The Frontier Line

Diversity: inclusive, not intrusive

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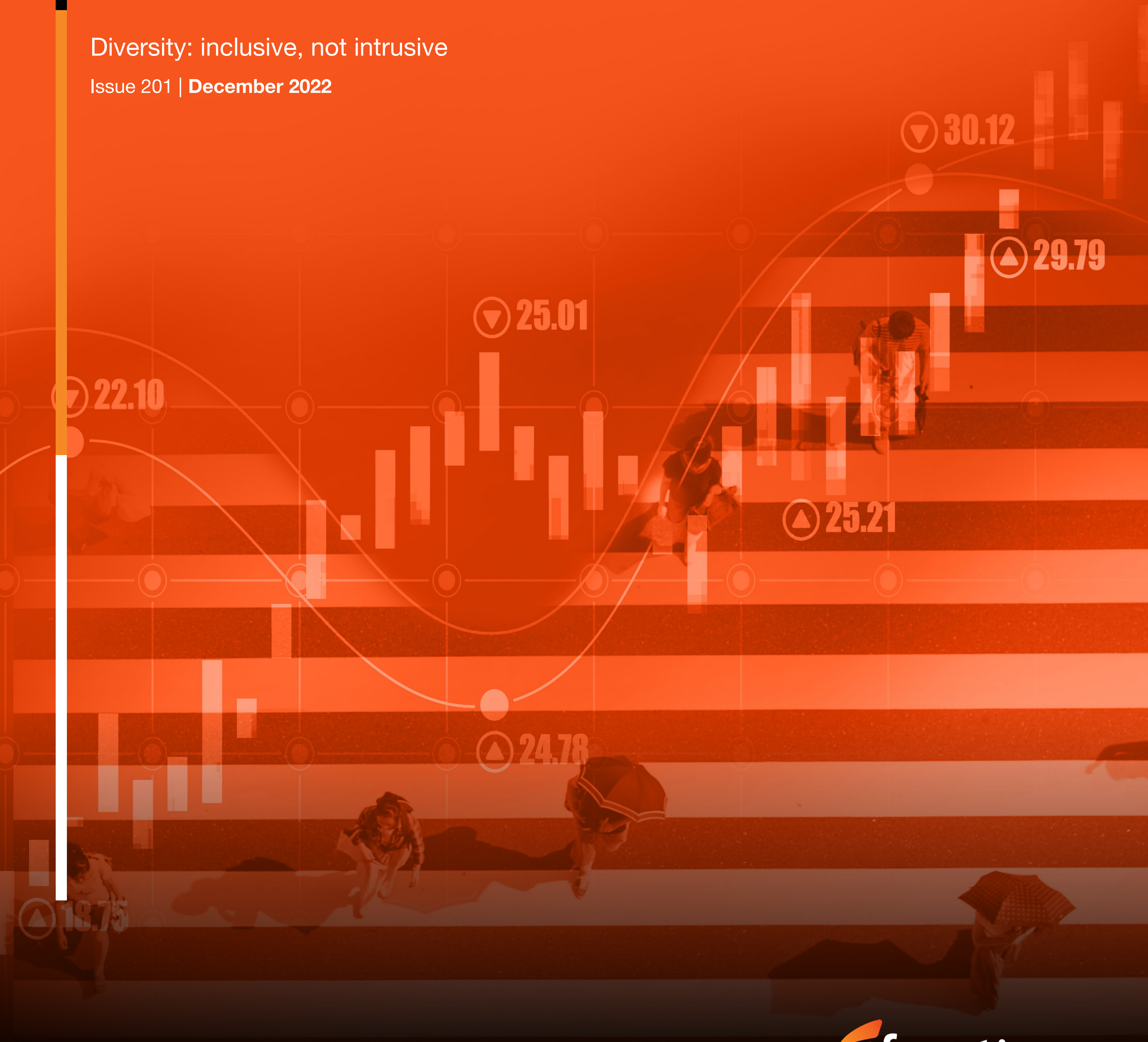

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About us

Frontier has been at the forefront of institutional investment advice in Australia for over 25 years and provides advice on $600 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Frontier's purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing, customisation, technology solutions and an alignment and focus unconstrained by product or manager conflict.

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Mary joined Frontier in March 2018 in an advisory role for the Capital Markets and Asset Allocation Team, as well as investment strategy more broadly, and is a member of Frontier's Investment Committee. Prior to joining Frontier, Mary was the Chief Investment Officer for the Meat Industry Employees' Superannuation Fund and most recently at Vanguard as Senior Investment Specialist. Mary brings a great breadth of portfolio management experience, having managed diversified and asset class-specific portfolios across her career, by both quantitative and fundamental processes, implemented directly and through external managers. Mary holds a Bachelor of Commerce (Honours) and a Master of Commerce (Honours) from the University of Melbourne.

Background

“Stale, male and pale.”

If you have ever had that taunt thrown at you and told “it’s just a joke”, keep reading. If you think there are too many people in leadership positions fitting that description, keep reading. If you don’t tick any of those adjectives, keep reading. Everyone else, read on.

In this paper, we take the opportunity to review some of the dimensions of diversity, drawing on examples from the Australian investment management industry and international experiences. From identity diversity to cognitive diversity, the focus is on equity and on trying to be more effective in decision-making.

We explore the tension between being inclusive and being intrusive, with a balance to be struck between better diversity mapping and employees’ rights to privacy.

Key to capturing the benefits of diversity within teams is open, forthright communication. Some of Australia’s largest institutional investors share their insights from trying to encourage the expression of alternative views and respectful debate.

While advice and thought experiments are provided within, the starting point must be to examine one’s own behaviour and biases; inclusive leadership starts with self.

Part 1: Diversity of identity

The many ways we see ourselves and see others give rise to identity diversity. In exploring select dimensions of identity, this section focuses on the Australian investment management industry, with much to be learnt from the experience in other countries. The tension between being inclusive and being intrusive is explored.

Gender diversity

Accessing talent

The Power of Gender Diversity in the Workplace, a 2018 Frontier research piece, examined empirical evidence on gender diversity, with a focus on the investment management industry. Suffice to report the gender employment disparity highlighted was significant, increasingly so with portfolio management responsibilities.

The paper primarily viewed diversity through an economic lens, with various analysis noting benefits reflected in profitability and performance. The inherent fairness argument for eschewing gender bias was taken as a given then and stands strong now.

The hunt for investment talent provides an additional reason to embrace diversity; ensuring a wider, deeper pool of applicants can help avoid the opportunity cost of not accessing ability. Achieving improved diversity may require innovation in recruitment practices, especially given the current tight labour market. Heightened awareness of biases in advertising, evaluation criteria, networks and role modelling are important first steps to closing the gender employment gap.

Australian institutional investors lamenting the paucity of female candidates for their advertised positions should assess whether their recruitment process is truly gender-neutral and then consider whether their recruitment should be proactively biased towards getting female applicants to address imbalances.

