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An Update on the Relationship between Workforce Diversity and Organizational Performance

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Introduction

Swiss business executive Oliver Gassmann characterizes the European business environment as one that features globalized competition, demanding customers, an increasing complexity and variety of products, escalating costs, and ever greater technical risks (Gassmann, 2001). Replace the phrase “escalating costs” with the phrase “escalating pressure for cost control,” and this description is fitting for most of the industrialized world. Firms are searching for any competitive edge they can get and cannot afford to allow any new competitive disadvantages. Therefore, increasing cultural diversity in world labor forces for the purpose of better organizational performance continues to receive great attention. When I first wrote about this subject seventeen years ago (Cox & Blake, 1991), it was scarcely mentioned in the business literature; today, even a casual investigation of published information will uncover hundreds of relevant articles. This paper updates my thinking about the connections between workforce diversity and organizational performance. I have three main objectives: (1) present the major arguments in support of organizational interventions to create and/or effectively manage diversity, (2) briefly review some of the recent research on the relationship, and (3) offer suggestions for tackling this subject in future research and in efforts of diversity management.
Arguments for a Diversity-Organizational Performance Link

In a much earlier writing, Stacey Blake and I offered a framework featuring six ways in which effective management of diversity has the potential to create a competitive advantage for firms (Cox & Blake, 1991). I believe that – with some updates – the framework remains useful for classifying the main arguments. Exhibit 1 shows a summary of the major arguments.

Exhibit 1: Managing Diversity & Organizational Performance – The Major Arguments

Cost Argument: Given the reality of diversity in workgroups, failure to manage the special challenges that it presents may lead to higher cost structures for firms by contributing to higher employee turnover, higher interpersonal conflict, and more miscommunication.2

Resource Acquisition Argument: As sources of labor become increasingly diverse, firms that are able to hire, retain and effectively utilize workers from all social-cultural backgrounds may gain an advantage in human assets over firms that less effectively meet their diversity goals.

Marketing Argument: By tapping the insights and understanding of people of different cultures, genders, ethnic groups, etc., firms may gain advantages in designing and selling products and services to a culturally diverse marketplace.

Creativity Argument: Human diversity in workgroups creates a richer flow of ideas and thus has the potential to increase creativity and innovation; this, in turn, can improve organizational financial performance.

Problem-Solving Argument: Diverse perspectives create a potential for better problem solving in workforces that are culturally diverse. These advantages should be observable in recognizing and defining problems as well as in generating useful solutions.

Values Argument: Organizations seek to perform on a diverse set of measures, including integrity on stated core values such as fair and respectful treatment of all members and/or promotion of equal employment opportunities in the broader society. Firms must be proactive in managing diversity in order to honor these values.

1 Adapted from Exhibit 2 of “Managing cultural diversity: implications for organizational competitiveness, Taylor Cox & Stacey Blake, Academy of Management Executive, 1991.
2 For an excellent case example of this argument see the article by Shell Oil president John Hoffmeister in the Oct. 2006 issue of World Oil.
Several observations and explanations about the arguments in Exhibit 1 are warranted:

First, the cost argument most clearly points out how critical it is to “manage” diversity. It assumes a presence of diversity in the workforce and tells us that failure to respond to this presence in insightful ways can lead to higher organizational costs. In evaluating the usefulness of this argument, it is wise to keep in mind that diversity occurs on so many dimensions that few organizations can realistically claim to have a workforce that is truly social-culturally homogeneous. Further, the dynamics of diversity that require attention in diversity-related organizational development interventions apply across types of diversity. Therefore, I argue that the management of diversity is a relevant challenge for virtually all firms.

Second, some of the arguments have selective applicability based on industry. For example, the marketing argument is most applicable to firms that sell products to end-users.

Third, although not based on the traditional measures of organizational performance, the values argument can be effective. Good leaders are highly principled people who take their responsibility for social welfare and integrity on stated organizational values very seriously. Such leaders often feel as a former Alcoa CEO does, who explained his desire to make diversity in the workforce a priority when he told me, “I don’t need a business case; this is the right thing to do for our workforce and for the business.”

**Review of Previous Research**

While the theoretical arguments that indicate the potential of diversity and its effective management to create a competitive advantage for organizations are well publicized, empirical research relevant to the topic presents a somewhat confusing picture (e.g. Kossek, Lobel & Brown, 2006). While a comprehensive review of relevant data on the diversity-performance relationship is beyond the scope of this paper, the paragraphs that follow will briefly review selected studies to give an overview of this body of work.

