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The evolution of CSR contracting in Italian non-financial listed companies

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Abstract

Most of the prior studies on executive remuneration lack nuanced qualitative analyses of the design of sustainability-related incentive plans. In particular, little is known about several design elements, such as the types and weights of key performance indicators (KPIs), the KPIs targets, and their range of values and achievement levels. Through in-depth documentary analysis, this chapter aims to fill this gap by exploring, through a detailed and comparative analysis, the design of incentive plans addressing environmental, social-, and governance-related goals. Specifically, this chapter focuses on the sustainability-related incentive components for CEOs of Italian non-financial companies listed on the FTSE-MIB index. The main findings show a general enhancement in the design of sustainability-related incentive plans, considering their use, scope, and specificity regarding targets and their attainment. However, weaknesses persist, particularly concerning the motivation behind adopting this form of incentive plan and the related KPIs. In addition, this chapter highlights a biased focus on a small subset of stakeholders, the delayed presentation of targets, and the low difficulty level in achieving these targets. For these reasons, this study stresses the need for more robust, transparent, and challenging sustainability-oriented incentive structures to contribute to corporate social, environmental and governance-related goals effectively.

Keywords: corporate governance, CSR contracting, executive remuneration, sustainability-related targets

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Introduction

Companies face new demands and are under external pressure to be accountable to all stakeholders and create long-term rather than short-term value. Supporters of the stakeholder perspective advocate corporate governance mechanisms that encourage boards to serve the interests of all stakeholders (e.g., employees, communities, and the environment) and shareholders (Cohen et al., 2023; Kaplan & Ramanna, 2021).

CSR contracting refers to integrating such concerns into the environmental- and social-related targets of executive remuneration contracts (Cohen et al., 2023; Flammer et al., 2019). By adopting CSR contracting, companies and their stakeholders can monitor the short- and long-term goals reached by key figures (e.g., CEOs) in sustainability-oriented initiatives and outputs, motivating their current behaviours towards sustainability.

CSR contracting is still a subject of debate among scholars. CSR contracting, on the one hand, enhances value (e.g., Flammer et al., 2019) and produces positive social and environmental effects (e.g., Bose et al., 2023; Derchi et al., 2023; Tsang et al., 2021). On the other hand, according to prior literature (Bebchuk & Tallarita, 2022), CSR contracting leads to flaws and dangers for stakeholders due to its metrics tied to limited dimensions of stakeholders' welfare and to a restricted subset of stakeholders. Also, CSR contracting is not subjected to effective scrutiny by outsiders, as outside observers might not assess (e.g., due to lack of time and/or expertise) whether its use provides beneficial incentives or primarily operates as a mechanism to enhance executives' discretion on their payoffs (Bebchuk & Tallarita, 2022).

Since the current literature has mainly focused on quantitative analyses of the presence (e.g., Hong et al., 2016), content (e.g., Maas, 2018), and outcome (e.g., Flammer et al., 2019) of CSR contracting, it could have possibly neglected a more nuanced analysis of its design evolution (Velte, 2024). In addition, the scant literature (e.g., Flammer et al., 2019; Hong et al., 2016; Keddie & Magnan, 2023; Ott & Endrikat, 2023) focused on a unique institutional setting, namely Anglo-Saxon countries (i.e., the United States). Little is known about the detailed design of CSR contracting in non-Anglo-Saxon countries. This chapter aims to fill this gap by highlighting how Italian non-financial listed companies design environmental, social, and governance related KPIs over time. Rather than investigating one specific element of the remuneration design, we consider multiple elements (e.g., KPIs types and weights, KPIs targets) and their relationships. Specifically, we analysed those companies constituting the FTSEMIB index from 2011 to 2023, dividing the sustainability-related remuneration design into short- and long-term incentive plans.

The chapter is structured as follows. The next section describes the concept and characteristics of CSR contracting. Subsequently, the sample, methodology used, and the main results are presented. To conclude, we discuss the observed issues and provide the practical implications and limits of the study.

The integration of sustainability criteria in executives' remuneration plans: related literature

Companies adopt sustainability-oriented mechanisms at the company- (e.g., within their business model) or the individual-level, as in the case of a remuneration policy for their corporate officers. Although executive remuneration packages are still mainly focused on financial-related key performance indicators (hereafter KPIs), non-financial and, more recently, sustainability-related KPIs are increasing (e.g., Qin & Yang, 2022; Tsang et al., 2021).

Including sustainability-related targets within the remuneration package is commonly known as CSR contracting. CSR contracting refers to using sustainability-related KPIs defined at the company-level (e.g., reduction of CO2 emissions), to align the interest of shareholders and managers to selected stakeholders (Flammer et al., 2019; Ikram et al., 2019). By including stakeholders' interests in the remuneration package, companies address different goals, for instance, employees' health and safety and environmental objectives (e.g., reducing waste) (Hong et al., 2016; Maas & Rosendaal, 2016; Yang, 2023).

Prior studies have shown that CSR contracting has become more prevalent over time (e.g., Aresu et al., 2023; Cohen et al., 2023; Flammer et al., 2019) and that it varies significantly across the organisational hierarchy (i.e., top managers, mid-level managers and all other employees) and in different industries (e.g., Derchi et al., 2023; Ikram et al., 2019).

Companies may voluntarily adopt CSR contracting due to country-, industry-, and company-specific features. In terms of country-specific features, for instance, the use of CSR contracting was proven to increase in those countries with higher shareholder protections and social and environmental (e.g., U.S. State Climate Adaptation and Resilience Plan) regulatory pressure (e.g., Aresu et al., 2023; Cohen et al., 2023; Hazarika et al., 2022; He et al., 2023). Prior literature (e.g., Cohen et al., 2023; Derchi et al., 2023; Flammer et al., 2019; Hazarika et al., 2022; Maas & Rosendaal, 2016) also highlighted the effect of industry-specific features on CSR contracting, such as the higher presence in emission-intensive sectors (e.g., oil and gas) or the pressure to conform to competitors' behaviours.

