High Pay Centre briefing: using pay ratio disclosures to inform ESG strategies and stewardship practices

Introduction

This briefing provides some information and ideas on how investors can use the new pay ratio disclosures that now appear in UK-listed companies' annual reports.

The ratios set out how pay is distributed across the company's UK employees, showing the pay for the CEO plus that of the upper quartile, median and lower quartile employee (on a full-time equivalent basis).

This provides an interesting new insight for investors into the business models and corporate cultures of the companies they invest in. It enables comparisons in pay between not just the CEOs of similar companies, but also of their employees, and enables measurement of employees' pay against recognised benchmarks such as the Real Living Wage, as calculated by the Living Wage Foundation.

Companies associated with low-paid work are at higher risk of reputational problems, as well as industrial disputes and employee engagement issues such as higher staff turnover and absenteeism, higher recruitment and training costs and lower productivity. The pay ratio disclosures could help investors to better identify where these risk factors are highest.

Our briefing sets out how investors can use the pay ratio disclosures in a one-page summary providing recommendations for:

- **Monitoring** pay ratio disclosures in annual reports;
- **Engagement** with companies whose disclosures provide grounds for concern;
- **Voting** at the AGMs of companies when engagement fails to achieve a progressive resolution.

The briefing also provides a summary of data from the first pay ratio disclosures, published in 2020, as well as recent CEO pay awards, that may be useful in terms of benchmarking pay levels reported in 2021. It also sets out the High Pay Centre view on prevailing pay practices, and the heightened case for treating inequality as a systemic risk, and for more active investor stewardship over fair pay as we (hopefully) exit the pandemic.

We hope that investors will find the recommendations and the data to be a useful complement to their stewardship activities. If you are interested in discussing further, please contact Luke Hildyard at the High Pay Centre via luke.hildyard@highpaycentre.org

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Summary of recommendations for investors

1) **Monitoring:** The pay ratios provide new data in annual reports on how pay is distributed across the company's UK employee population. This is potentially significant to investors, who should monitor:

   a. How pay for low and middle earners at investee companies compares to other comparable companies/industries; or to recognised benchmarks, such as the Real Living Wage calculated by the Living Wage Foundation?
   b. Whether annual reports provide sufficient detail on how the company distributes pay between low, middle and high earners; and on the extent of use of indirectly employed workers, and their pay and conditions.
   c. Whether reporting provide sufficient detail on how pay is set; who feeds into the decision; how pay differentials are communicated to the workforce; and future pay expectations

2) **Engagement:** It is not necessarily the case that companies with the widest pay gaps or lowest-paid employees are the worst employers. But questions should be asked of companies that fall into these categories, or that fail to report fully, including:

   a. What is the basis for the wide pay gaps and low-pay levels at the company in question, and how does this link to business strategy?
   b. How is pay set at the company in question, who feeds into the process, how are pay differentials communicated and what will future pay levels look like?
   c. What pay and conditions are offered to indirectly employed workers?
   d. Can trade unions, the best mechanism for ensuring fair working conditions and respect for employment rights and protections, organise freely at the company in question? Is pay negotiated through a collective bargaining process that ensures fair treatment and representation for all workers?
   e. What metrics – for example staff turnover or absenteeism – are used to measure the possible impact of pay practices on employee engagement?

3) **Voting:** Pay ratios are a recent innovation and we recommend engagement as the best means of improving practice. However, if companies are unable to justify low pay levels or wide ratios, investors should use their votes at AGMs to vote against:

   a. The remuneration report detailing the pay ratios.
   b. The re-election of the Chair of the Remuneration Committee, who has ultimate responsibility for pay practices.
   c. The re-election of the director responsible for workforce issues, who should be ensuring fair treatment and workplace voice for the company's workforce.

AGM Season 2021: Pay and the Pandemic

This section of the briefing is intended to help investors scrutinising and voting on corporate pay practices over the 2021 AGM season by providing some historical context to the awards.

The appropriateness of pay packages announced in 2021, which relate to the period including considerable business disruption as a result of the Covid 19 pandemic, can be judged in part by how they compare to past awards.

CEO pay awards are published in arrears, so the figures reported in this briefing were announced last year and relate to 2019. Similarly, those reported in 2021 will relate to 2020.

CEO pay last year - Median FTSE 100 pay: £3.61 million

The 2020 High Pay Centre and CIPD annual assessment of FTSE 100 CEO pay packages showed that median pay in 2019 fell by 0.5%, to £3.61m, from £3.63m the previous year. Pay of £3.61 million is roughly 119 times the earnings of the median UK full-time worker at £30,353.

A £3.6m median pay award - controversially high, even in a year not disrupted by the pandemic - is a useful benchmark to bear in mind when considering how to vote on pay packages awarded in 2020.

