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# The difficulties with a “business case” for equality, diversity and inclusion in the financial services workplace

Jeniz White, associate at Browne Jacobson, asks whether equality, diversity and inclusion (EDI) actually has a good business case?

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“The evidence tells us there is a strong business case for diversity”

“A diversity of perspectives and thought, when part of an inclusive culture, results in better judgements and decision making [and] … reduces the risk of groupthink and encourages innovation”

These are quotes from the Financial Conduct Authority (FCA) from earlier this year (see Why diversity and inclusion are regulatory issues and Diversity and inclusion – why it matters to us). The central concept is that pursuing equality, diversity and inclusion (EDI) will result in financial benefits for all stakeholders in a firm.

This article explores the extent to which this “business case” actually is or should be a reason for EDI. Is it really necessary or appropriate to incentivise EDI financially, when the issue might properly be described as purely ethical? A firm’s advancement of EDI may not necessarily generate obviously tangible financial benefits. If so, does this mean that, in the absence of a business case, EDI should not be pursued?

This question matters because it arises for other environmental, social and governance (ESG) considerations with the potential to run counter to (at least in the short term) shareholder value.

## Business case or lip service?

Does EDI actually have a good business case? Statistics cited by the FCA (see the January 2021 speech by Georgina Philippou: Why does the FCA care about diversity and inclusion?) seem more tentative than clear-cut as to increased EDI being the cause, and improved commercial performance being the effect:

“[McKinsey’s] [How [EDI] Matters] … Report, [from] May 2020, … found that the most ethnically diverse companies are 35 percent more likely to outperform the least diverse.

… the Race in the workplace: McGregor-Smith review (2017) … the potential benefit to the UK economy from full representation of BME individuals across the labour market, is estimated to be £24bn a year.”

There appear to be some unconvinced by EDI’s financial benefits.

- In its 2020 DP20/1: Transforming culture in financial services (and on its purposeful cultures webpage), the FCA acknowledged that “there are barriers to creating and maintaining healthy, purposeful cultures including fear of shareholders’ short-term profit expectations”
- Media articles last year reported that firms which make greater efforts on corporate social responsibility are more likely to be perceived as acting against shareholder value, thereby becoming targets of hedge fund activism.

However, there is evidence which suggests that shareholders are increasingly concerned with EDI, irrespective of financial returns. According to a survey of 600 investment professionals globally, including 100 UK participants:

- 90 percent of respondents agreed that "Strong [EDI] metrics have a positive impact on a company's share price";
- 72 percent of respondents said that their investment firm applies "exclusionary screening" (e.g., not considering investments in companies with poor EDI metrics); and
- 87 percent of respondents said that their firm actively invests in companies that have reduced their near-term return on capital (e.g., reduced dividend, share buybacks) in order to reallocate capital to ESG initiatives.

The FCA recognises that shareholders can also be societal or ethical stakeholders: "… for firms to be more purposeful is not just an FCA objective, but is increasingly a broader societal expectation. There are ever more insistent calls for firms and their leaders to step forward on … on [EDI], on ESG (environmental, social and governance issues), … and not just to act so as to optimise profitability" (DP20/1).

# Issues with data

While taking account of EDI metrics may be a growing investment trend, there are potential problems with the quality of data and of the degree of standardisation – and therefore the reliability – of metrics in any quantitative approach.

For instance, McKinsey (see above) says:

"Our … 2019 data … shows that companies whose boards are in the top quartile of gender diversity are 28 percent more likely than their peers to outperform financially"

but

"The interplay between boards … and company profitability is not well understood.

- Could … more diverse boards be operating differently?
- Or could a visible commitment to board diversity be signalling a company's openness towards increasingly diverse customers, employees, businesses and communities, which in turn is positively influencing financial performance?

… these questions warrant further research."

In short, causality in the EDI business case remains unproven. Proving causality will require firms to emulate the FCA in collecting more granular data, if only to understand and address EDI issues better (see the Ethnicity action plan).

Moreover, simply hiring or retaining larger numbers of personnel with diverse characteristics does not necessarily mean more:

- equality between personnel (or for personnel as individuals within broader society) or
- inclusion of personnel in a firm's decision-making processes.

As the FCA has highlighted:

- "… there's a fundamental danger in any conversation about diversity that we don't look beyond the immediate and simple metrics" (2017 LGBT in the Financial Services Industry Summit); and
- while EDI is "a crucial way to strengthen consumer outcomes" it is also "a matter of fairness",
- improving EDI is a "social good", and
- these latter factors should be enough to motivate firms to begin, continue and enhance efforts to increase EDI (see Why diversity and inclusion are regulatory issues).

# Intersectionality and inclusion

In addressing simple metrics, the FCA has also recognised the multiplicity and complexity of issues that can lie beneath (or belie) headline numbers:

"… black people are not all the same. We have different experiences as a result of background, sexual orientation, gender, having a disability, and so forth." (Why black inclusion matters to us, April 2021).

When individuals have multiple marginalised identities, they subsequently face layered, and often more challenging, levels of inequality (intersectionality). This requires firms' inclusivity methodologies (e.g., escalation and responsiveness within line management reports and structures, town halls or other discussion forums, and whistleblowing) to be more effective on a broader basis.

In the above speech, the FCA noted that “You cannot have meaningful representation without inclusion – black employees must feel able to speak up and feel like they are being listened to.” It’s one thing to recruit diverse talent but something else to enable already marginalised employees to thrive. In short, the FCA is saying that EDI needs to be a key feature of the entirety of a firm’s culture.

## The regulatory perspective

It is clear that, from the FCA’s perspective, there is a business case for EDI, even if the case isn’t one that is founded on increased short-term shareholder value (see DP20/1 above):

“Consumers who experience firms acting purely and selfishly for profit lose trust and may vote with their feet … and shareholders that are more sensitive to reputational and regulatory risk may decide they want to invest in firms that have healthy and sustainable profits.”

Further, the FCA’s obligation to protect consumers overrides shareholder value considerations which might potentially be inconsistent with EDI initiatives. Research by the FCA shows that Black adults are disproportionately represented among vulnerable consumers, putting them at greater risk of financial harm. One may expect these findings to be reflected in the FCA’s supervisory approach moving forward.

Whether or not a firm takes the view that pursuing EDI is a proper end in its own right, there is a clear regulatory impetus that the business case does not involve increasing productivity within a particular timeframe but, as the FCA puts it, involves “reflecting the society we serve”.

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