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Pay and the Pandemic

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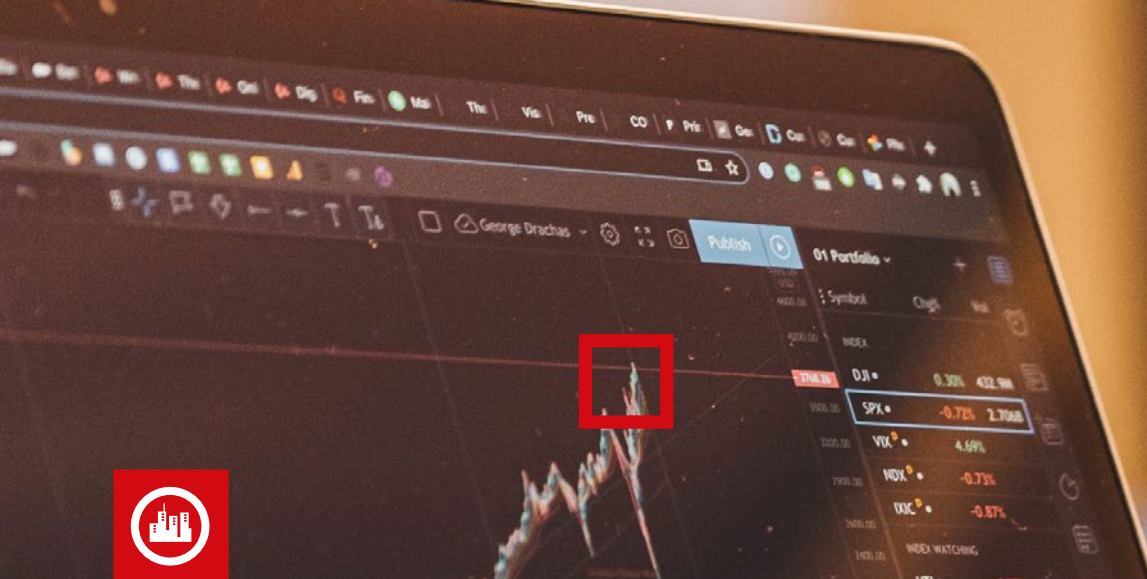
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Pay and the Pandemic

The decoupling of Dutch boardroom pay from performance during the Covid-19 outbreak

SOMO Paper | March 2022

The shareholder value revolution has coincided with rapid increases in Dutch top managers' pay. Theoretically, rising executive bonuses should reflect improved corporate performance, as measured by a series of operational and shareholder value indicators. However, critics argue that in practice the relationship between pay and performance is weak. Given its negative impact on the finances of most firms, the Covid-19 pandemic provides an insightful test case. What happened to Dutch executives' pay during the pandemic?

Our detailed analysis of the remuneration packages paid out to Dutch top managers before and during the outbreak of the Covid-19 pandemic shows that whilst executive pay rose quickly when economic conditions were

favourable, it continued to rise at the aggregate level even when the crisis hit. Despite sharp falls in profitability and the receipt of unprecedented levels of government support in 2020, average levels of remuneration of Dutch top managers *increased* by 15 per cent in the same year. Pay for performance practices have thus fostered a system that leads to large increases in pay for small improvements, while substantial decreases in pay are rare, even under the most dire circumstances.

More broadly, our empirical results show how the growing financialization and shareholder orientation adopted over the past three decades has promoted a gradual hollowing out of many large Dutch companies. The case of executive pay offers a lens through which we can observe some of the implications of these trends. ◀

Introduction

The outbreak of the COVID-19 pandemic in early 2020 introduced considerable disruption and sacrifice: workers were furloughed or made redundant, supply chains were disrupted and many businesses took on new debts or were forced to liquidate. Governments bailed out some firms through loans and other support at great national cost. But how did company executives do?

To answer this question, we collected detailed remuneration data on a total of 194 top managers heading 48 large multinational companies listed on the Amsterdam Euronext stock exchange over a period of four years (2017-2020) from corporate annual reports. The results indicate that despite the coronavirus pandemic and resulting fall in firms' profitability in 2020, aggregate levels of pay for executives were higher than in preceding years. The average pay of Dutch top managers in 2020 was EUR 2.7 million (EUR 3.6 million for CEOs), compared to an average of 2.3 million over the three preceding years (EUR 3.1 million for CEOs). This represents a pay increase of about 15 per cent for top managers and CEOs during a time of exceptional economic and social hardship.

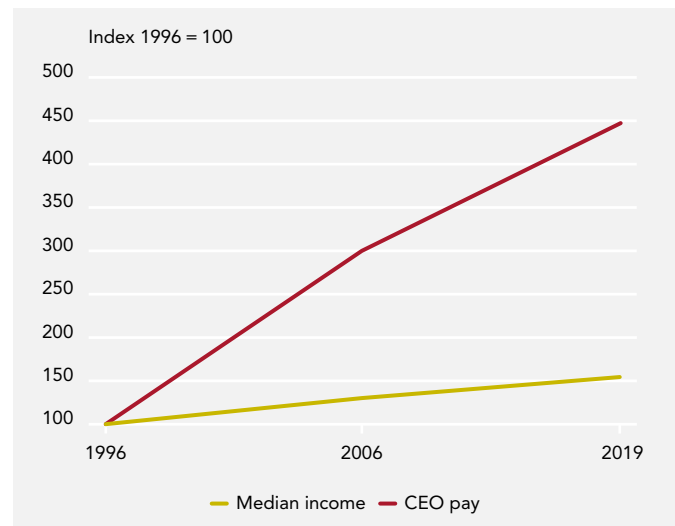
Although the findings are surprising, they reflect a longer trend - a growing disconnect between the interests of corporate elites and those of broader society. The paradox of the shareholder value revolution is that it has enriched those senior managers it intended to discipline, leading to runaway income and wealth inequality in Dutch society driven by what goes on within the firm. The effect of the shareholder value revolution, if it achieved anything, has been to introduce a more fundamental realignment of power, where, in the aftermath of financial breakdown, the costs of crises are socialised while the privileges of the top 1 per cent are protected.

