

THE COSTS AND BENEFITS OF DIVERSITY

Fundamental rights & anti-discrimination



Employment & social affairs



European Commission

THE COSTS AND BENEFITS OF DIVERSITY

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

Executive Summary

Employment & social affairs

Fundamental rights and anti-discrimination

European Commission

Directorate-General for Employment, Industrial Relations
and Social Affairs
Unit D/3

Manuscript completed in October 2003

This report has been drawn up by the Centre for Strategy and Evaluation Service (CSES) on behalf of the European Commission, with support from the European Community action programme to combat discrimination.

Centre for Strategy and Evaluation Services
PO Box 159
Kent TN14 5WT
United Kingdom

The full text of the report is available on-line at:

http://europa.eu.int/comm/employment_social/fundamental_rights/prog/studies_en.htm

The contents of this publication do not necessarily reflect the opinion or position of the European Commission

OVERVIEW

This study examines the measurement of the costs and benefits of workforce diversity policies, i.e. voluntary initiatives by businesses to recruit, retain, and develop employees from diverse social groups. The work has been undertaken against a background of the implementation of new anti-discrimination directives throughout the EU and increased investment in workforce diversity policies by businesses.

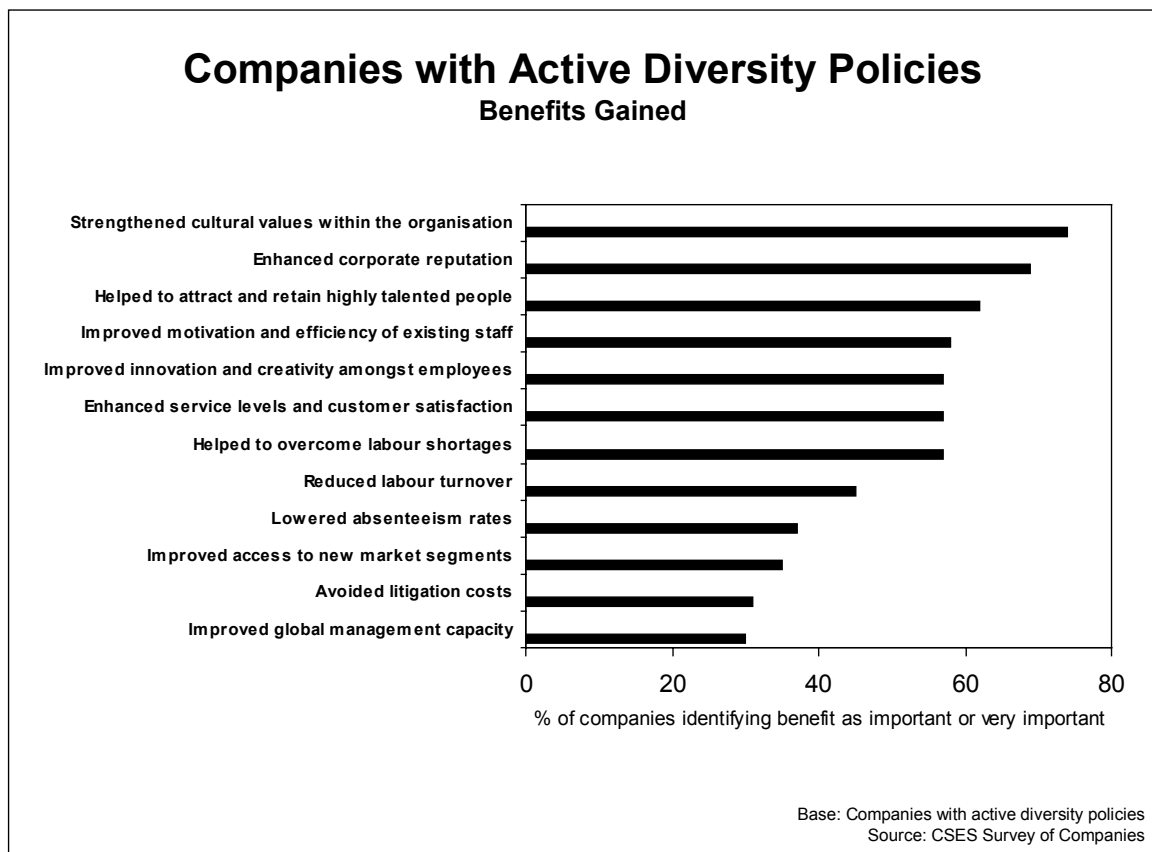
Multiple sources of evidence have been used to complete the study, including a survey of 200 companies in four EU countries; extensive literature reviews; development of 8 case studies of diversity promotion programmes in 6 Member States; and 48 interviews with companies, business organisations, national governments, equality agencies, trade unions, and non-governmental organisations.

