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SUPPORTING AND MEASURING EFFECTS OF DIVERSITY, EQUITY AND INCLUSION FOR COMPANY VALUE CREATION

Case Study of a Finnish Private Equity Company

Master of Science Thesis
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Examiner: Associate Professor Tuomas Korhonen
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ABSTRACT

Silja Tuominen: Supporting and Measuring Effects of Diversity, Equity and Inclusion for Company Value Creation – Case Study of a Finnish Private Equity Company
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Private equity (PE) field has faced increasing requirements for sustainability during the past years and more recently the emphasis has shifted towards diversity, equity and inclusion (DEI) that considers social aspects of sustainability. Pressures coming from legislation, investors and other stakeholders are forcing PE companies to act, but the knowledge of the effects and management of DEI in the specific PE context is non-existent. General research around DEI is also inconsistent which is hampering the implementation of DEI into businesses. To address this topical research gap, this study strived to uncover ways to support and measure DEI, and to recognize relevant DEI factors for financial performance and thus also for company valuations in the private equity context.

To meet the objectives of the study, cross-sectional case study was applied focusing on Finnish private equity company seeking to manage DEI in its several portfolio companies. Empirical insights were gathered through interviews with various actors in this setting providing diverse views on the topic. To support the primary data, a semi-systematic literature review was conducted to provide a supporting framework for the study based on the previous research. This framework was then utilized for the analysis of the interviews to enable comparison between previous research and new empirical findings. To finally provide case company with practical insights, action research was applied based on the results to offer guidelines on managing DEI in the private equity context and optimizing financial performance.

Results of this study demonstrated DEI management in the PE industry to have many similarities compared to previous DEI research, however the industry offers few distinctions with company structures, financing and time horizon. Therefore, it was concluded that private equity companies need to foster good communication, lead with example, commit management team and create tailored strategy for value creation when considering DEI management in portfolio companies. In addition, because the industry in general is highly business oriented it was noticed critical to further on provide evidence for the profitability of DEI. To support this, findings of this study demonstrated mostly positive indications for financial performance with increased diversity, equity and inclusion. Especially the role of inclusion and overall management of diverse groups were found significant. However, the sources for the performance were multidimensional, and certain environments were found more favourable than others. Due to all of this, measurements were found challenging, but even more important for following the realized performance in each private equity and portfolio company separately. Despite the unclear drivers of performance, strong trust for the importance and profitability of DEI was present in the industry.

This paper contributes to the diversity, equity and inclusion literature by bringing novel insights on management and performance of DEI in the private equity context that holds some differences to previous research. For private equity companies this paper offers practical guidelines on managing DEI in their own and portfolio operations to enable greater financial performance. Because of the high power that PE companies possess for managing other businesses, offers this study also support for more socially sustainable business widely. More research in the PE field is called especially for longitudinal performance studies of DEI to discover more specific results for the industry. Expanding the results to other countries with differing diversity and environment offers interesting research opportunities as well.

Keywords: diversity, equity, inclusion, DEI, private equity, management, measurements, financial performance, company value

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TIIVISTELMÄ

Silja Tuominen: Monimuotoisuuden, yhdenvertaisuuden ja osallistamisen vaikutus yrityksen arvoon sekä sen tukeminen ja mittaaminen – tapaustutkimus suomalaisessa pääomasijoitus-yhtiössä
Diplomityö
Tampereen yliopisto
Tuotantotalouden diplomi-insinöörin tutkinto-ohjelma
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Pääomasijoitusala on kohdannut kasvavia vaatimuksia kestävän kehityksen osalta viime vuosina ja lähiaikoina kiinnostus on kohdistunut erityisesti monimuotoisuuteen, yhdenvertaisuuteen ja osallistamiseen (DEI), joka kuuluu sosiaalisen kestävyyden piiriin. Lainsäädännön, sijoittajien ja muiden sidosryhmien paine pakottaa pääomasijoitusyhtiöitä toimimaan, mutta ymmärrys DEI:n hallinnasta ja suorituskyvystä on olematonta juuri pääomasijoituskontekstissa. Yleinen tutkimus DEI:n ympärillä on myös epäjohdonmukaista, mikä hankaloittaa DEI:n toimeenpanoa yrityksissä. Täyttääkseen tämän ajankohtaisen tutkimusaukon, tämän tutkimuksen tarkoituksena oli löytää keinoja DEI:n tukemiseen ja mittaamiseen sekä tunnistaa merkittäviä DEI-tekijöitä taloudellisen suorituskyvyn ja täten myös yrityksen valuaation kannalta pääomasijoituskontekstissa.

Työn tavoitteiden saavuttamiseksi työssä hyödynnettiin poikittaista tapaustutkimusta suomalaisessa pääomasijoitusyhtiössä, joka pyrkii hallitsemaan DEI:tä sen useissa portfolioyrityksissä. Empiirinen aineisto kerättiin haastattelemalla eri toimijoita tässä ympäristössä taaten monipuolisia näkökulmia aiheeseen. Ensisijaisen datan tueksi suoritettiin järjestelmällinen kirjallisuuskatsaus luoden työtä tukeva viitekehys pohjautuen aikaisempaan tutkimukseen. Tätä viitekehystä hyödynnettiin haastatteluiden analysoinnissa, mikä mahdollisti aikaisemman tutkimuksen ja uusien empiiristen löydösten vertailun. Lopulta luodakseen case-yritykselle käytännön osaamista, hyödynnettiin toimintatutkimusta perustuen työn tuloksiin, luoden toimintaohjeita DEI:n hallintaan ja taloudellisen suorituskyvyn optimointiin pääomasijoituskontekstissa.

Työn tulokset osoittivat DEI:n hallinnassa pääomasijoitusalalla olevan monia samankaltaisuuksia verrattuna aikaisempaan DEI-tutkimukseen, vaikkakin ala tarjoaa joitain eroavaisuuksia yritysrakenteissa, rahoituksessa ja aikahorisontissa. Tämän takia pääomasijoitusyhtiöiden on vaalittava hyvää kommunikaatiota portfolioyrityksen kanssa, johdettava esimerkillä, sitoutettava portfolioyrityksen johtoryhmä ja luotava räätälöity strategia arvonluonnille DEI:n hallintaa ajatellen. Lisäksi koska toimiala on yleisesti hyvin liiketoimintaorientoitunut, todettiin DEI:n kannattavuuden osoittaminen kriittiseksi. Tätä tukeakseen työn tulokset tarjosivat enimmäkseen positiivisia viitteitä taloudelliselle suorituskyvylle monimuotoisuuden, yhdenvertaisuuden ja osallistamisen lisääntyessä. Erityisesti osallistamisen ja ylipäätään monimuotoisten ryhmien hallinnan todettiin olevan merkittävässä roolissa. Suorituskyvyn lähteet olivat kuitenkin moniulotteisia ja tietyt ympäristöt todettiin muita suotuisemmiksi. Tämän takia mittaaminen todettiin haastavaksi mutta sitäkin tärkeämmäksi, jotta kunkin pääomasijoitusyhtiön ja portfolioyrityksen toteutunutta suorituskykyä voitaisiin seurata erikseen. Huolimatta epäselvistä suorituskyvyn ajureista, alalla vallitsi vahva usko DEI:n tärkeydestä ja kannattavuudesta.

Tämä diplomityö tuottaa uutta tietoa monimuotoisuus-, yhdenvertaisuus- ja osallistamiskirjallisuuteen tuoden uusia näkemyksiä DEI:n hallintaan ja suorituskykyyn pääomasijoituskontekstissa, joka pitää sisällään tiettyjä eroavaisuuksia aikaisempaan kirjallisuuteen. Pääomasijoitusyhtiöille paperi tuottaa taas käytännön ohjeita DEI:n hallintaan omassa sekä portfolioiden toiminnassa mahdollistaakseen paremman taloudellisen suorituskyvyn. Koska pääomasijoitusyhtiöillä on valtaa hallita usean yrityksen toimintaa, tarjoaa tämä työ myös tukea harjoittaa sosiaalisesti kestävämpää liiketoimintaa laaja-alaisesti. Lisää tutkimusta pääomasijoitustoimialalla kaivataan erityisesti DEI:n suorituskyvyn seuraamiseen pidemmällä aikavälillä, jotta voitaisiin havaita täsmällisempiä tuloksia toimialalla. Tulosten laajentaminen muihin maihin poikkeavalla monimuotoisuudella ja ympäristöllä tarjoaa myös mielenkiintoisia tutkimusmahdollisuuksia.

Avainsanat: Monimuotoisuus, yhdenvertaisuus, osallistaminen, DEI, pääomasijoitus, hallinta, mittaukset, taloudellinen suorituskyky, yrityksen arvo

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PREFACE

The threaded project of master's thesis is finally done and completes my studies in industrial engineering and management at Tampere University. Writing an entire master's thesis seemed very distant in the beginning of the year and I would have not managed to finish it without the help of my instructors both from the university and case company sides. I would like to give big thanks to Tuomas Korhonen and Teemu Laine for supporting the process with new ideas and encouragement throughout. Also, huge thanks for my case company providing me with the great opportunity to work on a meaningful topic in an interesting field.

Finishing my studies while playing sports professionally has been a challenge, but even greater advantage for me to succeed in both and maintain a good balance in everyday life. I'm grateful for all the knowledge I have gained during my studies, but especially grateful for all the people, places and experiences that I have been able to experience during this significant period of my life. However, now I'm excited to step outside of the academic world and face the new challenges ahead – whatever those might be.

Lahti, 27 November 2024

Silja Tuominen

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LIST OF SYMBOLS AND ABBREVIATIONS

CSDDD	Corporate Sustainability Due Diligence Directive
CSRD	Corporate Sustainability Reporting Directive
DEI	Diversity, Equity, Inclusion
EBITDA	Earnings before interests, taxes, depreciation and amortization
ESG	Environmental, social, governance
ESRS	European Sustainability Reporting Standards
FVCA	Finnish Venture Capital Association
GBBD	Gender Balance on Boards Directive
GP	General Partner
IPEV	International Private Equity and Venture Capital Valuation
KPI	Key Performance Indicator
LP	Limited Partner
PE	Private Equity
ROA	Return on Assets
ROI	Return on Investment
SFDR	Sustainable Finance Disclosure Regulation
SRI	Socially Responsible Investing
Tesi	Finnish Industry Investment (Suomen Teollisuussijoitus)
UN	United Nations
UNEPFI	United Nations Environment Programme Finance Initiative
UNPRI	United Nations Principles for Responsible Investments
VC	Venture Capital

1. INTRODUCTION

This chapter discusses the foundations of this study, starting from introduction to the topic and its relevance. Previous research and conflicts are discussed to recognize the research gaps and positioning of this study relative to prior research. Research scope, questions, objectives, methodology, and research structure are covered after this. Lastly the case company and its special features are introduced.

1.1 Background of the study

Numerous sustainability related studies have been conducted in recent years demonstrating the benefits for financial performance and market value of the company (e.g. Cantele & Zardini 2018; Zhou et al. 2022). This subject has raised awareness also in private equity (PE) market where sustainability matters have entered rapidly (Sharma et al. 2023). Expansion of the private equity market space has emerged a lot of discussion around environmental, social and governance (ESG) matters also in this specific context (Bian et al. 2023; Crifo et al. 2015). Because the business in the private equity market runs around company valuations, it offers interesting viewpoint for sustainability. Most of the actors in the private equity field already engage in ESG activities, but the main reasons are to avoid negative effects and to meet the demands of investors, rather than to gain financial benefits although the possibility is recognized (Zaccone & Pedrini 2020). Therefore, movement towards more proactive implementation instead of reactive is called in the private equity markets (Long & Johnstone 2023).

The focus of value creation in the private equity market has shifted towards more governance and operational changes, from the previous focus on the financing structure (Kaplan & Strömberg 2009). This has allowed new ways for value creation focusing for an example on ESG matters that have seized financial markets after more stakeholders have become exposed to sustainability issues. Despite the growing attention in ESG matters the role of social and governance actions have been overlooked on many occasions in value creation process. (Zaccone & Pedrini 2020) Despite this, the PE industry has encountered growing interest especially towards diversity, equity, and inclusion (DEI) matters in recent years. Institutional actors and consulting companies like Finnish Venture Capital Association (FVCA) and McKinsey & Company have already acted and recognized the importance of DEI for the long-term success in the private equity markets. These issues are recognized important for team performance, promotion of positive change, and for sustainable growth. (FVCA 2023a; McKinsey & Company 2023) These stakeholders are pushing private equity companies to act but understanding of the benefits is still vague, causing uncertainty to act.

Although actors in the private equity field have started to recognize the importance of these issues, the academic research has not recognized this field to date. This research gap has been identified and research have been called in the private equity context which is recognized to have special features in capital structure and ownership (Naghavi et al. 2020). Therefore, the research gap is deemed significant and possibility to enlighten this unknown area of diversity, equity and inclusion research is valued. Moreover, another special feature of private market is that the companies under management are non-listed companies, whereas majority of the previous research has studied the performance outcomes in large, listed companies. This consistency of previous research has been spotted in various papers, calling for more research in smaller non-listed companies. (Mahadeo et al. 2012; Marinova et al. 2016) All these special features of the PE market offer intriguing opportunities for research.

To better understand the studied concept of diversity, equity, and inclusion, it is important to determine these terms and establish how they are related to bigger entity of sustainability. Widely known ESG framework was originally introduced by United Nations to integrate environmental, social and governance factors in investment decisions of financial actors (UN 2004). Today ESG refers more broadly to concrete sustainability actions describing company commitments to environmental, social and governance issues, and the framework is not restricted to only financial markets (Chen et al. 2023). Environmental factors refer to actions managing environmental effects of the company (UN 2004). Social sustainability is determined by United Nations as “managing business impacts, both positive and negative, on people”, and it considers issues such as gender equality, human rights, health, decent working conditions and inequalities between countries (UN 2023). Whereas governance refers to corporate governance actions that support the functioning of the company, for example transparency, disclosures and compensation systems based on long term sustainability targets. Governance has central role in realizing social and environmental sustainability solutions in practice. (UN 2004) Out of these three subdivisions, environmental issues have been on the focus for the past years leaving social and governance issues more in the background (Zaccone & Pedrini 2020). The concept of diversity, equity and inclusion is specifically focusing on these overlooked aspects of social and governance issues.

Diversity, equity, and inclusion hereafter referred together as "DEI" are closely related matters but have each own definitions and objectives. Diversity simply means the representation and promotion of people with different attributes and backgrounds. Inclusion is more individual level view on how incorporated and substantial the individual feels in organization. Equity in turn refers to more organizational view of the systems and structures that allow every individual the same opportunity to succeed in the organization. (Davis 2022) To conclude the concept of DEI pursues more diverse workforce to feel included in the organization and to have equal opportunity in the organization. These actions are believed to create different benefits in organizational level. (Bernstein et al. 2020).

Many academic sources offer support for the positive implications of DEI management. For an example Campbell and Mínguez-Vera (2008) discovered gender diversity in boards to positively affect monitoring and therefore financial performance. Moreover, racial diversity is found to increase firm reputation and innovation which again leads to increased firm performance (Miller & Del Carmen Triana 2009). Further on racial diversity is linked with concrete financial performance as well (Smulowitz et al. 2019). The role of inclusion in DEI is seen extremely important, but it has still been less researched compared to diversity. The field has recognized possibilities in different areas of performance such as job satisfaction, organizational commitment, and creativity, but more research is called. (Shore et al. 2011) Inclusion can be seen as a complementary action for diversity management since diversity has limited role by itself (Randel et al. 2018). Furthermore, there is very limited discussion around equity regarding DEI performance. Bernstein et al. (2020) discuss equity being the final objective after diversity and inclusion, which might explain the limited literature, since also diversity and inclusion are lacking comprehensive understanding.

Regardless of the recognized positive implications of DEI management, the field is not unanimous on DEI's effect on performance (Bernstein et al. 2020). Some implications of insignificant or even negative outcomes of DEI activities have been proposed as well. For an example Adams' and Ferreira's (2009) study proposed gender diversity having generally negative effect on firm performance. Carter et al. (2010) in turn didn't recognize significant relationship between gender or ethnic diversity and financial performance within US boards, but at the same time stresses that results weren't negative either. Further on, many studies might offer positive outcomes only with certain moderators or presumptions. For an example Joecks et al. (2013) suggests that positive financial performance could be achieved only after reaching critical mass of women in the board which was stated to be 30 percent.

Also as mentioned above inclusion is seen as complementary action to realize the potential of diverse workforce on many occasions. Several papers support this idea that without effective management of diversity there might be negative or inconsistent results on performance. (Leung et al. 2023; Mor Barak et al. 2016; Randel et al. 2018) So, whether the performance created through DEI is positive, negative or insignificant for businesses it should be managed accordingly. As the uncertainty remains also clear guidelines for managing DEI have been challenging to gather. Therefore, these practical needs are also calling for more research and this paper will focus on filling these needs in the private equity market in question.

Diversity is a broad concept with many dimensions such as gender, age, race, physical attributes, beliefs, work experience, personality, socio-economic status, and nationality (Davis 2022). Still majority of the research is focused on small fractions of these dimensions such as gender and ethnicity that might be more visible, even though most of the dimensions are invisible to external observer. Also, the diversity research is usually restricted to decision making groups, generally board rooms. (Baker et al. 2020; Khatib et al. 2021) Geographically most of the research in board diversity is conducted in United States, but also many European countries have followed this trend and have conducted significant amount of research on the field more recently. In addition, bigger firms are more presented in this research compared to smaller firms. (Baker et. al. 2020)

All things considered, more research on diversity, equity, and inclusion in relation to company value and managing this value, is required. The private equity market offers a topical platform to discuss these issues as valuations are essential part of the business. Moreover, insights on management of this performance are called by the actors in the private equity field. Further on, diversity requires more broader perspective than gender and ethnicity, as they only present a small fraction of diversity. Changing global marketplace is also increasingly sensitive to issues in ESG management also highlighting the importance of DEI to avoid risks and negative effects for not complying with responsible business principles (Sroufe & Gopalakrishna-Remani 2019). The role of small and midsize companies is also compelling in regards of DEI performance as the structures might differ from large corporations.

1.2 Research questions, objectives, and process

According to the research gaps recognized, this research will focus on the role of diversity, equity, and inclusion in the private equity industry. In this context, value creation, management, and measurements of DEI are focused, to expand the understanding of possible benefits and practical recommendations. Scope of the research is Finnish private equity market, and the case study is based on a small Finnish private equity company and its portfolio companies. These portfolio companies consist of small- and mid-sized unlisted companies operating in various industries. Scope of the study focuses purely on this relationship between these two actors in the private equity field, but other stakeholders like investors and legislation are acknowledged in the process. Value creation with DEI is discussed mainly with financial performance leading to increased company value, but also separate non-financial factors affecting valuation is considered. Three research questions of this study are presented and discussed separately below.

First question discusses the management of DEI seeking for actions and structures to support DEI performance in portfolio companies. Entity of DEI covers three equally important areas that require management. As for example Randel et al. (2018) state, diversity alone doesn't achieve performance outcomes if it is not managed well. Structures in this paper refer to organizational structures that enable diversity, equity, and inclusion in organization. Whereas actions refer here to principles, policies and strategies that further enhance diversity, equity, and inclusion. Question is approached with semi systematic literature review, but also additional views from professionals in the field. As academic research has not covered the subject specifically in the private equity field the interviews are used to discover these special features. The first research question is formulated as follows:

RQ1. *How could DEI initiatives be supported through different actions and structures in portfolio companies?*

After investigating how the DEI phenomena could be supported in portfolios the second research question aims to uncover performance that this successful DEI management could generate. Because the current literature offers various views on performance, more comprehensive picture of the literature is gathered in semi systematic literature review, and this is complemented with insights from professionals. Again, the interviews bring a closer look into specific interpretations of performance in the private equity context. Objective is to discover different factors affecting the performance outcomes, which could be related to diversity, equity or inclusion or some combination of these. Performance outcomes are reviewed as financial performance that can be further interpreted to affect company valuations. Therefore, second research question is formulated as follows:

RQ2. *How can different DEI factors affect financial performance and company value?*

Third question seeks to bring these two previous questions together for assessment of DEI management and performance with measurements. It should tie together all the aspects of diversity, equity, and inclusion for follow-up. This question is approached with previous literature and interviews in conjunction to discover how these issues could be best supported with measurements. Measurements should support the value creation and support functions that have been discovered. As a result, some recommendations for measuring are pursued. Third question is formulated as follows:

RQ3. *How could measurements support management and value creation of DEI in portfolios?*

Answering these three questions, provides better understanding of management and performance of DEI especially in highly interesting field of private equity where understanding of these matters is insufficient. Simultaneously it opens the field for more academic research also in the future.

To conclude the objectives of this study, the goal can be split into two dimensions: (1) Create guidelines for supporting and measuring DEI initiatives in portfolios for enhanced performance and (2) Recognize key DEI factors affecting business performance and company value. Most significant constraints recognized for reaching these goals will be in information availability that is constrained in this context, and furthermore time constraints that are present with master's thesis. Research plan is summarized in Figure1 to clarify how the goals of the study are achieved through the different research questions, data gathering, methods and framework. Framework created in this paper will be based on previous research and private equity field characteristics, and it will support analysis of results in systematic manner.

This paper is based on a cross-sectional case study regarding diversity, equity, and inclusion in Finnish portfolio companies in the light of governing private equity company. Research is going to be based on multimethod qualitative research with the aim of understanding the above-described phenomena better. Qualitative data is gathered from literature and interviews, considering the availability and relevance of materials for each research question. Plan is to exploit both theoretical and empirical data for each of the questions to utilize already existing research, but also to broaden these perspectives with new empirical data from the private equity perspective. This is deemed especially useful since DEI itself encompasses plenty of research and new empirical data will provide new insights from the view of the PE industry. Lastly, based on the findings from literature and interviews, action research is applied to introduce practical guidelines for the case company.

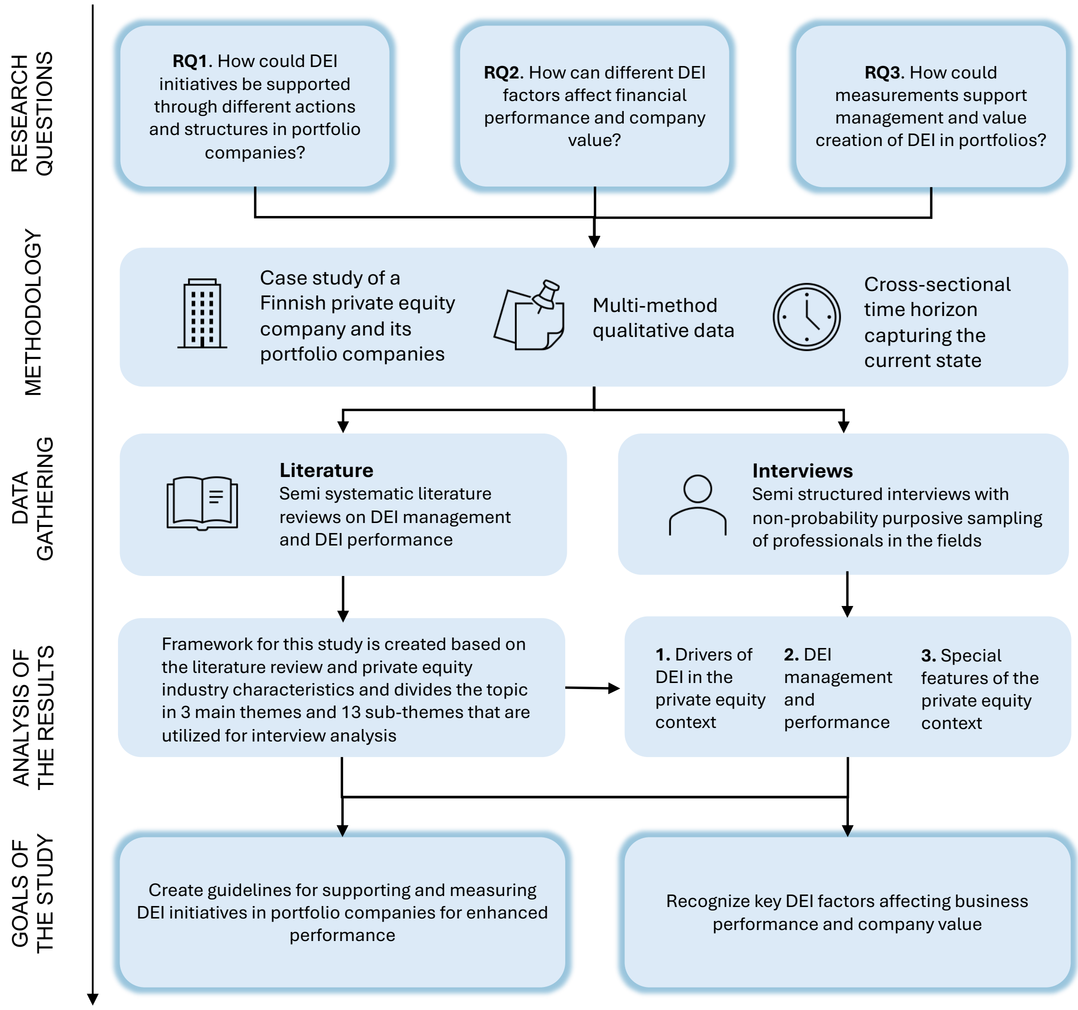

Figure 1. *Research plan*

Study will include interviews with various professionals with different backgrounds from the fields of DEI and private equity to include views from investing, managing, consulting, and operating levels. This purposive heterogeneous sampling enables more comprehensive view on the researched subject in the private equity context. Interviews will be semi structured interviews to allow in-depth and informal discussion around selected themes (Saunders et al. 2019, pp. 437). Because of the different backgrounds of interviewees, this chosen method enables all participants possibility to contribute their special knowledge related to the subject.

