HEALTH WEALTH CAREER

HOW DIVERSITY AND CULTURE IMPACT MERCER'S MANAGER RATINGS

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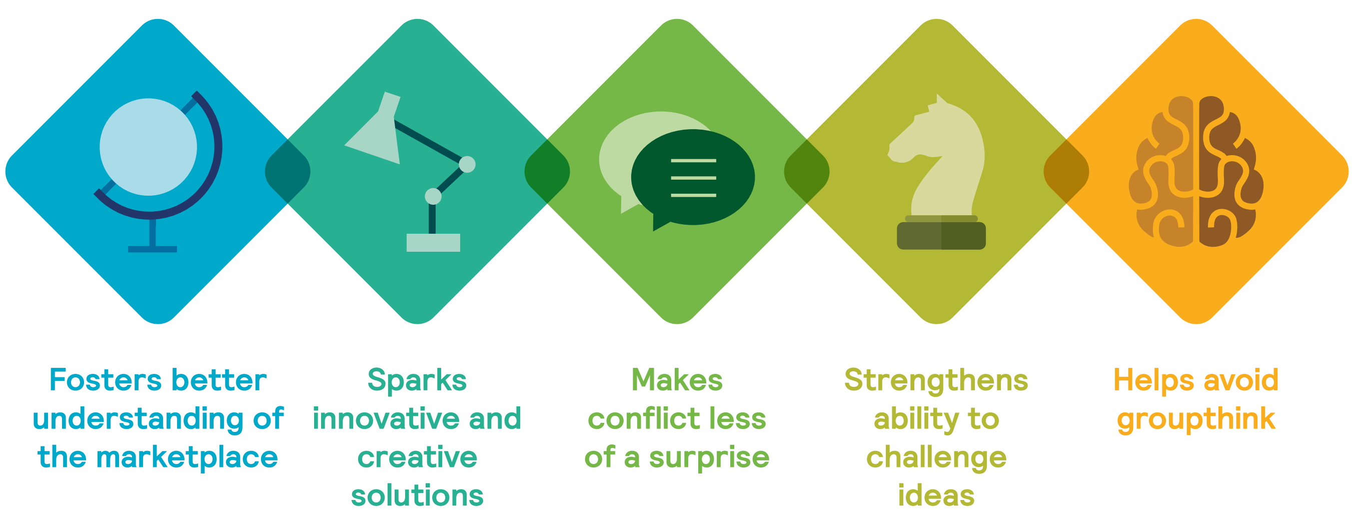
Mercer believes that it should be an imperative for any business to take action to improve its diversity and create a better culture. The body of evidence-based research demonstrating the value of diversity continues to grow, and the question is no longer "why diversity?" but "how do we improve diversity and benefit from its advantages?"

Diversity comes in many forms but can be broadly grouped into two types:

- **Cognitive diversity**, which is when teams comprise individuals who think — and approach problem-solving — in different ways; this may arise, for example, from different types of education
- **Identity diversity**, which is how people identify themselves, such as by gender, sexuality, nationality, age, ethnicity and so forth