In terms of company-specific features, companies may adopt CSR contracting, for instance, to build trust with different stakeholders (Qin & Yang, 2022). Also, corporate governance-related mechanisms seem to affect the adoption and effectiveness of CSR contracting, such as CEO's experience and power, board diversity and independence (e.g., Abdelmotaal & Abdel-Kader, 2016; Al-Shaer & Zaman, 2019; He et al., 2023; Homroy et al., 2023; Qin & Yang, 2022).

Different features, such as the beneficial stakeholders, the nature, the time frame, the KPI's target, and its weight, can impact CSR contracting design (Yang, 2023).

Beneficial stakeholders (i.e., those that can benefit from CSR-oriented initiatives and outputs) are heterogeneous (e.g., employees, investors), and their different time horizons (e.g., short- vs. long-term oriented) can create potential conflicts (Cohen et al., 2023). This heterogeneity leads to difficulties in including unique sustainability measures in CSR contracting that fit all the stakeholders' expectations. The

more diverse stakeholders' interests are, the more challenging it is to address all of them by incentivising executives to pursue specific stakeholders-oriented goals.

The company may choose different KPIs according to the stakeholders' prioritised interests (Yang, 2023). The nature of these KPIs, which refers to their general content (Maas & Rosendaal, 2016), can be classified as environmental- (e.g., related to carbon emissions), governance- (e.g., related to board diversity), and social-oriented (e.g., related to employees' welfare). Also, KPIs' nature can be generally related to an overall ESG performance (e.g., positioning in ESG market indexes).

The time frame is the time horizon related to the incentive achievement and can be short-term (one year) or long-term (e.g., three years). The choice of the time frame may be affected by the stakeholders' pressure to achieve specific short- or long-term goals (Flammer et al., 2019).

The target of the KPIs refers to the value or range to which the payout is connected. Companies can define targets through a quantitative value (e.g., 5% reduction of injury frequency rate) or without a precise formula or value (e.g., reducing the injury frequency rate).

Finally, KPIs' weight represents the portion of sustainability-oriented KPIs within a specific incentive plan. It can impact the CSR contracting substantive or symbolic role, signalling the extent to which sustainability-related goals are crucial in the overall remuneration or a mere legitimisation tool adopted by the company (Bebchuk & Tallarita, 2022; Cucari et al., 2023; Yang, 2023).

CSR contracting design can be challenging for different reasons. Sustainability-related criteria introduce new KPIs with different measurements, targets, and time horizons. Potential problems include, for instance, the missing link between sustainability-related strategic plans and targets within the incentive plans and the absence or complexity of sustainability-related targets. These targets are vaguely defined, easy to achieve, and difficult for outsiders to verify (Bebchuk & Tallarita, 2022; Hartikainen et al., 2021).

Sample and methodology

Sample

We follow these steps to create our analysis sample.

First, we selected all the companies listed in the FTSE-MIB index, which includes the 40 most liquid and capitalised companies and captures approximately 80% of the domestic market capitalisation between 2011 and 2023 (latest available month: May 2023). Due to the peculiarities of the financial sector, we excluded companies in the financial and real estate sectors from our analysis according to the FTSE classification. The total number of unique non-financial companies in the FTSE-MIB from January 2011 to May 2023 was 46. Due to the changes in the index, whose constituent's eligibility is quarterly validated¹, we selected for our analysis only those companies that were consistently members of the index in the majority of months from January 2011 to May 2023. Therefore, among the 149 months from

¹ For the methodology of eligibility of constituents, see the website of Italian Stock Exchange (www.borsaitaliana.it).

January 2011 to May 2023, we analysed only those companies that were present at least half the time, even with discontinuity. With this step, we excluded from the analysis 21 companies.

Finally, as foreign listed companies can be included as constituents of the FTSE-MIB, we excluded five companies (Ferrari, Fiat/Fiat Chrysler, Fiat Industrial/CNH Industrial, ST Microelectronics, Tenaris) as listed in foreign countries and did not apply the Italian corporate governance code in most of the analysed years. The final sample resulted in 20 Italian non-financial listed companies.

Importantly, we started gathering data from the Remuneration Reports (Italian and English versions) that began to be published in 2012, referring to fiscal year 2011, until the latest available data in 2023, to gather the information from unique, comparable reports. Also, we downloaded further documents relevant to this study: corporate governance reports, sustainability reports, and strategic plans (when available).

Methodology

Following prior literature (e.g., Cai et al., 2022; Hyndman & Liguori, 2023), data have been hand-collected using a document analysis approach. Document analysis is a procedure used in qualitative research based on documents' in-depth examination to elicit meaning, gain understanding, and achieve empirical knowledge (Bowen, 2009). In this study, documents have been used to track the changes and development of CSR contracting.

First, we downloaded all the available remuneration reports, a total of 231 documents². We then filtered only the information on CSR contracting, defined as the range of incentives based on environmental, social-, and governance-related goals, that can be summarised under the general term of 'sustainability-related goals'. Instead of relying on pre-selected keywords to identify this information, we meticulously reviewed the entire list of KPIs adopted and selected sustainability-related ones. The authors found a collective agreement in the few uncertain cases (e.g., KPIs related to the quality of internal processes). Among the directors, we analysed only the CEO's short- and long-term incentive plans. When the CEO also served other roles (e.g., General Director), we also examined the incentive plans related to the other roles performed by the person serving as CEO. At the national level, we reviewed the content of the different applicable corporate governance codes issued during the analysis period. Specifically, we analysed the content of the corporate governance codes issued in 2011, 2014, 2015, 2018, and 2020 (Italian Corporate Governance Committee, 2011; 2014; 2015; 2018; 2020).

² The final number is not, as expected, 240 documents (12 years analysed times 20 companies) as we excluded Luxottica in the years 2019-2023, after the merger with Essilor as the company started to follow the French Corporate Governance code, Pirelli in 2016 and 2017 (the company delisted from the Milan Stock Exchange on November 2015 and returned to the stock market on October 2017) and Mediaset in 2022 and 2023 (report drawn in accordance with the Dutch Corporate Governance code).

Second, we defined a list of items on CSR contracting to check throughout the report to gather comparable information among the companies analysed (see Table 1).

