Compete to Win: Diversity, Equity and Inclusion in the Financial Sector

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Sarah Hammer, Esq.[1]

One of the most devastating consequences of the COVID-19 pandemic is the extent to which it has exacerbated economic, racial, and gender inequality. Prior to the onset of the pandemic, racial minorities faced lower levels of income and wealth, higher unemployment, and greater food and housing insecurity, leaving them more vulnerable to the COVID-19 crisis.[2] Similarly, fewer women were employed, but those that were suffered lower earnings than men (the “gender wage gap”),[3] and held a higher percentage of service positions (often low paid and without paid leave and health benefits), making their jobs more susceptible to pandemic-related restrictions.[4] Worse, long standing systemic health inequities put many people from racial and ethnic minority groups at increased risk of getting sick and dying from COVID-19.[5]

These disparities were intensified by the pandemic. The U.S. unemployment rate peaked in April 2020 at an unprecedented level of 14.7%, a level not seen since data collection began in 1948, before declining to a still-elevated level of 6.7% in December.[6] Women, young workers, and racial and ethic minorities were the hardest hit.[7] Women of color have suffered the greatest harm, with data showing that the unemployment rate for Black and Latinx women is 25% and 50% higher than the national average, respectively.[8] As the country hopes to move forward with recovering from the pandemic, it should do so with deep consideration of how the crisis has exacerbated economic, racial, and gender inequality. The harms of inequality should be viewed as unacceptable and therefore addressed with urgency and the full force of economic and financial policy.

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[1] Sarah Hammer, Esq., is Managing Director of the Stevens Center for Innovation in Finance at the Wharton School, Senior Director of the Harris Alternative Investments Program at the Wharton School, and Adjunct Professor of Law at the University of Pennsylvania Law School.

[2] Hardy, Bradley L., and Logan, Trevon D., “Racial Economic Inequality Amid the COVID-19 Crisis, The Hamilton Project, 2020-17, August 2020, available at https://www.brookings.edu/wp-content/uploads/2020/08/EA_HardyLogan_LO_8.12.pdf.

[3] See the U.S. Census Bureau, American Community Survey, Median Earnings in the Past 12 Months (in 2018 Inflation-Adjusted Dollars) of Workers by Sex, Table S2002, available at https://data.census.gov/cedsci/table?q=s2002&tid=ACSST1Y2018.S2002.

[4] Raghu, Maya and Tucker, Jasmine, “The Wage Gap Has Made Things Worse for Women on the Front Lines of COVID-19,” National Women’s Law Center, March 30, 2020, available at https://nwlc.org/blog/the-wage-gap-has-made-things-worse-for-women-on-the-front-lines-of-covid-19/.

[5] “Health Equity Considerations and Racial and Ethnic Minority Groups,” Centers for Disease Control and Prevention, July 24, 2020, available at https://www.cdc.gov/coronavirus/2019-ncov/community/health-equity/race-ethnicity.html.

[6] Statistica Research Department, January 12, 2021, available at https://www.statista.com/statistics/273909/seasonally-adjusted-monthly-unemployment-rate-in-the-us/#:~:text=The%20seasonally%2Dadjusted%20national%20unemployment,rate%20was%20at%206.7%20percent.

[7] “Unemployment Rates During the COVID-19 Pandemic: In Brief,” Congressional Research Service, November 6, 2020, available at https://fas.org/sgp/crs/misc/R46554.pdf.

[8] Labor Force Statistics from the Current Population Survey, U.S. Bureau of Labor Statistics, available at https://www.bls.gov/web/empsit/cpsee_e16.htm.

