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YORKSHIRE & HUMBER
ACADEMIC HEALTH SCIENCE NETWORK

National Centre for Diversity

How Diversity Drives Innovation

A report by the National Centre for Diversity for the
Yorkshire & Humber Academic Health Science Network

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Introduction

Why diversity matters

Creating a more inclusive society has been a goal of many individuals, organisations and governments for many years, and this has been motivated by different reasons. For some, being more inclusive comes as a result of demands made by diverse groups within society, who demand more equality - whilst for others the reason for being more inclusive is it is 'the right thing to do'.

Often, organisations and businesses within these societies will be motivated by a need to meet legislative requirements, for example; from April 2017, Employers in the UK with 250 or more employees were required to publish data on their Gender Pay Gap. Notably, some organisations or businesses will take the lead in pushing the boundaries to be a more inclusive employer, with the assumption that a more diverse workforce will help their organisation or business perform better.

However, there are also significant demographic and financial reasons that diversity should not be ignored in the UK. McKinsey & Company (2013) highlighted that BAME communities made up 10% of the UK workforce, although only a little more than 20% of UK companies had at least 10% BAME representation on their top management teams. Financially, the purchasing power of women as customers is considerable, as they are involved in 80% of consumer goods purchased in the UK (McKinsey & Company, 2013).

Whilst anecdotal assumptions have existed about the benefits of having a more diverse workforce, such as 'the ability to attract the best talent' or 'being more responsive to diverse customers', the factual evidence of this has often been limited. However, more recently studies have been undertaken that comprehensively show, that what was previously seen as 'possible benefits' are now backed up by researched evidence, especially in relation to diverse workforces helping organisations/ businesses to innovate and drive market growth.

The Hewlett et al (2013) article in the *Harvard Business Review* outlined research undertaken amongst 1,800 professionals, 40 case studies, and numerous focus groups and interviews. The research scrutinised two kinds of diversity: *inherent and acquired*¹ and referred to companies whose leaders exhibited at least three inherent and three acquired diversity traits as having two-dimensional (2D) diversity. By correlating diversity in leadership with market outcomes as reported by respondents, the research found that companies with 2D diversity out-innovated and outperformed

¹ Inherent diversity involves traits you are born with, such as gender, ethnicity, and sexual orientation. Acquired diversity involves traits you gain from experience: For example, working in another country can help you appreciate cultural differences (Hewlett et al, 2013).

others. Employees at these companies were 45% more likely to report that their company's market share grew over the previous year and 70% more likely to report that the firm captured a new market.

The research also found that 2D diversity unlocks innovation by creating an environment where outside the box ideas are heard. However, most respondents (78%) work at companies that lack 2D diversity in leadership. Without diverse leadership, women are 20% less likely than straight white men to win endorsement for their ideas; BAME are 24% less likely; and LGBT people are 21% less likely (Hewlett et al, 2013).

Furthermore, Hewlett et al (2013) stated that this cost companies crucial market opportunities, because inherently diverse contributors understood the unmet needs in under-leveraged markets. The research also found that when at least one member of a team had traits in common with the end user, the entire team better understood that user. A team with a member who shares a client's ethnicity is 152% more likely than another team to understand that client. However, Hewlett et al (2013) argued that inherent diversity was only half of the equation. Leaders also need acquired diversity to establish a culture in which all employees felt free to contribute innovative ideas.

Probably the most highly cited research demonstrating the value of a diverse workforce was presented in the McKinsey & Company (2015) report 'Diversity Matters'; authored by Hunt et al (2015), which examined proprietary data sets for 366 public companies across a range of industries in Canada, Latin America, the United Kingdom, and the United States. The research looked at metrics such as financial results and the composition of top management and boards. The findings showed that:

- Companies in the top quartile for racial and ethnic diversity were 35% more likely to have financial returns above their respective national industry medians.
- Companies in the top quartile for gender diversity were 15% more likely to have financial returns above their respective national industry medians.
- In the United Kingdom, greater gender diversity on the senior-executive team corresponded to the highest performance uplift in the data set: for every 10 percent increase in gender diversity, EBIT² rose by 3.5%.
- The unequal performance of companies in the same industry and the same country implies that diversity is a competitive differentiator shifting market share toward more diverse companies.

² Earnings Before Interest and Tax (EBIT).

The Hunt et al (2015) report establishes that the relationship between diversity and performance highlighted in the research is a correlation, not a causal link and whilst this is an important distinction, the findings nonetheless permit reasonable hypotheses on what is driving improved performance by companies with diverse executive teams and boards. Furthermore, Hunt et al (2015) stated that:

“...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...”

