



Diversity Briefing

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QUESTIONS FOR DIRECTORS TO ASK





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Preface

The Risk Oversight and Governance Board of the Canadian Institute of Chartered Accountants (CICA) commissioned this briefing to raise awareness of the importance of diversity, both within organizations and on boards, and to provide practical steps to help directors address diversity issues as part of their oversight responsibilities.

Diversity is increasingly regarded as a business imperative. Studies have demonstrated the benefits of a diverse team in areas such as organizational performance and problem solving. The issue is receiving attention from industry and shareholder groups as well as regulatory and legislative bodies. When managed properly, diversity can provide an important competitive advantage for business.

This briefing focuses primarily on the importance of diversity within companies, and the ways in which it comes to the attention of the board through the board's oversight of areas such as strategy, risk and executive succession. It also addresses the importance of diversity on the board itself and offers questions that are intended to be a catalyst for useful dialogue among directors, for directors with management, or with outside advisors.

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Interim Chair, Risk Oversight and Governance Board

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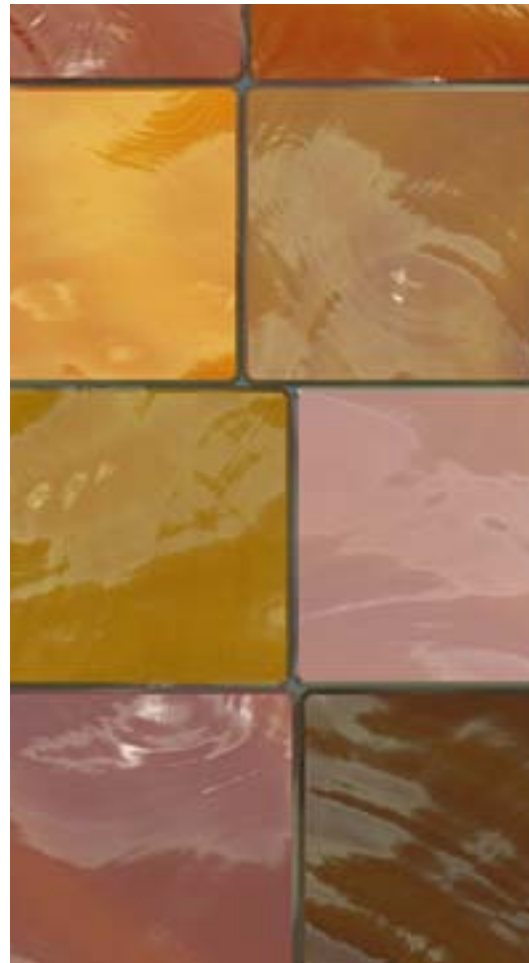
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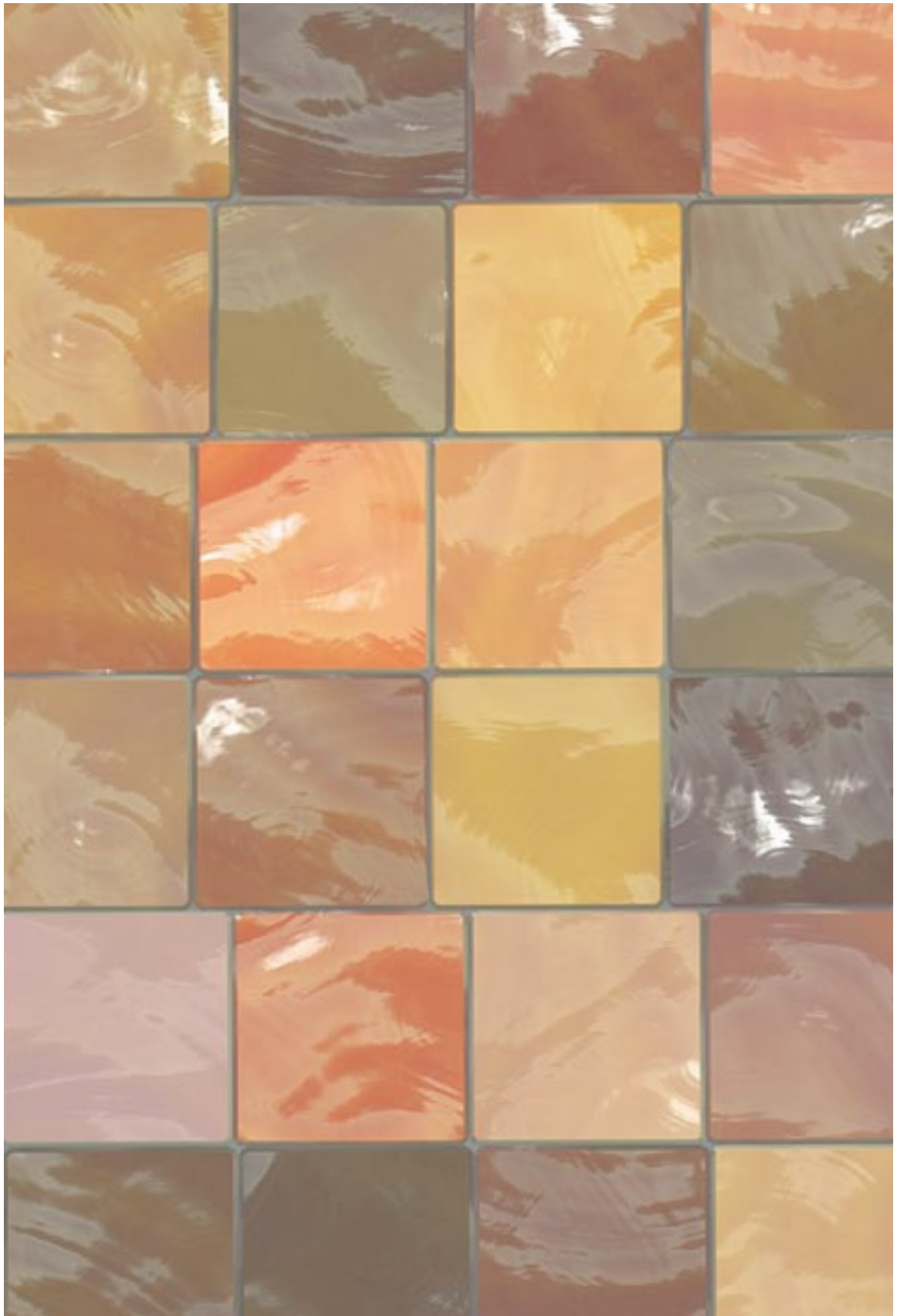
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QUESTIONS FOR DIRECTORS TO ASK



