Global Asset Management

The positive impact of board diversity

The RBC Emerging Markets Equity team

The lack of female participation in corporate boards globally is startling, and the problem is particularly acute in emerging markets (EM). The percentage of female directors on EM boards is only 10.2%[1]. Only seven companies added female directors to their boards in emerging Asia in 2018, and two thirds of corporations in the region have fewer than one female member on their boards. Korea fares the worst in EM; approximately 84% of its listed corporations have no female representation at board level[1]. At the same time, female participation in the global workforce has grown 20% over the last decade[1], and this increase is a secular trend that will have broader implications. In particular, it will continue to drive change in consumption and spending patterns, which can be a source of risk or opportunity depending on how responsive companies are in adjusting to this new reality. Female leadership can clearly help mitigate the risk of not understanding these changes and falling behind competitors.

Efforts to promote gender diversity at a corporate level are worthwhile and there is an overwhelming link between better corporate financial performance and board and/or executive team diversity. In addition, corporate diversity can provide a useful indication of a company's culture. In our view, those companies whose management teams embrace differing perspectives and skill sets tend to exhibit superior corporate culture, and are therefore more likely to succeed in the market place and sustain higher returns in the long term.

In this report we take a closer look at the positive impact that board diversity can have on a company's financial performance, and what shareholders such as ourselves can do to encourage change in this field.

Gender diversity and corporate performance

In recent years there has been an increasing number of studies supporting the presence of a strong link between gender diversity and the financial performance of a company.

Furthermore, companies with high scores in terms of gender diversity, which may include board diversity, women in management and company policies on diversity/inclusion, generally have lower subsequent price and earnings volatility and deliver higher subsequent returns than those companies who score poorly on these same metrics. This is illustrated in Exhibits 1 and 2.

Exhibit 1: Median forward 1yr ROE[2]

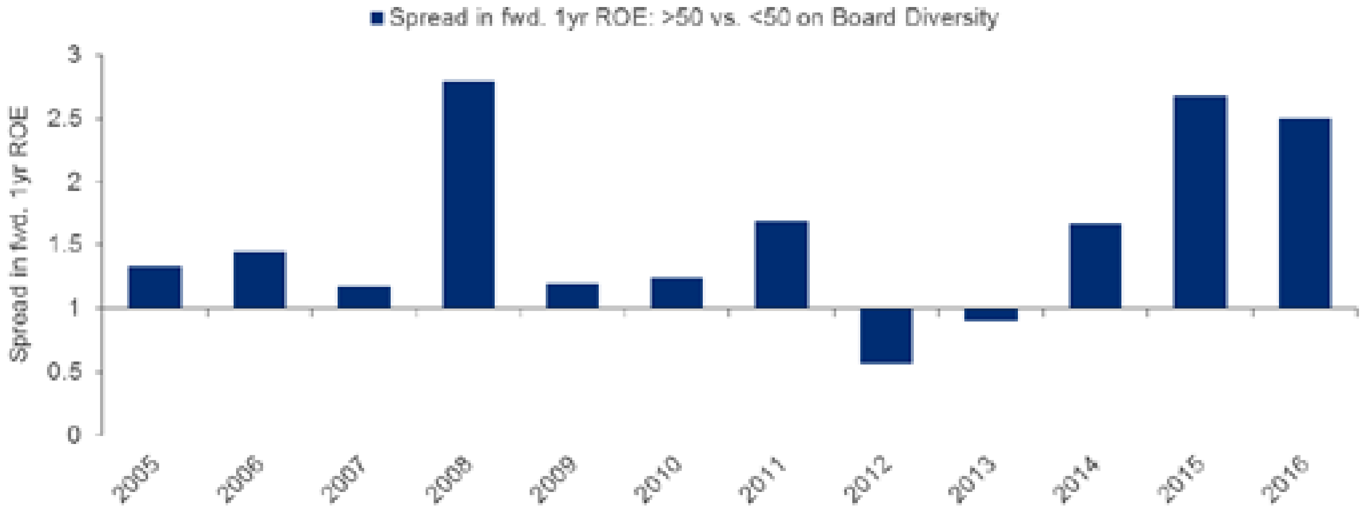
Source: Thomson Reuters ESG scores, BAML U.S. coverage, 2018. Based on Thomson Reuters ESG scores (annually, 2005-2016) for Board Diversity (Governance), Diversity & Opportunity Processes (Social), and % Women Managers (Social)

Exhibit 2: Median forward 3yr EPS volatility

Source: Thomson Reuters ESG scores, BAML U.S. coverage, 2018

Board diversity is of particular relevance. Companies with more diverse boards have tended to deliver higher subsequent one-year ROE than companies with less diverse boards nearly every year over the past decade (Exhibit 3).

