

# Diversity and Inclusion: Evidence on Corporate Performance

Presented by:

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Investment Committee, April 2016

## Overview



**1. Key Benefits of Corporate Diversity and Inclusion**

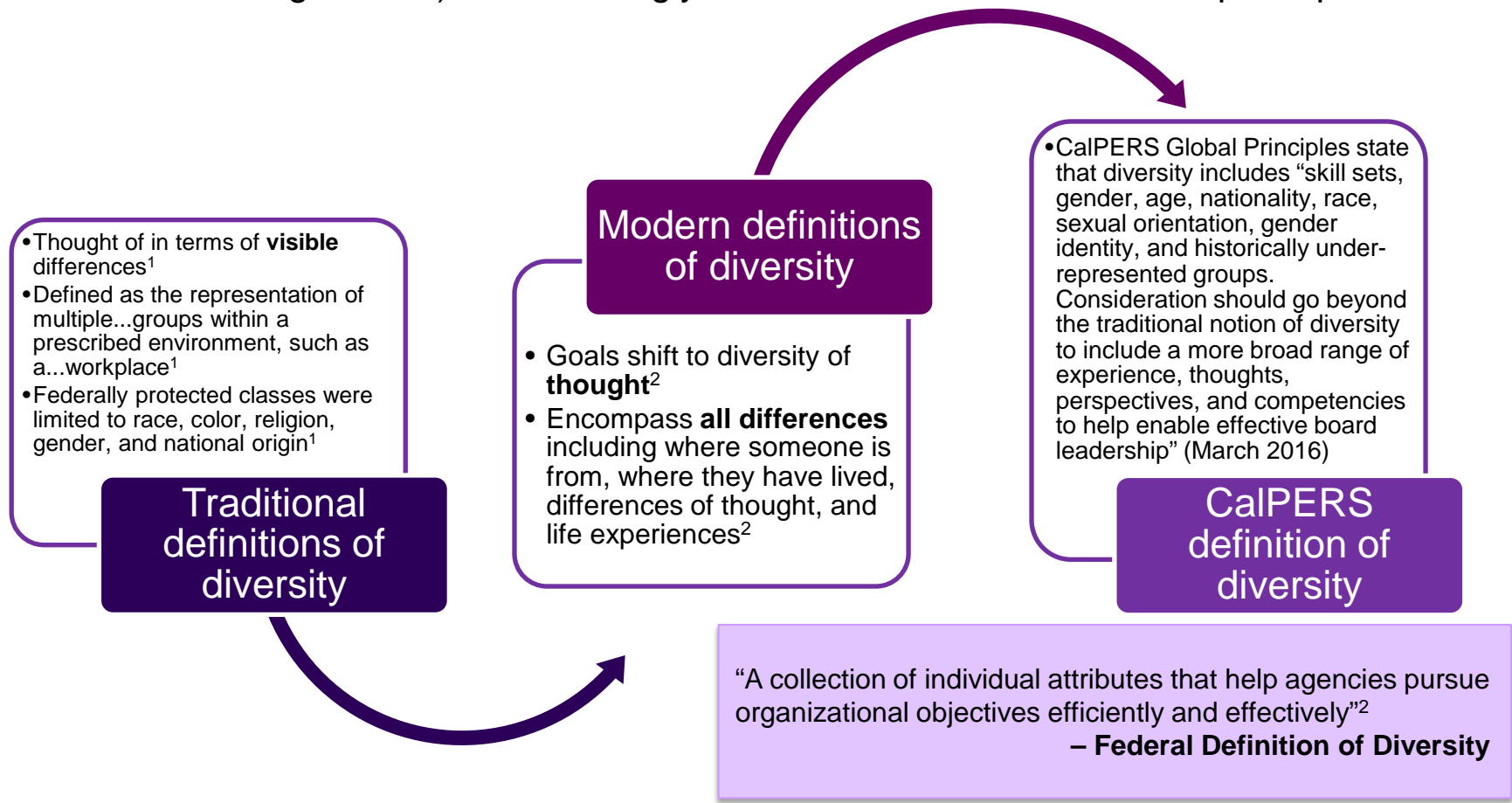
**2. How Corporate Diversity and Inclusion Enhance Business Performance**

**3. The Business Case for Diversity and Inclusion: Data and Analysis**



## Diversity → Inclusion

“Diversity” has evolved over the years from a limited racial and ethnic focus (in response to federal EEO regulations) to increasingly broad definitions based on unique experiences



1. The Evolution of Workplace Diversity, State Bar of Texas, <http://bit.ly/1ZXs1pI>

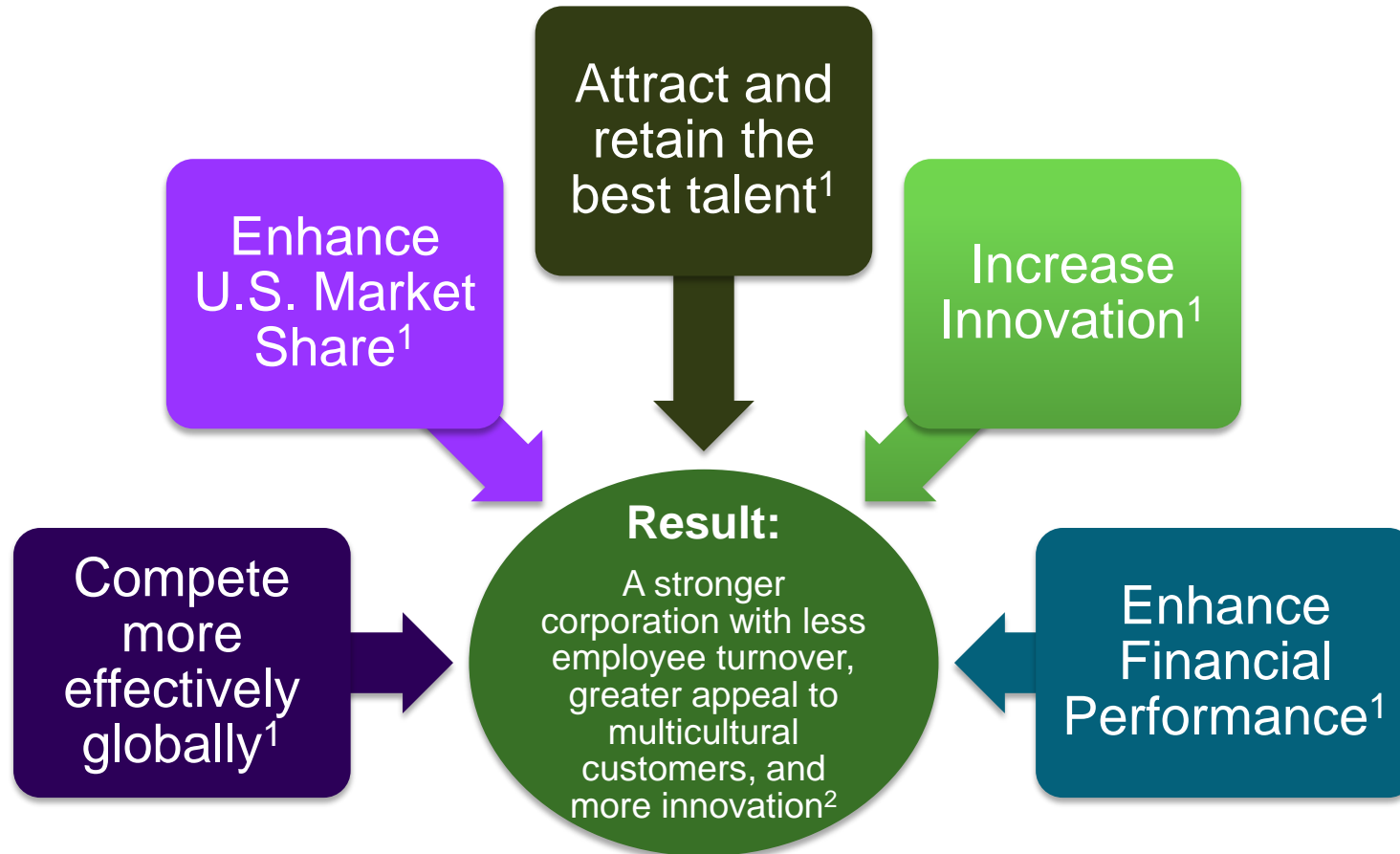
2. Government-Wide Diversity and Inclusion Strategic Plan, U.S. Office of Personnel Management, <http://1.usa.gov/1N4qNBu>