Our findings provide important insights into diversity policies and their measurement that are of relevance to business managers, social partners, and policy-makers.

Specifically, the report identifies a number of key issues:

- 1. Companies that implement workforce diversity policies identify important benefits that strengthen long-term competitiveness and, in certain instances, also produce short and medium-term improvements in performance (Exhibit A).**

Exhibit A



Our evidence suggests that the most important benefits arising from the implementation of diversity policies arise from strengthening organisational and human 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.

There are, of course, costs associated with the implementation of diversity policies. These include the cash costs of compliance with laws on discrimination and of the implementation of programmes to change internal cultures such that a diverse workforce is recruited, retained, and developed. Moreover, there are also opportunity costs associated with the diversion of management time, and the “execution risks” associated with major organisational change programmes.

2. Effective, systematic measurement of the costs and benefits of workforce diversity policies is essential to sustain existing programmes and to build the business case for greater investment, especially by “non-users”.

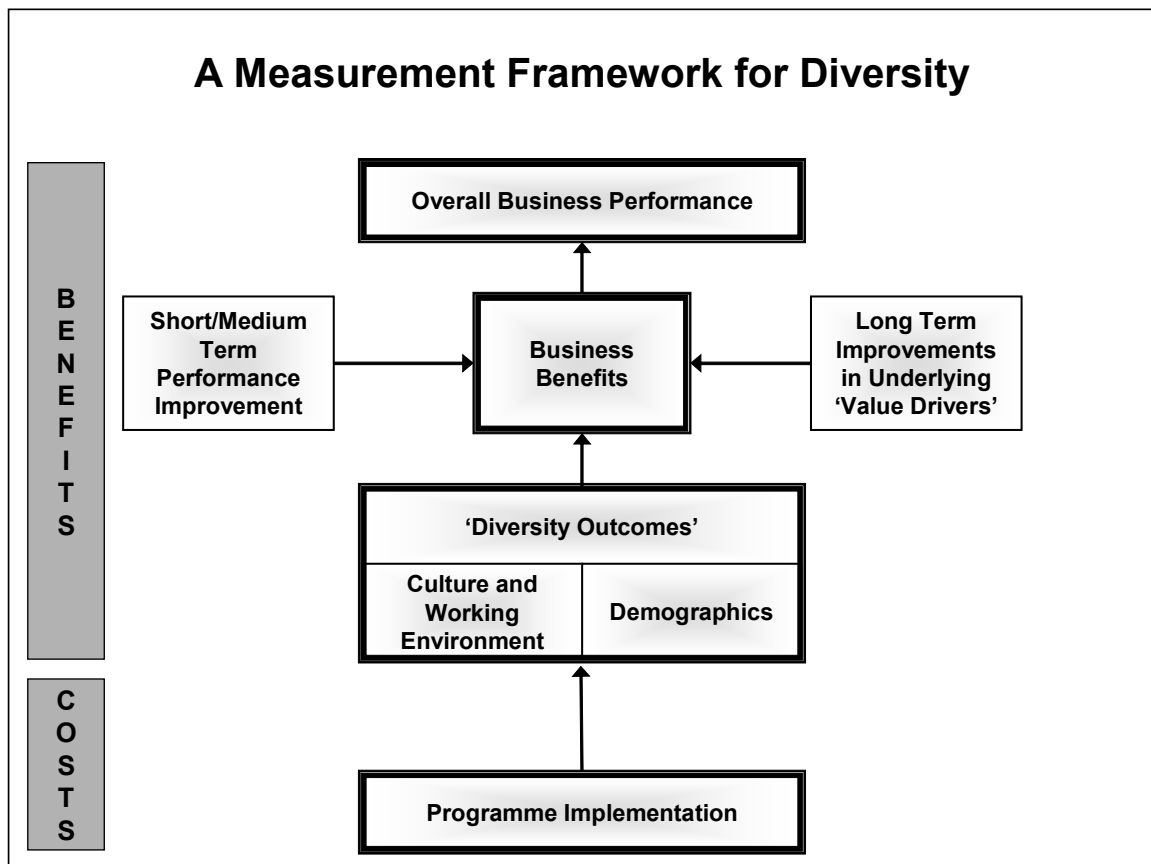
Leading companies measure the costs and benefits of investments in workforce diversity policies for a number of reasons: first, there is a tendency for measurement to drive action – “what gets measured gets done”; second, good practice requires the measurement of the costs and benefits of all forms of investment, including investments in intangibles; third, measurement provides a justification for the continuing use of scarce resources; and, finally, measurement enables managers to learn lessons for future, similar investments.