Hunt et al (2015) acknowledged that creating a diverse workforce is not an easy task and that companies need to have a robust transformation programme, which explicitly addresses barriers to employment and culture within the company, and that there is visible commitment from the leadership team.

The scale of the challenge was highlighted by the Cabinet Office (2017) ‘Race Disparity Audit’ report, which showed that following decades of equality and diversity legislation and many years of effort by organisations to develop diverse workforces, there remained significant racial injustices in all areas of public life: health, education, employment, housing and the criminal justice system. In the UK, Asian, Black and those in the ‘Other’ ethnic group were the most likely to be living in ‘persistent poverty’. The audit also found that whilst 1 in 25 White British people were unemployed, rates increased to around 1 in 10 for those of a Black, Pakistani, Bangladeshi or Mixed background (Universities UK & NUS, 2019).

Diversity and innovation

Whilst McKinsey & Company, Hewlett et al and others make the business case for having a diverse workforce, how does a diverse workforce contribute to more innovation within organisations and companies?

Klingler-Vidra (2018) in his global review of diversity and inclusion in business innovation argued that there are two distinct conceptualisations of ‘inclusive innovation’. Most often, ‘inclusive innovation’ refers to including people, places and industries in innovation processes and activities, so bringing underrepresented groups such as women or BAME communities into work in innovative sectors. The other conceptualisation is ‘inclusive innovation’, which is understood as a product or service that addresses social issues, such as technological innovations to enhance mobility or to reduce the occurrence of symptoms of certain diseases. ‘Inclusive innovation’ can therefore involve bringing people into the process of innovating (and encouraging inclusion and diversity through employment) or innovative products or services enabling the inclusion of members of society.

Warr et al’s (2017) study ‘Do Pro-Diversity Policies Improve Corporate Innovation?’, looked at the hiring policies of the 3,000 largest publicly traded companies in the United States to see if companies with a diverse workforce were better at developing innovative products and services. The study found that companies with policies that

encourage the retention and promotion of workers across the race, sexual orientation, and gender spectrum were more innovative and released more products (Locker, 2018).

Further evidence of diversity driving innovation was presented in a report by Lorenzo et al (2018), for the Boston Consulting Group (BCG), whose study suggested that increasing the diversity of leadership teams led to more and better innovation and improved financial performance.

Lorenzo et al (2018) surveyed employees at more than 1,700 companies in eight countries (Austria, Brazil, China, France, Germany, India, Switzerland, and the US) across a variety of industries and company sizes. The survey looked at perceptions of diversity at the management level across six dimensions—gender, age, nation of origin (meaning employees born in a country other than the one in which the company is headquartered), career path, industry background, and education (meaning employees' focus of study in college or graduate school). To gauge a company's level of innovation, BCG looked at the percentage of total revenue from new products and services launched over the past three years.

In both developing and developed economies, companies with above-average diversity on their leadership teams report a greater payoff from innovation and higher EBIT margins. Even more persuasive, companies can start generating gains with relatively small changes in the makeup of their senior teams. For company leaders, this is a clear path to creating a more innovative organisation. People with different backgrounds and experiences often see the same problem in different ways and come up with different solutions, increasing the odds that one of those solutions will be a hit. In a fast-changing business environment, such responsiveness leaves companies better positioned to adapt.

The Lorenzo et al (2018) survey also found a strong and statistically significant correlation between the diversity of management teams and overall innovation. Companies that reported above-average diversity on their management teams also reported innovation revenue that was 19 percentage points higher than that of companies with below-average leadership diversity - 45% of total revenue versus just 26%. In other words, nearly half the revenue of companies with more diverse leadership comes from products and services launched in the past three years. In an increasingly dynamic business environment, that kind of turbocharged innovation means that these companies are better able to quickly adapt to changes in customer demand. Of the six dimensions of diversity considered, all showed a correlation with innovation. But the most significant gains came from changing the makeup of the leadership team in terms of the national origin of executives, range of industry backgrounds, gender balance, and career paths. Age and educational focus showed a lesser effect.

Even with a diverse management team in place, companies will be able to take advantage of the unique viewpoints and perspectives of leaders only if they have the right inclusive foundation. The study therefore looked at the presence of the factors that allowed diversity to flourish and help the diverse management team reshape the company's innovation efforts. These factors included fair employment practices,

such as: equal pay; participative leadership, with different views being heard and valued; a strategic emphasis on diversity led by the CEO; frequent and open communication; and a culture of openness to new ideas (Lorenzo et al, 2018).

