McKinsey&Company

Diversity Matters

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Executive summary

Our "Diversity Matters" research looked at the relationship between the level of diversity (defined as a greater share of women and a more mixed ethnic/racial composition in the leadership of large companies) and company financial performance (measured as average EBIT 2010–2013). The research is based on financial data and leadership demographics compiled for this purpose from hundreds of organisations and thousands of executives in the United Kingdom, Canada, Latin America, and the United States. The size of the dataset allows for results that are statistically significant and the analysis is the first that we are aware of that measures how much the relationship between diversity and performance is worth in terms of increased profitability.

The analysis found a statistically significant relationship between a more diverse leadership team and better financial performance. The companies in the top quartile of gender diversity were 15 percent more likely to have financial returns that were above their national industry median. Companies in the top quartile of racial/ethnic diversity were 35 percent more likely to have financial returns above their national industry median. Companies in the bottom quartile for both gender and ethnicity/race were statistically less likely to achieve above-average financial returns than the average companies in the dataset (that is, they were not just not leading, they were lagging). The results varied by country and industry. Companies with 10 percent higher gender and ethnic/racial diversity on management teams and boards in the US, for instance, had EBIT that was 1.1 percent higher; in the UK, companies with the same diversity level had EBIT that was 5.8 percent higher. Moreover, the unequal performance across companies in the same industry and same country implies that diversity is a competitive differentiator that shifts market share towards more diverse companies.

Variations by country show that the bar for competitive differentiation continues to rise. For example, in the US there continues to be a linear relationship between ethnic/racial diversity and better financial performance. In fact, in the US, ethnic/racial diversity has a stronger impact on financial performance than gender diversity, with earlier pushes to increase women's representation in the top levels of business having already yielded positive results. By contrast, in the UK, increased gender diversity on the executive team corresponded to the highest performance uplift in the global dataset. From an industry perspective, certain industries perform better on gender diversity and others on ethnic/racial diversity. No industry or company was in the top quartile for both dimensions.

The relationship between diversity and performance highlighted in the research is a correlation, not a causal link. This is an important distinction, but the findings nonetheless permit reasonable hypotheses on what is driving improved performance by companies with diverse executive teams and boards. It stands to reason—and has been demonstrated in other studies, as we indicate—that more diverse companies are better able to win top talent, and improve their customer orientation, employee satisfaction, and decision making, leading to a virtuous cycle of increasing returns. That in turn suggests that diversity beyond gender and ethnicity/race (such as diversity in age and sexual orientation) as well diversity of experience (such as a global mindset and cultural fluency) are also likely to bring some level of competitive advantage for firms that are able to attract and retain such diverse talent.

Moving the needle on diversity is harder than completing a typical transformation due to barriers like unconscious bias. This makes it even more important that companies have a robust transformation programme that explicitly addresses unconscious bias, and that there is visible commitment from the leadership team. This may require challenge from within or beyond the company: data-driven diversity programmes can often highlight unconscious biases that impair the exercise of good judgement throughout the organisation, even when best practices are systematically followed and best intentions are assumed and exercised. However, case studies from the emerging field of behavioural economics and what is known as "nudge theory", as well as our own experience in working with clients, provide evidence that such change is possible.

Diversity matters because we increasingly live in a global world that has become deeply interconnected. It should come as no surprise that more diverse companies and institutions are achieving better performance. Most organisations, including McKinsey, have work to do in taking full advantage of the opportunity that a more diverse leadership team represents, and, in particular, more work to do on the talent pipeline: attracting, developing, mentoring, sponsoring, and retaining the next generations of global leaders at all levels of the organisation. Given the increasing returns that diversity is expected to bring, it is better to invest now, as winners will pull further ahead and laggards will fall further behind.

The "Diversity Matters" project

For several years McKinsey & Company has been developing research and initiatives on the topic of diversity in the workplace. The first report, "Women Matter", published in 2007, identified a positive relationship between corporate performance and elevated presence of women in the workplace in several Western European countries, including the UK, France, and Germany. McKinsey has since expanded the focus of its research on the relationship between performance and diversity to include diversity in race and ethnicity and sexual orientation as well as gender.

The research proceeded through the creation of proprietary datasets for 366 public companies across a range of industries in the United Kingdom, Canada, the United States, and Latin America. The data collected included the composition of top management and boards in 2014 and financial data, earnings before interest and tax (EBIT), for the years 2010 to 2013.[1]

In addition to capturing gender information, the dataset also included ethnic and/or racial information from publicly available sources.[2] We measured the relationship between leadership diversity and financial performance with the aid of the Herfindahl–Hirschman Index (HHI), a tool used for decades by economists to determine the level of competitiveness within markets and industries. By adapting the index, the Diversity Matters team was able to recognise a company that, for example, has two board members from two different ethnic minorities as being more diverse than a company with the same size board that has two board members from the same ethnic minority (see box). The size of the dataset allowed for results that were statistically significant and enabled the value of the relationship to be quantified in terms of the observed uplift in EBIT relative to the diversity of the leadership teams analysed.

Using the normalised Herfindahl–Hirschman index for diversity

What is the normalised Herfindahl–Hirschman index?	▪ The Herfindahl–Hirschman index (HHI) is a measure of market concentration and competition within an industry, measuring the size of a firm in relation to its industry ▪ The standard HHI is defined as the sum of the squares of the market shares of the largest firms within the industry, where the market shares are expressed as fractions. Formula: HHI= $\sum_{i=1}^{N}(s_i{}^2)$ where s_i is the market share of firm *i* in the market, and *N* is the number of firms ▪ This result is normalised to ensure a result between 0 and 1: Formula: NHHI= $(HHI - 1 / N) / (1 - 1 / N)$
How is it used to measure diversity?	▪ We used the HHI formula to differentiate diversity in companies that had the same number of executives outside the majority group, but where one executive team included a greater range of ethnic backgrounds ▪ For example, if one company had 8 white and 2 Asian executives and another company had 8 white, 1 Asian, and 1 black executive, using the HHI formula allowed us to credit the second company as having a more diverse executive team: $HHI_1 = 0.68 = (\frac{8}{10})^2 + (\frac{2}{10})^2$ $HHI_2 = 0.66 = (\frac{8}{10})^2 + (\frac{1}{10})^2 + (\frac{1}{10})^2$ ▪ An HHI of 1.0 indicates a team where everyone has the same race or gender. Increases in the HHI indicate a decrease in diversity. Decreases in the index indicate an increase in diversity ▪ For the normalisation, N is always 7, the number of ethnic groups used in the categorisation, even if that group is not represented in the team, and has a share of 0

