

Organizational performance



Diversity wins!

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Does diversity – the variety of an organization’s personnel – result in clear economic advantages? Convincing new evidence shows that companies with a diverse mix of board members left their competitors far behind during the volatile years as of 2008. Our new broad-based study covering companies in Germany, France, the United Kingdom, and the United States revealed differences in returns that exceed 50 percent. In addition, diversity is also a key differentiation factor in the war for young talent.

Our study defined five levers businesses can apply to build, manage, and sustain diversity. Getting this right means giving top talent the opportunities and space to deliver results with passion – ultimately leading to higher financial rewards for all.

Diversity helps drive success

We live in a volatile world. As the 2008 global financial crisis strikingly demonstrated, economic cycles continue to contract. Recent developments in the Dow Jones Industrial Average are the manifestation of this volatility (Exhibit 1).

Development of the Dow Jones is a striking example of volatility in recent years



SOURCE: Datastream

Exhibit 1

Simultaneously, talk is turning to diversity in organizations. Everywhere, the question seems to be how to bring, for example, more women or people with diverse ethnic backgrounds into top management. To some extent, external factors fuel these discussions (such as the threat of quotas in some countries). Knowing that talent is getting scarce is also a strong motivation.

But are diverse companies really more successful? McKinsey’s “Women Matter” study has already illustrated that gender diversity in executive boards breeds financial success. Our analysis broadens the diversity concept – reaching a similarly clear conclusion: diversity wins!

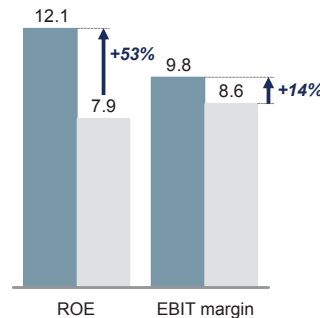
We wanted to know how well companies with high and low diversity in their top management¹ performed during the volatile years from 2008 to 2010. These years were especially interesting, since they required companies to react very fast to changing markets. Our analysis examined executive board composition, return on equity (ROE), and EBIT margin in around 180 publicly traded companies across 4 countries. These included the DAX 30 (Germany), CAC 40 (France), FTSE 30 (United Kingdom), and the 80 Fortune 500 companies (United States) with the highest and lowest board diversity.² The analysis focused on diversity groups that can be identified objectively: women and foreign nationals or people with different cultural backgrounds³ (simplified here to “foreigners”).

The outcome: companies with the highest (top quartile) board diversity stand out. From 2008 to 2010, these players achieved on average 53 percent more ROE, and EBIT margins 14 percent higher than the least diverse companies (bottom quartile, Exhibit 2).

ROE and EBIT margin are significantly higher in companies with diverse executive boards

Average per quartile^{1, 2}, 2008 - 10, percent, Germany, France, United Kingdom, United States

Diversity in the executive board
 ■ Top quartile
 ■ Bottom quartile



¹ Comparison of top quartile vs. bottom quartile of DAX 30, CAC 40, FTSE 30, the 80 Fortune 500 companies with the highest/lowest diversity levels; measured based on women and foreign nationals/ethnic minorities in the executive board; adjusted for statistical outliers

² Multivariate regression analysis of diversity for ROE and EBIT margin with country-specific “fixed effects” gives a coefficient of +9.89 (significant at 1% level) or +4.71 (significant at 10% level)

