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RADICAL ACTIONS THOUGHT PAPER SERIES

Updating the business case for diversity

In our [introduction](#) to New Financial's *Radical Actions* thought paper series, we set out our case for the need for radical action to drive a step change in diversity to a new equilibrium. This paper explores one of our proposed actions: a rethink, update and expansion of how the business case for diversity is framed and discussed. For the purposes of this paper, we use the term 'business case' to mean the strategic reasons why a firm should engage with the diversity and inclusion agenda.

Over the past two years, the D&I landscape has shifted significantly, with increased reporting requirements, both voluntary (for example, HM Treasury Women in Finance Charter) and compulsory (for example, gender pay gap reporting); greater accountability around diversity to more stakeholders, including government, regulators, clients, investors, staff and society; and diversity being pulled into the matrix of business functions rather than sitting in an HR silo. These pressures have catapulted the diversity discussion onto the C-suite agenda and are not going away any time soon.

This changing stakeholder context around diversity has brought more people into the diversity discussion than ever before. The more stakeholders that are brought into the diversity conversation, the more the business case needs to be tailored. Newcomers – and indeed the old timers – need to understand why diversity should matter to them. The time is right for a reappraisal of the business case driving firms to build more diverse and inclusive workplaces.

Here we examine the evolution of the business case for diversity, how the business case needs to be adapted to speak to different audiences and business lines, and how it can be applied more effectively to drive and embed sustainable change.

In this paper, we ask:

- How is the business case for diversity currently framed? Is it fit for purpose?
- Is the financial services sector over-reliant on research linking diverse boards with increased financial performance? What are the unintended consequences of this focus?
- How can the business case be applied more effectively?
- Where next for the business case?

We are posing more questions than we answer in this paper. But we have seen first-hand how the act of challenging the received wisdom about the business case can alter an individual's perspective and drive change – particularly in the financial services industry, which is all about the numbers.

This paper in summary

Here are our top five takeaways:

1. **Untapped potential:** The business case for diversity is a powerful tool in a firm's armoury to embed sustainable change – but all too often, it is not being used effectively. The over reliance on some aspects of the business case and under-use of others results in firms failing to recognise how powerful it can be to build a high level mandate, unlock resources and strengthen the governance and accountability framework that is crucial to achieving diversity goals.

2. **Constantly evolving:** The business case has expanded considerably as the sector's understanding of the benefits diversity brings has matured, and it continues to develop. We need to keep assessing the relevance and effectiveness of well-rehearsed arguments – are they convincing the unconvinced?
3. **Expanding a narrow focus:** The sector is too reliant on the link to financial performance. Although effective initially to pull cynics into the conversation, there are both upsides and downsides to this argument. What happens if future research shows a link between diverse hiring and a financial downturn? Yes, diverse teams may result in higher financial performance, but this presupposes that anything or anyone that delivers performance is positive, including a bully or excessive risk taker. Beware the consequences of bold statements – both positive and negative.
4. **Link to strategy:** The business case needs to be adapted to the specific context in which it is being applied or it will be too generic to impact change. It is too easy for business case discussions to remain at the theoretical level; the focus needs to remain on the *impact* the business case makes. People need to see the link with demonstrable behaviour change to believe a firm is genuinely committed to building a diverse and inclusive organisation
5. **Different audience, different owner:** It's time for the business case to be adapted to speak to different audiences in different areas of the business. Thus far, the business case has remained too high level and not broken down in a way that can make diversity drivers relevant for different audiences and business units. Who presents it and talks to it also needs to change. The business case needs to be made from the dominant group rather than being an 'ask' from under-represented groups. And it needs to come from (or at least be in partnership with) business, rather than originating with D&I/HR teams or passionate individuals.

