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Making the case for diversity as a strategic business tool in small firm survival and success

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ABSTRACT

Although human resource managers have long realized the impact of diversity on organizational outcomes, most of the research to date has focused on large organizations. Very little consideration has been given to small firms in the United States with fewer than 15 employees, which are not required to comply with federal Equal Employment Opportunity legislation. We propose that by valuing racial diversity and creating an inclusive organizational climate from inception, new small firms with growth objectives can increase their competitiveness, leading to better performance and long-term survival. Anchoring our arguments in intellectual capital theory, coupled with Cox and Blake's seminal work on valuing diversity, we provide testable propositions that detail why new small firms should pursue and view racial diversity as a strategic business tool, even when they are not legally required to attend to these issues. We offer practical recommendations for small firms seeking to create an affirming climate for racial diversity and strategies that can be used to recruit, select, retain, and benefit from a racially diverse workforce.

Introduction

While the positive (and negative) outcomes of racial diversity in large organizations are widely known, literature on small firms (firms with fewer than 15 employees) is particularly sparse (Ash, 2007; Headd, 2015; Stoner, Hartman, & Arora, 1996). Important differences between small and large organizations (e.g. presence of formal systems, agility, business environment, goals, and objectives) make generalizability of these outcomes unclear. The "liability of smallness" increases the risk of firm failure because small firms lack economies of scale and cannot raise as many funds to overcome unexpected changes in the market (Headd, 2015; Lumpkin, McKelvie, Gras, & Nason, 2010). In addition, firms that are eight years old or younger (new firms) also experience the "liability of newness," which involves the risk of firm failure because organizational routines are not yet well developed, and customers do not yet know or trust the firm, rendering the firm less able to compete (Freeman, Carroll, & Hannan, 1983; Lumpkin, et al., 2010; Stinchcombe, 1965). We focus on the unique combination of new and small firms, and argue that employees of such firms may possess stocks of knowledge that if fully leveraged early, could enable the firm to develop an inimitable competitive advantage. Because there is not much research on the impact of diversity and inclusion in new, small firms, we will use evidence from both "new" and "small" firms to support our ideas.

The preponderance of small firms and the changing demographics of the U.S. labor force underscore the importance of racial diversity in small firms. Between 1993 and 2011, small firms were responsible for 67% of net new jobs and employed 17 million individuals (Census Bureau 2016; Small Business Administration (SBA), 2013). Eighty six percent of the approximately 5.7 million firms in the United States employed fewer than 15 employees (Census Bureau, 2016). The vast majority of small firms are owned by white

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men, and employees in these firms are largely homogeneous in race (Ferguson & Konig, 2018; Holzer, 1998). It is interesting to note that, while only 7 percent of U.S. small firms are owned by African Americans, these firms are also racially homogenous (Ruef, Aldrich, & Carter, 2003). By 2020, it is estimated that minorities will comprise 40 percent of the overall labor force (Toossi, 2012). Potential problems with homogeneous workforces are well documented (see Apfelbaum, Phillips, & Richeson, 2014), and possible remedies to these problems include hiring a racially diverse workforce and creating inclusive organizational climates. There is some evidence that performance in small firms with diverse workforces is higher than in small firms that are not diverse (Hartenian & Gudmundson, 2000). If small business owners understood the potential implications and benefits of diversity in areas of communication, creativity, recruitment, persuasion, and turnover (among others), they might be able to maximize their organizational success (Ash, 2007). In other words, firm survival and success may partly hinge upon taking advantage of these demographic changes and developing a diverse base of intellectual capital for all small businesses. However, in the United States, these firms are not typically subject to Equal Opportunity legislation (i.e., Executive Orders on Affirmative Action and Title VII of the Civil Rights Act) due to employing fewer than 15 people. Such legislation has been shown to stimulate inclusion of those who might otherwise be intentionally or unintentionally excluded from the workforce (Kalev & Dobbin, 2006). Without the impetus of legislative compliance, small firms may need other motivations to pursue racial diversity.

When compared to older small business counterparts, new small firms are in a particularly precarious position. Fifty percent of new, small firms fail within five years. Scholars point to underdeveloped organizational roles and routines, and lack of trust relationships and established customers as being primary causes of new firm failure (Lumpkin et al., 2010). New, small firms are constrained by limited resources and limited stocks of human and social capital (Lumpkin et al., 2010). New firm founders and policymakers stand to benefit from an exploration of how a racially diverse workforce might reduce risk, build community reputation, and increase the social and intellectual capital of new firms. This would provide new firms with a competitive advantage, promoting business growth, and survival. New small firms which employ a racially diverse workforce early in the firm's development can enhance the quality of their intellectual capital, which potentially enhances firm success and long-term survival.

To proceed, we examine how intellectual capital theory informs arguments about why racial diversity is important for new small firms. Then, we incorporate the importance of intellectual capital for new small firms into Cox and Blake's (1991) well-known diversity framework, culminating in testable propositions which consider how inclusive organizational climates lay a strong foundation for firm competitiveness, performance, and survival. We conclude with recommendations that may be applicable to new small firms seeking to diversify their workforce.

Intellectual Capital

Researchers often use the Resource Based View (RBV) theory as a lens through which the resources in a firm can be strategically viewed and managed (Richard, 2000; Teece, 2000; Welsh, Davis, Desplaces, & Falbe, 2011). Resources can be tangible or intangible and include financial, social, human, and physical assets, as well as firm capabilities and competencies. The RBV theory assumes that each firm within an industry has heterogeneous resources that are not easily transferred (or are immobile) from one firm to another. In addition, the theory suggests that the resources a firm holds can be strategically used to drive the firm's direction and give it a sustainable competitive advantage, if these resources can be characterized as valuable, rare, difficult to imitate, difficult to substitute, and if the firm has established procedures and policies to leverage its resources (Barney, 1991; Wernerfelt, 1984).

The Knowledge Based View (KBV) of the firm, an extension of the RBV, holds that knowledge is one of the firm's most strategically significant resources (Juma & McGee, 2006; Spender, 1996; Wiklund & Shepherd, 2003), and this resource results when individuals in the firm interact. According to Spender (1996, p. 59), the KBV "can yield insights beyond the production-function and resource-based theories of the firm by creating a new view of the firm as a dynamic, evolving, quasi-autonomous system of knowledge production and application." Thus, it is the collective knowledge that results from employee interaction that becomes a leveragable resource. This resource is referred to as intellectual capital (Kong & Thomson, 2009; Youndt & Snell, 2004).

Intellectual capital has been identified as a critical factor that influences a firm's ability to create long-term profits, be innovative, and perform well in the knowledge-based economy (Hsu & Fang, 2009; Martin-de-Castro, Delgado-Verde, López-Sáez, & Navas-López, 2011; Subramaniam & Youndt, 2005). Intellectual capital is multidimensional, with the initial theory comprising three components:

human, relational, and structural capital (Stewart, 1997). Over time, these constructs have evolved and today are more commonly labeled human, social, and organizational capital (Youndt & Snell, 2004). Each component of intellectual capital is interrelated and acts synergistically to enhance the value of the firm.

Human capital, the principal component, refers to the explicit and tacit knowledge, skills, experiences, attitudes, and abilities of the firm's employees (Mention, 2012; Stewart, 1997; Youndt & Snell, 2004). Human capital is observed by many scholars as an antecedent of innovation, enhanced performance, and competitive advantage (Edvinsson & Malone, 1997; Hayton, 2005). Organizational capital is comprised of firm processes and strategies that support employee productivity, such as organizational structure, organizational culture, routines, intellectual property, and databases (Hsu & Fang, 2009; Youndt & Snell, 2004). Organizational capital enables management to disseminate the firm's collective knowledge. Lastly, social capital refers to the knowledge that emanates from the firm's connections with internal and external stakeholders and includes elements such as customer satisfaction, customer loyalty, market share, customer and supplier relationships, corporate reputation, and image (Hsu & Fang, 2009; Kaplan & Norton, 1992; Youndt & Snell, 2004). Social capital is a critical resource for new small firms as their size may limit access to a broad social network and the benefits that arise from network resources.

New, small firms are susceptible to a variety of internal and environmental forces such as fragile financial structures, dependence on a few customers, and competition (Pena, 2002). To counteract the effects of these deficiencies, scholars suggest that small firms leverage their intellectual capital to build a sustainable competitive advantage (Kemelgor & Meek, 2008; Scarborough & Cornwall, 2016). One way to increase intellectual capital is by diversifying the employee base early in the development of the firm, while continuously valuing inclusivity as a key strategic human resource management goal (McMahan, Bell, & Virick, 1998). However, because most employees of new small firms are relatively homogenous, the intellectual capital that would be available to them from a diverse employee base is not utilized. In addition, small businesses often lack a dedicated human resources manager, and therefore these duties may be left to the owner of the firm. Research has shown that integrating a high-performance work system into the structure of a small organization while also utilizing the intellectual capital of the employees can lead to more success (Coder, Peake, & Spiller, 2017). Thus, despite not having formal HR managers, firms can be more competitive in both the short and long-term (Hormiga, Batista-Canino, & Sánchez-Medina, 2011) if strategies are put in place to manage the firm's intangible assets early, when it is most critical to do so (Lichtenstein & Brush, 2001; Messersmith & Guthrie, 2010). To fully realize these benefits, however, new small firms must create inclusive organizational cultures, which "demonstrate value for all employees, as human resource practices are aligned with and supportive of diversity" (Scott, Heathcote, & Gruman, 2011, p. 740).

The Foundation for a Diverse Workforce: An Inclusive Organizational Climate

Racial diversity alone does not create the environment for organizational productivity (Gonzalez & DeNisi, 2009); nor do diversity programs alone create such an environment (Herdman & McMillan-Capehart, 2010; Scott et al., 2011). Diversity can be a "double-edged sword" if it is not accompanied by a climate that values diversity (Cox & Blake, 1991; Roh & Kim, 2016), giving rise to more negative outcomes, such as interpersonal discrimination and conflict, less coordination among work groups (Boehm, Dwertmann, Kunze, Michaelis, Parks, & McDonald, 2014; Milliken & Martins, 1996; Pelled, Eisenhardt, & Xin, 1999), lower employee satisfaction, more employee turnover (Greenhaus, Parasuraman, & Wormley, 1990; Scott et al., 2011), and lower performance (Joshi & Roh, 2009). Proper care must be taken in organizations that have specific diversity initiatives designed to improve inclusivity, as the way they promote these initiatives can determine their effects (Kidder, Lankau, Chrobot-Mason, Mollica, & Friedman, 2004).

Consequently, researchers have called for more research on the performance results of companies with HR policies that are inclusive, fair, and diverse at all levels (e.g., Joshi & Roh, 2009; Kulik, 2014). Factors leading to more inclusive climates for diversity include perceptions of justice in human resources policies (Buttner, Lowe, & Billings-Harris, 2012; Mor Barak, Cherin, & Berkman, 1998), voice and participation in decisions (Bell, Özbilgin, Beauregard, & Surgevil, 2011; Chrobot-Mason, 2003), social integration of minorities and women at work (McKay, et al., 2007), and equal access to opportunities (Chrobot-Mason & Aramovich, 2013), among others. A positive diversity climate has been linked to lower interpersonal discrimination among employees, which leads to better workgroup performance (Boehm, et al., 2014). A positive diversity climate has also been linked to higher psychological empowerment, higher "identity freedom", a climate for innovation, and higher organizational identification (Chrobot-Mason & Aramovich, 2013). This suggests that a positive diversity climate will increase organizational outcomes for all employees, not just minorities.

We are not aware of research on diversity climate which specifically examines new small firms, however, Boehm et al. (2014) found that smaller work groups tend to have less discrimination, presumably because work group members get to know each other on a more personal level, learning shared deep values (Daft, 2016). Although Boehm et al. (2014) were examining small groups within a larger organizational context, these ideas could be applied to small businesses as well. Because small businesses have fewer employees, these individuals will likely know each other on a more personal level and be able to communicate more effectively. Therefore, small businesses may have an easier time integrating diversity-related values than their larger counterparts. In addition, Richard, Roh, and Pieper (2013) argued that "smaller firms are more flexible and experience less inertia, leading to more effective implementation of DEM (diversity and equity management) practices as well as greater ability to adapt and change the demographic composition of management" (p. 234). New small business owners have a unique opportunity to be proactive and positive in their diversity approach, creating a diverse and inclusive climate (Shore et al., 2009) at inception and maintaining it, rather than implementing diversity haphazardly as the firm grows.

Proposition 1. New, small firms with inclusive organizational climates from inception will experience positive organizational outcomes, such as higher levels of job satisfaction and commitment, and lower turnover rates as they grow.

Valuing Diversity in New Small Businesses

Many corporate leaders agree that there is value in having a diverse workforce and investing in initiatives to achieve that outcome, given the potential benefits of doing so and the costs of not doing so (Chavez & Weisinger, 2008; Roh & Kim, 2016). However, many of these organizations are large and have the financial resources to invest in diversity initiatives that fit their organizational cultures. It is important to examine the differences in large and small firms to determine how and if small firms will also benefit from incorporating diversity initiatives into their company culture from the outset. We propose that the diversity focus will give the new small firms an advantage in a variety of competitive areas. Specifically, Cox and Blake's (1991) seminal work proposed that six key dimensions of business performance, namely (1) costs, (2) acquisition of human resources, (3) marketing, (4) creativity, (5) problem-solving, and (6) system/organizational flexibility can be positively influenced by the management of cultural diversity. These ideas are particularly relevant to the dynamic and competitive environment in which new small firms operate. Because small firms are typically focused on the objectives and vision cast by the owner, and because the policies and relationships are more informal than in larger companies (Jennings & Beaver, 1997), small firms may be able to capitalize on the intellectual capital they receive from beginning with a diverse workforce and focus on an inclusive culture. The intellectual capital accumulated by new firms with racially diverse employees could be viewed as a unique bundle of resources (Barney, 1991; Wernerfelt, 1984) that can help the firm reduce costs, solve problems effectively and efficiently, attract employees, develop new products, services, and marketing ideas, and build external relationships that may help a new, small firm survive and thrive. Accordingly, these resources may be rare, valuable, and inimitable with cultural experiences that enrich new small firms. In the following sections, we consider how Cox and Blake's (1991) key dimensions for managing diversity to obtain a competitive advantage apply to new small firms that are committed to cultivating a climate that supports and embraces racial diversity.

Diverse workforce knowledge and its influence on organizational and cognitive flexibility. Most research to date has examined the strategic choices of firms from the perspective of large organizations. Large firms can use their various sources of capital (financial, organizational, physical, and social) to create a competitive advantage in the marketplace (Barney, 1991). Less is known about the strategies utilized by smaller firms, but one thing is clear: new, small firms do not have access to the same resources, and must focus on some resources more than others (Coder et al., 2017). We argue that properly utilizing their human resources will help increase their chances of survival and success. Whereas large firms face challenges because of rigid structures and bureaucratic procedures, small firms may be able to access external social networks and utilize internal knowledge of employees with more efficiency because of their flexibility (Lumpkin et al., 2010). Small organizations also have flatter hierarchies and easier communication (Wilkinson, Dundon, & Gugulis, 2007), resulting in less formal procedures, which could lead to more innovative ideas (Peetz, Muurlink, Townsend, Wilkinson, & Brabant, 2017). The more diverse their employee base, the more likely they will have knowledge to draw from and multiple external networks to tap into, which could translate into more organizational flexibility overall.

In addition to organizational flexibility, cognitive flexibility has been associated with the "ability to excel in performing ambiguous tasks" and divergent thinking (Cox & Blake, 1991, p. 51) which can be used as tools to help the organization look at problems differently thereby creating new solutions to those problems. More diversity in the workforce could lead to more cognitive flexibility with a variety of perspectives interacting and creating firm benefits. Of course, this flexibility will likely only be recognized if the climate for diversity is strong and translates into an organization where individual ideas are heard and incorporated. As the new small firm encourages and manages the various perspectives emerging from its diverse workforce, it will likely become even more flexible (Gardenswartz & Rowe, 1998). In addition, as the new firm learns and makes use of information gathered through its diverse employee base, it can modify existing practices and processes to efficiently and effectively target offerings to specific market segments (Madhavaram & Hunt, 2008). This increased ability to respond to changing environments may increase the new small firm's chances of survival in an increasingly competitive marketplace.

Proposition 2. Early racial diversification of a small firm, combined with a climate that values diversity, will lead to more organizational and cognitive flexibility.

Diverse workforce knowledge and its influence on human resource acquisition. In comparison to larger firms, new small firms are often at a disadvantage when recruiting and hiring employees since they tend to have limited human resource personnel, smaller recruiting budgets, lower salaries and benefits, and liabilities of newness and smallness (Cardon & Stevens, 2004; Patel & Cardon, 2010). Sixty percent of small firm owners and managers view finding skilled workers as their greatest challenge (Howart, 2013). The National Federation of Independent Businesses found that "locating qualified employees" was the third biggest concern for U.S. small businesses, and it was also the concern that has increased the most over the last five years, right after "finding and keeping skilled employees" (Wade, 2016). Small firm owners are often not trained in executing human resource practices, and as a result, their firms may lack formal human resource policies or programs (Kotey & Slade, 2005; Patel & Cardon, 2010). These business owners are also time constrained (Klaas, McClendon, & Gainey, 2000) which could result in hiring the first applicant deemed eligible.

Small firms, particularly very small ones, rely primarily on inexpensive and convenient sources, such as direct applicants and employee referrals for recruitment of new employees (Deshpande & Golhar, 1994; Hornsby & Kuratko, 1990). Employee referrals tend to lead to racial homogeneity or replication of the current workforce, since friends and family who would be referred tend to be demographically similar (Mouw, 2002; Pager & Shepherd, 2008). With a diverse workforce, the firm has access to relational capital usually unavailable to small firm owners (Nahapiet & Ghoshal, 1998; Robinson, 2006), which can improve access to potential employees (Fernandez, Castilla, & Moore, 2000; Liao & Welsch, 2005). In addition, there is evidence that high quality applicants are looking for job characteristics that small businesses may be able to provide, such as challenge and variety in the job, autonomy at work, and the presence of friendly, supportive coworkers (Froelich, 2005). Therefore, there is hope that if small firms focus on diversity early in their formation, they may reap a competitive advantage in recruitment and selection of high quality, diverse employees.

Proposition 3. Early racial diversification of the small firm, combined with a climate that values diversity, will position the new firm to effectively recruit and hire more diverse employees in the future as the firm grows.

Diverse workforce and reduced costs. In addition to difficulties with recruitment, new small firms have many disadvantages when it comes to controlling costs. Because most new small firms are generally not well funded, the cost disadvantages can be enormous, and likely lead to the higher failure rate of new small firms (Audretsch, 1991). Typical strategic foci of large firms (diversifying products, increasing economies of scale, differentiating through brand image) are more difficult with the limited resources of small firms. In addition, some sought-after applicants value good pension and health insurance benefits (Froelich, 2005) and because small firms often cannot afford the same type of benefits or salary as larger firms, they may lose key employees.

Small firms may lack the ability to accumulate rare and valuable resources in the form of finances, but they may be able to utilize their flexible structures and social networks to cultivate human resources even more than larger firms

(Lumpkin, et al., 2010). In other words, utilizing the intellectual capital of a diverse workforce may be a method for new small businesses to reduce operations and transaction costs and compete with larger firms. However, this asset must be proactively developed and managed. Costs associated with not valuing and properly managing racial diversity may include lower levels of job satisfaction, increased turnover, and absenteeism among minority employees (Chrobot-Mason & Aramovich, 2013; Downes, Hemmasi, & Eshghi, 2014; Greenhaus et al., 1990). The more intellectual capital an employee brings to the firm, the more costly it is to lose that person (Kemelgor & Meek, 2008). In addition, as an organization's diversity level increases, white employees are more likely to turnover than minorities (Tsui, Egan, & O'Reilly, 1992) and the costs of rehiring and training new employees is high.

However, Chrobot-Mason and Aramovich (2013) showed that white men resist diversity initiatives less when the organization focuses on diversity for competitive advantage as opposed to when the diversity initiatives are framed as critical to adhere to affirmative action laws (Kidder et al., 2004). Therefore, it is important to ensure that all workers are valued (Scott et al., 2011), and diversity is approached in a positive, beneficial manner. Even when minority employees perceive discrimination, their intentions to quit are reduced and commitment is enhanced if the organization sincerely supports diversity (Triana, García, & Colella, 2010). The majority of the research on reducing turnover for diverse firms is focused on large corporations, and very little has been done on the reduction of turnover costs in small businesses. Regardless, this seems to be an area where the costs are borne for both small and large firms, and all firms are searching for ways to keep valuable employees. Using their flexibility and ability to adapt quickly, new small firms should begin with a climate that values racial diversity and a commitment to building a diverse employee base, so that as they grow they reap savings resulting from increased employee satisfaction, lower turnover, and greater productivity.

Proposition 4. Early racial diversification of a small firm's workforce combined with a climate that values racial diversity will lead to lower costs and more savings for the organization.

Diverse workforce knowledge and its influence on creativity, innovation, and problem-solving. Clearly, an organization's ability to innovate is related to its access to resources. For a new small firm, those resources tend to be the knowledge that the firm's employees and owners have and share. This knowledge may come from previous experiences and it may be developed through employee training and a culture that values learning (MacDonald, Assimakopoulos, & Anderson, 2007). For small firms (especially in family-owned firms, but also in other small firms) employee commitment has been shown to be related to firm innovativeness, indicating that employees are willing to build knowledge and take risks to benefit the firm (Ahluwalia, Mahto, & Walsh, 2017).

Many new small firms are known for their innovative products and ideas, which likely launched them into the market; whereas older and larger firms face problems of rigid structures and loyalty to the status quo. Small firms face a precarious balancing act between being creative and innovative and fitting in with industry norms in order to gain legitimacy (Lumpkin et al., 2010). In addition, larger firms have the resources available to invest in innovative ideas, and smaller and younger firms often do not. With respect to the employee relations literature, a similar balancing act has been found. New small firms have less rigid structures to deal with and therefore can try new and innovative employment practices, including the way their policies and procedures are formatted, the way their physical space is utilized, and the way employees and employers interact (Peetz et al., 2017). However, research shows that these new small firms seem to quickly adapt to similar employee relations techniques as the older firms (Peetz et al., 2017). One reason for this is that new small firms are likely too busy focusing on everyday issues of survival that they neglect to develop the intellectual capital of their workforce. In fact, one study showed that a high performing work system, which includes focused human resources practices, combined with an emphasis on developing the intellectual capital of the workforce, can produce an increase in sales growth, profit growth, and perceived success in small businesses (Coder et al., 2017). We posit that one way to increase the intellectual capital and subsequently the innovativeness of a small business is through employee racial diversity.

Employee diversity is an important antecedent to knowledge creation due to the firm's access to knowledge resources (Lauring & Selmer, 2013) through the various forms of intellectual capital. Human capital is the facet of intellectual capital which focuses on the specific knowledge, skills, and abilities that individual employees bring to the workforce, and social capital focuses on the relationships and interactions between employees in the organization (Youndt & Snell, 2004). The facets of intellectual capital interact with each other to impact the innovativeness of the firm (Coder et al., 2017). A diverse workforce likely increases human and social capital for a firm through the effect of diverse perspectives on creativity and innovation. For example, minority opposition stimulates consideration of issues from multiple perspectives, leading to improved performance and decision-making (Moscovici, 1985). Creativity and innovation are interrelated, as innovation stems from creativity (Glover, Boocock, Champion, & Daniels, 2016). Specifically, creativity is the generation of novel and useful ideas while innovation is the implementation of these ideas into new products/processes (Sarooghi, Libaers, & Burkemper, 2015). Innovation is highly correlated with intellectual capital (Ngah & Ibrahim, 2009) and the innovative capacity of a firm and the innovation process (opportunity recognition and exploitation) are positively influenced by knowledge-based resources (Rigby & Zook, 2002). Small firms' innovative capacity can be negatively impacted if they are unable to access important resources from the external environment (Glover et al., 2016).

Just as creativity and innovation are related, problem-solving has been shown to precede innovation (Glover et al., 2016). Although not all diversity research has shown a positive relationship between diversity and problem-solving (e.g., Bowers, Pharmer, & Salas, 2000), a study by Chatman, Polzer, Barsade, and Neal (1998) concluded that an inclusive culture strengthens the relationship between diversity and work processes, supporting the notion that organizational culture, an aspect of structural or organizational capital, is a moderator in the relationship between diversity and work outcomes. A long-term perspective may also be important. Watson, Kumar, and Michaelsen (1993) found that in the early stages of group development, ethnically homogeneous groups interacted and performed more effectively than heterogeneous groups. Over time, however, heterogeneous groups outperformed homogeneous groups resulting in more effective problem-solving and idea generation. In a similar study, McLeod, Lobel, and Cox (1996) discovered that ethnically heterogeneous groups outperformed homogeneous groups on a brainstorming task. The ideas produced by diverse groups were of higher quality and more effective and feasible than those of homogeneous groups. Diverse groups engage in more divergent thinking and resist pressure for conformity (Cummings, 2004). Although many of the studies described above used student samples, they are still useful in making the case that diversity is related to higher performance. These findings imply that organizations of all sizes would benefit from diverse perspectives when embarking upon idea generation and problem-solving activities. The importance of diversity in perspectives has been accepted in the research focusing on large organizations (e.g., Chrobot-Mason & Aramovich, 2013), and we posit that small firms would also see benefits from utilizing a diverse workforce within a culture that values diversity.

Proposition 5. Early racial diversification of a small business combined with a climate that values diversity will lead to more creative ideas, more innovative products and services, and enhanced problem-solving.

Diverse workforce knowledge and its influence on marketing. While new small firms may not be able to achieve low cost strategic goals as easily as larger firms, they may instead be able to compete using a differentiation strategy (Lumpkin et al., 2010). Small firms often lack the legitimacy that larger organizations build over time, which can inhibit the brand image that customers may rely on. In addition, small firms may not be able to be the first to market with as many new products as large organizations. However, Lumpkin et al. (2010) point out that small firms can compete through the quality and convenience of their products.

Additionally, because small firms tend to be closer in proximity to their customers, they often build personal relationships with these customers that help them gain useful knowledge about the customers' unique needs and how to meet these needs (Haksever, 1996), and this may help them develop quality products that are exactly what customers are looking for (Dewan, Jing, & Seidmann, 2003). This close proximity will also likely lead to a faster exchange of knowledge between customers and the firm (Wong & Aspinwall, 2004). Proximity could also help a new small firm compete by differentiating themselves on convenience, which is a key driver of the strategy of differentiation (Miller, 1988).

However, because small firms also tend to have fewer and more homogenous employees, their external networks to valuable customers may be limited. Consequently, a firm with a pool of racially diverse employees can have a clear strategic advantage in reaching out to customers. By using the knowledge stocks of workers from racially diverse backgrounds, a new small firm can specifically tailor its product offerings and better serve a variety of markets within a certain vicinity, and thus leverage its relational capital and its convenience for these customers.

As the demographic makeup of the workforce changes, so does the marketplace. Projections indicate that minorities will play an increasingly significant role in the U.S. economy in terms of purchasing power, and minority customers may prefer to patronize or support organizations that have a racially diverse workforce who understand their needs, culture, language, and preferences (Altinay, Saunders, & Wang, 2014). Prospective clients may also question an organization's diversity record before they are willing to begin a business relationship (Gardenswartz & Rowe, 1998). In fact, McKay, Avery, Liao, and Morris (2011) found that having a climate that values diversity is directly related to customer satisfaction a year later. Although these findings were in large organizations, we expect the finding will be similar in small firms.

Additionally, compared with large organizations, new small firms may have fewer resources allocated to marketing, so their need to maximize return on investment and leverage relational capital is greater. Were small firms able to capitalize on the advantages associated with racially diversity among employees, they could obtain a greater return on investment of marketing funds. Positive reputations and image are strategic assets (Fombrun & Shanley, 1990) and subcomponents of relational capital.

A reputation as an employer of racially diverse workers, and provider of convenient, relevant products and services may enable the new small firm to gain loyal customers who intentionally choose to do business with the firm. This will contribute to a positive community image with customers and other stakeholders. Overall, the literature points to racial diversity as being a critical knowledge resource which may serve as informal advertising, leading to increased visibility and reduced marketing costs.

Proposition 6. Early racial diversification of a small business combined with a climate that values diversity will increase the marketing capabilities of the new firm.

Since competitive advantages in small firms often revolve around human assets (Simpson, Tuck, & Bellamy, 2004), and the firm's intellectual capital, it is important for new small firms to recognize the benefits that can come from a diverse workforce. Cumulatively, we proposed that new small firms that hire racially diverse workforces, value racial diversity, and implement inclusive organizational environments may enhance their intellectual capital, leading to better performance (for example, reduced costs, more creative ideas, greater profit, organizational flexibility, etc.) and higher survival rates. Small firms that do not hire racially diverse workforces, value diversity, or implement inclusive environments could risk the long-term sustainability of their firms. Consequently, it stands to reason that workforce diversity, particularly with respect to race, should be viewed by new small firms as a strategic human resource management tool which is critical for long-term business survival and better performance.

Implications for Practice and Research

We have proposed that when new small firm owners recognize the importance of racial diversity and a climate that values racial diversity, this will allow their firms to be more responsive and adaptive to customer needs, develop innovative products, and build a sustainable competitive advantage. The intellectual capital gained from new and diverse employees can be shared with all organizational members so that the organization learns collectively as individuals are socially, contextually, and relationally embedded with each other and with the firm (Granovetter, 1992; Nahapiet & Ghoshal, 1998). New small firms, often overlooked in diversity and human resources scholarship, may benefit from and be well-equipped to manage and value the contributions of a racially diverse workforce due to the firm's size and flexibility. The large numbers of small firms, the millions of people employed by them, and the increasing diversity of the U.S. population make these ideas particularly important.

As shown in Table 1, we provide several recommendations to help new small firms create an affirming climate for diversity. We have chosen recommendations that even the smallest (and youngest) firms can begin to adopt. After examining their current (and projected) talent and knowledge resources, existing and potential customer base, and desired knowledge/skills, small firm owners should create a diversity plan that is tied to key performance indicators. Small firm owners can begin to make diversity a priority by writing diversity-related values into their mission statements, communicating the importance of racial diversity for their competitive advantage, and framing their values in such a way that all employees feel included and have mutual respect for fellow employees (Kidder et al., 2004).

