

ESG Spotlight

Race, ethnicity and public equity: a global snapshot

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Themes:

Racial and ethnic diversity, discrimination, public equity

Industries:

Multiple

Region:

Global

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Key insights

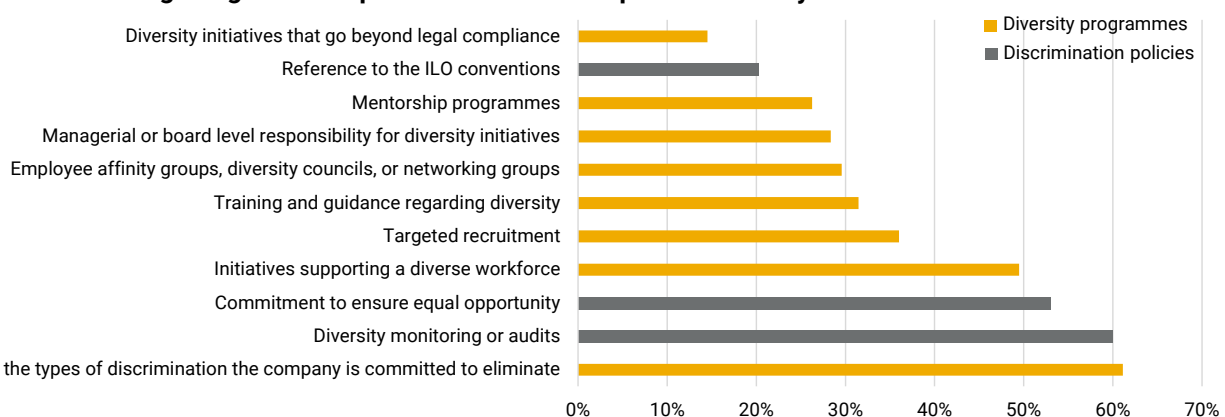
- Controversies related to race and ethnicity in 2020 include 288 incidents involving 130 firms listed on the Morningstar Global Markets Large-Mid index.
- Firms with incidents tend to disclose more initiatives, highlighting the value of investment risk analysis that goes beyond company disclosures alone.
- Only 15% of 3,343 firms sampled from this index disclose diversity initiatives that go beyond legal compliance, and only 20% reference the ILO conventions.

Assessing corporate risk management

Investor concerns about discrimination have been heightened since last year when, after a series of notorious events, issues of racial and ethnic justice dominated news headlines globally. While previous studies have focused on a range of diversity issues, such as gender equity and corporate leadership, this report presents a focused analysis of racial and ethnic issues linked to listed companies' operations, supply chains and the societal impacts of their business activities. We find that although a growing number of firms are disclosing diversity and anti-discrimination initiatives, management gaps persist and related controversies are on the rise. The Consumer Discretionary sector has experienced a growing number of internal workforce incidents involving Black employees and other underrepresented groups. The Financials sector is highly exposed to societal incidents due to institutional financing of projects affecting Indigenous communities and other underrepresented ethnic groups.

While investors can assess companies' preparedness to manage diversity and anti-discrimination initiatives, including those listed in Exhibit 1, our findings suggest that firms need to be more proactive in managing the initiatives that they have in place to mitigate controversies related to race and ethnicity.

Exhibit 1: Percentage of global companies that disclose specific diversity and anti-discrimination initiatives*



*n=3,343 companies listed on the Morningstar Global Markets (Gbl Mkts) Large-Mid index.

Source: Sustainalytics

A framework for addressing mounting concerns

Diversity and anti-discrimination

Diversity has been a focal point of the responsible investment community for decades,² but related initiatives gained momentum in 2020 as corporate leadership and investors voiced mounting concern about racial discrimination. While some have focused on workforce demographics, the Investor Statement of Solidarity to Address Systemic Racism and Call to Action underscores that attention is increasingly being paid to how investment decisions can have broader societal impacts related to racial equity and empowerment (Exhibit 2).

