Women in Focus

Gender diversity and socially responsible investing

A Barclays report, written by The Economist Intelligence Unit

The Economist Intelligence Unit

Foreword

Within socially responsible investing (SRI), gender diversity – particularly in senior management positions and on boards of directors – is garnering attention from a wide range of investors and asset managers seeking to shape social change, while simultaneously generating competitive returns.

Globally, trillions of dollars in assets under management are actively invested using a socially responsible investment lens.[i] And as the market continues to mature, gender diversity stands to become a key factor for judging a company's commitment to environmental, social and governance (ESG) criteria – the key components of SRI.

Evolution of an investment approach

SRI represents a values-based investing approach that increasingly includes both a traditional emphasis on a company's financial health and a more holistic emphasis on the impact of its operations on society.

Overview

While some aspects of SRI can be traced back for centuries, the relevance and financial weight of SRI players has grown substantially over the past three decades.

The definition used by the Forum for Sustainable and Responsible Investment (US SIF), one of the oldest and best known organizations focusing on SRI, provides a universal, respected starting point. US SIF characterizes the approach as "an investment discipline that considers environmental, social and corporate governance criteria to generate long-term competitive financial returns and positive societal impact."[ii] In much of the late 20th century, such factors were largely ignored by the financial community as unrelated to a company's bottom line, but that is changing as more investors recognize the potential benefits of SRI. Studies ranging from *Demystifying Responsible Investment Performance: A review of key academic and broker research on ESG factors,* a 2007 report by the United Nations Environment Programme (UNEP) Finance Initiative and Mercer,[iii] to *McKinsey Global Survey Results: Valuing corporate social responsibility,* a 2009 study by McKinsey & Company,[iv] suggest companies that consider SRI criteria perform better than their peers.

SRI creates a closer alignment with an investor's intrinsic social and cultural values and a means to support those values. Using SRI criteria, such as transparent governance and sustainable operations, investors gather a more complete picture of a potential investment's overall health, including assessing risks associated with environmental and social impact, inadequate governance and resource depletion. This comprehensive approach allows them to make better-informed decisions.

SRI explicitly encompasses a longer-term view of investment returns, which can help avoid costly market and economic disruptions. This perspective aligns clearly with institutional investors, such as pension funds, foundations and endowments that generally ascribe to longer time horizons.

Historic context

The idea that investments should consider social impact has roots dating back hundreds of years. But it was only in the 1960s that SRI emerged as a modern, agnostic investment approach, driven largely by the rights movements of the time, as well as the anti-war movement. The women's rights movements, with a focus on sexual discrimination, brought gender into the sphere of relevant SRI criteria. Labor and management issues were also being raised.

Launched in 1971, the Pax World Fund was the first US mutual fund dedicated to SRI. Its founders started the fund with $101,000 in assets to challenge corporations to adhere to socially responsible policies. More than four decades later, the fund had $3.3 billion in assets under management in 2014.

SRI weighs a potential investment's financial health and overall impact on society

Links strengthened between investment decisions and the ethical implications of those decisions

However, SRI remained on the periphery. “It was an issue that typical investment portfolio managers didn’t want to talk about or hear about. They thought it was a distraction, and so they certainly didn’t think you could use it to make money,” said Janice Hester-Amey, Portfolio Manager for the California State Teachers’ Retirement System (CalSTRS), who has been actively involved in SRI since 1977.[v] CalSTRS had about $190 billion in assets under management in mid-2014 and was the second largest US public pension fund.

The markets-based thesis behind SRI came to the forefront in the mid-1980s as opposition to South Africa’s racist apartheid system peaked. In Europe and North America, grassroots organizations pressured companies, fund managers and, especially, universities to divest themselves of any South African holdings. By 1988, according to one estimate, 155 college endowments had pulled investments from South Africa, representing billions of dollars in funds.[vi] Corporate, environmental and governance scandals in the ensuing decades reinforced the momentum that had built around SRI in the 1980s.

“For many entrants into the market in the 80s, social issues were their primary concern. In the US, certainly, apartheid drove that focus. But also there was increasingly a general link between the sort of ethical implications of one’s investment decisions and their consequences to the world,” David Wood, Director of Harvard University’s Initiative for Responsible Investment (IRI), said.[vii]

Exhibit 1: Global assets under management (AUM) using ESG criteria, in $ trillions

Source: Global Sustainable Investment Alliance, *2012 Global Sustainable Investment Review*

Sizing SRI assets

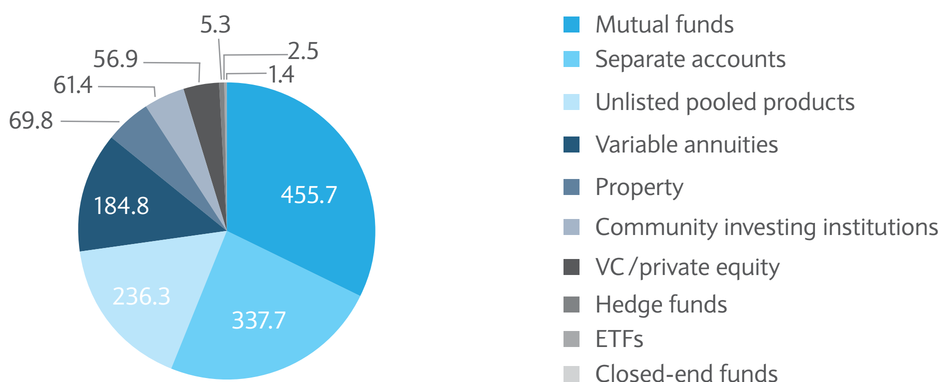
Estimates about the amount of assets invested using SRI criteria vary widely based on how qualifying investments are defined. A report by the Global Sustainable Investment Alliance (GSIA), an umbrella organization that includes US SIF, gives an authoritative view. GSIA found that at the end of 2011, assets totaling $13.6 trillion were under management by socially responsible investors, in seven markets, about 22 percent of the total assets under management in those markets. Europe accounted for almost two-thirds of this investment, with Australia, Canada and the United States representing almost all of the remainder (Exhibit 1).

Growth rates for SRI are equally difficult to pin down, especially globally. The United States, however, offers a relevant illustration of growth of such funds. US SIF reported that assets under management using ESG criteria in the United States grew 22 percent between 2010 and 2012, reaching $3.74 trillion or about 11 percent of professionally managed assets there. Indeed, between 1995 and 2012, assets under management following these criteria grew almost sixfold, slightly faster than overall asset growth, it said. Extrapolating these growth rates for assets under management globally suggests that SRI-focused funds could reach up to $53 trillion by 2025 (See sidebar, *SRI asset growth,* p7).