Small firms' size and flexibility can easily lead to increased employee voice and participation in decision making, which has been shown to increase the feelings of being accepted and valued in an organization (Bell et al., 2011; Chrobot-Mason, 2003). New small firm owners should make sure that human resource policies are fair, objective, and formalized to the greatest extent possible given the resources available. This may be a long-term process, but it should start early with clear job descriptions and require-

Table 1
Recommendations for developing an inclusive diversity climate in small businesses

Climate Strategy	Details of Strategy	Source
Develop Commitment to Diversity	Owners, managers, and employees need to gain an awareness of and value diversity at all levels.	(Avery & McKay, 2006; Herdman & McMillan-Capehart, 2010)
Develop Diversity Strategy	Tie the diversity plan to the mission statement and values, as well as key business results, such as firm performance.	(Jayne & Dipboye, 2004; Konrad, Yang, & Maurer, 2016)
Transparent Communication and Framing	Communicate reasons for diversity initiatives as creating a competitive advantage rather than to fulfill affirmative action laws.	(Kidder et al., 2004; Scott et al., 2011)
Allow Employee Voice and Participation	Allow employees to participate in decision making and voice dissatisfaction, especially as it relates to culture and climate.	(Bell et al., 2011; Chrobot-Mason, 2003)
Ensure Human Resource Policies are Fair and Objective	Make sure that selection practices, performance appraisals, promotion practices and compensation are fair, objective and as formalized as possible, given scarce resources.	(Knouse, 2009; Mor Barak et al., 1998; Roh & Kim, 2016)
Ongoing Diversity Training (long-term plan)	Create an ongoing diversity education and training program for firm owners, and then for all employees, as the firm grows.	(Roberson, Kulik, &Tan, 2013; Shen, Chanda, Netto, & Monga, 2009)
Assessment and Evaluation (long-term plan)	Develop a plan to assess Human Resource policies and climate for diversity. Regularly evaluate the effectiveness of all diversity initiatives, making changes as needed.	(Jayne & Dipoye, 2004; Konrad et al., 2016)

ments for jobs in advertisements, objective selection measures and performance appraisals, as well as fair compensation for employees with the same experience, irrespective of race. Fair HR policies should include ongoing education and training for all employees as money and time become available. Once a plan for creating an affirming climate for diversity is developed and worked into key areas of the firm, small business owners should consider ways to assess and evaluate diversity initiatives. While this measurement process is likely the most expensive part of a comprehensive diversity initiative, keeping tabs on the success of objective human resource policies, and perceptions of fairness, and inclusive climates can be invaluable for firms. Such initiatives allow firms to determine how to continuously propagate inclusive climates which will utilize the intellectual capital of employees and become a sustainable competitive advantage.

By starting with a commitment to racial diversity, strong recruitment, and objective selection processes, new small firms can make significant progress toward ensuring a racially diverse workforce. McMahan et al. (1998, p. 201) proposed that a “deeply embedded strategy of workforce diversity would require the interplay of all HR functions (for example, recruitment and selection, performance evaluation, compensation and benefits) and would interact with other organizational functions (that is, marketing and customer support) to create inimitability". High performing work systems such as these may be longer-term goals for small firms, but research shows that they can be successful (Coder et al., 2017).

Table 2 provides recommendations that help new small firms recruit and select a diverse workforce as these are two of the more critical areas where new business owners encounter challenges (Cardon & Stevens, 2004; Froelich, 2005) and are critical areas for racial diversity and inclusion. Given that smaller businesses tend to use word-of-mouth recruiting and employee referrals, the profile of workers that currently exists in the firm is maintained since individuals tend to associate with similar others, as mentioned earlier. Thus, we encourage new small firms to incorporate non-traditional ways of recruiting racially diverse workers. College/community college campuses with racially diverse student bodies, community and ethnic newspapers, and professional associations are just a few of the options that may provide inexpensive leads for recruitment of employees from racially diverse backgrounds. To attract a more racially diverse pool of applicants, firms should consider adding pictures of racially diverse employees on the firm's website, in employment advertising materials (McKay & Avery, 2005), and a diversity statement on all job advertisements. Minorities are attracted to firms that use such recruitment practices (Goldberg & Allen, 2008). However, if there is not an affirming climate for racial diversity, these recruitment techniques can backfire, creating

Table 2
Recommendations for recruitment and selection of diverse employees to small firms

Recruitment Strategy	Description of Strategy	Source
Recruit from a Variety of Sources	Recruit from colleges with diverse student bodies, advertise in minority newspapers or journals, and professional associations, etc.	(Newman & Lyon, 2009; Roach, 2006)
Recruit from a Diverse Applicant Pool	Start by recruiting racially diverse employees, but also consider a variety of ages, workers with disabilities, LGBTQ workers, etc.	(Ebrahimi, Saives, & Holford, 2008; Meyers & Degges-White, 2007)
Develop Job Advertisements that Attract Diverse Applicants	Diverse demographics of actors in pictures or on website; use a specific statement about how the firm values diversity in recruitment materials, but only if accompanied by an affirming diversity climate (as outlined in Table 1)	(Avery, Hernandez, & Hebl, 2004; Goldberg & Allen, 2008; Knouse, 2009; Lambert, 2015; Perkins, Thomas, & Taylor, 2000)
Use Objective and Fair Hiring Techniques	Use semi-structured interviews with job-related questions (rather than unstructured interviews), and objective rating scales. Use the same questions for all applicants.	(Huffcutt & Roth, 1998; McCarthy, Van Iddekinge, & Campion, 2010; McDaniel, Whetzel, Schmidt, & Maurer, 1994)
Regularly Assess Recruitment and Selection Techniques (long-term plan)	Use yield analyses, quality scores and HR data to track how well recruitment sources yield high quality, diverse applicants who are hired and retained; track effectiveness of selection measures to make sure that selected employees perform well.	(Carlson, Connerley, & Mecham, 2002; Konrad et al., 2016)

feelings of dissatisfaction, disappointment, and intentions to quit (Chrobot-Mason, 2003; McKay & Avery, 2005). In contrast, combined with supportive climates, these suggestions often cost little and are creative ways to attract more qualified employees who would be assets to the firm.

