Why the Government Pension Fund Global should invest in gender equality

THE OIL FUND AND GENDER EQUALITY

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Content

Summary

The Norwegian Government Pension Fund Global, commonly referred to as the Oil fund, is our shared wealth. The Fund is a remarkable success story, making the debate about how it ought to be managed contested. Those advocating for extended guidelines are often met with fierce opposition.

In 2019, CARE and Storebrand published a joint report, written by PwC, showing a link between gender equality and profitability. The report, building on an analysis of Nordic companies listed on the stock exchange, documented a positive correlation between financial results and the share of women in leadership positions. Companies with a higher share of women on boards and in management also experienced lower volatility and fewer years of negative results. This is consistent with international research on the same topic, and is echoed by World Economic Forum.

Oil fund guidelines already demand that the companies invested in report on global challenges such as children's rights, climate change, water management, human rights, tax and transparency, anti-corruption and ocean sustainability.
This is responsible investment management. As the UN Sustainable Development Goals are becoming a road map for more and more companies and customers, the right thing to do is often the most profitable. Climate risk is one of the most striking examples of this: In the long run, the cost of doing nothing is greater than the cost of adapting. What is profitable today is not necessarily profitable tomorrow, and the risks are becoming more real every day.

The seven global challenges reported on by the Oil fund are largely consistent with the Sustainable Development Goals. However, gender equality is not mentioned at all in the annual report, despite the UN Secretary General stating that gender equality is instrumental to reaching the other SDGs.

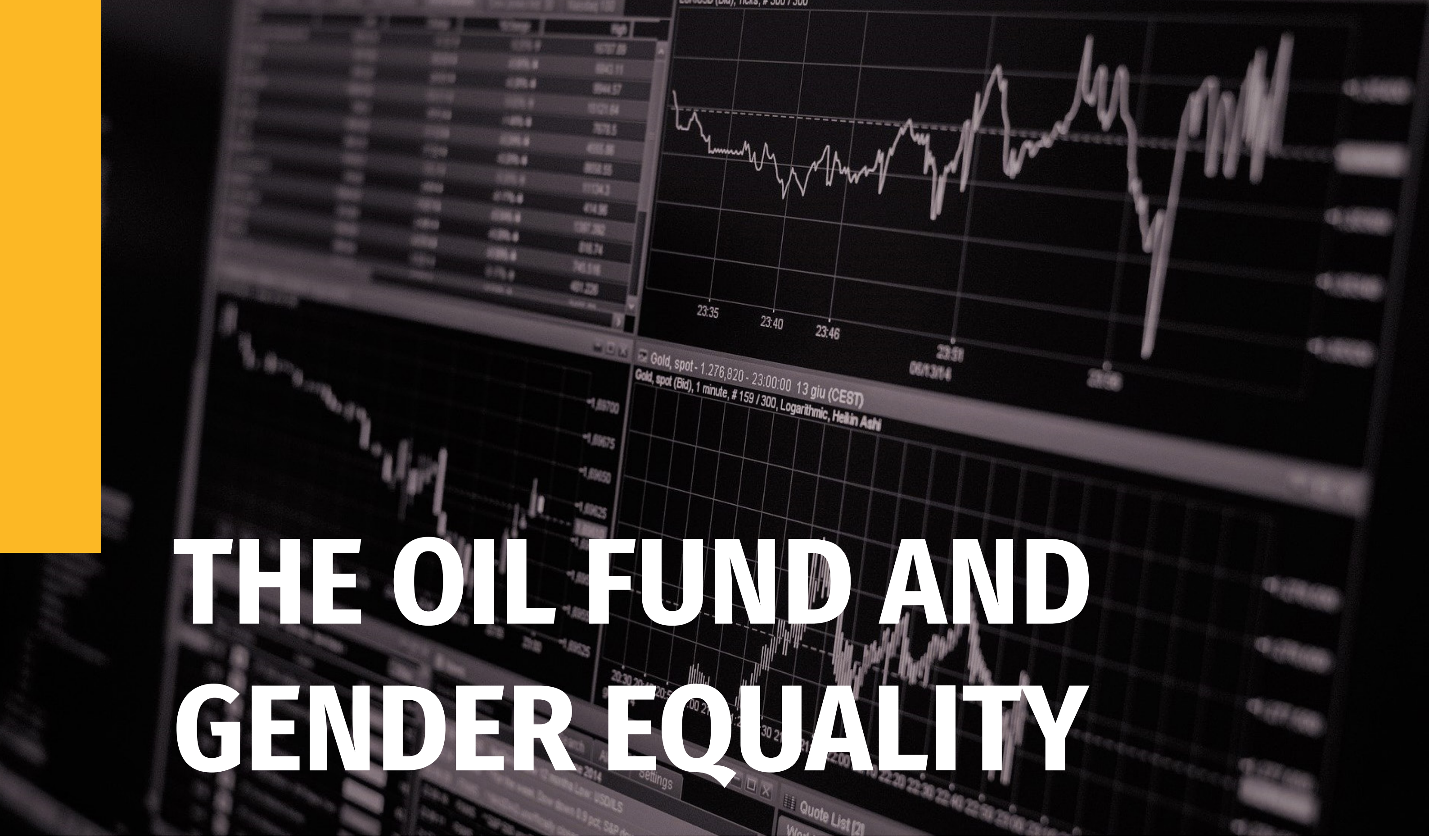
In this report, we make three suggestions for how the Fund can take gender equality into account in its investments. We strongly believe that gender equality and the Fund's goal of achieving the highest possible return with acceptable risk are mutually reinforcing. Here is how it can be done:

