



INVESTOR CONSIDERATION OF  
RACIAL AND ETHNIC DIVERSITY,  
EQUITY AND INCLUSION:  
**CURRENT STATE AND IDEAS  
FOR IMPROVEMENT**



**CAESARS**  
ENTERTAINMENT®



## PURPOSE OF THIS PAPER

This paper explores how companies, nonprofits, government entities and investors can accelerate the adoption of racial and ethnic diversity, equity and inclusion (DEI) as an investment criterion. It is a product of the Caesars Entertainment DEI Initiative, a group of 41 companies and nonprofits committed to accelerating DEI. Caesars commissioned Bea Boccalandro to develop the paper. Individuals interested in helping capital markets adopt racial and ethnic DEI, as discussed in this paper, are encouraged to contact [peopleplanetplay@caesars.com](mailto:peopleplanetplay@caesars.com).

Prodding equity markets to value racial and ethnic DEI is critical because every available tool is needed to address inequities in hiring, promoting, compensating and other treatment of racial and ethnic minorities. Minorities make up 37% of the U.S. population, yet only 10% of Russell 3000 board seats are held by nonwhites.<sup>1</sup> Parity at the management level is equally distant. Currently, fewer than 10% of Fortune 500 CEOs are nonwhite and fewer than 1% are nonwhite women.<sup>2</sup> Furthermore, even within pockets of corporate America that have achieved fair representation of racial and ethnic minorities, there is evidence that systemic institutional and cultural biases remain.<sup>3</sup> While these remain, businesses can never hope to benefit from the full intellectual resources of the entire workforce or to maximize the associated financial returns.

This paper explores the feasibility of accelerating progress toward the vision of racial and ethnic parity and justice within U.S. businesses by positively incentivizing and operationalizing improved investor behavior. Specifically, this paper explores five questions:

1. To what extent are investors interested in investing in companies with strong DEI practices regarding race and ethnicity?
2. To what extent do investors use DEI practices regarding race and ethnicity in selecting investments?
3. What are the barriers to investor use of race and ethnicity DEI practices in selecting investments?
4. What “bright spots” in furthering DEI practices regarding race and ethnicity exist in the investment community?
5. What actions might help investors consider DEI practices regarding race and ethnicity in selecting specific investments?



## Question 1: To what extent are investors interested in investing in companies with strong DEI practices regarding race and ethnicity?

Over the last 15 years, many investors have developed a strong interest in company performance on Environment, Social and Governance (ESG) as a way to evaluate corporate social responsibility. However, racial and ethnic DEI is one among many ESG factors (see Table 1). Increased interest in ESG does not automatically translate into increased interest in racial and ethnic DEI.

In 2004, the UN Global Compact, the International Finance Corporation (IFC) and the Swiss Government launched an effort to integrate ESG into capital markets. These actors suspected that companies that proactively manage ESG risks and opportunities are more likely to have stronger long-term financial performance. Academic and market research has turned that suspicion into something approaching an undisputed fact. As a result, today over a quarter of all professionally managed assets in the world take into consideration ESG factors.<sup>4</sup> Similarly, nearly 40% of all shareholder proposals submitted to Russell 3000 companies relate to ESG issues.<sup>5</sup> While this is not a blanket success outcome, it serves as a launchpad for the advancement of DEI race and ethnicity efforts.

The rise of ESG has included investor interest in racial and ethnic DEI. A study conducted by Allianz, for example, found that 85% of adults in the United States reported personally caring about the racial equality of the companies they invest in.<sup>6</sup>

However, race and ethnicity DEI is rarely considered among the top ESG investment criteria. For example, one study found that the top ESG issues considered by institutional investors and asset managers are conflict risk, executive pay, tobacco, environment, board issues, transparency and anti-corruption, and human rights.<sup>7</sup>

In other words, most investors say they are interested in racial and ethnic DEI, but it does not appear to be a priority ESG criteria.