The common themes of today's business case for diversity

Our [Diversity from an Investor's Perspective](#) research surveyed why asset owners (the big pensions schemes that provide an essential source of capital to the financial services industry) are acting on diversity, but the findings resonate widely across business. The five most common reasons are:

- 1) **To improve decision-making:** While some mention this in the context of the board room, others focus on how diverse perspectives can help to challenge group think and lead to better outcomes throughout their activities. The link between diversity of thought and good conduct is particularly relevant to the highly-regulated financial services sector, and both the [Financial Conduct Authority](#) and [Bank of England](#) have become increasingly vocal about it. Creating a culture where it is safe for people to speak up and break through group think helps firms make more informed and less risky decisions.
- 2) **To attract and retain talent:** As raised by the [Financial Services Skills Taskforce](#), there is a talent challenge looming for the financial services sector. It is no longer as attractive or exciting as it once was – for example data shows that there has been a decrease in the number of MBA graduates entering financial services firms and a lower number of applications for graduate vacancies. A report from [KPMG](#) in April 2019 also showed that the sector faces perception issues due to its reputation and lack of social mobility. Companies are having to think hard about how to attract new entrants to the sector and retain the people they already have. Firms should also be keeping abreast of demographic societal changes to prepare for the workforce of the future i.e. falling fertility rates, increasing number of employees with caring responsibilities, skills gaps, increasing automation and a rapidly ageing workforce.
- 3) **To innovate and compete:** New ways of thinking are essential to drive innovation that will improve the consumer experience and secure competitive advantage. As research by the [Boston Consulting Group](#) shows, increasing the diversity of leadership teams leads to more and better innovation. People with different perspectives view problems in different ways which can help reach new markets, differentiate products by audience, win new clients and move into different jurisdictions.

4) To reflect clients and communities: Both the workforce and client base is changing, and firms need to reflect these changes or risk irrelevance. For example, LGBT customers are among the most loyal according to the [World Economic Forum](#); disabled customers have a combined spending power of around [£80 billion](#), and between 2010 and 2015, private wealth held by women grew from [\\$34trn to \\$51trn](#). The stakeholder context is also changing. Contributing to community is an increasingly important factor in the financial services industry's ability to retain its social license to operate, and technology is enabling customers to more easily switch from manufacturers service providers that do not share their values.

5) To enhance financial performance: And of course, there is research to suggest that diversity yields higher returns. The gold standard research from [McKinsey](#) shows that companies with gender and ethnic diversity in leadership earn profits a third higher than less-diverse companies on average, reinforced by [Credit Suisse](#)'s research findings that companies with one or more women on the board delivered higher average returns on equity, lower gearing, better average growth and higher price/book value multiples.

Quantifying the impact of diversity in terms of performance has been transformative for business. When the research was first published, there was a step-change in the engagement of senior leaders. There is no doubt that it was instrumental in positioning diversity as a bottom -line business issue and significantly helped overcome inertia (which we know is considerable in the financial services sector).

For the asset owners in our research sample, the business case based on performance is very clear and it is broader than the McKinsey/Credit Suisse baseline. For example, Scott Stringer, the New York City Comptroller whose office oversees the city's \$200bn pension system said: "Diversity is a fiduciary duty... It has strong economic value for our investments. We want the companies in which we invest to harness the economic and financial benefits of diversity."

These five reasons above are not mutually exclusive; rather they overlap and reinforce one another, and they might be prioritised differently at different times. Underlying these five reasons is the moral, social justice argument that improving diversity is the right thing to do, and the sustainability perspective that diversity helps an organisation grow and become more resilient and adaptable.

Our *Diversity from an Investor's Perspective* research found that for asset owners globally, their own understanding of why diversity is important is improving, their motivations are becoming more nuanced, and discussion is evolving from representational diversity to culture and inclusion and the need for a broader cultural shift. This change in thinking from the financial services industry's most important client segment (that is, asset owners) is itself a reason to update the business case for diversity.

So what's the problem?

On paper, the business case looks sound. It covers a range of pertinent firm-wide issues (people, clients, decision-making process) and ultimately the research shows it leads to enhanced financial performance. So why has progress remained so slow? Why is the financial services sector not attracting and retaining more people from under-represented groups and when it does, why are they not visible at the top levels?

The financial performance paradox: It is to be expected that the business world – and particularly the financial services sector – should focus on diversity as a means to enhance performance. Of the five reasons above, the financial performance argument is the most clearly captured in numbers, which is the language of senior decision-makers across the industry.

