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Parity Beyond the Boardroom: Closing Diversity Gaps in the Corporate Pipeline

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In the third paper of our gender diversity series, we discuss one of the top remaining global gender issues: the gap in the corporate "talent pipeline" – where gender and ethnic representation at the board and employee levels is much higher than at the executive and senior management levels. This issue contributes to structural disparities in pay and, ultimately, may further advance a wealth gap for underrepresented groups that is hard to close.

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Key Points

- We examine gender and ethnic diversity globally, focusing on U.S. and developed market large-cap companies from 2019 to 2023. We discuss the implications of the diversity gap within corporate workforces and the corporate talent pipeline.
- Our research shows that female representation at the board and employee levels is much higher than at the executive and senior management levels. Ethnic diversity is greater among lower-level employees than in senior positions at large-cap U.S. companies. Notable differences are observed among resource-based and service-based sectors for both gender diversity and ethnic diversity.
- The trickle-down effect from increased gender representation in the boardroom, expected to help resolve the diversity pipeline issue, has not taken place as quickly as anticipated. We think this is largely due to national quotas driving the high percentage of female board directors, particularly in countries or markets that lag their peers.
- As investors, it's crucial to understand how to evaluate a company's diversity across the corporate pipeline and promote an equal and inclusive firm culture that captures intellectual capital across a broader spectrum of its workforce.

Overview: The Path Toward Gender Parity

Over the past decade, many regulatory bodies have set minimum quotas for board gender diversity, either mandatory or voluntary. These quotas, primarily targeting publicly listed companies, are mostly introduced by legislation, central governments, or primary stock exchanges. With quotas in place, we see more women joining corporate boards globally, with notable variations in countries.

The investment community has long debated whether greater levels of gender diversity positively impact corporate performance and economic growth, and most research looked at this question within a single country or industry. **Calvert's 2019 research found evidence that gender diversity is financially material to equity returns for both U.S. and international large-cap markets.**[1]

In recent years, it has become an industry norm for asset managers and other financial market participants to disclose the board gender diversity of their holdings and portfolio-level impact. The "Do No Significant Harm (DNSH)" principle introduced by the European Commission is one example – it includes mandatory disclosure of board gender diversity as one of its Principal Adverse Impacts (PAIs) and asks investors to set an acceptable threshold based on the indicator.

Investor attention to workplace diversity has also surged, encouraged by the growing diversity on corporate boards. However, simply adding women directors to boards can be seen as tokenism and does not necessarily indicate an inclusive culture.

Rather than focusing solely on board gender diversity, we evaluate gender diversity across the corporate ladder – among board directors, executives, senior managers and employees. This approach has been our practice since we launched the Diversity Research Index Series in 2020.

Progress Toward Parity: A Global Perspective

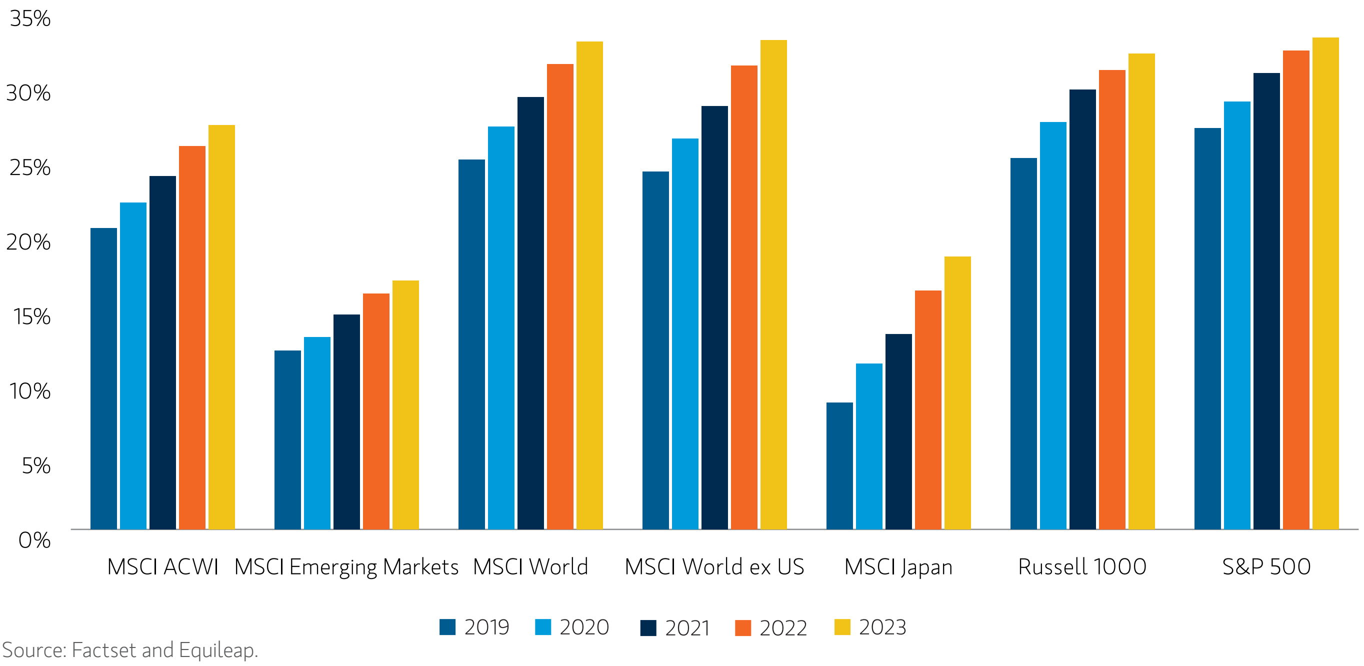
Over the last five years, companies globally have advanced female representation on corporate boards towards parity, with notable regional differences (Display 1). In developed markets, large-cap companies have generally surpassed the 30% female board representation threshold, widely acknowledged as the level whereby companies move beyond tokenism and achieve the benefits of diverse viewpoints and innovation. However, despite large strides forward, Japanese companies still lag the developed markets, standing at 18.3% female board representation.

