MSCI

RESEARCH INSIGHT

FROM MSCI ESG RESEARCH LLC

WOMEN ON BOARDS AND THE HUMAN CAPITAL CONNECTION

Meggin Thwing Eastman, Panos Seretis

March 2018

Contents

Executive Summary 3
Key Findings 3
Introduction 4
Talent Leaders More Likely to Have Diverse Boards 6
Women on Boards and Employee Productivity 8
Women on Boards and Financial Fundamentals 10
Conclusion 12

EXECUTIVE SUMMARY

Studies have asked whether having multiple women on a board of directors has translated into better financial performance. There is some research suggesting that this may be the case.[1] But does this question go to the heart of the matter? Increasing the diversity of a board's membership could improve its access to board talent, and thus lead to better board decision-making. But is that enough? Does the number of women on boards relate to a company's overall human capital policies and its financial performance?

Our findings suggest that the whole is greater than the sum of the parts. Companies with both a more diverse board *and* stronger talent management practices enjoyed higher growth in employee productivity compared to companies with a diverse board only and to companies with strong talent management practices only. All of these groups outperformed companies with both mostly male boards and lagging talent management practices; those companies had the lowest rates of employee productivity growth, relative to industry peers.

KEY FINDINGS

- Firms with leading talent management practices were 4.6 times more likely to have a critical mass of female directors than those with lagging practices; talent management laggards were 3.5 times more likely than the leaders to have mostly male boards.
- Companies with diverse boards (3+ female directors over three years) and leading talent management practices experienced growth in employee productivity (compound-annualized growth rate [CAGR] of revenue per employee from 2012-2016) that averaged 1.2 percentage points above their industry medians. This rate exceeded those for firms with just a diverse board and for firms with only strong talent management.
- Companies with both mostly male boards and lagging talent management practices experienced growth in employee productivity that averaged 1.2 percentage points below their industry medians. They also trailed companies that just had mostly male boards and those with only lagging talent management practices.
- Average dividend payout ratios and return on equity figures were consistently higher over three years for the companies with three or more women on their board and leading talent management practices than for those with mostly male boards and lagging talent management practices.

[1] E.g., Eastman, M.T. and D. Rallis.(2016). "The Tipping Point: Women on Boards and Financial Performance." MSCI ESG Research; "The CS Gender 3000: Women in Senior Management." (2014); and Carter, N. L. Joy, H. Wagner and S. Narayanan. (2011). "The Bottom Line: Corporate Performance and Women's Representation on Boards (2004–2008)." Catalyst.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

INTRODUCTION

Some researchers have posited that diverse boards might benefit companies financially because diversity begets greater creativity and decision-making,[2] while others have suggested that diverse boards indicate better utilization of available director talent.[3] Either or both of these may be true, but we believe they are too narrowly focused. In this paper, we hypothesize that board gender diversity is part of a larger picture of human capital quality and may serve as an indicator of attention to talent management at the board level. As we have previously found ties between strong talent management practices and growth in revenue per employee,[4] we asked three questions:

1. Is there a correlation between talent management practices and board gender diversity? That is, could board gender diversity information serve as a proxy or indication of attention to talent management across the firm?
2. Have firms with comprehensive attention to talent management (i.e., across the firm, including the board) experienced higher productivity rates than those without?
3. Have firms with comprehensive attention to talent management experienced better financial performance than those without?

First, we identified a universe of companies and categorized them according to their board gender composition and the strength of their human capital management practices.

BOARD GENDER COMPOSITION

As of October 26, 2017, 17.3% of board seats at MSCI ACWI Index companies were held by women. These directorships were not evenly distributed. The majority of female directors held seats at companies in the consumer discretionary, consumer staples and industrials sectors and the banking industry. Most of these companies were also based in developed markets. We therefore limited our universe to MSCI World Index[5] companies in these four groups to ensure the sample had reasonable representation of companies with multiple female directors.

---

[2] Hong, L. and S. Page. (2004). "Groups of Diverse Problem Solvers Can Outperform Groups of High-ability Problem Solvers." *Proceedings of the National Academy of Sciences,* Vol. 101, No. 46, pp. 16385-16389.

[3] Hunt, V., D. Layton and S. Prince. (2015). "Diversity Matters." McKinsey & Company.

[4] Lee, L-E. and M. Moscardi. (2018). "2018 ESG Trends to Watch." MSCI ESG Research.

