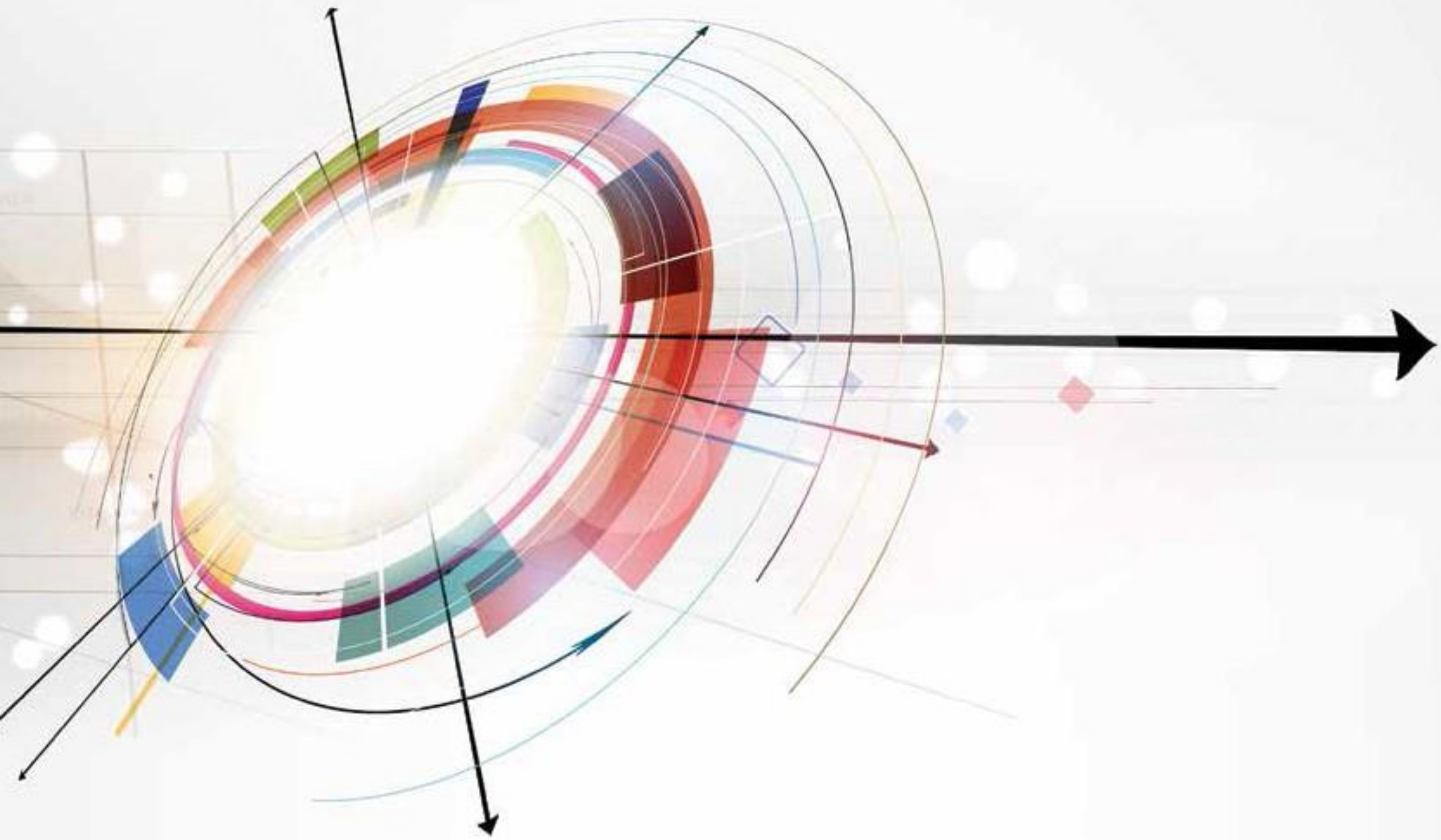

GLOBAL PERSPECTIVES AND INSIGHTS

Understanding the Effects of Diversity and Inclusion on Organizations

The Institute of Internal Auditors | Global

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The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 200,000 members from more than 170 countries and territories. The association's global headquarters are in Lake Mary, Fla., USA. For more information, visit www.globaliia.org.

