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Pax World Investments

The Business Case for Gender Equality

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Imagine that some all-powerful, alien being issued a decree to all U.S. businesses that they may empower only half their workers, and must discriminate against the rest. And then, because that being is all-powerful, it jumped into the future to see how its experiment turned out. I'll bet that in this fictional scenario the alien found that the U.S. struggled mightily to compete with more adept businesses in other countries.

Sadly, this isn't all science fiction: discrimination against women—roughly half the workforce—is a fact, all over the world, and in some places more than others.

Across the globe, with few exceptions, women are underrepresented in management, on corporate boards, and in better-paid technical professions. They are paid less than men for substantially equal work. They are discriminated against in ways ranging from the horrific, like genital mutilation, to perniciously subtle, like unconscious bias. While correcting these imbalances would certainly benefit women, gender equality is not a zero-sum game. Achieving gender equality is a good thing for *everyone*. Moreover, it's good for business.

Economic Impact

An overwhelming body of research supports the business case for gender equality. Starting at the macro level, management consulting firm McKinsey reported last year that the global economy could be between $12 trillion and $28 trillion larger in 2025 if gender gaps were reduced or

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KEY TAKEAWAYS

- » Gender equality is not a zero-sum game. Achieving gender equality is a good thing for *everyone*. Moreover, it's good for business.
- » Eliminating the gender gap would improve economic efficiency and could add $28 trillion to global GDP.
- » Companies that include women among senior decision-makers and provide equal opportunities to men and women, do better than their competitors.

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eliminated.[1] The lower figure represents the potential if all countries matched the performance of the best country in their respective region in terms of eliminating gender gaps, and the higher figure represents what could happen if all gender gaps were eliminated. What does $28 trillion look like? It's about the size of the gross domestic product (GDP) of the U.S. and China combined—which currently rank first and second on the global GDP list.

In its 2016 gender gap report, the World Economic Forum notes that economic gender parity could add $240 billion to the GDP of the UK, $1.2 trillion to that of the U.S., $526 billion to the GDP of Japan, and $285 billion to the GDP of Germany.[2] The International Monetary Fund asserts that closing gender gaps is as much a part of economic development as poverty reduction, and adds that greater gender equality improves economic efficiency in three ways: improved productivity, using more household resources to benefit children, and improved decision- and policy-making of institutions.[3]

Now let's take a closer look at the world of corporations and their investors. There is often an assumption that corporations, being economic actors on a competitive stage, always act in their own self-interest as skilled competitors are assumed to do, and thus if women are less well represented in senior and technical roles it must be for solid financial or competitive reasons. That's the same fallacy as assuming that there cannot be a $20 bill on the sidewalk, because if there were, it would have been picked up already. A wealth of literature shows that corporations that include women among senior decision-makers, eliminate pay gaps, and provide equal opportunities to men and women, actually do better than their competitors.[4]

Leadership and Workforce

More equal gender balance in the places where corporate decisions are made—the boardroom and the executive suite—is associated with better financial outcomes.

One of the most extensive studies that support the case for gender equality is also one of the newest, from Credit Suisse Research Institute.[5] This study looked at the impact of both board and executive diversity at over 3,000 companies globally, and finds clear evidence that more women on boards and in senior management generates higher returns on equity, while still having more conservative balance sheets. That means that having more women decision makers is associated with improved returns *without* raising the risk. As investors, we expect to get higher returns if we take more risks; getting higher returns without paying for it in terms of heightened risk indicates a very robust source of value. Moreover, the companies in this group of 3,000 large companies[6] with at least one woman on the board outperformed the group with no women for over 10 years, from 2006 through mid-2016.

