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BOARD RISK COMMITTEE

BOARD RISK REPORT

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Confronting DEI Pushback

Board Oversight in a Fractured Political Environment

By Phyllis J. Campbell

In the wake of the Supreme Court college admissions decision, legal actions against corporate DEI (Diversity, Equity and Inclusion) programs appear to be accelerating [1]. Firms such as Amazon, Comcast and Starbucks are among those that have already faced legal actions on the basis of DEI related charges, and on August 22nd two large legal firms, Perkins Coie and Morrison & Foerster, were sued because they offered fellowships specifically targeted to diverse candidates [2]. In June one observer noted that employers have walked a tightrope between establishing targets and goals, but not quotas. “This [college admissions] decision just snapped the tightrope” [3].

Arguably, the board’s role in steadying the DEI tightrope has become substantially more important. Virtually all large corporations have seen the headline consequences of linking the best possible business outcomes with sustainability, human rights, and diversity related initiatives. At the same time businesses have emerged among the most trusted institutions [4] and created heightened expectations about their performance, in part because of their transparent efforts to support a diverse set of stakeholders. Boards and executive management must now confront these expectations and mounting risks in today’s polarized world.

This article examines three areas relative to the state of corporate DEI programs:

1. What are the heightened risks DEI programs face and why should boards pay attention?

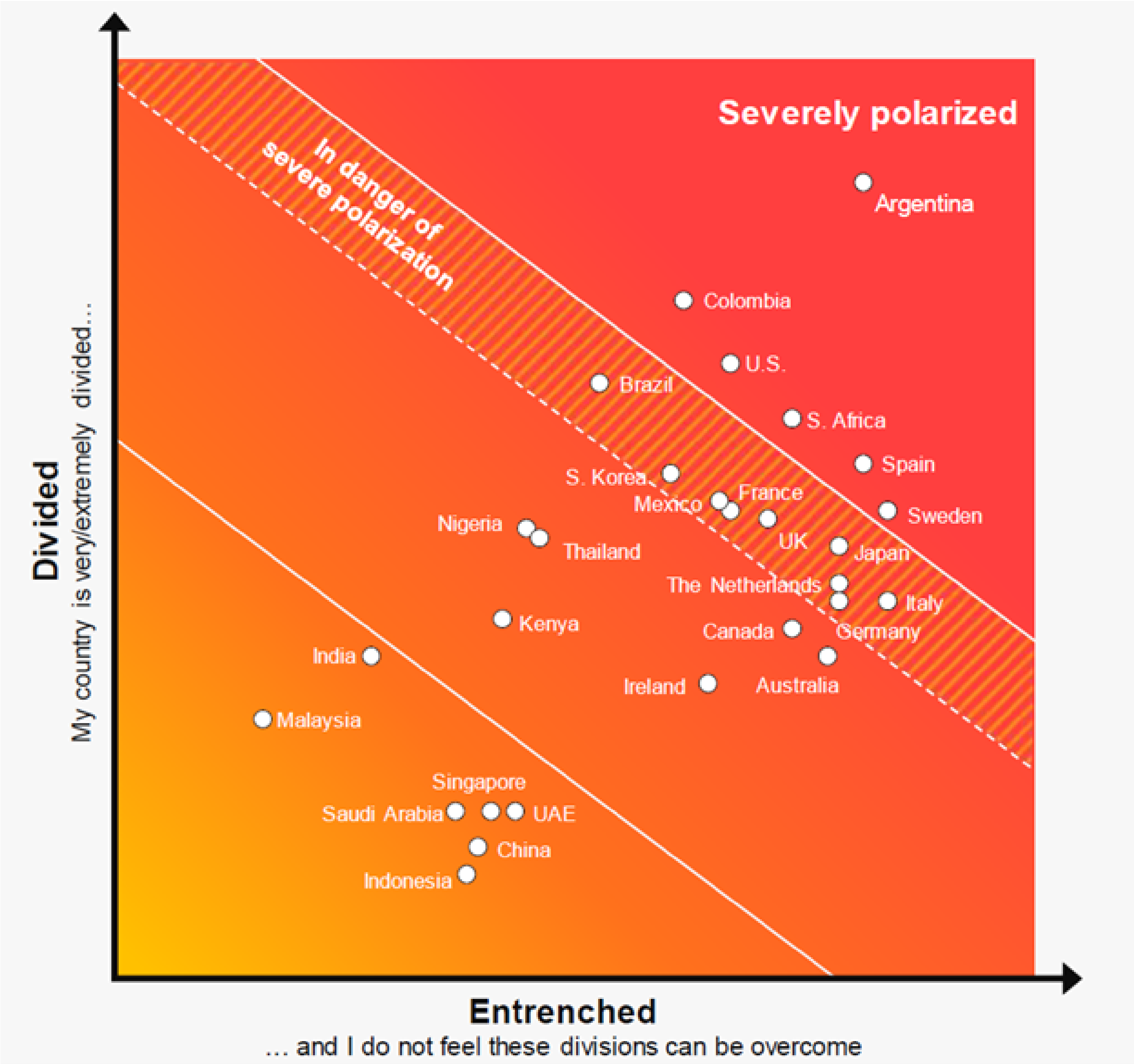
2. How can the board be assured that the companies they oversee are screening and managing those risks?