1. Follow-up of the Fund's ethical guidelines
The Council of Ethics are already conducting their own examinations, and can recommend observation or exclusion on the basis of infringement of women's rights through the human rights criteria in the guidelines. This has already been done, with some success, in the context of working conditions in the textile industry. However, this is labour intensive and might require a strengthening of the Council of Ethics.

2. Create a new expectation paper concerning gender equality
Just as the Fund operates with seven papers communicating clear expectations from the companies they invest in today, one can make a document on gender equality. If this is done, gender equality and women's rights should also be part of the annual report.

3. Integrate gender equality in position papers on good corporate governance
One way in which the Fund performs its active ownership is through considering who should sit on company boards. Extensive research document a positive link between equality on company boards, their profitability and lowered exposure to risk. The Oil fund's position papers on board efficiency and composition is the basis of its voting behavior and dialogue with the boards, but gender equality is not mentioned here either. This is an opportunity for the Fund to promote gender equality on boards of directors.

The Oil fund's tool box is already well equipped, and by strengthening one or more of these tools we can make a significant impact to global gender equality. That is in everyone's interest.



THE OIL FUND AND GENDER EQUALITY

1. The investment case for gender equality

GENDER EQUALITY DRIVES ECONOMIC GROWTH

Despite considerable progress towards closing the gap between male and female education levels in most countries, gender gaps in economic and political participation remain across developed and developing countries. These gender gaps undermine both economic and income growth.

It is particularly clear that increasing women's labour market participation is positively associated with GDP growth. There are a host of different studies – amongst others from the ILO, the WEF, PwC and academic journals – underlining that closing the gender gap in labour market participation will boost GDP.[1]

Women empowerment creates economic growth by increasing the total output of an economy, as the total workforce grows. At the same time, the gender gap restricts the pool of talent available. Closing the gender gap can therefore increase productivity, as talent is allocated more efficiently across the economy. Finally, reducing the gender gap can strengthen economic resilience, as it creates greater diversification in the economy.

For institutional investors with large and diverse portfolios that depend on well-functioning markets and sustainable growth in a host of economies globally, such as the the Norwegian Government's Pension Fund Global, there is a strong case to advocate increased female employment and women empowerment across the companies they own.

GENDER EQUALITY CAN IMPROVE CORPORATE PERFORMANCE

Gender equality is also linked directly to corporate performance. A significant body of literature shows that a more diverse corporate culture can lead to more innovation, creativity and critical thinking, as well as higher productivity and profitability.[2] The argument is that a more diverse workforce ensures both diversification and complementarities in knowledge and skills, which lay the foundation for greater knowledge spillovers between employees.

Gender equality in top management and on the board level is crucial to trigger the positive effects of a gender-inclusive organisation and work-force. Fundamentally, the explanation is that management should reflect the workforce. Similarly, female leaders are also better equipped to serve female markets. Evidence suggests that gender diversity, not least on management and board levels, can lead to increased profitability and improved corporate performance.

