Unlocking Diversity's Promise: Psychological Safety, Trust and Inclusion

by AMY EDMONDSON and STEPHEN SCOTT

Diversity is valuable – but it is inclusion that really drives performance. Psychologically safe workplaces enable and harness the benefits of mutual trust among staff to create a meaningful sense of belonging, and this is the key to unlocking the benefits of diversity.

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Investors, exchanges, regulators and policy-makers have pushed diversity to the top of the agenda for corporate board directors and executive leadership teams, and a spate of recent activism suggests an emerging consensus view: a company's leadership should better reflect the societies that host them.

Recent census figures show that slightly more than half of the U.S. civilian labor force (51.8%) are female. African Americans make up over 13%, Hispanic and Latinos another 18.5%, and other studies suggest that nearly 5% of Americans identify as LGBTQ. Yet corporate board rooms and C-suites remain overwhelmingly populated by white, straight, men. This seems set to change.

In a recent statement on its diversity priorities, Norges Bank – the world's largest sovereign fund – called on companies to set a target of 30% for female board members. Noting that 17% of companies world-wide have none, the fund's chief governance and compliance officer stated plainly: "What we want to see is better representation of women on the boards." With stakes in 9200 companies, representing some 1.5% of all traded stocks worldwide, the "Oil Fund's" views have obvious heft.

Norges is not alone.

NASDAQ CEO Adena Friedman made headlines late last year, when she announced intention to require that at least one woman and one person identifying as an underrepresented minority appear among the directors of companies listed on its exchange – the world's second largest. The SEC has yet to sign off on this proposed policy shift, but Friedman's priorities are likely to be consistent with those of the Biden administration. Her aims received lift with the passage of the Equality Act by US House of Representatives, and the UK government has also given recent voice to similar policy priorities.

Financial institutions would seem to agree with these policy prescriptions: State Street, for instance, recently announced that it will vote against directors when firms fail to disclose their gender, racial and ethnic make-up. Private equity leader, Carlyle, has established a credit line facility that is tied explicitly to board diversity goals. Early last year, Goldman Sachs announced it would no longer take public any company with a board made up exclusively of straight, white men, and the firm recently doubled down on prioritizing diversity when its asset management arm called upon companies to add more under-represented minorities to their boards. In January this year, JP Morgan Chase, Bank of America, Citigroup, US Bancorp and Wells Fargo all committed publicly to diversifying their ranks.

While equality of opportunity and representation may be an unalloyed good, in and of itself, many nevertheless feel a need to justify their stance on diversity by emphasizing performance benefits.

For those prioritizing shareholder returns, for instance, the oft-stated rationale is that diversity leads to improved financial performance. "There are many studies that indicate that having a more diverse board … improves the financial performance of a company," Friedman noted when announcing NASDAQ's new policy. So diversity is valuable, then, because it contributes to the bottom line.

Others, such as financial sector supervisors, may be less concerned with bottom-line, but many now contend that increased diversity is associated with reduced conduct risk as well. The UK Financial Conduct Authority (FCA), for instance, draws a clear link between diversity, firm culture, employee conduct, and consumer outcomes. So, diversity is to be valued for the risk reduction it engenders.

Central to these arguments are studies that purport to demonstrate a correlation between diversity and these superior financial results and risk related outcomes. Some studies find that firms with greater diversity (among teams, leaders and board members) tend to produce higher revenues, for instance. Other studies find that such firms outperform less diverse peers in terms of increased profitability, and that they do a better job of attracting and retaining more highly productive staff.

Perhaps. But we grow concerned when diversity is positioned as a means to an end, rather than being celebrated as an end in itself. If diversity is made subservient to profitability, then we are required to show that diversity does indeed generate higher returns. And the data here are, in fact, quite mixed. Indeed, some studies suggest that forced diversity results in a *reduction* in social solidarity, mutual trust, and shared purpose. This may be expected to negatively impact firm performance and, therefore, would stand as a strong argument *against* increased diversity.

This concern serves to highlight the critical importance of *inclusion* over merely statistical diversity. Where inclusion is low and diversity is high, firms may inadvertently foment a Balkanization among staff, with distinct sub-groups and sub-cultures working with poor cohesion and perhaps even at cross-purposes.