Sex and gender

The Australian Bureau of Statistics provides the following distinction.[1]

"The terms sex and gender are interrelated and often used interchangeably, however they are two distinct concepts:

- Sex is understood in relation to sex characteristics. Sex recorded at birth refers to what was determined by sex characteristics observed at birth or infancy.
- Gender is about social and cultural differences in identity, expression and experience."

Surely things are better now?

Frontier collects and analyses manager and fund level data as part of its ongoing research program. This is done primarily through its proprietary digital platform. Responses to the 'Full Due Diligence' questionnaire, sent annually to rated managers, provide a useful snapshot of the change in gender diversity over recent years.

[1] https://www.abs.gov.au/statistics/standards/standard-sex-gender-variations-sex-characteristics-and-sexual-orientation-variables/latest-release

Analysis of the latest responses show a marked increase in gender diversity over the past four years, based on one specific metric. In 2018, 45% of Frontier-rated Australian equity managers had all-male investment teams. In 2022, only 15% of Frontier-rated Australian equity managers had all-male investment teams.

Global equity managers have been markedly more gender diverse than their Australian counterparts. In 2018, 19% of the surveyed pool of managers had all-male investment teams. In 2022, no surveyed managers had all-male teams.

It is worth noting the percentage of rated managers with all-female investment teams remained constant over time at zero, regardless of domicile.

Chart 1: All-male investment teams

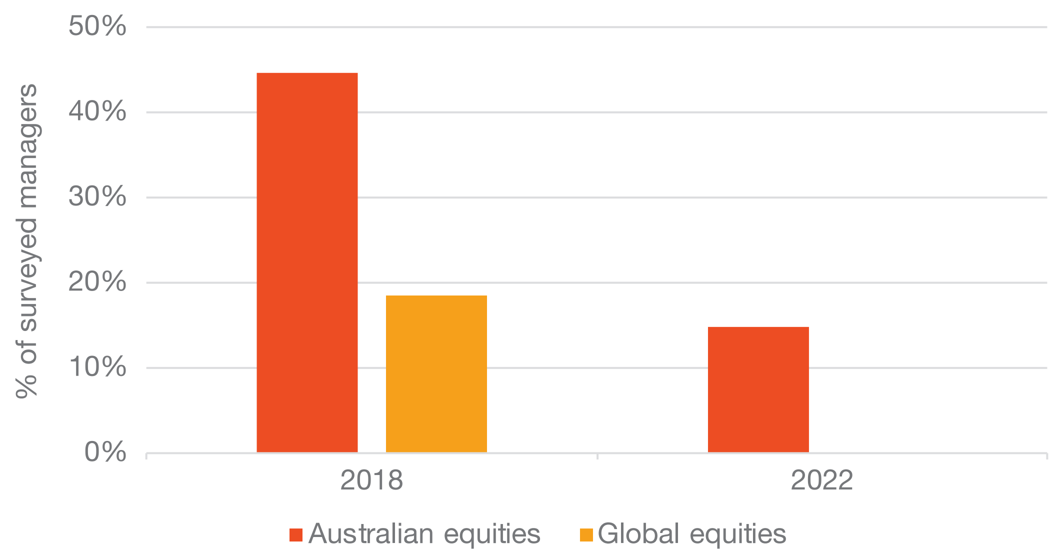
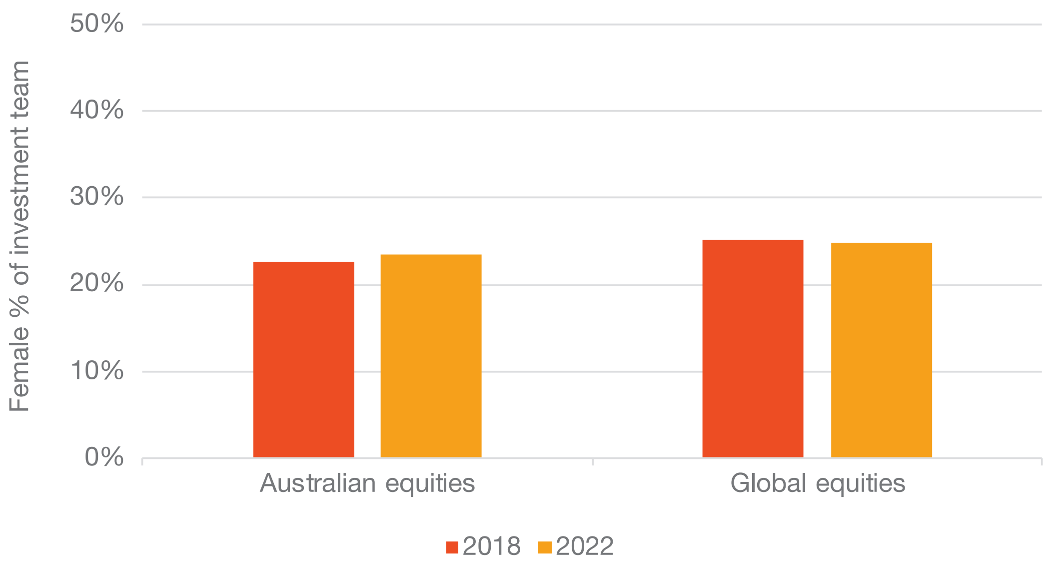


Chart 2: All-female investment teams

Disappointingly, there appears to have been little progress when gender diversity is measured by another metric: investment teams have been, and continue to be, male dominated. For teams with a mix of genders, female participation has been static at between 23% to 25%, with the ratio consistent for both domestic and international managers.

Chart 3: Female participation in diverse investment teams



Why the hang-up about sex?

Much of the discussion about diversity in Australian financial services has focused on gender. This is understandable given the evident historic bias in employment and the case for redressing this bias. However, there is another reason for the focus on gender: it is one of the few personal characteristics that can be assumed without appearing intrusive or discriminatory. Simple signals, such as self-selected titles of address, allow employers to informally categorise employees.

In Australia, there is a gender reporting requirement for many employers. Private sector employers with 100 or more employees are required to submit an annual report to the Workplace Gender Equality Agency (WGEA) on workforce gender composition, with employees categorised by female, male or non-binary on a voluntary basis. While the WGEA does not specify how employers collect gender data, it does advise that employees should not be included in the dataset if they choose not to disclose their gender status.

When completing Frontier's due diligence questionnaire, one North American global equities manager commented it "does not require employees to self-identify their ethnicity, gender, or disability status." Hence, its answer to the question about gender diversity was "based on visual assessment." While that response might evoke a wry smile, it is thought-provoking: how is your workplace demographic data collected?

Are men from Mars and women from Venus?

The 1992 bestseller, “Men are from Mars, Women are from Venus”, posited that not acknowledging the differences between men and women creates communication challenges. The book’s title created a popular cliché that persists, even though the author’s characterisation of men and women played to outdated stereotypes. There is now a plethora of contemporary articles that create new stereotypes – this time as investors.

Fidelity’s “2021 Women and Investing Study” focused on retail investors.[2] It noted the broad outperformance by women of men and attributed this to two factors: frequency of trading and consistency of investment. Fidelity observed women traded less, avoiding the negative impact of trading fees and attempting to time markets.

