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The business case for diversity management in the hospitality industry

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ABSTRACT

Societal and regulatory pressures increasingly encourage firms to invest in and manage workplace diversity. In service industries like hospitality and tourism (HT) where customer interface and service is salient, diversity management assumes even greater importance than compared to other industries. Yet the link between investment in diversity and its relationship with financial performance is not known. This study compares diversity management between HT and non-HT firms, and finds that HT firms manage diversity by taking more initiatives than other firms. More importantly, it finds that investment in diversity translates into superior financial performance when measured by Tobin's *Q* and firm credit rating.

1. Introduction

Globalization with increasing international trade and foreign investment, immigrant flows, and demographic trends have resulted in a diverse workforce and multicultural customers in the United States. Employees, customers, and society at large, are encouraging of diversity management in organizations. Recognizing these trends, several firms have proactively embraced diversity, thus deriving reputational benefits, like those featured in Diversity Inc.'s list.

Yet the evidence for a business case for diversity is weak (Hansen, 2003; Kochan et al., 2003). In their meta-analysis, Joshi and Roh (2009) find that 60% of the studies on the direct effects of diversity on performance were inconclusive, 20% were positive, and 20% were negative. However, the relationship improves within certain contexts, such as industry (Dos Reis et al., 2007; Richard et al., 2007). In a survey of empirical studies linking diversity with firm performance, McMahon (2011) states that the effect of diversity is more pronounced in service industries like airlines and hospitality due to the greater degree of interpersonal interactions wherein personalized customer service is likely to affect firm performance. In addition, industries may differ in terms of competition, product-service differentiation, technology, employee skills, and government regulation necessitating different management strategies and rendering diversity management more effective in some industries than others. Interestingly, Marriott, Disney, Wyndham, and Sodexo, all firms belonging to the hospitality and tourism (HT) industry, are ranked in Diversity Inc.'s Top 50 list for 2013. A representation of 8% in the list is much greater than the 3–4% representation of HT firms in the current S&P 500 index.

Although this evidence is anecdotal, this study tests and formalizes the critical role played by diversity management in HT firms relative to firms in other sectors of the economy (non-HT firms). It examines diversity in the hospitality and tourism industry because the pressures for diversity are likely to be greater for service-oriented firms than others. Moreover, the widely dispersed operations of HT firms necessitate hiring local and diverse employees unlike firms that produce products in a few locations that can be transported for worldwide distribution. Not surprisingly, among the 5 HT firms in Diversity Inc.'s 2010 ranking studied by Madera (2013), at least 50% of the workforce consists of women, and more than 50% consists of ethnic minorities in four companies. Besides internal staffing needs, external pressures come from regulations that prohibit discrimination based on diversity in public places such as hotels, restaurants, airlines and cruise ships. More importantly, external pressures come from customers of HT firms that reflect the makeup of the general population not only in the U.S. but internationally wherever they operate.

While diversity is recognized as a social imperative and a desirable part of a firm's corporate social responsibility, its effect on business performance has not been examined extensively, and the few studies that examine the issue report inconsistent results (Herring, 2009; Kochan et al., 2003; Van Knippenberg and Schippers, 2007). Within the HT industry where diversity management is vital, to the

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best of our knowledge, the direct effect of diversity management on firm performance has not been evaluated. This gap is important to fill as investment in diversity management requires not only the strategic resources of time and funds, but also the attention of top management in designing policy. Therefore, we analyze the effect of diversity performance on business performance in the HT sector, with practical implications for managers to determine whether diversity initiatives can be financially rewarding.

This study contributes to the literature in several ways. First, industry effects are delineated by comparing the role of diversity management in HT firms with non-HT firms. Second, by employing a large sample (34,543 firm-years in U.S. over the 1991–2011 period), the study relies on measures of diversity reported by independent sources of secondary information (MSCI ESG, described in Section 3) and of financial performance (Tobin's Q and firm credit rating), rather than self-reported perceptions of managers or employees. Third, this research evaluates the relationship between diversity performance and business performance at the firm level to examine the business case for diversity, an important metric for top managers, policy makers, and investors.

2. Literature review and theory development

2.1. Background

Diversity has been defined in different ways but is commonly understood to exist at two levels, surface and deep. Surface-level diversity has primary dimensions such as gender, race, age, sexual orientation, and secondary dimensions such as education, marital status, work experience, and functional background (Mok, 2002; Van Knippenberg and Dijksterhuis, 2000). Deep-level diversity generally refers to cognitive diversity, a variable that is not readily apparent and hence difficult to measure (McMahon, 2011). In this paper, diversity management and performance refer to the mostly time-invariant primary dimensions, and the manner in which an organization relates diversity to employment, promotion, work-benefits, and supplier contracting practices at the firm level.