Two studies of gender diversity in large U.S. firms indicate positive effects of gender diversity on their financial performance, measured in return on equity and return on assets. (Cordeiro & Stites-Doe, 1997; Catalyst, 2004). But these positive effects may be based on a number of factors. It is therefore necessary to examine what specific dynamics might affect performance. For example, a study of gender-diverse and same-gender groups performing a radio assembly task revealed no performance differences between the two groups (Myaskovsky, Unikel & Dew, 2005). In this case, the nature of the task (i.e. simple and mostly physical) may be a relevant factor in the research of the latter. A more cognitive task might yield different results. In one of the more revealing recent studies that analyzed this idea, Bowers (2000) reviewed data from 13 studies involving a total of 2,258 people. The types of diversity included gender, personality and ability. Measures of performance included some combination of the quality, quantity and accuracy of teamwork. He concluded that although none of these types of diversity appeared to have significant direct effects on team performance, when the task to be performed was rated as highly difficult (complex), significant performance advantages occurred for the diverse groups compared to the homogeneous groups.
A different aspect of diversity relating to task is cited as an important consideration by Horwitz and Horwitz (2007). After reviewing 35 studies of team diversity conducted between 1985 and 2006, the authors conclude that “task-related” diversity (e.g. function or education) positively impacts team performance, whereas “bio-demographic” diversity (e.g. gender or ethnicity) does not. The measures of team performance included both the quality and quantity of work.

Similarly, a study of top management teams from 57 manufacturing companies revealed that “job-relevant” diversity (in this case, diversity of education, work function, or tenure) appeared to improve financial performance, while age diversity did not. Also significant in the study is that the job-relevant diversity only improved financial performance if there was a sufficient level of debate and participation in decision processes. The authors’ very telling conclusion clearly points to the necessity of actively managing diversity:

“… for diversity to benefit a company’s bottom line, there must be a process by which the positive aspects of diversity are brought to bear” (Simons & Hope-Pelled, 1999, p. 669).

The above statement is also supported by a research of Sargeant & Sue-Chan (2001): In their study of racioethic diversity and group effectiveness, they found that diversity improved group efficacy – measured in the group members’ own perception – as long as the group was able to maintain good cohesion. In this case, a process promoting group cohesion could be considered as an adequate measure of diversity management.

Whereas the studies mentioned so far investigated the effects of diversity of team-members to the group’s own performance, a research on diversity in the field of education (Pitts 2005) examined the impact racioethic diversity among teaching faculty has on student performance. Pitts found that diversity among teachers had a positive effect on two of three measures of student performance: standardized academic achievement tests and college aptitude tests (SAT). Yet, a third measure of student performance, drop-out rates, was negatively related to faculty diversity. Though further empirical support would be needed, these results – transferred to a business context – give support to the idea that a leadership team’s diversity impacts their followers’ performance.

The work of Richard Allen and colleagues (Allen, Dawson, Wheatley & White 2008) reveals insight into yet another aspect worth consideration. They examined the relationship between employee perceptions of diversity among managers and non-managers and perceptions of firm performance. Based on their analysis they report strong support for a positive relationship between perceptions of diversity and perceived performance. A practical implication that they draw from the study is that:

“Organizations need to be sure they focus on initiatives that have a positive influence on employee perceptions of diversity within the ranks of senior managers and among non managers” (Allen et al., 2008, p. 32).

This study suggests that organizational interventions that affect employee attitudes toward diversity may also affect – or at least be related to – attitudes towards firm performance. Although the value of this work is limited by a reliance on perceptual measures, what employees believe about their
employers is certainly a determinant of employee behavior. Consequently, the management of perceptions is worthy of constant attention by organizational leaders.

This review of a sample of the recent work points to several considerations: Different dimensions of diversity (e.g. age, gender, race, education, etc.) seem to have a different degree of impact on performance, depending on the specific situational conditions (e.g. nature of the task at hand); diversity's positive effects can be tapped by providing supportive processes, i.e. measures of diversity management; both the factual degree of diversity and the subjectively perceived diversity seem to influence performance, so both deserve attention.