3. CalPERS Investment Committee, Investment Office Diversity and Inclusion, <http://bit.ly/1SLT1im>



# 1. Key Benefits of Corporate Diversity and Inclusion

Having diverse governance and leadership, a diverse workforce, and an inclusive environment have been demonstrated to increase a corporation's ability to:

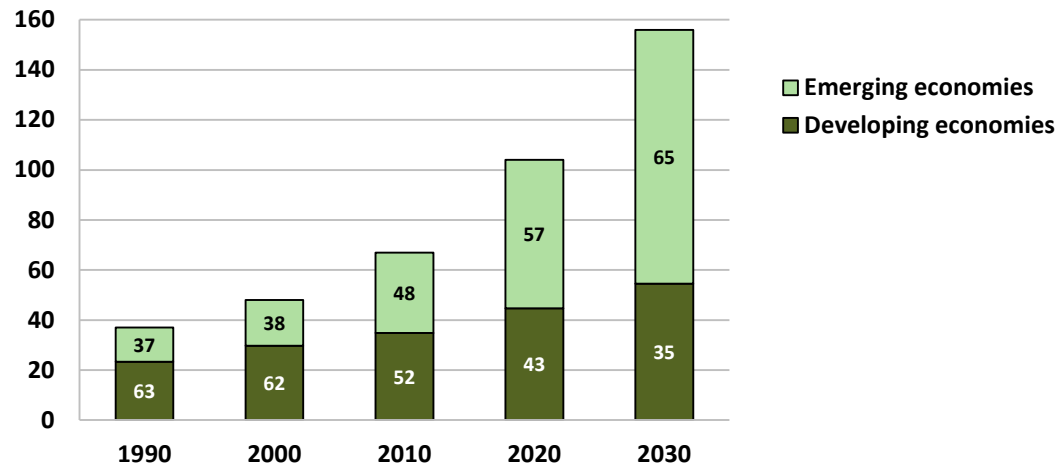


1. Why Diversity Matters, McKinsey & Company  
2. Why Diversity Matters, Catalyst



# U.S. corporations are increasingly relying on global markets.

% of global GDP: emerging economies versus developed economies, 1990-2030<sup>6</sup>  
(US\$ trillion at 2005 prices and purchasing power parity)



## U.S. Corporations are Moving into Global Markets

- Since 2004, 47 corporations have moved their headquarters overseas due to more favorable tax treatment<sup>2</sup>
- In the 2000s, U.S. manufacturing employment experienced a decade of unprecedented loss, shedding 5.8 million jobs<sup>3</sup>

## The Importance of Overseas Revenue

- Large U.S. firms have increasingly followed global growth, with 40% of profit for firms listed in the S&P 500 stock index now coming from overseas<sup>4</sup>
- Foreign exposure allows U.S.-based companies to capitalize on rapid growth in emerging markets like China, India, and Latin America<sup>4</sup>
- China's consumer economy alone is projected to reach \$6.5 trillion by 2020<sup>5</sup>

1. A Spike in Corporate Inversions, Congressional Research Service, <http://1.usa.gov/1tqllkh>  
 2. More companies bail on U.S. for lower taxes, CNN Money, <http://cnnmon.ie/1V38Kn3>  
 3. The Myth of America's Manufacturing Renaissance, ITIF, <http://bit.ly/1ybmiQe>  
 4. Why U.S. Companies Aren't So American Anymore, U.S. News & World Report, <http://bit.ly/25Fhtzy>

4. Why U.S. Companies Aren't So American Anymore, U.S. News & World Report, <http://bit.ly/25Fhtzy>  
 5. 3 great forces changing China's consumer market, World Economic Forum, <http://bit.ly/1RHjphF>  
 6. Managing a Global Workforce, Accenture, <http://bit.ly/1TuvNpN>



## Global Markets Require Multi-cultural Competencies

Competing in global markets requires having talent which can lead and manage multicultural teams and appeal to diverse customers



Global Cross-Cultural Competence

Executing a global strategy requires diverse teams capable of executing a business plan in a multicultural environment<sup>1</sup>

Firms require leadership with “Global Literacy”: team members with insights and sensitivities into multicultural customers and peers<sup>2</sup>

Diverse teams have been proven to be extremely effective in global markets<sup>3</sup>

*“Our mission is to continue to become better educated and increase our **competency in understanding the nuances of how we care for a **diverse population.**”<sup>4</sup>***

Bernard Tyson  
Incoming Chairman and CEO,  
Kaiser Permanente

1. Multicultural Leadership Starts from Within, Harvard Business Review, <http://bit.ly/1UOhnSV>  
2. The Development of Multicultural Competencies, Sage Press, <http://bit.ly/1N4rGKz>  
3. Diversity Management Is the Key to Growth: Make It Authentic, Forbes, <http://onforb.es/1RZZF84>  
4. CEOs Who are Diversity Champions, DiversityInc, <http://bit.ly/1Y9yEDF>

## Enhanced U.S. Market Share

The business need for diversity is evident in the rapidly changing demographic profile of the United States as well as the continuing rise in purchasing power of women and various ethnic / racial groups