Though prudent diversity management is imperative for U.S. firms due to a diverse workforce, and multiethnic, multiracial, and multicultural customer base, the degree of investment in diversity initiatives and the resultant diversity performance of a firm is often determined by an economic cost-benefit analysis. Diversity benefits a firm in several ways. First, recruiting for diversity enlarges the pool of potential applicants and suppliers that may result in wider selection, higher quality, and lower costs (Niederle et al., 2013). Second, diversity in the workforce often energizes individual performance and increases individual-firm identification increasing productivity and job satisfaction reducing voluntary turnover and the costs of new recruitment and training (McKay et al., 2009). Third, higher job satisfaction enhances the quality of interaction among employees and customers (Koys, 2001). Fourth, a diverse workforce provides access to new networks and enlarges sources of information (Williams and O'Reilly, 1998). Fifth, diverse thinking fosters an environment of creativity and innovation at the group level (Bantel and Jackson, 1989), and finally, better cultural congruence between service personnel and customers improves consumer experience and satisfaction.

Fostering diversity is associated with costs of communication, coordination and conflict, and can negatively influence an organization. Increased conflict can result due to lack of communication in teams because employees from diverse backgrounds may not understand or trust each other (Ancona and Caldwell, 1992). The coordination and integration costs associated with a diverse workforce can sometimes seem to be greater than the benefits of creativity and knowledge spillovers (Parrotta et al., 2012). Second, there are significant costs associated with implementation of successful diversity programs. These costs include diversity training of managers and traditional employees, search costs for non-traditional employees and suppliers, modifying corporate policies to be sensitive to cultural differences, infrastructural costs for accommodating workers with disabilities and women with young children, and such other related costs – which can negatively impact profitability. For example, Hansen (2003) estimated that organizations spend $8 billion annually on diversity training, flexible work arrangements and special recruitment (Kochan et al., 2003).

In addition to these monetary costs and uncertain benefits, especially in the short term, it is time-consuming to develop trust and relationships with new suppliers or contractors, and manage diverse employees. Transactions costs are reduced when dealing with long-standing suppliers and recruiting from known pools of candidates, thus leading owners and managers to maintain status quo rather than invest in diversity management.

2.2. Diversity in HT firms and non-HT firms

While all firms face the relative costs and benefits of diversity outlined above, the case for diversity may be stronger in the HT industry due to its service-orientation, labor intensity, and wide geographic dispersion. Ortlieb and Sieben (2013) argue that organizations employ diverse employees to obtain critical resources like access to different sets of experiences, world-views, and information regarding cultural sensitivities, in addition to complying with legal requirements and gaining stakeholder legitimacy. Prominent firms in the HT industry like Marriott, Sodexo, Hyatt recognize the need to train managers to understand diversity in their workforce and leverage diverse employees to be culturally sensitive to customers by making special efforts to promote and publicize their diversity initiatives in order to attract customers and recruit talent (Diversity Inc, 2013). Several of these companies also support campus organizations like the National Society for Minorities in Hospitality (NSMH) for development and recruitment of talent. Similarly hospitality curricula in universities emphasize diversity education as evidenced by textbooks and syllabus design (Hearns et al., 2007). These proactive activities project a positive image and underline the importance of diversity management in HT industry.

Prior empirical research confirms the distinction between service industries and other industries. In their meta-analysis, Joshi and Roh (2009) divide the economy into three broad industrial groups: service, manufacturing, and high technology. Their definition of service industries is based on the U.S. Census Bureau and includes retail trade, *hospitality*, and education. They report that diversity based on race, gender, and age had the strongest positive effect on performance for service industries. The relationship in the case of other industry categories (manufacturing and high technology) was negative. We believe that even among the service industries, the HT industry is unique because its employees have more frequent and direct interactions with customers and customer perception of quality and value of service depends on the richness of these interactions and on the firm's reputation. On the other hand, in customer-oriented industries like retail trade, the customer's perception of the transaction is dominated by the value of the tangible product sold by the retailer.

Within the HT industry, there is significant and growing amount of research on diversity underscoring its importance to the industry. Diversity studies focus on several related issues; the importance of empathy in diversity training (Madera et al., 2011), cross-cultural work values of hotel managers (Mok et al., 1998), employees' and managers' perceptions of the diversity climate (Garib, 2013), employer's perceptions of specific aspects of diversity (Houtenville and Kalargyrou, 2012) customer perceptions of