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Introduction

Diversity is a broad and extremely timely topic in today's environment. A conversation regarding diversity within an organization is worth having because significant research shows that it has a tangible impact on both workplace productivity and organizational value. In contrast, a lack of diversity is an organizational risk as relevant as any other risk worth being recognized by an internal audit activity.

According to the *International Professional Practices Framework* (*IPPF*), it is internal audit's mission "to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight**."** This edition of Global Perspectives and Insights sheds lights on how diversity impacts the workplace and affects productivity and organizational value. It will also explain why internal audit should be an advocate for diversity in all its forms within both its own activity and the organization as a whole.

What Is Diversity?

In order to have a proper conversation about diversity, it is important to establish what diversity means. This is a task that is not as easy as it may seem, one that goes beyond a simple glance at the dictionary.

Here is just one example: Diversity, according to the Association of American Colleges & Universities, is "Individual differences (e.g., personality, prior knowledge, and life experiences) and group/social differences (e.g., race/ethnicity, class, gender, sexual orientation, country of origin, and ability as well as cultural, political, religious, or other affiliations)."[1]

Definition of Diversity

1: the condition of having or being composed of differing elements**:** VARIETY, *especially***:** the inclusion of different types of people (such as people of different races or cultures) in a group or organization programs intended to promote *diversity* in schools.

2: an instance of being composed of differing elements or qualities**:** an instance of being diverse: a *diversity* of opinion.

Source: https://www.merriam-webster.com/dictionary/diversity

The Link Between Diversity and Inclusion

Also often included in conversation regarding diversity is the concept of inclusion, so much so that many publications bundle diversity and inclusion together using the acronym D&I. Although the two terms are interlinked, it is important not to confuse the two. While diversity refers to the full spectrum of human differences (including geographic, ethnic, cultural, gender, religion, age, and differences related to physical and mental disabilities), inclusion refers to, as an article by Gallup said, "a cultural and environmental feeling of belonging."[2]

"Inclusion has to be understood as very different from diversity because simply having a wide roster of demographic characteristics won't make a difference to an organization's bottom line unless the people who fall into any one demographic feel welcomed," said the article.[3]

Psychologist Bill Crawford describes the distinction this way: "One is a description of what is, while the other describes a style of interaction essential to effective teams and organizations."[4]

A Shifting Definition

Despite such examples, definitions for diversity and inclusion remain inconsistent depending on the context of the discussion. How diversity is defined can vary significantly from group to group or individual to individual.

> "Diversity: the art of thinking independently together."
>
> — Malcolm Forbes[5]

For example, a 2015 study conducted by Deloitte and the Billie Jean King Leadership Institute shows that millennials, as compared to baby boomers and members of Generation X, view diversity and inclusion differently. Millennials, said the study, view diversity as the blending of different backgrounds, experiences, and perspectives together within a team, while inclusion refers to the support for a collaborative environment that values open participation from individuals with different ideas and perspectives. This contrasts directly with baby boomers and Generation X members, who view diversity as a representation of fairness and protection regardless of factors such as gender, race, religion, etc.; additionally, they view inclusion as the creation of an environment that integrates individuals regardless of those factors.

"Millennials yearn for acceptance of their thoughts and opinions, but compared to older generations, they feel it's unnecessary to downplay their differences in order to get ahead," said the study. "Millennials are refusing to check their identities at the doors of organizations today, and they strongly believe these characteristics bring value to the business outcomes and impact."[6]

Another factor that may have an impact on how diversity and inclusion are defined is region, or rather the specific demographics within any given region. For example, Africa is one of the most diverse continents in the world, especially in terms of ethnic diversity. There are at least 3,000 ethnic groups in Africa along with 2,000 languages. Compare this with Japan and the Koreas, which, according to one study by the Harvard Institute, are among the most ethnically homogeneous areas in the world.[7] In one region, ethnicity would play a critical part in the discussion, while the other may place emphasis on other factors such as gender (in a 2018 study by the World Economic Forum, Japan ranked 129th in terms of women holding legislator, senior official, and managerial roles, while Korea ranked 133rd).[8] In other words, the region helps to define the terms of discussion regarding diversity and inclusion.