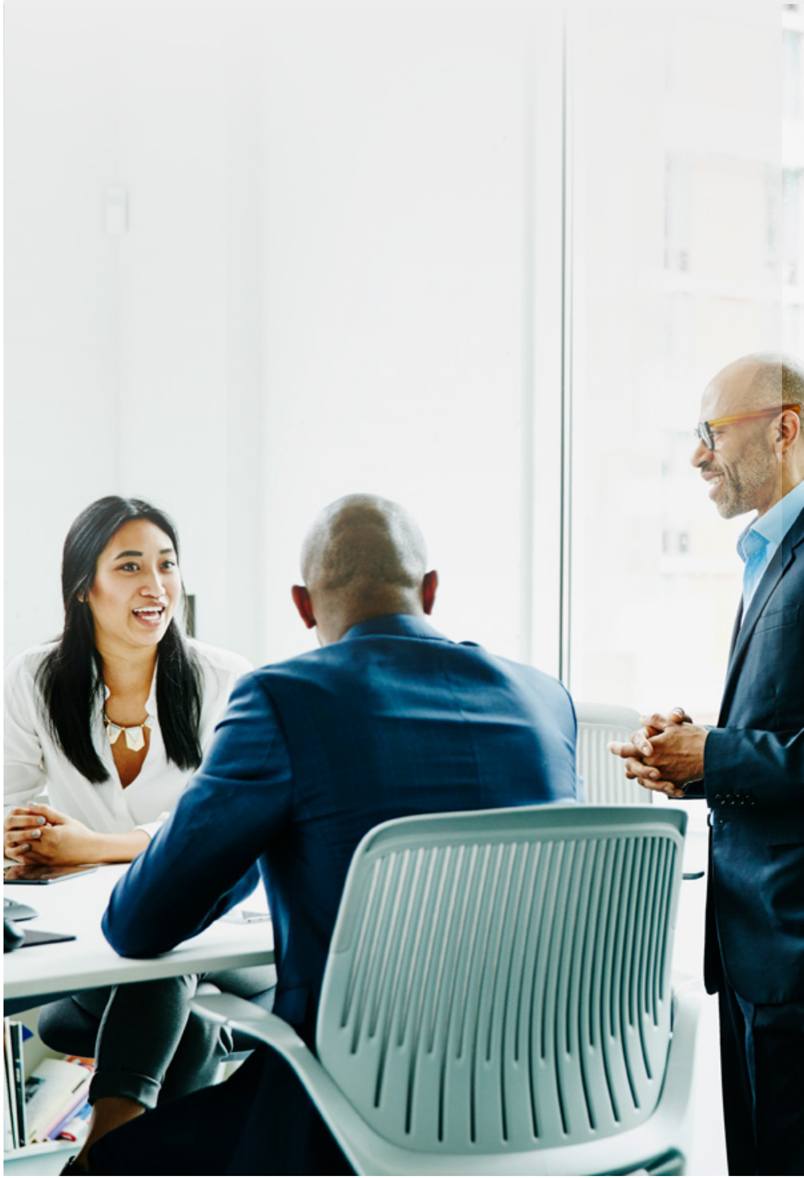
The two are connected — because people of different identities will often have different backgrounds and experiences, which should lead them to approach problem-solving in different ways — but are not necessarily the same. We refer to both types collectively as "diversity" in this paper. Overall, we believe diversity is a crucial aspect of an investment team, underpinned by the firm culture. The figure below outlines some of the benefits of diversity.

