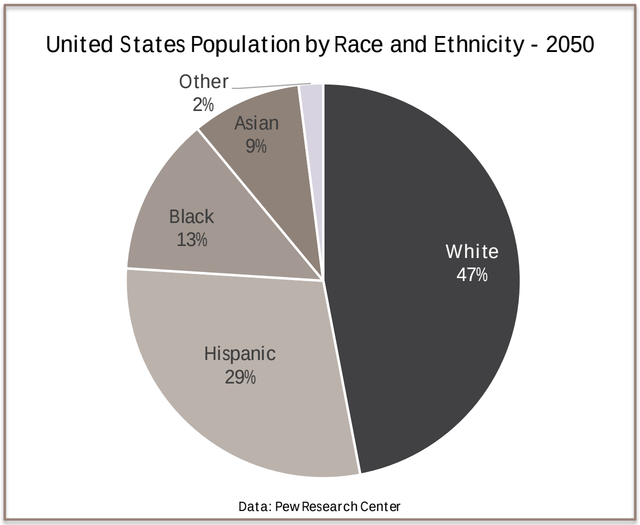
VIEW

The Value of Ethnic and Gender Diversity in Private Equity and Venture Capital

Increasing ethnic and gender diversity in private equity and venture capital, as well as in the entrepreneurial workforce in which managers invest, has been one of the hottest topics in our industry. Thus far, diversity efforts in private equity and venture capital have lagged industry at large, but a strong push is being made to increase the diversity of investment leadership teams and the workforce.

The drive to diversify is being fueled in large part by broad demographic changes. By 2050, the majority of the American population will be comprised of Hispanic-Americans (29%), African-Americans (13%) and Asian-Americans (9%).[1]

Despite their growing numbers, those from ethnic minority groups continue to struggle for economic and professional advancement, especially at the highest levels of the economy. For instance, despite making up about one-third of the population, minorities make up only four percent of the CEOs of the current Fortune 500 companies. A 2011 study found that of the 4,919 people serving on Fortune 500 boards, only 761 of them were ethnic minorities (15.5%).[2]



Among business leaders, the gender gap persists as well. While women account for about 35% of MBA degrees, only 17% of C-level executives are women, according to a recent McKinsey study.[3] Women of color make up only a tiny percentage of those at senior corporate levels. According to the Equal Employment Opportunity Commission, only 3% of executives and senior-level managers are African-, Hispanic- or Asian-American women.[4]

Fairview Capital's Pioneering Role

Fairview, which is the largest minority- and woman-owned private equity investment management firm in the country, strongly supports the industry's diversification efforts. Fairview was the first investment manager to serve as a conduit between institutional investors and minority- and woman-owned funds and we know first-hand that having a team of men and women from diverse backgrounds leads to greater creativity, enhanced teamwork and higher morale.

Fairview was founded in 1994 by JoAnn H. Price and Laurence C. Morse, Ph.D. to specifically address the scarcity of risk capital available to ethnic minority entrepreneurs and businesses, where investment opportunities were present but were largely untapped. As the first investment manager to raise funds with the specific mandate to invest in minority- and woman-owned funds, Fairview has played a leadership role for over 20 years.

The Firm has evolved since its founding to develop innovative investment programs specializing broadly in emerging (developing and diverse) managers as well as in venture capital, where Fairview maintains one of the leading programs in the nation. In all of its investment programs, Fairview's primary goal is to generate outsized performance relative to the broader private equity and venture capital markets.