Among all the definitions, however, there are some commonalties that allow all parties across the world, especially businesses with a global focus, to take part in the same conversation. The book *Diversity Primer* outlines three guiding principles to aid corporations in creating their own definition of diversity and inclusion, which internal audit may apply to assist in the process. All definitions, according to it, must:

- **Respect core human values.** Human dignity and basic rights should remain paramount regardless of the country/region in which one is doing business.
- **Respect local traditions.** One cannot expect to change the traditions and culture of the country/region in which business is conducted.
- **Find common ground.** Understand that there will be possible areas of disagreement when intersecting universal ideas with local context, yet strive to find the common areas and use them as a starting point for moving toward a more global focus.[9]

Diversity Effects on Organizations

Numerous studies illustrate how an increased focus on diversity and inclusion can positively influence the organization in facets from financial to cultural. Internal audit activities can more easily grasp the attention of their stakeholders and inspire organizational change if they educate themselves on what these studies have revealed.

Improved Profits

For example, a 2018 study by McKinsey & Company, “Delivering Through Diversity,” looked at the topic from a variety of perspectives to determine how diversity-based initiatives can have a significant effect on an organization’s profitability. Its findings included:

- Companies in the top quartile for gender diversity on executive teams were 21% more likely to outperform on profitability and 27% more likely to have superior value creation.
- Companies in the top quartile for ethnic/cultural diversity on executive teams were 33% more likely to have industry-leading profitability.
- Companies in the bottom quartile for both gender and ethnic/cultural diversity were 29% less likely to achieve above-average profitability than all other companies in Mckinsey & Company’s data set.[10]

In another 2018 study, the Boston Consulting Group found that companies in the Unites States with above-average diversity management scores have 19% higher revenues due to innovation than those with below-average diversity management scores. According to the study, differences ranging from diverse talents to diverse countries of origin can have a significant impact on revenue. “[I]f our hypothetical company were to hire 30 managers from a different industry (2% of the total management team), it would improve its innovation revenue by a full percentage point. Hiring 38 female managers (2.5% of the team) would have the same result, as would hiring 23 managers (1.5% of the team) from a country other than the one in which the company is based,” said the study.[12]

> “The most innovative company must also be the most diverse. We take a holistic view of diversity that looks beyond usual measurements. Because we know new ideas come from diverse ways of seeing things.”
>
> — Tim Cook, CEO, Apple[11]

Such benefits can also be seen on a macro level when countries or regions become more diverse in their demographic makeup, such as through immigration. In a 2018 study by The Hamilton Project, it was shown that highly-skilled immigration has a direct, positive effect on innovation.[13] In another 2018 study by the Migration Advisory Committee, it was shown that an increase in the immigrant share of the labor force by 1 percentage point was associated with a 2 to 3 percentage point increase in overall productivity in the United Kingdom.[14]

Improved Talent Recruitment, Retention, and Performance

Attention to diversity and inclusion can have organizational benefits beyond profits as well. According to a 2014 survey by Glassdoor, 67% of job seekers evaluate a company's diversity practices before accepting a job offer. For women, this percentage increased to 72%, while for people of color it increased further to 89%.[16] These figures imply that organizations that can meet or exceed the expectations of their applicants may have a significantly easier job hiring qualified talent.

