PANDEMIC EXTRACTIVISM

AN ANALYSIS OF AGGRESSIVE CAPITAL ALLOCATION STRATEGIES BY LISTED COMPANIES RECEIVING STATE AID DURING THE COVID-19 PANDEMIC

Research by **SfC - Shareholders for Change** co-financed by **SfC members Etica Sgr**, **fair-finance Vorsorgekasse** and **Friends Provident Foundation.**

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The aim of this research is to assess the behaviour of a sample of 320 companies in relation to the receipt of **State aid** by investigating their capital allocation and tax planning choices.

Companies' capital allocation decisions define long-term sustainability of their performance. These decisions are even more crucial since the Covid-19 pandemic.

This is the first report to identify those companies most exposed to capital allocation related risks. It also offers guidance to investors by suggesting monitoring and engagement questions to pose to at-risk companies.

Aggressive capital allocation behaviours by the 320 companies assessed

10%	20%	8%	8%
in workforce reduction	in dividends distribution	of companies have significantly increased the stock of own shares	located in countries with favourable tax regimes

The report finds that 26 companies use 'aggressive capital allocation' as defined by meeting more than one of the above indicators.

"Friends Provident Foundation is one of the sponsors of this research because our foundation has always been concerned with distortions in the allocation of corporate capital" – states **Colin Baines**, Investment Engagement Manager, **Friends Provident Foundation –**. *"In 2021 we funded the Fair Pay FTSE database, covering Exec pay ratios, gender pay gaps, Living Wage accreditation and union recognition at the UK's FTSE 100. Interestingly, some of the UK companies that score very low are also among the most 'aggressive', in terms of capital allocation, in this report".*

The 8 most ‘aggressive’ companies receiving state aid related to the Covid-19 pandemic

company	industry	country
ESSILORLUXOTTICA	manufacturing	France
INTERNATIONAL CONSOLIDATED AIRLINES GROUP, S.A	transportation and storage	Spain
UNIBAIL-RODAMCO-WESTFIELD	other service activities	France
TUI AG	administrative and support service activities	Germany
DELTA AIR LINES, INC.	transportation and storage	USA
UNICREDIT SPA	financial and insurance activities	Italy
COMPASS GROUP PLC	accommodation and food service activities	UK
COLTENE HOLDING AG	human health and social work activities	Switzerland

Profiles of the 7 most ‘aggressive’ companies receiving state aid non related to the covid-19 pandemic

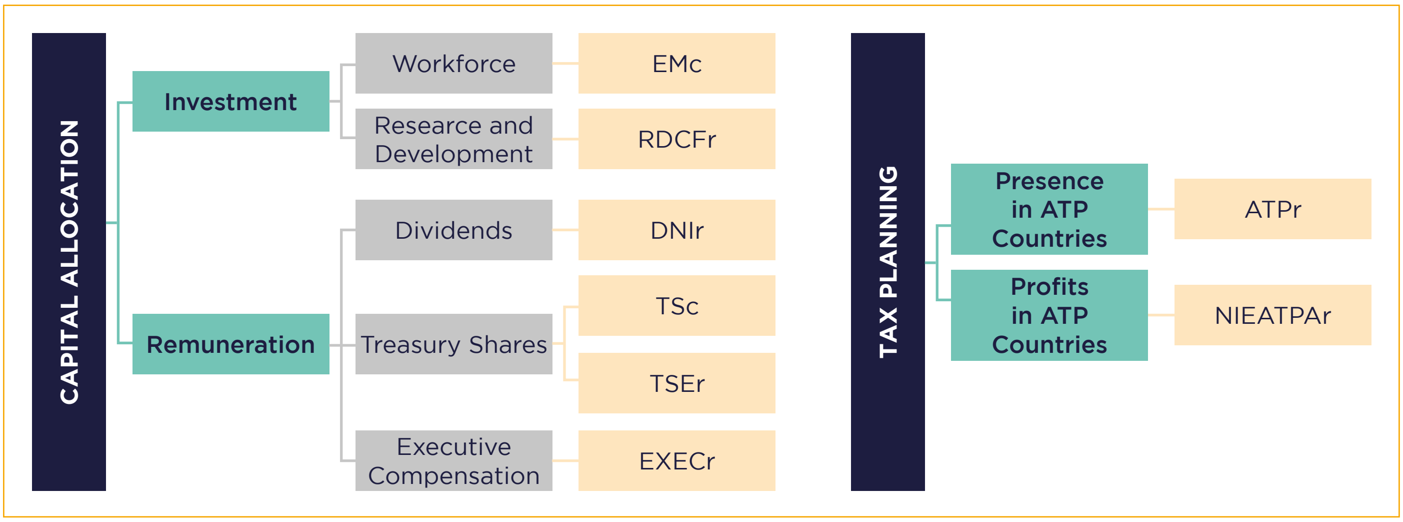
company	industry	country
ENEL SPA	electricity, gas, steam and air conditioning supply	Italy
PHARMA MAR S.A.	manufacturing	Spain
FERROVIAL SA	construction	Spain
CELLNEX TELECOM S.A.	information and communication	Spain
NATURGY ENERGY GROUP, S.A.	electricity, gas, steam and air conditioning supply	Spain
LINDE PLC	manufacturing	Ireland
UNION PACIFIC CORP	transportation and storage	USA

