To what extent does political affiliation influence firms' adoption of ESG-linked executive compensation policies?

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I. Introduction:

The goal of this research project is to better understand the extent to which companies are incentivized to use ESG-linked compensation based on the political affiliation of the state in which they are headquartered. Specifically, it aims to examine whether such compensation structures are driven by a genuine commitment to sustainability or primarily influenced by external factors, like the change of state political affiliation that companies locate on.

In the United States, two political parties, democrats and republicans, have different attitudes toward policies that incentivize companies to reduce their emissions. By identifying whether companies take a short-term or long-term approach to ESG-linked compensation, this study seeks to determine whether firms are motivated by social responsibility goals or by government policies when deciding their ESG-linked compensation policies. Specifically, it aims to assess whether a reduction in regulatory pressure—particularly in states with weaker ESG mandates, often aligned with Republican governance—contributes to increased corporate short-termism by discouraging the integration of long-term, sustainability-driven performance incentives.

Based on the findings of this study, there does not appear to be a clear or immediate correlation between the discontinuation of ESG-linked compensation policies and the political orientation of state governments, but there seems to be a trend of companies beginning to discontinue when the opposite party is in power. However, this conclusion is drawn from a limited dataset comprising only a small number of companies that have discontinued such policies, which may limit the generalizability of the results. This trend is also very recent, having emerged only in the past few years. Future political uncertainty could alter this pattern, but more time is needed to better understand the long-term effects.

II. Research Context:

Historically, Republican-led states are less likely to have ESG-linked compensation policies compared to Democrat-led states. Given that in many Republican-led states, there has been a continuous effort to counteract ESG initiatives, especially the policies that are perceived to disadvantage traditional energy sectors such as coal and natural gas. For instance, between 2021 and 2024, Republican lawmakers in 40 states introduced 392 bills seeking to use state contracting to steer money manager investments away from investments that are deemed to disadvantage the fossil fuel industry, according to a report Pleiades Strategy released.[1]

In contrast, Democrat-led states are more likely to incentivize ESG-linked compensation policies compared to Republican-led states. For instance, Washington state's Climate Commitment Act established a cap-and-invest program to reduce greenhouse gas emissions, which reflects a broader commitment to sustainability. Even though there has been no specific state-level policies in Democratic-led states that incentivize the integration of ESG metrics into executive compensation structure, a study published in the "Studies in Economics and Finance" journal found that companies with headquarters in Democratic-leaning states have a 31% higher incorporation rate of ESG-linked compensation plans compared to those in Republican-leaning states.[2]

Given the variation in ESG mandates across states, particularly the weaker ESG political affiliation in Republican-led states, this paper examines whether utility, energy, and extraction companies in these states are more likely to discontinue ESG-linked compensation policies than those in Democratic-led states. The analysis of this paper will focus on the discontinuation rate of such policies among 71 utility, energy, and extraction companies, assessing correlations between state-level political affiliation and corporate decisions on executive incentives.

By researching this question, the goal is to better understand to what extent companies are currently incentivized to use ESG-linked compensation due to the government political affiliation. By identifying whether companies used short-termism vs long-termism with their ESG-linked compensation, it is possible to deduce if companies are motivated by their social responsibility goals or government incentives to decide their ESG-linked compensation policies.

This paper focuses on comparing the discontinuity rate of ESG-linked compensation policy, rather than the ESG-linked compensation rate between Democrat-led and Republican-led states because the presence of such policies alone does not reflect how durable or committed firms are to ESG principles. Through examining the discontinuation rate, the paper can better understand the influence of regulatory shifts in Republican-led states where anti-ESG legislation has intensified especially over the past several years. Hence, examining the discontinuity rate helps to examine how external pressure like changes in government may cause companies to retract previously enacted ESG-linked compensation policies. This approach can help to offer insights into if companies are truly committed to ESG and sustainability, or if they are only implementing such initiatives to capitalize on government incentives.