3. Can companies demonstrate and communicate, especially to internal constituents, the importance of DEI activities to their competitive posture and their continuing commitment to maintaining those initiatives? Are there areas where the company’s actions can make a positive difference?

RISKS

The 2023 Edelman Trust Barometer's Global Report [4] shows that the general "cycle of distrust" is higher than ever, with polarizing forces at work in every country around the world.

Six Countries Severely Polarized



Source: https://www.edelman.com/trust/trust-barometer

Whether it is economic anxiety, class divides, or the "battle for truth," there are powerful voices on each side of the aisle. The U.S., in particular, stands out for its marked split along the Red-Blue state divide, which manifests itself in the Democrat/Republican party positions. The Edelman study states that Republicans are more likely to state, "our differences are insurmountable."

We only need to look at the Disney case in the state of Florida as an example of this divide around the DEI agenda and the difficulty firms have in managing that divide effectively. As a reminder, after intense internal pressure Disney's previous CEO (Bob Chapek) took a public stand against the "Don't Say Gay" bill winding its way through the Florida legislature and supported by Governor Ron DeSantis [5]. After initially lobbying behind the scenes to defeat the "Don't Say Gay" legislation, and after Disney employees shared their outrage that the company did not publicly denounce the proposed legislation, Chapek did so at the company's annual meeting. In direct response to the Disney position, Governor DeSantis began to mock the company as "woke Disney" and threatened and eventually nullified its tax-preferred status in its Orlando complex.

As a *New York Times* article stated, "The dispute between Disney and Florida lawmakers is indicative of mounting pressure corporations face to be involved in partisan battles" [6].

Disney continues to fight back, suing Governor DeSantis, stating that it was "subjected to a targeted campaign of government retaliation." The overall fight has been deemed "Man versus Mouse." The latest development in the ongoing battle is that Governor DeSantis abolished all DEI-related projects and training within Disney's governing district. A DeSantis board appointee called the initiatives "illegal and simply un-American."

Affirmative Action rollbacks are even more of a front-and-center issue for companies following the Supreme Court's June decision, ending racial preferences in higher education.

Soon after the Supreme Court decision, thirteen Republican state attorneys general sent messages to companies in the Fortune 100, advising that "hiring practices based on diversity, equity and inclusion may be illegal racial discrimination." A number of prominent companies were singled out as pushing "illegal racial hiring quotas" [7]. Though it remains to be seen whether the consequences of legal action will be significant, the reality of legal action being enforceable is probably negligible. It is important to anticipate the full range of negative rhetoric and pressures that will be enhanced during the current election cycle.

In the era of divided politics, Boards and CEO's must have "eyes wide open" that any actions around DEI are highly likely to become lightning-rod issues, especially where election cycles are taking place. In particular, as we approach the 2024 Presidential race, the issues will become more significant. Business should seek good counsel to help navigate choppy DEI waters.

Questions Boards Should Consider:

- Is our company setting quotas on supplier diversity that can be deemed to be "illegal (reverse) discrimination"?
- Is our company setting hard and fast hiring and promotion goals for certain protected-class employees that could be perceived to be racial preferences, at the expense of other groups?
- Has our company sought the advice of external experts to optimize outcomes for employees and shareholders simultaneously?

QUESTIONS/PRINCIPLES

It goes without saying that reputational risk is tied closely to long-term shareholder value. Today more than ever boards have an obligation to understand their company's DEI principles in the context of the current environment. Boards should be comfortable with internal and external DEI communications and of course core DEI principles that have benefited corporate outcomes over time. No matter the principles or the questions that are developed, it is important that there be an understanding between management and the board that certain issues and positions should rise to the level of a board conversation.

