# Non-financial metrics in executive compensation

## 1. Introduction

The main purpose of executive compensation plans is to attract and retain top leaders, align the interests of the management and the owners, as well as send messages to internal and external shareholders. Executive compensation programs have historically been designed to drive performance on key financial objectives, but many companies have now realised that pay for financial performance is only one of the factors considered by stakeholders when evaluating the appropriateness of executive pay. In recent years, companies have increasingly implemented non-financial metrics in their strategies which have been translated also to the executive compensation models. In this paper we address different kinds of non-financial metrics used in executive compensation. We also assess the advantages and disadvantages of using non-financial metrics as well as the differences and limitations it has compared to financial metrics. Different non-financial measures are then divided into different theoretical frameworks. Theoretical frameworks used in this paper are agency-, stakeholder-, and legitimacy theory, and they represent different kinds of perspectives on approaching executive compensation. We also carried out an empirical study regarding the use of different kinds of non-financial metrics in executive compensation in Finnish companies. At the end of this paper, we have presented the findings of our empirical research as well as general conclusions about the use of non-financial metrics in executive compensation. As of now there is not enough credible material about executive compensation in Finland, hence, all of the theory used in the report were about executive compensation in other countries, mostly from US. It should be noted that there are major differences between US and Finnish legislation, regulation and overall markets.

## 2. Executive compensation

With executive compensation, this report is referring to the pay practises of chief executive officers (CEO) we have identified such as what is the purpose, structure, or objective of the compensation. Even though there can be many different approaches to executive compensation, it is usually constructed from four parts, the base salary, an annual or otherwise short-term bonus, stock and options, and long-term incentive plans (Fernandes et al., 2012). It can also include other things such as employee benefits related to insurance or retirement.

## 2.1. Structure of the executive compensation

Each part of the usual compensation plan servers a different purpose, while the base pay could be seen as a way to attract talent with a guarantee of compensation and be used to calculate the bonuses, the other incentives can be used to guide the executives to act in a way beneficial to the company. The short-term plans can be seen as a way to incentivise consistent results and stable income, whereas the long-term plans require growth. The stock options, or sometimes even a requirement to buy shares before assuming the position, could be seen as a way to reduce excessive risk taking. Even though the compensation structure might be quite similar, the way the compensation is calculated can differ between companies and changes over time.

The topic of executive compensation is a popular topic of research, sparking discussion on how some perceive it to be excessive, especially in the US (Fernandes et al., 2012). Perhaps to alleviate shareholder concerns on the excessiveness of the executive compensation, some companies have started to be more transparent on their reporting or have started to have a more stakeholder conscious approach. The goal of this stakeholder approach is usually to consider interests of for example customers, suppliers, or other related communities to ensure the long-term success of the company (Freeman & McVea, 2005).

## 2.2. Different theoretical frameworks

The public remuneration reporting has brought up many different perspectives on which to approach executive compensation. It could be approached from an internal control perspective such as agency theory (Jones and Butler, 1992), value creation perspective through stakeholder theory (Freeman and McVea, 2005), or even legitimacy theory to legitimize their operations (Deegan, 2002). As such, the application of these theories might vary depending on many factors such as the country or industry the company operates in.

The agency theory is based on a principal's delegation of decision-making authority or control to an agent, resulting in agency problems (Jones and Butler, 1992). These issues can be related to either it being too difficult to monitor the agent, or there being a conflict of interest between the principal and the agent (ibid.). This theory could be adapted to executive compensation, resulting in both having a similar approach to, for example, risk while also controlling opportunistic behavior. From the agency theory perspective, the performance-based executive compensation should diminish the agency problem between the owners and the management, and align the interest of these two groups.

The stakeholder theory is an approach that tries to create value through a more strategic way. The goal of the stakeholder approach is to satisfy all relevant parties, integrating and managing relevant relationships to make their interests align, and as such ensuring the long-term success of the company (Freeman and McVea, 2005). In essence, it tries to secure a position in the competitive environment by reducing profitability, which could be especially beneficial in, for example, a growing industry.

According to Deegan (2002), social contracts are central to organizational legitimacy, and as such a requirement to demonstrate that the institution is beneficial to society. As corporate disclosure policies can be used to influence external perceptions about a company (ibid.), legitimacy theory could be used as a way to justify ESG reporting as a means to legitimize business operations. This approach could be especially relevant for companies operating in industries such as banking or mining.