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[1] Karin Rives, "Dozens of New State Anti-ESG Bills Introduced; Federal Legislation Expected," S&P Global Market Intelligence, January 31, 2025, https://www.spglobal.com/market-intelligence/en/news-insights/articles/2025/1/dozens-of-new-state-antiesg-bills-introduced-federal-legislation-expected-87342102?

[2] Emma Y. Peng and William Smith III, "Politics, Integration of ESG in CEO Compensation, and Firm Credit Ratings: Evidence from the USA," Studies in Economics and Finance, November 24, 2023, https://www.emerald.com/insight/content/doi/10.1108/sef-06-2023-0350/full/html?skipTracking=true.

A company that discontinues these practices when regulatory support weakens may suggest that its ESG efforts were either performative or compliance-driven. In contrast, companies that maintain their ESG-linked compensation despite shifting political or regulatory landscapes may demonstrate a stronger internalization of ESG principles as part of their core mission and values.

III. Literature Reviews:

Recent academic research has documented the growing prevalence of CSR-linked executive compensation as a corporate governance mechanism, and within the CSR-linked executive compensation structure, an increasing emphasis on ESG metrics such as increased sustainability and reduced carbon emission. A seminal study by Flammer et al. (2019) examining S&P 500 companies found that the adoption of ESG contracting increased significantly from 12% in 2004 to 37% by 2013. Their analysis demonstrates that incorporating environmental and social metrics into executive pay leads to meaningful organizational changes, including enhanced long-term orientation, improved firm value, and better environmental performance. Particularly noteworthy is their finding that ESG contracting reduced toxic emissions by 8.7% and increased investment in green innovation. The effectiveness of these incentives was found to be significantly greater when ESG-based compensation constituted a substantial rather than symbolic portion of total executive pay.

As international research shows, this trend of incorporating ESG criteria into executive compensation extends beyond the U.S. market. A comprehensive study by Tsang et al. (2021) examining firms across 30 countries found that ESG contracting increased from 2% to over 24% between 2004 and 2015. Their research reveals that ESG-linked compensation is particularly effective in promoting innovation in countries with weak stakeholder orientation and legal environments. The authors identify several channels through which ESG contracting drives innovation, including enhanced employee productivity, increased managerial risk-taking, and improved allocation of R&D investments. These findings suggest that ESG contracting can serve as an effective mechanism to overcome institutional weaknesses and promote long-term value creation through innovation. The study demonstrates that the impact of ESG incentives varies significantly based on institutional context.

As deducted from the reading “ESG-linked pay trend”, it can be summarized that ESG-linked pay adoption is influenced by a country’s culture, legal, and institutional environment. Overall, companies in wealthier economies are more likely to adopt ESG-linked pay than those in emerging economies, and government incentives are also highly linked to the adoption rate. For instance, France and Germany had higher adoption rates, and extractive industries generally showed the highest adoption rate. This is likely due to government incentives in these industries and nations, where companies can face fewer penalties if they adopt an ESG-linked pay system. Based on the reading “CSR contingent executive compensation contracts”, it can be seen that there has been an overall growing trend of companies tying executive pay to CSR metrics, which include ESG criteria such as environmental sustainability metrics. Based on the reading, industries with significant environmental and regulatory scrutiny are more likely to adopt ESG-contingent pay. Companies with strong governance and high credit ratings are more likely to adopt ESG-linked pay.

Both readings demonstrate that company types and company performance influence ESG-linked compensation. Overall, companies with strong governance and high stability in the extractive industries are more likely to adopt ESG-linked pay. Linking back to the research question, "If the political party changed, would fewer companies adopt ESG-linked compensation?" This led to the hypothesis that companies with higher scrutiny on their environmental practices are more likely to adopt ESG-linked pay to prevent public criticisms.