Vehicles to implement an SRI strategy are also more diverse in today's market. Again using the US market as an illustration, US SIF estimated that in 2012 about two-thirds of these assets – almost $2.5 trillion – were managed by institutional investors. In fact, public pension funds were among the first to embrace SRI – for example, the six largest UK pension funds and three of the largest US pension funds were among the original 2006 signatories to the Principles for Responsible Investment Initiative, a program supported by the UN. The remaining assets under management following an SRI approach were distributed among a wide range of investment vehicles,[1] including mutual funds, separate accounts or products privately managed for individual clients, unlisted pooled instruments, property funds, private capital and hedge funds (Exhibit 2) (See sidebar, *Underlying motivation,* p8).

Global SRI assets under management could reach $34-53 trillion by 2025

Exhibit 2: Vehicles for SRI investment in the US, among non-institutional investors, assets under management in $ billions



Source: US SIF, *Sustainable and Responsible Investing Trends in the United States, 2012*

1. Because of overlapping assets and other statistical overlaps, the individual components cited do not add to $3.74 trillion, the US SIF estimate for total AUM in the United States.

SRI asset growth

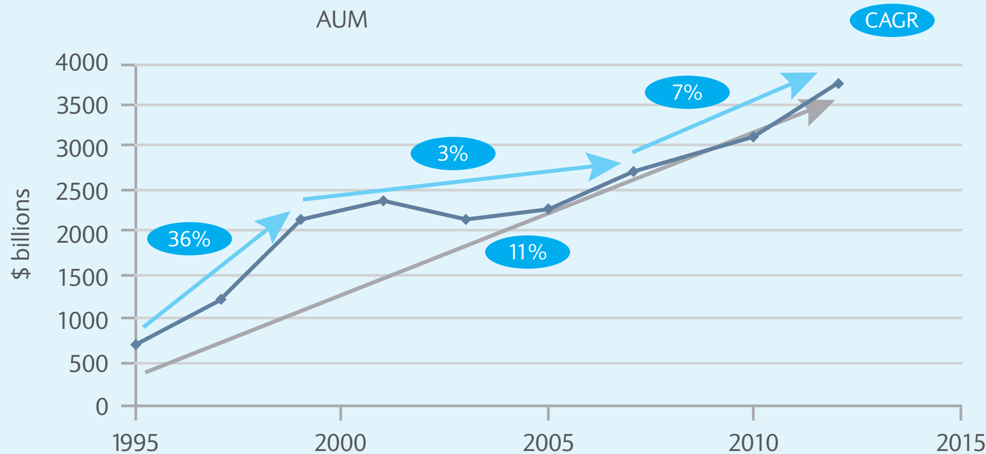
As with any attempt to look into the future, growth estimates for SRI must be viewed cautiously. Any number of unexpected events can change the historic trajectory suddenly. Ongoing changes in market behavior toward SRI may not register clearly on the scant data available, and significant differences in regional trends could have a noticeable impact on global growth. Such estimates should not be seen as predictions, but rather as directional guidance.

With these caveats, however, extrapolating from past growth rates suggests global assets under management using SRI criteria could reach as high as $53 trillion by 2025 and account for about 30 percent of total assets under management.

US SIF data is a relevant starting point, because it offers nearly two decades of data. The organization reported that assets invested in the United States using SRI criteria grew on average 11 percent annually between 1995 and 2012, rising from $639 billion to $3.74 trillion. Growth rates during this period varied widely, as illustrated in the chart below, and average annual growth between 2007 and 2012 had slowed to 7 percent. Using these growth rates as guides, it's reasonable to suggest that SRI in the United States could range from $6.5 trillion to $8.5 trillion by 2020 and from $9 trillion to $15 trillion by 2025.

Comparable growth data for assets under management globally is not available. However, the GSIA reported that $13.6 trillion in assets were under management globally in 2012 using SRI criteria. Applying the same boundary growth rates we've used for the United States would suggest such global assets under management could range from $23 trillion to $31 trillion by 2020 and $34 trillion to $53 trillion by 2025. This would represent about 20 to 30 percent of total assets under management globally in 2020[1] from about 22 percent in 2012. Most observers believe SRI investment will continue to grow slightly faster than assets under management generally, which would make the higher regions of this range most likely.

US AUM growth using ESG criteria, 1995-2012



Source: US SIF, *Sustainable and Responsible Investing Trends in the United States, 2012*

Compound Annual Growth Rate (CAGR)

1. Based on PwC estimate of global assets under management reaching $101.7 trillion by 2020.

Stu Dalheim, Vice President for Shareholder Advocacy at Calvert Investments, said SRI is rapidly assuming greater prominence within the range of investment approaches. "It will continue to move into the mainstream, making this a really exciting time for the entire industry," said Dalheim, whose firm had about $13 billion in assets under management in mid-2014. "As the impact of issues like climate change, water scarcity and human rights become more apparent to the broader market, there will be more and more incorporation of environmental, social and governance information."

Studies suggest positive impact on returns

Early in the evolution of SRI, some prominent economists theorized that the trade-off for using non-financial criteria for investment could be lower returns. Milton Friedman, the renowned economist, wrote famously in 1962, "There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits."[viii] Despite the opinions of such early skeptics, a growing volume of research suggests that investment returns and social responsibility may not be mutually exclusive, and focusing on socially responsible criteria may actually improve returns.

In a major review of academic and investment research in 2007, the UNEP Finance Initiative and Mercer reported that 17 out of 20 academic studies they analyzed found SRI strategies either neutral or positive for returns. The 10 brokerage reports they surveyed, which ranged from Goldman Sachs to Bernstein Research, also concluded the strategy was either neutral or positive. "The evidence suggests that there does not appear to be a performance penalty from taking ESG factors into account in the portfolio management process," the report concluded.

Market returns tell the same story. RBC Global Asset Management reported that since its launch in 1990, the FTSE KLD 400 Index (formerly the Domini 400 Social Index), which tracks socially responsible stocks in the United States, has slightly outperformed the S&P 500 Index.[ix] Similar results were found when RBC analyzed the 2002-2012 performance of the Jantzi Social Index, which tracks 60 Canadian companies that meet ESG criteria.

Following an SRI approach can help minimize long-term risks

Underlying motivation

As the range of investment vehicles that use an SRI approach expanded, client demand became a stronger catalyst for considering ESG issues. The US SIF 2012 report found, for example, that client demand was a major reason for asset managers to pursue SRI, cited by 72 percent of the funds studied, compared to 67 percent that cited risk and 64 percent that cited returns.

As asset owners, institutional investors are differently motivated. The report said their greatest motivation was their mission, cited by 87 percent of the responding institutions, followed by social benefit, 65 percent; returns, 38 percent; and risk, 32 percent. Client demand was only cited by 17 percent of the institutional investors as a motivation. (Respondents were allowed to make multiple choices.) Interestingly, the report found that when weighed in terms of assets under management, risk and return were the primary motivators for institutional investors.

