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CEOs' Debt-Based Compensation and Stakeholder Incentive Alignment: The Relationships Between CEO Inside Debt, CSR and Firm Performance

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ABSTRACT

We explore the incentive alignment qualities of CEO debt-based compensation – also known as CEO inside debt – by examining the consequences of CEO inside debt for multiple stakeholders, including employees, community, customers, suppliers, debtholders and shareholders. We argue contractual mechanisms that create long-term debt obligations to the CEO result in more investment in corporate social responsible (CSR) and that the combined effect of CSR investments and CEO inside debt accentuates the future multi-year performance, particularly in situations where firms suffer pressure from financial and/or product markets. This suggests that CEO inside debt results in greater incentive alignment between the CEO and different stakeholders in a way that enhances long-term economic value, ensuring that shareholders also benefit. This suggests CEO inside debt incentivizes the CEO to nurture multiple stakeholder relationships, delivering a balanced approach that appears to address the shortcomings attributed to other forms of incentives, such as stock and stock options. This provides the insight that CEO inside debt leads to a management approach that delivers shared value: the creation of economic value that appeases shareholders by investing in employees, community and the environment. We conclude that deserves more attention from governance scholars and boards who are attempting to incentivize a longer-term multi-stakeholder orientation.

KEYWORDS Inside debt; Incentive alignment; CSR; Executive compensation; Financial performance

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