IV. Theoretical Framework:

The theoretical framework employed in this paper is institutional theory, which posits that companies respond to regulatory, normative, and cultural pressures within their environment. According to this theory, firms operating in states with specific political affiliation are subject to greater coercive pressure to adopt ESG-linked incentives. In line with this framework, the paper explores the following hypothesis:

> ***Firms in Republican-led states are more likely to exhibit higher discontinuation rates of ESG-linked executive compensation, reflecting an institutional environment that fosters short-termism.***

V. Methodology:

This study builds on prior ESG-related research, including the work of Professor Hao Xing from Boston University. Due to its strong connection to ESG considerations, the utility, energy, and extraction industries were selected for analysis. These sectors have a significant environmental impact, social responsibility obligations, and governance requirements, making them subject to intense scrutiny from stakeholders and regulators regarding sustainability performance. Therefore, analyzing ESG-linked executive compensation policies within this industry is particularly relevant.

The first step of the analysis involved reviewing company proxy statements to determine whether firms included ESG-linked executive compensation. These proxy statements either directly or indirectly indicated the use of ESG-related performance metrics in executive pay structures. The findings were recorded in an Excel spreadsheet, with a value of "1" representing the presence of ESG-linked compensation and "0" indicating its absence. This initial classification was then verified using ChatGPT; if discrepancies were found between the model's output and the recorded data, further manual research was conducted. Once verification was complete, additional company information—including the state location of headquarters and stock ticker—was added. Finally, the data was sorted and analyzed to identify which companies had discontinued ESG-linked compensation. For instance, if a company had a value of “1” from 2010 to 2019 and a “0” starting in 2020, it was considered to have discontinued such compensation.

Following the implementation of this methodology, 35 companies were identified as having adopted—or previously adopted—ESG-linked executive compensation from a total of 71 companies in the utility, energy, and extraction sectors. Among these, 5 companies were found to have discontinued ESG-linked compensation. By collecting information about the geographical location of company headquarters and the political leaning of each state, companies were categorized into three groups: (1) those in Democratic states (states that have consistently supported Democratic candidates since 2008), (2) those in Republican states (consistently Republican since 2008), and (3) those in swing states (states with changing political affiliations between 2008 and 2024). Adoption and discontinuation rates were then calculated for each state and group. To further assess whether geographic or political factors influence ESG compensation discontinuation, correlation analyses and chi-square significance tests were conducted.

VI. Research findings:

Based on the state-by-state analysis on discontinuity rate and adoption rates by states headquartered in by the 71 companies on the list, it can be concluded that democratic states show the highest adoption rate of ESG-linked compensation at 59.09%, Swing states fall in between at 47.83%, while Republican states have the lowest adoption rate at 42.31%. This confirms our research that firms located in Democratic states are likely to have a higher adoption rate of ESG-linked compensation policy. Evidence from the literature reviews mentioned previously also back this up, where a *Studies in Economics and Finance* study found companies in Democratic-leaning states are 31% more likely to adopt ESG-linked compensation plans than those in Republican-leaning states.[3]

When comparing the discontinuity rate of ESG-linked compensation policy based on states’ political orientation, Swing states exhibit the highest discontinuity rate at 21.43% compared to Democratic states at 11.11% and Republican states at 4.17%. Unexpectedly, Republican states have both the lowest adoption rate of ESG-linked policy and discontinuity rate after adopting such policy. This suggests the opposite of our hypothesis: while companies in Republican-led states are less likely to adopt ESG-linked compensation policies, those that do are comparatively more likely to retain them.[4]

Despite the unexpected finding, another pattern shown in swing states discontinuity rate raised our interest in exploring more. Companies in swing states exhibit a higher possibility of discontinuing using ESG-linked compensation structures compared with companies located in states that consistently support one political party. An assumption was made that this may be

[3] See Appendix 1 and 2 for more details
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due to the shifting balance of power between Democratic and Republican parties, which can lead to a fluctuating regulatory environment and bring companies uncertainties regarding ESG initiatives.

