Does Diversity Pay?: Race, Gender, and the Business Case for Diversity

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The value-in-diversity perspective argues that a diverse workforce, relative to a homogeneous one, is generally beneficial for business, including but not limited to corporate profits and earnings. This is in contrast to other accounts that view diversity as either nonconsequential to business success or actually detrimental by creating conflict, undermining cohesion, and thus decreasing productivity. Using data from the 1996 to 1997 National Organizations Survey, a national sample of for-profit business organizations, this article tests eight hypotheses derived from the value-in-diversity thesis. The results support seven of these hypotheses: racial diversity is associated with increased sales revenue, more customers, greater market share, and greater relative profits. Gender diversity is associated with increased sales revenue, more customers, and greater relative profits. I discuss the implications of these findings relative to alternative views of diversity in the workplace.

Proponents of the value-in-diversity perspective often make the "business case for diversity" (e.g., Cox 1993). These scholars claim that "diversity pays" and represents a compelling interest—an interest that meets customers' needs, enriches one's understanding of the pulse of the marketplace, and improves the quality of products and services offered (Cox 1993; Cox and Beale 1997; Hubbard 2004; Richard 2000; Smedley, Butler, and Bristow 2004). Moreover, diversity enriches the workplace by broadening employee perspectives, strengthening their teams, and offering greater resources for problem resolution (Cox 2001). The creative conflict that may emerge leads to closer examination of assumptions, a more complex learning environment, and, arguably, better solutions to workplace problems (Gurin, Nagda, and Lopez 2004). Because of such putative competitive advantages, companies increasingly rely on a heterogeneous workforce to increase their profits and earnings (Florida and Gates 2001, 2002; Ryan, Hawdon, and Branick 2002; Williams and O'Reilly 1998).

Critics of the diversity model, however, are skeptical about the extent to which these benefits are real (Rothman, Lipset, and Nevitte 2003a, 2003b; Skerry 2002; Tsui, Egan, and O'Reilly 1992; Whitaker 1996). Scholars who see "diversity as process loss" argue that diversity incurs significant potential costs (Jehn, Northcraft, and Neale 1999; Pelled 1996; Pelled, Eisenhardt, and Xin 1999). Skerry (2002), for instance, points out that racial and ethnic diversity is linked with conflict, especially emotional conflict among co-workers. Tsui and colleagues (1992) concur, suggesting that diversity diminishes group cohesiveness and, as a result, employee absenteeism and turnover increase. Greater diversity may also be associated with lower quality because it can lead to positions being filled with unqualified workers (Rothman et al. 2003b; see also Williams and O'Reilly 1998). For these reasons, skeptics

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question the real impact of diversity programs on businesses' bottom line.

Is it possible that diversity has dual outcomes, some of which are beneficial to organizations and some of which are costly to group functioning? Diversity may be valuable even if changes in an organization's composition make incumbent members uncomfortable. As DiTomaso, Post, and Parks-Yancy (2007:488) point out, "research generally finds that heterogeneity on most any salient social category contributes to increased conflict, reduced communication, and lower performance, at the same time that it can contribute to a broader range of contacts, information sources, creativity, and innovation." This suggests that diversity may be conducive to productivity *and* counterproductive in work-group processes. Many of the claims and hypotheses about diversity's impacts have not been examined empirically, so it is not clear what effect, if any, diversity has on the overall functioning of organizations, especially businesses.

In this article, I empirically examine key questions pertaining to organizational diversity and its implications. Does diversity offer the many benefits suggested by the value-in-diversity thesis? Or, do costs offset potential benefits? Perhaps diversity is simultaneously associated with the twin outcomes of group-level conflict and increased performance at the establishment level. Although no singular research design could adjudicate between all the claims of proponents and skeptics,[1] the questions I raise warrant serious examination given the growing heterogeneity of the U.S. workforce. Using data from the 1996 to 1997 National Organizations Survey, my analyses explore the relationship between racial and gender workforce diversity and several indicators of business performance, such as sales revenue, number of customers, relative market share, and relative profitability.

VALUE IN DIVERSITY

The definition of "diversity" is unclear, as reflected in the multiplicity of meanings in the literature. For some, the term provokes intense emotional reactions, bringing to mind such politically charged ideas as "affirmative action" and "quotas." These reactions stem, in part, from a narrow focus on protected groups covered under affirmative action policies, where differences such as race and gender are the focal point. Some alternative definitions of diversity extend beyond race and gender to include all types of individual differences, such as ethnicity, age, religion, disability status, geographic location, personality, sexual preferences, and a myriad of other personal, demographic, and organizational characteristics. Diversity can thus be an all-inclusive term that incorporates people from many different classifications. Generally, "diversity" refers to policies and practices that seek to include people who are considered, in some way, different from traditional members. More centrally, diversity aims to create an inclusive culture that values and uses the talents of all would-be members.

The politics surrounding diversity and inclusion have shifted dramatically over the past 50 years (Berry 2007). Title VII of the 1964 Civil Rights Act makes it illegal for organizations to engage in employment practices that discriminate against employees on the basis of race, color, religion, sex, or national origin. This act mandates that employers provide equal employment opportunities to people with similar qualifications and accomplishments. Since 1965, Executive Order 11246 has required government contractors to take affirmative action to overcome past patterns of discrimination. These directives eradicated policies that formally permitted discrimination against certain classes of workers. They also increased the costs to organizations that fail to implement fair employment practices.

By the late 1970s and into the 1980s, there was growing recognition within the private sector that these legal mandates, although necessary, were insufficient to effectively manage organizational diversity. Many companies and consulting firms soon began offering training

[1] It is possible to derive propositions from arguments against the business case for diversity thesis, but works in this skeptical vein typically provide critiques of more optimistic views of diversity, rather than systematic, alternative theoretical formulations. When skeptics do put forth testable hypotheses, they tend to focus on intermediary processes and mechanisms rather than the diversity–business "bottom line" linkage, per se. I cite such critiques to show that there are reasons to be skeptical about the link between diversity and business performance.

programs aimed at "valuing diversity." In their study of private-sector establishments from 1971 to 2002, Kalev, Dobbin, and Kelly (2006) find that programs designed to establish organizational responsibility for diversity are more efficacious in increasing the share of white women, black women, and black men in management than are attempts to reduce managerial bias through diversity training or reduce social isolation through mentoring women and racial and ethnic minorities. They also find that employers who were subject to federal affirmative action edicts are likely to have diversity programs with stronger effects.