Exhibit 2: Investor coalitions that issued statements on diversity and discrimination in 2020

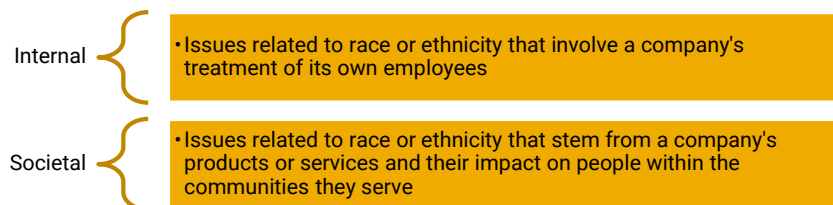
Organization	Description
Racial Justice Investing Coalition	Investor Statement of Solidarity to Address Systemic Racism and Call to Action received initial endorsements from 128 institutional investors managing about USD 2tn in assets under management (AUM).
The Thirty Percent Coalition/Coalition for US Board Diversity	With national and international members representing USD 7tn AUM, the coalition works to increase diversity in corporate boardrooms and articulates the resolve of institutional investors to press for more diversity across gender, race and ethnicity.
Workplace Equity Disclosure Statement	Supported by over 100 signatories representing USD 1.88tn in AUM, the statement calls on companies to release meaningful data on policies, practices, and outcomes related to workforce composition, promotion, recruitment, retention rates and pay practices.
Canadian Investor Statement on Diversity & Inclusion	Canadian institutional investors managing more than CAD 2.3tn (USD 1.8tn) in assets signed the Canadian Investor Statement on Diversity & Inclusion, acknowledge the existence and impacts of systemic racism and calling for action in the industry.

Source: Sustainalytics³

Internal vs. societal issues

While previous reports on this topic have focused exclusively on workforce demographics, this report looks at issues of race and ethnicity by addressing both internal workforce considerations and the societal impacts of global business activities (Exhibit 3). For the purposes of this report, we have developed a framework to account for a range of concerns about racial and ethnic discrimination, from allegations of biased hiring practices to operations that have negative impacts on underrepresented groups. We take this approach because we believe it is just as important for investors to assess whether their portfolio companies are taking steps to improve equity for the communities in which they operate as it is for them to assess internal human capital issues.

Exhibit 3: Study categories for addressing concerns about race and ethnicity



Source: Sustainalytics

Material advantages of addressing internal and societal issues

Diversity, talent and profit

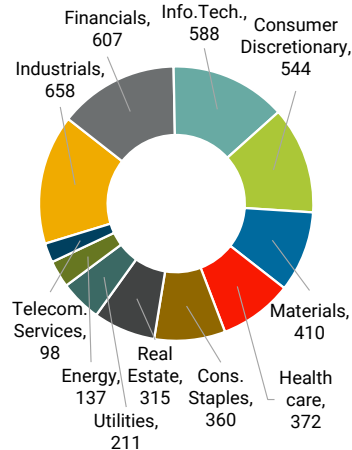
Advancing a diversity focused investment thesis may offer the twin benefits of affecting positive social change and potential upside exposure to firms with equitable corporate cultures. A 2018 McKinsey study of 589 executive teams found that firms with the most ethnically diverse teams were 33% more likely to outperform their national industry peers in regard to their average five-year EBIT margin.⁴ A proposed reason for such outperformance is that diverse groups can better innovate, anticipate market shifts and gain a competitive advantage.⁵

Risk mitigation

Another potential advantage of promoting racial and ethnic equity is that doing so may help companies mitigate risks related to discrimination. Such risks can materialize in macroeconomic disruptions due to civil unrest or controversies that can have direct financial and reputational effects on a company.⁶

Assessing corporate performance

Exhibit 4: Study universe, number of companies by sector*



*n=4,301 unique covered issuers listed on the Morningstar Gbl Mkts Large-Mid index
Source: Morningstar, Sustainalytics

To assess companies’ preparedness to mitigate risks related to racial and ethnic issues, we draw on two sources of information: 1) environmental, social and governance (ESG) controversies research and 2) management data related to diversity and anti-discrimination initiatives. Our study focuses on a sample of 4,301 firms listed on the Morningstar Global Markets Large-Mid index, covering 58 markets and 11 sectors (Exhibit 4). Each section of this report focuses on a subsample of this index for which Sustainalytics has relevant data coverage.

