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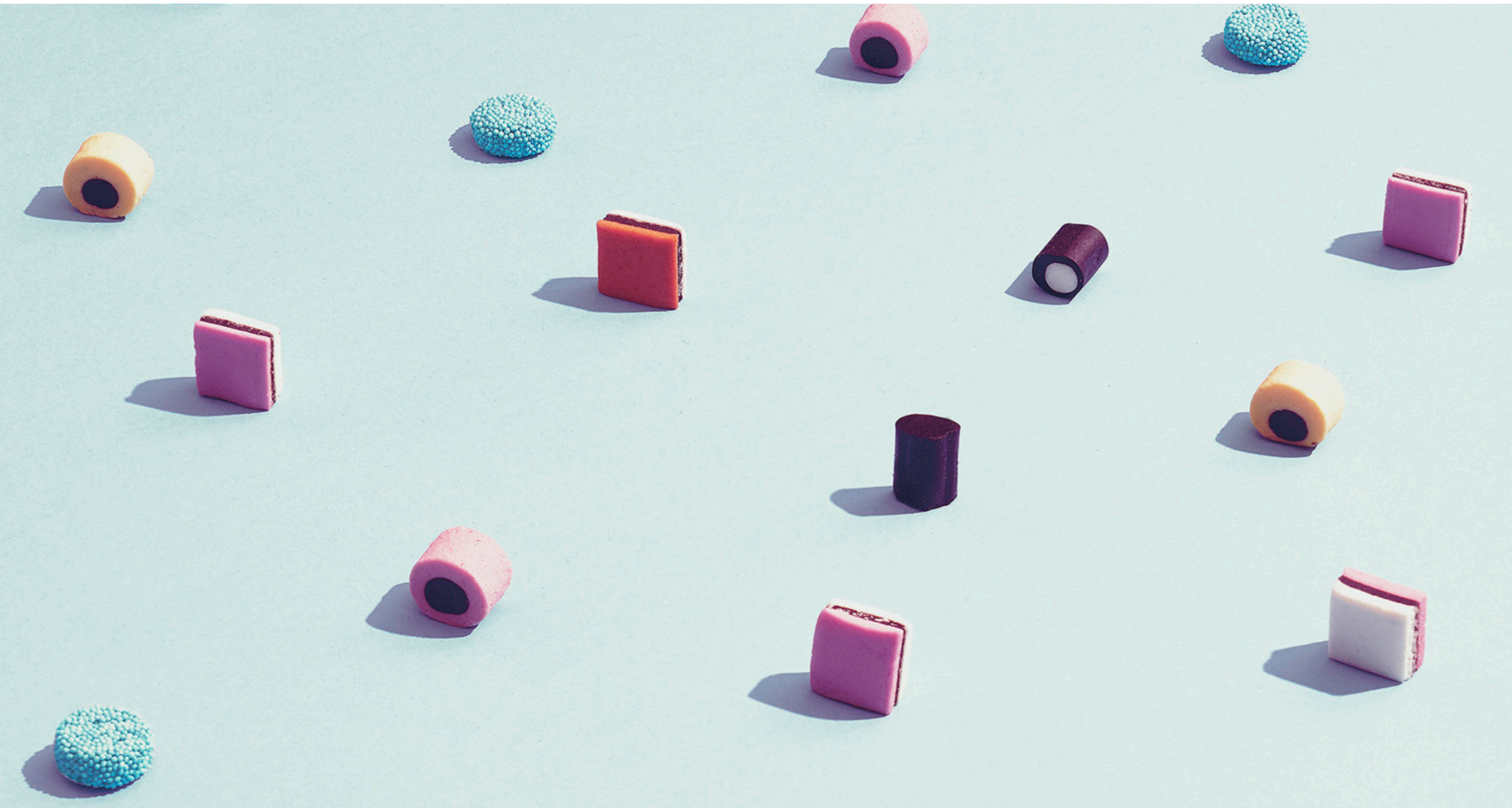
The diversity opportunity for new CEOs

New McKinsey research has uncovered a fascinating correlation between gender diversity and corporate performance.



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In this episode of the *Inside the Strategy Room* podcast, McKinsey partners Paula Ramos and Tom Meakin speak with communications director Sean Brown about the case for gender diversity in top management. (For more conversations on the strategy issues that matter, subscribe to the series on iTunes.)