During the 1990s, diversity rhetoric shifted to emphasize the "business case" for workforce diversity (Bell and Hartmann 2007; Berry 2007; Hubbard 1997, 1999; von Eron 1995). Managing diversity became a business necessity, not only because of the nature of labor markets, but because a more diverse workforce was thought to produce better business results. Exploiting the nation's diversity was viewed as key to future prosperity. Ignoring the fact that discrimination limits a society's potential because it leads to underutilization of talent pools was no longer practical nor feasible. Diversity campaigns became part of the attempt to strengthen the United States and move beyond its history of discrimination by providing previously excluded groups greater access to educational institutions and workplaces (Alon and Tienda 2007). Today, advocates are asked to find evidence to support the business-case argument that diversity expands the talent pool and strengthens U.S. institutions. Even if the shift from affirmative action to diversity has "tamed" what began as a radical fight for equality (Berry 2007), workforce diversity has become an essential business concern in the twenty-first century.

The Implications of Diversity for Workplace Dynamics and Business Outcomes

How might diversity affect business outcomes? Page (2007) suggests that groups displaying a range of perspectives outperform groups of like-minded experts. Diversity yields superior outcomes over homogeneity because progress and innovation depend less on lone thinkers with high intelligence than on diverse groups working together and capitalizing on their individuality. The best group decisions and predictions are those that draw on unique qualities. In this regard, Bunderson and Sutcliffe (2002) show that teams composed of individuals with a breadth of functional experiences are well-suited to overcoming communication barriers: team members can relate to one another's functions while still realizing the performance benefits of diverse functional experiences. Williams and O'Reilly (1998) and DiTomaso and colleagues (2007) concur, arguing that diversity increases the opportunity for creativity and the quality of the product of group work.

The benefits of diversity may extend beyond team and workplace functioning and problem solving. Sen and Bhattacharya (2001), for instance, propose that diversity influences consumers' perceptions and purchasing practices. Indeed, Black, Mason, and Cole (1996) find that consumers have strongly held in-group preferences when a transaction involves significant customer–worker interaction. Richard (2000) argues that cultural diversity, within the proper context, provides a competitive advantage through social complexity at the firm level. Irrespective of the specific processes, diversity may positively influence organizations' functioning, net of any internal work-group processes that diversity may impede.

The sociological literature on diversity continues to grow (e.g., Alon and Tienda 2007; Bell and Hartmann 2007; Berry 2007; DiTomaso et al. 2007; Embrick forthcoming; Kalev et al. 2006), but, to date, there has been little systematic research on the impact of diversity on businesses' financial success. Few studies use quantitative data and objective performance measures from real organizations to assess hypotheses. One exception compares companies with exemplary diversity management practices with those that paid legal damages to settle discrimination lawsuits. The results show that the exemplary firms perform better, as measured by their stock prices (Wright et al. 1995).

A second exception is a series of studies reported by Kochan and colleagues (2003). They find no significant direct effects of either racial or gender diversity on business performance. Gender diversity has positive effects on group processes while racial diversity has negative effects. The negative relationship between racial diversity and group processes, however, is largely absent in groups with high levels of training in career development and diversity management. These scholars also find that racial diversity is positively associated with growth in branches' business portfolios. Racial diversity is associated with higher overall performance in branches that enact an integration-and-learning perspective on diversity, but employee participation in diversity education programs has a limited impact on performance. Finally, they find no support for the idea that diversity that matches a firm's client base increases sales by satisfying customers' desire to interact with those who physically resemble them.[2]

DEMOGRAPHIC DIVERSITY AND ORGANIZATIONAL FUNCTIONING

Researchers studying demographic diversity typically take one of two approaches in their treatment of the subject. One approach treats diversity broadly, making statements about heterogeneity or homogeneity in general, rather than about particular groups (e.g., Hambrick and Mason 1984). The alternative treats each demographic diversity variable as a distinct theoretical construct, based on the argument that different types of diversity produce different outcomes (e.g., Hoffman and Maier 1961; Kent and McGrath 1969). Instead of assuming that all types of diversity produce similar effects, these researchers build their models around specific types of demographic diversity (e.g., Zenger and Lawrence 1989). Indeed, Smith and colleagues (2001) argue that scholars should not lump women and racial minorities together as a standard approach to research. The relative number, power, and status of various groups within organizations can significantly affect issues such as favoritism and bias, and aggregating these groups may mask such variations.

The results of research on heterogeneity in groups suggest that diversity offers a great opportunity for organizations and an enormous challenge. More diverse groups have the potential to consider a greater range of perspectives and to generate more high-quality solutions than do less diverse groups (Cox, Lobel, and McLeod 1991; Hoffman and Maier 1961; Watson, Kumar, and Michaelsen 1993). Yet, the greater the amount of diversity in a group or an organizational subunit, the less integrated the group is likely to be (O'Reilly, Caldwell, and Barnett 1989) and the higher the level of dissatisfaction and turnover (Jackson et al. 1991; Wagner, Pfeffer, and O'Reilly 1984). Diversity's impact thus appears paradoxical: it is a double-edged sword, increasing both the opportunity for creativity and the likelihood that group members will be dissatisfied and will fail to identify with the organization. Including influential and potentially confounding demographic and organizational factors—as I do in the following analyses—helps clarify the relationship between diversity and organizational functioning, especially in business organizations.