The politics of executive pay

Top managers at large Dutch corporations have always been well paid. But increases in pay over the past three decades have been significant. According to earlier research (Fennema and Heemskerk, 2008), the median CEO of Dutch large-cap AEX-listed companies received approximately EUR 750,000 a year in the mid-1990s. By 2006, the figure had increased more than threefold, to EUR 2.26 million. According to our own data (described below) it grew further to EUR 3.37 million by 2019, the year before the pandemic. This represents an increase of 450 per cent over the past 25 years. In comparison, Dutch median gross income over the same period only increased from EUR 22,689 to EUR 35,000, according to the Dutch Bureau for Economic Policy Analysis (CPB), equivalent to a 50 per cent rise.

Figure 1 shows these two very different trajectories as an index, reinforcing other studies which show the importance of wage income as a key driver of inequality in Western societies over the past decade (Piketty, 2014). The growing discrepancies mean that Dutch large-cap CEOs today tend to earn nearly 100 times the median gross income – or, put differently, they are paid more in 4 days than the average worker in a year.

Figure 1 Longer-term evolution of CEO pay vs. median income (1996=100).



The graph compares the evolution of the salary of the median AEX CEO to the median gross income over time, indexed to 1996=100. Data sources: CEO pay 1996 and 2006 from Heemskerk and Fennema (2006), 2019 data from annual corporate reports; median income from CPB.

These increases in executive pay have been accompanied (and partly driven) by a transformation in how top managers are paid. Although top managers receive an annual fixed salary like other workers, the larger part of their total pay often comes from bonus rewards linked to short- and long-term performance indicators, typically related to shareholder value creation. This trend has its roots in North American corporate practice from the 1980s onwards, when agency theory arguments took hold within boardrooms, markets and regulatory agencies.

When explaining declining American corporate influence, it was argued that managers of large corporations had become too powerful and complacent, content to build empires which maximised their influence and prestige at the expense of corporate efficiency and returns on shareholder investments (Lazonick and O'Sullivan, 2000). Pay for performance (P4P) practices were introduced as one tool to align managerial and shareholder interests to ensure shareholders were prioritised (Jensen and Murphy, 1990).

P4P practices link the discretionary part of top managers' pay to key performance indicators (KPIs) like Earnings Per Share (EPS) or Total Shareholder Return (TSR) which elevate the interest of shareholders (Baeten and Van Hove, 2021; UK Department for Business Energy & Industrial Strategy, 2021). Although the effectiveness of rewarding managers on the basis of shareholder-linked KPIs is contested, the practice has been widely adopted, including in the Netherlands.

How is CEO pay determined?

The process of executive pay setting at publicly listed Dutch firms typically works as follows: selected members of a corporation's board of directors form a remuneration committee (RemCo). In consultation with a company's human resources (HR) department and external executive pay consultants, they determine levels of fixed remuneration and select the KPIs to be used in setting performance-related pay. In most cases, performance pay consists of two components: a *short-term bonus* paid for the achievement of certain KPIs over the next 12 months, usually paid out in cash; and a *long-term incentive pay* (LTIP) component contingent upon the achievement of pre-defined goals over a period of 36 months, usually paid out in share options. More often than not, the latter is the largest component of pay.

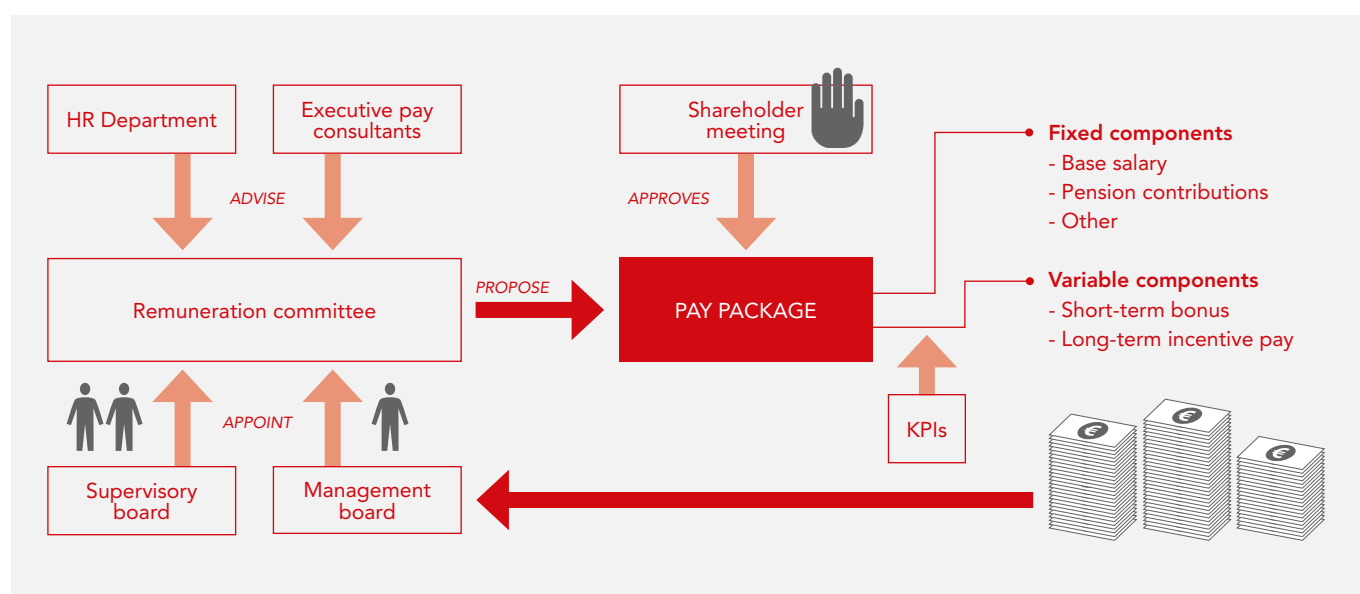
At the end of each fiscal year, a firm's RemCo internally establishes the extent to which executives have met pre-defined KPI thresholds and, based on their analyses (which are not made publicly available), recommend pay packages for their top managers, which at the same time

serve as a benchmark for setting the remuneration of other high-level employees across the company. The RemCo's proposal is then submitted to the annual general meeting for shareholder approval.

