Woman and Minority-Owned Private Equity and Venture Capital Firms

A market update and review of woman and minority-owned private equity and venture capital firms actively raising capital in 2020 based on data collected by Fairview Capital

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Fairview Capital's 2020 Market Review of Woman and Minority-Owned Private Equity and Venture Capital Firms

The universe of woman and minority-owned private equity and venture capital firms maintained its persistent growth rate through one of the most turbulent years in recent memory. In 2020, the global pandemic brought unexpected and extraordinary challenges, and recent high-profile injustices in society accelerated the demands for inclusive investing in women and minority-owned firms. Now numbering over 500 firms, this group continued its rapid growth with a record number of firms raising capital and Fairview tracking over 230 woman and minority-owned firms in the market in 2020, a 26% increase from the prior year.

The criteria for classifying a private equity firm as woman and/or minority-owned often varies. In this market review, we only consider ***institutional quality private equity and venture capital firms that are majority owned (>50%) by women and/or ethnic minorities.**** *The firms must be based in, and primarily investing in, the United States.*

Unlike prior years, growth during the year was not nearly as linear. The pandemic's onset resulted in a dramatic slowdown of new diverse firms entering the market beginning in March. Woman and minority-owned firms were disproportionality affected by the pandemic since the vast majority of firms are new. New firms have generally been the most difficult for limited partners to conduct due diligence on, particularly as processes shifted to virtual formats. Additionally, backing new managers was one of the first activities put on pause by limited partners, given the high level of market uncertainty. Despite facing these challenges in the first half of the year, woman and minority-owned firms swiftly returned to market in the second half of the year. Many firms saw their portfolios and strategies experience tailwinds from the pandemic, and the events of the year invigorated diverse managers and catalyzed new firm formation.

Recent high-profile incidents of racial injustice and inequity cast additional light on the relative lack of institutional capital invested with diverse managers and entrepreneurs, who have now been proven by numerous studies to outperform.[1] In turn, limited partners have launched various promising initiatives, ranging from efforts to be more inclusive of diverse managers in their processes to explicitly investing with diverse firms. Despite these well-intentioned efforts, the proportion of capital institutional investors commit to diverse firms remains stubbornly low. Woman and minority-owned firms private equity and venture capital firms accounted for just 4% of capital raised in 2020 while representing approximately 8% of the firms in market according to Fairview's analysis.

Institutional investors continue to battle misconceptions, biases and lack of information when investing with woman and minority-owned firms. We believe a deliberate,

* Defined by the U.S. Census Bureau as American Indian or Alaska Native, Asian American, Black or African American, Hispanic or Latino, and Native Hawaiian or Other Pacific Islander.

[1] Examples include:

- NAIC: Examining the Returns | 2019 - The Financial Returns of Diverse Private Equity Firms
- McKinsey & Company: Delivering through Diversity
- Harvard Business Review: The Other Diversity Dividend

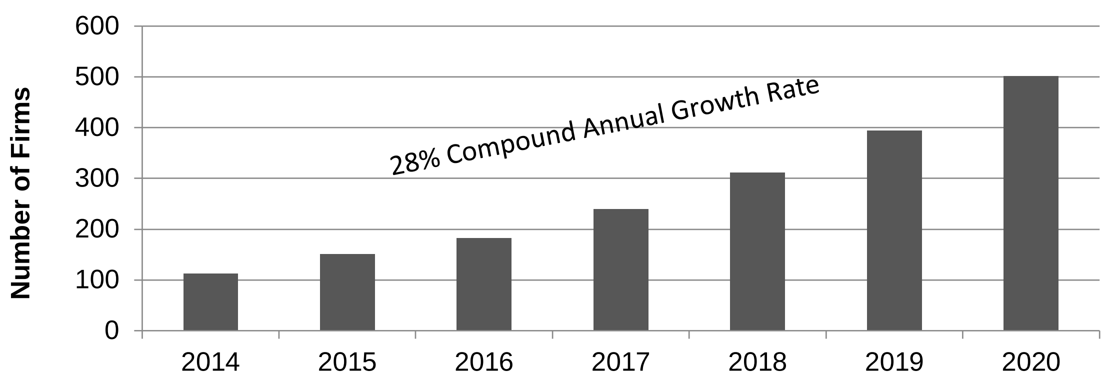
programmatic, commercial approach remains the best way to invest successfully with diverse managers. The growth in the category has increased complexity, as market dynamics have resulted in new firm formation in areas of the private markets often overlooked by institutional investors. Woman and minority-owned firms remain well-positioned to succeed, in part due to this differentiation. Fairview's seeks to see every institutional quality woman and minority-owned firm in the market every year and has perhaps the largest database of diverse managers in the country. Sharing this opportunity set's characteristics can serve as a valuable tool in catalyzing appropriately oriented capital for diverse managers. The following report shares key trends and data observed by Fairview in 2020.

