engaged in developing and leasing natural gas pipelines, and invests in rental housing projects (Xcel, 2013).

Approach to Corporate Social Responsibility

Being an energy company, Xcel's facilities are under federal and state regulation who have jurisdiction over air emissions, water quality, wastewater discharges, solid wastes and hazardous substances. Regulation means anything from requiring permits and licenses to inspections and approvals.

Even so, Xcel Energy voluntarily engages in renewable energy, energy efficiency, and plant improvement projects. In addition, the company reports its emissions through several different reporting programs (The Climate Registry, Carbon Disclosure Project, U.S. Environmental Protection Agency) utilizing a methodology established by the U.S. Environmental Protection Agency. Xcel Energy's approach to the environment is one the

balances costs with the environmental benefits while considering the interests of the communities that it operates in.

Regarding renewable energy, Xcel is the number one provider of wind power and is comprised of about 20% clean energy overall. With intentions to increase its wind portfolio by about 40%, Xcel continues to make commitments to grow the use of other clean energy options such as solar power while also engaging in energy efficiency initiatives. Some of these initiatives have even led to clean energy partnerships with companies forming facilities like the Solar Technology Acceleration Center where companies can collaborate and test project such as better battery storage. Other areas that Xcel Energy report on include waste and water management.

Xcel Energy Wind Growth (in Megawatts)

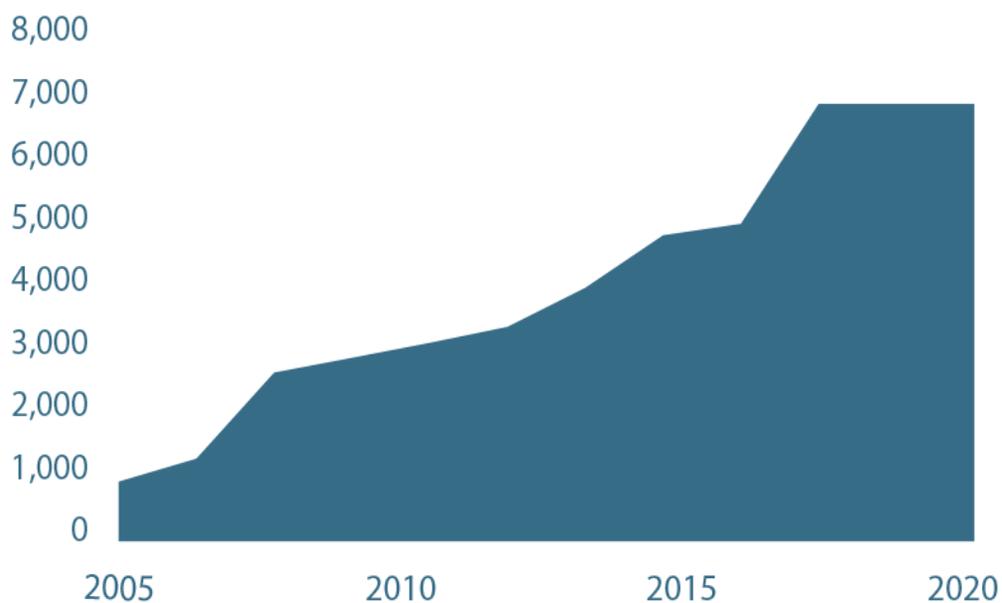


Figure 11: Xcel Energy Wind Growth

Xcel manages these responsibilities with a management system that flows from the executive board on oversight to the training of new employees. Areas of management include risk analysis, policies and procedures, monitoring, and follow-ups on compliance gaps in addition to training and communication:

Oversight	Board of directors—Nuclear, Environment and Safety Committee
	Chairman, President and CEO
	Strategy Council
	Environmental Policy and Services Department
Risk analysis	Goals and performance indicators at corporate and operating levels
	Multidisciplinary teams for developing new compliance programs
	Environmental Audit Program
Policies & procedures	Corporate environmental policy
	Formal, documented procedures
	Regular monitoring of new, evolving regulatory activity
Monitoring	Compliance tracking system
	Monthly performance reporting
	Routine facility audits
Follow-up for compliance gaps	Tracking for corrective action and internal audit findings
Training & communication	New employee orientation
	Site and topic specific employee training
	Updates and information communicated through internal channels

Figure 12: Xcel Measures for Compliance

In order to address and minimize violations, Xcel Energy conducts internal facility audits. In 2013 alone, the company conducted over 180 internal audits.