> "At Facebook, diversity is essential to achieving our mission. We need a team that understands and reflects many different communities, backgrounds, and cultures. Research also shows that diverse teams are better at solving complex problems and enjoy more dynamic workplaces."
>
> — Maxine Williams, global head of diversity, Facebook[15]

Once the talent is hired, attention to diversity and inclusion also increased the likelihood such talent is retained. According to a 2017 poll conducted by Deloitte, 72% of working Americans would or may consider leaving an organization for one they think is more inclusive. This is especially true of millennials; according to the same poll, 30% of respondents who identified as millennials have already left a job for a different organization with a more inclusive culture.[17]

"In a race for talent, an inclusive culture can really draw people in and make them stay if it's done right. And today, it is a make-or-break for some individuals. In order to ensure that people feel included, organizations should very closely evaluate their current inclusion initiatives to see if the efforts get to the heart of what their employees expect inclusion to be," said Deborah DeHass, Deloitte's vice chairman and chief inclusion officer.[18]

Additionally, diversity and inclusion in the workplace not only may help retain employees, but they can may also keep current employees operating at a high level. A 2017 white paper by Cloverpop found a direct link between workplace diversity and inclusion and decision-making; when diverse teams were tasked with making a calculated business decision, they outperformed individual decision-makers up to 87% of the time.[19]

An example that illustrates these findings in practice can be seen with India-based Lemon Tree Hotels. This organization prioritizes the hiring and training of people with mental and physical disabilities in their large workforce, as well as those with economically and socially disadvantaged backgrounds. According to their own internal studies, these employees are 15% more efficient than the average employee, are largely perfectionist in their attitude toward their work, and have a significantly lower attrition rate than the average employee. "The inclusivity/diversity philosophy of Lemon Tree Hotels is central to our business model, and we have built a culture of mainstreaming the disadvantaged," said Patu Keswani, chairman and managing director of Lemon Tree, as his company accepted the 2015 Asian Human Capital Award.[20]

Improved Board Performance

The benefits of diversity stretch all the way up to the board, as well, although in different ways. A highly cited 2012 study of 2,400 companies conducted by Credit Suisse found that organizations with at least one female board member yielded 26% higher returns on equity and net income growth than those who did not include women on their boards.[21]

Having said this, these findings have been contested. “There’s zero relationship between...gender diversity and company performance,” said Katherine Klein, University of Pennsylvania Wharton School of Business Professor, after reviewing two separate 2015 meta-analyses on the issue — one conducted by Post and Byron, the other by Pletzer, Nikolova, Kedzior, and Voelpel. “I think there are other arguments for this policy, but if you're trying to justify this policy on the basis of this is going to improve corporate performance, the best research evidence does not suggest diversity is going to improve corporate performance.”[22]

However, while the case for diversity within boards may be challenged, these same studies nevertheless see a statistically significant relationship between board gender diversity and corporate social responsibility (CSR), which is increasingly used by investors as an indicator of overall company health.[23] In 2016, Post and Byron meta-analyzed the results of 87 separate studies and found that the correlation between board gender diversity and CSR is .15. This indicates that gender diversity on boards is responsible for about 1% variance in companies’ engagement in CSR. While this is only a small correlation, it is stronger than the correlation between gender diversity on boards and corporate performance, which was found to be .047, inferring that gender diversity on boards is responsible for about two-tenths of 1% variance in corporate performance.[24]

Additionally, in PwC’s 2019 Annual Corporate Directors Survey of publicly traded U.S. companies, 94% of respondents said diversity brings unique perspectives to the boardroom, 87% said it enhances board performance, and 84% said it improves relationships with investors.[25]

Even if the link between board representation and corporate performance is still in debate, the desire for greater representation on boards is certainly manifesting in various pieces of legislation across the world, particularly in regard to gender. For example, as of the end of 2019 all publicly traded companies headquartered in the state of California must have at least one female director.[26] Norway has required women to make up 40% of directors at listed companies since 2008, and Spain, France, and Iceland all have similar mandates.

In fact, the gender gap on boards has narrowed significantly enough in the last 10 years that it may be a contributing factor in changing directors’ views on board diversity. According to PwC’s 2019 Annual Corporate Directors Survey, the percentage of directors who said that gender diversity is very important on their boards fell from 46% in 2018 to 38% — a level not seen in their survey since 2014. “After years of hearing about the need for gender diversity, and experiencing their boards’ response by bringing on new directors,” said PwC in their analysis, “many may be feeling ready to move on to other topics.”[27] This analysis should not be taken to mean that that gender diversity is no longer important to boards, but as board demographics improve and slowly approach parity, gender diversity may become less and less of a concern.