An analysis of the link between gender equality and financial performance of 65 of the largest publicly traded companies in the Nordics - represented by the OBX Index and the OMX NORDIC 40 Index - prepared especially for the CARE-Storebrand report Investing in Gender Equality, supports the international research. The analysis finds a correlation between companies with a higher share of women on the board of directors and higher revenue and equity growth, higher profit margins, higher return on equity and less volatility.

Similarly, the analysis finds a correlation between companies with a higher share of women in top management and higher profit margins, higher return on equity and less volatile, but slower growth. The analysis indicates that female representation leads to more responsible business practices, and that companies with more women in top management generate steady profits and financial returns with a lower risk of negative events that result in equity fluctuations and financial losses.

Three beneficial economic outcomes of closing the gender gap:

1. Increased total output of the economy

2. Increased productivity

3. Strengthened economic resilience

2. How to invest in gender equality?

The academic and corporate research indicating a positive link between gender equality and performance has not gone unnoticed in the investor community. In relation to the CARE-Storebrand report, interviews were conducted with investment professionals from Storebrand, the Skagen Funds and FSN Capital. While all agree that gender equality is good in its own right, the motivation for considering diversity or gender equality in portfolio management is primarily driven by the pursuit of profit. The report identifies two main approaches to investing in gender diversity.

The first approach revolves around screening companies based on internal measures of gender equality. Put differently, the first approach is based on the expectation that companies perform better when they are more diverse. It involves analyzing the internal conditions and processes related to gender equality in a company, such as gender balance at different management levels, recruitment or diversity strategies, and policies for equal compensation.

The second approach entails favouring companies that provide products or services that promote gender equality and women empowerment in exposed markets. Investors actively pick companies whose products and services contribute to empowering women and advancing gender equality, in light of the market potential.

Most importantly, however, the report concludes by way of three recommendations to investors:

1. Consider which investment approach to gender equality best complements your current investment strategy.
2. Integrate relevant gender equality indicators into the investment process
3. Employ active ownership. Push your portfolio companies on gender issues, for example by demanding data on gender balance and gender pay gaps, or require policies and activities to improve the gender balance.

"The motivation for considering diversity or gender equality in portfolio management is primarily driven by the pursuit of profit."

These recommendations, and the insights and findings from the CARE-Storebrand report form the basis for our recommendations to the Government's Pension Fund Global.

3. Investing responsibly

The Government Pension Fund Global (henceforth referred to as the Fund) is one of the largest funds in the world, owning a small stake in more than 9 000 companies worldwide spanning most sectors of the economy. Investments are spread across most markets and 73 countries. The diverse portfolio of stocks, bonds, real estate and income from lending reduces the risk of the Fund losing money.

The Government Pension Fund Global has a long investment horizon due to its mission of safeguarding and building financial wealth for future generations. The objective of the Fund's management is the highest possible return with moderate risk. As Norges Bank Investment Management (NBIM), which manages the Fund, notes, the Fund's long-term return depends on sustainable growth and development, well-functioning markets and good corporate governance.[3] The Fund seeks to improve long-term economic performance of its investments, and reduce financial risks emanating from environmental and social practices of the companies it invests in, by considering governance and sustainability issues that could have an impact on performance.

Considering the comprehensive evidence referred to above, CARE believes that gender equality is a natural factor to consider in the Fund's responsible investment approach. As noted by NBIM's CEO, companies' activities have a considerable impact on society and the world around them.[4] This also holds true for gender equality and women's labour market participation, which has been shown to affect the growth of markets as a whole. Given the Fund's diverse portfolio and size, the macroeconomic argument of increasing labour market participation is particularly salient. Moreover, gender equality is a sustainability issue that both academic research, corporate and investor insight maintain will influence the profitability of the companies positively.

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The Fund fundamentally has three means to exercise responsible investment: establishing principles, exercising ownership and investing sustainably. Gender equality can be integrated into all of them in a way that will bolster the Fund's responsible investment approach and its evaluation of governance and sustainability issues, without affecting the Fund's investment strategy. Evidence in fact suggests that including gender equality in ownership and investment can benefit the Fund's objective of securing the highest possible return with moderate risk.

