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Michael Norton

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Bhavya Mohan

University of San Francisco

Serena Hagerty

Harvard Business School

Michael Norton

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# Consumers Punish Firms that Cut Employee Pay in Response to COVID-19

Bhavya Mohan <sup>a</sup>, Serena Hagerty <sup>b</sup>, Michael Norton <sup>c</sup>

<sup>a</sup>University of San Francisco

<sup>b</sup>Harvard Business School

- a. Bhavya Mohan (corresponding author)  
Assistant Professor  
University of San Francisco  
2130 Fulton St  
San Francisco, CA 94117  
[bmohan@usfca.edu](mailto:bmohan@usfca.edu)  
925.389.7539
  
- b. Serena Hagerty  
Doctoral Candidate  
Harvard Business School  
Soldiers Field Road  
Boston, MA 02163  
[shagerty@hbs.edu](mailto:shagerty@hbs.edu)
  
- c. Michael Norton  
Professor  
Harvard Business School  
Soldiers Field Road  
Boston, MA 02163  
[mnorton@hbs.edu](mailto:mnorton@hbs.edu)

Two experiments, including one incentive compatible study, examine the impact of cutting pay for executives versus employees in response to COVID-19 on consumer behavior. Study 1 explores the effect of announcing cuts or no cuts to CEO and employee pay, and shows that firms' commitment to paying employees their full wages leads to the most positive consumer reactions. Study 2 further examines the effects of announcing employee and CEO pay cuts: though announcing CEO pay cuts in tandem with employee pay cuts can help mitigate the negative effects of employee pay cuts, consumers respond most positively to firms which prioritize paying employees regardless of their strategy for CEO pay. These positive perceptions are mediated by perceptions of financial pain to employees. We discuss the implications of our results for firms and policy-makers during economic crises.

**Keywords:** employee furloughs, CEO pay cuts, pay ratios, purchase intention

## INTRODUCTION

While the first coronavirus stimulus bill was being negotiated in 2020, potential voters were surveyed about hypothetical preconditions for companies to qualify for bailout money (Stewart 2020). Of these 8 conditions (which included a board seat for workers, protection of collective bargaining, and a guaranteed minimum wage), the condition that garnered the highest level of support was a commitment to no layoffs (Sheyman, Winter, and Coblenz 2020). In fact, this condition received more support than the second most popular condition, which limited the compensation of CEOs of firms receiving bailout money (Stewart 2020). We explore the implications of firms pursuing these different strategies not in qualifying for bailout money, but in retaining the goodwill and spending of their customers.

In March of 2020, retailers, food service providers, airlines, and factories around the world shut down as the coronavirus pandemic spread (Horowitz 2020). As a result of the economic fallout, many companies announced strategies for weathering the pandemic, which included new plans with regard to compensation for both employees and for upper management. However, there was heterogeneity in firm strategies. Some firms focused on laying off, furloughing, and reducing pay of employees (Vasel 2020). Consumer-facing retail employees were hit particularly hard – for instance, Kohl’s furloughed 122,000 store employees, while Gap Inc. furloughed 80,000 store employees (Smith 2020). Others focused on maintaining employee pay (Capiello 2020), as when Nike Inc. announced all employees would continue to be paid in full during store closures (Leon and Geller 2020), and when Columbia Sportswear, for instance, pledged that each of the company’s 3,500 retail employees would continue to receive their full salary through the pandemic (Lee 2020). Still other firms focused on cutting pay for members of upper management (Trentmann and Broughton 2020). Some instituted pay cuts for both employees and upper management; for example, Kohl’s and Gap Inc. also announced salary reductions to executive team compensation (Chochrek 2020; Smith 2020). Some instituted pay cuts only for upper management: Columbia Sportswear announced a CEO salary reductions to \$10,000 while pledging to maintain employee wages (Lee 2020).

However, even though top executives were advised by the *Harvard Business Review* that, “As CEO, you should take the largest salary cut yourself...” (Tarki, Levy, and Weiss 2020), not all firms followed suit. When J.C. Penney furloughed the majority of their 95,000 store employees without pay, no executive pay cuts were announced (Smith 2020). As firms

furloughed employees without pay, some executives even received additional bonuses, or large equity awards at low stock valuations (DiNapoli and Kerber 2020). Build-A-Bear furloughed 90% of its 4,300 store employees without pay, and publicly announced a 20% executive pay cut; two weeks later, however, top executives received stock grants equivalent to the value of their pay cuts, effectively preserving their salaries (DiNapoli and Kerber 2020).

