Coronavirus brings the corporate pay party to an end . . . for now

With dividends and bonuses slashed, investors and bosses are starting to feel the pain

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Roger Lawson dialled in and listened to directors of Rio Tinto answering questions about the mining giant's adherence to environmental targets. This was a first. Ordinarily, the experienced private investor would have attended the FTSE 100 company's annual meeting in the cavernous Queen Elizabeth II Conference Centre in central London last week, rubbing shoulders over tea and biscuits with fellow investors and watching the company's directors give presentations from the stage.

But the government ban on gatherings of more than two people to tackle the outbreak of Covid-19 means this year's meetings season is unlike any other.

Investors hope to be back at them in person next year. At that point, companies' response to the current situation — and pledges to rein in executive pay to show an understanding of the strains on broader society — will be scrutinised.

This looks set to be a crucial year for relations between companies, investors and communities. The Covid-19 health crisis has become an economic one and the government's shutdown has led to hundreds of billions of pounds in state support for businesses and employees.

Stock markets have plunged and corporate Britain is grappling with a cash crunch. Dividends are being axed and bosses are taking pay cuts in recognition of the economic upheaval.

The cuts affect a wide range of sectors and come in different forms. Dame Carolyn McCall, chief executive of ITV, will take 20% off her £923,000 salary during the period of the lockdown and waive any bonus. Andy Hornby, who runs The Restaurant Group, owner of Wagamama, did not receive the £98,000 bonus he was due last month and will take a 40% cut to his £630,000 salary for three months. Ryanair chief executive Michael O'Leary is taking a 50% cut to his pay for April and May; and in retailing, Paul Marchant, chief executive of Primark — owned by Associated British Foods — is also taking a temporary 50% hit to his pay.

For both executives and investors, the party is over — at least for the time being.

Rio Tinto is going ahead with its dividend payment this month. That is in stark contrast to the nearly 200 companies listed in London that have waived or suspended distributions.

The tally of abandoned payouts stands at £19.5bn, according to Russ Mould at AJ Bell, with almost £15bn from the FTSE 100. Intervention by the Bank of England means bank dividends have been put on hold and insurers left divided: while life insurer Legal & General is paying out, general insurer Aviva abandoned its dividend, worth £839m.

One City figure said general insurers had been "feeling very politically exposed because of the business interruption policies issue" — their refusal to pay out for Covid-19 related losses to corporate customers — explaining the gulf between insurers suspending dividends and those that might keep them, such as Phoenix, Standard Life and Prudential.

Companies that have taken support from government schemes are also expected to avoid paying dividends, at least in the short term. It poses a dilemma.

"Some people associate dividends with the wealthy getting wealthier," said Gervais Williams, who jointly runs an income fund at the investment firm Premier Miton, "but dividends go to pensioners and charities. Dividends are the cornerstone to ordinary people."

While some bosses have waived bonuses, taken cuts to salaries and made donations to charity, shareholders are on guard. Some companies are still issuing shares under long-term bonus schemes, including for executives who have taken cuts. And financial targets used to assess performance and executive pay are no longer valid because of collapses in equity prices and an inability to forecast results.

"The entire performance criteria basis for measuring and determining [share-based bonus] awards has been more or less destroyed — it's been ripped out from under us," said Roger Barker at the Institute of Directors (IoD).

Last week ISS, the body that advises shareholders on how to vote at annual meetings, issued new guidance. Any pay changes during 2020 may not be voted on until next year. It put companies on notice ahead of next year's season about their approach to annual bonuses through the year. "Many boards are likely to announce plans to materially change the performance metrics, goals or targets used in short-term compensation plans in response to the drop in the markets and the possible recession many economists now predict in the wake of the pandemic," ISS said in a new policy document, urging companies to explain now why they are making any changes.

ISS is also watching for a revamp of long-term incentive plans (Ltips): typically awards of shares that pay out in three or five years linked to performance. Moving the goalposts now, to make it easier for bosses to get awards or replace salary with shares, say, could store up problems for three years' time, when Ltips would typically start to pay out. By then, shares should have started to recover, meaning awards issued at today's bombed-out levels would be worth more.