Approaches to selecting investments

As SRI matured following its emergence in the 1960s and 1970s, approaches to selected appropriate investments shifted from excluding certain companies and industries to a more detailed search for desirable investments. Today, the common screening methods include:

- **Negative screening**: The earliest and most common method, negative screening excludes specific industries, such as tobacco and alcohol, and is often coupled with divestment movements.
- **ESG screening**: This approach evaluates a company's performance against ESG criteria and avoids those companies that fall short of the investment's performance criteria.
- **Norms-based screening**: International norms such as the Kyoto Protocol and the UN Global Compact are the foci of this approach, and companies that fail to meet these norms are avoided.
- **Positive screening**: Companies – for example, sustainable energy companies – are screened to be included in the investment portfolio, rather than excluded.
- **Best-in-class screening**: This approach doesn't exclude entire industries, but encourages investment decisions based on leadership in ESG issues. For instance, it could include an oil company making strides in renewable energy innovation or a tobacco company pioneering water conservation methods.

The 2012 US SIF report found that negative screening remains the dominant approach in terms of assets. In a study of SRI investors with about $2 trillion under management, investments totaling about $1.2 trillion were guided using negative screening, $197 billion was invested using positive screening, and the remaining $614 billion followed an integrated approach.

Divestment, an offshoot of negative screening techniques, became a rallying cry for anti-apartheid activists in the 1980s and remains relevant. The primary goal of this approach is to humiliate the target – originally the South African government – into changing its policies by generating public awareness of an issue and pressuring asset holders, such as college endowment funds, to sell shares seen as tainted.

Today, with political and humanitarian challenges in Africa and Asia and increasing concern about climate change, divestment is experiencing a rebirth. Investments linked to oppressive countries like Sudan, Myanmar and Iran, as well as to fossil fuel extraction, are being divested by many socially responsible investors and asset managers. Beyond any direct impact on corporate finances, divestment campaigns have proven to be a strong tool for bringing public scrutiny to investment choices.

> "For forcing the public dialogue, divestment has been a very powerful means of creating the grassroots campaign"
>
> Amy Domini, Founder and CEO of Domini Social Investments

Trillium Asset Management estimated that by 2013 more than 300 grassroots organizations had formed in the United States to push divestment of fossil-fuel assets. In 2014, Stanford University became the first major US school to announce it would divest its endowment funds, with total assets of about $19 billion as of August 2013, of coal investments, joining about a dozen smaller campuses that had also said they would divest of fossil fuels.

"Stanford has a responsibility as a global citizen to promote sustainability for our planet, and we work intensively to do so through our research, our educational programs and our campus operations," Stanford President John Hennessy said in the announcement.[xxii]

Studying the issue from a different perspective, McKinsey & Company in 2009 found that, by a large margin, chief financial officers (CFOs) and investment professionals believed corporate social responsibility programs added value to a company. Two-thirds of the CFOs responding to a global survey believed such programs add value, and only 7 percent said they reduce value. In the same survey, about three-quarters of investment professionals that responded said these programs add value, while only 5 percent said they reduce value.

"The primary issue has to be a value issue for the beneficiaries. All other issues have to be collateral benefits," Hester-Amey at CalSTRS said in an interview, adding long-term investors "have accepted the idea that because they are universal owners and because they own global portfolios that in the long run – in the very long run – they pay for all the externalities. Whether they actually believe that they can make money in pursuing an ESG strategy, they at least believe that they can minimize or mitigate their risk by paying attention to the issue."

Beyond financial returns, social and cultural benefits are also important, but are often difficulty to measure. This ambiguity contributes to the lingering doubts surrounding SRI, particularly among a business community that believes what can't be measured can't be managed or controlled. Good governance in general is also difficult to quantify.

Wood at Harvard said some metrics, such as the number of women on boards, which are easier to accommodate in data-driven analysis, have allowed more investors to consider SRI criteria. "The things that are amenable to enumeration or quantification [are] just easier to fit into financial cultural systems. Those kinds of things become investment issues … to the extent that they can be absorbed into the structures that process information for the financial industry," he said.

Gender diversity is becoming more relevant in weighing governance

Moving beyond negative screening

As momentum behind SRI grew, approaches for selecting appropriate investments changed from a focus on what shouldn't be held to a more targeted perspective on desirable holdings (see sidebar, *Approaches to selecting investments,* p9). In the late 20th century, negative screening predominated, and SRI focused on avoiding certain industries. Among the most common were tobacco, firearms, pornography, alcohol and gambling, as well as companies engaged in animal testing. As apartheid became a global concern, political conflicts and human rights were included among negative screening criteria.

Many investors gradually moved to a more positive screening approach. A company's overall performance against ESG criteria might be evaluated, for instance, or such criteria might be given similar weight to traditional financial criteria in making investment decisions. Themed investment strategies, for example around clean-energy industries or labor policies, also appeared.

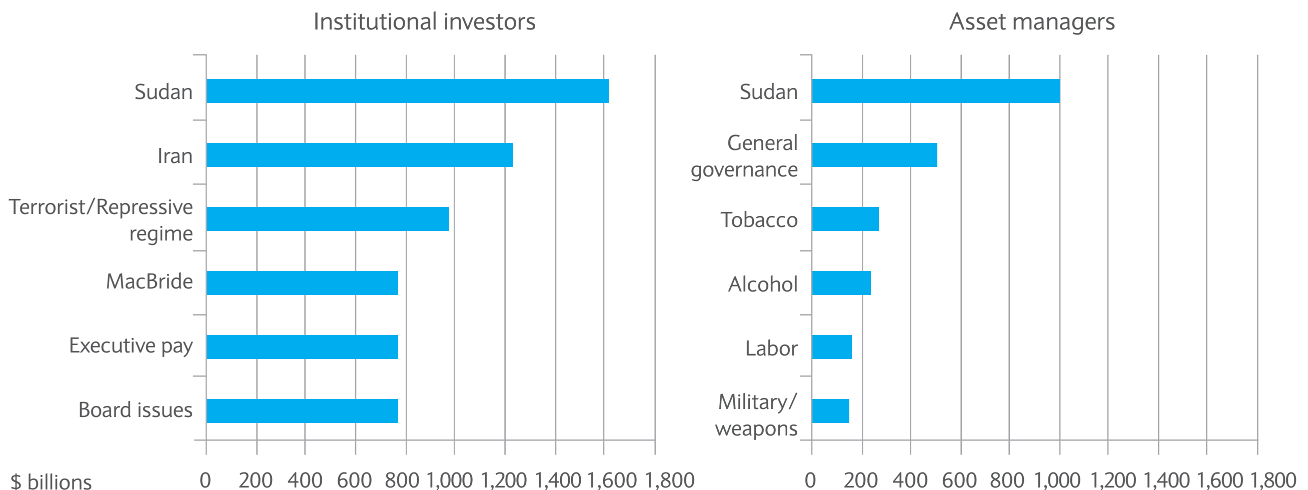
As SRI criteria and methodologies have evolved toward thematic investing, certain themes among the ESG framework have garnered more mindshare among investors than others. A US SIF study shows that in terms of assets under management, institutional investors and asset managers heavily favor social criteria for investment decisions.[x] Governance criteria were a distant second in each case.