In “How America Saves 2021”, Vanguard reported a similar gender difference in trading activity by defined contribution plan participants: the percentage of men who traded in a year was almost double the percentage of women.[3] That gender difference had persisted for a decade.

In “Addressing Gender Folklore” (2017), State Street’s Centre for Applied Research survey concluded “female professional investors tend to be more long-term goal oriented than their male counterparts”.[4] State Street does question the behavioural biases that have contributed to the gender gap in the investment management industry, in particular the belief women are more risk-averse than men and the belief there are inherently male characteristics that make for better leaders.

Institutional investors will be well-served to consider their own beliefs about the differences between men and women, be it as investors, team members or team leaders. If these personal beliefs rest on reductive notions of gender, then they may contribute to entrenching biases in employment practices and workplace culture.

Paying talent

The gender pay gap measures the difference between the average earnings of women and men in the workforce, across all industries and occupations. In Australia, the WGEA estimates women earned on average 14.1% less than men across the workforce in the year to May 2022.[5] The WGEA provides a breakdown by industry showing the gender pay gap in average weekly ordinary full-time earnings in Financial and Insurance Services was 19.0% for the same period.

The gender pay gap is not a measure of pay equity, which the WGEA defines as “equal pay for work of equal or comparable value”.[6] However, pay inequality can be one of the factors contributing to the gap’s persistence.

Pay transparency practices vary globally, from industry-averages to company-specific data. Denmark is at the forefront of the move to address gender pay gaps by increased transparency: since 2006, Danish companies above a size threshold are required to disclose wage statistics if more than ten men and women are working in the same job.[7]

Undertaking a pay equity audit is a recommended practice for Australian employers who care about reducing the gender pay gap, as it allows a more informed assessment of disparities and potential biases in practice. Fostering greater openness about pay is also a positive step.

[2] https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/about-fidelity/FidelityInvestmentsWomen&InvestingStudy2021.pdf
[3] https://institutional.vanguard.com/content/dam/inst/vanguard-has/insights-pdfs/21_CIR_HAS21_HAS_FSreport.pdf
[4] https://www.top1000funds.com/wp-content/uploads/2017/11/Addressing-gender-folklore.pdf
[5] https://www.abs.gov.au/statistics/people/people-and-communities/gender-indicators-australia/latest-release
[6] https://www.wgea.gov.au/pay-equity
[7] https://women.govt.nz/documents/country-case-studies-pay-transparency

In Australia, employers have been able to legally include pay secrecy clauses in contracts of employment, although the Fair Work *Legislation Amendment (Secure Jobs, Better Pay)* Bill 2022 proposes banning such secrecy clauses. Notwithstanding the passage of legislation, the trend is toward openness, with some of Australia's largest banks removing pay secrecy clauses in 2022.

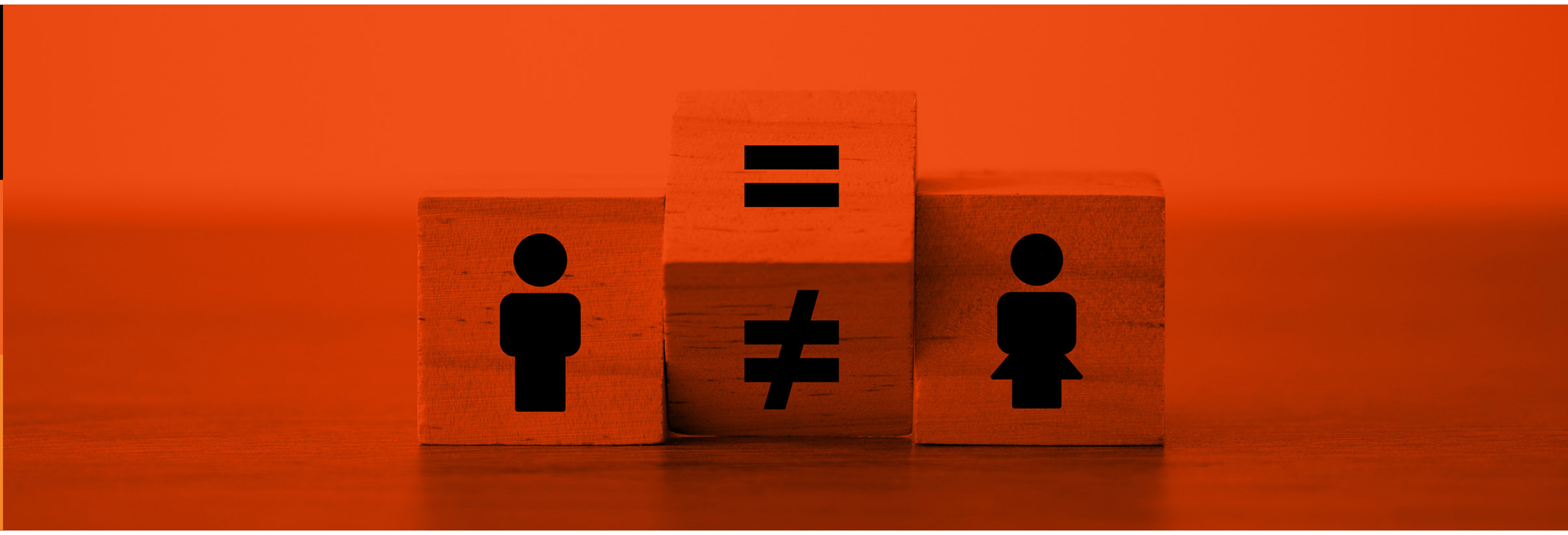
Two of the large consulting firms have raised the disclosure standard higher by introducing pay transparency. PwC were the first mover as part of its drive to attract and retain talent in a competitive job market, disclosing pay bands for employee grades for the 2023 financial year.[8]

The City of New York has recently introduced a pay-disclosure law requiring employers to list salary ranges in job advertisements, effective from 1 November 2022. Similar requirements are already in place in some USA states, with others in the process of introducing salary transparency obligations on employers.

Scandinavian countries lead the field for income transparency, with Finland, Norway and Sweden publishing tax records each year. While Finland restricts publication to incomes over a certain threshold, Norway and Sweden publish everyone's total income and total tax paid. Norway has been doing so for centuries and made its records accessible online in 2001.

Salary transparency might breed discontent, foster resentment among colleagues, or create discomfort (given privacy around money is a widely practiced social norm). Alternatively, such transparency might increase employee trust and motivation and would mark a step toward pay equity by highlighting any biases in employment and remuneration.

It is a useful exercise for Australian team leaders to consider the likely repercussions of introducing salary transparency at their own organisation. Such a thought experiment may highlight equity and cultural issues that warrant action.



Age diversity

Is ageism the new sexism?

Age, like sex, is a protected characteristic under the Fair Work Act, but one which is also typically 'guessable'. Simple proxies, such as graduation dates or years of experience, allow most job applicants to be pigeon-holed, sometimes to their detriment.

Protected characteristics

"An employer must not take adverse action against a person who is an employee, or prospective employee, of the employer because of the person's race, colour, sex, sexual preference, age, physical or mental disability, marital status, family or carer's responsibilities, pregnancy, religion, political opinion, national extraction or social origin."