### Overall Demographics are Changing

- The Pew Research Center recently released an extensive study on the shifting demographics of race in the United States, showing that within a century (from 1960 to 2060), Hispanic and Black Americans will, together, comprise 45% of the 2060 population<sup>1</sup>

### Minority Spending Power Continues to Grow

- The Nielsen Company reported 92% of the total growth in US population from 2000-2014, came from multicultural consumers<sup>2</sup>
- According to a report from UGA's Selig Center, the national buying power of African Americans is currently \$1.1 trillion and will rise to \$1.4 trillion in 2019<sup>3</sup>
- The buying power of Hispanics will be \$1.7 trillion by 2019 and will account for 10.6% of U.S. buying power<sup>3</sup>

### The Nature of the Economy Has Shifted

- According to the SBA, small businesses represent 99.7% of all US employer firms<sup>4</sup>
- According to the Census Bureau, people of color own 22.1% of all U.S. businesses<sup>5</sup>
- Strong diversity in business ownership has played a key role in advancing an economy that meets the needs of all consumers<sup>5</sup>

1. Ten demographic trends that are shaping the U.S. and the world, Pew Research Center, <http://pewrsr.ch/1RNzWzs>

2. American Diversity is Destiny, The Nielsen Company, <http://bit.ly/1RHljjj>

3. Buying power of minorities in US economy growing at 'exponential rate', The Red & Black, <http://bit.ly/1LGoPJw>

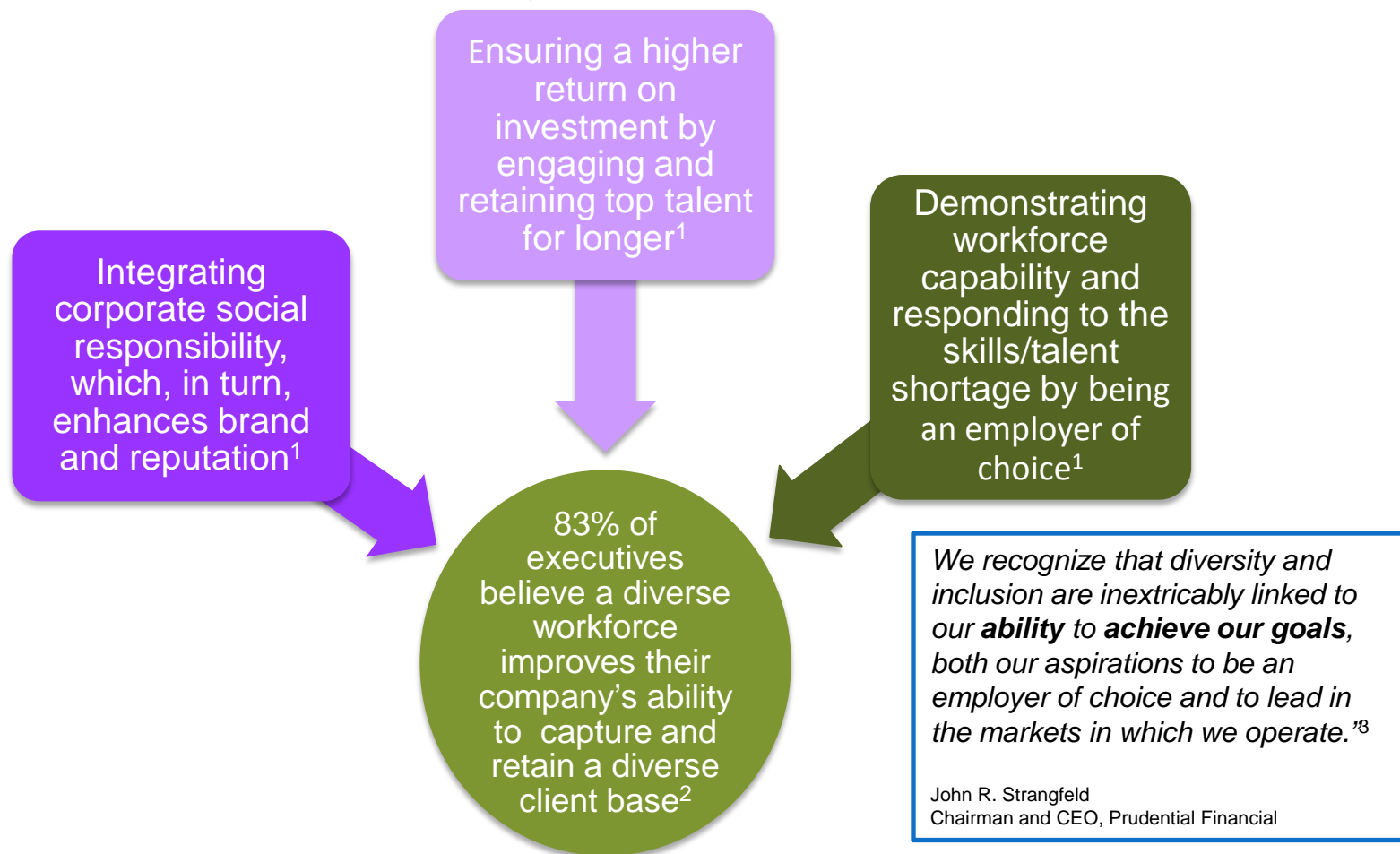
4. How Important Are Small Businesses to Local Economies?, The Houston Chronicle, <http://bit.ly/VYwvBa>

5. Minorities: The force fueling small-business growth, CNBC, <http://cnb.cx/1eAZHXB>



## Talent Management: Recruitment and Retention

Recruiting, retaining, and promoting diverse employees is critical to a corporation's success and leads to increased returns by:



1. Only skin deep? Re-examining the business case for diversity, Deloitte, <http://bit.ly/1XafSvM>

2. Diversity Matters, McKinsey & Company, <http://bit.ly/1S08Fdc>

3. CEOs Who are Diversity Champions, DiversityInc, <http://bit.ly/1Y9yEDF>





## Diversity of Thought and Combatting Groupthink

Workplace diversity and inclusion can reduce negative impacts of group decision-making, or groupthink, and encourage innovation and risk management via diverse perspectives

Groupthink blocks individual creativity and thought, resulting in irrational decisions and concerns being set aside for fear of upsetting the group's balance<sup>1</sup>



A condition which can lead to groupthink is group members having similar social backgrounds<sup>1</sup>



Highly diverse groups are, therefore, much less likely to engage in groupthink<sup>1</sup>

85% of large global corporations believe diversity is crucial to fostering innovation in the workplace<sup>2</sup>

*“As a company, we believe **diversity** sits at the **root of innovation**. Diversity of culture, experience and thought all drive innovative thinking.”<sup>3</sup>*

