ESG Lab #2: diversity & inclusion

London, 17 January 2018

There are strong moral and economic cases to be made for encouraging diversity and inclusion – but many organisations, not least within the financial sector, still struggle to get it right. PAI Partners' ESG Lab set out to consider some solutions.

Few social issues have generated so much momentum, so quickly, as the call for gender equality over the last 18 months. Fifty years after the second wave of feminism emerged, calling among other things for sexual equality at work, the recent presidential election in the US and sexual harassment scandals in the entertainment industry have triggered a wave of protest, activism and challenge to male domination and privilege throughout society, politics and business.

The success of the #metoo movement and of campaigns for pay transparency and equality is forcing companies and investors to reassess their practices and performance. Gender equality is, of course only one element of diversity and inclusion. It is, however, helping to focus minds on the importance of, and benefits that flow from, diversity and inclusion in the workplace.

"It's been a tumultuous year," noted Cornelia Gomez, head of ESG at PAI Partners, introducing the firm's ESG Lab in London in January on the subject. "Some facts we have known for a long time – around pay-gaps, diversity in business, minorities' inclusion in the workplace etc. – have caught up with us. It has led to the topic becoming more material for LPs [Limited Partners] … and we want to understand the challenges, the roadblocks and the solutions that PAI as a majority shareholder and our portfolio companies can implement."

The terms defined

Equality is ensuring that everyone is accorded the same opportunities, regardless of gender, race and sexual orientation

Diversity requires that people of different genders, races, backgrounds and points of view are represented at all levels of an organisation

Inclusion is the degree to which all individuals feel part of critical organisational processes

The case for diversity and inclusion

Louise Weston, a business psychologist at consultancy Pearn Kandola, and moderator of the seminar, set out why diversity and inclusion should matter to companies and their investors: "There's a moral case for diversity and inclusion, but we know it has an impact on business performance." Diverse and inclusive organisations perform better in terms of employee engagement and productivity, staff retention, creativity and innovation and client service experience. Those that get it wrong, on the other hand, can suffer reputational hits and compensation costs.

Weston adds that decision-making in diverse organisations tends to be more effective than in those that suffer from "group think" – citing well known examples such as the Challenger shuttle disaster in 1986 and the collapse of Lehman Brothers in 2008, when monocultural organisations failed to recognise the risks they faced.

Diversity can also be important in winning and retaining clients. "We find that diversity matters increasingly to our clients, and demonstrating our commitment to workforce diversity is accordingly a priority for us," said Alex Scott, a partner at PE firm Pantheon. "If your investment manager doesn't represent your values, you're probably not going to allocate money to them."

He continued: "When we meet our clients, we try to configure the team that reflects that client's own ethos and values, and which is empathetic to the people we're talking to … Having a diverse bench gives us the ability to be responsive to those various scenarios and preferences."

9%

The percentage of senior roles in private equity held by women.

Despite these clear benefits, the finance sector in general, and private equity in particular, does not have a good record, especially with regard to gender balance. "For PAI, it's the beginning of a journey," acknowledges Gomez. "We don't have 50-50 management diversity, for example. But as a forward-looking GP, we recognise the need to tackle the issue."

As part of its response, PAI has become the first French PE house to join Level 20, an organisation set up by women in private equity to promote greater female representation in the industry. Its goal is to raise the percentage of women in senior roles in private equity from the 5% level when the group was established in 2015, to 20%. Last year, the percentage of women in senior roles in the industry stood at 9%, according to a report from Preqin.

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>
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Investors are stepping up

Investors recognise the case for diversity, said Natasha Buckley, who heads the Principles for Responsible Investment's private equity work. "LPs have become more vocal about this over the past few years. They recognise that companies with higher levels of diversity perform better."

"LPs also recognise the investment case for more diverse leadership at the GP level, and there's lots of goodwill from GPs to work on this," Buckley added, "but things aren't going to change overnight. It's a long-term issue."

"Diversity is coming up at every almost event and GP discussion that we have," said Silva Dezelan, director of sustainability at Robeco Private Equity.

"We want to see more and do more as an LP, because this is a potential risk, and a potential opportunity, for portfolio companies, and hence for GPs."

So what is standing in the way of greater diversity and inclusion? The primary barrier, argues Weston, are the unconscious biases that we all have. "Our expectations and our experiences colour how we see the world," she said. In hiring, for example, confirmation bias can lead interviewers to unconsciously favour candidates with certain qualifications or backgrounds. In forming work networks, homophily – humans' natural preference for people like them – can exclude people with different characteristics.

There is a range of regulatory and voluntary initiatives underway to address inadequate diversity and inclusion. Almost every country has anti-discrimination laws in place. In the UK, legislation has been introduced requiring larger companies to disclose the difference in average pay between men and women. Numerous companies and other organisations have set targets for representation of women or minority groups within their ranks.

Starting with the data

As with any business issue, the starting point is collecting the data to ensure that the issue is properly understood. “Data is always helpful: it allows you to understand where you might have a problem, and it may not be where you think,” says Mike Winstone, group human resources director at VPS, a PAI portfolio company. But he cautions that collecting the data is not enough: “The concern is that companies are holding all this data, and are reporting on it, but don’t actually do anything about it.”