Executive Compensation Structure

Xcel Energy structures its executive compensation plans around three principles: performance-based (financial, operational, and stock price), equity-based, and market competitive. The company balances short and long term incentives with a committee that reviews performance annually.

Long-term incentives are over a three year performance cycle and include 60% performance units, generally paid in stock and 40% performance shares which is 50% cash and 50% stock. The units are measured based on EPS growth as well as achieving environmental commitments while maintaining a competitive stock price whereas shares are based on total shareholder return relative to peers.

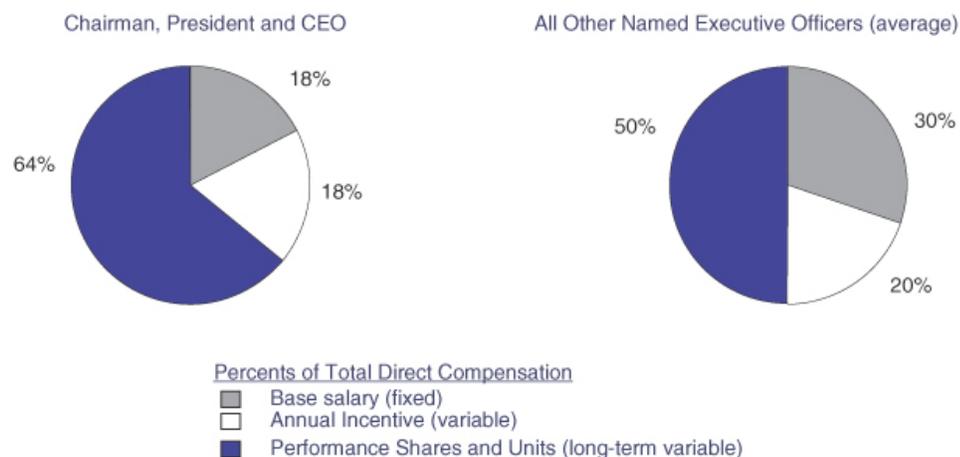


Figure 13: Xcel Executive Compensation Distribution

The annual incentive portion makes up the short-term incentives which also include an environmental leadership component to it. Xcel Energy allocates weights over four core goals: operational excellence, value to the customer, employee safety and engagement, and environmental leadership. In 2013, environmental leadership focused on energy efficiency and held a weight of 20% which was comparable to other areas as shown:

2013 Corporate Goal	% Weight	Key Performance Indicator
Operational Excellence	15%	System Average Interruption Duration Index (SAIDI)
	15%	Unplanned Outage Rate (UOR)
Value to the Customer	15%	Public Safety Index
	15%	Customer Value (Survey Rating)
Employee Safety and Engagement	15%	OSHA Recordable Incident Rate ⁽¹⁾
	5%	Employee Engagement (Survey Rating)
Environmental Leadership	20%	Energy Efficiency (GWh) ⁽²⁾

Figure 14: Xcel Corporate Goal Weightings

In 2013, Xcel outperformed in the environmental leadership objective, receiving a payout of 118%. Xcel does not disclose how it selects its key performance indicators (KPIs) per goal nor does it disclose how the target performance figures are calculated.

Analysis

Xcel Energy is in a unique position because a lot of its sustainability and social responsibility initiatives are based on regulations and requirements by federal and state law. Even so, the company chooses to adopt measures that will compensate executives for exemplary performance in areas of environmental leadership. The chart below shows one example of how Xcel goes beyond regulations by not only demonstrating the decrease in carbon dioxide emissions from 2005 but also projecting goals for further reductions moving forward. These reductions are also growing in pace.