Figure 1: Driving Better Solutions: Benefits of Diversity



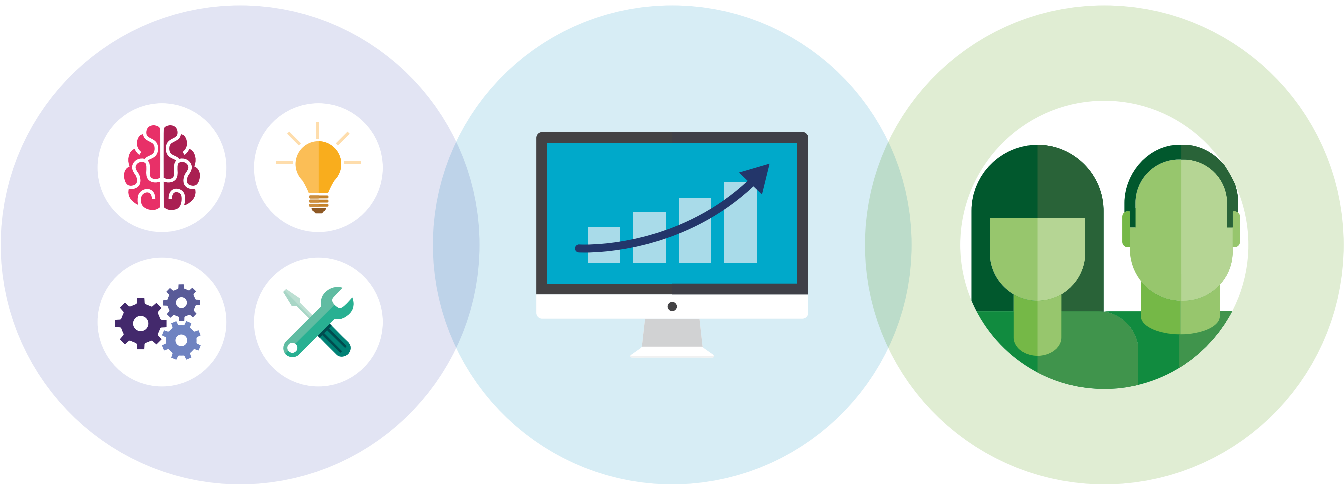
We believe diverse teams offer many benefits, but fundamental among these is the ability to create better solutions. This is true across all industries and service sectors, including the investment management industry. Collectively, diverse teams often have a better, and broader, understanding of the marketplace, and the combination of different cognitive styles is more likely to produce innovative and creative solutions — particularly to complex problems, such as those found in financial markets. Diverse teams are also better able to probe and challenge each other's ideas, providing the checks and balances needed to ensure robust solutions and guard against the behavioral biases we see in the investment industry. Expressed another way, diverse teams are less likely to fall into the trap of "groupthink," the phenomenon whereby the desire for group consensus overrides an individual's underlying preference to present alternatives, critique a position or express an unpopular opinion.

To be effective, however, diversity needs to be managed. Taken to extremes, different points of view can lead to conflict and a failure to cooperate. To function efficiently (and relatively harmoniously), diverse teams should comprise individuals with shared, common values around their objectives. Diversity can be a great asset, but individuals need to be aligned on the same page in terms of the team's ultimate goals. This requires a strong culture, skillful management and a recruitment process that considers and understands the compatibility of candidates' values with those of the team.



We sum this up by stating one of our core beliefs in manager research, which is that diverse teams with shared values are more likely to outperform (see Figure 2). If ever there was a free lunch in investing, we think it's very likely that the secret sauce in this dish would be diversity.

Figure 2: Diverse Teams and Outperformance



Our professional role in Mercer's manager research team is to assess investment strategies. Clearly, if we believe — as we do — that diverse teams are more likely to outperform, then it's only logical that we consider an investment team's diversity as part of our appraisal. Consideration of diversity has long been an important part of our research process, as illustrated in the four-factor framework used for assessing a strategy in Figure 3.

Figure 3: Manager Research Framework

Idea Generation

- Philosophy
- Investment process
- Competitive avantage
- Resources

Portfolio Construction

- Guidelines
- Style
- Risk
- Monitoring

Implementation

- Trading
- Turnover
- Capacity

Business Management

- Business structure
- Business enviroment/ culture
- Remuneration
- Non-investment distraction

Thinking about diversity is interwoven into this framework, and we highlight three areas:

Idea generation is where we assess a team's ability to generate value-adding investment ideas. Diversity helps in several ways here. First, a diverse team collectively has broader knowledge and better understanding of its market, which can only be an advantage over a team with a narrow perspective. Second, what could be more valuable to an idea-generation process than having a team that thinks of creative and imaginative ideas in today's complex financial markets? A team's diversity, or lack of, can have a significant impact on our assessment of a manager's idea-generation capabilities.

Portfolio construction covers the ability of a team to translate value-adding investment ideas into an effective portfolio. An important part of this is risk control — and what is the number one enemy of effective risk control procedures? It's groupthink. Effective risk control requires colleagues to be able to push back, to challenge and to provide a different perspective. At times, it even requires them to blow the whistle and say "no." Cognitive diversity, which helps combat the threat of groupthink, can only improve the effectiveness of risk control.