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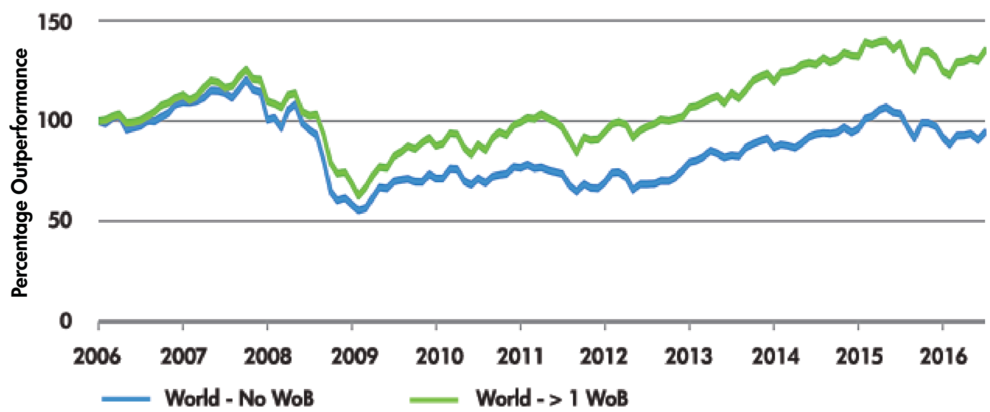
1 McKinsey Global Institute, "How advancing women's equality can add $12 trillion to global growth," September 2015.
2 World Economic Forum, "The Global Gender Gap Report," 2016.
3 Ana Revenga and Sudhir Shetty, International Monetary Fund, "Empowering Women Is Smart Economics," Finance & Development, March 2012, Vol. 49, No. 1.
4 Visit Pax Ellevate's Gender Research page for a list of studies on the relationship between gender diversity and corporate performance: http://www.paxellevate.com/resources/gender-research
5 Credit Suisse Research Institute, "The CS Gender 3000: Reward for Change," September 2016.
6 "Large companies" in this study, is defined as companies with a market capitalization exceeding $10 billion.

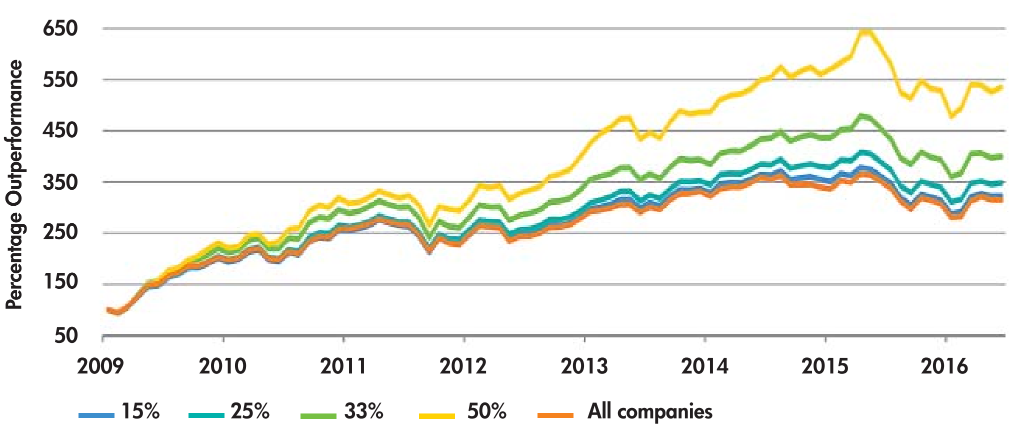
Global Performance: Companies Market Cap >USD 10 billion



Source: Bloomberg, Credit Suisse Research

That finding also applies to women in senior management. Companies with more women in senior management—even when "more" is limited to a single woman—outperformed the entire sample of over 3,000 companies in terms of share price from 2009 through mid-2016. In addition, the share price performance for companies with more women in management was better than the performance of companies with fewer. The best-performing cohort was the group of companies with greater than 50 percent women in senior management.

Share price performance for baskets with different tiers of female participation in senior management



Source: Bloomberg, CS Gender 3000

In 2015, RobecoSAM looked at gender diversity across all organizational levels, constructing one portfolio of companies with low gender scores (lower proportions of women in the workforce and management, and higher pay disparity) and high gender scores.[7] The companies in the portfolio with the top gender rankings outperformed the market over the decade between 2004