Projected 31% CO₂ Emission reduction by 2020

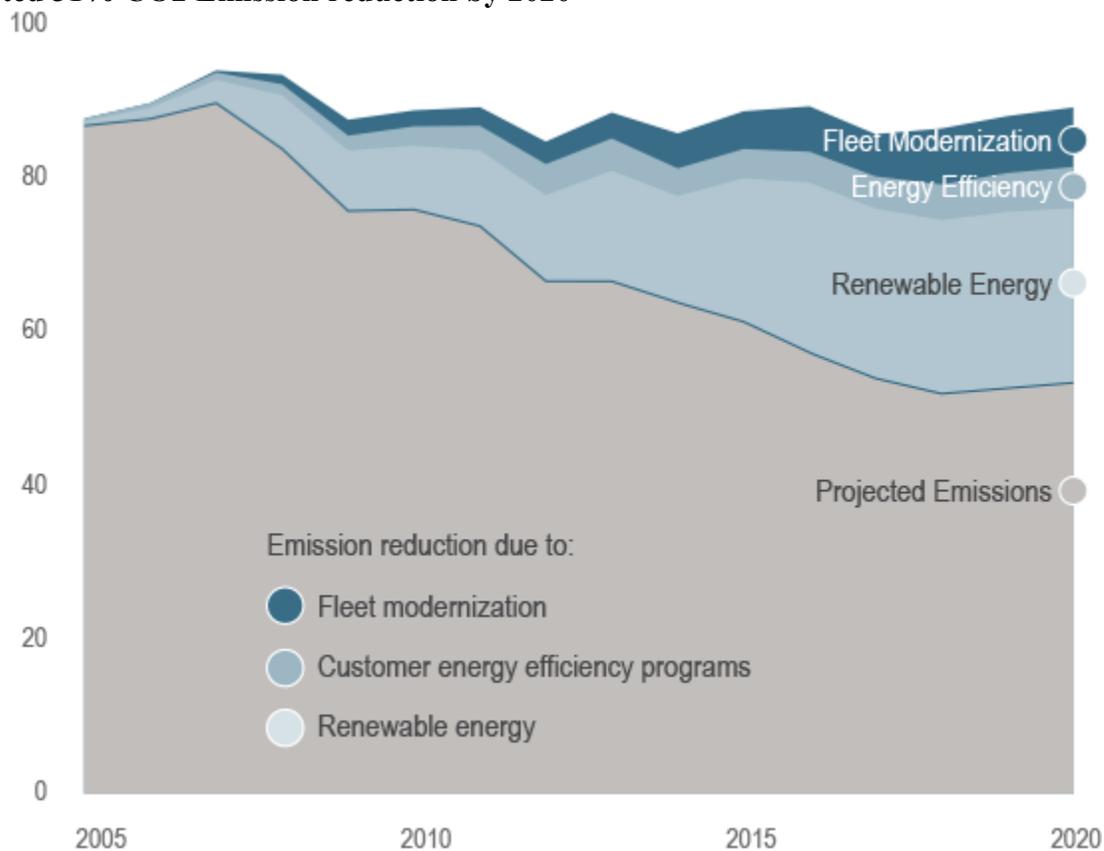


Figure 15: Xcel Emission Reductions

Xcel is an example of a company that has not only included a link between compensation and sustainability, but has made it an integral part of the plan, making up over 20% of the compensation metrics from an annual perspective and also another portion of the long-term incentives as well. By perpetuating the necessity of not only completing annual projects but sustaining them over at least three year cycles demonstrates a strong sustainability core.

Case Study: The Hershey Company

Company Background

The Hershey Company is a global confectionery company that provides chocolate, sweets, mints, beverages, and snacks. Operating in over 70 countries, the Hershey Company has leading brands such as Reese's, Hershey's Kisses, Jolly Rancher, and Ice breakers. The company breaks operations into two business units: the chocolate business unit and the sweets and refreshment business unit (Hershey, 2013).

Approach to Corporate Social Responsibility

The Hershey Company provides several different reports that outline its actions within the CSR space. While the company publishes an overall CSR report, it also provides a sustainability report and shares information regarding several programs that it

heads or is a part of such as CocoaLink which serves to use affordable mobile technology to share practical agricultural and social information to rural cocoa farmers in West Africa.

In 2013, the company introduced a new CSR model that focused on three core areas: Good Business, Better Life, and Bright Future. Each area focuses on smaller groups of initiatives but all three complement one another in building ethical, strong financial performance and representing Hershey as a strong steward of the global community. Within Good Business, Hershey is committed to projects around the environment, workplace atmosphere, responsible sourcing, and integrity and governance. The company believes this leads to Better Life which revolves around global giving, community engagement, and volunteerism. Finally, the company focuses on creating opportunities through education and nutrition which fall under Bright Future (Hershey, 2013).