ALTERNATIVE EXPLANATIONS

For-profit workplaces are appropriate sites for examining questions about diversity, as they are where employment decisions are made and the settings in which work is performed (Baron and Bielby 1980; Reskin, McBrier, and Kmec 1999). Moreover, it is organizational processes that perpetuate segregation and influence the character of jobs and workplaces (Tomaskovic-Devey 1993).

In assessing the relationship between diversity and business outcomes, the literature suggests that there are several organizational factors that might be influential. According to the institutional perspective in organizational theory, organizational behavior is a response to pressures from the institutional environment (Stainback, Robinson, and Tomaskovic-Devey 2005). The institutional environment of an organization embodies regulative, normative, and cultural-cognitive institutions affecting the organization, such as law and social attitudes (Scott 2003).

According to this formulation of organizational behavior, adoption of new organizational practices is often an attempt to gain legitimacy

[2] It would be preferable to model an array of internal processes in organizations to establish how diversity affects business performance (e.g., functionality of work teams, marketing decisions, or innovation in production or sales), but this is not possible with data from the National Organizations Survey because such indicators are not available. These topics do offer potentially fruitful paths for future research.

in the eyes of important constituents, and not necessarily an attempt to gain greater efficiency (DiMaggio and Powell 2003). Based on institutional theory, for-profit businesses that are accountable to a larger public may be more sensitive to public opinion on what constitutes legitimate organizational behavior. Publicly-held, for-profit businesses' employment practices should thus be more subject to public scrutiny. These businesses should employ relatively more minorities than private-sector employers, to the degree that they are under greater pressure to achieve racial and ethnic diversity, as public sentiment views such policies as a necessary element of legitimate organizational governance (Edelman 1990).

Organizational size is also important since it is positively related to sophisticated personnel systems (Pfeffer 1977) that may contribute to diversity in the workplace. Large organizations concerned about due process and employment practices will institute specific offices and procedures for handling employee complaints (Gwartney-Gibbs and Lach 1993; Welsh, Dawson, and Nierobisz 2002). At the same time, if some organizations, when left to their own devices, prefer hiring whites over racial minorities, their larger size and slack resources give them more ability to indulge preferences for white workers (Cohn 1985; Tolbert and Oberfield 1991).

Large establishments also tend to make greater efforts at prevention and redress because they have direct legal obligations. Antidiscrimination laws make discrimination against minorities and women potentially costly, but not all establishments are subject to these laws. Federal law banning sex discrimination in employment exempts firms with fewer than 15 workers, and enforcement efforts often target large firms (Reskin et al. 1999). Moreover, affirmative action regulations apply only to firms that do at least $50,000 worth of business with the federal government and have at least 50 employees (Reskin 1998). Establishment size may thus be related to vulnerability to equal employment opportunity and affirmative action regulations, which in turn should be related to increased racial and ethnic diversity. Indeed, Holzer (1996) shows that affirmative action implementation has led to gains in the representation of African Americans and white women in firms required to practice affirmative action.

Stinchcombe (1965) offers a rationale for why establishment age may also be meaningful. He suggests a "liability of newness," whereby organizational mortality rates decrease with organizational age. Younger organizations are more prone to mortality than are older organizations, so they approach threats to their existence differently. It is possible, therefore, that organizations of different ages vary in their responses to racial and gender diversity concerns.

The labor pools from which establishments hire may be important relative to the effects of diversity on business outcomes. The sex and racial composition of regional labor markets may influence an establishment's composition, as well as its relative success (Blalock 1957). Regional differences in residential segregation, however, may obscure regional effects of demographic composition (Jones and Rosenfeld 1989).

Finally, industrial-sector variations may relate simultaneously to levels of diversity and business performance. In particular, organizations in the service sector will be more proactive with regard to racial and gender diversity than will those that produce tangible goods, as their performance depends more on public goodwill. There are also reasons, however, to believe that the economic sector in which businesses operate can matter. Compared with manufacturing and public service, service-sector establishments are more likely to exclude blacks, especially black men, by using personality traits and appearance as job qualifications (Moss and Tilly 1996).

DIVERSITY, BUSINESS PERFORMANCE, AND EXPECTATIONS

Evidence that directly assesses the business case for diversity has, at best, proven elusive. Building on the present discussion, I offer several predictions. In its most basic form, the business case for diversity perspective predicts a return on investment for diversity (Hubbard 2004). It is thus fairly easy to derive some straightforward expectations:

Hypothesis 1a: As racial workforce diversity increases, a business organization's sales revenues will increase.

Hypothesis 1b: As gender workforce diversity increases, a business organization's sales revenues will increase.

Hypothesis 2a: As racial workforce diversity increases, a business organization's number of customers will increase.
Hypothesis 2b: As gender workforce diversity increases, a business organization's number of customers will increase.
Hypothesis 3a: As racial workforce diversity increases, a business organization's market share will increase.
Hypothesis 3b: As gender workforce diversity increases, a business organization's market share will increase.
Hypothesis 4a: As racial workforce diversity increases, a business organization's profits relative to its competitors will increase.
Hypothesis 4b: As gender workforce diversity increases, a business organization's profits relative to its competitors will increase.

It is possible that racial and gender diversity in the workforce are related to some outcomes but not others. My analyses thus incorporate an array of tangible outcomes and benefits surrounding sales revenue, customer base, market share, and relative profitability. Following the literature, I also examine relations between diversity and business outcomes net of other factors (e.g., legal form of organization, establishment size, company size, organization age, industrial sector, and region).

DATA AND METHODS

The data come from the 1996 to 1997 National Organizations Survey (NOS) (Kalleberg, Knoke, and Marsden 2001), which contains information from 1,002 U.S. work establishments, drawn from a stratified random sample of approximately 15 million work establishments in Dun and Bradstreet's Information Services data file. I use data from the 506 for-profit business organizations that provided information about the racial composition of their full-time workforces, their sales revenue, their number of customers, their market share, and their profitability. The NOS concentrates on U.S. work establishments' employment contracts, staffing methods, work organization, job training programs, and employee benefits and incentives. The data include additional information about each organization's formal structure, social demography, environmental situation, and productivity and performance.