A more detailed look by US SIF at specific criteria showed sharp differences. At the top of the list for both groups was screening for companies engaged in Sudan because of the ongoing human rights violations and political oppression there, but the remainder of their rankings diverged considerably (Exhibit 3).

Institutional investors leaned more heavily toward humanitarian and broad corporate issues. Their top six themes were Sudan, Iran, terrorist and repressive regimes, the MacBride Principles (a set of fair-employment guidelines), executive pay and board issues. Asset managers showed more interest in industry-specific criteria, citing in order Sudan, general governance, tobacco, alcohol, labor and military and weapons.

However, particularly in the wake of the financial crisis of 2008, governance became a more important SRI criterion among investors. And as investors look for ways to gauge a company's governance, gender diversity – and particularly women on corporate boards and in executive positions – has become an increasingly relevant element in their evaluations.

Exhibit 3: Top six ESG investment negative screening criteria in the US by assets under management, in $ billions



Source: US SIF, *Sustainable and Responsible Investing Trends in the United States, 2012*

Gender diversity and governance

Outside of agriculture, women are relative newcomers to the global labor pool. In the 20th century, especially the latter half, labor shortages linked to the two world wars and achievements by women's rights movements helped lead to significant change in developed economies.

Companies are becoming aware of the need to address gender diversity among board members and top executives

Where women stand today

In the United States, for example, participation by women in the labor force rose from 34 percent in 1950 to about 60 percent in 2000. Yet, despite these gains, women remain greatly underrepresented among senior corporate executives and in corporate boardrooms.

According to a 2011 report by Catalyst, an organization that promotes gender equality in the workplace, 51 percent of US middle managers were women, but only about 15 percent of senior executives and 17 percent of board members were women.[xi] A follow-up report in 2013 found there was no change in the number of board seats held by women in Fortune 500 companies, 17 percent.[xii]

Further, a 2012 report by McKinsey & Company found that for a sample of 235 publicly-listed European companies, only 10 percent of executive committee members and about 17 percent of corporate board members were women.[xiii] The consultancy also found that men were about twice as likely as women to be promoted from middle management to senior management and twice as likely again to move from senior management to the executive committee. And finally, a 2013 global survey by GMI Ratings, an analytical firm focusing on SRI, showed that while gender diversity is slowly improving – particularly in developed countries – the pace of change is much slower in North America than in Europe.[xiv]

Stephanie Sonnabend, Chair and Co-Founder of 2020 Women on Boards, an organization working toward the goal of women accounting for 20 percent or more of corporate board memberships in the United States by 2020, said the percentage of companies with women on their boards has grown slowly, from 15 percent of the board seats among US Fortune 1000 companies in 2011 to 17 percent in 2013. But she noted other measurements, such as the number of new local chapters in her organization, show greater awareness.[xv]

"These companies are beginning to know that it's something they need to address, but there are two real barriers here that are preventing progress," Sonnabend continued. "The first one is inertia. People get very comfortable in their position, and board members don't want to leave. Companies don't like to rock the boat if they don't have to. The second issue is that men continuously say there aren't qualified women, which is greatly not true. What it means is they don't know qualified women, and they're not willing to do the work that it takes to find qualified women."

Growing awareness of the importance of gender diversity

Such disparity between genders offers investors the opportunity to give precedence to companies with greater gender diversity, helping to push social change while backing companies whose gender policies may present clear market advantages. Like other topics relevant to SRI, gender diversity takes a long-term view of corporate value and returns. However, also like other ESG criteria, the impact of greater gender diversity on corporate performance remains a topic of debate despite a growing number of studies that show positive impact.

Mentions of board diversity in the financial press, as categorized by the Factiva database, offer one indication of the increased interest. In the first half of 2014, diversity was the sixth most discussed ESG issue in these publications, up from 13th in 2009 (Exhibit 4).[xvi] The increased interest in diversity outpaced every other topic except governance and animal welfare (which benefited from a very low base). Also during this period, specific mentions of gender diversity on boards rose from a ranking of 35th to 12th among more than 150 issues examined.

Further evidence of the growing importance of diversity as a priority topic for SRI is the growing volume of shareholder resolutions filed on this issue. Analysis of resolutions filed by members of the Interfaith Center on Corporate Responsibility going back to 1993 shows diversity was the sixth most frequent subject of resolutions filed from 1993 to 2014, accounting for 8 percent of the resolutions filed by members, roughly on par with issues including compensation, board governance and geopolitical human rights issues (Exhibit 5).[xvii]

Board diversity is discussed more often in financial press

Exhibit 4: Rankings of ESG issues mentioned in financial press

2009	2014
1. Sustainable energy	1. Sustainable energy
2. Sustainability	2. Sustainability
3. Compensation	3. Governance
4. Health	4. Compensation
5. Social equality	5. Social equality
6. Labor standards	6. Diversity
7. Political conflict/oppression	7. Health
8. Lending practices	8. Political conflict/oppression
9. Regulation/taxation	9. Agriculture/food
10. Fossil fuels	10. Labor standards
11. Governance	11. Environment
12 Environment	12 Fossil fuels
13. Diversity	13. Corruption
14. Agriculture/food	14. Board governance
15. Ethical issues	15. Ethical issues

Source: Factiva, EIU analysis/Arleta Majoch

Shareholder engagement is among measures used by SRI investors to promote gender diversity