Environmental sustainability is especially relevant to this company because chocolate production has long been an area of criticism regarding the unethical depletion of cocoa as well as other social, economic, and political factors that complicate sourcing raw materials for the company's products. In 2012, Hershey announced its intention to source 100% of its cocoa from certified sustainable sources by 2020. In addition to CocoaLink, the company has invested in programs to ensure long-term global viability of the crop. Hershey is committed to reporting annually on its progress towards this goal. In 2013, the company nearly doubled its target of utilizing 10% certified cocoa. The company also sources 100% of its palm oil through the Roundtable on Sustainable Palm

Oil (RSPO), which, if unsustainably produced, leads to deforestation and negative impacts on biodiversity soil health (Hershey, 2013).

Most of the company's sustainability initiatives flows back through its supply chain and rests on how Hershey sources its products. In order to address sourcing on a macro level, Hershey created a Supplier Code of Conduct that outlines standards on how its supplier network operates. One of the guidelines includes that at a minimum, suppliers must comply with local environmental laws and regulations though Hershey encourages actions that conserves natural resources. In addition, Hershey launched its Environmental Management System (EMS) which created a framework to monitor environmental standards at three of its plants. Hershey also has 97% of its US production at zero-waste-to-landfill facilities. These are only a few of Hershey's initiatives. Progress as well as goals can be found in the chart below which was taken from the company's 2013 Corporate Social Responsibility Report:

AREA	PROGRESS 2009–2013*	LOOKING AHEAD: 2014–2017
 Greenhouse Gas Emissions in U.S. Distribution & Logistics	Emissions ticked up 3.15% due to increased demand for our products	Reduce GHG emissions by an additional 10%
 Zero-Waste-to-Landfill (ZWL) Operations	Six manufacturing plants and five nonmanufacturing facilities achieved ZWL status	Attain ZWL status at an additional two plants
 Recycling	Raised recycling rate from 72% to 86%	Attain a recycling rate of 90%
 Waste Reduction	By end of 2013, had reduced waste 38% against 2009 baseline	Reduce Waste by an additional 5%
 Greenhouse Gas Emissions	Reduced total emissions by 22% from 2009 baseline, emissions per pound of product produced fell 5%	Reduce emissions by an additional 15%
 Water Use	Reduced total water consumption by 73% from 2009 baseline; water consumption per pound of product produced fell 72 percentage points	Reduce absolute water use an additional 17%
 Packaging	180 projects were completed, reducing packaging waste by 14 million pounds	Complete a minimum of 25 additional initiatives, resulting in the additional cumulative elimination of 16 million pounds of packaging material

Figure 16: Hershey's CSR Initiatives

Executive Compensation Structure

While both Intel and Xcel incorporated CSR and sustainability in the compensation packages, Hershey does not. This provides a unique perspective in understanding how a company may be socially responsible even without utilizing resources to reward management for ensuring the success of these projects. Nevertheless,

it is useful to understand how Hershey sets up its compensation structure so there is a frame of reference when comparing Hershey with the previous case studies.⁷

Hershey uses three key elements when determining the compensation package for its executives: base salary, annual incentive award, and long-term incentive awards. The base salary is a fixed component under annual review which serves to attract and retain highly skilled talent with good leadership abilities. The annual incentive award is a variable component that is based on both business results and individual performance. This award seeks to motivate and reward the execution of strategic priorities. Long-term Incentive Awards is also performance based and is split into performance stock units and stock options. Long-term incentives are primarily focused on stock price performance and is intended to motivated sustainable and positive long-term financial performance (Hershey, 2014). In 2014, the weights of each component were as follows:

