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Corporate Governance Update: Corporations and the Culture Wars

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Increasingly, corporations are finding themselves called upon to become—willingly or unwillingly—participants in a range of social and political controversies. While retail businesses long have been accustomed to consumer-driven activism such as boycotts and publicity campaigns, the current movement is significantly different. Today, institutional investors and other stakeholders are asking companies to take public stances on a wide array of topics, some of which may be wholly unrelated to the targeted company's corporate purpose. Investment funds themselves are feeling this pressure, as they are being asked by their own investors to become activists on social issues, and the rapid pace of recent external events—combined with the impact of social media—can demand hasty statements or actions.

In response, corporations need to proceed thoughtfully, deliberately, and with caution. While corporate policymaking and public statements on social and political issues are essentially management decisions, the board should be kept informed and has the right to weigh in, if it so chooses. At the same time, the need to respond quickly often necessitates that management take the lead. Ideally, the board should be comfortable with management's message, plan of action, and evaluation of the attendant risks.

In his 2018 letter to CEOs, BlackRock founder Larry Fink wrote that "[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society." This most-recent Fink letter has been cited by some as a call for companies to become social activists. Yet one can take the view that companies have societal responsibilities and, at the same time, support the view that companies do not fulfill those responsibilities by weighing in on social or political issues outside

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their corporate purpose. Making a positive contribution to society takes many different forms. Society benefits enormously from a company that pursues its corporate purpose with integrity and generosity, requiring leadership from its management and decency from all employees. The American economy, and a great many other elements of American life, depend on the success of companies that dedicate themselves to doing business honestly and well. Chief executives should take care that they do not create needless controversy by being drawn into social issues of the day and thereby undermining the success of their corporate endeavors. Without sustained profitability, after all, companies are unable to have a meaningful impact of any kind over the longer term.

Relevance and Responsibility

Over the past decade and a half, environmental, social, and governance issues have come to the forefront of business discourse. Shareholder proposals under SEC Rule 14a-8 in 2017 were concentrated on social and environmental issues. On the environmental front, support has surged in recent years for proposals requesting that companies disclose how they are assessing climate risk, and three such proposals received majority support in 2017 for the first time. BlackRock, Vanguard, and State Street have advocated for increased leadership and oversight regarding ESG risk and the integration of sustainability-related risk into corporate strategy. For many companies, environmental risk should be overseen by the board of directors as part of risk oversight generally, although for some, environmental risks may be overseen by a dedicated board committee that then reports to the board. Boards may benefit from director education on environmental and social risks as well as regular briefings on company-specific issues and how they are managed by the company. Boards should also be aware of any particular areas of significant shareholder focus and should be comfortable with the company's external reporting on ESG issues.

Gender diversity on boards and in executive leadership is a key social issue for investors. The related issues of gender pay equity and sexual harassment have also increased in prominence, and the business community has begun to view gender diversity and pay equity as essential to a healthy and successful enterprise. Happily, this is an area where the business case and the social benefit are aligned. Data show that diverse boards lead to better performance, risk management, and returns. Going forward, boards with a lack of diversity will find themselves under increasing pressure to take meaningful steps toward inclusion. Investors do and will continue to urge companies to remedy gender pay inequities and maintain a workplace free from sexual harassment so as to attract and retain top female talent.

Sustainability-related environmental concerns and enterprise-enhancing diversity initiatives are examples of the easier cases. It makes good business sense to take steps that are both societally beneficial and strategically sound. The difficulty comes when companies are called to address issues that relate to a small element of their business, or issues that are tangential or even unrelated to the corporate purpose, especially those that are high-profile and controversial. In recent months, companies have found themselves under pressure to take public stances on topics as varied as sugar consumption, the manufacture and sale of guns, immigration policy, and device use by children.