In the United States, the largest 500 companies tend to have more women on boards relative to the next 500 companies by market capitalization, a gap that has persisted from 2019 to 2023. For emerging markets, the number of female directors increased from 12% in 2019 to 16.7% in 2023. However, **overall, women remain underrepresented on corporate boards in emerging markets, with about half the representation seen in developed markets.**

DISPLAY 1

Women Capture More Boardroom Seats Over Last Five Years

(%) Female Representation on Corporate Boards, Global Markets, 2019 -2023



Source: Factset and Equileap.

Female representation on corporate boards improved globally from 2019-2022 but started to slow in 2023. We think this is partly due to a more challenging economic environment in 2023, which led to companies, of necessity, prioritizing cost reduction strategies over diversity and inclusion issues.

Additionally, we observed a pattern of deceleration across markets after achieving the 30% female board representation threshold. The S&P 500 reached 30.6% in 2021; Russell 1000 reached 29.5% in 2021; MSCI World ex US hit 31.1% in 2022; and MSCI World reached 31.2% in 2022. After hitting these milestones, the rate of increase slowed. The 30% target has been a key threshold for many diversity initiatives actively engaging with companies to increase the number of women on their boards. These efforts have significantly contributed to the progress we see today.

However, with progress faltering, it might imply that companies lack the motivation to continue advancing gender parity beyond the 30% marker. We view this as unfortunate. Although the 30% marker has been helpful in moving the diversity needle, we don't think it is high enough. In our view, gender parity should be the goal for all companies worldwide. One of the findings in our 2019 research was that the actual "tipping point" toward parity is 40%. In recent years, the goal of 40% or gender parity is being more broadly adopted.

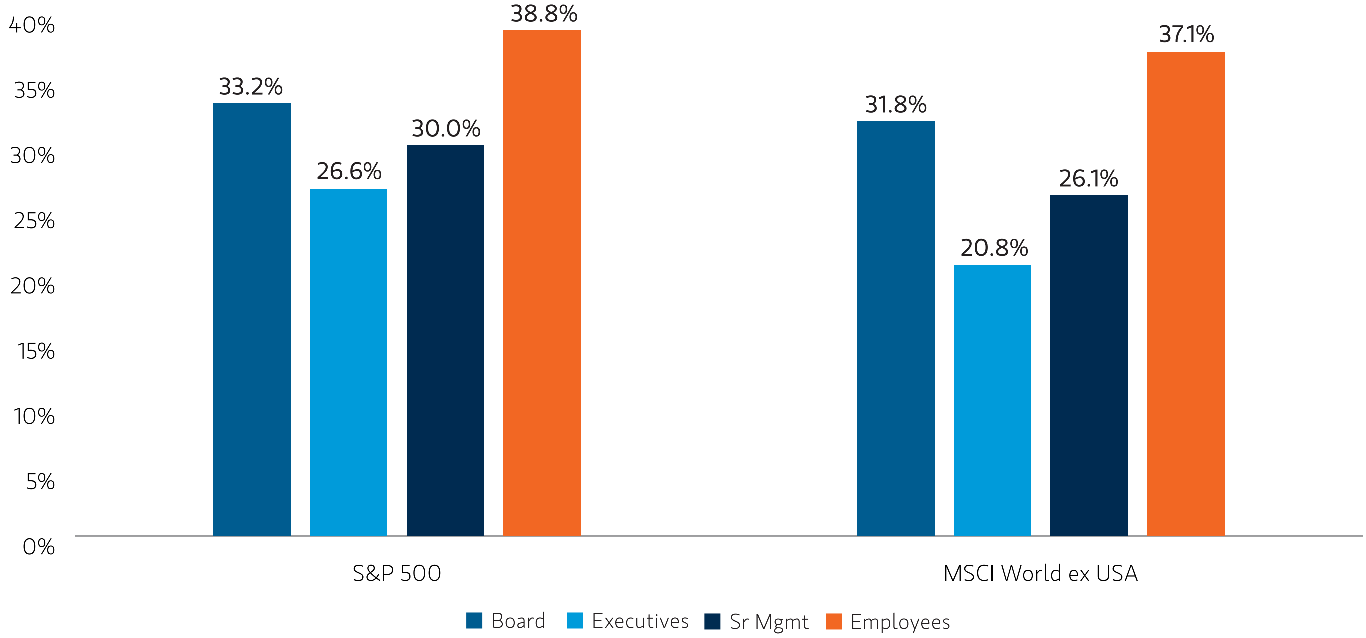
Gender Gap Persists Worldwide

Despite the forward strides made in placing more women on boards, women continue to face major challenges and disparities at various career stages. In both U.S. and international large-cap developed markets, there is higher female representation at the board and employee level than that at the executive and senior management level (Display 2). **Compared to their international peers, U.S. large-cap companies have a higher level of gender diversity across all job levels, particularly among executives and senior managers.**