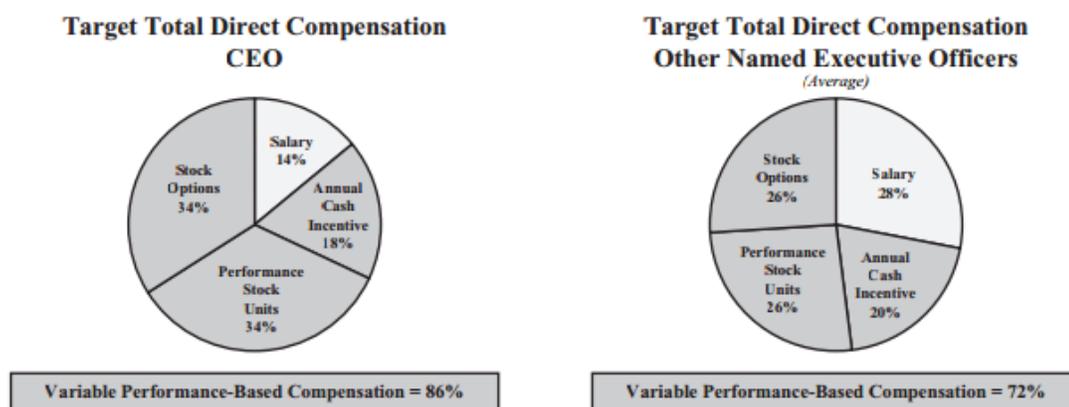


Figure 17: Hershey Executive Compensation Distribution

Some of the metrics used for long-term incentives in recent years include total shareholder return, three-year compounded annual growth rate in organic net sales outside the US and Canada, and adjusted earnings per share (diluted).

Analysis

While the Hershey Company focuses its executive compensation primarily on financial performance, it is clear that the company engages in many environmentally friendly and sustainable endeavors. Because of the complex nature of the chocolate industry, Hershey perhaps has a stake in its sustainable performance due to consumers' increased desire to have conflict free products. Ultimately, this affects Hershey's revenue stream which will impact its financial performance. In addition, if Hershey does not comply with environmental regulations, the costs that are incurred could significantly hurt the company due to fines and lawsuits, not to mention the tarnished image with not only consumers but also investors who would then view the company as risky.

Despite not utilizing sustainability metrics in its compensation package, the executives at Hershey are motivated to carry out these sustainability initiatives due to the value it brings to the company inherently. The company even gained many of the same awards as Intel, who does utilize these metrics such as being selected to the Dow Jones Sustainability World and North American Indices, identified by the Civic 50 survey as one of America's most community-minded companies, and being named to Corporate Responsibility Magazine's 100 Best corporate Citizens list (Hershey, 2013). In addition to being selected for the Dow Jones Sustainability Index, Hershey was awarded the bronze medal for overall sustainability performance.

DISCUSSION

Upon analyzing the cases of Intel, Xcel Energy and Hershey, it can be concluded that CSR and sustainability are indeed impacted by the link to executive compensation. However, utilizing such metrics in executive compensation may not be the impetus or even the core motivation for improvement in these areas. For example, Intel utilizes a system where the company measures what priorities are important to both the company and the shareholders. Because sustainability is a core area of importance to both, even without the executive compensation piece, it is expected that there would be improvement and effort put into performing well in this area as demonstrated by the lowered emissions levels prior to the added metric in 2008. What the link to executive compensation does have is the speed at which performance increases or improves. In addition, from the Xcel Energy case, the company is already regulated for performance in these areas, so even without the metric, the company would incur high costs for violations or other implications for not meeting standards. Therefore, once again, it is expected that even without the link to executive compensation, Xcel would be contributing efforts in these areas. What these metrics provide for Xcel, then, is sustainability of long-term initiatives. By having both annual and long-term incentives, Xcel is able to maintain certain levels of performance in the areas of CSR and sustainability because long-term incentives are evaluated on a three year basis. Neither of these companies demonstrate an inability to excel in the areas of sustainability without the use of sustainability metrics in compensation. In fact, through the Hershey case study, it is evident that these metrics are not a prerequisite in order for a company to perform well in the area of CSR and sustainability.

The findings from this study matched my original thoughts that the current use of sustainability metrics in executive compensation certainly does not hurt a company. In fact, there were positive results for the cases as well as from existing literature as documented. However, despite the positive results, current efforts and usage by companies are not scaled to be large enough to do anything more than speed up or sustain current efforts, marginally. If more emphasis was placed on these areas, the effects of these efforts may become greater norms in the industries these companies operate in.

While both Intel and Xcel can be considered internally successful because both improved their sustainability initiatives, it is also important to examine these companies comparatively. Externally, success does not necessarily have a universal measure as outlined in the literature review. However, one motive that was highlighted in pursuing CSR was recognition. Companies pursue these initiatives to improve their image in the eyes of society and their stakeholders. In this case, it would appear that either Hershey is the most successful due to its high placement on the Dow Jones Sustainability Index in comparison to its peers or that Intel is the most successful due to the number of rewards the company has received for its efforts in comparison to its case study counterparts. It must be noted that these companies operate in different industries and while Xcel may achieve similar milestones as its peers, the company has legal requirements to fulfill certain duties, which would not be recognized as going above and beyond in CSR.