1 Companies were classified into seven groups: finance, insurance, and professional services; heavy industry; healthcare and pharmaceuticals; telecom, media, and technology; consumer goods and retail; transportation, logistics, and tourism; and energy and basic materials. Top management teams were as defined in company websites, and included positions from the C-suite to senior vice presidents. Almost 5,000 leaders were included in the research.

2 Ethnic and racial categories used were African ancestry, European ancestry, Near Eastern, East Asian, South Asian, Latino, Native American, other.

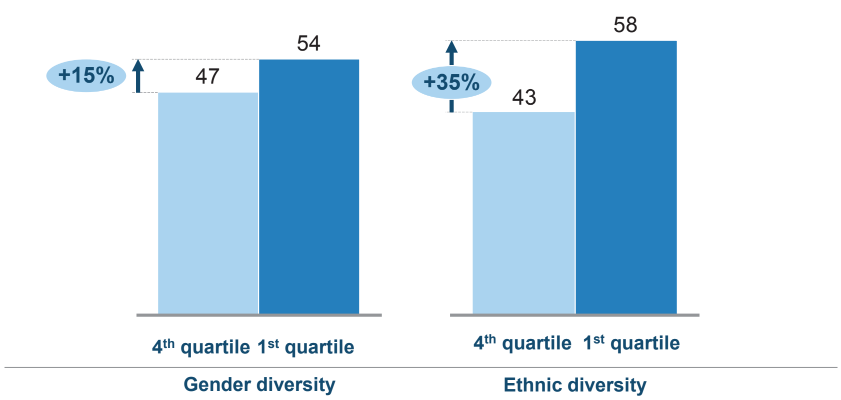
1 The relationship between diversity and performance

Analysis of the data from the group of 366 companies revealed a statistically significant connection between diversity and financial performance. The companies in the top quartile for gender diversity were 15 percent more likely to have financial returns that were above their national industry median, and the companies in the top quartile for racial/ethnic diversity were 35 percent more likely to have financial returns above their national industry median (Exhibit 1). This correlation does not prove that the relationship is causal—that greater gender and ethnic diversity in corporate leadership automatically translates into more profit—but rather indicates that companies that commit to diverse leadership are more successful. The existence of the relationship is statistically significant and consistently present in the data.

Exhibit 1

How diversity correlates with better financial performance

Likelihood of financial performance above national industry median, by diversity quartile
%



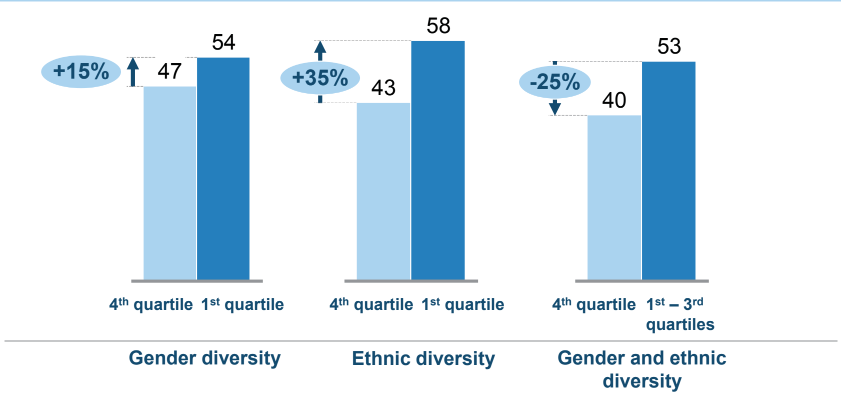
SOURCE: McKinsey Diversity Database

The reverse is also true, companies in the bottom quartile in both gender and ethnicity underperformed the other three quartiles (Exhibit 2).

Exhibit 2

How low gender and ethnic diversity correlates with poorer financial performance

Likelihood of financial performance above national industry median, by diversity quartile
%



SOURCE: McKinsey Diversity Database

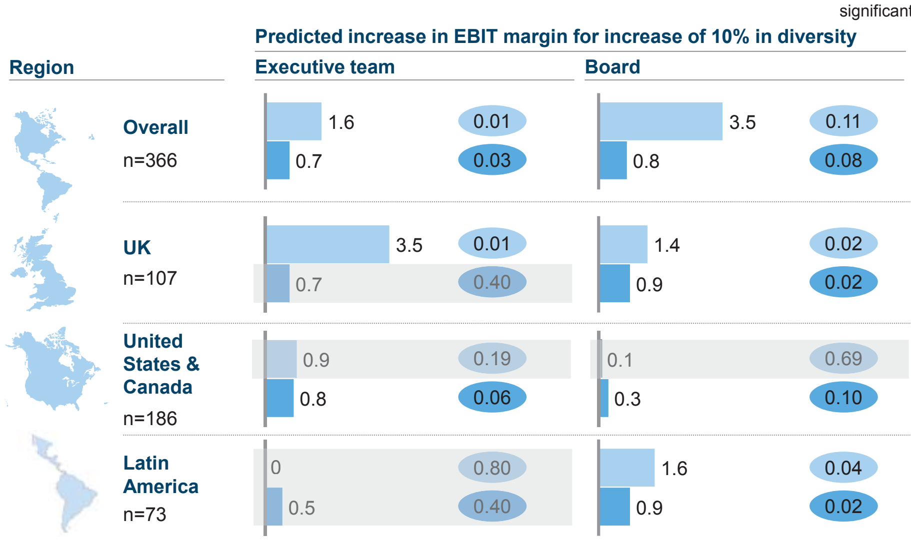
ASPECTS OF THE DIVERSITY–PERFORMANCE RELATIONSHIP

The analysis of the data revealed a positive relationship between financial performance and greater diversity in leadership. The strength and significance of that relationship varied by type of diversity (gender or ethnicity), country, and industry (Exhibit 3).