Literature review offers base for the study as plenty of research for DEI have been already carried out for decades in various environments. This previous research builds a base for the analysis of empirical data as a new framework is generated based on the literature review findings. Literature review is conducted in semi-systematic manner to discover the current literature on the fields of DEI management and DEI performance. Semi-systematic review offers good overview of the studied topic, and some common themes can be recognized from there which is especially beneficial here. Broad and scattered literature of DEI also limits the use of systematic literature review as reviewing all the relevant papers is not possible. The quality of the review is improved with explicit and systematic methods when describing the review process in following paragraph. (Snyder 2019)

The literature review is conducted in Scopus database with strict search terms separately for each of the fields of DEI management and DEI performance. Key terms for the research are private equity, diversity, equity and inclusion, management and performance that are further refined for more precise and broader terminology. It is important to notice the term "equity" that is used in two different contexts. Term "equity" by itself refers to one of the components of DEI, but when combined with "private equity" it refers to the industry. The journals for the search are limited to 25 high quality journals such as *Journal of Financial Economics*, *Journal of Management Studies and Journal of Business Ethics* that are noticed relevant in the field of DEI research. Semi-systematic review enables the subjective assessment of these results so that irrelevant papers can be still eliminated, and some relevant and highly recognized papers can be added. After all, final number of papers to be studied for management literature was 33 papers and for performance literature 40 papers. Search strategy in its entirety is presented in appendix A.

Structure of the paper follows common and good practices of research and is illustrated in the figure 2. First it includes introduction to the paper. After that the private equity market is discussed to better comprehend the context of the research that has some special features compared to previous research. Moreover, this chapter discusses the current knowledge and progress of DEI in the private equity industry in recent years. After this, DEI is addressed more widely by reviewing significant terminology and research for this paper. Based on the review, chapter 5 presents the created framework for this study. Next chapter discusses methodological choices of the study by discussing research strategies, data gathering, analysis and reliability and validity of the paper. Chapter 7 introduces the findings from the professional interviews in line with the framework structure. Summary then gathers findings from the literature and interviews for comparison and overview. Lastly conclusions chapter analyzes the results, their importance, limitations, and future research.

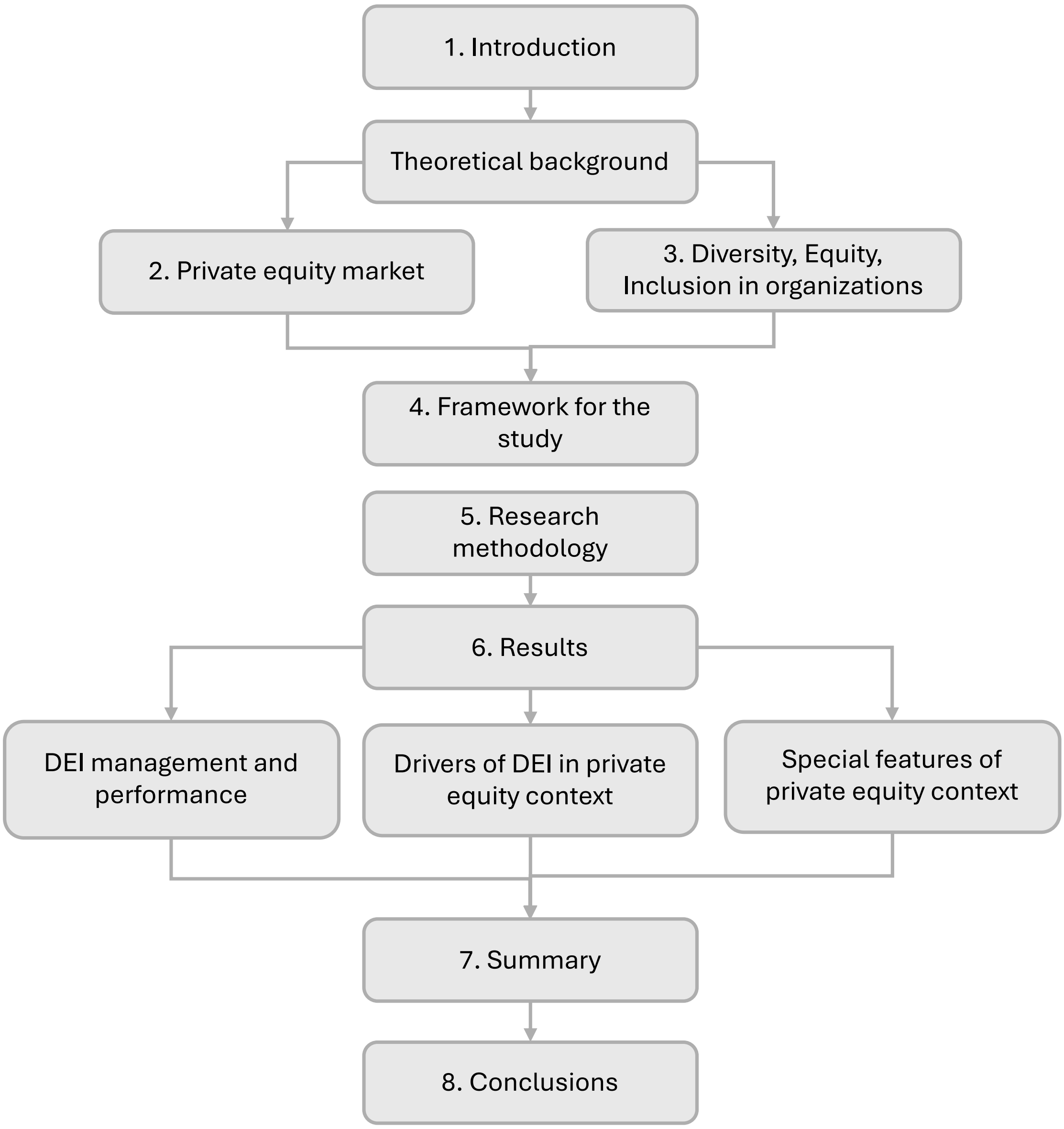

Figure 2. *Research structure*

1.3 Case company

Case company for this research is a small Finnish private equity company seeking for better tools to work with DEI in its operations. Company is specialized in buyout investments in small and mid-sized companies in Finland and Sweden. Portfolio companies are presenting various industries and growth stages.

Sustainability is one of the focus areas of the case company. Therefore, sustainable growth and responsible value creation are in a key role for their investments. Company follows United Nations Principles for Responsible Investments (UNPRI) and is a member of Finnish Venture Capital Association (FVCA) and complies with their guidelines and code of conduct. The growing demands for sustainability matters have actuated process to improve DEI matters within the case company.

Case company is faced with growing demands from investors and legislation to focus on diversity, equity and inclusion, but not enough support is available to initiate this process in sustainable manner. Because of this recent pressure, company seeks to be a trend-setter and lead the industry towards better understanding of DEI. At the same time reaching for greater returns and competitive advantage. Figure 3 presents the interaction of the case company objectives and the research questions to illustrate shared value that the research holds.

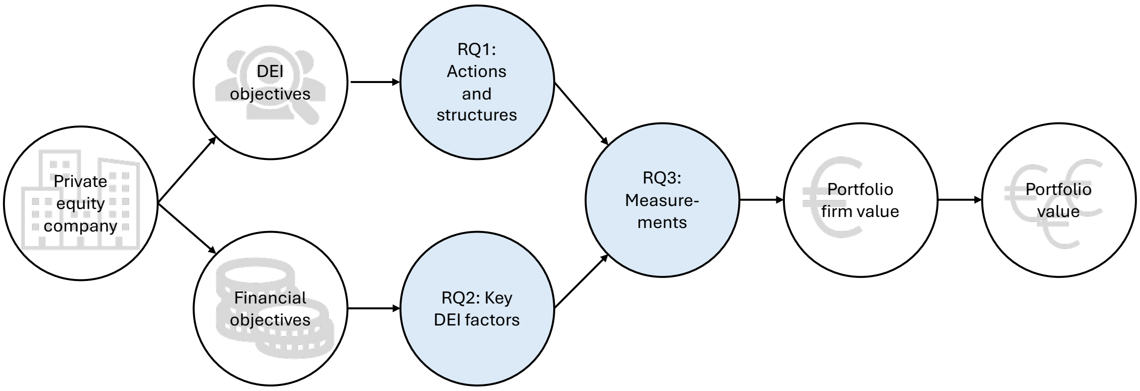

Figure 3. *Positioning of the research in case company*

Private equity company has two coexistent objectives for the study as it is supposed to support simultaneously DEI objectives, but also the financial objectives of the company. The three research questions are supporting these objectives as illustrated above. Realization of DEI objectives are ensured with the first research question as finding best principles for promoting DEI. On the other hand, financial objective is pursued through finding DEI factors that would allow higher financial performance. As outlined in this chapter these objectives are complex and cannot be totally separated which is demonstrated with third research question that aims to find ways to measure material factors and management initiatives to support both objectives. This would influence firm valuations and therefore whole portfolio value when successfully executed.

2. PRIVATE EQUITY MARKET

Private equity market offers some special features compared to conventional markets that are relevant when discussing DEI management and performance. Therefore, this chapter introduces the structures, principles, strategies, valuation models and relevant legislation present in this context.

2.1 Main principles in the private equity market

The private equity market has been growing substantially during the past years as growth per annum averages nearly at 20% and the assets under management reached 13,1 trillion dollars in June 2023. However fundraising activity declined globally and reached a lowest point since 2017 with just over 1 trillion dollars raised from investors. These numbers represent the macroeconomic challenges as financing costs have increased and uncertainties in the private equity market persist. (McKinsey & Company 2024) On top of that, fast-changing environment around legislation and sustainability have affected the development of the private equity market vastly (Bian et al. 2023). Especially the growing interest around DEI in the market has brough up the question how DEI can be managed in this specific context (FVCA 2023a). Given the challenges created by the changing environment, also new possibilities for value creation can be recognized in this growing market space.

Private equity offers alternative way of funding for private companies and at the same time alternative way of investing mainly for institutional investors but also wealthy private investors. Private equity has proven to offer more predictable and less volatile returns for investors, and it has gained a lot of interest in recent years. (Zeisberger et al. 2017, p. 314) Several sources have also recognized private equity returns generally exceeding public market returns especially in leveraged buyout which makes this market truly interesting for all the parties involved (Brown & Kaplan 2019; Harris et al. 2014). At the same time past performance has been recognized as a poor indicator for future performance, and the maturing of the private equity market with rising competition is undermining the performance persistence (Braun et al. 2017).

Private equity funds invest in private companies or public companies that it will take private. After this the goal is to increase the value of the companies with active ownership and governance to be able to sell it forward with a profit after a finite lifespan. Different strategies to create value and exit the investment are utilized to maximize the success of investments. (Kaplan & Strömberg 2009) One specific feature of the private equity market is its comparatively long and fixed investment periods with high illiquidity. So, with the tempting returns there also comes a downside of large, committed capital and unpredictable capital calls performed by private equity fund. (Zeisberger et al. 2018, pp.11-12) Structure, strategies, lifecycle, and trends of private equity are discussed more closely in next paragraphs.

Private equity (PE) market is structured as presented below in Figure 3. Private equity company offers funding and expertise in their chosen investment strategy for closely selected private companies. PE company usually organizes both the fundraising and all the managerial tasks related to fund, as general partner (GP) and investment manager. GP is the actor responsible of the fund, all the debt and liabilities, and it holds accountability for the investors. GP makes the investment decisions based on the beforehand designated mandate that investors are aware of. In contrast, investment manager manages the day-to-day activity related to fund including deal sourcing of potential investments, advisory services for portfolio companies, and reporting processes between entities. (Zeisberger et al. pp. 6-7)

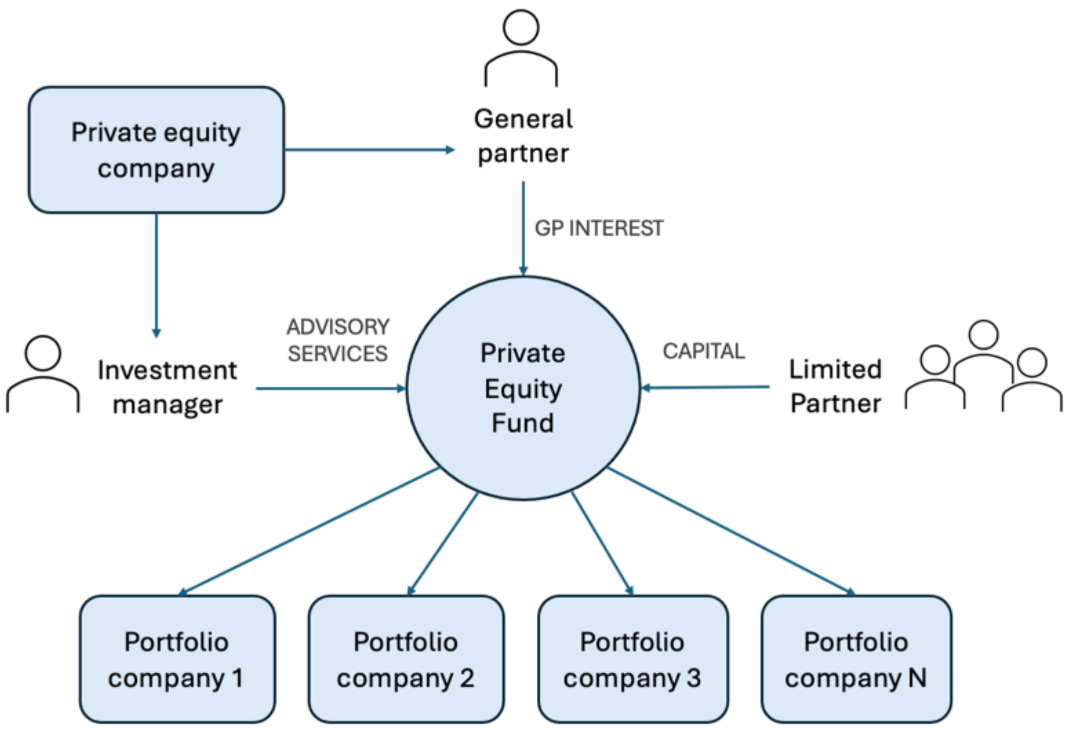

Figure 4. *Private equity market structure (Adapted from Zeisberger et al. 2018, p. 6)*

Investors of private equity are referred as limited partners (LP) as their liability is limited to the capital invested into the fund. Investments are called by the private equity company at a certain time and LPs are expected to answer these calls in a short period of time. At the end of an investment period LPs wish to gain profits on their invested capital. Pool of limited partners include different pension funds, banks, insurance companies, corporations, and other major financial actors. Most of the capital is contributed by LPs, but also GP will hold a small share of the capital committed. This will align the interests of GP and LP even though the investment share is only typically 1-5 % of the total capital committed to the fund. (Zeisberger et al. 2018, pp. 6-7)

This study focuses on the interface of private equity company and portfolio company, which is why the relationship between these actors is reviewed more closely in figure 4. Continuous information sharing between these entities and other stakeholders is demanded to align the interests of different actors and to work in conjunction. Furthermore, key performance indicators are also monitored regularly to recognize crucial areas of business and value creation. (Zeisberger et al. 2019, pp. 137-139) This study aims to strengthen specifically DEI reporting and management process between private equity and portfolio company. Regardless of private equity company and its portfolios being the context of the study, allows this research further benefits for all the parties involved. Better DEI management allows portfolio company to also focus on this aspect and further disclose this information to its own stakeholders. Equally importantly it offers possibility to disclose this information to private equity stakeholders demanding better DEI management.

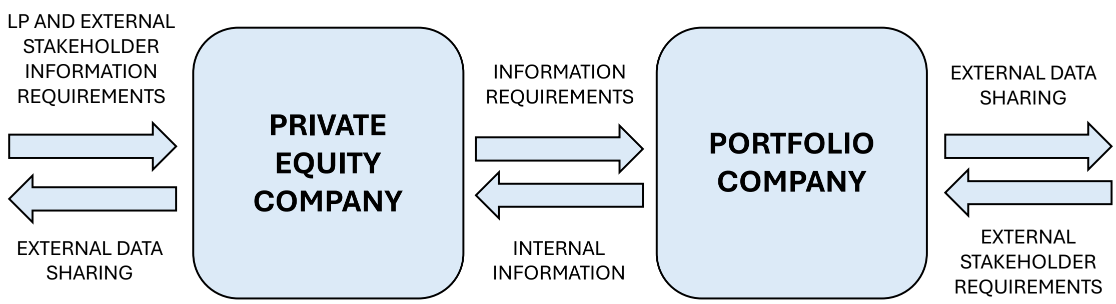

Figure 5. *Information flow between private equity and portfolio company*

In the core of a successful investment management are corporate governance, management team liaison, operational changes, and nowadays more and more responsible business. Firstly, corporate governance refers to practices related to strategy, leverage, operations, management, and monitoring. Main principles guiding the governance of portfolio companies are sense of urgency, active ownership, and alignment of interest between PE company and management team. Secondly, even though private equity company may have the majority ownership in portfolio company the role of management team is crucial since it handles the day-to-day business in portfolio companies. Therefore, shaping and evaluating the management team before and during investment period is important for value creation. Third way for managing investment is operational changes in existing operations to increase effectiveness and profitability. Example targets of operational changes could be sales growth, gross margin improvement, overhead reduction, and capital efficiency. Finally, investments for greater impact than financial performance defined as responsible investing has been established also in the private equity market and is believed to generate wide-ranging benefits. (Zeisberger et al. 2018, pp. 133-184) Responsible investing is discussed more closely in chapter 2.4.

There are three main strategies for PE companies to invest which are: buyout, growth equity and venture capital (VC). These strategies differ in the shares owned and in the maturity of the portfolio company. Most common strategy and the one also focused within this study is buyout strategy, which means buying majority stake of a portfolio company to access strategic and operational decision making in the company. Despite this, cooperation with management team and other stakeholders is still necessary to make the acquirement successful. Usually, significant portion of the financing is done through debt which is why leveraged buyout is more established term for this type of transaction. (Zeisberger et al. 2017, pp. 43- 45) Companies targeted in buyouts are usually already established companies with steady cash flows and market position (Zeisberger et al. 2017, p. 51).

Growth equity and venture capital differ from buyout usually in terms of buying minority stakes of the company. Growth equity is targeted for already established companies to enable new growth possibilities in fast growing businesses. On the other hand, venture capital targets companies in early stages to help establish stable market position and growth. Despite the lack of majority stake, these investments incorporate also active participation in the development of the companies. (Zeisberger et al. 2017, pp. 19-33) These two investment strategies are not considered within this study, but these might be touched upon when reviewing previous studies as these are closely related.

Typically, PE fund will invest in limited number of portfolio companies during its life cycle, averaging in 10-15 companies. The fund lifecycle is usually around 10 years, including fundraising, investment, holding and divestment periods. These periods are partially overlapping and can differ vastly between fund types. Commonly the fundraising starts with PE firm establishing minimum capital target for the fund and the moment that this target is reached is called “first closing”. Year of the “first closing” also defines the vintage year that the fund is referred as, for an example “vintage 2024 fund” refers to fund starting its investments in 2024. Thus, after first closing GP can start deploying the money and invest in selected companies. Fundraising will usually continue still a defined period after first closing until “final closing” is held. After this the investment period usually lasts for

4-5 years, and it is predefined in fund documentation. However, there is also alternative ways to prolong this period, add capital to current investments or recycle the capital already gained through investment for new investments. Holding period begins when first investment is made and usually lasts around 3-7 years. This is the phase where actions to increase company value are done with close cooperation with GP and portfolio company, and the success of these actions define largely how long the holding period will last. Divestment period is the phase where investments are exited and invested capital and profits (or losses) are gathered. This phase is happening mostly at the same time with holding period when some investments are already exited, and some are still closely managed. (Zeisberger et al. 2018, pp. 8-10)

2.2 Company valuation principles

Company valuations are constant area of discussion in private equity since it largely defines the success of investments. There are common guidelines for valuation like International Private Equity and Venture Capital Valuation Guidelines (IPEV), which are commonly used as a basis for a good valuation principles. Nonetheless, companies tend to use varying principles in their valuation processes, which is acceptable as long as the principles are justified and used to create fair value. (IPEV 2022) This chapter will present good valuation principles and specific techniques used in this work.

IPEV presents principles to encourage all investment entities to apply consistency of valuation, appropriate judgements of methods, calibration, and rigor in valuation. Fair value is the price that would be received by selling the asset in that moment. Consistency should be applied to measurement date and valuation techniques for similar investments considering industry and other characteristics. Under some circumstances like changing markets, information availability or stage of a company, the change of valuation methods might become appropriate. Judgement should be used in the selection of valuation methods in such way that valuation considers all the possible aspect affecting the fair value. Factors like nature of the industry, data quality, consistent data availability and comparability should be considered in selection of methods. (IPEV 2022)

Calibration of the reached valuation helps to define the value compared to other market valuations, like recent investments or comparable investment. Using calibration ensures fair value also in the future. Rigor in the valuation process means careful interpretation of market information because of the uncertainties present in the valuation process. Additionally, documentation of the valuation policies, listing of assumptions included in valuation, and independent/external valuation committee is recommended to perform robust valuation process. (IPEV 2022)

Common valuation methods include multiples, industry benchmarks, discounted cash flows, net assets, and recent investments. Each of these methods have their own strengths and they might be more suitable in certain situations than others. Multiple is commonly used method and even though IPEV doesn't rank these methods it encourages to use multiple valuation when possible. Multiple valuation is based on earnings or revenue multiplied with appropriate and reasonable multiplier based on factors such as size, risks, and future prospects of the company. Earnings before interests, taxes, depreciation and amortization (EBITDA) is commonly used number to illustrate the earnings, when available. Multiple is usually estimated with comparable company that can be competitor, actor in the same industry, or just company with similar performance. After this, modifications on multiple will be made based on factors that can be seen to affect multiple positively or negatively, like leverage, taxes, depreciation, tolerance to changes, rate of growth, reliance on key employees and so on that differ between valuation and comparable company. (IPEV 2022) Format of multiple method is presented in figure 6 below to gather enterprise value and further equity value after net debt.

EBITDA **x** Multiple **=** Enterprise value (EV) **-** Net debt **=** Equity value

Figure 6. *Multiple valuation method*

When considering ESG effect on a company value, a study by Crifo et al. (2015) noticed ESG to be significant for valuations and investors to emphasize between different ESG factors asymmetrically. Prominent difference was realized between the positive and negative effects, where ESG had more significant negative effect on valuation when performed poorly compared to smaller positive effect of good ESG performance. (Crifo et al. 2015) This highlights in a way the role of ESG in a risk management role to mitigate the negative effects. As one separate factor, governance had the biggest negative impact on company valuation when performed poorly and in turn good environmental and social performance had significant positive effect on valuation (Crifo et al. 2015).

Also mentioned in IPEV's guidelines is the increasingly important role of ESG factors that can be seen to have qualitative or quantitative impact on valuation. In many instances ESG considerations might not be separated in the valuation since it is included in projected cash flows already. ESG actions can be assumed to affect quantitatively cash flows, risk profiles or comparability on peer companies. Qualitative factors can also affect the willingness of participant to pay even though it is challenging to measure. Diversity of work force, management team or business model could be some of these factors affecting value. (IPEV 2022) As Zeisberger et al. (2017, pp. 149-151) highlight, the role of management team is vital for the company to reach desired changes, targets and plans effectively. Furthermore, Kaplan’s and Strömberg’s (2009) paper discusses the importance of governance and management team on value creation. Considering these statements, it can be concluded that ESG and especially governance has in fact material impact on company value.

Valuation method in this case study is based on presented multiple method. Multiple method is used because steady flow of revenue is recognized in buyout investments, where companies have proceeded over the start-up phase. EBITDA is used here as a revenue indicator as it presents revenues in a reasonable manner. Therefore, value creation with DEI should be showing either in multiple or directly in EBITDA to improve the value of the company. In this case the effect on financial performance is emphasized over multiple as financial performance is more accessible and concrete meter for evaluation. However, it is recognized that previously mentioned better governance and management team might have positive effects on the multiple valuation. Most relevant valuation periods from the PE company point of view are pre- and post-investment periods. To increase the value most, it might be beneficial to consider the level of DEI already before investment to discover best value creation possibilities. At the same time the willingness to develop DEI should be considered also.

2.3 Environmental, social and governance requirements in the private equity markets

Financing field has encountered rising requirements for sustainability actions and reporting for the past years in terms of legislation but also other stakeholders. The motivation to execute more responsible business in the field of private equity is multidimensional and changing. New legislative transformations are affecting in the background as new external and internal motivations arise for a variety of reasons.

Because of the fast-changing legislation and stakeholder demands, socially responsible investing has been introduced also to the private equity markets following the trend in public markets (Crifo & Forget 2013). There is no unambiguous definition for responsible investing, but it can be defined simply as an investment that looks beyond financial targets and contributes positively to portfolio companies and their environment. Furthermore, the extent of responsibility can vary a lot which might make the term misleading on some occasions. (Zeisberger et al. 2018, pp.173-174)

Responsible investing and ESG are closely related frameworks where ESG can be recognized as concrete ways to view responsible investing (MacNeil & Esser 2022). Term

ESG was introduced to large public in 2005 by the United Nations Environment Programme Finance Initiative (UNEPFI) to discuss responsible investing that considers environmental, social and governance aspects (UNEPFI 2005). Since then, United Nations have formed “Principles for Responsible Investment” (PRI) which acts as an important tool for many financial actors to implement ESG in their investing strategies. The signatories of PRI have increased rapidly in past years. (UNPRI 2023) Socially responsible investing have been seen to affect value creation, risk management and fund raising positively also in the private equity markets, which is why ESG is raising interest within market participants (Crifo & Forget 2013). Nowadays ESG is used beyond financial markets and many companies are using this framework to define their sustainability actions (MacNeil & Esser 2022).

The benefits of socially responsible investing are vague and according to some research the average financial returns are lower compared to traditional funds. Despite this, there is inevitably growing demand for socially responsible investing as most major actors are considering these issues in their practice and investors are increasingly reviewing their impact on ESG dimensions. There is also evidence that investors with ESG emphasis are willing to sacrifice fraction of their financial returns for more sustainable investing. Differences between capital owners is also detected as actors complying with PRI or organizational missions are more likely to pay for non-pecuniary benefits of responsible investing. (Barber et al. 2021) Good ESG practices might offer benefits especially in risk management, competitive advantage and corporate reputation, and these are all believed to offer financial benefits in the long run (Chen et al. 2023). Current implementation of SRI is based more on an investor’s preferences than false performance beliefs, which demonstrates how crucial this matter is for investors (Barber et al. 2021).

In March 2021 European Union started to regulate financial actors reporting responsibilities to achieve more effective sustainability strategies and avoid claims of “greenwashing”, known as misleading sustainability information. This *Sustainable Finance Disclosures regulation* (SFDR) lays down universal and transparent rules for financial market actors such as funds and financial advisers to inform about their environmental, social and governance integration into their operations. This regulation aims to improve information availability, comparability and generally further enhance financial sectors accountability for sustainability matters. It is not yet obligatory for small financial actors, but it is recommended since it is transparent way for investors to compare financial actors and probable future direction of finance. (SFDR 2019/2088) SFDR is probably the most essential regulation considering financial actors including private equity companies.

Based on SFDR, actors in the financial market are divided into different categories implying their sustainability commitment of each product. Article 6 financial product is characterized with the absence of sustainability goals. However, disclosure demands "transparency on the integration of sustainability risks" and explanation if these risks are not considered relevant for the product. Following the previous one, Article 7 described as "transparency of adverse sustainability impacts at financial product level" requires more detailed and reasoned explanations if harmful impacts on sustainability are not accounted for. The following articles 8 and 9 already consider sustainability as substantial part of their functions. Article 8 is defined as "transparency of the promotion of environmental or social characteristics in pre-contractual disclosures" indicating that the financial products promote environmental or social and governance practices, or combination of these with the possibility to promote financial objectives as well. In article 9 on the other hand, financial product has sustainability as the main objective referred as "transparency of sustainable investment in pre-contractual disclosures". (SFDR 2019/2088) These classifications have also gained some critics as growing number of actors implement different strategies for sustainability and different terms are used haphazardly. This implies that SFDR doesn't completely remove the problem with greenwashing in financial sector. (Cremasco & Boni 2022)

Other significant directive that entered force in 2023, is *Corporate Sustainability Reporting Directive* (CSRD) which considers only large, listed companies for now. Directive demands detailed sustainability reporting in line with financial reporting that considers environmental and social aspects. (CSRD 2022/2464) Based on guidance on the *European Sustainability Reporting Standards* (ESRS) this could mean reporting DEI for an example in areas of diversity, gender equality, gender pay gaps and inclusion of people with disabilities in organization (ESRS 2023/2772). The objective for underrepresented gender in boards of these companies varies between 40% of non-executive directors or alternatively 33% of all director positions by June 2026 stated in *Gender Balance on Boards Directive* (GBBD 2022/2381). These changes force PE companies to address these issues in their portfolios, as this will probably directly or indirectly consider them in the future.

Another notable environmental regulation is *EU Taxonomy* (2020/852) which classifies environmental actions and guides companies and investors to make environmentally sustainable investment decisions. This classification system doesn't regulate corporate investment decisions directly but offers guidelines for more environmentally friendly economic activities. (EU Taxonomy 2020/852) One directive in preparation is *Corporate Sus-*

tainability Due Diligence Directive (CSDDD), which would aim to control negative environmental and social sustainability effects with better governance. This would mean identifying, preventing, lowering, and terminating negative social and environmental actions throughout the value chain. (European Commission 2024) As can be seen, many new legislative reformations to fix current issues are being presented and prepared for coming years.

In addition to legislation many non-legislative actions are also entering the private equity market rapidly. Especially the growing demands of stakeholders in the market make financial actors to act ahead of legislation. Especially LPs tend to demand certain level of ESG performance for their investments, but according to Bian et al. (2023) there are certain limits to what extent LP does view ESG substantial. Moreover, different aspects of ESG are seen to have different effects to investment decisions in private equity. Poor overall ESG policies had significant negative impact on investment probability, and good ESG policies had only minor positive impact on investment probability as environmental aspect was deemed significant. (Crifo et al. 2015) Besides external pressure from LPs, many PE investors have nowadays shifted towards more internal motivation, where new opportunities for value creation and value protection have been recognized (Zeisberger et al. 2017, p.175).

To conclude, the pressure for ESG in private equity seems to come largely from legislation and external demands, but also increasingly from inner beliefs of the benefits and importance of socially responsible investing. Possibilities to manage risks, match the competition in the market and attract financing affects the implementation of ESG. The fact that socially responsible investors are willing to accept lower returns, offers potential benefits for responsible portfolio companies in terms of lower cost of capital (Barber et al. 2021).

2.4 Entry of diversity, equity and inclusion into the private equity market

Following the ESG requirements set by legislation, stakeholders, and internal needs, the pressure towards DEI issues has increased rapidly as well in the past years in the private equity markets, as DEI covers issues of social and governance aspects of ESG. These DEI matters are not widely acknowledged in the legislation yet, but their importance is deemed to increase. As the private equity market drives the change in private companies it should ensure that these companies are prepared for the growing demands of DEI for example within CSRD requirements. Also, non-legislative pressures from other stakeholders are vital as well for the functioning of all the companies.

Several organizations working within the private equity markets have published guidelines, research, and reports on the status of DEI in the industry. For an example American management consulting company McKinsey & Company studied the PE market and found that institutional investors are increasingly interested of investment team diversity, but also the board diversity in portfolio companies (McKinsey & Company 2022). These findings point out the pressure coming from investors towards private equity companies to consider these issues in their own operations as well as in their portfolios to be able to collect the funds also in the future. Same study noticed also geographical differences in the collection of the data where European companies were more likely to collect only gender diversity data compared to companies globally collecting data also from ethnicity or race (McKinsey & Company 2022). This can partially be explained by the varying levels of diversity around the globe, but anyhow the lens of diversity is narrow considering only these demographic diversity metrics.

Study of venture capital companies in Nordics did have similar findings where gender was the most measured attribute followed by age and national origin, dismissing some important diversity factors commonly measured in other regions. Also, most of the companies were focusing on the aspect of diversity, overlooking the aspect of equity and inclusion in their own and portfolio company operations. However, half of the respondents stated that they followed a defined diversity strategy. (Inklusiiv & Validei 2022) These findings spot real challenges and shortages in Nordic DEI work in VC industry within measurements and comprehensive strategy work.

Further on, recent study of the diversity of boards of portfolio companies in the Finnish VC and PE markets was conducted, where a positive trend of gender in portfolio boards between 2019-2022 could be recognized, but still the average percentage of women was as low as 12% in average in 2022. However, buyout companies were performing little bit over this average and the holding period seemed to have significant effect on the number of female board members. These numbers are quite well aligned with other unlisted midsize companies on the market. On the other hand, portfolios were outperforming other unlisted companies in board age and national diversity. (PwC & FVCA 2023) Potential for improvement and change in the PE market can be recognized as the current state is not yet sufficient despite recent advancements.

Finnish Industry Investment company (“Tesi”) studied VC and PE industries specifically in Finland looking at the investment teams of these companies. Increase in gender diversity in management roles could be spotted, but especially in partner roles female representation hasn’t increased significantly in past years. Overall positive trend in gender diversity is recognized. Age diversity is quite evenly distributed in the industry overall but looking at specific roles clear segregation can be noticed, as young people tend to work in analyst roles, moving towards, manager and then partner roles, where older representation is more common. Anyhow, growing number of young professionals are present in the industry diversifying the age structure. Educational background builds upon business studies that is covering 64% of all the employees. Professional backgrounds hold more diversity covering experiences from finance, consulting, industry, medicine and so on. (Tesi 2023a)

These studies made by various organizations working in the private equity markets have resulted also in common guidelines recommended to advance DEI issues. Guidelines consider different functions of PE companies covering internal, deal flow and portfolio actions. For portfolio companies communication about value of DEI is highlighted as well as trainings, networking, and policy creation. Defining key performance indicators (KPI) for following DEI and business performance simultaneously is also recommended. Utilization of thought leaders in organizations is brought up as well to promote DEI more effectively, as they have opportunity to affect people around them. However, the ultimate change in actions is stated to be derived from the investment team which is why it is important to consider DEI issues internally firsthand before communicating this value forward to portfolios. (FVCA 2023a)

Furthermore, Tesi suggests few steps for DEI work in their ESG handbook. They encourage companies to start by executing analysis on current diversity and equal opportunity within the company. The current practices and policies of hiring, promoting, and evaluating should be reviewed. After these, design of gender equality and non-discrimination plans is encouraged. This type of planning is also part of legislative actions in bigger companies. To further improve operations, strategy for diversity and inclusion is recommended to achieve targets set. This also means creation of KPIs that support the development towards these targets. Examples of KPIs are percentage of employees from diverse backgrounds and similarly this percentage in leadership roles. (Tesi 2023b)

As can be seen industry bodies have already taken the action to support the development of DEI also in the private equity context. However, the work is still in its early days as noticed from the numbers presented. Also, existing guidelines are quite generalized and whether these can be applied for all companies is little bit unclear. Furthermore, because performance outcomes of DEI are inconsistent within research, it raises question for practical implementation of these guidelines. Notwithstanding these guidelines and studies offer a good starting point to study more closely the DEI management in PE context.

3. DIVERSITY, EQUITY, AND INCLUSION IN ORGANIZATIONS

To better understand the topic of the study this chapter introduces the concepts of diversity, equity, and inclusion, and positions these within organization. After this, previous literature on the DEI field is reviewed covering the topics of management and performance of DEI.

3.1 Defining diversity, equity, and inclusion in organizations

Diversity, equity and inclusion concept is closely related topic to sustainable development, contributing to social aspect of sustainability. This aspect has been far overlooked in organizations, but more comprehensive sustainability attitude is driving businesses also towards better social sustainability (Ajmal et al. 2018). Social sustainability manages negative and positive business effects on people in a proactive way (UN 2023). Matters related to diversity have been researched for decades but the concept of DEI is not fully established, and different variations of terms are present. Most of the research recognizes the role of diversity and usually also inclusion, but equity is less present in the literature (Bernstein et al. 2020). Even so, in the context of this research all the components of DEI are considered as it has been done in the private equity market consistently (FVCA 2023a; FVCA 2023b; McKinsey & Company 2022).

Concept of DEI consists of three components, of which diversity is discussed first. Diversity is presumably the most familiar component out of DEI and has been widely recognized in research and in organizations. Simply put, diversity denotes the spectrum of distinctions among individuals, encompassing factors such as age, race, gender, values, experiences, socioeconomic status, and behavioral patterns. While some of these factors might be visible to human eye, most of them stay unseen, making them more difficult to manage. (Davis 2022) Pinkett (2023) divides diversity into four layers that cover personality, internal dimensions, external dimensions, and organizational dimensions as the outermost layer. Personality is rarely discussed and measured in DEI research, but it is in the core of each individual. Second layer of internal dimension includes factors that individual has limited influence if any such as age, gender, sexual orientation, physical ability, ethnicity, and race. (Pinkett 2023) Out of these, especially gender can be recognized to be widely researched topic in the diversity literature (Baker et al. 2020). On the contrary, for external dimensions people have a sense of control such as geographic location, educational background, work experience, religion, and appearance. Lastly organizational dimensions consider specific organizational factors like functional level, division, and management status. (Pinkett 2023) These different levels of diversity are presented in the figure 7 below. This separation presents well the multidimensional nature of diversity which has not been fully acknowledged by research as most research focuses only on a few of the internal dimensions.

Figure 7. *Diversity dimensions (Adapted from Pinkett 2023)*

Second component of DEI is equity which is less known term and has gained a limited attention in DEI research. Probably better-known term in organizations is equality which however has a slightly different meaning from equity. Equality means offering everyone the same resources and opportunities whereas equity takes into consideration the different circumstances of individuals and offers everyone a fair chance to succeed. Equity therefore works to remove societal barriers of favoring different groups of people. It can be also understood as the process for achieving equality. (Davis 2022) Equity in DEI literature is on many instances perceived as the outcome of diverse and inclusive environment (Bernstein et al. 2020). Regardless of a small amount of research on equity it holds a key role for social sustainability of organizations (UN 2023).

Inclusion is the third component of DEI which considers the perception of each employee of how well they are valued and integrated into the organization. It is important to acknowledge that diverse organization is not necessarily an inclusive one. (Davis 2022) To be included in workgroup Shore et al. (2011) defines two needs to be fulfilled: belongingness and uniqueness. These dimensions make sure that individual gets to be their unique self and feels belongingness in the workgroup despite their differences (Mor Barak 2015). Inclusion is therefore highly subjective meter that might be a challenge for organizations to manage.

All the three components of DEI have their own definitions, but together they form an entity that will promote difference among individuals, offer these individuals same opportunities and make them feel included in the organization. These components are not dependent on each other which makes it crucial to focus on each component separately. At the same time the collective performance of all three is substantial. (Davis 2022) To understand each component, it is useful to understand their presence within organizations. Diversity focuses on the composition of different people in the work group. Equity is more focused on organizational level as it considers system level outcome. On the contrary inclusion considerers more the subjective interpretation of how people are included in the company. (Bernstein et al. 2020) Based on this, diversity can be seen as the phenomena that is managed with inclusion, and the goal is to achieve equity.

3.2 Managing diversity, equity, and inclusion in organizations

Diversity management is not so well-known concept in business world, but also research on the subject is inconsistent (Davis et al. 2016). Clear consensus on how these diverse workgroups should be managed is limited and empirical evidence is missing (Tang et al. 2015). This paper tries to specify different components of diversity, equity, and inclusion management, when possible, but in general DEI management is used to describe the overall phenomena. Most of the studied papers bring up term diversity management as a tool for managing diverse workforce. This action of managing diversity is defined by Cox (1993, p.11) followingly:

> *"Planning and implementing organizational systems and practices to manage people so that the potential advantages of diversity are maximized while its potential disadvantages are minimized."*

This broad definition is used in this paper as it considers the potential positive and negative effects that should all be managed. It doesn't either limit systems or practices further, indicating that all components of DEI can be addressed. This is necessary since many papers also discuss the concepts of inclusion and equity as part of the diversity management action (Donnely 2015; Ng & Sears 2020; Shen et al. 2009; Sippola & Smale 2007; Syed & Özbilgin 2009). Diversity management is recognized to have high business emphasis whereas equality stems more from social justice. However, these shouldn't be separated but rather managed as one. (Ylöstalo 2016) Inclusion is then again recognized to be crucial part of diversity management and is believed to have influence on business performance (Carstens & De Kock 2017; Mor Barak 2015; Tang et al. 2015). These highlight the need for more comprehensive DEI management considering all the components.

Globalization, increased competition, and more diverse groups have led to growing need for management of diverse workforces to maximize performance of diverse work groups and businesses (Sippola & Smale 2007). When diverse groups are managed well, the companies are better to respond dynamic and highly competitive markets (Cox & Blake 1991). There is some empirical evidence showing that diversity management can further on lead to better firm performance with inclusive climate, advancement opportunities and power distribution (Carstens & De Kock 2017). The better performance is often referred by these internal improvements, but case study of Rabobank proved also market share expansion caused by new customer acquisition that was achieved with more diverse organizational image. However, this increase in diversity made by Rabobank didn't directly improve inclusion and equity in organization. (Subbeliani & Tsogas 2005) This is an interesting finding supporting business case with diversity while ignoring the inclusion and equity aspects. Moreover, this finding is in contradiction with literature emphasizing the importance of inclusion (Pless & Maak 2004).

In addition to business objectives, other motivations might lead the transformation towards diverse organizations. These motivations might be related to legislation, shortage of personnel or avoidance of discrimination. Nonetheless, these motivations are stated to be weak to unleash any potential from diversity. (Pless & Maak 2004) Moreover, poor diversity management can eventually lead to negative corporate image, losses of talented workforce, or losses of customers (Donnely 2015). All the mentioned opportunities and risks demonstrate well the need for better management of DEI to manage the possible effects in favorable way.

The role of different components of DEI in management point of view is complicated and focus has been more on diversity and inclusion. Diversity management has been changing drastically in the past decades and literature increasingly focuses on the role of inclusion rather than only on diversity. (Tang et al. 2015) Different ways of enabling inclusion are recognized within organizational culture, climate, and leadership, that each help to include diverse workforce better to the organization (Jauhari & Singh 2013; Pless & Maak 2004; Randel et al. 2018). To date, diversity management has performed poorly to achieve equitable employment and working opportunities in organizations. To reach this goal of equity, more holistic view and better social policies are required in organizational level when managing diversity. (Lacerenza et al. 2024; Ng & Sears 2020; Syed & Özbilgin 2009) Even though the focus has been either on diversity or inclusion management, in many cases the need for more holistic management is recognized.

In addition to DEI management literature focusing partly on different components of DEI, also different levels of management are discussed. For an example Sippola's and Smale's (2007) paper divide diversity management roughly in three levels referred as philosophy, policies, and practices. Philosophy level refers to organization wide strategies, mission, vision, values, and culture. Then again policies describe more concrete guidelines on how organizations plan to work around DEI. Practices are then actual actions that are done based on policies. (Sippola & Smale 2007) These chosen levels vary, and different approaches is used between papers, but in this literature review these three levels are used to categorize the current literature.

DEI management on a philosophy level

Philosophy of DEI determines how diversity is viewed in organizational level and is strongly connected to DEI strategy. Further on it affects all the functions of policies, and practices. Many times, it is considered to require complete cultural change in organization to implement diversity management, highlighting the importance of philosophy and culture. (Carstens & De Kock 2017; Pless & Maak 2004) Philosophy in DEI management have been recognized to shift from diversity towards inclusion in ever greater measure (Sippola & Smale 2007). Especially inclusive culture and climate are arising areas of interest in DEI field. It is even argued that culture of inclusion is needed to grasp the potential of diverse workforce (Carstens & De Kock 2017; Pless & Maak 2004). In inclusive culture differences as well as similarities are appreciated, and integration of workforce is pursued there. Moreover, values and norms play crucial role in culture which emphasizes their importance for diversity as well. (Pless & Maak 2004) Equity is often connected to this more holistic view and strategic objective of diversity and inclusion (Bernstein et al. 2020). Even though equity is rather rarely discussed in the literature it should be the goal of diversity management.

The strategic view on diversity can differ and Olsen and Martins (2012) offer one distinction between diversity strategies. One possibility is to put diversity as the strategic objective. (Olsen & Martins 2012) This terminal value approach has objective purely on diversity, which usually doesn't pay attention to equal opportunity (Sippola & Smale 2007). On the contrary diversity can be viewed more as a resource and business performance as the objective. The latter is recognized more appealing for diverse individuals because it values more the individual input for business performance. After all, it is important to highlight that these two views are not mutually exclusive. (Olsen & Martins 2012) These strategies expect some benefits whether it is related to image, legislation or performance. Importance of strategic focus on DEI management was noticed also by Donnely (2015) who argues that policies and practices were highly impacted by strategy and therefore affected the recruitment and retention of work force, that has direct impact on organizational performance. Moreover, these effects are emphasized for minority groups like women (Hanappi-Egger 2012). DEI strategy therefore drives all the actions related to it as in any strategy.

The role of managers and HR was consistently brought up especially when talking about the strategic dimensions of diversity management. It is usually up to top management to set up the strategic directions and allocate resources to DEI management. Role of management is therefore crucial in cultural change towards diverse organizations but is not sufficient alone. (Cox & Blake 1991) On the contrary managers communicate plenty with HR about organizational DEI strategies. The role of HR is more on the policy and practical level, but the cooperation with top management is still inevitable. When manager's role to implementation of this strategic dimension was reviewed, it was evident that managers lack of motivation might be one reason why value creation with DEI was limited, despite the HR practices in place. (Buengeler et al. 2018) Managers have far-reaching effect as they set standards for employees in the organization which is why their promotion of value in diversity is needed to facilitate inclusive work environment and gain benefits from diversity (Shore & Chung 2022). The effect of one person or top management team can therefore be very significant, rising issues if DEI is not prioritized in top management.

This leads us to the organizational structures that are present in organizations but might not support DEI strategy in the best possible way. In many cases organizational positions doesn't present diversity in ideal way. There might be high level of diversity in organization, but the division between hierarchical levels might not be equal. (Ortlieb & Sieben 2014) So even if diversity and inclusion are realized, equal opportunities might be absent and therefore equity would not be materialized. This historical burden of organizational hierarchies is still affecting against individuals belonging to historically discriminated groups despite numerous laws and initiatives in place (Syed & Özbilgin 2009). Moreover, even though inclusion promotes differences among individuals, practices of differentiation might lead to hierarchization of these differences even unintentionally (Ortlieb & Sieben 2014). Therefore, careful discretion should be implemented in diversity management to avoid hierarchization and unintentional harm.

Additionally, power structures in organizations might cause issues in implementation of DEI management partly because HR field that usually drives practical DEI initiatives is viewed having relatively low power within organizations. This issue was recognized with external diversity and inclusion consultants who needed to prove their value for the organizations. Otherwise, these external actors had many benefits ranging from broader knowledge and lack of personal relationships within organizations. (Kirton & Greene 2019) This view can be integrated with the notion of the importance of managements involvement since they obtain higher power in organization to make things happen. Furthermore, since power is still unevenly distributed in organizations (Syed & Özbilgin 2009), the historically discriminated groups are rarely in positions to make change because maintaining lower positions in organizations. These power structures can be recognized as a hindering factor in both organizational and national levels that highly effect how individual diversity is interpret in these contexts (Syed & Özbilgin 2009).

Context of the management is recognized significant as there has been recognized issues in transferring DEI management internationally. Context can be analyzed through many factors such as nation, industry, and organization. These various contexts have impact for the legislation, culture, demography, approach to DEI and so on. (Bešić & Hirt 2016) For an example Finnish context is recognized to have high legislative and organizational commitment to equality, but also quite high homogeneity among nation. This has somehow led to illusion that no inequalities would be present, and people are even hiding or downplaying these experiences. (Ylöstalo 2016) Recognizing these contextual factors becomes especially important when company has operations in different locations. The philosophical base was anyhow considered to require only minor changes in multinational companies, whereas this change was more necessary with local practices. (Sippola & Smale 2007)

DEI management on a policy level

Policies have significant role in diversity management presenting the strategical ambitions and philosophies in more concrete people-centered way (Sippola & Smale 2007). It is recognized that creating clear guidelines is one issue slowing down diversity in organizations. It is easy to state certain equal philosophies, but ways to ensure these are more difficult. (Shen et al. 2009) The aim of these policies and following practices is to standardize ways to act across organizations. Problems might be caused if the policies are not aligned with the concrete practices in organizational level (Shore & Chung 2023).

Different areas of DEI policies can be practiced focusing on recruitment, pay, promotion, retention and so on. Depending on the DEI strategy used by the organization the policies might have different objectives. Strategical focus on assimilation focuses on suppressing differences to fit the dominant culture and on the other hand integration focuses on valuing and encouraging differences among individuals. These will affect the creation of non-discriminative policies. The first strategical focus will emphasize that demographical differences should be dismissed, whereas the second emphasizes recognition and respect of these differences. It is proposed that the second approach will make especially underrepresented groups to feel more accepted and this would have impact on work outcomes. Meaning that policies should go beyond diversity to promote the benefits diversity management can offer. (Olsen & Martins 2012) Policies can therefore drive different diversity strategies, and therefore the strategical choice made earlier could be very significant for the outcome.

Compared to strategical planning of DEI, policies are designed more in HR level, where these issues are managed (Shen et al. 2009). The role of management's ambitions and strategical guidelines are still crucial for the realization of the policies (Shore & Chung 2023). Moreover, Ng and Sears (2020) found out that perceived commitment of managers in diversity management will influence this implementation process by HR. Motivation of managers was emphasized to be more on the bottom line, but HR will drive diversity management more based on the broader organizational view. (Ng & Sears 2020) These both motivations can be beneficial and applied simultaneously as noted earlier, but the premise is to recognize the benefits of diversity (Olsen & Martins 2012). Human resource department tends to be most knowledgeable on diversity management matters as they tend to have the main responsibility for planning and executing these actions in organizations. Nevertheless, the objectives that diversity management aims for are still unknown for most of the HR managers. (Davis et al. 2016) This lack of knowledge could be considered great barrier for effective policy creation, since setting these targets and objectives will further encourage managers to take these steps (Noon & Ogbonna 2021). So, without strategy and targets, the policy implementation could be endangered.

Desired outcomes resulting from good diversity policies might be related to conflict management, work outcomes, recruitment, or retention (Ng & Burke 2005; Olsen & Martins 2012). Policies are important for creating inclusion in organizations, and this requires that the policies are initiated in organizational level but also understood in employee level (Tang et al. 2015). For creating better DEI policies engagement of employees could be beneficial to understand the functionality of current practices (Shen et al.2009). This could furthermore help align the view on DEI management across the organization, because one issue in diversity management spotted by Tang et al. (2015) was the different perceptions and biases between managers and employees, where other groups were incriminated for insufficient diversity management. However, when DEI policies are in place and successful it can make the organization more attractive especially for minority and high achiever employees. People are more aware of diversity nowadays and people with high abilities tend to choose more progressive organizations, which emphasizes the DEI strategy and policies in place. (Ng & Burke 2005)

Compared to philosophical level, policies might need more adaptation to local culture or legislation (Sippola & Smale 2007). Particularly in multinational companies the recognition of crucial factors of the country in question is deemed important (Hennekam et al. 2017). Syed and Özbilgin (2009) propose especially that national policies play a crucial role for shaping organizational diversity policies. Furthermore, they emphasize that organizational level policies and procedures are crucial to align the diversity management work in specific context and individual level. (Syed & Özbilgin 2009) Alignment of the individual diversity values and perceived organizational diversity initiatives affect the perceived ethical responsibility positively. With work towards aligning these interests, organizations can ultimately affect individual behaviors that promote organizational citizenship behavior such as loyalty, compliance, and sportsmanship. (Rabl et al. 2020) To conclude when creating policies, it is important to consider specific context, diversity strategy and employees to align needs of everyone.

DEI management on a practical level

Practices to manage DEI are the concrete actions made by the organization and individuals to support DEI. Practices will work to diminish biases that might be present, for example hiring people like themselves without considering their actual fit to the position. Practices are most evident level of diversity management since these define eventually how well DEI is managed. (Shen et al. 2009) To demonstrate this, organizations can have extensive ambitions on strategic and policy level, but if these aren't realized in practice, DEI goals won't be achieved (Shore & Chung 2023).

Several papers recognize recruitment as a crucial part of diversity and inclusion management as it ultimately determines the level of diversity in the organization (Ganji et al. 2023; Ortlieb & Sieben 2014; Pless & Maak 2004). As inclusion definition states diversity is not enough, but recruited people should also share the diversity values of the company, since the inclusive climate is ultimately created by the people (Pless & Maak 2004).

This fit between personal values and organizational values was recognized important for the recruitment process in diversity management also by Ng and Burke (2005), who recognize this as a factor affecting the attraction of highly skilled employees. In inclusive organizations the diverse skills of a workforce are valued, and competencies are predefined in the recruitment process (Ortlieb & Sieben 2014; Pless & Maak 2004). Moreover, the process should reflect the strategical choices of DEI, and this should be assessed regularly (Pless & Maak 2004). Based on assessments and continuous data collection clear targets for recruitment should be defined (Noon & Ogbonna 2021).

Second concrete inclusion practice that was recurrent in the literature was training and development (Noon & Ogbonna 2021; Ortlieb & Sieben 2014; Pless & Maak 2004). Training and development should be employed in all organizational levels of individual, team, and organization. Individual development is usually conducted with mentoring to increase skills and knowledge both ways. This creates relationships beyond hierarchical levels and enhances inclusion. Team development is crucial to determine group outcomes and trust is stated to be key to this. Organizational development focuses on group level trainings that create awareness, understanding and reflection on the state of diversity. (Pless & Maak 2004) One concrete issue in organizational development spotted by Ortlieb and Sieben (2014) was the scope of the trainings that was restricted to only some groups like lower-level employees, which doesn't support the idea of inclusion. Regardless of trainings, it is challenging to make people to act certain way and resistance towards these trainings was also recognized by Noon and Ogbonna (2021).

Some social events are recognized inclusive practices in case of diverse organization where this was referring to participation to lunches, gatherings and so on that promote sense of community and work to remove organizational structures. Issues in realizing this arise when the social order is still present in this setting and for an example managers stay separated from the other group. (Ortlieb & Sieben 2014) Therefore these social events could easily also increase inequality if inclusivity is not truly considered. Ways to work through these hierarchical groups should be considered and interaction between different groups should be encouraged.

Reward and compensation systems should be based on fair and equal principles. According to DEI principles there shouldn't be disparities among salaries, and salary should be tied to performance in a way that same work would allow same compensations. (Pless & Maak 2004) Even though this issue has been under inspection, the pay gap between women and men for an example has still caused widespread debate (Shen et al. 2009). Moreover, it is good to recognize that employees possibly compare their compensation both inside and outside of the organization (Ganji et al. 2023). Behavior supporting diversity and inclusion could be also combined to reward systems, allowing support for DEI incentives (Pless & Maak 2004). Rewards can be executed also in team or organizational level, but here comparison between teams should be considered as well. Rewards might be financial or nonfinancial to allow flexible compensation systems suitable for everyone. Part of reward systems are also equal promotion opportunities. (Ganji et al. 2023) In Finnish context some inequalities in promotion have been recognized, but people tend to downplay or accept these blindly (Ylöstalo 2016). Without clear policies there might be uncertainties in promotion process as managers are shown to rather promote people similar to them. In non-diverse businesses this creates further issues in the field of DEI. (Shen et al. 2009) Transparency and clear policies should be emphasized based on these findings so that equity could be achieved.

Practical implementation of DEI is usually down to HR and managers, where it is crucial to connect the policies and practices to signal DEI behavior further on to all employees (Ganji et al. 2023; Mor Barak et al. 2022). Managers are argued to have great impact on group's inclusion climate especially for marginalized group members. They can sustain or discourage inclusion in group because group members are usually following the example of the manager. To increase inclusion managers should collect feedback from group members and observe the group that reflects managers own behaviors as well. (Shore & Chung 2022) To elaborate, the commitment of managers to DEI policies set by top management is reflected directly to the group. If decoupling between policies and practices are observed the group level inclusion will suffer. (Mor Barak et al. 2022) Moreover lower inclusiveness was detected to lead to higher retention and mental health issues (Lacerenza et al. 2024).

Extremely important component of practical level is measurements, analysis, and target setting. To make progress in DEI management by increasing diversity and improving performance, effective ways to measure are required. (Buttner & Tullar 2018) Measurements should consider wide array of factors of diversity, but also the diversity management practices assessing inclusion and equity as well (Shen et al. 2009). Buttner and Tullar (2018) propose diversity metric to assess the organizational diversity in comparison to relevant labor market. This way the diversity of the organization could be assessed in reasonable way that considers the pool of labor that might differ vastly between nations, industries and so on. (Buttner & Tullar 2018) Furthermore measurements can be integrated to performance measures to see which practices and factors produce greater performance (Martín-Alcázar et al. 2012). Especially in the private equity industry measurements are embedded in the core business.

Diversity management practices might have difference between contexts which should be considered in international organizations. In some cases, the legal and social context might be so different that similar practices are not applicable or the whole DEI strategy might need adjustments. (Bešić & Hirt 2016) On other perspective some companies view it important to maintain strategical level of DEI globally, but practices could be adapted to local needs (Sippola & Smale 2007). Some practices could be also derived from cultural differences which could cause challenges to shape them.

Summary of diversity management

It is recognized that diversity management is lacking empirical research (Tang et al. 2015) and the field of research is varying. Diversity management seems to cover in many instances dimensions of inclusion and equity as well, but these terms are also brought up by recent research more consistently compared to prior research. Recent research also highlights the role of inclusion for positive outcomes through diversity management. (Lacerenza et al. 2024; Mor Barak et al. 2022; Randel et al. 2018; Shore & Chung 2022) Common themes in DEI management literature were strategy, culture, managers role, recruitment, training, promotion and compensation and it was commonly combined to one or many of the DEI components.

The philosophical and strategical idea behind diversity management is recognized crucial and it will determine the policies and practices accordingly (Pless & Maak 2004; Shen et al. 2009). Different strategical approaches were proposed by Olsen and Martins (2016), which offers a good way to distinct different strategies. The role of comprehensive management was emphasized, and all the levels of philosophy, policies and practices had their own inputs to the management process. Any misalignments within these management levels could be harmful for the organization. Especially the policy and practice decoupling were proposed to affect negatively to employees' perceptions of the inclusiveness of the organization. Managers in different levels had high power to impact this coupling or decoupling. (Mor Barak et al. 2022) Issues considering DEI are recognized and discussed many times, but concrete actions might be lacking. Inequalities could be moreover hidden and downplayed because of perceived support that organizations offer in DEI. (Ylöstalo 2016)

Role of managers was discussed in several papers, and they were recognized to be driving the transformation towards better DEI management (Cox & Blake 1991; Ng & Sears 2020; Shore & Chung 2022). To increase management's commitment, training, target setting, and measurements were recommended, but ultimately management needs to use their own discretion (Noon & Ogbonna 2020). Furthermore, the values of organization or top management should be connected to employees' personal values to unleash potential from inclusion (Rabl et al. 2020). Everyone can therefore affect the outcome, but these personal values might be difficult to manage on all occasions.

Other crucial factor affecting the commitment towards DEI strategy is human resources HR, that is responsible for most of the practical level work within DEI. Organizations DEI commitment was demonstrated to be predictable based on CEO pro-diversity behavior and how this commitment was perceived by HR. (Ng & Sears 2020) Equally managers could be recognized to have different reactions to diversity management practices set by HR, which would affect the creation of inclusive climate. Uncertainty of managers towards value creation through diversity could be indeed diminishing the opportunity to create value (Buengeler et al. 2018). The relationship between HR and managers is therefore highlighted. The role of HR is also developing with diversity management, and it should consider different aspects of diversity (Martín-Alcázar et al. 2012).

Contextuality of DEI management was discussed in several papers, and it was evident that it should be considered when planning DEI management. The level of adaptation differed slightly between cases, but especially practical level tended to be more adaptable to local context (Bešić & Hirt 2016; Sippola & Smale 2007). On the other hand, strategical level was recognized in some cases to be more universal, and it could be created to be applicable for all conditions (Sippola & Smale 2007). Differences between legislation, policies and demographic compositions were spotted to cause challenges in DEI management (Bešić & Hirt 2016).

The possible implications that DEI management could have on different performance outcomes and benefits was discussed in some papers covering DEI management (Carstens & De Kock 2017; Lacerenza et al. 2024; Pless & Maak 2004; Randel et al. 2018). Also, DEI measurements were recognized as an important component for performance outcomes. Overall management of DEI has crucial role in shaping organizations in favorable way to unleash greater performance. (Martín-Alcázar et al. 2012; Shen et al. 2009) Next chapter attempts to uncover current literature on these possible performance outcomes especially related to financial performance.

3.3 Creating financial performance with diversity, equity, and inclusion

As recognized, diversity should be managed to maximize positive and minimize negative effects on performance (Cox 1993, p. 11). Review on diversity management offered insights into possibilities for managing diversity, but the concrete benefits for companies stayed unclear to some extent. Previous chapter highlighted the importance of valuing diversity as an asset to gain performance benefits (Olsen & Martins 2012), and the possibility for competitive advantage was recognized (Pless & Maak 2004). For many businesses and managers, the driving motivation was on financial benefits, highlighting the role of business orientation in addition to moral values (Ng & Burke 2005; Subeliani & Tsogas 2005). Especially in the context of this study the financial performance is a key indicator of a business success and is therefore reviewed closer.

Various diversity factors have been identified and studied on firm performance. Categorization of diversity by Pinkett (2023) recognized internal, external, and organizational dimensions. Factors of internal diversity are the most common ones in literature consisting of gender, race, ethnicity, nationality, and age. External factors that can be influenced by individuals such as education and work experience were present to some extent. Then again, only few studies considered organizational diversity of tenure, functional level, and location as a part of the research. Majority of the studies were conducted in management level or board rooms, and companies were listed on the stock market. Different contexts of countries and industries were considered in the literature extensively. Role of inclusion and equity was studied in literature less, but these findings are reviewed here as well.

When financial performance or firm performance is discussed within the papers, two common meters stand out to be the most common. First one is Tobin's Q that is market-based meter and second one is return on assets (ROA) that is accounting based meter. Many studies use both to discover performance from multiple views. Carter et al. (2010) summarizes Tobin's Q to measure wealth and ROA to measure income. As a market-based measure Tobin's Q is also recognized more complex and future oriented. (Carter et al. 2010) Both measures are valid, but for portfolio companies the ROA is more topical since these companies are not publicly traded. Next the DEI performance studies are discussed within different categories.

Demographic diversity

Few studies consider demographic diversity that can contain all types of differences between population. Demographic diversity is recognized with increased firm financial performance for an example in Erhardt's et al. (2003) study that focused on the percentage of women and minorities in US boards. Firm performance was measured with ROA and ROI to demonstrate financial benefits. (Erhardt et al. 2003) To complement these previous findings of direct relationship between demographic diversity and firm performance, Miller and Del Carmen Triana (2009) found that reputation and innovation was affected partially by the presence of women and racial minorities in boards that further on affected firm performance. This shows how value can be created through different moderators.

Following these findings, Ararat et al. (2015) studied similarly multiple diversity factors and found that a compound of diversity factors affected firm performance more significantly than these factors separately. Firm performance was found to be moderated through more intense monitoring in boards. Moreover, in this study the relationship was recognized to be nonlinear and context to be significant. (Ararat et al. 2015) The contextuality of demographic diversity in boards was furthermore presented on Aggarwal's et al. (2019) study demonstrating similarly positive performance for standalone firms, but negative for group affiliated firms. Negative effects might be explained with majority shareholder that doesn't drive individual firm goals in a similar manner than group goals. (Aggarwal et al. 2019)

Gender diversity

Almost half of the results of the literature review considers the role of gender for firm and financial performance commonly through some moderators. For an example, gender diversity in the boardroom was successfully investigated by Campbell and Mínguez-Vera (2008), finding implications for financial performance and therefore firm value. These findings were explained with better monitoring caused by higher gender diversity in the board and best results occurred when diversity was at its highest representing fifty-fifty division of gender. This study expanded the context of the diversity studies to Spain when most of the previous studies were focusing on the US context. Spain as a context enables interesting insights from the country where family-owned businesses are high, presence of women on boards have been particularly low and legislative actions have been introduced to balance this inequality. (Campbell & Mínguez-Vera 2008) Later on, Reguera-Alvarado et al. (2017) conducted similar study also in Spanish context. This study recognized significant rise on the number of women on boards after legislative actions taken by the country, but in a bigger picture the percentage is still far from desired. Nevertheless, similar to previous research, this study reveals positive results for financial performance with higher gender diversity and supports the social and business case for gender diversity in Spanish context. Further on, findings also indicate positive support for the utilization of legislative action to increase gender diversity. (Reguera-Alvarado et al. 2017)

Also, India has been adopting legislative act considering board composition in 2013 that requires appointment of at least one woman in the boards of listed companies. This was found generally to result in positive market reaction, when the appointed women were qualified for the position and not related to the family of the management. This would have further on positive effect on removing gender bias and increasing firm value. Therefore, the positive power of legislation was also recognized in this case when the appointment of women was conducted appropriately. After all, it is stated that the focus should rather be on appointing qualified directors who have distinct capabilities to increase firm value. (Lawrence & Raithatha 2023) Lowered gender bias would also suggest possibly more equal and inclusive opportunities in the future. This event study should encourage listed companies to appoint female directors even without legislative pressures to gain financial and social benefits.

The benefit of appointing at least one woman in the board was discovered also in the context of European manufacturing companies. Here firm performance was recognized to be caused through inclusive innovation that could be created with gender diversity in board and management. Results highlight the possibility to gain both social and economic benefits through gender diversity. (Del Mar Fuentes-Fuentes et al. 2023) In addition to increasing the value of the firm, women in the boards were discovered to have significant effect on the sustainability performance as well in the European context (Qureshi et al. 2020). The interplay between gender diversity and sustainability is interesting as they partly supplement each other, because better sustainability focus would suggest also better focus on DEI.

Gender diversity in top management teams has also been a subject of discussion. Perryman et al. (2016) suggest positive outcomes for having gender diverse top management teams. This leads to lower risk associated to the business and it increases firm performance. When the management team is more diverse the compensation between male and women tends to be also more equal, suggesting higher diversity might lead to higher equality. (Perryman et al. 2016) Similarly Fernando et al. (2020) recognize indications of increased firm performance with better managerial ability when the top management team is more gender diverse. This gender diversity was recognized to further on foster performance better in case of crisis. The managerial abilities of women are highlighted through the results, breaking general beliefs of the applicability of women as leaders. (Fernando et al. 2020) Gender diversity can also mitigate possible negative effects on firm performance in uncertain environments (Kim et al. 2021). Crisis tolerance can be seen even more important as crises in the fields of health, warfare, environment, and economy have been increasingly present.

Despite the positive implications offered by most of the papers, more unclear effects have been discovered as well. Adams and Ferreira (2009) found initially negative performance and firm value when gender diversity was increasing in US corporate boards unnecessarily, highlighting the competence of the board instead. Further on, Carter et al. (2010) had indistinct results when it came to financial performance caused by gender diversity of the boards in the US. When measured with ROA, positive link between the number of women could be found, but when measuring with Tobin's Q this relationship was not present. Therefore, no causal relationship between these variables can be proved. Results encourage similarly to appoint board directors based on their qualification and not only to pursue financial outcomes. (Carter et al. 2010)

Moreover Marinova et al. (2016) studied gender diversity in Dutch and Danish boardrooms and found no significant effect on firm performance. Companies on the scope were listed companies and performance was measured with Tobin's Q. At the time of the studies about 40% of the companies had at least one woman on the board, but the average female presentation of these boards was as low as 5,4%. (Marinova et al. 2016) The low number of female representations in the boards raises a question whether the results are relevant when gender diversity has been so low. However, these findings are still in contradict with some of the papers suggesting that positive effects could be achieved only with the presence of one woman (Del Mar Fuentes-Fuentes et al. 2023). Overall, this study presents well the ongoing debate that has not been settled about gender diversity in the boards and therefore in organizations in general.

The complexity of gender diversity and performance in management was further on discussed by Richard et al. (2004) who discovered inverted U-shaped relationship between these variables when higher risk taking was present, meaning that certain level of diversity was demanded for higher performance. The spotted performance was at its highest when gender diversity was around 30%. These findings undermine the role of business environment, but also the level of diversity that was deemed important. (Richard et al. 2004) Similarly, Joecks et al. (2013) argues that there is a critical mass that needs to be achieved to gain the benefits from board gender diversity. Therefore, suggesting that tokenism and only small number of women in the board could lead even to negative firm performance. The critical mass that is supported in this case is around 30% of women that was translated into having minimum of three women in board. When reaching these numbers, the board could outperform purely male dominant boards. (Joecks et al. 2013)

Similar nonlinear relationship was also found on wider organizational level. To address gap in previous research Ferrary & Déo (2023) discussed gender diversity in middle management and staff levels. Following previous studies also these levels of the organization could be detected to affect financial performance and offer competitive advantage that is difficult to imitate. The detected relationship between gender diversity and financial performance was moreover recognized nonlinear and “hat-shaped”. Balanced gender diversity that employed women between 40–60% was recognized most profitable. (Ferrary & Déo 2023) This differs from the findings from boards where this number was lower and even one woman could be recognized beneficial (Del Mar Fuentes-Fuentes et al. 2023). The role of women and men was further on investigated and homogeneous groups didn’t have differences between them in performance but heterogenous groups outperformed these (Ferrary & Déo 2023). This is interesting finding that has not been considered in most studies, that highlights diversity and denies superiority of either gender.

These nonlinear models could explain the inconsistencies in previous research to some extent, where positive negative and neutral performance implications have been detected. These nonlinear models also support higher gender diversity, that is present in most companies at this moment. For an example in Marinova’s et al. (2016) case study presented board gender diversity of 5,4 %, which is far from the desired level of for an example 30% presented by Joecks et al. (2013). Whether legislative actions could increase this number and still maintain the positive results of spotted gender diversity is unclear (Joecks et al. 2013). Even though some studies did support the performance achieved with legislative reformations, the appointment of qualified people was still emphasized as the main goal (Lawrence & Raithatha 2023). Thus, the judgment between competence and gender might present issues in the appointment process when pursuing maximal performance.

To better understand these differing results, several studies recognize also the contextuality of the performance outcomes to be essential. Different models for circumstances where diversity is beneficial have been presented. For an example Dwyer et al. (2003) found positive results for firm performance with moderating effects by strategic orientation and organizational culture. Especially the presence of high growth orientation increased the gender diversity performance. These findings would imply that organizational environment might play crucial role in achieving performance outcomes. (Dwyer et al. 2003) Further on, Conyon and He (2017) found board gender diversity to positively affect firm performance, especially in high-performing firms. These studies demonstrate strategical and organizational factors that might determine performance outcomes to an extent.

In addition, Naghavi et al. (2020) investigated differences across multiple nations and cultures to recognize where women create positive performance on boards. Institutional and cultural norms are in fact recognized to affect the role of women and more positive results with gender diversity could be grasped in countries where feminist and collective features are valued more, equality is higher and high uncertainty is avoided. On the other hand, opposites of these tend to have negative outcomes for women in boards. (Naghavi et al. 2020) Similar study conducted by Lee and Thong (2023) also set some boundaries for gender diversity on the board to create financial performance. This relationship was more significant in countries with stronger shareholder rights, greater regulations towards gender diversity, women empowerment and during covid crisis. (Lee & Thong 2023) Similarities between these papers can be recognized in the empowerment and equal role of women. The risky and uncertain environment is also common factor that was brought up in Fernando's et al. (2020) paper. Gender diversity seems to create more stable management in case of high-uncertainty and when the uncertainty is to be minimized. (Fernando et al. 2020) These findings do also support the case for inclusion and equity, because the perceived role of women in the country and organization was found significant for the results.

Racial and national diversity

Racial diversity refers to surface level characteristics within nationality which is sometimes also referred as racio-ethnicity. These two might be connected, but not necessary as ethnicity should consider more the cultural background instead of surface level characteristics. (Richard 2000) Because of the selected studies, this paper discusses race as an overall term for these. Nationality in turn refers to the country that someone has citizenship over, that in many cases might be related to race and ethnicity, but again not necessarily (Nielsen & Nielsen 2013). These terms are therefore closely related, and sometimes interchangeable between papers, but differences are good to acknowledge.

Racial diversity was classified in Roberson's and Park's (2007) study only into two groups in US context, because of data restriction. These were namely ethnic majority of Whites and ethnic minorities of Black, Hispanic, Asian, Native American, and so on. (Roberson & Park 2007) This division into two groups is recognized inadequate to grasp the true nature of diversity, but in many cases, it might be enforced (Richard 2000). As well as women, racial minorities are underrepresented in organizations and especially in leadership roles (Miller & Del Carmen Triana 2009). It is worth noting that most of the racial diversity studies are focusing on US context and each country holds a specific composition of workforce racial diversity.

Studies of racially diverse groups generally indicate positive firm performance with some moderators. Richard (2000) conducted organization wide research on this subject and found positive indications but highlighted the importance of context for these results as diversity itself didn't deliver these results. Business strategy was the factor significantly affecting performance outcomes which were reviewed with multiple measures. Results demonstrate that the recognition of context might allow or disallow the firm performance from racial diversity. (Richard 2000) Further on Richard et al. (2004) studied racial diversity in management considering the context of innovativeness and risk-taking. In this study higher innovativeness revealed significant U-shaped relationship between racial diversity and firm performance. This indicated best results with low level or high level of diversity. On the other hand, risk taking negatively affected the performance gained from diversity, but only marginally. (Richard et al. 2004)

Similar findings were achieved by Roberson and Park (2007) who found similar U-shaped relationship between leader racial diversity and firm performance. So first the growing diversity will decrease performance and only after about 25% of diversity the performance shifts to be positive. Moreover, the diversity reputation could affect investors' expectations about earning prospects, risks and growth potential connected to the business. These findings emphasize the importance of diversity but furthermore the diversity management. (Roberson & Park 2007) To sum up, benefits could be created both internally and externally as long as required diversity is achieved.

Moreover, firm reputation and innovation was recognized to moderate the relationship between board racial diversity and performance to some extent (Miller & Del Carmen Triana 2009). Another moderator proposed to moderate the relationship between management racial diversity and firm performance is participative strategy making that focuses on inclusiveness in organization. This increased the performance to some extent with higher racial diversity, but results were more significant for gender diversity. (Miller & Del Carmen Triana 2009) The competitive landscape is also proposed to be factor for performance outcomes. More racially diverse management groups are found to be able to compete more intensively in environments where is high growth potential and this is related to higher market share. (Andrevski et al. 2014) Important factors for performance outcomes can be therefore recognized inside and outside of the organization, making some of them more difficult to influence than others.

Previous studies have been focusing on specific organizational groups, but Smulowitz's et al. (2019) study intends to compare these effects across the organization. Results indicate strong support for racial diversity affecting financial performance in all hierarchical levels of a law firm. Against the initial hypothesis the impact of diversity was not more relevant in managerial level and even higher financial performance was recognized when diversity was more concentrated in lower levels. No clear explanation for this was discovered. (Smulowitz et al. 2019) Results would suggest more research on lower levels of organizations to discover what might drive these outcomes of high performance.

Regardless of majority of the results supporting business case for racial diversity, some contradicting results have also been presented. Carter et al. (2010) did not find solid support for this as they researched board composition in US context. The financial performance was supported when measuring with ROA but not with Tobin's Q. Moreover, no causal link was recognized to prove the performance through racial diversity. It is still highly stressed that no negative implications for performance were recognized either, so these results don't repeal the business case for diversity. Moreover, some possibilities for these differing results are considered like exclusion or conflicts, that are recognized to be possible with diverse groups. (Carter et al. 2010) Compared to most of the previous papers, lack of any moderators distinguishes this paper, which might indicate the conclusion that racial diversity itself might be insufficient to create performance benefits and other actions to manage this diversity might be needed.

Moreover, Frijins et al. (2016) found cultural or ethnic diversity on boards to even negatively affect firm performance measured with both ROA and Tobin's Q. Therefore, the negative effect and frictions created by cultural diversity seems to be outweighing the positive performance, and to reach these benefits it might require better management of diversity by better communication and integration. Complexity and firm presence in foreign markets are noticed to mitigate the negative results for an example. (Frijins et al. 2016) Even with the negative implications there is faith to turn these positive with certain management, indicating again the need for inclusion and equity.

To add to the cultural diversity context, one study considering nationality is presented. Nielsen and Nielsen (2013) discussed national diversity in top management teams. The globalization and international organizations have made this subject significant since multinational top management teams are increasingly common. They find evidence supporting the conclusion that the diversity context will affect the strength and direction of firm performance. In case of national diversity factors contributing for better firm performance were team tenure, internationalization of the company, and industry munificence. For some other diversity factors, these same contextual factors had negative implications. Therefore, macro-social context is significant and should be considered in creation of diversity strategy. (Nielsen & Nielsen 2013)

Age diversity

Age diversity has been studied to some extent, but considerably less than previously reviewed diversity attributes. Li et al. (2011) focused solely on age diversity's effect on firm performance and found positive implications for this. Study was conducted in Chinese context focusing on employee level and strategy was used furthermore to define the context. Firm performance was measured with ROA and employee productivity. When comparing results to Western societies the performance effects of age diversity were even greater, which was explained by better awareness for these matters in Western context. (Li et al. 2011) Results are somewhat similar to previous findings and for example the role of strategy is highlighted similarly to Richard's (2000) research.

Furthermore, in emerging economy of Mauritius, Mahadeo et al. (2012) studied the board demographic diversity, also including age diversity. Within other demographic diversity factors, age is detected to have positive effect on short-term performance, even though negative correlation for ROA is found. Overall heterogenous boards are supported with more gender and age diversity, but also management of diversity strategy is highlighted, since the results are not all positive. At the same time some limitations are considered, like family led boards, that control and limit diversity to some extent. (Mahadeo et al. 2012) The management of diversity is again highlighted as the outcomes of diversity can be differing, so minimizing the negative effects might be crucial as well.

Last study focused on Korean manufacturing context, where also few human resource management practices were considered in the results. The framework proposes age diversity to affect relational coordination with moderating effects of two practices of structural empowerment and multisource feedback. Further on, relational coordination is proposed to affect firm performance measured with financial performance and competitiveness. Age diversity did have indirect effect on firm performance that was generally negative, but effect could be diminished by structural empowerment. (Lee & Kim 2020) Also here the relationship between diversity can be recognized complex, and different diversity factors act in a different way. Furthermore, HR practices can be seen affecting relationship between diversity and performance.

Knowledge diversity

The last diversity group discusses knowledge that covers functional, educational, and expertise diversity. Functional diversity refers to experience from various functional positions that can be beneficial through good networks, knowledge of what each function does, and knowledge of where to find relevant knowledge for each situation. Results of Cannella's et al. (2008) study on this functional diversity in top management teams in US brought support for firm performance, when more members were located in the same office, but negative when members were geographically dispersed. Higher environmental uncertainty did also have positive effect on the relationship. (Cannella et al. 2008)

Expanding the knowledge of functional diversity in top management teams, Buyl et al. (2011) conducted research in Dutch and Belgian context, simultaneously reviewing the role of CEO in this phenomenon. Results show support for CEO characteristics affecting the firm performance created by top management team functional diversity. Better performance for functional diversity was supported to some extent when CEO had marketing experience, was not the founder of the firm and had higher tenure. (Buyl et al. 2011)

Functional and tenure diversity was further on studied by Binacci et al. (2016) in family-owned businesses. In family dominated firms, performance was negatively affected when tenure diversity was high in organization, whereas this effect was only minimal in non-family dominant firms. On the other hand, increase in functional diversity was more beneficial to family dominant, compared to non-family dominant firms. Family businesses are different in nature. Initially communication and cohesion in family led business might be better, reinforcing diversity, but risk for personal conflicts might be greater and tenure could be one possible source of conflict in family businesses. (Binacci et al. 2016) Again the context of business proved its significance for performance outcomes as not all companies might be capable of grasping same benefits.

Board's educational background and firm performance was studied in Mahadeo's et al. (2012) paper, with some other diversity factors. As a result, when focusing only to educational background, higher diversity was detected to lead to lower firm performance in the short term. These results are backed with notions of lower group cohesion and effectiveness. Another discovery of the paper was that different diversity types tend to support each other, for an example higher gender and age diversity tend to lead to higher educational diversity as well. (Mahadeo et al. 2012) However study of Lee and Kim (2020) found that higher educational diversity increases firm performance in case of high structural empowerment and high multisource feedback. These HR practices were recognized crucial for the performance outcomes. (Kim & Lee 2020) Further on, educational background was found to be significant also in cases of high uncertainty where it clearly mitigates the negative performance effects (Kim et al. 2021).

Inclusion and equity

Most of the studies don't consider role of inclusion or equity directly as part of financial performance, but similar ideas are presented in many papers. For an example many studies apply some moderators between diversity and financial performance, and these are usually related to the idea of inclusive and equitable organizations. Interestingly most of the papers presenting these ideas are more recent papers. (e.g. Del Mar Fuentes-Fuentes et al. 2023; Vlas et al. 2022)

Good example is Del Mar Fuentes-Fuentes et al. (2023) paper that considers the moderator of inclusive innovation that encourages everyone in the organization to be included in the innovation processes. This has implications inside and outside the organization, since the diverse workforce can be more effectively utilized, and this might also disclose reputational benefits valued by stakeholders. (Del Mar Fuentes-Fuentes et al. 2023) Inclusiveness has been recognized as important factor in value creation here and it aims towards more equitable conditions as everyone should be offered same opportunities. Still as recognized in DEI management chapter, truly equitable opportunities are disrupted with traditional hierarchies in organizations (Syed & Özbilgin 2009).

Further on, Havrylyshyn et al. (2023) recognize the issue that minority presentation in board can be overlooked in decision making. They notice the differing conclusions in research made within women board representation and performance outcomes and propose that the inclusion might be the explaining factor. To reduce gender bias they propose more formal and intensive contact between men and women directors during meetings. Previous experiences of token-women who had only symbolic role in board was recognized to impair board performance when board was male dominant. (Havrylyshyn et al. 2023) It is recognizable that organizations have deep rooted patterns and biases that need work to get past. These issues should be acknowledged in individual, but also organizational levels. Furthermore, structural empowerment and multisource feedback was recognized important especially when fostering performance from educational diversity, but results were not the same for all diversity factors (Lee & Kim 2020).

Moreover, some papers emphasize even more structural approach to DEI management to achieve greater performance. Leung et al. (2023) researched diversity programs effect on firm performance. This study covered large number of US listed companies for the period of 15 years, providing strong support for the benefits of diversity management. This management should be comprehensive covering diversity in its all aspect, and therefore the study reviews the effect of multiple activities. Study provides support for more comprehensive focus on diversity management and strategies. Again, the contextuality is recognized and innovative and creative environment provided best support for diversity. (Leung et al. 2023)

Vlas et al. (2022) presented model to better integrate racially diverse workforce with management routines to foster financial performance. These routines included formal mentoring, formal network groups, internship programs and career track succession planning that together further increase inclusion for diverse workforce. There were also indirect effects identified from managerial cognition practices of bonuses, performance appraisals and diversity training. By combining these routines and practices, enhanced firm performance could be achieved. Managerial practices were recognized especially important to enhance managers precision to recognize diverse resources and capabilities. (Vlas et al. 2022) This shows how the organizational practices can affect individual level actions and create organization wide change.

Diversity and equality management is researched by Armstrong et al. (2010) who explore this important, but much lacking area within DEI research. Consideration of equality within diversity studies is rare especially when connected to performance, therefore this study offers unique ideas for DEI performance. Diversity and equality management systems brought additional benefits for high performance working systems, such as productivity, increased innovation, and reduced turnover in employee level. (Armstrong et al. 2010) Support systems for DEI can therefore create even greater benefits from diversity.

As most of the papers are considering environments of conventional majority groups, Blount and Smith (2021) researched how would minority groups perform if they were to be the majority group. Paper supports the case of diversity as it concludes that minority businesses only hiring minority employees would suffer performance outcomes in a long term because of the lack of diversity. (Blount & Smith 2021) This is in line with Ferrary's and Déo's (2023) idea of diverse groups instead of homogeneous groups. These studies demonstrate well the case for diversity and equity as those suggest that all groups should be equitable and be provided with same opportunities to gain best results.

Summary of DEI performance

Looking at the results of the literature review, few observations can be made. Firstly, the financial performance created through different diversity factors is mainly positive or the outcome could be affected through some moderators to make it positive. Examples of these moderators are innovativeness, competitiveness, and strategical choices (Andrevski et al. 2014; Armstrong et al. 2010; Del Mar Fuentes-Fuentes et al. 2023; Dwyer et al. 2003; Li et al. 2011; Vlas et al. 2022). Only few studies find no effect or negative effect for DEI performance (Carter et al. 2010; Frijins et al. 2016; Marinova et al. 2016). Despite focusing on financial performance of the companies, many papers also recognize the indirect benefits that could be gained.

Different diversity factors from gender, race, age, and knowledge were studied in multiple contexts to add the relevance of the results. Still majority of the studies are focusing on gender in boardroom or management teams, leaving other areas with less attention. However, these results highlight the importance of diversity because it clearly affects firm performance one way or another. Any of these diversity factors cannot be recognized as the most significant, but all studied factors are found noteworthy. Carter et al. (2010) recognizes the selection of studied factors to be affected by the presence of diversity in particular country. In US higher ethnicity is present making more studies to consider this aspect whereas in Europe higher homogeneity of ethnicity has led to higher focus on gender diversity for an example. (Carter et al. 2010)

To better understand the conditions where diversity might be most beneficial, more research is called, but several common factors could be recognized from these papers as well. Inclusive actions and practices were discussed in several papers moderating the relationship, showing the significance of management, as mere diversity might have not offered same results. Actions of empowerment, participation and inclusion are brought up to support different functions of company (Del Mar Fuentes-Fuentes et al. 2023; Dwyer et al. 2003; Lee & Kim 2020; Leung et al. 2023; Richard et al. 2013). Other internal actions of organizations such as strategy is brought up affecting the performance outcomes as well (Dwyer et al. 2003; Li et al. 2011).

Further on, some external conditions like high uncertainty were proposed in some of the papers as a condition where diversity was deemed to be more significant (Cannella et al. 2008; Fernando et al. 2020; Kim et al. 2021; Lee & Thong 2023; Naghavi et al. 2020). At a country level gender diversity was also highly dependent on legislation and the empowerment of women in business world (Lee & Thong 2023; Naghavi et al. 2020). For innovative companies the benefits seem more substantial as diversity would allow greater innovation in many cases (e.g. Armstrong et al. 2010; Leung et al. 2023; Richard et al. 2004). Still as many of these conditions have been researched with differing diversity factors, it cannot be concluded that same conditions are beneficial for all types of diversity.

Majority of the reviewed papers study large, listed companies and the lack of studies in smaller and un-listed companies is recognized in several papers (Mahadeo et al. 2012; Marinova et al. 2016; Naghavi et al. 2020). Furthermore, many studies discuss DEI high up in the hierarchy such as board rooms and top management teams (e.g. Campbell & Mínguez-Vera 2008; Nielsen & Nielsen 2013). Whether this brings out the true nature and extent of DEI can be questioned as these groups cover only a fraction of the company. As legislation only monitors board composition at this moment there is a possibility to distort the true state of DEI in an organization. Also, the high focus on gender diversity is limiting the other factors studied.

4. FRAMEWORK FOR THE STUDY

After reviewing the context of the private equity market and current literature on DEI, framework for this study is created. This framework is utilized further on in the analysis of the results. It needs to be highlighted that DEI in the private equity market is still widely unexplored and academic research hasn't addressed this research area. Nevertheless, various factors are recognized to drive the implementation of DEI in the PE context. Furthermore, the private equity field is recognized to have some similarities to current DEI literature, but some of its special features have not been addressed in research previously. These observations are illustrated in the framework that is presented in figure 8 demonstrating these three areas of previous DEI research, special features of the private equity context and forces driving these fields together.

Middle section of the framework introduces these forces driving DEI into the private equity industry. To some extent PE context is not so differing from standard business environment except certain differing management and financing structures (Zeisberger et al. 2017, pp 43-45). There are several common factors, pushing the fields of PE and DEI towards each other. Firstly, the general interest that DEI has raised in the PE markets during the past couple of years can be identified. Despite the lack of academic research many studies considering the state of diversity, equity and inclusion have been prepared within the industry. Possibilities within DEI have been noticed for example on reputation, innovation and financial performance (e.g. Miller & Del Carmen Triana 2009). However, this interest itself hasn't been enough to initiate industry wide transformation.

Awakening of this interest has many reasons, but one factor supporting this is stakeholder pressure coming from various sources. As discussed in earlier chapters, legislation is one major force pushing all companies, not only PE companies, to comply with ESG related reporting more precisely (CSRD 2022/2464). Then specifically in the PE industry, investors have started to demand better ESG and further on DEI practices from their investments (Crifo & Forget 2013; McKinsey & Company 2022). Caused by this, also industry bodies have raised awareness around this issue (FVCA 2023a). Combination of these various pressures is strongly affecting the companies in the PE industry. Also, personal moral values do guide the behavior to some extent within companies (Ng & Burke 2005). Due to increasing demands for DEI, many PE companies have reacted and are now actively trying to capture the value of DEI (Subeliani & Tsogas 2005).

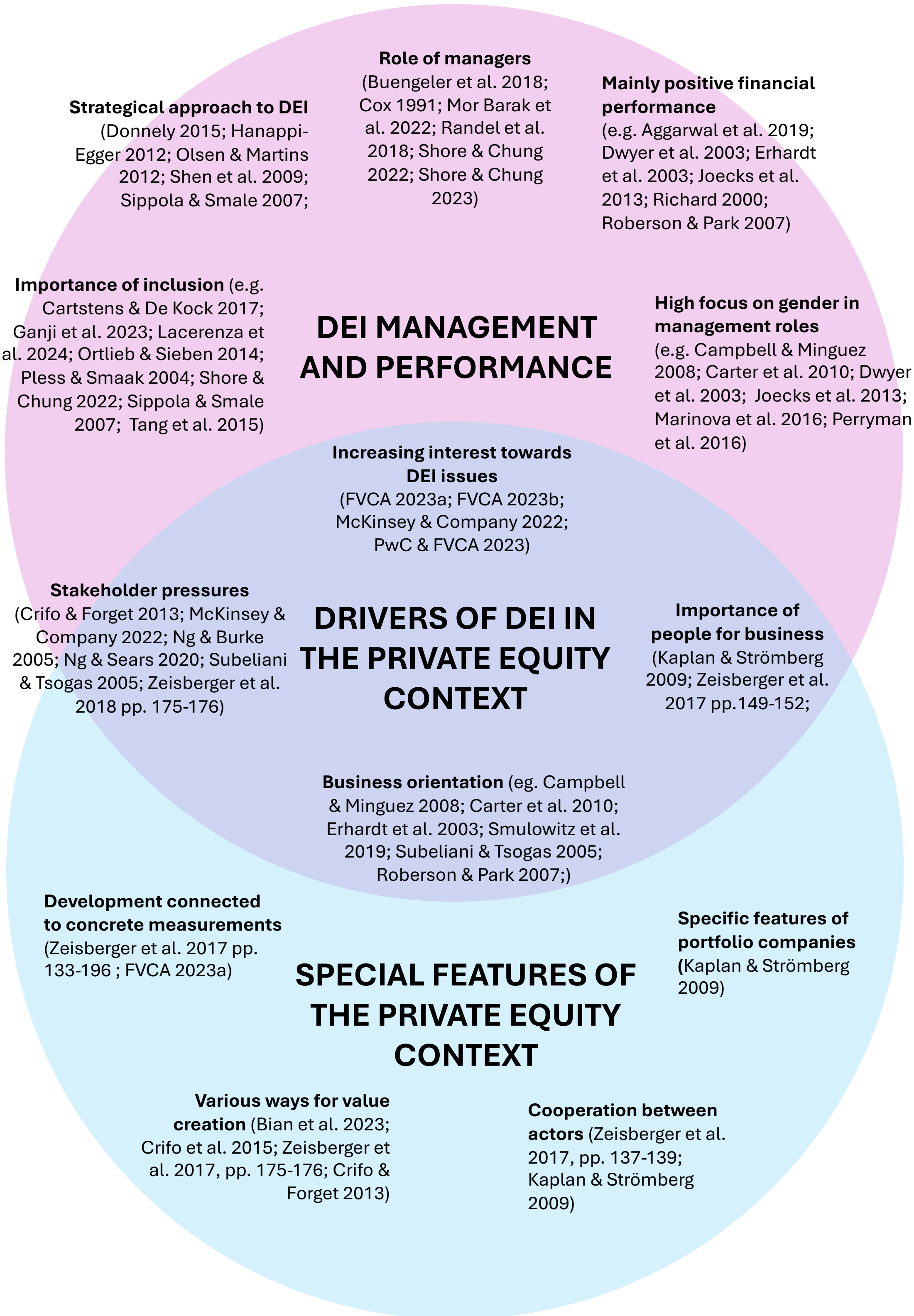

Figure 8. *Framework for the study*

Third force driving the change is the business orientation. As discussed in private equity chapter, the market is highly business oriented, and success is largely measured with company valuations and monetary measures (IPEV 2022). Then again DEI literature has also focused quite heavily on proving the business case for DEI as it is argued to have concrete business benefits even to the extent of company valuations (Campbell & Mínguez-Vera 2008). This is witnessed with large quantities of research focusing on financial performance of DEI (e.g. Campbell & Mínguez-Vera 2008; Carter et al. 2010; Erhardt et al. 2003). These studies were present with varying results, that might also explain the ongoing debate about the relevance of the DEI as the business case stays unclear. Management of DEI seems to be highly business motivated in general (Subeliani & Tsogas 2005), but this effect is presumably even greater for private equity companies that have limited timeframe to increase the value of the companies. This business motivation is not sufficient by itself at the moment as the business case stays unclear.

Fourth force combining the fields is the importance of people that is obvious for DEI as it is people centric approach to business, but this is also highlighted in the PE context as the business development is built closely around people. Private equity company can execute any changes but if the management and employees in the portfolio company are not cooperating these changes won't matter (Zeisberger et al. 2017, pp 149-151). For an example, when considering the DEI implementation in portfolios the commitment of the management is crucial to lead the organization for this change (FVCA 2023a). Moreover, the non-financial criteria of management teams can affect the company valuations of portfolios, raising the importance of qualified teams even more in the PE context (Kaplan & Strömberg 2009).

When looking at the upper section of the framework which is based on the literature review, some common themes in DEI management and performance were present. Despite the academic efforts validity of these themes in the PE context is not confirmed. However, these themes should be considered in regards of this study as they offer a base for understanding DEI management and performance in any context. Themes collected from the literature consist of importance of inclusion which was spotted to be crucial part of managing DEI but had some implications for the outcomes as well (e.g. Richard et al. 2013; Tang et al. 2015). Strategical approach was highlighted in the DEI management as this issue should be considered comprehensively and strategy will ultimately determine all the following steps of the management process (e.g. Olsen & Martins 2012). Role of managers was highlighted on many occasions and their role for implementing DEI practices was seen important (e.g. Buengeler et al. 2018). The results of DEI performance studies were mainly positive offering positive firm performance with higher diversity. However, the field is not totally unanimous, and some neutral and negative performance outcomes was suggested as well (e.g. Campbell & Mínguez-Vera 2008; Carter et al. 2010; Erhardt et al. 2003). All these studies were largely discussing the role of gender diversity over other diversity attributes and focused on top management teams and corporate boards (e.g. Campbell & Mínguez-Vera 2008).

On the other hand, lower part of the framework presents some special features of the PE context that should be considered when viewing DEI in this context. These consist of the fact that portfolio companies are small and mid-sized non-listed companies, that might get listed after the holding period. This is significant in a sense that many of the studies in the literature review were carried out in listed companies and the performance was measured relative to market performance. Another special feature is the cooperation between multiple actors in PE context, namely the general partner and portfolio management who have a special relationship (Zeisberger et al. 2017 pp.137-139). Research in the PE context has considered various ways for value creation and one topical subject is ESG. However, in the private equity field sustainability discussion is many times limited to environmental and governance issues, but possibilities for value creation with social aspect can be spotted as well. (e.g. Bian et al. 2023; Crifo et al. 2015) Lastly in the PE context the development is highly tied to concrete measurements proving the performance which might offer both opportunities and challenges when following the progress of DEI (Zeisberger et al. pp. 133-196). This might differ compared to other industries where measuring is not that tied to the core business.

5. RESEARCH METHODOLOGY

In this chapter the methodological choices of the study are presented to respond to the goals of the study. These cover the selection of research design, strategy, data gathering and data analysis. Finally, assessment of validity and reliability of the chosen methods is carried out to weigh the suitability and deficiencies of the selected methods.

5.1 Research design and strategy

This paper focuses on a topical subject of DEI in the private equity market. The current knowledge of DEI management and performance is scattered and inconsistent calling for better understanding of the topic. Furthermore, research in the context of private equity is non-existent. Because of these, this research is structured to address the research gap of DEI performance and management in compelling context of the private equity market. Aim of this study is to enlighten the relationship between DEI and company value as well as to support the process of DEI management and measurements to further improve DEI performance in the private equity context. To reach the goals of this study, the research design needs to support this accordingly.

Firstly, because new knowledge and theoretical guidelines are called by the research, inductive reasoning is used as a base for theory development after literature review. Induction provides a way of collecting observations and creating new theories based on the observations, which is suitable since no clear theory is yet established in DEI performance or management in PE context (Saunders et al. 2019, p. 155). In many instances, as well as now, induction and qualitative research method are used together to expand knowledge on certain subject. Qualitative research collects data from non-numerical sources to understand relationships and meanings between matters. (Saunders et al. 2019, p. 179) This method and more specifically multi-method qualitative research offers ways to better grasp subject with limited knowledge. Multiple sources of qualitative data from literature and interviews are used to ensure more comprehensive understanding and enable building new knowledge on top of the previous research. This study can furthermore be characterized with explanatory and exploratory purposes with aims to understand relationships between variables and to clarify the researched subject (Saunders et al. 2019, pp. 186-188). In this case variables under research were DEI and performance. At the same time better understanding for managing this performance was called.

Secondly, to understand this phenomenon holistically in the chosen context of private equity, case study was applied for this research. This case offers unique possibility to study DEI related performance in a highly performance driven context. Case study can obtain in-depth insights of the chosen case which might take a closer look into a person, organization, event, or some other matter (Saunders et al. 2019, p. 196). In this case, the focus was on a private equity company controlling other businesses referred as portfolio companies. More specifically case was focusing on the phenomena of DEI in this context. Defined by Yin (2003, p. 53) case study is an investigation of a real-life phenomenon, where the phenomena and its context are inseparable entities as demonstrated also here.

Case studies can also be divided into intensive or extensive research studies where intensive research focuses on one case more holistically and contextually, whereas extensive focuses on many cases aiming for more generalizable results of studied context (Eriksson & Kovalainen 2008, p. 119). Both have their own advantages, but intensive case study was applied in this study, to allow more in-depth and qualitative research of one case. Nonetheless this doesn’t mean that intensive case study couldn’t focus on the phenomena or create theoretically informed results as well (Eriksson & Kovalainen 2008, p. 119). In this case study, this feature can be recognized as studied phenomena of DEI is in a key role and the private equity context offers support for this studied phenomenon. Moreover, generalizability of the results is not the only meter of scientific relevance and results can be theoretically significant in a single case study as well (Flyvbjerg 2006).

For a case study it is critical to define the scope and boundaries of the study. Moreover, the case usually demands flexibility since more issues and views might arise during the case study. (Eriksson & Kovalainen 2008, p. 127) In this case the scope was limited to private equity company and its portfolio companies. This means that other up- and downstream actors were excluded when discussing DEI phenomena. However, these other stakeholders are considered important for the context, and for their role in demanding and promoting DEI was discussed to understand the structure of the market. Research context was also limited to the Finnish private equity market with small and midsize companies, which is less researched area in the DEI field (Baker et al. 2020). This creates distinct differentiation from previous research because smaller companies are usually lacking comprehensive governance structures and policies which are important to support implementation of social sustainability actions as proposed by United Nations (2004). Study structure was also flexible in terms of question setting, results, and interviews to enable adjusting the view, if new information suggested so.

Thirdly this study aimed to offer new practical guidelines to better manage DEI performance which called for additional research strategy of action research. This strategy offers way to participate actively in the problem-solving process and develop some part of the business. (Eriksson & Kovalainen 2008, p. 193) Second goal of the study as mentioned was to create better ways to manage and measure DEI performance which demands practical insights. Results of the study offer general instructions for managing DEI and this knowledge is turned into practical insight in the scope of the case company.

Lastly the time-horizon of the study was defined as cross-sectional which enables research at a specific time focusing on the selected case (Saunders et al. 2019, p. 212). Time-horizon in this case was constrained by the nature of the research with only limited time to execute. Even though this subject would be interesting to study also in longitudinal study, offered this specific cross-sectional study interesting possibility to deepen the current knowledge of a topical issue. Moreover, practical guidelines were demanded quickly since this issue is topical and actions by private equity companies are called immediately. Then again, this cross-sectional study offers tools to review the development of DEI and company valuations also in the long run.

5.2 Data gathering

Primary data gathering in this case was done with interviews as it was seen important to gather real life experiences and thoughts of DEI matters in the PE context that has not been yet a subject of academic research. Interviews were conducted in semi-structured manner which enables structured guidance of the conversation, but also focus on topics that each interviewee has specific knowledge on (Saunders et al. 2019, pp. 437–438). In this case interviewees with similar backgrounds were identified difficult to find supporting the semi-structured interview with similar base, but varying focuses. As Hirsjärvi and Hurme (2022) recognizes semi-structured interview can have various levels of structuration. In this case the themes in interviews were covering all three of the research question in areas of DEI management, DEI performance and DEI measurements, however the selection of specific questions and time spend on each theme might have differed. Interview questions are presented in Finnish and English in the appendices B and C. These questions were not shared with the interviewees beforehand, but the themes of the interview were shared to give an idea of desired topics, increasing the credibility of the interviews (Saunders et al. 2019, p. 452).

The population where the interviewees were selected was identified to be covering all the actors who are knowledgeable on both subjects of DEI and private equity. For the use of this case the target population was specified to be Finnish markets where the case company operates. To define the final sample, the methods of non-probability purposive sampling were used since it allowed the gathering of experts who can best answer the research questions. Moreover, this sampling method is highlighted for small samples such as case studies to offer most informative results. (Saunders et al. 2019, p. 321) The final sample in this case therefore focused on a small sample within case company environment covering internal and external professionals in this environment. These professionals were recognized to have expertise in the fields of this research with varying extents of DEI and private equity, specifying the interviews as expert interviews (Hyvärinen et al. 2017).

Number of interviews was concluded to five, that was limited by qualified interviewees in the case environment. However, with purposive sampling the quality of interviews is recognized to overrun the number of interviews which was recognized important in the sample selection (Eskola & Suoranta 1998). With DEI being recent topic in the industry, not many in the PE industry are familiar with its principles. These five interviews offered anyhow various views as the interviewees all represent different roles in the PE context. This allowed more comprehensive results understanding the needs and views of different actors. The sample is presented below in table 1.