Ajay Banga  
President and CEO,  
MasterCard Worldwide

1. Only skin deep? Re-examining the business case for diversity, Deloitte, <http://bit.ly/1XafSvM>  
2. Diversity Matters, McKinsey & Company, <http://bit.ly/1S08Fdc>  
3. CEOs Who are Diversity Champions, DiversityInc, <http://bit.ly/1Y9yEDF>

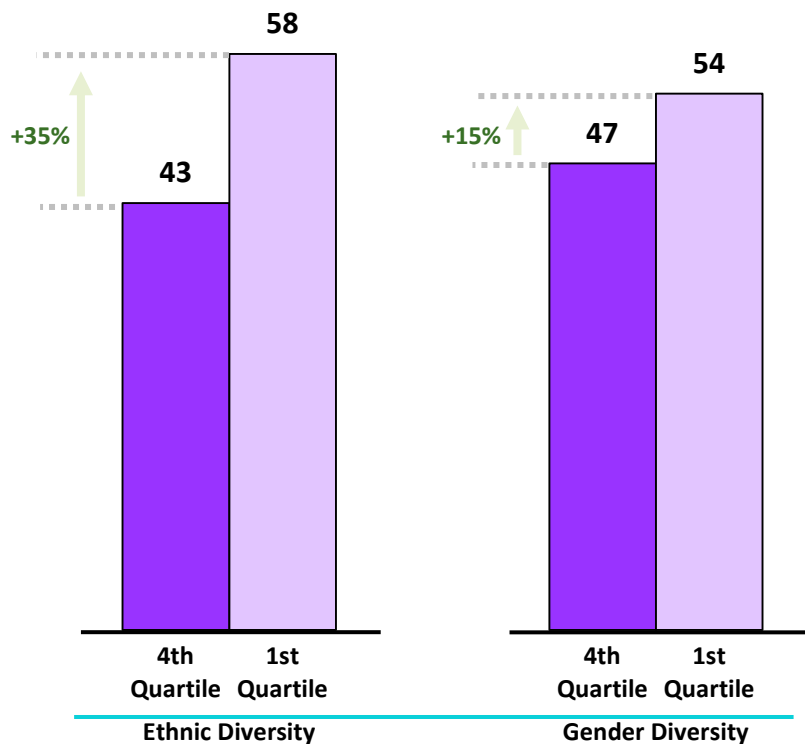


## 2. How Corporate Diversity and Inclusion Enhance Business Performance

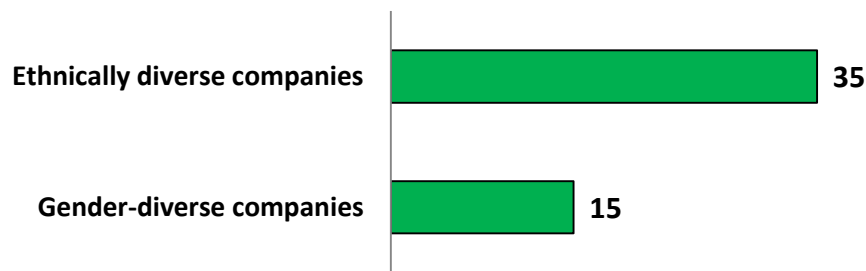
### How diversity correlates with better financial performance<sup>1</sup>

Likelihood of financial performance above national industry median, by diversity quartile %

% difference between top and bottom quartiles



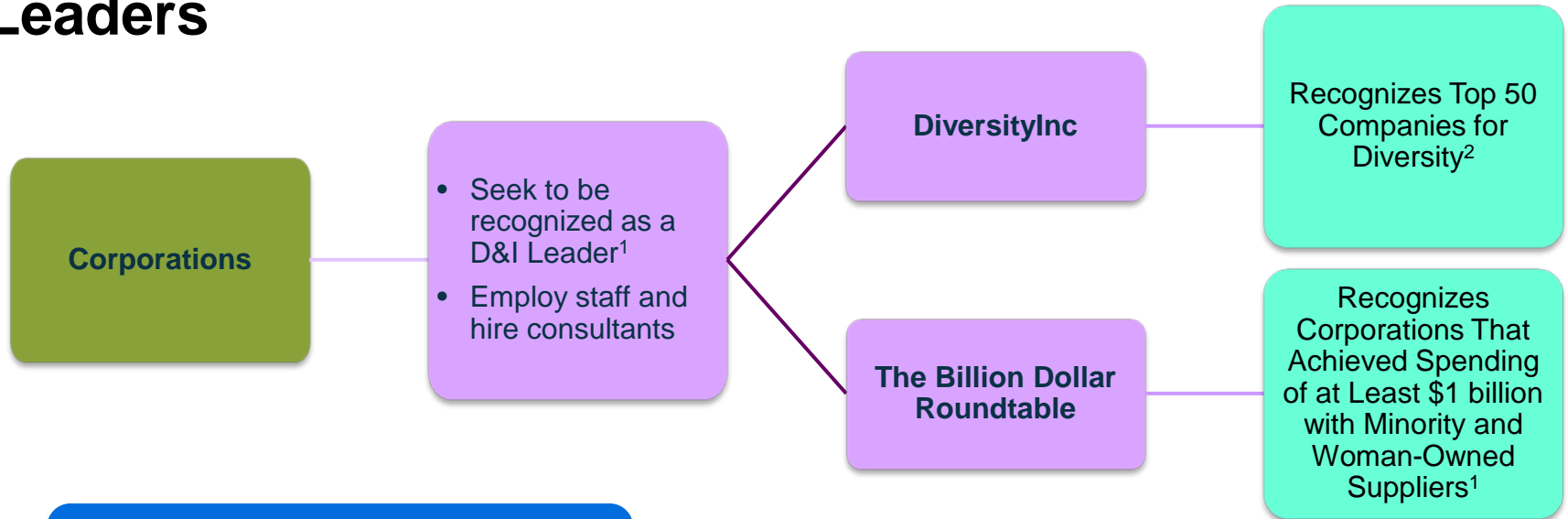
Companies in the top quartile for diversity are more likely to outperform financially than those in the bottom quartile<sup>1</sup>



85% of CEOs think their D&I strategies have improved the bottom line<sup>2</sup>

1. Diversity Matters, McKinsey & Company, <http://bit.ly/1S08Fdc>  
 2. PwC's 12 Gifts of Diversity, PricewaterhouseCoopers, <http://bit.ly/1OiUx1f>

# Leading Corporations Compete for Recognition as D&I Leaders



**Kaiser Permanente**

Celebrated as a top diversity and inclusion employer by both *DiversityInc* and *The Billion Dollar Roundtable*<sup>1</sup>