But, New Financial is concerned that there is a very narrow and linear perception of the business case for diversity. The default is still the [McKinsey](#) and [Credit Suisse](#) research correlating increased diversity with financial performance – many articles, speeches and blogs mention one or other, usually within the first three paragraphs. This is robust, helpful research, and we are not questioning the soundness of the methodologies. Our point is that relying too heavily on the financial performance argument has its downsides. Have we ever considered the (unintended) consequences of this message that diversity delivers outperformance?

- **Higher bar for women and individuals of diverse backgrounds:** As discussed in our [Diversity from an Investor's Perspective](#) research, many among the unconvinced want to see hard data that using diverse fund managers will yield an uptick in returns. The business case is focused on arguing diversity delivers improvement, rather than providing evidence that appointing diverse managers does not compromise performance. If firms will only act if they feel they stand to make a gain, the result is a higher bar for diverse hires compared to the mainstream. While the data is presented in aggregate, its findings are interpreted and applied at an individual level, which in turn feeds a mindset that expects outperformance of diverse colleagues. This results in higher expectations of what people from under-represented groups can deliver and a lower tolerance of failure.
- **What goes up can come down:** What would happen if the numbers flatline over a time period, or even reverse? Should companies then halt attempts to improve diversity across their workforces? Should they fire all women and people of diverse backgrounds in order to continue to maximise performance? Because that would be a natural consequence of sticking rigidly to the financial performance argument.
- **Anything goes:** The narrow focus on the supremacy of performance contributes to a tolerance (or indeed the promotion) of any behaviours that deliver performance, including bullying, harassment, and excessive risk-taking. Are we really advocating that anything that delivers outperformance is desirable?

What's in a name: On the one hand, calling the reasons to tackle diversity “the business case” contributes to a narrow, bottom-line based argument. We are not yet able to capture all the different ways diversity can enhance performance. We know companies’ ability to measure diversity is still limited. There just isn’t data to back up the wider reasons (1-4 in the list of reasons on p2 above) so everything ends up sitting with 5 (financial performance). But on the other hand, presenting a business case for diversity means that it is approached in the same way as any other strategic opportunity on the C-suite’s agenda – starting with developing an idea, generating senior buy-in, understanding the risk tolerance for success and failure, and getting adequate resource and investment in place.

The who: Traditionally, the people / roles that are making the business case tend to sit with the D&I function and/or with passionate individuals from under-represented groups. We are demanding that those on the outside make their case to be included, yet we never demand that those on the inside justify their right to exclude. Why should diverse groups have to prove their worth unlike their mainstream counterparts?

A top table discussion: Up to now the business case has been targeted at senior leaders. This is understandable, especially for firms who are only just beginning to think about diversity. Some firms we spoke to said that their top team ‘get’ the business case and are moving onto the how to make it stick throughout the organisation. We found that many firms are grappling with the challenge of engaging their middle managers, but little thinking has been done to build a business case that speaks specifically to them. The more stakeholders that are brought into the diversity conversation (and this is precisely what is happening now), the more the business case needs to be tailored.

A philosophical approach: In the same way that the business case needs to be adapted to difference audiences, it can only have impact if it is linked to the strategic direction of the firm in which it is being applied. If the business case remains too generic, diversity won’t gain traction or result in demonstrable action. Firms can spend too much time in the theoretical realm without moving to the next stage of translating those benefits into action.

The relentless Sisyphean quest for incontrovertible proof: A big chunk of the diversity headspace of senior management and those responsible for the D&I agenda still gets eaten up on “show me evidence that diversity delivers improvement” in order to make change. D&I and HR teams are forever being asked for data that sets out incontrovertible proof of the benefits for diversity, but that dataset can never truly exist. We will never have a counterfactual unless there is a mirror image planet out there where business has been dominated by women or some other beings for 500 years. Why is this counterfactual required

when there is no empirical evidence that (white) men dominating the upper echelons of business and society for 500 years is optimal? There is a philosophical fallacy sitting at the heart of this unremitting quest for empirical evidence. Is the pursuit of the holy grail of proof holding the industry back from fully developing its understanding of the benefits of diversity, and quantifying those benefits?