DISPLAY 2

Globally, Female Representation Lags at Corporate Senior Levels

(%) Female Representation at Board, Executive, Senior Management and Employee Levels (S&P 500 Index and MSCI World ex US Index, December 2023)



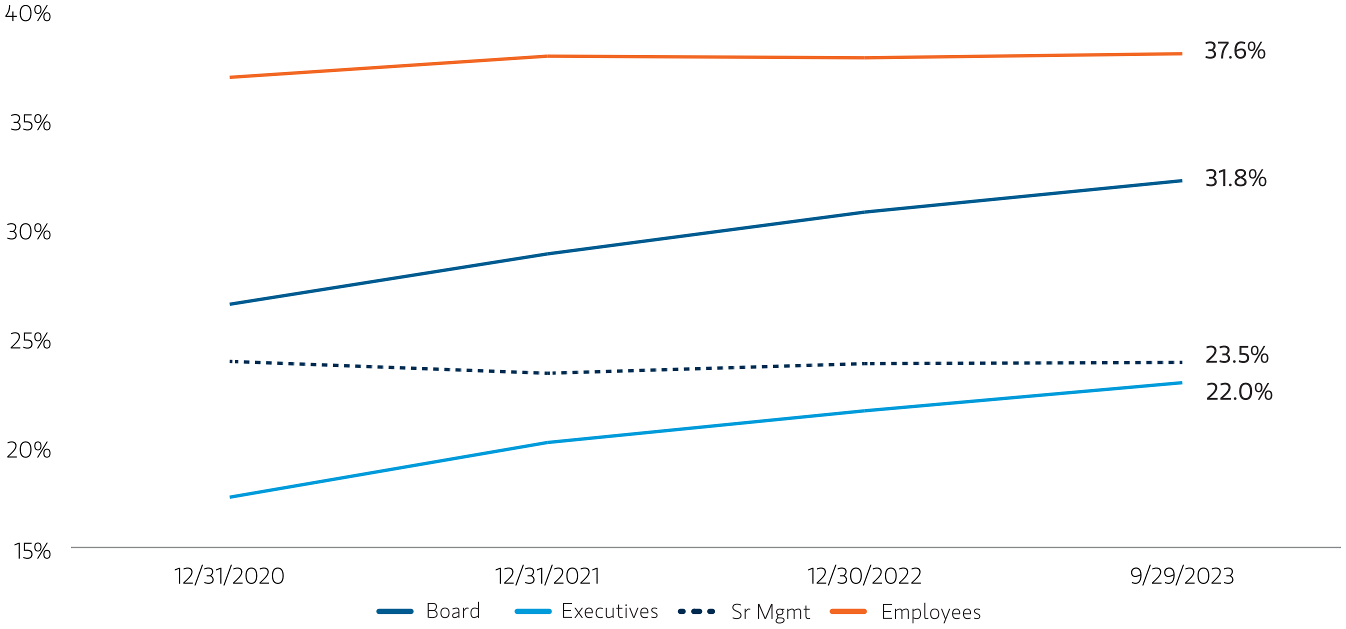
Source: Factset and Equileap.

In looking at the gender diversity gap across GICS sectors from 2020 to 2023, we see that it is largely unchanged (Display 3). **Energy, Materials and Utilities are outliers as they see a much higher percentage of women on their boards than percentage of female employees.** Although companies have added more women to their boards and executive teams, the gender gap among senior managers has barely closed, and, in some cases, has widened. The incremental changes at top job levels are encouraging, but women still have fewer career advancement opportunities, and this is especially true for entry-level employees moving toward senior management roles.

