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Investing for Diversity, Equity and Inclusion 101

This article provides a high-level background on the rising investor-level interest in diversity, equity and inclusion (DEI), explains how DEI links to financial materiality and offers a framework for investors to consider when putting DEI principles into practice.

Why Invest with a DEI Lens?

Historically, policies and institutions in the U.S. have resulted in deep systemic inequities and the underrepresentation of marginalized communities in positions of leadership, all of which has further driven widening socioeconomic disparities.[1,2,3] Recent influential movements such as Black Lives Matter and #MeToo have highlighted these differences and underscored the need and opportunity to invest in building a safer, more equitable society.

While there is both an economic and moral imperative, there is also mounting evidence of the financial materiality of DEI issues. A recent McKinsey study found companies at the top quartile of gender and racial/ethnic diversity were 36% more likely to experience above-average profitability than peer companies in the fourth quartile, an increase from prior years and further highlighting the widening earnings gap.[4] Moreover, there is growing evidence that companies with good corporate DEI practices, for example, access to healthcare, fair chance employment and opportunities for skill development, are more likely to mitigate operational, regulatory and reputational risks and to build trust with workers, consumers and the communities in which they operate.[5]

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DEI investing has attracted greater interest with advances in academic and corporate research on the financial materiality of DEI factors[6,7,8] as well as a clear business case around the opportunity to invest in underserved and untapped markets. Shareholder resolutions related to social issues constituted the largest share (41%) of proposals submitted in the 2021-2022 season for the Russell 1000.[9] In the current 2022-2023 season, DEI topics feature prominently in shareholder resolutions related to enhanced board, executive and workplace diversity; racial, gender and other pay equity disclosures; and political contributions and lobbying disclosures.[10]

The growing interest in DEI investment opportunities has also been marked by the launch of several gender lens investing and racial justice themed private and public market funds over the last five years. A 2022 Cerulli[11] survey found more than one-third of asset managers currently provide or are developing products focused on DEI, and more than half of managers have impact investing strategies focused on community economic development. These shareholder resolution and product development trends demonstrate that investors increasingly believe that incorporating DEI factors into the investment process can be an important risk mitigation tool and can enhance their ability to generate sustainable returns.

Framework for DEI Investing

DEI investing cuts across different themes including racial equity, gender equity, LBGTQ+ rights, disability rights and veterans' rights. Within these themes, DEI investing can be considered from the perspective of who distributes capital or how that capital is distributed.

Glenmede's investor framework to DEI investing includes three applications, listed in order of level of impact:

1. Investing in diverse investment managers.
2. Investing in diverse companies.
3. Investing in business models and investment strategies that provide opportunities and access to historically marginalized communities. Conversely, this also means engaging with or divesting from companies that exacerbate inequities.

The graphic below illustrates this framework when applied to racial and gender equity.

This framework offers a more in-depth approach to investing in DEI, requiring investors to collect demographic data (Application 1) alongside information on how companies are impacting society and communities across the supply chain. This could be additional qualitative information around a company's efforts to build an inclusive culture, for example, providing robust parental leave and sourcing from diverse supply chains (Application 2), or it could be a focus on screening out exposure to industries that have historically harmed communities of color (e.g., private prisons[12] and predatory lending[13]) and tilting toward companies that offer affordable housing and access to quality education (Application 3).

Challenges and Opportunities

While there continues to be growth in DEI investing, the industry faces several structural and systemic challenges:

1. *Systemic biases in the due diligence process:* According to a 2021 Knight Foundation study, women and people of color control only 1.4% of the U.S. asset management industry's $82 trillion in assets.[14] One of the biggest challenges to allocating more capital to managers who are women and people of color are the inherent inequities in the traditional due diligence process. For example, many emerging managers face significant barriers to growth due to minimum assets under management and track record requirements.

Opportunity: There is growing popularity for use of alternative due diligence frameworks, such as Due Diligence 2.0, which provides a rigorous yet more inclusive approach to assessing risk.

