**Source:** *The Business Times,* p35
**Date:** 26 April 2017

# Missing link in the diversity debate

Boards should engage effectively with diversity to achieve potential gains. BY CHRIS BENNETT AND MAK YUEN TEEN

THE push to improve diversity, especially gender diversity, gained considerable momentum following the global financial crisis. Many policymakers, regulators and commentators have expressed the view that the problem could have been largely avoided if there had been more diverse boards, which would have examined issues from a wider range of perspectives.

An increasing number of countries have introduced gender quotas or targets at the board level, with some extending or proposing to extend requirements to senior management. There have also been concerns about the lack of ethnic and age diversity on boards, although to a lesser extent.

Unlike many other countries, the lack of gender diversity on Singapore boards started to receive scrutiny only over the past few years. However, calls to take action to improve the situation have grown louder, with government-supported committees such as the Diversity Task Force and Diversity Action Committee leading the push to improve gender diversity. The review of the Code of Corporate Governance in Singapore, which is currently in progress, is seen as an opportunity to address this issue through possible regulatory reform.

There is a social justice argument that can be made for diversity and inclusiveness. This argument only requires evidence that certain groups, such as women, are under-represented in certain sectors or levels of society. In some countries, especially Continental European and Nordic countries, this argument alone may be sufficient to lead governments to legislate for gender diversity. However, not everyone sees social justice the same way and efforts to promote diversity on the basis of social justice can get bogged down in arguments about values and beliefs.

Instead of a social justice argument, an altogether different argument – that diversity leads to better decisions and, therefore, improved financial performance in companies – is often advanced. This "business case" argument underlies the advocacy for improved gender diversity in many countries, including Singapore.

Much research has been undertaken about the impact of diversity, particularly gender diversity at the board level, on financial performance of companies in various countries. However, the results of these studies are ambiguous and often yield conflicting results; some studies have found diversity improves financial performance, some say that it has little effect and some that it damages financial performance.

Studies on the relationship between gender diversity and financial performance often suffer from serious methodological flaws, leading to concerns about causality and spurious inferences. The debate over the moral or ethical case for diversity is replaced by a debate over the evidence for its financial impact.

Part of the problem is that those claiming a link between gender diversity and financial performance often do not explain clearly why or how that link works. Often, differences in behavioural traits or decision-making styles between women and men, or the importance of having women who understand the company's customers or other stakeholders, are cited.

The argument then goes that having women would lead to a diversity in perspectives or decision-making styles. While these differences between genders exist at the aggregate level, they do not apply to all women and men or in the same way in all cultural environments.

Further, how diversity translates into differences in financial performance is not clearly explained. Rather than asking the question "Does board diversity improve performance?", perhaps a more useful question is "Under what conditions does diversity improve performance?"

There is some well-established evidence supported by good research that we can consider:

■ Sometimes, diversity does yield significant benefits in decision-making. Studies have shown that it can improve creativity and problem-solving, and help avoid the key biases that blight judgment and decision-making in corporate contexts – notably "groupthink".

■ Intellectual, fact-based (cognitive) disagreements tend to lead to more appropriate decisions, while emotional attachments between individuals can lead to groupthink and inappropriate decisions.



**If companies are forced to improve numerical diversity through regulation and do not believe in its benefits, they are likely to improve numerical diversity through "tokenism" and not put in the necessary effort to engage with diversity, say the writers.** FILE PHOTO

■ Interpersonal conflict can have a significant adverse impact on the quality and speed of decision-making.

■ Less diverse boards are likely to be more cohesive, which makes getting agreement simpler but makes considering issues from multiple perspectives more difficult.

■ Greater diversity in board membership inevitably increases the complexity of interactions between directors, including decision-making.

■ The human mind prefers things to be simple, even if that does not always produce optimal results.

These various implications of diversity may go some way in explaining the ambiguous results about the link between board diversity and financial performance. If it's not managed, increasing diversity simply makes decision-making and reaching agreement harder.

Given that diversity can improve performance under certain conditions, recognising the conditions under which it works becomes critical.

Just making a group numerically diverse won't improve performance, in the same way that just writing down a business strategy won't improve performance. Once any plan has been devised, it needs to be implemented and supported effectively to obtain the potential benefits.

Diversity in numbers alone isn't enough to bring benefits but skilled engagement with it enables the potential benefits to be captured. Engaging with diversity (under the right conditions) exercises the mind's innovation "muscle". This is because both engaging with diversity and being creative require that we suppress our internal biases. Engagement with diversity makes the innovation "muscle" stronger, more efficient and more productive.

Effective engagement with diversity requires consciously recognising the potential benefits of cognitive conflict and the need to suspend biases and avoid rapid judgments in order to understand "why" individuals reach the conclusions before dismissing them as inappropriate.

Boards that engage effectively with diversity can make better, more creative decisions. Better, more creative decisions should create competitive advantage. Competitive advantage should, in turn, lead to better outcomes and better firm performance.

To reiterate, there are several things that companies need to do to realise the benefits of diversity:

■ Numerical diversity is a start and a necessary condition but is not enough on its own to achieve the benefits.

■ Board diversity has to be embedded within broader frameworks of corporate governance, such as proper consideration of board composition and sound selection processes, and an understanding of how to translate numerical diversity into improved decisions and performance.

■ Diversity in all its forms, if it's significant in depth, sustained in impact, and challenging by nature, should when supported and focused promote the financial benefits boards and companies seek.

■ Recognise that diversity is supposed to increase cognitive dissent – arguments about facts and the way that they are interpreted. This is how diversity brings new perspectives, challenges existing norms and conventions, and promotes creativity and innovation.

■ Directors need to encourage cognitive conflict and at the same time discourage emotional conflicts among directors. Clearly, the role and skills of the board chair are key here but all directors need to be aware of the issues. The same principle applies to all work groups and teams.

■ The right kind of training is critical. Turning board diversity into better decisions and better firm financial performance is no different from any other activity and requires knowledge, commitment and hard work.

If companies are forced to improve numerical diversity through regulation and do not believe in its benefits, they are likely to improve numerical diversity through "tokenism" and not put in the necessary effort to engage with diversity. It may also not address the problem of groupthink. Consequently, the lack of benefits will become self-fulfilling and this may then undermine the "business case" for diversity.

While we share the frustrations with the slow pace of improvement in gender (and other kinds of) diversity on Singapore boards, we believe that attitudinal and mindset changes and a willingness to engage with diversity among directors are critical for gender diversity to make a difference to performance of companies. Such changes are likely to come about only with better selection processes for directors and progressive refreshing and renewal of boards, and director training that helps all directors engage effectively with diversity.

Therefore, focusing on initiatives to improve these areas, with a measured approach to improving numerical diversity, may be the better course of action for Singapore at this point in time.

So, "Yes", there is a need to get the numbers to achieve diversity, but "No" it is not enough to merely have people from different groups. There is a danger that diversity becomes just a numbers game, leading to no positive effects or even adverse effects on performance. Boards and directors have to engage effectively with diversity to get the undoubted potential benefits.

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