*“Our approach to this program was not to treat it as an initiative, but as a strong, standard, sourcing function that is integrated in how we procure and operate. We handled the program like a business function with a strategy that ties to our mission, and built the appropriate resources, budget, strong process and policy to support this strategy.”<sup>1</sup>*

Sally Saba,  
Executive Director, National Supplier Diversity  
Kaiser Permanente

1. Bank of America and Kaiser Permanente, Billion Dollar Roundtable, <http://bit.ly/1TusKxM>  
 2. Top 50 Companies for Diversity, DiversityInc, <http://bit.ly/1yYZE1r>

## Diversity On Corporate Boards

A critical factor in ensuring the successful development of an inclusive environment within a corporation is the strong commitment of senior leadership to diversity and inclusion. Having a diverse board is likely to contribute to the commitment of senior leadership to diversity and inclusion, as well as enhance the organization's competitiveness overall<sup>1</sup>

### Boardroom Diversity Leads to:

- Improved competitiveness<sup>2</sup>
- Talent management<sup>2</sup>
- Greater access to capital<sup>2</sup>
- More sustainable profits<sup>2</sup>
- Better relations with stakeholder<sup>2</sup>

### Boardroom Diversity is Built on:

- Different perspectives<sup>2</sup>
- Different background<sup>2</sup>
- Different experiences that align with the company's strategic goals<sup>2</sup>

### Reaching Board Success:

- Boards can best fulfill their duties when their members reflect the composition of current—and future—stakeholders, particularly employees and customers<sup>2</sup>

1. Board Diversity is a Means to Competitiveness, NACD, <http://bit.ly/1otrPAP>

2. The Diverse Board: Moving From Interest to Action, National Association of Corporate Directors, <http://bit.ly/233HVUO>



# Diversity and Inclusion: Summary

Diversity is a business imperative

## D&I results in

- Workforce retention
- Enhanced market share in domestic and global markets
- Greater organizational and financial efficiency

## D&I needs to be embedded in

- Corporate governance
- C Suite
- Workforce

Ethnic diversity is of particular importance in corporate governance given increasing domestic and global multiculturalism

*"I believe that the **collective wisdom** of our **diverse workforce**, combined with our inclusive, high-performing team culture can **spark innovation** and help take our business to the next level."*<sup>1</sup>

**André Wyss**  
U.S. Country Head, Novartis and President,  
Novartis Pharmaceuticals Corporation

*"A diverse organization will out-think and out-perform a homogenous organization every single time"*<sup>2</sup>

A. Lafley, CEO,  
Procter & Gamble

79% of executives believe diversity initiatives have a positive impact on company culture<sup>3</sup>

1. CEOs Who are Diversity Champions, DiversityInc, <http://bit.ly/1Y9vEDF>  
 2. Does Your Company's Diversity Match Your Customers?, Reuters, <http://reut.rs/1V3dUQ3>  
 3. Diversity Matters, McKinsey & Company, <http://bit.ly/1S08Fdc>

### 3. The Business Case for Diversity and Inclusion: Data and Analysis

- The available data analysed by Credit Suisse, show that since 2005 the return on equity of companies with a woman on the board member has averaged 14.1% vs 11.2% for all male boards.
- Looking at companies that have >15% of women in senior management, we find the return on equity was 14.7% compared to 9.7% at companies with <10% in 2013.
- We find higher profitability in all sectors but energy where the underperformance was just 1%.
- Where there is greater diversity in CEO and key operations roles, profitability is 27% higher.
- At LGBT embracing companies, returns average 10% higher.
- The returns from diversity have been superior in each and every year.

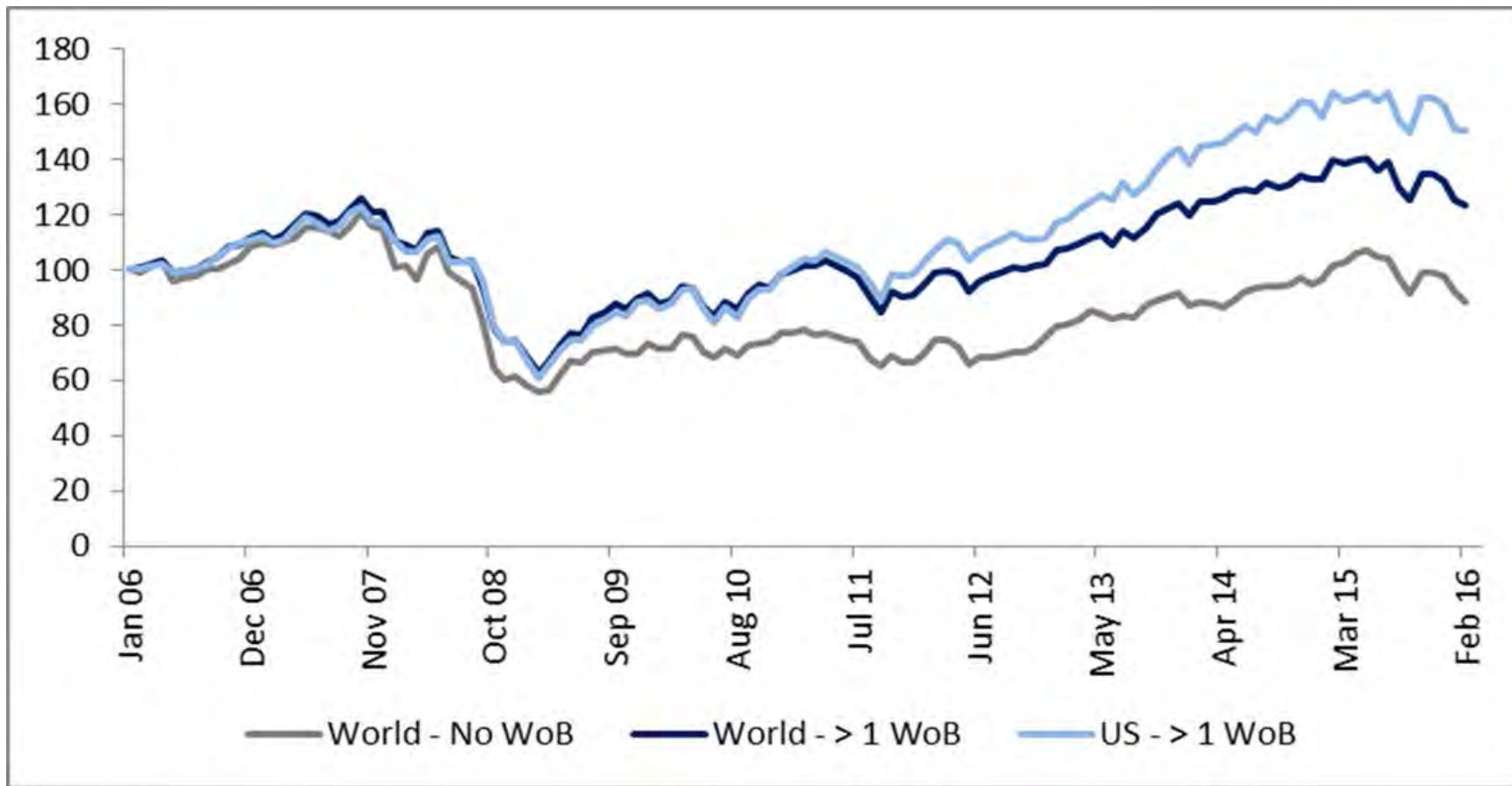
## The Business Case for Diversity and inclusion: Data and Analysis (continued)