P4P practices have led to an increase in levels of executive pay. P4P legitimises higher levels of pay because of its supposedly "meritocratic" appeal, but it has also made it easier to conceal actual levels of pay from public scrutiny because of the complexity of reward structures. This has led to accusations that P4P is a smokescreen for unwarranted executive pay increases that are detached from wider outcomes. Many studies have, for example, questioned the effectiveness of P4P in improving company operating performance. Researchers have found that the adoption of P4P is associated with large increases in pay for only modest improvements in operating performance, and that underperformance rarely leads to pay decreases (Bebchuk and Fried, 2004). Levels of pay have risen more rapidly than share prices in the medium-term (Bivens and Mishel, 2013); one study even found that the share prices of higher-paying firms tend to perform worse in the medium term (Marshall and Lee, 2016).

While evidence on P4P's effectiveness at improving operating performance is weak, another set of literature argues that these shareholder value oriented KPIs encourages the *financialisation* of the firm. That is, they can push top managers to use forms of financial engineering to increase distributions, typically through debt-financed share buybacks or dividend payouts, merger and acquisition activity, and creative accounting. Whilst this may allow managers to hit shareholder value oriented KPIs in the

Figure 2 The setting of executive pay



short term, the long term operational and financial implications are moot (Baker et al., 2020).

This report will now explore two particular aspects. First, how these KPI metrics incentivise managers to maximise share prices in the short term via financial rather than operating channels. And second, whether P4P does, in fact, correspond with improvements in performance, whether measured by operating outcomes or even in terms of shareholder payouts. Empirically, we zoom in on the year 2020 when the outbreak of the Covid-19 pandemic severely disrupted economic and social life. But before doing that, we will explore what we mean by financialisation in more depth.

Prioritising shareholders in the Netherlands: longer time trends among large Dutch corporations

Over the past decades, the prioritisation of shareholder interests has become more prevalent in Dutch corporations – in that sense, they have become more ‘financialised’. Financialisation has been used to imply a number of different processes and outcomes (Van der Zwan 2014; Klinge, Fernandez and Aalbers 2021). We here focus on it as a process whereby firms use a variety of financial techniques, for example, increasing debt and repurchasing their own shares, in order to improve returns to shareholders.

Data box 1 Data used to study the financial structure of Dutch corporations

Sampling strategy

To understand the wider changes within the Dutch economy, we obtained data using the WSCOPENL list in Refinitiv Eikon. This list captures public companies which are either headquartered or conduct most of their business in the Netherlands. We then applied several data cleaning steps. First, we filtered for non-financial companies only by excluding companies with SIC codes between 6000 and 6799. Second, we removed companies with missing values for any of the following annual variables during the period 2000 to 2020: capital expenditures, long-term debt, market capitalisation, net sales or total assets. Third, we removed companies whose revenues in 2019 (i.e. before the Covid-19 pandemic) were less than EUR 1 billion. This leaves us with a sample of 30 large companies: Aalberts, Accell Group, Airbus, Akzo Nobel, Arcadis, Arcelor Mittal, ASM International, ASML, Brunel International, Fugro, Heijmans, Heineken, Hunter Douglas, Ahold Delhaize, BAM, Boskalis Westminster, DSM, KPN, Philips, Vopak, PostNL, Qiagen, Randstad, RELX, Shell, SBM Offshore, Sligro Food Group, TKH Group, Unilever, Wolters Kluwer.

Variables used

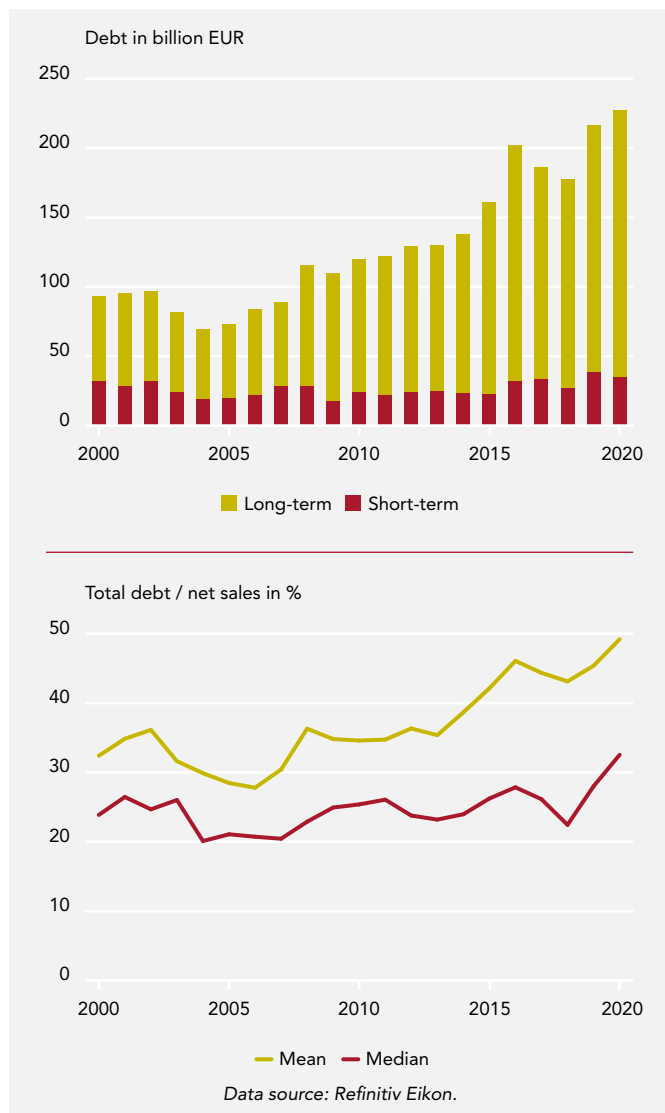
For this sample of firms we retrieve the following variables from WSCOPENL: Net sales or revenues (WC01001; data coverage in our sample: 100 per cent); Research & Development Expense (WC01201; coverage: 51.7 per cent); Short Term Debt & Current Portion of Long Term Debt (WC03051; coverage: 100 per cent); Long Term Debt (WC03251; coverage: 100 per cent); Cash Dividends Paid – Total (WC04551; coverage: 99.7 per cent); Capital Expenditures (Additions to Fixed Assets) (WC04601; coverage: 100 per cent); Com/Pfd Purchased, Retired, Converted, Redeemed (WC04751; coverage: 93.8 per cent); Price/Earnings Ratio – Close (WC09104; coverage: 100 per cent); Price/Earnings Ratio – Avg High-Low (WC09106; 100 per cent).