Fair Work Act 2009, Section 351[9]

[8] https://www.pwc.com.au/media/2022/fy23-pay-bands-transparency.html
[9] http://www5.austlii.edu.au/au/legis/cth/num_act/fwa2009114/s351.html

For employers, gathering age data about their workforce can be quite straightforward and not widely considered intrusive. For example, the process of onboarding within the financial services industry often involves police checks and other procedures which require the provision of identification that includes date of birth. Once on board, employers may need to know date of birth for remuneration, insurance and taxation reasons.

Age does have a distinct attribute: unlike most identity characteristics, age is guaranteed to change over time. 'Forever young' may be a beauty industry promise but reality, barring tragedy, will see us all progress from youth to old age. Self-interest alone argues for breaking down age-discriminatory behaviour in the workplace: the jump from 'too young' to 'too old' can happen to anyone.

Ageism in the financial services industry tends to be associated with an apparent reluctance to employ older workers. However, negative attitudes about age can impact people across their lifespan. In its 2021 report, 'What's age got to do with it', the Australian Human Rights Commission (AHRC) provides data on the pattern of ageism in Australia. Its survey and focus group discussions found outdated expectations and stereotypes persisting for younger adults, middle-aged and older Australians.[10] The AHRC report supplements the 2021 World Health Organization (WHO) Global Report on Ageism, which recognises the pervasiveness of ageism.[11] The WHO report notes evidence that ageism can intersect with sexism for young women in the workforce.

The human tendency to simplify the world by grouping is seen in the popular usage of terms like Boomers, Gen X, Millennials and Gen Z. While living through world events and social change can shape perspectives and allow shared frames of reference, the lazy use of generation labels ignores individual diversity. And the risk is, in using generational affiliation to contribute to team bonding, the resultant generational exclusion contributes to groupthink.

Given the cyclical nature of economies and markets, lived experience can be particularly valuable in investing, but insights are not restricted by age. Assumptions about age should be challenged before they influence recruitment, training, promotion and retention decisions. And the apparent tolerance for jokes about age, which would not be tolerated about gender and race (as noted in the AHRC's report), has no place in a diverse and inclusive workplace.

Ethnic diversity

Where are you from?

The language used when exploring ethnic diversity varies markedly between countries. Despite – or perhaps because of – its history of racism, there is a hesitancy in using the language of race in Australia. The diversity conversation emphasises backgrounds and cultural identity, with the centrality of Indigenous issues widely accepted.

In Australia, terms like 'ethnic' or 'multicultural' are commonly used in informal discussion. In bureaucratic communication, 'Culturally and linguistically diverse (CALD)' is now widely used, twenty years after the phasing-out of the overly simplistic 'Non-english speaking background (NESB).'

The 2021 Australian Census did not include questions about race or ethnicity, beyond recognising Aboriginal and Torres Strait Islander peoples. Instead, the Census asked about ancestry, allowing up to two answers. However, the Federal Government has recently announced it will begin collecting ethnicity data to more effectively measure diversity in Australia.[12]

A broader set of diversity indicators – rather than simply 'country of birth' and 'language spoken at home' – may better capture the richness of Australia's cultural diversity and allow more targeted provision of services and policy measures. However, it also raises questions about the politics and ethics of reinforcing ethnic identity classifications, of excluding certain cultural identities or of creating an implied default.

There are currently no requirements for Australian employers to collect or provide data on cultural or ethnic diversity. But with almost thirty percent of Australia's population born overseas and hundreds of 'languages spoken at home', the focus in many workplaces has moved from seeking diversity to trying to ensure inclusion.[13] Inclusive action can range from simple measures, like hosting 'A Taste of Harmony' morning tea to celebrate the cultural heritages of staff, to more structured workplace practices around mentors and relatable role models.

[10] What's age got to do with it? (2021) | Australian Human Rights Commission
[11] https://www.who.int/teams/social-determinants-of-health/demographic-change-and-healthy-ageing/combatting-ageism/global-report-on-ageism
[12] https://www.abc.net.au/news/2022-06-16/federal-government-to-measure-ethnicity-data-multiculturalism/101158038
[13] https://www.abs.gov.au/media-centre/media-releases/30-australias-population-born-overseas

Race and ethnicity

National Geographic provides the following distinction.[14]

"'Race' is usually associated with biology and linked with physical characteristics such as skin colour or hair texture. 'Ethnicity' is linked with cultural expression and identification. However, both are social constructs used to categorise and characterise seemingly distinct populations."

In contrast to Australia, the word 'race' is widely used in the USA. The US Census currently uses five race groups (White, Black or African American, American Indian or Alaska Native, Asian, and Native Hawaiian or Other Pacific Islander), while noting these reflect a social definition of race based on self-identification.[15]

Providing data on the race of their employees is obligatory for many American employers. The US Equal Employment Opportunity Commission mandates all employers meeting certain criteria annually submit demographic workforce data in which employers categorise employees under a range of mandated ethnicity and race categories.[16] The Commission prefers the information to be based on self-identification, but, if employees decline to self-identify, employment records or observer identification may be used.

The U.K.'s 2021 Census categorises five broad ethnic groups, with multiple sub-groups, but UK employers do not have to track the ethnic characteristics of employees.[17] However, in Northern Ireland, employers of size must monitor the 'community background' of their employees, including job applicants, appointees, promotees and leavers.[18] 'Community background' means whether an individual is from the Protestant or Roman Catholic communities, or neither. This Northern Irish requirement illustrates how the language and the focus of ethnic and cultural diversity vary between countries and can reflect historical divisions, injustices and priorities.

Balancing diversity data and privacy

You can't ask that!

While diversity data allows employers to better understand their workforce, caution is advised in the collection of such data as good intentions are an inadequate defense for discriminatory behaviour.

The recent media spotlight on KPMG, due to its questioning of graduate job applicants regarding their sexual orientation and gender-diverse experience, highlighted the potential for discrimination cases which could be launched by unsuccessful applicants. KPMG stated they ask such voluntary questions "to build a statistical picture of (its) progress in achieving a diverse workforce".

Another example which may be considered well-intentioned overreach is seen in the targets set by the UK's Diversity Project. This is a worthy initiative that champions a diverse and inclusive investment and savings industry and whose members include asset owners and investment consultants. However, one of its current aspirational goals is for its member firms to collect socio-economic data for their employees.[20] This trend to categorising people may be discomforting for those who prefer to eschew class labels or to clearly demarcate between work and home personas.

The Equality Commission for Northern Ireland goes even further: "Although not a legal requirement, we also recommend monitoring by age, disability, race, marital status, civil partnership status, sexual orientation, and those with and without dependents." [21] The Commission claims that monitoring these additional grounds is 'good practice'.