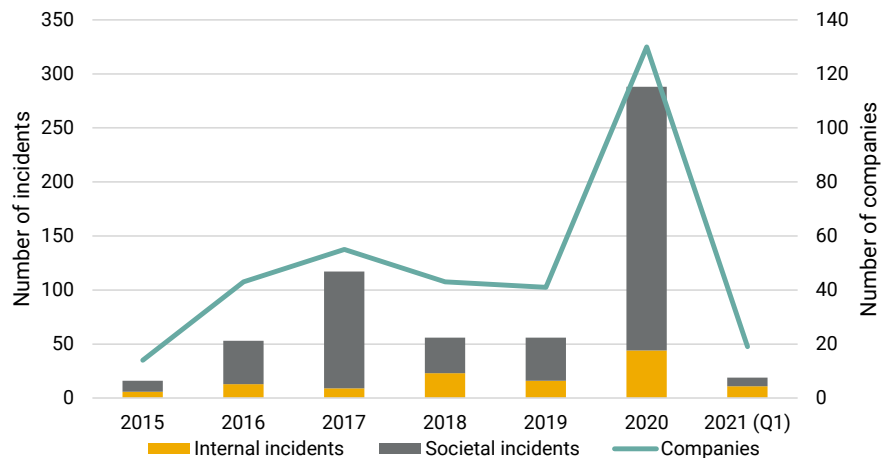
First, we surveyed corporate controversies related to race and ethnicity and identified an uptick in 2020. Then, we assessed companies’ performance on related management indicators over a six-year period and observed an increase in strong initiatives but also gaps across markets and sectors. Finally, we assessed the relationship between corporate initiatives and incidents.

Corporate controversies linked to race and ethnicity

Our sample includes 206 firms that were involved in 605 incidents globally between 2015 and Q1 2021.⁷ For the purposes of this study, we have focused on incidents involving allegations that a company has negatively impacted an underrepresented racial or ethnic group. The data collection process involved a text mining scan of incident descriptions in Sustainalytics’ incidents database followed by a review of each incident.⁸ We then applied a customized framework to divide our sample into two subsets: internal and societal incidents.

Most of the incidents in our sample (483 of 605) pertain to societal issues, such as discriminatory marketing practices or operational activities that have negative impacts on underrepresented ethnic communities. The rest of the incidents (122 of 605) regard internal issues, such as allegations of biased hiring practices.

Exhibit 5: Global equities’ exposure to race and ethnicity incidents over time*



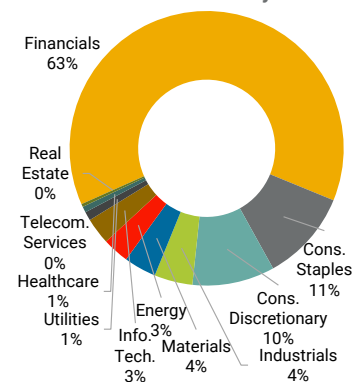
*n=605 incidents, 206 sampled firms listed on the Morningstar Gbl Mkts Large-Mid index. **Source:** Sustainalytics