Moving forward from the status quo requires a financial sector that understands diversity and the deep inequalities facing the country. The data on benefits of diversity in business is substantive: Diverse teams are critical for growth, as companies that establish inclusive business cultures and policies are more likely to report increases in creativity and innovation.[9] In turn, studies show that this creativity and innovation may result in ~19% higher revenues.[10] Diverse corporate boards are associated with more effective risk management,[11] fewer financial reporting mistakes,[12] and investment in higher-quality audits.[13] Research even shows that companies that embrace gender diversity on their executive teams are 21% more likely to experience above-average profitability.[14] In sum, diversity is correlated with better business outcomes.

Despite these numbers, the statistics on diversity within the financial services sector are abysmal. Among the CEOs of the ten largest U.S. banks, there are literally no women or people of color.[15] Within the ten largest private equity firm executive leadership teams, they are comprised of less than 10% women or people of color.[16] In venture capital, 65% of firms have zero female partners[17], and only 4% of the entire venture capital industry identifies as African American.[18] Among CEOs of the ten largest investment management firms, there are few women or minorities in the top ranks.[19] Moreover, a review of asset management firm ownership shows that firms with female or minority ownership make up just 1.3% of all industry assets under management, despite the fact that diverse-owned funds perform at a level comparable to that of their non-diverse peers.[20]

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[9] "Women in Business and Management: The Business Case for Change," Global Report of the The International Labour Organization, 2019, available at https://www.ilo.org/global/publications/books/WCMS_700953/lang--en/index.htm.

[10] "How Diverse Leadership Teams Boost Innovation," BCG Henderson Institute Study, January 23, 2018, available at https://www.bcg.com/en-us/publications/2018/how-diverse-leadership-teams-boost-innovation.

[11] Chen, Jie, et. al., "Research: When Women Are on Boards, Male CEOs Are Less Overconfident," *Harvard Business Review*, September 12, 2019, available at https://hbr.org/2019/09/research-when-women-are-on-boards-male-ceos-are-less-overconfident.

[12] Wahid, Aida Sijamic, "The Effects and the Mechanisms of Board Gender Diversity: Evidence from Financial Manipulation," *Journal of Business Ethics*, vol. 159 (2019), at 705-725, available at https://link.springer.com/article/10.1007/s10551-018-3785-6.

[13] Lai, Karen M.Y., et. al., "Board Gender Diversity, Auditor Fees, and Auditor Choice," *Contemporary Accounting Research*, vol. 34, no. 3 (2017): at 1681-1714, available at https://onlinelibrary.wiley.com/doi/10.1111/1911-3846.12313.

[14] "Delivering through diversity," McKinsey Report, January 18, 2018, available at https://www.bcg.com/en-us/publications/2018/how-diverse-leadership-teams-boost-innovation.

[15] Wharton analysis as of January 20, 2021.

[16] Wharton analysis of executive and management committees at the ten largest private equity firms, as of January 25, 2021. *See, also,* "Women in PE: Into the Man Cave," *The Deal*, June 22, 2020, available at https://www.thedeal.com/private-equity/women-struggle-climbing-private-equity-ladder/.

[17] "More Women Became VC Partners Than Ever Before in 2019 But 65% of Venture Firms Still Have Zero Female Partners," *Medium*, February 7, 2020, available at https://medium.com/allraise/more-women-became-vc-partners-than-ever-before-in-2019-39cc6cb86955.

[18] "Black Venture Capitalists Control Silicon Valley's Quiet Racism," *Bloomberg News*, August 24, 2020, citing a 2018 study by the National Venture Capital Association, available at https://www.fa-mag.com/news/black-venture-capitalists-confront-silicon-valley-s-quiet-racism-57617.html?print#:~:text=The%20U.S.%20population%20is%2013,investments%2C%20are%20African%2DAmerican.

[19] Wharton analysis as of January 20, 2021.

[20] "Diversifying Investments: A Study of Ownership Diversity and Performance in the Asset Management Industry," The Knight Foundation, January 28, 2019, available at https://knightfoundation.org/reports/diversifying-investments-a-study-of-ownership-diversity-and-performance-in-the-asset-management-industry/.