# 3. Non-financial metrics in executive compensation

The common misconception is that accounting measures are more important and objective than non-financial measures. Accounting measures depict the company's performance on what is companies' purpose – creating return for shareholders. However, accounting measures do not portray what contributes to a company's performance. According to Kaplan, accounting measures alone can give misleading signals about continuous improvement and innovation (Kaplan, 1992). Hence, non-financial measures are needed for an accurate portrayal of the company's prospects to compete in the markets. Non-financial measures are not only important to the shareholders, but they have been used as a tool to help executives to manage and operate the firm. According to Kaplan, executives rely on multiple measures to focus attention on the critical areas in the business (Kaplan, 1992). Each set of measures can be adapted to best portray the company in question.

### 3.1. Traditional non-financial metrics

The traditional non-financial measures can include important information about company's business models, processes, and systems. In this part of the report, we are going to introduce the reader to a balanced score card which is a set of measures used to give an overall view of the company.

The balanced scorecard is a concise set of measures which helps management to optimize business operations. According to Kaplan, the balanced scorecard meets many managerial needs by bringing together main goals and respective measures (Kaplan, 1992). The balanced scorecard aims to balance each aspect of the business operation by maximizing the main goals of the company while minimizing the downsides to each goal. Although non-financial measures are often used to help manage internal processes, they are rarely tied to executive compensation as these metrics can contain sensitive information about the business. Therefore, companies are hesitant to disclose these metrics to the public.

Balanced scorecard can be divided into following perspectives:

- financial perspective (accounting measures)
- customer perspective (brand image, customer satisfaction)
- internal business perspective (internal processes, systems)
- innovation and learning perspective (development of existing products and new products)

We are going to focus on customer, internal business perspective, and innovation and learning perspective as they are non-financial components of the balanced scorecard.

Financial perspective

Financial perspective measures reflect a company's past performance. These measures include for example cash flow, operating income, and return on equity. Shareholders are usually interested in these measurements as they provide insight into the competitive advantage that the company might have compared to the others in the markets.

Internal business perspective

Proper working processes and systems ensure that the company can meet customers' expectations. Internal business perspective measures measure company's internal processes, concepts, and systems. Internal business perspective not only solidifies company's targets for employees but also provides insight of the company's situation for executives. Internal business perspective goals include things such as costs, cycle time, productivity, and quality.

Innovation and learning perspective

Innovation and continuous learning are the paths to success. Increasing competition in the markets has pronounced the importance of continuous learning and innovation. With innovation and learning, the firm can stabilize its standing in the markets or gain an advantage over other companies. According to Kaplan, a company's ability to innovate, improve and learn correlates directly to company's value (Kaplan, 1992). Innovation and learning perspective goals consists of development of existing products and new products. The measurements can be new product's sales compared to overall sales. The measurement signals executives about the state of the product so the executives can take action in regard to the product. With overall work shifting from manufacturing work to professional service work, it places greater significance on employees' competence. Competence refers to the competence of all professionals who plan, produce, process, or present the products or processes as value creating persons for clients. (Sveiby, 1992)

Customer perspective

Many companies' purposes are to create value for customers. Hence, customer satisfaction has become one of the most important missions for firms. Executives must translate the company's mission to specific goals which are then measured in various ways. The balanced scorecard requires the managers to translate general mission statements on customer service to specific measures which matter to customers. (Kaplan, 1992) Customer satisfaction is then measured with how the company manages to achieve the set goals. One of the difficulties with the balanced scorecard measurement is setting satisfactory goals for the company. The goals must present accurately the properties that customers place an importance to. Also, the satisfactory level for company's performance for customers varies among the customers. The company might overachieve its goals with some of the customers while failing to satisfy others. While setting the goals for the balanced scorecard, the company must consider its capability to achieve the set goals. Executives must translate the company's mission to specific goals to improve customer satisfaction. Companies also rely on market research companies to evaluate their customer satisfaction levels.

