

## ***I. Tying Executive Compensation to Diversity Hiring Initiatives***

### **A. Introduction**

Firms often tie executive compensation to corporate social responsibility goals such as increased diversity, energy efficiency, employee wellbeing and product safety.<sup>1</sup> Large companies such as Nike, Starbucks and McDonald's have begun to incentivize executives to achieve diversity hiring goals by increasing executive compensation if these goals are accomplished.<sup>2</sup> Some companies such as Microsoft and Verizon have been tying executive compensation to diversity initiatives for years, and they have expanded their diversity goals since.<sup>3</sup> A large part of this shift was due to the protests happening in the summer of 2020; the changing political climate led prominent business leaders to pledge to fight racism, and work to recruit and promote minority employees.<sup>4</sup> In 2018, only a fifth of S&P 500 companies included a diversity metric in their compensation programs.<sup>5</sup> By May of 2021, "a third of S&P 500 companies had disclosed using a diversity measure in their compensation structures."<sup>6</sup> While there are various federal and state statutes regulating company diversity, companies themselves have

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<sup>1</sup> O'Kelly E. McWilliams III & Jennifer Budoff, *Why and How to Link ESG Metrics with Exec Compensation*, LAW360 (Jul. 1, 2021, 1:32 PM), <https://www-law360-com.ezproxy.bu.edu/articles/1398378/why-and-how-to-link-esg-metrics-with-exec-compensation>

<sup>2</sup> Emily Glazer & Theo Francis, *CEO Pay Increasingly Tied to Diversity Goals*, WALL ST. J., (June 2, 2021, 5:33 AM), <https://www.wsj.com/articles/ceos-pledged-to-increase-diversity-now-boards-are-holding-them-to-it-11622626380>

<sup>3</sup> *Id.*

<sup>4</sup> Amelia Lucas, *Chipotle will link executive compensation to environmental and diversity goals*, CNBC, (Mar. 4, 2021, 12:01 AM), <https://www.cnn.com/2021/03/04/chipotle-will-link-executive-compensation-to-environmental-and-diversity-goals.html> [<https://perma.cc/2QUG-3ZF7>]

<sup>5</sup> Allen Smith, *More Companies Use DE&I as Executive Compensation Metric*, SHRM, (Jul. 12, 2021), <https://www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/dei-as-executive-compensation-metric.aspx> [<https://perma.cc/LB99-S49X>] (quoting Glass Lewis, a governance solutions firm, in its *Racial & Ethnic Diversity in the Boardroom* report)

<sup>6</sup> Glazer & Francis, *supra* note 2.

been employing increasingly stringent standards and goals.<sup>7</sup> In addition to the shifting political climate and moral values of diversity hiring, companies may also be incentivized to tie executive compensation to diversity hiring due to a likely overall increase in company value.<sup>8</sup> In the long-run, diversity and inclusion (DE&I) may lead to better financial performance and investment returns, therefore justifying the higher CEO pay.<sup>9</sup>

This article discusses the recent shift that has led large companies to tie executive compensation to diversity hiring initiatives. First, Part II explains what diversity initiatives and goals are, and the various forms these programs can take. This includes an overview of the history and rationale behind these initiatives. Next, Part III discusses the recent federal and state statutes regulating diversity in companies, as well as companies' own goals to increase diversity within. This includes a look into the changes major companies such as Starbucks, McDonalds and Apple have undertaken. Next, Part IV discusses the costs and benefits of tying executive compensation to diversity. This includes a discussion of theories both in favor of tying executive compensation to diversity hiring, and arguments that oppose this strategy. Next, Part V explains what a model executive compensation program would look like, including ways to best support DE&I initiatives, and possible pitfalls of which companies should be wary. Lastly, Part VI summarizes the current state of programs in which executive compensation is tied to diversity hiring. This summary offers a prediction on how this will affect future diversity in companies.