[14] https://www.nationalgeographic.com/culture/article/race-ethnicity
[15] https://www.census.gov/quickfacts/fact/note/US/RHI625221#:~:text=OMB%20requires%20that%20race%20data,report%20more%20than%20one%20race.
[16] https://eeocdata.org/pdfs/EEO-1%20Component%201%20Instruction%20Booklet.pdf
[17] https://www.ethnicity-facts-figures.service.gov.uk/style-guide/ethnic-groups
[18] https://www.equalityni.org/Employers-Service-Providers/Large-Business/Registration-and-monitoring/Monitoring
[19] https://www.afr.com/companies/professional-services/kpmg-asked-graduate-applicants-if-they-were-gay-20220926-p5bl3t
[20] https://diversityproject.com/resource/the-diversity-projects-5-year-goals/
[21] https://www.equalityni.org/Employers-Service-Providers/Large-Business/Registration-and-monitoring/Monitoring

Human capital disclosure

Many may bristle at the concept of lumping individuals together as human capital, whereby employees are viewed as a company's asset to be reported on akin to financial capital. However, there has been a notable trend in recent years to recognise the strategic importance of investing in human capital and ensuring workplace practices benefit both employees and business performance.

Workplace diversity is an important part of human capital management and is an explicit metric in the 2018 human capital reporting guidelines (ISO 30414) issued by the International Organization for Standardization.[22] Recent moves to raise the human capital reporting requirement in various countries may, therefore, have implications for reporting on diversity practices, particularly by listed companies.

In the USA, the Securities and Exchange Commission (SEC) requires reporting companies to disclose information about their human capital management, to the extent such disclosure would be material.[23] The disclosure requirements are currently principles-based, rather than prescriptive.

A similar human capital disclosure directive is in effect in the European Union, with its 28 member states requiring large companies to publish corporate responsibility reports on their human capital practices.[24] The directive explicitly includes diversity in the non-financial information which should be disclosed to allow the identification of sustainability risks.

In 2021, Japan's Tokyo Stock Exchange revised its Corporate Governance Code to expand on the disclosure recommendations relating to the promotion of diversity.[25]

As global human capital disclosure moves from policies to practices and performance, these international changes may foreshadow increased workforce demographic data collection by Australian companies.

Prefer not to answer

Countering an employer's wish or need to collect diversity data about its workforce is an employee's right to privacy. The Australian Privacy Principles, as listed in the *Privacy Act 1988*, set out the requirements for collecting, using and disclosing personal information, with a higher standard applied for sensitive personal information.

The large-scale cyber theft of data from Medibank and Optus in 2022 have heightened public awareness of the risks inherent in personal data being held by organisations. Purpose, retention and destruction are all essential elements of any privacy policy but respecting an employee's right to choose not to disclose non-essential data is also important.

In 'Counting Culture 2021', the Diversity Council of Australia (DCA) and the University of Sydney Business School present an approach for defining, measuring, and reporting on workforce cultural diversity.[26] The DCA stresses the importance of ensuring the purpose is clear, anonymity is assured, and data collection is accurate and respectful.

DCA framework

Core measures are the minimum required to get a basic understanding of your workplace, and include:

1 Cultural background
2 Language
3 Country of birth

Additional measures enable a more detailed understanding to be gained and include:

4 Religion
5 Global experience

[22] https://www.iso.org/standard/69338.html
[23] https://www.sec.gov/rules/final/2020/33-10825.pdf
[24] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095
[25] https://www.jpx.co.jp/english/news/1020/20210611-01.html
[26] https://www.dca.org.au/research/project/cou4ting-culture-2021

Those looking to build diverse teams and capture the advantages of diversity, or even simply to avoid unintentional discrimination, will benefit from increasing their knowledge of their workforce. However, there is a balance to be struck between better diversity mapping and employees' rights to privacy and to abstain from being put in boxes. At a minimum, 'prefer not to say' should be an option on any voluntary survey regarding identity.

Part 2: Diversity of thought

In this section, the role of diversity in avoiding groupthink is canvassed, as are the challenges in harnessing diversity for better decision-making. Accommodating different communication styles is a necessary condition for capturing diversity benefits in investment management. Some of Australia's pre-eminent institutional investors share their experiences with managing diverse teams and capturing the benefits they offer.

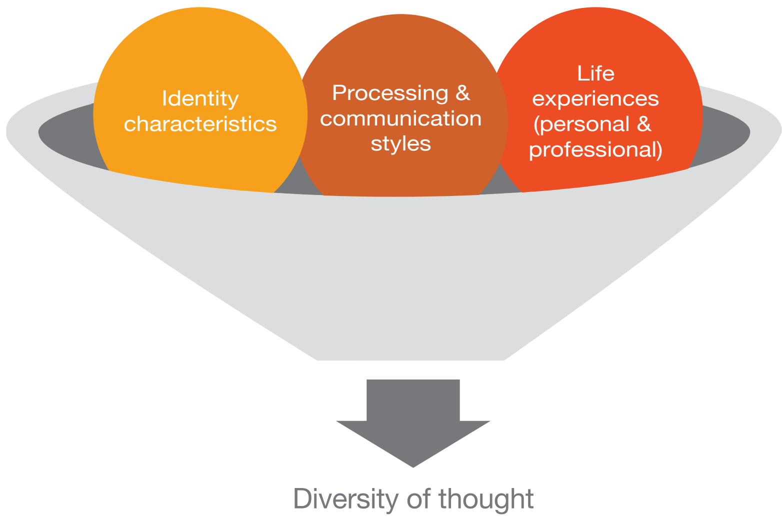
Cognitive diversity

Perspectives

Cognitive diversity encompasses different ways of thinking, learning and finding solutions to problems.

For an institutional investor, an important goal of team management is to achieve better investment decision-making and implementation. Cognitive diversity within the team can help in reaching the goal more effectively, to the extent it assists in avoiding groupthink and encourages the expression of a greater breadth of ideas.

Cognitive diversity can be a way to leverage identity diversity. The typical metrics of diversity, such as gender and age, may not contribute to better decision-making if those characteristics do not contribute to diversity of thought. A seemingly diverse team may consist of members who bring similar knowledge, training and perspectives to the tasks at hand, while another team's apparent homogeneity may mask very different life experiences and information-processing styles.



However, it is reasonable to expect diversity of experience and background will contribute to diversity of thought that, in turn, can lead to better decision-making. Improved outcomes are, of course, conditional on maintaining capability and competency.

Uncertainty

Part of the challenge and excitement of investment management is operating surrounded by uncertainty. When chance plays a significant role in determining outcomes, decision-making can become the choice of a good path, rather than the search for the right answer. Identifying possible paths and associated consequences, and assigning likelihoods to those paths and consequences, are integral to the investment decision-making process.

A compelling argument for increased diversity in investment teams is that possible paths and risks may be better identified if a scenario is being considered through different perspectives. These different perspectives may arise from different lived experiences or from different ways of processing information.

Avoiding groupthink

Dare to be different

Groupthink occurs when people within a group favour harmony and consensus over considering alternative perspectives which may lead to a better decision but at a cost of group fractiousness. While it was only developed as a theory of decision-making in 1972 (by Irving Janis[27]), its behavioral underpinnings are such that it is likely groupthink has been in action since time immemorial.

Challenge and contrarian thinking can create discomfort within a group, while consensus can be validating for group members. However, when the goal is a better investment decision, there is no place for tribalism and hierarchy that stifle independent ideas and arguments.