Along with effectively recruiting a racially diverse applicant pool, new small firm owners should ensure that current selection techniques are as objective and bias-free as possible. Since interviews are the most common technique used to hire employees, it is important to focus on reducing the likelihood of a similar-to-me bias and making the interviews more predictive of future performance. Interviewers should use structured interviews, asking job-related and situational questions (McDaniel et al., 1994), which can eliminate racial similarity bias (McCarthy et al., 2010), along with increasing the likelihood of finding the most qualified applicants for job vacancies. Choosing the most qualified person is particularly important to small firms who have few employees and are less able to afford hiring mistakes.

Academic Implications and Future Research Ideas

Practitioners and researchers alike need a deeper understanding of how intellectual capital functions to increase small firms' performance. Prior studies have demonstrated the value of intellectual capital for large firms, but examining new small firms will add significantly to our knowledge in this area. As we have noted throughout, there are important differences between large corporations and new small firms. New, small firms often experience a lack of legitimacy in the community, a lack of resources for marketing, recruiting, or high-level human resource policies, and a focus on survival that can engulf other strategies. While some of the theories and findings on larger corporations may help inspire new small firms to plan for the future, more research is needed to determine what would actually be beneficial and predict a competitive advantage for the firms as soon as possible. Therefore, we next outline a plan for a research program to address the significant gaps in the literature to date.

There has been a call for more mixed methods designs when studying psychological issues in business (e.g., Eid & Diener, 2006). Combining qualitative and quantitative methodologies would be a good way to gain both the depth of the personal experiences and stories of individual business owners with the generalizability of quantitative methods (Johnson & Onwuegbuzie, 2004). For example, qualitative interviews with small firm owners about their strategies for diversity and inclusion would likely reveal specific struggles with survival as a focus to the detriment of employee inclusivity. New small business owners could explain their struggles, while also sharing practical ideas that have worked for them. It would be interesting to compare the experiences of new small firms that have a homogenous workforce and want to diversify with those that do not believe diversifying in the early stages would be helpful. In addition, a comparison between homogenous and heterogeneous small firms could also highlight the particular strengths and struggles of each.

It may be beneficial not only to compare the diversity (in terms of numbers of employees from different racial groups) of new small firms, but to also compare the levels of inclusive climate indicators, objective HR policies for recruitment and selection, and ongoing training and assessment techniques across a variety of new small firms. Researchers could use the in-depth knowledge gained from the qualitative interviews to develop quantitative studies that would reach a wider participant pool, and therefore be more generalizable. For example, a survey might include questions about how well the owner feels that he/she communicates diversity initiatives to employees, specific struggles that might be affecting the company's ability to be more inclusive, and the extent to which they are able to incorporate objective human resource policies into their daily existence. In addition, questions could revolve around recruitment and selection policies that we have suggested in Table 2. Finally, questions related to the utilization of intellectual capital would help determine how much employees' knowledge and networks are used to increase innovation within the company as well as reach new customers outside the firm. Based on our comprehensive arguments, we believe that new small businesses that attempt to be more inclusive will show better firm performance rates over time than those that are not.

Another fruitful stream would be to compare the owners' desire for inclusivity with their employees' perception of the positives and negatives of such a strategy. Clearly having buy-in about the importance of the inclusivity strategy is important for a small business. Owners may see backlash from employees if the strategies are not communicated clearly and connected to the firm's mission and values.

Many of the ideas above could benefit from longitudinal studies. For example, tracking firms that begin with a racially diverse workforce and an inclusive diversity climate and comparing them to firms that did not have a diversity plan from the outset would be interesting. We believe that the racially diverse new firm will reap performance benefits earlier and stronger than firms that try to implement racial diversity plans later in their development, or firms that do not implement diversity plans at all.

Conclusion

Given the scant scholarly literature on diversity in small firms, we encourage researchers to empirically examine the relationship between new small firms' racial diversity, intellectual capital and performance. The current arguments contribute to the literature about the benefits of a racially diverse workforce that is managed within an inclusive climate for diversity, and set the stage for future researchers to fill the gap in the literature between the ways that large and small firms must approach diversity and inclusion efforts. First, we brought to light the importance of studying diversity in new small firms using findings from extensive diversity research on large organizations. Second, we proposed that, if properly combined with a climate that values racial diversity, small firms can benefit as much as, if not more than, large organizations by employing a racially diverse workforce. A racially diverse workforce will lead to more intellectual capital and knowledge resources, which helps new small firms develop innovative ideas, solve complex problems, and recruit and retain more qualified employees as the firm grows. New small firms' focus on racial diversity as an asset will increase the likelihood of attracting a diverse customer base. Being equipped with these advantages should help new small firms survive in an increasingly competitive marketplace. Finally, founders of new small companies often have growth as a goal, therefore it is important that they begin to incorporate a strong foundation and system for managing racially diverse human resources at the inception of the business, since increased diversity of their workforce may enhance the company's ability to grow and thrive (Cox & Blake, 1991). Future researchers should build on these arguments with mixed methods studies designed to bring depth and generalizability to the argument that new, small firms should develop a diversity and inclusion strategy from the outset.

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