## **B. Brief History**

Diversity in the workplace has been long sought after, as it offers benefits to both companies and employees such as improved decision making, risk oversight, innovation, and a better employee

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<sup>7</sup> Ed Hasan & Ifedapo Adeleye, *Should Employers Tie Executive Compensation to DE&I Goals?*, SHRM, (May 25, 2021), <https://www.shrm.org/hr-today/news/hrmagazine/summer2021/pages/should-employers-tie-executive-compensation-to-diversity-goals.aspx> [<https://perma.cc/T2SD-PQ9Z>]

<sup>8</sup> *Id.*

<sup>9</sup> Robin J. Ely & David A. Thomas, *Getting Serious about Diversity: Enough Already with the Business Case*, HARV. BUS. REV. (Nov. 2020), [<https://perma.cc/2QET-AFLQ>]

experience.<sup>10</sup> “In 2003, MIT professor Thomas Kochan noted that companies were spending [around] \$8 billion a year on diversity [initiatives]”.<sup>11</sup> However, since Trump’s election, and recent political movements such as #blacklivesmatter, diversity initiatives have boomed.<sup>12</sup> “A 2019 survey of 234 companies in the S&P 500 found that 63% of diversity professionals had been appointed or promoted to their roles during the past 3 years.”<sup>13</sup> Diversity initiatives and goals within companies can, and have, taken various forms.<sup>14</sup> For example, programs can invest sizable sums of money in good DE&I causes, establish DE&I company training, institute supplier diversity programs, and create diversity hiring goals.<sup>15</sup> Diversity hiring aims can be reached through a variety of methods, such as setting objectives for the percentage of interview candidates that will be diverse, diverse leadership hiring goals, and diversity staff goals.<sup>16</sup>

There are federal regulatory laws that have been passed to oversee and regulate diversity in companies and financial institutions. In 2015, Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd Frank) required six federal agencies to “establish an Office of Minority and Women Inclusion (OMWI) to be responsible for all matters relating to diversity in management, employment, and business activities.”<sup>17</sup> The Dodd-Frank Act also instructed each OMWI director “to develop standards for

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<sup>10</sup> Ellen Holloman & Hyungjoo Han, *How Social Movements Are Affecting Corporate Governance*, LAW360 (Aug. 26, 2021, 10:05 AM), <https://www-law360-com.ezproxy.bu.edu/articles/1410355?scroll=1&related=1>

<sup>11</sup> Pamela Newkirk, *Diversity Has Become a Booming Business. So Where Are the Results?*, TIME (Oct. 10, 2019, 6:10 AM), <https://time.com/5696943/diversity-business/> [<https://perma.cc/WT6J-BMZ4>].

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> Melisande Schifter, *7 Ways Companies Are Advancing Racial Justice in Business*, WORLD ECON. FORUM (June 18, 2021), <https://www.weforum.org/agenda/2021/06/7-ways-companies-are-advancing-racial-justice-in-business/> [<https://perma.cc/9AMA-32FL>]

<sup>15</sup> *Id.*

<sup>16</sup> Soman Mondal, *Diversity Hiring: 6 Steps to Hiring More Diverse Candidates*, IDEAL. (Sept. 14, 2020), <https://ideal.com/diversity-hiring/> (explaining various ways in which diversity hiring aims can be accomplished).

<sup>17</sup> Final Interagency Policy Statement Establishing Joint Standards For Assessing The Diversity Policies And Practices Of Entities Regulated By The Agencies, Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Release No. 34-75050, Docket No. OP-1465 (2015).

assessing the diversity policies and practices of the entities the agency regulates.”<sup>18</sup> Later, in 2017, the Trump administration passed the Tax Cuts and Job Act, making it easier for corporations to factor diversity and inclusion into executive bonus calculations.<sup>19</sup> Despite the increase in businesses targeting diversity, people of color and women remain severely underrepresented in most prominent fields.<sup>20</sup>

### C. Recent Regulatory Developments

Deloitte and the Alliance for Board Diversity published a report examining the current makeup of boards of directors at Fortune 500 companies.<sup>21</sup> When looking at board positions, “[w]hite women have seen the largest increase in representation.”<sup>22</sup> “Women and minorities combined [hold] 38% of Fortune 500 board seats.”<sup>23</sup> Despite these statistics, there continue to be significant shortcomings. For example, “there has been no substantial increase in the representation of minority men on boards at Fortune 500 ... companies.”<sup>24</sup> Even worse, “black men lost one seat in the Fortune 100 and five seats in the Fortune 500 in the last year” and “[m]inority women still represent the smallest percentage of boardroom seats at both [levels]”.<sup>25</sup> In response, many states have passed laws to increase diversity hiring and many companies have begun to form their own executive compensation incentive plans.<sup>26</sup>

#### 1. State and Federal Regulations

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<sup>18</sup> *Id.* at 1.