Incidents have increased

Accounting for the incident uptick in 2020

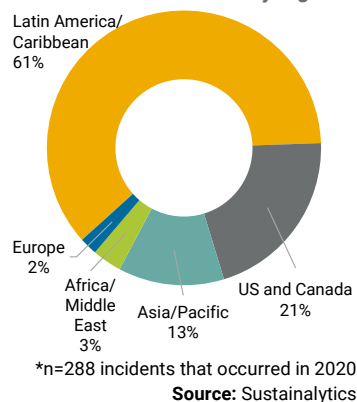
Of the 605 incidents related to race and ethnicity in our sample period, nearly half (288 of 605) occurred in 2020, representing a 175% increase in internal incidents and a 510% increase in social incidents compared to 2019 (Exhibit 5). While companies are increasingly exposed to controversies related to marginalized ethnic groups, the spike in 2020 may also be driven in part by improved news reporting on the topic, which also contributes to company visibility and risk.

Exhibit 6: 2020 incidents by sector*



The Financials sector accounts for 181 (63%) of incidents sampled in 2020 (Exhibit 6). Most of these incidents (163) stem from banks and financial institutions being named in NGO reports for their financing of firms that have allegedly negatively impacted Indigenous communities. Prominent instances were triggered by NGO reports that scrutinize banks’ financing of companies that allegedly used forced labour, contaminated water sources or contributed to increased land disputes within Indigenous communities, including communities located in Brazil.⁹

Exhibit 7: 2020 incidents by region*



Overall, 176 (61%) of our incidents sampled in 2020 occurred in the Latin America/Caribbean region (Exhibit 7). The prevalence of banks implicated in incidents linked to Indigenous groups in this region highlights that Indigenous peoples may not be adequately included in the discourse and due diligence process when banks finance projects that can affect native land and livelihoods.

The increase in internal incidents in 2020 was largely driven by the Consumer Discretionary sector, which accounts for 10 of the 44 (23%) internal incidents in 2020. Four of this sector’s 10 incidents involve Amazon.com. Employees in the US and UK, for instance, alleged that they experienced racial discrimination and harassment by co-workers,¹⁰ that they were denied opportunities for promotion in favour of white employees,¹¹ or that they were asked to partake in discriminatory hiring practices.¹²

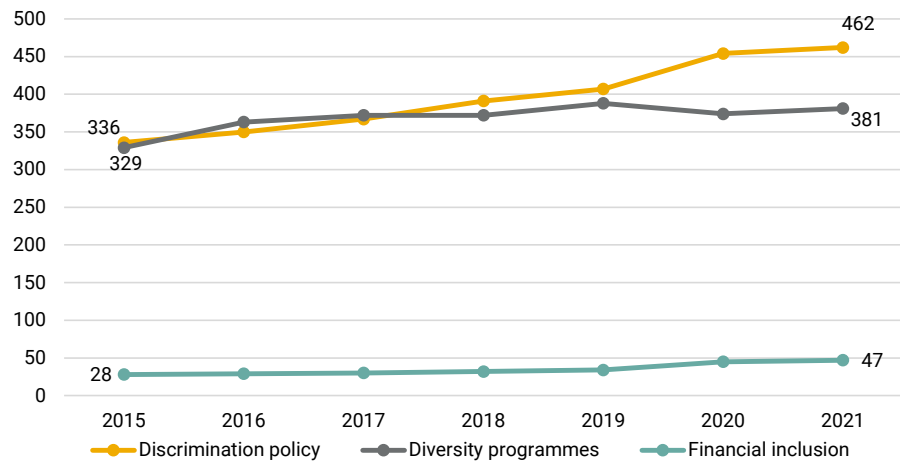
Management initiatives

One indication of a firm’s stance on diversity is the strength of its related programmes and policies. Since 2015, the number of sampled firms that disclose strong discrimination policies and diversity programmes, based on our ratings, has increased by 38% and 16%, respectively (Exhibit 8). Overall, however, only 18% (462 of 2,569) of our covered sample have strong discrimination policies and only 15% (381 of 2,569) have strong diversity programmes – two indicators that are relevant for all economic sectors.¹³

Financial inclusion

Another relevant indicator for the Financials sector (n=416 firms) is financial inclusion initiatives, which can help people with low- or moderate-income access to services – including underserved ethnic communities – build financial stability. Key services include affordable credit, mortgages, insurance, pensions and lending for small and medium enterprises. The number of firms with strong financial inclusion assessments has grown by 68% since 2015. Still, today only 11% of the sector have strong financial inclusion programmes; 42% have adequate ones, 20% have weak ones and 27% appear to have none.

