WOMEN ON BOARDS AND THE HUMAN CAPITAL CONNECTION

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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.

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.

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\(^5\) The MSCI World Index covers large- and mid-cap companies in 23 developed markets. As of Jan. 31, 2018, it had 1,649 constituents.
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.\(^6\)

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\(^6\) 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.
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

<table>
<thead>
<tr>
<th></th>
<th>TALENT LEADERS</th>
<th>ALL</th>
<th>TALENT LAGGARDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>3+ WOB</td>
<td>47</td>
<td>182</td>
<td>6</td>
</tr>
<tr>
<td>ALL</td>
<td>99</td>
<td>617</td>
<td>58</td>
</tr>
<tr>
<td>1- WOB</td>
<td>17</td>
<td>218</td>
<td>35</td>
</tr>
</tbody>
</table>

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.
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.
**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*

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**WOMEN ON BOARDS AND EMPLOYEE PRODUCTIVITY**

In a January 2018 study, we found MSCI World Index companies that were Talent Leaders had higher growth in employee productivity (revenue per employee) relative to their GICS® 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.

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

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.

Source: MSCI ESG Research, Thomson Reuters
Exhibit 5: Average Employee Productivity for Talent Laggards by Number of WOB

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).
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.
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.
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