Insert Table 1 here

Specifically, we analysed whether the company justified the inclusion of sustainability-related targets throughout the remuneration report. We also examined whether the payment was in cash or shares (e.g., stock grants and options). We also checked for the weight of CSR contracting within the incentive plan, the name and, whenever available, the weight of each KPI adopted within CSR contracting, the KPI's target, minimum and maximum values according to the remuneration policy, and the degree of achievement of each target. We finally collected data on the existence of any entry gate (i.e., the presence of a paramount financial or non-financial target whose achievement is fundamental to making the short- or long-term incentive plan applicable).

Data were gathered considering short-term bonuses (i.e., those based on one-year targets) and long-term incentive plans (i.e., those based on more than one-year targets, like three-year targets).

Results

Table 2 (panels A and B) shows the main results on the use and evolution of CSR contracting and its main features. Specifically, Panel A refers to short-term incentive plans, while Panel B refers to long-term ones.

Insert Table 2 here

In the period analysed, within short-term incentive plans, 17 companies out of 20 have adopted CSR contracting at least once (Campari, Luxottica and Mediaset never adopted CSR contracting in the period analysed). Five companies (Campari, Diadorin, Luxottica, Mediaset and Recordati) have never inserted CSR contracting within long-term incentive plans.

Considering short-term variable remuneration (i.e., one-year time horizon), cash was the most common way to implement CSR contracting. Only in a few cases, some companies paid their executives with a cash/share mix (e.g., Prysmian, Italgas).

Considering long-term variable remuneration (i.e., three to five years' time horizon), share-based remuneration was the most typical form of payment. Specifically, companies chose to integrate sustainability into their executives' stock-option plans (e.g., Telecom Italia) or the stock grants (e.g., Atlantia). In limited cases, companies used cash in the long-term variable remuneration (e.g., Buzzi Unicem and Pirelli).

In the sample analysed, 11 companies out of 20 started to adopt CSR contracting in the short-term variable remuneration before 2019. Also, an average company included CSR contracting in its CEO's long-term incentive plan five years later, compared to the short-term plan year. Only two companies, Pirelli and Terna, included

CSR contracting in the long-term variable remuneration before including it in the short-term variable remuneration (7 and 1 year before, respectively). Then, other companies, Atlantia and Salvatore Ferragamo, adopted CSR contracting within the same year in short- and long-term variable remuneration.

In general, as shown in Figure 1, there has been a positive evolution as more and more companies have started to link social and environmental goals in both short and long-term variable remuneration. In line with prior literature (e.g., Maas & Rosendaal, 2016), CSR contracting is more frequent in short-term rather than long-term incentive plans, emerging in long-term plans mostly since 2020 in several companies, such as Buzzi Unicem, Eni, Leonardo, Prysmian, Saipem and Snam.

Insert Figure 1 here

Only two companies (Eni and Saipem) started to use CSR contracting in 2012. Eni, for instance, started to use CSR contracting in 2012 in the short-term incentive plan with a weight of 30% (within the variable remuneration component). It first diminished to 10% in 2014 but then increased to 25% in the period 2015-2023. At the end of the period analysed, 15 companies out of 20 had included CSR in at least one variable component of the remuneration (i.e., short- or long-term).

Also, it seems that typically, once adopted, companies continue to use CSR contracting without interruptions. In our sample, only one company (Prysmian Spa) interrupted its use in 2018, stating that “sustainability goals, already considered important by the company, will be reintroduced to the MBO system in 2019, together with targets focused more on individual roles and the performance of Business Units.” (Prysmian Spa, Remuneration Report 2018).

In addition, as shown in Figure 2, the average weight of sustainability-related goals in the variable part has increased³ from 15% to 18% in the short-term incentive plans and from 10% to 21% in the long-term. Terna, for instance, moved from a 15% weight in 2017 to a 25% weight in the latest years, considering short-term incentive plans. Enel adopted CSR contracting in its long-term incentive plans with a 10% weight in 2018, then moved to a 25%.

Insert Figure 2 here

Enel registered the highest weights within short-term variable remuneration plans from 2020 to 2023, Eni had the highest weight in 2013, and Saipem in 2021, allocating 30% of the short-term incentive plan to sustainability-related remuneration.

³ Although companies mostly disclose the exact weight of sustainability-related variable remuneration and relative KPIs, some companies provided the weight as a range or provided only a list of KPIs. As an example, Prysmian short-term variable remuneration weighted between 10% and 15% of variable remuneration, with a list of 4 KPIs. In these cases, an average value was computed to estimate the weight of each KPI.

Referring to the long-term plans, the highest weight was registered in Buzzi Unicem from 2020 to 2022, with 50% of long-term variable remuneration linked to sustainability-related KPIs. Other companies, such as Eni in 2020-2023, Telecom Italia in 2022 and Atlantia in 2021-2022, had between 30% and 35% of long-term variable remuneration linked to sustainability-related KPIs.

In terms of KPIs, there has been an evolution in the measurement of the KPIs adopted, as shown in Figure 3. Specifically, at the beginning of the analysis period (e.g., 2012 and 2013), the sustainability-related KPIs and their weights were often vague and generally related to sustainability. For example, in 2013, Saipem assigned a bonus (weight 10%) in the short-term variable remuneration plan linked to a target called ‘sustainability in terms of health and safety’. However, throughout the analysis period, companies refined sustainability-related KPIs and inserted several specific measures to embrace sustainability into the CEO’s variable remuneration. The same company, for example, in 2020 assigned to the short-term variable remuneration plan a sustainability-related bonus (weight 25%) linked to several KPIs on employees’ health and safety (Total Recordable Injury Frequency Rate), environmental protection (e.g., implementing specific initiatives of energy efficiency), and on improving diversity and risk management.

As shown in Figure 3, the evolution of KPIs is different for short- and long-term variable remuneration.

Insert Figure 3 here

In the case of short-term variable remuneration, KPIs adopted were mostly generically related to ESG (e.g., identified as a “sustainability target”) at first, with a residual part of KPIs related to social issues (e.g., employees’ health and safety)⁴. Social KPIs were present in most cases, while environmental- (e.g., percentage of renewable energy used/produced by the company) and governance-related KPIs (e.g., anti-corruption training activities) were present in very few cases. Still, environmental-related KPIs have grown over the years compared to governance-related ones.