In order to develop a clearer understanding of the adoption of ESG-related compensation over the years based on political affiliation, further analysis was conducted. Companies were sorted into two groups depending on the political affiliation of the state they are headquartered in. Overall, the number of companies adopting ESG-related compensation in both Democratic and Republican states are increasing. However, there are several trends that can be observed based on the change in presidency. In 2016, when President Trump first came into office, there were no companies in Democratic states that had ESG-related compensation. This changed when Biden came into power and the number of companies in Democratic states suddenly increased. However, once again, President Trump's win in 2024 has seen a decrease in the number of companies. While it is too early to label this trend, it seems as if companies in Democratic states are more likely to discontinue ESG-related compensation when the party in power is Republican. It will be interesting to see how this plays out in the coming years and if more companies in Democratic states begin to discontinue.

Conversely, companies in Republican states have seen more stable growth. The number of companies has grown significantly from 2010 to 2024. However, a similar trend to the one seen in companies in Democratic states seems to occur in 2020. The year that Biden came into office saw a decline in the number of companies in Republican states who implemented ESG-related compensation. While this may signal that companies in Republican states too react unfavorably when the party in power is Democratic, this occurred during 2020 when the effects of Covid-19 were being felt by corporations. Whether the discontinuation is due to cost-savings or a change in the political party is hard to evaluate.[5]

VII. Connection With Short Termism

Prospectively, the impact of the new U.S. presidency on ESG-linked executive compensation will largely depend on the administration's political and regulatory priorities. A presidency that supports climate action, social equity, and strong corporate governance is likely to accelerate the adoption of ESG metrics in executive compensation plans. Conversely, a presidency that deprioritizes or pushes back against ESG initiatives may slow or even reverse that momentum. A supportive administration may expand their efforts to require greater transparency and standardization. The extent to which ESG principles are promoted, enforced, or challenged at the federal level will play a critical role in shaping corporate behavior, in regarding the integration of sustainability or ESG-linked metrics into executive compensation structures.

[5] See Appendix 3 for more details

Additionally, a supportive administration would likely strengthen the hand of institutional investors, such as BlackRock and State Street, who have been vocal advocates for ESG accountability. These investors often support shareholder resolutions that link ESG targets to compensation, especially in sectors like energy, manufacturing, and technology. If the presidency is critical of ESG initiatives or adopts a deregulatory stance, the push for ESG-linked executive pay could lose momentum and more companies may discontinue this type of compensation. In such an environment, boards of directors may choose to prioritize traditional financial performance metrics such as revenue growth, earnings per share, or total shareholder return, rather than environmental or social goals.

VIII. Limitations In The Research

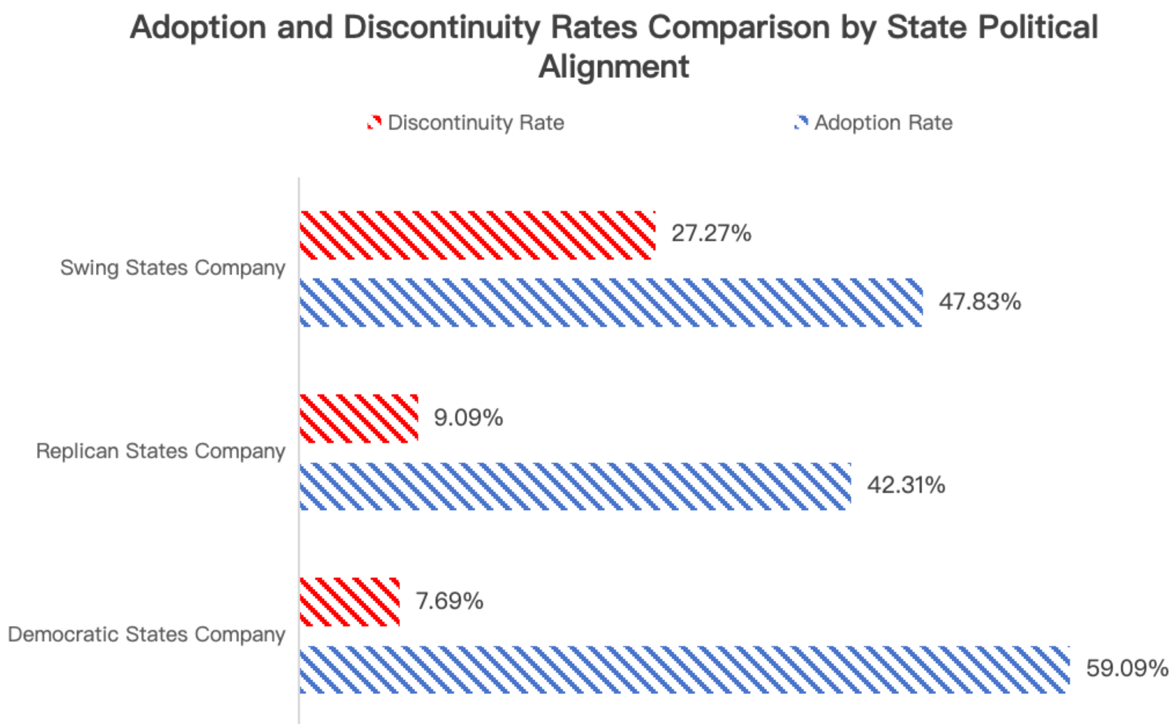
A limitation of this study is that because of the small sample size each state has, it might be challenging to determine a pattern of discontinuation rate. For instance, out of the 13 companies in Democratic states that have adopted the ESG initiative, only one discontinued. Hence, it is important to note that adoption rates vary between states due to a limited sample number of utility, energy, and extraction companies located in each state. For instance, although all are headquartered in Democratic states, firms in California exhibit a 0% ESG adoption rate, whereas those in Colorado, Connecticut, and Delaware show a 100% adoption rate.This can make it difficult to determine the real trends between ESG-linked compensation adoption vs the political status of the state due to the limited number of the companies that discontinued such practice. Future research with a larger sample across a greater number of different companies could help address this issue and uncover more reliable patterns.