Introduction

“Diversity is quite simply a business imperative. At its heart, it reflects a commitment to find the best available talent and ensure that decisions are informed by inputs from people with varying backgrounds, experiences and perspectives — ultimately, these are key ingredients for success.”

David Denison, FCA
President and Chief Executive Officer, Canada Pension Plan Investment Board

Diversity as a strategic business issue

Diversity is an increasingly important element of doing business in Canada, and is a concept that boards of directors are likely familiar with. It is also an area of enhanced focus for shareholder groups and regulatory bodies. Diversity is no longer regarded as simply a human resources issue, limited to fair hiring practices or enhancing an organization’s image. There is increasing recognition that it can also contribute to corporate strategy and effectiveness, and that diverse organizations may have opportunities and advantages that more homogeneous companies may not.

Boards of directors, as part of their responsibility to oversee the strategic direction, financial performance and risk management of their companies, should have an understanding of how the issue of diversity affects key areas of the board’s mandate. While successful management of diversity may lead to business benefits or competitive advantages, failure to adequately address these issues could present a risk to a company’s ability to innovate, attract clients and partners, or keep pace within its industry.

There is a growing body of research regarding the benefits of diverse teams in the areas of organizational performance and problem-solving. In addition, there are some powerful examples of leading global companies which successfully utilized diversity to help generate innovative products and services that delivered tangible benefits to their bottom lines.

PepsiCo attributed one percentage point of its 7.4% revenue growth in 2003, or about US\$250 million, to new products inspired by diversity efforts.¹ Seeking to expand into ethnically diverse markets, PepsiCo used its diverse workforce to obtain unique insights into the needs of customers in those markets. PepsiCo products such as guacamole-flavored Doritos chips, Gatorade Xtremo, and Mountain Dew Code Red were inspired by and targeted to minorities. “I believe that companies that figure out the diversity challenge first will clearly have a competitive advantage,” Steve Reinemund, PepsiCo’s then-chairman and CEO, told *The Wall Street Journal*.²

While many of the documented examples of diversity initiatives focus on race and gender, the concept of diversity is broader and encompasses factors including age, culture, personality, skill, training, educational background and life experience. The influence of a variety of perspectives and viewpoints can contribute to flexibility and creativity within organizations, which can in turn help them thrive in a complex and competitive global economy.