2. *Lack of standardized corporate disclosures:* While there continues to be calls for enhanced corporate diversity disclosures, only a fraction of companies currently discloses intersectional data about their employees. For example, only 34% of companies in the Russell 1000 disclose their EE0-1 report as of 2022.[15] The lack of standardized measurement tools and data can make it difficult for investors to discern if and how a company has followed through on its commitments to DEI.

Opportunity: Fund managers with a robust process for identifying and engaging on DEI issues related to portfolio companies may be better positioned to generate long-term value for their investors.

3. *Lack of standardized manager disclosures:* Fund managers have been increasingly asked to report on their diversity as clients continue to demand diverse managed funds.[16] Unfortunately, there is no standard template for collecting information about the DEI characteristics of fund managers, and many, especially those with smaller teams, are also conscious of data privacy concerns. This has led to disclosure fatigue as fund managers complete varying templates from different asset owners requesting DEI information.

Opportunity: The emergence of manager DEI reporting frameworks, including the Institutional Limited Partners Association Due Diligence Questionnaire and the eVestment framework, may position investors toward standardized sources to better understand the underlying diversity of their investment portfolios.

Conclusion

As the industry continues to evolve with increased pressure from investor coalitions, shareholders and regulators to advance DEI topics and improve disclosures, there is an opportunity for investors to enhance their ability to mitigate risk and generate long-term sustainable returns.

To learn more about the different facets of DEI investing, including gender lens and racial equity investing, please see the Appendix below and visit our website. For information on investment solutions that seek to advance diversity, equity, and inclusion, please reach out to us at **SustainableAndImpactInvesting@glenmede.com.**

Want to learn more about DEI investing?

- Glenmede's Sustainable & Impact Investing Capabilities brochure details our approach, platform offerings and resources. Please email SustainableAndImpactInvesting@glenmede.com to request a copy.
- Glenmede's S&I Investing thought leadership page features several articles of interest:
  - Advancing Economic Mobility Through Sustainable and Impact Investments looks at how the likelihood of a child in a low-income family climbing the socioeconomic ladder is largely dependent on where they grew up. We explore how investment and philanthropic tools may seek to close health, social and economic inequities in these communities.
  - Racial Equity Investing: Opportunities for Impact & Alpha highlights how racial equity investing provides opportunities to advance racial equity and tackle racial inequities in the U.S. while generating financial returns.
  - Gender Lens Investing in Public Markets: It's More Than Women at the Top explores the materiality of five dimensions of gender equity: women in leadership, access to benefits, diverse supply chains, pay equity, and talent and culture.
  - Applying an Intersectional Investment Lens Across Gender and Race provides an investor framework for how investors can employ a cross-cutting view across multiple dimensions of diversity to their investments.

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[3] Alexander, M. The New Jim Crow: Mass Incarceration in the Age of Colorblindness. (New York: The New Press, 2010).

[4] McKinsey. "Diversity Wins: How Inclusion Matters," May 19, 2020.

[5] Duty and Diversity. Harvard Law School Forum on Corporate Governance, March 4, 2021. https://corpgov.law.harvard.edu/2021/03/04/duty-and-diversity/.

[6] Morgan Stanley. "Does Ethnic Diversity on Corporate Boards Affect Stock Prices?" January 5, 2022.

[7] Rock, D., & H. Grant. "Why Diverse Teams Are Smarter." Harvard Business Review, November 4, 2016. https://hbr.org/2016/11/why-diverse-teams-are-smarter.

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[10] Ibid.

[11] "Growing Demand for Diversity Investment Products." ESG Clarity, February 8, 2023. https://esgclarity.com/growing-demand-for-diversity-investment-products/.

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[13] Rothstein, R. The Color of Law: A Forgotten History of How Our Government Segregated America (New York: Liveright, 2016).

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[15] Patni, M. "Companies Disclosing Their EEO-1 Reports Saw Higher 2022 Returns." Just Capital, March 16, 2023. https://justcapital.com/news/companies-disclosing-their-eeo-1-reports-saw-higher-2022-returns/.

[16] Albright, A. "Endowment Pros Look to Funnel Trillions to Diverse Fund Managers." Bloomberg, February 28, 2023.