### 3.2. ESG / CSR non-financial metrics

*Corporate social responsibility*

Corporate social responsibility (CSR) takes place when a company consciously and purposely acts to improve the social well-being of those whose lives are affected by the company's economic operations. CSR blends and harmonizes economic operations with social systems and institutions, with the goal of achieving balance between company's economic operations and the society's requirements for community welfare. Many companies have responded to the mounting pressures from various stakeholders to transfer their corporate operations to become socially and environmentally responsible by implementing more sustainable practises to showcase how they are addressing these important issues. These issues include for example, greenhouse gas emission reductions, fair and safe labour practices, waste management and resource stewardship amongst other stakeholder concerns. (Weber & Wasieleski 2018)

One of the recent developments in corporate governance is the integration of CSR criteria in executive compensation. Integrating CSR criteria in executive compensation is often done by linking executive compensation to environmental and social performance, for example employee satisfaction, emission targets, product safety, energy efficiency or compliance with ethical standards in developing countries. (Flammer et al. 2019, Hong et al. 2016) In a study made in 2015, sample from Standard and Poor's 500 Index public company filings showed that most common CSR-linked non-financial incentives were related to:

- 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

The results indicated that CSR is likely to be financially beneficial for companies and their shareholders. Encouraging company's management to participate in CSR activities was more common in companies with more shareholder-friendly governance. Companies that provided compensation linked to CSR had higher levels of social performance on average, indicating that provision of incentives indeed lead to more CSR activities. (Hong et al. 2016)

Another study covering a database of information on CSR contracting in all S&P 500 firms during a 10-year period (2004-2013) showed results that suggest that incorporating CSR criteria in executive compensation has a positive effect on company performance. Results suggested that including CSR criteria in executive compensation leads to increase in long-term orientation, increase in firm value, a reduction in emissions, increase in CSR, and higher engagement in the development of green innovations. It was also concluded that results were even more significant when the share of CSR-based compensation was higher. In general, CSR contracting should help in shifting management's attention to stakeholders that are less salient but also financially material to the company in the long term, thereby enhancing corporate governance. (Flammer et al. 2019)

*Environmental, social and governance*

Companies have been increasingly implementing environmental, social and governance (ESG) performance metrics for executive compensation (Bebchuk & Tallarita 2022). Environmental issues typically include things such as energy efficiency, climate change, emissions, and several other environmental factors. Social responsibility is typically considered as human- and labour rights and product liability. Governance aspect can include issues relating for example, to anti-corruption, actions and independence of the management, tax payments. (Silvola & Landau 2021) Over the last few years institutional investors as well as various other stakeholder groups have been increasingly demanding for ESG compensation metrics. Companies are now being asked to show that their stakeholder-friendly rhetoric is matched with real action, and many business advisers and leaders believe that effective way of proofing that is to integrate ESG factors into executive compensation. (Reali et. al. 2021, Bebchuk & Tallarita 2022)

The nature of ESG targets is changing, focus shifting more towards environmental and social targets, especially in long-term incentive plans (LTIPs). ESG targets that relate to the long-standing social and governance metrics such as health & safety, risk, and employee engagement have been appearing in bonuses and LTIP's for some time. The "new" ESG targets are related to more lately emerging stakeholder concerns, especially around sustainability, diversity, and climate change. (Gosling et. al. 2021)

ESG performance can be measured by either input (actions the company will take towards a goal, e.g., internal carbon pricing mechanism) or output (direct measurement of the goal itself, e.g., reduction of emissions), investor often preferring the output targets because of their objectivity. When a company has one or two critical indicators of ESG performance, it might be most effective to implement those most material criteria into key performance indicators (KPIs). Many companies however have complex interactions with environment and society, making it more sensible to use scorecard with multiple material dimensions of ESG impact in compensation. Due to their long-term nature, ESG measured are more often implemented into LTIPs rather than annual bonuses, although they can also be implemented to annual bonuses if they can me assessed meaningfully over single year time frames. Research has shown that there is strong alignment between shareholder value and ESG, but this only fully emerges over the periods of 5 years or more, which also encourages the implementation of ESG measures to LTIPs rather than yearly bonuses. (Gosling et. al. 2021)

Majority of companies state that they are using ESG goals in executive compensation, but do not disclose the relevant targets and outcomes, or they leave considerable discretion to their boards. The few companies that do disclose clear and objective goals as well as actual outcomes, only small minority provide adequate contextual information that would allow outsiders to review and assess the compensation arrangements. (Bebchuk & Tallarita 2022)

### 3.3. Differences between the approaches

There are some clear differences in the rationale on using non-financial and financial metrics in executive compensation. In this section, we analyse how the objectivity and cost efficiency differs between the approaches.