Gaining acceptance

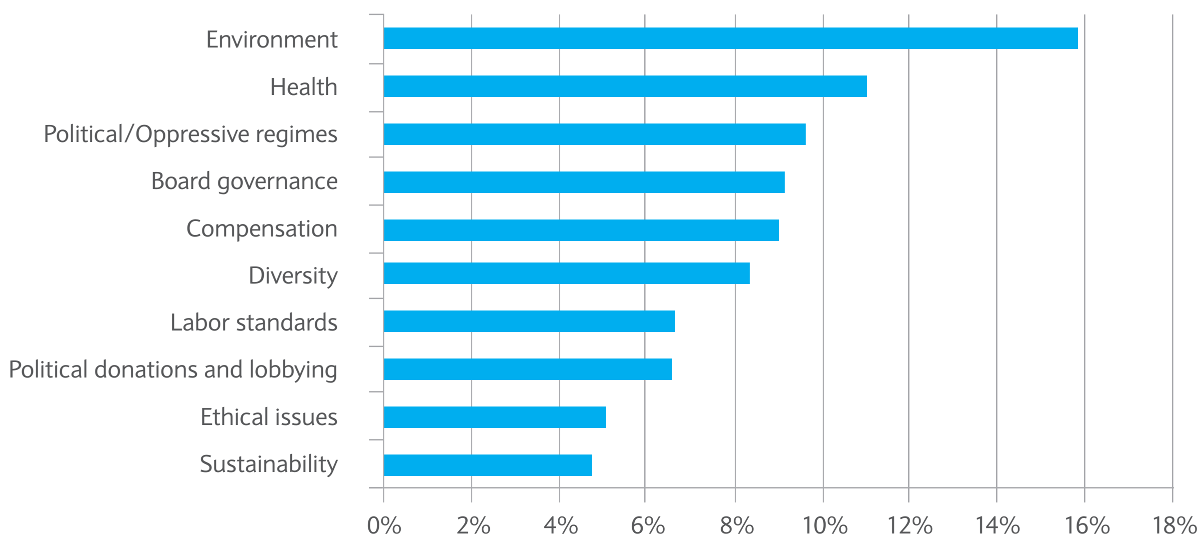
As awareness grows, investors are beginning to become engaged directly with companies to press for greater diversity. Analysis of the data suggests a greater acceptance among shareholders and corporate executives of diversity issues as a relevant topic. From 1993 to 2014, shareholder resolutions covering diversity issues were supported by 20 percent of shareholder votes, compared with a mean of 15 percent for all resolutions. In the first half of 2014, diversity-related resolutions received on average 26 percent supportive votes from shareholders, compared with about 9 percent in 2000. While the analysis documents the increased importance of diversity (and ESG issues generally) among shareholders, the low percentages reflect a continuing focus on purely financial considerations by most voting shareholders.

Further, the volume of resolutions withdrawn between 1993 and 2014, a proxy for corporate responsiveness, shows more than half of the resolutions related to diversity were withdrawn, compared to about 35 percent of all resolutions. Withdrawal rates for diversity-related resolutions matched those concerned with reporting and transparency, and these issues had the highest rates among the issues examined.

A more nuanced approach involves shareholders' engagement and activism. While it might have a public face, the effort is primarily behind the scenes with shareholders meeting with corporate executives and others to discuss issues and find solutions. Amy Domini, Founder and CEO of Domini Social Investments and founder of the Sustainability Group, which together had $1.4 billion in assets under management in mid-2014, said she and others began discussions with Apple in December 2013, about gender diversity on its board and in its executive ranks.

"We asked them to change the language of their charter to explicitly state that diversity was a goal of that body," said Domini, a long-time proponent of SRI and co-author in 1984 of *Ethical Investing*. Apple subsequently changed the charter

Exhibit 5: ICCR shareholder resolutions filed, 1993-2014



Source: Interfaith Center on Corporate Responsibility (ICCR), EIU analysis/Arleta Majoch

to stipulate it would seek "highly qualified women and individuals from minority groups to include in the pool from which board nominees are chosen." By mid-2014 the company had appointed BlackRock co-founder Sue Wagner to its board (joining Andrea Jung, appointed to the board in 2008) and Burberry CEO Angela Ahrendts as senior vice president for retail and online stores.

Corporations are also responding by creating offices that focus on senior-level diversity. "Diversity and inclusion offices reflect the organizational commitment to trying to grapple with these issues. It affirms that the corporation takes the concerns seriously and does not treat them as throwaways," said Gail Cooper, Vice President for Programs for Re:Gender, formerly the National Council for Research on Women, which brings researchers and corporate executives together to address gender diversity topics.

Many methods are available to measure and promote gender diversity in corporations. Determining the prevalence of women in middle and senior management and on boards is among the most common. More forward-looking approaches include examining internal policies for the professional development of women at all levels. Mentoring programs, internal promotions and pay equality are also indications of progressive gender policies, as are external recruitment efforts that actively identify female candidates for top jobs and board appointments. Family-friendly policies that benefit both sexes, such as on-site day care and flexible hours, can also encourage women to aspire to roles of greater responsibility within a company, even where women are currently underrepresented at the high echelons.

Greater gender diversity among investors

The growing power of female investors is also adding momentum to the emergence of gender diversity as an SRI priority. As of 2011, just over half the wealth in the United States was controlled by women, and by 2020 it is predicted to grow to two-thirds of total US wealth. Another study projected that globally over the next 40 years women will inherit about 70 percent of the wealth transferred from one generation to the next.[xviii] There is also research that shows about 70 percent of women change financial advisors within a year of becoming widows, suggesting dissatisfaction with traditional guidance.

Domini said about 55 percent of investors in her funds are women, compared to an average in the fund market generally of about 45 percent. While some of the difference may be influenced by marketing that has "feminine messaging," women also tend to mull their investment decisions more carefully than men, she said. "Women are a little more startled by money, and they study the options before they make investment decisions," Domini continued. "They don't really want to know whether Coke is a better buy than Pepsi. They want to know whether this investment style is one that they can be comfortable with even in a bad market. … I think that might be one reason women are drawn to social investing, they can connect the dots. They can see the little pieces of impact from dozens of social investors making a big statement."

> Women are expected to control an increasing share of private wealth, adding momentum to gender diversity

Studies relate gender diversity on the board to improved corporate performance

Many studies have shown that women are less likely to view money as morally neutral and more likely to integrate ESG issues into their decisions. The Millionaire Corner blog by the Spectrem Group, for example, reported a survey of 1,150 investors in 2012 that found female respondents were about 50 percent more likely to follow SRI than male respondents.

A gender shift toward women in the composition of the investor base may help drive heightened awareness of gender diversity among corporate leadership as a significant SRI opportunity.