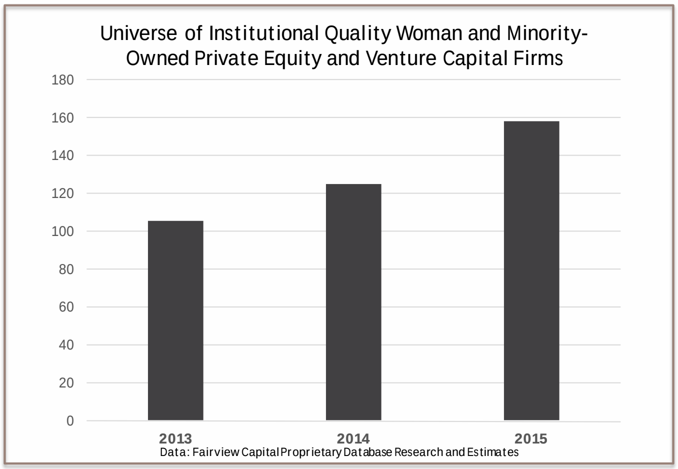
[1] Pew Research Center, *U.S. Population Trends, 2005-2050* (2010)
[2] G. William Domhoff, University of California, Santa Cruz, *Diversity Among CEOs and Corporate Directors: Has the Heyday Come and Gone?* (2013)
[3] McKinsey & Co., *Women in the Workplace 2015*
[4] Catalyst, *The Diversity Dividend: Women of Color* (2015)

Sophisticated institutional investors continue to entrust Fairview with their capital to identify and invest in high quality woman- and minority-owned private equity and venture capital funds. Fairview currently manages multiple mandates with this specific focus. In addition, the Firm has found that as the number of woman- and minority-owned firms continues to grow, they play an increasingly important role in the Firm's broader mandates.

The vast majority of woman- and minority-owned private equity and venture capital firms are newer and smaller, and are often below the radar of traditional institutional investors. Fairview's pioneering role has enabled the firm to continue to find and invest effectively in these funds due to its diverse network and experience.

Diversity in Private Equity, Venture Capital and Startups

The universe of woman- and minority-owned private equity and venture capital firms has grown and evolved from a very small group in the early days of the industry to over 150 firms today.[5] In aggregate, woman- and minority-owned private equity firms comprised well under 10% of the overall private equity market in 2015, according to Fairview research. While still underrepresented, these managers employ a wider range of strategies, industries and geographies than ever before, and are also increasingly more experienced and highly competitive with the broader private equity industry.



The ethnic and gender diversity mix within the set of woman- and minority-owned firms continues to change over time. In 2015, 38% of such funds in the market were sponsored by woman-owned firms, up sharply from 18% in 2014. African-American and Hispanic-American managers together tend to comprise the majority of funds being raised by ethnic minority-owned firms; however, in the past year Fairview observed an increase in the number of Asian-owned firms in the market, up to 30% in 2015 from 20% in 2014.

In terms of strategy, 42% of woman- and minority-owned funds in the market in 2015 were pursuing venture capital investments, while 30% were pursuing buyout opportunities. Reflecting venture capital industry dynamics that have been more encouraging for women and minorities, the number of woman- and minority-owned venture capital firms with funds in the market has increased by over 40% year-over-year.

While the woman- and minority-owned segments of the private equity industry continues to expand at a disproportionately higher rate relative to the overall private equity market, the industry has a long way to go to achieve demographic balance compared to the broader population. A database created by the firm Social + Capital shows that among 71 of the top venture capital firms, which collectively have more than $160 billion in assets under management, in 2015 more than 92% of the senior investment professionals were men and that 78% of them were white, with Asians comprising 20% of the remaining positions. This means less than 2% of senior investment professionals are African-American, Hispanic-American, or other minorities.[6]

Several efforts are underway to accelerate the pace of change, including the formation of the National Venture Capital Association (NVCA)'s Diversity Task Force, which is charged to "develop meaningful solutions to support diverse groups of venture capitalists and entrepreneurs in order to build a stronger innovation ecosystem." Last year, the Diversity Task Force, along with 45 NVCA member firms, sent a "commitment letter" to President Obama pledging to:

[5] Woman and minority-owned firms defined as those with >50% ownership by women or ethnic minorities.

[6] Social+ Capital Senior Investment Team Member database, last updated in October 2015

- Adopt HR policies within their firms to create work environments that foster respect and dignity for all. In addition, they will immediately explore and develop a forthcoming set of NVCA model HR policies.
- Contribute regularly and actively to programs and initiatives that encourage women and underrepresented minorities to consider, pursue and thrive in venture capital and entrepreneurship careers.
- Commit to visible leadership by sharing regularly within their community and throughout their portfolios the best practices that demonstrate a long-term commitment to change.

