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October 2015

Responsible Capitalism: Chapter 2

Responsible Capitalism and Diversity

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On the surface, corporate Britain has made great strides in improving its record on diversity: There are greater numbers of women and ethnic minorities in increasingly senior positions. Even in male-dominated sectors, such as financial services, some of the most important leadership positions – US Federal Reserve Chair, Managing Director of the IMF, head of the US Securities and Exchange Commission – are now held by women.

This is indisputably progress, but a closer interrogation of the statistics shows a less encouraging picture. For example, while the number of women on boards of the UK's largest companies is at a record high, many are in non-executive positions. The number of women holding executive level positions has only increased from 5.5 per cent to 8.6 per cent in five years. (Women on Boards, Davies Review Annual Report 2015). Equally, more than half of FTSE100 companies have no non-white leaders at board level, whether executive or non-executive; and two-thirds have no full-time minority executives at board level.

In five years the number of women holding executive level positions only increased **3.1%**

There are still significant gaps on pay. Female bosses earn around three-quarters of their male colleagues, with the average pay gap between men and women aged between 46 and 60 sitting at £16,680. This is even more pronounced at director level. (National Management Salary Survey, Chartered Management Institute, 2014). Legislation to force companies to disclose pay differences between men and women has never been enacted by government and corporate practice on this remains inconsistent.

There have been a number of high profile campaigns to improve diversity on boards, notably groups such as the 30 Percent Club. This was set up to achieve 30% female representation on boards, on the basis that 30% is the proportion when critical mass is reached. In a group setting, this is where the voices of the minority group become heard in their own right, rather than simply representing the minority. However, while these campaigns have achieved some progress, it is clear that UK plc is still poorly diversified at senior management level.

The latest Hermes survey reveals that the majority of investors do not consider this lack of diversity to be very important: Only around a quarter (23%) see gender diversity at board level as important or vitally important. Equally, the majority resist any sort of regulator-imposed diversity criteria, with just 19% believing this would be a good idea.

Yet, at the same time, 53% of those surveyed believe that diversity of experience is important, and 69% believe that board independence is important. Arguably, this is because regulatory attention has been focused on these areas. The corporate governance argument for the separation of the chairman and CEO role, for example, or of paying attention to a company's carbon footprint, has been well-made and widely accepted.

The percentage of employers that consider lack of diversity very important is only

23%

The average pay gap between men and women aged 46-60

£16,680

The diversity argument still has less resonance for many companies. Senior management can often see diversity as a legislative chore, or simply another compliance target to be met. This is less institutional sexism or racism, but more a failure to recognise why diversity is important and the advantages it brings to a business. Senior executives may have sympathy with the social case for achieving a greater mix within their businesses, but few see it as a necessity for achieving the right balance of growth and risk management.

The main goal of board independence and diversity of experience is not simply to tick a corporate governance box. It is to avoid the pernicious and value-destroying practice of 'group think'. The perils of this type of culture have been seen in corporate scandal after corporate scandal – Enron, Barings, sub-prime loans, the banking crisis, to name just a handful. It may be convenient for the members of a board to think in the same way, but it is rarely good for business.

