CORPORATE BRITAIN AND COVID-19

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Introduction

Corporate Britain and Covid-19

The Covid-19 pandemic and resulting economic turmoil have made the contentious issue of executive pay levels - and the corporate governance and investor stewardship practices that determine them – more sensitive than ever.

The crisis saw the UK economy contracted by 9.4% in 2020, during the peak of the pandemic, and left real household incomes falling even as the recovery took hold in 2021-2022.[1] The Government was forced to provide billions of pounds worth of public money to support business throughout the period.

Box 1: Support schemes from which businesses benefited include:

- The Coronavirus Job Retention Scheme (furlough) estimated to have cost £70bn
- Various business interruption loan schemes, with a total value of £80bn of loans guaranteed by the state
- The Coronavirus Corporate Finance Facility managed by the Bank of England, which at its peak held £18bn of corporate debt
- Tax relief from business rates worth £11bn
- VAT deferrals with £33bn worth of payments deferred
- Grants for small businesses and companies in the retail, hospitality and leisure industries totalling £11bn.[1]

[1] House of Commons Library, *GDP – International Comparisons: Key Economic Indicators*, February 2022 via https://commonslibrary.parliament.uk/research-briefings/sn02784/

Beneficiaries of these measures included some of the UK's biggest businesses. When the High Pay Centre analysed early uptake of the furlough scheme alone in May 2020, we found that nearly a quarter of FTSE 350 companies had taken advantage of the scheme.[2]

Beyond direct recipients of funding, there have been scarcely a business in the country that did not indirectly benefit from the support provided to jobs, incomes and companies that enabled economic activities to continue to a much greater case than would otherwise have been the case.

Executive pay and the pandemic

Prior to the pandemic, average pay for a typical FTSE 100 CEO stood at around £4.5 million, nearly 150 times the pay of the median full-time worker in the UK, compared to roughly 70 times in 1999 and between 10 and 20 times at large companies at the start of the 1980s.[3]

Dependency on support from public money; wider hardship experienced by workers losing their jobs or being furloughed on reduced pay; and of course

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[2] High Pay Centre, *How are UK-listed companies responding to the economic shutdown,* April 2020 via https://highpaycentre.org/wp-content/uploads/2020/08/report_copy.pdf

[3] Median CEO pay, which is a better measure of typical pay levels, was £3.3 million roughly 107 times the median worker in 2019, however we do not have data to make accurate long-term historical comparisons. For figures on mean pay see High Pay Centre, *What happened to CEO pay in 2020?*, August 2021 via https://highpaycentre.org/wp-content/uploads/2021/08/CEO-pay-report-2021-web-copy.pdf (p6); High Pay Centre, *Why Champions of free markets should worry about executive pay*, May 2019 via https://highpaycentre.org/wp-content/uploads/2020/08/Shackleton-Top-Dogs-Chap-2.pdf (p17) and High Pay Commission, *Cheques with Balances: Why tackling high pay is in the national interest* (November 2011) via https://highpaycentre.org/wp-content/uploads/2020/10/Cheques_with_Balanceswhy_tackling_high_pay_is_in_the_national_interest.pdf (p9)

the huge public health emergency created a potential moral issue around the appropriateness of very high executive pay awards. More pragmatically, at a time of considerable (and still ongoing) uncertainty, pay for top earners is one area where businesses could potentially make significant savings to strengthen their financial resilience. For most companies, staff costs will be amongst their biggest (if not their single biggest) expenses. Top earners represent a disproportionately large element of those costs, and many executives and senior managers already enjoy significant personal wealth and can therefore afford to sacrifice further earnings without compromising their lifestyle.

Therefore, while every business will have its own individual circumstance, it is reasonable to take executive pay cuts, whether intended as a gesture of solidarity or prudence or a combination of the two, as a general indicator of a responsible business with good governance/investor stewardship and a focus on both its long-term resilience and societal expectations of business conduct.

As such it is useful to understand:

- ***Which businesses*** reduced executive pay as a result of the pandemic, why they did so, and to what extent?

- What were the particular ***characteristics of these firms***?

Our research

Methodology

In order to understand which firms had cut executive pay and by how much, a team of academics from the Open University (UK), University of Nottingham (UK) and Western University (Canada) analysed over two thousand news, announcements and reports on the Regulatory News Service (RNS) from March to May 2020 made by largest UK companies, i.e. those with a market capitalisation of over £500 million. Banks and financial firms were excluded from the analysis because there was a quasi-regulatory announcement from the Bank of England calling for these firms to take certain measures in the light of the pandemic, including reductions in bonus payments for senior staff. In total, 216 firms were included in the final sample.