[5] The MSCI World Index covers large- and mid-cap companies in 23 developed markets. As of Jan. 31, 2018, it had 1,649 constituents.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

If our hypothesis that more gender diverse boards signified such companies were more focused on a fundamental approach to talent management is true, we would expect this to manifest most clearly at firms whose boards had persistent gender composition characteristics. We therefore focused our investigation on companies that had been constituents of the index for the entire 2014-2016 period and were in one of the four previously mentioned sectors, a total of 617 firms. We defined two groups of companies whose boards had consistent gender characteristics over that period:

- **'3+ WOB'**: firms that had three or more women on the board (WOB) for all three years
- **'1- WOB'**: firms with one or zero women on the board for all three years

Because the number of companies with persistently all male boards over the three years was relatively small, we did not create a separate group for them.

HUMAN CAPITAL MANAGEMENT

We used five human capital management metrics from MSCI's ESG Metrics dataset to assess the strength of companies' talent management practices (as of Dec. 5, 2017): workforce engagement surveys, leadership training programs, workforce diversity, training hours and support for degree programs. Using this data, we identified companies that we considered to be either Leaders or Laggards. The majority of companies fell in between.

- **Talent Leaders** showed evidence of some *best practices* such as annual engagement surveys, comprehensive succession planning and development programs at multiple levels, quantitative diversity targets in the recruitment process, reporting annual training hours per employee, and/or and offering support for degree programs and certifications to employees.
- **Talent Laggards** had not publicly disclosed any evidence of employee engagement initiatives, plans to improve diversity in workforce or training, or development activities.[6]

[6] Companies were classified as "Talent Leaders" if they had at least two best practices and at least two standard practices and "Talent Laggards" if they had no best practices or standard practices in place. Individual practices are determined as best, standard or weak practice based on their potential impact to attract, retain and develop skilled workforce. For more information on the indicators and methodology, please see ESG Metrics.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

TALENT LEADERS MORE LIKELY TO HAVE DIVERSE BOARDS

Combining the board gender composition and human capital management criteria described above, we saw that *3+ WOB* companies were more likely to be *Talent Leaders* and *1- WOB* companies were more likely to be *Talent Laggards* (Exhibit 1).

Exhibit 1: Distribution of Companies by Categories

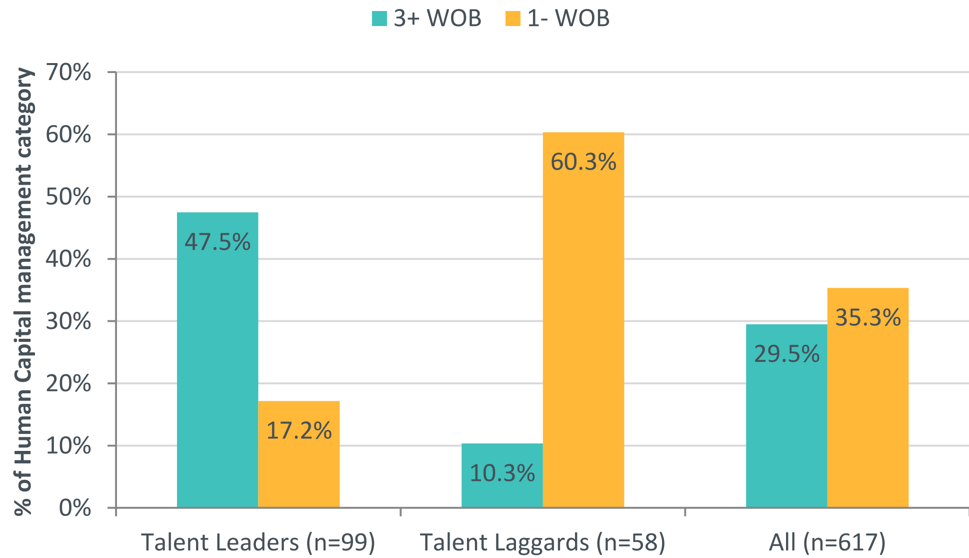
	TALENT LEADERS	ALL	TALENT LAGGARDS
3+ WOB	47	182	6
ALL	99	617	58
1- WOB	17	218	35