Regarding long-term variable remuneration, the ESG category mainly refers to sustainability index positioning. In only one case, Snam, in 2017, the KPI was a generic “Sustainability” target that the company did not clarify. As shown in Figure 3 (Panel B), after 2019, there has been a change in KPIs adopted in long-term variable remuneration with environmental KPIs, mostly related to the footprint of the company (e.g., reduction of CO2 emission, reduction of waste) being used in most

⁴ ESG-related KPIs can refer to generic sustainability-related initiatives or represent ‘mixed’ KPIs that comprise environmental, governance and social features, such as the positioning in ESG indexes. Generic sustainability related KPIs were more common in the first years analyzed, being then substituted by ‘mixed’ ESG KPIs.

cases. The adoption of social- (e.g., reduction of gender gap) and governance-related KPIs (e.g., the percentage of women at the executive level) increased but remains a residual part.

Also, most companies adopted outcome-oriented KPIs (e.g. Lost Time Injury Frequency Rate, cumulative avoided GHG emissions over three years). Among the few cases of process-oriented KPIs, Italgas in 2017 assigned a short-term bonus also based on the number of institutional investors met during the year⁵.

Notably, many companies use a few sustainability-related KPIs that CEOs should focus on to increase their bonuses. For instance, Leonardo relied during 2018-2020 only on one sustainability-related KPI within the short-term bonus: the inclusion in the Dow Jones sustainability index. Limited cases utilised a broad list of social and environmental KPIs. As an example, in 2021, Prysmian relied on five KPIs to monitor its sustainability-related goals within the short-term remuneration plan: frequency rate of injuries, percentage of women hired (split considering both desk workers and management positions), investment plans for CO2 emission reduction and positioning in sustainability indexes.

In line with prior studies (e.g., Bebhuk & Tallarita, 2022; Maas & Rosendaal, 2016; Yang, 2023), social KPIs are the most frequently used, followed by environmental KPIs. Also, there are cases with only environmental-related or social-related KPIs, or cases using both social and environmental-related KPIs. In line with prior studies in different institutional contexts (e.g., Bebhuk & Tallarita, 2022; Maas & Rosendaal, 2016), among the KPIs adopted, the most common social-related KPIs refer to the health and safety of employees, often measured through the injuries frequency rate (e.g., Saipem in 2018, short-term plan) or the lost time injury frequency rate (e.g., Atlantia in 2022, long-term plan). Relatively fewer cases incorporated KPIs related to diversity, equity, and inclusion targets, such as the percentage of women hired (e.g., Prysmian in 2023, short-term plan) and the manager gender pay gap (e.g., Salvatore Ferragamo in 2023, long-term plan).

The most common environmental KPIs were related to reducing CO2 or GHG emissions and adopting renewable energies. Specifically, Snam in 2018 adopted in the long-term incentive plan a KPI called “reduction of gas emissions,” measuring the reduction of natural gas emissions over three years, compared to the results recorded at the end of 2016. KPIs on emissions can be expressed either in absolute numbers (e.g., CO2 kg) or, more commonly, as a percentage (e.g., reduction in %). Importantly, companies have started to measure emissions in relative terms by calculating emission intensity as a ratio between emissions and the amount of production (or revenues). For instance, in 2020-2022, ENI used a KPI called GHG emissions intensity upstream Scope 1 and Scope 2, calculated as the ratio of GHG emissions and gross hydrocarbon production on an operated basis. Interestingly,

⁵ Outcome-oriented means that KPIs measure a specific outcome/output (e.g. GHG emissions’ actual reduction) while process-oriented means that KPIs measure a process/initiative that will lead to a final outcome/output (e.g., number of projects related to circular economy).

KPIs related to GHG/CO₂ emissions are mostly limited to Scope 1 and Scope 2 emissions. (e.g., Saipem in 2023, short-term plan; Enel in 2021-2023, long-term plan). In terms of renewable energies, for instance, A2A added one sustainability-related KPI into its CEO's long-term incentive plan: the installed capacity from renewable sources.

In addition to the prior social-oriented or environmental-oriented KPIs, companies track their sustainable progress with more general, investor-oriented KPIs. Specifically, in line with prior literature (e.g., Maas & Rosendaal, 2016), a standard indicator used by companies has been the presence and the positioning in sustainability indexes created by external agencies, such as the Dow Jones Sustainability Index and the FTSE4GOOD index (e.g., Terna in the period 2016-2021, that measures, within the CEO's long-term incentive plan, its average positioning in the Dow Jones Sustainability Index in three years).

An explicit formula is sometimes missing in terms of KPIs' measurement (e.g., Recordati in 2022, short-term incentive plan), while there are cases of formulas explicitly provided (e.g., ENI in both short and long-term incentive plans).

Furthermore, in many cases analysed, there is no generic motivation behind CSR contracting (i.e., generally linked to a sustainability-related strategy and business model), with the risk of disconnection from crucial corporate objectives. Indeed, only a handful of cases actively establish the linkage between the KPIs and the corporate strategy. As an example, ENI, in the 2023 remuneration report, justifies the choice of a KPI related to upstream GHG net emissions, arguing that it reflects Eni's commitment to reducing GHG emissions in line with the medium/long-term objectives that will lead the company to decarbonise all products and processes by 2050.