Relation with pay analyses

It is important to note that the sample of firms’ financial accounts is not identical to the one of our executive pay database because of the longer time period of this part of our analysis (not all current AEX and AMX companies have been in business for two decades), and some missing data points. Nonetheless, the two samples strongly overlap. The purpose of the analysis of financial accounts is to map the wider contours of the Dutch economy, which serves as critical background information to the pay analyses that follow.

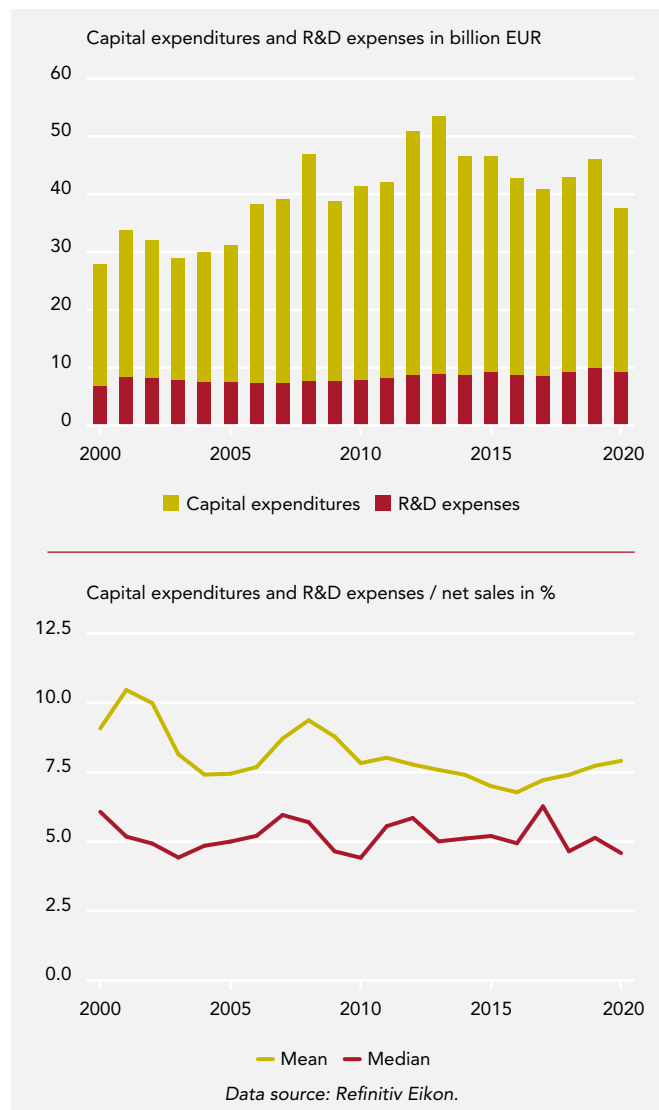
To map longer-term trends in the Dutch corporate landscape and examine the degree to which Dutch firms prioritise shareholder interests, we analysed the aggregate financial accounts of a panel of large Dutch non-financial firms. Drawing on the Refinitiv Eikon database, this group includes 30 firms, including blue chip companies such as Shell, Ahold Delhaize, Unilever and Philips (cf. data box 1).

Figure 3 Large Dutch corporations' debt over time



Looking at the aggregate financial accounts of this sample of firms, we note a steady rise in corporate debt from around EUR 93.0 billion in 2000 to EUR 227.9 billion in 2020, overwhelmingly driven by increases in long-term debt (Fig. 3A and 3B). The increase in the stock of debt has outpaced sales growth. This development raises questions about what that debt has been used for.