**Suggestions for Future Work**

The existing research makes it clear that the relationship between workforce diversity and organizational performance is complex. Further research is necessary not only because the findings are somewhat inconsistent, but also because there is still room to examine diversity and performance while integrating the findings of related fields of research, such as organizational culture and organizational change; such an integrative approach will help to better understand the influence of subjective perception and the function of values.

The following advice for future research and diversity-related organizational development interventions seems warranted:

- Maintain a broad view of the measures of organizational performance
- Recognize the legitimacy and power of social responsibility and honoring of core values as criteria for investing in diversity related organization change
- Distinguish appropriately between diversity and managing diversity
- Pay close attention to nuances in the relationship, specifically:
  - the type of diversity
  - the type of industry
  - the task to be performed

Each of these points will be briefly discussed:

**Maintain a Broad View of the Measures of Organizational Performance**

One of the most important considerations in developing research or organizational intervention projects related to cultural diversity is the definition of performance measures. A wide range of measures are potentially appropriate, including employee satisfaction and turnover, creativity and innovation, success in hiring the best available talent (e.g. % of first-choice job offers that are accepted), market share, promotion of equal employment policies, honoring organizational values, worker productivity, return on investment, and many others. Each of these measures has a place in the definition of performance, but the priority attached to them depends a great deal on how the leadership and owners of individual firms view their organization's mission and how they prioritize the interests of the various constituencies to which they feel some responsibility.

Sorting out these priorities involves determining “the unit of analysis” – that is, whether one is interested in outcomes of work at the individual, work-group or organizational level. The term
“organizational performance” can be construed as including measurements at all three levels of analysis, depending, as was suggested earlier, on how the organization defines its goals and responsibilities. My experiences suggest that the closer one is to measuring outcomes at the individual level, the stronger the link between diversity (i.e., the impact of being culturally different) or of managing diversity and organizational performance. The link weakens somewhat as we move to the group-outcome level of analysis and still more as we move to strictly organizational metrics linking ROI. But this erosion of impact on performance as one moves toward organizational outcomes does not imply overall weakness in the diversity-performance relationship. Instead, it recognizes that organizational outcomes like ROI are determined by many more factors than individual or even work group outcomes.

The Legitimacy of Social Responsibility and Value Integrity as Criteria

Much of the published work on the relationship between workforce diversity and organizational performance focuses on strict financial indicators such as return on sales, return on assets, or return on investment. I think this is unfortunate. To the extent that organizational leaders view social responsibility goals, employee welfare, and integrity on core values (such as workplace fairness and universal respect) as legitimate measures of organizational effectiveness, the “business case” for managing diversity takes on a broader and (some would argue) deeper meaning. My advice to leaders is not to sell these “softer” indicators of firm performance short. For example, where fairness and employee welfare are core values, data such as that shown in Table 1, taken from a German subsidiary of a U.S. based company, are valid and should be included among the measures of organizational performance.

Table 1: Data on Employee Perceptions of the Work Climate

<table>
<thead>
<tr>
<th>% agree / strongly agree</th>
<th>Germans</th>
<th>Non Germans</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is tension &amp; conflict here between Germans &amp; non Germans</td>
<td>15 %</td>
<td>50 %</td>
</tr>
<tr>
<td>Employees who are not German are often assumed to have limited abilities or negative traits based on their cultural identity</td>
<td>15 %</td>
<td>55 %</td>
</tr>
<tr>
<td>I have personally experienced an incident of ethnic harassment at this firm in the last 24 months</td>
<td>2 %</td>
<td>27 %</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Men</th>
<th>Women</th>
</tr>
</thead>
<tbody>
<tr>
<td>The procedures for promotions here are fair</td>
<td>42 %</td>
</tr>
<tr>
<td>I like my current job well</td>
<td>74 %</td>
</tr>
</tbody>
</table>

3 Source: Author’s unpublished study of a manufacturing company, circa 2000, sample size = 164, 59 % of the total workforce
Reducing gaps in attitude toward the organization and reported work experiences such as those in Table 1 is a tangible, hard-data, organizational performance achievement. Both employees and customers like to identify with firms that show integrity and demonstrate a concern for worker welfare and a willingness to address, at some level, the challenges of the societies in which they operate.

