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The Investment Case for Gender Equality

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The case for gender equality has never been stronger—the ethical case as well as the investment and economic cases. Progress, however, remains slow and somewhat patchy, for the same reasons that efforts to tackle other forms of inequality are measured by the turtle's pace rather than the gazelle's: The power elite almost never give up ground without a fight. But that's turning into a losing, if protracted, battle.

The largest share of most nations' wealth comes from people: Two-thirds of global wealth, according to the World Bank, comes from the present value of future earnings of the labor force—and women, because of lower pay and fewer paid work hours than men, hold only 38 percent of that now.

The logical power of the case for equality persists, and, increasingly, investors are understanding the power of that logic. Over the past couple of years we have seen some large, mainstream asset managers[1] and asset owners[2] begin to withhold votes from all-male boards or from certain committee chairs at all-male boards. Shareholder proposals asking that companies conduct pay audits and take steps to mend gender pay gaps have been getting double-digit votes. Although few have passed, the vote tallies are respectable, especially considering that at many of the tech companies that receive these proposals, insider voting power is considerable. For instance, Pax World Funds' pay equity resolution at Oracle received nearly 40 percent of all votes cast, which, considering that Larry Ellison, a cofounder and ex-chief executive officer of the company, owns nearly 30 percent of the shares, constitutes a majority of the independent shareholders.

The literature that supports votes such as these and investor interest in diversity continues to grow and is becoming richer in content: No longer are the studies only about the correlation between board gender diversity and share prices, or other measures of financial performance. Those studies are still being done, but the landscape is more varied now, encompassing subjects such as risk, sustainability, and innovation, and their connection with gender diversity. Here are some noteworthy recent additions to that literature.

ECONOMIC IMPACT

The often-cited McKinsey (2015) report showed that global annual gross domestic product (GDP) could be $12 trillion higher if gender inequality were reduced—and $28 trillion higher if it were eliminated—by 2025. We don't have up-to-date figures on that, but evidence of economic benefits to gender equality continues to mount. Wodon and De La Briere (2018) noted that if women had the same lifetime earnings as men, global wealth per capita would be $23,620 higher, or $160 trillion higher in aggregate. The largest share of most nations' wealth comes from people: Two-thirds of global wealth, according to the World Bank, comes from the present value of future earnings of the labor force—and women, because of lower pay and fewer paid work hours than men, hold only 38 percent of that now. Unrealized potential, indeed.

We're not on a path that would get us even close to realizing that potential right now, because the global gender gap is on track to close in 202 years, according to the World Economic Forum.[3] But there are smaller, practical steps that could offer immediate help. Maternity leave is an excellent example: Amin and Islam (2019) finds a "large, positive and statistically significant" relationship between the length of paid maternity leave and the proportion of female workers in the private sector in developing countries. Interestingly, many developing countries already do provide some paid maternity leave. The 800-pound-gorilla outlier is the United States, which is the only developed country in the world that does not mandate paid maternity (or parental) leave, and one of only two of all the countries in the Western Hemisphere that do not have mandated maternity (or parental) leave (Hernandez 2018). Across the globe, the only other countries that achieve this distinction are New Guinea, Suriname, and a handful of island nations in the South Pacific.

Clearly, there's work to be done to really achieve the economic potential that comes from equality. Much of that work needs to be done by policymakers at both national and subnational levels, and some of the change that needs to happen is also cultural. Turban et al. (2019) provides some excellent insight into the cultural dimension of inequality by trying to explain the divergence in the literature between studies showing that gender diversity is positive for firm performance and those that show it can harm performance. Looking at more than 1,000 firms in more than 35 countries, the study found that gender diversity was associated with positive firm financial performance—market value and revenue—in countries where there is a widespread cultural belief that gender diversity is important. "In other words," the authors note, "beliefs about gender diversity create a self-fulfilling cycle."

There's a lot to be gained from that cycle. Israel et al. (2019) notes that women are expected to hold $72 trillion worth of the world's financial assets, and women are accumulating those assets 1.5 times faster than men. In the United States alone, if the labor force participation of women were equal to that of Norway, the U.S. economy could be $1.6 trillion larger than it is—that's 8 percent of GDP (Bovino and Gold 2017). And remember, at least one study found a link between labor force participation and maternity leave. That really is a $10 bill on the sidewalk for the United States.