The resulting sample is representative of U.S. profit-making work organizations. For each organization sampled, Dun and Bradstreet's Market Identifiers Plus service provides several important pieces of information: company name, address, and telephone number; size (in terms of number of employees and sales volume); year started; and business trends for the past three years. In addition, historical information on the sampled organizations is available from the Dun's Historical Files. The unit of analysis is the workplace.

DIVERSITY

There are two basic approaches to measuring diversity, either globally or as distinct indicators. Following Skaggs and DiTomaso (2004), I opt for separate but parallel indicators of racial and gender diversity. There are several reasons for this. Previous research shows that race and gender as bases for diversity are extremely important in understanding human transactions. For most people, these group identities are not easily changeable. In addition, the base of knowledge in the social sciences is more fully developed for these identities than for others that may be relevant. On a pragmatic level, indicators for these two dimensions are readily available in the data source, while others are not (e.g., sexual preference or age).

The specific indicator draws from the Racial Index of Diversity (RID) (Bratter and Zuberi 2001; Zuberi 2001), which provides an unbiased estimator of the probability that two individuals chosen at random and independently from the population will belong to different racial groups. The index ranges from 0 to 1. A score of 0 indicates a racially homogenous population; 1 indicates a population where, given how race is distributed, every randomly selected pair is composed of persons from two different racial groups.

$$\mathrm{RID} = 1 - \frac{\dfrac{(\Sigma\, n_i\,(n_i - 1))}{\mathrm{N}\,(\mathrm{N} - 1)}}{1 - (1/\mathrm{i})}$$

In this formula, N is the total population, n_i denotes that population is separate racial group ($_i$), and i refers to number of racial groups. The RID is a measure of the concentration of racial classification in a population if the population to which each individual belongs is considered to be one racial group, and $n_1 \ldots n_i$ is the number of individuals in the various groups (so that $3n_i = N$ for a population with three racial groups). If all the individuals in a racial group are concentrated in one category, the measure would be .0. To constrain the RID between .0 and 1.0, I calculate the actual level of diversity as a proportion of the maximum level possible with the specified number of races, that is, $1 - (1/i)$. In a population with an even racial distribution, the RID would equal 1.00.

One limitation of the RID (as with most indexes of dissimilarity) is that it treats overrepresentation and underrepresentation of subgroups as mathematically equivalent for computational purposes. Arguably, an organization with a 20 percent underrepresentation of minorities (relative to the population) would be very different from an organization with a 20 percent overrepresentation of minorities (relative to the population).

To correct for this limitation, I modify the RID to incorporate the idea that power relations between superordinate and subordinate groups are asymmetrical. The key idea is that of parity. The Asymmetrical Index of Diversity (AID) is

$$\text{AID} = (1 - S) \text{ if } S > P$$

$$\text{AID} = (1 - P) \text{ if } P \geq S$$

where **S** is the proportion of the organization composed of the superordinate group, and **P** is the proportion of the population composed of the superordinate group.

Scores can range from 0 (completely homogeneous organization composed of the superordinate group) to "parity" (i.e., $1 - P$) (where the superordinate and subordinate groups have reached proportional representation in the organization). For example, if the superordinate group constitutes 75 percent of the population, AID scores can range from 0 to .25 (or 25 when multiplied by 100). If the superordinate group constitutes 50 percent of the population, AID scores can range from 0 to .50 (or 50 when multiplied by 100).

The racial diversity index and the gender diversity index are both operationalized using two alternative premises: (1) without the underlying notion of parity (i.e., RID) and (2) with an underlying notion of parity mattering (i.e., AID-R and AID-G). Both models work well, but the AID-R and AID-G models with the parity assumption give a better fit. Moreover, they provide a theoretical rationale for why diversity is related to business outcomes. Given these results, I use both the AID-R and AID-G (parity) operationalizations (for both race and gender).

In this study, the superordinate racial group, whites, make up 75 percent of the population in the 1996 to 1997 NOS. Scores on the asymmetrical index of diversity for race thus range from a low of 0 (homogenous white) to a high of 25 (racial parity). Males, the superordinate gender, make up 54 percent of the population in the 1996 to 1997 NOS. Scores on the asymmetrical index of diversity for gender thus range from a low of 0 (homogenous male) to a high of 46 (gender parity).

Business Performance

To measure average annual sales revenue, respondents were asked, "What was your organization's average annual sales revenue for the past two years?" Responses range from 0 to 60 billion dollars. For multivariate analysis, I add a small number (.01) to each observation before dividing it by 1 million and taking the log of these values.

To measure the number of customers, respondents were asked, "About how many customers purchased the organization's products or services over the past two years?" Responses range from 0 to 25 million customers.

To measure perceived market share, respondents were asked, "Compared to other organizations that do the same kind of work, how would you compare your organization's performance over the past two years in terms of market share? . . . Would you say that it was (1) much worse, (2) somewhat worse, (3) about the same, (4) somewhat better, or (5) much better?"

To measure relative profitability, respondents were asked, "Compared to other organizations that do the same kind of work, how would you compare your organization's performance over the past two years in terms of profitability? . . . Would you say that it was (1) much worse, (2) somewhat worse, (3) about the same, (4) somewhat better, or (5) much better?"

Controls

Respondents were asked about their establishments' legal form of organization (if for profit). Specifically, "What is the legal form of organization? Is it a sole proprietorship, partnership or limited partnership, franchise, corporation with publicly held stock, corporation with privately held stock, or something else?" Responses are dummy coded for proprietorship, partnership, franchise, and corporation. I exclude not-for-profit organizations because the focus of this study is on the "business case for diversity."

To determine organization size, respondents were asked about the number of full-time and part-time employees who work at all locations of the business. Responses range from 15 to 300,000 employees. Respondents were also asked about the establishment size (i.e., the number of full-time and part-time employees on the payroll at their particular address). Responses are coded from 1 to 42,000.