In the above analysis there were several limitations that are out of this study's scope. The most apparent limitation was confidentiality. Many of the details behind how the companies chose their metrics or the specific weights were not released to the public. Furthermore, looking at only three companies, the breadth of industries is not portrayed

in the study. There are also other factors that may impact a company's performance in sustainability such as shifting consumer sentiments or heavier regulations that are not necessarily within the scope of this study to measure. A direct link between executive compensation and performance is not always clear nor is it exclusive, and it can often be difficult to separate what the impact of compensation was from a natural progression towards improvement in these areas.

Possible next steps and future analysis can include looking into other industries to compare the importance of sustainability in those industries and how specific companies perform in those areas to those that have been analyzed in this study. In addition, one can also examine other companies within the industries touched on here to compare performance relative to the level of importance standard to the industry. One can also analyze the costs of compensating for these metrics and compare the cost savings from performing more sustainably.

IMPLICATIONS

This study can help non-academics understand how the leaders of the business world are being compensated for their performance and to what degree that performance is currently tied to social responsibility in the area of sustainability. By understanding how these metrics influence the performance of a company, consumers can understand their own influences and power in shaping the values held and initiatives pursued by companies. For example, specifically for Intel, consumers would then understand that Intel takes a large part in determining its initiatives from sources that consumers have control over. By understanding how companies build out their plans, consumers understand their relevance. They can also push for greater transparency from understanding the limitations of the study.

This study can also help executives by illustrating the progress from three companies that have been recognized for their efforts and implement best practices from them. In addition, by understanding the impact that these compensation plans have on their respective companies, executives can evaluate the strengths and weaknesses of each and adjust their own. Understanding that the plans themselves can speed up progress but that companies also need a core value for sustainability is important for executives to understand when creating their own links to these metrics.

Regarding recommendations, companies should first evaluate what kind of emphasis or value their company has on sustainability to begin with. If the value is high, linking sustainability metrics to compensation is justified. If not, even if there were metrics in place, the motivation to sustain initiatives will only be short-term. Therefore, a company must re-examine how it can contribute as a socially responsible enterprise before applying metrics. Once this has been put in place, companies should slowly

increase the weight held for sustainability in order to not only speed up progress, but to highlight the importance of these initiatives as well as sustain the efforts long-term. These metrics should not be the only accountability measure for a company's socially responsible behavior. Rather, it should enhance or support the company's value for such behavior. If the company does not emphasize enough weight on sustainability in its compensation plan, perhaps it is better not to include them at all, as demonstrated in the Hershey case study.

CONCLUSION

Executive compensation plans come in many different forms and serve to emphasize many different areas of performance, but the ultimate purpose, regardless of industry, firm structure, or company size, is to incentivize upper level management to make decisions and perform in accordance with the interests of shareholders relating to impact on company strategy, decision-making, and value creation. In recent years, corporate social responsibility has become more prominent in the business world, especially when it comes to sustainability. Reasons regarding this emphasis include looking for good will and investors who are increasingly emphasizing their own values towards CSR. CSR performance only adds value to the company if it ultimately enhances profits. Therefore, one must understand the costs and consequences of not only acting socially responsible but including them in executive compensation metrics.

This study looked at the sustainability performances of Intel Corporation, Xcel Energy, and the Hershey Company and analyzed how they related their endeavors to their compensation packages, if at all. While both Intel and Xcel showed improvement and positive results from the use of these metrics in their compensation packages, neither of them demonstrated an inability to perform in a socially responsible manner without these metrics due to Intel's customer value for sustainability and Xcel Energy's regulation factors. Hershey proved to be successful without utilizing those metrics at all. Improvements from adding the compensation piece include the speed of sustainability measured activities as well as created long-term incentives to continue initiatives. While companies can improve their performance in CSR through the utilization of these metrics, the weight of the metrics are not currently high enough to severely impact

performance or outweigh companies whose management can recognize the value of CSR initiatives even without these metrics. Therefore, the success of sustainability initiatives for companies is currently rooted in executive motivation due to the intrinsic benefits that these initiatives add to the company's image or value rather than compensation.

Ultimately, a company must first identify its emphasis on CSR as an entity and implement those values throughout the organization utilizing executive compensation metrics only as an enhanced incentive to speed up, sustain, and effectively manage sustainability efforts.

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