- Globally, companies with one or more women on the board have seen an excess share price CAGR of 3.4% over the past 11 years. Companies with male-only boards have seen share prices lose 1.2% on average per annum over the same period.
- In the US, companies with one or more women on the board director have outperformed men only boards by 2.4% per annum.
- For our basket of 275 companies providing a supportive LGBT environment, we find share prices have offered incremental returns of 1.7% over a custom benchmark and a 3.3% higher return vs MSCI ACWI.
- This basket trades at a 9% discount to benchmark despite higher returns, similar dividend payouts and similar leverage.

## Diversity – companies with 1 or more women on the board have outperformed by 3.4% annually over the past 10 years

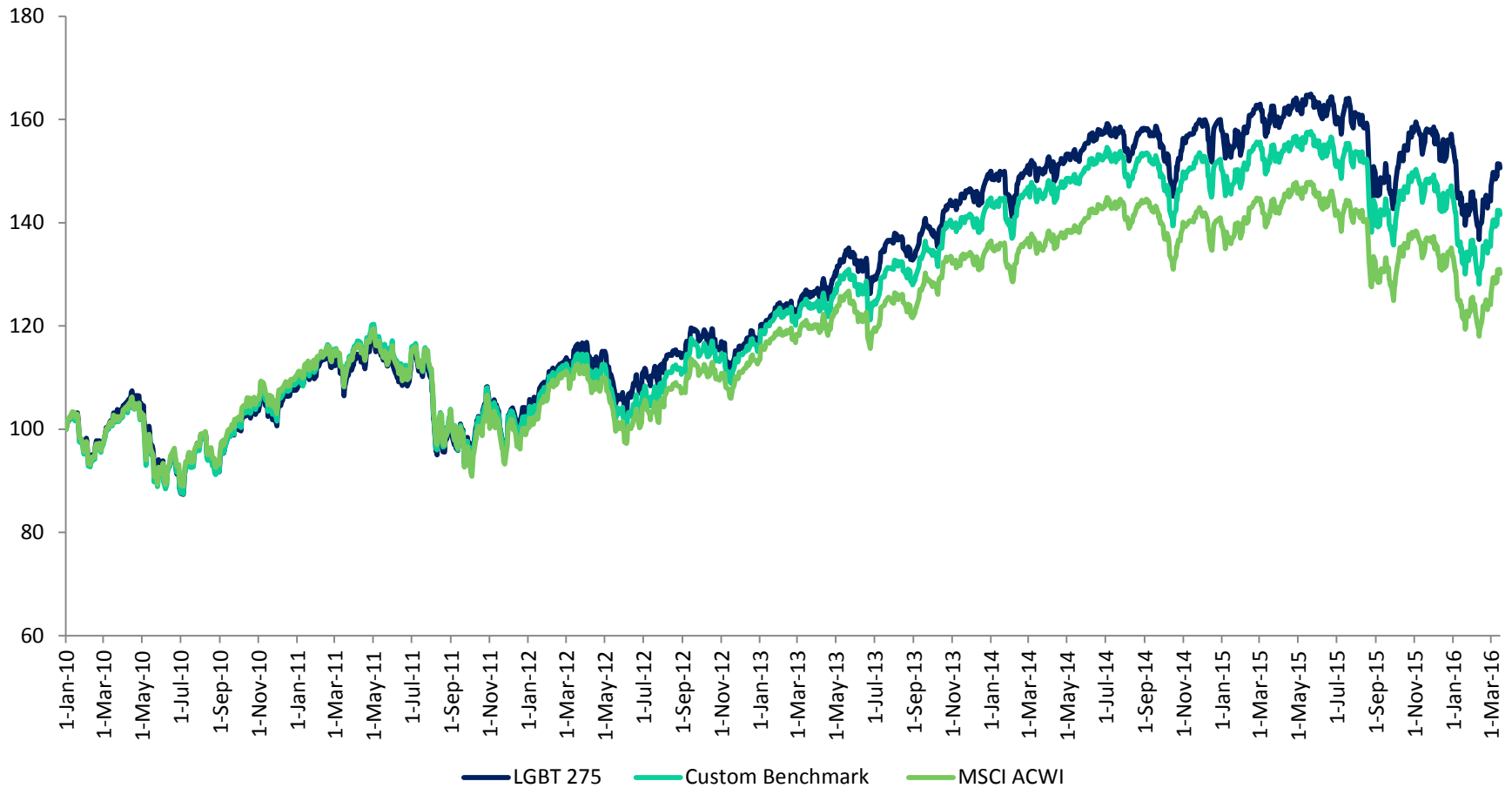
US companies with 1 or more women on the board have outperformed by 4.1% annually

(companies over \$10bn)





**An open and inclusive LGBT environment sees companies outperform by 1.7% annually vs a custom benchmark and by 3.3%vs MSCI ACWI benchmark over the past six years**



## What do we see that's different at companies embracing diversity?

- Payout ratios are 20% higher on average and act as a brake on potentially value destructive M&A or empire building.
- Diversity appears to offer companies asymmetric protection - superior upside in growth markets and a defensive play in down cycles.
- Diversity protects investors from the dangers of management group think.
- Studies that women focus on managing downside risk whilst men trade to maximise upside returns that can lead to underperformance.
- Credit Suisse finds very different results for M&A decisions between male and female CEOs that also indicate a difference in managing downside risk. This also explains different structures to remuneration packages.
- Better retention > lower hiring costs > fewer productivity losses & better working "culture".

## What is the risk from not embracing diversity?

- Collective intelligence is not maximised unless views are different. The same views = the same answers.
- Business challenges are evolving rapidly. Homogenous boards run the risk of trailing the structural shifts – the challenge of **online business**.
- The key challenges today are mainly in technology – **cybersecurity**. By not embracing diversity, companies miss out on many of the **skills** required for these new challenges.
- The consumer is changing rapidly – the shift in mix to other markets, the shift in mix towards Millennials.
- Understanding consumer **values** – the values of a specific consumer group spread far more broadly than the immediate group itself. Value-driven consumers and value-driven employees have far higher retention rates.
- 70% of household purchasing decisions are made by a woman.
- 23% of LGBT adults have switched products or services to LGBT supportive companies
- 71% of LGBT consumers stay loyal to a brand even if it is more expensive.