PRINCIPLES

In addition to adhering and contributing to internationally agreed standards from inter alia the UN and OECD, the Fund formulates its own expectations of companies in so-called expectation documents. As of today, the Fund has published seven clear expectations of the companies in their portfolio, which according to NBIM all largely coincide with the UN Sustainable Development Goals (SDG). The expectations are related to:

1. Children's rights
2. Climate change
3. Water management
4. Human rights
5. Tax and transparency
6. Anti-corruption
7. Ocean sustainability

The purpose of the expectations is to set out how the Fund expects companies to address global challenges in their activities. However, Sustainable Development Goal 5: Gender Equality, is not covered by any of the seven expectations. As previously mentioned, gender equality is a performance indicator for a healthy economy - both on a corporate and national level. It is a key global challenge with ramifications for all other sustainable development goals.[6] As demonstrated in the report Investing in Gender Equality, academic research clearly shows that women empowerment and economic development are closely related and influence each other.[7]

In 2018, the Fund also published position papers on selected corporate governance issues. The position papers inform the Fund's voting on board candidates and dialogue with company boards. An important premise of these papers is to make boards effective and contribute to better governance. Currently, there are position papers on the subjects of industry expertise on the board, time commitment of board members and separation of chairperson and CEO. There is a considerable body of research, amongst others referred to in the CARE-Storebrand report, that shows a positive correlation between gender balance on the board of directors and the company's profitability as well as moderate risk.

Moreover, improving the gender balance on the board level is a long-standing policy objective in Norway. In 2006, the Norwegian government introduced quota legislation that required both public and state owned companies to have 40% female board representation by 2008, where failure to comply resulted in fines or company closures. Given Norway's position on the importance of gender balance on the Board, as well as the conclusive results from already existing research, it would be natural to consider either including gender equality in the current position papers, or dedicate a new one to the issue.

EXERCISING OWNERSHIP

Voting is one of the most important tools the Fund has to exercise its ownership. Internationally recognised standards, the Fund's expectations and positions serve as the foundation for its voting decisions.

The Fund aims to vote at all general meetings. As a large, long-term investor, the Fund also engages directly with individual companies' board and management on a regular basis. In line with its expectations, the Fund especially highlights climate change, water, children's rights, human rights, anti-corruption, tax and ocean sustainability as relevant issue areas for the companies' board of directors.

If gender equality is recognised as a key means to contribute positively to both sustainable economic development and corporate profitability, both the expectations and positions should be revised to incorporate gender equality so as to improve the safeguard of the Fund's assets. It is crucial that gender equality is on the board's agenda, and that the board has targets for equality in the company. If a board of directors is concerned with gender equality, they will challenge a company that performs poorly to do something about it.

Each additional woman in a senior position or to the board, could yield a 3% - 8% increase in profitability.

IMF: Gender Diversity and Firm Performance: Evidence from Europe

INVESTING SUSTAINABILITY

Responsible investment is "an integral part of the Fund's investment strategy". The Fund assesses sustainability issues as part of its risk management and investment decisions.[8] Similarly, the Fund also aims to use sustainability data to identify long-term investment opportunities.

Closing the gender gap in labour market participation has many positive outcomes. Gender equality creates economic growth by increasing the total output of an economy, as the total workforce grows. In addition, a gender gap restricts the pool of talent available and closing the gender gap can therefore increase productivity, as talent is allocated more efficiently across the economy. Finally, reducing the gender gap can strengthen economic resilience, as it creates greater diversification in the economy.

On a corporate level, closing the gender gap may lead to both higher productivity and performance, in addition to more critical thinking. This is achieved partly due to diversification and complementarities in knowledge and skills, which lay the foundation for greater knowledge spillovers between employees, as well as more critical and creative thinking. A gender equal organization often has a strong culture, which has been shown to affect a company's long term performance by making the workplace more innovative, enjoyable and motivating. On the other hand, a complete lack of diversity and gender balance may constitute a significant risk factor for a company's long-term performance.

Consequently, the Fund should consider gender equality issues and information as part of its risk assessments and sustainability disclosures. It may for example be covered as part of country and sector analysis of labour conditions and human rights, as the Council of Ethics successfully did in its studies of textile manufacturers. Moreover, as illustrated by the discussion of investing in "solution" companies that provide products or services that advance gender equality[8], gender equality can be used as an indicator to identify long-term investment opportunities.

Lastly, there are sectors and companies the Fund does not invest in for sustainability reasons in order to reduce exposure to "unacceptable risks". The Norwegian Ministry of Finance has established ethical guidelines for observation and exclusion of companies from the Fund. As of today the the exclusion guidelines can be split into two categories:

1. **Product-based exclusion or observation:** Companies that produce weapons that violate fundamental humanitarian principles, tobacco or sell weapons or military material to states that are subject to investment restrictions. Observation and exclusion can also be applied to mining and energy companies where a significant part of revenues or operations are based on coal.