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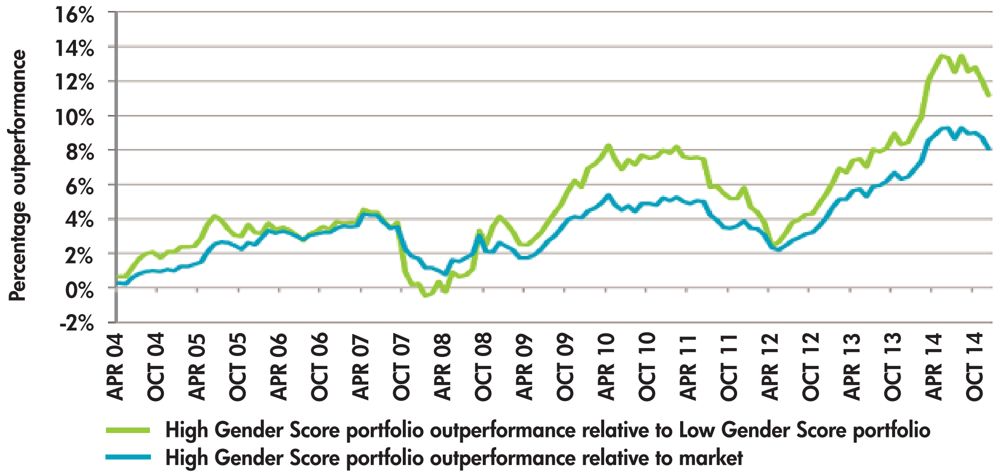
[7] RobecoSAM, "Does corporate gender equality lead to outperformance?" 2015.

and 2014, and the highest-ranked companies outperformed the portfolio with the lowest gender score by an even greater margin.

Top-ranked companies based on the RobecoSAM Gender Score outperform



Source: RobecoSAM

But what about the United States? There's a widely-held belief that Europe is ahead of the rest of the world when it comes to diversity; are these global results perhaps driven by Europe? No. A recent academic paper looks at the performance of over 2000 firms in the United States between 2000 and 2013, using a new technique to help explain the diversity of findings in previous academic work.[8] The striking insight from this work is that for high-performing companies, having women on the board is positively and significantly associated with better financial performance.[9] What that means, for people who aren't statistics whizzes, is that having more women on boards can be a very good thing for financial performance, but that it's not enough to overcome other factors that make performance dismal at companies. That makes sense. If women were really some kind of silver bullet that overcame every other wrong decision and misguided strategy, it's very likely that someone really would have picked up that particular $20 bill, if it never had been on the sidewalk to begin with.

Morgan Stanley also weighed in on the value of gender diversity in 2016, taking a very comprehensive approach to what "gender diversity" means in business.[10] That approach included five themes: gender diversity in executive ranks and on boards; pay equality; representation of women at employee, manager, executive and director levels; policies promoting equal opportunity and diversity; and work-life balance programs. The study found that companies with better gender diversity had better financial performance (return on equity) and lower volatility than less diverse peers, and that outperformance stretched over a five-year period. Moreover, the top fifth of companies, in terms of gender score, had much better performance[11] than peers,

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[8] Conyon, Martin J. and He, Lerong, "Firm Performance and Boardroom Gender Diversity: A Quantile Regression Approach," March 16, 2016.
[9] Financial performance is measured by Tobin's Q, the value of the firm's debt plus equity divided by total assets.
[10] Morgan Stanley, "Gender Diversity is a Competitive Advantage," May 12, 2016.
[11] This was measured by information ratio, a measure of risk-adjusted returns.

indicating that having better gender balance was better for companies than a tick-box approach of having token women in decision-making roles.

Grant Thornton also shows a strong link between gender diversity in corporate decision-making and the growth prospects of businesses.[12] They examined companies in the U.S., UK and India, and concluded that companies with women on boards and in executive management had better returns on assets in all three markets. Overall, the opportunity cost, or potential value sacrificed by companies with no women in leadership ranks, totaled $655 billion in all three markets.

The Value of Diversity in Decision-making

If you take a quick trip through literature, both academic and popular, on the value of diversity in decision-making, a couple of ideas jump out. One is that diverse groups are smarter than homogeneous ones, in terms of solving problems and making decisions.[13] People who bring different experiences, skills and backgrounds to group decision-making process force the group members to examine more alternatives, prepare better for decision-making, and anticipate different viewpoints. The variety of ideas that come up in diverse groups is one source of this outperformance, and another is more careful information processing that happens in more diverse groups.[14]

Being better at group decision-making and diversity doesn't mean being more comfortable. It is often more difficult to reach a decision, much less a consensus, in a diverse group, and the likelihood of conflict is greater. In short, just because diversity makes for better decision-making doesn't mean it's more fun. Perhaps that's one reason for the glacial pace of progress in achieving greater diversity in corporate executive ranks and boardrooms; the network of people we know, like and are comfortable with, just feels more convivial than groups that include people we don't usually think of as being in the tribe. This is a place where the "no pain, no gain" advice has some traction.

