Methods and Indicators to Measure the Cost-Effectiveness of Diversity Policies in Enterprises

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1. BACKGROUND

1.1. PROJECT BACKGROUND

Article 13 of the Amsterdam Treaty provides the European Union with powerful legal competencies to strengthen the battle against discrimination, in all its forms. One outcome has been legislation designed to combat discrimination and harassment in the workplace. Directives passed in 2000 establish a general framework for the respect of equal treatment in access to employment, access to vocational training, employment and working conditions, and membership of vocational, industrial, or professional organisations[1]. The Directives cover direct and indirect discrimination on the grounds of race, ethnic origin, religion, belief, disability, age, or sexual orientation.

But legislation alone may not be enough to ensure that all of the EU's citizens enjoy equality of opportunity in the workplace and that, ultimately, labour market outcomes are more equitable. To achieve these wider policy goals, additional action is needed to ensure that companies adopt the detailed human resource policies needed to recruit, retain, and develop a diverse workforce. Such policies are specific to the situation and needs of each business, and are designed to implement competitive strategy. Whilst laws can be effective at prohibiting unacceptable behaviour, they may well be less effective when it comes to promoting the development of new human resource policies of the type needed to exploit workforce diversity. Legislation, by its nature, is unlikely to be able to prescribe the details of such policies for all companies.

New policy mechanisms are needed to overcome these problems. To this end, the European Commission has established an Action Programme[2], the aims of which include development of a greater understanding of discrimination in the workplace. Part of the programme examines the activities of businesses that have, voluntarily, set out to implement workforce diversity programmes: to go beyond compliance with existing anti-discrimination legislation.

This is an important area, for the development of new policy mechanisms. Evidence has begun to emerge that a number of leading companies, and some small and medium-sized enterprises (SMEs), have set up diversity policies for business reasons i.e. to create improved wealth and to strengthen competitive advantage[3]. The reputation of some of the businesses involved and the growing scale of the activity, suggests that there exists a "business case" to justify the investment of resources in the establishment of diversity policies. Identification of this "business case", and its dissemination to companies through public sector action could help to stimulate wider use of diversity policies by the corporate sector.

Central to this business case is a clear understanding of the costs and benefits of diversity policies. Companies need to be able to weigh these up, such that the cost-effectiveness of investments in new human resource policies can be assessed. Yet, relatively little is known about how companies measure the costs and benefits of

[1] Directive 2000/43/EC (principle of equal treatment between persons irrespective of racial or ethnic origin) and Directive 2000/78/EC (general framework for equal treatment in employment and occupation)
[2] Community Action Programme to combat discrimination, 2001-2006
[3] See for example, CSR Europe *'Business and Diversity – Helping businesses score higher in managing diversity'* (2002)

diversity policies. Without information about these business practices, the credibility of the business case for workforce diversity is undermined.

1.2 PROJECT OBJECTIVES

The aim of the project is to undertake a study of the feasibility of establishing methods and indicators to measure the costs and benefits of diversity policies in companies in a European context to enable the effectiveness of such policies and practices to be properly assessed and disseminated.

Such indicators form a critical part of the "business case" for diversity policies in the workforce. A credible understanding of this is important for the encouragement of corporate social responsibility and to promote non-discrimination on grounds of race, disability, religion, belief, age, or sexual orientation.

Methods and indicators proposed by the study may form the basis of further practical work to measure the impact of diversity policies on companies and to disseminate the results to opinion-formers and decision-makers.

1.3 PROJECT FOCUS

Companies pursue a range of different types of diversity policy that are relevant to overall labour market outcomes. In general, they fall into three categories:

- **Workforce diversity** – actions by companies to exploit the diversity of their current employees or to increase the diversity of their workforce;

- **Community support** – business-funded programmes to help socially-excluded groups participate in the labour market either through the acquisition of skills or through support for Third Sector enterprises;

- **Procurement diversity** – implementation by companies of policies to purchase goods or services from suppliers controlled by members of socially-excluded groups or to insist that suppliers implement workforce diversity policies.

This project focuses primarily on the use by companies of "workforce diversity" policies.

2. WORK UNDERTAKEN

2.1. PROJECT STRUCTURE

The project has been undertaken in three parts. Set-up activities made up the first phase. The second phase was the main fieldwork, and the main report was produced in the third, and final, phase.

In the original project design, the second (fieldwork) phase was organised around a series of consecutive stages, each designed to complete a discrete task. Specifically:

- **Stage One** – identification of existing indicators (and methods of measurement) used by companies to measure the costs and benefits of workforce diversity policies.

- **Stage Two** – assessment of the relevance and effectiveness of existing indicators for companies in a European context, including a review of key areas of the socio-cultural context in the EU that might affect the appropriateness or feasibility of existing indicators.

- **Stage Three** – development, if necessary, of new means of measuring the costs and benefits of diversity policies in companies that are relevant and effective in a European context.

- **Stage Four** – development of a strategy to disseminate the information gathered on the cost and benefits of diversity policies to the main actors for diversity policies in companies.

At the interim review stage of the project it was agreed to modify these tasks. Findings from the initial review of existing indicators and of the business case for diversity suggested that the project scope should be amended, such that more emphasis was placed on understanding wider obstacles to investment in diversity policies and on identifying mechanisms for improving the business case and promoting workforce diversity.

A number of changes in fieldwork coverage were agreed:

- A limited review of the socio-legal environment in the EU would be undertaken to identify direct obstacles to the effective measurement of costs and benefits of diversity policies by companies. This would focus on a review of legal restriction on the processing or holding of sensitive data by companies.

- Because socio-legal factors could also act as more general obstacles to investment in workforce diversity policies, there would be a limited review of this issue. Findings could contribute the development of ideas for stimulating greater use of workforce diversity policies.

- There was no need to develop new indicators. As will be shown in the report, there is an extensive range of existing indicators, based on the experience of companies in the EU and the USA. Of greater importance is the need to develop a systematic framework for performance measurement. Development of such a framework would be undertaken as part of the project.

- A review of dissemination strategies would be carried out. This would have two objectives. First, it would provide ideas for the dissemination of the report's findings. Its second objective would be to identify ideas for promoting greater use of diversity by companies and for overcoming obstacles to investments in diversity.

- There would be a limited review of potential obstacles to the adoption of diversity policies from the perspective of companies. This would be carried out through a small-scale survey and would also provide an opportunity to identify possible priorities for the improvement of the business case for diversity.

- Development of a limited number of ideas for recommendations for future work that needs to be undertaken by academics, research institutes and governments to help build the business case for diversity.

2.2. SUMMARY OF WORK UNDERTAKEN

Multiple sources of evidence have been used to achieve these tasks. They include reviews of literature; a survey of 200 companies in four EU countries; the development of 8 case studies of diversity promotion programmes in 6 EU countries; and an extensive programme of interviews.

A total of 48 people have been interviewed. The programme covered 10 large companies, 4 small companies, EU-level business organisations, academics diversity promotion organisations (governments, equality bodies, social partners and business organisations in Member States) and stakeholders (non-governmental organisations and trade unions).

A fuller description of the overall project methodology is set out in Appendix B.

3. DIVERSITY POLICIES IN ENTERPRISES

3.1. 'DIVERSITY'

"Workforce diversity" within companies is associated with policies designed to recruit, retain, <u>and</u> develop employees from diverse social groups. This leads to a change in the mix of people employed in some cases, and, in other instances, to changes in the type of people employed in specific managerial or technical positions. In all cases, such policies go beyond compliance with national anti-discrimination legislation.

But a "diverse workplace" is difficult to define in practice. There is, as yet, no widely accepted way of distinguishing between workplaces that are 'diverse', and those that are not. This, as we shall see later on, poses considerable problems for the development of a credible "business case" for investment in workforce diversity policies by companies.

These difficulties are the result of two important factors. Firstly, a "diverse workplace" is an outcome of major changes in the internal culture of a company. Although companies can, and do, set targets for changes in the representation of selected groups in the workforce or in key managerial or technical positions, long-term changes in workforce mix and in the effectiveness of all employees will only emerge if a new employment culture is created. To achieve these goals, this culture should be based on equitable employment practices and internal attitudes that value difference and focus on individuals and their talents.

Without such changes, the sustainability of diversity policies based principally on representation-based targets is questionable. But it is extremely difficult to measure the shifts in values that accompany changes in internal cultures because of the importance of context-specific qualitative factors in determining and classifying corporate cultures.

The second problem is more practical. Not all companies set out to achieve the same goals in their diversity policies. Some, as we shall see in later sections, focus on using diversity to achieve short-term business benefits. Others are more concerned to avoid regulatory pressures, and hence use representation-based targets as one of a number of mechanisms for demonstrating compliance with anti-discrimination targets. There are also companies which invest in diversity policies as a way of strengthening long-term "value drivers" – the key sources of competitive advantage and hence performance.

Some progress in developing 'maps' of the extent to which individual workplaces are, or are not, diverse has been made by a number of independent consultancy firms.

One of the most transparent and rigorous is "The Equity Continuum" developed by the Centre for Diversity and Business[4]. It uses an extensive data gathering process within companies to classify them within one of the five levels of the equity continuum. The classification takes into account company policies and behaviours in eight organisational activities (such as work environment, training, and customer focus), and six organisational processes (such as commitment, measurement, and strategy).

For companies that participate in the process, the data generated also provides an opportunity for external benchmarking against other companies. In other words, it can be used as a measure of progress in establishing a diverse workplace (Exhibit 1).

[4] See for example, Centre for Diversity and Business *'Developing Standards to Measure Diversity'* (2002)

Exhibit 1

Diversity Assessment Tool – "The Equity Continuum"	
Level 1	**"Compliance"** These organisations are motivated by compliance. Their aim is to meet their legal or other obligations, to avoid the negative consequences of non-compliance. These organisations focus on equality (treating everyone the same way) rather than diversity (respecting people's differences). Initiatives generally stop if the external requirements driving the initiatives change or fall away. Organisations at this level have primarily a reactive approach to implementing equity initiatives.
Level 2	**"Beyond Compliance"** These organisations recognise the value in going beyond simple compliance. They aim to support groups that have been historically disadvantaged, recognising the benefits to their internal and public image. Equity in these organisations means being seen to do the right thing for disadvantaged groups. Initiatives that go beyond compliance generally stop if the leadership or public interest driving those initiatives changes or falls away. Diversity initiatives are isolated within these organisations and there is no plan to integrate diversity into all aspects of human resource management or the wider organisational culture.
Level 3	**"The Business Case"** These organisations understand that certain diversity initiatives can improve organisational efficiency, recruitment, employee retention, team effectiveness, or market related opportunities. They evaluate diversity opportunities qualitatively and quantitatively to identify programmes with an overall business benefit. Initiatives can survive the loss of employee or public interest if the business case driving the initiatives remains valid. These organisations use an inclusive definition of diversity with the vision of creating an environment that is equitable for all.
Level 4	**"Employer of Choice"** These organisations have internalised diversity as a core organisational value. Key opinion leaders view diversity as an essential element of continued growth. Diversity is integrated into all aspects of the organisation and all employees consider themselves responsible for creating an environment that is fair and equitable for all. The commitment to diversity is not affected by economic trends. A wide range of people view these organisations as "Employers of Choice".
Level 5	**"Leader in Diversity"** These organisations have achieved their internal vision of equity for all and now seek to foster diversity beyond their own boundaries. They recognise that diversity contributes to a strong economy, which benefits all participants including the organisation. Diversity is firmly integrated into all aspects of organisational life.

Source: The Centre for Diversity and Business

The "Equity Continuum" highlights important differences between the diversity policies pursued by companies and uses a structured approach to classify them. It provides participants with a measure of progress that can be compared externally through benchmarking.

However, the model relies on internally generated data and a proprietary assessment tool. This makes it difficult for academics to gain access to the data and to use it to make empirical analyses of correlative links between different "degrees of diversity" and differences in corporate performance.

As we shall see in a later section, the evidence from such analyses forms an important part of the business case for investment in intangible assets of all types. Investments in diversity policies can make a major contribution to strengthening human and organisational capital: two of the most important types of intangible asset.

3.2. ADOPTION OF DIVERSITY POLICIES – DRIVERS OF CHANGE

3.2.1. Reasons for Adoption of Workforce Diversity Policies

Companies adopt workforce policies for three main types of reason:

- **Ethical** – some companies believe that providing employment opportunities for members of socially disadvantaged groups is "the right thing to do". Such motives are strongest in companies of all sizes with philanthropic traditions, and in smaller companies because the private views of owners or managers have a greater impact on corporate activity than in larger-scale enterprises.

- **Regulatory** – there is evidence that some companies establish diversity targets based on representation targets as a mechanism for demonstrating compliance with anti-discrimination targets. This can have the effect of changing the mix of people employed by a company but may do little to change wider values and attitudes.

- **Economic** – a number of companies invest in diversity policies because they believe that this will generate economic benefits that will exceed the costs of implementation.

Evidence from literature and our interviews with companies suggests that companies adopt diversity policies for more than one of the above reasons[5]. However, the relative importance of each type of reason differs between companies.

Companies with philanthropic traditions, for example, may decide to expand or sustain their investments in diversity because of potential economic benefits. Similarly, companies might begin the process of organisational change as a response to legislation but then expand it as they become more aware of potential business benefits.

In this project we focus solely on the economic reasons for adopting workforce diversity policies, because we are principally concerned with understanding the costs and benefits that make up the business case. Notwithstanding this, it is important to remember that companies may reach the decision to become 'diverse' because of a complex interplay of factors, of which economics is only one.

[5] See for example, Gandz J. *'A Business Case for Diversity, Paths to Equal Opportunities'* (2002, a report for the Canadian Government)

3.2.2. Economic Drivers of Change

When companies invest in diversity policies on economic grounds this is, in general, as a result of a qualitative or quantitative judgement that benefits will, over time, exceed costs and risks. But to understand *why* the company considered this investment rather than any other, we need to look at wider reasons for change.

In general, companies examine such investments in response to the emergence of new business opportunities or because of the impact of internal or external pressures on business performance.[6]

Investments in diversity policies represent decisions by companies to create business opportunities or strengthen overall competitiveness by building up human or organisational capital. They are decisions to invest in intangible assets; one of the most important sources of competitiveness for companies in the modern, knowledge-based economy[7].

Our research identifies the major "drivers of change" that are forcing managers, workers, and investors to consider investments in workforce diversity policies.

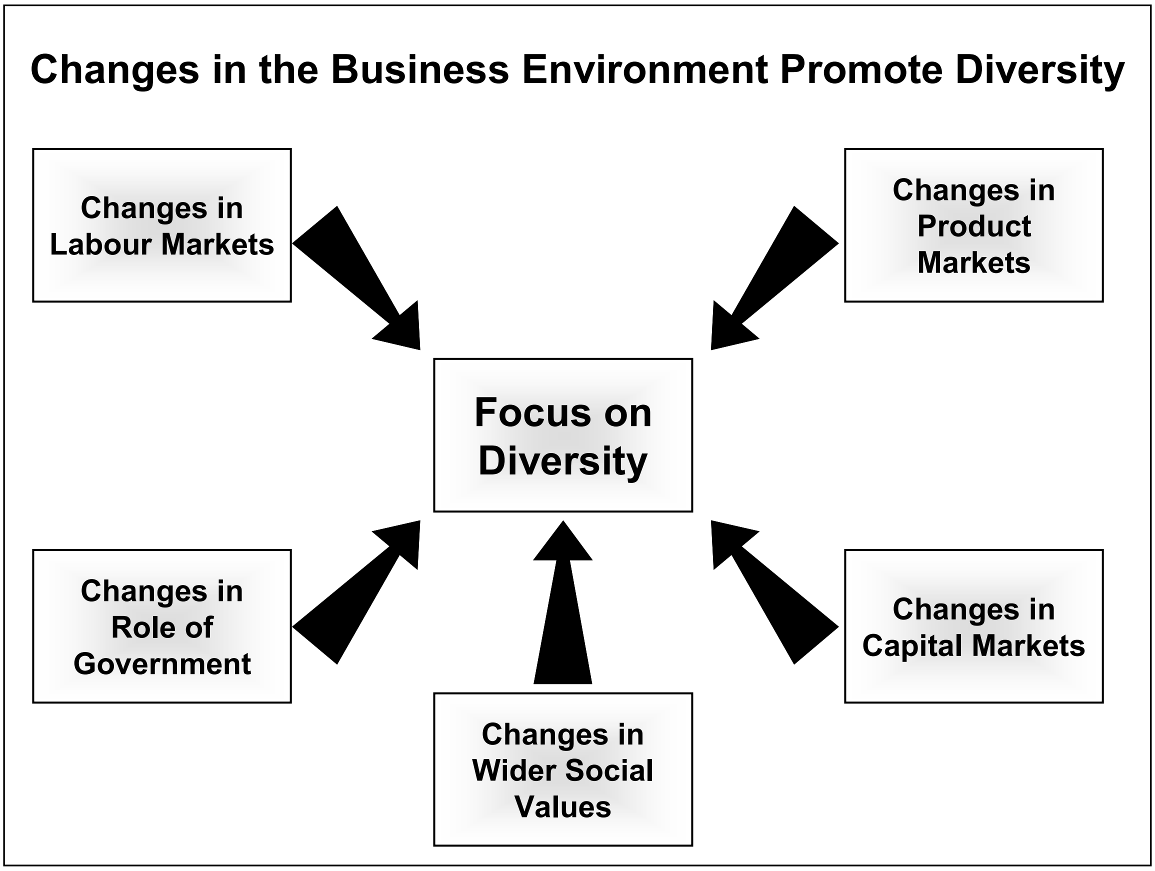
Companies are considering investments in diversity because of major changes in the following areas:

- **Product markets** – the needs of customers and the activities of competitors;
- **Labour markets** – the availability, quality, and values of current and future employees;
- **Capital markets** – the views of investors as to what drives acceptable investment returns;
- **Government influence** – the impact of public policy through regulation, legislation, and political pressure; and,
- **Wider social values** – the expectations of citizens as to how companies should behave when carrying out their commercial activities.

These factors interact, and, taken together, represent powerful incentives for major, internal changes in the human resource (HR) policies of companies (Exhibit 2).

[6] See for example, McKinsey Global Institute *'Manufacturing Productivity'* (1993) and *'Service Sector Productivity'* (1994)
[7] See for example, Blair M. and Kochan T. *'The New Relationship – Human Capital in the American Corporation'* (2000) Lev B. *'Intangibles – Management, Measurement, and Reporting'* (2001)

Exhibit 2



Source: CSES

3.2.2.1. Product Market Changes[8]

A number of major changes are taking place in markets for goods and services that are increasing the value to companies of investments in human and organisational capital. Such changes include:

- **Rising competitive intensity** – this is the result of factors such as globalisation and maturity of demand. In response, companies seek to improve operating efficiency and innovation. Both rely, in part, on up-grading human capital in general, and greater workforce diversity in particular. Improvements in operating efficiency, for example, depend on new human resource policies that increase loyalty, commitment, and discretionary effort of workers, as well as investments in equipment and work organisation. A further response to these changes has been greater investment in marketing and corporate reputation to achieve market-place differentiation. Diversity policies can, in certain circumstances, have an important positive impact on corporate reputation.

- **Emergence of new market segments** – traditional market sectors are fragmenting and new markets emerging as a result of wide range of factors, including technological change, rising affluence, market liberalisation, de-

[8] These trends are described extensively in Business Decisions Limited *'The Power of Customers to Drive Innovation'* (2003, a report for the European Commission)

regulation, and demand maturity. Workforce diversity policies are of particular importance for successful penetration of three groups of markets: the needs of socially or environmentally aware customers ("values markets"); goods and services purchased by socially-excluded groups; and, "contentious markets" – sectors funded by governments or heavily regulated and surrounded by social concerns. For markets based on the purchasing power of diverse social groups, diversity policies help companies gain an insight into the concerns of customers. In "contentious markets", workforce diversity policies help to strengthen corporate reputation, a key purchasing criterion[9].

- **Increasing emphasis of knowledge** – over the last decade the fastest growing manufacturing sectors have been those most dependent on research and development (R&D) and innovation. Competition in these sectors depends on gaining access to human capital and unlocking the creativity of existing workers.

- **Increasing emphasis on service** – along with a major expansion in the overall service sector, the last 20 years have witnessed a major increase in the service component of manufactured goods in both business-to-business and consumer markets. Higher service levels depend, primarily, on up-grading the quality and organisation of human capital within companies.

Changes in product market factors affect companies of all sizes. Larger companies are affected by globalisation, for example, directly and SMEs experience its impacts indirectly through supply chain pressures.

3.2.2.2. Labour Market Changes

In response to major changes in labour markets, many companies are modernising human resource policies. In many instances, this includes the introduction of diversity policies.

Important changes include:

- **Shifting labour market demographics** – in most OECD countries the proportion of younger workers is declining and female labour market participation is rising. At the same time, the number of employees from ethnic minorities is increasing. Alongside these quantitative changes, levels of education are also increasing. Taken together, these changes make it more difficult for companies to find new workers from traditional labour market groups. Diversity policies are one mechanism used by companies to overcome these problems[10].

  In some retail sectors, for example, the declining number of younger people has stimulated a number of companies to expand employment opportunities for older workers.

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[9] Cogman D. and Oppenheim J. *'Controversy Incorporated – Addressing the Social Concerns that Surround Contentious Markets'* (The McKinsey Quarterly, Winter 2002)
[10] Rutherford S. and Ollearnshaw S. *'The Business of Diversity – How organisations in the public and private sectors are integrating equality and diversity to enhance performance'* (2002, a report for the UK Cabinet Office)

- **Changing employee attitudes** – major changes have taken place in the values and expectations of workers. Traditional employee-employer relationships are being eroded as workers place increasing emphasis on openness, participation, equity, and equal opportunities in the workplace. For some workers, choice of employers depends increasingly on the 'values' of the company. New human resource policies and new organisational models are being introduced in response to these changes[11].

Evidence from our interviews with companies suggests that labour market factors are of particular importance for SMEs. By their nature, SMEs are more dependent on local labour markets than large companies and are, therefore, more exposed to local shifts in demographics and attitudes. Lack of availability of labour is also a more serious and immediate problem for smaller enterprises: they do not have the scale or resources to overcome shortages.

3.2.2.3. Capital Market Changes

Capital market changes have increased the pressure on companies to invest in the development and management of intangible assets of all types. Changes include:

- **Rising importance of 'intangibles' in market valuations** – despite recent falls in public equity markets, intangible assets continue to be as important as tangible assets in determining the market value of companies. Because of this, major investors have begun to place much greater emphasis on monitoring non-financial factors. Research evidence suggests that human capital is recognised by investors as one of the most important forms of intangible asset[12]. This, in turn, helps to create a potentially positive environment amongst investors for diversity programmes: a mechanism for enhancing human capital investments.

- **Increasing investor interest in the management of risk** – recent high-profile corporate failures in the USA and Europe have highlighted to investors the need to monitor the effectiveness of the management of risks of all types by managers. This includes compliance with anti-discrimination legislation. Moreover, investors have become aware of the importance of corporate reputation as an intangible asset and the threats that anti-discrimination litigation poses to it. Diversity programmes can help companies manage such 'reputational' risks.

- **Growing importance of ethical investments** – in both Europe and the USA there is an increasing interest amongst institutional and retail investors in owning equity in "ethical investments". These are businesses that meet pre-determined standards of economic, social, and environmental practice. On the basis of the Global Reporting Initiative standards, such practices include the presence of workforce diversity policies[13].

[11] See for example OECD *'Technology, Productivity and Job Creation'* (1998)
[12] Bassi L, Lev B. et al *'Measuring Corporate Investments in Human Capital'* (in eds. Blair M. and Kochan T. *'The New Relationship – Human Capital in the American Corporation'*)
[13] Global Reporting Initiative *'Sustainability Reporting Guidelines on Economic, Environmental, and Social Performance'* (2000)

Pressures from capital markets are principally a problem for larger companies: few SMEs are funded through public capital markets. But investors in SMEs can play a major role in influencing business strategy and investments in intangibles. Owners of private companies are affected by changes in social attitudes and are often aware of new ideas about drivers of business performance. Moreover, because of the nature of the link between owners and managers in many smaller companies, the private views of investors can also play a part in determining the approach taken by an SME to recruiting people from disadvantaged groups.

3.2.2.4. Changes in the Role of Government

Throughout the last century governments have influenced business behaviour through legislation and taxation. In recent years, new mechanisms have been added to these traditional tools.

Major changes include:

- **Emerging role of regulatory agencies** – in many OECD countries, "network industries" (such as electricity generation and distribution) have been liberalised. But at the same time new regulatory agencies have been established to ensure effective competition and to protect consumers. In this new environment, market participants often need to convince regulators of their 'suitability' and reliability. Investments in corporate reputation are one mechanism for achieving this.

- **Increasing scale of privatisation and out-sourcing of government activities** – throughout the OECD area, governments have taken steps to privatise investments in industries and to use the private sector to provide government-funded services. Participation in these markets depends on companies being able to meet the formal and informal decision-making criteria of officials. Alongside traditional criteria of price and quality, decision-makers often consider corporate reputation, especially in sectors surrounded by social concerns.

New forms of anti-discrimination legislation have accompanied these changes. These have increased the ease and potential scale of litigation if companies fail to comply. More importantly, new legislation provides companies with an indirect 'signal' of the concerns of citizens. This helps businesses to focus investments in corporate reputation in ways likely to have the greatest impact on policy-makers.

Action by governments affects companies of all sizes. SMEs and larger companies take advantage of changes in how government services are delivered. And, anti-discrimination legislation applies equally to all types of company. It also has the effect of 'signalling' to SMEs that there have been changes in the expectations of citizens and that corporate behaviour should take account of them. This is an important and frequently overlooked role of social legislation. It is of particular importance for SMEs for, as we shall see in later sections, the behaviour of smaller firms is more constrained than that of larger enterprises by local attitudes and values.