Business management is where we assess how well a business and its people are managed. Culture is a key component within this. Is the culture conducive to getting the best out of staff? Does the firm have an inclusive ethos? Are team members — at all levels — positively engaged with the business? Is the business able to attract the best staff from the broadest talent pool by avoiding the limitations of only seeking people who look and think like the existing team?

We have seen that diversity is an important factor when rating a manager, so what does Mercer look at to "measure" a manager's diversity? There are three broad areas, summarized in Figure 4: (a) aspects of the team diversity that can be objectively measured (for example, gender or age); (b) measures of team diversity that are harder to see (for example, thinking styles or team culture); and (c) corporate policies.

Figure 4: Assessing Diversity

People

- Gender
- Age
- Prior experience
- Nationality/language/ethnicity
- Education/training/qualifications

- Thinking style
- Personality
- Team dynamics
- Values and culture

Corporate

- Diversity and inclusion policies
- Diversity and inclusion targets and initiatives
- Compensation and promotion
- Unconscious bias training
- Recruitment practices
- Agile working?
- Returner programs?
- Industry initiatives?
- Diversity and inclusion certification?

Not all diversity is immediately apparent. Like an iceberg, much of what makes us all different lies beneath the surface and cannot be seen. For example, identity features such as sexual orientation, personal values, beliefs, family status, religion, politics and heritage are not aspects of diversity that we can consider. However, many other diversity aspects — such as gender, age, prior working experience, ethnicity, professional qualifications, nationality and level of education — are visible and relevant. The presence or lack of visible diversity along these lines will clearly be evident to us when we review a manager, and we also collect much of this information through our database, MercerInsight. If we come across a team that is, for example, composed solely of white, middle-aged men of a similar educational background, we will not necessarily conclude that the team lacks cognitive diversity. However, when confronted with a team like this, we will certainly dig deeper and question the degree of potential bias in the team, and our conclusion could well be that this is a homogeneous team that lacks diversity of thought. Conversely, we come across teams with abundant visible diversity, and we often (but not always) find that these are vibrant teams possessing strong idea-generation skills without the restraints of groupthink.

An experienced and insightful manager researcher will also be able to assess more complex dimensions of diversity, such as cognitive thinking styles, team dynamics and personality styles. Particularly when explored over successive meetings and interviews, a researcher can get a thorough understanding of the extent of diversity (both cognitive and identity) within a team. To do this, the researcher will consider a number of questions: Does the team have a dominant leader? Is there a low level of challenge within the group, regardless of any surface-level diversity? When a team is under pressure from poor performance or from client outflows, is it more vulnerable to groupthink? How does the team reach decisions, and how does it manage any mistakes it has made? What is the team leader's attitude toward diversity? Does the team have a culture of accountability, or blame? Does the team present an illusion of unanimity, but, in reality, team members are hesitant or reluctant to disagree? How does a team work through dissenting views? Does any recent staff turnover tell us anything about team dynamics and the value placed on diversity? Does the remuneration structure (team versus individual bonus) have any implications for how a team reacts to challenge or debate or the way the team manages dissenting views?

Our ability to assess diversity doesn't stop at the makeup of a team. We also consider a manager's corporate policies. For example, does the manager have a formal diversity and inclusion policy? Does the firm have mandatory unconscious bias training for staff? If the answer to these is "yes," are these reflected in a positive approach to diversity and culture at the team level, or is this an exercise in ticking boxes by the organisation? Other questions relate to the firm's recruitment practices. Does the manager conduct open market searches for staff, or does the firm just call in people they already know to interview? Which of these approaches is more likely to result in a diverse team? Mercer routinely collects this information through our database and will arrange research meetings dedicated to discussing corporate policies.

Successful investment teams can come in many shapes and sizes. But we firmly believe a diverse team with shared values is more likely to outperform its less-diverse peers.

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