"We are mindful about what's going to happen in three years," said Ashley Hamilton Claxton at fund manager Royal London Asset Management.

While speculation has mounted that companies will look at ways to redraw pay schemes quickly to ensure executives do not lose out, such attempts have not come to fruition — at least not yet.

And while investors have made it clear that companies axing dividends should inflict similar pain in the boardroom, they also have a more nuanced message.

The Investment Association, which represents the institutional community, last week wrote to the bosses of FTSE 350 companies promising to support British business through the pandemic.

Schroders has also written to "UK plc", setting out that where companies raise capital, dividends should be suspended and remuneration revisited. It also delivered another message: "In the short term, companies need to prioritise their key stakeholders, in particular employees, but also customers and suppliers."

Sacha Sadan at Legal & General Investment Management has written to bosses, encouraging them "to focus not only on shareholders, but on all of your stakeholders, most importantly your employees, as well as your supply chain relationships, the environment and the communities in which you operate".

Hans-Christoph Hirt of Federated Hermes thinks this is a moment for boards to look at the impact of the crisis on employees, customers and the supply chain. He reminded companies of their "social licence to operate" at a time when "all businesses will benefit directly or indirectly from government interventions".

“Ultimately, companies that will succeed in the aftermath of this crisis will probably be the ones that have looked at the stakeholders,” he said. It points to a difficult juggling act. Executive pay faces more intense scrutiny than usual, requiring remuneration committees to use more discretion over whether to hand out pay deals more typically created in a formulaic way. “Remuneration committees are cognisant of the difficulties right now,” said Richard Buxton, head of UK equities at Merian.

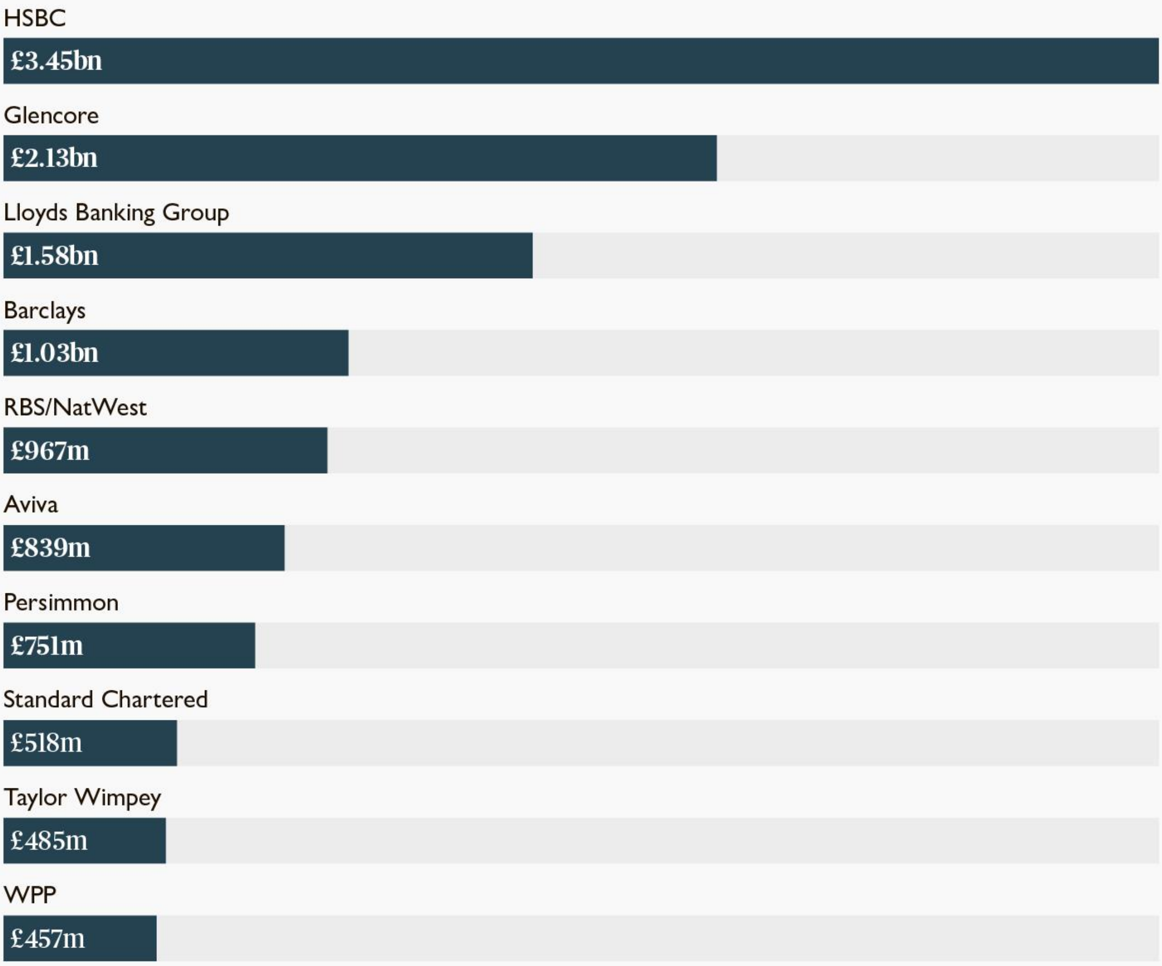
“It’s so encouraging to see boards and management teams offering salary cuts and no bonuses. People should really be using this crisis to reset the public’s suspicion of fat cats and big business.”