- **The universe of woman and minority-owned firms now totals over 500 and continues to grow rapidly**
- **New firms are raising smaller pools of capital and first-time funds represent a larger proportion of the opportunity set than ever before**
- **New firm formation activity is most significant in venture capital, a segment of private equity that has proven highly resilient**
- **Diverse managers continue to feature a natural diverse multiplier effect at the portfolio company level, while at the same time, firms explicitly targeting woman and minority entrepreneurs are at an all-time high**
- **The need for intentionality and genuine programmatic approaches to backing woman and minority-owned firms is at peak levels**

The universe of woman and minority-owned firms now totals over 500 and continues to grow rapidly

As previously shared, the universe of woman and minority-owned private equity and venture capital firms maintained its persistent growth rate through the turbulent year. In

Exhibit 1: Universe of Woman and Minority-Owned Private Equity and Venture Capital Firms



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2020

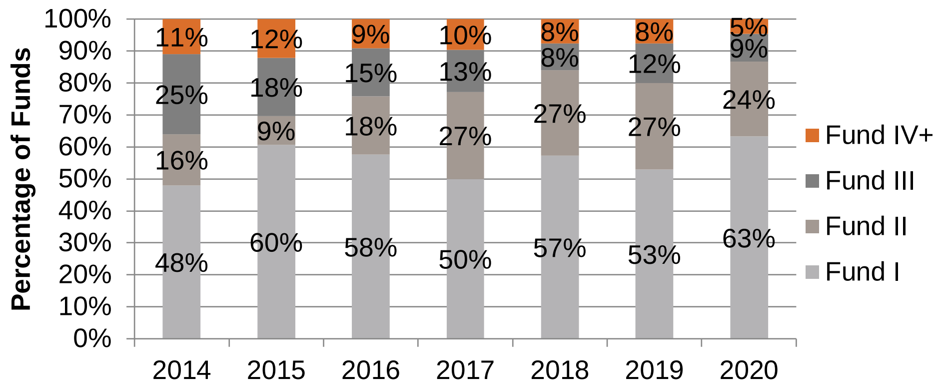
2020, the universe crossed the 500-firm threshold. The number of woman and minority-owned firms experienced its largest one-year growth in history, increasing to 502 firms from 394 in 2019. Since 2014, the universe of woman and minority-owned firms has been growing at a 28% compound annual growth rate.

The growth in the universe of woman and minority-owned firms reflects the increasing level of diverse talent in the industry and talented individuals' rising conviction to build their own firms. Institutional investors are slowly becoming more receptive to these opportunities, in part through recognizing the outsized return potential. However, as the data shared in this report will indicate, the opportunity set can be complex and difficult to access effectively unless a deliberate, programmatic approach is taken.

New firms are raising smaller pools of capital and first-time funds represent a larger proportion of the opportunity set than ever before

The trend in new firm formation by women and minorities continued in 2020, as experienced women and minorities launched firms at a record pace. While the majority of the opportunity set over the past seven years has been comprised of first-time funds, in 2020, a record 63% of woman and minority-owned firms in the market were raising first-time funds. For institutional investors looking to tap the return potential of diverse managers, the importance of being able to successfully evaluate first-time funds and select the best has never been greater.