The corporate governance and stewardship characteristics of these firms that the academics analysed were:

- ***Female representation*** on the corporate board
- Ownership by ***institutional investors*** (pension funds and asset management firms).

The relationship between boardroom diversity and executive pay reductions during the pandemic is a subject of considerable relevance that can add to the debate about the impact of greater female board representation on firm performance, governance and sustainability[4].

Asset management firms and pension funds represent two of the largest classes of investors, and can generally be considered as independent of management. A significant number of asset managers and pension funds are signatories to the Financial Reporting Council's 'Stewardship Code' committing them to active engagement with investee companies. Therefore, they are potentially a more independent, objective and engaged arbiter of whether executive pay levels are appropriate or proportionate than other investors. If they are more or less likely to endorse executive pay reductions that could strengthen or weaken the argument that such reductions were necessary[5].

Data on board representation and share ownership was gathered from BoardEx and Execupcomp, institutional ownership data was from Eikon and accounting and financial data was from Worldscope.

Finding: Executive pay cuts

Slightly less than half of the firms in the sample (104 out of 216) take at least one measure to reduce executive pay as a response to Covid-19.

[4] See e.g., Cook, A., Ingersoll, A. R. and Glass, C. (2019) "Gender gaps at the top: Does board composition affect executive compensation?.", *Human Relations* 72, 1292-1314; Main, B.G. and Gregory-Smith, I. (2018). "Symbolic management and the glass cliff: Evidence from the boardroom careers of female and male directors." *British Journal of Management*, *29*(1), pp.136-155.

[5] Asset management firms are found to be instrumental in corporate decisions to cut back shareholder payout as a result of the pandemic (Ataullah, A, Le, H. and Wood, W. "Institutional investor heterogeneity and corporate response to the Covid-19 pandemic", *British Journal of Management.* https://onlinelibrary.wiley.com/doi/full/10.1111/1467-8551.12601).

A firm's decision to cut salaries across the whole workforce is not considered as executive compensation reduction. Pay reductions, if applied to executives only, include at least one of the followings:

- cutting directors' base salaries
- directors forgoing pay increases or cancellation of pay increases
- cutting bonuses
- directors forgoing bonuses or cancellation of bonuses

Even within these components, the size and duration of the pay cuts varied substantially. Some firms had a higher level of reduction for certain directors (for example CEOs and chairmen) or reduced compensation of executive directors only. 78 firms specifically mentioned reduction relating to salaries while only 29 mentioned reduction relating to bonuses.

In some firms, reduction in executive pay was stated as directors' voluntary actions while in others it was part of corporate policy. Most firms refer to 'conserve cash' or 'strengthen liquidity' as the main reason for their actions. Some firms specifically link the reduction in executive compensation to the adverse impact of Covid-19 on their employees[6].

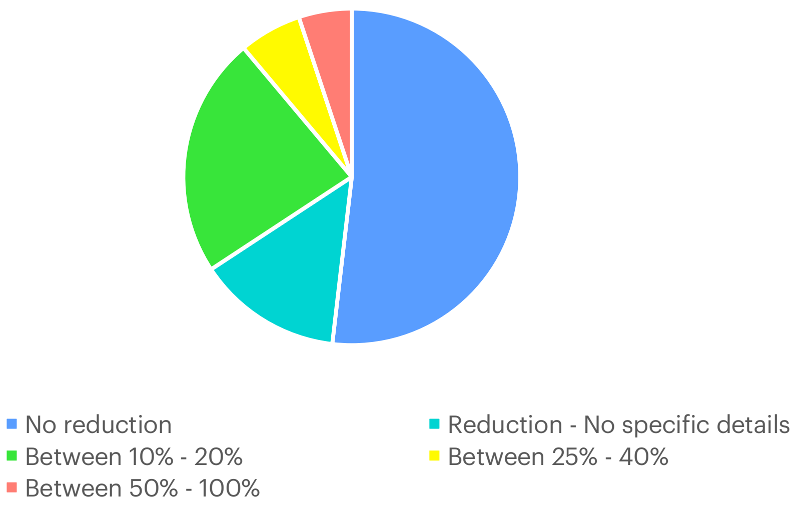
[6] For example ABF, Computacenter and Essentra.

Based on the details of announcements on Covid-19-related executive compensation decisions, firms were put into five broad groups:

- no reduction
- some reduction but no specific details
- reduction at least between 10% to 20% of base salaries
- reduction at least between 25% to 40% of base salaries
- reduction at least between 50% to 100% of base salaries.