1 Robert Rodriguez, *Diversity Finds its Place*, HR Magazine, 1 August 2006.

2 *Pepsi, Vowing Diversity isn’t Just Image Polish, Seeks Inclusive Culture*, Wall Street Journal, 19 April 2005.

Canada's diversity is not reflected in its corporate leadership

Canada is one of the most ethnically diverse countries in the world, and is home to more than 200 distinct ethnic groups. According to the 2006 census, more than five million people (or 16.2% of the population) belong to a visible minority.³ In Toronto and Vancouver, visible minorities make up more than 40% of the population, and these numbers increase dramatically every year.

Yet a glimpse into any large corporate office shows a vastly different picture. Visible minorities make up only 5.2% of senior management in large Canadian companies, and 1.6% of executive management in the public sector. Overall, visible minorities account for just 11.2% of all management roles. Many highly skilled immigrants are employed in jobs for which they are very over-qualified.⁴

The situation of women is similar. The *2008 Catalyst Census of Women Corporate Officers and Top Earners of the FP500* revealed that only 16.9% of corporate officers in Canada's largest businesses were women. The proportion of women in line roles — positions often necessary for promotion to top leadership — was even lower, at 11.4%. There is a wide disparity between this situation and the educational qualifications of Canadian women. In 2005, women earned 61.8% of bachelor's degrees, 51.8% of master's degrees and 44% of doctoral degrees in Canada.

Representation of women on boards also remains relatively low. In the *2009 Catalyst Census: FP 500 Women Board Directors*, 14% of board seats were held by women, an increase of only three percentage points since 1999. More than 40% of companies had no female directors. Women held just 3.2% of board chair seats in 2009, up slightly from 1.2% in 2003 when Catalyst first began collecting this information.

Many organizations appear to have a wide pool of untapped talent at their disposal, but struggle to address diversity. An enhanced focus on diversity could help improve hiring practices, better integrate employees and more effectively utilize skill sets needed by Canadian companies.

Implications for directors

To effectively fulfill their oversight role, directors should recognize the potential business implications of diversity for their organization. While management is responsible for assessing diversity within the organization, developing diversity initiatives and measuring the results; directors should be aware of diversity as it affects various areas of the board's mandate.

Issues for consideration by directors include:

- The influence of diversity on the organization's ability to innovate and stay ahead of the competition;
- The potential advantages of including diversity as a component of the organization's strategies;
- The benefits of considering diverse perspectives in order to improve problem-solving and increase the effectiveness of risk management;
- The need to incorporate diversity into management succession planning; and
- The importance of board diversity as a component of board effectiveness.

³ In Canada, the term "visible minority" refers to a person who is not Aboriginal and who is non-Caucasian or "non-white" in colour, as defined under Canada's Employment Equity Act.

⁴ *Visible Minorities*, Catalyst Quick Take, 2008; Statistics Canada, *Selected Educational Characteristics*, 2001 Census (2003).

Diversity within the Organization

A tool for competitive advantage

A 2005 study on the business case for diversity found that, on average, organizations with a strong commitment to diversity outperformed their peers. The study found that the top 50 “diversity organizations” (companies that emphasized diversity as part of their corporate strategy) in the US had a median difference in their net profit margins of +2.7% per year over their counterparts and had higher median returns on equity (between 2.5% and 6%) than their counterparts every year⁵.

Some of the ways in which diversity may contribute to increased returns are discussed below.

Fostering innovation and creative problem-solving

One of the key business benefits of diversity is its potential effect on innovation and problem-solving. The Conference Board of Canada notes that “hiring immigrants, new Canadians, or temporary foreign workers can provide Canadian businesses with such benefits as: expanded access to talent, knowledge, and a base of skills; potential links to new global and domestic markets and business opportunities; and fresh perspectives and diverse points of view leading to enhanced innovation and creativity.”⁶

Google’s decision to diversify its research and development processes spurred the innovation that led to the development of Google Finance. In 2004, Google set up its first R&D facility outside the US in Bangalore, India, and hired a diverse Indian workforce who came from a spectrum of religious backgrounds and spoke a variety of languages. Google Finance was conceived by two Indian scientists at that facility and launched by the company in 2006.

