

The PODfolio Podcast Episode 13: Inclusion & diversity – a frank discussion

NIMISHA SRIVASTAVA Essentially, the critical issue is, how do you give opportunities to people who are not at the right school, so they're not in the right recruiting programs?

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SPEAKER: Welcome to the "PODfolio," Willis Towers Watson's investment podcast series, where we'll give you an update on the latest developments across global markets and talk to expert guests on hot topics that matter to institutional investors and their portfolio.

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LOK MA: Hello, and welcome to this episode of the "PODfolio" podcast. I'm your host, Lok Ma, and I've been looking forward to this one quite a lot. Today, we're talking about inclusion and diversity in the investment industry. Obviously, a hot topic right now and not just in a professional sense, but this idea of how all of us, with our different backgrounds, should interact with each other in this world we share is, of course, something that many of us are thinking and talking about right now.

So I'm delighted to be joined by Chris Redmond, our global head of manager research. So welcome to the show, Chris.

CHRIS REDMOND: Thank you, Lok.

LOK MA: And also, to welcome back Nimisha Srivastava, global head of credit research and also the star of our most downloaded episode so far. And that was episode nine on the credit market. So welcome back, Nimisha.

NIMISHA SRIVASTAVA Good to see you again, Lok.

LOK MA: Now I know you guys recently published a paper on inclusion and diversity and investment. We'll include a link on the podcast page. And I actually read an interview with Chris about this research in the Financial Times in the UK. So it obviously made a bit of a splash.

Now just to give the two of you kind of heads up about the sorts of areas that I want to go into. I don't think I want to just stay in the comfortable, everything's positive areas of this kind of discussion. I've started following some advice to expose myself to opinions that I don't instinctively agree with. And that includes views that I&D is not necessarily what it's built up to be, or that we're not going about it in quite the right way.

So I do want to get your reactions to some of these opposing views. Now my intention is not to deliberately provoke or offend. But I do believe that it's important to speak our minds on these things. So on that note, shall we kick off by kind of asking you guys for a definition of what inclusion and diversity might mean to you guys? And maybe I could start with you Nimisha.

NIMISHA SRIVASTAVA Sure. I mean, to us the basis of good inclusion and diversity means a robust decision making process that captures cognitive diversity. So we believe teams that are more diverse from a cognitive angle leads to better outcomes. And in order to maintain a strong and collective decision making, you need to be inclusive and be OK with different views, different people, different backgrounds. So that's maybe putting it simply.

LOK MA: So you mentioned cognitive diversity, which I think in a decision making kind of process that's got to be the one that matters but also appreciate that's not going to be the kind of thing that's easy to measure. So what kind of, I guess, characteristics do you tend to focus on when you think about what level of diversity there is?

NIMISHA SRIVASTAVA Sure. And you're right. There are the observable diversity characteristics such as gender and ethnicity. And there is research to suggest that that does lead to more cognitive diversity. And then there are things that are not so measurable-- you know, where someone grew up, what school they attended, what they studied, how many languages they speak. You know, all of that goes into cognitive diversity.

And where I would say in various stages of measuring that-- some of that we do measures such as in education and somewhere where we're going to measure more of, including background. Chris may want to add additional details there.

LOK MA: Chris?

CHRIS REDMOND: Yeah I think as Nimisha points to, our goal has been to establish a pretty high baseline measure of diversity through those things that you can observe. And we'll continually push to expand that set of things as we kind of navigate all of the data protection laws and make sure that we comply with that.

It's then the work over and above that from a manager research perspective that allows us to get into some of the other areas Nimisha's referring to and kind of really dig into the culture of an organization and get a sense for the more inclusionary aspects of that.

LOK MA: So that's very interesting to me because when people talk about I&D, I tend to think of gender and ethnicity. It's actually interesting to hear that you go so far beyond that to try to get to that holy grail of the cognitive diversity. I mean, maybe staying with you Chris, can you just tell us a quick bit about the current state of diversity within the investment industry?

CHRIS REDMOND: Disappointingly poor is the honest assessment. And disappointingly poor and lacking in transparency would be a further addition. There was a good paper published quite recently by an organization called the Knight Foundation, which did a study on various mutual fund and asset managers within-- in the sorts of arenas that our institutional clients would traffic.

And that revealed that there was around about 5% of those asset manager organizations that were women owned. And around about 4% were minority owned. So around about 10% overall of the asset management industry, in terms of the mutual fund industry, is either women or ethnic minority owned. That's clearly a really long way away from society and from what might be a reasonable aspiration.