In terms of targets, the information is often missing or unclear⁶. However, companies have improved their disclosure in recent years, presenting targets as actual, minimum and maximum values to be reached. For instance, a positive evolution has been registered in Enel (short-term incentive plan) and Atlantia (long-term incentive plan). Targets' design is generally more detailed in long-term incentive plans, often providing minimum, maximum and target values. Usually, targets are known ex-post (i.e., when companies provide the prior year's remuneration data for the payment) rather than ex-ante (i.e., when companies provide their policy). For instance, from 2013 to 2017, Snam designed its CEO's short-term bonus, linking it with the following KPI: number of accidents occurring per million hours worked during the year. However, there were no targets when presenting the KPI within the remuneration policy; the targets are only known ex-post and related to the result achieved. Also, targets are often presented not as actual values of a specific KPI (e.g. GHG emissions reduction of 20%) but as a multiplier in relation to fixed remuneration. For instance, in 2017, ENI specified that, in relationship to the CEO's short-term incentive plan, the 'target level of share of incentive payable in the year (65%) is

⁶ A target design was considered as clear when the relationship between a specific KPI value (e.g., minimum and maximum values) and its relative pay-out was defined by the company (e.g., by disclosing minimum and maximum pay-outs and/or by interpolation).

equal to 98% of fixed remuneration (min 83% and max 146%), while the target level of the deferred portion (35%) of the total incentive is equal to 68% of fixed remuneration (min 38% and max 181%)’ but without presenting the 2017 specific targets of the two sustainability-related KPIs adopted within the plan: CO2 emissions and severity incident rate. In a few cases, companies declared not to include targets for confidential reasons (e.g., Buzzi Unicem in its 2021 report).

Interestingly, targets are likely to be reached and ‘above target’ achievements are frequent. Very few cases have seen companies explicitly stating that they have not reached CSR targets. For instance, in the 2023 report explaining the achievement of the 2022 goals, ENI admitted not to have achieved the 2022 targets related to the KPI ‘severity incident rate’. In long-term incentive plans, the plan is often too recent to investigate the ex-post achievement of a sustainability-related goal.

Discussion and Conclusions

Although the previous versions of the Italian Corporate Governance Code (2011, 2014, 2015, and 2018) vaguely mentioned the concept of sustainability, the latest version (2020) explicitly introduced the concept of sustainable success. With the 2020 revised version of the code, companies are recommended to create businesses with a purpose that “consists of creating long-term value for the benefit of the shareholders, taking into account the interests of other stakeholders relevant to the company” (Corporate Governance Code 2020, p.4). In addition, the relationship between variable remuneration and performance objectives has also been clarified (Corporate Governance Code, 2020, Art. 5, Recommendation 27). Specifically, it is recommended that these performance objectives should be consistent to promote the company’s sustainable success and include non-financial parameters, where relevant.

In recent years, companies have started to include CSR contracting in both components of variable remuneration (i.e., short- and long-term). Also, the number and content of KPIs adopted signal an increased attention toward different dimensions (i.e., social, and environmental) of sustainability issues. This positive evolution seems to highlight, thus, the greater attention by the business community towards incorporating sustainability-oriented goals within corporate governance mechanisms. In particular, following the latest Corporate Governance Code revision (2020), Italian companies seem to have increased the weight and content of CSR contracting, made targets more specific (especially in long-term incentive plans), and promptly presented their achievement in the following years.

The positive evolution of CSR contracting frequency and design may reflect the institutional and media pressure (e.g., via international sustainability-related agreements like the 2016 Paris Agreement and the UN Sustainable Development Goals) to embrace sustainability within business-related behaviours and initiatives. Specific agreements and initiatives can be indirect turning points affecting company-level mechanisms, including non-financial reporting and CSR contracting. In Italy, for instance, Legislative Decree n. 254/2016, adopted by the Italian Parliament, enacting Directive 2014/95/EU regarding the disclosure of non-financial and diversity information, has led to higher pressure to incorporate non-financial information in reporting (e.g., Korca et al., 2021).

However, it must be acknowledged that, in the current situation, there is still a lot of room for improvement in adopting CSR contracting by Italian non-financial listed companies.

First, in the current forms of CSR contracting's adoption, it is often unclear why companies choose to integrate sustainability and why a specific set of stakeholders (e.g., employees) has been prioritised over others (e.g., local communities). Based on the available reports, the link between specific KPIs within CSR contracting and short and long-term goals at the corporate level is far from clear. Companies should define and disclose the motivation behind CSR contracting and link its use to corporate strategy. To validate the internal adoption of CSR, it is recommended that companies clarify the importance of certain KPIs in achieving specific strategic goals of sustainable development and how they are linked with the corporate strategy and the business model. This clarification may also be helpful to validate the adoption of CSR externally, as stakeholders not considered in the KPIs adopted should understand why their interests have been perceived as less critical by the company. Also, through a specific link between the KPIs and the corporate strategy, all those external entities from the company (e.g., investors and analysts) should be able to understand whether the adoption of CSR contracting is effectively incentivising the executives towards a more strategic, sustainable purpose rather than being a mere window-dressing tool to gift executives without any tangible purpose.

Second, another issue that companies are facing is the balance of short- and long-term sustainability goals. Corporate goals differ in their time horizon, and it may be helpful to restructure short- and long-term incentive plans to contain objectives whose achievement can be effectively measurable and feasible in that time horizon (Downie & Bourdon-Leblanc, 2023). On the one hand, there seems to be a learning curve of sustainability-related issues' integration in the variable remuneration component, as most companies adopted CSR contracting first in their short-term incentive plans and then in the long-term (Downie & Bourdon-Leblanc, 2023). However, companies provided no clear explanation of why sustainability has been integrated first in the short- and only later in the long-term component. Although some companies differentiate between KPIs used in the short- and long-term incentive plans, a clear explanation of this choice is missing. For instance, in 2020-2022, Buzzi Unicem used the Lost Time Injury Frequency Rate as a KPI within the CEO's short-term bonus. On the other hand, CO2 emissions reduction was adopted as a KPI in the long-term incentive plan. Still, the company does not clarify the choice to use different KPIs in different plans, and a stakeholder could only speculate that specific goals on environmental protection might be reachable only in the long-term, given the need to make further investments that take some time to provide outcomes (Downie & Bourdon-Leblanc, 2023).

The preference for typically relying, at first, on short-term incentive plans can be risky. Although short-term components may be a more straightforward tool to introduce sustainability into a remuneration package, it should be noticed that they are more vulnerable than long-term components as they may be based on excessively discretionary, internal (i.e., with no relative performance evaluation against

a peer group) goals that cannot be meaningfully reviewed or assessed by outside observers (Bebchuk & Tallarita, 2022; Downie & Bourdon-Leblanc, 2023; Ritz, 2022). Also, as CSR contracting does not immediately exert a significant effect (Derchi et al., 2021), one could speculate that the introduction of sustainability within the short-term has been done only for legitimacy purposes, as short-term components can depict sustainability as an immediate need of the company in the eyes of the stakeholders.

