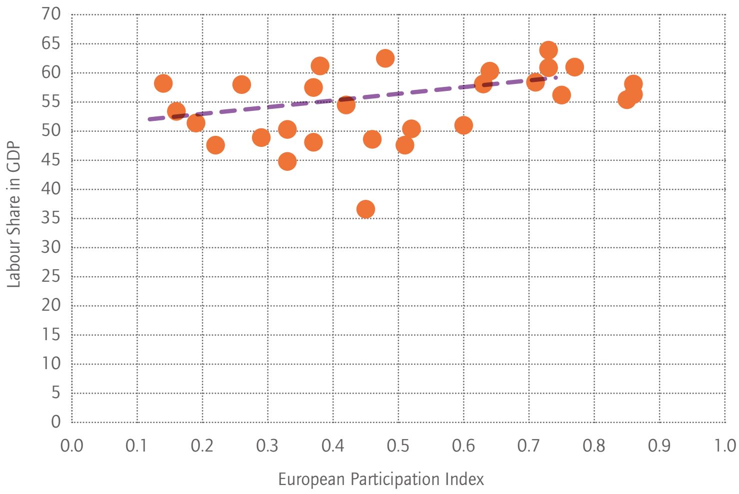
More democracy at work and a bigger slice of the pie

Figure 6.17 More democracy at work, a more equally shared pie: Countries with a higher European Participation Index score also tend to have a higher labour share in GDP



Data source: Own compilation, based on European Participation Index & ILO income share as a percent of GDP, 2017 figures.

The wealth a country creates should be shared with both the workers and the employers. For this reason, the International Labour Organization measures the part of the created wealth that goes to the labour force, rather than to the owners of capital.

The 2019 dataset shows that, globally, the part of the wealth going to workers has decreased since 2004 and is now only just above 50%. In Europe, wage shares are generally higher, with quite a few countries having wage shares of over 60%.

There are various factors behind the reduction of the part of the wealth that goes to the employee: the financialisation of the economy, globalisation, and, of particular importance, the power of employees (Guschanski and Onaran 2018). Where trade unions and collective bargaining institutions are present, employees can push for a larger piece of the pie by negotiating higher wages (Moore et al. 2019) The same relation can be seen in Figure 6.17 which shows the European Participation Index on the x-axis (for more information see page page 140) and the wage share, as estimated by the ILO, on the y-axis. The plot shows that countries with a higher score on the EPI (i.e. where workers have a stronger voice in companies) also tend to be countries where a larger part of created wealth goes to workers.

Shareholder extraction of profits leave companies more vulnerable to the Covid-19 crisis

Excessive payouts to shareholders have greatly increased company indebtedness over the past decade

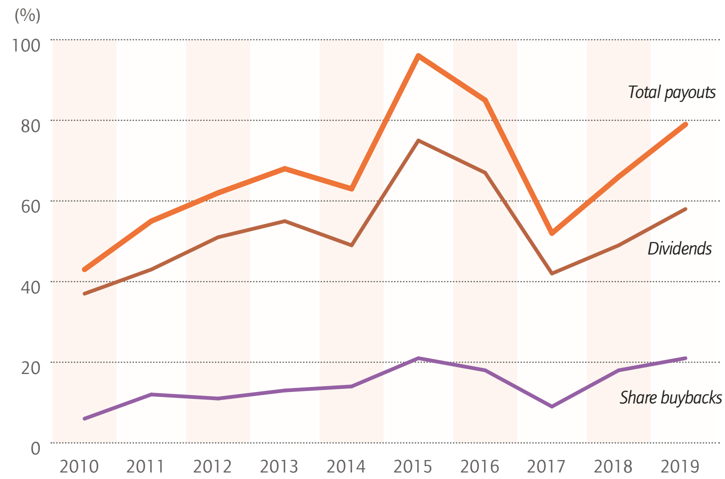
In the past decade, shareholders have extracted the great majority of profits from companies listed on the stock markets in Europe. The concept of 'shareholder value' is used to justify the extraction of profits by shareholders rather than keeping them in the firm as reserves for a 'rainy day'. However, the consequence of 'shareholder value' has been increasing debt levels, leaving companies more vulnerable to economic downturns such as the those caused by the Covid-19 crisis.

Traditionally, shareholders have extracted profits from companies in the form of dividends, which are paid out on an annual or quarterly basis to shareholders. Prior to the arrival of 'shareholder value' in Europe, most investors were 'patient', being satisfied with long-term continued reinvestment in the firm rather than short-term payouts. Generally, less than half of company profits were paid out as dividends.

However, in the past decade, shareholders have become more oriented to short-term financial performance. As a result of investor pressure, dividend payouts have increased to over 50% of profits in most years, even exceeding 70% of the profits of the non-financial companies in the STOXX 600 (the 600 largest companies listed on European stock exchanges) in 2015 (Figure 6.18). On top of that, shareholders are increasingly demanding 'share buybacks', which involve companies using their profits to 'buy out' shareholders and trade cash for their shares. Sometimes companies even take on additional debt to buy back shares. With the exception of 2017, about 20% of company profits in Europe went towards share buybacks in every year in the second half of the 2010s.

The combination of increased dividends and share buybacks means that the majority of profits are now paid out to shareholders, reaching a high of 96% of net income in 2015. The long-term consequences are that companies have fewer financial resources for a 'rainy day', and that the total debt of the non-financial STOXX 600 companies increased from €2.3 trillion in 2010 to €3.6 trillion in 2019 (or from 28% to 31% of total assets).

Figure 6.18 Payouts to shareholders as a % of profits, 2010-2019



STOXX 600 nonfinancial companies
Source: own calculations from CapitalIQ data

As a result of investor pressure, dividend payouts have increased to over
50%
of profits in most years

One of the consequences of this is that the financial vulnerability of companies has increased, and with it the risk of job losses, job cuts and a deterioration of working conditions during the Covid-19 crisis. Many of these companies are now receiving or asking for public assistance in the form of bailouts or short-term work subsidies. However, some of them still intend to continue paying out funds to shareholders. As some countries have done on a limited basis, stronger restrictions on share buybacks and dividend payouts by companies should be introduced, for example prohibiting shareholder payouts by companies receiving public subsidies and/or who are in a financially precarious situation (i.e. those which receive a 'below investment grade' rating by credit rating agencies).

What is shareholder value?

The concept of 'shareholder value' originated in the US and was first implemented on a large scale by US companies (Jensen and Meckling 1976; Rappaport 1986). In the 1990s and 2000s the EU and many European countries passed legislation designed to make financial markets more 'shareholder friendly', such as authorising companies to pay executives with stock options, to buy back their shares, and to increase the power of institutional investors. However, shareholder value is increasingly being criticised for promoting short-termism and underinvestment, encouraging managers (particularly of banks) to pursue risky strategies, and increasing debt (Vitols 2015; ESMA 2019; Lazonic et al 2020).