Consider, for instance, research into gender diversity conducted among hundreds of leading firms across 35 countries and 24 industries. "We found that gender diversity relates to more productive companies," the authors concluded, "*only* in contexts where gender diversity is viewed as 'normatively' accepted. By normative acceptance, we mean a widespread cultural belief that gender diversity is important."

Although at first glance circular, these results in fact suggest that diversity only drives performance in cultural contexts that allow firms to *use* the insights women and minority groups may bring to the table. Once again, inclusion is the key, and that is not guaranteed by diversity alone.

Diversity of thought is often argued to be a key benefit of any diversity initiative. But while promoting a more diverse "internal marketplace for ideas" may ensure that a wider range of alternatives will be put forward within a collaborative group, this will not ensure that the group will adopt the superior ideas. Nor is it immediately clear why a wider range of ideas, promulgated and considered among more diverse teams, should be expected to reduce conduct risk. Something essential is missing...

We've spent over 20 years studying workplaces (Amy) across the healthcare, tech, pharma, consumer products, and financial sectors, and conducting internal investigations (Stephen) into fraud, corruption, impaired performance and economic collapse. We find consistently that psychological safety plays a central role – and often *the* central role – in the success of organizations and teams, wherever people with diverse skills and backgrounds must work together effectively to accomplish challenging goals.

The desire to *belong* is perhaps the greatest driver of behavioral choice. The subtle fear of exclusion due to a failure to fit in to a dominant culture, or from saying the wrong thing, inhibits the expression of dissenting views or novel ideas. Simply hiring for a diverse workforce does not guarantee that everyone in a firm will feel a sense of belonging. It must be fostered in order to create real inclusiveness, and this flows from psychological safety and the trust dynamics among employees and teams.

Defined as an environment in which people believe that they can speak up candidly – whether with ideas, questions, concerns, or to admit mistakes – psychological safety is vital to realizing the benefits of diversity, because it helps to make inclusion a reality. And the higher the uncertainty and learning required in a given set of tasks, research shows, the more critical is psychological safety to the achievement of those undertakings.

It is thus critical in the banking and financial sector, where we have clear data on the consequences of its absence. Over the last five years, the UK's Banking Standards Board (BSB) has conducted an annual survey of the country's bankers. Survey respondents consistently complain of poor psychological safety.

This results in a broad unwillingness to 'speak-up' when they witness misconduct. As the BSB rightly observes, "speaking up, diversity and inclusion are inextricably linked."

> *The wisdom of crowds works only when the crowd contains a diversity of thought and each individual feels safe to voice their thoughts. In a firm where different views are welcomed, respected and encouraged, such views will be offered, and the organisation as a whole will be better placed to learn more quickly, catch problems earlier and enhance both its competitiveness and its appeal as an employer.*

Where bank employees do elect to speak up, the BSB finds that in 80% of such cases these employees elected to approach a direct line manager. "This aligns with previous research that emphasises the importance of managers both as sources of behavioural cues and as important engineers of a culture of psychological safety," the BSB concludes.

In a recent speech, newly-installed CEO Nikhil Rathi expanded upon the FCA's related views:

> *"We care because diversity reduces conduct risk and those firms that fail to reflect society run the risk of poorly serving diverse communities. And, at that point, diversity and inclusion become regulatory issues. This is much broader than representation. It is about a firm's culture. Not just in relation to diversity, but inclusion, too. Do people feel comfortable in the work environment such that they can demonstrate, share and bring to bear their diversity of experience and background?"*

Building a fearless, inclusive organization that realizes the benefits of diversity through greater inclusion and belonging is the most important goal for any leader today, whether in the public or private sector. Those who care about diversity must also care about psychological safety, just as those who care about psychological safety must also care about diversity, inclusion, belonging and trust among staff.

A firm's culture must engender belonging and inclusiveness if different views are to be expressed and heard. Key to this is creating psychologically safe and high trust work environments. Leaders who appreciate this, therefore, will not hire for diversity alone. Rather, they will attend to psychological safety throughout their organizations: measuring it, managing it, and looking for it among all employees.

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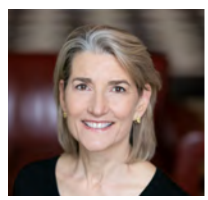

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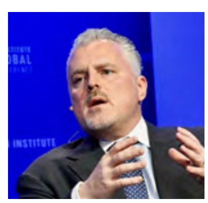

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About Starling

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