SOURCE: Public sources of information; Bloomberg; Datastream; McKinsey analysis

Exhibit 2

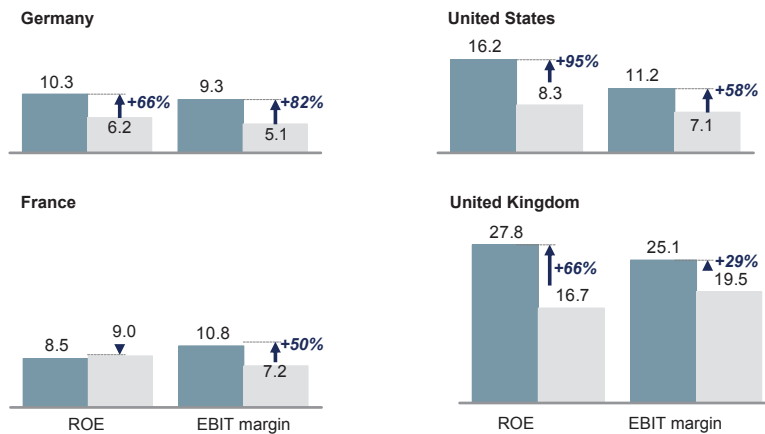
Trends were similar across all countries studied. Average ROE is 66 percent higher in the DAX 30 and FTSE 30, and 95 percent higher among the US companies. France is the only nation where no ROE difference is apparent – but a significant gap of 50 percent in EBIT margin is evident. In every examined country,

- 1 Germany: “Vorstand”; United States and United Kingdom: “Board”; France: “Comités Exécutifs”
- 2 To ensure the statistic validity of statements despite market volatility, data was adjusted by eliminating top and bottom 10% outliers for ROE and EBIT margin
- 3 German companies: “foreign nationals”; United Kingdom, the United States, and France: “ethnic background” due to longer history of immigration. For future studies, we recommend also including other diversity groups for which it is currently difficult to access data

Companies with more diverse boards show superior financial performance across countries

Average per quartile¹, 2008 - 10, percent

Diversity in the executive board
 ■ Top quartile
 ■ Bottom quartile



¹ Comparison of top quartile vs. bottom quartile of DAX 30, CAC 40, FTSE 30, the 80 Fortune 500 companies with the highest/lowest diversity levels; measured based on women and foreign nationals/ethnic minorities in the executive board; adjusted for statistical outliers
 SOURCE: Public sources of information; Bloomberg; Datastream; McKinsey

Exhibit 3

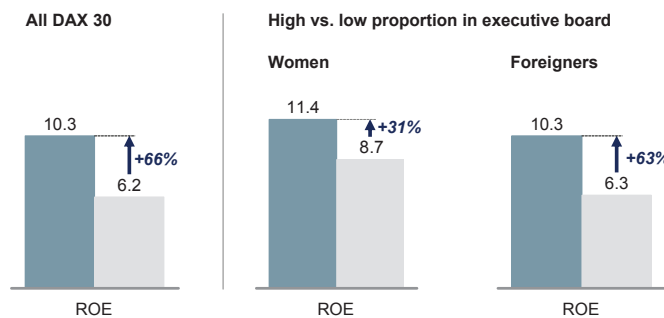
more diverse companies show higher EBIT margins than less diverse companies (29 to 82 percent). Given the broad range of companies listed in traditional benchmark indices, industry-specific effects remain negligible (Exhibit 3).

Take German top management for example: even when analyzed separately, companies with higher proportion of women or foreigners in their boards achieve superior economic success (Exhibit 4).

DAX 30 companies with more women or foreigners on the executive board achieve higher ROE

Average per quartile¹, 2008 - 10, percent

Diversity in the executive board
 ■ Top quartile
 ■ Bottom quartile



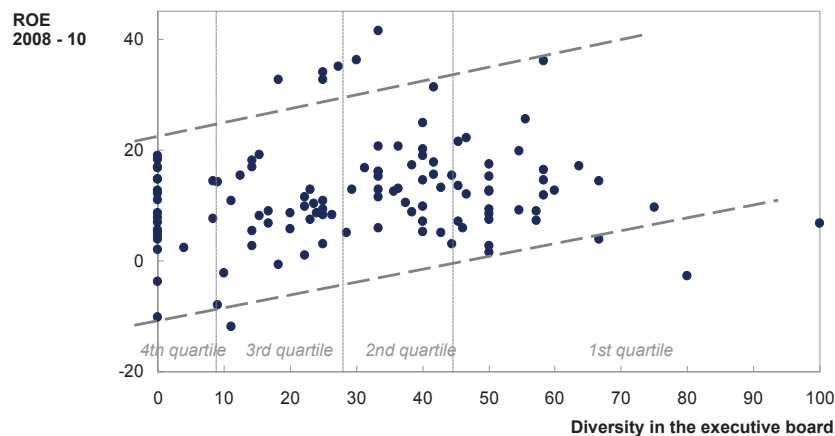
¹ Comparison of top quartile vs. bottom quartile of DAX 30; measured based on women and foreign nationals in the executive board; adjusted for statistical outliers
 SOURCE: Public sources of information; Bloomberg; Datastream; McKinsey

