Exporting the winner-take-all economy: micro-level evidence on the impact of US investors on executive pay in the United Kingdom

Working paper 38

November 2019

Lukas Linsi, Jonathan Hopkin and Pascal Jaupart

Keywords: investors, UK, firms, US

Link to working paper:
http://eprints.lse.ac.uk/102217/1/Linsi_Hopkin_Jaupart_exporting_the_winner_take_all_38.pdf

More on the theme of #LSEWealth and #LSEKnowledge

Income inequality, and the increasing concentration of income and wealth at the top of the distribution, have become a major cause for concern in both scholarly and public debate. The share of income taken by the top one per cent in the UK has more than doubled between 1975 and 2014, from 6.1 to 13.9 per cent. What has been driving this worrying trend? Previous research has invoked factors such as the rising capital share, the growing political power of the wealthy, technological change, and financialization. In our new working paper we uncover another cause: the *Americanization* of the British economy.

While most previous research on top income inequality has worked with aggregate national-level data, our study proposes investigating the dynamics driving income gains at the top using fine-grained micro-level data on the elites that populate the 'top 1%'. To do so, we retrieved detailed information on the remuneration of high-level managers at publically listed UK firms, which are disclosed in companies' annual reports. We were able to collect this data for two to five high-level managers at several hundred UK companies each year between 2007 and 2014 (the size of our sample fluctuates between 670 and 980 companies per year). This grants us with a time-series panel dataset that ranges from 1,800 to 3,100 individual annual salary points. Altogether, the companies in our dataset cover roughly 40 percent of all UK-incorporated firms listed on the London Stock Exchange, making it very comprehensive.

To find out what has been driving the remarkable growth in pay for UK executives in recent years, we combined this detailed information on executive pay with data on the corporations that employ the managers in our dataset, and undertook a series of econometric analyses to uncover the statistical determinants of UK executives' levels of pay. In line with previous studies, we found salaries to correlate with some individual characteristics (such as their connectedness, gender and age) as well as attributes of the companies they work for (such as their size, stock price and financial performance). Less obviously, our data reveals that *who owns* a company also matters a great deal. In particular, we found strong indications that salaries for British high-level managers increase as levels of corporate ownership by US-based investors grows. In our most restrictive models, each percentage point increase in the ownership of outstanding stock by a US-based investor is associated with a substantial 0.4 per cent increase in pay for top managers in British firms – a big deal in the light of the rapid internationalization of corporate ownership in the UK over the past two decades.

Why would that be? A benign reason for these findings could be that the entry of US investors improves the performance of the firms they acquire, with increasing levels of pay merely reflecting greater profitability. However, testing for this possibility in our analyses, we found no indication whatsoever that the Americanization of British firms is associated with better financial results. So why are British executives paid more if US owners become more influential, even if financial performance stagnates? Leveraging the fine-grained nature of our dataset we explore a number of further potential mechanisms. We find that the effects also apply to incumbent (as opposed to newly hired) managers, are largest in the financial services and high-tech industries, and channeled through increases in the equity-component of executives' salary packages.

Overall, the fact that greater US ownership increases pay (and in particular its performance-related components) of incumbent managers without punishing them for bad outcomes, suggests that they are driven not so much by US investors pushing for higher pay, but rather by local managers being able to leverage growing US ownership in order to legitimize higher pay for themselves. A plausible scenario that is consistent with our findings is that local managers take advantage of growing US ownership to push remuneration committees for a re-orientation towards highly paid US executives as the relevant peer group, which their pay shall be benchmarked to. This leads to a situation in which equity-based remuneration increases sharply for UK managers as it gradually catches up to US levels, while simultaneously shielding them from punishments for underperformance.

More broadly, our findings highlight the centrality of within-firm wage bargaining processes in shaping trends towards ever greater income inequality.

LSE International Inequalities Institute

For further information on the work of the Institute, please contact the Institute Manager, Liza Ryan at e.ryan@lse.ac.uk

International Inequalities Institute
The London School of Economics and Political Science
Houghton Street
London
WC2A 2AE

Email: Inequalities.institute@lse.ac.uk
Web site: www.lse.ac.uk/III
@LSEInequalities