Creating value by addressing social injustice

The death of George Floyd and the ongoing pandemic have highlighted social inequities that were previously ignored. Board and workforce composition and the inequitable impacts of business practices on diverse communities reflect and perpetuate underlying racial and ethnic injustices that create systemic risk. But addressing social injustice can help to create long-term value.

Setting the scene

Social injustice occurs when people do not have access to the same rights and opportunities afforded to others, due to race, ethnicity, gender, sexuality, religion, disabilities or other characteristics. Examples include inequitable access to employment, education, housing, health services and finance; negative stereotypes; and poor and marginalised communities' greater exposure to pollution and climate change. These inequities contribute to widening income inequality and persistent, multi-generational gaps in family wealth, educational attainment and health indicators.

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Social injustice polarises society, frays democracy and hinders economic growth, as well as raising profound ethical questions. These forces create systemic risk that may impact the performance of the economy and markets. Inequalities created by social injustice pose a threat to long-term universal owner returns, similar to other long-term ESG issues such as climate change.

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Addressing the financial risks of social injustice is therefore in investors' own financial self-interest – in addition to being the right thing to do. But the risks are poorly understood. While initiatives to create greater visibility, such as the Task Force on Inequality-related Financial Disclosures (TIFD)[2] and the World Economic Forum's inclusive growth benchmarks[3] are underway, they are still emerging.

[1] See, for example: https://www.borgenmagazine.com/difference-between-an-inequality-and-an-inequity/ and https://study.com/academy/lesson/social-justice-lesson-for-kids-definition-issues-examples.html
[2] https://thetifd.org/
[3] https://www3.weforum.org/docs/WEF_Inclusive_Growth_Development.pdf

Our systemic stewardship approach

We use engagement, voting recommendations and public policy advocacy to identify company-specific risks and opportunities and build momentum for broader societal changes conducive to long-term value creation. Our systemic stewardship approach to diversity, equity and inclusion (DEI) pushes boards and companies to create value by making three positive changes. First, build more inclusive boards, workforces and cultures that help to dismantle obstacles and enable all individuals to maximise contributions to their companies. Second, reduce harmful company practices that perpetuate injustice in society. Third, develop proactive strategies and products that reduce inequities.

Build more inclusive boards, workforces and cultures

We expect all companies to address inequities within their boards and workforces. DEI is an ethical and business imperative. Expanding and improving upon DEI, both at the leadership level and throughout the wider organisation, creates enduring value by improving decision-making, attracting talent, enhancing workforce satisfaction, and stimulating insight and innovation. A growing body of evidence supports the system-wide benefits of social and economic inclusion, by linking more diverse company leadership with greater financial performance.

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Many companies continue to fall short in terms of reflecting the diversity of society on their boards, in senior management and throughout the workforce. We strongly advocate for boards of diverse composition, in the broadest sense, and for the execution of meaningful workforce-level DEI strategies. Our expectations include meaningful CEO and board commitments and effective board oversight of a clear strategy accompanied by targets and disclosure of performance.

We expect companies to have moved beyond public statements towards actively building inclusive cultures. This should include the recruitment and career progression of members of underrepresented groups, including at the board and senior levels; training all employees in dignity and respect, plus unconscious bias and allyship; and increasing employee engagement, retention and development.

Through our engagement with US paint manufacturer Sherwin-Williams, we were pleased to see the company publish its first diversity, equity and inclusion report. This included a commitment from the CEO, numeric goals to increase diverse representation in management roles, and employee testimonials. And as part of a concerted effort to increase gender diversity across the Japanese companies in our engagement programme, we welcomed the significant improvement that plastics products manufacturer Nifco made in its disclosure of data on human capital management and gender diversity. While the company was unable to meet its target to improve the proportion of women managers to 8% by the date specified, it described various measures to improve this. For example, it has appointed a female executive officer from outside, changed its personnel system and has focused on identifying and developing young talent to become management candidates. It is also working to set a new target.

Covid-19 disproportionately impacted the health and employment of racially and ethnically diverse people and widened pre-existing disparities, as in developed markets these groups tend to be over-represented in frontline roles, such as retail, hospitality, healthcare and manufacturing. Companies with higher diversity among frontline workers versus more senior office-based roles need to be mindful of, and work to address, the disproportionate racial and ethnic safety implications that arise.