## Question 2: To what extent do investors use DEI practices regarding race and ethnicity in selecting investments?

Not only do investors not consider racial and ethnic DEI an ESG priority, but there is a gap between their stated interests and their actions. Only about half of the individual investors citing interest in ESG issues have invested according to such issues. Similarly, institutional investors rarely make decisions based on a company's racial or ethnic DEI and fewer than 15% of shareholder proposals have racial and ethnic DEI content.<sup>8</sup> Low prioritization of racial and ethnic DEI among investors also extends to startup investors. A 2016 survey by LinkedIn found that the majority of investors in startups ranked "founder commitment to a diverse team as the least of their concerns when considering [whether] to invest."<sup>9</sup>



As a result, despite their growing attention to ESG issues, equity markets are not forwarding race and ethnic DEI in any meaningful way. Companies with strong race and ethnic DEI are rarely rewarded and companies with weak race and ethnic DEI are seldom identified, much less punished, in capital markets.

**Table 1. Race and ethnicity DEI is one of many ESG elements**

Environment (E)	Social (S)	Governance (G)
<ul style="list-style-type: none"> <li>Climate change</li> <li>Deforestation</li> <li>Greenhouse gas (GHG) emissions</li> <li>Resource depletion, including water</li> <li>Sustainable supply chain</li> <li>Waste and pollution</li> </ul>	<ul style="list-style-type: none"> <li>Community involvement</li> <li>Conflict</li> <li><b>Employee diversity and inclusion</b></li> <li>Health and safety</li> <li>Working conditions (slavery, child labor, etc.)</li> </ul>	<ul style="list-style-type: none"> <li><b>Board diversity</b></li> <li>Bribery and corruption</li> <li>Executive pay</li> <li>Political influence and donations</li> <li>Taxes</li> </ul>



### Question 3: What are the barriers to investor use of race and ethnicity DEI practices in selecting investments?

Secondary research has uncovered three key reasons why investors don't consider racial and ethnic DEI in their decision making: skepticism of the business case, inadequate data and investor bias.

#### Skepticism of the business case

A Morgan Stanley survey found that lacking proof of market-rate financial performance among ESG investments, including racial and ethnic diversity, is the top barrier to greater ESG investments.<sup>10</sup> Over one-third of both institutional and individual investors aren't convinced that racial and ethnic DEI does not undermine financial performance, much less that it improves it.<sup>11</sup>

Unfortunately, existing evidence does not refute the skepticism regarding the value of racial and ethnic diversity in financial performance. The research is contradictory and inconclusive. Researchers, for example, have concluded the evidence that racial and ethnic diversity leads to stronger business performance is "elusive" and "equivocal."<sup>12</sup>

It's not that studies haven't identified correlations between racial and ethnic DEI and performance. They have. For example, 2015 McKinsey & Company research on over 350 public companies found that for every 10% increase in racial and ethnic diversity on the senior-executive team, earnings before interest and taxes (EBIT) rose 0.8%.<sup>13</sup> A more recent McKinsey & Company report found that companies with the most ethnically diverse executive teams are 33% more likely to outperform their peers on profitability.<sup>14</sup> Furthermore, an analysis of an index of companies selected for their commitment to racial and ethnic diversity found them to be less volatile, have stronger competitive advantages and possess healthier balance sheets compared with the overall market.<sup>15</sup> It should be noted, however, that not all studies have identified positive relationships between racial and ethnic DEI and company performance. In fact, some studies have found a negative correlation.<sup>16</sup>

Regardless of their conclusions, the key limitation of the above studies is that they do not demonstrate that racial and ethnic DEI directly affects performance (either positively or negatively), only that it correlates with performance. It could be that racial and ethnic DEI is what scientists call a "marker" for other factors that affect performance. For example, the positive correlations might be explained by companies with racial and ethnic DEI being more innovative, open-minded or environmentally

sustainable. Thus, the above studies might actually be showing that these factors, not racial and ethnic diversity, drive performance. One reason the marker theory resonates with investors is that several large studies that go beyond tracking correlations to explore causality didn't find that racial and ethnic diversity drove performance.<sup>17</sup>