Be it at an investment committee or an internal research meeting, the expression of alternative and dissenting views is to be encouraged, but preferably done without undermining the cohesion of a team. Simple techniques, like the meeting chair being last to speak or reframing questions, can be effective in encouraging more varied contributions.

The Bank of England, the Financial Conduct Authority and the Prudential Regulation Authority (PRA) published a joint discussion paper in 2021, "Diversity and inclusion in the financial sector – working together to drive change."[28] The key consideration for the Bank of England and the PRA was "the linkage between insufficient diversity and inclusion and groupthink, which can present a serious risk to safety and soundness."

Speaking up and shutting up

Having different voices around the table is only the first step in harnessing diversity for better decision-making. It is also important all voices are empowered to speak up and all voices are heard. As such, inclusion may require some voices learning when to stay silent.

Too often in investment management, meetings are structured for debate where the loudest and most strident argument wins. To benefit from diversity in perspectives, decision-making processes and forums must be structured to cater for diversity in communication styles.

The extra twist is identity characteristics can intersect with communication styles, sometimes reflecting cultural norms or learned behaviors to survive as non-dominant groups. Not letting quiet voices be drowned out by loud voices is essential to leveraging the potential breadth of ideas and experience; enabling this is an example of inclusive leadership.

[27] https://archive.org/details/groupthinkpsycho00jani/page/n7/mode/2up
[28] https://www.fca.org.uk/publication/discussion/dp21-2.pdf

Values cohesion

Shared purpose

While the dangers of groupthink are widely agreed, not all diversity of thought is to be embraced. Most groups have core shared values, whether they are expressed as mission statements or organisational purpose. Commitment to those shared values is usually a necessary condition for working effectively and can create the psychological safety that makes dissent on other matters less confronting. Supportive leaders who promote shared purpose within their teams will benefit from the more open expression of innovative thinking.

Diversity in practice

Some of Australia's largest institutional investors have been proactive in recognising the benefits of diversity in decision-making and in addressing the challenges of managing teams of diverse thinkers. In the following interviews, they share insights garnered from their experience.

Adaptiveness

As CEO of State Super, John Livanas is responsible for one of Australia's largest superannuation schemes. The singular function of State Super (providing superannuation benefits to its members) provides clear focus to John, who sees his role as mustering the resources and capabilities appropriate to achieving good outcomes for members. He recognises different ways of thinking about how to achieve outcomes will contribute to achieving better results and has consciously built his team for diversity of thought.

For John, cognitive diversity has its value in 'adaptiveness', allowing the team at State Super to respond to changing circumstances and come to a collective understanding of new paths to the targeted outcome. This adaptiveness is especially important for State Super's investment team as it operates in a dynamic environment, which makes rigidity of thought a liability.

John recognises the challenges of getting the balance right within the team: sufficient differences to avoid groupthink, but not so different that the team fractures. Acknowledging individual traits, strengths and weaknesses is paramount for a leader to be able to harness the capabilities of a diverse team.

An important aspect of chairing State Super's internal meetings is to ensure the sum of individual voices comes to a solution, not simply the loudest voice. John knows, from past experience, how cognitive diversity can be expressed in ways that may seem dissonant. He nurtures the art of debating, trying to develop the capacity of team members to construct arguments in ways that recognise the impact of words and the receptiveness of others to different communication styles.

Change

Kristian Fok, Chief Investment Officer, is a strong advocate for cognitive diversity within the Cbus investment team. He believes the link to better decision-making is clear; the challenge is in understanding and harnessing diversity.

His most recent effort has been on developing tools to better extract insights from portfolio managers and analysts, making allowance for their different communication styles. Kristian recognises team or committee meetings are typically structured with a bias toward the extroverted, who relish arguing ideas and are comfortable with confrontation.

And so, while the discipline of papers, followed by debate, remains central to his team's approach, Cbus has been trialling other avenues, such as chat forums, to elicit contributions from the broader group. Additional training for moderators aim to encourage meeting participation, as does reframing questions to allow different ideas to bubble up.

Kristian believes leveraging its collective knowledge is a way to give the Cbus team an edge in dealing with rapidly changing investment markets. Diversity can allow the team to better anticipate and adapt to change, be it as turning points or new strategies. Managing diversity means recognising the different ways individuals respond to change: embracing it, preferring certainty, or making an experiential assessment. The responsiveness may depend on how change is presented; while some team members relish big picture strategic frameworks, others require actionable components. However, as the team leader, he tries to put the spotlight not on how individuals are different, but on how to improve the way the team works together.

Purpose

The Future Fund's 'joined-up investment approach' rests on bringing together a variety of views and sharing insights across the team. Deputy Chief Investment Officer, Portfolio Construction, Ben Samild is an active contributor to this whole-of-portfolio approach.

Ben acknowledges the constant practice needed to embed true diversity of thought into an investment decision-making process, but the benefits are worth the effort. Bringing different skills and views to the table allows for better identification of risks and opportunities, particularly for more strategic assessments of secular themes.

The Future Fund Management Agency invests the assets of six special purpose public asset funds and Ben sees the clarity of purpose as key to allowing such a diverse group of individuals to work together so constructively. 'Investing for the benefit of future generations of Australians' is both the bond and the metric for success.

With a background in psychology, Ben is well-credentialled to understand group behaviour and the ongoing tension between habit-forming tendencies and innovative thinking. He has seen the disadvantages of adversarial environments, where the direct contest of ideas can exacerbate an 'us/them' mentality, leading to an unhealthy culture. In such an environment, decision-making can eventually become too safe, as alternative ideas are not shared for fear of reprobation. In contrast, Ben observes an ongoing focus at the Future Fund on encouraging the freer and more democratic expression of ideas. To this end, it has even used formal observers to better understand meeting dynamics and undertaken bias training.

Each step in the inclusion journey at the Future Fund has been taken, in his view, because it is the right thing to do and because it improves the organisational and decision-making culture. For Ben, the benefits show not just as investment performance, but also as shared pride in a workplace where individuals are valued.

Part C: Boardroom diversity

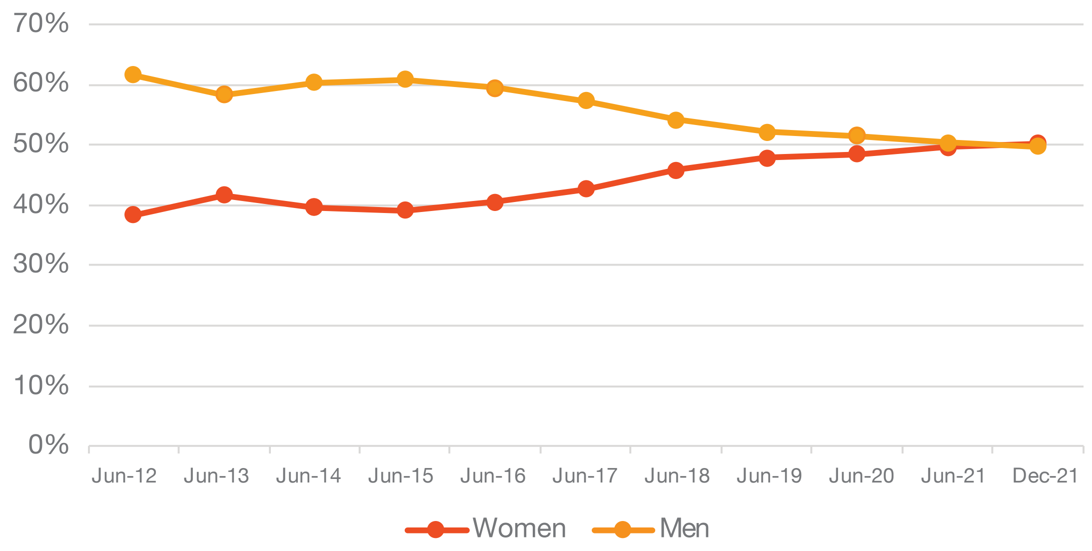
The progress in increasing gender diversity in Australian boardrooms is encouraging. However, the narrowness of disclosure does not permit a more informed commentary on the extent of broader board diversity and its contribution to improved decision-making.