There are already a large number of indicators of cost and benefit in use by companies. Most of these are qualitative and tend to focus on costs and ‘intermediate outcomes’, such as changes in workforce attitudes or demographics. As yet, there is little evidence of quantitative assessment of costs or benefits. There is also little evidence of any systematic measurement of costs, benefits and intermediate outcomes.

Notwithstanding these problems with measurement, it is possible to construct a framework for performance measurement that provides a systematic method of identifying costs, benefits, key processes, and intermediate outcomes.

This model approach is 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 outcome, and forces companies to consider carefully different types of benefit and how to measure them. Companies of all types and sizes can adopt this framework. Within a common structure, the specific indicators and methods of measurement can be tailored to meet the needs of each business (Exhibit B).

Exhibit B



Source: CSES

3. A complex group of obstacles limit the scale of investment in diversity policies amongst companies in the EU. These include legal restrictions on the holding and processing of sensitive data; differences in national cultural responses to different social groups; difficulties in changing the culture of businesses; a lack of awareness amongst companies of the contents, benefits, mechanisms, and rationale of diversity policies. Public policy has an important role to play in helping to overcome some of the obstacles.

Evidence from our pilot survey of companies suggests that there are two major 'internal' obstacles that limit investments in workforce diversity policies. These are difficulties in changing the culture of a business and a 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. There is considerable scope to use public resources to help overcome these deficiencies in knowledge.

In contrast, the scope for public policy to help companies implement cultural change programmes effectively is limited. The main problems facing companies are a lack of management expertise and a fear of change amongst workers and managers.

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 to measure changes in workforce demographics: a key intermediate outcome and measure of progress. This is particularly the case for programmes that seek to involve gay and lesbian citizens, people from different ethnic backgrounds, and workers with different religious beliefs.

As well as these legal restrictions, differences in social attitudes towards different groups across the EU may limit the scale or distort the design of workforce diversity policies.

4. In comparison with the evidence available to support investments in other forms of intangible asset, the business case for investment in workforce diversity is embryonic and fragmented. However, action by governments and other actors can be taken to overcome these weaknesses, especially through the provision of more information about the experience of companies that have invested in diversity policies.

The report identifies a series of steps that can be taken to strengthen the evidence for investment in workforce diversity programmes and to disseminate good practice in this field more widely (see Section 9 of the Executive Summary).

EXECUTIVE SUMMARY - TABLE OF CONTENTS

1. Study background and objectives
2. Work undertaken
3. Diversity policies in enterprises
4. Benefits and costs of diversity policies
5. Measurement of the costs and benefits of diversity policies
6. The business case for diversity
7. Obstacles to the adoption of diversity policies
8. Conclusions
9. Recommendations

EXECUTIVE SUMMARY

1. STUDY BACKGROUND AND OBJECTIVES

New European Union (EU) directives establish a general framework for the respect of equal treatment in employment. 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 persuade companies to recruit, retain, and develop a diverse workforce.