<sup>19</sup> Emily Brill, *Tying Executive Bonuses to Diversity Is Gaining Momentum*, LAW360 (March 2, 2021, 6:34 PM), <https://www.law360.com/articles/1359492/tying-executive-bonuses-to-diversity-is-gaining-momentum>

<sup>20</sup> Newkirk, *supra* note 11.

<sup>21</sup> Jessie K. Liu, *Skadden Offers a Scorecard on Diversity in the Corporate Boardroom*, THE CLS BLUE SKY BLOG (July 14, 2021), <https://clsbluesky.law.columbia.edu/2021/07/14/skadden-offers-a-scorecard-on-diversity-in-the-corporate-boardroom/> [<https://perma.cc/K2WX-2AAP>]

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

In August 2020, the SEC began requiring companies to disclose information about their “human capital resources.”<sup>27</sup> However, this rule gave companies wide discretion over what to include in their disclosures, and very few chose to disclose demographics.<sup>28</sup> In August 2021, however, the SEC approved Nasdaq Stock Market LLC’s (NASDAQ) proposed rule requiring each NASDAQ-listed company to have at least two diverse board members, or explain why it does not.<sup>29</sup> However, NASDAQ stated that it “will verify that the company has provided an explanation, but will not assess the merits of the explanation.”<sup>30</sup> It is thus questionable how effective NASDAQ’s measures will be. It is also questionable whether two diverse board members are enough. NASDAQ’s rule requires disclosure on the voluntary self-identified gender, racial characteristics, and LGBTQ+ status of the company’s board.<sup>31</sup> This bill received some backlash on the grounds that it is not the role of NASDAQ to ensure such things.<sup>32</sup> There are also state laws in place regarding demographic disclosure, and even mandatory diversity requirements in California and Washington enacted in 2020.<sup>33</sup> In June 2020, New York began requiring any for-profit companies authorized to do business in New York to disclose the number of women directors on their boards.<sup>34</sup> This differs from many other states who only require company disclosure if the company is

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<sup>27</sup> David Vance, *The SEC Just Mandated Human Capital Disclosure: What Does This Mean for You?*, Chief Learning Officer (Nov. 5, 2020), <https://www.chieflearningofficer.com/2020/11/05/the-sec-just-mandated-human-capital-disclosure-what-does-this-mean-for-you/>

<sup>28</sup> Al Barbarino, *SEC Commissioner Says Exec. Comp Should be Tied to ESG*, LAW360 (June 29, 2021, 8:45 PM), <https://www-law360-com.ezproxy.bu.edu/articles/1398383?scroll=1&related=1>

<sup>29</sup> Public Statement, Allison Herren Lee & Caroline A. Crenshaw, Commissioner, *Statement on Nasdaq’s Diversity Proposals—A Positive First Step for Investors*, SEC (Aug. 6, 2021), <https://www.sec.gov/news/public-statement/statement-nasdaq-diversity-080621> [https://perma.cc/72MF-BMYW]

<sup>30</sup> *Nasdaq’s Board Diversity Rule What Nasdaq-Listed Companies Should Know*, NASDAQ (Oct. 1, 2021), <https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Thi ngs.pdf>

<sup>31</sup> *Id.*

<sup>32</sup> Holloman & Han, *supra* note 10.

<sup>33</sup> Liu, *supra* note 21.

<sup>34</sup> *Id.*

listed on a public exchange.<sup>35</sup> California and Washington have gone as far as to require a certain number of board seats be held by women or minorities.<sup>36</sup> California additionally required “that all publicly listed companies headquartered in the state appoint at least one director from an underrepresented background to their board by the end of 2021.”<sup>37</sup>

## 2. *Company regulations and Goals*

Beyond federal and state regulations, many large companies, including Nike, Apple, Starbucks, and Chipotle, have taken it upon themselves to put in place executive compensation plans tied to diversity hiring initiatives. According to a Pearl Meyer survey, most compensation plans’ bonus payouts are of the magnitude of 10% following Apple.<sup>38</sup>

### (a) Nike

Nike disclosed the diversity goals that it hopes to reach through a five-year road map to 2025.<sup>39</sup> This includes a 49.5% increase in female employees across the company, and at least a 29% increase in the United States V.P. leadership for racial and ethnic minorities.<sup>40</sup> It plans to achieve these targets by tying its diversity goals to executive compensation.<sup>41</sup>