THE COST OF GENDER BIAS AND DISCRIMINATION

Even if we continue to not pick up that particular $10 bill, we really ought to quit dropping new bills onto the sidewalk. Bias and discrimination are costly, both for the economy and for companies. Smith et al. (2018) created a Predatory Behavior Index (see table 1) and applied it to venture capital (VC) and private equity funds to assess the relationship, if any, between fund performance and predatory behavior on the part of the VC firm. They found that fund-level investment performance was negatively correlated with predatory and discriminatory behavior. That finding sounds less surprising than it is. Until the #MeToo and #Time'sUp era began, it is probably fair to say that most people in the investment industry regarded gender inequality and discrimination as an immaterial issue. Many probably still do, but that group is shrinking as findings like these come in.

The idea that discrimination could be costly for individual companies isn't really new, of course; investors often have reacted negatively to new filings of class-action lawsuits. But the implications of discrimination are starting to be felt beyond the realm of class action. One example from our own experience at Pax World Funds involves a pay equity shareholder proposal we filed at Oracle. For the second time, in 2018, Oracle put the proposal in its proxy for all shareholders to vote on and recommended that shareholders vote against it, arguing that Oracle already had internal programs to prevent discrimination and promote diversity. What it didn't say was that the company also faces an ongoing lawsuit, filed by the U.S. Department of Labor, alleging that the company "systematically shorted women and minorities $400 million in wages." In early 2019, the Comptroller of New York City called on the Securities and Exchange Commission to investigate whether Oracle provided misleading information to investors in its opposition statement to the Pax World Funds pay equity proposal. It's not clear if this has ever happened before with regard to discrimination, but if it has, it hasn't happened often.

The ability to hide negative information without financial consequences is disappearing. High-profile cases of discrimination, harassment, and sexual violence make the news more often, and one of the main tools companies have

Table 1

DEFINITIONS OF PREDATORY BEHAVIOR

Predatory Behavior	Example	Weighting
Enabler	Invested funds in a company run by a founder with a known track record of predatory behavior	1
Inappropriate Conduct	Made inappropriate comments of a sexual nature to a person seeking funding at an industry event	2
Discrimination	Denied business opportunities to an employee because of their ethnicity or gender	3
Domestic Violence	Accused of being abusive to a romantic partner	3
Inappropriate Sexual Relationship	Having an affair with a colleague	3
Sexual Harassment	Pestering a colleague for sex	4
Racial Harassment	Abusing a subordinate using racially charged language	4
Intimidation	Threatening someone's career if they speak out against an alleged assault	4
Assault	Physically assaulting someone and committing bodily harm	5
Sexual Assault	Rape	5

Note: A predatory behavior incident may consist of more than one act. For example, someone who commits domestic violence may also commit physical assault or sexual assault. The PB Index takes into account the severity of each act, as well as the number of acts committed.

Source: Smith et al. (2018)

used to camouflage such stories is also part of the spotlight—and discriminatory programs and actions tend to wither in sunshine. Some technology firms, in the spotlight because of historically poor performance on gender diversity, are starting to end the practice of requiring new employees to sign contracts that force all discrimination and harassment claims to be settled by mandatory arbitration, with forced confidentiality. Among the firms that have taken this step recently are Google, Facebook, Airbnb, eBay, Square, and Microsoft. This might expose companies to legal action regarding discrimination, but it also may encourage companies to improve their cultures and institute more effective programs to embrace diversity, and in the end improve their financial performance.

LEADERSHIP AND WORKFORCE

New studies continue to support the idea that having more gender-diverse leadership is associated with financial outperformance. Hunt et al. (2018) updated McKinsey's 2015 research about the relationship between inclusion and diversity and financial performance. The study included more than 1,000 companies in 12 countries and correlated the diversity of leadership with profitability (earnings before interest and taxes margin) and value creation (economic profit margin). It found that companies with more-diverse leadership teams performed better on the two measures, and the results were statistically significant. Moreover, companies in the top quartile for gender diversity in leadership were "21 percent more likely to outperform on profitability and 27 percent more likely to have superior value creation."

