More than a buzzword

Assessing the financial and transparency effects of corporate gender diversity

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Introduction

In recent years, gender diversity has increasingly been recognised as an important issue in the workplace. Using S-Ray® data, supported by academic and industry research, we assess the effects of gender diversity on global public corporations¹. In particular, we examine whether more diverse companies demonstrate better financial performance and greater non-financial transparency.

To focus on gender diversity specifically, we examine a composite of quantitative metrics used within our ESG Diversity Feature that are focused on the percentage of women at various levels of the company, including the board, management, and overall employees. These metrics capture the current diversity of the company rather than stated policies. While corporate gender diversity also encompasses the inclusion of non-cisgender individuals, we focus our discussion on women in the workplace due to data availability constraints. We hope to expand this research to include non-binary individuals as more data becomes available.

Corporate Diversity Trends

Gender diversity is increasingly a major topic of discussion among corporations. This year alone has seen several large companies announce that a female CEO will take the reins in 2021. These include Citigroup, the first major Wall Street bank to take this step²; Wellington Management, one of the world’s largest independent investment management firms³; and Mercedes-Benz Canada, which has appointed a female to lead the company as both President and CEO⁴.

¹. The scope of the analyses is the Arabesque S-Ray Global All-Cap Universe, which closely resembles the Global All-Cap indices of major index providers. Methodology and constituents are available upon request.
². Jolly, 2020
³. Wellington Management, 2020
⁴. Mercedes-Benz Canada, 2020
Turning to the data, we see that these are not one-off cases. There has been a sharply increasing trend in gender diversity over the studied period (December 2009 – November 2020). We theorize below on the reasons for that increase. However, it should be noted that the median company has a diversity value below 30%: There is still progress to be made.

There are several potential exogenous factors that may have contributed to this trend. An analysis of the U.K. Labour Force Survey data found that women’s increased participation in the workplace can partly be explained by increasing educational levels. Furthermore, the societal expectations of a woman’s role has changed: women today are less restricted by their marriage and family commitments than ever, as observed by the increasing number of working mothers.

There have also been several regulatory developments regarding gender diversity over the period studied. Many countries in developed markets - including Norway, Spain, France, and Italy - have enacted quotas at the board level to improve gender diversity. Countries in Asia Pacific are also following Europe’s lead. The Companies Act of 2013 in India mandates that listed companies have at least one female director. In the United States, many states currently require companies to have at least one female director, with increasing quotas coming over the next two years.

5. The median of the gender diversity composite metric, which accounts for gender diversity at varying levels of an organization, is 29.3% as of 30 November, 2020.
6. Roantree & Vira, 2018
7. Valls Martinez, Cruz Rambaud, & Parra Oller, 2019; Bennouri, De Amios, & Falconeri, 2020
8. Verma, 2018
9. Hatcher & Latham, 2020
Finally, the United Kingdom has set a voluntary 2020 target\textsuperscript{10} of 33% female board representation in the FTSE 350 companies. While this is met collectively, 41% of companies do not individually meet this target\textsuperscript{11}.

These regulatory pressures are not all entirely governmental: some influential companies have also implemented policies to drive diversity forward. For instance, Nasdaq has proposed new listing rules related to board diversity and disclosure wherein companies listed on their exchanges will be required to have at least one female director and one underrepresented minority and/or LBGTQ+ director, and to disclose this data in a standardized fashion\textsuperscript{12}. Additionally, Goldman Sachs will require at least two diverse board members for any US or European company for which they underwrite an IPO\textsuperscript{13}.

The growing sustainable investing landscape is also a likely contributor to the positive trend in diversity. ESG assets under management in the U.S. grew from $3.7 trillion to $12 trillion between 2012 and 2018, and could potentially account for fifty percent of institutionally managed assets by 2025\textsuperscript{14}. Globally, ESG assets under management exceed $30 trillion\textsuperscript{15}. Most notably, there has been substantial growth in thematic and impact investing specific to gender-related issues. Public investment products with a gender lens have grown exponentially from $100 million AUM in 2014 to $3.4 billion in 2019\textsuperscript{16}. This trend is seen in venture capital, private equity, and private debt as well, where there has been a 138% increase in funds focused on gender issues over the last three years\textsuperscript{17}.

**Gender diversity and financial performance**

While increasing regulations and the growth of ESG investing are some of the external factors relating to the increase in corporate gender diversity, there are notable internal benefits to companies with greater gender diversity. Over the period of this study, more gender diverse firms outperformed the universe, while less gender diverse firms underperformed. Therefore, the gender diversity “factor” return, calculated by evaluating a portfolio that goes long the most gender diverse quintile and short the least gender diverse quintile\textsuperscript{18}, is positive as well.

\textsuperscript{10} Instead of a gender diversity quota, UK companies are encouraged to increase their board gender diversity in accordance with a voluntary target set in the Hampton-Alexander Review.
\textsuperscript{11} Department for Business, Energy & Industrial Strategy, 2020
\textsuperscript{12} Goldman Sachs, 2020
\textsuperscript{13} Nasdaq, 2020
\textsuperscript{14} Collins & Sullivan, 2020
\textsuperscript{15} Global Sustainable Investment Alliance (2018), 2018 Global Sustainable Investment Review.
\textsuperscript{16} Bryant, 2020
\textsuperscript{17} Beigel & Hunt, 2020
18. Gender diversity quintiles are calculated intra-industry. In each period, the stocks in each FactSet RBICS industry are sorted by their score on the gender diversity composite. The top 20% of stocks in the industry comprise the top quintile portfolio, while the bottom 20% comprise the bottom quintile. The quintile portfolios are then weighted using each stock’s weight in the benchmark. This serves to mitigate the effects of inter-industry differences and more accurately capture the returns to diversity by measuring the performance of firms that are more (less) gender diverse relative to their industry peers.