Board member representation for ethnic minorities has been notably slower, but growth has been seen overall. A 2018 study of Fortune 500 companies by Heidrick & Struggles illustrates a few areas where progress has been made, and one area that has fallen in terms of minority representation. It is important to note that while these statistics do not indicate any improvement in board performance, they do infer that there is nevertheless a moral desire for greater representation which should not be discounted:

- African-American board members held 11% of overall seats in 2018, up from 5.3% from 2009.
- The percentage of Asian and Asian-American board members nearly doubled, representing 8% of seats in 2018 compared to 3.9% in 2009.
- Hispanic board members made up 4% of board memberships in 2018, down from 5.1% in 2009.[28]

Much like it did for gender, PwC's Annual Corporate Director's survey also shows that the percentage of board members who said that racial-ethnic diversity is important on their boards fell, in this case from 34% to 26%. As progress continues to be made, albeit gradually, it can expected that this figure will continue to fall.[29]

Diversity Risks

No discussion regarding the benefits of diversity and inclusion is complete without noting the risks an organization faces if such actions are not taken. This is where internal audit can play a role in assuring stakeholders are aware not just of how diversity and inclusion can benefit an organization, but how lacking them can be a risk to the organization's long-term goals.

For example, lack of diversity may place the organization at greater risk of liability exposure. "For employment practices liability, diversity is a risk-management technique," said Machua Millett, a Bostson-based chief innovation officer at FINPRO U.S., during a panel discussion at *the Business Insurance* Diversity and Inclusion Institute leadership conference.[30] Millet used the example of third-party employment practices suits, which often stem from employees harassing third parties, such as vendors or customers. "That's much less likely to happen if you have smart, diverse people thinking about the risk that you are taking on," he said.[31]

Lack of diversity also has the potential to negatively impact the goods and services an organization provides. An ethnically homogeneous workplace, for example, may lack the ability to spot consumer-focused content that may be viewed as offensive or inappropriate to a particular demographic. Often, should such content reach the public eye, the backlash can cause significant long-term damage to a company's reputation. Bizfluent lists examples of what it calls "tone-deaf deliverables" that could result from improper implementation of diversity and inclusion initiatives. Although a more diverse and inclusive workplace alone will not identify all such issues, a wide-as-possible spectrum of perspectives and experiences would be beneficial if taken into account before a product reaches the marketing stage:

- Poor translations of titles, slogans and other text.
- The unintentional use of derogatory or offensive language due to misunderstanding certain words' connotations.
- Ineffective marketing to all but one demographic group.
- Assumptions about how different consumer groups will interpret and use products.[32]

Also worth noting is the simple truth that consumers whom organizations depend upon care more about diversity and inclusion than ever before. According to a 2014 study by Nielsen, 55% of global consumers are willing to pay more for products and services offered by companies that make a positive social impact.[33] Many businesses have already made efforts to get ahead of this sentiment, as can be seen in the 2019 Business Roundtable in which 180 corporate CEOs presented a view that companies should have a social responsibility that transcends their role as producers of goods and services. Additionally, in January 2020 the World Economic Forum in collaboration with the Big Four accounting firms published a proposal that contained a new set of core metrics and recommended disclosures for measuring non-financial aspects of business performance such as diversity, as well as other environmental, social, and governance topics.[34]

Adapting to a Globalized Environment

While the world is not getting smaller in a literal sense, technologies have allowed organizations to more easily than ever before operate on a global scale. Not only can companies reach wider consumer bases, but they also have access to talent pools that go far beyond what is available within a single region. Without giving a greater consideration to diversity and the implementation of initiatives that prioritize a more inclusive organizational culture, companies operating on a global level risk limiting their ability to operate effectively and competitively. For example, an organization based in the United States may have manufacturing factories in Asia, as well as offices in Europe, Africa, Australia, or Latin America. In such cases, the multinational organization must have a firm understanding of each culture within its sphere and work to foster an inclusive environment that accounts for all facets of the diversity discussion without alienating any single party.