In contrast, issues of corporate reputation tend to be limited to larger companies. This is a driver of long-term business value: a concept normally linked to the valuation of businesses on public capital markets. It would be misleading, however, to suggest that SMEs are unconcerned about issues of corporate reputation. They have a different focus to that of larger companies. In many cases, their focus is more localised and linked to local or regional governments.

3.2.2.5. Changes in Wider Values in Society

Finally, there have been major changes in the values and attitudes held by citizens. Over time, these have a significant effect on legislation, regulatory activity, and the way in which government institutions operate. Values and attitudes define, for example, the qualifying requirements that companies must satisfy in order to maintain their "licence to operate".

In all OECD countries governments set the rules for the operation of product markets. Over time these rules change, in response to shifts in technologies, business opportunities and public values. The structure and content of the rules that govern market behaviour determine how businesses must behave and which types of business will be allowed to participate in product markets. It is this rules-based framework that defines the licence to operate for all companies.

Relevant changes in social values include:

- **Greater support for fairness and equal opportunity in the workplace** – this has driven new, anti-discrimination legislation, and will influence public officials in their assessment of the suitability of companies in markets where government either funds services or regulates participants intensively.

- **Increasing interest in overall business conduct** – increasing numbers of citizens are concerned to understand how the goods and services sold by companies are produced. One result has been the emergence of new market segments. Another consequence is the growing pressure for greater transparency and reporting of corporate environmental, social, and economic activity.

4. BENEFITS AND COSTS OF DIVERSITY POLICIES

4.1. BENEFITS OF DIVERSITY POLICIES

4.1.1. Types of Benefits

Our research identifies two principal types of economic benefits that companies seek from investments in workforce diversity policies. Specifically, such investments create economic benefits for companies by:

- **Strengthening long-term "value-drivers"** i.e. the tangible and intangible assets that allow companies to be competitive, to generate stable cash flows, and to satisfy their shareholders. These include building a differentiated reputation with key stakeholders and customers, and improving the quality of human capital within the company.

  These intangible assets are non-physical sources of value (claims to future benefits).

  Leading companies accept that there are no simple "cause and effect" relationships between strengthening these factors, improving competitiveness, and creating value. However, they believe that, taken together, these factors have a powerful indirect impact on their competitiveness over the long-term.

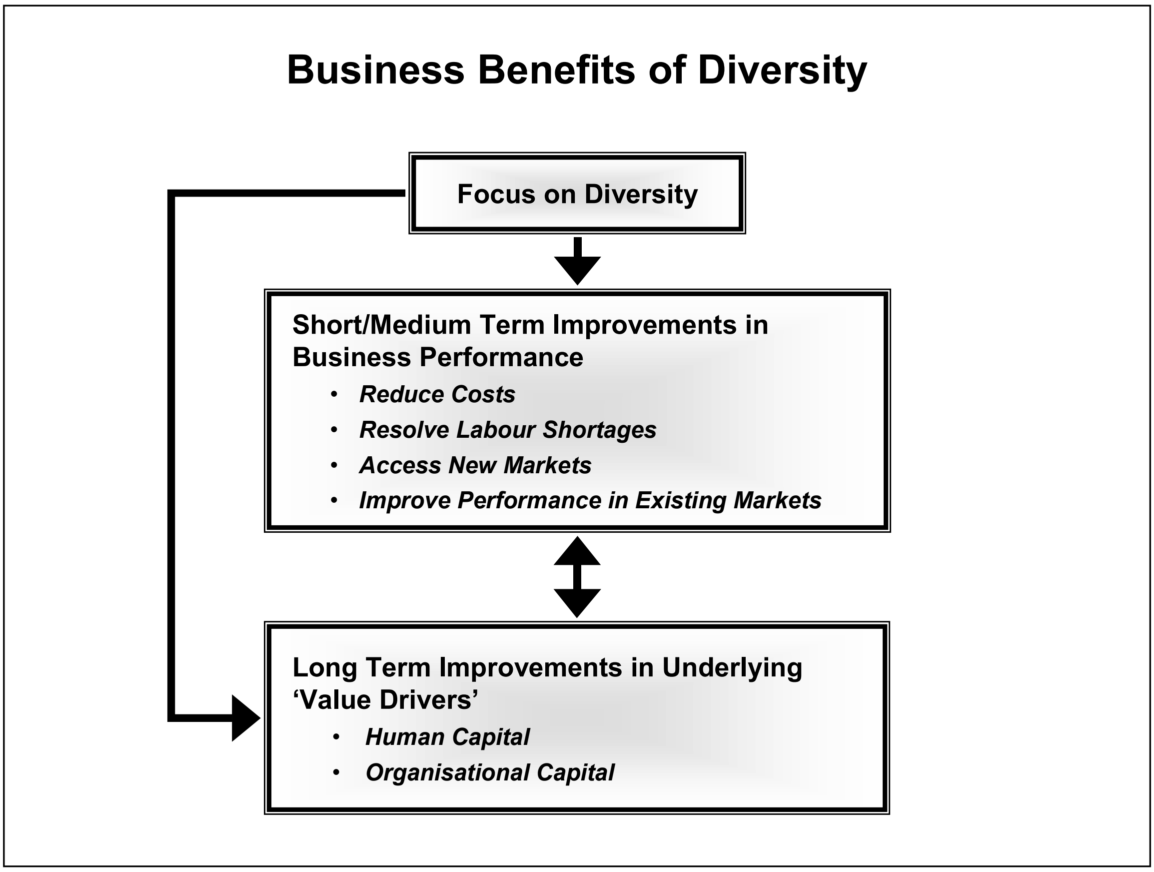
  But important dimensions of these strategic benefits are difficult to measure and the direct link to investment in diversity policies is difficult to establish. Yet, on a more positive note, these are benefits that are relevant to large numbers of companies, hence they have widespread relevance.

- **Generating short and medium-term opportunities to improve cash flows** e.g. by reducing costs, resolving labour shortages, opening up new markets, and improving performance in existing markets. These are also known as "return-on-investment" (ROI) benefits.

  Because of their nature, many of these benefits are more straightforward to measure, and a link to investments in diversity can, in certain circumstances, be identified. However, most of these benefits are "context-specific" i.e. they are particular to the strategy and market position of specific companies. This limits the relevance of the specific benefit to companies in similar situations.

The two principal types of economic benefits are illustrated diagrammatically below (Exhibit 3).

Exhibit 3



Source: CSES

In overall terms, no single company is likely to gain all of these benefits. There is no "one size fits all" diversity strategy. Despite the importance of intangible assets to large numbers of companies, factors such as size, strategy, sector, and market position will determine the diversity strategy pursued by each company. As strategies will differ, so will the projected benefits.

Another important issue is the difficulty of linking together business benefits and investments in diversity. Even for short and medium-term improvements in cash flows, it is likely that diversity policies are only one of a number of factors that have contributed to improvements in operating performance. Higher productivity as a result of better staff motivation may, for example, be the result of changes in work organisation or new technologies as well as the establishment of workforce diversity policies.

These problems are made worse if attempts are made to link together investments in diversity and changes in 'top-level' performance – profitability, cash generation, business value, return on capital etc. In a manufacturing business, for example, shifts in annual profitability may be heavily influenced by factors such as raw material prices, capacity utilisation and levels of customer demand. The impact of investments in diversity would be limited in scale and difficult to establish in this situation.

But these problems in linking together investments in intangibles (such as diversity) with business performance should not provide the basis for undermining the importance of such investments. They provide an opportunity to improve the operational performance and strategic assets of a company. Over the medium and long-term these become more important as drivers of performance.

4.1.2. Long-term "Value Drivers"

Investments in diversity policies contribute to a strategy of long-term value creation by creating and strengthening human and organisational capital. Along with knowledge capital, these are the principal intangible assets used by companies in a wide range of sectors to establish competitive advantage and to create value[14].

4.1.2.1. Human Capital

Theories of human capital emphasise the way in which employee competencies create value for an organisation in the same way that ownership of physical capital contributes to the performance of a firm[15].

There are a large number of definitions. Most emphasise knowledge, competence and commitment of the workforce.

Workforce diversity policies can create an environment in which the mix of people within a company is changed, the abilities of all employees are fully exploited, and high quality people are recruited, retained, and developed, irrespective of, for example, gender, age or ethnic origin. These changes in the quality of human capital create a number of benefits for companies. Specifically:

- **Access to 'talent'** – leading companies recognise that their long-term capacity to respond to change, to make high quality strategic decisions, to implement strategies, and to meet the needs of customers depends on attracting and retaining the highest possible quality of employees. This "war for talent" can take place at all levels of a company or be confined to specific technical or managerial functions. Diversity policies are one of the most important mechanisms used by companies to gain greater access to 'talent'.

  Companies of all sizes can invest in diversity policies to gain access to 'talent' on a long-term basis.

- **Global management capacity** – a specific long-term problem facing many larger companies is the need to manage global business networks. Diversity policies can help achieve this by ensuring access to a wider pool of talent, and by making companies attractive to people from different cultural backgrounds.

- **Innovation and creativity** – a number of companies pursue diversity policies because they believe that greater heterogeneity within key workgroups and amongst important managerial groups will lead to greater creativity and, in turn, more innovation[16]. In this case, investments in human capital are being

[14] Lev B. *'Intangibles – Management, Measurement and Reporting'* (2001)
[15] Chartered Institute of Personnel Development *'Evaluating Human Capital'* (2002)
[16] See for example, Hoffman L. and Maier N. *'Quality and acceptance of problem solutions by members of homogeneous and heterogeneous groups'* (Journal of Abnormal and Social Psychology, Vol. 62 1961)

used to strengthen the capacity of companies to build knowledge capital: another important types of intangible asset.

All of these benefits are, in themselves, difficult to quantify, although there are some company-specific measures of the ‘quality’ of human capital. These measures tend to rely on objective criteria, such as academic or vocational qualifications, and the extent of ‘fit’ with company and job-specific requirements. But, simple causal links between these benefits and investments in diversity policies are difficult to establish in any simple or credible way.

4.1.2.2. Organisational Capital

Investments in workforce diversity can also enhance organisational capital. This is defined as the *capabilities of an organisation*, including organisational design, market and corporate reputation, codified knowledge from all sources, and shared culture, values, and norms.

Our research suggests that some companies invest in workforce diversity policies because it can help them build up three important forms of organisational capital:

- **Reputation with governments and other stakeholders** – for many companies, governments and societies are critical stakeholders. Although, this is particularly the case in heavily regulated industries, governments have an important impact on companies in most industries. Through regulatory decisions and other policies, governments influence the ability of companies to operate effectively. Leading companies recognise that they must develop sophisticated relationships with governments to ensure that their views are respected. This includes building a reputation with policy-makers and opinion-formers that demonstrates that companies are sensitive to the principal concerns that governments and citizens have about the activities of the corporate sector.

  Through these initiatives, companies strengthen their metaphorical “licence to operate”. There is evidence that increasingly this will be influenced by the extent to which companies adopt employment policies based on equitable treatment of workers.

  Reputation with opinion-formers also influences the attractiveness of a company to prospective employees. It plays an important role in helping companies become “an employer of choice”, and hence helps them win the “war for talent”.

- **Marketing image** – investments in workforce diversity policies can help companies gain access to long-term, strategic markets where buyers are influenced by social concerns. In such situations, the social and environmental image of a company is a critical qualifying criterion for market participation. Governments, for example, are reluctant to employ private sector contractors with a poor reputation in employment practices.

- **Cultural values within the company** – some companies that employ workforce diversity policies describe themselves as "values-drive". These companies believe that their internal culture is a unique source of competitive advantage and as such differentiates them from their competitors. They also believe that it is fundamental to their ability to compete in a future environment that will change rapidly and be dominated by knowledge[17].

  These companies believe that a strong and relevant set of cultural values will encourage the creativity of their staff, attract talented recruits, help managers to deal with change, ensure responsible behaviour towards external stakeholders, and sustain a focus on the long-term goals of the business.

  Investment in workforce diversity policies enables such companies to strengthen these values in relevant and complementary ways.

Most of these benefits can be measured using some form of quantitative technique. Reputation and marketing image can, for example, be measured using survey tools or media impact measures. The attributable impact of diversity policies on these outcomes is, unfortunately, more difficult to establish. Investments in diversity are only one of a numbers of factors that influences reputation, marketing image, and cultural values.

4.1.3. Short and Medium-term Opportunities to Improve Cash Flows ("Return-on-Investment" Benefits)

4.1.3.1. Cost Reductions[18]

Our research suggests that investments in workforce diversity can reduce operating costs in a number of ways. These include:

- **Avoidance of litigation and legal costs** – improvements in the working environment and organisational culture that result from workforce diversity policies can, over time, reduce the incidence of direct and indirect discrimination.

- **Reduced labour turnover** – high labour turnover creates additional recruitment and training costs for companies. There is substantial evidence of the links between workplace culture and retention rates. The cultural changes needed to achieve greater workforce diversity can ensure higher worker satisfaction and hence lower labour turnover.

- **Lower absenteeism** – unplanned absenteeism reduces workplace productivity and generates additional employment costs. Improvements in the working environment and culture tend to reduce absenteeism.

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[17] See for example. The European Policy Centre *'Job Creation through the Third Sector: The Role of the Corporate Sector'* (1999)

[18] These benefits are described in a number of sources: see, for example, Gandz J. *'A Business Case for Diversity'* Paths to Equal Opportunity' (2002, a report for the Canadian Government); Hubbard E. *'Diversity and the Bottom Line: Facts, Figures and Financials'* (Diversity Factor, Vol. 7, 1999); and, The Society of Management Accountants of Canada *'Measuring the Impact of Diversity'* (1996)

All of these benefits can be measured quantitatively and a link to investments in diversity policies may be established. But the link still remains a partial one. Improvements in labour turnover and absenteeism, for example, will also be the result of changes in the way work is organised and the type of technology used in the production process.

These benefits are of particular importance for SMEs.

4.1.3.2. Access to Labour

Investments in diversity policies can help companies overcome labour shortages[19]. This is particularly the case for SMEs and for larger companies in labour-intensive service sectors, such as retailing, hotels, restaurants, and postal delivery.

These benefits can be measured quantitatively and, in the case of improved access to new labour pools, the link with investments in diversity policies can be clearly seen.

4.1.3.3. Access to New Markets

Evidence from a range of different sectors suggests that workforce diversity policies can help companies gain access to the purchasing power of diverse groups[20]. In most cases, this involves market segmentation and companies tailoring existing products or services to meet the needs of these groups of customers rather than continuing to provide them with an undifferentiated offer.

Diversity policies help companies to achieve this because they bring into the organisation employees who are more sensitive to the needs of these new groups of customers than traditional employees. Greater sensitivity to customer needs helps companies design, market, and sell more relevant products and services to diverse social groups.

Although these benefits can be quantified, the links to investments in diversity are more difficult to establish because a wide range of factors affect the take-up of new products and services. The links are most apparent in sectors where customer needs are satisfied through networks of retail outlets. In these sectors, companies have carried out market trials based on pairs of similar outlets to compare the impact of changes in the customer offer. Changes that are the direct result of workforce diversity policies (such as the use of more mature sales staff) can be isolated.

For example, a leading variety retailer in the UK developed a programme to increase its focus on shoppers from a particular ethnic group. The programme included changes in merchandise range, opening hours, communication mechanisms, and in-store customer support. To begin with the programme was piloted in a single store. Geo-demographic trading area analyses were used to identify other stores with similar customer profiles, thus enabling the results of the pilot store to be compared with other outlets and the impact of the new marketing programme to be isolated. This approach enabled the owners of the store network to develop evidence to support the expansion of the programme.

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[19] Friedman D. *'Help Wanted – Segment Labour Markets to Overcome Shortages'* (McKinsey Quarterly, Spring 1998)
[20] See for example, CSR Europe *'Business & Diversity – Helping businesses score higher in managing diversity'* (2002)

4.1.3.4. Performance in Existing Markets[21]

There is evidence that companies can achieve improvements in their performance in existing markets as a result of workforce diversity policies. These benefits include:

- **Higher productivity** – a working culture based on equitable treatment and respect for difference, helps to improve motivation, increase worker availability, and stimulate the application of discretionary effort. These changes tend to improve operating efficiency with consequent benefits for unit costs, quality, and production flexibility.

- **Greater customer satisfaction (and loyalty)** – in sectors where there is a high degree of direct contact with the end customer, improvements in service levels have a significant positive impact on customer satisfaction. This generates greater customer loyalty and improved sales revenues. Worker satisfaction and motivation are important drivers of service levels. Investments in workforce diversity help to unlock the potential of existing employees and to bring in new workers, many of which are highly motivated.

  This approach is sometimes described as a "virtuous cycle". In most service sectors, important customer needs are satisfied through direct interaction with the employees of the supplier. If this human interaction is unsatisfactory, customers are less likely to buy from that supplier again. On the other hand, the more satisfied a customer is with the service provided by a supplier, the greater the likelihood that loyalty will develop. Loyalty is important for business because it reduces the cost of attracting new customers.

Our research suggests that companies of all sizes can achieve these benefits from investments in workforce diversity policies. Moreover, the scale of the benefits can be identified quantitatively. But the links to workforce diversity policies are difficult to establish. These are operating performance outcomes, and as such they are the result of a series of investments including methods of organising work, new technologies, and product range.

4.2. COSTS OF DIVERSITY POLICIES

Sustainable workforce diversity and equitable treatment in the workplace for all employees are *outcomes* of a change in the internal culture of a company. Evidence from the experience of a wide range of companies that have implemented "culture change" programmes highlights the time and cost needed to achieve change[22]. Diversity (and the process of achieving it) is, in other words, not "cost free".

As well as the costs of legal compliance (explained in section 4.2.1.), companies face three types of additional cost when they invest in workforce diversity policies. These are:

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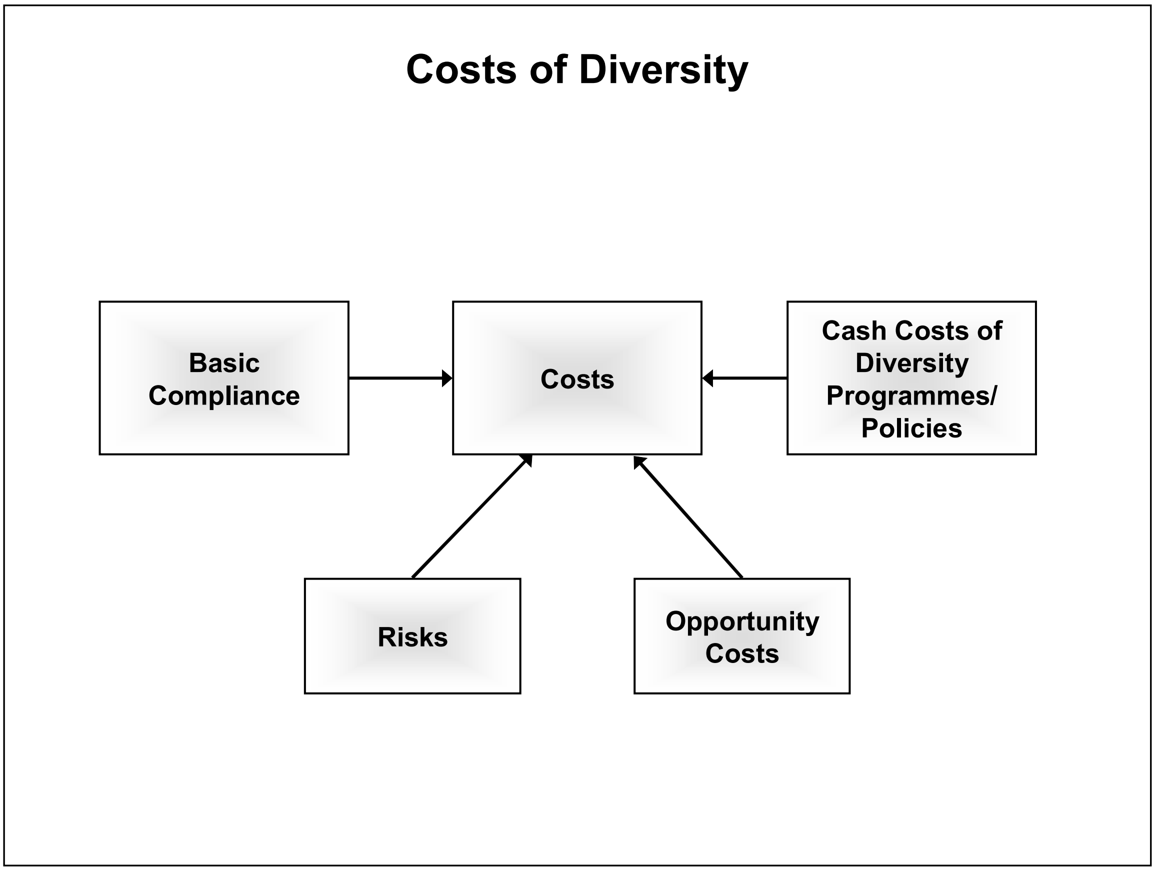
[21] See for example, Hayes V. *'Beyond Employment Equity – the business case for diversity'* (Ivey Business Journal, September 1999), and Liberman V. and Harrington L. *'Does Diversity pay off'* (Across the Board, June 2002)

[22] See for example, Business Decisions Limited *'New Forms of Work Organisation: The Obstacles to Wider Diffusion'* (2002, a report for the European Commission)

- Cash costs;
- Opportunity costs; and,
- Increased business risks

These are illustrated diagrammatically below (Exhibit 4)

Exhibit 4



Source: CSES

4.2.1. Costs of Legal Compliance

Our interviews with companies and business organisations identified a number of potential costs of compliance with new, national workplace anti-discrimination legislation based on the recent EU directives. Potential costs include:

- Creation and maintenance of new HR record-keeping systems;
- Training of HR staff and employees involved in recruitment and employee development; and,
- Establishment and communication of new HR policies, covering areas such as harassment, recruitment, and training.

Along with these new direct costs, companies highlighted a potential increase in business risk, if the availability of new legal rights (shift of the burden of proof and more extensive compensation) stimulated an increase in litigation that proved, ultimately, not to be justified.

However, the extent of these costs for a specific business will be influenced by the scale and nature of existing, internal human resource processes, and existing legislative requirements. Existing legislation to prevent workplace discrimination on the grounds of gender, for example, will have ensured that many of the potential costs are already being met. These are legal requirements in all Member States, and cover harassment as well as discrimination in employment. Nevertheless, costs will be highest for companies with informal or inadequate human resource (HR) policies and processes and for those that are based in countries with limited, existing workplace anti-discrimination legislation in areas other than gender.

4.2.2. Cash Costs of Diversity

Companies face a range of different cash costs when they invest in workforce diversity policies. Though some are "one-off" and short-term in nature, most are long-term, recurring expenses. Such costs are incurred throughout the period of implementation of the new approach, and are only reduced when there is clear evidence that the internal culture of the organisation has changed.

The main cash costs associated with workforce diversity policies are:

- **Specialist staff** – during the implementation of a workforce diversity policy many companies establish specialist units to oversee and support the process. These groups can be located in the human resource (HR) function or within business units. Expenditure on specialist staff is a recurring cost. They are needed throughout the implementation period;

- **Education and training** – a recurring feature of most diversity policies is the need for training and education. Attitudes of existing managers and employees need to be shaped. Existing and new employees need new skills. And, all employees need to be informed about new organisational goals, strategies, and policies. Expenditure on training tends to be "front-loaded" i.e. most is incurred towards the beginning of the investment period;

- **Facilities and support** – depending on the objectives of the diversity programme, additional facilities and support may have to be provided. If the aim is to increase the employment of people with disabilities, for example, this may require investments in physical facilities and possibly provision of support;

- **Working conditions and benefits** – to attract and retain employees from diverse backgrounds, many companies need to reform existing employment contracts, benefits packages, and working conditions. There are significant additional costs associated with these changes, and the costs are incurred on a continuous basis. An expansion in the number of gay and lesbian staff will, for example, require changes in pension and other similar benefits. Likewise improved medical benefits and different holiday arrangements may be needed to recruit and retain older staff;

- **Communication** – throughout the period of programme implementation there is a continuing need for two-way communication with all employees. Communication sustains morale, builds commitment and awareness, and reinforces progress. Costs associated with communication include information technology (IT), production of materials, use of facilities, and additional staff costs;

- **Employment policies** – at the beginning of the implementation process, most companies establish new employment policies. These establish new, shared goals and define acceptable (and expected) behaviours in areas that have a critical impact on the working environment. New policies can also cover employee development and training. The costs associated with the development and implementation of new policies are predominantly incurred at the beginning of the period of implementation. Costs include management and employee time to draw up new policies, and reproduction and distribution expenses.

- **Monitoring and reporting processes** – once the process of implementation of workforce diversity policies has begun, most companies set up some form of monitoring and reporting process. This measures progress against objectives, and provides an important 'feedback' mechanism to help senior managers adjust the implementation plan, if necessary. Setting-up and maintaining the monitoring and reporting process requires additional costs, such as IT, staff, and facilities. Although set-up costs are mainly incurred at the beginning, the costs of operating the system recur throughout the period of implementation.

4.2.3. Opportunity Costs of Diversity

Opportunity costs represent the loss of benefits because a scarce resource cannot be used in other productive activities. They are the cost of resources consumed. Although such costs are non-cash, they are still of considerable importance, especially in small and medium-sized enterprises (SMEs). It is good practice in all "investment decisions" to place a value on opportunity costs and to take them into account when considering the overall balance of costs and benefits offered by an investment opportunity[23].

