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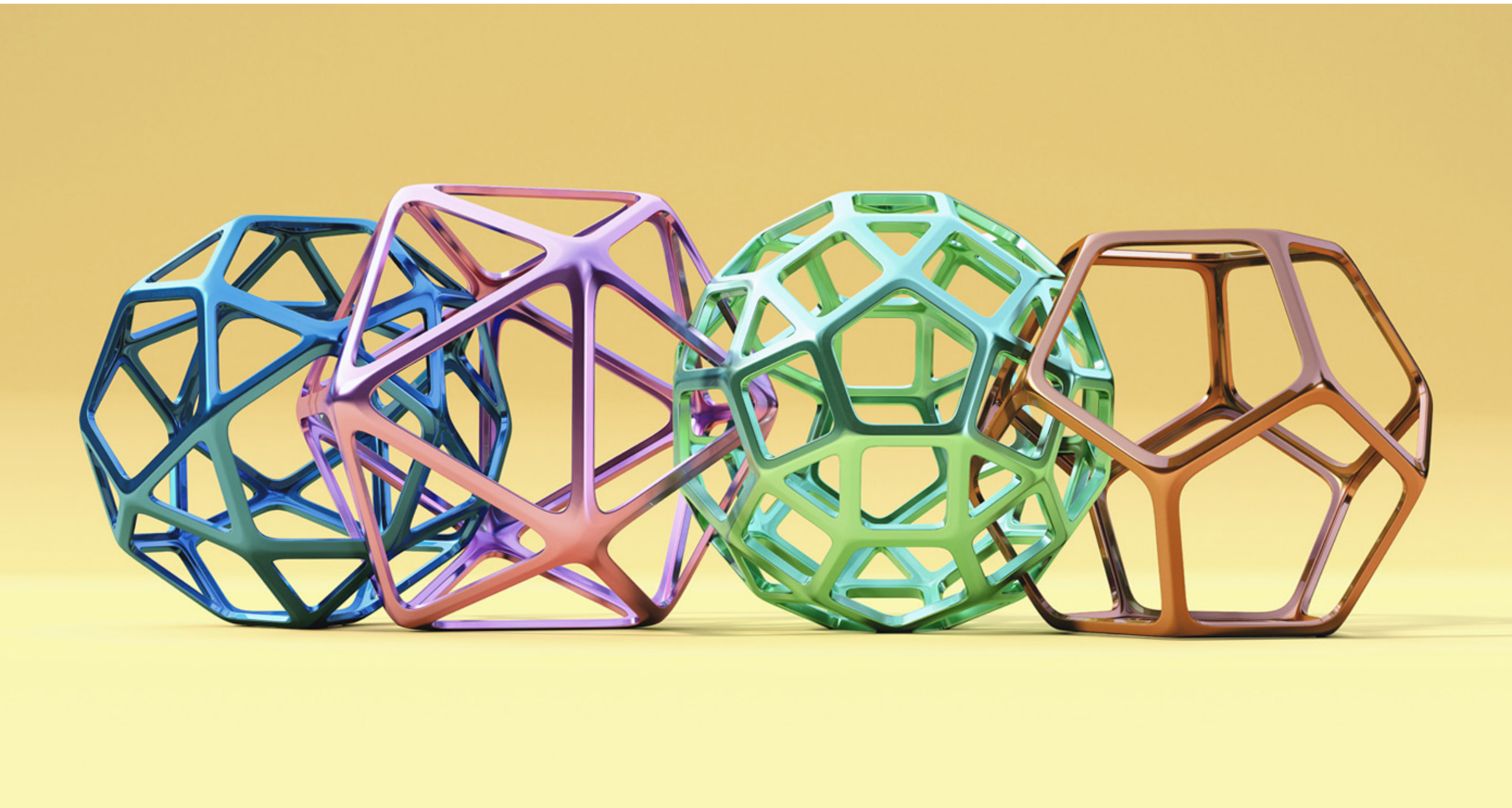
# How private equity can catalyze diversity, equity, and inclusion in the workplace

Private equity has an opportunity to transform the global business community and improve returns.