The biggest CEO to employee pay gaps

New requirements requiring Britain's biggest companies to publish the pay gap between their CEOs and low and median earning employees came into force in 2020. These apply to all UK listed companies with 250+ employees.

The pay ratios can be used to calculate averages across industries. Typical ratios should not be seen as a target by companies – many people would argue that pay ratios are too wide across the board. However, the companies with the widest gaps in their sector might be priority concerns for investors.

Excessive CEO pay awards and wide pay ratios could lead to reputational issues for the company in question, and may cause resentment across the workforce. At many companies, substantial payments to CEOs – particularly when coupled with pay for other high earners – have significant opportunity costs.

If a proportion of this expenditure were re-directed to pay for lower earners; or to investment in innovation or productivity; it might be considered a more worthwhile use of scare resources

Table 1: Average pay ratios and lower quarter pay across industries (2020)

Industry	Average CEO/median employee ratio	Average lower quartile pay threshold
Banks	88	34,100
Basic Materials	43	32,094

Construction & Materials	75	27,408
Consumer Goods	62	31,672
Financial Services	35	44,486
Health Care	87	35,071
Industrial Goods & Services	71	27,501
Insurance	59	34,222
Media	71	33,849
Oil and Gas	81	40,704
Real Estate	47	30,256
Retail	140*	17,993
Technology	39	33,290
Telecommunications	49	30,472
Travel & Leisure	82	21,607
Utilities	56	32,917

*Retail ratio does not include Ocado, an outlier with a CEO to median employee ratio of 2,605 :1

Companies with the lowest-paid employees

The pay ratio disclosures also enable calculations of pay at the lowest quartile of the company's UK employee population.

This information is as important to investors as the data on CEO pay. It shows the extent to which companies value their workforce compared to comparable organisations, and can also be compared to recognised benchmarks such as the Real Living Wage as calculated by the Living Wage Foundation. This stands at £9.50 an hour in 2021, equivalent to an annual salary of £17,290 based on a 35 hour week.

Companies with lower-paid employees may suffer from poorer employee engagement, higher staff turnover, worse industrial relations or additional reputational risk.

Historic low-pay levels can be used to compare against the levels reported in 2021, to see how the Covid 19 pandemic has affected low pay across major UK employers, as well as providing an indicator of which companies are likely to emerge as Britain's lowest payers.

The companies with the lowest-paid lower quartile employees across sectors last year are detailed in Table 2. Companies with the lowest pay levels in corporate Britain are particularly likely to face criticism of their pay practices. Pay levels may also have an impact on employee engagement and commitment.

Table 2: Companies with the lowest-paid low-paid employees (2020)

Company	Index	Industry	Lower quartile threshold
Mitchells and Butlers	100	Travel and Leisure	£14,014
Associated British Foods	100	Retail	£14,175
WH Smith	250	Retail	£14,276
Homeserve	250	Consumer Services	£14,493
Wetherspoons	250	Travel and Leisure	£14,760
Telecom Plus	250	Telecommunications	£15,632
JD Sports	100	Retail	£16,067
Domino's Pizza	250	Travel and Leisure	£16,264
William Hill	250	Travel and Leisure	£16,268
Dunelm	250	Retail	£16,409

Companies that have drawn on public money during the Covid-19 crisis

Many companies have drawn on government support, such as the Coronavirus Job Retention Scheme (furlough); the Bank of England 'Covid-19 Corporate Financing Facility' or the Large Business Interruption Loan Scheme.

While the furlough scheme is used to pay employees rather than companies, it still amounts to a huge support mechanism for companies. It has enabled major savings on wage costs, potential redundancy costs or of their own furlough arrangements. It should also mean trained/experienced staff are ready to return to work when the lockdown is lifted. The certainty offered by the furlough programme has also created space for business leaders to concentrate on other pressing issues. Therefore, excessive executive pay awards at companies that have taken advantage of the scheme may be particularly controversial.

The Government has not published a comprehensive list of companies that have received money through the furlough scheme. Therefore, our record of FTSE 350 firms that have done so, based on public announcements and media reports, is potentially non-exhaustive:

Table 3: FTSE 350 Companies that have used the furlough scheme

Company	Index (at Q3 2020)	Industry
Associated British Foods	100	Consumer Goods
Compass	100	Industrial Goods & Services
GVC Holdings	100	Travel & Leisure
Intercontinental Hotels	100	Travel & Leisure
International Airlines	100	Travel & Leisure
Intertek	100	Industrial Goods & Services
JD Sports	100	Retail
Melrose	100	Industrial Goods & Services
Next	100	Retail
Rentokil	100	Industrial Goods & Services
Rolls Royce	100	Industrial Goods & Services
Whitbread	100	Travel & Leisure
Aston Martin	250	Industrial Goods & Services
Babcock	250	Industrial Goods & Services
Balfour Beatty	250	Construction & Materials
Biffa	250	Industrial Goods & Services