We explore consumer reactions to CEO versus employee pay cuts for two main reasons. First, cutting CEO pay during the pandemic was largely seen as a reputational move (Trentmann and Broughton 2020), but the effectiveness of such cuts in shaping positive consumer sentiment has not been assessed. Second, in contrast to the more than 300 publicly traded firms announcing executive pay cuts, far fewer firms have publicized a different potentially effective reputational move: a commitment to paying their retail employees through the pandemic (Trentmann and Broughton 2020; Cappiello 2020). We therefore explore the relative effectiveness of disclosure about cutting and maintaining both employee and executive pay on consumer attitudes and behavior.

## **CONCEPTUAL BACKGROUND**

In the decade leading up to the COVID-19 pandemic, the wage growth of employees lagged compared to executive wage growth, even amidst record high economic growth and low unemployment rates (Gould 2019); for example, CEO pay increased a third more quickly than the U.S. stock market between 1978 and 2018 (Mishel and Wolfe 2019). As a result, comparisons of CEO to average or median employee compensation have received increased attention in recent years (McGregor 2013). Indeed, a strict CEO pay ratio limit of 50:1 for firms receiving government aid was in the first stimulus relief package put forward to the United States Congress in 2020; this, however, was replaced with a less stringent measure that allowed CEO's to keep the greater part of their compensation (Anderson and Pizzigati 2020; Zahn 2020).

Previous survey research suggests that both consumers and citizens hold strong beliefs about the fairness of the gap between employees and management. For instance, Americans report an "ideal" ratio of CEO pay to unskilled worker pay of 7:1 (Kiatpongsan and Norton 2014), dramatically lower than the actual average pay ratio across US firms of 287:1 (AFL-CIO 2019). Moreover, recent research shows that consumers prefer firms with lower CEO-to-worker pay ratios, and that the disclosure of high pay ratios can negatively affect actual purchase

behavior, via diminished perceptions of fairness (Benedetti and Chen 2018; Mohan et al. 2018). Thus, building on previous research, we first propose that disclosing that CEOs are taking pay cuts during a crisis leads to an increased purchase interest relative to the CEO maintaining their full salary.

However, we further propose that a firm's treatment of its employees – specifically, the decision not to layoff or furlough employees without pay – may matter even more to consumers. Why might consumers punish firms for cutting employee wages? We draw on research that documents fundamental aspects of social perception – warm versus cold, and competent versus incompetent – and demonstrates the unique affective and behavioral consequences of such perceptions (Cuddy, Fiske, Glick 2008). Research suggests that for-profit firms are perceived as competent but cold (Aaker, Vohs, Mogilner 2010), perceptions that have been associated with emotions such as hostility, envy, and anger (Parrott Smith 1994; Smith 2000). In addition, research suggests that consumers typically have very negative perceptions of firms that they view as motivated by profit, as opposed to other goals such as social welfare (Bhattacharjee, Dana, Baron (2017). Moreover, previous research suggests that consumers evaluate and respond to firm's treatment of employees (Creyer and Ross 1996; Hiscox, Broukhim, and Litwin 2011; Paharia, Vohs, and Deshpandé 2013; Pelozo, White, Shang 2013); in one study, signage ensuring good working conditions led consumers to pay up to 40% more for these labeled products (Prasad et al. 2004). Together, these two streams of literature lead to our prediction that when firms cut employee wages – demonstrating a “cold” concern with profit over social harm – consumers will react negatively and seek to harm such firms; in contrast, firms that maintain employee wages thereby demonstrating a “warm” concern with the social welfare of employees will be rewarded by consumers.

Moreover, and in line with the survey of hypothetical predictions for firms to qualify for a bailout, we explore whether maintaining employee wages may have a greater positive impact on consumer perceptions than cutting CEO pay. There is a wide gap in personal financial impact when comparing the effects of a CEO pay cut to an unpaid employee furlough (Trentemann and Broughton 2020). In 2018, the average American CEO made \$14.5 million dollars, compared to an employee average of \$39,888 (Campbell 2019). An across the board 50% pay cut leaves the CEO with \$7.25 million, but reduces the average employee to below the poverty line. Indeed, in response to their CEO taking a salary cut (while 20,000 employees remained furloughed without

any pay), a representative of United's union offered the following response: "Our members recognize that United's executives taking pay cuts is more of a symbolic gesture than a hardship... The personal financial impact by a CEO and a front-line employee taking pay cuts is not comparable." (Trentemann and Broughton 2020). We introduce a new construct that taps into this difference in perceived hardship faced by CEOs and employees experiencing pay reductions, predicting that when making purchase decisions, consumers are more responsive to the financial pain of an employee facing salary loss than the financial pain of a CEO facing salary loss. We predict that this sensitivity to employee financial pain mediates the negative effects of salary cuts on purchase intention, over and above general perceptions of wage fairness.