Table 1. *Interview descriptions*

Interviewee	Role	Organization
I1	Investment Director	State-owned investment company
I2	Head of Legal & ESG	Industry association
I3	Head of People & Culture	Portfolio company
I4	Managing Partner	Private equity company
I5	Sustainability reporting leader	Consulting company

First interview offered an investment point of view on the matter, giving good insights on investor needs and thoughts that are crucial for the success of the PE companies as well. Second interview offered more general view on the Finnish PE industry overall. Third interview brought the subject more on a practical level, offering views from the portfolio company point of view. Fourth interview considered the PE company's own aspirations and views. On the other hand, last interview offered external point of view on the subject that consulting companies present. Four of these interviews was conducted through Teams-meeting and one was done on the premises of a company. Interviews were conducted either in Finnish or English depending on the preference of the interviewees to make the setting as comfortable as possible for information sharing.

All the interviews were recorded, and the time of these interviews varied between 30 – 50 minutes, excluding the time that was spend on introducing the research and free discussion around the topic that was left out from the final recording. During this the data protection of the interviewees was presented and related form was sent afterwards. Transcription was done with the help of Word's transcription tool and final work was modified manually by removing all the fill words and repeats and correcting the grammar to make the translation of forthcoming citations easier.

5.3 Data analysis

Created framework (presented in chapter 4) and discovered themes worked as a base for the analysis of the interviews. Therefore, the analysis of interviews was done with thematic analysis as well, which allowed usage of predefined themes for the data analysis. Therefore, thematic analysis worked here in a deductive manner when utilizing framework base and enabling flexible use of the data. (Saunders et al. 2019, p. 652) This allowed testing of these previous themes in a new context that was desired in this case (Tuomi & Sarajärvi 2018). The analysis process was started by familiarizing and reading through the transcribed texts repeatedly to enable further analysis (Saunders et al. 2019, p, 652). To support the analysis, the process was continued by doing transcript summaries to collect the most essential findings from each interview to support the conceptualization of results (Saunders et al. 2019, p. 649).

For the practical analysis, help of data analyzing tool "Atlas" was used. This enabled easy coding and grouping of data. Coding combines common meanings appearing from the interviews that are later combined to bigger themes according to the framework (Saunders et al. 2019, p. 653). The predefined research questions and framework guided the coding in this study to focus only on certain themes leaving some of found codes irrelevant for the study purposes. However, creation of new themes was not excluded for the study purpose if it seemed necessary. This challenge in deductive approach is recognized as priori codes might not support the research questions or data fully (Saunders et al. 2019, p. 653). After recognizing relevant codes and themes their relationships to one another was compared to discover hierarchical positioning of the themes (Saunders et al. 2019, pp. 657–658).

5.4 Reliability and validity of methodology

The quality of the chosen methodology was assessed with two components of reliability and validity to ensure the objectivity of the research. Firstly, the reliability expects the research methodology to provide similar results despite the time and manner the research is conducted. Whereas validity considers how well the chosen methods uncover the truth. (Kirk & Miller 1986) In qualitative research reliability and validity might not always be the best indicators of the quality of the research as the reality is considered socially constructed and complicated (Saunders et al. 2019, p. 216). This applies for this research as well and the objectivity was assessed with this in mind.

To support reliability, this paper provided clear descriptions of methodologies used, allowing the replication of the research even though the limitation for reaching exactly same findings was recognized. Threat for this was especially the low number of professionals that could be reached for the interviews. However, to increase reliability of the results wide scope of backgrounds was used to gain insights from various perspectives. One common threat for reliability covers any kind of biases and errors of either the participants or the researcher (Saunders et al. 2019, p. 214). These were strived to avoid with assessing general attitudes towards the topic and reserving enough time for each interview to avoid rush. One focus area for this paper was also the transferability which allows external observers to interpret the research fully and understand the applicability of this research for different settings that they might be interested in (Saunders et al. 2019, p. 217). So even when this paper is providing insights for specific PE context, the transparent process was aimed to allow the interpretation of results in different settings as well. For an example the Finnish context of private equity was brought up with examples to enable comparison to other countries.

Validity was in turn assessed with chosen measurements, accuracy of the conducted analysis and generalizability of the results (Saunders et al. 2019, p. 214). As a qualitative study the measures are difficult to assess and it is accepted that the truth might not be fully achieved, but for this specific case it represents the truth of the interviewees. One possible risk for this could be the interviewees urge to present themselves or their companies in better light consciously or unconsciously (Saunders et al. 2019, p. 215). To minimize this risk, anonymity of the interviewees and their organizations was applied and their rights as a participant were clearly explained. Another threat for generalizability of the results might be the case selection as the context is rather specific and covers the environment of a small Finnish private equity company. However, by addressing this deficiency clearly, no harm for the validity is created. In the analysis process some threat recognized was the varying language used between the interviews and to avoid possible misunderstandings, the citations used were approved after hand to ensure correct interpretations. The objectivity of the analysis was further on supported with theory driven analysis themes gathered from the literature.

6. RESULTS

Results of the study are discussed in separate chapters covering different areas of the framework. To support this analysis all themes in the framework are discussed separately. After reviewing all the areas, there should be clearer picture of how the private equity industry is influenced by DEI, and what similarities and differences there is to the conventional markets regarding the management and performance.

6.1 Drivers of diversity, equity and inclusion in the private equity context

Firstly, the common drivers that were listed in the framework are discussed separately. Present themes in this area are interest towards DEI, stakeholder pressures, business orientation, and importance of people for business. Representation of these areas of interest for this chapter are iterated in figure 9.

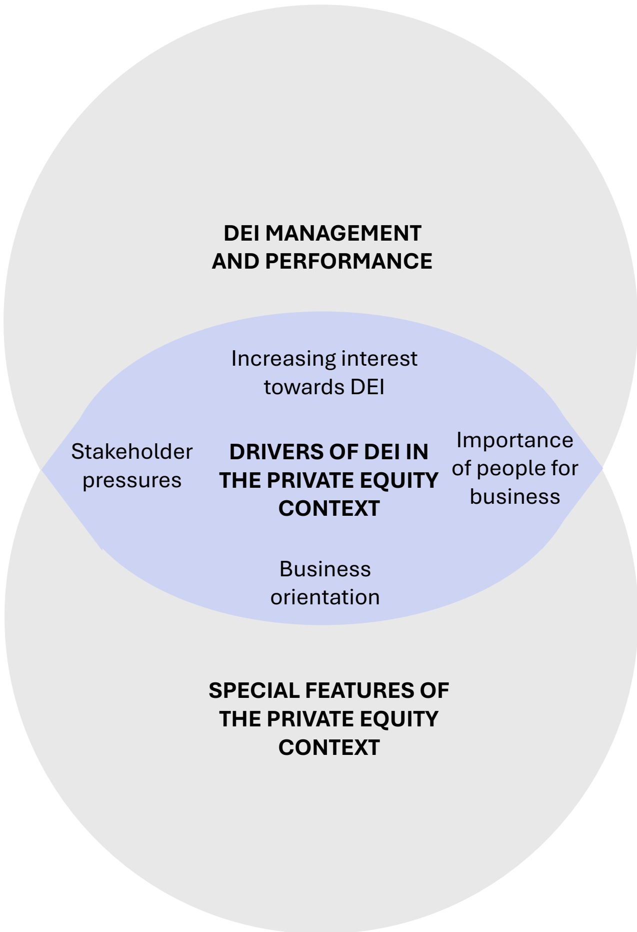

Figure 9. *Drivers of DEI in the private equity context*

Interest towards DEI in PE context

Overall, from the interviews conducted, it can be reasoned that DEI is deemed very important, yet the overall state especially in the PE context is recognized insufficient (I1; I2; I4). This was partly expected as the research in PE is lacking, and this matter has been brought up to company agendas only during the past few years (I2). The journey of DEI is recognized to be in its early days in Finnish PE context where management and measures are still quite inadequate to support real value creation from DEI (I1; I3; I5). However, the insufficient state of DEI draws interest in the PE context as fixing this could have particularly great effects for the performance (I4).

Although the challenges recognized in the current state, improvements towards better diversity, equity and inclusion were already spotted in multiple interviews (I2; I4; I5). The timeline of the development is varied as some of the organizations have been focusing on these matters longer than others (I3). The PE industry has faced a rapid change over the past years as this subject has entered the market with stipulation coming from various sources such as investors and legislation (I1; I2; I4). Especially year 2022 was found to be revolutionary for the industry (I2).

However, in a bigger picture the development of DEI in Europe and Nordics is lagging compared to for example United States where this has been an active subject of discussion for over a decade (I3). Therefore, the importance of DEI is believed to increase in the coming years before it will reach satisfactory level that is then perceived as an industry standard (I1). This change is however slow, and progress is seen only after years (I4; I5). Future direction was considered important as the deficiencies are recognized in the industry:

> *"The role [of DEI] is important and is developing in the direction that it is even more important. We certainly aren't excelling in this area and the numbers aren't good. Thirteen percent of partners in PE firms are women, it is pathetic number quite frankly."* (I2)

Despite the importance that is acknowledged, DEI is still identified to be only one part of the portfolio management and a current trend to be addressed (I1; I2). It is recognized that DEI is a part of bigger entity of sustainability that is rarely totally separated from this context (I4; I5). Usually focus on sustainability will generate better focus in DEI matters as well (I5). Despite the subject is stated important it is recognized to be getting maybe more attention than it should:

“Such an image is created that it [DEI] would be extremely significant matter, but in a bigger picture looking from further away, if we look back 5 years or 5 years forward, the influence will diminish.” (I1)

With all this in mind the DEI issues are extremely topical matter in PE context. These matters have gained more space in the industry and this progress is believed to continue due to many lacks identified. On the positive side, recognition of these insufficiencies offers new opportunities for development.

Stakeholder pressure

Various motivations for the current focus on DEI issues were recognized. Different positions of the interviewees revealed some flows of motivations in the chain of actors. Market pressure was for example motivating government led investors to be interested in these issues (I1). While on the other hand industry bodies had noticed this pressure coming from investors which was partly driving their motivation to drive this matter forward to PE companies (I2). Increasing legislation was also one common factor driving the change in the industry (I2; I4). Pressure for PE companies was described followingly:

“It is a requirement from investors in the private equity market to increase focus on DEI matters. So, both from a regulatory and from a commercial perspective focus is expected to increase on DEI matters.” (I4)

Legislation was even recognized to be one possible threat for companies planning to get listed in the future – which is highly possible for portfolios – as stated by one of the interviewees:

“Good point to note is that if you want to get listed, these companies are faced in the future with this so-called quota directive, that going forward, there [in the board] 40% of both genders must be presented.” (I2)

These legislative reformations are driving more and more also social reformations in the field of sustainability, increasing the role of DEI as well. Because the management teams in portfolios might not be always up to date on changing legislations, has general partner a responsibility to recall about these requirements (I2). Legislative actions are recognized significant to influence companies views on sustainability as a whole and trigger the materiality assessment for these matters (I5). Incoming “Corporate Sustainability Reporting Directive” drives the change towards better sustainability awareness through reporting:

“CSRD what that is all about, it is a reporting directive, so how companies are supposed to report, but what they actually want to drive is the change.” (I5)

To complement these various business motivations, also values played a role as a motivation. Even without financial benefits these issues were deemed important (I1). The current state of the PE industry further fostered these values clearly, as especially role of women was brought up continually in the conversations (I2; I5). These personal values were important motivation at individual level. Linked to these values was the external image that companies were overall keened to build in the marketplace (I3). More diverse organizations could for an example attract more talented employees and customers (I3). The social responsibility of the PE industry is moreover recognized important as they have great possibility to affect the direction of Finnish companies (I2). This responsibility to value DEI by PE companies was described followingly:

> *"Private equity investors make strategic investment decisions, and in my opinion, their investment choices inherently communicate their values. By choosing to invest in diverse and inclusive companies, they are not only making a financial decision but also a value statement. This, in turn, sets expectations about what kind of companies are invested in and what kind of value base is being built"* (I3)

As noticed, there is widely differing pressures present in the PE industry and their combine effect has driven the industry towards the transformation of better DEI management. Relevant pressures are coming from general market pressure, investors, legislation and through personal values. However real change is perceived to be achieved with internal change (I2). To reach this the business motivation for DEI was recognized important and this is discussed the next section.

Business orientation

One ultimate motivation that was recognized for DEI in all the interviews, was the internal business motivation that was highlighted for the PE context specifically (I1; I2; I3; I4; I5). This internal motivation that companies had was recognized important and was spotted to eventually drive the change in the industry, because merely external pressure from the investors was recognized insufficient to achieve any real changes when the internal support was not there (I1; I2). Therefore, it was highlighted that GP needs to trust that DEI is truly beneficial for companies (I1). Few of the interviewees brought up the business orientation of the industry with following examples:

> *"Industry is ultimately only and only after the profits and performance."* (I1)

> *"Private equity investor is an investor, this is business, so the ultimate motive for doing these things is that our investment yields better, we would make better decisions with lower risk, and that is the ultimate reason for doing these things."* (I2)

In addition to pure financial motivation, more concrete business needs were recognized. In high innovation environment the need for more diverse and inclusive organization was recognized crucial to be able to cope with given challenges (I3). Since research field has shown some positive implications for DEI it attracts more businesses to comply with these principles and drive the business case for DEI. However, the slight uncertainty of these results slows down this process (I5). This struggle in the PE field was described followingly:

> *"I think that is what PE houses are struggling with, they know they need to work with the topic [DEI] because it is expected and they think it is important but they don't really know what kind of exact value and for PE houses, money is the value in the bitter end, so you have to be able to transform this into some kind of monetary terms and comparable terms"* (I5)

As described PE companies are struggling in the interface of DEI and financial performance as concrete proof for the performance is lacking. The need for this proofing was recognized as otherwise the matter was not deemed that significant. Also, for GP to demand this work in portfolio companies, the proof of benefits was expected. Especially as scarcity of resources is present also in the PE industry. (I1) As a result the matters that GP brings to the portfolio agenda needs to truly be the best combination to develop the company.

Despite the strong financial motivation present in the industry, the vague nature of DEI brings challenges for the implementation and management process (I1; I3; I4). So, while these proofs for the benefits are called, it is perceived to be rather difficult to demonstrate these things in a concrete manner. To match this current imbalance between these matters more research and understanding is called for the business benefits.

Importance of people

It has become evident that the PE industry is very human centric, and business is based on development work done together with GP and portfolio management (I2) which increases the relevance of DEI for the industry. Especially the role of portfolio management was emphasized and as the whole organization is built upon their initiative, they have huge role in developing the business but also DEI (I1; I2; I3; I4; I5). What kind of diverse qualities are then needed in this context is little unclear. Private equity companies were recognized to especially lack gender and educational diversity (I4; I5). However, the varying nature of portfolio companies raises a need for GP to consider these varying environments (I1). This makes it more difficult to generalize type diversity present or needed in these varying environments. Despite this, common ideas of what kind of diversity is valued could be gathered from the interviews.

It was evident that diversity of thinking was something that most of the interviewees brought up as the main purpose of diversity (I1; I2; I3). This was backed up with diverse experiences and backgrounds that do have impact on way of thinking (I4). All the different attributes that are present in the diversity conversation are somehow related to this, but what is actually the best indicator of different thinking is difficult to evaluate (I1). Different attributes that were brought up in the interviews were gender, education, cultural background, socio-economic background, skills, and overall experiences and views (I1; I2; I3; I4; I5). These are probably the more obvious forms of diversity, but many other attributes are relevant for this conversation as well.

Conversation of diversity often leads to conversation about genders since it is probably the easiest way to differentiate individuals from another (I1; I2; I4). However, it is realized that gender is not the only and furthermore might not be the best indicator of diversity (I2; I4; I5). It is stressed that gender doesn't create your thinking, but rather your experiences through education and other experiences. Therefore, everyone should be treated as individuals with no presumptions. Despite, gender can be generally showing some behavioral patterns and might offer some indication of diversity. (I2) Literature tackles gender diversity also a lot which is further discussed in separate chapter of the framework.

The level of diversity in the companies is dependent on the company's own will and especially management as they have the right to organize their business in a best way possible within the limitations of legislation (I2). This diversity should serve the business needs and maybe in some cases diversity is not seen beneficial (I1). There were few examples of challenges that diversity might bring in business environment that might undermine the performance. These are presented in the following phrases:

> *"There are endless examples of this, yes, a diverse workforce certainly brings a lot of good, but if at the same time you have to change the organizational language to English and two thirds of the workforce goes silent. So, these are difficult."* (I1)
>
> *"DEI or diversity can lead to conflict and if conflict is not resolved in a constructive manner, it can also be of course negative for the performance."* (I4)

There might be also some unconscious bias hindering the creation of diverse organizations and therefore the performance. Affinity bias is one of them making people favor individuals with similar characteristics compared to themselves. This is recognized to be comfortable solution as we maybe understand and get along better with these people.

(I2) But to truly see the contribution of different perspectives we need to get over these biases (I3). Many times, the best advice and opinions are coming from the people that are different than us, if we just accept this feedback (I2). It is good to recognize that these biases are not always working against minority groups but could be against anyone.

In addition to different diversity factors the relevance of the skills for the positions were highlighted (I1; I5). In the end of the day building organizations is based on competence and in that case basic meters like gender are not viewed particularly useful metrics to assess these skills (I5). Every company should consider the relevant diversity for them individually (I3). The goal of increasing diversity and building the most efficient groups might contradict in some point which demands then careful assessment of the chosen approach. Sometimes looking even beyond diversity was emphasized by creation of teams with shared goals and inclusivity (I3; I5). Discussion of diversity many times leads to inclusion like in following statement by one of the interviewees when asked about important diversity factors:

> *"If thinking generally I would rather talk about inclusivity than diversity."* (I3)

This highlights the importance of including everyone rather than focusing on how they are different. Many times, diversity in organizations is emphasized, but as can be seen it might not be the most relevant matter. So, even when diversity could offer some benefits it is important to further consider inclusion and competence of individuals as well. Role of inclusion is assessed within separate theme of the framework as it was one major topic in the literature.

6.2 Diversity, equity and inclusion management and performance

This second chapter discusses the framework themes that were present in previous DEI literature, but not yet acknowledged in PE context. These themes consist of strategical approach to DEI, role of managers, mainly positive financial performance, importance of inclusion and focus on gender in management teams. Visual representation of these themes is reviewed in figure 10 below.

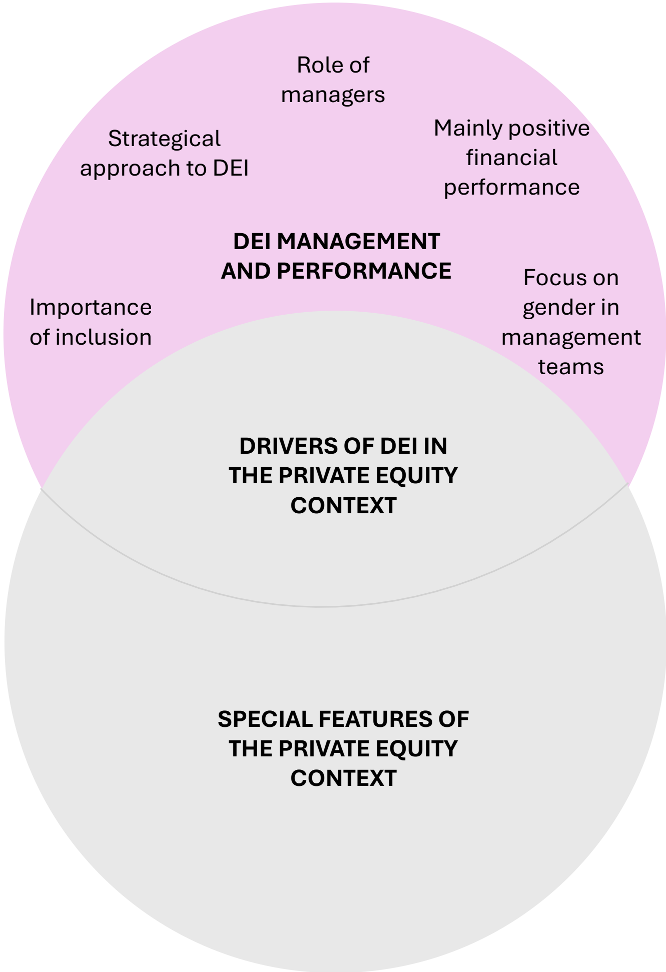

Figure 10. *DEI management and performance*

Strategical approach to DEI

The strategical approach was recognized to be important part of DEI management also in the interviews (I2; I3; I4; I5). However, too imprecise statements in the strategy are seen more harmful than beneficial (I1). This requires well defined strategy that is part of existing business strategy (I2; I4) and complements the contents of this existing strategy (I5). This is important since processes of a company are thereinafter following this strategy (I2; I5). After all, the cultural change was deemed essential and was pursued with this strategical work (I2; I3; I5).

It was recognized that DEI strategy should be well rationalized (I1; I3; I5). This would mean assessing which DEI matters are important and why are these important to each organization and business. Only after assessing these issues, it is possible and realistic to add these things to strategy. (I1; I3) This points out that each organization should have individual approach to DEI and one universal model might not fit everyone. There were few recognitions of certain operations and environments where diversity was recognized particularly important or challenging, demonstrating the individual needs that organizations and processes might have. It was found quite important for innovation and creativity, but maybe not so for when making decisions as described followingly in the interviews:

> *"It is hard for me to imagine that in an organization where there is a need to innovate, that it could work without a kind of diverse organization and without an inclusive organization."* (I3)
>
> *"There are tasks and actions where this kind of diversity and creativity and finding solutions and so on will definitely work better with diversity, whereas if you have contract negotiations and you need to find like consensus it might happen faster if you speak the same language and are in the same 'bubble'."* (I1)

After rationalizing organization specific needs, practical work like measurements become much easier (I3). Having certain clear goals and milestones were noticed critical when developing DEI matters (I2). Again, the measurements should still present the matters that are prioritized in the organization and only measuring for the sake of measuring will not lead to wanted results (I1; I3). Other practices that were significantly noticed to be derived from DEI strategy were recruitment processes, interview questions, promotion processes, mentoring programs and basically everything related to these (I2). One practice to drive the change effectively could be also incentives for managers to guide the work into desired direction (I5). All this work should always follow the strategical guidelines.

Despite justifying the need for clear and rationalized DEI strategy, the practical implementation was identified with several challenges. It was pointed out that these issues are much easier to talk than to really implement (I1). The lack of consensus on the effects of diversity attributes most likely complicates this work further on. Many of the interviews brought up the importance of having diverse thinking in the organization (I1; I2; I3), but when starting to assess where this is best captured it gets more complicated (I1). Also, the fact that this diversity of thinking should be still aimed to complement the business needs in the best way possible, creates additional challenge (I1). Good demonstration of these challenges for strategy creation was described as follows:

> *"Where does this thinking come from, exactly this, does engineer think differently than business student? Does young think different than old? Does woman think different than man? Does skin color affect your thinking? And after you have created some picture that okey they think differently than they, then you still need to*

figure out that which combination of different thoughts brings the best outcome for my business." (I1)

Even when focusing on the management of DEI in portfolio companies, the strategical work needs to be addressed also in PE companies. This was evident in the interviews as the state of DEI in the PE company was seen to affect further on the implementation process in portfolios (I2; I5). Also, the fact that PE companies have possibility to affect DEI matters proactively by their investment decisions brings something special to the DEI management in this context (I2). By strategically choosing to invest in companies with minority founders or founders with interest in DEI matters it is probably easier to drive DEI management in these organizations and reap the benefits. Current number of investments in for example companies with women founders was found insufficient (I2). All in all, strategy has a key role for initiating the DEI work as long as it is defined and rationalized carefully, and these challenges can be overcome.

Role of managers

When talking about the overall management of diversity, it is recognized to be much more challenging to manage diverse teams compared to more homogenous teams, making it a crucial part of the work (I2; I3). With increased globalization and diversity, it becomes inevitable for companies to manage this phenomenon. Also, the national context might offer differences with varying levels of diversity that needs to be accounted in the management actions (I1). Therefore, similarly to literature, the role of managers was deemed extremely important for the implementation but also possibly for the performance. The management of DEI was recognized to possibly be the difference between positive and negative performance as described followingly:

"So, it [DEI] can affect positively, but it can also affect negatively, and that management is what very often in a way determines whether the outcome is positive or negative from a performance point of view" (I3)

When focusing on the actors affecting DEI implementation in portfolios, the first initiative to DEI management might come from the owners, in this case from the general partner, who has the possibility to influence the direction of portfolio companies (I1; I4). This role of owners is recognized to be material because they have power to say which matters are important as DEI could be one of them (I2). Will it be one of the prioritized matters under the holding period is then dependent on the will of the PE company. If DEI is not one of the priorities it is unlikely to be improved during the holding period. (I4) In that sense owners have high responsibility to push these issues forward in portfolios. Further on owners are recognized to create certain value base in this liaison (I3). With the high business orientation in the industry this matter should serve the business purpose as well for the owners to drive it forward.

The main responsibility to implement these issues was however recognized to be with the top management of portfolio company, as stated, it is unlikely that nothing will happen without management's initiative (I1; I2; I4). Also, the power to foster the culture and embrace the individuals was thought to be heavily on the managers (I2; I3). Based on this if management is not committed, these issues are difficult to drive forward in the organization which is why considering management commitment is important. In that sense they have high responsibility to manage and encourage diversity so that benefits could be harnessed (I3). Also choosing the right people for management positions would seem material based on this. The responsibilities of managers were described for an example as follows:

> *"It comes down to having a manager who sees those benefits, is able to get them all included, is able to create an atmosphere where everyone is valued equally, everyone has psychological safety and feels safe to bring their opinions forward and then we discuss, debate and decide together the result."* (I2)

The responsibility to foster DEI management is seen to flow within the organization and everyone is recognized to have possibility and responsibility to influence. The initial force needs to come from top level, but they need to sell it forward to other level managers and further on to all employees. Other level managers have more practical level responsibility to build and manage teams with diverse people. HR is recognized to be one these manager roles that also have high influence on creating structures and processes to support DEI management. (I3) Usually when the strategical stance has been set, the practical work in HR is likely to happen (I5). Individuals in the organization do also carry the responsibility to embrace diverse environments and foster inclusion of different perspectives (I3). Therefore, organization wide responsibility to foster the change can be noticed.

External consultants or advisers can be also one resource to support the implementation process (I4). They can challenge existing perspectives and offer recommendations from outside perspective (I5). In addition, external or internal consultants could act as a linkage between GP and management team to promote DEI and advice in the implementation process if this is seen necessary (I4). However, people not tied to high hierarchical level in the organizations were recognized to have limited power to drive the change by themselves. Again, they can offer help, but after all the top management needs to truly want to drive these things and allocate the resources there. (I1)

Mainly positive financial performance

As recognized the performance created through DEI in the PE context was considered as an important motivation. The actual effects of DEI to firm performance are anyhow proved to be complicated. Many studies have found positive links between these matters, but showing what specific aspect generates this performance is rather challenging. However, the interviews showed positive attitude towards the performance, and it was believed to be beneficial in one way or another (I1; I2; I3; I4; I5). At the same time, general uncertainty in the field is creating challenges to focus on DEI (I5). Performance in this context is indicating to financial and firm performance through different moderators.

In line with literature review, the interviewees were mainly positive in their believes towards DEI performance. There was knowledge on the state of research, and these were referred when talking about performance to support the case for diversity (I1; I2; I3). Moreover, general trust that these issues are relevant and have some kind of an effect was present (I1; I2; I3; I4; I5). These views were personal views based on experiences, research, and values. One interviewee expressed this trust followingly:

> *"So, even without those studies, I intuitively believe that these things, they have a positive meaning in terms of the outcome, whatever it is. Or if not, then they are a value in themselves."* (I1)

Above citation also reveals this uncertainty within these performance outcomes. Even though many possibilities for value creation was found, these were recognized not to be certain (I1; I3). Poor management of DEI could transform the benefits into negative (I3) or some benefits might not be transferable between all companies (I1). This certain information was lacking, and this was admitted by stating that there just wasn't an answer for these performance effects yet (I3; I4; I5). This uncertainty seems to slow down the overall process to implement DEI. Value aspect of DEI is also present in the above citation regardless of the effects being negative or positive (I1). This was present to some extent as the social responsibility of companies is recognized (I2; I3; I4), but the performance motivation seems to still overrun this. The uncertainty of performance was described followingly, demonstrating the willingness, but challenge to act:

> *"Something is with this kind of performance, it must be. What it is and exactly what that kind of nest is it all about, I haven't figured that out and I wish someone would do it, because I would act then."* (I5)

Importance of inclusion

The management component of DEI was recognized crucial for performance already in the chapter discussing role of managers as stated that the management might be the differing factor between positive and negative performance through DEI (I3). One crucial factor of the management is the inclusion that commits diverse employees to the organization (I2).

The role of inclusion for the performance is recognized important. With these diverse groups it is necessary to include different views in the processes, otherwise the diversity benefits cannot be exploited (I2; I3; I4). Generally, when people feel better the results are estimated to be better which is why inclusion is also believed to create positive performance (I1). Moreover, with high diversity this is even more important as people might not automatically feel included or comfortable (I1). Inclusion is recognized to be more of a culture where these different skills are accounted for (I3). With inclusive culture, the organization is also probably more likely to become more diverse as it creates space for people to be diverse and further employ people from diverse backgrounds. The idea and importance of inclusion is well summarized in the following sentence:

> *"The world needs inclusivity. We need people who can create environments, cultures and management systems where different views can be brought up and space created for diverse people to not only have a seat at the table, but also to have a voice at the table."* (I3)

Inclusion is after all difficult matter to define and lead, as it is it little bit vague. That is why defining the role of inclusion for each organization is needed. In some cases, it might not be possible either to include everybody in decision making or some other processes as it might complicate them too much. That is why inclusion is such a difficult matter in business context. (I1) With the possible performance benefits there is also recognized downside of being counterproductive as without inclusion the performance of diverse groups might be even negative (I3). This role for performance is described followingly:

> *"Well, I believe that you won't be able to extract the values of diversity if part of the organizations does not feel included. So, in that sense, it is instrumental to actually extract the values from a diverse working environment"* (I4)

The role of managers for the creation of inclusive climate is important similarly than any other DEI matter. Managers need to create the spaces for all the relevant people to attend and be heard (I3), but to some extent each individual is also recognized to have the responsibility to include themselves (I5). Due to the current hierarchical systems this might not be self-evident as some groups might need to go the extra mile to be heard, but it is important to actively affect and demand the change. Inclusion seems to act with same principles in different environments, but the assessment of the necessity of inclusion should be accounted for different processes.

High focus on gender in management roles

Similar to literature, the theme of gender diversity was present in the interviews as well. During the previous chapters many instances gender has been used as an example when discussing DEI matters. The role of gender diversity is discussed further on and various reasons for this is proposed based on the interviews. Despite the high focus on gender most of the interviews recognized the wide variety of different diversity present in the industry.

In the PE context this theme seems to be quite material as the field is recognized to be heavily divided by gender. Overall, the industry is recognized to be quite homogeneous (I1; I2) mostly consisting of males (I4; I5). Maybe greater issues were however recognized on how the genders are positioned in the industry as only around 13% of the partners are women. This was questioned because females were recognized to be increasingly interested of the finance field, and in financial institutions the gender diversity could be overall divided quite evenly, but just the roles differed vastly. (I2) On the other hand the willingness of females to pursue these manager roles could be one matter affecting this (I1). Whether this is based on social structures, some kind of bias or gender differences could be further investigated.

Similarly, the equity aspect considering genders was discussed as the organizational pay structures seem to support male dominant positions in many instances. To tackle this, transparent assessments of the compensation models should be done. In that sense the unadjusted gender pay gap as a measure was found useful to also uncover these positional differences and conduct the analysis based on that. This is also one of the measures present in emergent legislative requirements. (I2) The actual stage of equity was recognized hard to confirm, but with the positional segmentation this is seen quite evident to have imbalance as well (I5).

The power of having women on the teams was however recognized important many times as they bring usually differing perspectives and skillsets. It is challenged that these differences would be derived from the gender itself but rather the experiences, backgrounds and education. However, women are believed to gain increased results with lower risk and better rationalizing, but the best results are noticed for mixed teams with higher diversity including females and males (I2). To enhance the position of women in the organizations the role if inclusion is again spotted crucial (I2).

Despite the possibilities recognized for gender diverse teams, the role of gender was questioned as the best determinant of performance (I1; I2; I5). Gender is recognized to be easy to talk and measure which is why it is often included in the discussion (I1). Also, emphasis is given as deficiencies are spotted in the industry (I2; I5). To some extent women and men are recognized to generally have some differing characteristics, but the role of gender as a meter for diversity was questioned with a following example:

> *"I think it is so ridiculous generalization as it gets that all women are like this, and men are like this. This is not true. We should see those individuals instead of assuming that women are a certain way"* (I2)

Interviews didn't show similar focus on management teams than the research. Whereas the role of whole organization for the management and performance was emphasized (I3). Again, research is probably easier to conduct in these management teams as information is better available. This can sometimes be misleading because it does present only a small fraction of organizations state of DEI, and it could be easily manipulated to enhance the company image. However, if the board works as a good example by driving DEI management it is more likely that whole organization is affected by it (I5).

6.3 Special features of the private equity context

The private equity context offers some distinctions from conventional markets that are deemed important for DEI management. These features are not so much present in previous literature. Themes cover portfolio company characteristics, cooperation, value creation and measurements. Iteration of these themes is presented in figure 11 below.

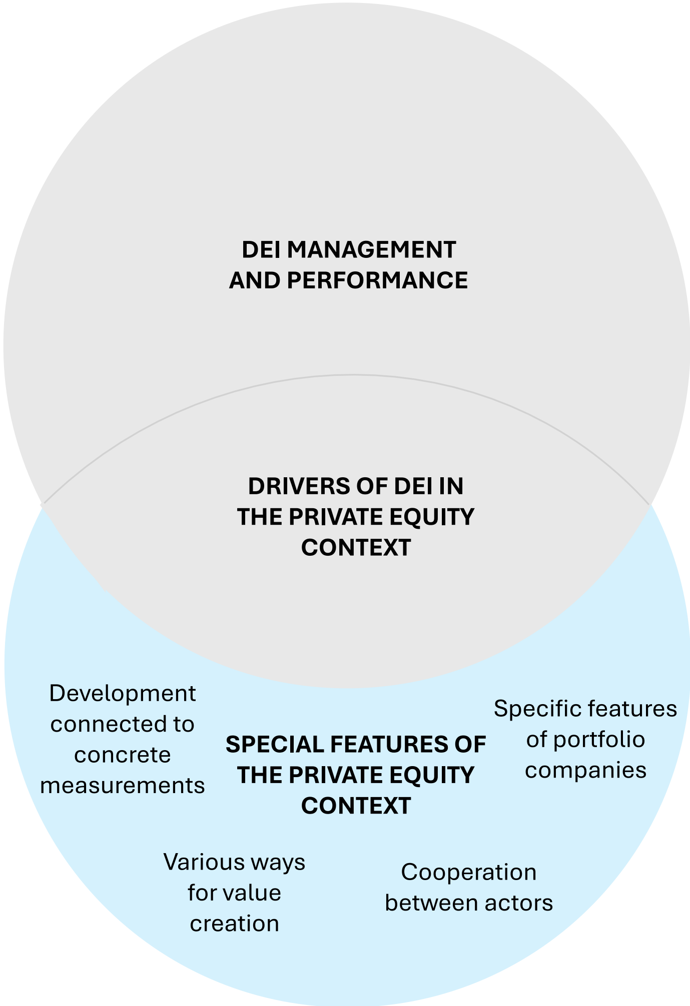

Figure 11. *Special features of the private equity context*

Specific features of portfolio companies

Overall, when considering the private equity environment some distinctions to conventional markets are made that should be considered in DEI management. The literature covering DEI performance was consistently focusing on large, listed companies which presents completely opposite from portfolio companies.

Biggest notion made in the interviews was the high influence, power, and pace of change that PE companies can drive in the marketplace (I1; I2; I4). These are especially true in leveraged buyouts where general partner has the majority ownership of the portfolio company and manages multiple companies in the same fund. This makes the management of DEI even more important matter for society by offering major opportunities, but also high responsibility to shape these portfolios with right incentives. General partners role for picking the right incentives was spotted crucial (I1; I4). Whether DEI is one of the focus areas will be then highly dependent on how its benefits for the portfolios could be proved (I1). The high influence of PE companies was demonstrated well with one of the interviewees as follows:

> *"What we do in investment team has extremely wide impact on companies and through that to society as whole. You don't have that anywhere else and that is why this is particularly compelling place to influence, because the small 3-person investment group – their triple effect to society might be much bigger than the size of the team."* (I2)

Some varying demands for the performance could be also spotted as the time horizon for private equity investment is limited. At the same time pace of change with DEI matters is recognized slow as results can be seen only after years (I5). This might be an issue if the benefits aren't accumulated to financial benefits during the investment's holding period. As said PE companies need to carefully select which parts of the operations to develop to best serve the returns in selected time horizon (I1; I4). Anyhow if the financial benefits aren't grasped directly, the indirect effect on company's value should be present through better governance and social sustainability. So, this should not be a barrier to implement DEI, but might hinder the process.

Most of the previous research is conducted in large, listed companies which undermines these results for portfolio companies that are exactly the opposite. Size of the company probably affects the implementation and management of DEI to an extent as resources and structures might differ but on the other hand the environment is recognized to be also quite similar to conventional markets. The portfolio companies that are managed, do their own business at the end of a day with only slightly differing management structures (I1). In fact, the PE industry faces similar challenges than any other industry with DEI management (I2). Therefore, many of the framework areas recognized from the literature were identified similarly in the interviews.

Cooperation between actors

The cooperation between GP and portfolio management team is particularly close which brings its own challenges and opportunities for the DEI management. Various ways for supporting cooperation between GP and portfolio company in DEI implementation was identified and they were noticed to follow the general development process of portfolios (I2). One thing brought up several times was leading with example, meaning that to really sell the idea of DEI's functionality to portfolios, PE company needs to follow these practices as well (I2; I5). This means further on trusting this idea themselves (I1). Otherwise, it will be hard to convince the other party to act as one of the interviewees stated followingly:

> *“My view is that you have to walk the talk, so if the private equities is walking that talk, it is also easier to say to the board they invest in, like come on guys, we actually need to have a this kind of look, but if they are not walking the talk, it is very hard to convince someone to do a change when you're not interested in doing it yourself.”* (I5)

In addition to this, clear and consistent communication about these matters was recognized important. There needs to be clear understanding that DEI matters are prioritized and how these things are followed from the GP point of view (I4). Common ways for cooperation are various reports that portfolio companies need to provide for GP in regular manner and DEI could be included in these as a one part (I3). Combining financial and DEI reporting could also allow better view on the progress made in relation to financial performance. Reporting and measuring gives higher emphasis on these matters (I1; I5). On the other hand, this type of one-sided reporting might be insufficient to truly support the operations in portfolios (I3). This would suggest maybe better two-way communication, because at the end of a day these two actors are working towards same goals.

Various ways for value creation

Different ways for value creation are actively being sought in PE companies. Usually, the value creation is based on financial performance, but the performance is created through various ways. These various ways to create value through DEI are viewed here. Benefits through DEI were observed partly unconsciously as this matter is admitted challenging. Especially the innovation, problem-solving and creativity were recognized to increase with DEI, even though it might not be necessary for all companies or functions but generally it should be value creation opportunity (I1; I3). Again, it is highlighted that people need to be encouraged to bring these ideas forward highlighting the importance of inclusion (I4). Furthermore, the benefits of diversity are recognized material for company development as different views are more likely to assess the company in more comprehensive way (I2; I5). This is especially important in PE context where portfolio companies are likely to be different from another. (I5)

One class of benefits through DEI could be recognized with image that the company wishes to share. This image could be targeted towards customers, but also to promote the image to potential employees. (I3) This might be even a direct claim coming from customers to pay attention to DEI and then whether you exploit or dismiss this business opportunity will define the benefits gained and could separate business from competition (I1). Considering PE context as DEI is a quite recent focus area in the industry, it could be certainly a possibility to stand out from the competition.

It is noticed that the ways for value creation can be different for each company which is why the strategy creation should already address these possibilities to create value. One universal model for value creation is not probably possible (I1). All the components of diversity, equity and inclusion could be seen to affect performance in some way, and it is difficult to separate these matters totally. Starting point for DEI could be very differing between countries and this could affect the importance of these matters also (I1; I4). These environmental factors were present also in literature explaining some differences for performance.

Development connected to concreate measurements

PE context is highly concentrated on concrete measurable benefits, which will appear also in the case of DEI. This is found with some challenges as DEI is not well measurable in all cases. This theme introduces some ways to tackle these challenges and find ways to measure DEI reasonably.

Measurements were recognized overall important and described crucial for development of DEI matters (I1; I2; I3; I4). However, interviewees were recognized with slightly differing views on measuring. Overall, the current meters used in general are found insufficient (I5) as they tend to be demographic meters that are used without further consideration (I1; I3). Measuring should support the overall picture of DEI, so the meters should be based on the focus areas of each organization as stated followingly:

> *"Then when you understand why it [DEI] is important, then it is easier to find sufficient meters for them as well."* (I3)

One theme emerging from the interviews was the high development focus in the PE context as PE investors tend to always want to measure everything (I1). As a result, DEI matters were recognized to need some justification to implement (I1; I4; I5). Important motivation in PE context was the business motivation, so if these business benefits cannot be proved it is not thought credible (I1). Most of the DEI research has been also focusing on measuring different performances so this development focus is present also more widely within DEI field. Ultimately, as stated within motivations in business world the business benefits are the primary motivation so in that sense also DEI should be proved to have some financial benefits (I1; I2; I5). The importance of proving the business performance was expressed followingly:

> *"And if it is reasoned that we do this because it has positive effect on performance, so then it means that you should be able to show that this is the case."* (I1)

Interviewees identified some challenges in DEI measurements that are complicating the use of ideal meters and measuring strategies. Many of DEI matters are recognized rather challenging or even impossible to measure which has led to the use of simple demographic meters. DEI is recognized to be quite vague matter causing these challenges in measuring. In some instances, accepting the fact that measuring might not be viable is emphasized even when the pressure for measuring in PE context is noted. (I1) At the same time as the trajectory of DEI in the PE markets is recognized to be still in its early days, these simple meters might be the way to start the progress. These meters might consider for an example gender, age, special needs (I3), salaries, religion, or backgrounds (I5).

To respond these challenges some good principles for measuring were brought up in the interviews from various points of views. Firstly, as mentioned measures should support the strategical ambitions that DEI is aiming for (I3). Simply when starting the measuring it might be beneficial to see only whether these matters are acted on, making the measuring easy, but also showing the positive development without pressure about the concrete results that might lag behind the actions (I1). For an example taking action to promote inclusiveness in the organization is not probably showing right away in employee surveys. When progressing DEI further on beyond demographic measures, meters of cognitive diversity and level of inclusion are considered important despite the challenges that interviewees were aware (I3). For an example measuring inclusion with surveys was noticed to contain some problems with reliability as it is a subjective meter (I4). Equity was another matter that should be also assessed through the processes of companies. To do these assessments some extra work needs to be put in to objectively assess the salaries, tasks, and promotions within the organization. (I2)

As these matters are not expected to change overnight, long-term commitment for measuring is needed (I5). Further on, from the PE company point of view it might be beneficial to follow the overall development within whole portfolio and between portfolios to recognize possible patterns over time. In general, the meters should be concrete and easy to understand (I4). Measures should be also transparent and openly discussed within organization to discover any issues that might be present. Lastly to enable demanded development, target setting needs to guide the direction of change. (I2)

There can be recognized some kind of contradiction between matters that were considered important like inclusion and diversity of thinking and matters that are currently measured. At present measuring these vague matters is noticed rather challenging (I1). Also, measuring only for the sake of measuring is identified as one problem in businesses in general (I3). To overcome these issues, better understanding of how these matters are defined and further measured needs to be done (I1; I3). Challenges for desired measures was described followingly:

> *"But when we talk about this kind of cognitive diversity it is quite difficult to actually measure it. It can be things like how many different educational backgrounds or how many different nationalities or how many different countries we have experience from, but that cognitive diversity in general is quite difficult to measure."* (I3)

Even though definite link between various DEI matters and performance maybe cannot be created, the follow-up between these meters is still recommended as it at least excludes clear negative impacts (I4). Nevertheless, financial performance is highlighted in PE context so portfolio companies could follow the DEI progress alongside with other performance indicators that are relevant for the specific company. For an example, if innovation is deemed important, DEI measures could be linked with new innovations proposed (I4) or similarly if DEI is thought to improve brand image (I3), DEI measures could be reviewed within brand image. By doing these procedures companies can ensure positive development that is beneficial for their business.

Private equities as active owners have possibility to put pressure on portfolio companies by requesting measuring if they believe it brings value to the business (I4). But as have been emphasized the measuring should be based on company specific needs and therefore cooperation with management team in measuring and target setting should be done to serve the needs of both parties.

7. SUMMARY

DEI matters are found significant matter for businesses in general including also the private equity industry as the pressure from legislative but also commercial perspective is increasing. It seems inevitable for PE companies to respond these growing demands in order to raise funds also in the future, and for portfolio companies to grow their operations and ensure stock market listing possibilities in the future. Also, the direct and indirect financial benefits that literature proposes are evident. This chapter brings together the empirical findings covering DEI management and performance in PE context and complements these findings with findings from literature review considering overall DEI research. Summary of these findings is presented in table 2.

Drivers of diversity, equity and inclusion in the private equity context

Overall, when looking at the entry of DEI matters into the private equity context, a rapid change can be observed during the past few years. However academic research hasn't addressed this issue yet. External pressures driving the change in the industry consist of legislation, investors and market changes. On the other hand, guiding internal motivation seems to be the high business orientation that is present in the PE industry. Therefore, PE companies are seeking to benefit DEI financially, but also personal and company values drive the change to some extent. These internal motivations are recognized crucial for the change. Subject of DEI is not totally unknown in the PE context as people are recognized significant for business development and therefore diversity of thinking and inclusion of these different views are valued essentially. Despite this, industry is described rather homogeneous with shortcomings in gender and educational diversity.

In global research DEI issues have been addressed already for decades. Especially in United States a lot of emphasis has been targeted towards workforce which is recognized more ethnically diverse than in many countries (Carter et al. 2010). Recently the research has been covering increasingly also European context and focus has been shifting from mere diversity also towards inclusion and equity. Research around DEI is highly motivated to prove the business case for DEI as financial benefits are researched widely. However, these studies are offering quite differing views for the performance which is causing issues for the PE industry in specific that is highly dependent on this performance. Research identifies also legislation as a significant force driving the change, but differences between countries exist.

Diversity, equity and inclusion management and performance

Previous DEI literature covers some important areas considering management and performance. These same areas are discovered also in the PE context with slightly differing functioning. Strategical approach for DEI management is recognized important and it should support the value creation through DEI (Shen et al. 2009). However, in practice many challenges for stating concrete and rationalized DEI strategy are complicating the process. This strategical work should be carried out both in private equity and portfolio companies. Further on the important role of managers is spotted from the literature, but empirical findings reinforce this view that no company-wide changes can be implemented without management's commitment and resource allocation. In the PE context the general partner, have distinct opportunity to demand DEI from portfolios, although again support from the portfolio management is inevitable. Findings of this study highlight moreover the whole organization's role for the change. Overall, the management of diverse workforce is found much more challenging compared to non-diverse groups, and this is proposed to be one possible factor influencing the direction of DEI performance.

Research focusing on the performance of various DEI factors is predominantly positive and many factors were found significant, but some inconsistent results appear still with differing reasoning. Generally, more diverse groups are found to outperform more homogeneous groups and managing this diversity is deemed significant for the performance. DEI factors included in the research are gender, age, race, nationality, knowledge, but also inclusion and equity. Interviewees express positive believes for the general performance outcomes partly based on previous studies, but also personal experiences and believes. Despite this, the complex nature of performance and chances for negative performance are addressed when DEI is managed poorly. This slight uncertainty in the PE context causes precautionary to act.

More recent papers notice the role of inclusion and other support functions for the performance more often addressing the complex relationship of DEI performance (e.g. Del Mar Fuentes-Fuentes et al. 2023; Richard et al. 2013). Inclusion is even more highlighted in the empirical findings as stated to be vital part of the value creation process. Measuring and managing inclusion raise several concerns undermining the practical use as inclusion is hard to define and measure in organizations. Moreover, the type of diversity, firm characteristics, and industry conditions are noticed significant for the diversity performance (Lee & Thong 2023; Nielsen & Nielsen 2013). These business specific needs are significant for the PE context as portfolio companies represent various growth stages and industries. Literature indicates tendency to focus on gender diversity mostly in large corporate boards and management teams over other settings (e.g. Campbell & Mínquez-

Vera 2008). Focusing only on top management teams or boards might give incorrect image of the state of DEI in the whole organization. In the PE context especially high focus in gender diversity is brought up when discussing management structures and compensation equality. However gender is recognized insufficient to cover whole essence of DEI, but its simplicity often guides the conversation and practical work.

Special features of the private equity context

The context of the private equity industry is recognized distinct to a degree and DEI work is noticed to possibly be affected by these industry characteristics (Naghavi et al. 2020). Firstly, the companies under management are small- and mid-size companies that are not listed in the stock market. This differs from the mainstream research that focuses on large and listed companies and therefore the stated performance results are not directly applicable to the PE industry. However, most of the studies use at least one accounting based meter to support the reliability of the results, making them relevant for un-listed companies as well (e.g. Ararat et al. 2015; Joecks et al. 2013). The limited timeframe of the investments in the PE industry makes the management of DEI even more challenging as the change is slow and management team really needs to commit to the process over a longer period of time. Another difference noticed for the PE industry are the possibilities to affect. Private equity companies have major effect on multiple portfolio companies, making them responsible for much larger entities than they might be themselves. Therefore, the possibilities to affect society furthermore is much greater than in conventional companies. At the same time business in the PE industry is fundamentally viewed similar to conventional markets with high focus on core business and performance.

The cooperation theme is present in previous literature mainly between HR and CEO which is found significant for the implementation of DEI (Ng & Sears 2020). In the PE context active ownership of the PE company demands more comprehensive cooperation between actors. Firstly, to support cooperation between general partner and portfolio management, general partner needs to lead by example to build trusting relationship and sell the idea of DEI forward. Other ways to support this relationship in terms of DEI are regular communication through reporting and measuring. Specifically in the PE industry DEI is recognized as a possible competitive advantage since it is still a new trend in the industry that could be utilized. Similar possibilities for value creation within creativity and innovation are brought up in the results as well, and even more possibilities are brought up in the literature. Measuring is another theme highly present in the PE industry, and DEI is not an exception. To best support the DEI development measures are recommended to be concrete, rather simple, support the strategical ambitions and be followed in conjunction with financial performance. However, meters beyond diversity are desired as the focus is shifting to more comprehensive view covering inclusion and equity as well (Ortlieb & Sieben 2014).