*Objectivity of the approaches*

In general, Bebchuk and Fried (2003), state that companies are not aligning CEO compensation to the company performance, and that executive compensation might be part of the agency problems, rather than solving them (managerial power approach). This problem is stronger if management can affect the design of the executive compensation system. From this perspective, non-financial metrics provide a clear objectivity issue as it might be easier to manipulate the non-financial metrics compared to the accounting / market-based measures. Overall, one could argue that management has more room for masking their compensation models to be aligned with company performance if the models are based on non-financial metrics which are less transparent and standardized. This view is also supported by Bebchuk and Tallarita (2022), who found that almost all S&P 100 companies who had implemented ESG metrics into CEO compensation, were hardly disclosing any detailed information on how the compensation model was formulated.

Even though, there clearly is less standardization on the non-financial metrics compared to the financial ones, it might not directly be linked into management extracting private rents from the company at the cost of the shareholders. As Angelis and Grinstein (2014) found, firms tend to choose performance measures that are informative of CEO's actions, which is in line with the optimal contracting theory. The optimal contracting theory suggests that the companies (through the Board of Directors) use management compensation systems to optimally align the incentives of the management and the shareholders to maximize shareholder value. Therefore, if the corporate governance is functioning efficiently, non-financial measures might provide more tools for companies to align the CEO incentives with the company. With a functioning corporate governance, one could argue that such objectivity issues should not emerge no matter if the company decides to use non-financial metrics in the management remuneration (if the Board of Directors has the ability to choose them correctly).

No matter the approach, there is a clear demand for stronger transparency in how non-financial metrics are used in executive pay. Regardless, if the objectivity of non-financial measures can be defended there is at least a clear risk of management having the ability to manipulate the not fully objective non-financial measures. Overall, if the company wants to apply non-financial metrics into the executive compensation, they should be objective, take into account a major pool of stakeholders, easily reviewable by outsiders as well as standardized (Bebchuk and Tallarita 2022).

*Ownership and metrics used*

Company's shareholder structure is one factor affecting the strategy and compensation models used in executive pay. Different types of shareholders have different goals for the company, and different opinions on what are the most important things to emphasize in the company operations (in addition and parallel to generating profits). For instance, state and other public sector shareholders have additional incentives to just purely generating profits. State and other public owners have stricter reputational responsibilities w.r.t., which companies they are investing in, thus state-owned companies are expected to behave in increasingly responsible manner when it comes to ESG topics. Therefore, state-owned companies could be expected to have non-financial (especially ESG related) metrics used in their executive compensation more than comparable privately owned companies.

*Costs of the approaches*

How the costs vary on between the non-financial and financial metrics are hard to estimate, and academia provides quite little direct evidence on how the costs vary between the approaches. However, previous research has indicated some points which affect the costs of different models which are discussed next.

There is clear evidence that increased reporting leads into increased effort and potentially costs. If the company wants to clearly report the metrics used in management compensation model (as it should), adopting new metrics into executive pay might have a significant (negative) cost impact. Especially if the non-financial metrics become more regulated, although it increases objectivity, it also increases the costs associated with using these metrics in executive pay.

However, non-financial metrics might reduce the long-term costs of recruiting through providing higher employee satisfaction. Flammer et al. (2019) found that by adopting CSR criteria in executive compensation, companies are able to increase employee satisfaction which transfers into higher employee engagement. This further reduces the employee churn and the company might also be able to attract new talented employees easier.

### 3.4. Comparative effectiveness of approaches

Regardless of the aforementioned potential objectivity issues, non-financial metrics might provide some clear benefits for the company especially in the long-term. Using non-financial metrics in executive pay might increase the employee satisfaction and even further, the employee innovation. In addition, Flammer et al. (2019) found that firms using CSR contracting have increased firm value, increase in long-term operating profits and improved environmental and social performance.

Overall, non-financial metrics in executive pay can be seen decreasing myopic behaviour among executives. Applying non-financial metrics in management remuneration models might capture effects of longer-term goals which financial metrics are unable to capture, like the innovation, product development as well as investments in new growth opportunities. Tsang et al. (2021) also provide an empirical support for this view as they found that companies which use non-financial metrics in executive compensation can increase innovation within the company through incentivising management more into the long-term strategy.