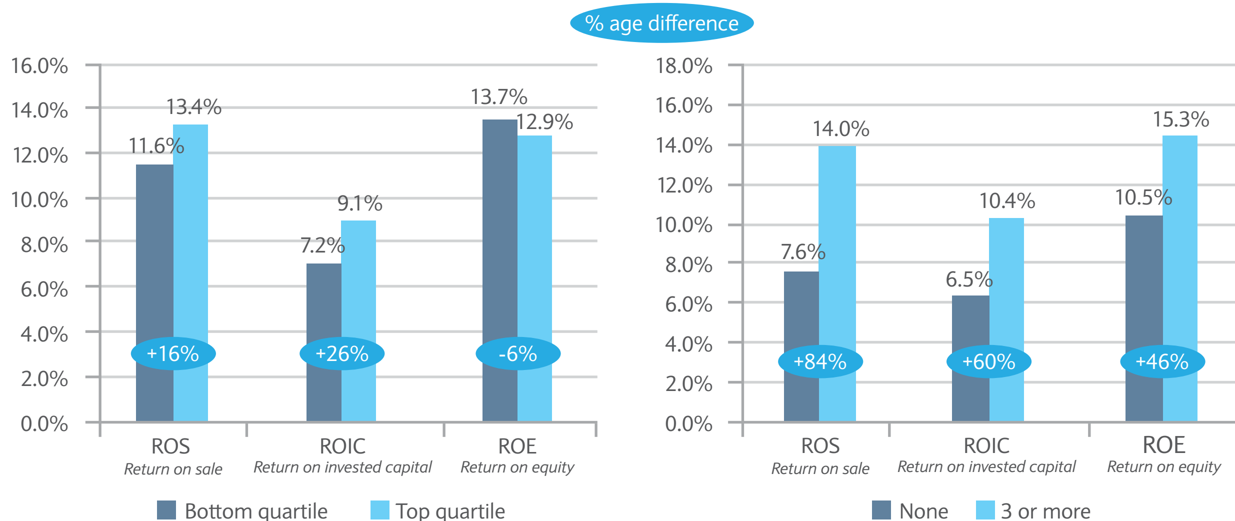
Adding value in the boardroom – and the bottom line

Beyond moving closer to social equality, evidence suggests that gender diversity can also improve results, lower risk and create a more effective corporate culture. Overall, many studies have shown, for example, that heterogeneous groups make better decisions than homogeneous ones. Scott E. Page, a leading researcher in the power of diversity, told *The New York Times*, "Diverse groups of people bring to organizations more and different ways of seeing a problem and, thus, faster, better ways of solving it. Any one of us can get stuck. If we're in an organization where everyone thinks in the same way, everyone will get stuck in the same place."

A growing body of studies mirrors results published by Catalyst in 2011, which compared the top quartile of US Fortune 500 companies based on female board membership to the bottom quartile (Exhibit 6). Catalyst found that between 2004 and 2008, the return on sales was 16 percent higher for the top quartile and return on invested capital was 26 percent higher. The results were starker when companies with three or more female board members were compared to those with none.

Studies have also shown that female board members are less likely to be influenced by legacy "old boys' networks" and more willing to challenge proposals and conventional boardroom wisdom. Women are also likely to monitor corporate practices more closely and be tougher

Exhibit 6: Impact of female board members, 2004-2008, US Fortune 500 companies



Source: Catalyst, The Bottom Line: *Corporate performance and women's representation on boards (2004-2008)*

custodians of a company's mission. All these factors would tend to decrease risk and improve governance. Indeed, a global study by the British law firm, Eversheds, found that companies with more gender diversity on their boards tended to perform better and weathered the 2008 financial crisis better, including those in the financial sector.[xix] Eversheds also found that since the crisis, companies – especially banks – have accelerated the appointment of women to their boards. "One of the strongest correlations from the statistical analysis was between better performing companies and a higher percentage of female directors," the report said.

Further, a 2010 report as part of McKinsey & Company's Women Matter initiative found the corporations with women on their executive committee showed better financial performance.[xx] Average return on equity for companies in the top quartile in their sector for women on executive committees was 41 percent higher between 2007 and 2009 than for companies with no women on the committee, the report said. Average earnings before interest and taxes (EBIT) margin was 56 percent higher.

"The big benefit is that the research shows that companies that have diverse boards outperform those companies that don't. It's very much a bottom-line issue," said Sonnabend of 2020 Women on Boards. Sonnabend also sits on the boards of two companies.

Amy Hillman, Dean of Arizona State University's W.P. Carey School of Business, said in an interview, "We're really seeing strong evidence that gender diversity within the boardroom makes for better decisions coming out of the boardroom, and it's a very relevant measure of ESG when investors are looking at a firm. … We've seen in the past that there is a strong correlation between having more diversity in the board and engaging in more socially responsible measures by the firm. Gender diversity has become an issue of good governance for a number of institutional investors."[xxi]

Many talented women and men are attracted to companies that show gender diversity at the highest levels

Greater gender diversity is also seen as a gateway to broader racial, ethnic and socio-economic diversity, which compound the benefits of bringing different perspectives into corporate leadership. "People like to choose people who look like them and with whom they feel comfortable. People's brains are hard wired against diversity. So the things that have to be done to get people to accept someone different, that's a tough hurdle," Hester-Amey said.

Gender diversity among senior management and board members can deliver additional benefits for a company, such as attracting high-caliber recruits who ultimately add to the financial value of a company. Talented women and men concerned with ESG issues may view diversity as an argument in favor of joining a company. Hillman said, "The research that we've done really shows a very strong relationship between a company's social performance and their ability to attract and retain high-quality talent. As I think about the students on our campus who are going into the workforce, for example, they're much more likely to look into a company's ESG factors than they ever have been in the past."

