CYPRIUM
PARTNERS
Non-Control Capital for the Middle Market

Private Equity Grapples With Its Diversity Problem

Posted March 19, 2022

By Jeremy Nobile

CRAIN'S CLEVELAND BUSINESS

The private equity sector has generally ignored diversity, equity and inclusion since its first investment firms popped up between the 1940s and '50s — something that may seem pretty ironic for an industry with equity in its name.

Of course, equity in this field and equity in a broader societal sense don't refer to exactly the same things.

But there's no question the PE industry has a diversity problem.

Asset managers and their investors are beginning to appreciate the importance of diversity in this industry, either because it's the right thing to do or because of the mounting evidence of the positive results that tend to follow teams and companies that are ethnically and gender diverse.

"Limited Partners are increasingly focused on the diversity of the managers they back, and I would expect this trend to continue," said Liz Burke, an assistant vice president with global private equity firm The Riverside Co.

But there remains a lengthy road ahead before this industry might be considered equitable in terms of its own demographics and the ways its record piles of dry powder are deployed.

"At the end of the day, PE guys care about making money and generating returns. As long as they are doing that and continuing to raise bigger and bigger funds, they will do what they do without changing," said Marques Martin, an Ohio-based co-founder of Fvlcrum Funds, a rare private equity shop focused on investments in minority-owned companies.

That firm has raised $109 million so far for its inaugural fund, according to public filings.

"Really, the only way PE firms will change is when limited partners tell them to change," Martin said. "Until that happens en masse, I don't think you see all PE firms embrace this."

To be sure, while matters of DEI are coming up more often in the PE sector, it is not something PE firms and their investors are universally pushing for, at least not yet.

The Ernst & Young 2020 Global Private Equity Report determined that 74% of PE firms with fewer than $2.5 billion had not set targets for diversity and had no plans to do so, while 63% reported the same with respect to gender diversity.

But diversity is something firms say they are increasingly hearing about. The question is whether this is lip service or something that leads to action.

"We do get those questions about diversity more frequently, both in the context of recruiting and more generally," said Beth Haas, a partner with Cyprium Partners, a private equity firm that makes non-control investments.

"But our industry has a long way to go," she said. "A first step is trying to get collective teams to look a bit more like the general population, and I think that goes a really long way."

Private Equity Grapples With Its Diversity Problem

March 19, 2022

Pushing for diverse decision makers

Belonging to the thin ranks of women in PE, Haas said she's faced sexism by men who have been surprised by or dismissive of her presence or what she might have to contribute during meetings. She's grown accustomed to being the token female in board rooms and conventions and jokes that she's won a number of lady-drive golfing contests because she was the only woman on the links during a corporate event.

PE firms are seemingly more deliberate about hiring and advancing women in the business, and they're making more strides here than on the front of ethnic diversity.

Evolution Capital Partners is promoting chief revenue officer Susan Williamson, who joined the company in 2019, to managing partner. Evolution founder Jeffrey Kadlic said this is not to check a so-called box for diversity goals, but because she is the best person for the job.

Nonetheless, he said he recognizes the value of having diversity of thought in decision-making roles for the business. It's a philosophy that is being promoted at the firm's portfolio companies as well.

"I would say our industry has evolved from the '80s and '90s to today where you are doing everything you can to get the edge, and our industry is finally arriving at the point where diversity of communication and thought is really that next area where we can create outsized returns," Kadlic said.

A 2019 report by Preqin found that just 17.9% of worldwide private equity employees were female — the lowest representation of any asset class — while only 9.9% of senior roles and 5.2% of firm board seats were held by women.

In terms of ethnic diversity, data is a bit harder to come by.

But research by the Knight Foundation in 2019 found that less than 4% of U.S. private equity firms had minority ownership. The same study reported that firms owned by women and minorities controlled just 1.3% of assets in a $69 trillion U.S. asset management industry.

"I think LPs are starting to put pressure on PE general partners to add diversity, and the aggressive ones are saying, 'We are not going to invest unless you have diverse decision makers, not just diverse pictures on your website,'" said Anne Richie, managing director for The Mezzanine Fund in Cleveland, a new, builder capital debt fund targeting woman- and minority-owned businesses, which are vastly underrepresented within the capital deployed by investment firms.

An analysis of Crunchbase data found that Black female startup founders were receiving just 0.34% of venture capital spent in the U.S. at midyear 2021 — a trend that came to light despite the level of venture funding for startups led by Black women pacing at a five-year high.

While VC and PE are two different animals, this is one indicator of the dearth of capital that flows to a segment of diverse business owners.

Private Equity Grapples With Its Diversity Problem

March 19, 2022

Having more women and diverse individuals making the decisions at investment firms, Richie said, will translate to more capital flowing to corners of the business world where it has been historically absent.

A learning curve to tackle

In terms of building diverse teams, part of the challenge is that the demand for people outpaces supply, Haas said.

There's a bit of a chicken-and-egg dilemma here. One reason the pool of diverse candidates in private equity is so shallow may be because the industry has been so homogeneous for so long.

Haas said Cyprium has worked with a new startup known as the Finance Farm League that helps connect undergrads of color from regional schools and historically black colleges and universities and match them with job opportunities.

But a big challenge, said Cyprium founder John Sinnenberg, is that firms like his are competing against all of the several thousand other PE funds out there, including the Blackstone and Carlye groups of the world.

Firms are also generally evolving in how they think about who might fit in the PE ecosystem.

This means looking at candidates from less traditional career paths besides the common route many take to the PE business through the investment banking sector, said Maureen Leitch, director of global talent management for Riverside.

She said Riverside, the largest PE firm with roots in Cleveland, is making efforts to connect with diverse candidates earlier in their careers in finance school and looking beyond finance disciplines more regularly.

In many cases, there's a learning curve to tackle.

"We have often found that diverse candidates are not even familiar with what private equity is," Leitch said. "So part of this is education, building up the Riverside brand and nurturing those connections. PE has been this very private, elite sector, and we are trying to help break that cycle."

So why does diversity in the PE business matter?

Many firms seem to acknowledge this is just the right thing to do, especially as the country continues to reckon with its history of racial and gender inequality.

But there's also a clear business case to be made. Various studies show that diverse businesses don't just make better decisions, they make better investments.

And in the PE world, diverse teams are more likely to invest in diverse companies. That's the sort of trend that can help support the generation of wealth minorities in particular have been sidelined from — something that has inspired funds like Mezzanine and Fvlcrum that want to channel capital to woman- and minority-owned businesses.

Private Equity Grapples With Its Diversity Problem

March 19, 2022

Pointing to studies that show America is on track to be minority white by 2045, Marques Martin argues that ignoring diverse companies and the broadening racial wealth gap could be economically perilous.

“I think these factors have mobilized folks to say that we have got to figure out a way to start getting capital and opportunities in the hands of people who are ultimately going to be the majority of our country, because if we don’t,” he said, “the risks that poses to our country are too significant and dire to think about.”

Source: Crain’s Cleveland Business