## **OVERVIEW OF STUDIES**

Two experiments (including one incentive-compatible study) examine consumers' reactions to cutting versus maintaining pay for both executives and employees. Study 1 explores the effect of announcing cuts or no cuts to CEO and employee pay, and shows that firms' commitment to paying employees their full wages leads to the most positive consumer reactions. Study 2 examines the effects of simultaneously announcing employee and CEO cuts, and shows that while CEO pay cuts can mitigate the negative effects of cutting employee pay to an extent, consumers respond most positively to firms which prioritize paying employees, regardless of CEO pay level. These effects are mediated by perceptions of financial pain to employees.

## **STUDY 1**

The key objective of Study 1 is to examine whether revealing employee salary cuts versus CEO salary cuts affects consumers in an incentive-compatible context. In this study participants read about four firms and were asked to choose which firm they would like to receive a \$50 gift card to in an actual lottery. Participants were either given no additional information or were given full information about the firms' salary decisions for retail employees and CEO.

### ***Method***

**Design and Participants.** Participants ( $N = 501$ ; 41% female; age:  $M = 37.07$  years,  $SD = 10.67$ ) were recruited through Amazon Mechanical Turk and paid a flat rate for compensation. Study 1



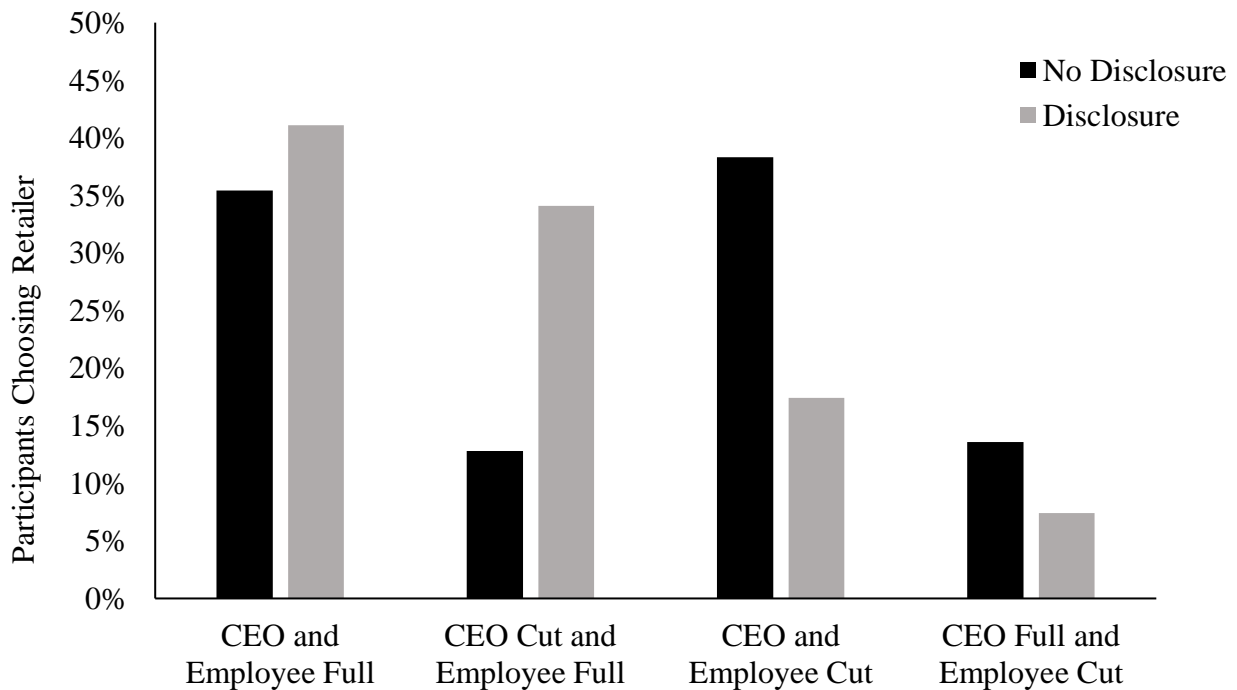
used a two condition, between subject design. All participants were given initial instructions that they were going to read a description about four different companies and be asked which company they would prefer to buy from. In the *no disclosure* condition, participants read “J.C. Penney is a nationwide chain of retail stores that sells apparel in-store and online.” They then read the exact same description for Kohl’s, Nike, and Columbia. In the *disclosure* condition, participants read “J.C. Penney is a nationwide retailer that sells apparel in-store and online. Due to the COVID-19 epidemic, they decided to continue to pay their CEO’s full salary, and no longer pay their retail employees’ salaries.” They then read the same description for the other three companies, but were informed that Kohl’s ‘decided to cut their CEO’s salary, and no longer pay their retail employees’ salaries’, Nike ‘decided to continue to pay their CEO’s full salary, and continue to pay their retail employees’ salaries’, and Columbia ‘decided to cut their CEO’s salary, and continue to pay their retail employees’ salaries’.