Exhibit 4

Of course, diversity alone cannot account for financial success – there is a plethora of other influencing factors. Statisticians refer to such relationships not as direct causality, but as a highly significant correlation (Exhibit 5). What we can say with confidence is that companies with highly diverse top management teams have been significantly more successful in recent years – regardless of geography or sector.

Return on equity (ROE) correlates with diversity in the executive board

Correlation between ROE and executive board diversity, percent



SOURCE: Public sources of information; Bloomberg; Datastream; McKinsey

Exhibit 5

Diverse companies handle volatility better

Diversity is intrinsically linked with financial success. But why? From detailed analysis, we identified three concrete driving forces. First, diverse companies focus their people selection and development more on performance. Second, they are more agile in adapting to the everyday realities of their workforce. Third, this makes them more flexible and creative on the market.

Relentless performance orientation leads to more diversity

When recruiting and promoting employees, a clear focus on performance potential (instead of emphasizing origins and career histories) not only improves commercial results, it also generates more diversity. This emphasis on performance was apparent in almost all highly diverse companies. One prominent example is Ford's plant in Germany. Their performance-based review system includes a reviewer/auditor principle plus a 360-degree feedback and makes top management more permeable for diversity. Today, a British manager leads the multinational car production at Ford's Cologne plant and a female Turkish manager supervises final assembly.

Agility in adjusting to new employee realities

Society changes rapidly. The traditional family is on the decline while diversity is on the rise. In 2010, 58 percent of Germans were single (1990: 52 percent).⁴ The typical American household (“mom, dad, and two kids”) now makes up just about 20 percent of the US population compared with around 44 percent in 1960.⁵ Everyone expects to be able to have both kids and a career. In addition, the boundaries between private and professional life are blurring. Some 88 percent of the workforce claim they are available to their employer beyond business hours. Publically presenting one’s private identity – as is the case with social networks – is becoming mainstream. Flexible offices, working hours, and work concepts are becoming increasingly common: two out of three German workers wish they could work from home more often, or already do.⁶ Organizations that adapt to these new realities will be better positioned to attract the “best” – and likely the “most diverse.”

Faster and more creative response to market realities

As many studies have shown, diverse companies react better to market shifts and new customer needs. Google’s global reputation as an innovation driver, for example, is also rooted in the diversity it cultivates (and outright celebrates). With programs like BOLD, Google actively seeks out diversity in its workforce. BOLD offers internships to students who can write a convincing paper describing how they could contribute to Google’s diversity. Combined with the freedom that Google gives its employees to spend up to 20 percent of their working hours on their own projects, diversity fuels their success.

Better opportunities, more passion: how companies can drive diversity

How can organizations actively build and manage diversity and thus improve its financial performance? Often, the first step is to establish professional diversity management. Our study could not find a direct link between the number of diversity department staff and actual diversity in a company. However, this does not mean diversity administration is not important. What it indicates is that diversity managers cannot solve the diversity challenge on their own.

The key to more diversity lies in relentlessly focusing on performance, while visibly dismantling barriers. Only then will top performers get the opportunity to use their skills with passion. When analyzing the most diverse companies we found five levers top management can apply now:

- 1. Make diversity a business objective.** Clear top management commitment is pivotal for more diversity. Such advocacy goes well beyond embed-

4 German Federal Statistical Office 2008, 2010
5 US census
6 BITKOM 2011

ding nebulous guiding principles into corporate philosophy. Companies need to specify expectations of their employee mix and track self-imposed targets regarding age, nationality, gender, sexual orientation, or international experience (for example). Top organizations have embedded diversity deep within their objectives and strategies – and they have set up a professional diversity management closely tied to top management.