Lorenzo et al (2018) concluded by stating that there has long been anecdotal evidence supporting the idea that diversity fosters innovation. Now there is a databased case as well. The evidence is clear: companies that take the initiative and actively increase the diversity of their management teams - across all dimensions of diversity and with the right enabling factors in place - perform better. These companies find unconventional solutions to problems and generate more and better ideas, with a greater likelihood that some of them will become winning products and services in the market. As a result, they outperform their peers financially (Lorenzo, 2018).

A few years previously, Becher (2012), in his article 'Diversity drives innovation' listed a number of sources which further demonstrated the link between more diversity in the workplace and improved innovation and business performance:

- In a Forbes Insights report, 'Fostering Innovation Through a Diverse Workforce', 85% of survey respondents agreed a diverse and inclusive workforce brings the different perspectives a company needs to drive innovation. 97% of the companies surveyed had formal diversity and inclusion strategies in place, viewing it as a competitive advantage that helps capture new clients, and adds to the potential for adding consumers in emerging markets.
- Companies with a strong commitment to diversity on average outperformed their peers with higher profit margins, and greater return on equity and assets. ("The Business Case for Commitment to Diversity", 2008).
- The 2009 report, Does Diversity Pay? Race, Gender, and the Business Case for Diversity, showed that companies with greater racial and gender diversity performed better in terms of sales, revenue, number of customers, and market share.

(Becher, 2012)

A practical example of diversity driving innovation was highlighted by Johansson (2019), whose clients have included Disney, Johnson & Johnson and Pfizer. During his interview with Weier (2019), Johansson gave the example of Aheda Zanetti who moved from Lebanon to Australia as a child, and she discovered that the dress code for the Australian beach culture is not the dress code for a traditional Muslim woman. She thought, why does it have to be that way? Why can't I combine my traditional Muslim culture with Australian beach culture? So, she created the burkini. So, what would the market size of that be? Well, it's enormous. Her own company, Aheda, has grown by leaps and bounds. Now this idea and others like it has been picked up by others; Nike last year launched its Nike Pro Hijab for Muslim female athletes. Johansson (2019) commented:

"Aheda was able to bring two cultures together—the beach culture she found in Australia, and the culture of her faith. And with those perspectives, she realised the

market potential wasn't zero, it's actually massive. The idea here is that diverse perspectives trump experience and expertise in a world where the rules are constantly changing. We've become the most connected society in history, and this enormous ability to combine concepts across disciplines and cultures is the world we live in. And the most exciting thing about this realisation? It points us to where innovation will happen in the future.”

Another practical example of innovation from a healthcare system is that of Cleveland Clinic Florida, which has a multi-ethnic, multicultural and multi-generational clinical and administration team. Barsoum (2018), who as President, illustrated the value of diversity driving innovation by stating that the diversity in the Clinic's workforce and culture has enabled the Clinic to provide their increasingly varied patient population with world-class care. Barsoum (2018) pointed out that empathy is another area where diversity opens doors, thus enhancing patient engagement and satisfaction. For Barsoum (2018), on the hospital floors, 'caregivers work hard to provide culturally appropriate care because seeing another person's perspective through their cultural lens is easier if they have walked in their shoes or, over the same hills'. Furthermore, Barsoum (2018) felt that the best collaboration comes from diverse teams and at Cleveland Clinic this occurred at the highest operation level, which ultimately improved the quality of care that patients received and to achieve this required pushing boundaries and researching new ideas. This focus on diversity within the Clinic helped it to be recognised as number one on the Diversityinc Hospitals and Health System list³.

Fan (2011), who was a senior director in the Office of Diversity at Walmart wanted people to recognise, that in addition to cultivating a diverse workforce, organisations must also foster an inclusive work environment where creative ideas can germinate and grow. For Fan (2011), common characteristics of an inclusive work environment include: Trusting and empowering employees to make a difference in continuous business improvements; respecting a predisposition toward collaboration and diversity of thought; knowing how to think creatively to solve problems and capture opportunities; and valuing and leveraging differences.

Conclusion

Keller and Price (2011) maintain that research 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 achieved, 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

³ <https://www.diversityinc.com/the-2019-top-50-diversityinc/>

on specific goals. 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 organisation and require the infrastructure to actively manage against targets (not quotas) to hold individuals accountable for outcomes.

Hunt et al (2015) summarised their research by emphasising that in a world that is both diverse and deeply interconnected, companies and institutions with greater levels of diversity are achieving better performance. Hunt et al (2015) further highlighted that most organisations 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, who with the right level of support can drive innovation within the organisation.

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