Sean Brown: From McKinsey's Strategy and Corporate Finance Practice, I'm Sean Brown. Welcome to *Inside the Strategy Room*. When we talk about organizations we often think in terms of their performance and their overall health. Gender diversity tends to be a subject that many relate to the health part of that equation. But new research has uncovered a fascinating correlation between gender diversity and corporate performance. Joining us today to discuss this research are Paula Ramos, a partner with our New Jersey office, and Tom Meakin, a partner based in our London office. Paula and Tom, thanks for joining us today.

Paula, for executives seeking to build the case for gender diversity in top management, can you give an indication of how important gender diversity is for corporations? What's the business imperative?

Paula Ramos: The first answer to that is, yes, it is really important. As you say, when we think about organizations—their health and their performance—we often think this is a topic that should be correlated with health. When we see the data, it's actually very correlated to economic performance. That makes a very compelling case for change.

Sean Brown: Tom, what did you find in the data?

Tom Meakin: Paula's exactly right, Sean. If you look at the data, it's a very clear and compelling case. Companies that are top quartile in terms of diversity are 21 percentage points higher performing in profit terms than those companies in the bottom quartile. This has moved on from being a health issue and being something you do for social purposes. Gender diversity creates more value too. It makes better organizations.

Sean Brown: Can you tell us about what the foundation was for the research that we're talking about today. How long has it been going on and where do you see it going in the future?

Tom Meakin: That's a great question, Sean. This research builds on more than two years of work that a group of colleagues have done to examine the link between CEOs, their actions, characteristics, and company performance. Some of our listeners may well be familiar with some of the other research we published on boldness in new CEOs, or the link between internal and external CEOs.

We have a database that's constantly growing and that includes roughly 600 S&P 500 CEOs over the last ten years. We use that database in order to put data and facts behind a topic—CEO performance—that has hitherto either been not analyzed at all, or analyzed based on a small number of case examples of really successful CEOs, supposedly, or a qualitative judgment. We've tried to marshal data against it and we have used that in order to examine topics. Gender diversity is the latest in the series. We're working on others, including long-termism and capital-resource allocation.

Sean Brown: Fascinating. Tom, in your research you talk about the role that the CEO plays in driving gender diversity both at the start of their tenure and at the end of their tenure. What was the average tenure for the CEOs in your research? And how did they drive gender diversity over time?

Tom Meakin: As you say, in this piece of research we look at gender diversity through the lens of the CEO because we believe that a CEO, and, in particular, a CEO at the point of transition, is incredibly well placed to make significant moves here. Indeed, two-thirds of CEOs change their management team, which we define as a 50 percent turnover or more in the first two years of their tenure.

But actually, the results are slightly depressing. In spite of the significant opportunity to change, there's very little improvement—only two percentage points. Even more depressing than that is the fact that all the movement happens early. Most of the change happens in that first two to three years. That's the opportunity. That's where CEOs can have the greatest window for action, yet we see very few improvements—with some exceptions, of course, as you would expect in a database this large, toward the back end of the CEO's period.

But to answer the first part of your question, the average CEO tenure in our database is about eight years. So, you know, it's not as though they're lacking for opportunity to make some change here, even though our research looked to the first two years.

Sean Brown: Are there any differences between internal and external CEO appointments in terms of what percent of CEOs actually take advantage of the opportunity to improve the gender diversity of their teams. And what percentage do they change? What's the impact?

Tom Meakin: Within our overall data sets, roughly 80 percent, 78 percent, to be exact, of our CEOs are what we call internal promotions. They have made it to the top job from within. Twenty-two percent are external appointments. Counterintuitively, and in contrast to some other research we've done that demonstrates that external appointments are more bold in their early period, it's actually the internals that make more significant moves.

Among our group of internal CEOs, again roughly 80 percent of the sample, the diversity rate within their management teams at the start of their tenure was 11 percent, so roughly one in ten of the people on their management team were female. At the end of their tenure that number had jumped up by six percentage points, to 17 percent. In contrast, external CEOs—those that came in from outside—stayed still. They had a higher starting position, at 13 percent, but that position remained the same, again, at 13 percent, right through until the end of their tenure.

Sean Brown: Did you poll female CEOs in the research and were there any significant differences between the new female CEOs versus male CEOs?

Tom Meakin: We also looked at female CEOs as part of the research and the first thing to say is they're a relatively small proportion of the overall sample—roughly eight percent. Now, given our bar for statistical accuracy, this posed some problems, particularly when we wanted to look at that number and how it varied by industry. However, on that relatively small sample we saw no perceivable difference in their propensity to drive improvements in gender diversity versus their male colleagues.