The same challenges and opportunities that face investment team leaders in harnessing diversity for better decision-making also face board chairs.

Gender diversity

The success of the Australian Government in achieving gender balance within its own boards attests to the merit of explicit targets. In 2016, the Australian Government committed to gender diversity for Government boards, with targets set for women to hold 50 per cent of Government board positions overall and for women and men to each hold at least 40 per cent of positions on individual Government boards. The latest data released shows gender balance achieved, with 50.2 per cent of Australian Government board positions held by women as of December 2021.[29]

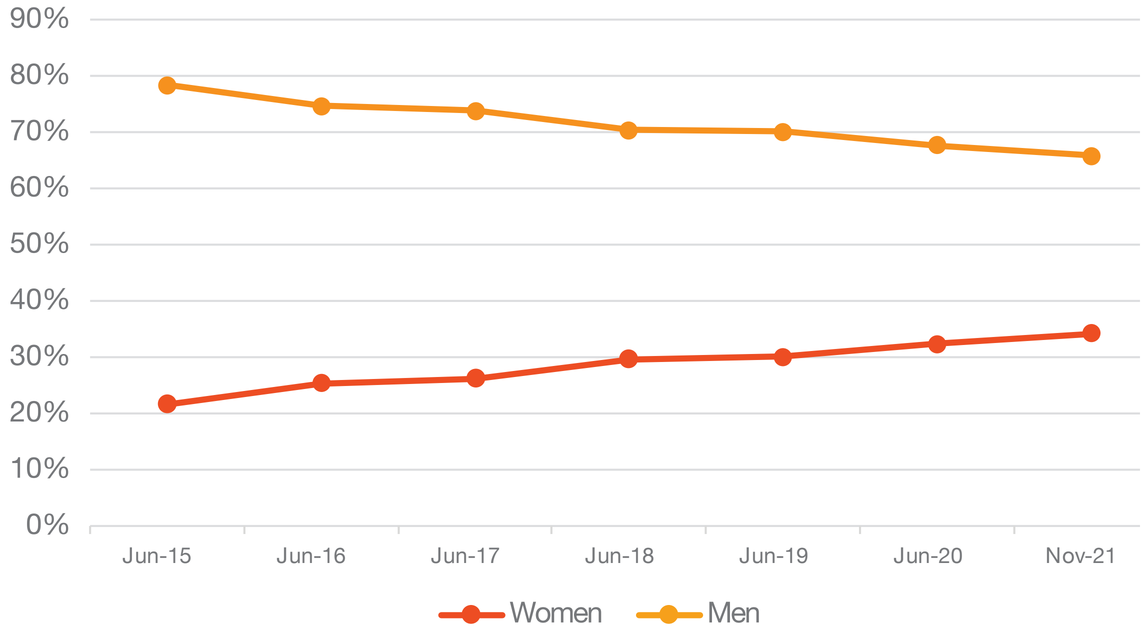
Chart 4: Gender balance on Australian Government boards



No such targets apply to the private sector overall, although many individual companies have set goals for gender diversity at the board level and report on their own progress. The Australian Institute of Company Directors (AICD) estimates 34.2% of ASX200 board directors were women as of 30 November 2021 and there were no ASX200 boards without women at that date.[30]

[29] https://www.pmc.gov.au/office-women/leadership/gender-balance-australian-government-boards
[30] https://www.aicd.com.au/about-aicd/governance-and-policy-leadership/board-diversity/Board-diversity-statistics.html

Chart 5: Gender imbalance on ASX200 boards



Board diversity disclosure

The Australian Stock Exchange, through its Corporate Governance Principles and Recommendations, recommends listed entities should have and disclose a diversity policy and set measurable objectives for achieving gender diversity.[31] Diversity should be measured at three levels: board, senior executives and workforce.

While the disclosure emphasis is on gender, the ASX Corporate Governance Council recommends "boards of listed entities consider other facets of diversity in addition to gender when considering the composition of the board. In particular, having directors of different ages, ethnicities and backgrounds can help bring different perspectives and experiences to bear and avoid 'groupthink' or other cognitive biases in decision making."

Corporate disclosure practices in the United States reflect the broader definitions of diversity evidenced in the country's population survey and equal opportunity monitoring. In the 2022 S&P 500 Board Diversity Snapshot, Spencer Stuart reported 93% of S&P 500 boards disclosed their racial/ethnic composition and 94% disclosed their gender composition. [32]

For companies listed on the Nasdaq stock market, board disclosure has been expanded with the recent introduction of Nasdaq's Board Diversity Rule.[33] This requires companies to disclose the gender and ethnic composition of their boards. Corporations will also be required to provide an explanation as to why they do not have at least two diverse board members, being at least one woman and at least one "underrepresented minority" or LGBTQ+ board member.

Age and gender of directors are typically reported in Australian annual reports. However, it is difficult to know the extent of the ethnic and cultural diversity of Australian boards when this is (perhaps appropriately) neither measured nor benchmarked. Of course, names and the gallery of director headshots allow superficial conclusions to be drawn by the interested reader.

Disclosing a board skills matrix can provide investors with insights about the professional backgrounds of directors as a group. This may inform board renewal and give confidence about the capabilities available to the board in its decision-making. However, good decision-making captures more than professional backgrounds. Expanding the skills matrix to encompass identity characteristics and non-skills criteria may provide additional useful insight for investors, albeit the appropriate balance between diversity mapping and privacy must be determined.

[31] https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf
[32] https://www.spencerstuart.com/research-and-insight/sp-500-board-diversity-snapshot
[33] https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf

Active shareholders

Some of the world's largest public pension funds have stated their responsibilities as active shareholders include the promotion of boardroom diversity and advancing this cause will create long-term shareholder value.

