



## Non-financial metrics in executive compensation

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125,058	154,568	95,054	154,000
125,487	56,845	97,511	95,000
124,000	110,000	99,011	154,200
105,450	150,000	99,216	110,000
	35,000	101,090	89,000
	22,000	101,684	50,000
		101,962	68,700

# Agenda

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## 1. Introduction

## 2. Executive compensation

- Purpose and objectives
- Theoretical frameworks

## 3. Non-financial metrics

- Traditional non-financial metrics
- ESG and CSR approach

## 4. Empirical evidence

- Methodology and data
- Short-term non-financial metrics
- Long-term non-financial metrics
- Key takeaways

## 5. Conclusions and future research



# Introduction

1

Companies are increasingly expected to behave socially responsible ways

2

This trend is driven by multiple drivers like changing regulation but also emerging investor activism

3

Increasing usage of non-financial metrics in executive compensation could lead to different costs and benefits in the future



What are the pros and cons of using non-financial metrics in executive compensation and why are certain companies using these metrics more than others?



Executive compensation mainly based on accounting metrics



Executive compensation utilizes non-financial metrics



# Executive compensation – theoretical frameworks for rationalizing different measures in executive pay

## Purposes & objectives of executive compensation

Usually consists of four parts

- Base salary
  - Attract talent
  - Used as a basis for other incentives
- Annual/short-term incentive plan
  - Consistent results
- Long-term incentive plan
  - Long-term growth
  - Financial sustainability
- Stock and options
  - Reduce excessive risk taking

*Can also include pension or insurance benefits*

## Theoretical frameworks



### Agency theory

- Management of the company has the authority for decision-making
- Creates an agency problem between the owners and the management



### Stakeholder theory

- Stakeholder theory tries to create value through a more strategic way
- Satisfy all the relevant parties and integrate & manage relevant relationships to make their interests align
- Ensure long-term success to the company



### Legitimacy theory

- Social contracts are central to organizational legitimacy
- Justify ESG reporting and usage in management compensation as a means to legitimize business operations
- Especially relevant for companies operating in industries such as banking or mining

# Traditional non-financial measures used vs. movement towards CSR & ESG measures

## Traditional non-financial measures

### 1. Customer perspective

- ✓ Percent of sales from new products
- ✓ Percent of sales from proprietary products
- ✓ On-time delivery (defined by customer)
- ✓ Share of key accounts' purchases
- ✓ Ranking by key accounts

### 2. Internal business perspective

- ✓ Manufacturing geometry vs competition
- ✓ Cycle time
- ✓ Unit cost
- ✓ Engineering efficiency
- ✓ Actual introduction schedule vs plan

### 3. Innovation and learning perspective

- ✓ Time to develop next generation
- ✓ Process time to maturity
- ✓ Percent of products that equal 80% of sales
- ✓ New product introduction vs competition

## ESG & CSR measures



Compliance with ethical standards



Environmental compliance, -goals, performance, and -projects



Greenhouse gas emissions reductions & energy efficiency



Health & safety. e.g., product safety. reduced injury rated, employee well-being



Performance relative to a corporate responsibility index (e.g., Dow Jones Sustainability Index)



Sustainability & Diversity

# Empirical evidence – Data & methodology

We investigated how Finnish companies use non-financial metrics in executive compensation and why