Social media has also irrevocably altered the dynamic for public companies. While very few investors will use social media platforms to communicate with the companies that they have invested in, they generally take notice of social media trends. Moreover, it is very difficult to tell with social media platforms whether the people who are targeting the company's action or inaction on any particular issue have any relationship with the company (i.e., customer, supplier, employee) or whether they are simply individuals motivated by social and political factors. In today's world, companies must actively monitor social media platforms while taking care not to react too quickly—or too slowly—to any particular trend or perspective. This is further complicated by the fact that two individuals with different beliefs can receive vastly different social media news feeds, leading them to opposite conclusions. One person may view the company as being criticized for its stance while another individual will be more likely to see positive stories and comments due to the way the different social media platforms function. In addition, social media has significantly truncated the time periods under which companies must respond before any particular social media story goes "viral." This is part of the reason why management has the primary responsibility to respond to these issues while keeping the board apprised of any concerns and reactions: Management can respond within minutes or hours while it might take a board hours or days to be in a position to respond.

Delta Airlines' attempt to stay neutral in the gun control debate shows the futility of any bid to please all sides, and even the impossibility of avoiding controversy altogether in certain situations. According to the *Washington Post*, Delta—under public pressure—ended a discount available to members of the National Rifle Association to travel to their annual convention, a type of discount routinely offered to many other groups. Delta announced that this step was an attempt “to refrain from entering this debate and focus on its business.” Nonetheless, Delta immediately encountered fierce political pushback from the State of Georgia, where the airline is based, as well as from the NRA and its supporters, which resulted in Delta losing a $38 million tax break. Similarly, when Kevin Plank, chief executive of Under Armour, stepped down from President Trump’s American Manufacturing Council in the wake of racially-driven tensions in Charlottesville, Va., he cast it as a neutral move, stating that “Under Armor engages in innovation and sports, not politics.” His resignation was taken as a political statement nonetheless, as were prior favorable comments he had made about President Trump’s pro-business policies, and shortly thereafter, Under Armour took out a full-page ad in its hometown newspaper to “clarify” the company’s stances on a range of hot-button issues including immigration, equal rights, and diversity.

The Delta and Under Armour examples show how quickly a seemingly minor political statement can explode into public controversy. If a chief executive makes a comment about a political issue, or if a company changes or establishes a policy that seems to have political implications, almost overnight there can be enormous public pressure for the CEO or the company to express a viewpoint on a wide range of issues. Under Armour’s business has nothing to do with the travel ban, yet that issue was headline news at the time and thus had to be included in the company’s “clarification.” Businesses hardly wish to alienate a sizable portion of their customer base, yet in a country intensely divided along political lines, outrage becomes inevitable the moment a company enters the culture wars on one side or the other. The slippery slope from one controversial issue to all the controversial issues is very steep. Furthermore, attempts to remain neutral in a particular debate will often be viewed as picking a side. While it is management’s job to navigate between the Scylla and Charybdis of red and blue America, the board may find it necessary to intervene if it becomes convinced that management decisions in this regard are likely to be harmful to the company and its shareholders.

‘Fink v. Friedman’

Milton Friedman wrote that social responsibility is “one way for a corporation to generate goodwill as a byproduct of expenditures that are entirely justified in its own self-interest.” Yet in the current climate, that goodwill lasts only until the next issue comes along. Public statements on social issues are quickly forgotten, and the stream of controversial topics is never-ending. Friedman cautioned decades ago that “the doctrine of ‘social responsibility’ taken seriously would extend the scope of the political mechanism to every human activity.”

It is as fraught in the current climate to cite Milton Friedman as it is Larry Fink. Yet there is no need to choose between the two. Larry Fink is correct that companies serve a social purpose and should make a positive contribution to society. And Milton Friedman’s limitation is worth heeding. A company that seeks to serve every social purpose would be hard-pressed to deliver financial success at the same time. Profitability, achieved through ethical business practices, is the engine that drives corporate impact and, with responsible leadership, produces meaningful benefits to society that last longer than the next news cycle.