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Environmental, Social, And Governance:

Why Corporations' Responses To George Floyd Protests Matter

July 23, 2020

(***Editor's Note:*** *In this, the first report of a two-part series on racial inequality in the corporate world, we explore how protests surrounding the death of George Floyd in the U.S. prompted an unprecedented global corporate response.)*

Key Takeaways

- Stakeholders are increasingly holding companies to a higher social standard, demanding that they demonstrate a real commitment to advancing racial equality, beyond donations and promises.
- We believe racial injustice is becoming a material issue that has the potential to change our ESG Evaluations and credit perspectives, although the full effects are not yet clear.
- The sheer scale of demonstrations against racism and social injustice after George Floyd's death has led some corporations to publicly denounce all forms of discrimination, and we expect this will continue.
- Companies' values and discrimination records are under intense scrutiny, prompting responses from 217 S&P 500 companies as of June 25, 2020, to protect their reputations and businesses, particularly from negative comments on social media.

The horrific May 25 death of George Floyd, an unarmed black man, while in Minneapolis police custody, sparked protests across the U.S. This incident came at a time when many communities were already reeling from the economic and social impact of the COVID-19 pandemic, particularly on people of color, and it was captured on video for the world to see. Thousands of people hit the streets carrying placards saying Black Lives Matter, igniting a movement that has spread to other countries and gained support from many public figures.

The issue of racial inequality is not new, but the flurry of reactions from the usually reticent corporate sector is. The huge number of demonstrators calling for justice and change--among them customers, suppliers, and shareholders--has put the onus on corporate leaders to show how their policies are contributing to a more equitable and inclusive workplace. Companies have also been quick to take a stand after video clips of incidents involving employees flooded social media. Many have also publicly condemned discrimination, pledging to review policies and

PRIMARY CREDIT ANALYSTS

Neesha-ann Longdon
London
neesha.ann.longdon
@spglobal.com

Caitlin Harris
San Francisco
caitlin.harris
@spglobal.com

Dimitri Henry
New York
+ 1 (212) 438 1032
dimitri.henry
@spglobal.com

SECONDARY CONTACTS

Corinne B Bendersky
London
+ 44 20 7176 0216
corinne.bendersky
@spglobal.com

Michael T Ferguson, CFA, CPA
New York
(1) 212-438-7670
michael.ferguson
@spglobal.com

Lori Shapiro
New York
+ 1 (212) 438 0424
lori.shapiro
@spglobal.com

See complete contact list at end of article.

committing to diversity and inclusion initiatives.

S&P Global Ratings believes more corporations will announce tangible steps to align themselves with stakeholders' social values. No one could have foreseen that George Floyd's death would be a tipping point. Companies are realizing that failure to listen to all stakeholders, nurture a diverse and inclusive workforce, and engender strong community relations can damage their reputations and undermine their business models. The next step could be the elevation of social factors to the same level as the environment and governance. Only time will tell how social factors, such as racism and inequality, will affect companies' futures. However, failure to address them could have an impact on their ESG performance and, ultimately, on credit quality if loss of customers reduces profitability.

Social Commitment Is An Inextricable Part Of ESG

To assess a company's social profile in our ESG Evaluation, we gauge a company's effectiveness in developing a long-lasting, productive, and inclusive workforce, including through diversity, recruitment, and people management policies. We consider four key factors--workforce and diversity, safety management, customer engagement, and communities--to determine how well an entity is managing its exposure to these social risks and opportunities compared with sector peers globally (see "Environmental, Social, And Governance Evaluation Analytical Approach," published June 17, 2020, on RatingsDirect).

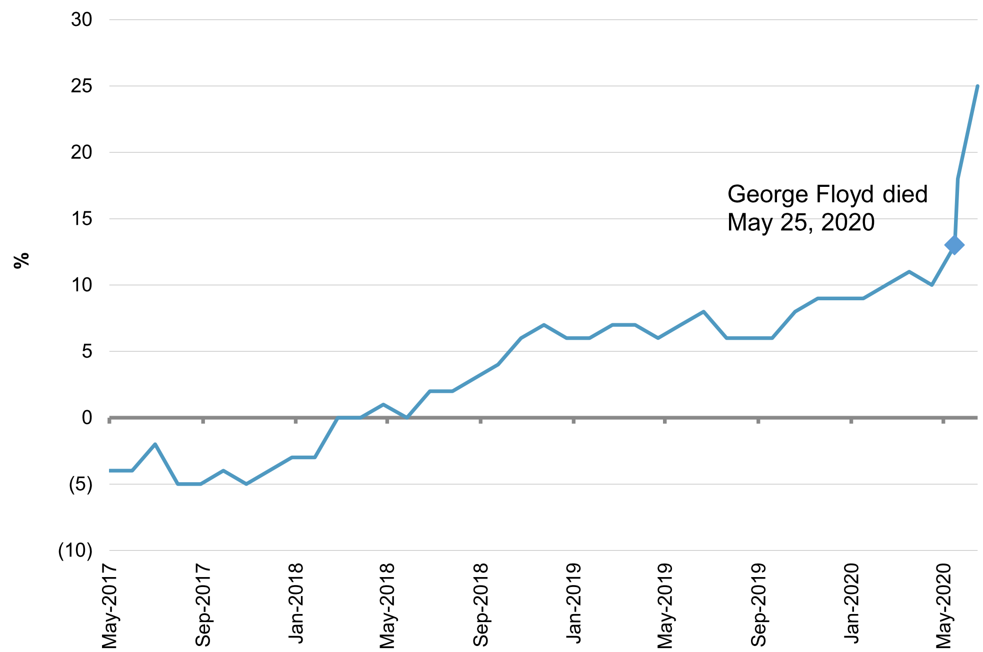
In our opinion, a company that builds up strong social credentials can maintain its consumer base, thereby supporting stable revenue streams. This year, social issues have taken the spotlight, starting with the COVID-19 pandemic and moving to social injustice (see "The ESG Pulse: Social Factors Could Drive More Rating Actions As Health And Inequality Remain In Focus," published July 16). Carried along by social media, interactions between companies and the general public are becoming highly visible, providing a platform for stakeholders to demand that companies take decisive action to address racism.

Consumers Are Increasingly Demanding Change

As the Black Lives Matter movement rolls on, social media has given companies keen insights into customers' evolving behavior and preferences. Major brands are uniquely positioned to influence people's mindsets globally. With this in mind, a younger generation of consumers--including Generation Z and millennials in their 20s and 30s--is taking a leading role in the movement, calling on companies to take a stand. Through social media, some consumers are using their collective voices to hold companies accountable for not only their words but also their actions or inaction. They want companies to make a financial investment to enhance diversity and inclusion, combat pay inequality, and support anti-racism initiatives, thereby addressing practices or policies that might be perpetuating racism in its many forms.

Chart 1

Support For Black Lives Matter Movement Surges After George Floyd's Death
Registered voter net support in the U.S.



Source: Civiqs

This emerging consumer base of socially aware individuals may influence how businesses are perceived in the market, and corporations are taking notice. Companies are increasingly aware that failure to maintain stakeholder buy-in can lead to a loss of market share, which can affect credit quality in the long term. For example, a DeVries Global survey (published June 2, 2020) of 1,000 Americans found that more than 62% of respondents under the age of 35 said they will be "doing more research on brands and their inclusivity practices before purchasing." This implies companies that publicly demonstrate such practices may benefit from satisfying their customer base. To illustrate, after sportswear giant Nike launched its 2018 campaign featuring NFL quarterback Colin Kaepernick, its sales increased and its stock price reached an all-time high. Kaepernick controversially knelt during the national anthem before a 2016 game to protest against police brutality, and became a free agent the following season.

In our opinion, the Business Roundtable's revision of its Statement on the Purpose of a Corporation to, promote "an economy that serves all Americans," demonstrates the recognition that a company should do more than appease shareholders; it should instead aim to balance the interests of all stakeholders, including customers, employees, and local communities. More corporations are realizing that, by rethinking recruitment and talent management strategies, they can set themselves apart from competitors and reinforce customer loyalty. This is especially true in today's recessionary environment amid subdued consumer spending.

We believe a company's transparency and communication will play a critical role in maintaining customer satisfaction, one of the performance indicators we assess under customer engagement in our ESG Evaluation, as consumption habits evolve with the changing situation (see "The ESG Lens On COVID-19, Part 1," published April 20, 2020). At the end of the day, companies that are able to respond swiftly to customers' demands and take concrete actions to meet their stated social objectives may come out on top.