Source: MSCI ESG Research

There was a striking difference in the makeup of *Talent Leaders* and *Talent Laggards* by board gender composition (Exhibit 2). Nearly half (48%) of *Talent Leaders* were companies with consistently at least three women on the board (*3+ WOB*), versus 30% of all companies analyzed and only 10% of *Talent Laggards*. In contrast, three-fifths of the *Talent Laggards* were companies with consistently one or zero women on the board (of which two-thirds, or 38% of all *Talent Laggards*, had no female directors at any time from 2014-2016), versus 36% of all companies and only 17% of *Talent Leaders*. Companies in the *Talent Leaders* group were 4.6 times more likely to have a gender diverse board than *Talent Laggards*, while *Talent Laggards* were 3.5 times more likely to have mostly or entirely male boards. However, despite the strong correlations, we are not able to say whether either of these conditions has a causal relationship with the other.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

Exhibit 2: Board Gender Composition of *Talent Leaders* and *Laggards* Groups



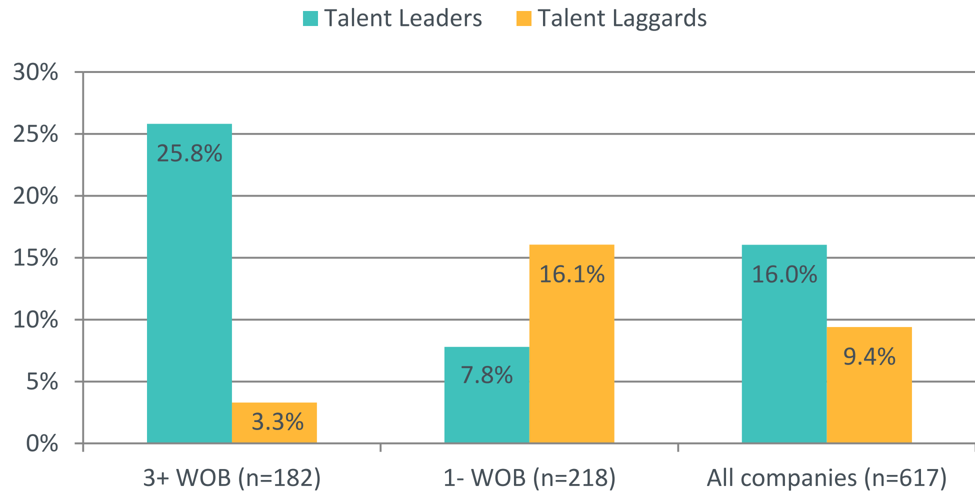
The chart shows the percentage of each group (Talent Leaders, Talent Laggards, and all companies analyzed) made up of companies with 3+ WOB boards and 1- WOB boards from 2014-2016.

Source: MSCI ESG Research

Although fewer companies qualified as either *Talent Leaders* or *Talent Laggards* than had *3+ WOB* or *1- WOB* boards, similar relationships could be observed when looking at the human capital composition of the board diversity groups. Over a quarter of the *3+ WOB* group were also *Talent Leaders*, 3.3 times as many as among *1- WOB* companies. Conversely, *1- WOB* companies were nearly five times more likely to be *Talent Laggards* than those in the *3+ WOB* group.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

Exhibit 3: Human Capital Composition of *3+ WOB* and *1- WOB* Board Groups



The chart shows the percentage of each board group (3+ WOB, 1- WOB, and all companies analyzed) made up of companies that were *Talent Leaders* and *Talent Laggards* from 2014-2016.

Source: MSCI ESG Research

WOMEN ON BOARDS AND EMPLOYEE PRODUCTIVITY

In a January 2018 study,[7] we found MSCI World Index companies that were *Talent Leaders* had higher growth in employee productivity (revenue per employee) relative to their GICS®[8] sub-industry median over five years (2012-2016) than did *Talent Laggards*. *Talent Leaders* outstripped their sub-industry peers on average, while *Talent Laggards* experienced lower growth than their peers.