2. **Value diversity in recruiting (“skills”).** The candidate screening process is constantly improving. Organizations commonly request applications that omit a candidate’s photo, name, and age to be more unbiased in their assessment. This is the first step towards more objectivity. IBM Korea recently pushed the boundaries by publicly claiming: “Extra points will be granted to gays, lesbians, bisexuals, and transgender candidates in document screening.” Examples like this may look odd to some⁷ – but more and more companies are now making real strides towards more diversity in recruiting. Have a look at your current recruiting procedures. Are you evaluating mainly the candidate’s fit with the company? Or do you ask “Can this candidate contribute something ‘different’ to make us better?” Explicitly appreciating diversity as an advantage leads to different (better) recruiting decisions.
3. **Consistently break down barriers (“passion”).** One of the most basic actions is to eliminate physical barriers and establish the appropriate facilities (day care, prayer rooms; vegetarian, halal, kosher cafeteria food; parking places for disabled drivers; etc.). This is already standard practice in many companies, requiring no more than regular checks by top management. What is more important is to break down psychological barriers and anchor respect for diversity. Frequently, a single inappropriate remark or insinuation is enough to rob a person of any passion for their work – not to mention any personal offense they might take. Zero tolerance is the only appropriate response to disrespect of any kind. It can be helpful to prepare a code of conduct to raise awareness of cultural benefits and norms (including sanctions for any breaches). Above all, top managers need to serve as role models. Ultimately, even the tiniest gesture from the board ripples out across the entire company.
4. **Remain truly unbiased in reviews and promotions (“opportunity”).** Every board member in any company will say: “We evaluate people on a strict performance basis.” And most companies actually do have excellent performance management systems up and running. Top players, however, stand apart because they install mechanisms to keep personnel processes as objective as possible. These include:
 - *360-degree feedback.* Superior employee reviews do not stem solely from direct supervisors. They contain input from colleagues at various levels, and comprise a structured evaluation. Ideally, evaluation dimensions are standardized and communicated to everyone involved.

7 Favoring one group would violate equality laws in many countries

- *Reviewer/auditor principle.* In the top companies, an auditor looks over the final employee evaluation to ensure that not one single person decides an employee's professional fate.
- *Upward feedback.* One mechanism used to promote diversity is the (often anonymous) assessment of managers by their direct reports. This can reveal any early signs of potential discrimination.
- *Strength-based development.* Unbiased assessment of current performance is not sufficient. Employees should also be gauged on their potential. Doing this involves systematically compiling their particular strengths as the basis to derive individual development objectives. Such an approach makes it possible to recognize talent early and provide the appropriate support. The development aspiration should be to continuously build on individual's strengths – not to use uniform objectives that lead to a homogeneous workforce.
- *Career committees.* Similar to the reviewer/auditor principle, many top companies have committees that meet regularly to track development in the entire talent pool. Beyond discussing reviews, these committees also confer about concrete career paths for each employee. Decision by committee is ultimately the best way to ensure maximum objectivity. And the effort involved is usually more than offset by improvements to supporting and developing talent.

5. Launch the flagships. Key changes begin visibly. This makes it important to launch one or two high-visibility flagship projects. Two advantages result. First, it signals full top management commitment. Second, these projects are often more likely to succeed. One example is ING-DiBa's "50+" development initiative, which established training groups for new employees over 50. The impact speaks for itself: over 30 people have completed "apprenticeships" with very good results – and the project generated significant local and national media buzz. Another showcase example is IBM's "reverse mentoring" effort. Managers without diversity background are assigned mentors from diversity groups. The intent is to sensitize them to diversity issues in management. These and other flagship projects reinforce diversity in companies and inspire other organizations to take their first steps along the pathway to diversity.

Diversity wins!

Our new and broad-based analysis shows: diversity pays off – socially and financially. Making your company more diverse may sound like a challenging task. But the five levers we have found show: team diversity is actually doable. If you really want to give the opportunities to the best and most passionate talent: it's time to act now. In the end: diversity wins!

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