Figure 1 shows that amongst those firms that reduced pay (which represents less than half of the full sample), a reduction of between 10% to 20% of base salaries was the most common action (by 50 firms) while reduction between 50% to 100% salaries was the action chosen by only 11 firms.

Figure 1 - Executive Pay Reduction by Large UK Firms in Response to Covid-19

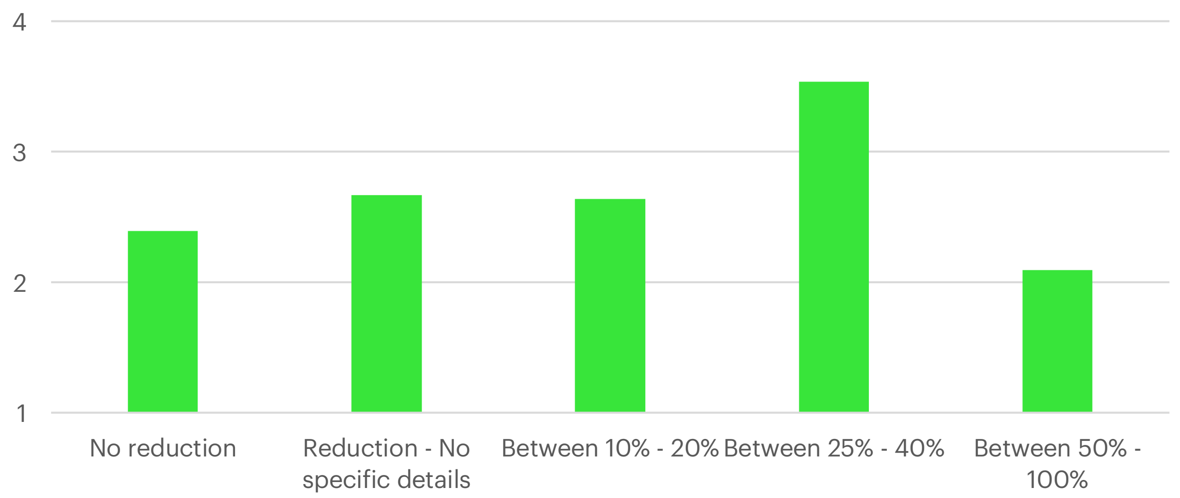


Finding: Women on boards

On average, firms that reduced executive pay have more female directors than firms that did not, with firms that reduced at least between 25% to 40% of base salaries having the most female directors. However, firms that reduced pay most significantly had the lowest female representation of all.

Figure 2 compares the average number of female directors in firms with decisions to cut pay in the five groups of firms.

Figure 2 - Average Number of Female Directors on the Boards of Large UK Firms and Executive Pay Reduction in Response to Covid-19

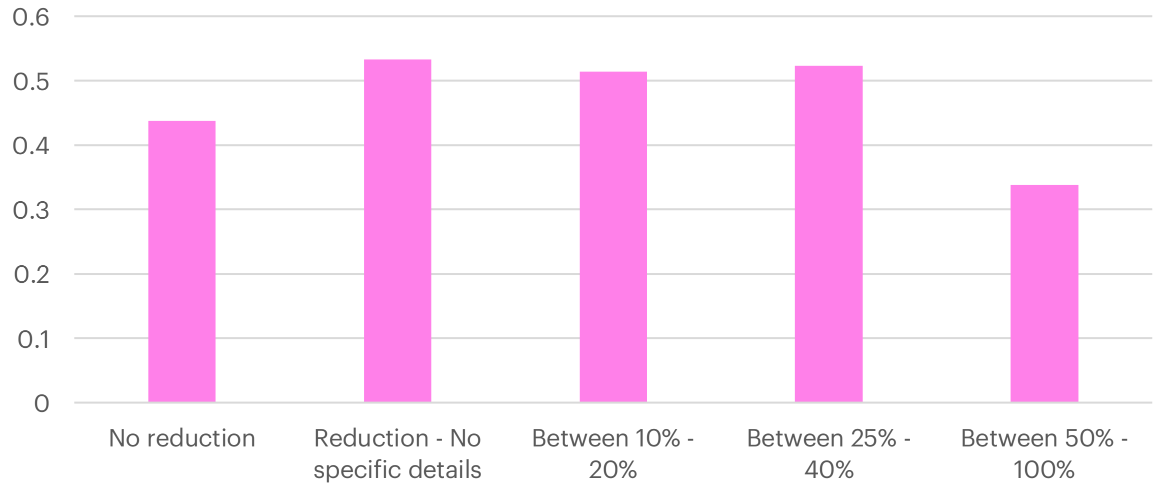


As correlation is not the same as causation, this finding does not establish a link between female board representation and Covid-related cuts in executive pay, never mind greater sensitivity to societal concerns and egalitarian pay practices more generally. However, the fact that firms with greater female representation generally made more substantive executive pay cuts suggests that a relationship between these two characteristics could merit further exploration.