Third, it is undeniable that the concept of sustainability itself is challenging to measure as it comprises not only different activities and impacts (e.g., direct and indirect CO₂ emissions) but also different stakeholders (e.g., employees, local and national communities) whose interests are often in contrast and difficult to measure (Bebchuk & Tallarita, 2022). This seems to be a relevant issue for the companies analysed, as KPIs adopted often tackle only a specific sub-group of stakeholders rather than different groups (Yang, 2023). Stakeholders' salience is different; for instance, employees' health and safety can represent a critical risk in particular industries (e.g., oil and gas) but less of a concern in other industries (e.g., media). Targeting different KPIs to different stakeholders can help embrace the heterogeneous interests of the latter. For instance, considering only the natural environment as a stakeholder can be limited while tackling multiple stakeholders can be more helpful. For example, Buzzi Unicem's long-term plan in 2020-2022 aimed only at environmental sustainability by adopting a KPI named "CO₂ emissions of the Group". On the other hand, Enel's long-term incentive plan 2021-2023 aimed to manage environmental and social issues by adopting two different KPIs, "GHG emissions' intensity" and "the percentage of women in management succession plans". Along the same line, it should be noted that some companies chose to integrate sustainability so that their externalities may still be negative, but the reward would still be present. It is the case, for example, of those companies that chose to measure the health and safety of their employees in terms of time lost due to employees' injuries. In this case, the link between the sustainability-related reward and the sustainable outcome may be weak, as the incentive aims at treating the employees' health and safety in terms of the company's efficiency (i.e., time lost) rather than ensuring employees' safety.

Fourth, when designing an incentive plan, it is pivotal to present the target and do it in a timely manner. In the current situation, although there has been an improvement in recent years, targets are often missing. Also, when included, they are frequently not measured in terms of the specific KPI value/percentage but in generic percentage terms (where target = 100%) or in terms of a multiplier of the fixed remuneration, thus highlighting the reward but not the target. Then, importantly, companies typically do not disclose ex-ante the targets related to those KPIs called to embrace sustainability in the remuneration plan. While this may be due to confidentiality purposes, as disclosing such targets may be considered sensitive information, it should be noted that, at most, a target range would be beneficial to all the stakeholders (e.g., potential investors) called to evaluate the effectiveness of the incentive plan (Bebchuk & Tallarita, 2022; Maas, 2018). Wherever targets are

provided ex-post, as often happened, those stakeholders called to evaluate their effectiveness have already made their choices, attenuating the incentives' purpose.

Finally, targets should be challenging for the incentive to be effective. In most cases analysed, all sustainability-related objectives, especially in the short-term incentive plans, were over-performed, meaning that achieving the objective was beyond the target. On the one hand, this could be interpreted as a positive outcome of CSR contracting as it signals that executives are effectively driving companies toward more sustainable businesses. On the other hand, one could argue that the variable part of the remuneration plan is not working effectively as an incentive but as an easy-to-achieve goal, resembling more a gift to executives rather than an actual challenge in linking personal with broader organisational objectives.

The flaws highlighted can lead to a low-quality design of CSR contracting, that inefficiently incentivises CEOs to address CSR-related issues (Albuquerque et al., 2022; Yang, 2023). Overall, CSR contracting design can still improve to become an effective form of integration of sustainability into executives' remuneration. Specifically, there may be some corporate governance mechanisms that can help improve its design. Based on additional exploratory analysis, those companies where the sustainability-related committee members are also (with at least one member) within the remuneration committee tend to improve CSR contracting design⁷. However, further analysis is needed to detect whether and how sustainability-related and remuneration committee members interact and effectively contribute to a better, high-quality CSR contracting design (Yang, 2023).

The improvement suggested in this section can make this mechanism, whose positive consequences have been highlighted by prior literature (e.g., Cohen et al., 2023; Flammer et al., 2019; Qin & Yang, 2022), a crucial one in improving environmental and social performance both in the short- and long-term, contributing to the recently recognised principle (Italian Corporate Governance Committee, 2020) of sustainable success. Indeed, CSR contracting can play a positive role in helping executive directors and managers (e.g., mid-level managers) accomplish corporate sustainability-related goals, such as net-zero emissions.

This chapter aims to contribute to the studies on the evolution of sustainable corporate governance practices due to changes in recommendations (e.g., corporate governance codes' revisions) by providing critical practical implications to understand whether CSR contracting is effective or based on undemanding, discretionary goals set by corporate leaders to exert their power and legitimise themselves given

⁷ Among the 17 companies that adopted CSR contracting, we analyzed whether and how sustainability was integrated within the board specific sub-committees and whether sustainability-related committee's members were also in the remuneration committee. Specifically, we found that 4 out of 17 companies never had a sustainability-related committee with at least one member also sitting in the remuneration committee. These 4 companies also poorly designed CSR contracting (e.g., in terms of targets' design).

the more substantial scrutiny they face on ESG issues. Also, companies can benefit from the study's empirical evidence by identifying the factors contributing to best-practice initiatives in adopting CSR contracting. Analysts, consultants, and investors can avail the results of our research to evaluate and compare effective and ineffective CSR practices, disentangling those companies tackling sustainability seriously from those merely legitimising the adoption of a novel practice that is useless and potentially harmful due to the insensitivity of the remuneration package to the actual outcome. Finally, policymakers can use our results when defining norms and recommendations (e.g., corporate governance codes) that can interact with the self-regulatory, internal corporate governance, and monitoring mechanisms in place.

The study is not free from limitations. First, we considered only the FTSE-MIB segment, thus not providing a complete picture of the state and evolution of CSR contracting in the Italian context. Second, the interplay between financial and sustainability related KPIs (and their features in terms of weight and targets) has not been explored in detail. Third, being a qualitative study, we have not investigated the significant implications of CSR contracting regarding financial and social-environmental corporate performance. Finally, further investigation is needed at the company-level to detect whether and how sustainability is effectively integrated into a company's strategy and, therefore, whether and how organisational processes can pursue sustainable objectives together with financial ones.