Profiles of ‘aggressive’ companies not receiving or not disclosing state aid

company	industry	country
AMADEUS IT GROUP, S.A.	information and communication	Italy
AT&T INC.	information and communication	USA
AZIMUT HOLDING SPA	financial and insurance activities	Italy
BP PLC	manufacturing	UK
E.ON SE	electricity, gas, steam and air conditioning supply	Germany
KOHLS CORPORATION	wholesale and retail trade	USA
NATWEST GROUP PLC	financial and insurance activities	UK
PERNOD RICARD	manufacturing	France
SIEMENS AG	manufacturing	Germany
THE SWATCH GROUP LTD.	manufacturing	Switzerland
VIVENDI SE	information and communication	France

"A company's capital allocation decisions define the long-term sustainability of its performance. These decisions are even more crucial since the Covid-19 pandemic." – says **Aldo Bonati**, Corporate Engagement and Networks Manager, **Etica Funds** –. *"Tracking metrics such as investments in R&D, dividends, buyback, CEO pay gap and tax payments helps predict companies' exposure to reputational risks. In addition, we can infer how these companies have used public resources granted during the pandemic. This is the first report to identify those companies most exposed to capital allocation related risks. It also offers guidance to investors by suggesting monitoring and engagement questions to pose to at-risk companies."*

The research focuses on **capital allocation** - on investments in workforce, dividend payouts and share buyback programs, and **tax planning**. Reduction of workforce and use of 'aggressive' dividend payout or share buyback schemes are considered as actions favouring short-term interests and hence potentially incompatible with State aid. The actions implemented with the aim of minimising a company's tax burden, while legal, may be carried out in contradiction to the intent of the law, thus achieving "aggressive tax planning" (ATP).



A set of indicators has been defined to assess the behaviour of these companies related to employment trends, dividend payments, stock buyback programs, and share of subsidiaries in aggressive tax planning (ATP) countries. These indicators revealed 'aggressive' capital allocation behaviours.

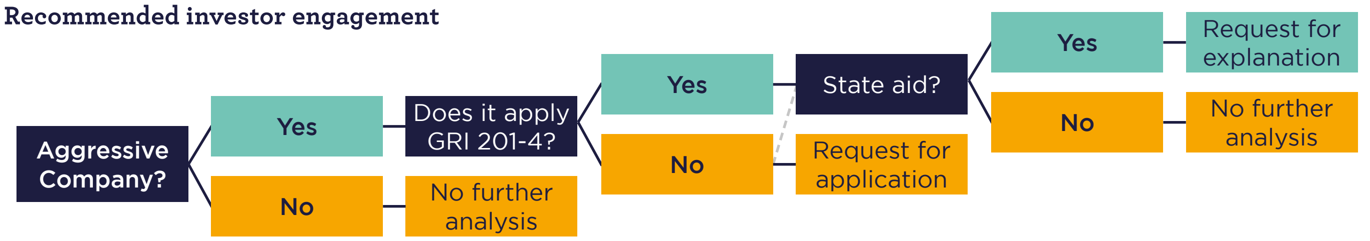
A set of approximately 320 listed companies has been defined, in Europe and North America, based on their presence in the most relevant national or global stock market indexes. Most of them are blue chips with a relatively good ESG profile.

In 2020, almost a third of the analysed companies were identified as 'aggressive' in at least one of the considered indicators. Out of these, 26 were 'aggressive' in more than one indicator. With respect to this selected group, the research extended the analysis to the financial years 2018 to 2020, to understand if such behaviours represent a trend or are limited to 2020, assessed investment in R&D, analysed executive remuneration as well as profitability of subsidiaries in ATP countries. The latter three have been defined as '**aggravating indicators'**.

Finally, companies' financial reports have been analysed in order to check if most 'aggressive' companies received any State aid in 2020, as a consequence of the Covid-19 pandemic. In particular, GRI Disclosure 201-4, asking companies to report the total monetary value of financial assistance received from any government during the financial reporting period.

65% of the companies reported in accordance to GRI standards, but only 23% disclosed information according to Disclosure 201-4.

Recommended investor engagement



57% aggressive capital allocation companies obtained State aid in 2020.

30% government assistance was directly linked to the Covid-19 pandemic.

As far as Europe is concerned, these companies are:

- **EssilorLuxottica (FR);**
- **International Airlines Group (ES);**
- **Unibail-Rodamco-Westfield (FR);**
- **Tui (DE);**
- **Unicredit (IT);**
- **Compass (UK);**
- **Coltene Holding (CH).**

As responsible, long-term investors we consider that 'aggressive' capital allocation behaviour is not compatible with obtaining State aid. This is particularly true in presence of a pandemic emergency where, more than ever, it would be more appropriate to invest in sustainable, long-term development and resilience of companies and not in short-term value for shareholders. Moreover, aggressiveness' in corporate capital allocation is not only a problem for shareholders. It can also become a problem for workers and communities, which - as the research shows - may be deprived of public resources to serve private interests.

For this reason, based on the results of this report, SfC - Shareholders for Change will engage the above-mentioned companies, asking for more accountability in the use of public resources.

The aim of SfC engagement will be to draw the attention of companies and investors to the issue of State aid, its disclosure and, more in general, the impact of 'aggressive' capital allocation policies on the long-term value of companies (also irrespective of the obtaining of State aid).

"fair-finance is constantly striving to improve the sustainability profile of its investment portfolios also through the engagement with companies included in our funds' portfolios and the asset managers who manage them.

We supported this report because 'aggressiveness' in corporate capital allocation is not only a problem for shareholders. It can also become a problem for workers and communities, which – as the research shows – may be deprived of public resources to serve private interests."

Rainer Ladentrog, Marketing Manager **fair-finance Gruppe**

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