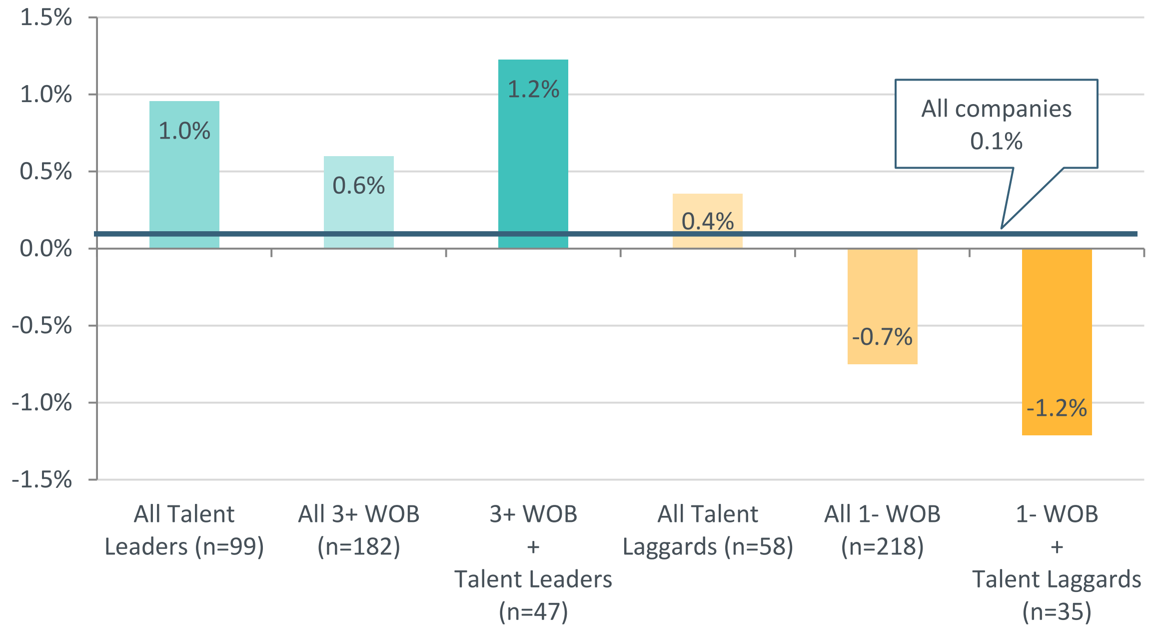
We replicated that analysis here for the 617 companies in our data set, looking at employee productivity growth for each of the groups described in Exhibit 1. We hypothesized that if board gender diversity reflects an extension of corporate attention to talent management, it would be reflected in employee productivity growth. The findings (Exhibit 4) support this hypothesis: not only did *Talent Leaders* outperform *Talent Laggards* and *3+ WOB* companies outperform *1- WOB* companies, but *3+ WOB Talent Leaders* did best of all while *1- WOB Talent Laggards* stood the farthest behind.

[7] Lee, L-E. and M. Moscardi. (2018). "2018 ESG Trends to Watch." MSCI ESG Research.

[8] GICS is the global industry classification standard jointly developed by MSCI and Standard & Poor's.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

Exhibit 4: Average Growth in Employee Productivity by Group



The chart shows average growth of employee productivity (measured as CAGR of revenue per employee for 2012-2016) relative to sub-industry median for each of the groups defined in Exhibit 1. We have not included 1- WOB Talent Leaders or 3+ WOB Talent Laggards in the chart because the sample sizes were too small for meaningful analysis.

DATA

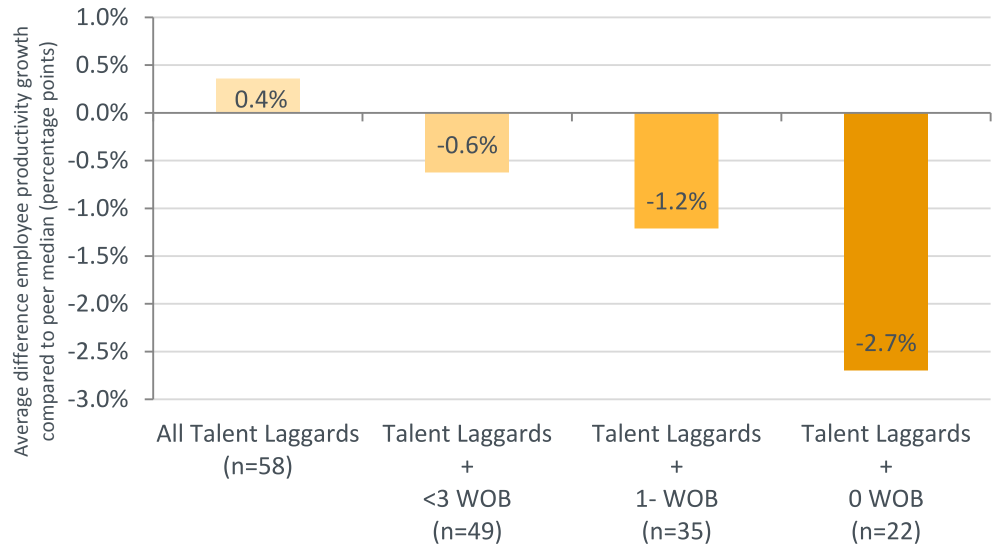
	Talent Leaders	All	Talent Laggards
3+ WOB	1.2%	0.6%	NA
All	1.0%	0.1%	0.4%
1- WOB	NA	-0.7%	-1.2%

