DEI INSIGHTS

Diversity, Equity and Inclusion Are the Necessary Corporate Differentiators

BY JULIA GAVRILOV

A Moritt Hock & Hamroff partner discusses the potential legal implications for companies that are not committed to diversity and inclusion as increasing shareholder pressures and legal complaints mount.

The call for diversity, equity, and inclusion (DEI) is louder and more urgent than ever. The vast body of empirical evidence demonstrates that greater DEI efforts lead to better team decision making, work product and results in increased corporate profitability. The greater urgency springs from the “Great Resignation,” increasing investor and regulatory pressure, demand for supporting data and the ever-growing threat of litigation.

The Great Resignation

Fueled largely by the effects of the COVID-19 pandemic on both the workplace environment and the disproportionate toll it has taken on women and people of color, we now bear witness to what has been penned “The Great Resignation.” Talent is leaving the workforce at extraordinary rates and reassessing the workplace environment. Studies show that many are now choosing to work for companies with a demonstrable commitment to workplace DEI. As organizations are scrambling to keep their best talent, companies that are more diverse and inclusive or, at a minimum, can demonstrate a meaningful commitment to DEI, are better positioned to retain and recruit talent.

Regulatory and Investor Demands for Data Transparency

Better retention and recruitment of talent, however, is just one of the many reasons why DEI should be prioritized by every company.

A recent PricewaterhouseCoopers multi-year, global, cross-industry survey found that organizations are investing at unprecedented rates in DEI programs, with 75 percent now saying it is a priority. Yet, despite this heightened commitment, only four percent of organizations are succeeding in key dimensions of successful DEI programming. This is reflected in a McKinsey study recently finding that although 40 percent of entry-level positions are held by people of color, the number falls to a staggering 10 percent at the C-Suite level. A separate study resulted in similar findings for women in these roles. While companies often focus their DEI efforts at the hiring level, this methodology falls short as the internal promotion system fails to advance diverse individuals over time through organizational ranks.

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Although many companies have made progress in diversifying their boards and executive leadership teams, others that have been slower to do so are now faced with increased pressure to move beyond verbal commitments and incremental progress.

Regulators and investors have been prodding companies to make voluntary disclosures detailing data in their corporate diversity profiles. By mere example, in August 2020, the U.S. Securities and Exchange Commission (SEC) enacted a regulation requiring companies to disclose information about their “human capital resources,” prompted by nationwide protests over racial discrimination and inequity.

In August 2021, the SEC also approved the Nasdaq Stock Market’s Rule 5605(f), which, subject to transition periods and limited exceptions, requires virtually all Nasdaq-listed member companies to hire at least one director who self-identifies as female and at least one director who is an underrepresented minority, and that any company failing to meet such quotas must publicly explain why.

Litigation as Leverage

Litigation is also being used as a leverage tool to increase public companies’ commitments to diversity, disclose their diversity data and make significant financial investments in diversity initiatives. In the last two years alone, at least 12 shareholder derivative suits were commenced in U.S. Federal courts against various large, U.S. multinational companies, including a wireless technology company, computer technology company, a social networking company and their respective boards of directors, as well as the companies themselves as nominal defendants.

Most, if not all, of the actions have been similar in nature, alleging that the respective corporation failed to appoint racially diverse directors and officers – while simultaneously making public statements avowing a commitment to racial diversity, including, but not limited to, claiming to have a multitude of policies, internal controls and processes designed to ensure diversity both at the management level and within the board itself –constituted, among other things, securities fraud.

A number of the complaints further alleged the respective company's directors breached their duty of candor and violated federal proxy laws, resulting in irreparable harm and severe financial and reputational damage to the corporation and sought various relief, including, among others, the resignation of certain directors and the appointment of diverse replacement directors, annual diversity training for the board and/or senior leadership, the creation of a six-figure fund to hire, promote and mentor minority workers, and a requirement that the respective corporation publish an annual "diversity report."

Although many of the lawsuits were dismissed on grounds that the respective plaintiffs did not sufficiently plead demand futility and/or that the state law claims should have been asserted in the appropriate state jurisdiction with leave to amend the federal claim under Section 14(a) of the Exchange Act, the outcome of these lawsuits is meaningless. The mere commencement of these actions and the nature of the relief sought therein reflect a growing trend that litigation can be utilized to leverage some degree of change in the corporate DEI landscape, particularly one that is supported by data metrics.

Privately Held Companies and Other Organizations Are and Will Be Subject to Similar Demands

While the demands for data transparency have largely been made of public companies, privately held companies and other organizations will not be held to any lower standard. In the summer of 2021, the New York Department of Financial Services announced an initiative that would collect and publish diversity data on the demographic makeup of board and/or senior management teams of New York-regulated banking institutions with over $100,000,000 in assets, non-depository financial institutions with over $100,000,000 in assets and entities authorized to engage in virtual currency business activity.

In due course, this required level of transparency will permeate every organization and will become the gold standard in establishing how clients, investors and society alike will perceive any organization. Those companies that release their own transparent reports, set diversity goals, and monitor those goals will be better poised to meet targets, retain talent and avoid legal or regulatory issues.

One of the many measures that a company can take to diversify its workforce at every organizational level—and minimize the likelihood of litigation being used to drive that change—is by implementing a proper internal mentorship and sponsorship program. Senior mentors can advise and provide guidance to junior minority employees with similar backgrounds. Even more instrumental would be to have these same senior mentors in a position to sponsor, or advocate for, such employees, which should necessarily lead to the advancement of diverse talent and, in turn, increased profitability.

Another measure widely viewed as a key component to furthering DEI efforts is the inclusion of men as allies. Male allies are men who associate with and support diverse colleagues, including those who privately and publicly advocate for DEI. They also meet with diverse colleagues in the workplace to discuss DEI, identify cases of inequality or lack of diversity and work to fix them. When men at all levels of an organization understand, appreciate and value diversity, they are empowered to advocate and support diverse employees in the workplace and work towards DEI.

The trend toward data-driven metrics is likely to dominate the next phase of diversity activism, leading to the prioritization of diversity and a culture of inclusion. DEI are the differentiators necessary for companies to successfully overcome the Great Resignation, comply with regulatory bodies and governmental initiatives, insulate against potential litigation, remain competitive and be viewed favorably by clients, investors and the public at large.

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