An added feature of this McKinsey report—and something that is starting to figure in the overall literature on diversity and financial performance—is the effect of having diverse leadership in specific roles. Several studies from earlier years documented the positive results of having women chief financial officers;[4] more studies are beginning to look at the distinction between staff and line functions and, like the McKinsey report, are showing that having more women in line roles is particularly likely to be associated with outperformance.

Subramanian (2018) found something similar: S&P 500 companies with higher scores for diversity (a measure that includes board diversity, women in management, and diversity or inclusion policies) generally had higher return on equity (ROE) than companies with lower scores.

Interestingly, that study also mentioned that the United Kingdom's target for having 33 percent women on the boards of the Financial Times Stock Exchange (FTSE) 350 by 2020 appeared to be "essential."

The same theme came out in research conducted outside the United States. Trinh et al. (2018) looked at the effects of female leadership among the United Kingdom Financial Times Stock Exchange (UK FTSE) 100 stocks and found that the proportion of women on boards was significantly and positively correlated with firm value, measured by Tobin's Q. Interestingly, that study also mentioned that the United Kingdom's target for having 33 percent women on the boards of the Financial Times Stock Exchange (FTSE) 350 by 2020 appeared to be "essential." Although the U.K. plan is not yet mandatory, the government's push for better board diversity was taken quite seriously, particularly in light of the recent requirement that companies with more than 250 employees report on average pay by gender. Even now, much of the writing about quotas or mandates for board diversity tends to focus on the results from a single study in 2009 that found that Norway's gender diversity quota, which was passed in 2003 and took effect in 2006 with a two-year compliance window, was associated with drops in Tobin's Q both upon announcement and for several years afterward. But now that many other countries have either mandated or strongly urged more board diversity, our understanding of the impact of mandatory board diversity should broaden, and the Norway study no longer should be the last or only word on board diversity mandates.

For example, in 2011, Italy passed a law to mandate board diversity. That law required that Italian companies appoint at least three women to their boards by August 2012. Bruno et al. (2018) found that there was no impact on company performance when static models were used, but when a dynamic model was employed, the increase in board gender diversity was significantly correlated with return on assets, return on equity, return on invested capital, and return on sales. The authors note that the results of their study support other studies that show stronger correlations between a critical mass of women on boards and financial performance.

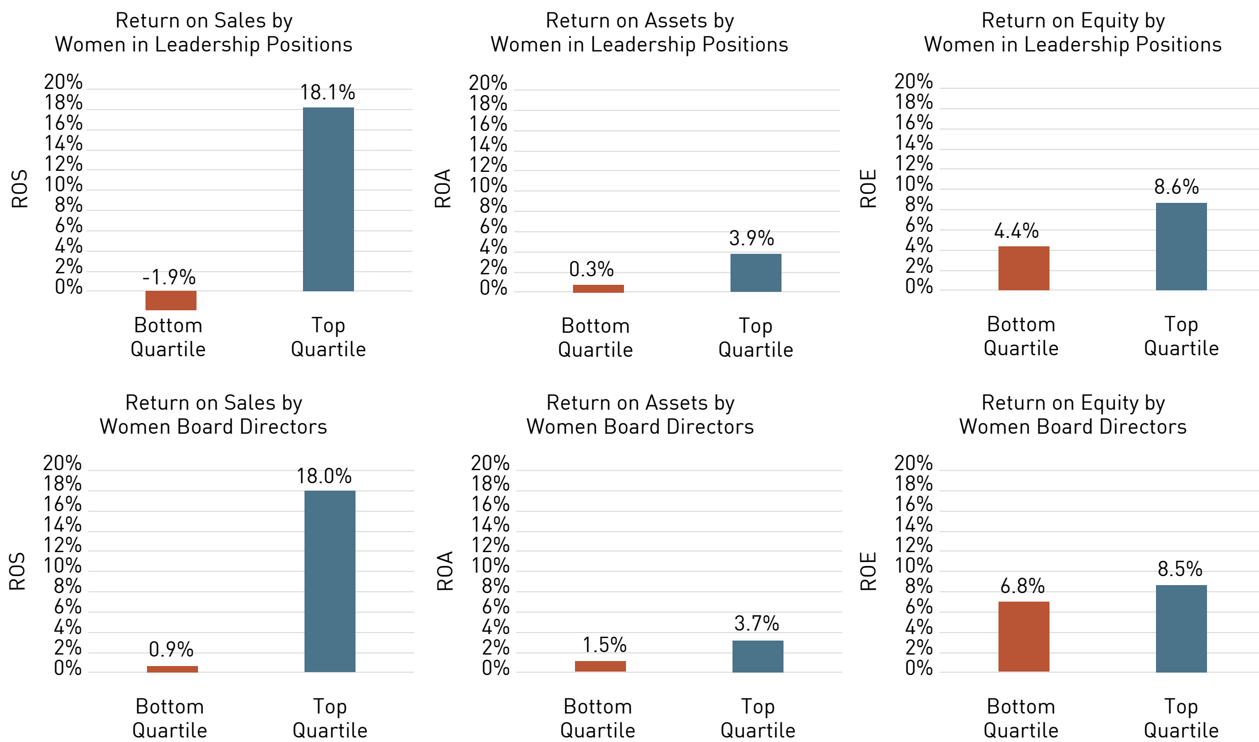
Jiang et al. (2019) looked at the impact of having women board chairs in China, yet another milestone in the expanding literature on the impact of gender diversity in specific roles. That report found that the 2,489 publicly traded Chinese firms with chairwomen performed better between 2000 and 2014 than those with male board chairs, and that the presence of a chairwoman also was associated with more effective board supervision and better attendance among independent directors.