Investors Are Raising Their Voices

Investors are increasingly leveraging their ownership interests to push companies to display greater transparency and accountability regarding diversity. Companies are at risk of losing future investments if they do not address investors' mounting concerns regarding racial injustice. There are other compelling reasons for companies to take a hard look at their business practices. The results of a 2019 McKinsey study make a case for diverse corporate cultures; the findings show that the profitability of companies in the top quartile for ethnic diversity was 36% higher than for those in the bottom quartile.

Moreover, diversity and labor issues have a prominent spot on the agenda this year at annual general meetings, where investors file and vote on topics they want companies to address. As an example, on Juneteenth (June 19, 2020), the annual holiday commemorating the end of slavery in the U.S., around 70% of investors in network security firm Fortinet voted in favor of a resolution to request the release of quantitative diversity data. Votes carrying resolutions on workforce management issues are also becoming more common. Similar shareholder motions filed at companies like Gilead Sciences, Morgan Stanley, and Mastercard were withdrawn before the annual meetings, once companies had committed to improving the reporting and disclosure of diversity data. This demonstrates how investor pressure can also lead to corporate action.

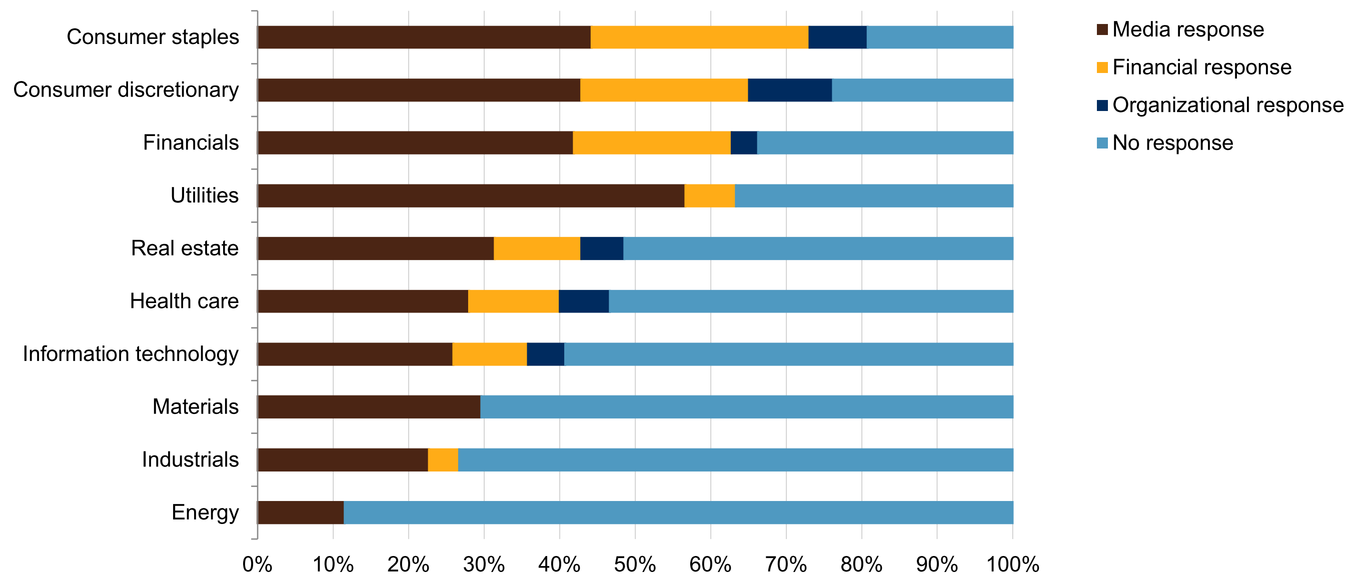
Consumer Goods And Financial Firms Are Among The First Responders

Corporates and financial institutions are facing closer scrutiny from stakeholders on their social record. In our view, companies that engage meaningfully with stakeholders, and integrate social inequality solutions into their decision-making and strategy, will be in a better position to safeguard their reputations. We consider such factors as part of the preparedness assessment in our ESG Evaluation.

Reactions to the Black Lives Matter protests from corporates listed on the S&P 500 index suggest that customer-facing companies in the consumer goods and financial institution sectors were the first to respond as of June 25 (see chart 2); 43% or 217 of the S&P 500 companies have issued one or more public statements. This could imply that these sectors are under greater pressure to openly show support for equality and align their actions with stakeholders' values. On the other hand, sectors such as energy, industrials, and materials are lagging in their responses.