DISPLAY 3

Gender Diversity Greatest at Employee and Board Levels

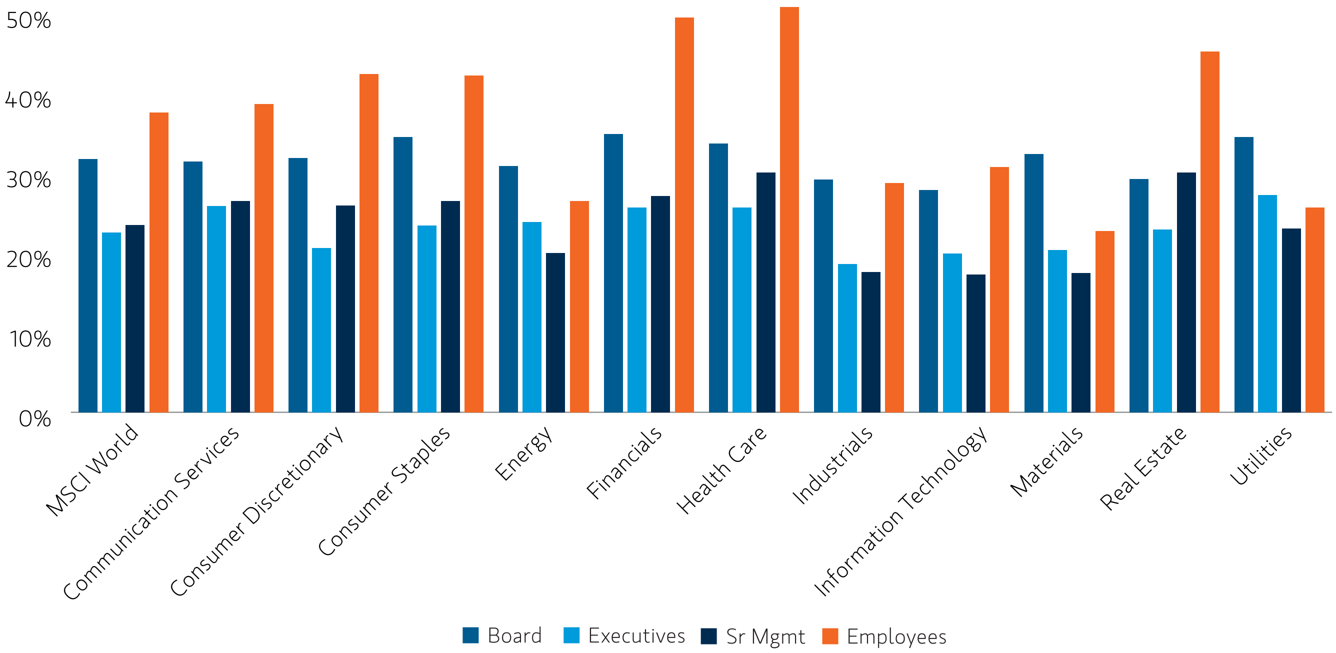
(%) Female Representation at Board, Executive, Senior Management and Employee Levels
(MSCI World Index, 2020 - 2023)



Source: Factset and Equileap. Data is as of 12/31 for 2020, 2021 and 2022. Data is as of 9/29 for 2023.

Most Sectors Show Greatest Gender Diversity at Employee or Board Level

(%) Female Representation at Board, Executive, Senior Management and Employee Levels
(By Sector Grouping, MSCI World Index, September 2023)



Source: Factset and Equileap.

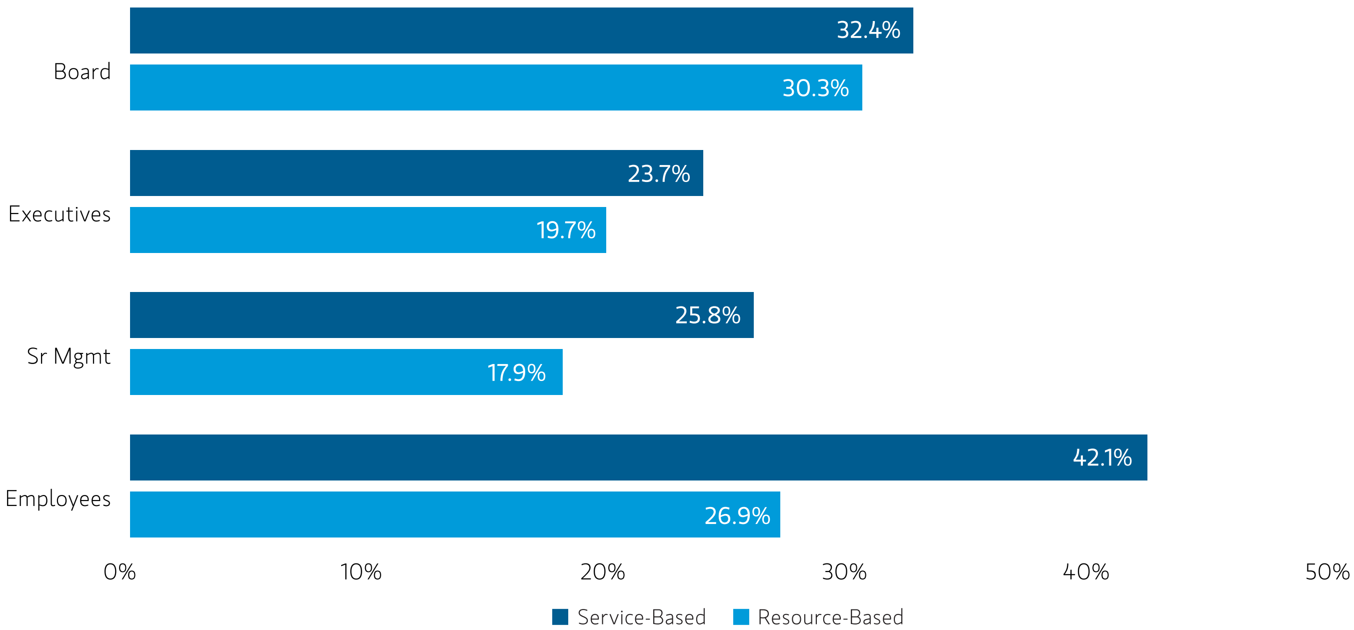
On the whole, service-based sectors marginally outperformed resource-based ones in advancing women workers toward leadership positions. As discussed in our first gender diversity paper, "More Women at Work: Historical Perspectives," service sectors generally have much higher female representation among their talent pools due to demographic shifts and increased job demand over the last five decades. So, in theory, the service sectors are better equipped to promote women towards senior management. **However, the percentage of women on corporate boards falls within a range of 28% to 35% across all service sectors, which is slightly higher than resource sectors at around 30%.** Information Technology has the lowest representation among all sectors, at 27.86%.