Finally, it is worth mentioning that the impact of gender diversity isn't confined to the universe of publicly traded companies. Kumbuli et al. (2018) found that among borrowers, companies in the top quartile of women in senior management and boards outperformed the other

Figure 1

PERFORMANCE OF TOP QUARTILE COMPANIES FOR GENDER DIVERSITY

On average, over 11 years, companies with a higher percentage of women in leadership positions (WLP) and higher percentage of women in board positions (WBD) outperform companies with the lowest percentage of WLP and WBD as measured by ratios ROS, ROA, and ROE.



Source: Najada Kumbuli, Leigh Moran and Jenn Pryce, "Just Good Investing: Why Gender Matters to Your Portfolio and What You Can Do About It," Calvert Impact Capital, December 2018

three quartiles in terms of return on sales, return on assets, and return on equity (see figure 1).

INNOVATION

The literature about the impact of gender diversity on specific parameters of company performance is also expanding, particularly on the impact on innovation. Griffin et al. (2019) reinforces the importance of diverse leadership, finding that companies with more gender-diverse boards have more patents and more novel patents. It also found that companies with more gender-diverse boards had greater innovative efficiency, a measure that includes citation-weighted patent counts normalized by research and development capital. Interestingly, although many may associate more-innovative companies with higher volatility, this study also found that the companies with greater board gender diversity had lower stock return volatility.

Lorenzo et al. (2018) found that companies with more-diverse leadership teams, in both developed and developing economies, have a greater payoff to innovation: Forty-five percent of their total revenue came from innovation, compared with 26 percent for companies with below-average gender diversity in leadership (see figure 2).

Much of what is written about innovation focuses on entrepreneurship. Although innovation is not the same as entrepreneurship, the two are often related: More-innovative cultures tend to foster more entrepreneurship. Here, too, there is new grist for the mill.

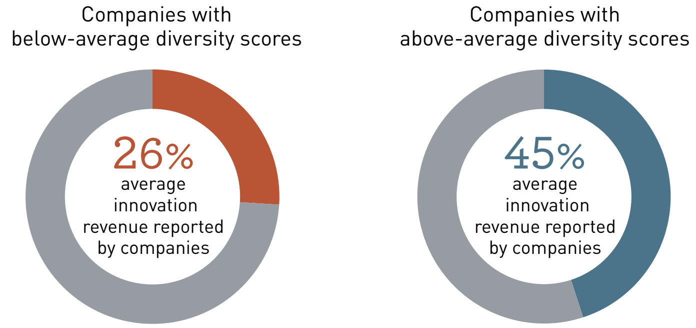
The literature on female entrepreneurship universally documents a persistent gender gap: Women entrepreneurs have a harder time getting venture or angel capital, they tend to get less money, and often the terms on which capital is provided are inferior to those of men. But much of that literature, including Ross and Shin (2019), also documents that women entrepreneurs tend to do better than men in terms of profitability. Abouzahr et al. (2018) found that women-owned startups deliver more than twice as much revenue per dollar invested compared to startups founded by men.