> **In a letter sent to over 40 companies as part of a collaborative initiative, we made the business case for permanent paid sick leave.**

In the US, we have collaborated with the Interfaith Center on Corporate Responsibility (ICCR) and 150 institutional investors and their representatives to challenge companies on the growing reputational, financial, and regulatory impacts associated with the lack of comprehensive paid sick leave (PSL) benefits for all employees. According to the National Partnership for Women & Families, 70% of the lowest-waged workers in the US do not have paid sick days to care for their own health.[4]

In a letter sent to over 40 companies as part of the collaborative initiative, we made the business case for permanent PSL and asked companies for a written response providing more transparency around paid sick leave policies. We also urged companies to help make the pandemic recovery and the future operating environment more equitable by providing permanent paid sick time for all workers.

[4] Quick Facts (paidsickdays.org)

CASE STUDY

Starbucks

At coffee chain Starbucks, we were concerned that the company's anti-bias efforts had stalled since its initial 2018 US-wide training session, which followed the unjustifiable arrest of two African-American men in one Philadelphia store.[5]

In 2021, the company's chief inclusion and diversity officer and his team met with us and responded to our questions on the impact of its anti-bias training. He also explained the progress made on its global inclusion and diversity strategy. Starbucks appointed a global chief inclusion and diversity officer in 2020 and expanded its inclusion and diversity strategy in 2021, mandating anti-bias training for vice president levels and above. The company said it would continue to explore mandating training for all partners (employees) in practice, while tracking enrolment and completion rates for its expanded version of the open-source training.

The chief inclusion and diversity officer confirmed that the company had considered the experiences of racially-diverse customers by collecting feedback from external civil rights groups as a proxy for customer experience, plus taking feedback from customer helplines. Managers were expected to respond to concerns raised by partners through its anti-bias questions in the annual partner survey.

Additionally, we welcomed the company's commissioned Civil Rights Assessment, which has been conducted by a third party annually since 2019, and the company has expressed a commitment to sustaining a Third Place where everyone should feel welcome.

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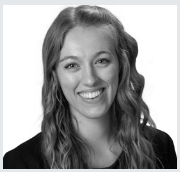
Theme lead: Executive Remuneration



Sarah Swartz
Themes: Natural Resource Stewardship, Risk Management

DEI continues to feature prominently in our 2022 Corporate Governance Principles, where we have updated our expectations for North America. We will challenge companies with an aspirational target of 50% overall diversity and consider recommending voting against the chair of the nomination and governance committee where there is not at least 40% overall diversity on the board, with a minimum of 30% women and at least one person of a racially or ethnically diverse background.

We also believe that diversity and inclusion should go beyond gender and race to include diversity of skills, experience, networks, psychological attributes, and characteristics (including, but not limited to, race, ethnicity, gender, sexual orientation, age, disability, nationality, and socioeconomic background). Social inequalities and pay wage gaps persist for people with disabilities and members of the LGBTQ+ community.

We have started to incorporate the discussion of self-identification and aggregate disclosure of all diversity dimensions at the board level and will continue to engage on this topic in the 2022 proxy season. Self-identification at the highest level of companies exemplifies commitments to inclusion and belonging that can ripple throughout the organisation.

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Reduce harmful company practices that perpetuate inequities in society

Fixing the company internally is a pre-requisite for its ability to recognise and prevent harm to customers and stakeholders. Doing so requires understanding and addressing deeply-rooted and complex problems that inevitably impact both a company's workforce and the society within which it operates. The company must gain a clearer picture of the potentially inequitable impacts of its activities on external stakeholders, with effective oversight and performance evaluation.

For example, we have engaged with the Walt Disney Company, which has recognised the need to amplify underrepresented voices, and the importance of accurate representation in media and entertainment. The company created two senior leadership councils focused on DEI in the workforce and content.