To be clear, some studies do find a causal relationship between ethnic and racial DEI and company accounting performance. One study of students who set up businesses in the Netherlands, for example, found that teams with over 50% ethnic minority members had higher sales, profits and profits per share.<sup>18</sup> Another study found that good diversity management improved sales performance.<sup>19</sup> Yet another study found that ethnically diverse teams were 58% more likely to conduct error-free work, as measured by how they priced stocks, compared to homogenous groups.<sup>20</sup> These studies, however, cannot be generalized into findings that team diversity results in meaningful accounting or market performance. There are simply too few studies and they cover too narrow a sliver of equity markets.

The bottom line is that research on the business case for racial and ethnic DEI is nascent and, thus, still inconclusive. Investors currently don't have compelling evidence that asking companies to strengthen their racial and ethnic DEI will likely boost return on equity.

#### Inadequate data

An investor interested in using racial and ethnic DEI to inform their investment decisions will likely not find standardized and quality data to allow this. Four hundred of the Fortune 500 companies do not disclose the racial and ethnic breakdown of their workforces by level.<sup>21</sup> It's even less likely that they share their inclusivity practices, how many times they have been sued for racial discrimination or other racial and ethnic DEI information. Additionally, researchers say that existing data is so inconsistent as to be borderline useless.<sup>22</sup>

Furthermore, even if the customary data used today were available and standardized, they are overly simplistic. Existing company-level data consist mostly of the percentage of racial and ethnic minorities in specific roles. Yet, achieving a certain level of representation of minority individuals in certain positions does not constitute DEI. It leaves out equity and inclusivity. Diversity adds value only if it results in diverse views and perspectives. And headcounts do not guarantee this.

In other words, inadequate data undermines investor consideration of racial and ethnic DEI practices in their investments.

## Bias

The existence of both conscious and unconscious bias against racial and ethnic minorities across American society is well documented. Although there is no definitive research proving that the financial markets have this bias, there is no reason to expect they would be an exception.

Existing data from similar markets that could shed light on bias in the investment market is inconclusive. For example, a study of the basketball gaming market found a bias against teams with a high proportion of blacks.<sup>23</sup> Yet, another study found no discrimination against minority sports-team managers among bettors.<sup>24</sup> The bottom line is that we don't have investment-market research proving or disproving the existence of prejudice against racially and ethnically diverse companies, but it's probable that such bias exists.

The three key barriers to investor consideration of race and ethnicity DEI appear to be an insufficiently compelling business case, inadequate data and, possibly, both conscious and/or unconscious bias.

## Question 4: What "bright spots" in furthering DEI practices regarding race and ethnicity exist in the investment community?

Numerous efforts within the investment community are trying to increase the use of racial and ethnic DEI practices in investment decision making. Below are a few examples.

**Financial products.** Enterprising organizations are creating indices, mutual funds and exchange-traded funds (ETFs) of companies that perform well on racial and ethnic DEI. For example, the NAACP worked with Impact Shares, a nonprofit fund manager, and Morningstar, the research organization, to establish the NAACP Minority Empowerment ETF. The criteria for the index, identified and compiled by the NAACP, include levels of social activism, equal opportunity, and diversity of workplaces within each company. These include board diversity, discrimination policies, supplier diversity, digital divide programs, DEI initiatives, community reinvestment, and health and safety management. These criteria are measured and tracked by the fund's ESG research provider, Sustainalytics. The index is then constructed from the top 200 scoring companies by Morningstar. The ETF allows investors to allocate their capital passively while the NAACP works with companies on how to adopt and maintain strong practices that benefit investors. The portion of the management fee that is not used to cover expenses goes to the NAACP in return for its engagement with the indexed companies.