To determine an organization's age, respondents were asked, "In what year did the organization start operations?" The difference between the year of the survey and the year of establishment yields the organization age, ranging from 1 to 361 years.

To measure industry, respondents were asked about the main product or service provided at their establishments. Responses are dummy coded into the following 12 categories: agriculture; mining; construction; transportation and communications; wholesale; retail; financial services, insurance, and real estate; business services; personal services; entertainment; professional services; and manufacturing.

The region in which the establishment is located is dummy coded into four categories: Northeast (CT, DE, MA, ME, NH, NJ, NY, PA, RI, and VT), Midwest (IA, IL, IN, KS, MI, MN, MO, ND, NE, OH, OK, SD, and WI), South (AL, AR, DC, FL, GA, KY, LA, MD, MS, NC, SC, TN, TX, VA, and WV), and West and others (AK, AZ, CA, CO, HI, ID, MT, NM, NV, OR, UT, WA, and WY).

RESULTS

How is diversity related to organizations' business performance? Does a relationship exist between the racial and gender composition of an establishment and its sales revenue, number of customers, market share, or profitability?

Figure 1 illustrates the distribution of establishments with low, medium, and high levels of racial and gender diversity. Thirty percent of businesses have low levels of racial diversity, 27 percent have medium levels, and 43 percent have high levels. Regarding gender diversity, 28 percent of businesses have low levels, 28 percent have medium levels, and 44 percent have high levels.

Table 1 presents means and percentage distributions of various business outcomes of establishments by their levels of diversity. Average sales revenues are associated with higher levels of racial diversity: the mean revenues of organizations with low levels of racial diversity are roughly $51.9 million, compared with $383.8 million for those with medium levels and $761.3 million for those with high levels of diversity. The same pattern holds true for sales revenue by gender diversity: the mean revenues of organizations with low levels of gender diversity are roughly $45.2 million, compared with $299.4 million for those with medium levels and $644.3 million for those with high levels of diversity.

Higher levels of racial and gender diversity are also associated with greater numbers of customers: the average number of customers for organizations with low levels of racial diversity is 22,700. This compares with 30,000 for those with medium levels of racial diversity and 35,000 for those with high levels. The mean number of customers for organizations with low levels of gender diversity is 20,500. This compares with 27,100 for those with medium levels of gender diversity and 36,100 for those with high levels.

Table 1 also shows that businesses with high levels of racial (60 percent) and gender (62 percent) diversity are more likely to report higher than average percentages of market share than are those with low (45 percent) or medium levels of racial (59 percent) and gender (58 percent) diversity. A similar pattern emerges for organizations reporting higher than average profitability. Less than half (47 percent) of organizations with low levels of racial diversity report higher than average profitability. In contrast, about two thirds of those with medium and high levels of racial diversity report higher than average profitability. Also, organizations with high levels of gender diversity (62

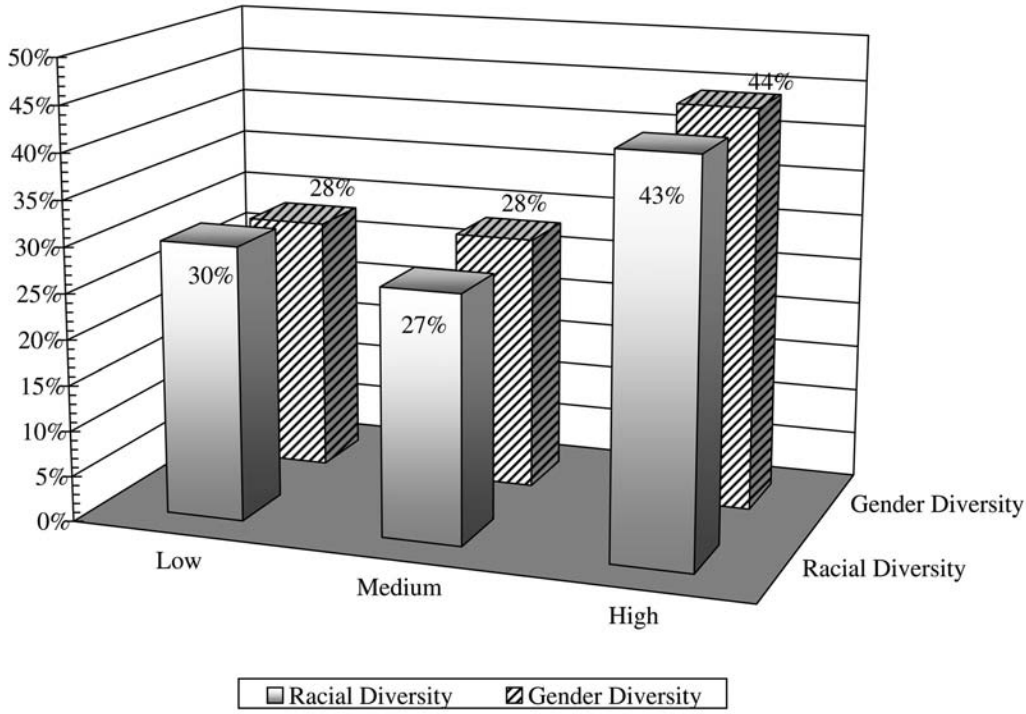

Figure 1. Percentage Distribution of Racial and Gender Diversity Levels in Establishments

Table 1. Means and Percentage Distributions for Business Outcomes of Establishments by Levels of Racial and Gender Diversity

	Racial Diversity Level			Gender Diversity Level			
Characteristics	Low (<10%)	Medium (10–24%)	High (25%+)	Low (<20%)	Medium (20–44%)	High (45%+)	Overall
Percent in racial or gender diversity category	30	27	43	28	28	44	100
Mean sales revenue (in millions)	51.9	383.8	761.3	45.2	299.4	644.3	456.3
Mean number of customers (in thousands)	22.7	30.0	35.0	20.5	27.1	36.1	31.9
Percent with higher than average market share	45	59	60	45	58	62	56
Percent with higher than average profitability	47	63	61	45	58	62	56

percent) are more likely to report higher than average profitability than are those with low (45 percent) or medium levels (58 percent) of gender diversity.

Although interesting, the descriptive statistics do not provide much information about the net relationship between diversity and organizations' business performance.[3] To address this

[3] Before engaging in disputes about *why* diversity matters to business outcomes, it is essential to first establish conclusively that there is a correlation. This research establishes the correlation and plausible explanations about why it matters. Unfortunately, the limitations of cross-sectional survey data prevent a full exploration of mechanisms. First, in using only survey data, it is difficult to rule out the possibility of unmeasured differences between organizations with low and high diversity. Second, I can specify plausible models for a direct causal link from diversity at Time 1 to business outcomes at Time 2. But, I could also specify equally plausible models for business outcomes at Time 1 that generate (or at least permit) various levels of diversity at Time 2. Another limitation of cross-sectional survey research is its inability to formally identify mechanisms.

Table 2. Regression Equations Predicting Sales, Number of Customers, Market Share, and Relative Profitability with Racial and Gender Diversity

	Model 1	Model 2	Model 3	Model 4
Independent Variables	Sales	Customers	Market Share	Profitability
Constant	4.847***	12111.880***	3.364***	3.361***
Racial diversity	.087***	509.398***	.009***	.008**
Gender diversity	.042***	278.971***	.004*	.006**
R^2	.058***	.038***	.021***	.025***
N	506	506	506	470

Notes: Coefficients are unstandardized. For the dummy (binary) variable coefficients, significance levels refer to the difference between the omitted dummy variable category and the coefficient for the given category.
* $p < .1$; ** $p < .05$; *** $p < .01$.

issue more rigorously, Tables 2 and 3 present results from multivariate analysis. Table 2 shows the relationship between racial and gender diversity in establishments and logged sales revenue, number of customers, estimates of relative market shares, and estimates of relative profitability. Model 1 shows that diversity and sales revenues are positively related. Diversity accounts for roughly 6 percent of the variance in sales revenue. These results are fully consistent with Hypotheses 1a and 1b. Model 2 shows that racial and gender diversity are also significantly related to the number of customers. As the racial and gender diversity in establishments increase, their number of customers also increases.

Diversity accounts for less than 4 percent of the variance in number of customers, but the relationship is statistically significant for both racial and gender diversity. These results are consistent with Hypotheses 2a and 2b. Model 3 in Table 2 shows a positive relationship between racial and gender diversity and estimates of relative market shares. As diversity in establishments increases, estimates of relative market share also increase significantly. The relationship is statistically significant for racial diversity and marginally significant for gender diversity. These results are consistent with Hypotheses 3a and 3b. Finally, Model 4 displays the relationship between racial and gender diversity and estimates of relative profitability. As diversity increases, estimates of relative profitability also increase. The results are statistically significant and consistent with Hypotheses 4a and 4b.

But do these results hold up once alternative explanations are taken into account? Table 3 presents the same relationships as Table 2, but it includes controls for alternative explanations. Model 1 of Table 3 presents the relationship between racial and gender diversity in establishments and logged sales revenue. In Model 1, the relationships between racial and gender diversity and sales revenues remain significant ($p < .05$), net of controls for legal form of organization, company size, establishment size, organization age, industrial sector, and region. Model 2 shows that a one unit increase in racial diversity increases sales revenues by approximately 9 percent; a one unit increase in gender diversity increases sales revenues by approximately 3 percent. Combined, these factors account for 16.5 percent of the variance in sales revenue. The results in Table 3 provide support for Hypotheses 1a and 1b (i.e., as a business organization's racial and gender diversity increase, its sales revenue will also increase).

Model 1 of Table 3 examines alternate explanations of sales revenue. Net of all other factors, privately-held corporations have significantly lower sales revenues than do other legal forms of business. No other legal forms depart significantly from the omitted category. Model 1 also shows that sales revenues increase marginally as company size increases, and significantly as establishment size increases and organizations age.

The standardized coefficients for this model (not reported in Table 3) show that a one stan-

Different researchers can offer several hypotheses about the mechanisms that produce the observed relationship between variables (in this case, diversity and business outcomes).

Table 3. Regression Equations Predicting Sales, Number of Customers, Market Share, and Relative Profitability with Racial and Gender Diversity and Other Characteristics of Establishments

	Model 1	Model 2	Model 3	Model 4
Independent Variables	Sales	Customers	Market Share	Profitability
Constant	4.998***	61545.4	3.403***	3.363***
Racial diversity	.093***	433.86***	.007**	.006*
Gender diversity	.028**	195.642**	.001	.005**
Proprietorship	–.821	–370.78	–.232*	–.161
Partnership	.663	–6454.6	–.017	.256
Public corporation	–.109	7376.29	.214*	.202
Private corporation	–1.484**	–8748.7*	.008	.019
Company size	.00001*	.352*	.000**	.000**
Establishment size	.00001**	.119	.000	.000
Organization age	.013**	44.813	.001	.001
Agriculture	–1.942	4188.66	–.206	–.033
Mining	.739	–28856*	–.168	–.264
Construction	–.967	–875.7	–.152	–.036
Transportation/communications	–.052	1498.75	.119	.226
Wholesale trade	.008	–16383**	.136	–.064
Retail trade	–1.183**	7209.83*	.08	–.087
F. I. R. E.	–.683	–8335.4	–.212	.085
Business services	–1.49*	1552.28	.204*	.112
Personal services	–1.566*	1480.03**	.423**	–.001
Entertainment	–4.708**	–1504.5	–.191	–.076
Professional services	–.615	–13539**	.138	–.023
North	2.196***	23143.9***	–.06	–.039
Midwest	2.616***	14968.3***	–.023	–.073
South	1.82***	21152.8***	–.055	.059
R^2	.165***	.155***	.075**	.064**
N	506	506	469	484

Notes: Coefficients are unstandardized. For the dummy (binary) variable coefficients, significance levels refer to the difference between the omitted dummy variable category and the coefficient for the given category.
* $p < .1$; ** $p < .05$; *** $p < .01$.

dard deviation increase in racial diversity produces a .188 standard deviation increase in sales revenue. Furthermore, the relationship between racial diversity and sales revenue (Beta = .188) is stronger than the impact of company size (Beta = .067), establishment size (Beta = .087), and organization age (Beta = .077). Gender diversity is also important to sales revenue. It maintains a statistically significant relationship to sales revenue (Beta = .082), net of controls. Therefore, not only are racial and gender diversity significantly related to sales revenue, but they are among its most important predictors.