Exhibit 3

Strength and statistical significance of the relationship between financial performance and diversity

Gender
Ethnicity
xx P-value
Not statistically significant[1]



1 P-values of 0.1 and under were considered statistically significant (90%).

SOURCE: McKinsey Diversity Database

Nuances in gender and ethnic diversity

Closer inspection of the analysis revealed many interesting, non-intuitive findings. In the United States, for example, companies have made efforts in recent years to increase the number of women on executive teams and boards. Although representation is still limited, there has been measurable progress (Exhibit 4).

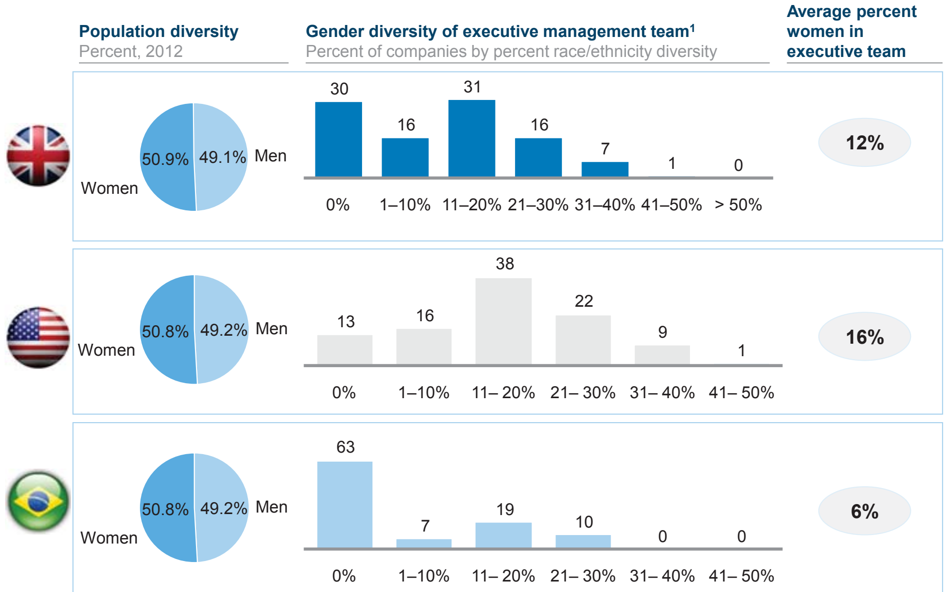
At the same time, the data appears to show that less attention has been given to the attainment of racial and ethnic diversity. By this measure it becomes apparent that US companies would need to make a dedicated effort to achieve a diversity of leadership that reflects the demographic composition of the country’s labour force and population (Exhibit 5).

Interestingly, the US dataset shows no statistically significant correlation between gender diversity and performance until women constitute at least 22 percent of a senior executive team. From that point, the correlation observed for US companies is that for every 10 percent increase in gender diversity there is an increase of 0.3 percent in EBIT margin.

In the UK the relationship between gender diversity and performance is much more apparent and powerful. The correlated benefit is an increase of 3.5 percent in EBIT for every 10 percent increase in gender diversity in the senior executive team (and 1.4 percent for the board). That is, UK companies experience more than ten times the impact for their efforts in gender diversity than US companies do, even after reaching the 22 percent tipping point.

Exhibit 4

Women are still underrepresented at the top of corporations globally

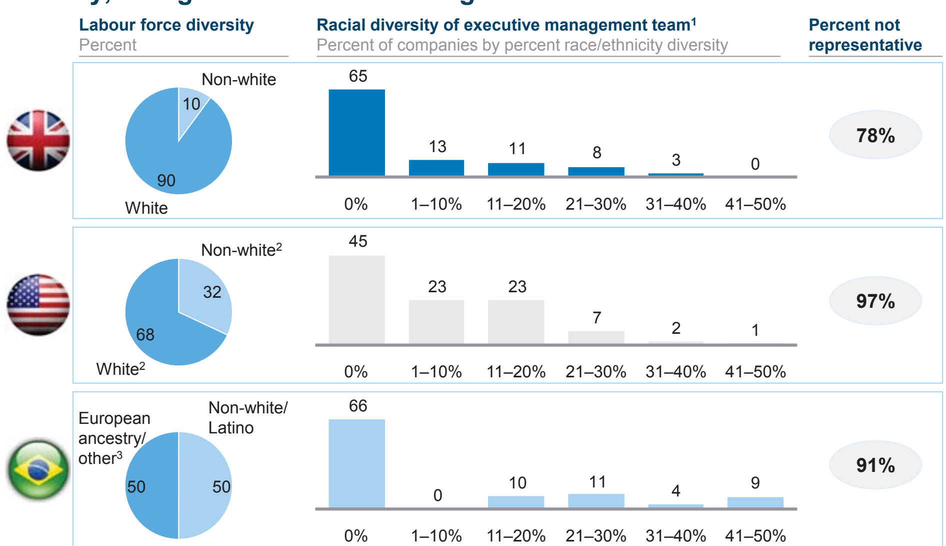


1 Number of companies = 107 for UK, 186 for US, 67 for Brazil

SOURCE: US Census Bureau, McKinsey Diversity Database

Exhibit 5

Compared with other countries, the UK is doing a better job in racial diversity, though it still faces challenges



1 Number of companies = 107 for UK, 186 for US, 67 for Brazil
2 Undocumented labour force, largely Latino, estimated at 6 to 8 million (Bloomberg, Pew), has not been included in the breakdown
3 Other includes mixed race, African ancestry, native

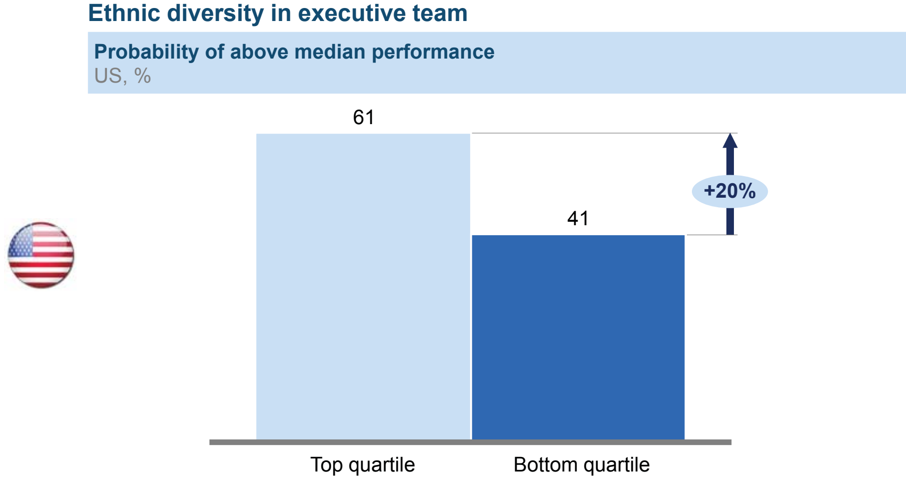
SOURCE: Companies websites, McKinsey Diversity Database

For every 10 percent elevation in ethnic diversity in the executive leadership of US companies, there was a 0.8 percent improvement in EBIT. Cumulatively, more racially diverse companies had better financial performance: companies in the top quartile for ethnic diversity in leadership roles had a higher probability of above-average performance than those in the bottom quartile (Exhibit 6).

Exhibit 6

Relationship between ethnic diversity and performance by quartile

Ethnic diversity in executive team



SOURCE: McKinsey Diversity Database

Above-median financial performance was achieved by a higher percentage of companies in the top quartile than the bottom quartile for ethnic diversity in all the countries and regions we investigated (Exhibit 7).

Exhibit 7

Percentage of companies with EBIT above national median by quartile

Region	Top quartile ethnic diversity	Bottom quartile ethnic diversity
Overall	58%	43%
United Kingdom	61%	45%
United States & Canada	61%	41%
Latin America	53%	47%

NOTE: Includes 186 organisations in United States and Canada, 107 in the United Kingdom, and 73 organisation in Latin America (67 from Brazil)

SOURCE: McKinsey Diversity Database

Diversity as indicator: Some revealing details

A number of trends in the countries and industries reviewed suggest that the relationship between diversity and performance is likely to grow in importance. For instance:

- **Demographics.** In the United Kingdom approximately 30 percent of births in 2011 were to parents of non-European ancestry.*

- **Talent shortage.** In Europe the acquisition of talent has been identified as a significant management challenge for the next five years. The ethnic composition of the UK labour force is now about 10 percent non-white, up from 6 percent in 1991. However, little more than 20 percent of UK companies attain 10 percent ethnic diversity on their top management teams.†

- **Purchasing power.** As customers, women are involved in 80 percent of consumer goods purchases in the UK. Gay and lesbian households increasingly represent a mainstream and sizable consumer segment.‡

- **Legal requirements.** Regulators in some European countries have introduced diversity targets for boards, such as those set out in the UK Equality Act 2010.

As a result of these trends, the relationship between diversity and performance will become more pronounced throughout these markets, and not just in particular segments.

* David Coleman, *Immigration, Population, and Ethnicity: The UK in international perspective,* The Migration Observatory, 17 April 2013.
† "Facing a skills shortage? Fix it yourself", McKinsey & Company, 2013; McKinsey Diversity Database.
‡ *Women Matter: Moving corporate culture, moving boundaries,* McKinsey & Company, 2013; *The Power of "Out" 2.0: LGBT in the workplace,* Center for Talent Innovation, 1 February 2013; *African-American Consumers: Still vital, still growing,* Nielsen, 21 September 2013.

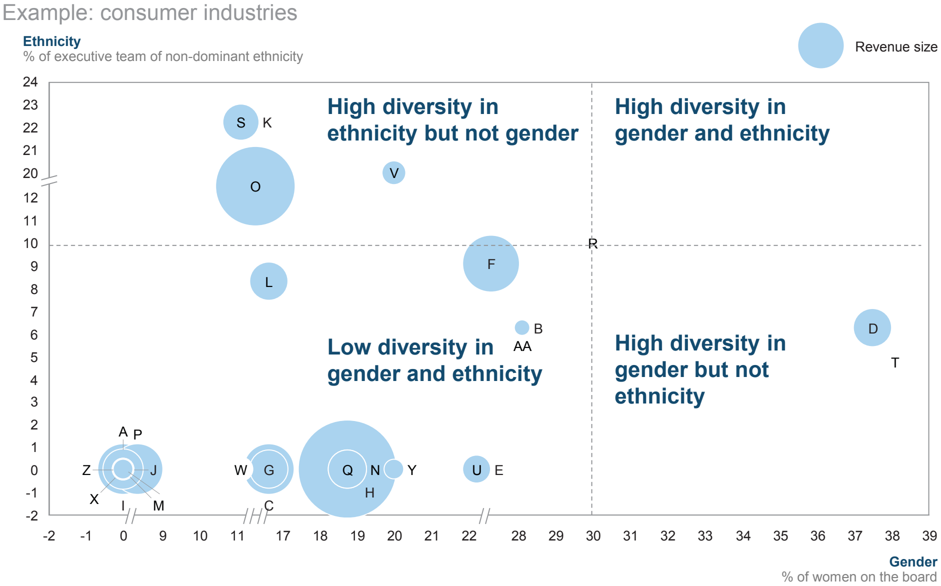
ONE PROGRAMME DOES NOT FIT ALL GROUPS

A glance at consumer industries in the UK reveals that some companies have made progress in leadership diversity in ethnicity or gender, but none has managed to lead by both measures (Exhibit 8).

Exhibit 8

No companies perform well on both gender and ethnic diversity

Example: consumer industries



SOURCE: McKinsey Diversity Database, companies websites

The approach of many companies has been to adopt a single diversity programme to cover all action groups: racial/ethnic, gender, and sexual orientation. Yet the data suggests that such an approach is insufficient, resulting in a focus on a particular category rather than the issue as a whole. Tailored programmes and dedicated efforts are needed to ensure relevance to business and to make progress on any dimension.

2 Why do more diverse companies perform better?

The Diversity Matters research revealed that more diverse companies perform better, but the data did not indicate why this is so. To understand causation it was necessary to consult additional evidence, including other McKinsey research on diversity. This material allowed reasonable hypotheses to be made concerning the factors driving better performance by companies with diverse executive teams and boards. The most important drivers identified were advantages in recruiting the best talent, stronger customer orientation, increased employee satisfaction, and improved decision making.

Exhibit 9

Diversity has a positive impact on many key aspects of organisational performance

Diversity management helps to…	Rationale
…win the war for talent	▪ A strong focus on women and ethnic minorities increases the sourcing talent pool, a particular issue in Europe. In a 2012 survey, 40% of companies said skill shortages were the top reason for vacancies in entry-level jobs
…strengthen customer orientation	▪ Women and minority groups are key consumer decision makers: for example, women make 80% of consumer purchases in the UK ▪ Gay men and women have average household incomes that are almost 80% higher than average
…increase employee satisfaction	▪ Diversity increases employee satisfaction and reduces conflicts between groups, improving collaboration and loyalty
…improve decision making	▪ Diversity fosters innovation and creativity through a greater variety of problem-solving approaches, perspectives, and ideas. Academic research has shown that diverse groups often outperform experts.
…enhance the company's image	▪ Social responsibility is becoming increasingly important ▪ Many countries have legal requirements for diversity (e.g., UK Equality Act 2010)

SOURCE: *Women Matter,* McKinsey & Company, 2007, 2008, 2010, 2012, 2013; Thomas Barta, Markus Kleiner, and Tilo Neumann, "Is there a payoff from top-team diversity?", *McKinsey Quarterly,* April 2012; Martin Dewhurst, Matthew Pettigrew, and Ramesh Srinivasan, "How multinationals can attract the talent they need", *McKinsey Quarterly,* June 2012; *Diversity wins!,* McKinsey & Company, November 2011; McKinsey qualitative survey; *The War for Diverse Talent,* Green Park, September 2010; Scott E. Page, *The Difference: How the power of diversity creates better groups, firms, schools, and societies,* Princeton University Press, 2007; McKinsey analysis

THE ADVANTAGE IN TALENT RECRUITMENT

In the decade before the financial crisis, it became apparent that demographic pressures and economic growth would intensify competition for qualified leaders and experts in the advanced knowledge economies. McKinsey's 1997 research paper "The war for talent" demonstrated that better talent translates into better financial performance and concluded that companies could gain competitive advantage through superior talent management practices. A deliberate approach to talent management could yield measurably higher financial returns and create a powerful business-enhancing virtuous cycle.

Since the 1990s, the dynamics that defined this talent crunch have expanded in scope and power. Talent has become scarcer and pricier in emerging as well as developed markets, and the competition to recruit and retain talented employees has consequently intensified. Diversity in leadership can help a company secure access to more sources of talent, gain a competitive recruitment advantage, and improve its global relevance.

Today's talent recruitment terrain

Scarce top talent. The pool of skilled experts and leaders has not kept pace with demand. More than a third of employers surveyed by McKinsey in 2012 said that the skills gap caused "significant problems in terms of cost, quality, and time".[3] In years to come society will need to address the educational and socioeconomic issues underlying these skills gaps; in the meantime, employers must continue to compete for scarce talent while building skills within their organisations. In a survey of 2,700 employers, only 31 percent believed they were doing a good job in recruiting and retaining young talent.[4]

Scarce "interaction" talent. It is widely recognized that technological changes have transformed job requirements in developed countries, but less well known that employment is growing fastest in positions requiring extensive human interaction, from legal and health professionals to frontline customer service staff in banking and retail.[5] This employment category already accounts for a large proportion of jobs: 41 percent in the US, 37 percent in Germany, and 26 percent in Brazil, for example. Leading companies are exploring new and better approaches to how, where, and by whom interaction work is performed.

Scarce emerging-market talent. Competition for talent is intensifying in emerging markets. Ambitious local companies are moving fast to hire and retain local talent, while companies in developed markets are thinking twice before making offshore commitments.[6]

Geographic mismatches. There are variations in the supply of and demand for talent from country to country, but differences in national systems of professional certification as well as language and cultural barriers make it difficult for skilled workers to move from market to market.

Reflecting social change

Diversity management is one important means of addressing talent shortages. Diversity programmes give companies an advantage in competing for the best talent—an advantage that is growing as workforces in many advanced economies become more ethnically diverse as a result of immigration and birth-rate demographics. For example, in the US, half of all infants under the age of 1 in 2010 were members of a racial or ethnic minority group. In the UK, the percentage of workers of European ancestry within the total workforce has fallen by almost 10 percentage points in the past decade. In both the US and the UK, women make up almost half the workforce.

A recent Gallup poll found that only 13 percent of employees were actively engaged at work, and that the management behaviour most likely to affect engagement was "demonstrates strong commitment to diversity".[7] Level of engagement are lowest for the cohort born after 1980, and multiple surveys have indicated that diversity is particularly important to Generation Y or the Millennials, as they are known.

Because they are underrepresented, the groups targeted by diversity efforts are often good sources of desirable talent. A recent study found that on average, lesbian, gay, bisexual, and transgender (LGBT) recruits were more highly skilled and more likely to have advanced degrees.[8]

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3 "Facing a skills shortage? Fix it yourself", McKinsey & Company, 2013.

4 "Facing a skills shortage? Fix it yourself", McKinsey & Company, 2013.

5 Susan Lund, James Manyika, and Sree Ramaswamy, "Preparing for a new era of work", *McKinsey Quarterly*, November 2012.

6 Susan Lund, James Manyika, and Sree Ramaswamy, "Preparing for a new era of work", *McKinsey Quarterly*, November 2012; "Facing a skills shortage? Fix it yourself", McKinsey & Company, 2013.

7 *State of the Global Workplace,* 2013, Gallup, Inc.

8 *The Power of "Out" 2.0: LGBT in the workplace,* Center for Talent Innovation, 1 February 2013.

IMPROVED CUSTOMER ORIENTATION

By committing to diversity as a strategic imperative, companies align their own organisation more closely with an increasingly heterogeneous customer base. This enables them to forge stronger bonds with customers in two respects: reaching key purchasing decision makers and taking a customer perspective.

Reaching key decision makers

Diversity groups represent the majority of the general population and an emphatic majority where purchasing decisions are concerned. In the UK, for example, 80 percent of purchasing decisions are made by women. By 2025, women are expected to own 60 percent of all personal wealth and control £400 million more per week in expenditures than men.[9] In the United States, estimates of buying power indicate that LGBT individuals controlled $790 billion in 2012, and African Americans are expected to control $1.1 trillion by 2015.[10] A top team that reflects these powerful demographic groups will have a better understanding of their market decision behaviour and how to impact.

Taking a customer perspective

Corporate leaders with a customer perspective are able to respond to market developments more quickly and creatively. Diversity helps companies react more effectively to market shifts and new customer needs.[11] A senior executive at a global company in Asia stated an obvious if difficult truth when he said, "In our top-100 executive meetings we spend more than half of our time speaking about Asia. But if I look around the room I hardly see anybody with an Asian background". Fortunately, CEOs from many different industries are increasingly adopting the view that "it is crucial for a company's employees to reflect the people they serve".[12]

Many companies have put theory into practice in more closely reflecting their customer base. Coca-Cola, for example, has ensured that 38 percent of new US hires are people of colour and instituted mentoring programs to support the progression and retention of individuals from minority backgrounds. Walmart conducted benchmarking to understand the demographics of every country it operates in, and encouraged each country to create its own diversity and inclusion plan to reflect local needs.

GREATER EMPLOYEE SATISFACTION

Diversity increases employee satisfaction and fosters positive attitudes and behaviours in the workplace. Workplace diversity increases job and life satisfaction for women and members of minority groups provided the workforce is diverse *enough*. For minority workers, for example, the boost in satisfaction kicks in when representation exceeds 15 percent of the workforce. Where diversity recruitment is a token effort, psychological outcomes are poorer.[13]

It is hardly surprising that workers from ethnic minorities report higher job and life satisfaction in more diverse workplaces. The presence of sufficient numbers of minority-group members (or women in traditionally male-dominated environments) boosts individuals' confidence and self-esteem, while breaking down the

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9 *Women Matter: Moving corporate culture, moving boundaries,* McKinsey & Company, 2013.

10 *The Power of "Out" 2.0: LGBT in the workplace,* Center for Talent Innovation, 1 February 2013; *African-American Consumers: Still vital, still growing,* Nielsen, 21 September 2013.

11 *Diversity wins!,* McKinsey & Company, November 2011.

12 Boris Groysberg and Katherine Connolly, "Great leaders who make the mix work", *Harvard Business Review,* September 2013, pp. 68–76.

13 Noemí Enchautegui-de-Jesús, Diane Hughes, Kristen E. Johnson, and Hyun Joo Oh, "Well-being in the context of workplace diversity", *Journal of Community Psychology,* 2006, volume 34, number 2, pp. 211–23.

prejudices that led to exclusion in the first place. Similarly, research has shown that gay employees in a diverse workplace feel more secure and positive about their employers and jobs than those in a less diverse environment.[14] A supportive culture among colleagues and supervisors is more important than the presence of a non-discrimination policy, necessary though such a foundations is.[15]

BETTER DECISION MAKING AND INNOVATION

Managers working on tough problems have often assembled diverse teams of thinkers to challenge one another and improve the quality of their answers. A diversity of informed views enables objections and alternatives to be explored more efficiently and solutions to emerge more readily and be adopted with greater confidence. Research by Scott Page indicates that the presence of women and minority members on a leadership team enhances problem solving in the same way, since they add perspectives from their different experiences.[16] Ethnically and gender-diverse top teams offer companies more problem-solving tools, broader thinking, and better solutions.

This finding has resonated with leaders of top companies for inclusivity. For instance, Paul Block, CEO of US sweetener manufacturer Merisant, commented "People with different lifestyles and different backgrounds challenge each other more. Diversity creates dissent, and you need that. Without it, you're not going to get any deep inquiry or breakthroughs".[17]

Page's research was based on professional rather than demographic diversity—having an engineer and a lawyer on an executive team, for example. He understood that benefits derived from one form of diversity would not necessarily be derived from others, but believed that professional and demographic diversity often went hand in hand.

Innovation, diversity, and market growth

A recent article reporting research by the Center for Talent Innovation (CTI) provided further support for Page's research on the correlation between diversity and better decision making, and stressed the importance of inclusive leadership in maximising the benefits of diversity.[18] It identified two forms of diversity:

- **Innate diversity.** Teams that reflect the composition of a company's customer base in terms of gender, ethnicity, culture, sexual orientation, and age are better positioned to understand its changing needs and develop winning innovations.

- **Acquired diversity.** Diversity at leadership level breaks down insular biases through personal experience, making the organisation more likely to act inclusively, foster a communicative culture, and create an environment where workers are free to voice unorthodox views and suggest creative solutions.

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14 C. S. Munoz, "A multi-level examination of career barriers for sexual minority employees", unpublished doctoral dissertation, 2005; C. R. Waldo, "Working in a majority context", *Journal of Counseling Psychology,* 2006, volume 46, pp. 218–32. The studies focused on lesbian, gay, and bisexual workers as they found insufficient data on transgendered employees.

15 Ann H. Huffman, Kristen M. Watrous-Rodriguez, and Eden B. King, "Supporting a diverse workforce: What type of support is most meaningful for lesbian and gay employees?", *Human Resource Management,* 2008, volume 47, issue 2, pp. 237–53.

16 Scott E. Page, *The Difference: How the power of diversity creates better groups, firms, schools, and societies,* Princeton University Press, 2007.

17 Boris Groysberg and Katherine Connolly, "Great leaders who make the mix work", *Harvard Business Review,* September 2013, pp. 68–76.

18 Sylvia Ann Hewlett, Melinda Marshall, and Laura Sherbin, "How diversity can drive innovation", *Harvard Business Review,* December 2013.

The CTI concluded that when leadership lacks innate or acquired diversity or fails to foster a "speak-up" culture, fewer promising ideas make it to market. Ideas from women, ethnic minorities, LGBT individuals, and members of Generation Y are less likely to win the endorsement they need to go forward because 56 percent of leaders don't value ideas they don't personally see a need for. This thinking can exert a stranglehold on an organization if its leaders are predominantly white, male, and heterosexual, for example, or come from similar educational and socioeconomic backgrounds. In short, the data strongly suggests that homogeneity stifles innovation.[19] This finding is supported by a new study that found that if a market is dominated by any one ethnicity, it tends to make worse decisions.[20]

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

20 Sheen S. Levine, Evan P. Apfelbaum, Mark Bernard, Valerie L. Bartelt, Edward J. Zajac, and David Stark, "Ethnic diversity deflates price bubbles", *PNAS,* 17 November 2014.

3 *How can companies become more diverse?*

As the data shows, winning companies have achieved some success in attaining gender or other forms of diversity in their leadership groups. However, many companies have had mixed experience in attaining levels of diversity that make a difference. Progress is undeniable, but slow and incremental. One of the most important lessons is that diversity does not simply happen—it does not come from a memo or end with the recruitment of a few individuals from target groups. Rather, diversity in the top team and indeed at all levels of an organisation is best achieved through dedicated programmes that focus on specific goals.

Diversity programmes are in essence a form of change programme: they seek to alter the composition of leadership teams or staff and to disrupt old habits and routines. However, research into change management has found that change programmes have a high failure rate of about 70 percent.[21] Most efforts stall because those involved—management and employees—do not believe in them or make them a priority.

Successful diversity programmes have clear objectives and are led from the top (not just the CEO, but the entire top team). They foster active involvement from the wider organization and require the infrastructure to actively manage against targets (not quotas) to hold individuals accountable for outcomes. Exhibit 10 sets out questions for leaders to ask when planning a change programme and suggestions to help organizations reach their diversity goals.

Exhibit 10

Key steps for successful diversity programmes

	Diversity	
1 **Aspire** Where do we want to go?	**Define a clear value proposition**	▪ Create a **clear value proposition** for having a diverse and inclusive culture ▪ Set a **few clear targets** (not quotas) that balance complexity with cohesiveness
2 **Assess** How ready are we to go there?	**Establish a fact base**	▪ Understand the **current situation** in terms of **statistics** and **mindsets** and learn from external best practices. Understand root causes and underlying mindsets
3 **Architect** What do we need to do to get there?	**Create targeted initiatives**	▪ **Differentiate initiatives by diversity group,** for example, gender initiatives do not always resonate with other minorities. Lead from the top
4 **Act** How do we manage the journey?	**Define the governance model**	▪ Define the **rollout strategy** for all initiatives. Launch 1-2 highly visible **flagship projects** at the beginning of the effort. **Monitor rigorously**
5 **Advance** How do we keep moving forward?	**Build inclusion**	▪ Continuously **address potential mindset barriers** through systematic **change management**. Link diversity to other change management efforts

SOURCE: Scott Keller and Colin Price, *Beyond Performance: How great organizations build ultimate competitive advantage,* Wiley, 2011

21 Scott Keller and Colin Price, *Beyond Performance: How great organizations build ultimate competitive advantage,* Wiley, 2011.

Diversity programmes designed to raise the representation of women and minorities in organisations face particular challenges with resistance and inertia arising from unconscious (and sometimes overt) biases that can be deeply engrained in an organisation's culture and unknowingly practised by individuals.[22] Applying best practices in change management will be necessary but may not be sufficient to enable the organisation to attain meaningful diversity goals.

In addition to individual biases, there may be barriers in the composition of leadership teams and in the structure of the organisation as a whole. These barriers can have many causes and hinder progress even when companies are implementing other best practices. For instance, research by Groysberg and Connolly on creating diverse and inclusive organisations identified persistent institutional barriers to the recruitment of women such as exclusion from networks that open doors to development and unexamined assumptions about the tension between family demands and job requirements.[23]

McKinsey's own research found a number of additional and equally important barriers to the recruitment of all diversity groups: the lack of a clear and consistent mandate with visible support from leadership; inadequate collection and use of data on the advantages of more diverse organisations; and training that was limited and exclusive in its content and audience, rather than covering people inside and outside target groups. All these barriers can be overcome, but must first be identified and understood, and then addressed individually as part of a many-sided approach to inclusiveness.

Lessons from behavioural economics and social psychology

Recent developments in the fields of behavioural economics and social psychology help to explain why diversity is lacking in organizations, and what methods can be used to increase it.

1. Underlying reasons for bias

A body of research in cognitive psychology and behavioral economics over the past 40 years has established that human behaviour is heavily influenced by subconscious, instinctive, and emotional "System 1" responses, rather than being under the exclusive control of rational, deliberate "System 2" thinking.* As a result, behaviour and attitudes in the workplace are influenced by an array of cognitive biases that affect decision making. The most relevant for diversity are:

- **Implicit stereotypes (sometimes referred to as "subconscious bias"):** the association of groups of people with certain traits or activities, such as men with science and mathematics and women with arts and languages.† Without our being aware of it, these associations can powerfully influence decisions such as which candidate to hire.

