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Diversity Drives Results

Why we think true diversity within a team leads to better investment decisions.

One of the most common requests we get at Brown Capital from clients and prospects is for a copy of our Diversity Equity and Inclusion (DEI) Policy. Our response often surprises people: We don't have one. This strikes many as odd, since Brown Capital is one of the largest and oldest African American-founded asset managers in the world.

The main reason why we do not have a DEI Policy is that we view diversity to be so central to who we are and how we manage money, that it would be impossible to capture in a standard policy. The truth is, since Eddie Brown founded the firm more than 40 years ago, our entire investment process has been predicated on having diverse teams bring different perspectives to investment decisions. Furthermore, we consider diversity in much broader terms than just demographics (race, gender, sexual orientation, etc.) to include how team members think, feel and make decisions.

As you may know, Brown Capital has employed teams—as opposed to individual portfolio managers—to oversee our portfolios for decades. In a previous blog post titled “Team Decisions,” Chief Executive Officer Keith Lee outlined the rationale behind our commitment to a team-based approach, highlighting three key points: why we use teams instead of individual portfolio managers (PMs), why each team member serves as both a PM and research analyst, and why team members are generalists as opposed to industry or regional specialists. This article complements Keith's and addresses a key issue: why we think diversity within teams leads to better decision making. Diversity is not just an add-on to our structure but rather the foundation of our investment process. So why is that?

A broader definition

Over the years we have found that, as it pertains to making investment decisions, there are many different dimensions to team diversity, namely:

- Demographic diversity (age, gender, race and ethnicity, sexual orientation, etc.)
- Cultural diversity (national origin, language, religion, etc.)
- Industry-specific expertise

- Geographic experience and knowledge
- Cognitive types (thinking styles, values, beliefs, perspectives)
- Previous jobs, inside and outside the industry
- Family background and upbringing

As you can see, this is a much more expansive understanding of diversity than standard questionnaires and policies consider.

Research on diversity

Recent academic research appears to confirm our long-held intuition that diversity within teams leads to improved decision-making, especially in complex, uncertain situations. Studies show that diverse groups bring a wider range of perspectives, experiences and cognitive approaches, all of which improve outcomes. Katherine W. Phillips, a professor of organizational behavior at Columbia Business School and an expert on diversity and inclusion, found in her studies that diverse teams are more likely to engage in deeper analysis and critical thinking. Her research reveals that even the mere presence of diversity in race, gender or background leads team members to expect that different opinions will appear, which makes them more prepared to process information more carefully. This increased vigilance can drive better outcomes, as team members are more likely to reevaluate evidence and challenge their initial judgments. Similarly, Scott E. Page, a social scientist and professor at the University of Michigan, emphasizes in his research that cognitive diversity—differences in problem-solving approaches—often outweighs individual ability when tackling complex problems. Page's “Diversity Prediction Theorem” illustrates that a group's accuracy improves not just with individual ability but by the variance in perspectives, showing that diverse teams tend to outperform homogenous ones. His work underscores that diversity contributes to collective intelligence, making teams more capable of generating innovative and effective solutions. As you might imagine, there is academic debate around some of these claims, which we leave to others to sort out.

Diversity in action

To illustrate the power of diversity in action at Brown Capital, let's zero in on the International Team, although the domestic Small Company Team enjoys similar benefits from team diversity. Consider the recent purchase of **Camtek** in the International

Small Company portfolio. Camtek is headquartered in Israel and specializes in advanced inspection and metrology solutions for the semiconductor industry. As artificial intelligence (AI) drives the race for higher computing power, techniques such as advanced packaging of semiconductors, where Camtek is a key player, are becoming more prevalent. Our decision to invest in Camtek was made by the recently expanded International Team of six portfolio managers/analysts, each bringing his or her own unique perspectives to the table.

In our team review of the Final Candidate Report for Camtek, one member with deep experience in semiconductors brought a sharp focus on the cyclical risks of the company. This perspective spurred a deeper analysis into how Camtek can grow throughout the semiconductor cycle. Furthermore, the team's diversity in tenure yielded a more nuanced view of the current AI boom. The team's younger members had a sanguine view of AI, while the more experienced members urged caution and patience, having previously navigated other disruptive technologies such as the internet and e-commerce during the tech bubble in the 90s.

Another recent addition to the International Small Company portfolio highlights other aspects of the power of team diversity. **Dr. Lal Pathlabs** is the leading chain of diagnostic and healthcare testing centers in India. In discussing this new idea, the diverse geographic background of our team, with members raised in both developed and emerging markets, helped us better understand the different pathways to industry consolidation between the U.S. and India. In the U.S., market leaders like Labcorp and Quest Diagnostics have a competitive advantage due to stringent regulations overseeing clinical laboratory testing. Compared with smaller players, the scale

of the leading companies makes it easier for them to invest in the systems, technology and personnel needed to comply with evolving regulations. In emerging markets like India, however, the implementation of similar regulations can be more prolonged and inconsistent at the local level than in the U.S. While possible regulatory changes in India present potential advantages for leaders like Dr. Lal, we did not factor them into our thesis initially, thanks to the team's geographic familiarity. Instead, we examined other areas of differentiation, namely the franchisee-management capabilities and overall consumer experience, where in our view Dr. Lal stands out.

Finally, our team comprises members with varied cognitive styles—some more analytical and data-driven, others more focused on qualitative insights that provide a sanity check to quantitative metrics. In the case of Dr. Lal, one of our colleagues was stuck on the company's competition, which led us to conduct more interviews with competitors. As our understanding of the competitive landscape and Dr. Lal's mass-market brand positioning deepened, we stress-tested the margin assumptions in our model to reflect a variety of competitive outcomes.

At times, the diversity within the team may lead to a "lone wolf" dissenter. We think this is a good thing—addressing the concerns of a teammate makes our research process stronger. It not only reveals added information, but also helps us avoid groupthink. The diversity of our teams drives rigorous discussion and debate in which we challenge each other's assumptions before ultimately arriving at more informed investment decisions. As you can see, diversity at BCM is not a policy or an afterthought, but rather a foundational part of our investment approach that we think leads to better outcomes. 🌈

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