By “stirring up the pot” in positive ways, diversity can encourage the intellectual debate and conflict which helps lead to innovation, and may also help groups such as management teams or boards of directors approach problem-solving more creatively. A number of research studies have demonstrated ways in which diversity can enhance creativity or team problem-solving.

- In a study of 28 teams, heterogeneous teams solved complex tasks better than homogeneous teams. The diverse teams exhibited a higher level of creativity and a broader thought process.⁷
- In a study of 45 teams from five high-tech firms in the US, teams composed of people with different functional specialties worked more effectively with other internal teams and showed a higher product innovation rate.⁸

Questions for directors to ask:

1. How might greater diversity within the organization enhance innovation in order to support our corporate strategy and set our company apart from competitors?
2. How has management addressed the issue of diversity on teams at both the staff and management level in order to enhance problem-solving abilities?

5 *The business case for commitment to diversity*, by Stanley F. Slater, Robert Weigand and Thomas J. Zvirlein, Harvard Business Review Case Study, 15 May 2008.

6 *Immigrant-Friendly Businesses: Effective Practices for Attracting, Integrating, and Retaining Immigrants in Canadian Workplaces*, The Conference Board of Canada, November 2009, page 4.

7 *The influence of team composition on team performance and dependence on task complexity*, Higgs, M.J., Plewina, A. and Ploch, G. (2003). Henley, UK, Henley Business School, University of Reading (Henley Working Paper Series, HWP 0314). Studies carried out at Ford Motor Company in Cologne and Dunton, Germany.

8 *Cross-functional teams: blessing or curse for new problem development?* Ancona, Deborah G., and Caldwell, David E. Working Paper, Sloan School of Management, Massachusetts Institute of Technology, July 1990.

Enhancing risk management

The term “groupthink” refers to faulty decision-making due to group pressures which lead to a deterioration of “mental efficiency, reality testing, and moral judgment.”⁹ Groups affected by groupthink may ignore alternatives, take excessive risks, or fail to develop contingency plans. Homogeneous groups in which all members come from similar backgrounds and are insulated from outside opinions may be more vulnerable to groupthink.

The risk of groupthink is an important consideration when it comes to risk management. Some cases of corporate failure include evidence of a failure on the part of management to consider differing points of view. A diverse mix of backgrounds and perspectives, particularly among the senior risk management team, can help guard against this risk, and can help contribute to a culture which encourages questioning, debate and openness to different perspectives.

In oral evidence before the UK House of Commons Treasury Committee, Lord Myners, the Financial Services Minister, described one of the largest risks in a decision making forum as “the mutual reinforcement of prejudice and a desire to achieve early consensus in a comfortable way”.¹⁰

Questions for directors to ask:

3. How is diversity taken into account in the composition of the senior risk management team?
4. How can we foster a corporate culture which encourages diversity of thought and opinion and engaged debate among the senior management team?

Strategic workforce planning

Diversity plays an increasingly important role in workforce planning. Like much of the industrialized world, Canada is undergoing a profound demographic shift. Employers are grappling with an aging population, low birth rates and global competition for skilled workers.

As the baby boomer generation retires, many companies will experience a skills shortage. Sectors that are already affected include technology, medicine, tourism and public sector organizations. Indicators of the tough labour market outlook include the following:

- The Conference Board of Canada reports that a shortage of up to one million workers is expected in the next 20 years.¹¹
- In a winter 2008-09 survey by the Bank of Canada, 20% of the firms surveyed said labour shortages were restricting their ability to meet customer demands.¹²

In the face of these workforce challenges, a significant advantage may be gained by tapping the talent pools that are already available in Canada but are currently underutilized. By recruiting and developing employees from these previously neglected talent pools, companies can not only strengthen their workforce, but also develop a corporate culture which can help them to compete more effectively in the global fight for talent.

Questions for directors to ask:

5. How does the company’s workforce planning address effective succession and sustainability?
6. How is inclusiveness factored into workforce and management succession planning?

⁹ Coined by social psychologist Irving Janis in 1972.

¹⁰ *Women in the City*, Tenth Report of Session 2009-10. House of Commons Treasury Committee. April 3 2010.