**Measure.** All participants were then told “You have the opportunity to be entered into a draw for a chance to win a \$50 gift card for EITHER Nike, Columbia, Kohl’s, or J.C. Penney. It is your choice whether to be entered for the draw. Please make your selection below. If you win the gift card draw, then we will give you the amount of the gift card. Your odds of winning the raffle are approximately 1 in 500.” Participants then chose which of the four retailers they would want a gift card to if they won the lottery.

## ***Results***

**Choice.** Overall, the disclosure of payment decisions influenced which retailer participants chose. Participants in the disclosure condition were significantly more likely to choose Columbia after reading the company cut the CEO’s salary, but kept paying retail employees (34.1% vs. 12.8%,  $\chi^2(1,501) = 31.50, p < 0.001$ , Cramer’s  $V = 0.25$ ). Participants were also slightly more likely to choose Nike when informed that the company kept paying both CEO and retail employees (41.1% vs. 35.4%,  $\chi^2(1,501) = 1.72, p = 0.19$ , Cramer’s  $V = 0.06$ ). However, participants in the disclosure condition were significantly less likely to choose Kohl’s after reading the company cut both CEO and employee salaries (17.4% vs. 38.4%,  $\chi^2(1,501) = 27.21, p < 0.001$ , Cramer’s  $V = 0.23$ ) and significantly less likely to choose J.C. Penney after reading the company kept paying the CEO salary but cut employee salaries (7.4% vs. 13.6%,  $\chi^2(1,501) =$

5.20,  $p = 0.02$ , Cramer's  $V = 0.10$ ). Overall, Columbia had the greatest increase in participant choice in the disclosure condition by cutting the CEO pay and continuing to pay retail employees; see Figure 1.



**Figure 1.** Study 1. Consumers responded the most positively to the firm (Columbia) that cut the CEO's pay and continued to pay the retail employees' salaries.

### *Discussion*

This experiment provides evidence that revealing information about retail employee and CEO pay cuts can affect consumers' real-world choices. Overall, consumers responded the most positively to the firm that cut the CEO's pay and continued to pay the retail employees' salaries in full (Columbia). Even when the firm chose to pay the CEO in full, consumers still responded favorably to the firm's decision to pay employee salaries (Nike). Moreover, consumers were less likely to choose a firm that had cut employee pay, even when CEO pay was also cut (Kohl's).

## **STUDY 2**

The key objective of Study 2 is to examine whether consumers' purchase intentions are affected by disclosure of information about a firm's decision to cut or to continue to pay the salaries of the CEO and the retail employees. Study 2 also examines a potential mediator- the role of perceptions of financial pain to employees as a result of these salary decisions.

### ***Method***

**Design and Participants.** Participants ( $N = 630$ ; 63% female; age:  $M = 46.08$  years,  $SD = 16.48$ ) were recruited through an Amazon Mechanical Turk Panel and paid a flat rate for compensation. Study 2 used a 2 (retail employee salary: *full* vs. *cut*) X 2 (CEO salary: *full* vs. *cut*) between subject design. All participants were given initial instructions to imagine that they were looking to purchase a new pair of shoes and found a high-quality pair at a price point below their budget being sold online by a well-known retailer. Participants then read "Imagine that you then learn that due to the COVID-19 epidemic, the well-known retailer closed down their physical stores. In this company, the CEO's salary costs \$14 million dollars a year. Continuing to pay all employees their regular salary would cost \$14 million dollars."