Was it fun for the board of Nike to listen to its first woman member, Jill Ker Conway, exhorting the company to pay more attention to the female athletic equipment market? We may never know, but we can certainly imagine that it wasn't. Judy Rosener writes about Nike's and Conway's journey in her book *America's Competitive Secret: Women Managers*, noting that the board took a while to warm up to Conway's idea that the company create a women's division.

> "Initially her idea was rejected out of hand. As Nike president Richard Donahue recalled, "Our habit was to make a male product, color it pink and sell it." Conway kept arguing for a separate division run by women and targeting female customers. Eventually the board acquiesced, and by late 1993 the women's division accounted for 20 percent of Nike's domestic revenues."[15]

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[12] Francesca Lagerberg, Grant Thornton, "The value of diversity," September 29, 2015.
[13] Katherine W. Phillips, "How Diversity Makes Us Smarter," Scientific American, October 1, 2014.
[14] Katherine W. Phillips, Katie A. Liljenquist and Margaret A. Neale, "Better Decisions Through Diversity," Kellogg Insight, 2009.
[15] Judy B. Rosener, *America's Competitive Secret: Women Managers*, (New York: Oxford University Press), 1995, pg 127.

By May 2016, Nike's revenues from its women's segment had revenues of nearly $6.3 billion, and the company announced plans in 2015 to grow that to $11 billion by 2020.[16]

Yes, that's an anecdote, and that is not the same as proof. But it does comport with the results of real research, such as a Harvard study that documented that teams with more women on them outperformed teams with higher IQ scores on a set of tasks including brainstorming, decision making, and visual puzzles.[17]

The bottom line is that there are good, well-researched reasons why having more equal gender balance results in better outcomes.

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Women in Specific Roles

Innovation

It is widely understood that the proportion of women in STEM fields is low, and making progress in evening the scales has been difficult and slow. So, we often tend to think of R&D, or the whole enterprise of innovation, as being a man's world—and while it often is, there is evidence that gender diversity brings value to it.

In examining whether diverse teams were better at producing innovation, and in particular, radical innovation (as opposed to incremental innovation),[18] researchers found that the probability of making a radical innovation increased significantly when the R&D team was more gender-diverse. That comports with the findings of a paper that came out in 2015 looking at board diversity and innovation, which found that firms with more gender-diverse boards achieved greater innovative success.[19] The two works focused on gender diversity in very different places—R&D teams and boards—yet both found value in that diversity.

Another benefit of diverse teams resonates well for innovation: more gender-balanced teams are also more likely to experiment and be creative. "At the heart of the innovation strategy are people prepared and able to work collaboratively in teams and to exchange and synthesize knowledge from many different sources."[20]

A study of the impact of women in top management over a 15-year period found that having women in top management improved firm financial performance[21] in companies focused on innovation, in part because of the ability of diverse groups to bring different perspectives to the process of decision-making.[22] Another part of that equation was that women tend to have some of the behavioral attributes in managers that are particularly supportive of creativity and innovation: bargaining and negotiation, and coalition building and cooperation, rather than domination.

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[16] Trefis Team, "Here Are The Three Key Growth Drivers For Nike," Forbes, November 24, 2015.

[17] Anita Woolley and Thomas W. Malone, "Defend Your Research: What Makes a Team Smarter? More Women." Harvard Business Review, June 2011.

[18] Díaz-García, Cristina; González-Moreno, Angela; Sáez-Martínez, Francisco Jose, "Gender Diversity within R&D Teams: Its Impact on Radicalness of Innovation," Innovation: Management, Policy & Practice, Vol. 15, No. 2, June 1, 2013.

[19] Chen, Jie and Leung, Woon Sau and Evans, Kevin P., "Board Gender Diversity, Innovation and Firm Performance," November 30, 2015.

[20] The Lehman Brothers Centre for Women in Business, "Innovative Potential: Men and Women in Teams," 2007.

[21] Measured by Tobin's Q.

[22] Cristian L. Dezso and David Gaddis Ross, "Does Female Representation in Top Management Improve Firm Performance? A Panel Data Investigation," Strategic Management Journal.