### (b) Starbucks

Starbucks also implemented changes to its executive annual bonus plan to create a tie between executive compensation and increased

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<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> Eric Rosenbaum, *Apple’s New Executive Bonus Formula is Designed for the Fast-Changing World We Live In*, CNBC, (Jan. 16, 2021, 9:59 AM), <https://www.cnbc.com/2021/01/16/apple-ceo-tim-cook-cash-bonus-not-tied-to-sales-profits.html> [<https://perma.cc/3NVY-8U9S>]

<sup>39</sup> John Donahoe, *Read John Donahoe’s Introduction to the FY20 NIKE, Inc. Impact Report*, NIKE (March 10, 2021), <https://news.nike.com/news/fy20-nike-inc-impact-report-ceo-letter> [<https://perma.cc/CL5B-3YVJ>]

<sup>40</sup> *Id.*

<sup>41</sup> Lauren Thomas, *Nike Sets Fresh Diversity Targets for 2025, and Ties Executive Compensation to Hitting Them*, CNBC (Mar. 12, 2021, 7:49 PM) <https://www.cnbc.com/2021/03/11/nike-sets-diversity-goals-for-2025-ties-executive-comp-back-to-them.html> [<https://perma.cc/ZM3S-S4N8>]

diversity and inclusion.<sup>42</sup> Starbucks noted that it was “increasing the individual performance factor from 30 to 50 percent of the overall payout calculation, with the goal of holding senior leaders individually accountable to drive inclusion and sustainability.”<sup>43</sup> Starbucks executives are collectively accountable for three-year representation goals focused on increasing the representation of people of color in managerial positions.<sup>44</sup> If the targets are met or exceeded, payout will increase by 10%, while there will be an automatic 5% reduction to payout if growth is 0-5%, and a 10% reduction to payout if growth is negative.<sup>45</sup>

### (c) McDonald’s

McDonald’s has announced its goal to increase the number of women in leadership roles globally from 37% to 45% by the end of 2025.<sup>46</sup> It hopes to reach gender parity by the end of 2030.<sup>47</sup> Additionally, the company aims to increase representation of underrepresented groups in leadership roles from 20% to 35% by the end of 2025.<sup>48</sup> For the executive incentive program, executives will be measured on metrics relating to improving diversity representation, and creating a “strong culture of inclusion” for the employees.<sup>49</sup> Aside from the 5-year plan, the 2021 short term program metric will focus on human capital metrics as 15%.<sup>50</sup>

### (d) Apple

This year, Apple added an ESG “bonus modifier” to its cash incentive program, which could lead to a 10% increase or decrease in total bonus payout.<sup>51</sup> Successfully executing ESG goals can increase the bonus by 10%, while failing to do so can cause a reduction of 10%.<sup>52</sup> It is likely, however, that the effect of the ESG metrics will not come until

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<sup>42</sup> Smith, *supra* note 5.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> Amelia Lucas, *McDonald’s sets targets to diversify its leadership, seeks gender parity by 2030*, CNBC (Feb. 18, 2021, 8:42 AM), <https://www.cnbc.com/2021/02/18/mcdonalds-sets-targets-to-diversify-its-leadership-seeks-gender-parity-by-2030.html> [<https://perma.cc/TS2B-S7Z6>]

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> Smith, *supra* note 5.

<sup>50</sup> Lucas, *supra* note 47.

<sup>51</sup> Rosenbaum, *supra* note 39.

<sup>52</sup> *Id.*

2022, like most companies.<sup>53</sup> Apple has already instituted increased transparency when it comes to climate initiatives, but investors are looking forward to seeing the company apply the same approach to diversity and inclusion.<sup>54</sup>

#### **D. Costs and Benefits of Executive Compensation Being Tied to Diversity Hiring**

##### *1. Benefits to Compensation Program*

There are multiple theories offered as to why companies are motivated to offer compensation contracts tied to diversity goals, such as the shareholder theory, stakeholder theory and institutional theory.<sup>55</sup> Overall, all three theories emphasize that compensation contracts would generally increase company value, as they would make a positive impact on the company's corporate social standing.<sup>56</sup> Diversity measures are often used by investors who are evaluating companies they want to invest in, employees who are choosing which companies they want to work for, and clients to determine what companies they want to work with.<sup>57</sup>