All participants then read information about the status of both the retail employees and the CEO salaries at this company. For retail employee salary information, participants read either that "The company has decided to continue paying their retail employees their salaries" (*Retail Employee Full*) or "The company has decided to stop paying their retail employees their salaries" (*Retail Employee Cut*). For CEO salary information, participants read either that "The company has decided to continue paying their CEO their salary" (*CEO Full*) or "The company has decided to stop paying their CEO their salary" (*CEO Cut*). Information about employee salaries and CEO salary were presented in randomized order.

**Measures.** As the primary dependent measure, all participants were asked "Given the opportunity, how likely are you to purchase the shoes from this retailer?" (1= Not at all likely; 7 = Very likely). As in Study 1, participants were asked how much pain the company's decision causes the retail employees and the CEO, separately (1=None at all; 7 = Very much). As a secondary measure, they were asked how fair they thought the wage the retailer pays its CEO is and how fair the wage for retail employees is (1= Not at all fair; 7 = Extremely fair).

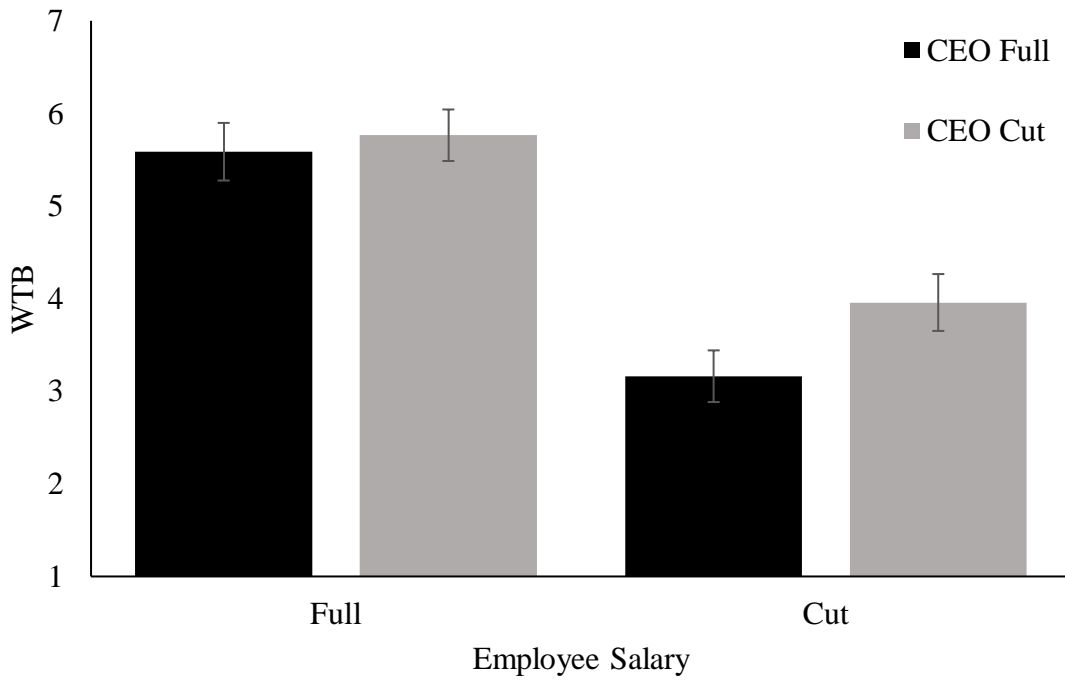
## **Results**

**Willingness to Buy.** A 2 (retail employee salary: full vs. cut) X 2 (CEO salary: full vs. cut) ANOVA analysis on willingness to buy revealed a main effect of retail employee pay ( $F(1,629) = 199.27, p < 0.001, \eta_p^2 = .24$ ), such that participants were more likely to buy when retail employee salaries were still being paid. There was also a main effect of CEO pay ( $F(1,629) = 10.58, p = 0.001, \eta_p^2 = .02$ ), such that participants were more likely to buy when the CEO salary was cut. There was also a significant interaction ( $F(1,629) = 4.28, p = 0.04, \eta_p^2 = .01$ ), revealing that cutting CEO pay increased WTB only when retail employee salaries were also cut. If retail employee salaries were still being paid, participants indicated the same WTB whether CEO salary was paid ( $M = 5.59, SD = 1.51$ ) or if CEO salary was cut ( $M = 5.79, SD = 1.61$ )  $t(312) = -1.01, p = 0.32$ . However, if retail employee salaries were cut, participants indicated greater WTB if CEO salary was also cut ( $M = 3.96, SD = 2.06$ ) compared to when CEO salary was paid in full ( $M = 3.16, SD = 2.19$ ),  $t(314) = -3.3, p = 0.001$ ; see Figure 2.