For example, the California State Teachers' Retirement System (CalSTRS) suggests "diverse boards initiate strategic changes more effectively, increase the exchange of ideas and lead to better performance." The California Public Employees' Retirement System (CalPERS) equates board diversity with good performance, noting that "it is essential in today's global economy that boards avoid 'groupthink' and ensure there is the breadth of experience, skills and knowledge necessary to meet complex business needs."[34]

The Australian Council of Superannuation Investors (ACSI) provides a collective voice on environmental, social and governance issues on behalf of its members, which includes many of Australia's largest superannuation funds and institutional investors. In its Governance Guidelines, ACSI recommends its members vote against the boards of ASX200 companies with poor gender diversity. ACSI bases this approach on the belief "companies are likely to be most successful when they harness collective intelligence, and approach problems with cognitive diversity. Diversity of thought assists boards to set and challenge company strategy, and to better understand the markets in which they operate."[35]

Australian institutional investors should assess whether their own board diversity policies and disclosure practices are consistent with the standards expected from the boards of investee companies.

Around the board table

Following the adage that 'a fish rots from its head', it is incumbent upon a board to set the tone for organisational culture through it's own behaviours and those of senior management. The diversity of a board sends a message to its workforce and to external stakeholders, as do the top-down decisions regarding rewarded behaviour and promoted values.

The challenges in effectively harnessing diversity of thought and communication styles are as pertinent for boards as they are for investment teams. However, the same benefits are on offer: avoiding groupthink, considering different perspectives, accessing different networks.

New perspectives may not come from new directors themselves. They may come from existing directors when the board conversation changes as diversity is introduced. This may arise either because views are no longer assumed or ideas are articulated differently, or through productive interactions.

Regular refreshment of the board is one way to avoid conformity coming from familiarity and to maintain robust debate. However, the need to ensure appropriate skills and continuity of strategic goals argues against excessive turnover.

Boards are often criticised for the opaqueness of their recruitment processes. Nomination committees can perpetuate biases in director selection, leading directly to increased governance risks through groupthink and overboarding. The overboarding risk arises when directors sit on so many boards that they have excessive board commitments and are unable to appropriately fulfill their duties. Groupthink and overboarding are more likely to occur when appointments are made from within a limited network of directors.

Greater transparency in the director recruitment process and greater diversity on the nominations committee may be necessary to effect change and benefit from a broader range of experience and backgrounds.

[34] https://www.calpers.ca.gov/page/newsroom/calpers-news/2017/engagement-corporate-board-diversity
[35] https://acsi.org.au/policies/acsi-gender-diversity-voting-policy/

Alignment

With over twenty-five years of board experience, Angela Emslie, Chair of Frontier Advisors, can appreciate the progress made during that time regarding board diversity, while recognising the need for further improvement.

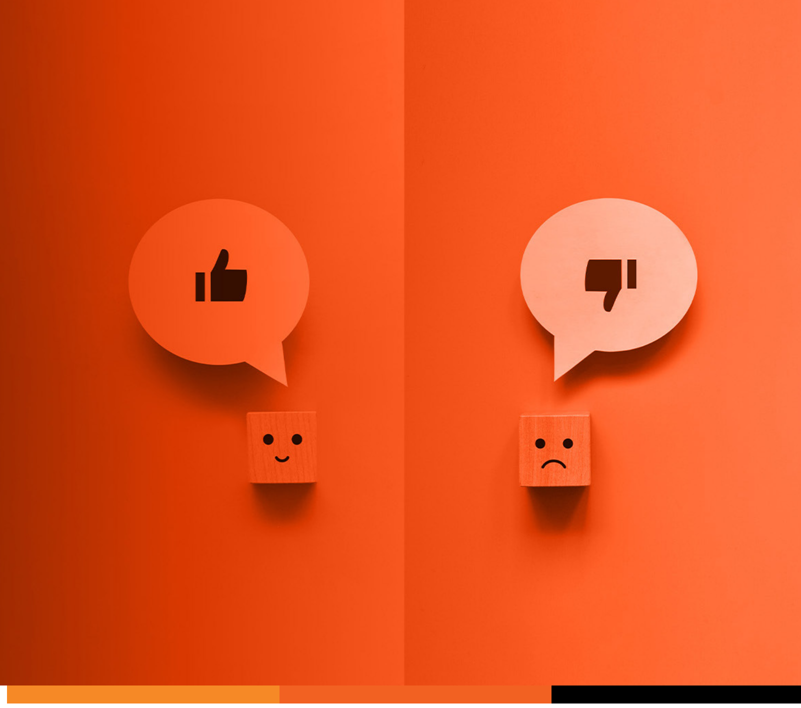
The pace of change has sped up in recent years and she attributes this to increased identity focus within the broader society, reflecting the willingness of many to claim their differences. The most responsive boards have typically been those with many employees, those who have 'taken the temperature' of their workforce and customers, and those that recognise how the tone they set impacts the organisational culture.

The evolution of many boards, from rigid governance agendas towards a greater focus on problem-solving, has heightened the need for cognitive diversity amongst directors, according to Angela. For boards that collaborate with their CEOs on complex issues, the benefits of having different perspectives on contemporary topics are sizable. As the #MeToo movement gathered momentum, it was clear that board conversations about harassment and the risks arising from toxic cultures benefited from more diverse voices.

Angela has seen first-hand how valuable it can be to have representativeness of stakeholders at the board table. However, she warns against compromising skills for box-ticking diversity. Representation can be a particular challenge for smaller boards, for those with significant stakeholder intersectionality, and for those requiring technical knowledge.

Having a clearly articulated board culture that includes open and respectful dialogue in its promoted behaviours can help in navigating different communication styles. Being deliberate in asking for opinions, leaving enough space for challenge, calling out biases – are all ways for a chair to achieve synergy from a diverse group of independent-minded people. However, Angela posits that the first step should be ensuring a cohesive objective. She offers industry fund boards examples of how alignment with a clear purpose outweighs differences arising from employee/employer backgrounds.

The final word



This report marks another stage of our commitment to research the value of diversity.

From diversity to inclusion

Alas, there is still a need to measure and track progress on increasing diversity, given the evidence (in industry data and anecdotally) of systemic biases. The significant under-representation of women in investment management and at board level suggests continued inequality of opportunity, be it through recruitment or workplace practices.

A lack of diversity, most clearly evidenced in the absence of women at decision-making levels of an organisation, may be a symptom of more fundamental cultural problems that investors should investigate before allocating capital. Of course, the same critical lens should be applied to investors' own decision-making structures.

But diversity is more than just identity representation. Rather than a tick-the-box approach, what is needed is a greater appreciation of the nuances of diversity: recognising the many dimensions of individuals without restricting them to labels.

And, while diversity practices might get people into a workplace, inclusion is what keeps them there. A genuine culture of inclusion and open communication can allow diversity of thought to flourish. With diversity of thought laying the groundwork for adaptability and innovation, teams should be a step closer to achieving the goal of better decision-making.

Increasing expectations from engaged stakeholders and disclosure requirements demand more tangible measures of diversity practice than virtue-signalling policies and platitudes. It may seem the measurement challenge is how to collect identity data without being intrusive. But the real challenge is how to measure and integrate inclusive behaviour, communication and leadership. The benefits that can flow from broadening perspectives and listening to different voices are worth the effort in meeting that challenge.

Want to learn more?

Please reach out to Frontier if you have any questions or visit frontieradvisors.com.au for more information.

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