Exhibit 3: Companies with more diverse boards have delivered higher subsequent ROEs almost every year since 2005



Source: BAML U.S. coverage universe based on Thomson Reuters Board Diversity Score (2005-2016)

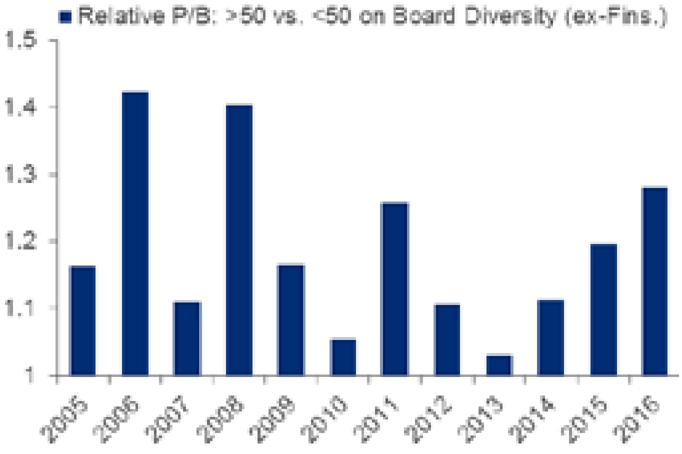
Another reason why CEOs should care about gender diversity is because their shareholders care. This is not just from an altruistic perspective, but also from a risk-reduction perspective. The number of women in the global workforce is growing rapidly and there is a huge potential impact on the market and the economy as a result of this change. In the U.S., 44% of women make decisions about financial assets in their households; globally, that number rises to 74%[2]. Companies need, at the very least, some level of female leadership presence to mitigate the risk of not understanding changes in spending and consumption behaviour. As noted earlier, at this point it should not be surprising that board diversity appears to be a consistent signal of future risk: companies scoring highly on board diversity have seen much lower price and EPS volatility than companies with low scores (Exhibit 4).

Exhibit 4: Companies with diverse boards have seen consistently lower price volatility, along with consistently lower EPS volatility

Source: BAML U.S. coverage universe based on Thomson Reuters Board Diversity Score (2005-2016/2014). Based on spread in forward 1-year price volatility (left) and 3-year EPS volatility (right) for companies in BofAML US coverage universe scoring >50 vs. <50 on Thomson Reuters Board Diversity metric.

Companies with high board diversity scores tend also to re-rate and command higher multiples (Exhibit 5).

Exhibit 5: Companies with more diverse boards have traded at a consistent premium



Source: BAML U.S. coverage universe based on Thomson Reuters Board Diversity Score (2005-2016)

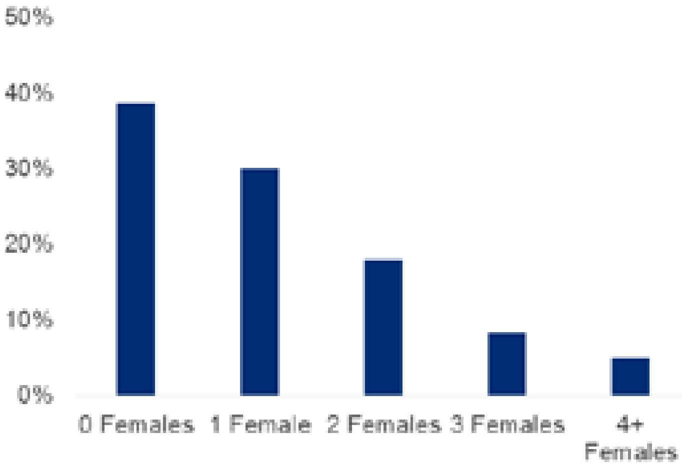
A study from MSCI ESG Research's analysis[3] largely corroborates these findings. In this analysis, companies in the MSCI World Index were categorised into two groups, those with strong female leadership and those without. A company was deemed to have strong female leadership if it had three or more women on its board, or if the percentage of women on the board was above the country average. A company was also considered to have strong female leadership if it had a female CEO. On an equal-weighted basis, MSCI World Index companies with strong female leadership enjoyed both premium returns (average annual ROE of 10.1% versus 7.4%) and a superior average valuation (price to-book ratio of 1.76 versus 1.56) compared to companies without strong female leadership.

Emerging Markets lagging in board diversity

Women hold only 17% of board seats globally and approximately 25% of those positions are held in the U.S.[1] European companies including Italy, France, and Norway tend to lead, while EM countries are lagging. Approximately 70% of companies in EM Asia have fewer than two women on their boards (Exhibit 6). Compared to the 17% global average, women only held 10.2% of board seats at MSCI Emerging Markets Index-listed companies in 2017 , up from 9% in 2016 (Exhibit 7). At the current rate, it will take two decades for at least 30% of EM board seats to be filled by women. The countries with the highest number of all-male boards are South Korea, Taiwan, Hong Kong and China. Of these countries, South Korea has the lowest female board representation, with its rate standing as low as 2.4%[1].