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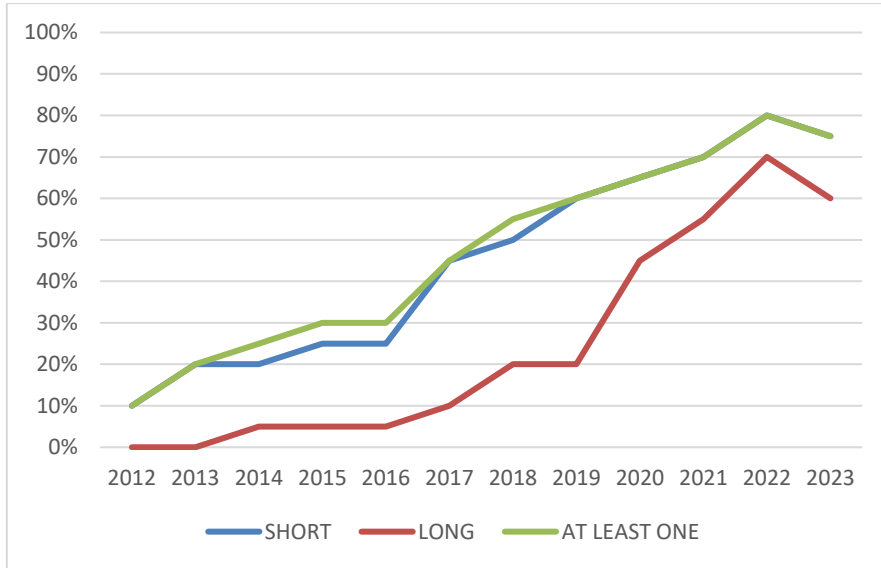


Figure 1. The percentage of companies adopting CSR contracting in variable remuneration. Source: Authors' elaboration

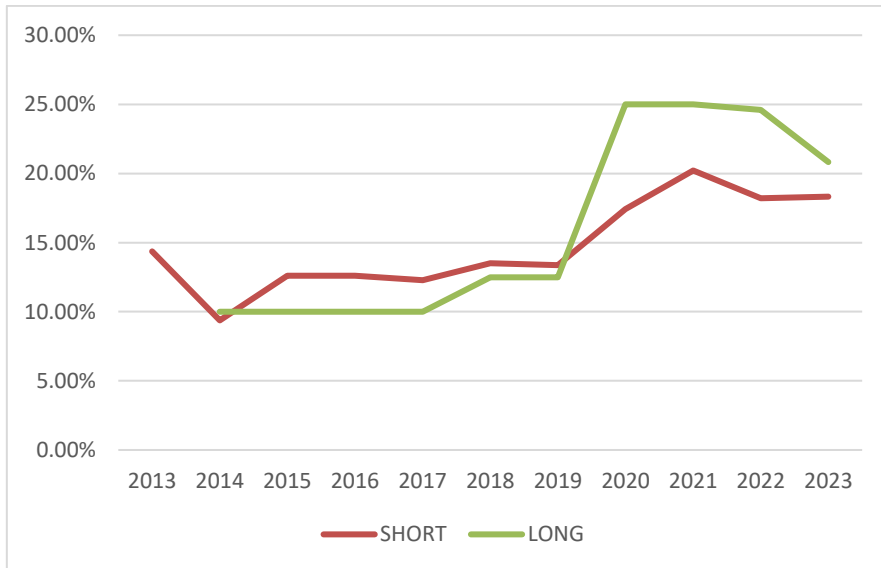


Figure 2. The weight of CSR contracting as a percentage of variable remuneration. Note: 2012 is omitted in the graph as none of the companies adopting CSR contracting disclosed the weight of sustainability-related KPIs in both short- and long-term incentive plans. 2013, for long-term plans only, is missing for the same reason. Source: Authors' elaboration.



Figure 3 (Panel A). A breakdown of the KPIs adopted each year in short-term variable remuneration plans. Environmental, Social and Governance categories are defined according to the classification of Principles for Responsible Investment (2012). Source: Authors' elaboration.



Figure 3 (Panel B). A breakdown of the KPIs adopted each year in long-term variable remuneration plans. Environmental, Social and Governance categories are defined according to the classification of Principles for Responsible Investment (2012). Source: Authors' elaboration.

Table 1. The definition and a real-life example of items analysed, related to CSR contracting.

ITEM	DEFINITION	EXAMPLE (FROM A REPORT)
Motivation	It expresses the reason behind CSR contracting	PRYSMIAN, 2022, long-term plan: “It fosters the alignment of interests towards sustainable value creation in the mid-to long-term, reinforcing the retention of key resources”
Form of payment	Payment is either cash- or share-based	SNAM, 2017, long-term plan: “Plan with annual granting and three-year vesting period”
CSR contracting (and KPIs) weight	The portion of CSR contracting (and of their specific KPIs) within a specific incentive plan	A2A, 2021, short-term plan: “Sustainability (weight 23%)”
KPIs formula	The formula used to measure a KPI	ENI, 2018, short-term plan: “Severity incident rate: Total recordable injuries weighted for severity/hours worked x 1,000,000.”
KPIs target	The value or percentage to be reached	Terna, 2017, long-term plan: “Dow Jones Sustainability Index (DJSI) positioning: 100% is reached if the firm position is in the second decile of the index; Non inclusion in DJSI (0%), inclusion in DJSI (80%), position in the first decile of the index (130%), Positioning in the 1st decile of the index for all years of the Plan and inclusion into the “Gold Class” for at least one of the three years (150%).”
KPIs achievement	The degree of achievement of a specific result to which the payout is linked	Italgas, 2022, short-term plan. “Diversity and Inclusion: percentage of women in managerial positions at 31/12/2022. Target: 22%, Achieved: 24.7%”
Entry gate	A paramount financial or non-financial target whose achievement is fundamental to making the incentive applicable	Saipem, 2022, short-term plan: “Adjusted Net Financial Position at December 31, 2022 and Total Recordable Injury Frequency Rate at December 31, 2022”

Table 2 (Panel A). The evolution and main features of CSR contracting within short-term incentive plans.