Exhibit 2: Fund Sequence of Woman and Minority-Owned Firms in the Market



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2020

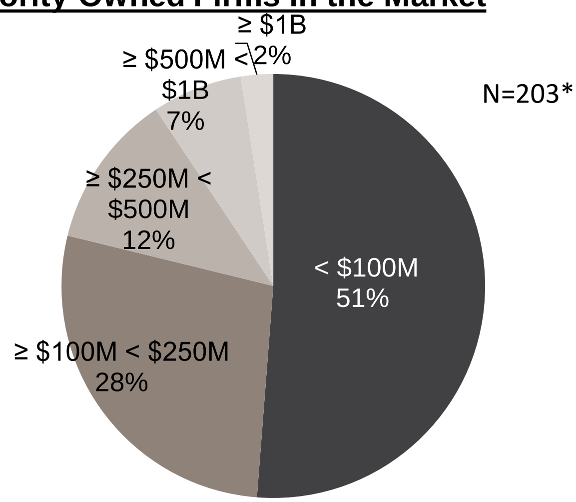
The rate of increase in new firms entering the market in the face of challenging market conditions was surprising. This persistence speaks to the high level of conviction on the part of woman and minority managers. The high profile social injustices that took place during the year perhaps served as a motivator for new firms. Many featured investment strategies to address social injustice, including investing in underrepresented entrepreneurs. Other firm initiatives include establishing pledge funds, incorporating diversity as a mission-based value driver, partnering with not-for-profits to advance social causes, and leveraging platforms to speak openly about inequities. These trends began before 2020, but appear to be accelerating.

For the fourth consecutive year, firms raising second-time funds represented more than 20% of the opportunity set in 2020. On an absolute basis, there were a record number of second-time woman and minority-owned firms in the market. These are firms re-entering the market after successfully deploying a first-time fund. Growth in the absolute number of second-time funds is an encouraging data point as it indicates these firms have successfully raised and deployed a first-time fund and are on a path to building an enduring franchise. Typically, these firms are seeking to broaden their institutional limited partner base. Despite a preponderance of young firms, a significant number of woman and minority-owned firms in the market feature experienced investors with track records developed at larger, more well-established firms. Many woman and minority-owned firms have established themselves as leaders in their respective categories within tenured private equity and venture capital firms and more are poised to follow.

In a year that put a spotlight on African-American-owned firms, there were 67 raising capital in 2020. Of the 67 firms, 54 were male-led and 13 were woman-led. Collectively, this represents a 56% increase from the prior year. Notably, 63% of African American male-led firms were raising venture capital funds and the remainder were raising capital for growth equity, buyout, and other related strategies. The number of African American women-led firms raising capital in 2020 nearly doubled from the prior year. All African American women-led firms were raising venture capital funds.

Expected fund sizes for most woman and minority-owned funds generally correlate to fund sequence and strategy, reflective of trends in the broader private equity and venture capital market. However, fund sizes are typically smaller than average. The average target fund size for woman and minority-owned firms in 2020 was $158 million, down from $172 million in 2019.[2] The median target fund size for woman and minority-owned firms declined to $75 million (compared to $100 million in the prior year).

Exhibit 3: Fund Size of Woman- and Minority-Owned Firms in the Market



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2020
*Excludes 31 funds due to undisclosed fund sizes.

The broader private equity industry featured an average target fund size of $368 million in 2020. Noteworthy is that capital concentration remains elevated – funds of $1 billion or more secured 53% of capital raised from January 2020 to October 2020, a category where woman and minority-owned firms are the most significantly underrepresented.[3] Again, part of the disparity in average fund size can be explained by the fact that the majority of woman and minority-owned firms are raising first-time funds which are typically

[2] 2019 and 2020 averages exclude one major statistical outlier.
[3] Fairview Capital data and Preqin Q3 2020 Private Capital Fundraising Update

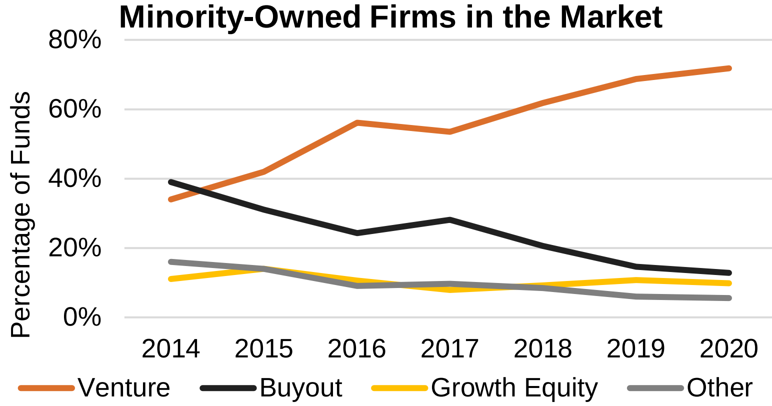
smaller than average. Also, within the buyout segment, there are very few women or minorities leading large and mega buyout firms – whose funds drive up the overall industry average.