Source: MSCI ESG Research, Thomson Reuters

While *3+ WOB Talent Leaders* experienced slightly higher gains than all *Talent Leaders* (1.2% compared to 1.0%), at the bottom end of the scale, the absence of women on the boards of *Talent Laggards* seemed to correspond to more significant human capital problems. The more consistently male a *Talent Laggards* company's board was, the more its employee productivity growth trailed its peers (Exhibit 5). Although the number of *Talent Laggards* companies with no women on their boards over three years was relatively small, the trend held throughout the sample set.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

Exhibit 5: Average Employee Productivity for Talent Laggards by Number of WOB



Source: MSCI ESG Research, Thomson Reuters

The chart shows average growth of employee productivity (measured as CAGR of revenue per employee for 2012-2016) relative to sub-industry median for Talent Laggards by number of women on the board (WOB). See the Appendix for a list of the 22 0 WOB Talent Laggards.

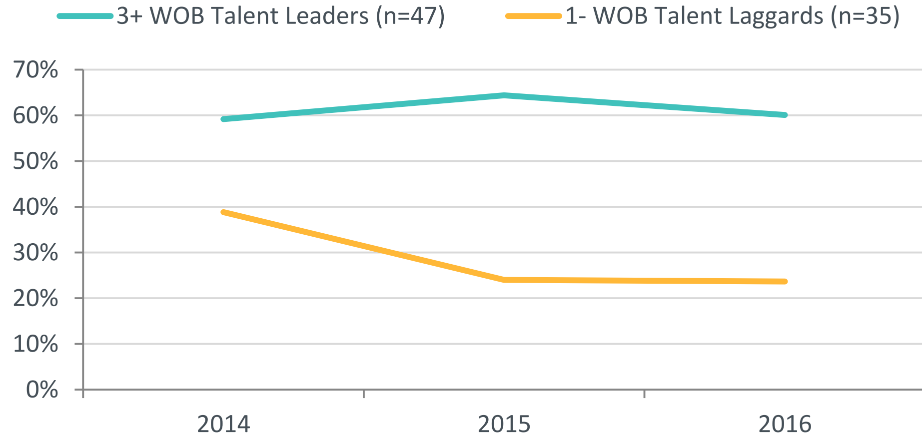
But did these disparities translate into observable differences in financial fundamentals?

WOMEN ON BOARDS AND FINANCIAL FUNDAMENTALS

Higher growth in revenue per employee, assuming stable expenses and equity, should translate into higher return on equity (ROE). ROE is a true bottom-line profitability metric, comparing profit to equity; essentially, it shows how effectively a company's management converts equity into profit. Companies with strong ROE might also be expected to have more cash on hand to return to shareholders via dividends. And, in fact, this was what we observed among our sample of companies (Exhibits 6 and 7).

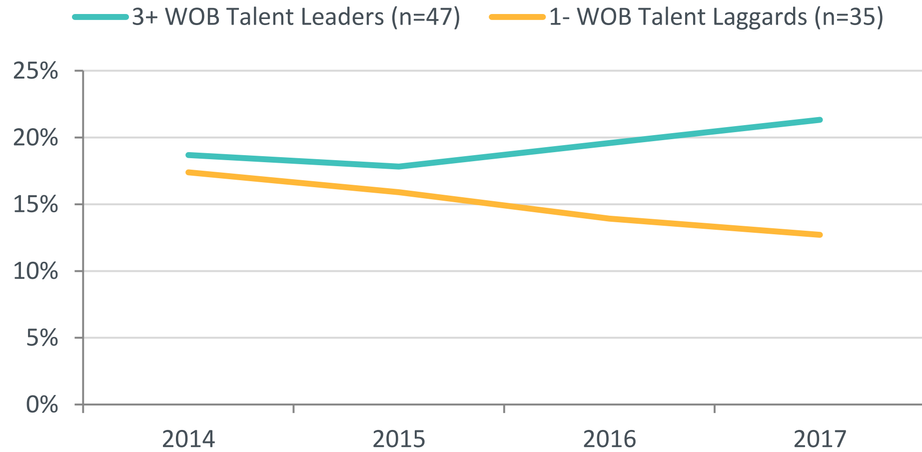
© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