## Diversity allows companies to make better decisions about strategy and manage risk

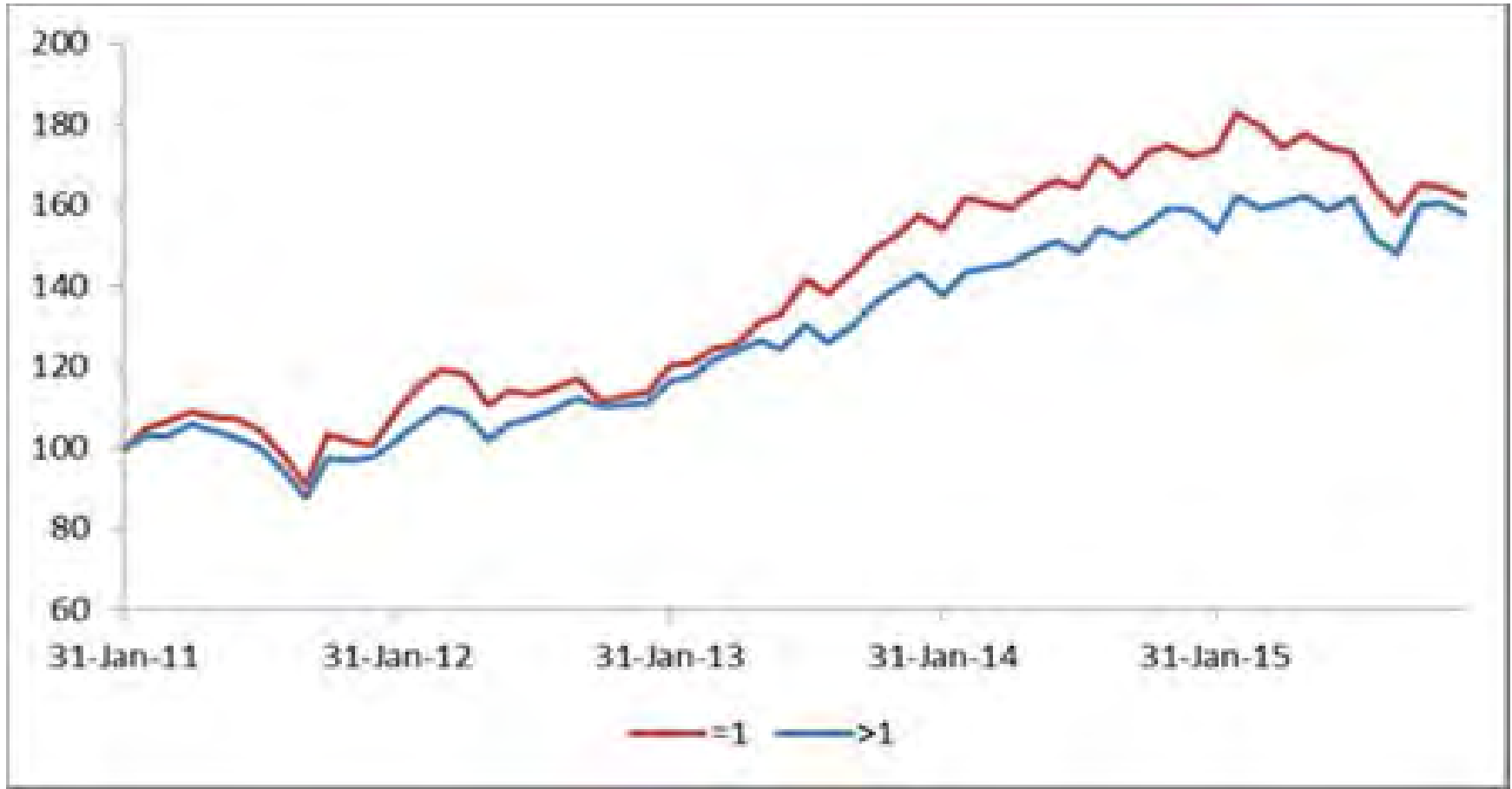
- Happy people are 10% more productive at work according to University of Warwick studies.
- Knowing your customers leads to better sales – from the shop floor to the boardroom.
  - **China** = 30% of global luxury goods sales. Only one of the European luxury goods houses has a China specialist on their board - an 8% shareholder.
  - **Emerging markets** = 40-50% of sales for many global staples companies. Only Nestle and Unilever have boards that reflect that.
  - **Yahoo's** 15% stake in **Alibaba** = 50% of YHOO's value (ex-deferred taxes). No China expert or Alibaba director on YHOO's board.
  - **Apple** – market is expecting the China success to be replicated in other emerging markets. Does the board have the skills?
  - **Silicon Valley** – brands have largely missed the China opportunity. Why does Uber think it will win?

## Diversity beyond gender, ethnicity and LGBT

- Diversity is far broader
  - Age
  - Gender
  - Sexual Orientation
  - Race/Ethnicity
  - Thoughts/Perspectives
  - Education
  - Experience – sector exposure, country exposure, functional exposure
  - Length of tenure
  - And how all the different aspects interact with each other
- Concurrent experience on other boards is not a benefit either to corporate performance or returns for investors