**OMXH 25 companies used in empirical analysis**

**Broad range of different industries included in the sample**

**All companies operate under the same laws and standards**









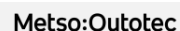
















**Annual reports and remuneration reports used to gather data, mainly consisting of 2021 compensation**

**10,924 €'m**  
Avg. market cap

**17**  
Different industries


























**25**  
Companies

## Short-term non-financial metrics – multiple companies use non-financials metrics at least partly in executive pay

Company	Industry	Market cap €'m	Environmental	Social	Governance	Traditional non-financial measure	Other
 CARGOTEC	Machinery	2,616	✓				
 elisa	Diversified Telecommunication Services	7,827		✓		✓	
 fortum	Electric Utilities	13,076					✓
 Huhtamaki	Containers & Packaging	3,809	✓				
 K	Food & Staples Retailing	8,472					✓
 kojamo	Real Estate	3,536				✓	
 KONE	Machinery	23,110					✓
 KONEGRANES	Machinery	2,189					
 Metso:Outotec	Machinery	7,121					
 NESTE	Oil and Gas	35,626		✓			
 NOKIA	Communications Equipment	25,980	✓				✓
 NOKIA RENAULT	Auto Components	1,475					
 Nordea	Commercial Banks	37,132		✓	✓	✓	✓
 ORION	Pharmaceuticals	6,657					
 outokumpu	Metals & Mining	2,319					✓
 Qt	Software	1,236					
 SAMPO	Insurance	25,053					
 SSAB	Metals & Mining	5,429		✓			
 storaenso	Paper & Forest Products	11,436		✓			
 Telia	Diversified Telecommunication Services	10,735					
 tietoenvy	IT Services	2,968					✓
 TOKMANNI	Multiline Retail	755					
 UPM	Paper & Forest Products	19,073					✓
 Valmet	Machinery	4,548					
 WARTSILA	Machinery	4,522					
Total			3	5	1	3	8

Source: Company annual reports, company websites

## Long-term non-financial metrics – much less frequent usage on non-financial metrics, focused on environmental

Company	Industry	Market cap €'m	Environmental	Social	Governance	Traditional non-financial measure	Other
 CARGOTEC	Machinery	2,616					
 elisa	Diversified Telecommunication Services	7,827					
 fortum	Electric Utilities	13,076					
 Huhtamaki	Containers & Packaging	3,809					
 K	Food & Staples Retailing	8,472	✓				
 kojamo	Real Estate	3,536					
 KONE	Machinery	23,110	✓	✓			
 KONE CRANES	Machinery	2,189					
 Metso:Outotec	Machinery	7,121	✓				
 NESTE	Oil and Gas	35,626	✓				
 NOKIA	Communications Equipment	25,980					
 NOKIA RENAULT	Auto Components	1,475					
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 Telia	Diversified Telecommunication Services	10,735					
 tietoenvy	IT Services	2,968					
 TOKMANNI	Multiline Retail	755					
 UPM	Paper & Forest Products	19,073	✓	✓			
 Valmet	Machinery	4,548					
 WARTSILA	Machinery	4,522					
Total			5	2	0	0	0

Source: Company annual reports, company websites



## Empirical analysis – key takeaways

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**Most of the companies use financial metrics in compensation**

- Financial metrics are the baseline for almost every company's executive compensation models
- Non-financial metrics are more of an addition to the financial ones, and account for small part of executive pay



**Usage of non-financial metrics is more common among "dirty" industries**

- Especially in the long-term incentive plans, industries such as machinery, oil and gas, and paper are dominant
- Also, Sampo and Outokumpu are going to include ESG related goals in compensation plan next year
- These industries could be deemed to require confidence of external stakeholders



**Most of the companies include "other" metrics in executive compensation**

- Other metrics include mostly indicators such as strategic objectives, targets or goals
- These are included in the analysis as most companies included these separately from financial metrics as well as metrics related to operational activities
- Potentially could represent non-financial aspects of the company which they are not willing to publish – the disclosure is very limited and hard to observe from outside

# Conclusions, limitations and future research

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## Conclusions

- Agency, stakeholder and legitimacy theory can be used to explain usage on non-financial metrics
- Companies potentially use categories such as operational and strategic objectives or goals to hide traditional non-financial metrics
- Adoption of ESG and CSR metrics in executive compensation is quickly increasing
- Percentage share of ESG and CSR in executive compensation is low at around 10 to 20% of total
- Different industries have very different approaches to executive compensation

## Limitations

- Sample size used was quite small and data was collected for just 2021
- The companies were collected from multiple industries and were of varying sizes
- Companies have different ways to define and use ESG or other non-financial metrics

## Future research

- The data collected could be controlled for company size or industry
- Approaches between countries and reporting standards could be compared