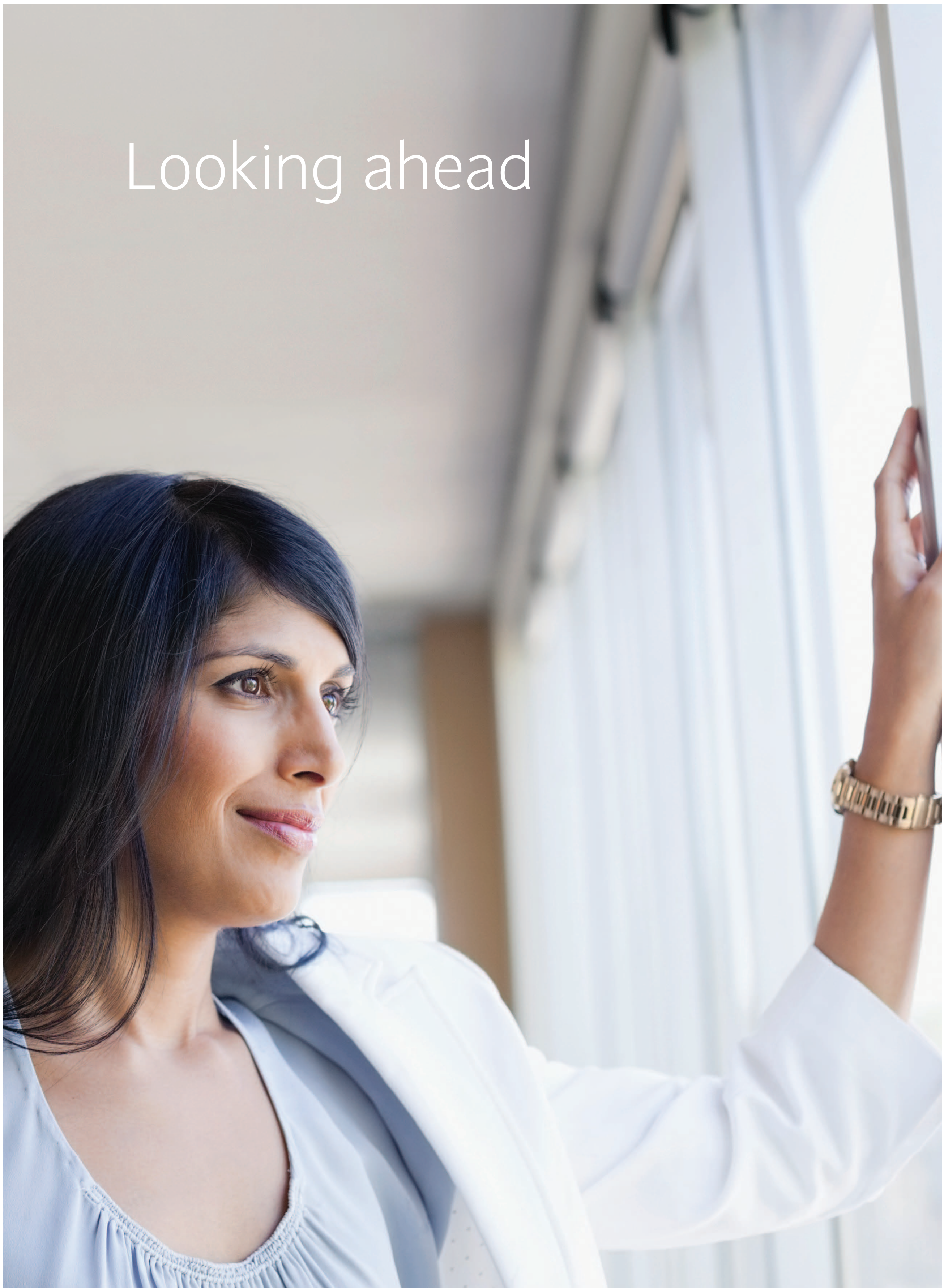
Sonnabend concurred, "The diversity at the top sends a message throughout the entire organization in terms of how that company demonstrates the value of diversity. So, if that company wants to hire and retain the best talent – men and women – they need to demonstrate that they are open to diversity at the top and that there are the same opportunities for women coming into an organization as there are for men. That message rings very loud and clear."

Consensus and causality

Although there is a wide body of research that reports a correlation between increased gender diversity among corporate leadership and better relative corporate performance, some studies have found no statistically significant correlation at all. Importantly, none of the available studies have claimed to establish causation. Does gender diversity create better companies, or do better companies embrace gender diversity?

"It may be a plausible explanation that companies that are much more focused on social performance or environmental performance are the ones that are more conscious about putting more females on the board," Hillman said. "It may be that because there are relatively few women in the set of directors that would be considered, that those few women are more attracted to the better firms in terms of financial performance."

But Hester-Amey at CalSTRS questioned why massive research is even needed before change occurs. "I think there are two ways to look at that. One is that none of this evidence was needed for men before they got their jobs. They just got them," she said. "And two, at the very least, it shows that the difference doesn't hurt. In other words, women directors don't negatively affect performance. It doesn't darken the Earth. It doesn't ruin anything."


Looking ahead

Extrapolating from historical growth rates, SRI should continue to grow over the next decade and beyond, and will likely outpace the growth of assets under management generally. As SRI continues to attract mainstream investors and asset managers, screening approaches that integrate environmental, social and governance considerations with financial metrics will be used more frequently.

Greater corporate transparency will bolster interest in SRI topics

In parallel, companies will face increased pressure to report metrics related to ESG issues. Indeed, proponents of SRI anticipate a time when such integration becomes the norm, and funds and investors that look solely at financial criteria move to the margins of the investment community.

Dalheim at Calvert said greater transparency will drive further interest in SRI strategies. "As more investors ask questions of companies, the companies provide more information to the market. That means that other investors who hadn't been paying attention to these issues will now see this information," he said. "And the companies are getting better at presenting information about sustainability in clear and compelling ways that connect to the value drivers of business. As that occurs, more investors should see the value of it and incorporate it into their processes."

In terms of gender diversity, targeted investment vehicles will also become more sophisticated as the market grows. "What I'm hoping will happen is that we will start having a more nuanced understanding of what is good governance and what is not good governance," said Hillman. "We're very, very quick to adopt something and say, 'This will cure bad governance.' Whether it's 'let's get more women on the board' or 'the board should be made up of only outsiders plus one insider,' it's almost as if best practices are to solve something in a black-and-white fashion when it's much more gray than it portrays."

Domini added that while gender diversity reinforces the sense of a corporation's culture, how diversity is weighed can become more sophisticated. "If we see a cement company with no diversity, that's disappointing, but there's no unique female vision of marketing cement that is being overlooked. So we wouldn't mark that company as being as dramatic an example of failure as if it were a company in media, in advertising, in household products, in consumer non-durables, in consumer durables, or in technology," she said. "We now look much more industry-specific at the behaviors of companies and make the call."

Further, while many asset management products today are linked to specific themes, such as environmental protection and labor rights, there are very few linked solely to gender diversity (See sidebar, *Thematic investing trends*, p22). Market demand could grow, however, if mounting evidence convinces investors of a direct link between gender diversity and better corporate results, mitigated risk, and a progressive corporate culture. Gender diversity could also become a straightforward proxy for identifying companies that pursue a wide range of ESG objectives.

Despite gains the women have made in the workplace and in corporate leadership, many proponents acknowledge change will be slow, suggesting gender diversity will be a long-term issue. "The advancement of gender equity requires very practical solutions," said Cooper with Re:Gender. "The efforts need to cut across all aspects of society, all sectors, all institutions. It's not up to business alone to ensure that this leadership is front and center. Nor is it solely up to the political or nonprofit arenas. All have to work together to bring about a better gender balance and to create greater leadership diversity."

Thematic investing trends

With increased competition, funds focusing on narrower themes could proliferate as managers seek to create distinctive products. Climate change will remain an important theme, with investors looking closer at topics such as water scarcity and clean energy. Fossil fuels, for example, have become a new target for divestment campaigns. Trillium Asset Management, an SRI fund manager with more than $1.5 billion in assets under management in mid-2014, and its partners estimated in 2013 that grassroots divestment campaigns had been organized on more than 300 college campuses in the United States and that the cities of Seattle and San Francisco had pledged to rid their portfolios of assets linked to fossil fuels.[xxiii] "There are compelling ethical, political, and financial reasons to move your investments out of fossil fuel companies," the report said.