LOK MA: Indeed. And this is where I want to throw some kind of counterarguments at you, if you like. Maybe we'll start with Nimisha. So what's wrong with the idea of having a meritocracy, so just basically giving everyone the same chance regardless of their background, and just using the best people available for the job? So doesn't that logically lead to the best results?

NIMISHA SRIVASTAVA Yeah. And for sure, you want meritocracy and to find the best people. The key in me, in what you just said, is best available. That's one big problem, is finding the talent that actually is diverse and pushing through the biases that may exist in what constitutes someone who's best.

So if you haven't solved those two issues, you're inherently looking at the same pool. And then yes, your argument holds. But if you haven't adjusted your thinking to go beyond that, you're sort of stuck in the same pool forever. And so it does require an awkward kind of expanding of mind of, what is best? Why do we think that's the case? What are the requirements for someone to be good in this role, and is that actually true?

CHRIS REDMOND: And perhaps, to add to that, there's absolutely nothing wrong with a meritocracy. It's just we don't have one. The system is set up to not give everyone the same opportunities, to give the same kind of fair shot that would allow a true ideas meritocracy. It's a deeply embedded set of unconscious and conscious biases that exist that stop it. And that's really what we're talking about addressing.

LOK MA: And I know you've produced a detailed paper on this. Can you just give us some headline evidence that shows that a strong I and D culture or a better I and D culture does actually lead to these better results? Maybe Nimisha?

NIMISHA SRIVASTAVA Yep, so that was a key basis of our paper is, is this true? And what we found was there was a positive relationship between more diverse teams and better outcomes to the nature of the 20 basis points of outperformance from teams that are more diverse to those that are less. And that's pretty significant, if you're talking about asset classes today, where 20 bits means the difference between outperforming and underperforming a benchmark.

LOK MA: And I think in this people-based area, it's just good to have some solid quantitative evidence like that. And 20 basis points, as you say, if you think about typical investment strategy, that's of the order of 10% of the total portfolio return above risk-free rate. So definitely a material factor, I would say. So turning to the actual process for researching the asset managers and making recommendations, Chris, is that 10% also? Is that kind of the right ballpark, in terms of the attention that you give to I and D culture?

CHRIS REDMOND: Yeah, I think that is about the right sort of level. It's a really tough thing to do, I think, to assign that weighting to it. There is undoubtedly signals and areas that we are explicitly assigning weight to that are linked to inclusion and diversity. But the reality is that inclusion and diversity in culture does transcend lots of things. It does speak to how an organization is put together and how it operates. So it's a tough question to put, what's the weight on it. But something of the order of 10% to 20% feels about right.

LOK MA: And here's another slightly thorny question. So I'll throw it out there, and either of you, do jump in when you feel happy to answer this. Are we sure about the cause and effect

behind all this? So I just want to play devil's advocate a bit here and ask you about the potential for a kind of a peacock effect, so the strongest peacock will get the best food and therefore can grow the most kind of magnificent tail. But the magnificent tail isn't what is giving the peacock the strength.

So in other words, the well-run managers, they get the good results, they have good revenue coming in. So they've got the time and resources to then devote more of their efforts to improving I and D, rather than I and D being the thing that's driving the good performance. I'm just wondering whether either of you wants to jump in to react to that?

CHRIS REDMOND: So I love, Lok, that you've framed it in that way. And it's a wonderful encapsulation of the common challenge, I think, that we get. To my mind, it's important to kind of pull back to the principles, the principle of a more diverse, more cognitively-diverse team being better, making better decisions, being more robust, I think, is largely agreed with and bought into. So you have a principles-based argument that we've now set out to effectively supplement with data.

Now, the reason we've done that is because I think we need that to catalyze the industry to actually do something. People agree with the principle, but they don't do a great deal. So I haven't yet answered your argument other than to say, we are not pursuing better inclusion and diversity within the asset management industry because the data tells us to. We're doing it because the principles that underlie it tell us to do it, and the data supports it. So I think that's an important distinction to start with.

Even if we're wrong on that, and the reality is that well-run, high-quality asset managers have subsequently gone on to invest in inclusion and diversity and made themselves better, I don't see the downside. It just means we're biasing ourselves towards those well-run asset managers that drive good outcomes that have subsequently decided to go down this route. So I don't believe that's the case. But even if it was, I don't see the downside.

LOK MA: Good.

NIMISHA SRIVASTAVA I may go, if I may, Lok, may go through an actual case study, if you will, of a good peacock turning bad. We had a very good asset manager with a strong leader, and he had a strong co-leader who was a different thinker, different background. She happened to be female. He was male. But she just brought a different lens to it, and she left.