Model 2 in Table 3 presents the relationship between racial and gender diversity in establishments and number of customers. This relationship remains statistically significant ($p < .05$), controlling for legal form of organization, company size, industrial sector, and region. A one unit increase in racial diversity increases the number of customers by more than 400; a one unit increase in gender diversity increases the number of customers by nearly 200. The overall model accounts for 15.5 percent of the variance in number of customers. These results fully support Hypotheses 2a and 2b (i.e., as a business organization's racial and gender diversity increase, its number of customers will also increase).

Model 2 also examines alternate explanations of sales revenue. Again, the relationship between racial diversity and number of customers (Beta = .120) is stronger than the impact of company size (Beta = .056), establishment size (Beta = .004), and organization age (Beta = .027). Gender diversity is also more highly related to number of customers, maintaining a statistically significant relationship (Beta = .079) net of controls. These results again suggest that racial and gender diversity are among the most important predictors of number of customers.

Model 3 in Table 3 shows that racial diversity (Beta = .088) maintains its significant relationship to market share, controlling for legal form of organization, company size, and industrial sector. The relationship between gender diversity (Beta = .025) and relative market share, however, becomes nonsignificant. Model 3 accounts for 7.5 percent of the variance in estimates of relative market shares. These findings are consistent with Hypothesis 3a (i.e., as a business organization's racial diversity increases, its market share will also increase), but they do not support Hypothesis 3b. Still, racial diversity is among the most important predictors of relative market share.

Model 4 in Table 3 reports the net relationship between racial and gender diversity and relative profitability. In this case, the relationship between racial diversity and relative profitability remains marginally significant ($p < .1$), net of other factors. The relationship between gender diversity and relative profitability remains statistically significant. Model 4 explains less than 7 percent of the variance in estimates of relative profitability, but the results are consistent with Hypotheses 4a and 4b (i.e., as a business organization's racial and gender diversity increase, its profits relative to competitors will also increase). Both racial diversity (Beta = .076) and gender diversity (Beta = .089) are among the most important predictors of relative profitability.

Overall, the multivariate analyses strongly support the business case for diversity perspective. The results are consistent with all but one of the hypotheses suggesting that racial and gender diversity are related to business outcomes. The significant relationships between diversity and various dimensions of business performance remain, even controlling for other important factors, such as legal form of organization, company and establishment size, organization age, industrial sector, and region. Indeed, racial diversity is consistently among the most important predictors of business outcomes, and gender diversity is a strong predictor in three of the four indicators.

CONCLUSIONS

This article examines the impact of racial and gender diversity on business performance from two competing perspectives. The value-in-diversity perspective makes the business case for diversity, arguing that a diverse workforce, relative to a homogeneous one, produces better business results. Diversity is thus good for business because it offers a direct return on investment, promising greater corporate profits and earnings. In contrast, the diversity-as-process-loss perspective is skeptical of the benefits of diversity and argues that diversity can be counterproductive. This view emphasizes that, in addition to dividing the nation, diversity introduces conflict and other problems that detract from an organization's efficacy and profitability. In short, this view suggests that diversity impedes group functioning and will have negative effects on business performance.

A third, paradoxical view suggests that greater diversity is associated with more group conflict *and* better business performance. This is possible because diverse groups are more prone to conflict, but conflict forces them to go beyond the easy solutions common in like-minded groups. Diversity leads to contestation of different ideas, more creativity, and superior solutions to problems. In contrast, homogeneity may lead to greater group cohesion but less adaptability and innovation.

Drawing on data from a national sample of for-profit business organizations (the 1996 to 1997 National Organizations Survey), my analyses center on eight hypotheses consistent with the value-in-diversity (business case for diversity) perspective and use both objective and perceptual indicators. Although some may see perceptual indicators as problematic, the combined use of indicators in these analyses is a strength of the research design. It is highly unlikely that the distinct indicators have the same set of unobserved processes or sources of measurement error that might produce spurious results.

The results support seven of the eight hypotheses: diversity is associated with increased sales revenue, more customers, greater market share, and greater relative profits. Such results clearly counter the expectations of skeptics who believe that diversity (and any effort to achieve it) is *harmful* to business organizations. Moreover, these results are consistent with arguments that a diverse workforce is good for business, offering a direct return on investment and promising greater corporate profits and earnings. The statistical models help rule out alternative and potentially spurious explanations.

So, how is diversity related to the bottom-line performance of organizations? Critics assert that diversity is linked with conflict, lower group cohesiveness, increased employee absenteeism and turnover, and lower quality and performance. Nevertheless, results show a *positive* relationship between the racial and gender diversity of establishments and their business functioning. It is likely that diversity produces positive outcomes over homogeneity because growth and innovation depend on people from various backgrounds working together and capitalizing on their differences. Although such differences may lead to communication barriers and group conflict, diversity increases the opportunities for creativity and the quality of the product of group work. Within the proper context, diversity provides a competitive advantage through social complexity at the firm level. In addition, linking diversity to the idea of parity helps illustrate that diversity pays because businesses that draw on more inclusive talent pools are more successful. Despite the potentially negative impact of diversity on internal group processes, diversity has a net positive impact on organizational functioning.

Alternatively, it is possible that the associations reported between diversity and business outcomes exist because more successful business organizations can devote more attention and resources to diversity issues.[4] It is also possible that these relationships exist because of some other dynamic that the models do not consider. Nevertheless, the results presented here, based on a nationally representative sample of business organizations, are currently the best available.