These benefits might not be homogenous across industries, as companies operating in certain industries might have more benefits from including ESG metrics into executive pay than others. Maas and Roosendaal (2014) found that companies in "dirty" industries (like utilities and energy) are applying non-financial targets in executive compensation more than companies in other industries. Therefore, when investigating the comparative effectiveness of these two approaches and how they could be used together one needs to factor in the industry and investigate these scenarios case-by-case.

### 3.5. Limitations

In this section, we discuss the potential limitations of using non-financial metrics in executive compensation. First, companies might be not willing to take the risk that management is able to manipulate the non-regulated non-financial metrics and extract private benefits from the company. As discussed earlier, there is a clear risk that management can manipulate the non-financial measures more which might end up being costly for the company and the shareholders.

Second, if long-term metrics in executive compensation are used to measure long-term strategies (as Flammer et al. 2019 suggested), one practical limitation in this approach is that the results are visible only in the long run. Long-term performance is always a relatively nonvisible factor, as the effects of the changes are seen only after many years, and the short-term effects might even be negative. Therefore, companies might be reluctant to take the risk of the metrics not working even though there would be potential benefits.

Finally, the non-financial metrics focus on a small number of dimensions, which might not be optimal for all stakeholders (Bebchuk and Tallarita, 2022). In practice, it is impossible to find an optimal goal for "all stakeholders" even though one would use the narrow approach of stakeholderism. Different stakeholder groups (employees, customers, etc.) and even different subgroups within the same stakeholder group have very different objectives and goals. Therefore, it is likely impossible to apply a certain non-financial metric for executive compensation model, which would then capture the interests of all stakeholders.

### 3.6. Theoretical support for non-financial indicators

Even though traditional non-financial measures, such as some parts of the balanced scorecard model, can be used as a way to give better insight into the overall performance of a company, its usage in executive compensation has not been popular. One possible reason for why some of the information is not published might not be related to how accurately it can measure the company performance, but rather that companies are not willing to lose their competitive advantage by publishing potentially sensitive information.

When analysing the more traditional metrics through the agency theory, most of indicators do not seem to help with management opportunism but might help unify the long-term goals of the management and the shareholders. Keeping this in mind, it leaves mostly strategical aspects of the innovation and learning perspective, and the customer perspective as possible ways to calculate executive compensation.

In terms of stakeholder and legitimacy theory, most of the indicators in the balanced scorecard are related to operational efficiency and development of operations. As such, this leaves mostly the customer perspective as a way to measure relationships with customers.

From an agency theory perspective, the ESG and CSR metrics could be used as a way to reduce managerial opportunism surrounding ESG and CSR. As for example reducing emissions or ensuring ethical operations could reduce short-term profits of a company, these metrics could be used to control related conflicts of interest.

As stakeholder theory is based on building relationships with related stakeholders such as employees, suppliers and customers, most of the ESG and CSR related metrics can be used to see how external stakeholders are treated. While this approach reduces the focus on some stakeholders such as the stockholders, it can give a more comprehensive picture of the operations.

While there is some overlap between the stakeholder theory and the legitimacy theory, the legitimacy theory can be used in a different way. In stakeholder theory most of the potential benefits are derived from the increase in long-term performance of a company, while legitimacy theory can be used to explain ESG and CSR metrics as bridging the gap between internal operations and external expectations. This can be particularly important in industries such as banking or mining.

All in all, the theoretical frameworks introduced can be used to justify the usage of non-financial metrics as a complement to financial metrics. While most of the traditional non-financial metrics such as product design or cycle time could be considered sensitive information and, in some ways, unnecessary when compared to financial metrics, this leaves mostly strategical aspects and the customer perspective. As such, the CSR and ESG metrics could be used to convey information on operations without giving away sensitive information, as well as ensuring continuity and legitimacy of operations.

# 4. Empirical evidence

As most of the previous research on executive compensation is conducted on data from the US, we tried to have a different approach to collecting the data. In this analysis, we collected data only on large Finnish companies to have a uniform set of data to have more comparable results. We collected data on how executive compensation is currently calculated, after which we compared it to the theory we found.