Gender diversity at different corporate levels is positively correlated for large-cap companies in developed markets. This means that companies with high gender diversity at one job level usually have high gender diversity at other job levels as well. Yet, the advantage (percentage difference in service-based versus resource-based sectors) decreases from 15.2% at the employee level to 7.9% at the senior management level (Display 4). The difference narrows even more at the executive (4.0%) and board (2.1%) levels.

DISPLAY 4

Gender Diversity in Service- Versus Resource-Based Sectors

(%) Female Representation at Board, Executive, Senior Management and Employee Levels (By Sector Grouping, MSCI World Index, September 2023)



Source: Factset and Equileap.

Ethnic Pipeline Gap Differs from Gender Gap

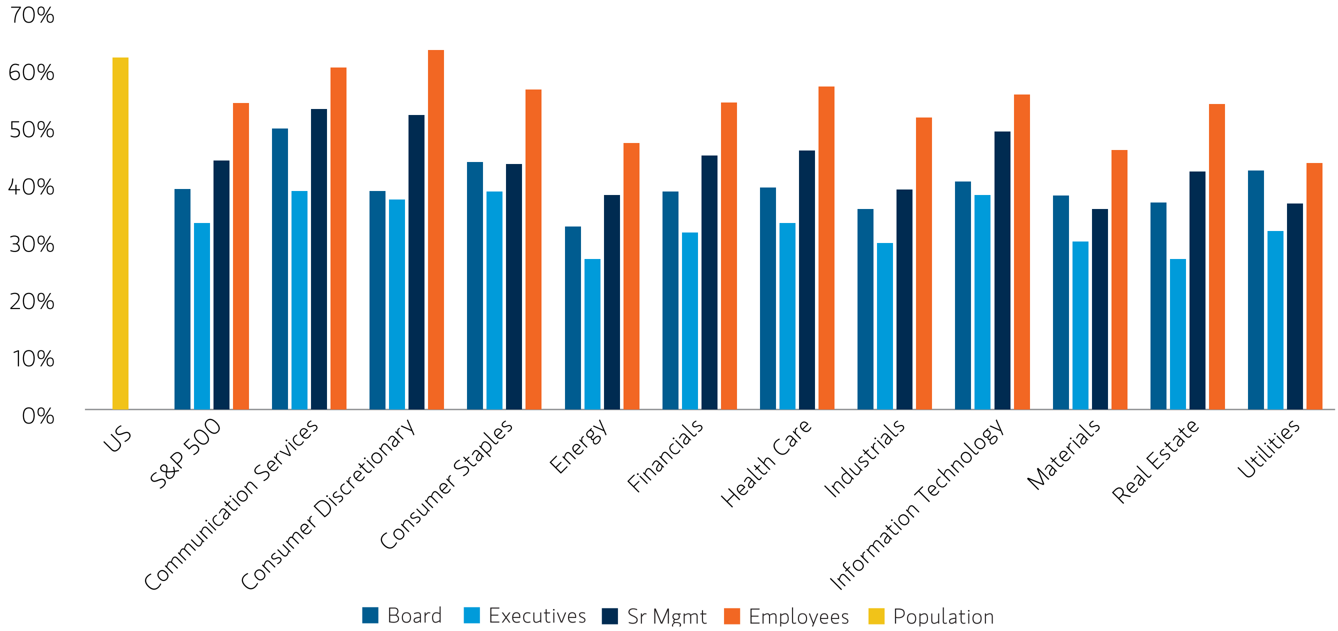
The corporate pipeline issue exists for ethnic diversity in U.S. companies as well. We use ethnic fractionalization[2] as the metric to evaluate ethnic diversity for a group. With more companies disclosing their EEO-1 (Employment Equal Opportunity) data, it's now possible to assess the U.S. workforce structure in terms of ethnic diversity. The EEO-1 data is available for 83.8% of S&P 500 companies, with no sector coverage lower than 75%. Unfortunately, **ethnic diversity data for international companies is largely unavailable below the corporate board level, so we can't accurately measure ethnic representation at the executive and senior levels.**

For U.S. companies, the overall ethnic diversity gap is wide but presents differently than for gender diversity. The level of ethnic diversity at the employee level (53.5%) is much higher than at the board (38.5%), executive (32.5%), and management (43.4%) levels for S&P 500 companies (Display 5). Compared to gender diversity, board-level ethnic diversity does not stand out in the pipeline. **Moreover, based on the 2020 U.S. census, the ethnic fractionalization of U.S. population is 61.4%, higher than the workforce of S&P companies across all seniority levels.** This implies the workforce in U.S. large-cap companies is less ethnically diverse than the general U.S. population.