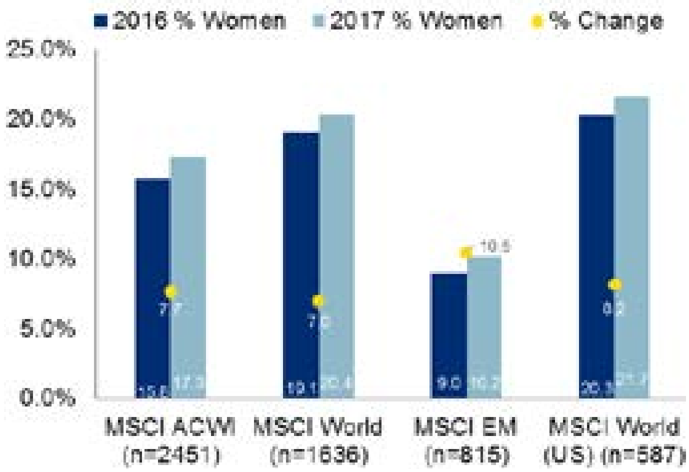
A surprising example of poor gender diversity at board and executive levels can be found at certain EM retailers, despite the fact that they tend to target primarily female customers. During one of our recent research trips to South Korea we met with one of the largest names in the Cosmetics, Fragrance and Toiletries industry, and while this is a very well-run company with a long history and many high-quality brands in its portfolio, it has no female board members. This surprised us, and we consider it to be a source of risk as the cosmetics industry tends to target mostly young women, yet its board was wholly comprised of older males. We believe that board diversity could have helped this industry face some of its key challenges, from the shift to online shopping to the changing behaviour of consumers who have become more sensitive to price. Similarly, the company board of the largest brand of nappies, tampons and tissues in Mexico has only male directors, none of whom are likely to have ever purchased some of those items. These two examples illustrate the risks that can arise from serving a predominantly female customer base while having no female representation on the company's board. These two companies are not outliers in EM, and the list of companies in similar situations is long.

Exhibit 6: Percentage of companies in Emerging Asia by number of female directors on the board.



Source: Merrill Lynch, MSCI, February 2019

Exhibit 7: Global trends in women on boards, 2016-2017 - % of director seats by region.



Source: MSCI ESG Research. 2017

Are companies changing? Progress in this area has been slow for two main reasons: first, the tangible impact that efforts in this area have on organisational effectiveness, but also on business performance, remains somewhat difficult to measure. As a result, board-level conviction in the value of these efforts is mixed. Second, embracing diversity is not just a matter of increasing the representation of diverse talent in terms of gender, ethnicity or age. CEOs need to gain a deep understanding of where in their organisations diversity matters most, and need to create truly inclusive organisational cultures to realise the benefits of diversity, which is a far more complex task.

What are we doing on this issue?

Given the overwhelming evidence of a link between corporate performance and gender diversity, as well as the importance of the latter from a corporate social reasonability standpoint, we place a particular emphasis on this area and regularly engage on this issue with the companies we own. We discuss our position with the companies that we find lagging in this area to solicit a change, and we also voice our position via proxy voting. We also have established a policy – which has been communicated to all the companies we own – to vote against management when proposed changes at board level do not include female representation.

We meet with more than 500 companies every year, and in general we have found EM companies to be open and willing to discuss the issue of gender diversity and most companies seem to understand the risks associated with having a workforce or board that is not diverse. Even companies that have been slow to adapt acknowledge that increasing the number of women in the workforce and on boards is the right thing to do, which is encouraging. When we engage with companies on this topic, if the company recognises that the issue of gender diversity needs to be addressed, this is an encouraging way to start discussions. Our aim is for all our investee companies to make a visible commitment to implementing policies and programmes that will promote diversity, and we believe that this can be easily monitored and measured. We are long-term investors and we understand that for some companies it can take time to effect real change in this area. The pace of progress can be slowed by a number of factors, such as corporate bureaucracy or contractual obligations, and is not necessarily because a company is reluctant to change. In cases such as these we need to be patient. An example of this is our recent engagement with a Korean company with a male-dominated board. The company had recognised the problem and had already identified a new female board member, but there was currently no vacancy on the board and as a result, the company needed to wait until an existing board member either resigned their seat or their tenure came to an end. We consider this to be reasonable, however, if we feel that a company is dragging its feet on this issue we will be more assertive during our engagement meetings.

In our view EM is still in the early stages of this theme percolating the investment landscape, but as shareholders we can encourage the companies we own to make the necessary changes and to disclose the information that investors care about.

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Guido is Head of Research and a Portfolio Manager for the Emerging Markets Equity team in London. Before joining RBC Global Asset Management in 2010, Guido was an Emerging Markets Portfolio Manager at Rexiter Capital Management. Previous experience includes roles as an Emerging Markets Equities Analyst at Rexiter and Securities Analyst then Junior Portfolio Manager at HSBC Asset Management. Guido began his career in the investment industry in 1998 as an Equity and Derivatives Trader for BSI in Italy.
Guido holds a BSc from Università Cattolica Del Sacro Cuore and an MBA from Carroll Graduate School of Management, Boston College.

[1] MSCI Women on Boards Progress Report, January 2018. [2] BofA Merrill Lynch, May 2018. [3] MSCI ESG Research, Women on Boards, November 2015.

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