*by David Baboolall, Alexandra Nee, and Lareina Yee*



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**Business leaders hear a lot about disruption.** But 2020 redefined the term. By March, the novel coronavirus had completely changed ways of life and work for billions of people. In May, the death of George Floyd produced an equally seismic shift in cultural awareness of systemic racism and set in motion urgent calls for racial equity—globally. And today, second and third waves of COVID-19 cases are tearing through many countries, exacerbating socioeconomic, gender, and racial inequities.

This article discusses how—in the current moment of upheaval—private equity (PE) has the ability and imperative to improve diversity, equity, and inclusion (DE&I) in the workplace; and in so doing, provide additional levers for financial outperformance. Our long-running research on diversity across industries shows that companies with greater diversity in leadership ranks are more likely than those with less diverse leadership to perform better than industry average on margin growth.[1] Applying this analysis to PE suggests an additional lever for value creation within firms' portfolios. Improving DE&I will not only provide an additional opportunity for financial outperformance, but DE&I commitments may also help firms raise capital.

By focusing on DE&I, the PE industry can create more equitable and inclusive places to work, attract better talent, redefine corporate culture, and set a standard for businesses everywhere.

## The opportunity for PE

While the Fortune Global 500 comes first to mind when thinking about the corporate leaders of the economy, PE firms and their portfolio companies have an outsize ability to influence the status quo of the business community. Globally, about 10,000 PE firms have more than $3.9 trillion in assets under management (AUM).[2] In North America alone, about 4,700 firms own more than 18,800 companies.[3] With that kind of influence, if PE firms were to continue to reduce gender and racial inequalities across the companies they control, they could change the face of business.

McKinsey and LeanIn.org's new report, *Women in the Workplace 2020*, confirms that PE lags corporate America on gender and diversity in senior ranks. Our analysis presents overall trends and averages for the industry, and we fully recognize that some PE firms have made advancements on DE&I. On the whole, gender and racial diversity at PE firms are stronger in entry-level positions than at the top (exhibit). On average at the start of 2020, about 20 percent of senior leaders at PE firms (managing-director level) were women while the share of women on executive teams in the rest of corporate America was about 30 percent.[4] PE also trails on ethnic diversity. In 2020, investment deal teams are about 1 to 2 percent[5] Black in the United States, with other people of color comprising the remaining 11 to 12 percent of diversity at the managing-director level.[6] Public companies do better, with approximately 13 percent Black and Latinx executives.[7] But that's still far below the US demographic composition (about 30 percent Black and Latinx in 2019) and also lags behind the ethnic-minority population that holds a graduate degree (about 23 percent of the total workforce with relevant graduate degrees in 2019). PE portfolio companies' management teams and boards of directors represent a further area of opportunity.

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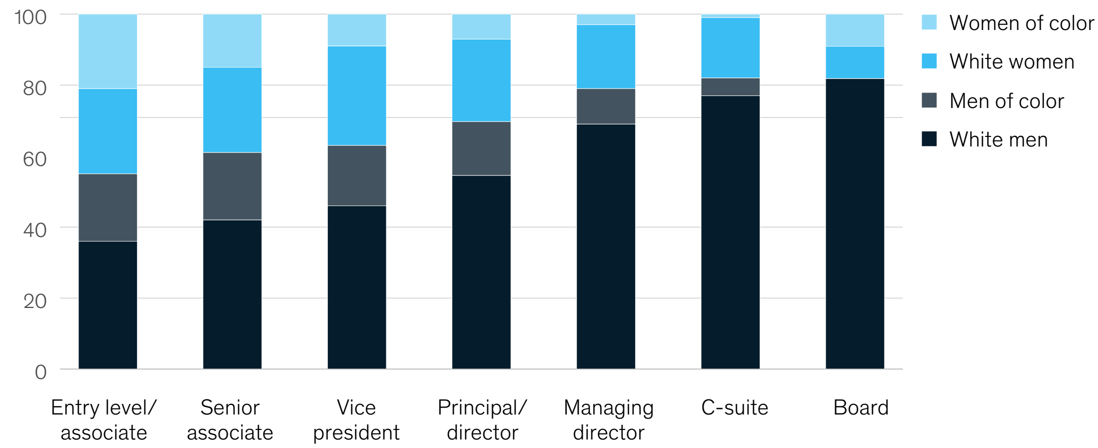
1 Sundiatu Dixon-Fyle, Kevin Dolan, Vivian Hunt, and Sara Prince, *Diversity wins: How inclusion matters*, May 2020, McKinsey.com.
2 PitchBook Data, October 2020, pitchbook.com.
3 Ibid.
4 *Women in the Workplace 2020*, McKinsey and LeanIn.Org, September 2020, womenintheworkplace.com.
5 Based on active members in the 2020 McKinsey Black Investor Professionals Forum Database. Weighted average of active members as a percentage of all investment professionals in the more than 150 North American firms represented in the database.
6 Figures from *Women in the Workplace 2020* dataset.
7 Ibid.

