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## RESEARCH BRIEFS

# CULTURAL DIVERSITY AT THE TOP: DOES IT INCREASE INNOVATION AND FIRM PERFORMANCE?

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### RESEARCH QUESTIONS

Cultural diversification has gathered pace within Western societies over the last 30 years, particularly in North America and Western Europe. A central theme of this trend is the emergence of “global cities” like New York and London that tend to play a dominant role in their national economies. London, for example, accounts for nearly 20% of Britain’s GDP. Such economic successes have led some observers to argue that cultural diversity delivers an economic bonus, while others, citing structural problems of segregation and discrimination, claim that diversity is disruptive. These two views illustrate a key question that remains—what is the economic value of cultural diversity?

The literature gives some answers. For instance, there is good evidence that diversity encourages entrepreneurial behavior. Less certain, however, is why this is so. One argument is that immigrants tend to be proactive and more likely to engage in entrepreneurial activity. Conversely, some argue that people who belong to diverse groups may have fewer employment opportunities in indigenous firms, which motivates them to start their own businesses.

Irrespective of its causes, questions still remain around whether the greater entrepreneurial activity of migrants relates to economic achievements. Current theorizing suggests that diversity can be both beneficial and problematic for business performance. To illustrate, some studies show that more diverse teams have better problem-solving capabilities because they are able to draw on a wider set of perspectives and skills. Other studies, however, suggest that diversity is associated with lower levels of trust and communication difficulties, leading to poorer quality decisions. At the firm level, some studies suggest that more diverse firms can be discriminated against by customers and that firms run by immigrants or minorities may lack connections to mainstream indigenous institutions (e.g., local

authorities, banks), making it more difficult to operate smoothly and translate their efforts into results. Yet some argue that diverse firms have better access to markets thanks to their greater variety of ties with suppliers and institutions.

In a nutshell, diversity is a widespread contemporary phenomenon whose effects on the economy remain nebulous. To shed light on this difficult subject, Max Nathan (London School of Economics) and Neil Lee (University of Lancaster, UK) conducted research to address whether cultural diversity helps or hinders firm performance.

### STUDY DESIGN AND METHOD

Nathan and Lee used a large data set of 7,600 London-based firms between 2005 and 2007, a period that followed the entry of eight Central and Eastern European countries to the European Union (EU) in 2004. As a consequence, the UK experienced an unprecedented influx of immigrants that changed the social landscape, with London being the most affected.

With its “superdiversity” and intense economic activity, London offered an ideal setting for Nathan and Lee’s investigation. Specifically, the duo assessed diversity among firms’ owners and partners—where critical decisions on strategy, markets, and joint ventures are made. Looking at the configuration of ownership, Nathan and Lee categorized companies by the level of immigrant diversity. To take into account the long history of immigration in the UK, Nathan and Lee assessed the ethnic background (Caucasian British vs. non-Caucasian) of the ownership structure too. They also measured performance in terms of innovation, commercialization, and sales orientation. Innovation was defined as the exploitation of new ideas, commercialization reflects how successful firms are in the market, and sales orientation shows which markets firms focus on (i.e., local-London, national—the rest of Britain, or international).

## KEY FINDINGS

The results confirmed the diverse mix of people in London and how interwoven they are into the business community—nearly 40% of firms surveyed had at least one immigrant owner or partner. This diversity, they found, benefits innovation. Diverse firms performed better than non-diverse firms in virtually all forms of innovation. In particular, firms that had a mix of immigrants and natives in their top echelons were more likely to develop innovative products or services. In addition, firms whose top echelons were exclusively occupied by immigrants were more likely to modify existing products, introduce new equipment into their operations, and invent and implement new ways of working. Nathan and Lee argue that these findings are in line with the idea that diversity brings a variety of perspectives, skills, and ways of thinking that are subsequently translated into greater novelty in products/services and ways of performing tasks.

This positive effect of diversity on innovation, however, did not necessarily benefit firm performance. The findings showed that diversity at the top did not translate into firms being more successful at bringing their innovations to market. And having a diverse top team was unrelated to revenue growth. In fact, firms that were run exclusively by immigrants did worse in that regard than firms run by a mixture of immigrants and natives. The same pattern held when the measure of ethnic diversity within each firm was defined in terms of whether the top team contained more non-Caucasians than British Caucasians. Once again, more diversity was connected with superior innovation, but not better financial results.

In the next part of the study, Nathan and Lee looked at whether diversity matters more in knowledge-intensive sectors. It is in knowledge-intensive industries where the multitude of perspectives that diversity brings should be most likely to spur innovation. Yet Nathan and Lee did not find support for this idea. Instead, diversity impacted innovation across sectors. In fact, in a few cases diversity at the top was found to be detrimental for innovation in the knowledge-intensive sector. Likewise, diversity had no apparent impact on commercialization in knowledge-intensive industries.

Nathan and Lee then tried to identify which markets more diverse firms orient themselves toward. They found that diverse firms were primarily deriving sales either from London or internationally but not from the rest of the UK. Specifically, firms with a mix of immigrants and natives at the top were more likely to focus on the London market while firms that were run exclusively by immigrants had

mostly an international focus. A sensible explanation is that London's superdiversity and size provides a favorable environment for diverse firms while the overseas connections of primarily immigrant owners, along with London's position as a gateway to foreign markets, lends itself to an international orientation.

Finally, Nathan and Lee addressed the question of whether immigrants establish firms because of strong entrepreneurial inclinations or simply because no other alternatives exist. They found that rather than being forced into entrepreneurship because of poor job opportunities, immigrants tend to choose to be entrepreneurs. This is in line with recent research that suggests that immigrants may be more likely to be proactive and hence, entrepreneurial (Cao, Hirschi, & Deller, 2013).

## CONCLUSIONS AND IMPLICATIONS

Today there is unprecedented movement of individuals across national borders, leaving many unanswered questions about the economic benefits of diversity. Nathan and Lee shed light on a number of key issues associated with the benefits and limitations of diversity within a concentrated urban area such as London. First, diversity at the top brings innovation advantages for firms across the board (e.g., creation of new products or new ways of doing work). Second, within London the diversity bonus for innovation extends to all types of businesses and is not limited to the knowledge-intensive sector. This suggests that within densely populated areas like London, having diverse perspectives, ideas, and skills may confer distinctive innovation benefits in every type of industry. Third, immigrants may tend to become entrepreneurs not because of lack of alternatives but because they may be more inclined to do so in the first place.

On the other hand, more diverse firms apparently do not capitalize on their superior innovativeness with greater growth. It might be that the novel ideas of diverse firms simply fail in the market or perhaps obstacles exist that block the path from innovation to successful commercialization. Obstacles could include discrimination and less structural and financial support for firms with diverse or immigrant ownership. Some recent research also suggests that the link between innovation and commercialization success may not be linear, but instead follow a more complex U-shaped pattern (e.g., Choi & Williams, 2014). This invites the possibility that the innovativeness of diverse London firms did have market success, but that simply was not captured by Nathan and Lee's methodology. Future research is clearly needed to address this possibility.

We also see that diverse London firms focus their commercialization efforts either locally or internationally but not nationally. This may also reflect the uniqueness of London's superdiverse environment and the fact that immigrants often have good connections overseas. Nathan and Lee conclude by noting that their pioneering study offers ammunition to proponents of multicultural cities. At the same time, however, they also offer a cautionary tale. Even in London and other superdiverse cities, discrimination constraints may persist, limiting the positive impact of diversity and preventing immigrants and minority communities from fully contributing to economic success.

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