Smaller fund sizes also explain why diverse managers are often below the radar of many institutional investors and their consultants. Smaller fund sizes result in narrower fundraising processes and require more proactive engagement by institutional investors. Larger institutional investors looking to penetrate the return potential of diverse managers must be flexible in their commitment sizes to access smaller funds.

New firm formation activity is most significant in venture capital, a segment of private equity that has proven highly resilient

Venture capital and the technology sector have proven resilient this year. Against that backdrop, the proportion of woman and minority-owned firms pursuing venture capital strategies rose to a record high of approximately 72%. This figure is up from 69% in 2019, and represents a continuation of a trend that started in 2015 when venture capital first surpassed buyout as the strategy featuring the most diverse managers.

Exhibit 4: Fund Strategy of Woman and Minority-Owned Firms in the Market

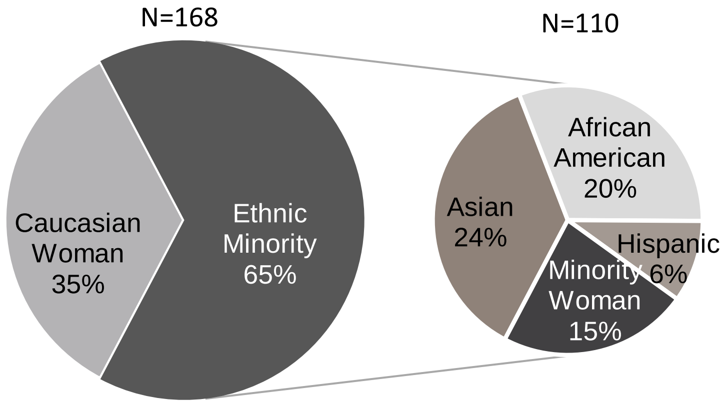


Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2020

Diverse venture capital talent has been growing in recent years to fuel this trend. Additionally, venture capital funds are typically smaller (most seed and early-stage strategies can be executed with funds smaller than $100 million), which make them less daunting to raise for newer firms.

Fewer strides are being made by women and minorities in the buyout and growth equity categories. On a relative basis, the universe of woman and minority-led growth equity and buyout funds has experienced a long-term decline due to growth in the venture capital category. However, on an absolute basis, the number of woman and minority-owned growth equity funds increased by 15% from 2019 to 2020 while the number of buyout funds also increased by 11% over the same period.

Exhibit 5: Diversity of Woman and Minority-Owned Venture Capital Firms in the Market

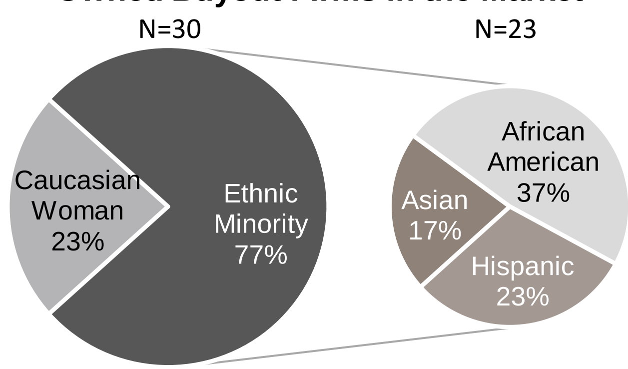


Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2020

The subgroups of woman and minority-owned venture capital firms in market were evenly split between women and minority men. The number of woman-owned venture capital firms has been a particularly strong area of growth. Notably, the universe of minority women venture capital firms is increasing. In fact, they represent 15% of all woman and minority-owned venture capital funds in the market, a record. Hispanic-led venture capital firms, which comprise 6% of total woman and minority-owned firms, are most underrepresented.