Though there are no set of guidelines that are applicable to all, it is important for the board to agree upon principles that may govern public policy positions. The Edelman report suggests some guidelines:

- Be a source of trustworthy information.
- Base actions on facts.
- Act on the same values over time.
- Link any action/stance to strategy and competitiveness.

And consistently communicate the company's DEI principles internally to reinforce corporate culture.

The job of the board is to align with management on guideposts and to be available to consult on such questions as:

- Whether and under what circumstance should the company take a public DEI-related position?
- Does the company understand, and has it planned to address, possible negative reactions and outcomes after a DEI related incident? Has there been appropriate DEI specific scenario planning? Is the company prepared to communicate the "why's" of its actions?
- Are there other like-minded parties/associations with whom the company can associate to convey its position?
- Does the company clearly understand what policy issues and potential positions around DEI and other related issues should rise to the board level?

OPPORTUNITIES

It remains important for the CEO and the board to ensure they crystallize a core set of beliefs and practices around DEI if they haven't already. They should ensure that go-forward DEI plans are tied to strategy and the business plan of the company. For example, it is critical that DEI initiatives encompass board and employee recruitment and retention, with special attention being given to inclusivity in the company culture.

Toyota, North America is a good example of a company that ties its core mission with DEI and business purpose. Their mission statement is: "Toyota is driving towards a future with limitless possibilities for all—and diversity and inclusion are critical to reach that destination" [8].

Toyota also has a Diversity Advisory Board (DAB) that works with its team members and leaders to develop aspirational diversity intentions relative to employees, dealers, suppliers, and other stakeholders.

Disney's stated cultural core mission is: "Across Disney, we cultivate, value and encourage curiosity, creativity and collaboration from everyone, and we strive to build supportive environments that inspire optimism and drive innovation" [9].

In support of its commitment to DEI outreach, Disney directs more than 50% of its annual charitable giving to programs serving underrepresented communities and intends to spend at least $1 billion annually with diverse suppliers by 2024 [10].

When and if a DEI-related controversy arises for engaged companies such as Toyota or Disney, boards should consider several questions:

- Is our company's public position consistent with our brand and mission?

- Is there more risk in diminishing our brand by publicly appearing to be at odds with elected officials?
- How can we successfully reconcile core DEI beliefs with a hostile political climate?

It is the role of the board to encourage its respective company to use corporate voice and reputation to stand up for the issues and initiatives where it can make a difference and where initiatives are tied to mission.

The Edelman Trust Barometer states that “employers are one of the few trusted institutions” and “people want more societal engagement from business, not less.” This engagement includes speaking out and taking action on issues such as economic inequality, workforce re-skilling and other related issues that have a DEI overlap. The Barometer indicates that if business can show that it is investing in initiatives such as fair compensation, re-skilling initiatives and in local communities—there will be more widespread support, including from many politicians.

There is no question that speaking up publicly on any DEI issue today is a complicated matter. Communications should not appear to be too self-serving nor should they go overboard in appearing to heavily favor a single disadvantaged group at the expense of others.

Edelman makes a point to encourage companies to use the power of their brands to celebrate what brings us together and emphasize our common interests to strengthen the social fabric.

CONCLUSION

An opinion piece in the *Economist*, “The Overstretched CEO” [11] opined: “What to do? In a fractious world, business cannot hide from politics and geopolitics. But the lesson of the “wokelash” is that outspokenness can backfire.”

This is a difficult lesson for companies with strong core beliefs and it is the job of directors to help protect the brand and make sure that long-term value is preserved, not imperiled. That’s a central reason why DEI-related risk conversations (and scenario planning exercises) at the board are so important.

Companies that link DEI directly to economic outcomes will maximize value for shareholders and other stakeholders (such as customers, employees, communities, and suppliers) and will out-compete their (less enlightened) peers in the long run.

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Phyllis J. Campbell is an independent advisor and board member, with a focus on board governance and CEO effectiveness. She founded her consulting practice in 2023 to help foster high-performance boardroom climates and effective board-CEO partnerships.

Phyllis has an extensive career of board service, both in the for profit and not-for-profit sectors. Phyllis was elected to the Remitly (RELY) board as of April 2023. She is also a board member of the Air Transport Services Group (ATSG). She served as an independent director for Alaska Air Group from 2005-2020. She previously served on the Nordstrom board of directors and chaired the Audit Committee for seven years. In addition, she is a member of SanMar's Advisory Board and the Allen Institute. *Click here for full bio.*

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