Our research with companies suggests that investment in workforce diversity can create a number of opportunity costs. These include:

- **Diversion of top management time** – effective implementation of a sustainable workforce diversity programme requires considerable leadership from top managers. Commitment and time from senior managers is needed to champion change, to lead an organisation in a new direction, to overcome obstacles, and to maintain commitment. High quality senior managers are scarce and, hence, their time is valuable. This is a particular problem in SMEs, where the number of managers with appropriate expertise is scarcer than in large-scale enterprises;

[23] See for example Brealey R. and Myers C. *'The Principles of Corporate Finance'* (1988)

- **Diversion of functional management time** – as with top managers, investment in workforce diversity requires considerable support from managers at all levels and in all functions. Involvement in diversity programmes reduces the time available for other tasks;

- **Productivity shortfalls** – in some businesses, especially smaller ones, recruitment of new employees can have negative, short-term impacts on productivity. New workers may have less knowledge and less experience than existing employees, and often require additional training in order to achieve expected levels of productivity. They may also need support from existing experienced workers, leading to further reductions in productivity. But these costs should, in the longer-term be recovered through greater commitment and performance. Large companies have the resources to finance these costs and to accept short-term reductions in efficiency. However, these problems are particularly acute in SMEs, because they lack the financial resources to employ additional staff to provide assistance and to sustain temporary reductions in operational performance.

4.2.4. Business Risks of Diversity

Extensive evidence shows that many programmes designed to restructure organisations or to change corporate cultures take longer than planned to implement or fail completely[24]. This "execution risk" is widely understood amongst companies. Sustainable diversity policies are an outcome of a successful change in corporate culture. Investments in workforce diversity policies can, therefore, create additional business risks.

Programmes to reform corporate cultures fail, or have a more limited impact than planned, because of complex obstacles to change within organisations. Companies may lack the resources or expertise to manage programmes of cultural change. Traditional power and authority structures may be threatened, leading to opposition to change from key groups such as middle managers. Important stakeholders within an organisation may be unconvinced of the need for change. These, and other factors, can make it very difficult for organisations to change established corporate values and attitudes.

4.3. FINDINGS FROM SURVEY OF COMPANIES

As part of the fieldwork phase, an exploratory, 'pilot' survey of companies was undertaken using a structured, pre-coded questionnaire and telephone interviews. Senior managers responsible for human resource or personnel policy were interviewed in 200 companies in Austria, France, Sweden and the UK.

Selected on a random basis, the sample was structured using quotas to cover an agreed spread of company sizes and different sectors. The survey focused on companies with more than 50 employees.

[24] See for example Milgrom P. and Roberts J. *'Complementarities and fit – strategy, structure, and organisational change in manufacturing'* (Journal of Accounting and Economics, No. 19, 1995)

The survey's principal objective is to provide an initial insight into the perceptions of companies as to the principal obstacles to investing in workforce diversity policies. As well as this, information was gathered about the views of companies in other related areas, including the costs and benefits of diversity policies and the business case for investing in diversity.

Using evidence from the survey and the typology of companies identified in the "Equity Continuum" we divided respondents into two groups:

- **"Compliance Only"**: These organisations aim to comply with legal obligations to ensure equal treatment for all employees.

- **"Active Diversity Policies"**: These organisations are of two types: "Some Initiatives" (comply with legal obligations but also some individual initiatives to support diverse groups); and, "Integrated Approach" (strong business case for diversity combined with extensive investment in diversity policies)

Data from the survey should be treated as being 'indicative' only. This is a pilot survey and the sample size is not large. Moreover, it was collected via a telephone interview with a senior manager. This means that responses are based on the opinions of these individuals and have not been validated through visits, observation or the opinions of employees. In some situations, this may lead to a degree of "over-claiming" by some organisations.

Whilst care should be taken with the interpretation of the data, it nevertheless provides some useful indicative findings.

More detail about the survey is provided in Appendix B and a copy of the questionnaire is available in Appendix G.

4.3.1. Business Perceptions of Benefits

Evidence from our interviews and literature review suggests that companies seek two types of economic benefits from investments in workforce diversity policies: short and medium term opportunities to improve cash flows; and, opportunities to strengthen long-term value drivers.

This is confirmed by information from our survey. This shows that companies gain a mix of both types of benefit, but that the strengthening of long term value drivers is the most important (Exhibit 5). This is despite the fact that these benefits are difficult to measure and the direct link between these factors and improved competitiveness and business value is difficult to establish.

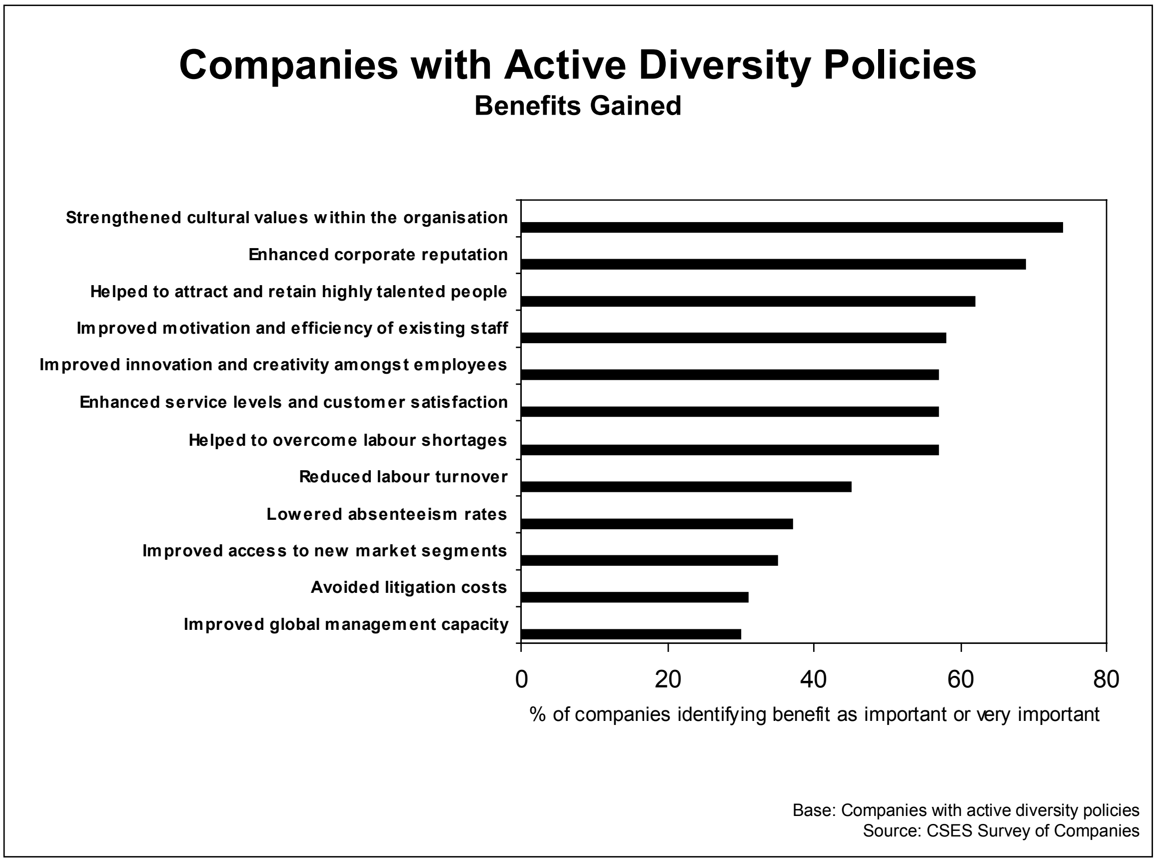
Companies in our survey say that the most important benefits arising from active diversity policies arise from the **strengthening of organisational and human capital**. Specifically:

- *Strengthening cultural values within the organisation (74% of respondents);*
- *Enhancing corporate reputation (69%);*
- *Helping to attract and retain highly talented people (62%); and,*
- *Improving innovation and creativity amongst employees (57%).*

Companies also identify a number of **short and medium term opportunities to improve cash flows** ("return-on-investment" benefits), particularly:

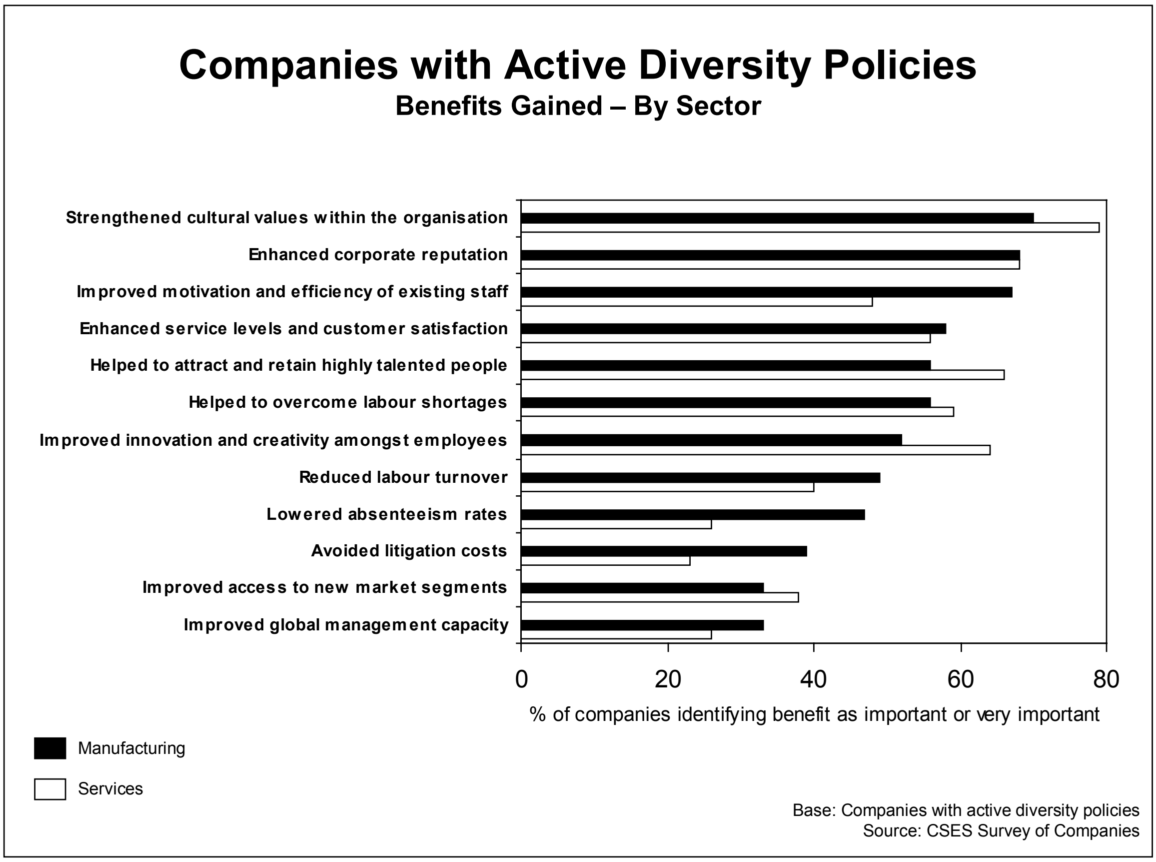
- *Higher productivity arising from improved motivation and efficiency of existing staff (58%)*
- *Enhanced service levels and customer satisfaction (57%)*
- *Helping to overcome labour shortages (57%)*

Exhibit 5



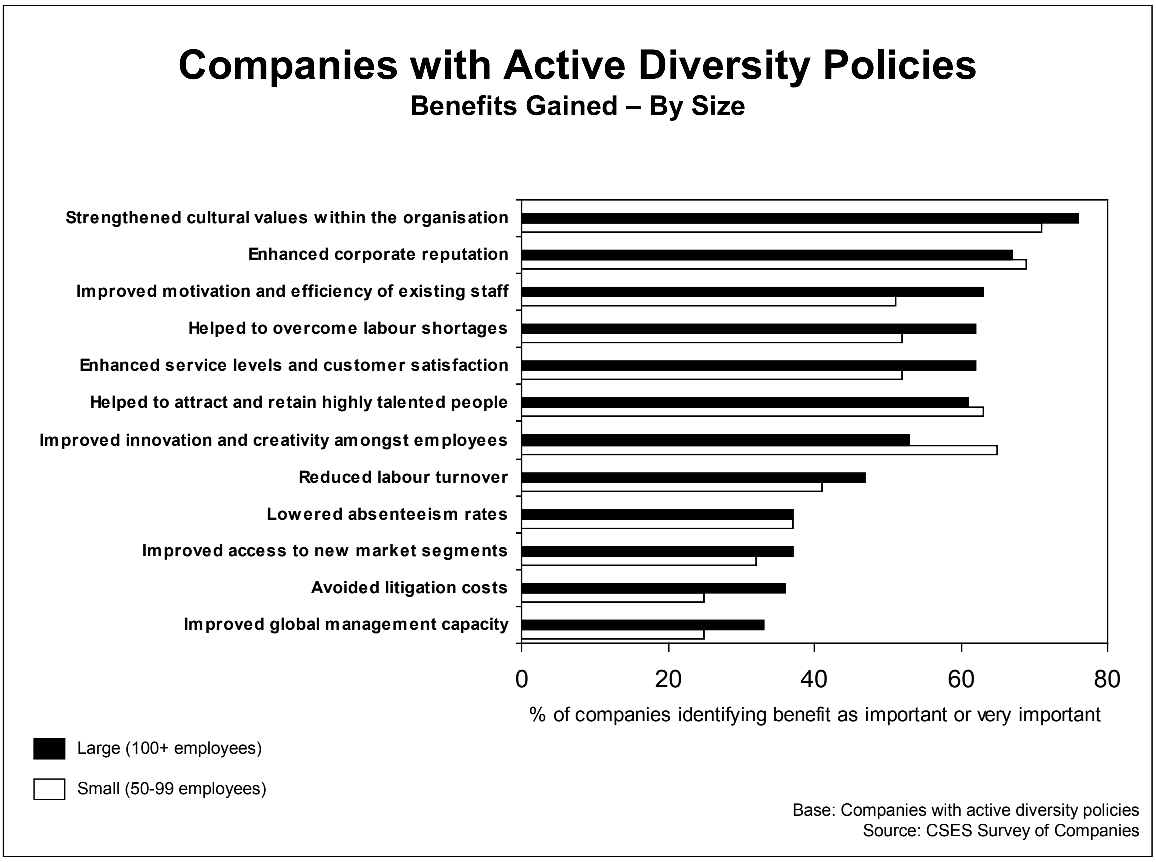
There are some differences between companies of different types. Manufacturing companies, for example, perceive greater benefits than service sector companies in terms of improved motivation and efficiency of staff, lower absenteeism rates and avoiding litigation costs. All of these are short and medium term opportunities to improve cash flow. Service companies, on the other hand, perceive greater benefits in terms of organisational and human capital, particularly improved innovation and creativity amongst employees and helping to attract and retain highly talented people (Exhibit 6).

Exhibit 6



There are also differences between companies of different sizes (Exhibit 7). Larger companies, for example, perceive greater benefits than smaller companies in terms of improved motivation and efficiency of staff, enhanced service levels and customer satisfaction and helping to overcome labour shortages. Again these are short and medium term opportunities to improve cash flow. Smaller companies, on the other hand, place particular emphasis on improved innovation and creativity amongst employees.

Exhibit 7

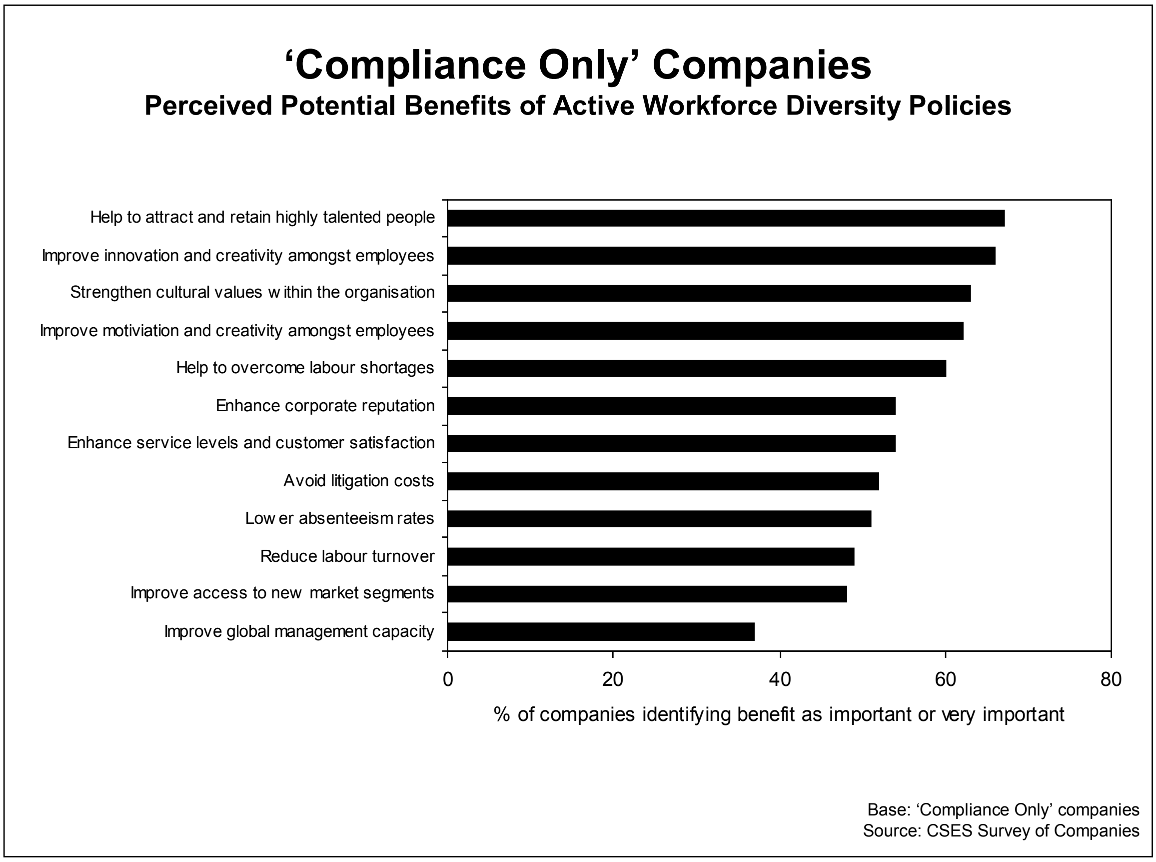


Some differences are also apparent between countries, although small sample sizes mean that care must be taken in the interpretation of these findings.

Our survey also explored the perceptions of companies who have not (yet) implemented active diversity policies about the *potential* benefits to be gained.

Interestingly, these companies identified a broadly similar profile of benefits as those who already have the experience of implementing diversity policies. In particular, they highlighted long term organisational and human capital benefits such as the ability to attract and retain highly talented people, improved innovation and creativity amongst employees, and strengthening of cultural values (Exhibit 8).

Exhibit 8



4.3.2. Business Perceptions of Costs

Evidence from our survey of companies confirms our findings from our interview programme and literature search. Companies incur a mix of cash costs, legal costs and opportunity costs.

Companies who have already introduced active diversity policies identify the following **cash costs** as the most significant:

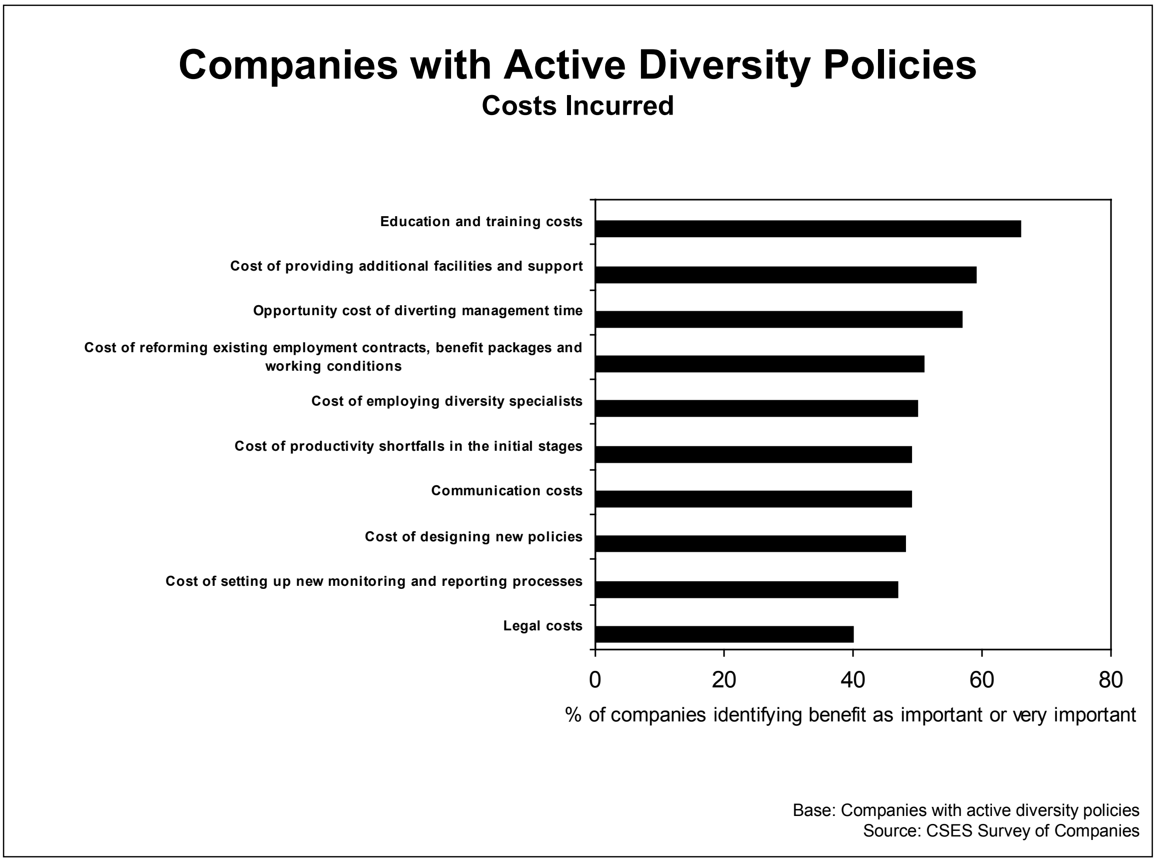
- *Education and training costs (66% of respondents)*
- *Cost of providing additional facilities and support (59%)*

But companies also identify significant **opportunity costs**, particularly the opportunity costs of:

- *Diverting management time (57%);*
- *Productivity shortfalls in the initial stages (50%)*

This is illustrated in Exhibit 9 below.

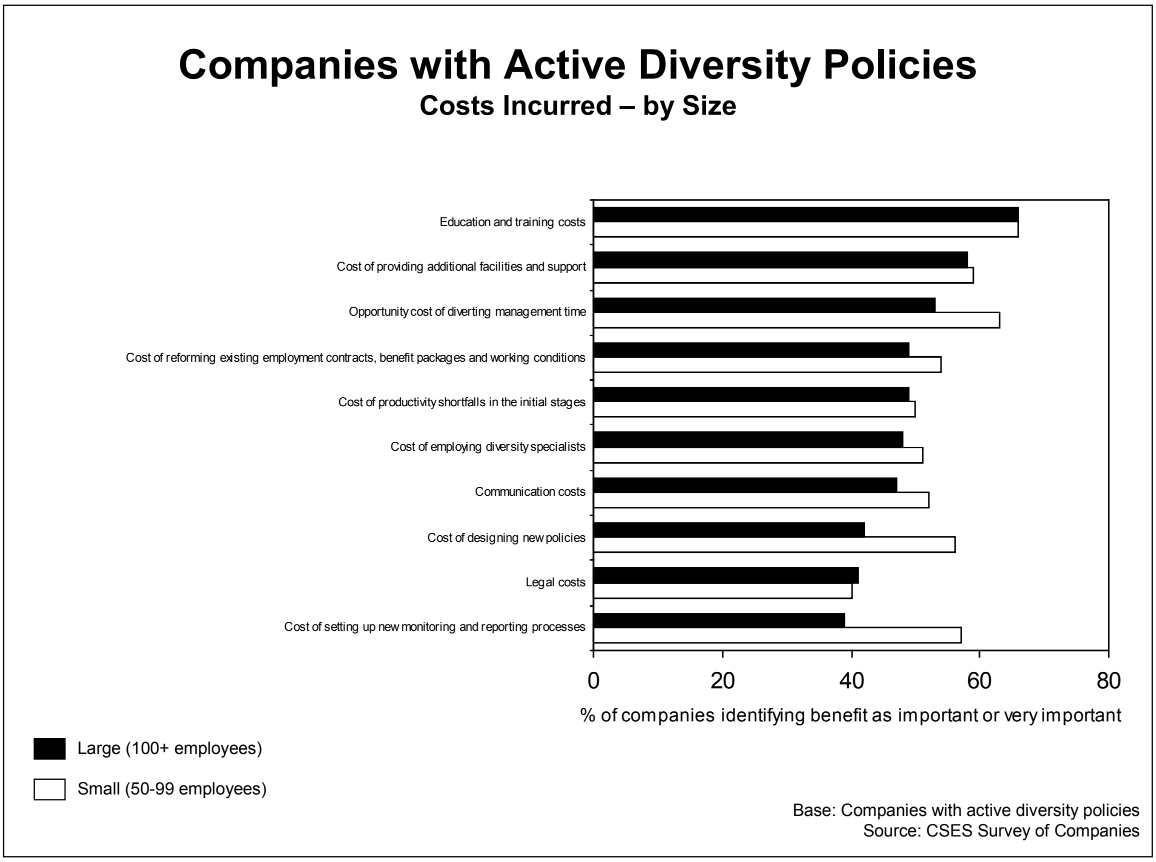
Exhibit 9



In overall terms, manufacturing companies and service companies have similar experiences regarding the costs incurred during implementation of diversity policies. There are only small differences of emphasis. Manufacturing companies believe that education and training costs are more significant than service sector companies. Service companies, on the other hand, believe that the cost of setting up new monitoring and reporting processes are more significant.