The shareholder theory emphasizes the fact that managers favor shareholders and are therefore likely to engage in shareholder-maximizing activities.<sup>58</sup> There has been a strong push by shareholders to only invest in firms who have showed a commitment to diversity.<sup>59</sup> Since July 2020, shareholder derivative suits have been filed against at least twelve publicly traded companies for lack of board diversity; these suits sought various forms of relief such as the replacement of current non-diverse directors with diverse directors, or the creation of billion dollar funds to hire minority employees.<sup>60</sup> Last year, Apple had opposed a proxy measure by one of its shareholders that asked for executive compensation to be linked to ESG measures.<sup>61</sup> This year, the company

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<sup>53</sup> *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> Atif Ikram et al., *CSR-Contingent Executive Compensation Contracts*, *J. OF BANKING & FIN.*, 1, 4 (2019).

<sup>56</sup> McWilliams & Budoff, *supra* note 1.

<sup>57</sup> *Id.*

<sup>58</sup> Bryan Hong et al., *Corporate Governance and Executive Compensation for Corporate Social Responsibility*, *J. BUS. ETHICS* 136, 199–213 (2016).

<sup>59</sup> Liu, *supra* note 21.

<sup>60</sup> *Id.*

<sup>61</sup> Rosenbaum, *supra* note 39.



chose to include this measure in its executive compensation plan, in part due to activist shareholders.<sup>62</sup>

On the other hand, the stakeholder theory may also explain the push for companies to engage in diversity hiring initiatives and tie executive compensation to such initiatives.<sup>63</sup> It is closely tied to the shareholder theory, but is long-term and instead focuses on the stakeholders such as customers, suppliers, and employees.<sup>64</sup> “[C]ompanies that fulfill their ... responsibilities to stakeholders,” including prioritizing diversity hiring, will benefit long-term.<sup>65</sup> To support the stakeholder theory, “[t]he Harris Poll found that 54% of employees said they would consider quitting if their company did not take a stand against racial injustice.”<sup>66</sup> Furthermore, a recent Edelman survey found that “42% of [people] said they had started or stopped using a [certain] brand ... because of its response to protests against racial injustice” in the past year.<sup>67</sup> The Coca-Cola Co. updated its outside counsel guidelines to require that the U.S. law firms it uses take concrete steps to promote diversity, including providing self-identified diversity data and ensuring that a certain percentage of the firms’ attorneys are diverse.<sup>68</sup> Additionally, the CEO of Goldman Sachs announced in 2021 that the company will only take those companies public that have at least two diverse board members.<sup>69</sup> The institutional theory argues that a company takes actions which allow it to establish and enforce its social legitimacy.<sup>70</sup> Therefore, by tying executive compensation to diversity hiring initiatives, companies are attempting to cater to the expectations that both financial and non-financial companies have of them.<sup>71</sup>

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<sup>62</sup> *Id.*

<sup>63</sup> Hong et. al., *supra* note 59.

<sup>64</sup> *Id.*

<sup>65</sup> Holloman & Han, *supra* note 10.

<sup>66</sup> Schifter, *supra* note 14.

<sup>67</sup> *Id.*

<sup>68</sup> McWilliams & Budoff, *supra* note 1.

<sup>69</sup> Hugh Son, *Goldman won't take companies public without 'at least one diverse board candidate,' CEO says*, CNBC, (Jan. 23, 2020, 8:15 AM), <https://www.cnbc.com/2020/01/23/goldman-wont-take-companies-public-that-dont-have-at-least-one-diverse-board-candidate-ceo-says.html> [https://perma.cc/77UQ-LXZ9]

<sup>70</sup> Ikram et. al., *supra* note 56.

<sup>71</sup> *Id.*

## 2. *Costs to Compensation Program*

On the other hand, despite arguments in support of such executive compensation programs, there are also theories that argue the possible downsides of employing these initiatives. For example, it could lead to an agency problem where [p]ossessing higher degrees of managerial power ... allows managers to have greater influence over how they are compensated, [possibly] leading to overcompensation.”<sup>72</sup> Some find CEOs to be grossly overpaid as is.<sup>73</sup> Managers may be able to use these contingent incentive plans to extract more money for themselves.<sup>74</sup> Others question why we need such measures in place, because many believe that executives should be intrinsically motivated to increase diversity in hiring, without the increase in pay, as it is the right thing to do.<sup>75</sup>

Overall, however, the benefits of installing such programs seem to outweigh the possible cost, as many large companies have developed long-term plans and goals to increase diversity by tying it to executive compensation. The reputation and size of the companies moving towards tying executive compensation to diversity initiatives shows that it is likely to be a good investment and that the benefits outweigh the costs. Furthermore, these concerns could most likely be avoided by installing a proper executive compensation program.