Companies that have carried on with share awards paying out in three years’ time have indicated they will reconsider amounts when they come to fruition. For instance, when Barclays issued shares to its directors last month at a price of 124p (they had been at 180p at the start of the year), it said the remuneration committee had “full discretion to ensure that the final outcomes are warranted based on the performance of the group in light of all relevant factors and that there have not been any windfall gains”.

Others have decided to wait until the dust settles before making awards. Retail landlord Hammerson is holding off issuing shares to executives through a new restricted shares scheme after its stock plunged from 200p at the start of March to little more than 82p now.

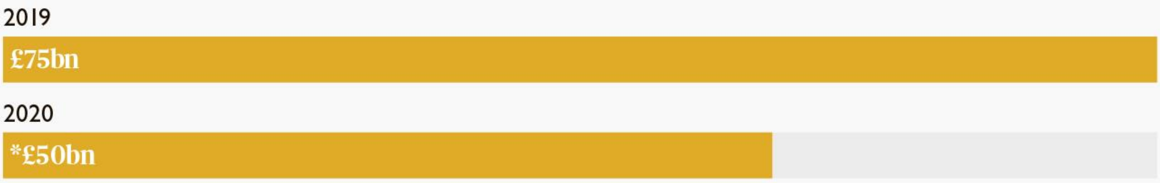
Taking a cut

The dividends dropped



Source: AJ Bell

Total FTSE 100 dividends



*Estimate. Source: AJ Bell

The pay surrendered



Some investors think restricted share schemes, less “geared” and less complex than traditional Ltips, could become more common when the crisis abates.

Companies are aware of their responsibilities. Simon Patterson, managing director at pay consultants Pearl Meyer, said: “Most boards want to do the right thing. Not only will we meet again, as the Queen said, we will remember how companies behaved at this time.”

In America, the $2 trillion relief package announced comes with restrictions on pay. In the UK, only the banks have been subjected to restrictions on paying cash bonuses by the Bank of England.

The business department appears to be relying on persuasion rather than force. “While executive pay is ultimately a matter for individual companies to decide, so as long as they comply with the law, we would expect companies to act in a socially responsible way and exercise judgment and discretion when considering executive pay at this and any other time,” a department spokesperson said.

Barker at the IoD thinks it is a moment to rethink. “It’s a new world that we’re entering now in terms of how we’re going to determine compensation . . . Executive pay looks as if it is going to have to be fundamentally restructured.”