Finally, Eastman (2019) provided evidence that more-innovative publicly listed companies, as identified by annual lists from Forbes, Fast Company, MIT Sloan, and Boston Consulting Group, tended to have more women on their boards than industry peers (see figure 3), and were much more likely to have a critical mass (three)

Figure 2

COMPANIES WITH MORE-DIVERSE LEADERSHIP TEAMS REPORT HIGHER INNOVATION REVENUE

On average, over 11 years, companies with a higher percentage of women in leadership positions (WLP) and a higher percentage of women in board positions (WBD) outperform companies with the lowest percentage of WLP and WBD as measured by ratios ROS, ROA, and ROE.



Source: Najada Kumbuli, Leigh Moran and Jenn Pryce, "Just Good Investing: Why Gender Matters to Your Portfolio and What You Can Do About It," Calvert Impact Capital, December 2018.

Figure 3

INNOVATIVE COMPANIES AND BOARD DIVERSITY

Source: Meggin Thwing Eastman, "What Innovative Companies and Women on Boards Have in Common," MSCI Blog, 2019

of women on their boards and one-and-a-half times more likely to have quantitative diversity targets.

RISK

Another theme that has emerged strongly in the literature linking many parameters of sustainability with financial performance is risk, and the literature about gender is very much a part of that new theme.

Ali et al. (2018) looked at whether board gender diversity was associated with default risk. The authors tracked 831 Australian nonfinancial companies over a five-year period and found that a higher proportion of female directors reduced default risk. This paper is quite unusual in that it documented a causal relationship between diversity and default risk; most of the papers in the literature on financial performance and sustainability of any type only look at correlation.

Li and Zeng (2018) delved into a particularly important risk event for investors—a stock price crash. Tracking more than 3,400 chief financial officer (CFO)-company combinations in the Standard & Poor's (S&P) 1500 between 2006 and 2015, the researchers found that firms with women CFOs were less likely to have a future stock price crash than firms with male CFOs, primarily because women CFOs are less likely to engage in bad news hoarding—the practice of selectively withholding bad news from investors due to concerns about careers, compensation, or litigation risks. Nobody wants to hear bad news, but it's better, especially for investors, to hear it when the news is fresh, rather than waiting; often the bad news gets worse as it ages, and, in any case, delayed disclosure of unfavorable events reinforces investors' concerns about the quality of management.

SUSTAINABILITY

Sometimes the interesting findings about the effects of gender diversity relate to other aspects of corporate value rather than correlating directly with measures of financial performance. One interesting strain of the business-case literature on gender is about the impact of women in leadership on company sustainability.

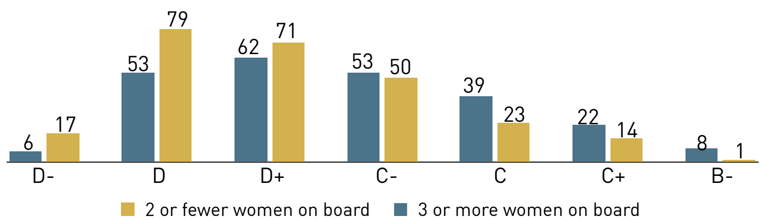
There is a wealth of literature, both academic and financial, linking sustainability with competitive or superior financial performance. A few studies also show that more sustainable companies or funds underperform, but these are significantly outnumbered by those showing outperformance, or at least competitive performance. Friede et al. (2015), a metastudy conducted by Deutsche Asset Management and the University of Hamburg, surveyed more than 2,000 studies and reported that approximately 90 percent found a non-negative relationship between corporate financial performance and environmental, social, and governance (ESG) scores, and that

Figure 4

RELATIONSHIP BETWEEN GENDER-DIVERSE BOARDS AND SUSTAINABILITY SCORES

Companies with gender-diverse boards rated higher more often.