Exhibit 6: Average Dividend Payout Ratios by Year for 3+ WOB Talent Leaders and 1- WOB Talent Laggards



Source: MSCI ESG Research, Thomson Reuters

Exhibit 7: Average ROE by Year for 3+ WOB Talent Leaders and 1- WOB Talent Laggards



Source: MSCI ESG Research, Thomson Reuters

These patterns were visible to varying degrees in each of the four sectors represented in the data set; however, once broken down to the sector level, the number of companies in each group was very small and the sector-specific results therefore inconclusive.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

CONCLUSION

Starting from the premise that directors are an essential part of a company's human capital, we examined relationships between board gender diversity and workforce management practices. Our hypothesis was that higher numbers of female directors could indicate a higher level of attention to talent management firm-wide. We found strong relationships to support this idea: Companies with a critical mass of female directors (three or more each year from 2014 to 2016) were substantially more likely than average to also have strong human capital management practices, and vice versa. The inverse also held true: Companies with few or no female directors were more likely to have lagging human capital management practices, and vice versa.

Further, we found substantial differences in employee productivity growth between these groups, with the highest growth relative to industry peers found in companies with diverse boards and leading workforce management practices. These firms experienced stronger productivity growth than those with diverse boards only and those with strong workforce management only over a three-year period.

In contrast, companies with few or no women on the board and lagging practices experienced lower employee productivity growth than their industry peers on average during the same time frame. They experienced lower growth than the group with mostly male boards or the group with lagging practices only. Finally, we found that average dividend payout ratios and return on equity figures were consistently higher over three years for the companies with three or more women on their board and leading talent management practices than for those with mostly male boards and lagging talent management practices.

Collectively, these findings may bolster the idea that board gender diversity is a reflection of the attention being paid by companies to human capital recruitment, management and development. Executed effectively, we believe this could contribute to higher long-term value creation by the firm. Companies prioritizing talent at all levels, including the board, consistently outperformed all other groups analyzed in this study, while companies that apparently failed to make talent management a priority across the firm consistently underperformed. Investors might point to companies with strong human capital practices when seeking to engage companies whose practices are behind the curve.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

CONTACT US

esgclientservice@msci.com

AMERICAS

+ 1 212 804 5299

EUROPE, MIDDLE EAST & AFRICA

+ 44 20 7618 2510

ASIA PACIFIC

+ 612 9033 9339

ABOUT MSCI ESG RESEARCH PRODUCTS AND SERVICES

MSCI ESG Research products and services are provided by MSCI ESG Research LLC, and are designed to provide in-depth research, ratings and analysis of environmental, social and governance-related business practices to companies worldwide. ESG ratings, data and analysis from MSCI ESG Research LLC. are also used in the construction of the MSCI ESG Indexes. MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc.

ABOUT MSCI

For more than 40 years, MSCI's research-based indexes and analytics have helped the world's leading investors build and manage better portfolios. Clients rely on our offerings for deeper insights into the drivers of performance and risk in their portfolios, broad asset class coverage and innovative research.

Our line of products and services includes indexes, analytical models, data, real estate benchmarks and ESG research.

MSCI serves 99 of the top 100 largest money managers, according to the most recent P&I ranking.

For more information, visit us at www.msci.com.

© 2018 MSCI Inc. All rights reserved. Please refer to the disclaimer at the end of this document.

NOTICE AND DISCLAIMER

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the “Information”) is the property of MSCI Inc. or its subsidiaries (collectively, “MSCI”), or MSCI’s licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the “Information Providers”) and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or redisseminated in whole or in part without prior written permission from MSCI.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, “Index Linked Investments”). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on www.msci.com.

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.’s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.’s company filings on the Investor Relations section of www.msci.com.

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI’s products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD, FEA, InvestorForce, and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and Standard & Poor’s. “Global Industry Classification Standard (GICS)” is a service mark of MSCI and Standard & Poor’s.

© 2018 MSCI Inc. All rights reserved.