Appendix

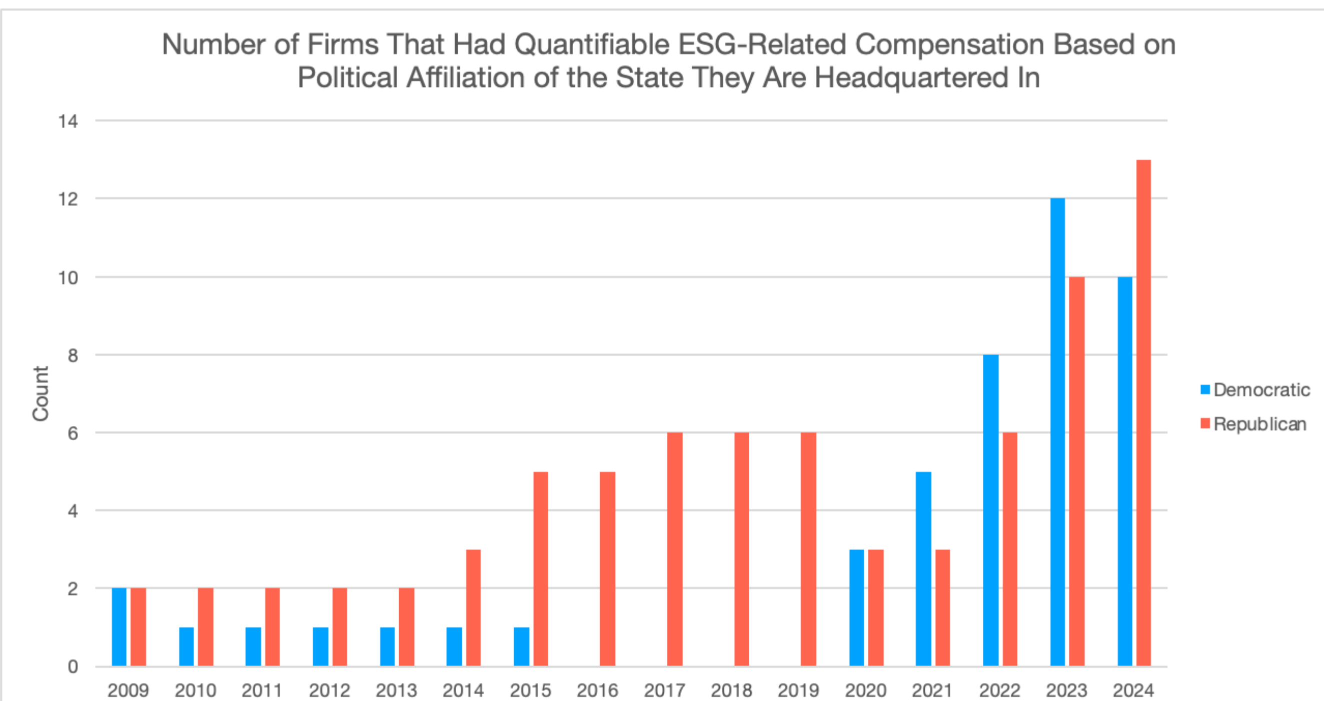
Democratic States	**Company count by state**	**ESG incentive adopting companies by state**	**States by number of companies that dropped ESG incentives.**	**Adoption Rate (# of ESG-adopting companies (Dem)/# of companies (Dem))**	**Discontinuity rates (#ESG dropouts (Dem)/ #ESG adopters (Dem))**
California	2	0	0	0.00%	0.00%
Colorado	3	3	0	100.00%	0.00%
Connecticut	2	2	0	100.00%	0.00%
Delaware	1	1	0	100.00%	0.00%
Illinois	5	2	0	40.00%	0.00%
Massachusetts	2	1	1	50.00%	100.00%
New York	3	2	0	66.67%	0.00%
Virginia	2	0	0	0.00%	0.00%
Washington	2	2	0	100.00%	0.00%
TOTAL	**22**	**13**	**1**	**-**	**-**
AVG.	**-**	**-**	**-**	**59.09%**	**7.69%**
Republican States	**Company count by state**	**ESG incentive adopting companies by state**	**States by number of companies that dropped ESG incentives.**	**Adoption Rate (# of ESG-adopting companies (Rep)/# of companies (Rep))**	**Discontinuity rates (#ESG dropouts (Rep)/ #ESG adopters (Rep))**
Alabama	1	0	0	0.00%	0.00%
Idaho	1	1	0	100.00%	0.00%
Indiana	3	1	0	33.33%	0.00%
Kansas	1	0	0	0.00%	0.00%
Mississippi	1	0	0	0.00%	0.00%
Missouri	2	1	0	50.00%	0.00%
Nebraska	1	1	0	100.00%	0.00%