Company	First Year of Adoption	Weight of CSR Contracting (evolution)	KPIs content	Target design	Target achievement
Enel	2012	from 5-10% range to 30%	mostly social KPIs used (e.g., injuries frequency rate)	provided since 2015 (min, target and max values)	mostly achieved at the target level or overachieved
Eni	2012	moved from 30% (in 2013) to 25%	since 2015, one social (related to incident rate) and one environmental (GHG emissions intensity) KPI used	mostly expressed as a multiplier in relation to fixed remuneration	mostly achieved and expressed as a performance score (not the actual value)
Saipem	2012	from 10% to 20%	many KPIs used, mostly social (e.g., total recordable injuries frequency rate) and environmental-oriented (e.g., GHG emissions)	not provided	mostly achieved at the target level or overachieved. Information provided, in particular, since 2019
Snam	2013	from 10% to 20%	both social (e.g., injury frequency rate) and related to the inclusion and positioning in sustainable indexes (e.g., FTSE4GOOD)	provided since 2014 (first only target values, then also min and max), with targets communicated ex-post	mostly achieved at above target levels
Buzzi Unicem	2015	always 8%	one social KPI: lost time injury frequency rate	not shown for confidential reasons	first not provided, then since 2020, achieved
A2A	2017	moved from 5% to 23%	at first, generically related to sustainability, then more specific with social (e.g. D&I) and environmental dimensions	mostly unavailable in the remuneration policy and disclosed since 2021, in the year of achievement	mostly overachieved and shown as a deviation from the target value (target = 100%)
Italgas	2017	from 15% to 25%	mostly social and environmental-oriented (e.g., injury frequency rate, energy intensity)	provided since 2021 (min, target and max)	mostly achieved and expressed as a performance score or the actual value
Prysmian	2017	from 10-15% range to 20-30% range	mostly social-oriented (e.g., % women hired; injuries frequency rate)	provided since 2020 as a target range	provided since 2020, mostly achieved and shown as the actual value achieved

Terna	2017	from 15% to 25%	mostly social-oriented (on workplace safety)	mostly provided (min, target and max values)	mostly overachieved and shown as a deviation from the target value (target = 100%)
Finmeccanica/ Leonardo	2018	10%	first inclusion in the DJSI, then injury frequency rate added	ON/OFF target or provided as a target value	sometimes not provided, sometimes achievement disclosed
Moncler	2018	constantly 10%	mostly unclear, based on the sustainability plan	not provided	not provided
Pirelli	2019	from 10% to 15%	mainly two KPIs used: the value of the 'green performance' revenues and D&I (women hiring objective)	not provided	not provided
Telecom Italia	2020	from 20% to 22%	mostly social-oriented (e.g., employee engagement) and on customer satisfaction	provided (min, target and max values), with targets communicated ex-post	achieved mostly at the target level or overachieved
Atlantia	2021	constantly 20%	based on the internal ESG agenda and the external rating of ESG performance	not provided	not provided
Recordati	2022	always 5%	vaguely expressed: ESG initiative linked to sustainability plan	not provided for confidential reasons	mostly yes (ON/OFF)
Diasorin	2023	always 10%	vaguely related to the ESG strategic plan	ON/OFF target	not available info (plan too recent)
Salvatore Ferragamo	2023	constantly 20%	mainly environmental-oriented (e.g., improvement on recycled material)	mostly provided as the target value	not available info (plan too recent)

Table 2 (Panel B). The evolution and main features of CSR contracting within long-term incentive plans.

Company	First Year of Adoption	Weight of CSR Contracting (evolution)	KPIs content	Target design	Target achievement
Pirelli	2012	from 10% to 20%	until 2021, only related to positioning in ESG indexes, then environmental KPIs added (CO2 emissions reduction)	not always provided (e.g., for confidential reasons)	mostly unclear info
Terna	2016	from 10% to 15%	inclusion in ESG indexes	mostly provided (min, target and max values)	achieved
Snam	2017	from 10% to 20%	first only environmental-related, then a social KPI added (on gender gap)	mostly provided (min, target and max values)	achieved
Enel	2018	from 10% to 25%	first only environmental KPIs (until 2020), then 1 social and 1 environmental	provided (min, target and max values)	achieved
Buzzi Unicem	2020	constantly 50%	one environmental KPI used: CO2 emissions intensity	mostly not provided	mostly not available info (plan too recent)
Eni	2020	constantly 35%	only environmental KPIs used (e.g., related to circular economy)	provided (min, target and max values)	not available info (plan too recent)
Italgas	2020	from 15% to 20%	first on indexes' inclusion and environmental-related, then environmental-related only (e.g., reduction of CO2 emissions)	mostly provided (min, target and max values)	not available info (plan too recent)
Moncler	2020	constantly 15%	first only environmental KPIs (until 2021), then also related to diversity and the inclusion in ESG indexes	mostly provided (min, target and max values)	not available info (plan too recent)
Prysmian	2020	from 20-30% range to 20%	both social (e.g., leadership index) and environmental (e.g., recycled waste) KPIs	mostly provided as a target range	mostly achieved
Atlantia	2021	constantly 30%	both environmental (e.g., carbon footprint) and social (e.g., work safety)	first mostly not provided, then provided as a target value	not available info (plan too recent)

Finmeccanica/Leonardo	2021	constantly 20%	always 1 social (related to female new hires) and 1 environmental (related to emissions' intensity)	provided as a target range	not available info (plan too recent)
A2A	2022	constantly 20%	environmental-related, on renewable sources	provided (target = 100%)	not available info (plan too recent)
Telecom Italia	2022	from 30% to 20%	1 social-oriented and 1 environmental-oriented KPI	provided (min and max deviations from target)	not available info (plan too recent)
Saipem	2023	constantly 20%	both social (e.g., on D&I) and environmental-oriented (e.g., avoided GHG emissions)	not provided	not available info (plan too recent)
Salvatore Ferragamo	2023	constantly 20%	both social- (e.g., on gender pay gap) and environmental-oriented (e.g., renewable energy)	provided (min, target and max values)	not available info (plan too recent)