Figure 4 Large Dutch corporations' internal investments over time

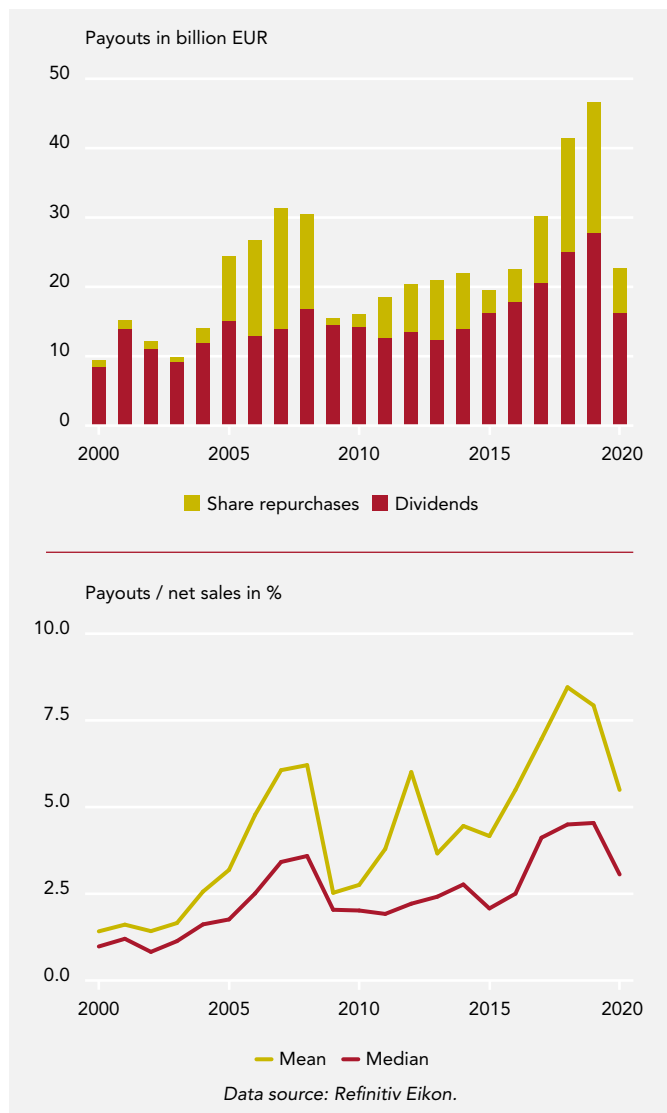


Internal investments, here approximated by capital expenditures (resources spent on acquiring new buildings, machinery and equipment) and research and development expenses, were rising until 2013 but have declined since then (Fig. 4A and 4B). In some years for some companies in our sample, net investment (capital expenditures less depreciation) was negative. In short, rising levels of long-term debt did not translate into increases in long-term productive capacity measured by capital expenditure and R&D.

Notably, external investments, such as the acquisition of other firms, have not increased either. Apart from exceptional spikes in the years 2000 (EUR 39.5 billion), 2008 (EUR 29.6 billion) and 2016 (EUR 16.3 billion), the panel companies' combined acquired net assets averaged around EUR 9.5 billion per year. The data suggests that many of the acquisitions made during that time period involved acquiring firms at a significant premium above their identifiable net assets, which resulted in the reporting

of more “goodwill”. Goodwill as share of total assets rose from an average of 10.1% in 2000 to 17.7% in 2020. The carrying value of goodwill depends on, amongst other things, expectations about the ability of those underlying intangible assets to generate future cashflows. When expectations change, accounting rules require for an impairment assessment which can lead to a writedown of goodwill assets. Because it involves assets that are vulnerable to writedowns, goodwill can signify growing risks.

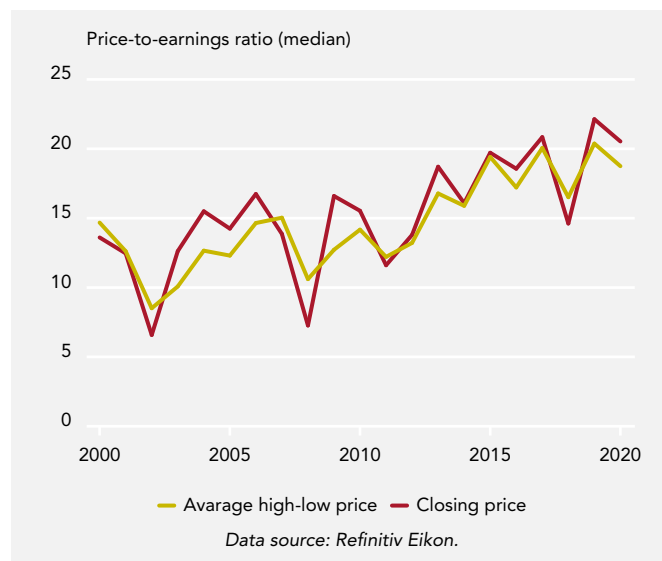
Figure 5 Large Dutch corporations’ payouts over time



In contrast to these stagnant trends in investment, companies substantially increased their payouts to shareholders over the same period (Fig. 5A and 5B). Aggregate payouts of the 30 Dutch firms in our sample increased from EUR 9.3 billion in 2000 to EUR 30.5 billion before the onset of the global financial crisis in 2008. Following a sharp decline in 2009, payouts rebounded thereafter, surpassing their earlier highs in 2018 and 2019 when they reached EUR 41.5 billion and EUR 46.7 billion, respectively. A significant part of this growth, which coincides with the

incurring of larger debt, was driven by share repurchases. In addition to the receipt of dividends, shareholders thus also benefited from corporate share repurchases which drive up the earnings per share ratio. This has happened in a context where low interest rates already pushed stock prices upward. As a result, the financial valuation of companies on the stock market relative to their capacity to generate earnings was gradually inflated, as indicated by growing price-earnings ratios (Fig. 6).

Figure 6 Large Dutch corporations’ price-earnings ratios over time



Overall, the analysis of the financial statements of this sample of large Dutch firms shows noteworthy trends that pre-date the pandemic. Over the two decades before the outbreak of Covid-19, the exposure of large Dutch corporations to long-term debt increased substantially, but this was not accompanied by growing investments in fixed capital or R&D. In contrast, firm resources were increasingly channelled towards shareholders who benefitted from share repurchases and dividend payments. These developments played out in the context of an increasing divergence between firms’ operating performance, on the one hand, and their stock market valuations on the other. The ultra-low interest rate environment and loose credit conditions over the past decades made it easier for large corporations to generate shareholder returns without necessarily investing in the long-term sustainability of their businesses or their broader social responsibilities. It is against this background that the outbreak of the Covid-19 pandemic hit the world economy in early 2020.

Data box 2 Executive pay dataset

Sampling strategy

Our sample includes 194 executive managers (chief executive officers [CEOs], chief financial officers [CFOs], chief operating officers [COOs], executive directors, etc.) at 48 large multinational companies listed on the Amsterdam Euronext stock exchange, who were observed during the time period 2017-2020. Only managers employed for a full year are included in the analyses. Some of the managers enter or exit the sample during the four-year period. The reported analyses are based on a sample of a total of 411 observed salary points.