North Carolina	4	3	0	75.00%	0.00%

Oklahoma	1	1	0	100.00%	0.00%
South Carolina	2	0	0	0.00%	0.00%
Tennessee	3	1	0	33.33%	0.00%
Texas	6	2	1	33.33%	50.00%
TOTAL	**26**	**11**	**1**	**-**	**-**
AVG.	**-**	**-**	**-**	**42.31%**	**9.09%**
Swing States	**Company count by state**	**ESG incentive adopting companies by state**	**States by number of companies that dropped ESG incentives.**	**Adoption Rate (# of ESG-adopting companies (Swing)/# of companies (Swing))**	**Discontinuity rates (#ESG dropouts (Swing)/ #ESG adopters (Swing))**
Arizona	1	1	0	100.00%	0.00%
Florida	3	1	0	33.33%	0.00%
Georgia	1	0	0	0.00%	0.00%
Nevada	1	0	0	0.00%	0.00%
Ohio	9	4	1	44.44%	25.00%
Pennsylvania	7	4	1	57.14%	25.00%
Wisconsin	1	1	1	100.00%	100.00%
TOTAL	**23**	**11**	**3**	-	-
AVG.	**-**	**-**	**-**	**47.83%**	**27.27%**

Appendix 1: ESG Incentive Adoption and Discontinuation Counts and Calculated Rates by Companies' Headquarters States



Appendix 2: Adoption and Discontinuity Rates Comparison by State Political Alignment



Appendix 3: Number of firms that had quantifiable ESG-related Compensation based on the political affiliation of the state they are headquartered