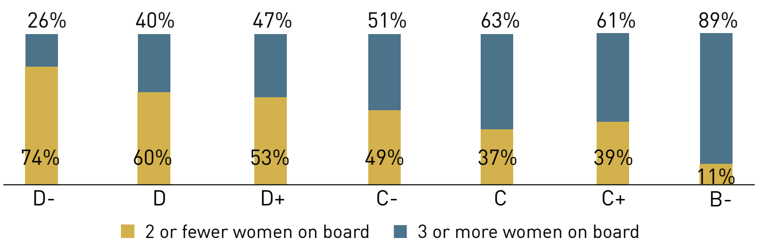
ISS-oekom scores distribution of S&P 500 companies by board gender diversity



Source: ISS-oekom, ISS Analytics

Firms without diverse boards are overrepresented among worse ESG ratings.

Percentage of companies receiving each ESG score by board gender diversity

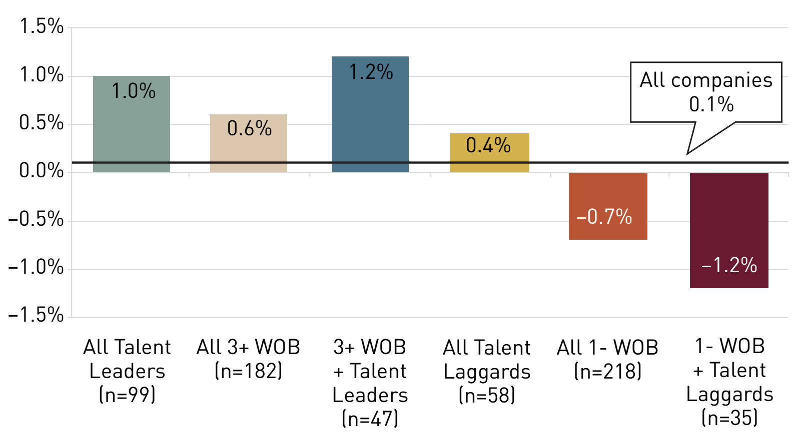


Source: ISS-oekom, ISS Analytics

Source: Cristina Banaham and Gavrial Hasson, "Across the Board Improvements: Gender Diversity and ESG Performance," Harvard Law School Forum on Corporate Governance and Financial Regulation, September 6, 2018

Figure 5

AVERAGE GROWTH IN EMPLOYEE PRODUCTIVITY BY BOARD DIVERSITY CATEGORY



Note: Figure 5 shows the average growth of employee productivity (measured as CAGR of revenue per employee for 2012-2016) relative to the sub-industry median for talent leaders, talent laggards, and both talent leaders and laggards. We have not included 1- WOB Talent Leaders or 3+ WOB Talent Lagggards in the chart because the sample sizes were too small for meaningful analysis.

Source: Meggin Thwing Eastman and Panos Seretis, "Women on Boards and the Human Capital Connection," MSCI, 2018

the "large majority" of that 90 percent found that the relationship was positive.

By inference, then, it is useful to know whether gender diversity is related to corporate performance on sustainability.

Banahan and Hasson (2018) found that companies in the S&P 500 with more gender-diverse boards, specified as companies with three or more women on the board, also had superior ESG scores. Moreover, the ESG score used does not include board gender diversity as a component, which avoids circular reasoning (see figure 4). The study also tested the durability of the relationship, looking at one-, three-, and five-year time periods and finding that companies with gender-diverse boards in all three time periods tended to perform better on ESG metrics than peers that did not. This bears out something that seems intuitively obvious: The benefits of board diversity aren't about instant gratification, but that's still good to test quantitatively.

The findings of the ISS work echo those of the International Finance Corporation (IFC), whose scope is global, which focused on developing and less-developed economies. Di Miceli and Donaggio (2018) found a substantial body of literature linking higher proportions of women in business leadership with enhanced ESG standards. The authors of the IFC report found 70 peer-reviewed papers that supported the connection between higher proportions of women in leadership with companies that had higher ESG standards, with what they called a "particularly clear connection" between companies with at least 30 percent female boards and higher ESG performance, reinforcing the "critical mass" theme in the gender literature. Those studies also found positive connections between enhanced ESG and stronger internal controls, management oversight, reduced fraud risk, positive workplace environments, greater stakeholder engagement, and improved brand reputation.