DISPLAY 5

In S&P 500, Ethnic Diversity Highest for Employees and Management

(%) Ethnic Fractionalization for U.S. Population and S&P 500 Workforce - by GICS Sector, November 2023



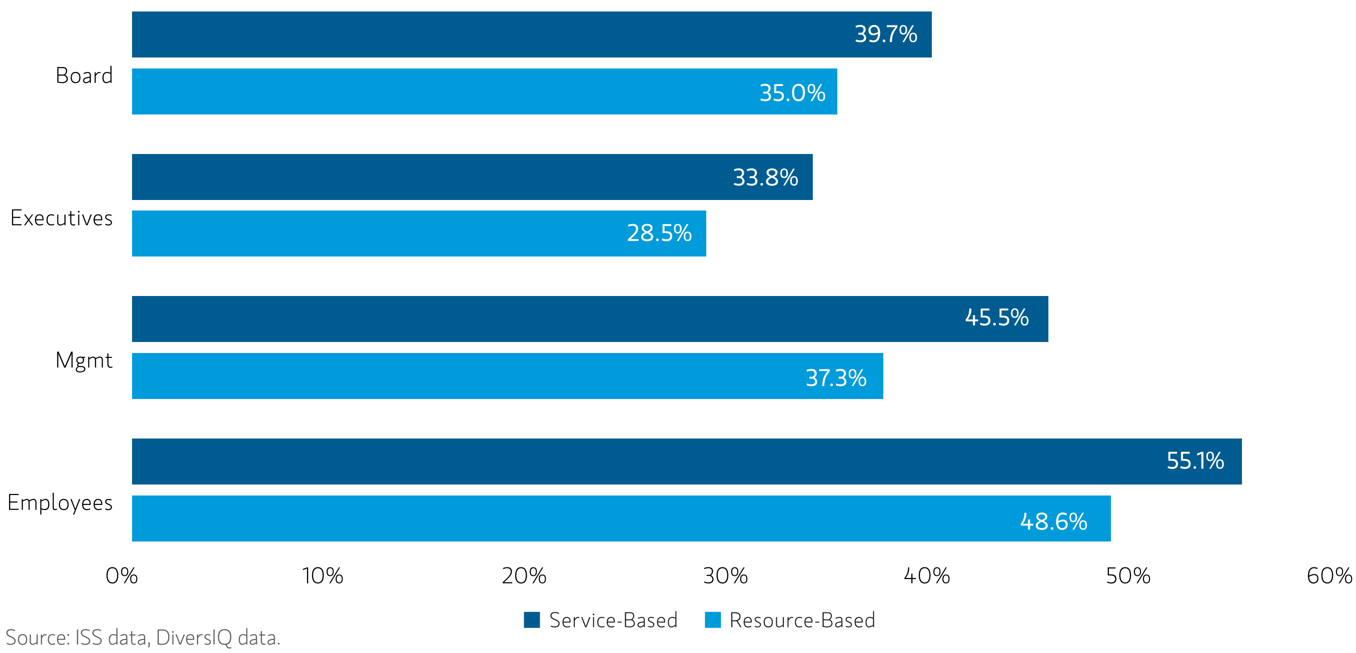
Source: US Bureau of Labor, ISS Data, DiversIQ Data, Ethnic Fractionalization of the U.S. population, 2022 Census.

Across all S&P 500 sectors, ethnic diversity is lowest at the executive level, in line with the gender diversity gap, and highest among employees. However, the level of ethnic diversity within sectors is not as varied as we observed for gender diversity. Resource-based sectors overall have relatively lower levels of ethnic diversity across their workforces than do service-based sectors (Display 6). **The difference in ethnic diversity between resource and service-sector companies widens slightly from employees (6.5%) to management (8.2%), then narrows at the board (4.7%) and executive (5.3%) levels.**

DISPLAY 6

Ethnic Diversity Gap Between Sectors Widest at Management Level

(%) Ethnic Fractionalization at Board, Executive, Management and Employee Levels
(By Sector Grouping, S&P 500 Index, November 2023)



Source: ISS data, DiversIQ data.

The pipeline issue is evident beyond the gender or ethnic lens alone, and further marginalizes workers with intersectionality (disadvantaged in both diversity dimensions). According to McKinsey, "At nearly every step in the pipeline, the representation of women of color falls relative to white women and men of the same race and ethnicity."[3] Although female representation has grown slightly throughout the corporate pipeline over the past five years, women from ethnic groups other than white or Caucasian remain greatly underrepresented in corporate America, and the progress for this group also lags its peers.

Why Trickle-Down Effect Has Not Closed the Diversity Gap

Historically, women have faced barriers to moving up the corporate hierarchy. With fewer women being placed in senior positions, which are generally higher paying, the diversity pipeline issue has led to a structural wealth gap by gender. A similar wealth gap is observed for other minority groups, as their underrepresentation in the corporate pipeline is also apparent.

As board members usually play an active role in hiring decisions and influencing the culture of their companies, **the widespread expectation has been that a greater number of female board directors would lead to an increase in the number of female executives and managers.**[4] This implicit assumption is commonly referred to as the trickle-down effect.[5] Yet, as illustrated in the above sections, **the trickle-down effect has not noticeably closed the gender or ethnic diversity gap, and the pipeline issue still hampers the career advancement of marginalized groups.**

A possible explanation for this situation is that high board gender diversity has been driven mostly by the impact of national quotas or quota-equivalent policies. Interestingly, the level of board ethnic diversity is not particularly high and there are only a few national quotas related to ethnic diversity. To examine this assumption, we reviewed the regulations on board gender diversity for all countries or markets in the MSCI All Country World Index and grouped them into four categories.