Of note, globalization does not mean that an organization needs to lose its regional identity, nor does it mean that one single global standard should dilute cultural characteristics. "Instead of creating a single, boring global village, the forces of globalization are actually encouraging the proliferation of cultural diversity," said Michael Lynton, CEO of Sony Pictures Entertainment, writing for *The Wall Street Journal*.[35] A successful global culture is not one that is identical across an entire landscape, but rather one that is highly adaptable regardless of region. This is a mindset that should be adopted by any organization that wishes to operate in a global context to recruit talent or provide products or services to a market that extends beyond the regional level.

"Balancing the benefits of integrating into a globalized world against protecting the uniqueness of local culture requires a careful approach," said the United Nations, Educational, and Cultural Scientific Organization (UNESCO). "Placing culture at the heart of development policies does not mean to confine and fix it in a conservative way, but on the contrary to invest in the potential of local resources, knowledge, skills and materials to foster creativity and sustainable progress. Recognition and respect for the diversity of cultures also creates the conditions for mutual understanding, dialogue, and peace."[36]

The Challenges Implementing Diversity and Inclusion Policies

Although the wealth of evidence cited here implies that internal audit can and should use its role to help promote diversity and inclusion within its organization, auditors should proceed carefully. If mishandled, such initiatives have the potential to not just be ineffective, but have a net negative effect in the very areas the organization is trying to improve.

For example, there is significant debate about the effectiveness of the increasingly common practice of unconscious bias training. The training is designed to raise awareness of the underlying prejudices we all have as a result of the ethnic and cultural stereotypes ingrained into our environment. Almost 20% of companies in the United States today offer unconscious bias training, and in a 2017 survey about 35% percent of hiring decision-makers in the United Kingdom said that that they intend to increase investment in such diversity initiatives.[37] To cite one extreme example, Starbucks closed 8,000 stores for one afternoon in 2018 to conduct a nationwide bias training following a widely publicized incident in Philadelphia.[38]

However, despite widespread implementation, evidence regarding the effectiveness of unconscious bias training is decidedly mixed. A 2019 study conducted by the Chartered Institute of Personnel and Development (CIPD) found an "extremely limited" evidence base for unconscious bias training leading to positive change in employee behavior. According to the study, such training "doesn't usually show a sustained impact on behavior and emotional prejudice, and alone is not sufficient to create a diverse and inclusive organization."[39]

"Unconscious bias has become a much more popular topic over recent years, but it doesn't necessarily follow that you can reduce bias and prejudice by explaining the psychology of it [to people]. In some cases, it can unleash it," said Jonny Gifford, research advisor of CIPD and lead author of the report.[40]

Even members of minority groups who attend these trainings appear to suffer some adverse effects. "Women and minorities often leave training sessions thinking their co-workers must be even more biased than they had previously imagined. In a more troubling development, it turns out that telling people about others' biases can actually heighten their own," said Joanne Lipman, writing for *Time*.[41]

Such findings do not call into question the good intentions of such programs, but they do speak to a potential weakness in how such programs present their material. These findings suggest that promoting diversity and inclusion should not be forced, nor should it be used as an element to control employee thoughts and opinions — even if that is a kneejerk way to view diversity and inclusion policies from a leadership perspective.

"As part of my work in diversity and inclusion, company leaders frequently ask me for specific suggestions on what they can do to increase diversity," said diversity and inclusion consultant Paulo Gaudiano, writing for *Forbes*. "Sometimes the answer surprises them: achieving diversity should not be your goal." Instead, he argues that diversity should be viewed as an outcome achieved by working to improve company performance, not as a condition imposed upon a company for its own sake.