And if I think about the four areas that we look at in a firm, its investment team, approach, firm and team stability, and sort of alignment with clients. So you now have something that hit the investment team, in that she left. You had less diversity in the team, because he didn't replace her. That started to, then, effect the approach and the way he managed the portfolio of less inclusion, less appreciation for different views. He didn't have that strong voice of challenge and diverse thinking.

And the extreme case was, he didn't want to hear opposing views. That, then, led to firm and team stability issues, where you had more people leave. It didn't actually work, because he didn't have diversity, which led to better decisions. He had less diversity, and that led to poor investment decisions. And then the ultimate stability issue is the firm then shut down. So to us, that's a good case study of, yes, I maybe can't prove the positive you just said, but I can certainly prove the negative.

LOK MA: Thank you. And Nimisha, at the beginning of this, I think you mentioned that you look at kind of signs pointing towards cognitive diversity, rather than a kind of physical appearance, or the kind of very easy to measure type proxies. Can you just go into a little bit more detail on that? So I mean, I guess my question is, how do you make sure you don't end up with a bunch of people that look different, but they actually think and act in the same way, more like your historically typical well-off, straight white males? How do you make sure there is actual true cognitive diversity?

NIMISHA SRIVASTAVA Sure. And I may touch on one of the tools that we're in late stages of developing is actually a committee diversity tool. Because not just managers look, but our clients and asset owners want to think about the diversity in their decision making as well. And so it's a tool-- and I'll go through it only because it addresses your question-- where it does include the inherent traits that we went through-- ethnicity, gender, age-- but also be the acquired traits, the education, the work experience, political views, languages, where you've lived in the world, what type of environment you grew up in.

And then the last lens are those cognitive traits, what type of role have they played, what type of-- I don't want to say personality-- but what type of person are you? What motivates you? And the complete view of all of this is what we think is necessary to actually force committees and teams to think about those questions you just raised. Do they have a balance across everything? Are there any gaps?

It may lead to a pretty score at the end of it, and it may not lead to a pretty score at the end of it. But that's sort of irrelevant. I think the point is just making sure you've got a good blend across all of that. So that that's where we want people to get, is to just be a bit more reflective, whether they're a manager. That's fine if you believe in cognitive diversity and you think you're a team of all white males is diverse. How are you actually measuring that? And sharing some of these tools with them to be able to showcase that. And we think it would lead to some gaps across some of these elements.

LOK MA: And you mention some of those things that you look into, things like educational background and economic background and so on. I do want to go into that in a little bit more detail. But just by the way, I don't mean that straight white guys are kind of villains in some way. And I think it's important to say that. Because sometimes the commentary makes it feel a little bit that way.

So anyway, let's move on to kind of thinking about improving the state of inclusion and diversity in the industry. And we're going to touch on some of those other characteristics as part of this, as well. Chris, what do you think about the dangers of trying to improve I and D incrementally, so in one area at a time?

So for example, you put policies in place, and you end up with a good representation of women, which is something that you kind of read about in the papers. And then you realize, oh, no, we just found out we haven't got enough minorities. So you kind of go back and undo some of that stuff. Do you see a bit of a danger in some places?

CHRIS REDMOND: I think there could be. And I think this is a really finely balanced issue that you're raising of the desire for sort of perfection, the desire to achieve that ultimate goal of having the asset management industry actually reflect the society in which you operate and the savers whose money that is they are investing. It validates, that's where we want to go.

But we're an awfully long way away from that, and we know we need to go on a journey, and ideally a quick journey.

But that pursuit of perfection, I think, risks inertia. And it risks you deciding not to push on with the gender lens or ethnicity, because you're so almost afraid of making a misstep. So I'm not sure I have a great answer for you other than to say, I think we would encourage action rather than inaction, and acknowledge that there might be times when the full picture is not coming together and you're making more progress in one area. And whilst that's not perfect, at least it's progress and it's a movement forward.

LOK MA: And I now just want to kind of go a bit beyond the obvious characteristics around gender and ethnicity and think about some of the other things that Nimisha mentioned. What about class and economic background, which I think is rightly starting to get more attention now? So how do you make sure that improving I and D doesn't just mean giving lots of opportunities to women and minorities, as long as they are kind of from the middle classes, and you're still effectively ignoring people from the less wealthy family backgrounds, the ones who are not as familiar with the industry to start with, and so on?

NIMISHA SRIVASTAVA Sure. I'll go first, Lok. And I think there are two elements in what you just raised. And essentially, the critical issue is how do you give opportunities to people who are not at the right school, so they're not in the right recruiting programs? And so in our minds, what we've seen asset managers do to try to address the issue is start younger and actually just engage more in their local communities as well as building more channels for high school talent, for college talent, to bring awareness of the issue.

