Achieving Diversity in Private Equity

Diversity is a major topic of conversation in the private equity community, and it's easy to see why: There simply are few women and people of color serving in lead investment roles across the industry. For example, **a 2019 study** by the data analysis firm Preqin found that only 17.9% of private equity employees worldwide are women, the lowest figure of any asset class. A variety of other studies, including separate ones by Deloitte and Stanford University, point to low racial and ethnic diversity in the private investment universe.

At the same time, a great deal of research in recent years has highlighted the positive impact diversity can have on investment outcomes. For example, **one 2019 study** by Rock Creek Group, the International Finance Corporation and Oliver Wyman found that gender-balanced teams have a 20 percent higher net internal rate of return. That's one major reason that nearly every private equity client engaging us today is seeking assistance in the pursuit of a more diverse talent pool.

Given these market realities, we thought it would be helpful to hear from a range of leading figures at several of the large limited partners (LPs) in private equity to gather their thoughts on the value of diversity from their points of view, the industry's hiring practices and how they impact diversity, and how these leaders believe general partners (GPs) could be operating differently to integrate a greater diversity of views into their investment process. Our interviews included:

- Dan Feder, managing director of investments, the University of Michigan
- Caroline Greer, managing director and chair of the Diversity & Inclusion Office, Commonfund
- Rich Hall, deputy chief investment officer, The University of Texas/Texas A&M Investment Management Company (UTIMCO)
- Eric Lang, senior managing director of external private markets, Teacher Retirement System of Texas
- Michael Langdon, senior investment officer, Oregon State Treasury
- Kim Lew, vice president and chief investment officer, Carnegie Corporation of New York
- Kristin Mugford, senior lecturer at Harvard Business School; previously Bain Capital's first female managing director

Reflecting on these conversations and our experiences, we offer some recommendations for organizations where diversity is a priority.

Investors are paying attention

Almost all of the LPs we interviewed said they pay attention to a GP's level of diversity (or lack thereof). While generating the best returns is obviously the primary goal, they said, diversity is a clear sign of a firm's culture and its ability to have differentiated perspectives on how to support and create value in the portfolio.

"A diversity of perspectives can help an investment team achieve superior returns," said UTIMCO's Rich Hall. "One investment professional might see a deal differently, or might understand a different segment of the population. That can help in the overall investment decision and deal process."

Kim Lew of Carnegie Corporation of New York said that when she talks with private equity firms, she always puts her concerns about diversity in business terms.

"I will say, 'It looks like you have all white males, and they all went to the same schools,'" Lew said. "'Are you concerned that you might be missing a point of view as demographics change? If this is not a concern for you, why not?' Nine times out of 10 it is a question of laziness. They haven't taken the time to think about it in those terms. I tell them that they will get better returns with more diverse points of view. They might miss some of the more interesting deals without diversity on their teams."

Many LPs have already taken matters into their own hands. For example, Commonfund, the OCIO (outsourced chief investment officer) firm serving institutional investors, established a diversity office in 2018 to advance the discussion around diversity and serve as a resource for clients, investors and internal teams choosing outside managers. Team composition and ownership questions are included in due diligence questionnaires and diverse managers are included in the research process of every search. "This is touchy for GPs, because in many cases they are weak on the diversity front," said Commonfund's Caroline Greer.

Michael Langdon from the Oregon State Treasury said diversity is a key consideration when his group chooses GPs. "When it comes to a new investment decision, we certainly consider the makeup of the GP's team — at that moment in time, but also the future vision in terms of how they want to address the issue. We expect teams to consider and spell out the concrete steps they are taking to show results."

The emerging talent population can support this evolution

Beneath the lack of racial and ethnic diversity is a similar lack of diversity in backgrounds — most have experience with the same Wall Street institutions followed by degrees from the same top-tier MBA programs. However, as one LP put it, "the talent pool is there to be recruited." Though diversity on private equity investment teams remains low, the population of business school graduates is becoming more diverse. Women accounted for 39% of MBA enrollment in the United States in 2019, according to the Forté Foundation, while ethnic minorities make up between 18% and 33% of the most recent classes at the top U.S. MBA programs.

Hiring in the broader business and investment communities is already reflecting increased diversity in business schools. It stands to reason that private equity firms can become more diverse by moving beyond their traditional hiring approaches — expanding beyond hiring from the same set of business schools and the same "2+2" background (two years in investment banking at a major Wall Street firm and two years in private equity).

"There is rigidity in the system that is making it hard to open the aperture to get more people into the industry," said Kristin Mugford, a lecturer at Harvard Business School who was Bain Capital's first female managing director. "So we are in this bad cycle and wondering why the number isn't changing."

How to increase diversity

Based on our experience working with firms to find and develop diverse talent, we've identified several approaches private equity firms can take to increase diversity.

Connect with the talent pool

There is an opportunity for the private equity community to connect with a more diverse talent pool, but it requires focus and effort — which only stem from a long-term commitment.

Candidates and LPs will figure out quickly whether a GP's diversity efforts are genuine. The University of Michigan's Dan Feder said that it's obvious when firms are "just checking a box" as opposed to consistently embracing diversity for the right reasons.

Support the pipeline

It's easy to interview only the most obvious people from the same schools and pathways. But by casting a wider net from the start of your recruiting effort and digging a bit deeper, firms can engage a more robust and diverse talent pool. These efforts can start early — at the graduate or undergraduate level — by collaborating with organizations devoted to embedding diversity in business, like **SEO** (Sponsors for Educational Opportunity) and **Toigo**.

"The bigger firms have more of an opportunity to do this because they simply have larger populations," one LP told us. "But many view this as a luxury, not an imperative."

Consider targeted senior-level hires

If you look around your boardroom or look at your website and notice that everyone looks the same and their bios read the same, you may be craving some more diversity. But there's a chicken-and-egg problem at play — it can be hard to attract young, diverse talent when you have no senior role models. Looking outside your company's walls to bring in new senior talent can help set the right tone and encourage others at lower levels to follow.

Exercise creativity and openness in hiring

Building more diverse teams will require some unconventional thinking on the hiring front. You have to expand your vision beyond the same few schools and prerequisites, and open your team's mind to different profiles and how they may complement your existing team and benefit the investment process. That means being open to hiring people who are more senior, more junior, or from different arenas such as consulting, public markets investment, or corporate development or operating roles.

Remember that retention is as important as recruitment

Building an inclusive culture, creating strong people development and embracing workplace flexibility are central ingredients to success. Make sure your diversity hires know they work for people invested in keeping them and helping them thrive. This includes giving them the right experience (deals, boards and special projects) and feedback along the way. It also means flexible policies that balance the workload across the team as individuals go through different stages of life (new children, aging parents, etc.). And it means forging a culture that embraces true authenticity and invites everyone to share his or her point of view. "The reality of it is, there is a science and art to effectuating change," Langdon said. "The science is the stats and the funnel, the piece everyone is talking about. The art is making people feel better about the environment. That's the piece no one seems to have cracked."

Carrying on the conversation

The diversity discussion carries on as institutional investors continue to seek out investment managers who will achieve the best results. This is a topic that private equity firms can't afford to ignore, as they think about enhancing returns and satisfying the interests of the LP community.

As Rich Hall noted at the conclusion of our discussion, "I hope this is an enduring topic, not just a trending topic."

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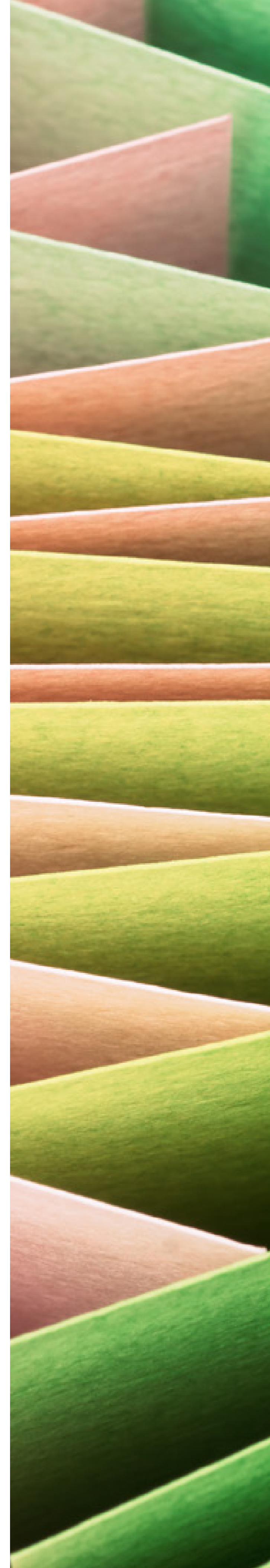

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