There are also some differences of emphasis amongst companies of different sizes (Exhibit 10). Smaller companies (with 50-99 employees) believe that the cost of designing new policies and of setting up new monitoring and reporting processes are more significant than larger companies. Smaller companies also identify the opportunity cost of diverting management time as more significant than larger companies, probably because management resources are scarcer in smaller organisations.

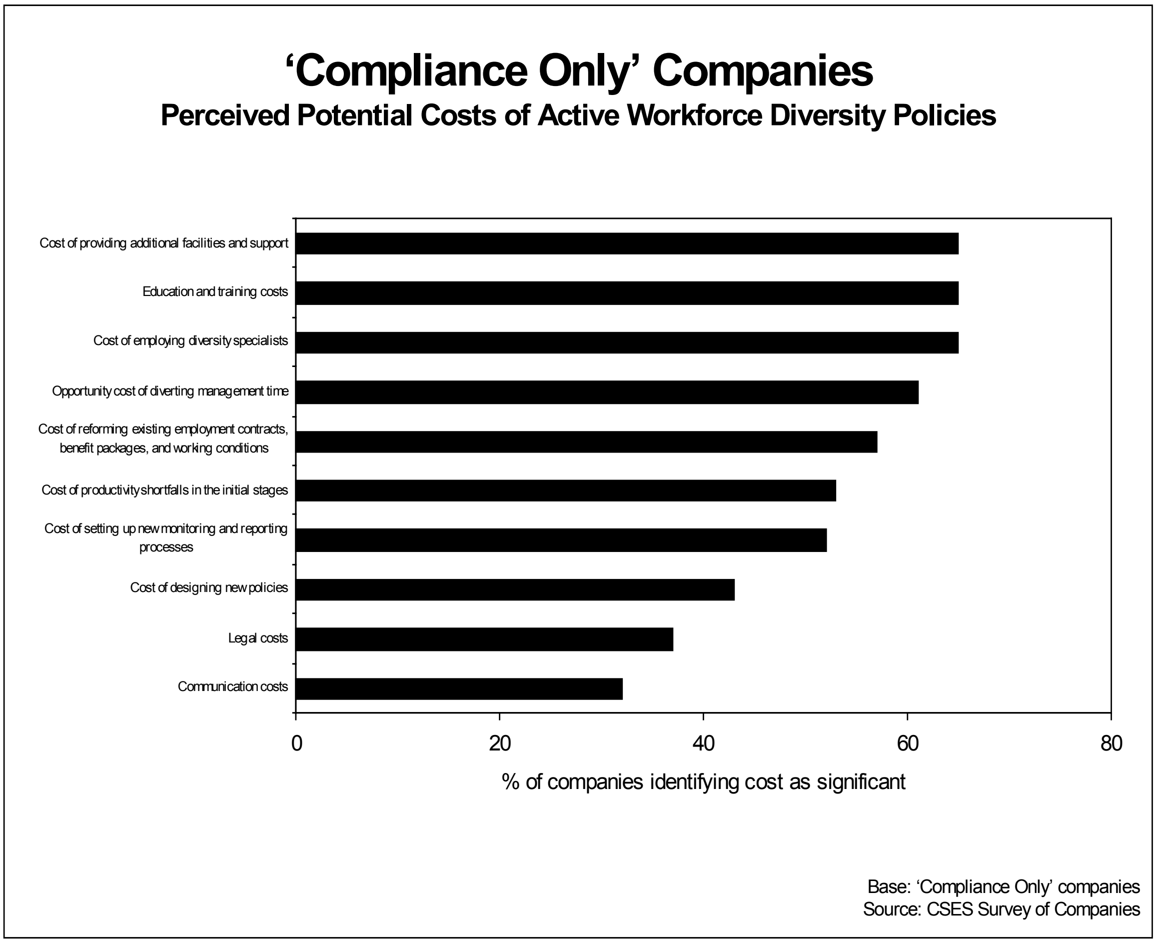
Exhibit 10



Our survey also explored the perceptions of companies who have not (yet) implemented active diversity policies about the *potential* costs involved.

Interestingly, these companies identified a very similar profile of significant costs to those who already have the experience of implementing diversity policies. They highlighted education and training costs and the costs of providing additional facilities and support as the most significant cash costs. They also identified the opportunity cost of diverting management time as a significant cost (Exhibit 11)

Exhibit 11



5. MEASUREMENT OF THE COSTS AND BENEFITS OF DIVERSITY POLICIES

5.1. Why measure the costs and benefits of workforce diversity policies?

The costs and benefits of investments in workforce diversity policies are measured by companies for a number of reasons:

- Firstly, there is a tendency in all organisations for measurement to drive action by managers and workers – **"what gets measured gets done"**. This happens because of the frequent link between pay and other benefits and performance against objectives. When managers introduce new diversity policies, ensuring they are measured is an important mechanism for ensuring they are implemented. Evidence from our interviews with managers supports this. It also suggests that in some companies things that are not measured are not seen to be important. There are, it seems, some corporate cultures in which measurement is used to signal strategic and financial priorities to employees.

- The second reason is linked to the nature of the decision to introduce workforce diversity policies. As we have seen, diversity policies are a form of cultural change programme within companies. Such programmes require the commitment of extensive scarce resources (management time, expertise and cash) over an extended period of time, create additional business risk, and deliver benefits in the future. Implementation of a diversity programme is, therefore, a form of **"investment decision"**, and as such is competing for scarce resources with other investment opportunities. Identification of costs and benefits, therefore, forms a critical part of the initial decision-making process. Measurement of the extent to which these have been realised forms part of the "feedback loop" to ensure that investment objectives are achieved.

- Measurement provides managers with a tool to **justify the use of scarce resources** to investors and other key stakeholders. Without this, there is a risk that investments in intangible assets (such as workforce diversity programmes) will not be sustained.

- Finally, measurement enables managers to **improve the performance of the existing programme** and to learn lessons for future, similar investments.

Measurement of costs and benefits of diversity policies by companies also helps to create evidence of the "business case" for such investments. In turn, this can convince other companies to make investments in workforce diversity policies.

It should, however, be stressed that there are important differences of emphasis between large companies and SMEs when it comes to measurement. SMEs, unlike large-scale companies, are unlikely to use formal investment planning and appraisal processes. But on all other issues there is considerable similarity of approach.

5.2. Modern Performance Measurement

Businesses of all sizes are successful over long periods of time if they have a strategy. This can be formal or informal but in most cases consists of[25]:

- Choosing a market or customer segment that the business intends to serve;

- Identifying critical internal business processes that the business must excel at to deliver a superior value proposition to customers in the target market segments;

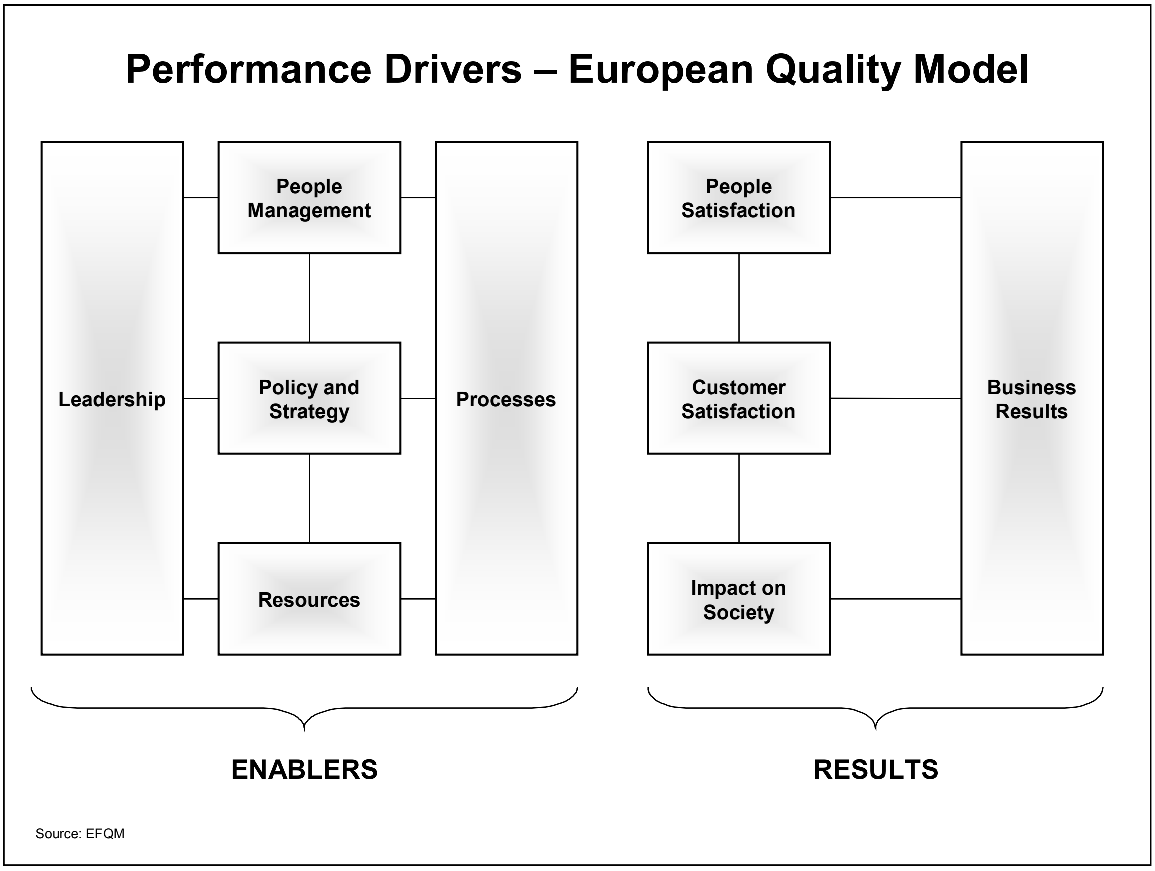
- Selecting individual and organisational capabilities required to achieve internal, customer and financial objectives.

In the past these capabilities have tended to be based on tangible assets, but increasingly they are based on a mix of tangible and intangible assets, including human and organisational capital.

Modern models of business performance, such as the European Quality Model, encapsulate the links between 'outcomes' (the results of strategy) and 'enablers' (the processes and capabilities that drive performance) are encapsulated in (Exhibit 12)[26].

[25] See for example, Porter M. *'What is Strategy?'* (Harvard Business Review, November-December 1996)
[26] Hardjono T., ten Have S., and ten Have W. *'The European Way to Excellence'* (1995)

Exhibit 12



Source: European Foundation for Quality Management

This approach forms the basis of new methods of performance measurement. The most widely used amongst major companies in the EU and the USA is the "Balanced Scorecard" (Exhibit 13)[27]. Developed at the Harvard Business School during the 1990s, this approach to measuring business performance focuses on:

- A mix of financial objectives and non-financial "performance drivers" measured using a mix of qualitative and quantitative approaches;

- Forward-looking measures that translate strategy into a comprehensive set of performance indicators that provide a framework for a strategic measurement and management system;

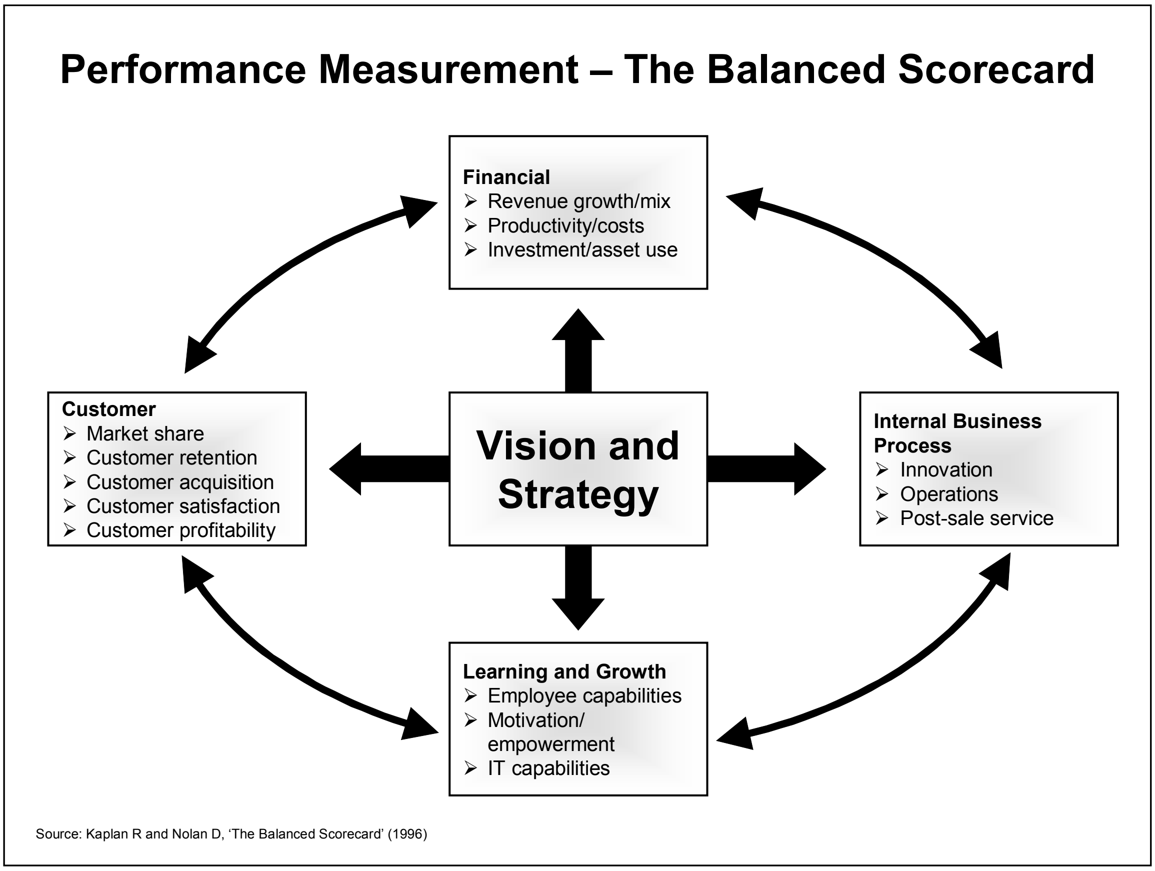
- Monitoring progress in building capabilities and acquiring intangible assets needed for future growth;

- Multiple drivers of performance in four key areas: financial, customer, internal business processes, and learning and growth (including human capital, business culture, and employee motivation);

[27] Kaplan R. and Norton D. *'The Balanced Scorecard – Translating Strategy into Action'* (1996)

- Complex cause and effect relationships and multiple layers of performance measures that distinguish between inputs, intermediate outcomes, operational performance, and overall business performance;

Exhibit 13



Source: Kaplan and Nolan

This new approach is very different to traditional performance measurement methods. Based on the "accounting model", traditional methods were backward-looking, focused on accounting profit, and exclude investments in intangible assets. Moreover, because of their nature, most investments in intangibles are treated as current expenses within traditional, historic cost accounting models[28].

5.3. Current Measurement Practices for Diversity

Our research with leading companies suggests that current measurement of the costs and benefits of diversity policies focuses principally on two things:

- Activities to establish a workforce diversity policy, such as investments in training, communication, creation of policies, establishment of support networks, top management commitment, and creation of new organisational structures; and,

[28] This is, for example, the required treatment in International Accounting Standard (IAS) number 38.

- Intermediate outcomes from activities to implement a new workforce diversity policy, such as changes in workforce demographics (representation measures) and changes in employee attitudes.

There is little evidence of any systematic holistic measurement of either costs or benefits. In some companies steps have been taken to identify benefits and this is predominantly on a qualitative basis. For example, in a small number of other companies, small-scale case studies have been identified that highlight possible business benefits from diversity. These examples tend to be limited to benefits that achieve short or medium-term improvements in business performance, such as improved labour retention.

SMEs differ from large companies in three important respects. First, SMEs tend to assess benefits in an even more qualitative fashion. In part, this is reflection of the types of benefits most widely gained by SMEs. It also reflects a lack of complex, formal measurement systems within smaller companies.

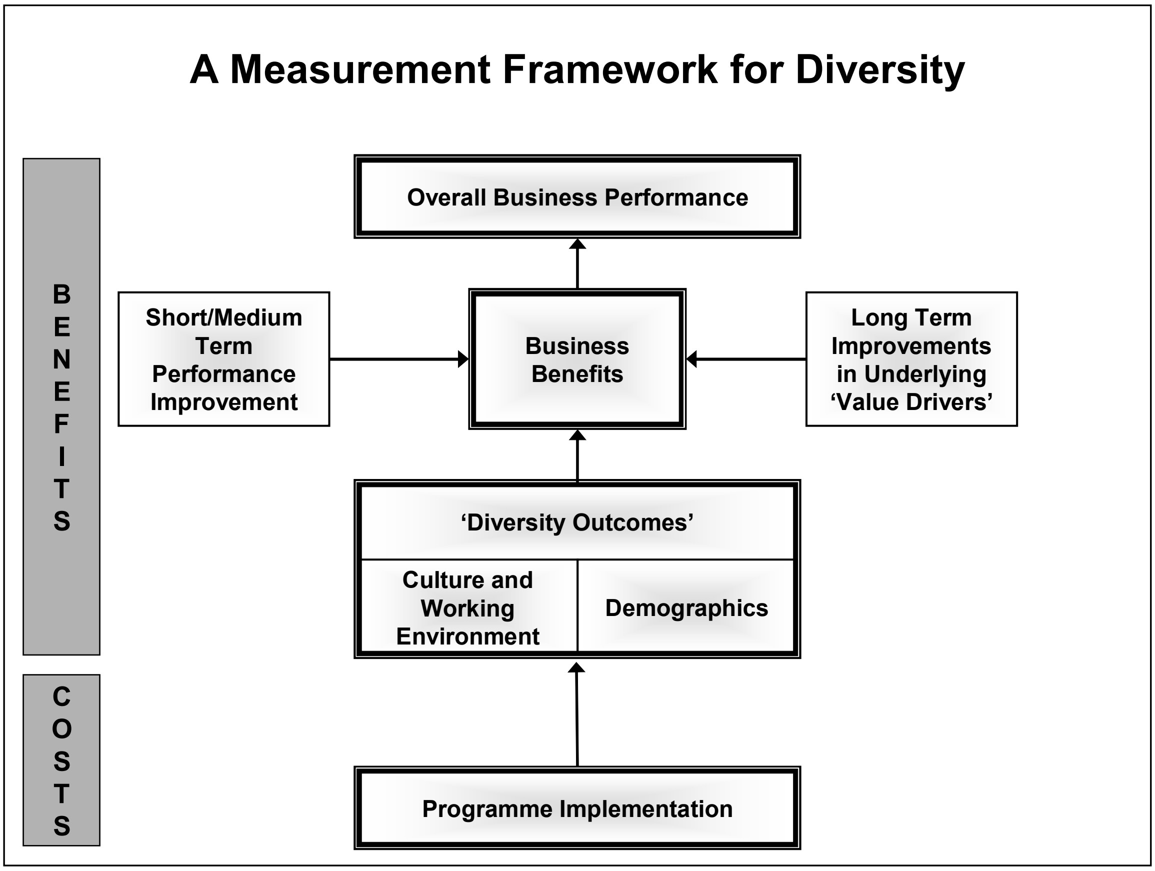
A second difference is that SMEs tend to make more use of the traditional "accounting model" for formal management information than is the case in larger companies. This approach ensures that historic cost accounting data derived from the formal books of account provides the basis for internal decision-making rather than information based on cash flows and non-accounting information.

Finally, SMEs appear to have a clearer understanding of the cash and opportunity costs of supporting diversity policies than some large-scale enterprises. This is partially due to the more widespread use of traditional performance measurement systems amongst smaller firms. But it is also a reflection of the limited scale of financial and management resources within most SMEs and, therefore, the need for tighter control over expenditure and use of key resources such as management time.

5.4. Framework for the Measurement of Costs and Benefits ("A Model")

Although most current measurement systems of the impact of diversity policies have only a limited focus, it is possible to construct a 'model' of what a more rigorous and systematic approach could look like. Based on our knowledge of the types of benefits that diversity policies can deliver, and taking account of modern performance measurement methods and the current measurement practices of leading companies, we have developed a proposed performance measurement framework for the costs and benefits of diversity policies (Exhibit 14).

Exhibit 14



Source: CSES

The 'model' approach has three important parts:

- **Programme implementation** – here measures cover actions by companies to facilitate cultural change ('enablers') and to remove obstacles, such as work practices or cultural norms that lead to indirect discrimination. Actions here are a combination of inputs and processes. This part of the measurement framework measures activities and costs.

- **Diversity outcomes** – these are the *intermediate outcomes* of the actions undertaken to implement a workforce diversity policy. As such, none of the outcomes in this part of the model generate business benefits but they are a necessary step that must be passed through before such benefits can be realised. The use of intermediate outcome measures is an important mechanism for gauging progress, and is consistent with modern performance measures and existing measurement practices.

- **Business benefits** – in this part of the model, we capture the business impact of investment in a workforce diversity policy. Our framework is based on the types of benefit companies seek from diversity. Short and medium improvements in business performance are measured in terms of operational outcomes (such as improved customer loyalty or penetration of new markets) rather than overall business results. Improvements in intangible assets, in contrast, form an obvious part of the "learning and growth" dimension of Balanced Scorecard, for example.

The framework is designed around the performance measurement frameworks used by large companies, but the basic structure and underlying ideas are relevant to smaller businesses.

We have used the model to structure our review of indicators of the costs and benefits of workforce diversity policies. By doing this, the model provides a framework for classifying each of the indicators we have identified. This highlights the role that different indicators play in helping companies understand the "business case" for diversity. The framework highlights, for example, the distinction between intermediate outcomes and business benefits.

5.5. Indicators of Costs and Benefits and Methods of Measurement

5.5.1. Programme Implementation

The principal indicators for measuring programme implementation are:

- Top management commitment;
- Diversity strategy and plan;
- Organisational Policies;
- Employment Benefits;
- Managerial incentives;
- Organisational structures;
- Reporting process (monitoring and evaluation);
- Communication;
- Support networks;
- Education and training; and,
- Productivity losses

The most widely used methods of measurement for each of these indicators is shown in the exhibits below:

Management Time

Exhibit 15

INDICATOR	METHODS OF MEASUREMENT
Top Management Commitment	Management Time Spent on Diversity issues (as a proportion of total time)
	Communication (e.g. Number of mentions in formal speeches)
	Inclusion of Diversity Outcome target in Performance Contract (Yes/No)
	Nature of Diversity target in Performance Contract (assessment of different types of measure- representation, changes in attitudes or benefits)
	Membership of new diversity management structures (e.g. number of senior managers on Diversity Councils, or equivalent)

These measures provide an indication of the extent to which corporate leaders are committed to the successful implementation of a diversity strategy.

Diversity Strategy and Plan

Exhibit 16

INDICATOR	METHODS OF MEASUREMENT
Diversity Strategy and Plan	Presence of Diversity Strategy (Yes/No)
	'Quality' of Diversity Strategy – does the strategy meet best practice standards for coverage and content? Integration into overall corporate strategy
	Presence of Annual Diversity Action Plan (Yes/No)
	Quality of action plan – extent of integration into overall corporate or business annual action plan

Measurement of these activities confirms that the corporate vision for greater diversity has been codified and forms part of the formal statement of the aims, objective, and direction of the business. Inclusion of measures of the inclusion of an annual action plan highlights the effectiveness of formal process of implementation of the strategy.

Organisational Policies

Exhibit 17

INDICATOR	METHODS OF MEASUREMENT
Organisational Policies	Has Recruitment Policy been amended to take account of Diversity strategy? (Yes/No)
	Has Staff Development Policy been amended to take account of Diversity strategy? (Yes/No)
	Have Policies governing staff behaviour been amended to take account of Diversity strategy? (Yes/No)

These measures confirm to senior managers that relevant HR policies now take account of the wider corporate strategy. HR policies provide important guidance for managers and employees.

Employment Benefits

Exhibit 18

INDICATOR	METHODS OF MEASUREMENT
Employment Benefits	Presence of diversity related employment benefits (e.g. same sex partner benefits, retirement age and pension changes, new medical care, holiday arrangements, child care facilities, job sharing, flexible working, telecommuting, access facilities etc) (Yes/No)
	Costs of diversity-related employment benefits (set-up costs and on-going running costs)
	Utilisation of diversity related employment benefits (e.g. proportion of women employees using childcare facilities, recent immigrants attending language training)

These indicators highlight three things. First, they demonstrate changes in working conditions needed to recruit and retain a more diverse workforce. Second, they provide information about the scale of costs involved in making such changes. Finally, they provide an assessment of the usage of benefits. Low levels of usage of a benefit may, for example, be the result of its poor design or irrelevance, or, equally, it may provide early warning of a failure to recruit certain groups of workers.

Managerial Incentives

Exhibit 19

INDICATOR	METHODS OF MEASUREMENT
Managerial Incentives	Presence of managerial incentives as part of performance contract (senior management and middle management) (Yes/No)
	Presence of measurement processes to assess management performance on diversity related issues (e.g. "upward feedback")
	Nature of incentives and processes – assessment of the nature and appropriateness.
	Cost of diversity related managerial incentives

This confirms to senior managers that managerial incentives (especially pay and promotion) have been aligned with wider strategic goals. It is also a measure of one of the costs of diversity policies.

