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DIVERSITY HUB

Some believe that recruiting people from different backgrounds and cultures could help investment teams produce better results. This month's Diversity Hub looks at where investors could find the people needed to build inclusive teams.

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DIVERSITY: MIXING IT UP

With the voices calling for greater diversity in the investment industry getting louder, *Andrew Holt* looks at the issues defining the debate.

Diversity has been a much-discussed issue in finance for some time. But for investors, there is a practical challenge: how can an effective diversity, equity and inclusion (DE&I) approach be incorporated into an investment strategy?

The big point in the whole debate is that this isn't a clear-cut issue. A clearly defined target like net zero with its precise future objectives, it is not. Inevitably, therefore, different investors have different ways of interpreting the issue.

This is something Omer Sanchez, chief investment officer of the endowment and foundations practice at Cambridge Associates, recognises. "Diversity means different things to different organisations," he says.

"We work with clients who have different definitions. One, for example, specifically focuses on black and Latino-owned investment firms. That doesn't mean we are not going to work with other diverse firms," he adds. "But in terms of the intentionality in that context, it is a bit more of a narrow definition."

Sanchez then notes the important focus within the debate itself. "I have worked with a lot of other foundational clients where they have a broader definition: focusing on women and people of colour. What is most important, is that its relevance and resonance for you as an organisation, and in terms of your mission," he adds.

A different view

Adding another interpretation, Newton Investment Management's Mitesh Sheth has an interesting take on the debate from an investor's perspective. "I don't sit here as chief investment officer of multi-asset strategies thinking that I must tick a diversity and inclusion box," he says.

Instead, Sheth looks broadly across the investment market, where numerous people are doing the same job and questions how he can get different perspectives – an intellectually diverse economy of scale. "For me, it starts with, where do I find untapped pools of talent. People who have different life stories, different risk appetites and see the world through a different lens," he says.

Sheth defines this in a different way, at least compared to the normal diversity narrative. "You don't start with how people look, or with their CV, you have to do personality and risk assessments: what is the different risk appetite of the people in your team?"

This, notes Sheth, can be done by taking a different approach to recruitment, such as finding people coming straight out of school who cannot afford to go to university. "I find that an interesting population," he says.

Also, he says, those who have worked in the industry and taken a career break, helping them back into the industry is another non-traditional route, which can be easily defined as diversity. "I have been able to bring in diverse talent who can see the world through that different lens and different life experiences," Sheth says.

Three Ps

Addressing the matter of having a commitment to invest with diverse firms, Sanchez says there is an important starting point. "I would say that if you are working with an adviser, or even if you are not, you want to be sure the diligence you are undertaking and the coverage you have of firms is inclusive and expansive. You are looking at the broadest set of investment opportunities that you can, including diverse firms."

Sanchez adds there is an important part to doing this. "The key element is making sure you are incorporating [diversity] into the investment policy, because that is the document that is going to guide the implementation." And from there, hopefully everything flows.

When it comes to investment firms defining the objectives necessary to build a more diverse portfolio, Sanchez offers some advice based on Cambridge Associates' 'three Ps' framework, which are purpose, priorities and principles.

"Purpose is about establishing the true norm of an organisation, what do you stand for, what is your mission and what are your values. And being clear about that. Priorities are about setting those thematic priorities, adding to that vision and values," Sanchez says.

"Then the principles are the parameters you are going to set in a policy context ultimately guiding implementation and have a common understanding of what success looks like," he adds. "So that would be things like defining diversity and looking at a particular metric to gauge progress. Hence the diversity objectives that have been set."

Outperforming

Connecting the issue back to an ESG grounding – from where many would say it has developed – Kazee Clement, senior executive director of The Network of Networks (TNON), which mentors corporates on diversity issues, says investors should begin by reviewing their portfolio companies for ESG risk, since companies rated higher on ESG outperform the market. It is a basic argument that leads many ways.

"The social aspects of a company's ESG profile include customer relations, a company's internal diversity and inclusion initiatives, response to societal trends, health and safety, and responsible production, which are all linked to DE&I," she says.

As part of this, Clement argues that investors should remain resolute in their commitment to ESG principles and "not be swayed" by the rise of the anti-ESG agenda, and with it, a commitment to DE&I. "While this issue is unlikely to disappear, it is crucial to encourage companies to continue advancing their DE&I agendas," she says.

Several organisations, including the Financial Conduct Authority and Nasdaq, have already established DE&I rules for public corporations, which can serve as valuable guidelines for investors, she suggests. "Investors should embrace ethnicity pay gap reporting as part of a comprehensive approach, in addition to achieving the Parker targets and fostering an inclusive board culture."

The right questions

From these clear narratives, there is, for Clement, a clear imperative on the investor community. "The investment community should demonstrate a strong commitment to raising DE&I topics with companies, as investors have the power to influence management and boards by engaging in meaningful dialogues," she says.

In this context, Clement says that management companies are increasingly engaging with shareholders, making it an attractive avenue for setting the context for conversations on DE&I. "This engagement can involve asking pertinent questions such as addressing efforts to reduce the ethnicity pay gap, assessing the return on investment in DE&I initiatives, examining the diversity characteristics of the executive pipeline and holding [senior] individuals accountable for DE&I progress," she says.

But there is an issue. Like all ESG-related data, diversity data is not perfect. Therefore, Clement suggests a course of action that other investors may question. "Investors must proactively identify companies" that excel in DE&I efforts and "those that lag" behind. "Investors need to push for more comprehensive and transparent data collection practices." She is not alone in calling for this.