### **E. How to Install a Model Program**

Compensation committees in companies have faced challenges due to the speed at which multiple factors converged at the same time such as “human capital broadly, DE&I, increased disclosure requirements, and growing investor expectations.”<sup>76</sup> However, “the decisions ... that compensation committees implement now will lay the [path] for

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<sup>72</sup> Hong et al., *supra* note 59.

<sup>73</sup> Stephen Miller, *Should Employers Tie Executive Compensation to DE&I Goals?*, SHRM, (March 21, 2016), <https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/ceos-overpaid.aspx> [<https://perma.cc/85FG-LSBZ>]

<sup>74</sup> Hong et al., *supra* note 59.

<sup>75</sup> Hasan & Adeleye, *supra* note 7.

<sup>76</sup> Marcel Bucsescu & Andrew Lepczyk, *The Compensation Committee’s Role in Human Capital and DE&I, According to Fortune 500 Committee Chairs*, NACD BOARDTALK (June 30, 2021), <https://blog.nacdonline.org/posts/compensation-committee-hcm-dei> [<https://perma.cc/PT93-B3EX>]

future developments.”<sup>77</sup> Developing such an initiative is not easy, and the company must take into account multiple considerations when figuring out what program is most appropriate for that company specifically. A company must determine which goals support the company values, who in the company the incentives should be applied to, a reasonable timeline to meet the goals, and exactly what the incentives will be and how they will factor into compensation.<sup>78</sup> A company should also test pay metrics before including them, in order to uncover any unintended consequences or the possibility of gaming the system and finding ways to achieve good scores on performance metrics without actually achieving the diversity goals of the corporation.<sup>79</sup> Boards can move from incorporating these metrics generally, to more specific incentives as they better understand the issues.<sup>80</sup> Further, the board must be committed to its stated goals; its program should not be a short-term publicity exercise, as increased DE&I requires a multi-year effort.<sup>81</sup> It is important to foster and manage a strong corporate culture, which is set from the top.<sup>82</sup>

### 1. *Long Term vs. Short Term*

Many companies that have tied executive compensation to DE&I objectives have employed annual bonuses, rather than long-term incentives such as stock options.<sup>83</sup> For example, Archer-Daniels-Midland Company had a short-term plan involving a bonus pool, “with one quarter of payouts based on individual performance including a consideration” of advancement of DE&I goals.<sup>84</sup> This is in line with the method most companies have taken “to include diversity in their

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<sup>77</sup> *Id.*

<sup>78</sup> Seymour Burchman, *A New Framework for Executive Compensation*, HARV. L. SCHOOL FORUM ON CORP. GOV. (Mar. 13, 2020)

<sup>79</sup> Blair Jones, Key Considerations for Companies Looking to Integrate ESG and DE&I Into Compensation Programs, HARV. L. SCHOOL FORUM ON CORP. GOV. (July 2, 2021), <https://corpgov.law.harvard.edu/2021/07/02/key-considerations-for-companies-looking-to-integrate-esg-and-dei-into-compensation-programs/>

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> Holloman & Han, *supra* note 10.

<sup>83</sup> Smith, *supra* note 5.

<sup>84</sup> Krishna Shah, *Diversity Inclusion Metrics in Executive Compensation*, GLASS LEWIS (Mar. 2, 2021), <https://www.glasslewis.com/diversity-inclusion-metrics-in-executive-compensation/> [<https://perma.cc/R3JJ-3U3H>]

compensation program.”<sup>85</sup> However, some companies’ short-term plans are a little better, as they define set goals and disclose the results of their programs. For example, “Edison International includes ‘Diversity, People & Culture’ as a 10% weighted metric under its short-term incentive plan.”<sup>86</sup> It chose a tangible goal and disclosed its actual results, finding an increase of 1.6% in the diversity of its executive and leadership populations, and noting that its goal was met.<sup>87</sup> However, diversity should be promoted by long-term programs rather than by short-term incentives. Companies such as McDonald’s and Starbucks have begun to create long-term incentive programs by making incremental steps over a three, five or ten-year period.<sup>88</sup>