Institutional ownership

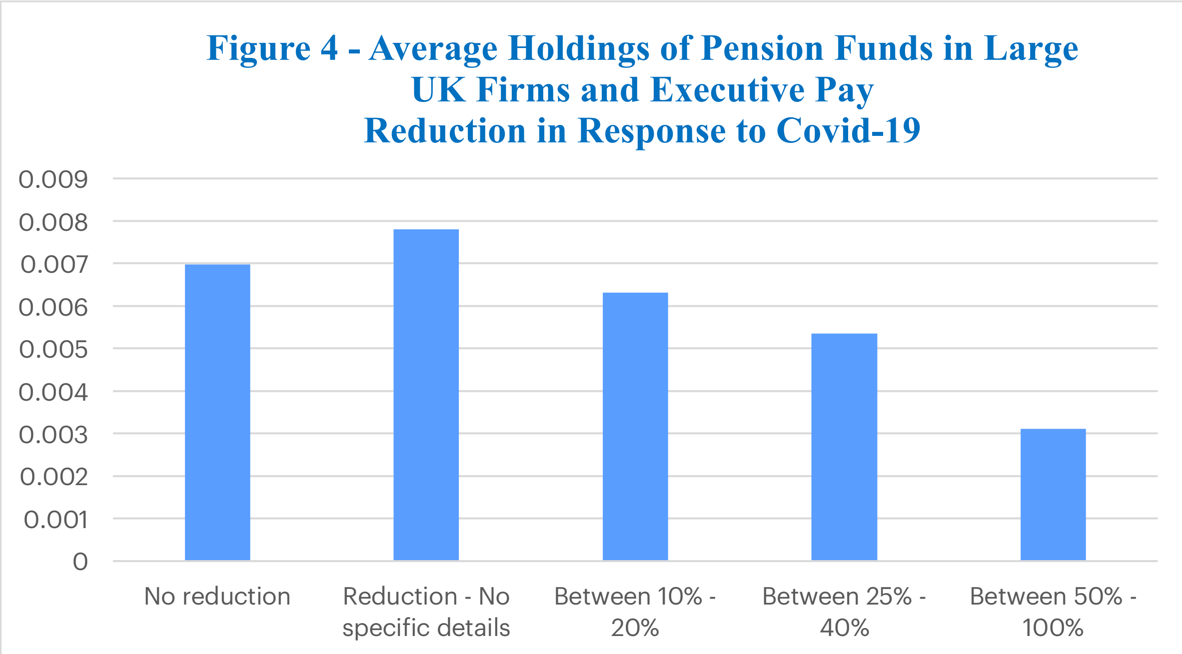
Figure 3 shows that on average, firms that reduced executive pay have higher ownership by asset management companies than firms that did not, although as with female board representation, firms that made the most significant cuts to executive pay have lower than average institutional holdings.

Figure 3 - Average Holdings of Asset Management Companies in Large UK Firms and Executive Pay Reduction in Response to Covid-19



Again, this does not indicate that higher institutional ownership caused firms to cut pay, but it supports the possibility of a relationship between the two factors that could merit further research.

Looking at pension funds only, Figure 4 shows that the average shareholding in firms that reduced executive pay with no specific details is higher than the average ownership in firms that did not reduce. However, the average ownership in other groups of firms that reduced compensation is lower.



This confounds the initial proposition that a higher proportion of pension fund ownership could increase the chance of reductions in executive pay. One explanation for this could be that pension funds hold a smaller proportion of total shares than all institutional investors combined, so their influence over corporate behaviour may be more limited.

Multivariate analysis

To supplement these findings, the academic team conducted further analyses, this time using multivariate regressions controlling for variables, including *Firm Size, Sector, Leverage, Cash Reserves* and *Market-to-Book value*, as well as *Board Size* and *Board Salaries*, the latter is measured in two alternative ways: the average salary per director and the total salaries of all directors on the board.