**Data products.** As seen above, Sustainalytics is collecting company data, identified by the NAACP, that goes well beyond representation of racial and ethnic minorities at the board level to include data and program information around issues such as supplier diversity and community involvement. Other organizations, including State Street and Calvert Research and Management, are also working on improving the quality of company ESG data, including racial and ethnic DEI practices.



**Institutional investor pressure.** Several progressive public U.S. pension plans, advisers to city retirement and investment funds in New York and Chicago, and money managers, such as BlackRock and State Street, include racial and ethnic DEI as an investment criterion.

**ESG frameworks.** The principal ESG frameworks, including the Global Reporting Initiative (GRI) and the Dow Jones Sustainability Index (DJSI), have normalized the collection of some racial and ethnic DEI data such as the racial breakdown of board members. Although the collected data points are too basic to properly represent company racial and ethnic DEI practices, they still represent progress over available data a mere 10 years ago.

## Question 5: What actions might help investors consider DEI practices regarding race and ethnicity in selecting specific investments?

Below is a list of possible actions to help promote investor adoption of racial and ethnic DEI criteria. This list is not comprehensive and is meant only as a starting point for people and organizations looking for ways to support the adoption of racial and ethnic DEI criteria in capital markets.

**Quality research.** Research that definitively answers whether racial and ethnic DEI practices drive corporate performance, and under what circumstances, could make the business case to investors. Commissioning such research might be an effective way to promote inclusion of racial and ethnic DEI practices in investment decisions.

**Standardization of race and ethnicity DEI data.** A commission could be established to establish best-practice race and ethnicity DEI disclosures by industry — taking into account business risks and opportunities — in order to help standardize the data available to investors.

**Voluntary disclosures by leadership companies.** By simply agreeing to disclose specific data on their racial and ethnic DEI practices and results, and encouraging others to do the same, companies can help normalize transparency around racial and ethnic DEI, thus improving the quality of available data. A place to start might be to disclose the EEO-1 report provided annually to the U.S. Department of Labor. This report details the composition of U.S. workforce by race (and gender) across major job categories.

**Advocacy with companies.** The Thirty Percent Coalition is a national organization of public and private companies, professional services firms, institutional investors, government officials and many major advocacy groups that are collaborating to increase the number of women, including women of color, on corporate boards. The Coalition organized letter-writing campaigns and shareholder resolutions aimed at companies without women serving on their boards. A similar effort focused on racial and ethnic DEI might achieve similar success. Another approach could be similar to what Black Enterprise did. In 2014 it published the “list of shame” consisting of tech companies without a single black director.

**Advocacy for legislation.** California took the step of requiring minimum levels of female representation on company boards. Advocating for state and federal legislation requiring racial/ethnic representation on company boards might be a productive way to promote racial and ethnic DEI practices in companies.

## CONCLUSIONS

While interest in racial and ethnic DEI is on the rise, few investors apply it in their investment decisions. The key barriers to greater consideration of racial and ethnic DEI in the capital markets appear to be a weak business case, inadequate data and, possibly, conscious and unconscious bias. Fortunately, there are a plethora of ways to overcome these barriers to help accelerate the adoption of racial and ethnic DEI criteria among investors and, thus, promote racial and ethnic DEI within businesses. Promising actions include commissioning quality research on the business impact of racial and ethnic DEI practices, standardizing race and ethnic DEI reporting elements, promoting voluntary disclosure of company racial and ethnic data, conducting advocacy with companies and conducting advocacy with government entities.