Organisational Structures

Exhibit 20

INDICATOR	METHODS OF MEASUREMENT
Organisational Structures	Have diversity management structures been established? (e.g. Diversity Council) (Yes/No)
	Membership of diversity management structures? – extent of involvement of senior managers
	Have diversity oversight units (e.g. a Diversity Team) been established to provide support and monitor progress? (Yes/No)
	Role and importance of oversight units – extent of independence, resources, reporting relationships, activities
	Cost of specialised diversity staff

This provides a method of ensuring that part of the "institutional architecture" of the business has been re-designed to ensure on-going focus on diversity issues by senior managers, and to provide independent assessment of progress. Oversight units can also be important sources of support and expertise.

Diversity Reporting Process (Monitoring and Evaluation)

Exhibit 21

INDICATOR	METHODS OF MEASUREMENT
Diversity Reporting Process	Has a system been established to monitor diversity performance (achievements to date versus plan) (Yes/No)
	Effectiveness of process (timeliness, penetration)
	Cost of diversity operating process

This indicator ensures that a critical mechanism has been established to close the feedback loop between strategy and implementation.

Communication

Exhibit 22

INDICATOR	METHODS OF MEASUREMENT
Communication (Verbal and Written)	Number of positive and negative mentions (or "column inches")in articles in external media (TV, general press, specialist press) of diversity-related issues (absolute and changes over time)
	Assessment of relevance and quality of mentions – review of journals, TV slots
	Number of mentions (or "column inches") in articles in internal media (e.g. company newsletter) of diversity-related issues (absolute and changes over time)
	Number of mentions (or "column inches") in communications with shareholders and investors of diversity-related issues (absolute and changes over time)
	Number of mentions (or minutes) in key speeches of diversity-related issues (absolute and changes over time)
	Cost of communication activities

Communication is a key input into the process of changing attitudes and building support for diversity policies amongst employees, managers, investors, and, in some cases, customers. This indicator helps senior managers assess the scale and nature of communication activity.

Support Networks

Exhibit 23

INDICATOR	METHODS OF MEASUREMENT
Support Networks	Presence of diversity support networks (e.g. "Women in Management", or members of a gay and lesbian employee group) (Yes/No)
	Membership of diversity support networks (number of members as a proportion of total eligible group)
	Activity of diversity support networks (e.g. number of meetings per year)
	Cost of support networks

Support networks provide members of disadvantaged groups with the opportunity to share experiences and to gain confidence from the success of others. They can also help with problem-solving. This indicator helps mangers assess the scale and cost of such networks.

Education and Training

Exhibit 24

INDICATOR	METHODS OF MEASUREMENT
Education and Training	Cost of diversity training for existing employees and new employees
	Participation in diversity training – existing employees (absolute numbers, proportion of specific groups such as middle managers)
	Participation in diversity training – new employees (absolute numbers, proportion of specific groups such as middle managers)
	Perceived value of diversity training amongst existing and new employees (extent of agreement with opinion questions in post-training assessment form)
	Impact of training on future development (link between attendance on training/development courses and retention or development of target groups)

Education and training helps to change attitudes of existing staff towards diversity policies and to provide members of disadvantaged groups with the skills needed to for promotion and effectiveness. This is also a major area of expenditure. This indicator helps senior managers assess the extent, nature and cost of training inputs.

Productivity Losses

Exhibit 25

INDICATOR	METHODS OF MEASUREMENT
Productivity Losses	Productivity per employee compared with previous periods
	Productivity per new employee (compared to average)

Investment in diversity policies often requires recruitment of different types of employee. Some may have little experience of the type of work being offered and will require training: others may require support to attain targeted productivity levels. Such costs are highlighted by this indicator.

5.5.2. Diversity Outcomes

The next part of our performance measurement framework covers the intermediate outcomes from implementation of workforce diversity policies.

Two principal types of indicator are used:

- Workforce demographics (‘representation’); and
- Employment culture/working environment

The principal methods of measuring these indicators are shown in the tables below:

Workforce Demographics

Exhibit 26

INDICATOR	METHODS OF MEASUREMENT
Workforce Demographics	Number of people from target groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups) in workforce as a whole
	Number of people from target groups in workforce (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups) compared to external benchmarks - compared to community in travel to work area or compared to other companies (e.g. through a benchmarking service)
	Number of people from target groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups) in specific parts of the workforce (e.g. in management or in specific functions)
	Pay levels of people from target groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups) compared to pay levels of other equivalent graded employees
	Changes in the number of people from target groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups) – year-by-year comparison
	Number of people recruited into the organisation from target groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups)
	Number of people promoted within the organisation from target groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups)
	Number of people leaving the organisation from target groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups)

These are ‘representational’ measures. They show changes in the formal demographics of a workforce. The ability of companies to measure these changes depends on national legal restrictions on the protection of sensitive data.

Demographic measures are used by managers as an indicator of progress. They illustrate the initial outcomes of the investment in a diversity policy.

Employment Culture and Working Environment

Exhibit 27

INDICATOR	METHODS OF MEASUREMENT
Employment Culture/ Working Environment	Number of formal internal complaints which are diversity related
	Number of formal external complaints which are diversity related
	Number of litigation cases that are diversity related
	Cost of settling diversity related litigation cases
	Cost of resolving complaints
	Employee attitudes on diversity related issues – responses to opinion questions in employee survey – within the company as a whole
	Employee attitudes on diversity related issues – responses to opinion questions in employee survey – comparison between different groups within the company (e.g. differences between perceptions of women and men)
	Employee attitudes on diversity related issues – responses to opinion questions in employee survey – comparison over time
	Employee attitudes on diversity related issues – responses to opinion questions in employee survey – compared to responses in other companies (e.g. via a benchmarking study)
	Employee attitudes on diversity related issues – index created based on responses to opinion questions in employee survey

This indicator provides managers with an insight into changes in the culture of the enterprise. It helps them measure progress. Changes in cultural values are a critical pre-condition for an effective diversity policy.

5.5.3. Business Benefits

The final part of the measurement framework covers the business benefits that managers believe are linked to investments in workforce diversity policies. Although, the exact mix of benefits will differ between companies, we have included all of the major types of benefit in our list. Performance indicators used by a company will, of course, be tailored to reflect the specific objectives of the overall diversity strategy.

The main indicators used by companies cover each of the main types of business benefit (strategic and shorter term) that diversity policies can generate. Specifically:

- Cost Reductions;
- Labour shortages;
- Access to new markets;
- Improved performance in existing markets;
- Access to talent;
- Global management capacity;
- Innovation and creativity;
- Reputation with governments and other stakeholders;
- Marketing image;
- Cultural values

A range of methods of measurement is used to assess the achievement of these benefits. Some of the most widely used are described in the tables below.

Cost Reductions

Exhibit 28

INDICATOR	METHODS OF MEASUREMENT
Cost Reductions	Labour turnover by specific groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups) compared to average for firm
	Absenteeism by specific groups (e.g. age, gender, ethnic groups, disabled, gay/lesbian, different religious groups) compared to average for firm
	Direct Recruitment costs – changes over time
	Expenditure on discrimination-related litigation cases – legal costs (changes over time)
	Expenditure on discrimination-related litigation cases – settlement costs (changes over time)

This indicator highlights direct cost reductions that can, in general, be linked to investments in diversity policy. It shows short-term, tangible benefits.

Labour Shortages

Exhibit 29

INDICATOR	METHODS OF MEASUREMENT
Labour Shortages	Number of unfilled vacancies (internal and external) – absolute and changes over time
	Number of applicants for job vacancies (internal and external) – absolute and changes over time
	Time taken to fill vacancies (internal and external)

This indicator links directly to one of the short and medium-term reasons for investment in diversity policies: overcoming labour shortages.

Access to New Markets

Exhibit 30

INDICATOR	METHODS OF MEASUREMENT
Access to New Markets	Penetration of selected new markets (proportion of sales going to specific groups)
	Penetration of selected new markets (proportion specific groups who have ever bought product/service)
	Penetration of selected new markets (proportion specific groups who have bought product by level of loyalty – once, occasionally, regularly, always)
	Attitudes of selected target groups to the organisation and its brands, products, services

This is another indicator of a tangible short-term benefit from investment in diversity policies. It uses traditional measures of market penetration to highlight the effectiveness of the business in gaining access to new markets. It allows managers to track each stage of the penetration process.

Improved Performance in Existing Markets

Exhibit 31

INDICATOR	METHODS OF MEASUREMENT
Improved Performance in Existing Markets	Levels of customer satisfaction with product/service – changes over time
	Level of customer loyalty (occasional versus regular users)– changes over time
	Levels of operating efficiency – output levels, quality levels, waste, cycle time in homogenous work teams compared to diverse work teams

This is a high-level operational indicator. Diversity programmes will be one of a number of factors that will affect this indicator. Managers will use the indicator to evaluate the overall operational effectiveness of the company. Qualitative assessments may be made of the specific contribution of investments in diversity.

Access to Talent

Exhibit 32

INDICATOR	METHODS OF MEASUREMENT
Access to Talent	Profile of existing employee competencies compared to competencies needed by the organisation (via skills audit)
	Employee satisfaction – overall and amongst key groups (e.g. technical specialists or young managers with high potential)
	Organisations reputation (via attitude survey) as an employer amongst key groups (e.g. new graduates)
	Retention rates amongst key employee groups (e.g. young managers with high potential)
	Number of applicants for key management/functional job vacancies - changes over time

This indicator helps managers understand whether they are recruiting, retaining, and developing the right mix of human resources. Diversity policies are one of a number of factors that can influence this indicator.

Global Management Capacity

Exhibit 33

INDICATOR	METHODS OF MEASUREMENT
Global Management Capacity	Proportion of top management team from "non-traditional" backgrounds
	Proportion of managers with high potential from "non-traditional backgrounds"
	Proportion of managers with high potential and from "non-traditional backgrounds" participating in key development programmes

This indicator focuses on a specific dimension of human capital. It helps managers understand whether or not they are being successful in creating a cohort of managers able to perform effectively in a diverse operating environment.

Innovation and Creativity

Exhibit 34

INDICATOR	METHODS OF MEASUREMENT
Innovation and Creativity	Extent of heterogeneity within key work groups – e.g. proportion of people from "non traditional" backgrounds in multi-functional product development teams
	Performance of different types of key work groups – traditional versus non-traditional
	Expenditure on innovation as proportion of sales
	Time-to-market cycle – time taken for new products or services
	Proportion of sales based on new products or services introduced within last three years

This indicator looks at overall innovation performance in general, and the differences in performance between diverse and non-diverse teams. At a general level, this helps managers understand whether they are continuously improving their product, services, and processes. It also provides an insight into the specific contribution that diversity may make in the product development process.

Reputation with Governments and Other Stakeholders

Exhibit 35

INDICATOR	METHODS OF MEASUREMENT
Reputation with governments and other stakeholders	Attitudes of opinion formers and general public towards organisation on key diversity related issues (via opinion survey)
	Attitudes of local communities towards organisation on key diversity related issues (via opinion survey)
	Media penetration – mentions (positive and negative), types of journal, extent of coverage

Diversity programmes can help companies protect and enhance their reputation with government: a key stakeholder in all business activity. This indicator helps managers assess the nature of the reputation of the company with governments, and, over time, to measure changes.

Marketing Image

Exhibit 36

INDICATOR	METHODS OF MEASUREMENT
Marketing Image	Attitudes of customers in key target markets towards the organisation – current, and over time (e.g. tracking study)

This is a traditional measure of the image of a company with its customers. In certain sector and markets, diversity policies may affect the marketing image of a company. This indicator tracks changes in that image.

Cultural Values

Exhibit 37

INDICATOR	METHODS OF MEASUREMENT
Cultural Values	Profile of existing employee values compared to cultural values desired by the organisation (via "values audit")
	Internal survey of employee opinions and attitudes

This is a high-level version of the measure of attitudes used to assess the intermediate outcomes of an investment in diversity. In this case, the indicator focuses on the overall culture of the enterprise as well as diversity-related aspects.

An increasing number of major companies believe that cultural values are an important determinant of success. They believe that a strong set of values will encourage creativity, attract new talent, help ensure responsiveness to external change, and ensure responsible behaviour.

6. THE BUSINESS CASE FOR DIVERSITY – AN ASSESSMENT

6.1. INVESTMENT IN INTANGIBLE ASSETS – "THE BUSINESS CASE"

The "Business Case" is term used to describe the evidence needed to convince companies to consider investments in assets, both tangible and intangible. It helps companies to understand the kinds of costs, risks, and benefits that are associated with such investments, and provides information about cause-and-effect mechanisms that link together inputs, processes, and outcomes.

Implementation of a workforce diversity policy by an organisation is a form of investment in intangible assets, especially organisational and human capital. A review of the business case for other types intangible assets (such as investments in R&D, innovation, brands, and work organisation), suggests that a persuasive and credible case for investment depends on four types of evidence of costs and benefits[29]. Specifically:

- **'Testimonials'** – publicly expressed views of major opinion leaders within the business community;

- **Case Studies** – detailed, company-level analyses of the costs, benefits, and processes associated with investments in intangibles. Ideally, these explain cause-and-effect mechanisms clearly, and provide extensive information about the internal implementation processes[30]. In some instances, written case studies can be complemented by 'live' demonstration projects;

- **Surveys** – opinions of large numbers of companies captured through telephone and postal surveys. This is an extension of testimonial-type evidence. It normally covers penetration (extent and nature of usage), costs, and perceived benefits. Some surveys may also try to capture quantified data about costs and benefits;

- **Empirical Research** – carried out by academics and consultancy firms, this looks at large numbers of companies and seeks to identify correlative relationships between specific activities (such as the use of new forms of work organisation) and firm-level performance[31].

  These studies often highlight differences in performance between groups of companies who invest in new forms of work organisation or brands, for example, and those that do not.

  Different methodologies are used, including those based on data in published company accounts, and those that use 'panels' of companies in longitudinal studies to examine the impact of investments in work organisation, for example, on measures of operational performance, such as productivity, quality, cycle time, and waste.

Evidence of this nature and scale, however, takes time to develop. Exhibit 38 illustrates some of the key stages in the process.

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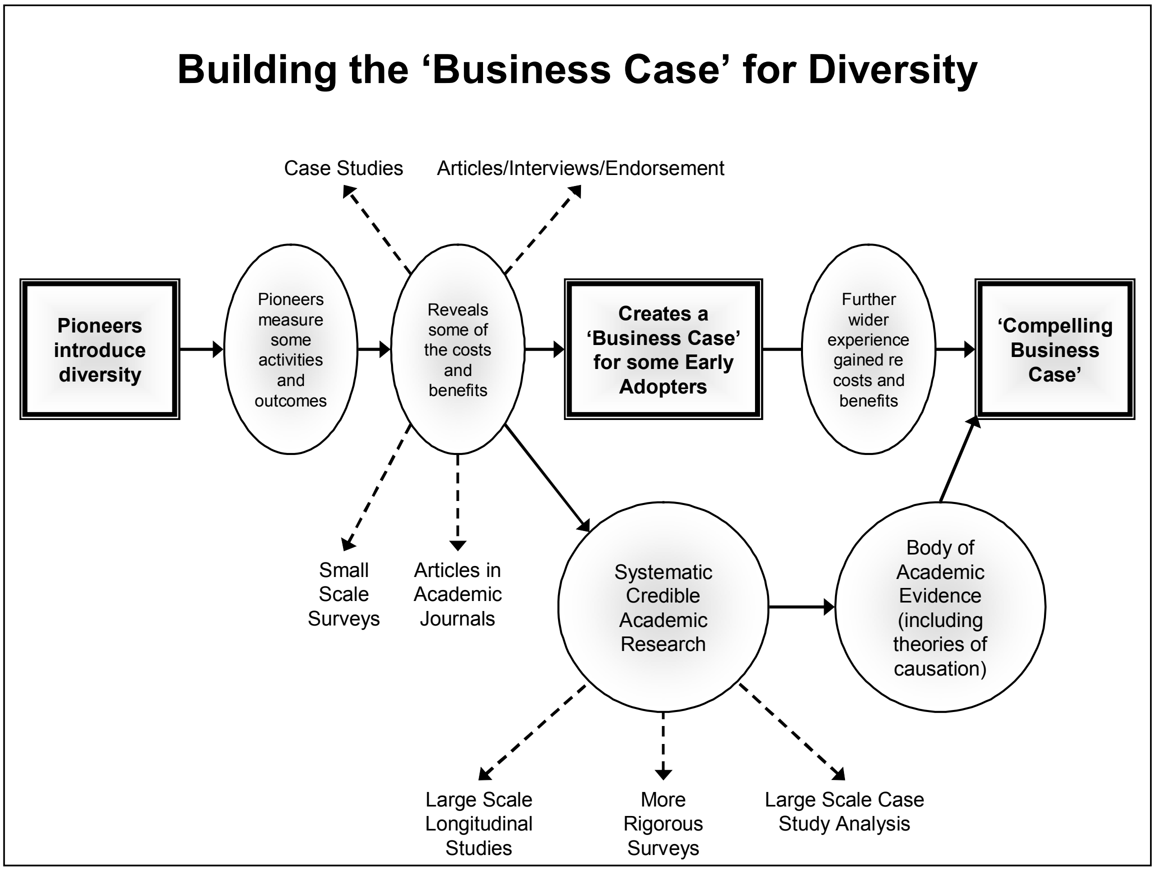
[29] See for example Baumol W. *'The Free-market Innovation Machine – analysing the growth miracle of capitalism'* (2002), Lev B. *'Intangibles – Measurement, Management, and Reporting'* (2001), and Business Decisions Limited *'New Forms of Work Organisation and Productivity'* (1999, a report for the European Commission)

[30] See for example, Business Decisions Limited *'New Forms of Work Organisation: Case Studies'* (1998, a report for the European Commission)

[31] See for example, NUTEK *'Towards Flexible Organisations'* (1996, a report for the Swedish National Board for Industrial & Technical Development).

Exhibit 38



Source: CSES

The process begins with the activities of a small number of 'pioneers', who invest in new types of assets based on emotional factors, such as vision or belief. There is, at this stage, no formal evidence. In the next phase, the experiences of these pioneering firms are made public. This can take many forms, including disclosure by the businesses themselves, consultancy reports, and articles in business journals and newspapers. After this has happened, there tends to be increased interest amongst academics that tends to lead to the setting-up of long-term research projects (surveys, firm-level studies etc.) and the writing of extended case studies by leading business schools. At the end of the process, this new academic evidence combined with testimonial evidence, starts to provide a multi-faceted business case.

Multiple forms of evidence are important because of the structural characteristics of intangible assets, and hence the nature of their impact on the economic performance of businesses.

Unlike tangible and financial assets, the business case for investment in intangible assets faces three important problems[32]. First, the benefits of the intangible asset can be only partially secured by their owners, and, as result, there are often enormous 'spillovers', especially with investments in employees. A second problem is that investments in intangibles are inherently more risky. They are more difficult to manage, benefits are more difficult to identify, and cause-and-effect relationships are

[32] Lev B. *'Intangibles – Measurement, Management, Reporting'* (2001)

more difficult to establish. Finally, it is difficult to realise the value of such investments independently of the company itself. There are few markets in intangibles. This raises further the risks of such investments.

Faced with these problems, companies look for a range of different types of evidence of the cost-effectiveness of investments in intangibles.

Our analysis of the nature of the business cases used to support investments in other types of intangible asset provides a 'model' with which to make an initial review of the case for investing in workforce diversity policies.

6.2. THE BUSINESS CASE FOR DIVERSITY – AN INITIAL REVIEW

6.2.1. Evidence

Looking first at **"Testimonial"** evidence, there are an increasing number of examples of opinion leaders in the business community expressing support for investments in workforce diversity policies. Leading global business organisations, such as the Conference Board and the World Economic Forum, have expressed support, along with top managers from a number of major multi-national companies.

This form of evidence is particularly strong in the USA and Canada, but less well developed in Europe. In the European context, the process of building this form of support is at a relatively early stage, although organisations such as CSR Europe, the Conference Board, CEEP, UNICE, and UEAPME have taken steps to raise awareness of the benefits of investments in workforce diversity[33].

A small number of senior managers in leading EU-based multi-national companies have also begun to express their support for workforce diversity policies and to articulate some of the benefits they have gained from such investments (Exhibit 39).

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[33] Reports produced include: CSR Europe *'Business and Diversity – Helping business score higher in managing diversity'* (2002), and UNICE, CEEP, and ETUC *'Good Practices for the Employment of Handicapped People'* (1999)

Exhibit 39

Support for Diversity – Examples of European Senior Managers

An Post

"Equality initiatives have played an important part in a wider change management portfolio, which is helping An Post prepare for the business challenges posed by liberalisation of the postal sector and developments in information technology, as well as driving change into the 21st century." (Chief Executive)

Barclays

"Levelling the playing field, ensuring that the best people are in the best jobs makes for better business. When you are in a highly competitive service industry like banking, in a society where gender equality is fast becoming a core value, it makes absolute sense to pursue gender equality in the workplace. In a mature financial services market like ours it would be nothing short of a dereliction of duty not to go after the fastest growing customer base." (Chief Executive)

BP

"The people we have form our human capital. To me that is a more important corporate asset than all of the plant and equipment, all of the oil fields and pipelines.

If we can get a disproportionate share of the most talented people in the world, we have a chance of holding a competitive edge.

That is the simple strategic logic behind our commitment to diversity and to the inclusion of individuals – men and women regardless of background, religion, ethnic origin, nationality or sexual orientation." (Chief Executive)

Rabobank

"The number of people of ethnic minority background in the Netherlands has increased significantly over the last few years. In 2015, approximately one in five people living in the Netherlands will be of an ethnic minority background and this will be as much as 50% in most of the big cities. The co-operative Rabobank Group wants to be at the heart of this society as a bank for all types of customers." (Corporate Policy on Cultural Diversity)

Source: An Post, Barclays, BP, Rabobank, CSES

Extensive, business school-type **case studies**, the second form of evidence, are also more widely available in the USA and Canada than in Europe. This is an important form of evidence because it makes the case for investment in a tangible way[34]. Good case studies describe the experiences of individual companies, as well as providing coherent explanations of costs and benefits, and links between inputs, processes, and outcomes. Cause-and-effect relationships are also set out.

In Europe, the type of case study evidence available tends to be a limited presentation of the types of benefits achieved. Moreover, in most cases these benefits are confined to short and medium-term improvements in cash flow. And, benefits are not always quantified: many of the examples are qualitative in nature. Two examples are shown below (Exhibit 40).

[34] Examples include: Hayes V. *'Beyond Employment Equity – the business case for diversity'* (Ivey Business Journal, September 1999), Gandz J. *'A Business Case for Diversity, Paths to Equal Opportunity'* (2002, a report for the government of Canada), and collections of examples of diversity investments produced by the Conference Board for its members in the USA and Canada.

Exhibit 40

European Examples of Benefits from Diversity Policies

BT

There has been a productivity increase of between 15% and 31% since the company began its home-working scheme. This flexible working initiative forms part of a wider gender equality and diversity programme, and has resulted in a 96% return rate after maternity leave. The take up of home-working has resulted in savings of Euro 350 million in real estate costs.

Rabobank

A bank branch located in an immigrant district has many customers of non-Dutch origin. Before 2001, the bank limited customer access and contact with staff because of the threat of violence in the area. Much needed to be done to overcome these problems and improve staff motivation, customer satisfaction and higher profits. Today, customers are assisted at the cash point by Moroccan-speaking staff, contacts are established with ethnic intermediary groups, and tailored direct mail is used to communicate with customers from ethnic minority backgrounds. The building has also been substantially refurbished. Turnover in the first quarter of 2002 alone exceeded turnover for the whole of 2001.

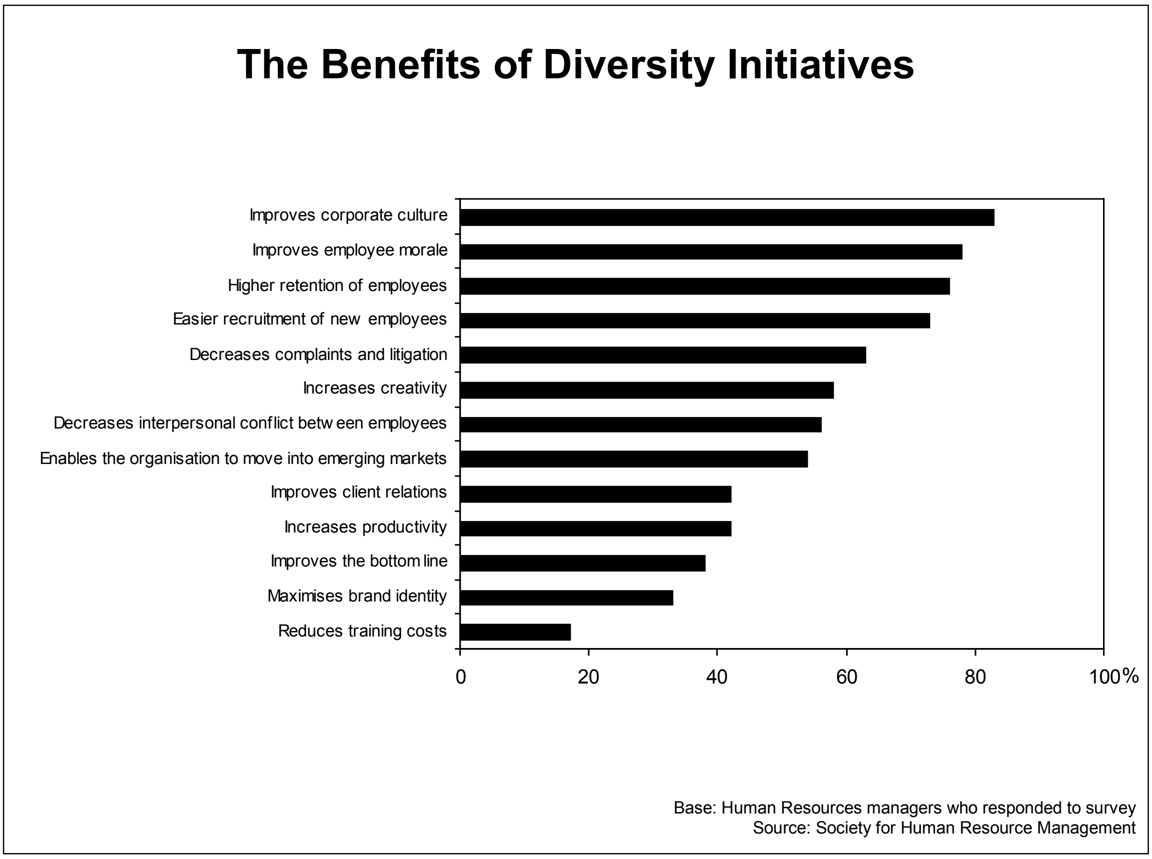
Source: BT, Rabobank, CSES

Despite their limitations, these examples perform a useful function as a support for the testimonial-type evidence from top managers and business organisations. Used well they can also signal to companies the potential presence of more extensive evidence.