Table 2. *Summary of the results*

	INTERVIEWS: DEI IN THE PE CONTEXT	**LITERATURE: DEI**
DEI in PE		
Increasing interest towards DEI	- The PE industry has faced recent interest in DEI, and it is believed to further grow - Research in the PE context is lacking - DEI is only one part of portfolio management	- Literature has addressed DEI already for decades - The research has been more active in US but also increasingly in Europe
Stakeholder pressure and internal motivations	- Pressure for DEI is coming from legislation, but also business needs including pressure from investors, market changes and values - External pressures recognized weak to truly create sustainable change	- Legislation one significant force, but depends substantially on each country's approach - External motivations recognized weaker than internal
Business orientation	- Business orientation in the industry seems even higher than in other industries and this applies to DEI as well - PE companies demand proof of concrete financial benefits	- In literature DEI research is usually considering the business benefits as it is substantial motivation for companies
Importance of people for business	- People with diverse attributes recognized important for the industry - Diversity of thinking is brought up as the primary reason for diversity - Inclusion highlighted over diversity in some instances	- DEI ideology creates benefits through higher diversity, inclusion and equity - Research has focused mainly on basic demographic diversity attributes so far - Shift from diversity to inclusion in increasing extents
DEI management and performance		
Strategical approach to DEI	- Strategical approach recognized important as long as it addresses company's individual needs in a concrete manner - Multiple practical issues recognized in creating efficient strategy - Strategy should be implemented for both PE and portfolio company	- Strategy described as a driving force for policy creation and practical work - Strategy should value diversity and its benefits - Support for the strategy is needed high up from the hierarchy
Role of managers	- Overall management skills noticed vital for diverse groups - In PE context the general partner might initiate DEI work, but portfolio management team support is necessary - Managers role was vital for encouraging and managing DEI in organizations	- Recognized important for the resource allocation and creation of inclusive environment - HR other important driver in organizations, but many times unaware of diversity management's objectives
Mainly positive financial performance	- Trust for positive performance through DEI was present one way or another - Possibility for negative performance through poor DEI management was also noted - Slight uncertainty of the performance is slowing down the implementation - Relationship recognized highly complex	- Most research gives positive implications for higher diversity, but no clear source of performance is found - Factors included in research: gender, age, race, nationality, knowledge - Role of management and inclusion is increasingly accounted crucial for performance - Environment was noticed to affect performance
Importance of inclusion	- Role of inclusion is highlighted for more diverse groups - Without inclusion performance from diversity is not believed to be achieved - Difficult to manage and measure in practice	- Rising topic in the DEI research - Topics consider inclusive culture, inclusive leadership, inclusive innovation - Found significant for performance in several papers
High focus on gender in management roles	- In the PE industry gender is active subject of discussion for diversity and equity - Gender is brought up many times in interviews because of its simplicity and topicality - However, gender's role for diversity is questioned	- Gender is by far the most researched diversity attribute probably due to its simplicity - Performance is studied mostly within board rooms or top management teams - This narrow focus might limit the true state and effects of DEI

Special features of PE		
Specific features of portfolio companies	- PE companies have greater power to influence society through portfolios - The time horizon for investment is limited creating challenges for value creation - Overall, industry doesn't differ that much, and portfolio companies run their own businesses after all	- Need for research in the PE context is recognized for differing capital and ownership structure - Previous research mainly discusses large and listed companies - Some of the reviewed papers only use market-based measures that are applicable only for listed firms
Cooperation between actors	- In the PE context the cooperation between general partner and portfolio management team is found differing due to the majority ownership - Walking the talk was considered vital for PE company when selling the idea to portfolios - Communication through reporting and measuring was found helpful	- Cooperation between management team and HR is found significant for the implementation - Research found uncertainty about DEI objectives among HR managers pointing out poor communication
Ways for performance	- Performance through innovation, creativity, corporate image, and more comprehensive assessment is recognized - Competitive advantage for early movers - Value creation possibilities might differ between companies and environments	- Role of management of DEI is noted - Increased innovation, better image, employee and customer attraction through DEI - Diversity noticed more powerful especially in high uncertainty environments, environments applying stronger DEI legislation and where higher empowerment of diversity is present
Development connected to concrete measurements	- Measuring is the base for development in the PE context, but measuring DEI has many challenges in practice - Meters should be concrete, rather simple, support the DEI strategy and be followed in conjunction with business performance - Measures should go also beyond diversity	- Research has sought ways for measuring DEI, but prevailing measures consider mainly demographic diversity factors - Some recommendations for meters are presented but these tend to be rather complicated

8. CONCLUSIONS

This paper addressed diversity, equity, and inclusion in the novel context of private equity industry that has shown growing interest towards the topic recently. This chapter introduces the conclusions that were made for managing the performance of DEI based on the previous literature and new empirical findings covering especially the Finnish private equity industry. Moreover, limitations and future research are discussed to find new interesting areas of research based on the findings of this study.

8.1 Theoretical contribution

This paper contributes to diversity, equity, and inclusion literature by addressing this entity in the private equity context that has been dismissed by DEI research to date (Naghavi et al. 2020). In addition, research is lacking understanding of the financial performance that DEI management could enable, and this study seeked to clarify this relationship further on. Results are gathered in conjunction with previous research and new empirical findings from a case study of a Finnish private equity company. Objectives of the study covered creating guidelines for managing and measuring DEI in portfolio companies and recognizing key DEI factors affecting financial performance and therefore company value. Existing literature discusses these areas to an extent, but distinct features of the private equity context provide new insights into this research field. The emphasis was put on the portfolio companies, but as noticed in this paper they cannot be totally separated from the managing PE company.

Diversity, equity, and inclusion have been studied already for decades especially in United States where diversity within nation is recognized substantial (Carter et al. 2010). More recent studies have been also executed in Europe since this matter has gained more attention due to globalization and growing diversity (Sippola & Smale 2007). Especially the growing demands from private equity stakeholders have directed PE companies to focus more on this matter. Overall, the previous studies discuss DEI mostly in boards and management teams limiting the full scope of the organization. Therefore, this paper strived to uncover insights on practical management and performance effects within portfolio companies, opening the discussion for this emergent and intriguing research area. The characteristics of portfolio companies are quite opposite of the companies studied in previous DEI research, so this paper offers new insight especially for small unlisted companies managed by external investors with limited investment period.

For managing DEI in portfolio companies, the empirical results provided support for the previous literature demonstrating many similarities the industry holds to conventional markets. The role of inclusion was recognized substantial for the management and performance of diverse groups as some papers have already suggested. For an example Mor-Barak's (2016) paper states inclusion to be key to diversity management, but empirical evidence behind this is still lacking to an extent due to poor understanding of the concept. Strategy was recognized also crucial for the DEI implementation (Shen et al. 2009), but through the empirical findings it was emphasized that the creation should be more rigorous to truly provide support for the organization by addressing the needs in a concrete manner. Supporting previous studies (e.g. Ng & Sears 2020; Randel et al. 2018), the empirical results demonstrated the view that managers need to be involved in DEI management and in PE context this considers both the general partner and portfolio management. Further on as most of the previous studies are focusing on gender, was this also common topic in the interviews as DEI is still poorly understood and gender is recognized easy to discuss compared to many other aspects of DEI. However, the role of gender as an indicator for diversity was questioned to an extent even though many studies did recognize it significant for financial performance, but not all.

Main new theoretical contributions of this research for the DEI management in the specific PE context were the various circumstances that the PE context brings to the management. Firstly, this environment was found to be significant for wider societal change since power of PE company extends to many companies. Therefore, the pace of change is greater, but at the same time responsibility to guide these companies is great which is why evidence for the benefits of DEI was requested. Secondly, the results uncovered this high business motivation that was hindering the DEI progress as uncertainty for performance persisted. Also, legislative and investor pressure was spotted to increasingly guide companies to consider these matters in their operations, but internal motivations were considered more important for the change than these external motivations so far. Thirdly, when managing DEI in portfolio companies the cooperation between GP and portfolio management was further on deemed significant as previous research has addressed mainly cooperation only within one organization. Some concrete ways to enhance this special relationship were recognized.

Support for the performance benefits created through DEI was suggested in the literature reviewed. This semi-systematic review revealed the current knowledge on DEI performance as multiple DEI factors were found to be significant for the performance, but not any factor was recognized as the ultimate source. Results indicated mostly positive performance through DEI, but some inconsistencies were found as generally acknowledged in previous DEI literature (Bernstein et al. 2020). Some ways to explain these inconsistencies were effects overruling one another as for some companies the performance might be positive and for some negative (Carter et al. 2010). Moreover, the business environment is underlined as some circumstances like uncertainty and innovativeness might offer better performance through DEI (e.g. Cannella et al. 2008). Additionally, the role of inclusion is deemed important as for example more frequent communication between board members was recognized with increased board performance (Havrylyshyn et al. 2023). Despite the unclear results, inconsequential number of reviewed papers suggested purely negative results and most papers indicated rather complex relationship with varying outcomes that were manageable. Review also suggested some trends in the research area as especially research considering inclusion was spotted to be increasingly present as well as research conducted outside United States.

Main new theoretical contributions for DEI performance in the PE context were, firstly, the positive believes that were present within actors in the PE field. Even with high uncertainty for the performance this issue was deemed important, and benefits were believed to be achieved one way or another. Moreover, social compliance was deemed as an important value. This view of valuing the benefits that could be gained with diversity was stated to be beneficial (Olsen & Martins 2012). Secondly the results gave high emphasis for the performance to be attained through various paths. Specifically in the PE context the performance benefits could be created through better image, greater innovation and first mover advantage as the industry is only starting to address these matters. However, for portfolio companies the benefits are more difficult to define due to great variance in businesses. Thirdly the PE context offered its own challenges for the performance as the business is highly dependent on portfolio performance. This business orientation within DEI is challenged with the limited investment period of portfolios and the measurability of the DEI that caused many practical issues for tracking the performance.

Overall, this paper provided support for the existing DEI literature covering important areas of strategy, management and inclusion, showing the overall essence of DEI to be similar between different industries. New practical insights for these areas were also discovered from the empirical findings as many challenges and opportunities were identified. On top of that the literature review offered clearer picture of the current state of DEI performance that was found to be substantial motivation for businesses as it mostly provided positive performance when it was implemented comprehensively and with good reasoning. At the same time the PE context offered new theoretical contributions considering management and performance of DEI and these should be considered when implementing DEI in the PE context.

8.2 Practical contribution

In addition to the theoretical findings, the practical contributions of this work are seen equally important as companies are missing practical guidelines to work on. Despite DEI has been an active subject of research, practical understanding was recognized lacking (Tang et al. 2015). This could be also noticed from the findings of this study that expressed many practical challenges with defining, managing and measuring DEI. Also, the uncertainty about business benefits was still hindering the process. So, despite growing attention, companies seek for better understanding to truly benefit the phenomenon of DEI. To further support especially PE companies to work with DEI issues in their operations, this paper addressed these practical needs observed. These new insights are targeted especially for PE companies trying to manage DEI in their portfolio companies. Practical contributions are delivered by answering the research questions of the study.

1. *How could DEI initiatives be supported through different actions and structures in portfolio companies*?

Firstly, it was noticed that in the PE context it was especially important to offer the support for portfolio companies. This means that PE company needs to lead by example and commit portfolio management for the cultural change that DEI requires. It was found much more credible to drive these things forward if these were already accounted by PE company itself. Role of management team was spotted crucial as they ultimately allocate the resources and have the power to create certain type of culture around DEI. To commit management, it was important to demonstrate the business benefits since in the PE context the business orientation was noticed a significant motivation. Bonus systems could be also tied to DEI targets to further commit management. In portfolio companies the management structure covers both the owners and top management that are both crucial for the work. However, each member of organization is responsible for the change, and they should be committed to the work as well through trainings and other practices. Trainings in the PE industry could focus on creating awareness, discussing legislative requirements and viewing performance studies as knowledge on these was lacking to an extent.

In essence of the DEI was the strategical approach that should be applied similarly than for any other matter company wishes to drive forward (Shen et al. 2009). To create effective DEI strategy the needs of each organization should be accounted separately and concretely as portfolio companies might operate in different industries and growth stages. However, portfolio companies tend to be small and mid-sized companies which supports the DEI implementation as the processes of the company might not be fully established yet. This could also overturn the challenges of a limited investment period as greater changes are achievable. Between owners and portfolio management active two-way communication should be applied to support the DEI work and this responsibility falls more on the PE company in this case. However, communication both ways will ensure that companies are on the same page and have possibility to affect the process. This should also create more trusting relationship as the parties work towards the same goals. One way to execute this communication was through regular reporting about the progress with qualitative or quantitative measures that are discussed later within research question three.

2. *How can different DEI factors affect financial performance and company value?*

From the semi-systematic literature review conducted it can be reasoned that DEI matters do influence financial performance and therefore also company valuations. Better governance systems around DEI could be another way to increase valuations indirectly as DEI is raising significance, but this was dismissed from the scope of this study. The results indicated positive financial performance for most parts, but relationship was found to be complex. For the practical use these findings support the implementation of DEI for increased performance. However, this requires the practical implementation to follow the good practices of management and measurements of DEI that are presented within other research questions. Even without clear understanding of the benefits, the empirical findings showed positive beliefs towards DEI in the private equity industry. Results revealed also highly optimistic view towards inclusion as the source of the performance. However, this trust was not sufficient itself as more science-based evidence was called to implement DEI in highly business oriented setting. The positive performance indications found from the research support this practical work in the PE context specifically.

Because no clear picture of the most valuable DEI attributes for financial performance couldn’t be identified it highlights the importance of each company assessing their own needs. This means that since the performance could come from different sources of diversity, equity and inclusion, it is important to consider where performance should be pursued for maximal benefit. All reviewed factors of gender, age, nationality, race, knowledge, inclusion and equity were seen significant for the performance without clear preference of the most valuable one. It seems beneficial to have diversity to an extent, but also having common sense in doing this as competence and availability of employees should always be considered. In practice, need for diverse thinking was highlighted as it was deemed to be the purpose of diverse workforce and driver for performance, but challenges assessing this were limiting the use.

In addition to diversity this paper highlights the importance of inclusion and equity for financial performance. This view hasn't been addressed in performance research so widely, but recently more, and empirical results of this study highlighted this as well. Further on financial performance was many times found to be created through different indirect factors like company image, innovation, employee attraction, or competitive advantage. For an example, higher gender diversity could improve the performance through image for service-based company (Subbeliani & Tsogas 2005) or inclusion could improve innovativeness in highly innovative business (Del Mar Fuentes-Fuentes et al. 2023). This complex relationship between DEI and financial performance is evident and demands focus on all areas of diversity, equity and inclusion.

3. *How could measurements support management and value creation of DEI in portfolios?*

Measurements were found essential in the PE the context overall and measuring DEI was not an exception. With measurements PE companies could ensure that the management and performance of DEI are following the objectives of the company, but some challenges for the practical execution were identified. Previous research has focused mainly on measuring diversity, but as this study addressed the importance of the other components of equity and inclusion for the performance as well, should these be considered in the measurements too. Especially inclusion that was stated to be crucial part of diversity management is recognized challenging to measure, but including this in the process is still considered important. These measures might not be perfect, but results emphasized accepting this imperfect nature and treating measures as a tool rather than the truth.

Effective measurements should support the strategical ambitions that are defined beforehand. Further on, measures should be concrete and specified to certain groups or functions to provide true insights of the state of DEI within organization. Research has mainly focused on diversity within boards and top management teams, but wider organizational diversity should be considered too as performance studies supported this as well (e.g. Smulowitz et al. 2019). Transparency should be also accounted so that measures are trackable and comparable between times and functions. As financial performance was one of the main motivations behind DEI should this be included in the measurements as well. By following DEI and business performance, the strategy can be further justified or adjusted even though creating unambiguous meter to track the relationship seems unrealistic. Tied to measuring is target setting that should be again based on company specific needs as this study offers inconsistent results for most profitable level of diversity. Overall higher diversity was spotted beneficial in several studies (e.g.

Erhardt 2003; Ferrary & Déo 2023), but some studies specified “critical mass” of diversity for the performance to be achieved (e.g. Joecks et al. 2013), whereas some studies supported having any level of diversity to gain benefits (e.g. Del Mar Fuentes-Fuentes et al. 2023). This leaves high responsibility for each company to assess their targeted levels of diversity.

Based on the practical findings the case company was provided with step-by-step guidelines to implement DEI management and track DEI performance. Guidelines cover both private equity company itself and portfolio companies since the two are inseparable in a sense. All the recommendations are based on the findings of the study and include practical examples to make the process as straightforward as possible. These guidelines are kept confidential and not provided within this work to protect the possible competitive advantage provided for the case company.

8.3 Limitations of the study

This study provided novel insights for the private equity industry pursuing better diversity, equity and inclusion throughout the industry to ultimately gain financial benefits. However, chosen methodology placed few limitations for the interpretation of the results. Used methodology covered semi systematic literature review and case study of a small Finnish private equity company. Sample for the semi structured interviews was selected based on the differing backgrounds of the interviewees. Objectivity in this study was considered difficult to fully obtain as methodology is based on subjective interpretation of the phenomena (Saunders et al. 2019, p. 216). Therefore, the following measures are used to judge the quality of this qualitative research instead. Credibility assesses methodology’s purposefulness, transferability the possibility to copy the research to another settings, dependability the occasional nature of the research, and confirmability the objectivity of the researcher (Shenton 2004).

Chosen case method with semi-structured interviews supported the objectives of the study well and offered credibility for the research. However, limiting the performance results was semi-systematic literature review that covered all types of companies rather than private equity companies, because of the lack of research in the private equity field. Therefore, the performance should be interpreted carefully even though it was recognized within this research that the private equity industry is in many ways presenting conventional industries and business principles. With this in mind, the transferability of the results into the private equity setting is possible as the research setting was described carefully for external bodies as well. This was supported by the researcher’s own role as a beginner in the private equity industry that required profound descriptions of the environment.

To some extent limiting the dependability of the methodology is low number of interviews that were conducted. Limiting this was the availability of professionals in the case environment that could provide insights from DEI and private equity interface. Therefore, there might occur some incidental results that are not recognizable for the whole private equity field. With differing backgrounds of the interviewees this shortage was compensated to cover more wider stance of views. Moreover, the clear descriptions about data gathering and analysis, lower the risk of results being misinterpreted.

The chosen case covered specific Finnish private equity company and therefore the results are not generalizable to all companies. As the context for DEI management and performance was recognized significant in this paper, the specific country and industry could be substantial for the results. However, as the literature review was used for the base of the research there was many similarities recognized for the DEI management between global markets and Finnish private equity context. For performance there wasn't sufficient base to compare concrete performance so additional research is required. Moreover, the cross-sectional study provided only the current state of DEI in the Finnish private equity markets, and with growing interest, the attitudes and believes could quickly change. However, capturing this current state is significant as it offered first insights into the Finnish private equity context when it comes to DEI research.

To assess the confirmability of the results few issues can be pointed out. Selection of the interviewees was based on subjective view of the researcher. Therefore, some perspectives on the matter could have been dismissed unintentionally. In qualitative research there is always a risk for analyzing results subjectively rather than based on research materials (Shenton 2004). To minimize this risk the analysis was based on framework created through previous literature. Moreover, the researcher attitudes towards the topic were assessed within the process, but no clear risks were registered as the topic was studied rigorously along the research process and no previous experiences prevailed the view. One method to enhance the confirmability could have been triangulation of the analysis, but resources for this were not available.

8.4 Future research

This paper opens many new research directions by introducing the concept of DEI management and value creation in the private equity markets. Chosen qualitative method unveiled interesting insights from the markets considering knowledge gaps, challenges and views on the chosen topic. Moreover, the literature reviewed, and above spotted limitations offer possibilities to widen the research field further on.

This paper touched the topic of DEI performance through previous literature and interviews, but desire to test this in practice in the private equity markets would be one especially interesting research direction. This could also tackle the limitation of a cross-sectional study to cover the performance in a longer period of time to truly study the changes within performance. Within performance the role of inclusion was spotted significant as well and more understanding for this component of DEI is called. This would firstly demand better conceptualization of inclusion in business world where it is recognized important, but its usage is still limited by business goals. After that the effects on financial performance could be tracked more precisely.

Expanding the diversity performance research was called in the literature to cover smaller and un-listed companies such as portfolio companies (e.g. Mahadeo et al. 2012). Also considering DEI in all levels of organization was limited and this could add value to the present research. One objective of the study was to recognize key DEI factors, and many significant factors could be spotted in this paper, but finding truly the most influential factors was unreachable. This paper also proposed the idea of diversity of thinking to be beneficial for performance. Therefore, recognizing the critical diversity factors and sources of diversity of thinking would be interesting areas of future research. As generalizable results seem challenging to reach, could more case studies covering different industries and companies be carried out.

As discussed within limitations this case covered only one Finnish private equity company and expanding the scope to other companies and especially to other countries is proposed as diversity, equity and inclusion are spotted to be dependent on the context. Finland serves as a country with rather low diversity and seemingly high equality, but as discovered this is not always accurate and the private equity industry is facing its own challenges here as well. However, countries where the situation with DEI is considerably lacking behind would be interesting settings to more drastically see the progress. Also, case study conducted in multiple countries for comparison of different aspect of DEI would offer new insights further on.

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APPENDIX A: SEARCH STRATEGY

	MANAGEMENT	PERFORMANCE
Search terminology	divers* OR diverse OR equity OR inclusi* OR dei AND measur* OR culture OR leader* OR climate OR manag* OR support* OR govern* OR action* OR structur* OR polic* OR practic* OR program* OR training*	diversity OR diverse OR inclusi* OR equity OR dei AND "financial performance" OR "company value" OR "firm value" OR "firm performance" AND NOT "financial inclusion" AND NOT "private equity"
Limited journals	Academy of management journal Business strategy and the environment Corporate governance: an international review Equality, diversity and Inclusion Gender in management Group and organizational management Human relations Human resource management Human resource management journal Human resource management review International Business Review International journal of human resource management Journal of business ethics Journal Of Business Finance And Accounting Journal of business research Journal of corporate finance Journal of financial economics Journal of international business studies Journal of management Journal of management studies Journal of organizational behavior Journal of world business Organizational behavior and human decision processes Sustainable development Strategic management journal	
FInal number of selected papers	**33**	**40**
Selected from the search	30	39
Added outside of the search	3	1

APPENDIX B: INTERVIEW STRUCTURE IN ENGLISH

Introduction:

- Can this interview be used for research purposes?
- Can the interview be recorded?
- Can you state your organization and specify your role in it?
- How are DEI issues present in your role and organization?

DEI management *("How could DEI initiatives be supported better in portfolio companies?" and)*

- How do you see the role of DEI in today's private equity market? What about in the future?
- What special features might private equity context bring to DEI management? Any challenges or opportunities?
- Who do you consider having an impact on fulfillment of DEI in portfolio companies?
- How do you see the role of managers in DEI management? What could be the role of general partner? How could cooperation be supported between managers and GP? Role of outside consultant?
- How should DEI be considered in strategical level?

DEI performance *("How can different DEI factors affect financial performance and value of the company?")*

- What kind of effects do you consider DEI having on firm performance overall? Positive or negative?
- What different ways value could be created with DEI?

- Do you recognize any concrete financial business benefits from DEI? Are there some areas that could be further improved in organizations to achieve these?
- What motivates your organization to work with DEI issues if any?
- What kind of diversity is valued in today's organizations? Why?
- What do you think is the role of inclusion for DEI performance?
- Do you think DEI performance might be affected by a specific context? (country, industry, competition etc.) What would favorable context look alike?

DEI measurements *("How can DEI progress be measured relative to portfolio performance?)*

- What is the role of measuring for DEI management? Any challenges or opportunities recognized?
- What kind of metrics do you think would be most useful in assessing DEI? (i.e. what should be measured and how?)
- Could DEI measurements furthermore be used to ensure firm wide performance somehow? How?

Closing

- Anything you want to add or any other views you would like to brough up?

APPENDIX C: INTERVIEW STRUCTURE IN FINNISH

Johdanto

- Voiko tämän haastattelun sisältöä käyttää tutkimus tarkoitukseen?
- Saako haastattelun nauhoittaa?
- Voitko tarkentaa organisaatiosi ja oman roolisi siellä?
- Kuinka DEI asiat ovat läsnä sinun roolissasi tai organisaatiosi toiminnassa?

DEI hallinta *("How could DEI initiatives be supported better in portfolio companies?")*

- Millaisena näet DEI:n roolin tämän päivän pääomasijoitus markkinoilla? Entä tulevaisuudessa?
- Mitä erikoispiirteitä pääomasijoitus konteksti saattaa tuoda DEI:n hallintaan portfolio yrityksissä? Joitain haasteita tai mahdollisuuksia?
- Keiden kaikkien uskot vaikuttavan DEI:n toteutumiseen portfolio yrityksissä?
- Millaisena näet johtajien roolin DEI:n hallinnassa? Mikä voisi olla general partnerin rooli? Miten yhteistyötä johdon ja GP:n välillä voitaisiin tukea?
- Miten DEI:n hallinta tulisi huomioida yrityksen strategisella tasolla?

DEI Suorituskyky *("How can different DEI factors affect financial performance and value of the company?")*

- Millaisia vaikutuksia koet DEI:llä olevan yrityksen suorituskykyyn? Positiivisia tai negatiivisia?
- Mitä eri reittejä pitkin tämä suorituskyky saattaisi rakentua?

- Tunnistatko mitään konkreettisia rahallisia liiketoimintahyötyjä, joita DEI saattaisi luoda? Onko joitakin osa-alueita, joita yritykset voisivat kehittää luodakseen näitä hyötyjä?
- Mikä motivoi organisaatiotasi työskentelemään DEI asioiden parissa, jos mikään? Millainen rooli sosiaalisella vastuulla on?
- Millaista monimuotoisuutta tarvitaan tämän päivän organisaatioissa? Miksi?
- Mikä on mielestäsi osallistamisen (inclusion) rooli DEI:n suorituskyvyssä?
- Uskotko että konteksti voisi vaikuttaa DEI suorituskyvyn toteutumiseen? Miten? (maa, toimiala, kilpailutilanne jne.) Millainen on suotuisa konteksti?

DEI Mittaaminen *("How can DEI progress be measured relative to portfolio performance?)*

- Mikä on mittaamisen rooli DEI:n hallinnassa? Joitakin haasteita tai mahdollisuuksia tunnistettavissa pääomasijoitus kontekstissa?
- Minkälaiset mittarit olisivat mielestäsi kaikista hyödyllisimpiä DEI asioiden arvioinnissa? (ts. mitä tulisi mitata ja miten?)
- Voitaisiinko DEI asioiden mittaamisella lisäksi varmistaa yrityksen laajuinen suorituskyky jollain tapaa? Miten?

Lopetus

- Onko mitään lisättävää tai jotakin mitä haluaisit vielä tuoda esiin?