¹¹ Conference Board of Canada, *The Future of Work: Confronting B.C.’s Labour Shortage Challenge*, June 2008; *From Baby Boom to Labour Crunch: Quebec’s Impending Labour Shortage*, December 2007; *Ontario’s Looming Labour Shortage Challenges*, September 2007; *Alberta’s Labour Shortage: Just the Tip of the Iceberg*, June 2006.

¹² *Business Outlook Survey*, Bank of Canada, Winter 2008-09 Survey, 12 January 2009.

Responding to globalization

Companies today operate in a world that takes little account of time zones or geographical boundaries and in which business cannot be conducted without understanding and managing cultural differences. The global financial landscape is beginning to shift as emerging-market countries undergo a period of rapid expansion. These countries increased their share of global financial assets from 3% in 1990 to 14% in 2006.¹³ Since 1990, cross-border capital flows have grown at a compound annual rate of 14.2% and have reached their highest levels ever.¹⁴ Emerging markets are continuing to significantly outpace growth in mature markets.

This economic strength has been bolstered by Chinese and Indian firms and Middle Eastern sovereign wealth funds buying up undervalued Western assets. In 2009, for the first time, emerging economies were expected to attract more than half of the global total of foreign direct investment.

This free cross-border flow of capital and resources has important implications. Senior managers with an in-depth understanding of cultural and corporate differences may have a significant advantage when negotiating cross-border transactions such as acquisitions and divestitures.

Leading corporations are increasingly demanding greater diversity from their partners, clients and customers. For example, 84% of the Fortune 100 have implemented supplier diversity initiatives. Boards will need to know how management addresses these needs and consider how the organization's diversity (or lack thereof) may affect its attractiveness to potential customers and partners.

Questions for directors to ask:

7. How can our organization's culture and approach to diversity set us apart from the competition and make us more attractive to preferred business partners?

Developing diversity initiatives

While diversity initiatives are specific to each organization, there are certain broad strategies which can be an effective starting point for many companies. The goal of these strategies should be to create a corporate culture focused on inclusiveness.

Boards have an important role to play in setting the tone from the top. They should also consider the tone set by management and the overall culture of the organization.

"Leaders signal attitudes toward diversity — that is to say, the values of diversity — in a variety of ways," says Harvard University professor Mahzarin Banaji. "They can embody the values of diversity such that they are expressed in small and consistent ways. It is less about making a speech at an event and more about showing through daily behaviour that different perspectives on all topics must be considered."¹⁵

It may be helpful to research the successful diversity initiatives of other leading corporations and use them as benchmarks. Corporate diversity initiatives should be articulated clearly and should relate specifically to the company's circumstances, strategy and goals.

Questions for directors to ask:

8. How are the company's diversity initiatives linked to organizational strategy?
9. How does the company's inclusiveness strategy compare to that of its key competitors?
10. Who champions diversity initiatives within the organization and what is the tone set by management as to the priority of diversity goals?

¹³ Farrell, Diana, Christian S. Fölster, and Susan Lund, Long-term trends in the global capital markets. The McKinsey Quarterly, Economic Studies, February 2008

¹⁴ *Breaking away from the pack: Embracing Canada's global competitiveness*, McKinsey & Company, 2008.

¹⁵ Banaji, Mahzarin. E-mail interview with Ernst & Young, 12 October 2009.

Assessing the effectiveness of diversity initiatives

The company's diversity strategy should include assessment of the effectiveness of diversity programs in order to monitor progress and document results. It is often difficult to show a direct link between diversity initiatives and the bottom line, but observations and experience can also provide reasonable indicators of change.

One element to be assessed is the pervasiveness of diversity within the organization, as the inclusion of only one or two individuals is unlikely to lead to a substantive change in the culture of an organization. Cornell University studied ethnic diversity within the 25 top-paid positions for 100 individual companies listed in Fortune magazine's annual list of best companies for minorities. The study concluded that unless at least 20%–25% of an organization's leaders come from an underrepresented racial background, chances are that any new or different ideas or perspectives will fail to surface, suggesting a need for a "critical mass" to cultivate diverse thought.¹⁶

Other considerations when assessing the effectiveness of diversity initiatives include:

- Focusing on broad business goals, such as recruiting and retaining top talent, improving performance and capturing market share and documenting whether diversity programs have contributed to achieving those goals.
- Making leaders accountable for diversity initiatives and the rewarding the achievement of inclusion goals.
- Documenting progress and thinking long term. Diversity is not an end but a process, and it can take years of implementing small changes before an organization is noticeably transformed.