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.

2. WORK UNDERTAKEN

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.

Fieldwork focused on:

- Identification of existing indicators (and methods of measurement) used by companies to measure the costs and benefits of workforce diversity policies;
- Assessment of the of the relevance and effectiveness of existing indicators for companies in a European context, including a review of socio-cultural factors in the EU that might affect the appropriateness or feasibility of existing indicators or create more general obstacles to the adoption of workforce diversity policies;
- Development of a new performance measurement framework for the costs and benefits of diversity policies in companies; and,

- 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.

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).

3. DIVERSITY POLICIES IN ENTERPRISES

“Workforce diversity” within companies is associated with policies designed to recruit, retain, and 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 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. A “diverse workplace” is an outcome of major changes in the internal culture of a company and it is extremely difficult to measure the shifts in values that accompany changes in internal cultures. Moreover, not all companies set out to achieve the same goals in their diversity policies.

Companies adopt workforce policies for three types of reason: ethical; regulatory (demonstrating compliance with anti-discrimination laws); and economic (generating economic benefits that exceed implementation costs). In a number of cases companies adopt diversity policies for more than one of the above reasons. This project focuses solely on the economic reasons for adopting workforce diversity policies.

Investments in diversity for economic reasons are taking place because of major changes in: 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 about the drivers of acceptable investment returns); government influence (the impact of regulation, legislation, and political pressure); and, wider social values (the expectations of citizens as to how companies should behave).

4. BENEFITS AND COSTS OF DIVERSITY POLICIES

4.1. 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 a company.

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. 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.

- **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.

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 performance.

4.2. Costs

Companies face four types of additional cost when they invest in workforce diversity policies. These are:

- **Costs of Legal Compliance** - potential costs include: record-keeping systems; training of staff; and, communication of new policies. However, the extent of these costs for a specific business will be

influenced by the scale and nature of existing internal processes and current legislative requirements.

- **Cash Costs of Diversity** - the main cash costs are: specialist staff; education and training; facilities and support; working conditions and benefits; communication; employment policies; and monitoring and reporting processes. Some of these are “one-off” and short-term but most are long-term, recurring expenses.
- **Opportunity Costs of Diversity** - opportunity costs represent the loss of benefits because a scarce resource cannot be used in other productive activities. These include: diversion of top management time; diversion of functional management time; and, productivity shortfalls.
- **Business Risks of Diversity** - many programmes designed to change corporate cultures take longer than planned to implement or fail completely. This “execution risk” is widely understood amongst companies. Sustainable diversity policies are an outcome of a successful change in corporate culture.

5. MEASUREMENT OF THE COSTS AND BENEFITS OF DIVERSITY POLICIES

5.1. Performance Measurement Framework

The costs and benefits of investments in workforce diversity policies are measured by companies for a number of reasons: first, there is a tendency for measurement to drive action; second, such programmes are investments; third, measurement justifies the use of scarce resources; and finally measurement enables managers to learn lessons for future, similar investments.

Current measurement of the costs and benefits of diversity policies tends to focus principally on two things: activities to establish a workforce diversity policy; and, intermediate outcomes from activities to implement a new workforce diversity policy, such as changes in workforce demographics. There is little evidence of any systematic holistic measurement of either costs or benefits.

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.

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 indirect discrimination. Actions here are a combination of inputs and processes. This part of the measurement framework tends to measure 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** – this part of the model captures 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 rather than overall business results. Improvements in intangible assets, in contrast, form part of more strategic measures.

5.2. Indicators of Costs and Benefits

A wide range of indicators are either in use currently or, based on existing business practices, available for use (Box 1).

Box 1

Coverage of Indicators of Costs and Benefit
<p>Programme Implementation</p> <ul style="list-style-type: none"> • 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 <p>Diversity Outcomes</p> <ul style="list-style-type: none"> • Workforce demographics (‘representation’); and • Employment culture/working environment

Business Benefits

- 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

Source: CSES

6. THE BUSINESS CASE FOR DIVERSITY

The “Business Case” is a term used to describe the evidence needed to convince companies to consider investments in assets, both tangible and intangible.