Exhibit 8: Number of global firms with strong inclusionary initiatives by year*



*n=2,569 firms listed on the Gbl Mkts Large-Mid index; sample includes only companies with indicator records extending back to at least 2015. **Source:** Sustainalytics

Rating gaps by market

Company performance on all three of these indicators varies widely across industries and markets. In the Financials sector, for example, more than 40% of sampled firms based in Australia, Canada and the UK disclose strong diversity programmes, compared to 33% of those based in the US, 20% in South Africa, 18% in Japan and 0% in China and India. Less than 4% (15 of 416) of firms in the Financials sector have a strong rating on all three of the indicators covered in Exhibit 8. Examples of strong performers include AXA and Lloyds Banking Group.

A range of initiatives

Investors developing diversity related investment strategies can assess and engage with firms in relation to activities and disclosures that help inform our indicator assessments. As shown in Exhibit 1 (p. 1), only a small portion of our sample discloses diversity initiatives that go beyond legal compliance¹⁴ (15%) or refer to International Labour Organization (ILO) conventions (20%). A larger segment of the market engages in diversity monitoring and auditing (61%) and list the types of discrimination that they are committed to eliminating (60%).

How do key initiatives relate to incidents exposure?

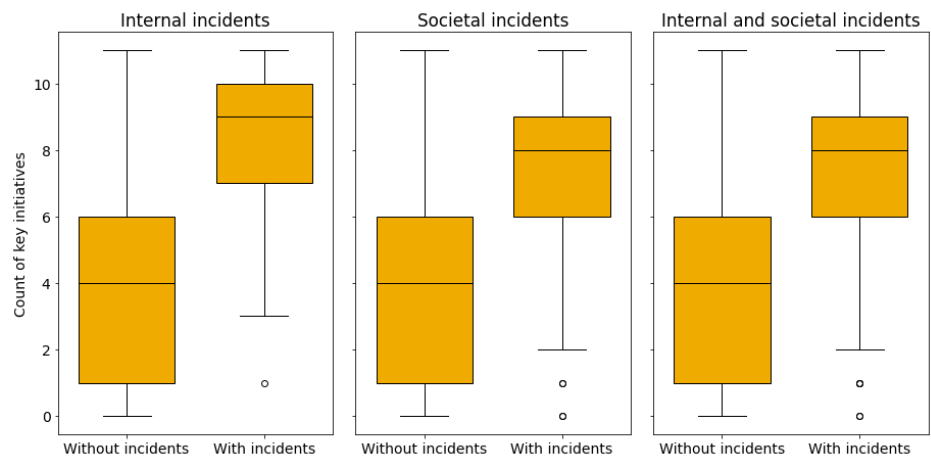
An initial step

To begin assessing the relationship between company initiatives and incidents linked to race and ethnicity, we divide our sample into two groups: companies that have key initiatives in place and those that do not. While the initiatives noted in Exhibit 1 pertain mainly to internal workforce issues, we also assess societal incidents to see whether such programmes and policies may be reflective of business practices within the communities in which companies operate.