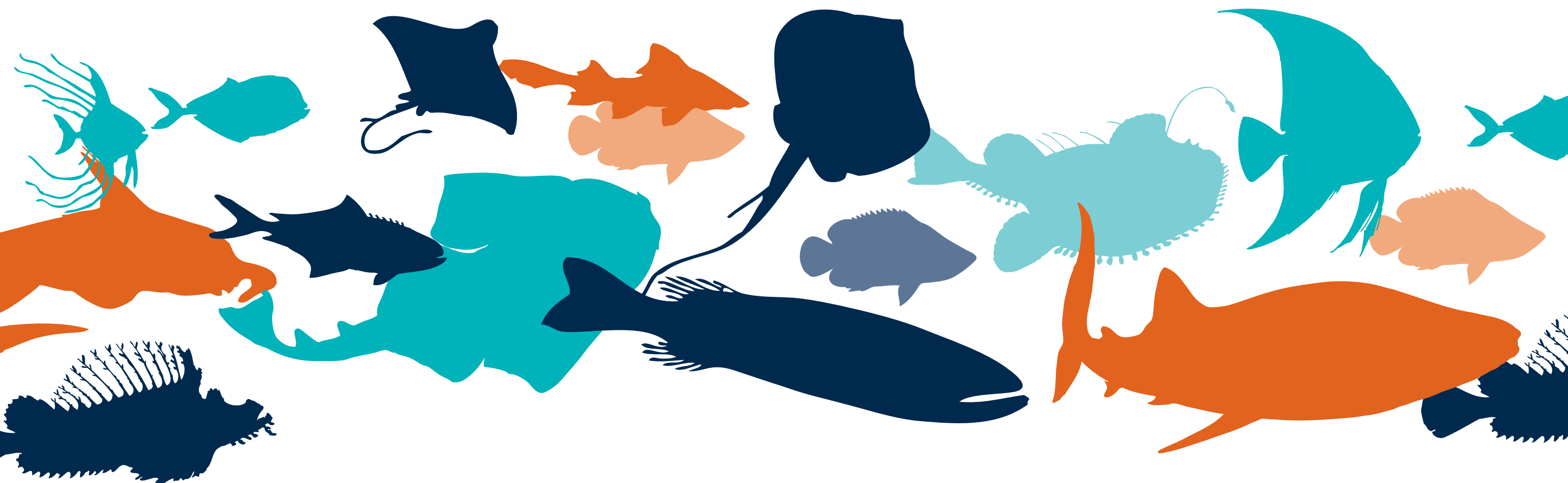
MSCI recently concluded that boards with gender diversity 'had fewer instances of governance-related scandals such as bribery, corruption, fraud, and shareholder battles'. (Governance Issue Report: 2014 Survey of Women on Boards. MSCI, ESG Research, November 2014).

But why might this be? While perhaps not quite from Mars and Venus, men and women often bring different, but complementary skills to the running of a business. This is most apparent in their approach to risk. Men tend to be greater risk takers, while women are naturally risk-averse and cautious.

Poorly considered M&A activity has been instrumental in the destruction of some previously great companies. Equally, it has been extremely value-enhancing for others. It is clear that the balance provided by men and women helps companies do better deals and it is one way in which gender diversity improves corporate performance.

However, the argument for diversity is not simply the better management of risk. There are sound arguments that it contributes to overall returns.

"Our latest research finds that companies in the top quartile for gender or racial and ethnic diversity are more likely to have financial returns above their national industry medians. Companies in the bottom quartile in these dimensions are statistically less likely to achieve above-average returns." (McKinsey & Company, Why Diversity Matters, January 2015).



For each female on the board the cost of acquisition fell by

15.4%

Businesses need to take risk to grow, but that risk needs to be appropriate and effective. There is tangible evidence that a diversified board makes better decisions: The University of British Columbia found that for each female director on a board, the cost of an acquisition fell by 15.4% while also lowering the number of a company's attempted takeover bids by an average of 7.6%. This suggests that the presence of women may help boards to be more prudent during transactions and demand a higher return on investment. (More women on boards, cheaper mergers. The Washington Post, 27 November 2013).

Intuitively, this would seem to make sense: After all, educational outperformance, workplace skill and strong productivity are not limited to a single gender or race. Therefore, by ensuring diversity, a company selects from the very widest talent pool. Equally, a company's customer base is likely to be diverse. Women now control 48 per cent of Britain's wealth. By 2025, that is predicted to rise to 60 per cent. A varied senior management team would seem to be in a better position to understand the needs and values of those customers.