Chart 2

Consumer Goods And Financial Services Sectors Dominate S&P 500 Company Responses To George Floyd's Death



Sources: Companies' social media channels, company websites, S&P Global Ratings.
Data as of June 25, 2020.

Perceptions Of Corporate Actions Carry A Significant Risk Of Alienating Stakeholders

The pressure on big brands is coming from many directions. Missteps on social issues, especially compared with peers, expose corporate entities to the risk of angering customers and sometimes even their own employees. From an ESG perspective, this could lead to lower employee and consumer satisfaction. However, in the longer term, such mistakes could have material financial and reputational repercussions.

For example, on May 30, 2020, Adidas retweeted rival competitor Nike's digital campaign urging action against racial injustice after George Floyd's death. Adidas quickly faced criticism from its employees, who claimed the athletic sportswear giant does not do enough to ensure accessibility or opportunity for people of color. The employees called on executives to increase the number of Black and Latino employees across all levels of the organization and demanded an internal investigation into whether race-related issues in the workplace are being adequately addressed. This ultimately led to organizational changes, including the Chief Human Resource Officer's departure from the company on June 30. Adidas has since doubled down on its promise to combat the broader issues of racial injustice in communities. It has increased its financial donation to Black communities to $20 million, committed to a minimum of 30% of all new positions in the U.S.

being filled by Black and Latino people, and financed 250 university scholarships for Black students over the next five years.

While, traditionally, these types of internal grievances would be managed behind closed doors, the effect of the Black Lives Matter movement is shifting these discussions onto the public stage, aligning employee demands with customers' expectations. The Adidas case is a clear example of how internal and external stakeholders can take a company to task on its social commitment. From an ESG perspective, it gives us a glimpse into possible consequences for a brand's image, and customer and employee loyalty, if companies fail to take what stakeholders perceive to be appropriate and effective action.

Many leaders of U.S. financial institutions, including banks and asset managers, have made public declarations of solidarity with the Black Lives Matter movement and against racism. Like their consumer goods counterparts, banks have made financial donations, but several have also been called out on previous allegations of discriminatory lending practices. According to data from the U.S. Federal Reserve, black-owned firms are more likely to apply for bank loans, but less than 47% of these applications are approved. At the individual level, a McKinsey study found that Black Americans are significantly more likely to be rejected for loans than white borrowers (28% and 11% respectively) or charged higher interest rates. A 2019 study by Berkeley Haas Business School also found that African Americans and Latino customers are charged higher interest rates than white customers with similar creditworthiness, by both face-to-face and online lenders.

Such instances of racial profiling are gaining the public's attention, with repercussions. Large U.S. financial institutions have paid huge fines over the years in relation to discriminatory lending practices: Bank of America's Countrywide Financial unit paid $335 million in 2011 to settle charges of lending bias; JPMorgan Chase paid $55 million to settle a lending discrimination lawsuit in 2017; and Wells Fargo & Co agreed to pay $175 million in 2012 for charging higher interest rates and fees to African Americans and Latino customers in 2012, and $10 million in 2019 on similar charges.

How Corporates Are Backing Words With Actions

Public displays of corporate solidarity with the Black Lives Matter movement abound, mainly as a result of stakeholders' calls for companies to more actively oppose racism. Ensuring that talk is leading to action is essential for companies to demonstrate that social values are embedded in their businesses' DNA. Companies are using a variety of mediums to express their commitment to the movement but each comes with reputational and financial implications, both positive and negative.

Social media provides a huge global audience

Companies have been widely using social media platforms--including Twitter, Facebook, and Instagram--to connect with customers and communities, and state their commitment to change. Media responses range from statements from CEOs and executives, promoting Black brand ambassadors, and launching anti-racism marketing campaigns, to directly calling out consumers that make racist remarks. Brand activism has become popular: A number of global brands--including Disney, Amazon, Unilever, Saatchi & Saatchi, and Netflix--have also released statements condemning racism and injustice on various social media channels.

Global brands have been lauded for publicly addressing racism head on, but not by everyone. Companies' media statements have also attracted criticism, in particular regarding their handling of previous allegations. For example, French beauty products company L'Oréal has come under fire after stating its support for the Black Lives Matter movement, in part due to its dismissal of black model Munroe Bergdorf--the brand's first transgender model--in 2017 for her comments about the "Unite the Right" rally in Charlottesville, Virginia. Social media channels allow businesses to reach an extensive audience but carry significant reputation risk, since users can directly and publicly question companies' values and commitment to inclusive workplaces.