- **Ingroup favouritism:** a preference for people who are like us, so that an individual might choose to work with someone of the same nationality, gender, and race.‡

- **Outgroup homogenity bias:** the tendency for an individual to think that the group of people they belong to (their "ingroup") is more diverse, while their "outgroup" is more homogeneous, with members who appear alike or even interchangeable.‡

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22 Allen R. McConnell and Jill M. Leibold, "Relations among the implicit association test, discriminatory behavior, and explicit measures of racial attitudes", *Journal of Experimental Social Psychology,* 2001, volume 37, pp. 435–442.

23 Boris Groysberg and Katherine Connolly, "Great leaders who make the mix work", *Harvard Business Review,* September 2013, pp. 68–76.

2. Techniques for overcoming bias

Behavioural insights can be harnessed to increase diversity in three main ways: by training and educating people to reduce personal biases, by changing organisational processes to take bias out of decision making; and by incorporating behavioural principles in the design of programmes and communications to spur action.

Educating and training people to reduce personal biases
Key success factors for raising awareness and building capability include:

- Tailoring delivery to the audience. For example, one engineering company used a computer simulation to show how a systematic 1 percent bias against women in performance evaluation scores caused women to be underrepresented in top positions.

- Getting people to experience bias personally. At Google, for instance, staff are encouraged to take a test that measures biases.

- Reminding people about biases at key moments, such as before reviews.

- Helping people to focus on differences to reduce homogeneity bias and stereotyping. In one experiment, French students discriminated against potential employers who were Arabs, but stopped doing so if asked to describe differences between their photos.[‡]

- Fostering empathy training and taking the side of the target group—a practice proven to reduce prejudice and discrimination. Simply asking “How would I feel in this situation?” can be enough to have a positive effect.[‡]

Changing processes and structures to reduce bias in decision making
Another way to increase diversity is to introduce techniques to minimise the influence of individual biases on key decisions. These techniques can take several forms:

- **Analytical.** One approach to reduce bias in recruitment is to define scoring criteria for each candidate and use an algorithm rather than human judgement to make decisions based on the criteria. Daniel Kahneman has applied this technique to improve the assessment of candidates for the Israeli army.[*] Modified versions of the technique have been used by a variety of companies, including McKinsey.

- **Debate.** One effective way to identify bias in decision making is to institute a “pre-mortem” by asking people to imagine what could go wrong if a particular decision is taken.[§] Another technique is to nominate an individual to act as devil’s advocate and challenge assumptions behind decisions, such as implicit stereotypes. A number of studies have shown that this approach leads to better decisions.[‖]

- **Organisational.** Companies can, for example, create a decision challenge team.

Applying behavioural economics principles to diversity efforts
McKinsey has identified seven ways to apply behavioural principles: use information about peers, use people’s natural reflexes, make sure information comes from a credible origin, provide strategic context, trigger an emotional response, make information salient, and appeal to an individual’s self-image. Many of these techniques can be used to enhance the effectiveness of diversity programmes; for instance:

- **Peers: highlight the positive achievements of peers.** This has been shown to be one of the most effective ways to influence people. For example, informing taxpayers that others pay their tax significantly increased tax contributions, whereas reminders of prosecution or how tax is used did not.[¶] A company could use internal statistics from other departments or business units that are more advanced in achieving diversity, as well as external data on highly regarded competitors. Telling employees about their peers' contributions to diversity is another effective technique.

- **Reflexes: prime people with images and words that discourage biases.** A striking example of the effects of priming—or introducing subliminal clues—was provided by research that showed that when Asian women were reminded about their gender, they performed significantly worse in a maths test than when they were reminded about their ethnicity.** Companies can use priming techniques strategically to reduce bias, for example by displaying pictures of well-known powerful women.

- **Origin: make sure that diversity messages come from trusted opinion leaders** within the organization, whether they are line workers or managers, rather than from a diversity group that may be seen as an outsider.[††]

* Daniel Kahneman, *Thinking, Fast and Slow,* Allen Lane, 2011.

† Brian A. Nosek, Mahzarin R. Banaji, and Antony G. Greenwald, "Math = male, me = female, therefore math ≠ me", *Journal of Personality and Social Psychology,* 2002, volume 83, number 1, pp. 44-59.

‡ Scott Plous, editor, *Understanding prejudice and discrimination,* McGraw-Hill, 2003.

§ Gary Klein, "Performing a project pre-mortem", *Harvard Business Review,* September 2007.

‖ Ryan T. Hartwig, "Facilitating problem solving: A case study using the devil's advocacy technique", *Group Facilitation,* number 10, 2010.

¶ Richard H. Thaler and Cass R. Sunstein, *Nudge: Improving decisions about health, wealth, and happiness,* Yale University Press, 2008.

** Clayton M. Christensen, Stephen P. Kaufman, and Willy C. Shih, "Innovation killers: How financial tools destroy your capacity to do new things", *Harvard Business Review,* January 2008.

†† Robert B. Cialdini, *Influence: The psychology of persuasion,* HarperCollins, 2007.

Conclusion

Diversity matters. In a world that is both diverse and deeply interconnected, companies and institutions with greater levels of diversity are achieving better performance. Most organisations, including McKinsey, have more work to do to take full advantage of the opportunity presented by a more diverse leadership team. Organisations also have more work to do on their talent pipeline to attract, develop, mentor, sponsor, and retain the next generations of diverse leaders at all levels. But with the rewards of diversity set to increase, investing now is the best plan. Winners will pull further ahead and laggards will fall further behind.

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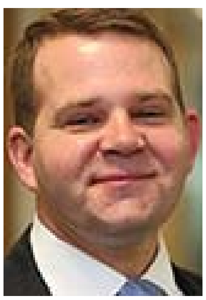

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