> "With fewer women being placed in senior positions, which are generally higher paying, the diversity pipeline issue has led to a structural wealth gap by gender."

This research includes regulations with quantifiable thresholds that apply to all listed companies in a country/region (such as Norway); or certain companies listed on a national public market (such as the Dubai and Abu Dhabi stock markets). Mandatory quotas are requirements by law, or market practices, whereby a company's non-compliance would elicit some form of penalty. Voluntary quotas are national recommendations that do not necessarily come with non-compliance punishments and could ask for more disclosure in some instances on a comply-or-explain basis.

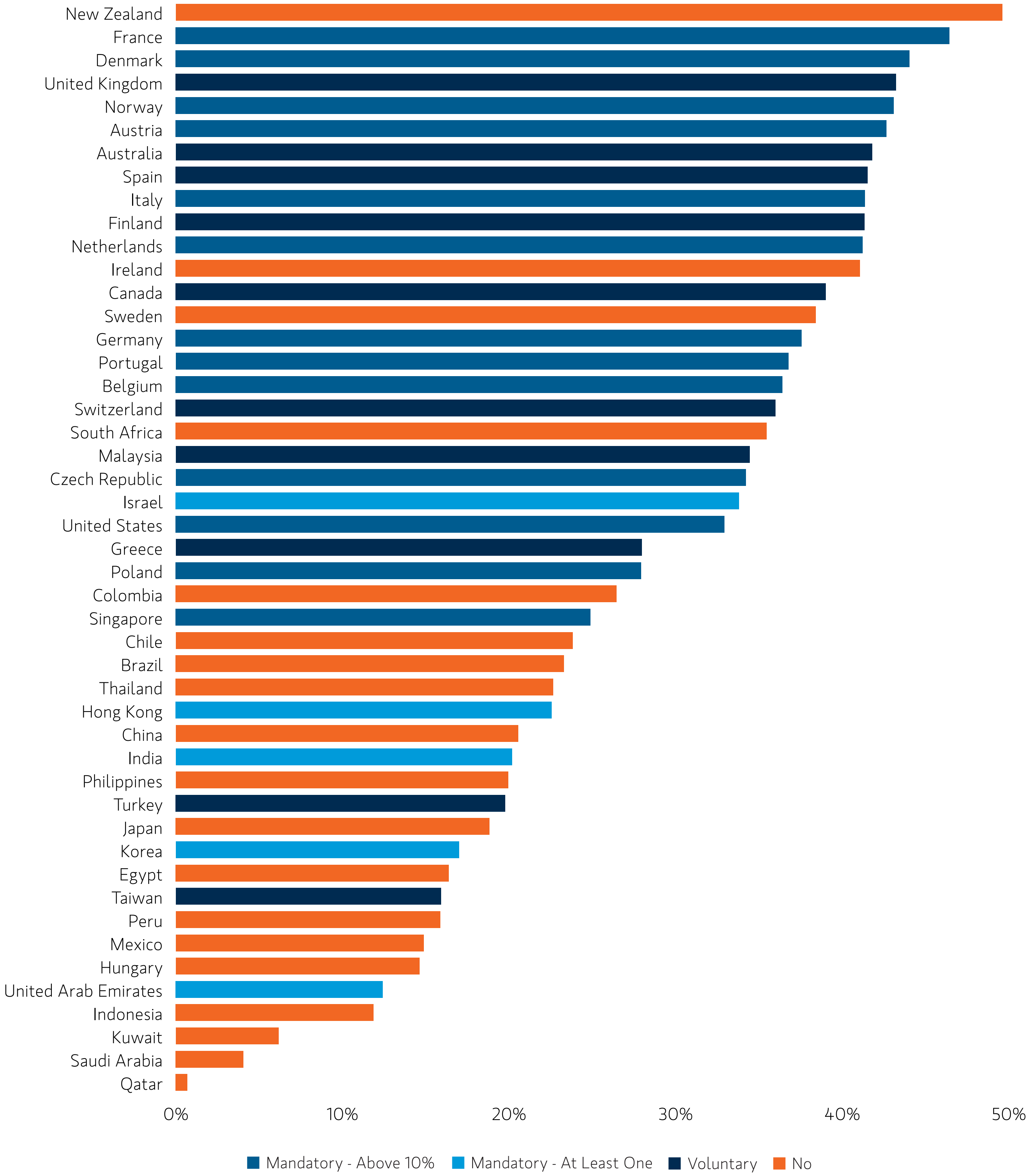
Across all countries in the MSCI All Country World Index (MSCI ACWI), we found a +0.61% correlation between national quotas and the percentage of women on boards (Display 7). The breakdown between various country quotas and the average percentage of female board directors is:

- Mandatory quota of above 10%: 39.27%
- Voluntary quota: 33.22%
- Mandatory quota of at least one woman on board: 21.19%
- No quota: 21.30%

DISPLAY 7

12 Countries Have 40% or More Women on Their Boards

(%) Female Representation on Corporate Boards - MSCI ACWI, 2023 (By Market and Board Gender Quota Type)



Source: Calvert, Deloitte, and MSCI.

