BNY MELLON
WEALTH MANAGEMENT

Diverse Companies Are Designed for Success

At BNY Mellon Wealth Management, we believe we have a responsibility to improve lives through investing. Our commitment to creating an inclusive, sustainable world that encourages people to thrive informs everything we do, not just within our organization but also with our clients. Individual investors and asset managers have the opportunity to make direct social, market and global economic impacts with their investments — but that's not the whole story. The evidence shows that in doing so, they also have the potential to generate significant financial returns.

Companies that make a concerted effort to build diverse teams see gains in profitability that set them apart from the competition. Investors who recognize the role that diversity can play in helping to deliver superior financial returns have an opportunity to take advantage of this disparity, and identify companies that are designed to succeed in the modern marketplace.

How Do Businesses Benefit From Diversity?

Decades of research have shown that when people from different backgrounds work together in a group, they are often more innovative and productive. Diverse teams are motivated to consider alternative perspectives and process information more carefully, and the resulting surge in creativity can lead to the development of new strategies, products and services.[1]

There appears to be a direct tie between diversity and better financial performance. Companies in the top 25% for gender or racial and ethnic diversity are more likely to have financial returns above their national industry medians —15% higher for gender and 35% for racial and ethnic diversity. For every 10% increase in racial and ethnic diversity on the senior executive team, earnings before interest and taxes (EBIT) rise 0.8%.[2]

When companies commit to diversity, they are also in a better position to attract top talent, maintain employee satisfaction and improve their customer retention. This competitive edge, in turn, helps to increase returns and profits.

Companies that want to reap these benefits need to have leaders who appreciate difference and recognize the potential of an inherently diverse team that includes people of different ages, genders, orientations, races and ethnicities. Leaders who foster an environment that encourages input from individuals with different perspectives are demonstrating "acquired diversity," a term coined by the Center for Talent Innovation (CTI).

By seeking out and appreciating the opinions, perspectives and ideas of a wide range of employees, leaders are more likely to unlock the innovative capacity of their team. These leaders can transform their workplace by developing a culture in which all voices are heard. Encouraging ideas from different perspectives

1 Katherine W. Phillips, "How Diversity Makes Us Smarter," Scientific American, October 1, 2014, republished on January 30, 2017.
2 Vivian Hunt, Dennis Layton, and Sara Prince, "Diversity Matters," McKinsey, February 2015.

can lead to the contribution of more ideas with greater market potential, ideas that otherwise may have gone unnoticed. According to CTI, companies with both inherent and acquired diversity were 45% more likely to have expanded their market share in the previous 12 months, and 70% more likely to have captured new markets, compared with companies that did not have both inherent and acquired diversity.[3] In other words, the research suggests that "homogeneity stifles innovation."

Women in Leadership Provide Additional Advantages

The presence of female executives is associated with strong firm performance as measured by both gross and net margins, according to a Peterson Institute survey of nearly 22,000 firms from 91 countries. There is also evidence that female managers are better at engaging employees than their male counterparts, by encouraging professional development, fostering a positive work environment and delivering consistent feedback and recognition.[4] High employee engagement has been linked with increased productivity, retention and profitability.

The financial benefits of having women in leadership positions have already caught the attention of some investors. At BNY Mellon Wealth Management, we have started to explore the market potential of a gender-focused portfolio. We initially focused on companies where women had a strong presence on the board of directors.

Currently, over 90% of S&P 500 companies have at least one woman on their board, but BNY Mellon research indicates women represent only 19.2% of all seats. Our analysis found that when women make up 30% of a company's board of directors, it correlates with a higher return on investment capital and other measures of business success.

The diverse set of skills and experience women bring to boards can help companies improve risk management and corporate governance, better represent the thinking of women consumers, and spur more diversity throughout the rest of the company. Women represent half the world; it stands to reason that companies that have a critical mass of women on their boards will benefit from that point of view.

How to Invest in Diversity

For investors looking to be more hands on in their approach, there are resources available that can help them evaluate if companies are successfully cultivating a diverse workplace. For example, Bloomberg has created a Financial Services Gender-Equality Index, which includes 26 public companies in the financial services sector. The index provides standardized data on companies' gender statistics, employee policies, gender-conscious product offerings and external community support and engagement.[5]

DiversityInc is a publication focused on bringing education and clarity to the business benefits of diversity. Each year, DiversityInc releases a list of the top 50 companies for diversity, which is based on how companies report on the breakdown of their current workforce, talent development opportunities, leadership accountability (in terms of results, communication efforts and visibility), as well as the diversity within the supplier businesses they work with.

Additional lists, broken down by specialized areas (e.g., top companies for global diversity, executive women, etc.), offer even more ways to evaluate these companies.

These lists present a starting point for investors looking for companies that actively promote diversity in the workplace. But it's also important for investors to perform their own due diligence. Just because a company says it's committed to diversity does not necessarily mean it's executing on its commitment. If a company declared it had great earnings, for example, you wouldn't just take their word for it. You would want to see the data supporting their claims.

Facebook is one example of a company that has strongly voiced its commitment to diversifying its workforce, yet continues to struggle with actually changing its demographics. In 2015, Facebook initiated an incentives-based recruiting strategy designed to increase the number of female, black and Latino engineers in the organization.

According to yearly diversity reports, however, the demographics barely changed between 2015 and 2016. The problem lies with the final hiring managers, who continue to nearly exclusively hire white or Asian men, even though strong minority candidates are making it through the rigorous interview process.[6] Until the actions of upper management align with the recruiters' efforts, or until the hiring process itself is re-evaluated, it seems unlikely that the company will be able to meet its diversity goals.

3 Sylvia Ann Hewlett, Melinda Marshall, and Laura Sherbin with Tara Gonsalves, "Innovation, Diversity and Market Growth," Center for Talent Innovation, September 2013.

4 Kimberly Fitch and Sangeeta Agrawal, "Why Women Are Better Managers Than Men," Gallup, October 16, 2014

5 "Bloomberg Launches Financial Services Gender-Equality Index," Bloomberg, May 3, 2016.

6 Ellen Huet, "Facebook's Hiring Process Hinders Its Effort to Create a Diverse Workforce," Bloomberg, January 9, 2017.

Companies should be able to measure results on issues like compensation, development opportunities and the makeup of its workforce and leadership team in order to show their progress toward diversity.[7] Those that can link these strategies to employee satisfaction, performance and the bottom line are those that investors should focus on.

Investors Could Benefit by Embracing This Approach

Demographic trends indicate that the U.S. population will only become more diverse in the future. The U.S. Census Bureau projects that by 2044, more than half of all Americans will belong to a minority group.[8] To remain successful, companies need to reflect these changing demographics in order to better understand the point of view of their consumers and retain top talent among their employees.

As more companies see the financial benefits of diversity, the trend toward building a more diverse workforce and leadership team will continue to grow. By incorporating diversity into their overall investment strategy, investors will have a new avenue to pursue market returns, as well as reinforce their commitment to a social cause.

7 Judith Lindenberger, "Diversity and the Workplace," Experience by Symplicity, 2017.

8 Sandra L. Colby and Jennifer M. Ortman, "Projections of the Size and Composition of the U.S. Population: 2014 to 2060," U.S. Census Bureau, March 2015.