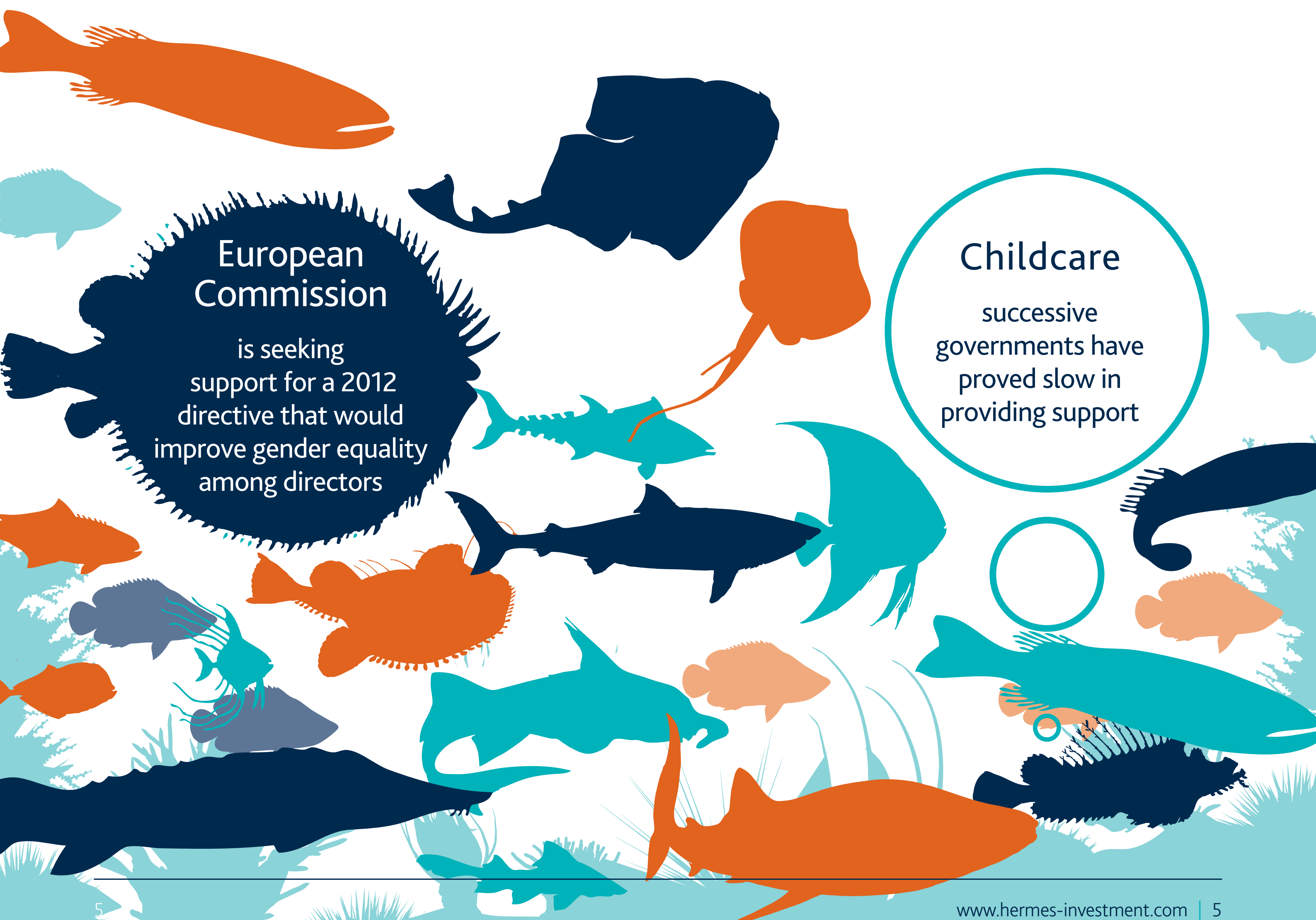
Investors increasingly understand the importance of good governance: There is clear evidence that well-governed companies outperform their poorly-governed counterparts and investors recognise this. However, they do not yet associate diversity with good governance. What steps could be taken to address this?

Quotas are controversial, though some believe that they are the only way to reverse entrenched practice. There are moves afoot in Europe to force the issue – the European Commission is seeking support for a 2012 directive that would oblige countries to put processes in place to improve gender equality among directors. Norway, France, Spain, the Netherlands and, from 2016, Germany, have quotas in place for female representation on boards.

An easier – and possibly less divisive - first step is full disclosure. Again, this is not widely seen as important but it is only through full disclosure that companies can take an honest look at their diversity record and consider how that might be improved.

There are, of course, other issues that may prevent women reach the top rung: childcare is an ongoing issue and successive governments have proved slow in providing support. Companies have historically been inflexible in their working hours, though this is changing slowly. Equally, women need to be better at understanding the value of networking and other areas where they are holding themselves back. There is push and pull in achieving diversity.

Ultimately, real sexism and racism is relatively rare. However, for many companies there is still a poor appreciation of why diversity is important. It is not simply a box to be ticked, but has real, tangible benefits for individual businesses.



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HM0039 09/15