2. **Conduct-based exclusion or observation:** Companies with an unacceptable risk of serious or systematic human rights violations, violations of the rights of individuals in situations of war or conflict, severe environmental damage, acts that lead to unacceptable greenhouse gas emissions, gross corruption or other particularly serious violations of fundamental ethical norms.

It is important that the Council of Ethics, which evaluates whether or not the Fund's investment is inconsistent with the ethical guidelines, considers gender equality. However, CARE does not recommend that this should be from a human rights and developmental perspective, rather than a corporate performance one.

As mentioned in the report *Investing in Gender Equality*, a potential challenge of the investment approach of screening companies based on internal, corporate measures of gender equality - such as the share of women in management positions or equal pay - is that it would exclude the majority of companies in large geographies, and a host of emerging economies. Both due to systemic gender gaps in the relevant markets, and the lack of corporate data on gender equality indicators in many markets. Instead, the Council of Ethics can consider exclusion or observation due serious or systematic violations of women's rights as part of the existing human rights criteria, as it already does.

4. How to include gender equality in NBIM's responsible investment approach

The overarching goal of the Government Pension Fund Global is to achieve the highest possible return with moderate risk. Therefore, the Fund considers governance and sustainability issues when investing in companies. The Fund's responsible investment and long-term management of its assets would be further strengthened by introducing a more explicit concern with gender equality in the Fund's investment management.

CARE believes the Fund would benefit from evaluating the extent to which gender equality is considered adequately in the portfolio management, and as a factor in responsible investment. Gender equality should inform both the enactment of the ethical guidelines, and the other measures for responsible investment. CARE is of the opinion that gender equality best can be integrated into the Fund's portfolio management through exercising ownership and ethical assessments of companies. This could be done effectively by implementing the following three concrete measures:

1. FOLLOW-UP OF THE GOVERNMENT PENSION FUND GLOBAL'S ETHICAL GUIDELINES

Observation or exclusion on the basis of violations of women's rights can be safeguarded and effected as part of the human rights criterion in the guidelines. CARE believes there is no need to change today's guidelines to safeguard the rights of women, but it requires sufficient resources to uncover serious or systematic violations of relevant norms. The Council of Ethics' studies of textile manufacturers show that it is possible to improve women's working conditions through the Fund's work. Such studies are highly effective, but require considerable resources on part of the Council of Ethics. A strengthening of the Council on Ethics may therefore be necessary.

2. CREATE A NEW EXPECTATION PAPER CONCERNING GENDER EQUALITY

As of today, the Fund has published seven clear expectations of the companies in their portfolio, which all largely coincide with the UN Sustainable Development Goals. Gender equality is however not covered by any of these expectations. SDG 5 is not only important in itself, but is also a prerequisite for achieving other sustainable development goals. CARE believes one should consider establishing a new expectation paper on gender equality. Additionally, gender equality and women's rights should be discussed in the Fund's annual reports.

3. INTEGRATE GENDER EQUALITY IN THE POSITION PAPERS ON GOOD CORPORATE GOVERNANCE

As part of its active ownership exercise, the Fund considers, among other things, who should sit on company boards. There is a considerable amount of research that shows a positive relationship between gender balance in boards and the companies' profitability and risk management. The position papers on the board's efficiency and composition form the basis for voting and dialogue with the companies' boards. Today, gender equality is not addressed, although there has been a long-standing goal in Norway to improve the gender balance in Norwegian corporate boards. CARE believes that the Fund's active ownership relating to board composition should be used to promote gender equality on boards of directors.

RECOMMENDATIONS

1. Strenghtening the Council of Ethics to follow up excisting ethical guidelines
2. Create a new xceptation paper concerning gender equality and include women's rights in the Fund's annual reports.
3. Improve gender in companies' boards through the Fund's active ownership

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About CARE

Founded in 1945, CARE is a leading humanitarian organization fighting global poverty and providing lifesaving assistance in emergencies. In 100 countries around the world, CARE places special focus on working alongside poor girls and women because, equipped with the proper resources, they have the power to help lift whole families and entire communities out of poverty.

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