The companies included are:

- *AEX index (large-cap)*: Adyen, Aegon, Ahold Delhaize, Akzo Nobel, Arcelor Mittal, ASML, ASR, BE Semiconductor, Galapagos, Heineken, IMCD, ING, JustEat Takeaway, Philips, KPN, NN Group, Prosus, Randstad, RELX, Shell, Signify, Unibail Rodamco, Unilever, Vopak, Wolters Kluwer (25 companies in total).
- *AMX index (mid-cap)*: Aalberts, ABN Amro, AirFrance-KLM, Alfen, AMG, Aperam, Arcadis, Basic Fit, Boskalis Westminster, Corbion, Eurocommercial Properties, Fagron, Flow Traders, Fugro, Grandvision, Intertrust, Jacobs Douwe Egberts, OCI, Pharming Group, PostNL, SBM Offshore, TKH Group, Warehouses de Pauw (23 companies in total).

Note on valuation of LTI pay

Executive pay packages consist of several components: fixed (base) salary, pension contribution, short-term bonus, long-term incentive (LTI) packages, and the residual category "other compensation". LTIs consist of options and ownership shares in the company that executives are awarded in a fiscal year, but which are only paid out at a later stage (provided that certain performance goals are achieved). Their value is calculated based on the current stock market price at the time of awarding, but their actual value depends on the evolution of share prices until the time at which they are vested. Accordingly, there is a distinction to be made between the total remuneration *awarded* and the remuneration *realised* in a year (with the latter being significantly influenced by LTIPs agreed three years earlier). The presentation of results in this report focuses on remuneration packages *awarded*, which are more directly connected to events unfolding in a particular year.

The pandemic reveals that CEO pay is detached from the real performance of the corporation and broader social concerns

The pandemic posed an existential threat to many firms which had to contend with a simultaneous disruption to their demand base and supply chains, making it difficult for many employers to meet their obligations to employees and other stakeholders. Whereas the lockdowns in 2020 generated new business opportunities for some companies in particular sectors (e.g. information technology, food delivery services and supermarkets), most corporations took a large financial hit. This meant that during the crisis most corporations relied on substantial government support. Some companies received direct assistance through the Dutch government's *Noodmaatregel Overbrugging voor Werkgelegenheid* [Temporary emergency bridging measure] (NOW) scheme that covered salary payments. But even companies that didn't draw on those funds were boosted by a range of indirect

government support measures during 2020 (e.g. monetary stimulus, wage payments for companies' independent contractors [ZZP-ers], government support for rent payments, etc.). In total, the Dutch public pandemic-related expenditure (ranging from vaccine development and purchase, testing and the direct costs of public services to subsidies to the private sector) from 2020 to 2022 amounted to EUR 82 billion (Algemene Rekenkamer [Netherlands Court of Audit] 2022).

The Covid-19 pandemic also represented a fundamental test of P4P principles. It might be expected that at a time of extraordinary economic and social hardship, where firm performance was directly or indirectly helped by extensive government support, corporations would temporarily reduce executive pay to recognise that outcomes were not the result of senior management action and to signal the social, financial and moral need to show constraint. However, the data shows a different and more complex picture. Data on executive pay at AEX and AMX-listed companies collected from corporations' annual reports

indicate that average levels of executive pay *increased* during the outbreak of the pandemic in 2020.

Table 1 shows descriptive statistics on the remuneration of top managers (including chief executive officers, chief financial officers, chief operating officers, executive directors, etc.) at the 48 largest Dutch companies during the years 2017-2020. Table 2 shows the same information for the subsample of CEOs only. The figures show estimated total amounts of payouts by adding up various pay components, as indicated in companies' annual reports. At the aggregate level, there is no indication of any reduction in pay. Mean levels of remuneration for all executives and CEOs were higher in 2020 than in any of the three preceding years, as were the minimum and maximum levels of pay in the respective sample. Comparing mean levels of pay in 2020 to the 2017-19 average, for all executives or CEOs, payouts were about 15 per cent *higher* during the outbreak of the pandemic than in the preceding years.

Table 1 Total remuneration awarded: all top managers

Year	Mean	Median	Min	Max	Observations
2017	2,436,041	1,838,000	307,000	11,647,000	97
2018	2,303,837	1,832,000	128,000	10,120,000	104
2019	2,188,952	1,814,000	258,000	8,682,000	105
2020	2,659,076	1,911,000	308,000	19,058,000	105

Monetary values in euros. Only individuals employed for the full year are included in the sample. DATA SOURCE: corporate annual reports.

Table 2 Total remuneration awarded: CEOs

Year	Mean	Median	Min	Max	Observations
2017	3,254,816	2,683,500	307,000	11,647,000	38
2018	3,145,900	2,297,500	313,000	10,120,000	40
2019	2,873,048	2,440,000	320,000	8,682,000	42
2020	3,599,925	2,400,000	531,000	19,058,000	40