The third principal form of evidence comes from the results of **opinion surveys**. As with testimonial and case study evidence this is more extensively developed in the USA and Canada than in Europe.

A well-known example from the USA is a survey carried out by the US Society for Human Resource Management (SHRM). This asks human resource managers, who are members of the society, to express an opinion as to the impact that diversity policies have on the competitive advantage of their organisation (Exhibit 41).

Exhibit 41



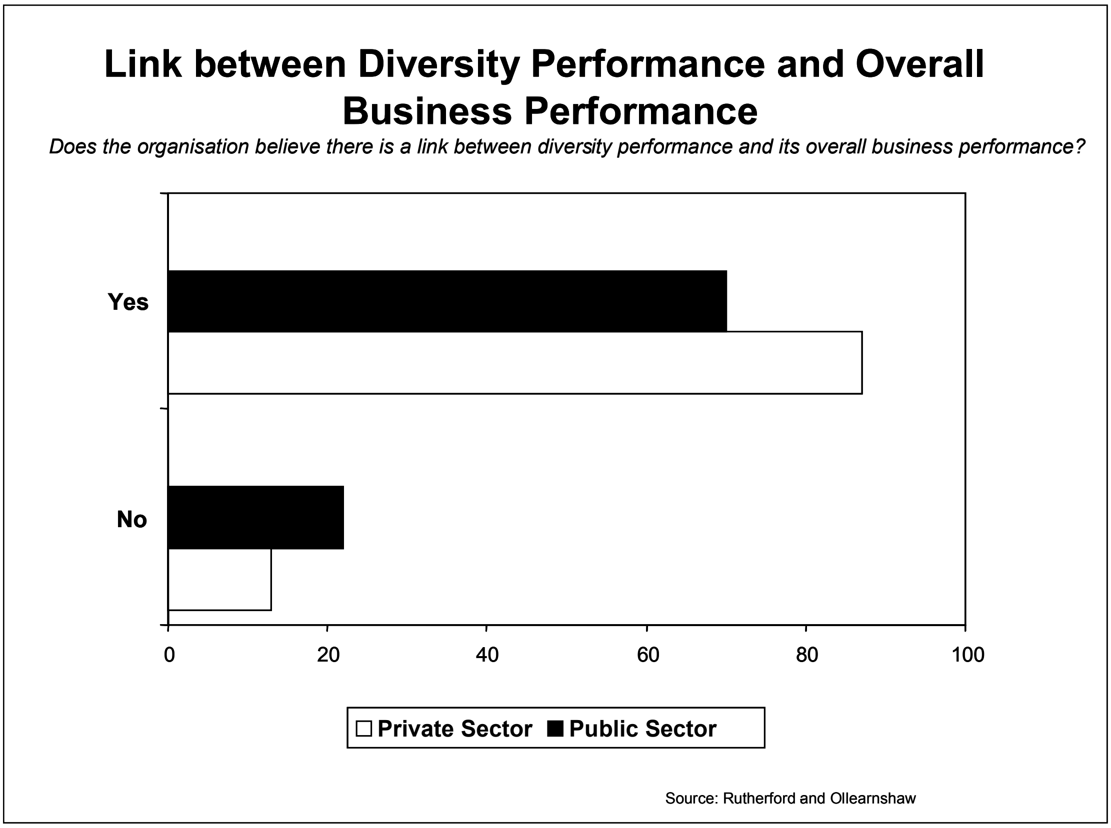
Source: SHRM

The results of the survey provide an important insight into the principal types of business benefits associated with diversity policies. The most widely cited being solving labour shortages ("higher retention of employees"), and reducing costs ("easier recruitment" and "decreases complaints").

There is some evidence that similar types of surveys are starting to be carried out in Europe. In the UK, for example, a study for the Cabinet Office[35] focused on major companies at the leading edge of good practice in diversity. The study found overwhelming support amongst this group of private sector businesses for the idea that diversity policies contributed to economic success (exhibit 42)

[35] Rutherford S. and Ollerearnshaw S. *'The Business of Diversity – How organisations in the public and private sectors are integrating equality and diversity to enhance business performance'* (2002, a report for the UK Cabinet Office)

Exhibit 42



The problem in Europe is that the use of these surveys is still in its infancy, and that the causal linkages between inputs, outputs, and outcomes are not explored fully.

Empirical research by academics is the final form of evidence used to support the business case for investment in intangible assets. Research by academics into the links between diversity and business performance is limited in its extent, and the work that has been carried out has been undertaken in the USA.

In the USA, a small number of studies have been undertaken that seek to demonstrate links between diversity and overall firm-level performance. Work for the US government, for example, identified two studies that showed a link between share prices, returns on investment, (and other financial measures) and publicly quoted companies that had evidence of commitment to promotion of women and minorities[36]. Another, and widely cited, study identified a negative link between stock price performance and the imposition of financial penalties for discriminatory behaviour in the workplace[37]. The problem with this study, however, is that its major finding may have little to do with diversity directly and much more to do with the investor assessment of the competence of managers to control risks.

The importance of this form of evidence can be seen from an examination of the business case for investments in work organisation. Here work by Massachusetts

[36] US Federal Trade Commission *'Breaking through the glass ceiling'* (1995)
[37] Wright P., Ferris S. et al *'Competitiveness through management of diversity: effects on stock price valuation'* (Academy of Management Journal, Vol. 38, 1995)

Institute of Technology (MIT) in the late 1980s into differences in performance between Japanese, EU, and US car manufacturers stimulated a wave of empirical studies[38]. This included longitudinal studies of panels of companies in Denmark, for example, that examined links between operating performance, information technology (IT) investments, and work organisation[39].

In contrast, more work has been undertaken in both Europe and the USA to examine the performance of heterogeneous work teams[40]. The value of the evidence generated by this research is, however, questionable. First, there are conflicting findings. Some studies suggest that heterogeneous teams are more creative or productive, whilst other evidence disputes this. Another, and equally important problem, is the nature of the methodology used to assess the issue. In general, the studies use experimental psychology techniques. As a result, some businesses are sceptical about the robustness and relevance of the findings.

6.2.2. Assessment

The business case for investments in workforce diversity is more fragmented and at an earlier stage of development than that for other forms of intangible asset, although it is more developed in the USA and Canada than in Europe.

There are a number of reasons for this:

- Quantification of costs and benefits, in order to produce a traditional analysis of cost-effectiveness, is difficult. Some of the most important costs are non-cash opportunity costs, and "execution risk" is difficult to take account of within classical investment appraisal models. Benefits, especially strategic gains, are also difficult to value, although short and medium improvements in cash flow can be quantified. The overall balance of cost-effectiveness is difficult to assess, and probably depends on a mix of quantitative and qualitative factors. This complex, internal business case for investment (and subsequent measurement of implementation) does not translate easily into evidence to support a "business case" with which to convince other companies.

- Measurement of 'diversity' at a business-level is more difficult than that for other types of intangible asset. Diversity is an outcome of a cultural change process and not an input to other processes. Moreover, there are different 'levels' of diversity and different forms of diversity strategy. Because of the difficulty in differentiating between 'diverse' and 'non-diverse' businesses, traditional empirical analyses are difficult to carry out. These problems are, however, beginning to be overcome with the utilisation of models such as the "Equity Continuum".

- Investment in diversity policies, rather than compliance with legislation, is a relatively limited activity amongst EU companies. There is a limited base of

[38] Womack, Jones and Roos *'The Machine that Changed the World'* (1990)

[39] Danish Ministry of Business and Industry *'Technological & Organisational Change: Implications for Labour Demand, Enterprise Performance, and Industrial Policy'* (1996)

[40] See for example, Watson W., Kumar K. et al *'Cultural Diversity's impact on interaction process and performance: comparing homogeneous and diverse groups'* (Academy of Management Journal, Vol. 36, 1993)

evidence, therefore, on which to construct more extensive analyses of costs and benefit. The small number of companies involved also limits the effectiveness of survey evidence.

- As with all forms of investment in human capital there are major gaps in publicly available knowledge. Accounting disclosure requirements do not require companies to provide any substantial data about the people they employ or about their HR policies. This lack of evidence further limits the scope of academic research that can be carried out. Some action is being taken to overcome these gaps through the (mainly voluntary) introduction of social and environmental accounting standards. But even with these there are problems in defining useful measures of human resource policies, including diversity. The Global Reporting Initiative (GRI) has, for example, experienced considerable difficulty in agreeing on relevant measures.

- Many of the short and medium-term benefits from diversity policies are highly "context-specific" i.e. they are limited to certain types of companies pursuing particular strategies in specific sectors. Although these benefits can, in most cases, be quantified and some link to diversity policies established, their limited relevance to many companies makes them a weak form of evidence in some instances.

- In general, the long-term, strategic benefits of diversity policies are more difficult to measure than the short and medium improvements in cash flow. Although steps are being taken to try and develop measures of human and organisational capital, they remain in their infancy. A further problem is that of 'attribution'. For example, improvements in the quality of human capital depend on a range of factors, not just investments in diversity policies.

- Discrimination covers a wide range of grounds, and strategic diversity policies aim to be able to overcome them all. BP's statement provides a clear example of such a policy. But there are major measurement difficulties in a number of areas, especially sexual orientation, ethnicity, religious belief, and disability. These difficulties are the result of practical problems (defining disability, for example), legislative issues (privacy rules), and cultural (social norms) factors. Difficulties in measurement make it more difficult for companies to track progress in terms of intermediate outcomes. This, in turn, limits the evidence available to support a business case.

Despite these difficulties, there is an emerging business case for investment in diversity policies. Its greatest strengths are its links to investments in human capital and the testimony of the small number of leading European businesses actively involved in the implementation of workplace diversity policies. Evidence from the USA is also useful, although its value is partially discounted because of the influence of US-specific socio-legal factors, such as affirmative action legislation.

In addition, evidence from other intangible assets with similar characteristics illustrates that progress can be made, and a business case and common indicators developed. There are strong similarities between investments in human capital in general, and investments in diversity policies in particular. Indeed, the latter is a sub-set of the former.

Recent work in the UK, for example, has begun the process of identifying ways in which measures of human capital management might be included in corporate reporting requirements[41].

The work identifies increased investor interest in measures of human capital management, and evidence of linkages between strong people management and performance. Although it is accepted that there is no single set of best practices or relevant indicators, there are benefits in introducing a common core of minimum reporting standards to promote consistency and comparability. Such standards will, it is believed, aid identification of trends over time and informed comparisons between organisations.

This core of minimum standards should focus on four areas (‘indicators’): the size and composition of the workforce; employee motivation; staff training and development; and, remuneration and fair employment.

There is, however, little agreement as to which metrics provide the greatest insight into these indicators of human capital management. Data may be strongly influenced by cultural and other factors, for example, and interpretation of information may require an understanding of the context within which the company operates.

6.3. FINDINGS FROM THE SURVEY OF COMPANIES

Evidence from our survey of companies makes a useful contribution to the analysis of the strength and nature of the business case for diversity. First, it provides an insight into why companies in the EU invest in diversity. In other words, it highlights the rationale for investment, as well as the costs and benefits. The nature of the rationale for an investment can help identify the nature of evidence needed to help convince other companies to consider it. Our evidence also provides opinions as to the relative importance of the different types of evidence that constitute the business case.

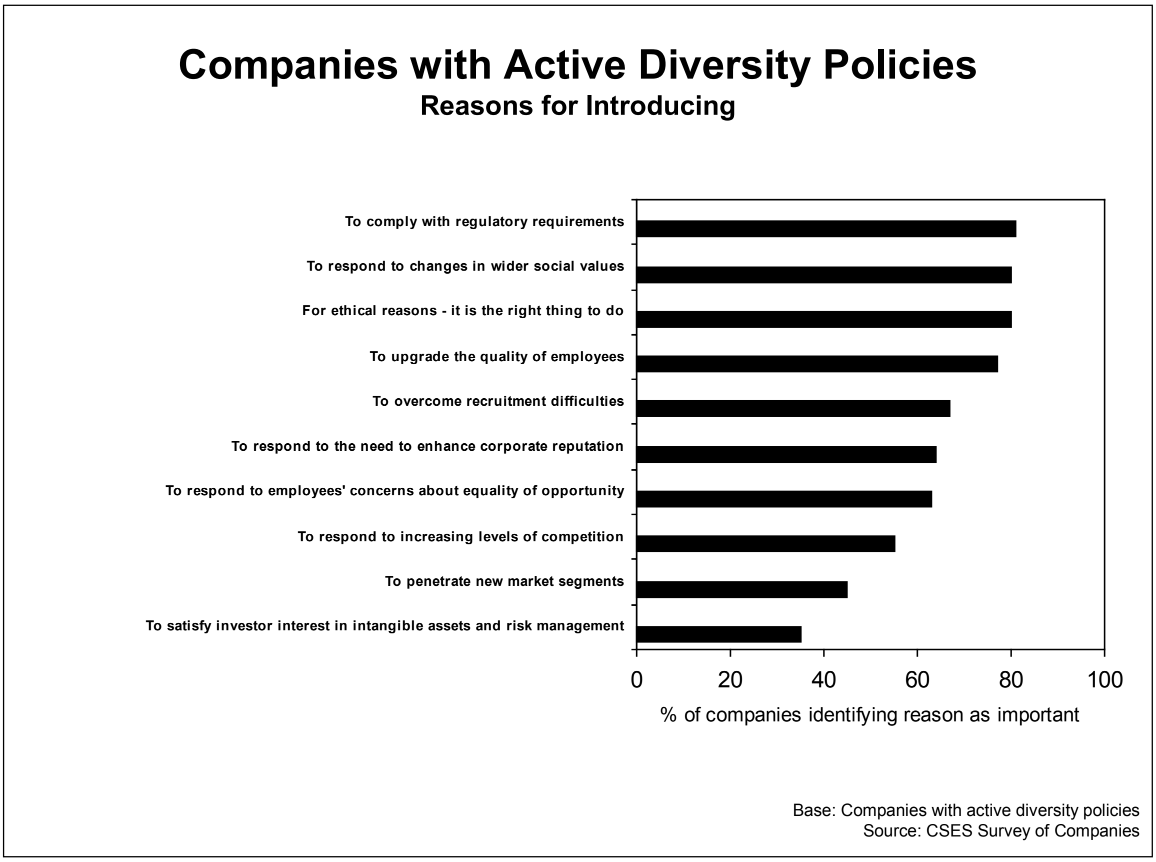
6.3.1. Reasons for Investing in Workforce Diversity Policies

Our survey identified some of the reasons why companies invest in workplace diversity policies (Exhibit 43). The most important reasons are:

- *To comply with regulatory requirements (81%);*
- *To respond to changes in wider social values (80%);*
- *For ethical reasons – it is the right thing to do (80%);*
- *To upgrade the quality of employees (77%).*

[41] *‘Accounting for People’*, consultation paper issued by the UK Task Force on Human Capital Management, 2003. This group is also known as the ‘Kingsmill Task Force’.

Exhibit 43

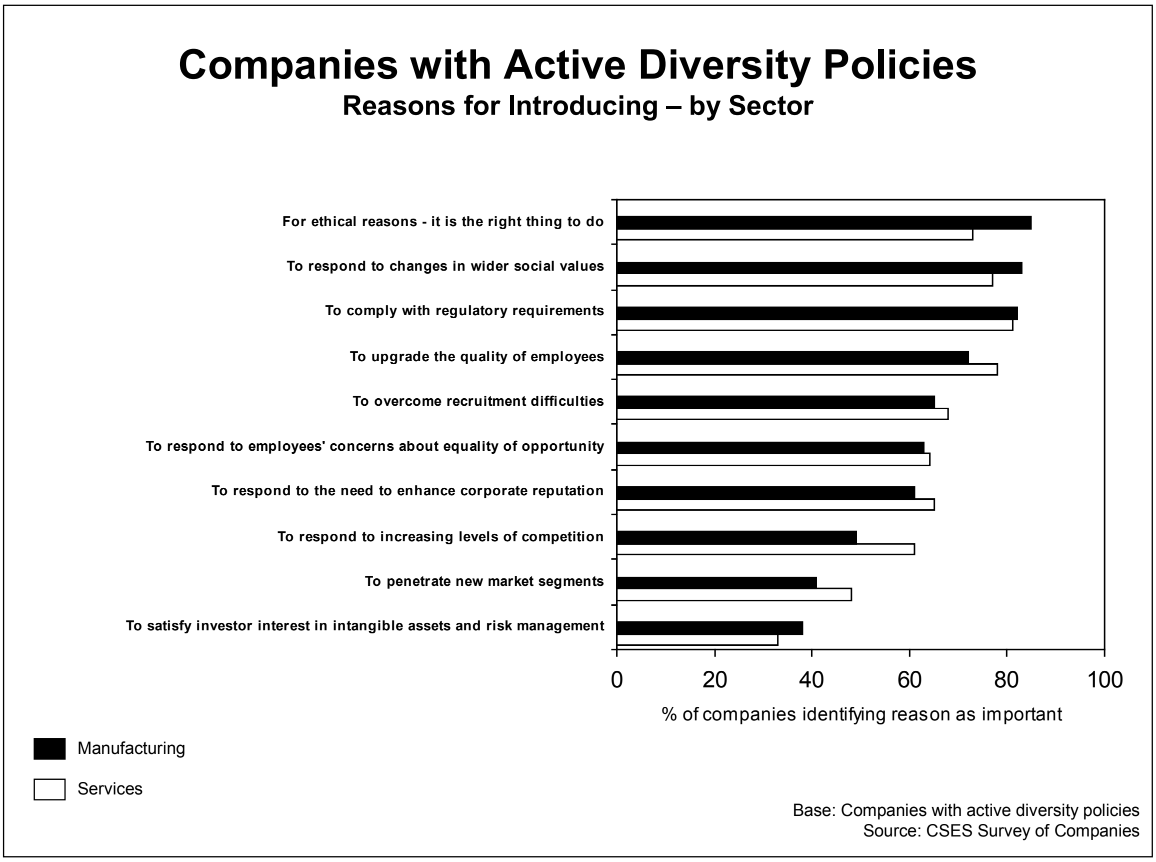


Three factors stand out from these responses. First, regulatory issues are clearly important. A significant number of companies have introduced some form of diversity initiative in response to regulatory requirements. Ethical factors also appear to play a part although this may reflect the impact on companies of changes in social attitudes. Governments, politicians, and civil society groups have urged companies to become more responsive to the views of citizens about social and environmental practices.

The final point confirms this, in part. The behaviour of companies appears to take account of the socio-cultural environment in which they operate. This may be due to factors such as the need to recruit talented staff, the importance of maintaining corporate reputation, and the opportunities to compete in markets dominated by governmental institutions.

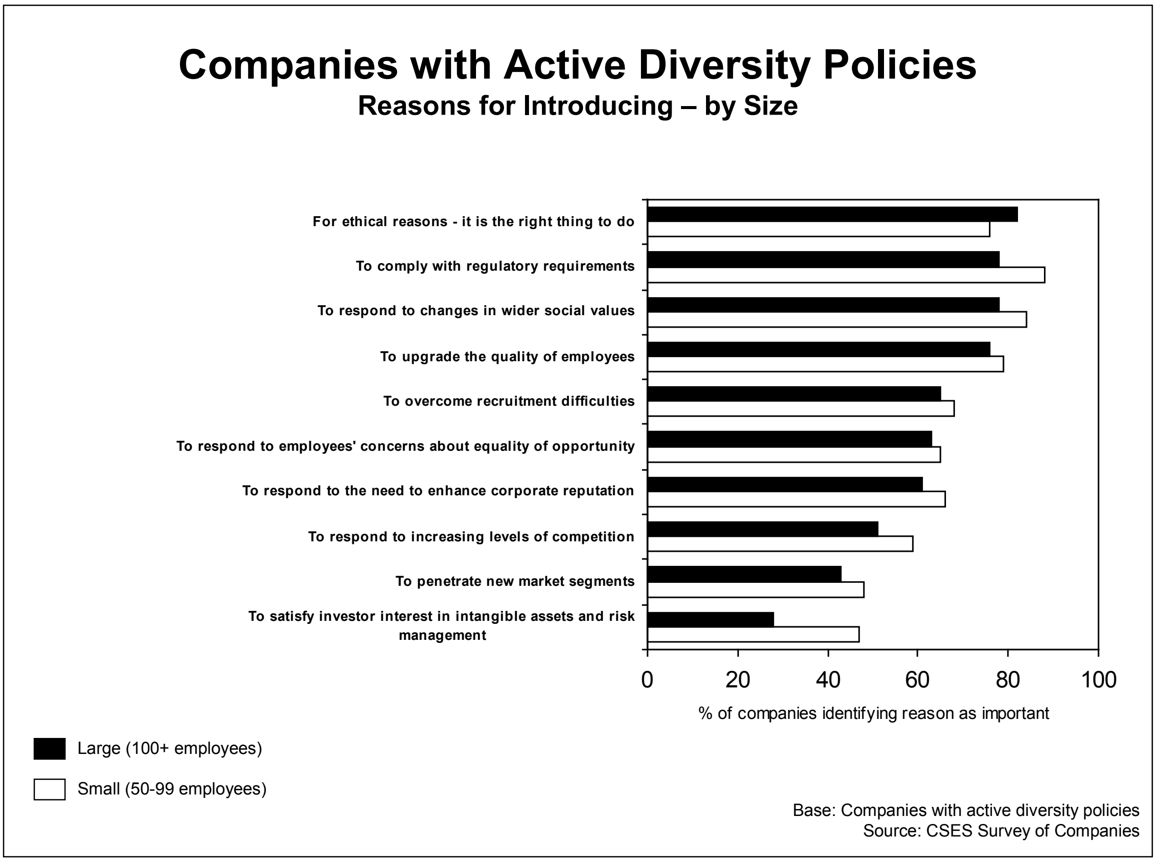
Whilst in overall terms, companies of different types have similar reasons for investing in workplace diversity policies there are some differences of emphasis. Manufacturing companies place greater emphasis on ethical reasons, whilst service sector companies cite increasing levels of competition as an important reason (Exhibit 44).

Exhibit 44



There are also differences between companies of different sizes. Smaller companies stress compliance with regulatory requirements and a desire to satisfy investor interest in intangible assets and risk management to a greater extent than larger companies (Exhibit 45).

Exhibit 45

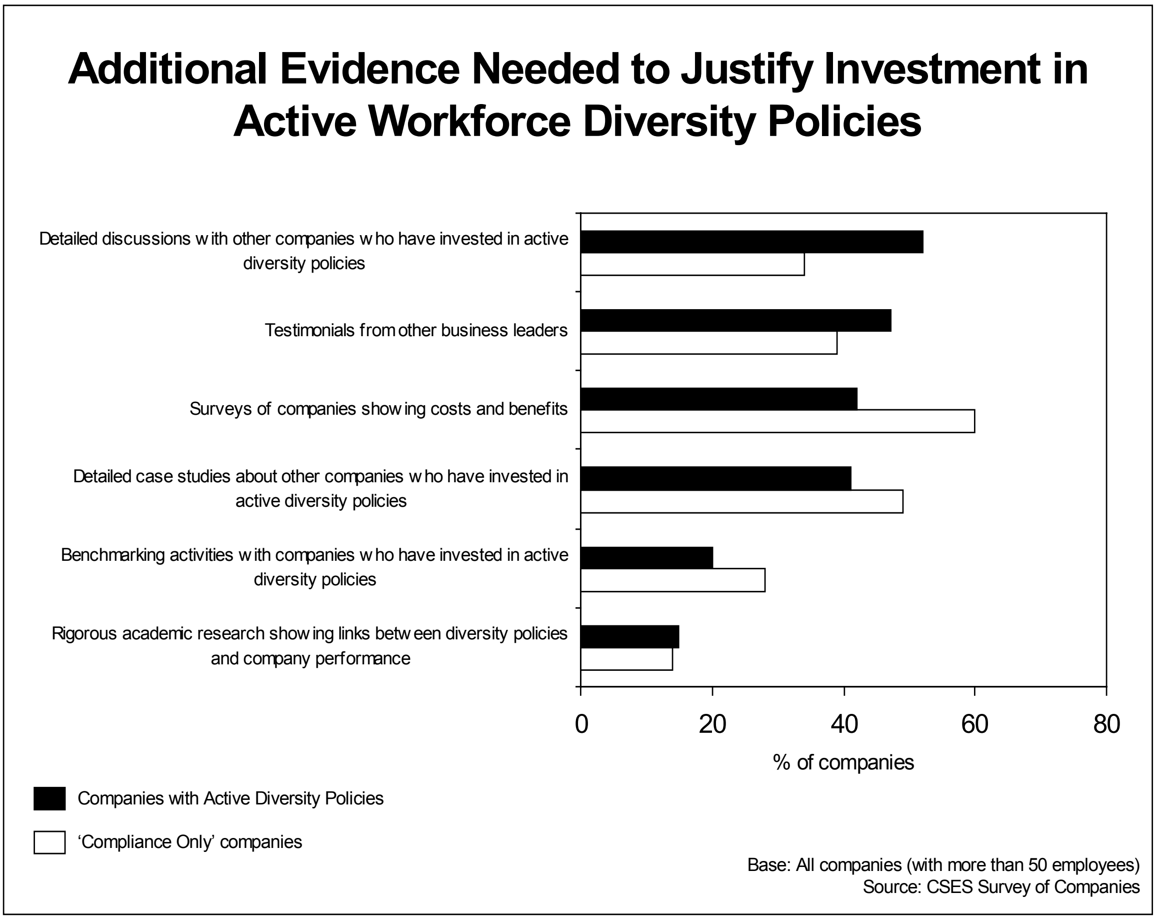


6.3.2. Evidence Needed to Justify Investment

Our survey also explored the additional evidence that companies believe would be useful for them to justify investment in active workplace diversity policies.