An aggregate assessment

Comparing these two groups, we find that that companies that have steered clear of incidents related to race and ethnicity tend to have fewer related key initiatives in place (Exhibit 9). A similar pattern also holds when controlling for market capital, even though larger firms typically have more expansive operational footprints and tend to be under more scrutiny by regulators, news media and the public.¹⁵ These results run counter to the idea that firms with more key initiatives in place would be expected to be less prone to related incidents.¹⁶

Exhibit 9: Companies with and without incidents by incident type*



*Total sample covers 3,343 firms; number of firms in each subsample varies by category.¹⁷ Line in boxes: median count of key initiatives; boxes: interquartile range (IQR) of the count of initiatives; whiskers: values that extend to within 1.5 IQRs of the lower and upper quartile. Dots: outliers.¹⁸ **Source:** Sustainalytics

A potential explanation

One explanation of this result is that companies may be putting additional initiatives in place only after becoming embroiled in controversies.¹⁹ We note, for example, that the adoption of discrimination policies grew the most in 2020, the same year in which the number of incidents spiked. However, we were unable to control for the timing of the adoption of these initiatives relative to the occurrence of the incidents because incidents records were updated daily throughout the study period, while relevant disclosure assessments were updated annually; we only used the latest company management scores as of Q1 2021 so as to have a larger and more complete sample.

An important message from this analysis is that determining the effectiveness of initiatives to improve racial equity requires looking at the issue from multiple angles, rather than solely looking at the strength of a company’s diversity initiatives. An issue as complex as ethnic diversity and inclusion requires a holistic view that incorporates factors such as company policies, incident records and an understanding of the regional and business context.²⁰

Developing a broader perspective

An analytical framework

The aim of this paper was to assess whether global equities have taken a balanced approach to addressing ethnic and racial issues – both to support diversity in the workforce and to promote more inclusive societies – and whether stronger initiatives result in a reduction of related incidents.

Strengthening initiatives and actions

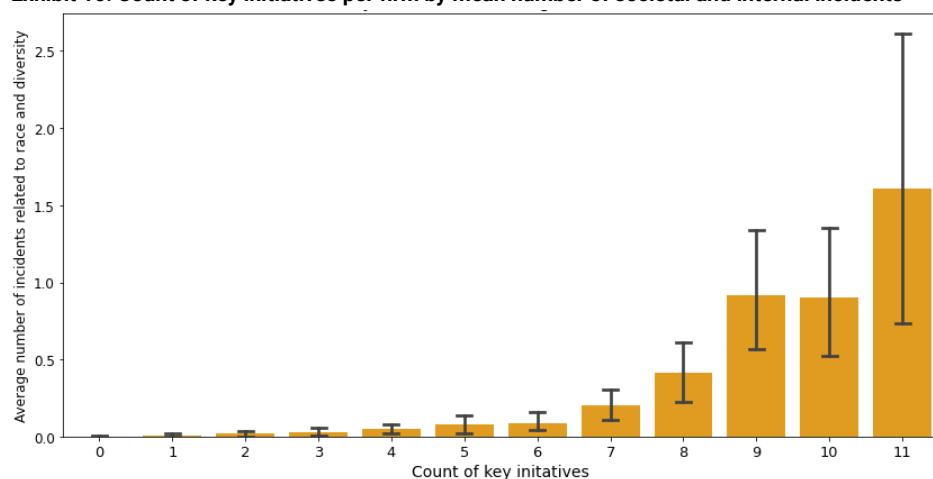
Our analysis indicates that although a growing number of companies disclosed diversity and anti-discrimination initiatives over our study period, controversies related to race and ethnicity have been on the rise. The findings of this report emphasize that global companies need to do more to manage concerns about racial and ethnic equity, not only by disclosing stronger programmes and policies but also by ensuring that these initiatives are implemented in an effective way to mitigate related risks and controversies.