### 4.1. Data & methodology

For our empirical analysis, we used companies included in the OMXH 25 index as of 9.11.2022 (please see Table below). These companies include a broad range of different industries, which provides insight into the potential industry variation in the management compensation models. Another reason we used these companies is that they operate according to the same laws and standards, while still being close enough in size that we do not necessarily have to consider the size of the company. The executive compensation model was observed from the point of view of the CEO, as the compensation models were usually the most detailed, allowing for a more detailed comparison.

We investigated the management compensation models of these companies by manually going through financial reports such as annual reports and remuneration reports. We used the 2021 annual reports and their section on remuneration, or if necessary, a separate remuneration report for the year to observe how executive compensation is calculated. To simplify the data, we split it into short-term and long-term sections, as this was also the model most companies used. The short-term section included compensation related to incentives that span a time period of one fiscal year, not including factors such as base pay, pension or insurance. The long-term part was defined as an incentive spanning multiple fiscal years, which were planned from year 2021 onwards. Even though we did not include it in the graphs, we also tried to identify companies willing to or planning to adopt ESG related metrics to their compensation models in the near future.

### 4.2. Findings

Every company we analysed had financial metrics as a core part of their executive remuneration plan, calculated through metrics such as earnings per share, total shareholder returns or operating profit. As such, we decided to mostly focus on the non-financial aspects in these charts, which we split into environmental, social, governance, traditional, and other metrics. The only outlier in the data was Elisa, in which the executive management do not receive any variable remuneration. In most cases, the weight of ESG metrics ranged from 10 to 20% of the total, whereas the more ambiguous category of other metrics could be anywhere from 0 to 100%.

As the goal was to analyse non-financial metrics used in companies, the specific financial metrics were not considered to be an important part of the analysis and only their weight in comparison to non-financial metrics were noted. Financial metrics were defined as for example indicators related to income from operations, such as net income, revenue or EBIT, or indicators related to shareholder value such as earnings per share or total shareholder return.

After removing financial indicators from the compensation models, there were three different types of indicators left which we categorised as "ESG", "Traditional non-financial measures" and "Other". Even though most companies used the term ESG in their remuneration reports, in this report the ESG section was split further into Environmental, Social, and Governance, to try to provide information on how companies might use these metrics internally and externally.

In terms of categories under the ESG, Environmental metrics were the most common. These environmental metrics were mostly around greenhouse gas emissions such as carbon emissions or impact, or biodiversity. The second most common was Social, where metrics related to internal stakeholders such as gender diversity or employee safety we included. The Governance section was defined as related to for example management structure and compliance, but it should be noted that this category might be underrepresented as executive compensation itself could be categorised as an aspect of Governance in ESG.

For Traditional non-financial metrics, most of the metrics left were related to external stakeholders, such as customer satisfaction, which had overlap with the social metrics of ESG. Due to the lack of traditional non-financial metrics in the reports, the "Other" category was created to include metrics that potentially included traditional non-financial metrics. The "Other" category includes things that could be internally calculated through traditional non-financial metrics, such as strategic objectives, performance, or targets, that the company might be hesitant to communicate publicly.

The ESG and CSR perspectives were represented by splitting it into environmental, social and governance to get a better understanding of what might be the motivation behind it. Environmental metrics includes things like CO2 emissions or biodiversity, social covers

Long-term non-financial metrics in executive compensation 2021

| 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 & Stables Retailing | 8,472 | ✓ | | | | |
| kojamo | Real Estate | 3,536 | | | | | |
| KONE | Machinery | 23,110 | ✓ | ✓ | | | |
| KONECRANES | Machinery | 2,189 | | | | | |
| Metso:Outotec | Machinery | 7,121 | ✓ | | | | |
| NESTE | Oil and Gas | 35,626 | ✓ | | | | |
| NOKIA | Communications Equipment | 25,980 | | | | | |
| nokian RENKAAT | 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 | | | | | |
| tietoevry | IT Services | 2,968 | | | | | |
| TOKMANNI | Multiline Retail | 755 | | | | | |
| UPM | Paper & Forest Products | 19,073 | ✓ | ✓ | | | |
| Valmet | Machinery | 4,548 | | | | | |
| WÄRTSILÄ | Machinery | 4,522 | | | | | |
| Total | | | 5 | 2 | 0 | 0 | 0 |

aspects such as personnel engagement score and, and governance includes for example compliance. We included traditional non-financial metrics to cover for example customer engagement and satisfaction, but as we expected from the theory, this aspect was not used that much in executive compensation. In addition, the other column was for metrics that were not clearly defined, such as strategic priorities or objectives, which we deemed could be a part of non-financial metrics. Either companies did not think it was necessary to clearly define what these metrics included, or it was deemed too sensitive to report.