The results reveal more complexity than a simple binary answer. On the one hand, there is a remarkable difference between groups: **countries with mandatory quotas of over 10% or voluntary quotas for board gender diversity tend to have a higher percentage of female representation.** Conversely, countries with a mandatory quota of at least one woman or no quota at all tend to see much lower female board representation. However, **some countries near or at board gender parity, such as New Zealand, do not necessarily have a quota in place.** In those instances, the higher percentage of female directors could be a natural result of stronger social norms on gender equality.

Quota systems work, in part, because many companies lacked female board directors for a long time, and their talent pool was diverse enough to draw from. However, newly added female directors often hold fewer important roles on boards (with lower compensation) than men, and this is also true for executives.[6] Having only one female member in a group is insufficient. As research suggests, a group's "collective intelligence" is correlated with the proportion of females in the group, and a higher level of diversity implies a better collective intelligence.[7]

Another reason gender quotas work at the board level is that gender diversity is undoubtedly the easiest diversity metric to observe: almost every listed company discloses its board directors publicly on its website or in corporate filings. Moreover, typically, the number of directors on a corporate board is limited, usually less than 20. As a result, diversity among board directors attracts a great deal of attention from investors and stakeholders. It is one of the most widely used metrics to evaluate a company's diversity performance. However, this can lead to tokenism when companies are pressured to demonstrate immediate diversity and inclusion efforts without being ready to promote a firm-wide inclusive culture.

We think diversity quotas help narrow the diversity gap on corporate boards, especially in countries with a history of discriminatory social norms and gender stereotypes. **A national quota can help initiate conversations and set targets, but it is not the only or necessarily best solution alone to tackle diversity, equity and inclusion (DEI) issues.** Most quota systems currently aim to close only the gender parity gap at the board level and exclude other diversity dimensions such as racial/ethnic and age criteria. **Focusing solely on gender gaps at the board level falls far short of achieving a diverse and inclusive corporate culture** and is insufficient to narrow the overall wealth gap of underrepresented groups driven by the structural diversity gap in the pipeline. While adding diversity at the board level improves a company's DEI performance, efforts should not stop there. Much more needs to be done beyond this accomplishment.

Conclusion

We observe a significant lack of both gender and ethnic diversity throughout the corporate talent pipeline for large-cap, developed markets. In terms of the gender gap, female representation at the board and employee levels is noticeably higher than at the executive and management levels. This pattern persisted for the period we examined, from 2020-2023. The gender gap varies by sector, with major differences between resource-based and service-based ones.

In terms of the ethnic gap, among U.S. large-cap companies, employee-level ethnic diversity is much higher than at the board, management and executive levels. Because fewer people from underrepresented groups are placed in these relatively higher-paying, senior positions, diversity gaps may contribute to wealth gaps found by gender and/or ethnicity.

The high representation of women on boards is likely due to national quotas adopted globally. Despite improved board-level diversity, we have not seen a corresponding increase in diversity in senior management. Clearly, the trickle-down effect has not yet fully materialized.

As diversity gaps at the critical management and senior levels are not closing as quickly as expected, we believe investors and companies need to intensify their efforts to address this situation. We think companies that can close their diversity gaps sooner are more likely to benefit from a boost in their intellectual and human capital. In our final paper of this series, we will discuss how to evaluate the talent pipeline issue using quantitative metrics, and the efficacy of such factors.

[1] Y. Chen, Calvert, "Evaluating the financial materiality of gender diversity factors", October 2019.

[2] Ethnic fractionalization evaluates the likelihood that two people chosen at random are from different ethnic groups. The index ranges from 0-1, with 0 meaning all people are members of the same group and 1 meaning each individual belongs to a separate group.

[3] McKinsey & Co. (2023). Women in the Workplace 2023.

[4] Kirsch, A. (2018). The gender composition of corporate boards: A review and research agenda. The Leadership Quarterly, 29(2), 346-364.

[5] Gould, J. A., Kulik, C. T., & Sardeshmukh, S. R. (2018). Trickle down effect: The impact of female board members on executive gender diversity. Human Resource Management, 57(4), 931-945.

[6] Li, Yuanjiawen and Wang, Tianxi and Xiao, Beiyun, Board Diversity through Quotas: Evidence from AB 979 (November 21, 2023).

[7] Woolley, A. W., Chabris, C. F., Pentland, A., Hashmi, N., & Malone, T. W. (2010). Evidence for a collective intelligence factor in the performance of human groups. science, 330(6004), 686-688.

DEFINITIONS

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Senior management is defined and reported by the company, and usually represents managerial levels below the executive level.

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MSCI World Index is a widely followed global stock market index that measures the performance of around 1,400 large and mid-cap companies across 23 developed markets.

MSCI World ex-US Index measures the equity market performance of large and mid-cap stocks across 22 of 23 developed markets (DM) countries, excluding the United States. The index covers approximately 85% of the free float-adjusted market capitalization in each country. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in U.S. dollars and assumes reinvestment of net dividends.

MSCI Emerging Markets Index is an unmanaged index of emerging markets common stocks.

MSCI Japan Index is designed to measure the performance of the large and mid-cap segments of the Japanese market.

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