Exhibit

## Gender and racial diversity in North American private equity decrease with career advancement.

**Private equity[1] employees by level, 2019,** %




[1]Survey covered companies in Canada and the United States. Eleven PE firms participated in the survey.
Source: *Women in the Workplace 2020* dataset

## How PE can catalyze DE&I advancements

Over the past five years, McKinsey has studied the strengthening business case for gender and ethnic diversity: companies with greater diversity within their leadership team correlate to stronger financial results.[8] Companies in the top quartile for gender diversity were 25 percent more likely to outperform industry-median EBIT growth than bottom-quartile companies.[9] Similarly, executive teams in the top quartile of ethnic diversity were 36 percent more likely to financially outperform the industry median.

If this business case were to hold for PE-backed companies, beyond the increased likelihood of financial outperformance for the portfolio company itself, a PE fund focused on driving significant change across the portfolio would produce significant enterprise value for the fund. While it is still early days for PE on improving diversity, and the correlation remains to be validated for privately held companies, the scale of potential value creation is significant.

Firms are already moving ahead. Since May 2020, we have seen an uptick in the number of PE firms focused on DE&I. Much of that is because the energy gathering around gender and racial equity is raising expectations for employers. But institutional investors and other limited partners (LPs) are also beginning to bring DE&I criteria into their thinking as they allocate funds to general partners (GPs). Furthermore, as the data show, the push for increased DE&I could also make financial sense for PE firms.

While the standard tactics to improve DE&I—including early recruitment and interview prep for underrepresented minorities, unconscious bias training, and inclusivity surveys—are helpful to any company, some PE firms are beginning to assert that they can and should do more. A set of tailored and unique actions can help GPs and their portfolio companies improve DE&I in their organizations and

[8] *Diversity wins*, May 2020.
[9] Ibid.

lead across the business community. Here's a small sample of those actions.

*PE firms* can do the following:

— *Make a public commitment.* Firms can, for example, establish an internal council on DE&I for themselves and their portfolio, with a C-level chair to signal that this matters. The council can develop metrics, set goals, and monitor progress on targets for both the firm and the portfolio.

— *Conduct diversity assessments of targets.* Firms can include DE&I throughout the deal life cycle. Building DE&I criteria into due diligence of targets and investment-committee reviews can help not only to assess risk but also to understand the value-creation opportunity inherent from improving DE&I. Once targets are acquired, owners should include DE&I in the 100-day value-creation plan. And they should revisit DE&I as one of the value-creation levers highlighted for buyers upon exit.

— *Focus on diversity performance.* Leadership can review firm and portfolio-company diversity metrics at all partner meetings, and even link a portion of compensation to deal teams' or portfolio companies' performance on these DE&I metrics.

Within *portfolio companies*, advancing DE&I includes the following steps:

— *Set diversity targets for boards.* PE firms have seats on the boards of most of their investments. They can use those to position qualified, diverse candidates; they can also add seats to create a diverse board of directors with relevant skill sets for their companies.

— *Establish diverse management teams.* Firms can review the diversity of each portfolio company's workforce and management and identify areas where increased DE&I could lead to improved culture and performance.

— *Remove structural racism from all corporate policies portfolio-wide.* Firms can examine current benefits and corporate policies and restructure them as needed to improve retention and promote equity in advancement of underrepresented minorities.

These levers are not exhaustive; instead, they are a few of the tangible ways that PE firms can lead in the creation of a more diverse, equitable, and inclusive workplace.

It is increasingly clear that PE's push on DE&I in this moment can serve as a catalyst, with outsize impact across the business community, while also increasing the likelihood of outperformance for early adopters.

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In the coming months, we will continue to share steps the industry can take to improve racial and gender diversity within its firms, portfolio companies, and as an industry.

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