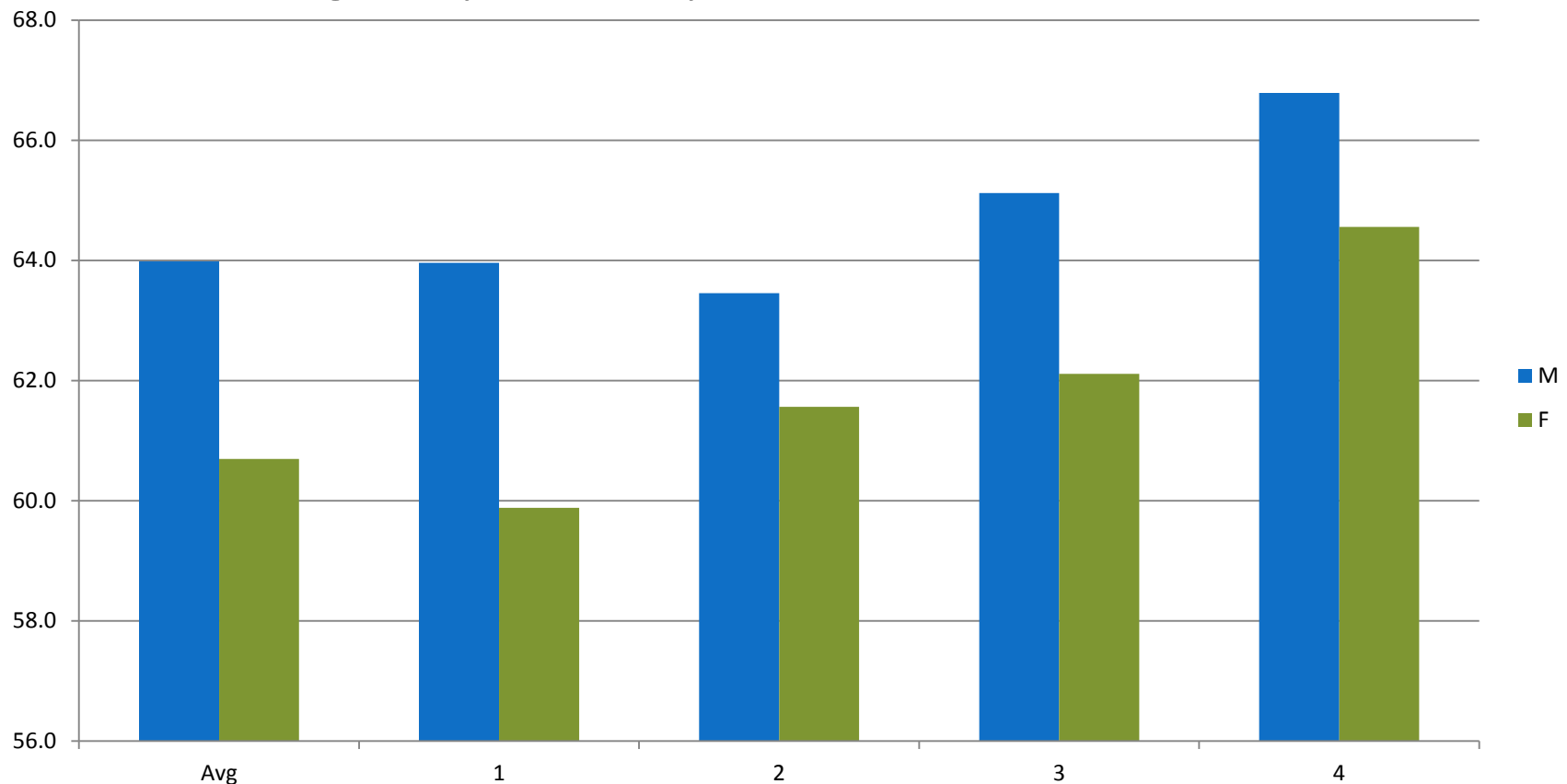
## Overboarding is a cost to investors

S&P 500 companies whose directors hold just one board seat outperform by >40bps per annum. The difference is even greater in Europe where the difference has averaged 5% per annum since 2010

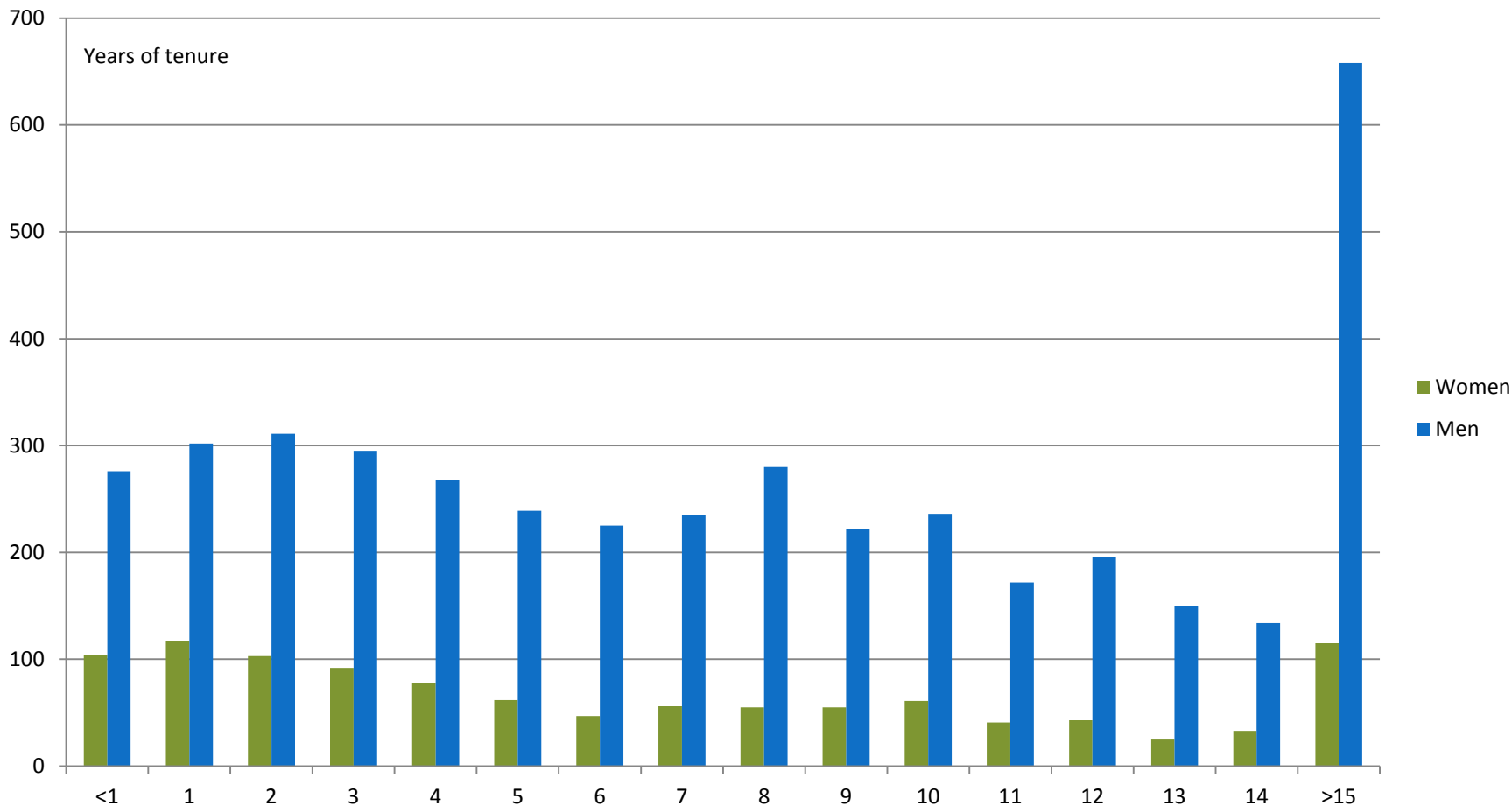


## Overboarding is concentrated amongst older directors whose management and operational experience is most outdated

This is a corporate governance challenge with regard to the demands of modern business challenges – cybersecurity, online business



# Diversity of tenure is necessary for skill replenishment and independence





# Age profiles of S&P directors – 50% of male directors are over 65