Only 13% of woman and minority-owned firms in the private equity market in 2020 targeted buyout investments, the largest segment of the broader private equity universe regarding the number of firms and dollars invested. African American owned firms comprised the majority of woman and minority-owned buyout firms in 2020.

Exhibit 6: Diversity of Woman and Minority-Owned Buyout Firms in the Market



Data: Fairview Capital Proprietary Database of Woman and Minority-Owned Firms as of December 31, 2020

The majority of woman and minority-owned buyout firms in the market in 2020 featured teams with track records of working together and in many cases teams spun-out of larger buyout firms. Sophisticated limited partners recognize that woman and minority-owned firms, as well as other newer and smaller firms, offer differentiated networks, smaller fund sizes, lower middle market strategies, and unique access to deals at attractive valuations. For newer buyout firms, we have observed many executing deals as fundless sponsors to generate track records, even after spinning out from top firms before raising a fund.

Diverse managers continue to feature a natural diverse multiplier effect at the portfolio company level, while at the same time, firms explicitly targeting woman and minority entrepreneurs are at an all-time high

As one of the most experienced firms in building portfolios of emerging and diverse managers, Fairview has amassed a unique set of data on these managers and their underlying portfolio companies. In its active funds-of-funds focused exclusively on investing in funds sponsored by woman and minority-owned private equity and venture capital firms, Fairview observes a natural diverse multiplier effect at the portfolio company level. In one example, 38% of the underlying 730+ portfolio companies featured women or minority executives. In another example, 53% of 175+ portfolio companies featured woman or minority executives. In a third younger portfolio, 76% of 35+ portfolio companies in the program featured woman or minority executives.

None of these Fairview vehicles, nor the sub-funds in the vehicles have an explicit strategy of investing in woman and diverse entrepreneurs. Organically, these managers are tapping into their differentiated networks and are explicitly or implicitly presenting themselves to entrepreneurs as less biased and relatable. The results lead to differentiated deal flow, more access to next generation entrepreneurs, and attractive deals and valuations given the proprietary nature of some of these opportunities. Performance benefits from this dynamic. Fairview's next generation funds focused on emerging and diverse managers consistently outperform, and have been highly additive to our clients' private equity performance.

Industry-wide, this year we observed 23 funds in market with a strategy of investing in women and minority entrepreneurs. All were venture capital firms. We expect to see more deliberate approaches to investing in diverse entrepreneurs in the future as more firms take advantage of this overlooked opportunity set.

The need for intentionality and genuine programmatic approaches to backing woman and minority-owned firms is at peak levels

The 2020 woman and minority-owned private equity and venture capital firm opportunity set has made the need for intentionality by institutional investors clear. A growing majority, 63%, of the opportunity set lies with new firms raising first-time funds. With a median fund size of $75 million, the opportunity set is increasingly skewing towards smaller funds. New firms and small funds require institutional investors to be more proactive in sourcing – diverse managers feature fundraising scopes that may be narrower and approaches that are significantly different from larger and more tenured firms. This dynamic also demands limited partners provide guidance and counsel to these firms. Additionally, a majority and growing proportion of the opportunity set is in venture capital, an asset class that features a high dispersion of returns and favors those investors with specialized networks and knowledge of the category.

The diverse manager market's characteristics favor investors who take a programmatic approach where a deliberate, appropriately diversified portfolio of diverse managers is cultivated. As more institutional investors seek to engage with diverse managers, we hope that they do so by channeling the philosophy central to Fairview's founding, as Fairview Co-Founder and Managing Partner Dr. Laurence C. Morse shared in his Comment on the Present Moment earlier in the year:

> "We resolved at our core that we would always treat others as we would like them to treat us. We chose a name for our new firm that we believed would continuously announce both our intention and our commitment that, within our doors, at our table, men and women of demonstrated talent, experience and ability seeking private capital to support a compelling investment thesis would always be given a "Fair View", as we sought to answer the question at the core of our firm's reason for being: are you capable of investing our capital in productive, profitable ways that will produce exceptional returns for our investors?"

Institutional investors who establish authentic, successful programmatic approaches to investing with diverse managers can benefit from the powerful combination of meaningful outperformance and long-term strategic value for their private equity portfolios. By acting on the present moment and opportunity set of woman and minority-owned firms, institutional investors can broaden access to capital while realizing the full potential of the private markets.