Because if you wait, actually, if you wait until college, you're almost too late. And to your point, you want to make it natural for a child to say, this is an interesting path I could take. We internally authored a-- not me, but maybe Chris was involved-- a children's book on financial literacy. Things like that is what's needed to solve the structural issue you raised.

From a more near-term angle, the other item that managers are thinking about is sourcing, so differentiating their sourcing channels and not just going to the same schools, looking at schools, maybe, they haven't looked at before. Particularly in the asset management industry, there is a bit of a bias into the well-known financial programs that are out there. But often times, that may ignore the local schools that may also have it, but that just alumni usually brings more alumni with them.

And so that's the cycle that people want to break. OK, let's explore these five schools. They have financial programs, or they might have related programs, and we teach them the finance angle. So those are the two things we've seen managers do that I think will help over the long term. Chris, I don't know if you have anything else to add from that angle. But if we had the answer to this, we would be in a much better shape as an industry whole. But I think starting small will at least start to move the needle.

LOK MA: Chris, anything to have?

CHRIS REDMOND: I would note that we face issues both in terms of the people putting their hand up to come into the industry and keeping them. So Nimisha is absolutely spot-on. It's about starting at an early stage to try and correct the perception of the industry, but also the processes around that recruitment stage that unfairly bias it towards people from a

particular background, particular education. And that will ultimately allow a more self-sustaining kind of change to occur.

LOK MA: Interesting that you say that, Chris. Because actually next week, on part of our initiative to interview trainees under this 100 Black Interns program which is in the UK. Of course you know, but in the UK, there's this initiative across the asset management industry to hire 100 Black interns for next year, essentially do what you're saying, giving people exposure to an area that traditionally they might not have been familiar because they're not from kind of professional backgrounds, and so on and so forth.

And also Nimisha, you mentioned a children's story. And I think the peacock that turned bad would make a wonderful children's story. So do please keep that in mind.

[LAUGHTER]

NIMISHA SRIVASTAVA [INAUDIBLE] too, Lok.

LOK MA: Yeah, maybe you can come back for a third episode and do that for us. Can I just say thank you to both of you for sharing your thoughts on these points. Because I know we've deliberately gone into some of the more sensitive and maybe uncomfortable areas.

I think it's probably time to wrap up now. And I'm just mindful that a lot of our listeners are asset owners as opposed to asset managers. So is there a final takeaway from each of you for the asset owners, in terms of how they can contribute towards better I and D culture in the industry? Nimisha?

NIMISHA SRIVASTAVA Sure. So Lok, our paper goes thorough a bit of what we think each industry participant-- asset managers, consultants, and asset owners-- can play in this issue. From an asset owner standpoint, we think there are simple things to do. One is just trying to push your management on the transparency element of, you don't know where you're going if you don't know where you stand today.

So step one with a lot of our clients at present is just measuring, what is the diversity in your portfolio? What are all the managers planning on doing over the next 12 to 18 months? And asset owners can play a powerful role in creating more accountability with managers if they don't have enough goals or haven't met them. We try to do that ourselves in pushing managers to be more prescriptive, as Chris shared earlier.

But certainly, asset owners can work with us in that journey. And then to your point of sort of turning the mirror internally, the second layer could be thinking about the shape of investment committees themselves and how to introduce more diversity there. And the third is thinking about the action plans that could be taken as a result. Maybe there are natural places to introduce diversity in new asset classes that will just improve the investment outcome of that plan, but also help improve the overall diversity in the portfolio, as well.

LOK MA: Thank you very much, Nimisha. Any final comments from you, Chris?

CHRIS REDMOND: I've probably sat through over 1,000 manager selection exercises, the kind of so-called beauty parade, which is an extraordinary experience to go through. It was

for the four or five asset managers putting on their best high and trying to give across the message of what they do, and why they do it.

What I think is very difficult to overcome is the natural tendency of the asset owner to pick somebody who speaks like them, who looks like them, because that's just inherently more comfortable, or to be pulled towards the organization that has the longest track record, the most unbroken period with the same people involved, with that kind of star PM. And I think our plea is to maybe just think about what the consequences of that mindset are, and whether we can broaden that out a little to acknowledge the fact that that's going to push you towards people who look the same and think the same.

And actually in the context of their total portfolio, that's going to be the wrong thing to do. It's really important, when you think about putting together all those pieces, that you have things that are different. And that should be front and center in the minds of the asset owner as they go through that management selection process.

LOK MA: So different is good. Thank you very much for your time as well, Chris. I hope our listeners enjoyed our conversation and that you're joining us for our next episode, which is going to be on ESG and sustainability. And in the meantime, do take care of yourselves.

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