Implementation of a workforce diversity policy is a form of investment in intangible assets, especially organisational and human capital. A review of the business case for other types of intangible assets, suggests that a persuasive and credible case for investment depends on four types of evidence of costs and benefits: ‘testimonials’ (publicly expressed views of major opinion leaders within the business community); case studies; surveys of companies; and empirical research.

Multiple forms of evidence are important because of the structural characteristics of intangible assets (‘spillovers’, lack of markets etc.), and hence the nature of their impact on the economic performance of businesses.

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. Many of the benefits are either highly “context-specific” or difficult to measure;
- 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;
- Investment in diversity policies, rather than compliance with legislation, is a relatively limited activity amongst EU companies; and,
- As with all forms of investment in human capital there are major gaps in knowledge because of weaknesses in accounting disclosure requirements.

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 a small number of leading European businesses. Moreover, evidence from other forms of intangible assets suggests that progress can be made. For example, work is now being undertaken to review the development of common reporting standards for human capital.

7. OBSTACLES TO THE ADOPTION OF DIVERSITY POLICIES

As with other forms of investment in new human resource (HR) policies, there are two groups of obstacles to implementation of workforce diversity policies: internal obstacles (specific to individual companies); and, external obstacles – these emerge from institutional structures, cultures/attitudes, and regulatory factors.

7.1. Internal Obstacles

Companies in our survey that have not invested in diversity identify 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.

To complement this, we also asked companies that had set up diversity programmes to identify the main problems they had faced during implementation. These were: 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; and, difficulty in quantifying the benefits to sustain investment;

7.2. External Obstacles

Our research identified three important types of external obstacle:

- **Legal restrictions on holding sensitive data** – Member State restrictions on the holding of “sensitive data” about employees (based in part on restrictive national interpretations of the EU Data Protection Directive) make it impossible to collect data on ethnic origin, religious belief, or sexual preference in most countries. This restricts the ability of companies to measure changes in workforce demographics: one of the critical measures of “intermediate outcomes”. Such restrictions could, potentially, distort the nature of investments in diversity by companies.
- **Historic gaps in anti-discrimination legislation** - 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. But only a limited number of countries at the time of writing have legislation designed specifically to prevent discrimination in employment on grounds of sexual preference or age.

- **Differences in national social attitudes and cultural values** - social factors, our evidence suggests, can influence the extent and nature of diversity policies adopted by companies, especially small and medium-sized enterprises (SMEs). A good example is the potential impact of different national responses to ethnicity.

8. CONCLUSIONS

There are a number of major conclusions:

- The business case for investment in workforce diversity is embryonic. It is also fragmented.
- Action can be taken by governments and other actors to overcome some of these weaknesses in the business case, especially through the provision of more information about the experience of companies that have invested in diversity policies.
- Despite these existing weaknesses, a potentially powerful case for investment in workforce diversity policies is beginning to emerge.
- 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).
- 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.
- 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.
- Investment in sustainable diversity policies in Europe is probably limited to a small number of pioneering companies today.
- 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.

- 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, especially restrictions on the holding of sensitive data in most EU countries.
- Effective dissemination of the findings of the report can play an important role in helping to overcome the lack of awareness about diversity policies amongst companies of all sizes.

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;
- Support for a network of demonstration projects across the EU based on leading companies in different sectors and of different sizes;
- 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;
- Support for a network of diversity promotion organisations across the EU designed to share good practices and ensure full dissemination of EU-funded research;
- Support for national studies designed to establish links between investments in diversity and business benefits; and,
- 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.

For Diversity



Against Discrimination

Additional information on 'Fundamental rights and anti-discrimination' is available from the following address:

European Commission
Directorate-General for Employment and Social Affairs
Unit D.3
B-1049 Brussels

Or consult our internet sites:

http://europa.eu.int/comm/employment_social/fundamental_rights/index_en.htm

www.stop-discrimination.info