What then must change?

The business case is just another lever that firms can pull to make change happen along with a host of other interventions such as collecting diversity data, designing specific programmes and removing bias from policies and processes. So how can the industry use the business case more effectively?

Update it regularly: All too often, firms create the business case for diversity at the beginning of a programme, or 3-5 year strategic plan, or when a new D&I lead joins the firm, and then it is quickly forgotten or becomes a boilerplate slide in D&I presentations. Used smartly, updated regularly and applied in a business-like way, the business case can drive change by feeding into accountability frameworks rather than gathering dust in the D&I armoury.

Make it strategic: Ultimately, firms should have a clear view of why diversity is important in their specific context. Tailoring the generic business case brings to life the benefits of diversity making it relevant to senior leaders who are accountable for progress in their areas. For example, [EY's internal research](#) showed that diverse teams yielded higher revenue growth than less diverse teams. It's one thing to say that diverse teams lead to innovative ideas, quite another to provide a firm-specific example of this in action.

Different audience, different business case: It is up to the D&I function to understand the story data is telling, layer in the different internal and external stakeholder discussions, and then weave these ideas together into coherent messages that are actionable. The drivers for change will vary across an organisation, so the messaging and business case needs to be reframed to suit and motivate each specific audience depending on their business line, their function or level of seniority.

- **External:** The business case mosaic that is most effective will be different for different firms, sectors and locations. For example, reflecting the diversity of society is particularly relevant to retail-focused companies, and public bodies such as regulators and central banks are obliged to reflect the people they serve; design firms might be more driven by the innovation argument. And priorities may change in response changing stakeholder expectations, requiring the business case to be re-positioned. For example, the Financial Reporting Council's [Annual Review of the UK Corporate Governance Code](#) has a strong emphasis on culture, the financial regulators are also developing the link between diversity and culture, and investors are beginning to seek more data on diversity at their investee companies.
- **Internal:** HR and D&I professionals can't embed sustainable change by themselves. But when we're trying to engage different internal stakeholders, have we thought about what will really prompt action? What are the other hooks that might hold more sway for different audiences? What's going to be the trigger for different stakeholders? For example, risk and compliance might respond to the group think and diverse perspectives argument, especially when preparing for regulatory interrogations. Design teams might be more attracted to the link between diverse teams and innovation, and business development teams might be hungry for data on how they can use the D&I platform to engage clients in different ways.

Target the forgotten middle: When firms start thinking seriously about diversity issues, they prioritise their senior teams for face-to-face training and coaching. This makes sense – so much of the D&I agenda is driven from the top that equipping senior leaders to show their commitment is vital. Staff lower down the chain of command then wait for permission and incentives from their leaders to spend time on diversity. But the business case shouldn't be limited to the senior audience. The hooks used to engage senior leaders are different to those that will make diversity meaningful to line managers.

For example, effectively managing diverse teams can take more time than managing people who look, act and come from a similar background to you, especially at first; launching an inclusive recruitment campaign might take more time to find a broader bench of candidates than using a personal network; running a meeting in a more inclusive manner requires preparation, both before a meeting and following up afterwards. There is a real opportunity here to engage middle managers in the diversity, often referred to in derogatory terms such as the “frozen middle”, or the “permafrost”.

So, what arguments really make a difference to this group? Setting a target, reporting against it and creating a link between diversity and pay and/or personal performance objectives is the approach of the HM Treasury Women in Finance Charter, and we can see this is bearing fruit. Managers will find the time to deliver against the priorities set by their bosses and if diversity is one of them, it will happen.

But surely there are other motivators? Have we spent enough – or indeed any – time thinking about what keeps middle managers up at night? Why do they need to deliver diversity in their world and what do they need to make it happen? Could a more diverse team help managers find different ways of reaching a changing client base? Could becoming more confident dealing with tricky conversations (whether that be talking about mental health or menopause) develop team cohesion and relieve pressure in the long term?