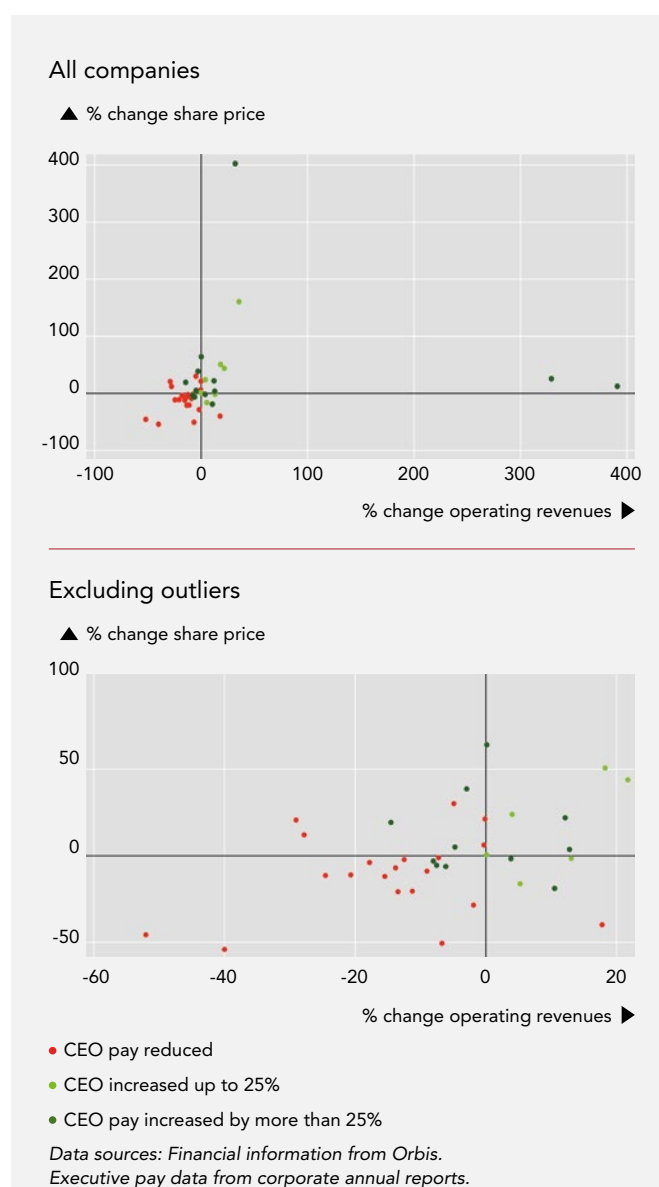
Monetary values in euros. Only individuals employed for the full year are included in the sample. DATA SOURCE: corporate annual reports.

Diversity of cases

Pay was not higher at all companies, however. We can categorise companies into three groups: one group of companies did very well during the pandemic and rewarded their executives with large increases in pay; one group of companies were hit hard by lockdown measures, struggled financially and reduced executive pay in 2020 as a result; and, finally, one large and diverse group of companies tended to pay their executives more despite failing to generate either operating improvements or share price increases, or sometimes both.

Figure 7 illustrates this diversity of cases by comparing the annual percentage change in operating revenues (x-axis) and stock market valuation (y-axis) in 2020 compared to 2019. The colour of the dot indicates the change in CEO pay in 2020 compared to 2019. The upper panel plots the distribution of all company cases from our executive pay database; the lower panel zooms in on the cases clustered around the intersection of the two axes (by excluding outliers with changes larger than 100 per cent).

Figure 7 Correlation between changes in share price, operating revenue, and changes in levels of CEO pay in 2020 vs. 2019



The figures emphasise two points: First, the correlation between changes in operating revenue and share price is low. At the extreme end, some companies enjoyed very large increases in share price for comparably small improvements in operating revenues, while other companies' share price increased only modestly despite large increases in

operating revenues. Excluding the outliers in panel (b), there appears to be almost no correlation between the two variables at all. Second, whereas CEO pay increased substantially in all cases where both share price and operating revenues improved (upper right quadrant), the inverse case is more complex. A number of Dutch companies (in upper left and lower left quadrant) increased CEO pay substantially despite declines in operating performance. Several remuneration committees even awarded CEO pay increases of more than 25 per cent against the background of simultaneous declines in both operating revenues and share price in 2020 (i.e. the three dark green dots situated in lower left quadrant). The picture is similar if we look at measures of profitability and corporate performance other than operating revenues. The relationship between pay and performance, in short, appears much weaker than P4P rhetoric suggests.

What explains the resilience of high pay in dire times?

The increases in average levels of executive pay during the outbreak of the Covid-19 crisis in 2020 in the Netherlands were driven by a combination of factors. Some firms awarded CEOs large pay rises due to performance improvements during the Covid-19 outbreak. Others gave large pay rises to CEOs despite weak performance. There were also many firms in between. At the aggregate, increases in pay outsize the reductions in pay among companies that performed poorly, leading to higher average pay despite the very difficult circumstances. We can say a number of things about our analysis.

First, increases in pay to reward good performance tend to be much larger than reductions in pay when performance deteriorates. As earlier studies suggest, disproportionate rewards for good performance in some cases is enabled by narrative strategies assigning exogenous lucky events to the competence of individual managers (Garvey and Milbourn, 2006), and in-group comparisons that disconnect justifications for high pay from a broader societal perspective (DiPrete, Eirich and Pittinsky, 2010; Van Veen and Wittek, 2016). Our in-depth review of Dutch corporations' 2020 annual reports indicates that such dynamics were also at play during the outbreak of the pandemic. Several of those firms with strong performance benefitted indirectly from governments' large fiscal stimulus packages used to fight the economic fallout of the pandemic. Also, the European Central Bank (ECB) was quick to start a new round of asset purchases, which included corporate bonds of publicly listed companies (Tooze 2021), fuelling a stock market boom in the process. Despite knowingly benefiting from government interventions and the ECB (at least indirectly) in many ways, those factors receive little

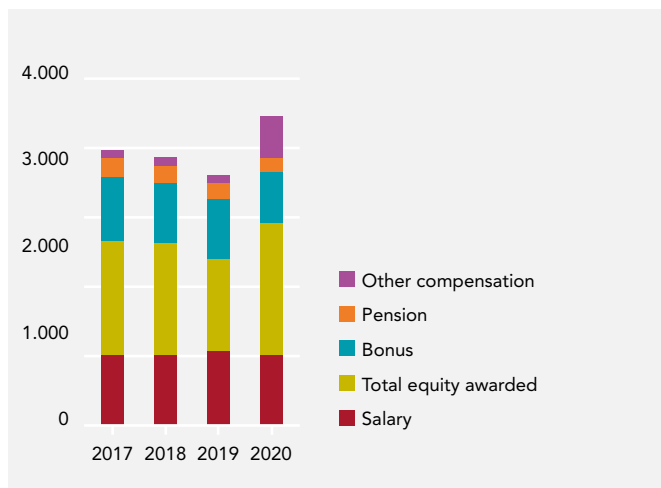
attention in corporate annual reports, which tend to emphasise "hard work", "professionalism" and "individual leadership" rather than the arguably at least as important role of government actions in driving good financial outcomes among some of the companies that did particularly well in 2020.