As can be seen from the chart above, most of the companies prefer to use financial metrics when considering long-term executive compensation. The notable exceptions seem to be companies operating in machinery, oil and gas, and paper and forest products, which could be deemed as industries that require the confidence of external stakeholders. Further proof for this is that Sampo, as well as Outokumpu are going to include ESG related goals in their CEO remuneration plans in the next few years.

Short-term non-financial metrics in executive compensation 2021

| 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 & Stables Retailing | 8,472 | | | | | ✓ |
| kojamo | Real Estate | 3,536 | | | | ✓ | |
| KONE | Machinery | 23,110 | | | | | ✓ |
| KONECRANES | Machinery | 2,189 | | | | | |
| Metso:Outotec | Machinery | 7,121 | | | | | |
| NESTE | Oil and Gas | 35,626 | | ✓ | | | |
| NOKIA | Communications Equipment | 25,980 | ✓ | | | | ✓ |
| nokian RENKAAT | Auto Components | 1,475 | | | | | |
| Nordea | Commercial Banks | 37,132 | | ✓ | ✓ | ✓ | ✓ |
| ORION | Pharmaceuticals | 6,657 | | | | | |
| outokumpu | Metals & Mining | 2,319 | | | | | ✓ |
| Qt The Qt Company | Software | 1,236 | | | | | |
| SAMPO | Insurance | 25,053 | | | | | |
| SSAB | Metals & Mining | 5,429 | | ✓ | | | |
| storaenso | Paper & Forest Products | 11,436 | | ✓ | | | |
| Telia | Diversified Telecommunication Services | 10,735 | | | | | |
| tietoevry | IT Services | 2,968 | | | | | ✓ |
| TOKMANNI | Multiline Retail | 755 | | | | | |
| UPM | Paper & Forest Products | 19,073 | | | | | ✓ |
| Valmet | Machinery | 4,548 | | | | | |
| WÄRTSILÄ | Machinery | 4,522 | | | | | |
| Total | | | 4 | 5 | 1 | 3 | 8 |

In terms of short-term non-financial metrics, there is a bit more spread across all the different categories. From the ESG perspective, we can see a similar trend that companies operating in for example mining or banking are more prone to include these metrics, possibly for the same reasons as when talking about the long-term.

From the traditional non-financial measure perspective, most of the companies included operate in a more customer-centric environment. As such, it could be inferred that a more stakeholder centric approach was deemed beneficial in the long-term.

Most of the companies are included in the "other" metrics, which were mostly indicators such as strategic objectives, targets, or goals. We included these in the chart, as most companies included these separately from financial metrics as well as metrics related to operational activities. As such, these strategic goals could represent non-financial aspects of the company which they are not willing to publicise due to concerns related to keeping their competitive advantage.

# 5. Conclusions and future research

In accordance with our identified theoretical frameworks, we found supporting evidence from the empirical evidence we analyzed. Most of the results could be at least partially explained by the theory even though our sample size was quite small, but the actual percentage share of non-financial metrics seemed to be quite small. As expected, most of the traditional non-financial metrics could not be identified from the remuneration reports, but whether they were absent or just not identifiable is up to interpretation.

Even after a recent focus on the subject, non-financial metrics in executive compensation are still not as commonly used when compared to financial measures. Even though 11 out 25 companies from our data have adopted the use of non-financial measures in their CEO remuneration plans, the non-financial part makes up only a relatively small percentage. As can be seen from the data, ESG metrics are mainly focused on the environmental and social aspects, with Nordea being the only company utilizing governance related measures, possibly due to operating in the banking industry. In some other cases, it could be inferred that the industry in which the company operates could affect the type and extent of non-financial metrics used.

As our data sample was focused on such a small sample, this also poses some limitations. In the future, further research which controls for company size or industry could be conducted, or companies operating under different reporting standards could be compared. Comparing countries and reporting standards could be used to more clearly identify if the reporting is due to, for example, long-term value creation or need for legitimacy of operations, or to see how differences in enforcement or legal systems change the results.

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