19. Metric definitions are listed in Appendix A.
These findings are consistent with previous academic and industry research, which indicate a positive relationship between gender diversity and financial performance. These include: a 2019 Credit Suisse study, which found that companies with a higher percentage of females on the board and within management outperformed\textsuperscript{20}; a study that found positive linear relationships between technology and financial companies’ female employment and their stock prices\textsuperscript{21}; and an analysis by McKinsey that shows that firms in the top quartile on executive gender diversity had higher EBIT and EP margins while the least diverse were more likely to underperform financially\textsuperscript{22}.

\textsuperscript{20} Credit Suisse Research Institute, 2019
\textsuperscript{21} Kwok, 2020
\textsuperscript{22} Hunt, Prince, Dixon-Fyle, & Yee, 2018
Gender diversity and transparency

In addition to financial outperformance, we find that gender diversity has a positive relationship with corporate transparency. Not only is corporate transparency pertinent to investors’ assessments of risk, it can also increase brand loyalty among consumers. ESG transparency in particular has been found to have a positive correlation with financial performance. The S-Ray ESG Transparency feature assesses a company’s level of disclosure and considers aspects such as disclosures relating to director compensation and articles of association as well as reporting standards and external verification. As the graph below shows, there is a statistically significant increase in average transparency as gender diversity increases.

Average Excess Transparency Score Relative To The Bottom Diversity Quintile

"ESG transparency in particular has been found to have a positive correlation with financial performance."

23. Transparency International UK, 2020
24. Kashyap, Menisy, Caiazzo, & Samuel, 2020
25. Calculated by regressing the S-Ray ESG Transparency values on a matrix of categorical variables representing the diversity quintiles 1-4. The graphed values — the coefficients to each dummy variable — represent the average increase in the Transparency value for companies within that quintile relative to companies in the bottom quintile. The T-statistic is a measure of the statistical significance of these differences, where anything greater than approximately 2 is significant.
In a concrete example of this transparency, gender diverse companies are substantially more likely to disclose greenhouse gas emissions data. S-Ray’s Temperature Score measures the extent to which corporations across the world are contributing to the rise in global temperature. Companies’ greenhouse gas emissions are translated to a score based on sector-specific emissions pathways, ranging from 1.5°C to >2.7°C. A score of 3°C, however, indicates that the company does not disclose emissions in line with the Greenhouse Gas (GHG) Protocol\textsuperscript{26}. The graph below shows the percentage of companies within each gender diversity quintile that have a 3°C Score, and thus have either missing or inadequate emissions disclosures.

![Percentage Of Companies That Do Not Disclose Emissions By Diversity Quintile](image)

Again, these findings are corroborated by multiple academic research studies. Among the relationships studied were positive and significant correlations between the diversity of the board and the quality of the firm’s sustainability reporting\textsuperscript{27}, the level of greenhouse gas emissions disclosure\textsuperscript{28}, the accessibility of corporate governance disclosures on company websites\textsuperscript{29}, and financial reporting transparency\textsuperscript{30}.

\textbf{“Gender diverse companies are substantially more likely to disclose greenhouse gas emissions data.”}

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\textsuperscript{26} GHG Protocol requires that emissions are reported separately for Scope 1 and Scope 2, and in units of tCO2e.
\textsuperscript{27} Al-Shuqar & Zaman, 2016
\textsuperscript{28} Al-Qahtani & Elgharbawy, 2020
\textsuperscript{29} Nel, Scholtz, & Engibret, 2020
\textsuperscript{30} Jahan, Mita, & Voulgaris, 2020
Conclusion

Clearly, gender diversity is an increasingly important issue for corporations as we transition towards a more equitable society. While the increased regulatory and societal pressures have pushed companies to increase their gender diversity, we have shown that gender diversity also positively benefits a company by improving both financial performance and non-financial transparency. In this case, the well-worn axiom of sustainable investing proves true, and companies can in fact do well by doing good.
Appendix A: Metric Definitions

Annualized Return: The geometric average return, expressed in units of return/year. For monthly returns, the formula is

$$r_{\text{Ann}} = \left( \prod\limits_{i=1}^{n} [1 + r_i] \right)^{12/n}$$

Annualized Volatility: The standard deviation of returns, expressed in units of return/year. For monthly returns, the formula is

$$\sigma_{\text{ann}} = \sqrt{\frac{12}{(n-1)} \sum_{i=1}^{n} (r_i - \bar{r})^2}$$

Tracking Error: The standard deviation of active returns, expressed in units of return/year. For monthly returns, the formula is

$$\text{TE}_{\text{ann}} = \sqrt{\frac{12}{(n-1)} \sum_{i=1}^{n} \left( (r_{i,p} - r_{i,b}) - (r_{i,p} - r_{i,b}) \right)^2}$$

Information Ratio: The ratio of active returns to tracking error. The formula is

$$\text{IR} = \frac{r_{\text{ann,port}} - r_{\text{ann,bmk}}}{\text{TE}_{\text{ann,port,bmk}}}$$

Name Turnover: The average number of names newly added or sold completely from the portfolio per year, expressed in units of names/year. For monthly rebalancing, the formula is

$$\text{TO} = \frac{12}{n} \sum_{i=1}^{n} \frac{\min(nms_{i,\text{liq}}, nms_{i,\text{new}})}{(nms_{i,\text{tot}} + nms_{i+1,\text{tot}})/2}$$

Sharpe Ratio: The ratio of annualized returns less the risk-free rate to the annualized standard volatility. In this analysis, the risk-free rate has been fixed at 0%. The formula is

$$\text{SR} = \frac{R_{\text{ann}}}{\sigma_{\text{ann}}}$$
Bibliography


Get in Touch

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