To address diversity in financial services, firms should adopt the same rigorous and competitive approach that they do in their businesses. *They must compete to win.* Here, winning means not just meeting, but exceeding, the challenges of increasing diverse representation at all levels of financial services and strengthening a culture of inclusion for all people. To use an investing metaphor, the financial sector vastly "underperforms" at diversity because it suffers from deep neglect and has not been aggressively measured and managed.[21] The financial sector would never accept underperformance in investments, and it must not accept it in their approach to diversity, either. Therefore, as with investment performance, the industry must select the most impactful diversity metrics, measure them, and hold itself accountable.[22]

Improving diversity is not just about investment firms, it is also about nurturing the ecosystem of the financial sector. This includes cultivating the next generation of diverse leaders, particularly in majority Black and Latinx high schools that are lacking in STEM curriculum,[23] and addressing the significant youth gender gap in STEM.[24] It also includes advancing diversity in the pool of math, finance, and economics professors that our college and graduate students learn from.[25] Diversity should also be championed in the policymakers and regulators who are responsible for overseeing corporate governance, promoting financial inclusion, protecting investors, and supporting access to capital.[27] And, to be sure, cultivating a diverse ecosystem is not just about gender and race — it's also about disability, socioeconomic status, veterans, sexual orientation, and more.

In launching our initiative on diversity and inclusion at the Harris Program at the Wharton School, we have received an outpouring of support from senior leaders and policymakers from across the financial services industry. These stakeholders have offered their time, expertise and resources to support diversity efforts. Now it is time for the entire industry to mobilize these assets with fierce intention. It should adopt a rigorous and competitive approach that employs impactful diversity metrics, measurement, and accountability. The industry should also nurture diversity in the ecosystem of the financial sector, including in high schools, colleges, and graduate schools. By taking these approaches, and harnessing the full capabilities of the sector, the financial services industry can advance diversity, equity and inclusion.

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[21] *See, for example,* U.S. House Committee on Financial Services, "Diversity and Inclusion: Holding America's Large Banks Accountable," February 2020, available at https://financialservices.house.gov/issues/diversity-and-inclusion-holding-america-s-large-banks-accountable.htm#workforce%20diversity.

[22] *See, for example,* U.S. House Committee on Financial Services, "Diversity and Inclusion: Holding America's Large Banks Accountable," February 2020, available at https://financialservices.house.gov/issues/diversity-and-inclusion-holding-america-s-large-banks-accountable.htm#workforce%20diversity. The House Report found that banks boards are not diverse, banks senior employees are not diverse, and banks have limited spending and investments with diverse firms. The House Report called for banks to share diversity and inclusion data with regulators and the public. This article suggests that the call for diversity and inclusion data be applied to the entire financial sector, not just banks.

[23] "Students of Color Are Missing Out On STEM Opportunities, So The Planet Is Missing Out On Their Brilliance," *Forbes*, September 24, 2020, available at https://www.forbes.com/sites/taliamilgromelcott/2020/09/24/students-of-color-are-missing-out-on-stem-opportunities-so-the-planet-is-missing-out-on-their-brilliance-heres-how-we-finally-achieve-equity-in-high-school-stem/?sh=112959a05148.

[24] "Gender gaps in STEM college majors emerge in high school," *Cornell Chronicle*, July 1, 2020, available at https://news.cornell.edu/stories/2020/07/gender-gaps-stem-college-majors-emerge-high-school.

[25] Davis, Leslie and Fry, Richard, " College faculty have become more racially and ethnically diverse, but remain far less so than students," Pew Research Center, July 31, 2019, available at https://www.pewresearch.org/fact-tank/2019/07/31/us-college-faculty-student-diversity/.

[27] *See, for example,* Brummer, Chris. "What do the data reveal about (the absence of Black) financial regulators?" Brookings Economic Studies Working Paper, September 2020, available at https://www.brookings.edu/wp-content/uploads/2020/09/ES-09.02.20-Brummer.pdf.