**Distinguish Between Diversity & Managing Diversity**

Another step toward improving both research and organizational interventions related to the diversity–performance link is to recognize the distinction between the implications of diversity as a characteristic of the workforce and the organization’s response to this presence (“managing” diversity). This advice has several applications:

First, to the extent that cultural diversity is an organizational reality and not a matter of choice by organizational decision makers, much of our focus needs to be on how organizations can develop an environment in which diversity can thrive rather than becoming a potential drag on performance. Second, and related to the above, analysis that examines the impact of cultural diversity in work teams or organizations on group and organizational outcomes must take into account the level of effectiveness in managing that diversity. If diversity is present and the environment for it is favorable, one can predict a positive impact of diversity. If diversity is present but the environment for it is not favorable, a negative impact of diversity on performance may be expected. **It is therefore the interaction of diversity and the environment for diversity that actually determines the performance impact.** Failure to look at these factors together is a frequent mistake. For example, some firms focus entirely on changing the demographic profile of new hires while giving the climate for diversity inside the firm little or no attention. As a second example, much of the research on diversity and performance examines levels of heterogeneity and task outcomes in workgroups without regard to the diversity-competence of members or the processes that allow diversity to inform group tasks.

Still another important application of this advice is that the amount of diversity and the extent to which people identify with various social-cultural group memberships—both of which are aspects of the term “workforce diversity”—have a great influence on managing diversity efforts. For example, part of the managing diversity effort is to deal with differences of culture between incoming members and the existing culture of the organization. This acculturation process is greatly affected by the types of cultural diversity that are brought into the firm. Among other aspects, the amount of cultural distance that has to be addressed varies widely depending on the specific cultural backgrounds of the entering members.

By paying strict attention to these implications of the distinction between diversity and managing diversity, we can improve our work with regard to the diversity-performance relationship. Exhibit 2 summarizes major factors involved in managing diversity to create a positive diversity climate.
Exhibit 2: Factors of Diversity Climate Requiring Attention in Managing Diversity Efforts

Individual / Intergroup Factors
- Prejudice
- Stereotyping
- Ethnocentrism
- Personality types (e.g. authoritarianism)
- Inter-group conflict
- Cultural differences

Organizational / Institutional Factors
- Organizational culture
- Mode of acculturation (e.g. assimilation vs. pluralism)
- Distribution of authority/power
- Level of integration in informal networks
- Human resource policies & practices

Attend to Differences of Diversity, Industry, and Task
A clear message of the recent research on the diversity-performance link is that we must give consideration to specific forms of diversity, type of industry, and type of task, as well as the interrelationships among these factors. Several specific questions that seem especially critical are:

- In what way/s is the type of diversity at issue in the group or organization relevant to the task or type of work to be performed?
- Is the industry one in which employees interface directly with the broader society?
- Are the products/services of the organization designed for sale to end-users?
- What is the diversity-profile of the important external constituencies of the organization (e.g. customers, suppliers, government regulators)?

One clarification regarding the first question is that “organizational tasks” should also include those that may go beyond tasks that derive directly from the main mission of the organization. They should include important auxiliary tasks such as resolving employee problems and maintaining high quality public relations.

Accurate answers to questions such as these will add a great deal of value to our understanding of the diversity-performance connections for a particular group or organization.

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4 Adapted from Figure 1.1 of Taylor Cox Jr, Cultural Diversity in Organizations: Theory Research & Practice, Berrett Koehler Publishing, San Francisco, 1993.
Conclusion

In summary, the material presented in this paper confirms that the relationship between workforce diversity and organizational performance is complex. In spite of this complexity, several conclusions seem appropriate:

- There are a variety of ways in which the presence of cultural diversity can impact organizational performance.
- When nuances such as the breadth of organizational performance measures, the type of diversity, the type of industry, and the nature of the tasks to be performed are properly taken into account, there is a significant amount of evidence that diversity can enhance organizational performance.
- In order to avoid possible performance losses and reap performance benefits of workforce diversity, organizations must create an effective climate for diversity (i.e. manage diversity well).

While debate will no doubt continue on whether and under what circumstances cultural diversity offers net value to firms, there can be no debate about the importance of the effective management of diversity. Some believe that through sustained and enlightened steps to create a diversity-welcoming organizational culture, firms will realize new opportunities of growth and prosperity. Others believe simply that since human diversity is an inevitable characteristic of workforces, the failure to proactively manage diversity leads to performance losses. Many are convinced that both these conclusions are true. Regardless of where one lines up on this philosophical spectrum, the effort to understand and promote diversity-friendly organizations will remain a priority for all insightful leaders.
References