Sean Brown: We've talked a little bit about laggards. What did some of the leaders do during the CEO transition that really helped turbocharge the gender diversity of their team?

Paula Ramos: I think the secret is putting it in the front line in terms of the KPI [key performance indicator]. If you measure it, the chances of it being effective increase significantly. If gender diversity is a true business priority, then put gender diversity in corporations and imagine the inclusive company of the future. Make it part of your KPI and make sure you track those KPIs weekly or monthly.

Sean Brown: We've talked about what a CEO can do in terms of recasting their top team, and obviously the makeup of the top leadership team is something that the CEO is going to have a big say in. However, the leadership pipeline also plays a big role. Did you look at whether either internal or external CEOs, when looking to increase the diversity of their top teams, looked outside their organization more or less? In other words, if you're an external CEO, are you more likely to bring in other external people and did that provide an opportunity to increase diversity because you're going outside the organization?

Paula Ramos: I think it has to do with going back from the funnel. As we know, there is a much higher chance the CEOs of top teams come from P&L-ownership roles and careers. You need to put the processes and systems in place so there are women in the pipeline coming in and there isn't a big fallout of women from the roles that are typically the ones that will take you to the C-suite.

Tom Meakin: I think the other thing we see is you've got self-reinforcement, particularly with external hires. If a management team by definition is relatively lacking in gender diversity, and those females that are on the management team are in staff functions, where we see women over-represented versus P&L functions, we observed that external CEOs bring some of their people with them. The chances are those people are in P&L roles, and because they're in P&L roles those people are male. So, you do see self-reinforcement, particularly in the case of external CEOs, which is perhaps why you see them holding flat in gender-diversity terms across their tenure, in contrast to their internal peers, who make relatively significant improvements driving gender diversity by 30 to 40 percent over the course of their tenure.

Sean Brown: We've talked a lot about the top-down approach and what the CEOs can do. What do you see employees doing to improve the landscape?

Paula Ramos: What I always say is the message from the top is necessary but insufficient. It's definitely something you cannot do without. However, there are many other things that need to happen in order to really advance. I would say getting the basics right is one of the big ones. So as you would do for any business objective, how do you tap the aspiration or the target? How do you set the reporting? And especially how do you set the accountability to see that kind of change happening? Then there are other things that are really important too. How do you de-bias and make the hiring and promotion processes fair? And then, finally, how do you lean forward to give access to resources, to mentoring, to the most exciting and promising projects to those who won't be necessarily the ones that raise their hands first, but the ones that might have the most capacity and capability to get it done?

Sean Brown: Thank you. We talked about how this is not just a female issue, but a male issue as well. What are some of the steps that men can take to improve this situation?

Tom Meakin: I really do think it's incredibly important that men see this as something for them to care about too. And not just because of some of the economic-performance data we talked about earlier, or that more diverse teams are better teams in performance, but also because, frankly, it will create opportunities for them to work with more talented, more diverse teams, and also to benefit from the gains that flexibility in their professional lives will get them on their personal sides.

I've seen a few things have an impact. One is really taking the mentorship of women seriously and proactively focusing on it. Secondly, being aware of unconscious bias, particularly in evaluation processes, but also in the allocation of new responsibilities, new opportunities, and senior exposure to some of the females in their team. And the third thing is role modeling, both in how they interact with and treat colleagues, both male and female, but also in the kind of lifestyle that senior men lead. Do they have a lifestyle that to the rest of their colleagues seems compatible with, for example, having a family? Or do they convey a relentless work 24/7 attitude to their professional life, which sends negative and damaging signals further down in the organization, and makes women on their team feel like those senior roles are either undoable or unattractive for them.

Paula Ramos: I would add that one of the things that really makes a difference is when men become acutely aware of their "mini me" biases, and we all have them. But once you understand that's just a human condition, you make trade-offs against that. Sometimes it will include feeling uncomfortable about giving someone a role who won't perform the role exactly the way you would, but that will be just as or more effective. I think that makes a huge difference. So, awareness in terms of checking off your "mini me" biases in the beginning are really important.

Sean Brown: Paula, Tom, thank you so much for taking the time with us on the podcast today. A transcript will be posted on McKinsey.com under the Strategy and Corporate Finance section, where you can also find links to previous episodes. And if you'd like to receive updates featuring our latest insights, you can sign up for email updates on our website, follow us on Twitter at McKStrategy, or connect with our community on LinkedIn via the McKinsey Strategy and Corporate Finance Practice page. Thanks again for joining us.

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