Table 1 shows the results of these findings. Columns (1) and (2) use the average of board salaries while specifications (3) and (4) use the total board salaries. Specifications (1) and (3) only consider the role of female directors while specifications (2) and (4) also consider the role of two groups of institutional investors: *Asset Management Firms* and *Pension Funds.*

The positive and significant coefficients of *Female Directors* in all four specifications indicate that firms with higher presence of female directors are more likely to announce executive pay cuts in response to Covid-19.

The positive and significant coefficients of *Asset Management Firms* suggest that firms with higher holdings of investors that take a more active role in monitoring the management are more likely to announce executive pay cut in response to Covid-19.

The coefficients of *Pension Funds* are however statistically insignificant, suggesting that pension funds did not have impact on corporate decisions regarding Covid-19 related executive compensation.

Table 1: Executive Pay Cut Decisions in Response to Covid-19

	(1)	(2)	(3)	(4)
Female Directors	**0.144*****	**0.132*****	**0.144*****	**0.132*****
	(0.040)	(0.042)	(0.040)	(0.042)
Asset Management Firms		**0.130***		**0.129***
		(0.075)		(0.075)
Pension Funds		**-0.059**		**-0.059**
		(0.072)		(0.072)
Firm Size	-0.055	-0.032	-0.055	-0.032
	(0.040)	(0.043)	(0.040)	(0.042)
Leverage	-0.261	-0.225	-0.260	-0.224
	(0.171)	(0.173)	(0.171)	(0.173)
Cash Reserves	-0.479	-0.399	-0.479	-0.400
	(0.299)	(0.304)	(0.299)	(0.305)
Market-to-Book	-0.015**	-0.016**	-0.015**	-0.016**
	(0.006)	(0.006)	(0.006)	(0.006)
Board Size	-0.043*	-0.035	-0.041	-0.031
	(0.024)	(0.025)	(0.026)	(0.026)
Board Salaries_Average	-0.023	-0.039		
	(0.073)	(0.073)		
Board Salaries_Total			-0.021	-0.037
			(0.073)	(0.073)
Trade Sector	0.225**	0.233**	0.225**	0.233**
	(0.101)	(0.103)	(0.101)	(0.103)
Service Sector	0.117	0.131	0.117	0.130
	(0.094)	(0.095)	(0.094)	(0.095)
Utility Sector	0.084	0.105	0.083	0.105
	(0.110)	(0.110)	(0.110)	(0.110)
Other Sectors	0.073	0.112	0.073	0.111
	(0.103)	(0.102)	(0.103)	(0.102)
Constant	1.878***	1.363*	1.902***	1.407*

	(0.655)	(0.724)	(0.655)	(0.720)
N	216	216	216	216
R^2	0.109	0.122	0.108	0.122
F-stat	2.257^{**}	2.163^{**}	2.256^{**}	2.161^{**}

Conclusion

The findings provide strong evidence that higher levels of female board representation and institutional share ownership increased the likelihood of companies undertaking executive pay cuts at the outset of the Covid-19 pandemic. If we see reducing executive pay as an example of responsible, societally-oriented decision making, it could even be argued that these factors could contribute to more responsible business practice. However, some caveats remain: Firstly, the research provides strong evidence, rather than definitive proof, of a link between these factors and Covid-related executive pay cuts. Why institutional ownership and boardroom diversity might have made pay reductions more likely still needs to be discussed and understood, with any conclusions imported into business practice.

Secondly, the most common pay cut was just 10%-20% of base salary, with many firms restoring pay to previous levels after just three months. For a FTSE 100 CEO, the average base salary stood at £954,000 in 2020 with various bonus payments and share award schemes averaging a value of over £2 million. In this context, a 3-month, 10%-20% reduction in base salary does not represent a meaningful reduction in executive pay or saving for the company. It then follows that if greater institutional ownership or female representation on boards delivered only minor reductions in executive pay, other measures – for example greater worker involvement in ownership and strategic decision-making – may be necessary to deliver truly responsible businesses fully aligned with the interests of wider society.

About the authors

Ali Ataullah is Professor of Finance at the Open University Business School (UK). He is also the director of the centre for Public Understanding of Finance, Institutions and Networks (PUFIN). His research interests include corporate governance and productivity. His current research focuses on the role of institutional investors in determining firms' investment and financing policies, which, in turn, affect climate risk. He is also exploring the role that communities' social capital play in determining firms' investment and financing decisions. He has published in leading academic journals, including Abacus, Accounting and Business Research, British Journal of Management, European Financial Management, European Journal of Finance, Financial Review and Human Resources Management (US). He has acted as consulting academic for two BBC programmes. He is also an associate editor for the European Journal of Finance.

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