Amongst companies who have already introduced active diversity policies, there is a belief that detailed discussions with other companies who have already invested in such policies, testimonials from other business leaders, and surveys of companies showing costs and benefits would have been most value in helping to justify investment (Exhibit 46).

Exhibit 46



Service sector companies and smaller companies (50-99 employees) would also value detailed case studies about other companies who have invested in active diversity policies.

There are some slight differences of emphasis amongst companies who have yet to introduce active workforce diversity policies. They would place the greatest value on surveys of companies showing costs and benefits and on detailed case studies about other companies who have invested in active diversity policies.

7. OBSTACLES TO ADOPTION OF DIVERSITY POLICIES

7.1. TYPOLOGY OF OBSTACLES

7.1.1. General Structure

For public policy to be effective in promoting the voluntary adoption of workforce diversity by companies there is a need to understand the obstacles to implementation as well the "business case" for diversity.

Our research suggests that, as with other forms of investment in new human resource (HR) policies, there are two groups of obstacles to implementation of workforce diversity policies[42]:

- **Internal obstacles** – these are specific to individual companies and emerge from institutional, attitudinal, cultural, and historic factors within individual enterprises. Notwithstanding this, large groups of companies may face similar types of obstacles;

- **External obstacles** – these emerge from national or regional factors, such as institutional structures, cultures/attitudes, and regulatory factors. They affect large groups of companies in a similar way.

7.1.2. Internal Obstacles

Our research has also identified a number of internal obstacles that may prevent implementation of workforce diversity policies within individual companies:

- **Awareness** – amongst some managers there may be a lack of knowledge about the business benefits of a diverse workforce and how to implement the necessary changes effectively.

- **Attitudes** – within some companies there may be negative attitudes towards the creation of a diverse workforce amongst important groups of workers or managers. This may reflect a wider opposition to all major changes in HR policies and processes, as well as a lack of belief in the relevance or value of workforce diversity. In addition, there may be well-established work practices that create indirect discrimination and which managers or workers are reluctant to change. These include, for example, patterns of employment that favour the children or other relatives of existing employees.

- **Economics** – there can be clear economic reasons why some businesses are reluctant to invest in many types of intangible asset, including the creation of a diverse workforce. Costs may be perceived to exceed benefits.

  Cash costs can be identified relatively easily, and experience of other analogous projects (such as the implementation of new IT systems or high

[42] Business Decisions Limited *'New Forms of Work Organisation: The Obstacles to Wider Diffusion'* (2002, a report for the European Commission)

performance work organisations) provides managers with important insights into potential opportunity costs and "execution risks".

Benefits, on the other hand, are often difficult to identify: there are major measurement challenges.

A further disadvantage of investments in diversity programmes is that intangibles are, in general, substantially more difficult to manage and operate than tangible assets. For managers, intangibles have significant disadvantages, including hazy property rights (leading to partial excludability and spillovers), high risk, and the absence of organised and competitive markets (non-tradability). Taken together, these problems make it difficult for companies to quantify benefits and hence undertake traditional investment appraisal processes.

- **Resources ("Business capacity to implement change")** – some companies, especially SMEs, may lack the key resources needed to implement the changes needed to create a more diverse workforce. Such resources include cash, managerial expertise, management time, external advice, and the competence and leadership of senior managers.

7.1.3. External Obstacles

Introduction of workforce 'diversity' policies by companies may be difficult to achieve because of wider cultural or attitudinal factors in certain regions or countries. Possible causes include national cultures that focus on the assimilation of ethnic groups rather than on acceptance of multi-culturalism; political beliefs that favour collective solidarity of workers rather than individuality; and concerns amongst supporters of socially-excluded groups that companies might use diversity policies to avoid proper implementation of anti-discrimination legislation[43].

7.2. FINDINGS FROM SURVEY OF COMPANIES

In the survey of companies, survey we defined workforce diversity policies as those designed to *actively* recruit, retain and develop employees from groups who may face discrimination in the workplace such as women, ethnic or religious minorities, disabled people, gay or lesbian workers, and older people.

In this section we look at the views of "non-users" and "users" ("some initiatives" and "integrated approach" respondents) about obstacles to investment in diversity policies.

[43] Wrench J. *'Cultural and Ethnic Diversity in Europe – New Perspectives for Business Strategies'* (2002, a paper for the Conference Board of Europe)

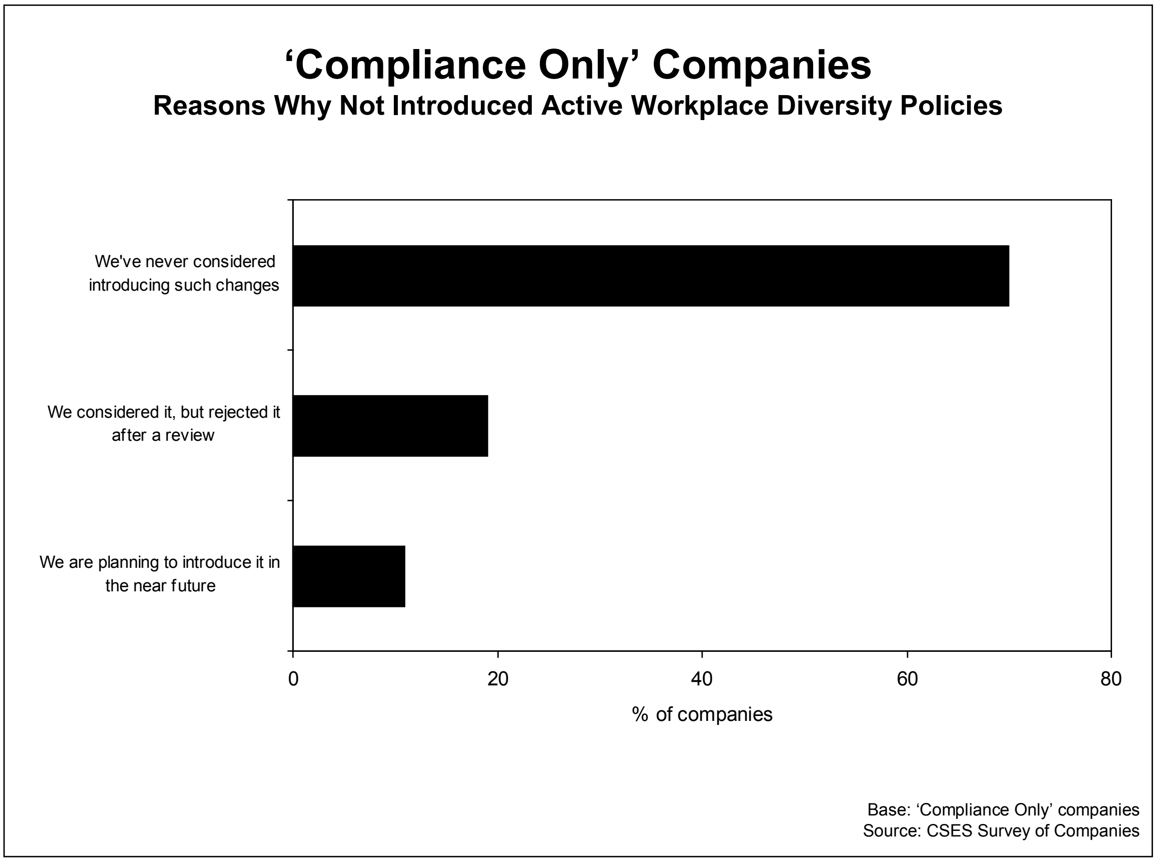
7.2.1 Non-users of Active Diversity Policies

Our survey reveals that circa 40% of companies in our sample were "non-users" of workforce diversity policies. Within this group of non-users, we have identified three sub-groups:

- Companies who have never considered introducing active diversity policies;
- Companies who have considered introducing workplace diversity policies but have rejected it after a review; and,
- Organisations who are planning to introduce workforce diversity policies in the near future.

These are illustrated in Exhibit 47 below.

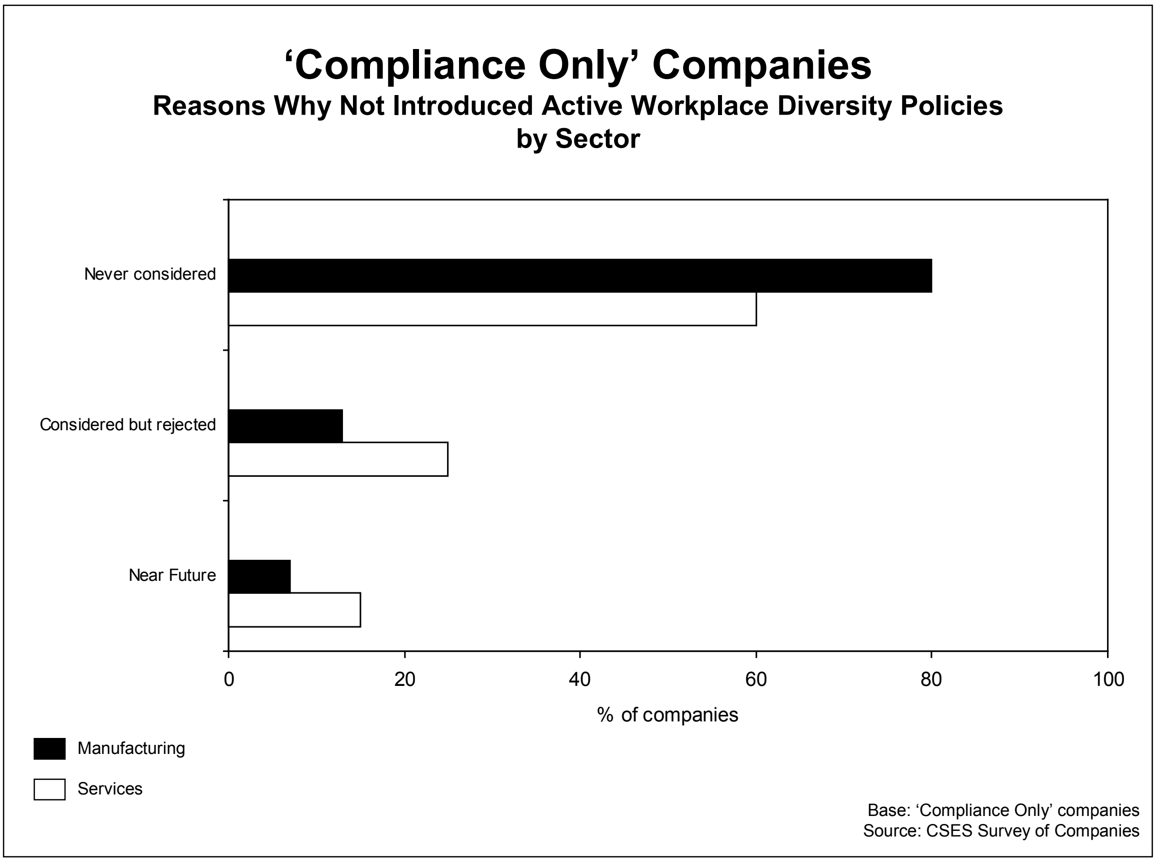
Exhibit 47



Our survey evidence shows that most Non-users (70%) have never considered introducing active diversity policies. In comparison, only a relatively small group (19%) have actively considered introducing diversity policies but have rejected it after a review. Finally, a small group (11%) are planning to introduce diversity policies in the near future.

There are, however, some differences between organisations in different sectors (Exhibit 48). Service sector companies are more likely than manufacturing companies to have considered introducing diversity policies and to be planning to introduce them in the future.

Exhibit 48

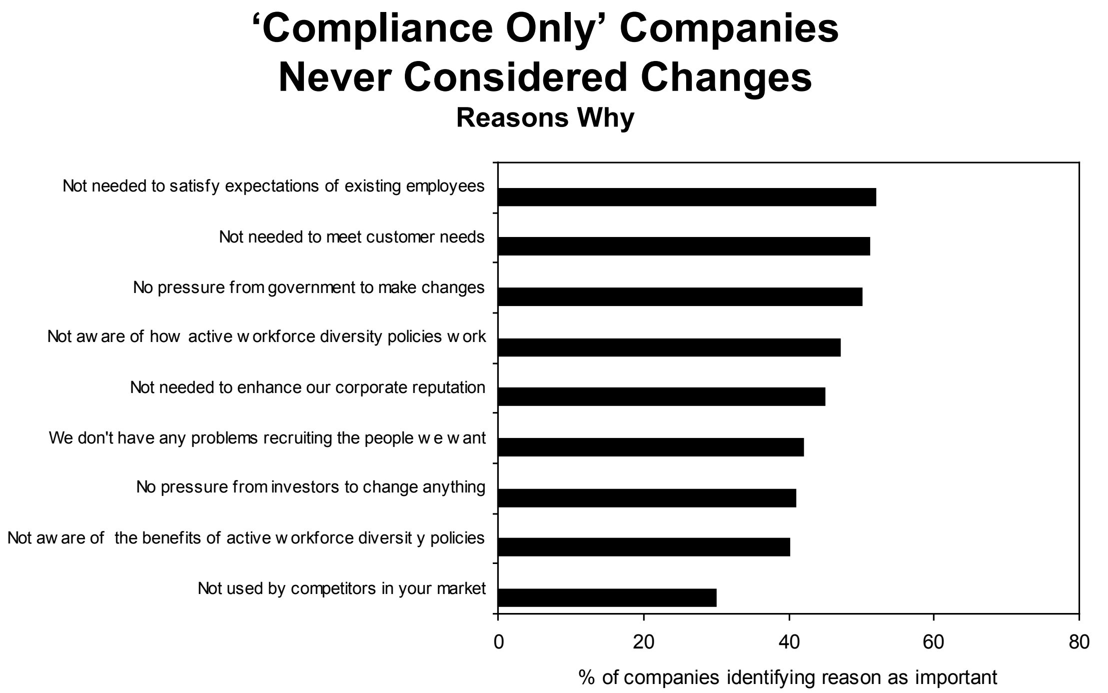


There are a wide range of reasons why companies in our survey have not considered introducing active diversity policies. The most important are:

- *Not needed to satisfy expectations of existing employees (52% of respondents);*
- *Not needed to meet customer needs (50%);*
- *No pressure from government to make changes (49%);*
- *Not aware of how active workforce diversity policies work (47%);*
- *Not needed to enhance our corporate reputation (45%)*

These are illustrated in Exhibit 49.

Exhibit 49



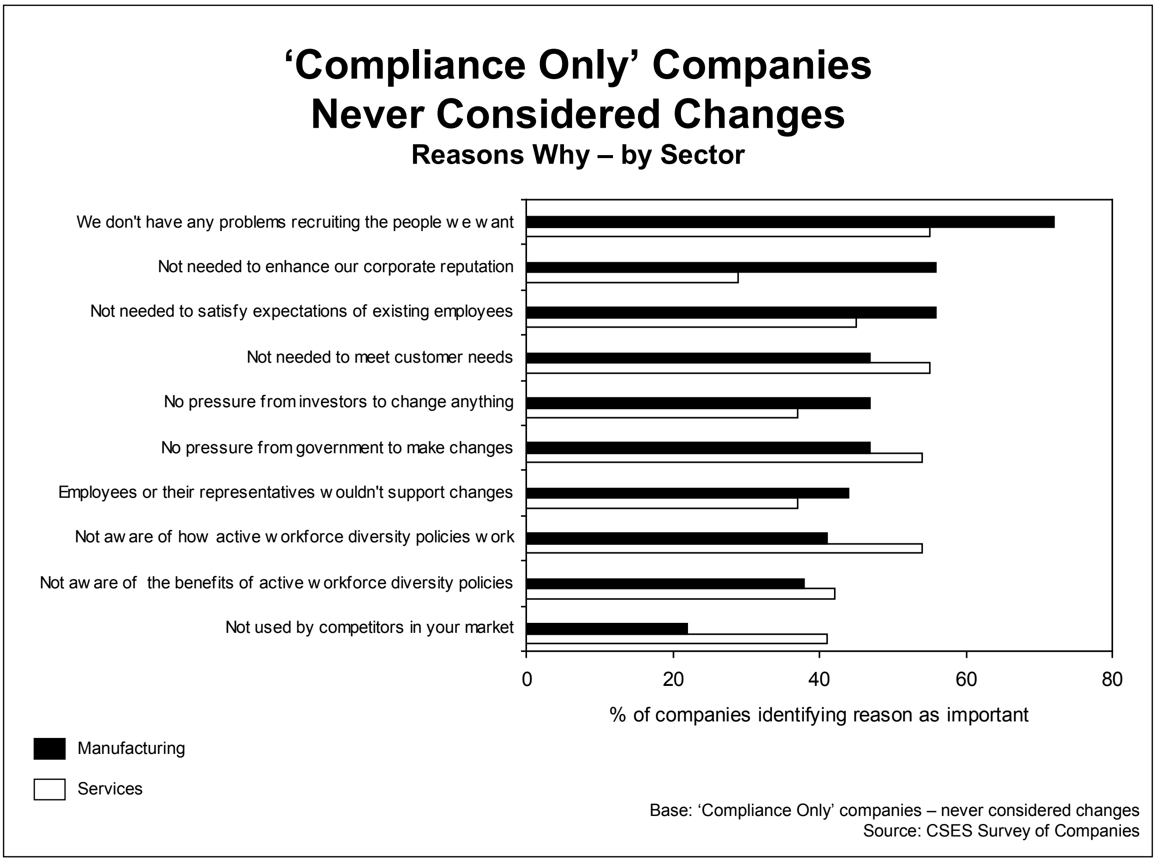
Base: 'Compliance Only' companies – never considered changes
Source: CSES Survey of Companies

On the basis of evidence from companies in our survey, there appear to be three main types of reason why workforce diversity policies have not been considered. First, there is a lack of awareness about such policies and the benefits they bring. Second, there is a perception that diversity policies are not needed to meet the current expectations of employees, potential future workers, customers, or the general public. Finally, there is a lack of pressure from governments or investors.

There are, however, differences between companies of different sizes and in different sectors.

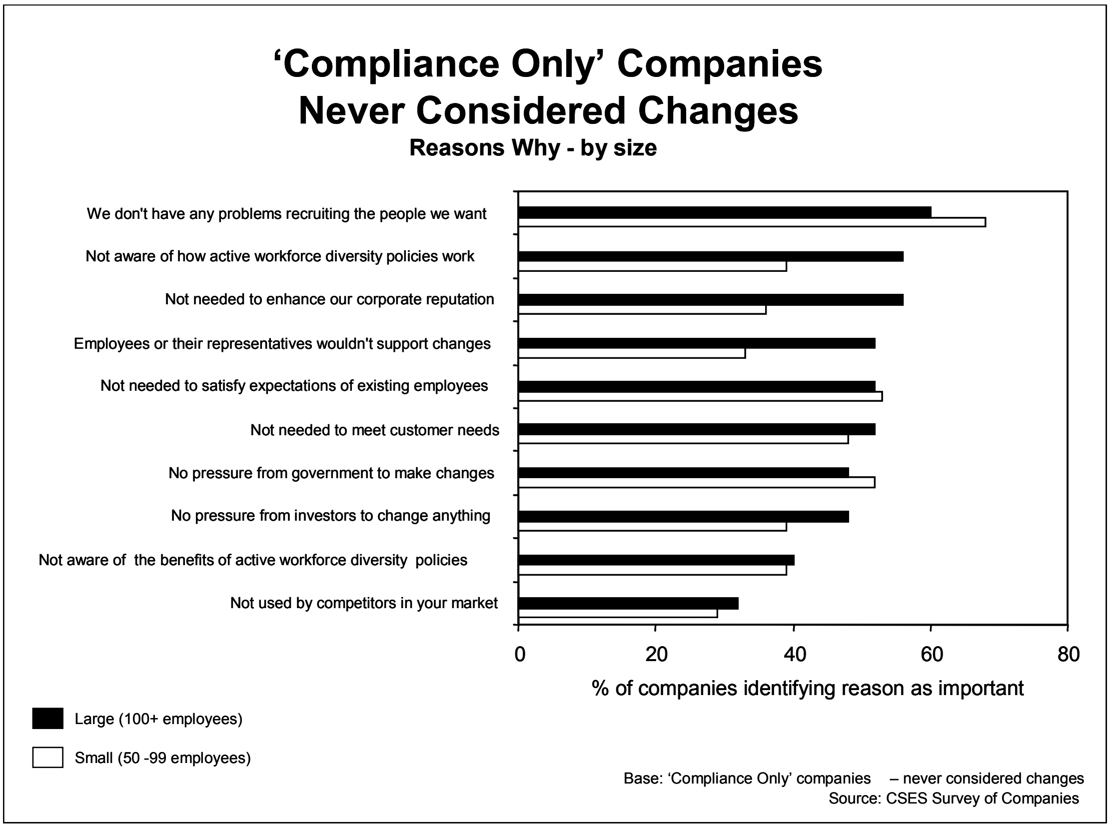
The most important reasons cited by manufacturing companies are lack of problems recruiting the people they want, and the belief that diversity policies are not needed to satisfy the expectations of existing employees or enhance corporate reputation. Service sector companies, on the other hand, admit (to a greater extent than manufacturers) that they are not aware of how active diversity policies work and competitors do not use them (Exhibit 50).

Exhibit 50



There are also some differences between companies of different sizes. Surprisingly, lack of awareness of how diversity policies work was identified as a more important reason amongst large companies than amongst smaller companies. Large companies also say (to a greater extent than smaller companies) that, employees or their representatives would not support diversity-related changes (Exhibit 51).

Exhibit 51



7.2.2. Users of Active Diversity Policies

Evidence from literature and our interviews with companies identifies some of the ***operational problems*** encountered by organisations when attempting to introduce active workplace diversity policies and other similar programmes[44]. Examples include failure to:

- Lead the organisation effectively from the top;
- Consult middle managers and employees extensively and involve them continually in the process;
- Communicate effectively with people throughout the organisation, in an appropriate manner and on an on-going basis;
- Build commitment to the new approach to overcome fears amongst managers and staff;
- Implement the new system in an integrated fashion;
- Adapt the implementation plan as necessary over time and to recognise that the change process is a continuous one;
- Invest adequately in training and new technology; and,
- Measure change throughout the implementation phase.

But much of the literature focuses primarily on the *symptoms* not the *underlying reasons* why problems occur. Few existing analyses address the causes, such as lack

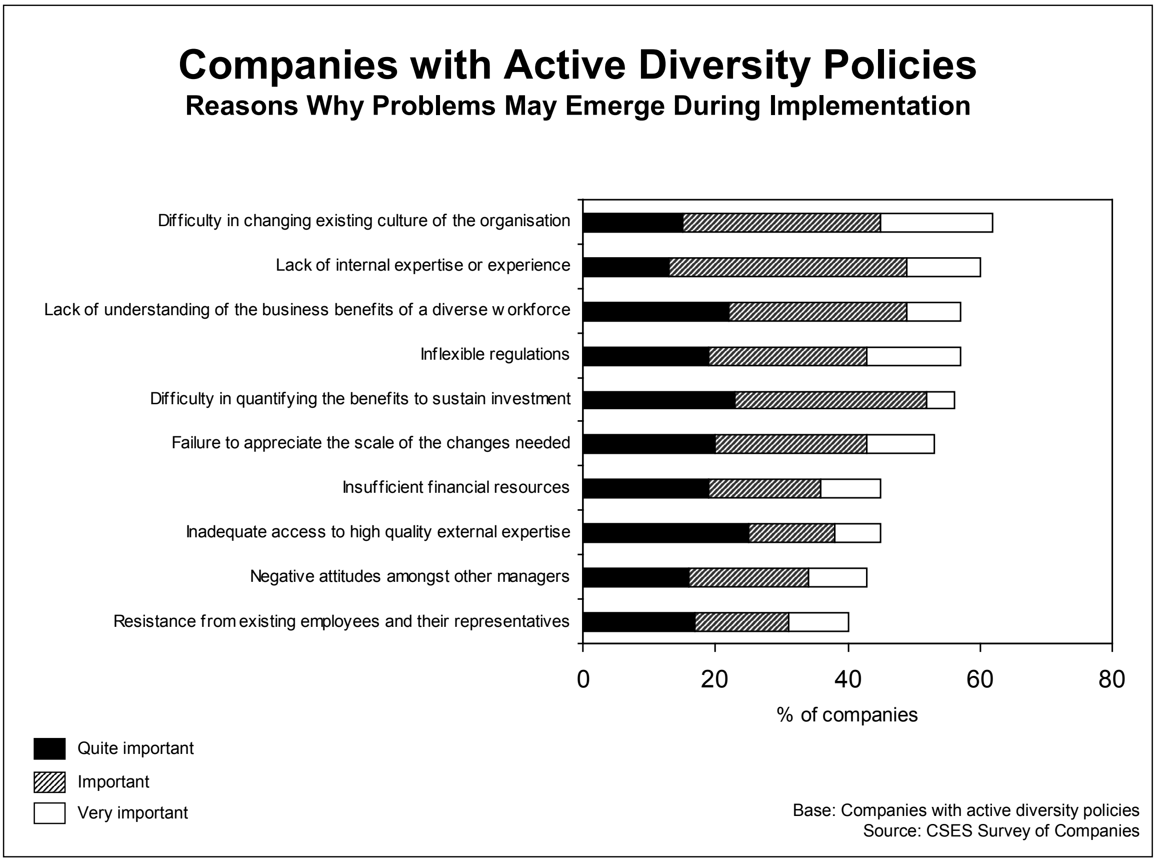
[44] See for example, Ashton D. and Sang J. *'Supporting Workplace Learning for High Performance Working'* (2002, a report for the ILO)

of access to expertise; lack of long-term commitment; lack of staff skills; negative attitudes; and insufficient financial resources.