## END NOTES

- <sup>1</sup> Kosmas Papadopoulos, Robert Kalb, Angelica Valderrama and Thomas Balog, "U.S. Board Diversity Trends," ISS Analytics, (May 31, 2019).
- <sup>2</sup> Catalyst, "Ask Catalyst Express: Women CEOs," (August 13, 2019).
- <sup>3</sup> Shanna Daniels and LaDonna M. Thornton, "Race and workplace discrimination," Equality, Diversity and Inclusion: An International Journal, Vol. 5. (2019).
- <sup>4</sup> Global Sustainable Investment Alliance, "2018 Global Sustainable Investment Review," Global Sustainable Investment Alliance, (2019).
- <sup>5</sup> Kosmas Papadopoulos, Robert Kalb, Angelica Valderrama and Thomas Balog, "U.S. Board Diversity Trends," ISS Analytics, (May 31, 2019).
- <sup>6</sup> Matteo Tonello, "Proxy Voting Analytics (2015-2018)," Conference Board, (November 2018).
- <sup>7</sup> Allianz Life Insurance Company of North America, "Allianz Life ESG Investor Sentiment Study," (December 2018).
- <sup>8</sup> Shirley Westcott, "2019 Proxy Season Preview," Harvard Law School Forum on Corporate Governance and Financial Regulation, (April 15, 2019).
- <sup>9</sup> Matteo Tonello, "Proxy Voting Analytics (2015-2018)," Conference Board, (November 2018).
- <sup>10</sup> Morgan Stanley, Sustainable Signals: Asset Owners Embrace Sustainability, (2018).
- <sup>11</sup> Caroline Fairchild, "Investors and startup founders think tech's diversity problem will solve itself," LinkedIn, (November 3, 2016).
- <sup>12</sup> RBC Global Asset Management, 2018 Responsible Investing Survey: Charting A Sustainable Advantage, (October 2018).
- <sup>13</sup> McKinsey & Company, Diversity Matters, (2015).
- <sup>14</sup> McKinsey & Company, Delivering through Diversity, (2018).
- <sup>15</sup> Dan Lefkowitz, "Why Diversity and Inclusion Matter to Investors," MorningStar, (December 18, 2018).
- <sup>16</sup> Robert Hogan and Daniel Huerta, "The impact of gender and ethnic diversity on REIT operating performance," Journal of Management and Training for Industries 5, no. 3, (January 14, 2019).
- <sup>17</sup> Kevin T. Wayne and Jonathan G. McCosh, "Diversity as a problematic predictor of organizational performance: Issues of context and expectations," Journal of Management and Training for Industries 5, no. 3, (2018): 31-50; and Deborah Rhode and Amanda Packel, "Diversity on Corporate Boards: How Much Difference Does Difference Make," Delaware Journal of Corporate Law; Wilmington Vol. 39, no. 2, (2014).
- <sup>18</sup> Sander Hoogendoorn and Mirjam van Praag, "Ethnic Diversity and Team Performance: A Field Experiment," abstract Tinbergen Institute IZA, (July 2012).
- <sup>19</sup> Patrick F. McKay, Derek R. Avery and Mark A. Morris, "Mean Racial-Ethnic Differences In Employee Sales Performance: The Moderating Role Of Diversity Climate," Personnel Psychology 61, no. 2, (2008).
- <sup>20</sup> Sheen S. Levine, Evan P. Apfelbaum, Mark Bernard, Valerie L. Bartelt, Edward J. Zajac, and David Stark, "Ethnic diversity deflates price bubble," PNAS 111, no.52, (December 30, 2014).
- <sup>21</sup> Platt, E., "Diversity beyond gender proves hard for investors to measure," FT.Com, (2018).
- <sup>22</sup> Sakis Kotsantonis and George Serafeim, "Four Things No One Will Tell You About ESG Data," Journal of Applied Corporate Finance 31, no. 2, (July 2, 2019).
- <sup>23</sup> Deniz Igan, Marcelo Pinheiro, and John Smith, (2012), "Racial biases and market outcomes: "white men can't jump," but would you bet on it?," MPRA Paper 36069, University Library of Munich, Germany (2012).
- <sup>24</sup> Rodney J. Paul, Andrew P. Weinbach and Justin Mattingly, (2018), Tests of racial discrimination in a simple financial market: Managers in major league baseball, International Journal of Financial Studies 6, no. 1, (2018).