Turning words into action: Having a well thought through, firm-specific business case that is adapted to different audiences is not enough. Translating the business case into demonstrable action is crucial. For example, if diversity is positioned as helping recruit and retain much needed talent, what does this look like in practice, and does the data show the impact of such an approach? Is inappropriate behaviour (be it sexist language or shouting at a colleague) challenged, recorded and reprimanded? Are non-diverse shortlists at interview stage sent back or just waived through? If an organisation states that diverse perspectives are central to its motivations for tackling diversity, how are people encouraged to offer differing views to the majority – are they supported or isolated? People will be looking for evidence that the firm is committed and will be closely watching to see what happens to those who do not live the diversity and inclusion principles as stated by the organisation’s business case.

Where next for the business case?

Joining the dots with data: Our recent research [A Forensic Approach to Diversity Data](#) found companies’ ability to measure diversity is underdeveloped, let alone measure the impact of diversity at organisational level or for individuals. But, as we enter the age of big data, this is going to change – and rapidly. Firms are increasingly seeking to measure diversity more systematically and the level of sophistication of diversity data will only grow. For the more advanced organisations, granular diversity data can be linked to a range of performance metrics and contribute towards building the business case for diversity. It can also build on what firms already have, for example modelling the real cost of attrition that is not currently being measured, especially as it becomes more accentuated as firms recruit more people from under-represented groups at entry level.

From organisational to individual: The overriding focus of the current business case for diversity is the benefits diversity brings to organisations. There is little research that centres on the benefits to the individuals working within those organisations. As noted in the Chartered Institute of Personnel and Development’s research [Facing up to the Business Case](#), there is work required to capture the human outcomes to diverse and inclusive working environments and the impact on retention, employee satisfaction and well-being. This approach would begin to fill the intersectionality gap – up to now, research has predominantly focused on individual aspects of identity e.g. age, gender. As data sets grow and our understanding of identity matures, a more holistic approach to the business case will develop, where individual experiences will be captured alongside organisational benefits.

Opportunity cost: We are on the cusp of being able to price the previously unquantifiable i.e. the risk attached to a lack of diversity and the opportunity cost of moving too slowly. This could be the crucial difference between diversity being treated as a nice-to-have and a material financial risk by businesses and investors. As reflected in [The 30% Club Are you missing millions report](#) firms are missing out on huge opportunities by not creating an enterprise approach to factoring gender into key areas of the business.

Only this January, the Financial Reporting Council's Annual review of the UK Corporate Governance Code effectively asks companies to build their business case for diversity based on sound decision making.

Changing the default: D&I professionals are all too familiar with the feeling of being backed into a corner trying to prove again and again why diversity matters in order to get anything done. If the industry wants a different outcome, it has to change its approach, which is what our Radical Actions series is all about. That includes (and this is radical) changing the default position from justification mode of why diversity is important, to instead challenging naysayers to defend the status quo or to prove that diversity has a long-term negative impact. For example, critics often assume setting targets and/or linking a portion of pay to targets creates a perverse incentive. Rather than the D&I function having to prove them wrong, it's time for the cynics to provide hard evidence of the detriment caused by hitting those targets.

Conclusion

While research correlating increased diversity with financial performance has an important role, it is time to update and expand the business case for diversity and inclusion. This doesn't mean that hard numbers are no longer helpful, rather that we need to build a new centre ground – positioning financial performance at one end of the spectrum and the moral imperative at the other is not enough to convince those firms and individuals that aren't already on board that they must work hard reap the benefits of diversity.

The agenda is evolving so quickly that it is hard for traditional research to keep pace. But patchy evidence shouldn't deter us from promoting the benefits of diversity and inclusion. Taking a more holistic approach to the business case will benefit all – the financial services industry as a whole, the organisations within it, individuals and society.

Diversity is not a zero-sum game. It's time to revisit the business case for diversity and use it to drive this agenda forward.

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About New Financial

New Financial is a think tank and forum that believes Europe needs bigger and better capital markets to help drive its recovery and growth. We believe diversity in its broadest sense is not only an essential part of running a sustainable business but fundamental to addressing cultural change.

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