Companies have donated millions of dollars to nonprofit organizations

One concrete form of action is financial contributions to Black Lives Matter chapters, national and regional charities, and legal defense funds, among others, aiming to highlight and address reports of police brutality. Some of these organizations are aligned with the American Civil Liberties Union Foundation, the NAACP Legal and Educational Defense Fund, and the Center for Policing Equity. Large corporate donors include the top 10 companies on the S&P 500 Index, such as Apple, Johnson and Johnson, Pepsi, and Bank of America. However, such financial commitments are also under scrutiny. Donation size is seen as an indicator of a company's true commitment and is often benchmarked against its market capitalization and the donations of peers.

Organizational policies and structures are changing

Some companies have gone a step further. We've seen changes to corporate structures and operations, more inclusive hiring practices, a shift in board composition, and diversity initiatives. Marks & Spencer's CEO, Steve Rowe, for example, has reportedly committed to taking "urgent" action to address racism and diversity as part of a comprehensive review of the company's diversity and inclusion approach. The aim is to expose policies and practices that maintain inequality in the workplace, and drive the business culture toward a more diverse and inclusive model.

Changes to a company's organizational structure are a less common response, but pressure is mounting. For instance, Matthew Fell, Chief U.K. Policy Director at the Confederation of British Industry, suggests that companies with historical links to the slave trade should regard their past as an important starting point to begin to address the systematic racism that leaves Black and other ethnic minority groups disadvantaged in the workplace. Ethnic minorities comprise approximately 14% of the U.K. population but make up only 8% of boardroom directors. Recognizing how historical foundations have preserved racial biases may foster more inclusive workplaces, which would likely translate into positive ESG benefits through an improved corporate culture.

Companies Need To Be SMART About Diversity And Inclusion

In the weeks following George Floyd's tragic death, corporate giants have made anti-racism pledges. However, the controversial issue of police brutality that disproportionately affects Black Americans, and systemic racism, have been with us for some time. We believe corporates' recent reactions to the wave of protests against racial discrimination, particularly on social media, signify their willingness to take on more social responsibility. But we believe that what really matters is how and when they do so.

If companies' policies are to have an impact, they must be specific, measurable, achievable, and time bound (SMART), following widely accepted goal-setting criteria. Progress must also be transparent, particularly as labor markets become more competitive. The relationship between companies and their stakeholders is moving away from being based solely on financial interests or demand and supply. It has been infused with a social conscience.

Although it is too soon to tell whether recent events will have a lasting impact, we believe racism and other forms of discrimination are becoming increasingly relevant to investors and consumers. We expect that companies recognized as having inclusive workplaces and employing socially responsible business practices could eventually have a credit advantage versus competitors. They will also measure up positively against their peers in the eyes of stakeholders, who will be hoping this change occurs in the near, rather than distant, future.

Related Research

- The ESG Pulse: Social Factors Could Drive More Rating Actions As Health And Inequality Remain In Focus, July 16, 2020
- Environmental, Social, And Governance Evaluation Analytical Approach, June 17, 2020
- Environmental, Social, And Governance: How We Apply Our ESG Evaluation Analytical Approach: Part 2, June 17, 2020
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This report does not constitute a rating action.

Contact List

PRIMARY CREDIT ANALYST

Neesha-ann Longdon
London
neesha.ann.longdon@spglobal.com

PRIMARY CREDIT ANALYST

Caitlin Harris
San Francisco
caitlin.harris@spglobal.com

PRIMARY CREDIT ANALYST

Dimitri Henry
New York
+ 1 (212) 438 1032
dimitri.henry@spglobal.com

SECONDARY CONTACT

Corinne B Bendersky
London
+ 44 20 7176 0216
corinne.bendersky@spglobal.com

SECONDARY CONTACT

Michael T Ferguson, CFA, CPA
New York
(1) 212-438-7670
michael.ferguson@spglobal.com

SECONDARY CONTACT

Lori Shapiro
New York
+ 1 (212) 438 0424
lori.shapiro@spglobal.com

SECONDARY CONTACT

Michael Wilkins
London
(44) 20-7176-3528
mike.wilkins@spglobal.com

SECONDARY CONTACT

Bruno Bastit
New York
bruno.bastit@spglobal.com