In an article for the *Harvard Business Review*, Frank Dobbin and Alexandra Kalev explain:

> "Executives favor a classic command-and-control approach to diversity because it boils expected behaviors down to dos and don'ts that are easy to understand and defend. Yet this approach also flies in the face of nearly everything we know about how to motivate people to make changes. Decades of social science research point to a simple truth: You won't get managers on board by blaming and shaming them with rules and reeducation."[42]

Internal audit has a responsibility to inform stakeholders of such risks and to be educated enough to inform them if their diversity and training programs are ineffective, especially if significant investment is placed into them. Internal auditors should consult with board members and recommend that organizations focus less on extinguishing employees' unconscious thoughts and more on nurturing ethical, benevolent, and inclusive behaviors. Individual attitudes are difficult to shape, and it is arguably unethical to do so. However, behaviors are much more within the organization's control.

> "All employees should have the feeling that they and their opinions matter."
>
> —Hans Nieuwlands,
> CEO of IIA Netherlands

Organizations with the aid of internal audit can and should prioritize creating conditions that entice employees to behave in ways that are viewed as inclusive. There are several ways internal audit can help cultivate this. For example, internal audit, specifically CAEs, can use their direct reporting line to the board to be an advocate for the creation of a diversity and inclusion charter, which is a document that explicitly commits the organization to enacting policies that promote diversity and equal opportunities for all in the workplace. Organizations in Europe have the option of signing the Diversity Charter, which is part of a network of individual charters united by a singular platform across 24 countries. As of 2019, more than 10,000 European companies have signed a diversity charter and have become a part of this network.[43]

Some questions CAEs may ask the board regarding the use the creation and implementation of a diversity and inclusion charter include:

- Does the organization have a diversity and inclusion charter?
- If so, is the desired culture described in the charter?
- If not, is the board open to the idea?
- If the charter exists, is it communicated effectively to all levels of the organization?
- Are diversity and inclusion targets defined in the charter? If so, how does the organization monitor progress towards those targets?

One resource organizations can consult when considering a diversity and inclusion charter is the Global Diversity & Inclusion Framework. The diversity and inclusion charter created by French multinational company Alstom is a good example; it emphasizes the promotion of diversity and inclusion best practices through three main activities:

- **Telling.** Communicating internally and externally about the positive impact of diversity and inclusion via all communication channels, events, and programs at every level of the organization.
- **Tracking.** Establishing qualitative and quantitative objectives to judge the impact of diversity and inclusion actions taken and monitor progress.
- **Training.** Providing learning tools for all employees to sensitize and to develop more inclusive behaviors, and putting in place actions to raise awareness about conscious and unconscious bias which adversely affects inclusion at every phase of work life, in every work environment, and at every hierarchical level.[44]

Closing Thoughts

Although the IPPF does not directly cite role of the internal audit activity in promoting diversity within the workplace, it does imply a role in assessing culture in that culture is central to the effectiveness of the organization.

Diversity and Workplace Culture Are Interlinked

Through audit engagements designed to assess the effectiveness of an organization's risk management activities, internal audit has a responsibility to support boards, audit committees, and executive management in their oversight roles. Having a pulse on organizational culture is central to that role, and diversity is a critical element of organizational culture that can be better understood through the consultation of internal audit. If diversity is not considered a part of the conversation, then internal audit risks not performing its duties in conformance with Standard 2120 — Risk Management.

In addition to raising awareness of the benefits of diversity and inclusion to stakeholders, internal audit can also lead by example regarding diversity within its own department. Explicitly make diversity a consideration when recruiting and establishing an effective and efficient departmental culture. Remember, diversity is an all-encompassing term; consider the benefits of not just diverse ethnicities, genders, and/or cultural backgrounds, but also the benefits of diverse talents and or work experiences. This is necessary to remain in conformance to Standard 1210 — Proficiency, which states that the internal audit activity "collectively must possess or obtain the knowledge, skills, and other competencies need to perform its responsibilities." If internal audit leads by example and implements diversity and inclusion its own activity, stakeholders will take notice and use the success of the internal audit activity as a model for the organization moving forward.

"When I think about how the role of internal auditing is evolving, I am struck by the diversity of issues we address," IIA CEO Richard Chambers wrote in a 2014 blog post. "Even once-unthinkable subjects like corporate culture are now subject to audit. This is as it should be."[45]

Audit Focus

Standard 2120 — Risk Management

The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes.

Standard 1210 — Proficiency

Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

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