Investors stand firm against attack on diversity

Most companies yet to make meaningful changes, writes Emma Dunkley

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Just weeks after US President Donald Trump issued executive orders to eliminate diversity, equity and inclusion (DEI) programmes across federal government and US-based corporations earlier this year, UK-listed GSK announced it was abandoning its diversity targets.

The pharmaceutical group said it would "make changes in several areas related to inclusion and diversity . . . including no longer setting aspirational targets for our leadership and supplier programmes". As a result, GSK removed this metric from executive bonuses.

GSK was not the only Europe-based multinational to take such action. London-listed Haleon, a consumer healthcare company, and medical devices maker Smith & Nephew confirmed they too have removed elements of their DEI metrics from their executive pay schemes. Others, such as German carmaker Volkswagen, have excluded US subsidiaries from their global diversity targets.

Despite the shift by some companies with large exposure to the US market, most businesses in Europe have yet to alter their policies in any meaningful way — with shareholders largely supportive of the stance.

"For the most part, the shift in sentiment in the US towards corporate DEI initiatives has not crossed the Atlantic," says Kimberley Lewis, head of active ownership at asset manager Schroders.

"Companies and investors in Europe have, in large [part], remained committed to corporate DEI programmes. The extent to which DEI has become embedded within European and UK corporate governance best practice suggests that there's unlikely to be a row back from DEI as an important corporate value," she adds.

However, Lewis warns that the changing dynamic in the US "reinforces the need for investors to actively engage with companies to help us better understand what the long-term risks of rolling back on DEI and other sustainability commitments are going to be."

Another senior governance executive agrees: "I don't think investors [in Europe] are asking companies to remove targets. In the UK there have been examples of companies removing them, but that is their own need to remove them, either to be compliant with what's going on in US or because in some cases they said they've achieved diversity."

Stefanie Drews, chief executive and president of Amova, formerly Nikko Asset Management, says responsible investors in Europe are unlikely to encourage companies to pull back their targets. But they would "expect more maturity and pragmatism around these targets, moving away from a simple box ticking exercise."

She adds: "Responsible investors believe that a diverse board and management make better decisions . . . Investors are not asking for ideology nor gestures, rather they seek meaningful targets that support business performance and enhance resilience. We need to be cautious of not oversimplifying DEI . . . we expect the region to continue supporting DEI progress in line with sustainable value creation."

Research suggests businesses meeting such diversity and sustainability goals outperform. According to a 2023 report by consultancy firm McKinsey, companies with representation of women exceeding 30 per cent on executive teams were "significantly more likely to financially outperform" those with 30 per cent or fewer. It also found that companies in the top quartile for ethnic diversity were also financially stronger.

A wider focus on sustainability can also help drive profit, according to a report by Morgan Stanley last year. The survey of more than 300 companies split equally among North America, Europe, and Asia, found the main reason for pursuing these policies was that the potential for value creation.

However, not all shareholders believe executives should be rewarded for meeting such goals. "The only factor that management, who are agents of the owners of the business, should be remunerated on is the profit they deliver for shareholders," says Barry Norris, fund manager at Argonaut Capital.

"I have generally found that management committed to meritocracy . . . are better stewards of the long-term interests of their shareholders and that ESG [environmental, social, and governance policy], in all of its forms, undermines the profit motive, which has been the engine of human progress and civilisation," Norris adds.

But Luke Hildyard, executive director of the High Pay Centre thinktank until last month, says only a minority of companies link remuneration to diversity and sustainability: under 10 per cent of FTSE 100 companies have a diversity-related performance target for executives.

He adds that “eliminating diversity targets specifically from CEO performance pay plans wouldn’t be hugely significant in changing the behaviour of CEOs or large companies more generally.

“There should probably also be more interest in socio-economic barriers to career progression, which intersect with gender, ethnicity and other demographic barriers but do affect a wider range of people regardless of their race or gender.”

Still, shareholders note that even if

such targets do not account for a large portion of pay, they send a strong signal to the market and more broadly reflect a company’s values.

For shareholders of European companies, the shift from sustainability and diversity by US companies has created a transatlantic rift that is at risk of widening.

“We’ve observed that some companies in our global funds are changing the language around their DEI policies . . . it’s important to ensure that companies that previously had DEI-related metrics in their remuneration frameworks are not now incentivising executives for hitting relatively weak or non-existent targets,” says Sawan Wadhwa, head of stewardship at investment manager Evenlode.

“It would be naive to think this [rift] isn’t problematic,” he adds. “Even if some European companies are doubling down on DEI initiatives, the fact that the US market is moving away from these targets and policies could well have a negative ripple effect across geographies.” Ultimately, this could potentially undermine the positive progress made over the past five years, he warns.