Endnotes

- 1 Acknowledgements: The authors would like to thank their Sustainalytics and Morningstar colleagues who helped in the preparation of the report. Members of the Morningstar Development Program (MDP) supported ESG incidents data curation – special thanks to Ben Slupecki, Paige Morris, Chris Stiemle, Ruitian Yan, John Carlson, Andrew Musgrave, Eden Alemayehu, Patrick Greco and Emma Bernstein. Sophia Velissaratou, Michael Thompson, Sarah Cohn, Wilco van Heteren and Simon MacMahon provided constructive feedback on earlier drafts. Alison Gray copyedited the report. Any errors that remain are those of the authors.
- 2 Scorgie, L. (11.11.2017), “Apartheid is Over, But Socially Responsible Investing is Not,” Medium, accessed (14.06.2021) at: <https://medium.com/@lesleyannescorgie/apartheid-is-over-but-socially-responsible-investing-is-not-8001bba4f6f1>
- 3 Racial Justice Investing (18.05.2020), “Investors Commit to Address Systemic Racism Through Their Portfolios,” Corporate Engagements And Policy Advocacy,” accessed (14.06.2021) at: <https://www.racialjusticeinvesting.org/press-release>; Pinilla, M. and Hampole, N. (07.10.2020), “Investors Are Committing to Action on Diversity. Now What?,” BSR, accessed (14.06.2021) at: <https://www.bsr.org/en/our-insights/blog-view/investors-are-committing-to-action-on-diversity-now-what>; Tiwari, S. (15.02.2021), “Those leading the charge for sustainable and diverse investing could do a better job diversifying their own offices,” The Toronto Star, accessed (14.06.2021) at: https://www.thestar.com/business/personal_finance/2021/02/15/those-leading-the-charge-for-sustainable-and-diverse-investing-could-do-a-better-job-diversifying-their-own-offices.html
- 4 Hunt, V. Yee, L., Prince, S. and Dixon-Fyle, S. (18.01.2018), “Delivering through diversity,” McKinsey & Company, accessed (14.06.2021) at: <https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity?cid=other-eml-alt-mip-mck-oth-1801&hikid=7136f77cb5de4b4e9f1de817d75a042d&hctky=2020225&hdpid=fdef79b6-4f45-4162-ac58-14db7193e4c6>
- 5 Hunt, V. et al. op. cite (18.01.2018)
- 6 Gaudiano, P. (20.11.2020), “A New Model For Corporate D&I Investing,” Forbes, accessed (14.06.2021) at: <https://www.forbes.com/sites/paologaudiano/2020/11/20/a-new-model-for-corporate-di-investing/?sh=4a727980269e>
- 7 Our sample includes *initial* incidents only, as defined by Sustainalytics’ controversy research methodology: Each incident is tied to one company, one location and one date. The corporate activity associated with a negative impact can be a single incident (e.g. an allegation of a regulatory violation) or an ongoing activity (e.g. a protracted legal case). An incident occurs in a specific location (e.g. at a factory). An incident chain consists of an initial incident and incident updates. The first mention of a negative activity by a company generates an *initial* incident. Incident updates refer to subsequent reports about the negative activity that either reveal material information (i.e. information that changes any aspect of the assessment and results in a change in its assessment) or offer additional context about the incident chain without any change in the assessment of the company.
- 8 Incident data curation and vetting were supported by the Morningstar Development Program.
- 9 APIB & Amazon Watch (2020), Complicity in Destruction: How Global Corporations Enable Violations of Indigenous Peoples’ Rights in the Brazilian Amazon, accessed (14.06.2021) at: <https://amazonwatch.org/assets/files/2020-complicity-in-destruction-3.pdf>
- 10 The decision from the tribunal stated that: “there was nothing of substance supporting a finding that race – or him having complained of discrimination – was a factor in any of the relevant decision-making (and, moreover, that in many instances, the evidence positively suggested that race was very unlikely to be a factor).” United States Courts Opinions: United States District Court Northern District of California: Saifullah Khan, Plaintiff, V. Amazon Web Services, Inc., et al., Defendants (02.12.2020), Impact News Service, accessed at (14.06.2021): http://ct.moreover.com/?a=43703020400&p=1so&v=1&x=N_HjhAYY2C00XQ1eZsZ7Ng; HM Courts & Tribunals Service and Employment Tribunal decision: Mr F Kabengele v Amazon UK Services Ltd: 2600569/2018 (13.03.2020), Impact News Service, accessed at (14.06.2021): <http://ct.moreover.com/?a=41623698957&p=1so&v=1&x=0BXOSQcUjjw0vYBv95quQ.....>
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- 12 Minyvonne, B. (26.02.2020), “Ex-Amazon manager says she scoured applicants’ social media to determine race, gender,” NBC News, accessed (14.06.2021) at: https://www.nbcnews.com/news/us-news/ex-amazon-manager-says-she-scoured-applicants-social-media-determine-n1143441?cid=public-rss_20200226