Furthermore, Clement adds investors have real power in shaping the debate. "Shareholders have the opportunity to clearly outline their expectations regarding diversity at executive and board levels within companies," she says. "In the United States, shareholders have started requisitioning proposals related to US equity audits, and the 2023 season witnessed an unusually high number of shareholder proposals focused on racial justice issues."

Lost generation

Adding a complex layer to the debate, Sheth warns that some errors in the past may have meant that some of the best diverse talent has left the industry. "Our industry, over time, has pushed out various talented people that don't fit the mould. These are the real interesting pool of talent as a starting point," he says, in a rallying call to bring them back, in a big and wide ranging diversity drive.

This presents a potential lost generation of diversity-focused investment professionals, just because they did not fit the norm: they were the wrong type at the wrong time.

Sheth, therefore, says the traditional way of assessing the issue is, for him, not the best way to think about diversity. "To define a firm in terms of diversity and inclusion are helpful markers, you will get different perspective, but it is a relatively crude measure. It is a starting point, but it isn't the answer."

Instead, he says: "What I am looking for is risk diversity and perspective diversity. This is hard, because as humans we like being comfortable. And here, we have to embrace discomfort."

In this interpretation, a different perspective is crucial for keeping investors sharp and focused, Sheth says. "When it comes to investment decision making it is important to gather those different perspectives, creating an environment where that dissenting viewpoint, that unpopular view is heard, and feels comfortable being heard – that becomes important," he says.

Fitting together

This presents a different version of diversity. And for Sheth, the focus for investors should begin with the hiring of talent. "The real key is creating an environment where different generations, different perspectives, languages and cultures can work together. And that is no mean feat. And it is not a one off exercise. You have to keep that work up."

This means that Sheth tries not to have a single house view, potentially a huge diverse approach – at least in investment terms. "We have different investors with different investment philosophies co-existing," he says.

Sheth has also observed where diversity works within the investment process and where it doesn't. "Diversity works well within idea generation and the risk management space, which is: what am I missing? What could go wrong? What should I consider? What should I be worried about?

I don't sit here as chief investment officer of multi-asset strategies thinking that I must tick a diversity and inclusion box.

Mitesh Sheth, Newton Investment Management

"Where it doesn't work so well is in the decision making," he adds. "Ultimately you have to make decisions with imperfect data. Here you need a single decision maker, or two or three individuals, where efficiently you can make the decision happen."

For Sanchez, diversity can fit easily together under the investment umbrella. "We are working with our clients so they can add value and have a greater impact on the world. The way to do that is work with active managers that can add that value.

"We owe it to ourselves, and our clients, to cast as broader net as possible and find the best managers out there, including diverse managers. From our perspective, diverse managers are an extension of our search for value added. We are not lowering standards.

"We apply the same rigorous diligence, extremely rigorous to diverse firms as we do to non-diverse firms."

Some investors may perceive diverse managers as riskier investments, despite evidence to the contrary.

Kazee Clement, The Network of Networks

Big blocks

That said, there are big stumbling blocks. Clement says there are a number of obstacles that can prevent capital from flowing towards diverse managers in the investment industry. The first is a lack of representation.

"Historically, the investment industry has been dominated by individuals from certain demographic groups, particularly white males," she says. "This lack of diversity in the industry can make it difficult for diverse managers to access capital, as networks and relationships often play a significant role in fundraising."

The second is perceived risk. "Some investors may perceive diverse managers as riskier investments, despite evidence to the contrary," Clement says. Here she cites asset management firm GCM Grosvenor, which reported that diverse managers outperformed their equivalent benchmark in 83% of the periods measured, but diverse-owned firms represent just 1.4% of assets under management in the US.

Third is a capital allocation bias. "Investment committees within institutional investors may have biases that favour established, well-known firms managed by individuals from more traditional backgrounds," she says. "This bias can make it challenging for emerging diverse managers to secure capital commitments."

Fourth is what Clement calls industry norms and culture. "The investment industry can have a culture that is resistant to change and diversity which can perpetuate stereotypes and biases, making it challenging for diverse managers to break through."

This presents a narrative that poses numerous challenges within the diversity debate. The immediate response to this is: how can it change?

Clement offers a comprehensive checklist. "It's essential to promote DE&I in the investment industry actively, including on-going education and training about diversity and unconscious bias, expanding access to networks for diverse managers so they can access influential networks," she says.

Before adding: "Ensuring greater transparency and reporting on diversity-related metrics to hold investors and firms accountable and finally, increasing support for emerging and diverse managers to help them establish their track records and gain credibility."

Never-ending quest

When it comes to the stumbling blocks, Sanchez adds his interpretation on a negative interpretation of diversity in investment. "The misperception that there is some form of return trade-off dealing with diverse firms in that you have to lower your standards to invest in diverse firms versus non-diverse firms. That is the premise that you can reject outright," he says.

"If you look at the research, it tells you there is no statistical difference between diverse and non-diverse firms. So that doesn't hold water from our perspective," he adds.

Sheth gives an interesting take on how long this whole process will take. "In terms of when [diversity] will be achieved, I don't think ever, because it requires continuous work. It is like weeding your garden. You are never done."

And he adds another fascinating challenging perspective. "The danger is that the longer the different perspectives have been together, the more they end up coming together. They end up agreeing more and becoming more comfortable with each other. And it is then you have to add some challenges into that mix."

Based on that, the diversity challenge in investment is a never-ending cycle. Therefore, investors need to get ready for a long ride.