Risk

Innovation is, of course, only one source of corporate competitive success and only one parameter of investment performance. So why focus on that? Because it helps to illuminate another area where perception and reality may not match perfectly: risk. Research and development, and especially radical innovation, is generally thought of as a risky enterprise. There's a vast collection of literature documenting the idea that most new products fail.[23] When they win, the success is spectacular enough to keep the enterprise of innovation going, but the risks are significant.

The idea that women are more risk-averse than men is pervasive. But is it right? Not entirely, at least not in the simplistic women-run-from-risk-while-men-live-on-tightropes form. Credit Suisse notes that in their study of 3000+ firms around the globe, women appear to manage more for downside risk, rather than focusing on absolute return as male managers seem to do.[24] Firms with more women decision makers tend to have higher dividend payouts and higher returns on capital employed, which "implies better returns for lower risk," per Credit Suisse. This is consistent with the findings that gender diversity on boards is correlated with decisions that add a hedging value premium and a reduction in risk.[25] An earlier study looked at insolvency, a different facet of risk, and found compelling evidence that having more women on the board is associated with a lower probability of insolvency for companies.[26]

Risk can show up in a thousand ways, including some that are sometimes cryptic. One of the subtler indicators of possible risk is earnings management, or the use of accounting techniques to create rose-colored glasses of corporate financial performance. Understandably, investors prefer to see corporate financial performance as it is, and quite a lot of financial analysis is aimed at penetrating the appearance of robustness created by earnings management to get at the true picture. From the studies that have been done on the intersection between gender diversity and earnings management, it appears that women's greater propensity to monitor risk manifests itself in accounting decision-making: women on boards and women CFOs are associated with lower earnings management, and higher quality earnings.[27]

The Bottom Line

The lives we live, from perspectives biological, societal, economic, and financial, are driven by heterogeneity. Men and women together can do more, and do better, than either gender—or really, any gender—can do alone.

Often, the resistance to achieving better gender balance is driven by the unspoken fear, on the part of the haves, that empowering have-nots will diminish their own opportunities or wealth. The economic studies, as well as the financial ones, cited here show the exact opposite: the world of economics and finance is not a zero-sum game. We're all better off when we *all* have equal access to opportunities, including the opportunity to make strategic decisions.

[23] See, for example, Joan Schneider and Julie Hall, "Why Most Product Launches Fail," Harvard Business Review, April 2011; Anne Fisher, "Why most innovations are great big failures," Fortune, October 7, 2014.
[24] Credit Suisse, "The CS Gender 3000: The Reward for Change," September 2016.
[25] Tashfeen, Rubeena, "Board Gender Diversity and Risk Management: And a View of The Financial, Investment and Liquidity Policies," July 17, 2016.
[26] Wilson, Nick and Altanlar, Ali, "Director Characteristics, Gender Balance and Insolvency Risk: An Empirical Study," September 22, 2009.
[27] See, for example, Ferdinand A Gul, Bin Srinidhi and Judy Tsui, "Do Female Directors Enhance Corporate Board Monitoring? Some Evidence from Earnings Quality," September 2007; Gerdinand A. Gul, Marion Hutchinson, and Karen M. Y. Lai, "Gender-Diverse Boards and Properties of Analyst Earnings Forecasts," *Accounting Horizons*, September 2013, Vol. 27, No. 3, pp. 511-538; and Bill Francis, Iftekhar Hasan, John Chool Park, and Qiang Wu, "Gender Differences in Financial Reporting Decision Making: Evidence from Accounting Conservatism," *Contemporary Accounting Research*, November 5, 2014.

Pax World Management LLC

Pax World Management LLC, investment adviser to Pax World Funds and creator of the Pax Global Women's Leadership Index,* is a pioneer in the field of sustainable investing. Pax World integrates environmental, social and governance (ESG) research into its investment process to better manage risk and deliver competitive long-term investment performance. Across all of its funds, Pax World withholds support from all-male corporate board slates, and working with other institutional investors, actively engages with companies to embrace gender diversity on their boards and advance women in the workplace. For over 45 years, Pax World has made it possible for investors to align their investments with their values and have a positive social and environmental impact. Today, its platform of sustainable investing solutions includes a family of mutual funds, as well as separately managed accounts.

* A custom index calculated by MSCI. One cannot invest directly in an index.

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