Zevin Asset Management, LLC

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Skin in the game:

Impact investors push for inclusion and accountability in the tech sector

Pat Miguel Tomaino, Director of Socially Responsible Investing

At Zevin Asset Management, we're committed to socially responsible investment performance. That means building client portfolios using rigorous fundamental and ESG (environmental, social, and governance) research. Then we engage with portfolio companies to move them toward environmental sustainability, social justice, and long-term risk management. That process of shareholder advocacy (also known as "impact investing or "active ownership") creates lasting, positive impact—and it's at the heart of what we do.

This memo describes the work we've been doing to move tech companies, step by step, toward inclusion, racial justice, and gender justice. Those changes create positive impact and opportunities for underrepresented workers, and as you'll see below, they can benefit portfolio companies in the long run.

The business case for inclusion

The technology sector has historically excluded minority and women workers. According to a study conducted by Intel, underrepresented people of color hold just 9 percent of technical roles in the sector. And a recent McKinsey report concluded that women hold 36 percent of entry-level tech jobs and just 19 percent of tech C-Suite positions.

Race- and gender-based inequality in tech threatens to further separate people of color (including Black, Latinx, and Native American workers) and women from security and opportunity. Alongside those sequences, inequality presents concerns for tech companies and long-term risks for investors' portfolios.

As knowledge companies, tech firms rely on their ability to find and hire talented individuals wherever they are and whatever they look like. Companies that fail to recruit/retain diverse talent because they have a poor approach to diversity and inclusion face material risks. Poor representation and hostile cultures drive turnover among people of color and women—which can increase companies' training and human capital costs. Workers who have faced discrimination can raise legal claims. And companies that fail to scan the market for underrepresented workers are at a disadvantage in the cutthroat competition among tech firms for new talent.

On the other hand, McKinsey research shows that firms in the top quartiles for gender and racial/ethnic diversity are more likely to have above-average financial returns. In a 2013 Catalyst report, diversity was positively associated with more customers, increased sales revenue, and greater relative profits. The Intel study cited above estimates that the tech sector could generate $300–$370 billion in additional annual revenue if tech companies reflected the racial diversity of the talent pool.

Failure to deliver

Big tech firms seem to understand that diversity is key to managing risk and opportunity with many tech CEOs saying inclusion is mission critical. Apple has said it wants to "break down historical barriers in tech," and Alphabet (Google's parent company) has committed to becoming "more reflective of the world we live in."

However, investors are concerned that the wealthiest tech firms in the world have been unable to improve inclusion in their businesses, and they're beginning to run into associated risks and controversy. Despite the above commitment, for instance, Alphabet remains predominantly white and male, and high rates of attrition among Black employees are hurting overall inclusion efforts. According to the most recently disclosed Equal Employment Opportunity report (from 2017), among Alphabet's group of 290 top executives, only 17 are underrepresented people of color.

Focusing on executive pay

Zevin Asset Management assessed portfolio companies through this lens and found that big tech firms are often missing the leadership and accountability to address diversity and inclusion. As impact investors, we believe that this accountability gap is an opportunity for shareholder advocacy and engagement.

We concluded that it was time for tech executives to put their money where their mouth is on inclusion and sustainability—just as many of their peers in other sectors have done. It is already well-established that aligning executive compensation packages with environmental, social, and governance performance helps drive sustainable change. That is because senior executives whose pay is influenced by sustainability metrics have "skin in the game" and consequently pay more attention to those issues. In addition, the importance of ESG challenges becomes clearer to everyone in the organization.

A large and diverse group of companies has made the change and linked a portion of executive pay with progress on sustainability, among them Alcoa, Unilever, PepsiCo, Walmart, and Danone. Because inclusion is a pressing challenge in the tech sector, linking executive compensation to diversity and inclusion metrics is an increasingly common best practice among leading tech companies. (Microsoft, Intel, and IBM have already set diversity goals and begun tying parts of executive pay to such goals.)

Taking on tech

In 2017, we began urging high-risk tech companies to link executive compensation plans to diversity and inclusion metrics. We had reached out to a dozen portfolio companies that were struggling to build workforces with a diverse mix of talent and perspective. Some lacked transparent reporting while others lacked a clear strategy to appoint women and minority board directors. Almost without exception, these companies lacked policies tying diversity metrics to executive pay.

When tech firms did not respond constructively to letters and meetings, we used shareholder proposals to increase pressure and get the attention of company boards. Zevin Asset Management filed proposals for 2018 shareholder meetings at Alphabet, Amazon, Apple, eBay, and Citrix Systems. Our message was clear: boosting accountability would be an important step toward improving inclusion and protecting investor value.

Progress and paralysis

In its first year, our initiative created positive change and a clear path forward for companies and investors. After negotiating with Citrix Systems over several months, we withdrew our shareholder proposal in recognition of new commitments from the internet security company. Citrix agreed to spell out how diversity and inclusion factors influence the company's annual CEO performance evaluation—a step that will increase executive accountability at a firm that had only recently built an inclusion team and clear goals.

A few companies fought our attempts at engagement. In a move that appeared to undermine its public commitment to diversity, Apple petitioned the SEC, arguing that investor concerns were not relevant. The e-commerce giant Amazon cited a technicality to avoid our shareholder proposal in 2018, but we plan to re-submit the measure for next year's shareholder meeting.

Spotlight on Alphabet

And at Alphabet, we went all the way to a vote in June 2018. Investor concerns grew in the months leading up to the annual meeting of shareholders. Alphabet had already reversed itself on a plan to publish gender-based pay data. Early in the year, media reported on conflicts between underrepresented employees and internal diversity opponents, as well as slow management response to reports of abuse.

A picture of disarray was emerging around racial and gender concerns at Alphabet. In an April 2018 meeting with Alphabet's new head of inclusion, we warned that executives were failing to make a visible business case for diversity and drive effective change. Alphabet needed to join tech industry leaders like Intel and link progress with executive compensation.

In the lead-up to the annual meeting, we connected with the workplace organizing platform Coworker.org and Google employees who were advocating for inclusion and flagging human capital risks within their company. Those alliances showed that investors and employees alike were concerned about inclusion strategy at Alphabet—further reinforced

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by our partnerships in this initiative with fellow investors Azzad Asset Management, Boston Common Asset Management, Consumer Health Foundation, RBC Wealth Management, the Sisters of the Order of St. Dominic of Grand Rapids, the Employees' Retirement System of Rhode Island, First Affirmative Financial Network, Friends Fiduciary Corporation, Loring Wolcott & Coolidge, Nathan Cummings Foundation, and the Unitarian Universalist Association.

This strategy is already producing results. Our proposal received global media attention and the votes of more than a quarter of Alphabet's external investors. And, in its newest inclusion report, Alphabet signaled the beginning of an encouraging shift: senior executives will play a more direct role in the racial and gender inclusion strategy. Investors need more specifics, so we will re-submit our proposal for 2019 and keep pressing for progress.

The way forward

Alphabet is well aware that leading tech firms have already linked inclusion with executive compensation. The question is whether Alphabet and other tech giants will join their peers and make a change. Our experience shows that impact investors aiming at risk management and positive change can move the needle—either through negotiation or extended confrontation. We will continue engaging with portfolio tech firms on executive accountability and inclusion through meetings, research, and further shareholder proposals next year.

For more information, or to get involved, contact Pat Tomaino at Zevin Asset Management (pat@zevin.com).

Disclosures: