BANK OF AMERICA INSTITUTE

BANK OF AMERICA

Diversity, Equity & Inclusion

The High Cost of Slow Progress

12 April 2022

A LACK OF DIVERSITY, EQUITY & INCLUSION (DEI) IS COSTLY FOR COMPANIES, INDIVIDUALS AND ADVANCEMENT OF SOCIETY

This is a redaction of a 42 page BofA Global Research report published on March 4, 2022

Key Takeaways

- Lack of diversity, equity & inclusion (DEI) is expensive.
- DEI is the right thing to do - and grows the bottom line.
- Box ticking doesn't cut it: DEI policies alone aren't enough.

Lack of diversity, equity & inclusion (DEI) is expensive

Is it $70trn in foregone economic output? Or $23trn in USD GDP? Or $172trn in lifetime earnings? No matter how you measure it, lack of diversity, equity and inclusion (DEI) limits national economies and reduces GDP. For a company, it means less innovation, weaker revenues and cash flows, and lower employee retention. For individuals, it impacts educational outcomes, physical & mental health, lifetime achievement & earnings, and wealth passed down. Diversity and inclusion should be desirable in their own right – we consider the financial implications of lagging.

DEI is the right thing to do – and grows the bottom line

Diversity matters: 56% of 87mn US Millennials are white compared to 75% of baby boomers. That doesn't include figures on gender, sexual orientation or the disabled. Companies with higher ethnic diversity are more likely to beat industry average financial returns. Greater acceptance of LGBTQ+ individuals is linked to gains in national wealth. Underemployment of the disabled has a knock-on effect for families, society and GDP.

Box ticking doesn't cut it: DEI policies alone aren't enough

Company culture & values are the biggest driver of overall employee satisfaction – more than compensation. Box ticking alone doesn't create culture – our analysis shows that simply having DEI policies has no bearing on employees' perception of culture & values.

Did you know?

- The $150bn US film and TV industry loses $10bn, or 7%, every year by undervaluing black films, filmmakers and executives. 92% of film executives and 87% of television executives are white. Partners at the top three talent agencies? They 'pale' in comparison: 97% white. (McKinsey)
- Companies with higher-than-average diversity had 19% higher innovation revenues. (Harvard Business Review)
- 76% of job seekers consider workplace diversity an important factor when considering employment. >50% of workers want employers to do more to increase diversity. (Glassdoor)
- 78% of respondents to a Harvard Business Review study said their organizations lack diverse leadership. Without this, HBR finds that women are 20% less likely than straight white men to gain acceptance for their ideas. People who identify as LGBT are 21% less likely, and people of color are 24% less likely. (Harvard Business Review)
- Black workers make up 13% of the US workforce, but 38% receive the minimum wage. (Pew Research)

The high cost of inequality

Lagging on diversity and inclusion is expensive. Studies show that more diverse teams drive innovation and performance. Two-thirds of young job seekers value diversity when considering an employer. Yet in 2021, there were only four black CEOs in the Fortune 500, and 30% of S&P 500 companies fail to have even one black board member. In 2021, NASDAQ introduced rules to increase diversity, as >75% of NASDAQ companies lacked even one woman and one underrepresented minority/LGTBQ member at the board level. So what does inequality cost in terms of economic output or lifetime earnings?

Ca.$70trn in economic output forgone in 30 years? Gender and racial biases lead to persistent labor market disparities and limit the economy. For example, closing gender and race gaps in education and employment would have generated US$2.6trn more in economic output in 2019 alone. The cumulative gains from 1990 would have been c.US$70trn in 2019 dollars, all else equal. Closing the racial earnings gap resulting from disparities in health, education, incarceration and employment opportunities would boost US GDP growth by 0.5%pt per year through 2050 – that's over $100bn in the first year alone and $8trn over 30 years. (Source: WK Kellogg Foundation)

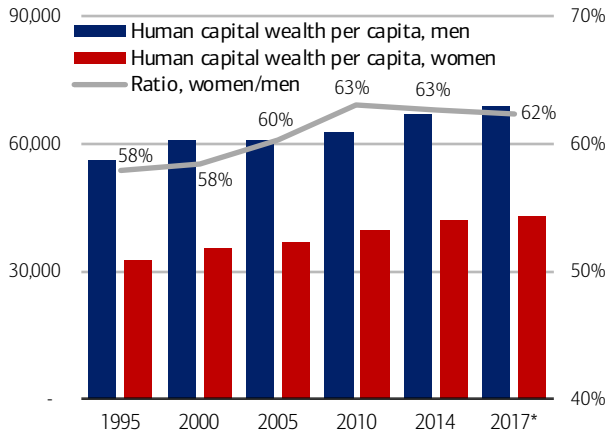
$23 trillion dollars in US GDP alone. The Federal Reserve Bank of San Francisco estimates that this was the cost of inequality in US education, employment and earnings during the years 1990-2019. Eliminating earnings gaps alone could have added $1.15trn to US GDP in 2019, about a 10% increase in labor income for the US economy. Even worse, this cost is likely to increase as minority populations increase: the value of greater equality increases as populations become more diverse.

Who leaves $172trn on the table?! The World Bank says we're doing exactly this when we fail to act on gender inequality in earnings over the lifetime of men and women. Women today account for just 38% of a country's human capital compared to 62% for men (Exhibit 1). (Human capital is defined by the World Bank as the value of the future earnings of adult citizens. Human capital wealth is the present value of future earnings of today's labor force.) Lost human capital wealth due to gender inequality is estimated $172trn – *this is twice the size of global GDP*. (Source: World Bank, World Economic Forum)

Gender gaps in education and health & survival are closing, but regional differences vary. Political empowerment of women remains low (Exhibit 2), just as racial differences in political representation remain particularly high.

Exhibit 1: Human capital wealth by gender (US$ of 2014)

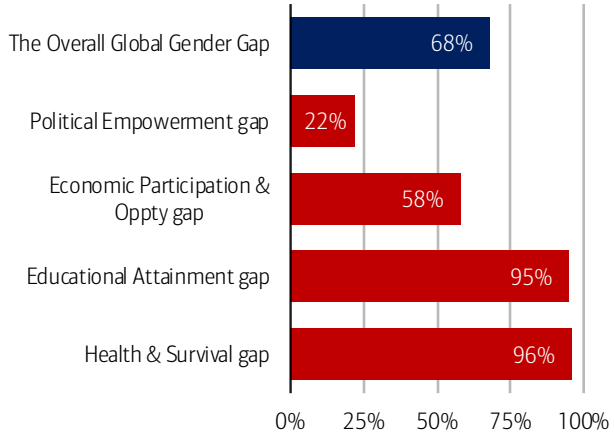
Women have closed 62% of the gap (2017 figures are projections)



Source: World Bank Group, Wodon (2018), The Cost of Gender Inequality series, 2020

Exhibit 2: The % of gender gaps closed as of 2021

Only 58% of the gap is closed on economic participation



Source: World Economic Forum Global Gender Gap Report 2021

DEI and ESG – $ upside to companies

Diversity should be highly desirable in its own right – it should facilitate matching the best people to the right roles to create the best outcomes. Today's society is more diverse than ever, and failing to act on this costs money. Inclusive companies are more successful in employee hiring and retention – particularly those employees from underrepresented groups. There is also a correlation between diversity & inclusion and greater innovation, higher cash flows, and a stronger bottom line.

Mention of diversity, equity and inclusion in UN PRI (Principles for Responsible Investing) signatories' proxy voting policies more than tripled from 6% in 2017 to 21% in 2020. Public commitment to improve diversity and inclusion has gained steam, but the gap between white men and 'the rest' remains stark – and this costs money.

Greater equality = a multiplier of innovation and growth

Diversity correlates with innovation. Simply put, the inclusion of team members with different perspectives and ways of thinking facilitates greater innovation – it seems pretty straightforward. So not surprisingly, workplace culture facilitates innovation. A workplace culture of equality has a meaningful impact on employees' willingness and ability to innovate. In fact, the 'innovation mindset' is six times higher in the most equal workplaces compared to the least equal.

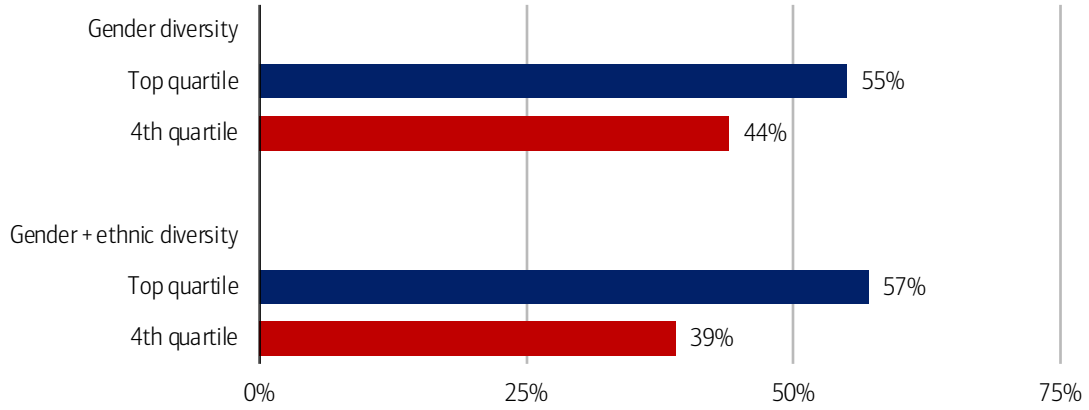
How does $8trn by 2028 sound? Innovation translates into economic potential. If the 'innovation mindset' were raised by 10% across countries, global GDP could increase by up to $8trn by 2028. This would come from greater employee productivity, higher retention rates, and improved growth. (Source: Accenture)

Financial results are enhanced by diversity & inclusion

Greater innovation, better decision-making and higher financial returns all correlate to a sense of inclusion. Companies with above-average diversity on their leadership teams report revenues from innovation that are as much as 19 percentage points higher than those with below-average management diversity. Those with top-quartile gender diversity are also more likely to see higher revenues than lower quartile peers. These companies tend to see DEI as a competitive advantage and an active part of their overall growth strategy.

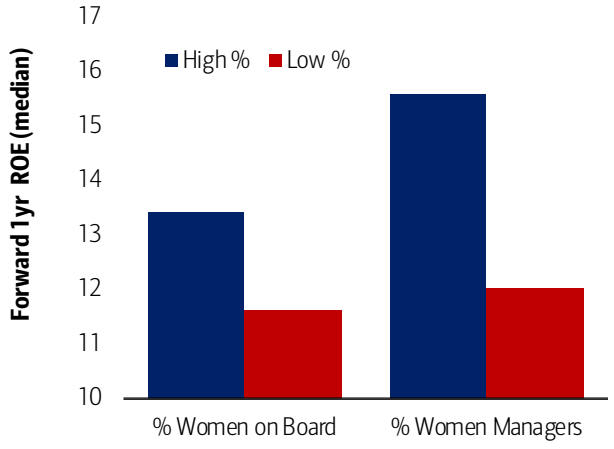
Diversity helps margins. More diverse companies report meaningfully higher EBIT (earnings before interest & tax) margins. McKinsey found a 57% likelihood of outperformance on EBIT margin for top-quartile companies by ethnic/cultural diversity. Other studies show a 0.8% increase in EBIT for every 10% increase on diversity metrics. In the US, there is a strong link between gender diversity and financial results.

Exhibit 3: The data suggests diversity correlates with better financial performance
Likelihood of financial outperformance (EBIT, 2014-2018), %



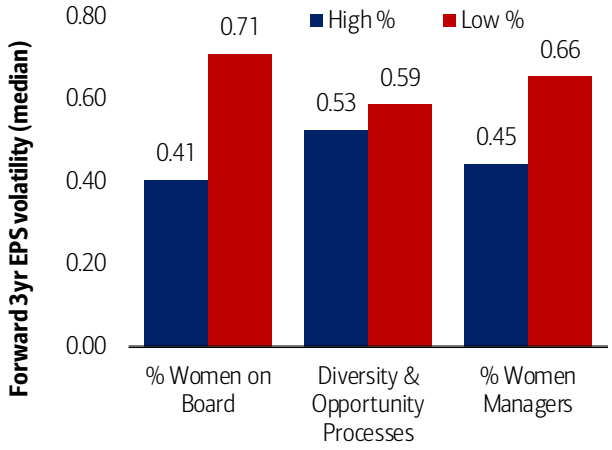
*Likelihood of financial outperformance (EBIT) is measured against the national industry median. N = 1,039 for gender; n = 533 for gender + ethnicity. US, UK, Brazil, Mexico, Australia, India, Japan, Singapore, France, Germany, Nigeria, S. Africa, Denmark, Norway, Sweden.
Source: McKinsey & Company, Diversity Wins, May 2020

Exhibit 4: Gender diversity correlates with higher future ROE
Median forward 1yr ROE based on % women on board and % women managers (2005-20)



*Data from 2010 on for % Women Managers
Note: High (Low) % of Women on Board defined as above (below) the universe median; High (Low) % of Women Managers defined as above (below) 30%
Source: Refinitiv, FactSet, BofA US Equity & Quant Strategy

Exhibit 5: Gender diversity signals lower earnings risk
Median forward 3yr EPS volatility based on ESG scores (annually, 2005-18) for Board Diversity (Governance), Diversity & Opportunity Processes (Social), and % Women Managers (Social)



**data from 2010 on for % Women Managers
Note: High ESG Score based on >50 score on Board Diversity, Yes on Diversity and Opportunity Processes, and >30% women in management. Low ESG Score based on <50 score on Board Diversity, No on Diversity and Opportunity Processes and <30% women in management.
Source: Refinitiv, FactSet, BofA US Equity & Quant Strategy

Moving DEI forward: box-ticking doesn't work

About 94,000 hours of our lifetimes are spent at work. If DEI is so important, how can companies make diversity & inclusion a part of their culture and reach equality in a time frame not measured in centuries, but in years? Relatively small changes can improve inclusivity and lead to gains in financial performance – it doesn't require wholesale change. But DEI needs to be a strategic priority for companies, not an afterthought or HR sideline and box ticking doesn't work. It needs leadership buy-in and active participation. Performance measures and clear goals need to be set, reviewed and discussed. Differences need to be seen and felt well beyond the boardroom.

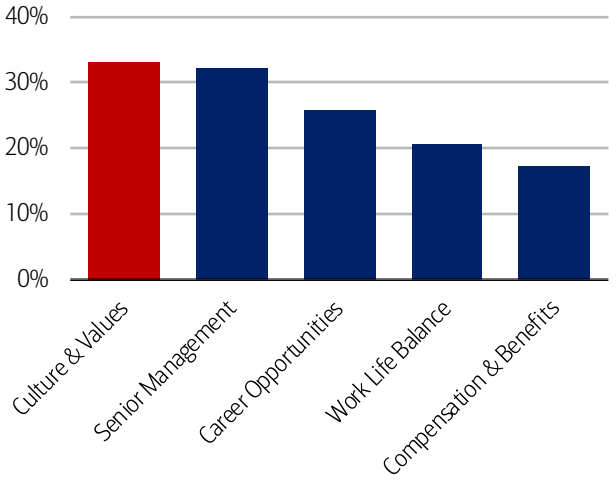
Hiring, pay and promotion: walking the walk

Senior leaders need to be accountable for diversity and inclusion, and DEI needs to be represented in all parts of a firm. Management teams should cultivate inclusive leadership at every level of an organization. Inclusive leaders consider different perspectives in their decision-making and listen effectively.

Culture is critical, and hard to game

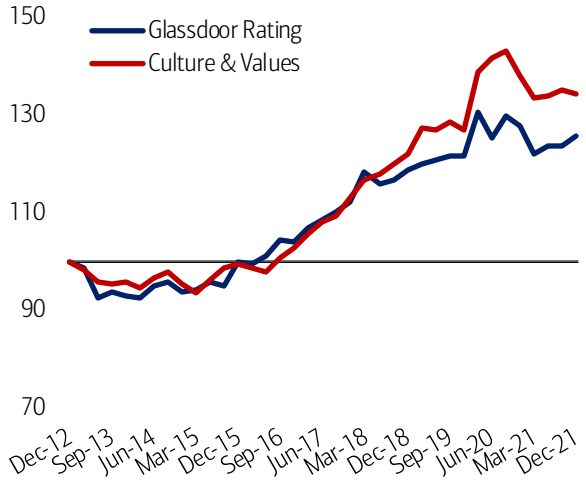
Based on glassdoor.com data, company culture and values are the biggest driver of overall employee satisfaction, more so than compensation. Moreover, companies with high Culture & Values rating can outperform their poorly ranked peers by around 30% within S&P 500 universe, generating even more alpha than Glassdoor rating itself.

Exhibit 6: Culture & Values score is the biggest determinant of overall job satisfaction
R-sq of specific ranks on overall company rank, Glassdoor data as of 12/2021 for US public companies



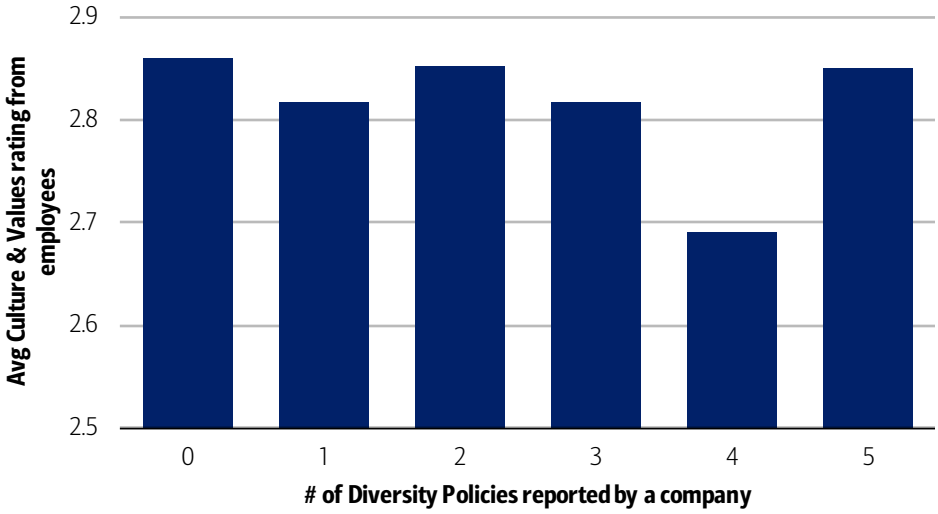
Source: Thinknum Alternative Data, Glassdoor.com, FactSet, BofA US Equity & Quant Strategy

Exhibit 7: Culture can be a more alpha-generative factor than overall Glassdoor rating
Cumulative relative returns of high culture-ranked companies vs. bottom-ranked peers within S&P 500



Source: Thinknum Alternative Data, Glassdoor.com, FactSet, BofA US Equity & Quant Strategy

Exhibit 8: The number of reported diversity policies vs. the culture & values ratings by employees
Simply having more DEI policies isn't enough to drive better company culture



Source: Thinknum Alternative Data, Glassdoor.com, ICE Data Indices, LLC, BofA US Equity & Quant Strategy

Once your teams are in the door, keep them

About 10% of companies have mentorship programs, yet firms who actively use these programs see a 9-24% increase in minority representation in management (source: Forbes). If you want your staff to stay, mentor them – and measure the results. Reverse-mentoring is gaining traction, where younger or minority staff enable senior leaders and managers to be more in touch with their organizations at a different level. The advantages of reverse-mentoring work in both directions, as junior staff have an opportunity to be heard and understood by more experienced employees.

Small steps with real impact: Companies can add diversity to their parental leave programs, to insurance policies, and to work schedules to facilitate diversity. Holiday policies can give flexibility to incorporate religious and cultural dates.

Mandatory staff meeting on December 25: Companies need to consider their diverse teams more than ever. In the US, 95% of workers have a day off on Dec 25, and 66% have a day off for Thanksgiving – but additional religious and cultural holidays should be considered. Companies may also need to think more broadly about other issues, such as dress codes, to make a more diverse workforce feel included.

Overall, companies that fail to prioritize diversity, equity and inclusion in their culture & core values will miss out on economic and financial growth opportunities due to lack of innovation, varying perspectives and broader skillsets that can contribute to the overall success of a company. In doing so, companies stand to benefit from stronger financial results, increased innovation and lower employee turnover. Ultimately when a culture is inclusive, society can advance with greater innovation and economic equality at a much more rapid pace.

Sources:

Kay Hope
Fixed Income ESG Analyst, BofA Global Research

Savita Subramanian
Head of US Equity Quantitative and Global ESG Research, BofA Global Research

Menka Bajaj
European ESG Strategist, BofA Global Research

Shuwen Wang
Equity & Quantitative Strategist, BofA Global Research

Disclosures