The concept of diversity was originally created to justify more inclusion of people who were traditionally excluded from schools, universities, corporations, and other kinds of organizations. This research suggests that diversity—when tethered to concerns about parity—is linked to positive outcomes, at least in business organizations. The findings presented here are consistent with arguments that diversity is related to business success because it allows companies to "think outside the box" by bringing previously excluded groups inside the box. This process enhances an organization's creativity, problem-solving, and performance. To better understand how diversity improves business performance, future research will need to uncover the mechanisms and processes involved in the diversity–business-performance nexus.

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APPENDIX

How do the organizations in the sample compare on their characteristics? Table A1 shows that establishments with low levels of racial diversity are more likely to be sole proprietorships (21 percent) than are those with medium (5 percent) or high levels (11 percent) of racial diversity. The same general pattern holds true for gender diversity and the tendency for estab-

[4] Some researchers try to work around survey data limitations by estimating fixed- and random-effects models and using instrumental variables approaches to correct for unmeasured heterogeneity. While panel data or even replicated cross-sectional data might allow one to stipulate temporal order, cross-sectional survey data can offer little in adjudicating such issues. Indeed, cross-sectional survey research is poorly equipped to offer a definitive answer on such issues. Without direct, cross-time measures of the central variables, it is difficult to discern which causal explanations, if any, may be at work.

Table A1. Means and Percentage Distributions for Characteristics of Establishments by Levels of Racial Diversity and Gender Diversity

	Racial Diversity Level			Gender Diversity Level			
	Low	Medium	High	Low	Medium	High	
Characteristics	(<10%)	(10–24%)	(25%+)	(<20%)	(20–44%)	(45%+)	Overall
Percent proprietorship	21	5	11	19	8	10	15
Percent partnerships	9	4	8	3	6	11	7
Percent corporations (and others)	70	91	81	78	84	79	78
Mean percent female	37	41	48	8	32	64	46
Mean organization size	129.8	1,265.8	546.0	343.2	799.0	391.0	581.8
Mean organization age	29.7	35.9	33.1	33.7	34.6	30.2	32.8
Percent in agriculture	1	<1	3	3	1	1	17
Percent in mining	<1	<1	1	2	1	<1	1
Percent in construction	7	6	4	17	2	1	6
Percent in transportation/comm.	5	6	8	11	8	2	7
Percent in wholesale	5	5	5	4	5	5	5
Percent in retail	19	20	25	11	16	28	21
Percent in F.I.R.E.	8	8	5	3	2	12	6
Percent in business services	10	9	7	12	12	5	9
Percent in personal services	6	3	5	2	2	8	4
Percent in entertainment	1	<1	1	2	1	<1	1
Percent in professional services	19	14	11	6	16	20	14
Percent in manufacturing	19	30	25	28	33	17	27
Percent Northeast	20	19	9	14	12	20	15
Percent Midwest	34	30	14	22	31	22	27
Percent South	22	23	37	28	28	28	28
Percent West	24	28	39	36	29	30	31

lishments to be proprietorships. Establishments with low levels of racial diversity are at least as likely to be partnerships (9 percent) as are those with high (8 percent) or medium levels (4 percent) of racial diversity. Businesses with low levels of racial diversity are less likely to be corporations (70 percent) than are those with medium (91 percent) or high levels (81 percent) of diversity. Establishments with low levels of gender diversity are slightly less likely to be corporations (78 percent) than are those with medium (84 percent) or high levels (79 percent) of gender diversity.

Although the differences are not large, businesses with low levels of racial diversity have slightly lower percentages of female employees (37 percent) than do those with medium (41 percent) or high levels (48 percent) of racial diversity. These patterns differ when broken down by gender diversity: among businesses with low gender diversity, 8 percent of the employees are female; among those with medium gender diversity, 32 percent of their employees are female; and among those with high gender diversity, 64 percent of their employees are female. Establishments with low levels of racial diversity also tend to be smaller (130 employees) than those with medium (1,266 employees) or high (545 employees) levels of racial diversity. The same pattern is true for gender diversity. The establishments with low levels of racial diversity also tend to be slightly newer (30 years old) than those with medium (36 years old) or high (33 years old) levels of racial diversity. Businesses with the highest levels of gender diversity tend to be the newest (30 years old), compared with those with low (34 years old) or medium (35 years old) levels of gender diversity.

Table A1 shows that industrial sectors do not differ greatly by levels of racial or gender diversity. The two apparent exceptions are in the retail and manufacturing sectors: 19 percent of organizations with low levels of racial diversity, 20 percent of those with medium levels, and 25 percent of those with high levels are in the retail sector. The same pattern holds true for gender diversity: 11 percent of organizations with low levels of gender diversity, 16 percent with medium levels, and 28 percent with high levels are in the retail sector. Establishments in the manufacturing sector are more likely to have medium levels of racial (30 percent) and gender (33 percent) diversity than they are to have low racial (19 percent) or gender (28 percent) diversity or high racial (25 percent) or gender (17 percent) diversity.

The table also indicates that there are regional differences in regard to various levels of racial diversity: 20 percent of organizations with low racial diversity are located in the Northeast, compared with 19 percent of those with medium levels and 9 percent with high levels. For gender diversity, 14 percent of organizations with low diversity, 12 percent of those with medium diversity, and 20 percent of those with high diversity are in the Northeast. More than one third (34 percent) of businesses with low levels of racial diversity are located in the Midwest, compared with 30 percent of those with medium levels and 14 percent of those with high levels. Twenty-two percent of businesses with low levels of racial diversity are located in the South, compared with 23 percent of those with medium levels and 37 percent of those with high levels. Nearly one quarter (24 percent) of businesses with low levels of racial diversity are located in the West, compared with 28 percent of those with medium levels and 39 percent of those with high levels. The percentage of establishments located in the South (28 percent) does not vary by level of gender diversity, and the percentage of establishments located in the West does not appear to be related systematically to level of gender diversity.

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