**Perceptions of Pain vs Fairness.** A 2 (retail employee salary: full vs. cut) X 2 (CEO salary: full vs. cut) ANOVA analysis on perceived pain to employees revealed a main effect of retail employee pay ( $F(1,629) = 299.78, p < 0.001, \eta_p^2 = .32$ ), no effect of CEO pay ( $F(1,629) = 0.17, p = 0.68, \eta_p^2 < 0.001$ ), and no significant interaction between retail employee pay and CEO pay ( $F(1,629) = 0.06, p = 0.81, \eta_p^2 < 0.001$ ). As expected, participants perceived a salary cut to be more painful for retail employees ( $M = 6.10, SD = 1.50$ ) than a full salary ( $M = 3.48, SD = 2.20$ ),  $t(628) = -17.47, p < 0.001$ . Similarly, participants perceived a salary cut to be more painful for the CEO ( $M = 4.64, SD = 1.98$ ) than a full salary ( $M = 3.06, SD = 2.16$ ),  $t(628) = -9.58, p < 0.001$ . Importantly a salary cut was perceived as more painful for retail employees ( $M = 6.10, SD = 1.50$ ) than for the CEO ( $M = 4.64, SD = 1.98$ ),  $t(631) = 10.45, p < 0.001$ . Perceptions of retail employee pain mediated our results [See Methodological Details Appendix].

To determine which construct best predicted willingness to buy, we entered all four mediators - perceived pain of employees, perceived pain of CEO, perceived fairness of employee wages, and perceived fairness of CEO wages - into a regression predicting willingness to buy. While perceived fairness of retail employee wages ( $\beta = 0.25, p < 0.001$ ), perceived pain of CEO ( $\beta = 0.15, p < 0.001$ ), and fairness of CEO pay ( $\beta = 0.24, p < 0.001$ ) were significant, positive

predictors, perceived pain of retail employees ( $\beta = -0.37, p < 0.001$ ) was the strongest predictor of willingness to buy across our measures.



**Figure 2.** When retail employee salaries were cut, participants indicated greater willingness to buy if CEO salary was also cut, compared to when CEO salary was paid in full.

### ***Discussion***

Study 2 shows that consumers are more responsive to news about retail employee salaries than to news about a CEO's salary. A firm's decision to cut the CEO salary only increased consumer willingness to buy when the retail employee salaries had also been cut. However, regardless of the status of the CEO salary, consumers were significantly more likely to purchase from a firm that continued to pay retail salaries throughout the crisis. This study provides evidence that consumers are most responsive to information about the salaries of retail employees, an effect mediated by perceptions of financial pain to retail employees. To show further evidence for our proposed mechanism, we conducted an additional study. We again found that consumers were more responsive to information about retail employee salaries than to information about the CEO's salary. These effects were again mediated by perceptions of

financial pain to employees, and held regardless of whether consumers' own wages were affected by COVID-19 [See Methodological Details Appendix].

## **GENERAL DISCUSSION**

Two experiments examine how executive pay cuts versus employee furloughs influence consumer purchase behavior. A firm's decision to continue paying employees matters more to consumers than executive pay cuts (Study 1). While CEO pay cuts can help mitigate the negative effects of cutting employee pay to some extent, consumers respond most positively to firms which prioritize paying employees; these effects are mediated by perceptions of financial pain to employees (Study 2).

Our research provides an initial understanding of the effect of employee furloughs versus CEO pay cuts on consumers, but there is much room for future research on when and why these effects arise. We demonstrated a mediating role for pain caused to the employee, and show that the results hold when controlling for individual wages lost, but future research can explore how other individual-level attributes (such as political affiliation) or firm-level attributes (such as the firm's CEO pay ratio prior to the pay cut) may moderate our results (Mohan et al. 2018). Moreover, future work can examine whether CEOs can take additional actions to mitigate the pain felt by employees, such as offering sick leave or paying for medical benefits (Morgan 2020). Future work can also examine whether firms can recapture lost goodwill from consumers, by re-hiring furloughed employees, providing bonuses, or increasing pay (Danziger 2020).

The longer-term effects of efforts to prioritize employee jobs and pay are yet to be determined. However, a firm's decision to support their employees, upon disclosure, can be publicized by the news media, activist groups, politicians, and competitors. Thus, consumer-facing firms who prioritizing paying their employees could gain equity as a result of greater customer awareness.

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