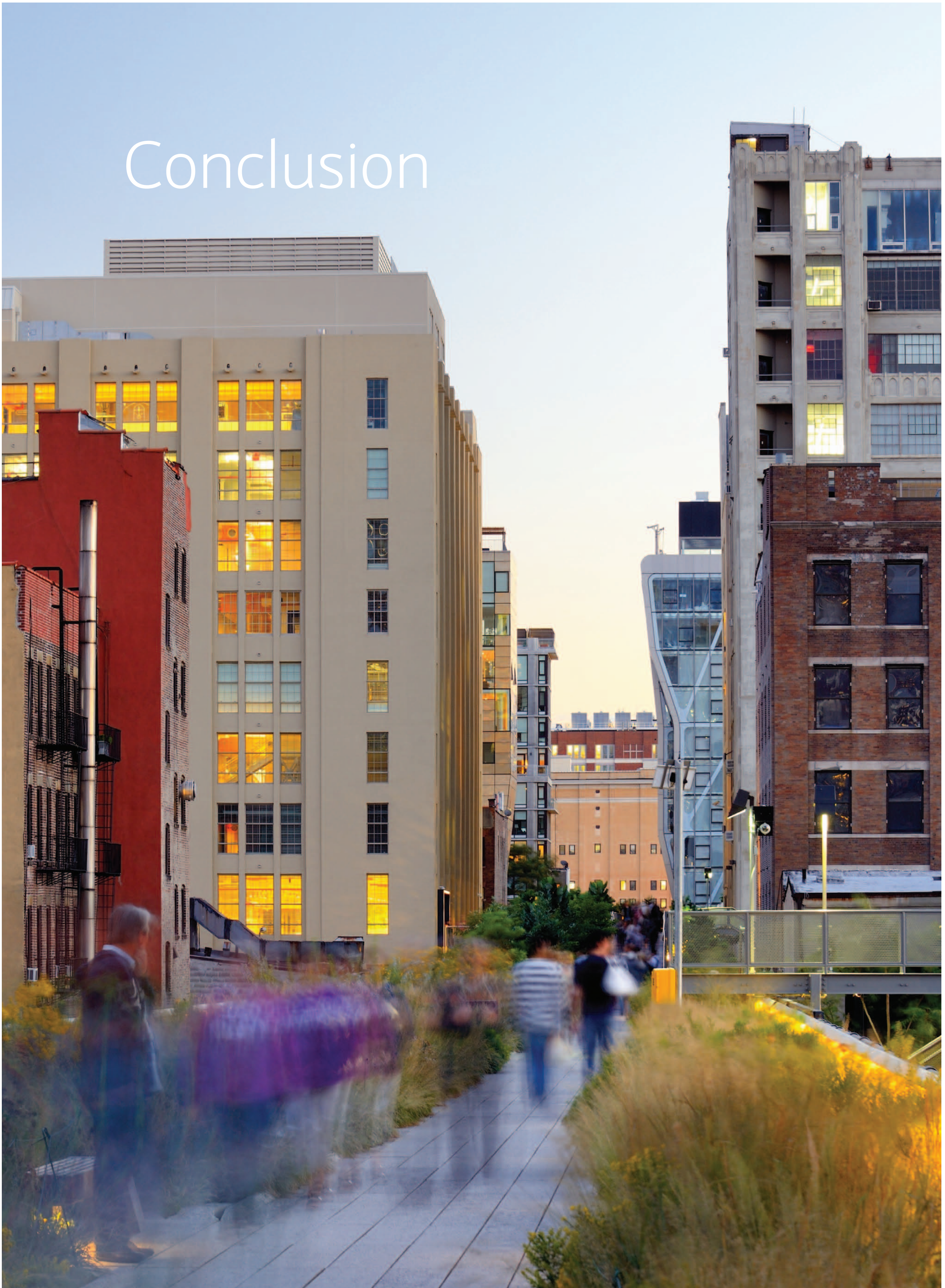
Other themes, including humanitarian crises and fair labor practices, will continue to attract their share of interest. Such long-term themes will be important, but the market will also react quickly to new and sometimes novel themes that have less longevity. Political repression, natural disasters and the latest report from a reputable non-governmental organization (NGO) like Greenpeace, for instance, can quickly attract attention to a narrow range of concerns. Governance considerations will also span long-term themes, such as gender diversity, and shorter-lived ones, such as the newest corporate scandal.

Amy Domini, Founder and CEO of Domini Social Investments, said she expected good global citizenship to grow in importance. "When I started, there was a lot of credit given to how nice a company was to its hometown," she said. "That has pretty much disappeared. Now the community we think of is a global community, and we really look at their corporate relationships with any part of the globe that they touch and see that as a community issue." Increased focus on ethical supply chains is part of this sense of global community, she said.

Gender diversity will likely become a greater priority as part of the larger SRI landscape. "I think it will eventually be integrated. There are just too many women on the planet," said Janice Hester-Amey, Portfolio Manager for the California State Teachers' Retirement System (CalSTRS). Investors and fund managers are "a class of people that are very devoted to performance," she continued. "I just cannot believe that something that continues to show (improved performance) over and over again is going to be left on the shelf just because of sexism. I just don't think in the face of long-term sustained performance that either shareholders or investors will stand for it, or that portfolio managers will stand for it. Nobody is going to let you get away with that when you're leaving hundreds of basis points on the table."

Demographic changes will also present clear opportunities, especially for asset managers. An aging population in developed countries will present opportunities to cater an older class of investors who retain their earning power longer than in the past and to explore new social themes like responsible pharmaceuticals and retirement communities. Growth in emerging markets, such as China and India, will offer new opportunities to use investments to guide corporate policy, while lesser developed markets present openings to invest in education, health and other infrastructure projects that improve standards of living.

Conclusion



At its core, SRI is an effort to improve the world using the power of share ownership. It bristles at the idea that maximizing shareholder value – the mantra of management philosophy at the turn of the century – must focus myopically on current market share price. While financial returns on investment naturally remain a priority, SRI brings a wider range of environmental, social and governance issues into consideration, creating a more holistic perspective of value. An evolving perspective of SRI suggests that incorporating an SRI lens to corporate or investment decision-making can actually achieve a "double-bottom line," delivering social impact as well as driving financial performance.

Gender diversity is becoming a focal point for socially responsible investors. Specifically, increasing the presence of women in senior management and on boards of directors promotes better governance, may improve corporate performance, helps attract and retain talent, and creates greater cultural equality. Gender diversity is also a credible proxy for ESG policies generally. And finally, gender diversity can pave the way for broader ethnic, racial and socio-economic diversity at the top of corporate hierarchies.

Institutional investors and fund managers cannot afford to overlook an easily assessed aspect of corporate culture and governance that delivers valuable benefits to the bottom line and to society generally. As part of socially responsible investing, gender diversity will undoubtedly become a key criterion for investors and asset managers who want to improve returns and heighten their performance against ESG metrics. And as SRI becomes more integrated with mainstream investment approaches, a focus on gender diversity could quickly become the new normal in the market.

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