Liu (2018) focused on the environment, looking at connections between board gender diversity and environmental lawsuits and finding that companies with higher proportions of women on boards had fewer such lawsuits. Interestingly, the connection was even stronger when the chief executive officer was male.

Issa and Fang (2019) focused on companies in one region—the Arabian Gulf

Cooperation Council countries, which often rank low on women's rights and gender diversity in business. The study examined 244 nonfinancial companies between 2012 and 2014, finding that those with more board gender diversity were significantly more likely to have better disclosure on the parameters of corporate social responsibility.

HUMAN CAPITAL

Another social factor that often is linked with more financially successful companies is good human resource management. Colton (2018), for instance, noted that publicly traded corporations that used employee engagement surveys tended to generate significantly higher returns with lower volatility and had a lower probability of default. There is more to the literature linking workplace practices with financial performance; that's just a recent example.

It was good, therefore, to see Eastman and Seretis (2018) linking human resource practices with board diversity. The links that MSCI found were strong: Companies in the international MSCI ACWI Index with leading talent management programs were 4.6 times more likely than talent management laggards to have a critical mass (three or more from 2014 to 2016) of female directors. Furthermore, the companies with at least three women on their boards and leading talent management practices saw combined annual growth in revenue per employee that was 1.2 percentage points higher than the means for their industry between 2012 and 2016 (see figure 5).

CONCLUSION

There is a wealth of literature illuminating the business and investment case for gender equality. Much of it, to be fair, focuses on leadership, likely because that is a factor that can be readily counted for most corporations, public and private. Other parameters of gender equality are far scarcer, which makes econometric or financial studies linking those parameters to financial performance vastly more difficult to do and often less robust statistically due to small sample sizes. Much new ground remains to be broken in the business case for gender equality, but what exists explains well why the world of finance is much more likely, now more than ever before, to view gender diversity as a material factor in financial management and investment.

We must never forget, though, that there is a moral and ethical case for equality that is just as strong. The myriad social and economic ills associated with discrimination, harassment, and gender violence bear eloquent witness to that ethic. What we are doing to advance gender in financial circles is not only financially smart, it is right. Many things that companies and investors do to make money, especially when they do it to make money really fast, are sometimes much less defensible ethically. It's delightful that the financial case for gender gives us a sensible investment criterion as well as the ability to sleep at night.

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ENDNOTES

1. See https://www.bloomberg.com/opinion/articles/2019-03-05/markets-don-t-buy-republican-skepticism-on-climate-change?utm_campaign=Carbon%20Brief%20Daily%20Briefing&utm_medium=email&utm_source=Revue%20newsletter.
2. See https://www.wsj.com/articles/new-york-state-fund-snubs-all-male-boards-1521538321.
3. "Closing the Gender Gap," https://www.weforum.org/projects/closing-the-gender-gap-gender-parity-task-forces.
4. See Gorte (2018) for a summary of those studies.

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Definitions:

The EBIT, or earnings before interest and taxes, margin is a company's revenue minus expenses, excluding tax and interest.

The United Kingdom Financial Times Stock Exchange 100 Index (FTSE 100) is a share index of the 100 companies with the highest market capitalization listed on the London Stock Exchange.

The Financial Times Stock Exchange 350 Index (FTSE 350) is a market capitalization-weighted stock market index incorporating the largest 350 companies by capitalization that have their primary listing on the London Stock Exchange.

Return on sales, or ROS, is a ratio used to evaluate a company's operational efficiency.

Return on assets, or ROA, is a financial ratio that shows the percentage of profit a company earns in relation to its overall resources.

Return on equity, or ROE, is a measure of financial performance calculated by dividing net income by shareholders' equity.

The Blau Index, also known as The Gibbs–Martin index of sociology, psychology and management studies, measures diversity.

The Standard & Poor's 500 (S&P 500) is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE, NASDAQ or the Cboe BZX Exchange.

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