C&C	250	Consumer Goods
Capita	250	Industrial Goods & Services
Centrica	250	Utilities
Cineworld	250	Travel & Leisure
Dixons Carphone	250	Retail
EasyJet	250	Travel & Leisure
Firstgroup	250	Travel & Leisure
Fisher	250	Industrial Goods & Services
G4S	250	Industrial Goods & Services
Grafton Group	250	Industrial Goods & Services
Greencore	250	Consumer Goods
Greggs	250	Retail
Hays	250	Industrial Goods & Services
Ibstock	250	Construction & Materials
Inchcape	250	Industrial Goods & Services
ITV	250	Media
IWG	250	Industrial Goods & Services
Marks and Spencers	250	Retail
Meggitt	250	Industrial Goods & Services
Mitchells and Butlers	250	Travel & Leisure

Morgan Advanced Materials	250	Industrial Goods & Services
National Express	250	Travel & Leisure
PageGroup	250	Industrial Goods & Services
Petrofac	250	Oil and Gas
Polypipe	250	Construction & Materials
Rank Group	250	Travel & Leisure
SSP Group	250	Travel & Leisure
Trainline	250	Travel & Leisure
TUI	250	Travel & Leisure
Wetherspoon	250	Travel & Leisure
WH Smith	250	Retail
Wood Group	250	Oil and Gas

Table 4: FTSE 350 companies who have benefited from the Bank of England Covid Corporate Financing Facility

Company	**Index (at Q3 2020)**	**Industry**
Intercontinental Hotels	100	Travel & Leisure
International Airlines	100	Travel & Leisure
Rolls Royce	100	Industrial Goods & Services
Firstgroup	250	Travel & Leisure
G4S	250	Industrial Goods & Services

Petrofac	250	Oil and Gas
SSP Group	250	Travel & Leisure
Burberry	100	Consumer Goods
Paragon Banking Group	250	Financial Services

The High Pay Centre view

Pay practices in the aftermath of the Covid 19 crisis are an important issue for investors. Ensuring that CEO pay awards are fair, proportionate and not excessive, and that low earners have enough to live on will be critical to public perceptions of both individual businesses and the investors that invest in them.

Pay distribution is also material to the success of the UK economy, on which UK-based investors depend. With the economy likely to be much smaller than envisaged for the foreseeable future, how we share the wealth we do have will become increasingly important. Cuts to CEO pay could be used to protect at-risk jobs or raise the pay of the low wage workers who have helped the country function during the crisis. When one considers very high earners in addition to the CEO, there is actually quite significant potential for companies to safeguard jobs and incomes by asking very highly-paid staff , by which we mean those earnig close to or over the threshold for the top 1% of earners in the UK, to make sacrifices.

Pay awards reported over the coming months will undoubtedly show CEOs taking pay cuts as demonstrations of solidarity with their staff and wider public, but we should ask whether these are sufficient. A pay package of £150,000 would put the recipient in the top 1% of UK earners, so there ought to be scope to pay CEOs more modestly than the current FTSE 100 median of £3.6 million, while still ensuring they remain very generously rewarded for taking on demanding jobs.

There has been a widespread recognition of the need to pay the low-paid workers who have helped the UK through the pandemic a wage that reflects their true value to society, and to address the inequalities that continue to afflict our country. By holding investee companies to account over pay practices, the investment industry has a vital role to play in this work.

Further reading

- High Pay Centre/CIPD annual FTSE 100 CEO pay review - https://highpaycentre.org/hpc-cipd-annual-ftse-100-ceo-pay-review-ceo-pay-flat-in-2019/

- High Pay Centre analysis of the first FTSE 350 pay ratio disclosures - https://highpaycentre.org/pay-ratios-and-the-ftse-350-an-analysis-of-the-first-disclosures/

- Research from University College London suggests that the pandemic is widening financial inequality - https://b6bdcb03-332c-4ff9-8b9d-28f9c957493a.filesusr.com/ugd/3d9db5_10010a26414a4f6eafeea8b24fd89936.pdf

- Research from the Resolution Foundation suggests that the share of total incomes accruing to the richest 1% in the UK is greater than previously thought - https://www.resolutionfoundation.org/app/uploads/2020/05/Who-gains.pdf

- Research from the Paris School of Economics suggests that pre-tax incomes are more critical determinants of differences in inequality between countries than tax levels - https://voxeu.org/article/pre-distribution-versus-redistribution

- A paper from the Trades Union Congress, setting out the case for workplace voice in corporate governance structures, and for setting workforce pay through collective bargaining agreements negotiated with trade unions – https://www.tuc.org.uk/research-analysis/reports/stronger-voice-workers