“The data will tell us where we are, but the question then is, what do you do with it? How do you use it to make the change?” says Dana Haimoff, a managing director at JP Morgan Asset Management who runs Level 20’s Future Leaders programme. Level 20 has undertaken a research project with Cambridge University Judge Business School to look at career paths in private equity to see if there are differences between those of men and women. It is also working with consultancy EY on a toolkit for GP firms, which provides best practise guidance on a range of issues impacting gender diversity, such as maternity issues, cultural change and hiring practices.

Regulations around employee data can be a challenge in both directions, participants noted. In France, for example, it is illegal to ask employees about their ethnicity and sexual orientation, but it is a requirement to track mentally and physically disabled workers; in the UK, the opposite is the case.

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Furthermore, the UK’s new rules on the gender pay gap only apply to firms with more than 250 employees. Winstone notes many businesses are structured with a Group ‘Topco’ employing a small number of senior managers, meaning those parts of the business – where gender pay differentials tend to be greater – will not be included in any statutory reporting requirements.

Quotas and targets, a help or hindrance?

The seminar discussed the introduction of quotas and targets as a means to increase the representation of women and minority groups, but most participants considered quotas to be a somewhat blunt tool, and often opposed by those they are designed to benefit: “Quotas can be useful in terms of making an overt statement [in favour of diversity], but they can be undermining if people feel they are in a role not because of who they are but because they represent a particular group," said Buckley at the PRI.

They too often fail to deliver their objectives, especially if they are perceived as tokenistic, she noted: "The evidence shows that if there is only one woman appointed to a company board, they are much more likely to leave within one year than if there are two or three women there."

However, simply raising the issue with investors can have salutary results. Buckley gives the example of the New York City's Bureau of Asset Management, which oversees the city's pension funds. "They present fund managers with a [due diligence questionnaire] on diversity. Although they don't yet weight the responses in their investment decisions, they won't invest with managers unless they complete the form: they have got an incredible response from GPs, who said 'we recognise we've got a problem and we need to do something about it' … Just asking the question can make a difference."

LPs can use their influence to actively encourage better practice from GPs, adds Buckley, who cited the Institutional Limited Partners Association's preliminary efforts to support LPs on this through the establishment of a diversity taskforce. The LP taskforce is currently testing ideas on developing research on the impact of D&I on performance, D&I metrics, incorporating D&I topics into the ILPA due diligence questionnaire tool, and potentially recommending a format for GP reporting on D&I information.

"As LPs, we should be asking for more information, whether quantitative or qualitative," on diversity and inclusion, said Dezelan at Robeco. "As we've seen with ESG integration in general, if LPs ask for more information, GPs will provide it. As a starting point, LPs might ask GPs what they are monitoring within their portfolio companies, and whether they have any commitments related to diversity at the firm level."

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> **Louise Weston, Pearn Kandola**

Looking further afield for talent

Another relatively straightforward solution is for human resources departments to apply more creativity to how and where they seek talent. For example, Dezelan noted that recruiters for investment management positions typically look for candidates with quantitative skills, but the large majority of those studying econometrics are men.

She quoted the findings of a study on women in portfolio management by Oliver Wyman, which found that, at the end of 2015, only 15% of portfolio managers globally were women. At 32%, however, Asia had by far the highest female representation, and this was unsurprising given that the percentage of women studying quantitative subjects in Asia is higher than in Europe and the US. "It's not that there are no women with quant skills – it's a question of knowing where to look for female talent," Dezelan said.

Sponsoring programmes can also be effective ways of bringing on talent from under-represented groups, and they tend to be more effective that mentoring initiatives. "Mentors advise: sponsors move you up," says Haimoff. It is important for organisations to actively promote such programmes to women or minority groups, participants in the seminar heard.

Companies do, however, need to be mindful of overcompensating. “It is important to avoid the backlash effect from introducing programmes for certain groups,” notes Valérie Rasson, head of human resources at PAI. Instead, training programmes, for example, should be introduced for all employees, but management might work to ensure that there are places reserved for minority groups, or minority employees are specifically invited to apply.

One of the most important factors, participants agreed, is strong buy-in from the top of the organisation, and a clearly articulated culture that values diversity and inclusion. “Around any cultural change initiative, unless you’ve got senior management commitment, it’s difficult to move forward,” says Weston.

The commercial case for action

Making a clear business case can help that culture cascade down throughout a company, argued Winstone at VPS. “There’s always a strong ethical case, but make it commercial as well, so people can see the benefit for the business, and the benefit for them.”

Ivan Massonnat, a partner at PAI, gave the example of portfolio company Kiloutou, a France-based equipment rental firm, and one that historically has been very male-orientated. “What they discovered was that when they recruited women, they tended to be more careful, for example wearing the protective equipment, the incident rate went down, and the profit at those centres was higher.”

“There isn’t a one size fits all solution to creating more diverse and inclusive organisations,” concluded Weston. “The numbers aren’t necessarily the critical path; it’s what organisations are doing to achieve those numbers … Do you know how diverse or inclusive your business is? What are the issues preventing better D&I? What are the initiatives that are being undertaken and how are they performing? Where might you have to focus your attention? If you’re asking those questions, the numbers should follow from that.”

Inevitably, this ESG Lab in January could not provide answers to all the participants’ questions regarding diversity and inclusion, but it contributed to an ongoing discussion between our LPs, our portfolio companies and PAI Partners.