In addition to these executive-led efforts, we were pleased that the board assigned oversight of workforce equity to the compensation committee. In the spirit of transparency, the company disclosed workforce diversity data (EE0-1) and added labels to negative stereotypes on its Disney+ service. Furthermore, we welcomed the company's intention to advance representation in front of and behind the camera and, as an example, we see this intention in its film *Encanto*, which depicts a Colombian family. We encouraged the company to set and disclose qualitative and quantitative DEI goals.

[5] https://www.theguardian.com/business/2018/apr/19/starbucks-black-men-feared-for-lives-philadelphia

We championed racial equity/civil rights audits in the US financial services sector in the 2021 voting season and at Apple in Q1 2022. We believe third-party audits enhance the quality of board oversight by providing expert insight into practices that have inequitable impacts on workforces and stakeholders. They can also help to identify the causes of deeply-rooted problems, and assess the effectiveness of company programmes. We know that meaningful shareholder support has already influenced companies. For example, during Q1 2022, one global bank said that sizeable shareholder support and engagement had helped it to decide to conduct an audit despite opposing the proposal during the 2021 proxy season.

> **We encourage companies to apply a DEI lens to innovate and create new products and services, including those that help to achieve the UN Sustainable Development Goals.**

The rise in income inequality is an important source of systemic risk.[6] We have long opposed excessive quantum of executive compensation on the basis of a lack of alignment with long-term investor interests. In engagements, we have also explained that excessive quantum contributes to income inequality, and highlighted that their compensation practices are creating some of the problems that other initiatives at those companies seek to fix.

In our public policy advocacy work we are increasing our focus on environmental justice issues. For example, our Q1 2021 response to the US Environmental Protection Agency's (EPA) proposed methane regulation in the oil and gas sector noted that methane leaks and flaring can be accompanied by toxic and particulate matter with deleterious local health impacts. We also pointed out that poor and marginalised communities are expected to experience disproportionately high negative impacts from climate change, which could exacerbate existing inequities and add another layer of investment risk.

Develop proactive strategies and products that reduce inequities

We seek to strengthen the health of the stakeholder ecosystem to reduce systemic risk. Poor and marginalised populations have many unmet needs, creating opportunities for companies. We encourage companies to apply a DEI lens to innovate and create new products and services, including those that help to achieve the UN Sustainable Development Goals (SDGs). These may open up new businesses, attract loyal customers, employees and business partners, and build brand value.

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Providing access to finance, for example, can open up new customer sets that create financial value while addressing inequities. We have engaged with credit card provider Visa, which has achieved its goal of providing 500 million previously underbanked or underserved people with access to an account. It has also helped to support small businesses and digitise government disbursements.

We encourage telecommunications companies to help close the digital divide, supporting access to the internet and quality education (SDG 4), as this is critical to closing gaps in employment, income, healthcare and other needs. Bell Canada invests in closing the digital divide in rural and indigenous communities beyond where it receives Canadian government incentives to do so, as it sees the financial and social benefits of connectivity. In the US, we have engaged with Comcast, which agreed that closing the digital divide and race gaps in education are in its long-term financial interest. It is working with consultants and engaging with the US First Lady, Dr Jill Biden, on enhancing internet uptake in disadvantaged communities.

For the roughly 750 million people in extreme poverty around the world,[7] we tend to focus on public policy and access to medicine to help meet basic needs such as food and critical services. For example, we co-signed a global investor statement coordinated by the Access to Medicine Foundation in support of an effective, fair and equitable global response to Covid-19, which is consistent with SDG 3 (good health and well-being). It also reduces risk to people and economies around the world.

Outlook

Active investors can drive meaningful positive change that addresses injustice and creates financial value. We seek to play a catalytic role focusing investor and company attention on the systemic risks of injustice and, conversely, the benefits of a more inclusive society.

Looking forward, we will increasingly hold boards to account for the social impacts of practices that create risks for their own companies and the wider financial system. We will also continue to encourage boards to take ownership of company purposes that enhance the health of the stakeholder ecosystems that impact their own and investor returns.

[6] https://www.forbes.com/sites/bobeccles/2022/01/27/the-role-of-systemic-stewardship-in-addressing-income-inequality/?sh=4d6f96a42a88
[7] https://unstats.un.org/sdgs/report/2021/goal-01/

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