Our survey examines some of the underlying causes.

Respondents[45] were asked to think about the reasons why problems emerge during the implementation of active diversity policies. They were asked to assess (on a scale of 1 to 5) whether each of a list of ten obstacles were important or not in their situation. The results are shown in Exhibit 52.

Exhibit 52



Five of the six most important reasons why problems emerge are primarily "internal":

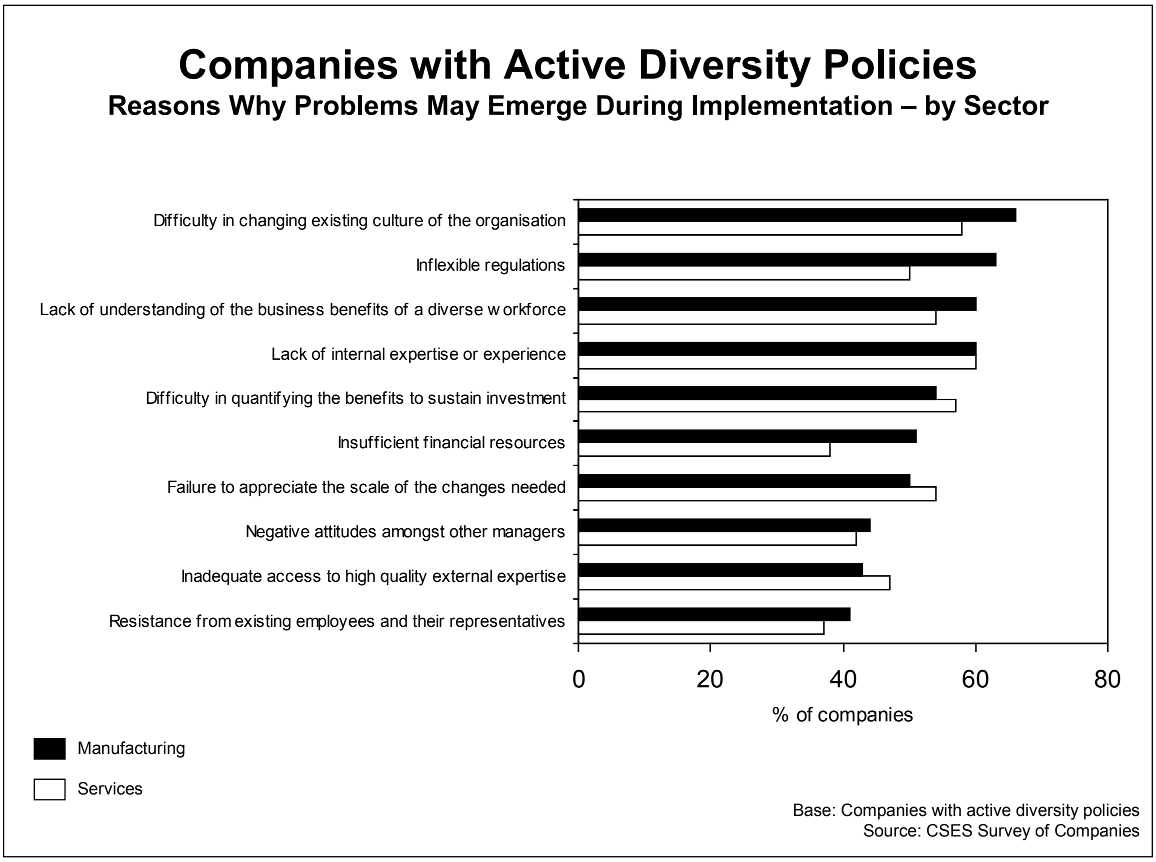
- *Difficulty in changing the existing culture of the organisation*
- *Lack of internal expertise or experience;*
- *Lack of understanding of the business benefits of a diverse workforce;*
- *Difficulty in quantifying the benefits to sustain investment;*
- *Failure to appreciate the scale of the changes needed.*

Only one of the six most important reasons why problems emerge is primarily "external" (*inflexible regulations*).

[45] The person responsible for Human Resources or Personnel Policy in the organisation, usually the HR Director (or the Managing Director in smaller organisations).

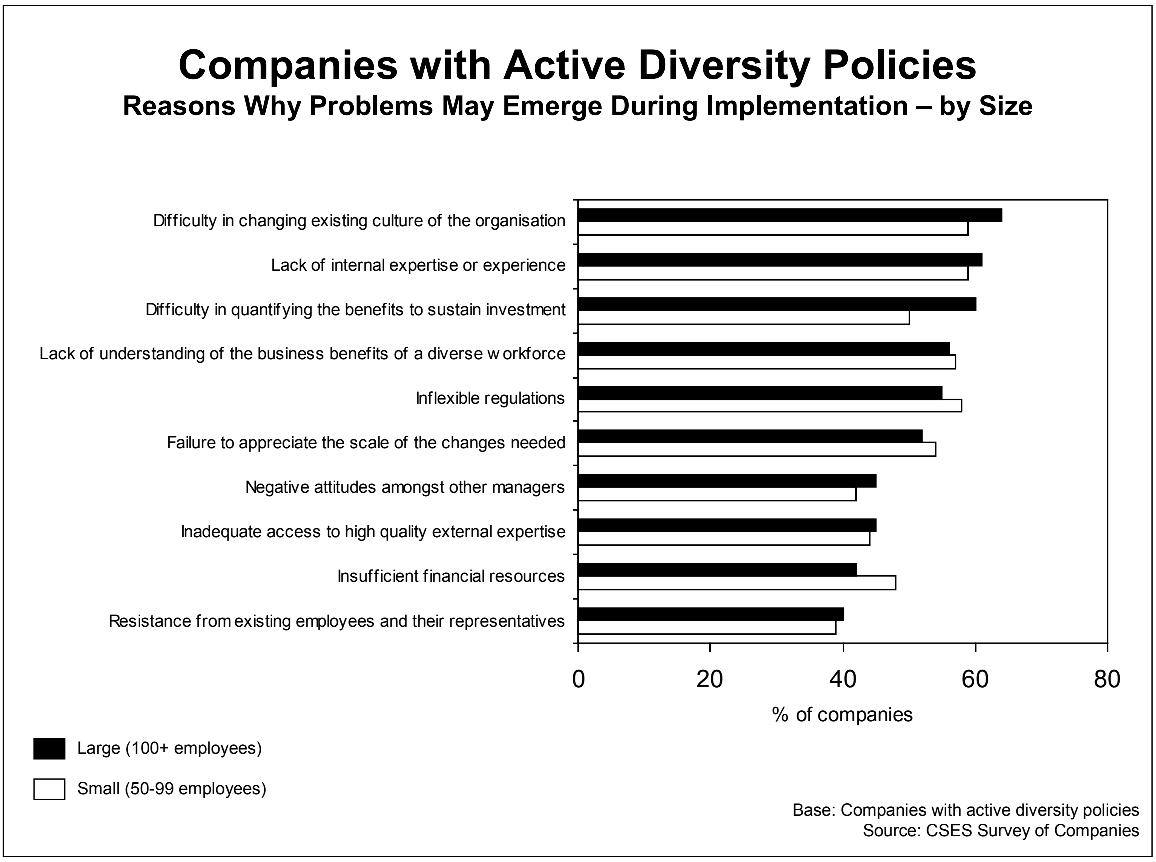
Interestingly, there are very few differences between companies of different types. In overall terms, manufacturing and service companies identify the same set of obstacles (Exhibit 53). Manufacturing companies do, however, place greater emphasis on inflexible regulations and lack of financial resources than service companies.

Exhibit 53



There are also strong similarities between companies of different sizes (Exhibit 54). The only significant difference is in terms of the emphasis placed on the difficulty in quantifying the benefits to sustain investment. Large companies identify this as a greater obstacle than smaller ones.

Exhibit 54



7.3. LEGAL RESTRICTIONS ON SENSITIVE DATA

Our analysis of the existing indicators used by companies to measure the costs and benefits of workforce diversity policies highlights the importance of being able to measure workforce demographics. This is one of the critical measures of "intermediate outcomes". Moreover, changes in workforce demographics are the most widely used targets for diversity programmes.

Measurement of workforce demographics is also important for assessing improvements in productivity, absenteeism, and labour turnover amongst particular groups. Some measures of innovation performance make additional use of workforce demographics to assess the relative performance of different product development teams.

If companies face difficulties in measuring workforce demographics, this could, potentially, undermine the effectiveness of diversity programmes. In an earlier section of the report we highlight the reasons why measurement is important.

The ability of companies to measure workforce demographics is determined by the nature of the information that they hold about each of their employees. This, in turn, is established by cultural norms, employment legislation (the need to identify disabled employees to meet quotas in some countries, for example), and restrictions on the holding of "sensitive data".

Member State restrictions on the holding of "sensitive data" about employees by employers are determined by:

- General legal principles included in national privacy and employment laws, especially the principles 'relevance' and 'proportionality';

- Specific restrictions set out in national employment and privacy laws;

- The EU Data Protection Directive of 1995 (Council Directive 94/46/EC) and its transposition into national law, especially the utilisation of exemptions to the restrictions on processing (and holding) "sensitive data"; and

- Employer obligations to promote diversity or avoid discrimination imposed by employment and anti-discrimination laws.

Based on a limited review of legal analyses produced for the European Commission[46] the following situation appears to be present:

- Collection of data on age, gender and disability is probably permitted in most EU countries. Such data passes the general test of 'relevance' for employment purposes; there are no obvious national restrictions; and, the EU Data Protection Directive does not add further restrictions.

- Collection of data on ethnic background, religious belief or sexual orientation of employees is probably not permitted in most EU countries. National employment and data protection laws forbid the collection of such data in a number of Member States. Moreover, Article 8 of the 1995 EU Data Protection Directive prohibits processing of "sensitive data", including information about ethnic background, religious belief or sexual orientation. Although, it also provides a number of exemptions as is shown below.

- However, the EU Data Protection Directive does allow Member States to establish exemptions to the requirements of Article 8, if they so wish. There are two principal forms of exemption: prior consent or authorisation; and obligations under employment law. Some countries have, however, not introduced these exemptions.

- Implementation of the new EU Directives outlawing discrimination in employment on a wide range of grounds may expand further the number of countries where collection of data on ethnic background, religious belief, and sexual orientation could take place. But this will depend on the extent to which Member States have implemented the exemptions to Article 8 of the EU Data Protection Directive.

The table below provides an assessment of the most likely situation today (Exhibit 55):

[46] Report for the European Commission (*'Protection of Workers' Personal Data in the European Union: General Issues and Sensitive Data'* - 2002) and Korff D. *'EC Study on the Implementation of Data Protection Directive – comparative study of national laws'* (2002, a study for the European Commission)

Exhibit 55

Country	Employee Data			Comments
	Sexual Orientation	Ethnic Origin	Religious Belief	
Austria	No	No	No	Decisions delegated to Works Councils but not allowed by Employment law to consent to collect data on private lives
Belgium	No	No	No	Specific prohibition by Royal Decree
Denmark	No	No	No	Specific prohibition under Employment law.
Finland	No	No	No	Strict relevancy test under Employment Law
France	No	No	No	Specific prohibition under Employment law.
Germany	No	No	No	Strict Data Protection law based on Article 8, and no exemptions implemented
Greece	No	No	No	Strict relevancy test under Employment Law
Ireland	Yes	Yes	Yes	Wide-ranging Anti-Discrimination law and exemptions implemented under Data Protection law.
Italy	No	No	No	Specific prohibition under Employment law.
Luxembourg	No	No	No	Strict Data Protection law based on Article 8, and no exemptions implemented
Netherlands	No	Yes	No	Relevance test in Employment laws prohibits two of the three areas. Specific requirement under Minorities Promotion Act to report ethnic changes.
Portugal	No	No	No	Interpretation of law by Date Protection Authority.
Spain	No	No	No	Specific prohibition under Data Protection law.
Sweden	Yes	Yes	Yes	Wide-ranging Anti-Discrimination law and exemptions implemented under Data Protection law.
UK	No	Yes	No (some exceptions in Northern Ireland)	Data Protection law allows exemptions and specific legal provision to collect ethnic data. Introduction of new Anti-Discrimination law, to implement EU Directive, may further widen extent of data collection.

Source: CSES

7.4. ANTI-DISCRIMINATION FRAMEWORK

National socio-legal frameworks play an important role in influencing the nature and scale of diversity policies within companies. Legal restrictions on holding sensitive personal data about employees make it difficult to measure the effectiveness of diversity programmes that attempt to include a wide range of disadvantaged groups. Such restrictions could, potentially, distort the nature of investments in diversity by companies.

Evidence from our survey of companies provides further evidence of the importance of social factors as drivers of change. Response to changes in social values is mentioned by more than 80% of respondents as a reason for investment in diversity policies. Our interviews with companies and business organisations provide additional evidence. In some countries, it is suggested, cultural values are one of the biggest barriers to the adoption of diversity policies. This is a particular problem for SMEs because, unlike larger companies, they are heavily exposed to local markets for products, labour and capital. Some large companies may also be affected by local cultural factors, especially if they operate in traditional service sectors such as retailing or financial services.

Anti-discrimination legislation forms an important part of the national socio-legal framework within which companies operate. It outlaws unacceptable employment practices and 'signals' important changes in social values to companies. Evidence from our survey and case studies also shows that it can, for certain companies, trigger investments in diversity programmes.

Although new EU directives will ensure that all Member States adopt a similar and comprehensive legal framework, the existing national pattern of anti-discrimination legislation may well have had an important influence on the extent and nature of existing diversity practices within companies.

The existing framework has a number of characteristics that are relevant to the adoption of diversity programmes by companies. These include:

- The presence of legislation in all EU countries to outlaw discrimination in employment on the grounds of gender because of earlier EU directives;

- A majority of EU countries have specific legislation (either labour law or anti-discrimination law) to combat discrimination on grounds of ethnic origin, religious belief, or disability. In the case of disability, there are two different types of mechanism: employment quotas; and anti-discrimination or employment legislation.

- Only a limited number of countries have legislation designed specifically to prevent discrimination in employment on grounds of sexual preference or age. This gap in legal provision is, in some cases, overcome through provisions in the national constitution.

- Most of the legislation in Member States is designed to outlaw discrimination and support equal treatment. Very few national laws go beyond this.

7.5. SOCIO-CULTURAL FACTORS[47]

[47] Dr. Juanita Elias of the BRASS Centre at Cardiff University carried out the literature review for this part of the project for CSES. The BRASS centre is an Economic and Social Research Council funded centre. It is a collaboration between Cardiff University's Department of City and Regional Planning, Business School, and Law School.

Our evidence from the survey of companies, case studies, and interviews highlights the importance of social factors in influencing the extent and nature of diversity policies in companies, especially SMEs. So far we have looked at some of the legislative factors. In this next section we provide a brief overview of the potential impact of national social attitudes and cultural values on decisions by companies to invest in workplace diversity policies.

We have not undertaken an exhaustive enquiry: these are initial ideas based on a limited review of literature and discussions with stakeholders.

Our brief comments cover ethnicity, gender, age, disability, and sexual orientation. Evidence from our research failed to identify significant differences between Member States in terms of cultural values and tolerance of religious differences, although our findings on ethnicity may provide some insight into differences in this area.

It is worth noting however, that our observations reflect ideal types and it is important to recognise that in reality all of these different identities (gender, age, sexuality, disability and ethnicity) overlap.

- **Ethnicity** - recent academic research suggests that there are important cultural differences within Europe, in national responses to immigration and cultural diversity[48]. It is suggested that this is not simply a matter of different states possessing a certain cultural predisposition towards different ethnic groups (“a sort of mental programming”) but that the historical development and institutional frameworks that exist within states have played a role in the development of cultures in which certain attitudes towards ethnic minorities are likely to flourish. Different types of response include the “guest worker model” (immigrant groups find it difficult to obtain full citizenship rights); assimilation of immigrants into the dominant culture (little tolerance of difference – immigrants become part of the dominant culture); and ‘multiculturalism’ (acceptance of differences between people from different ethnic backgrounds).

- **Gender -** researchers have identified a classification of welfare regimes that provides a useful indication of differences in the attitudes of different member states towards women and employment[49]. The classification divides the EU’s welfare regimes into a number of groups. These include: “conservative’”(high levels of welfare provision accompanied by promotion of family values); “social democratic” (high levels of provision and promotion of labour market opportunities); and “liberal” (reliance on private provision of support but promotion of access to labour markets).

- **Age** - our limited review of literature could not identify a dominant typology of differences in attitudes to the employment of older workers across the EU. Evidence from our interviews with stakeholders, however, suggests that there may well be differences of treatment of older workers across the EU. The

[48] Wrench J. *‘Cultural and Ethnic Diversity in Europe – New Perspectives for Business Strategies’* (paper for Conference Board – 3rd European Work-Life and Diversity Conference, 2002) and Castles S. *‘How nation-states respond to immigration and ethnic diversity’* (New Community Vol. 21, No. 3, 1995)

[49] Essping-Anderson G. *‘The Three Worlds of Welfare Capitalism’* (1990), and Liebfried S. *‘Towards a European Welfare State?’* in Room G. ‘European Development in Social Policy’ (1991)

major driver of these differences may well be how different cultures responded to the need for economic restructuring of traditional, manufacturing industries in the 1980s and 1990s. A number of different possible approaches can be identified. In some EU countries there has been extensive use of early retirement to remove older workers. In contrast, governments in other countries within the EU have shown limited support for early retirement, favouring either a market-based or more egalitarian approach.

- **Disability** - disabled people face significant barriers to employment across all EU member states. Evidence from our review of literature suggests that Member States set out to overcome these barriers in two different ways[50]. These may, in part, be influenced by differences in social attitudes towards disabled people and their role in the workforce. These two different approaches can be classified as: the "social model" (this approach seeks to integrate disabled people into the workforce by providing them with the opportunity to compete on equal terms with other workers); and, the "medical model" (this focuses on the individual limitations of disabled people and, thus, the need for radical state intervention in the labour market to secure economic rights for them).

- **Sexual Orientation** - our initial review of literature suggests that little survey research into cultural attitudes towards homosexuality across Europe exists. Notwithstanding the lack of available research, our assessment of the limited literature suggests that there are differences in cultural attitudes surrounding discrimination on the basis on sexual orientation, and that these need to be understood in terms of: the differing institutional and religious contexts that exist in EU member states; and, the visibility of gay and lesbian people in mainstream society. Some EU countries have, for example, strong traditions of equal rights and equality, combined with a culture of openness about sexuality. Other countries have traditions that emphasise a clear separation between people's public and private lives; the idea that what takes place in a person's private life remains private. Finally, attitudes towards homosexuality continue to be influenced by the historic importance of religion in the political and social institutions of certain countries and regions.

These factors may make it more difficult for companies, especially SMEs, to adopt diversity policies. Alternatively, they may distort the nature and content of diversity policies adopted by companies. Such policies may exclude certain groups, for example.

8. CONCLUSIONS

A number of important issues have emerged from our research. Specifically:

- **The business case for investment in workforce diversity is embryonic. It is also fragmented.** In comparison with the evidence available to support investments in other forms of intangible asset, there are also major gaps, especially the lack of empirical research and comprehensive case studies.

[50] See for example, Van Oorschot and Hvinden B. eds. *'Disability Policies in European Countries'* (2001)

There is, therefore, no comprehensive business case or single set of indicators of costs and benefits available to be "tested" in a European context.

- **Action can be taken by governments and other actors to overcome these weaknesses, especially through the provision of more information about the experience of companies that have invested in diversity policies.** Evidence from our survey of companies suggests that public support for greater networking between businesses, more surveys of companies, and collections of case studies would be useful.

- **Despite these existing weaknesses, a potentially powerful case for investment in workforce diversity policies is beginning to emerge.** It is based on a combination of qualitative and quantitative factors, derived from limited examples of benefits and the testimony of a small number of top managers and business organisations. There are also strong links to investments in human capital. Moreover, an increasing number of examples of costs and benefits of diversity policies are emerging, and these can be classified in ways that are relevant to businesses.

- **Although there are already a large number of indicators of cost and benefit in use by companies, these tend to be qualitative in nature and most focus on costs and 'intermediate outcomes' (such as changes in workforce attitudes or demographics).** There is little evidence of quantitative assessment of benefits, for example. Furthermore, there is no single set of indicators of cost and benefit that is relevant to most enterprises. In general, costs and benefits of workforce diversity policies tend to be "context-specific": they reflect the strategy and business situation of each company. Finally, there is little evidence of any systematic measurement of costs and benefits by companies. Taken together, these factors limit the scope for formal, quantitative analysis of the cost-effectiveness of workforce diversity policies.

- **Other, similar types of intangible asset, such as human capital investments, have begun to overcome these problems through the development of a combination of different types of evidence: testimonials from businesses; case studies; academic studies; and surveys of companies.** As an example of progress, work is now taking place to identify possible public reporting standards for human capital management.

- **Notwithstanding these problems with measurement, it is possible to construct a 'model' of performance measurement that provides a systematic method of identifying costs, benefits, and key processes.** We have drawn up such a model, based on existing measurement practices, evidence of costs and benefits, and modern performance measurement methods. It highlights the value of measuring investments in diversity programmes, makes a clear distinction between inputs and different types of outcomes, and forces companies to consider carefully different types of benefit and how to measure them.

This framework can be adopted by all types of company that invest in diversity policies. Within a common structure, the specific indicators and methods of measurement can be tailored to meet the needs of each business.

- **Investment in sustainable diversity policies in Europe is probably limited to a small number of pioneering companies today.** But a business case is beginning to emerge based, in part, on the experience of these companies. As a result, it is important to understand more fully the reasons why other companies have not yet invested in diversity policies, and the evidence needed to persuade them.

- **Evidence from our pilot survey of companies suggests that there are two major 'internal' obstacles to investment in workforce diversity policies. These are the difficulties in changing the culture of a business and lack of awareness of workforce diversity policies.** This "awareness gap" includes lack of knowledge about the content, rationale, costs, benefits, and methods of measurement of workforce diversity policies. Implementation of programmes to change business culture is difficult for most companies. The scope for effective public policy intervention is limited because the major problems tend to be a lack of management expertise and a fear of change. In contrast, there is more scope to use public resources to help raise awareness of diversity policies.

- **Our limited review of the socio-legal environment in the EU suggests that there may well be 'external' obstacles to the adoption of workforce diversity policies.** Restrictions on the holding of sensitive data in most EU countries limit the effectiveness of workforce diversity policies. Such restrictions make it impossible for companies to measure changes in workforce demographics: a key intermediate outcome and measure of progress. This is particularly the case for programmes that seek to recruit and develop gay and lesbian citizens, people from different ethnic backgrounds, and workers with different religious beliefs.

  As well as this legal restriction, there may also be problems because of differences in social attitudes across the EU. There are, for example, major differences between EU member states in the approach taken towards ethnicity. Such differences may limit the scale or distort the design of workforce diversity policies.

9. RECOMMENDATIONS

On the basis of our survey of companies, we have identified the following actions that could be undertaken to improve the evidence for the business case for investment in diversity and to strengthen the evidence for investment in workforce diversity programmes:

- Development of a compendium of case studies that describe why companies invest in diversity, the process of implementation, the costs and benefits of diversity, and performance measurement techniques. These cases should cover companies of different sizes, be extensive and should be made available electronically.

- Support for a network of demonstration projects across the EU based on leading companies in different sectors and of different sizes. The projects would help fund developments in the measurement of costs and benefits, and provide support for implementation. In return, participating companies would be required to provide access and support to other businesses.

- Investment in surveys of companies on a periodic basis across the EU designed to highlight the extent of penetration of diversity policies, obstacles to adoption, and costs and benefits. Evidence from the surveys should be made widely available through the creation of a dedicated web site. This could also hold copies of case studies.

- Support for a network of diversity promotion organisations across the EU designed to share good practices and ensure full dissemination of EU-funded research. An example of a similar network is the European Work Organisation Network (EWON) supported by DG Employment.

- Support for national studies designed to establish links between investments in diversity and business benefits. These should make use of the typology benefits developed by this report. Such studies will also pioneer mechanisms for determining the extent to which a company is a “diverse business”.

- Support for EU-level conferences that will highlight the benefits of workforce diversity for businesses of different sizes. These should be run jointly with social partners and other, relevant business organisations.

- Provision of information about the benefits of workforce diversity policies;

- Development of formal and informal networks to share information about the costs and benefits of workforce diversity policies, and methods of measurement; and,

- Establishment of programmes to develop new tools for measuring the benefits of workforce diversity programmes.

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