## 2. *Discretionary vs. Formal Metrics*

Determining how to measure performance in diversity hiring can be tricky; oftentimes in payment incentive plans, there is no clear disclosure of what specific diversity goals or achievements were considered.<sup>89</sup> Instead, the plans include just a sentence or two saying it was a factor.<sup>90</sup> “A soft goal reviewed by a judicious board can [lead to] better outcomes” than a weighted metric which is poorly conducted.<sup>91</sup> A large concern for investors is making sure that the goals included by a company are challenging and do not just reflect “de facto guaranteed payouts.”<sup>92</sup> When diversity goals are set subjectively, based on organization-specific factors, and exact considerations are undisclosed, it is difficult to figure out how rigorous the standards are.<sup>93</sup> Glass Lewis observed that when diversity is assessed on a discretionary basis, companies pay out to their executives at target level or higher.<sup>94</sup> Therefore, the firm looks for companies that give an explanatory disclosure of the performance assessment and ultimate award outcome, in order to assess whether the executive pay was justified.<sup>95</sup>

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<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> Smith, *supra* note 5.

<sup>89</sup> Shah, *supra* note 86.

<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

### 3. *Pitfalls to Avoid*

There are also risks that should be considered when developing a program to tie executive compensation to DE&I goals. For example, a company might wish to avoid imposing strict quotas and numbers due to the stigma associated with that strategy, as has been shown by the affirmative action debate as well.<sup>96</sup> Instead, a company might consider adopting a version of the “Rooney Rule,” as used by the NFL, and later adopted by Amazon, by requiring that diverse candidates be included in at least the first round of any management hiring process.<sup>97</sup>

Other problems companies have faced when trying to tie executive compensation to diversity initiatives includes issues with measuring performance, and disclosure of data that in some cases may be considered sensitive or protected information such as a person’s sexuality.<sup>98</sup> It is important to make sure the companies’ disclosures are accurate and complete, as they are subject to regulatory compliance.<sup>99</sup> Companies that fail to do so may face liability for misleading or deceptive statements.<sup>100</sup>

## F. Conclusion

In the coming years, public demand for an increase in diversity hiring initiatives is expected to only increase.<sup>101</sup> It is likely that many smaller companies will follow the path of these larger corporations and link compensation to diversity initiatives; such hiring goals might in fact be even more impactful in small businesses. Furthermore, NASDAQ companies will have to prepare and figure out how to adjust to the new disclosure rules, which will change the way large corporations hire long-term. We will probably have to wait a few years before we can observe the actual impacts of implementing a program tying executive compensation to diversity hiring initiatives, and based on its success or failure, new changes will likely be made down the road. Companies,

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<sup>96</sup> Smith, *supra* note 5.

<sup>97</sup> Stefanie Johnson, *What Amazon’s Board Was Getting Wrong About Diversity and Hiring*, HARV. BUS. REV. (May 14, 2018), <https://hbr.org/2018/05/what-amazons-board-is-getting-wrong-about-diversity-and-hiring> [<https://perma.cc/YE9W-7PWB>].

<sup>98</sup> Smith, *supra* note 5.

<sup>99</sup> Holloman & Han, *supra* note 10.

<sup>100</sup> *Id.*

<sup>101</sup> McWilliams & Budoff, *supra* note 1.

however, should be wary that increasing diversity does not, in itself, increase effectiveness; “what matters is how an organization harnesses diversity, and whether it’s willing to reshape its power structure.”<sup>102</sup> Simply committing to hiring more diverse employees is not enough, but it is a place to start. Further, we should be wary that executives are not being compensated extra, merely for maintaining what is the status quo already, or for marginal increases. It is also important to be aware that only adding a certain number of diverse employees is likely to not be representative of the amount of diversity that exists in the country. Therefore, while these efforts have the right intentions in mind, companies must proceed with caution for such initiatives to have meaningful effects.

Isha Kumar<sup>103</sup>

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<sup>102</sup> Ely & Thomas, *supra* note 9.

<sup>103</sup> Student, Boston University School of Law (J.D. 2023).