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Using ESG Tools to Help Combat Racial Inequity: One Year Retrospective

The events of last summer galvanized the nation and the world and drew much-needed attention to how systemic racism and injustice continues to burden communities of color, who also disproportionately bore the weight of the pandemic. In the months that followed, we witnessed a marked shift in corporate America. This shift was evidenced not only by the millions of dollars pledged towards fighting racial inequality but also in the growing recognition among business leaders that corporate America ought to play an active role in combatting racial injustice and inequity, both in the communities where they do business and their boards, management, workforce, business partners and customers. One year on, we review the ESG tools and approaches that have helped buttress efforts to address racial inequity and the increasing expectations of investors and stakeholders, and discuss how companies can continue to tackle these issues, including how a strong ESG oversight and governance framework can help boards and management in deciding when and how to speak out with respect to stakeholder priorities.

Last summer, as we wrote then, we saw a flurry of companies pledging significant sums to social justice efforts, with many companies launching initiatives to improve and accelerate hiring of Black candidates and to support Black and minority-owned businesses. The Business Roundtable launched comprehensive efforts to combat racial inequality in employment, finance, education, health and housing. Over the past year, a significant number of companies have turned their efforts inward to focus on improving and accelerating their own DEI initiatives and targets. We have seen an uptick in hiring for meaningful DEI roles, expansion in the internal DEI function, commitments to periodic anti-bias training across the workforce, and pledges to conduct audits of effectiveness and progress of DEI initiatives. Many companies have also publicly disclosed DEI goals and targets for their workforce, and in some cases, have tied DEI performance to executive compensation. How companies have conceptualized DEI has also shifted. Once a relatively siloed department, DEI is increasingly integrated into an organization's human capital management, business strategy, brand and reputation management, and supply chain functions. Most notably, we have seen an uptick in disclosure and transparency on workforce diversity data (in part due to demand from investors and proxy advisors) and growing recognition and discussion of the need to cultivate a pipeline of diverse employees and candidates for management and board roles. Companies are also enhancing supplier diversity, disclosing accordingly and supporting enabling diverse suppliers to operate at scale. A wide range of companies, across industries, are also embracing a principle espoused by the non-partisan Bank Policy Institute: "Never consider philanthropy a substitute for refining business practices to better serve overlooked communities or for emphasizing diversity and inclusion across the organization and its business processes."

While the press continues to scrutinize and closely track how companies are responding to issues of social and racial justice, investors have also focused in particular on DEI. In addition to private pressure from actively managed asset managers and "passive" institutional investors, the most recent proxy season saw an upswell in shareholder proposals on DEI matters, notably disclosure on diversity initiatives and outcomes. Pressure from investors has also prompted a growing number of companies to adopt a "Rooney Rule" requiring the inclusion of diverse candidates in board searches, and inclusive hiring practices announced by companies increasingly reach a range of internal workforce positions. A number of companies were also subject to shareholder proposals calling for disclosure of EEO-1 data—a call prompted and supported by a number of investors, including the NYC Comptroller, institutional pension funds and even large asset managers. Activist shareholders have taken the opportunity to use DEI to help leverage their economic campaigns. Together with other ESG issues, claimed or perceived DEI weaknesses have now become another tool in the activist's arsenal and can be deeply damaging to the credibility of the board and management where the company is caught flat-footed or has failed to demonstrate that it has focused on such matters prior to an activist emerging. At the same time, shareholders are becoming increasingly sophisticated on ESG and DEI issues and have demonstrated willingness to see through unfounded activist critiques.

Perhaps one of the most challenging developments for companies over the past several months is finding their voice amid the cacophony of public debate on racial justice matters. As the recent responses to voting rights measures demonstrate, companies are increasingly expected to have a principled position on a wider range of issues. Choosing not to speak out—a strategy that some companies have adopted in the past—may now be interpreted as delivering its own message. At the same time, speaking out on issues that may have a political dimension may attract its own backlash. Companies deciding when and how to communicate with their disparate stakeholders on polarizing political issues need to, more than ever before, stay attuned to the expectations and views of their core stakeholders (e.g., investors, employees, consumers and local communities), revisit their business's core purpose and values, and ensure alignment among the board and management. Existing ESG oversight and management processes will help companies to timely respond to stakeholder concerns. Boards and management will also need to remember that any messaging will naturally draw expectations of further action, and messaging that is not consistent with corporate behavior will likely draw harsh criticism.

Looking ahead, the events of last summer have left an indelible mark on the country and their impact will likely continue to be reflected in heightened investor, stakeholder and governmental expectations of companies. Calls for greater disclosure, transparency, effort and accountability to address racial inequity will continue to inform proxy voting policies, shareholder proposals and investor engagement priorities. Being an active participant in that evolving dialogue, and keeping attuned and informed, will be critical to corporate success, value creation and long-term sustainability for enterprises of every sort.

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