Second, companies use financial metrics flexibly to prevent executive pay from falling too sharply when performance deteriorates. For example, a number of companies adapted KPI targets or used "adjusted" financial figures in the evaluation of top managers' performance¹, arguing that they should not be held responsible for the outbreak of the pandemic (whereas no downward adjustments were made for top managers at companies benefiting from the same exogenous event). Others undertook changes in remuneration policies², which could be one factor contributing to higher pay-outs if, for instance, they give greater weight to higher-paid US CEOs in benchmarking levels of pay (Linsi, Hopkin and Jaupart, 2021).

Finally, reductions in performance-related pay were compensated by increases in other, non-performance-related salary components. Figure 8 shows the average value of each of the five pay components (salary, short-term bonus, long-term equity, pension and other compensation) over the four years for which we collected the data. The figures suggest that reductions in short-term bonus payouts in the year of the pandemic were more than offset by increases in LTI awards and special payments falling under the "other" category, contributing to higher pay overall despite the dire circumstances.

- 1 To give one example, Akzo Nobel's 2020 annual corporate report indicates that "[i]n determining the outcome of the STI elements, the Remuneration Committee applied a reasonableness test in which the actual level of the performance was critically assessed in light of the assumptions made at the beginning of the year, taking into account the impact of COVID-19" (AkzoNobel, 2021, p. 80).
- 2 For instance, in the wake of its dual listing on NASDAQ in 2020, Pharming Group revised its remuneration policy, commenting that "Pharming has set the objective to align itself with European best practices in the field of remuneration, but will also need to ensure that it preserves the urgent need to remain competitive in the important US labor market" (Pharming, 2021, p. 71).

Figure 8 Sample average values of various pay components, 2017-2020



In short: executive pay rises fast, but falls slowly. The number of companies imposing substantial pay cuts during the pandemic were small, and mostly involved companies in severe distress that also requested direct government assistance via the NOW scheme, which restricted bonus payments. On the other end, companies that benefited from lockdowns and unprecedented monetary stimulus increased pay sharply, whereas companies with mixed performances emphasised the impact of the crisis to (partly) absolve CEOs from responsibility for drops in profitability and shield their pay. At the same time, by benchmarking pay packages to those of other high-paid CEOs rather than to salaries of non-executive employees or incomes in society at large (DiPrete, Eirich and Pittinsky, 2010; Van Veen and Wittek, 2016), levels of pay are consciously disconnected from broader societal trends. Thus, these factors lead to rapid upward spirals in pay when business goes well, while punishments for bad performance are mitigated or absent altogether. The result is a growing disconnect between the pay of Dutch corporate leaders vis-à-vis their employees, and levels of pay for top managers that are ever more out of touch with the reality of ordinary citizens.

Conclusions

It is often during times of crisis, when institutions are under severe pressure, that a country's social fabric is revealed. The dynamics of executive pay during the outbreak of the Covid-19 pandemic in 2020 offers a picture of Dutch society in microcosm, how the wealthy are sheltered and how inequality is embedded in the infrastructure of firms.

Firstly, our results raise questions about the effectiveness of P4P systems to improve corporate performance. On the one hand, we observe a growing separation between the "economic" and "financial" reality of firms. On the other, in several cases we see an evident disconnect between performance and levels of pay. In line with other research (Bebchuk and Fried, 2004; Bivens and Mishel, 2013), our findings suggest that the adoption of P4P practices has fostered a system that leads to large increases in pay for small improvements, while substantial decreases in pay are rare, even under the most dire circumstances.

More broadly, our empirical results show how the growing financialisation and shareholder orientation adopted over the past three decades has fostered a gradual hollowing out of many large Dutch companies. The case of executive pay offers a lens through which we can observe some of the implications of these trends. P4P systems incentivise top managers to prioritise short-term financial goals and shareholder returns over long-term investments in employees or the adoption of more sustainable business models. Furthermore, the shift in the Netherlands towards a US-style model of corporate governance focused on shareholder value has led to a growing disconnect between top managers and the rest of the workforce. As our results illustrate, even in a period of crisis – irrespective of the sizable support provided by governments – many Dutch companies found it appropriate to maintain or even increase levels of executive pay. This should be part of a wider conversation about the purpose and responsibilities of large corporations in the Netherlands and beyond.

Policy recommendations

The Dutch Corporate Governance Code determines that remuneration policy ought to “focus on long-term value creation” (Monitoring Commissie Corporate Governance Code, 2016, p. 31). Our findings indicate that the current system is not fulfilling this task. We conclude with three recommendations on how to realign the system of executive pay with this fundamental principle of the Code.

- 1 Encourage vertical rather than lateral benchmarking:** top managers should be encouraged to compare their levels of pay to the rest of the workforce and broader society rather than other highly paid peers. The Code already mandates the publication of pay ratios. But the publication of these ratios alone has proven insufficient. To halt the upward spiral in executive pay, stronger measures are needed. For instance, executive pay could be capped at particular CEO-median employee pay multiples instead of following the ratchet effect of benchmarking against other, even better-paid CEOs. Another option is to introduce a maximum threshold on year-on-year increases in executive pay in relation to annual wage increases of the median employee.
- 2 Let stakeholders have a say in what KPIs to use:** RemCos’ ability to freely choose the KPIs used to determine levels of executive pay has shown to favour shareholder interests above all else. Concerns of other stakeholders and broader society should be given more weight in those decisions. This could be implemented by giving greater guidance on what KPIs to use in the Code, or by giving representatives of non-executive employees a greater say in RemCo deliberations.
- 3 Demand greater transparency and accountability on pay-setting evaluations:** Some firms currently provide more information about how pay levels were determined than others. But even for those providing more extensive information it is not possible for third parties to replicate pay-setting decisions. While understandably not all data can be made public, external auditors should at least assess these deliberations and report on them.

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