Is Diversity Management Related to Financial Performance in Family Firms?

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Compelled by regulatory and market forces, organizations are adopting measures for increased diversity in the workforce, top management teams and boards of directors. Inclusion of women and minorities is gaining importance in business. Diversity management in organizations has, of late, evinced keen interest in business researchers as well. Both academics and managers agree that diversity in an organizational setup is strategically important to bring value to the firm – either monetary or otherwise. Though diversity management and its impact on the financial performance of a firm is an important area of study, it has not been probed in the family business context. This article studies diversity management policies of family firms and attempts to find answers to two specific questions:

- Do diversity management policies and practices differ across family and nonfamily firms?
- What effect do these policies have on the financial performance of both types of firms?

Clan control and traditional practices may dissuade family firms from taking initiatives to enhance diversity. However, family firms are also known to

safeguard their reputation and would like to be seen to adopt socially progressive diversity measures. Therefore, the authors hypothesize that family firms are likely to adopt weaker diversity policies compared to nonfamily firms which may have a bearing on the firm's financial performance.

This study analyzed diversity indicators of 952 US firms from the MSCI ESG database from 1991 to 2011 and their effects on the financial performance and ratings of these firms as recorded in the S&P's Compustat and Ratings databases respectively. The diversity indicators studied included – woman or minority CEO, promotion of women or minorities, board diversity, diversity promoted in subcontractors, and a policy for employing the disabled and providing benefits to domestic partners.

The major findings of the study are as follows:

- Family firms had fewer diversity management policies compared to nonfamily firms.
- Family firms were less diverse compared to nonfamily firms on the counts of women or minorities in top management, on the board of directors or as subcontractors.
- Family firms had better financial performance than nonfamily firms.
- Family firms did not suffer financially due to lower diversity

Family managers may be averse to diversity management policies, as they might fear that they will dilute family ties, mutual trust and coordination, tacit knowledge and control over the firm. However, even though family firms are less diverse compared to nonfamily firms, their financial performance is better. The question that emerges from the findings is — does it make sense for family firms to be proactive in implementing diversity management policies? The answer is "Yes."

Diversity management is a dimension of corporate social responsibility (CSR) efforts that a firm undertakes. It has costs – for family firms in dilution in familiness and perhaps also in their ability to make profits. However, embracing diversity makes the family firm a more socially responsible corporate citizen and adds to its reputation – something that is generally highly valued by family managers. Diversity enables family firms to enrich their talent pool with distinct perspectives. Taking proactive measures to improve diversity protects the family firm from being labeled as socially irresponsible and against social sanctions. However, this needs to be done to the degree that the firm also preserves its profitability and investor returns.

Thus, the most crucial practical implication of this research is that family firms need to strike a balance between their diversity management policies and the degree of cohesion and control that the family wishes to exert on the firm. This will ensure that family firms have a rich set of talent and capabilities and be a socially responsible business, while they also sustain financial growth and performance that are rooted in their familiness.

As diversity policies do not have a significant financial role, the authors suggest that financial incentives may not lure family firms to adopt diversity measures. Instead, their diversity initiatives are more likely to be driven by factors such as organizational culture, legacy and strategy.

Organizational diversity is an upcoming area in research and, therefore, presently there are limited practical implications for practitioners. The authors admit to several limitations of their study as diversity phenomenon lacks sound quantitative measures that are yet to be developed. They also stress the need for a deeper qualitative study to know how firm policies on diversity actually take shape. The authors also suggest undertaking cross-cultural studies to understand the meaning and impact of diversity in the context of different countries (especially those in the eastern part of the globe that are known to

have a culture of stronger clan control, such as China, Japan, Korea or India). Readers are recommended to read the ‘Discussion and Conclusion’ section of the paper for a better understanding of future research needs in this area.