- 13 Generally, a strong policy is expected to be a formal document with clear commitments or definitions which is signed off by senior management and is applicable to the majority of the organization. A strong programme is expected to be formally disclosed with clear and quantitative targets, specific deadlines by which to achieve the intended objective, and provide monitoring of the progress made. It is also expected that programmes are overseen by senior management and often involve regular training for employees. S.1.2 Discrimination Policy assesses a firm’s commitment to prohibit workplace discrimination and ensure equal opportunity, and it is aligned with related conventions of International Labour Organization’s. S.1.3 Diversity Programmes assesses initiatives to strengthen workplace diversity and develop a more inclusive workforce, including having managerial or board level oversight, targets, training and guidance. S.4.2.3 Financial Inclusion assesses initiatives to promote access to financial services to people who are disadvantaged or lack access to the financial system.
- 14 This indicator assesses whether a company implements diversity initiatives, particularly those regarding people with a disability, that go beyond the country-specific legal requirements, based on the firm’s main country of operations and the number of employees.
- 15 Even when comparing companies within the same market capital categories, the tendency of companies with incidents to have more key initiatives in place than companies without incidents holds true. The exception was in the small market capital category (companies with a yearly revenue within the range USD 300mn and USD 2bn), where none of the 120 small market capital companies in the analysis had related incidents.
- 16 Similarly, Exhibit 10 shows that, on average, companies with more initiatives tend to have a higher average count of related incidents. The variance of the average count of incidents also tends to be higher for the firms that have more of these initiatives in place.

Exhibit 10: Count of key initiatives per firm by mean number of societal and internal incidents*



*n = 602 race/ethnicity related internal and societal incidents. The 11 initiative types are listed in Exhibit 1. The height of each bar represents the mean number of incidents that firms in each bracket have experienced since 2015. Error bars represent the 95% confidence interval of the mean number of incidents. **Source:** Sustainalytics

- 17 The table below shows the number of companies in each subsample covered in this exhibit.

Category	Without	With	Total
All incidents	3,140	203	3,343
Internal incidents	3,277	66	3,343
Societal incidents	3,180	163	3,343

- 18 Outliers include one firm with one internal incident and one key initiative, two firms with one societal incident and zero key initiatives, and two firms with one societal incident and one key initiative.
- 19 This idea is explored in Vezér, M. and Wennerström, M. The State of Pay: Executive Remuneration & ESG Metrics, Sustainalytics ESG Spotlight Series report accessed (14.06.2021) at: <https://connect.sustainalytics.com/esg-spotlight-the-state-of-pay>
- 20 For more information about how ESG incidents are incorporated into Sustainalytics’ ESG Risk Ratings, see: Vezér, M. and Romanesc, R. (20.07.2020), The COVID-19 Incidents Curve: Corporate Events & Impacts, Sustainalytics ESG Spotlight Series report, accessed (14.06.2021) at: https://connect.sustainalytics.com/the-covid-19-incidents-curve-corporate-events-and-impacts?_ga=2.28950968.580106426.1616441925-fec83158-00c6-ea11-a812-000d3abaa63a

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