IBM's renowned diversity program has been 15 years in the making. In 1995, then-CEO Lou Gerstner launched a diversity initiative that changed the culture of the company and became a cornerstone of its strategy. Eight task forces were created in 1995, each focusing on a different affinity group. The original program was expanded to the broader employee base with the formation of 72 diversity councils and 160 employee network groups.

In the decade after IBM's 1995 diversity initiative was launched, considerable progress was made in making the leadership more diverse. For example, the number of female executives worldwide increased by 370% and the number of ethnic minority executives that were born in the US increased by 233%. IBM's Market Development organization, established as a result of the diversity task forces' recommendations, has focused on growing the market of multicultural and women-owned businesses. The group's efforts have translated into hundreds of millions of dollars in new revenue. In 2001, the task force for people with disabilities recommended that IBM launch an initiative to seek government contracts by making its products more accessible. This effort is estimated to generate more than US\$1 billion in revenue by the end of 2009.

Questions for directors to ask:

11. Have clear and measurable goals been set for diversity initiatives?
12. Is responsibility for achieving diversity goals clearly assigned?
13. How do we assess and document the links between diversity initiatives and organizational performance?

¹⁶ *Examining the Link Between Diversity and Firm Performance: The Effects of Diversity Reputation and Leader Racial Diversity*, Cornell University ILR School, Center for Advanced Human Resource Studies Working Paper Series, 2006.

Diversity on the Board

The other key area in which directors should be cognizant of the importance of diversity is on the board itself. The previously outlined benefits of diversity apply equally to the board of directors. Diversity of thought and experience on the board can help lead to improved problem-solving, ability to take advantage of global opportunities, and avoidance of groupthink.

In addition, the board of directors is responsible for setting the tone at the top and influencing the culture of the organization. In order to best develop a corporate culture of inclusiveness, this should begin at the board level. Managers who see that the board has made a serious commitment to increasing diversity at the highest levels of the company will be more likely to adopt and disseminate that focus on diversity throughout the organization.¹⁷

Board diversity still presents a challenge for many organizations. A recent Ernst & Young survey found that boards of directors seldom reflect the global reach of their businesses. Almost half of the companies operating in 25 or more countries admitted that they had at most only a few foreign nationals on their boards.¹⁸ Yet they cited globally experienced staff as the most important cultural factor in conducting business around the world.

Board diversity is receiving increasing interest from regulators and investors alike. The U.S. Securities and Exchange Commission (SEC) now requires companies to disclose whether and how the nominating committee “considers diversity in identifying nominees” for director. In suggesting the need to disclose these types of policies, commenters noted that “there appears to be a meaningful relationship between diverse boards and improved corporate financial performance, and that diverse boards can help companies more effectively recruit talent and retain staff.”¹⁹

Questions for directors to ask:

14. How does the composition of our board compare to that of the company’s employees? Our customer base? The boards of our competitors or business partners?
15. What skills or perspectives do we need that we don’t have in our current board composition in order to maximize our effectiveness?
16. How have we articulated our approach to board composition and the steps taken to achieve increased diversity?

Conclusion

Diversity can be an important element of an organization’s strategy for the future. It is no longer just good corporate citizenship, but also good business. Directors are responsible for setting the tone at the top and overseeing the organization’s approach to diversity as it affects the strategy, risk, and performance of the company. Organizations that successfully leverage diversity may find that it becomes a contributor to profitability and improved performance in a global economy.

17 2008 Catalyst Census of Women Corporate Officers and Top Earners of the FP500

18 See *The new global mindset* [http://www.ey.com/Publication/vwLUAssets/The_New_Global_Mindset/\\$FILE/The%20New%20Global%20Mindset.pdf](http://www.ey.com/Publication/vwLUAssets/The_New_Global_Mindset/$FILE/The%20New%20Global%20Mindset.pdf)

19 <http://www.sec.gov/rules/final/2009/33-9089.pdf>

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Understanding Disclosure Controls and Procedures: Helping CEOs and CFOs Respond to the Need for Better Disclosure

*Available at www.rogb.ca

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