Diversity efforts are more advanced at venture-backed companies, though their results still lag demographic trends in the population as a whole. Beginning in 2014, major tech companies began releasing diversity data, which showed that only 28% of their workforces were women, while 64% were white and 21% were Asian-American, only 6% were Hispanic-American, 3% were African-American, and the remainder were classified as "other."[7]

However, the pace of diversity efforts among tech companies appears to be quickening. For instance, in early 2016, Pinterest hired Candice Morgan, an African-American woman, to be its first head of diversity, and the company has a goal of hiring 30% women and 8% underrepresented minorities for engineering roles, though as of July 2015, those rates were 21% and 2%, respectively.[8] Many other prominent tech companies have launched similar efforts, including Apple, Intel and Twitter.

The Proven Benefits of Diversity in Business

By now, the benefits of diversity are well known. A more diverse workforce brings a wide range of life experiences and perspectives, as well as varied skills, languages and cultural understandings, leading to a broader range of business contacts and the ability to address diverse customer bases.

But the challenges of creating a diverse workforce are also well known. Resistance to change, workforces that are currently homogeneous, cultural and perceptual differences between ethnic groups and varied communications styles are just some of the hurdles that companies face as they strive for a more diverse workforce. It's also a challenge for companies to implement, manage and oversee workplace diversity initiatives, especially when such efforts are competing for management attention with priorities such as customer relationships, competitive positioning and investor concerns.

Nevertheless, there are proven advantages of a diverse workforce, starting with bottom-line business performance. A 2015 McKinsey study analyzed the relationship between diversity and business results, and came to these conclusions:

- Companies in the top quartile for racial and ethnic diversity are 35% more likely to have financial returns above their respective industry medians.
- Companies in the top quartile for gender diversity are 15% more likely to have financial returns above their respective industry medians.
- Companies in the bottom quartile both for gender and ethnic diversity are statistically less likely to achieve above-average financial returns than the average companies in their sectors.
- In the U.S., there is a linear relationship between racial and ethnic diversity and better financial performance: For every 10% increase in racial and ethnic diversity on the senior-executive team, earnings before interest and taxes (EBIT) rise 0.8%.[9]

The same study reported on many of the tangible benefits of diversity, including:

- Creating an advantage in talent recruitment: Having a stronger focus on women and ethnic minorities increases the applicant pool.
- Greater employee satisfaction: Workplace diversity increases job satisfaction for women and members of minority groups, provided that the workforce is diverse enough. For minority workers, the boost in satisfaction starts when representation exceeds 15% of the workforce. However, where diversity is a token effort, psychological outcomes are poorer.
- Better decision-making and innovation: The presence of women and minority members on a leadership team enhances problem solving by adding more perspectives from their varied

[7] Wall Street Journal, 2014 Diversity in Tech
[8] Wall Street Journal, Pinterest Hires Its First Diversity Chief (2016)
[9] McKinsey & Co., Why Diversity Matters (2015)

experiences. Teams that reflect the composition of a company's customer base in terms of gender, ethnicity, culture, sexual orientation and age are better positioned to understand its changing needs and to develop useful innovations. Diversity at the leadership level breaks down insular biases, making the organization more likely to act inclusively, foster a communicative culture, and create an environment where workers are free to voice unorthodox views and suggest creative solutions.

Conclusion

With the population of the country itself diversifying rapidly, it is a welcome development that the venture capital, private equity and entrepreneurial communities have made workforce and leadership diversity a top business objective. It will take support among limited partners, investment managers, fund managers and company executives to transform this vision into reality.

Private equity and venture capital investors have a unique opportunity to lead the way. Unlike public market investing, where investors have little direct contact with top management, private equity and venture capital investors are typically much more connected to portfolio company management. This means more specific choices can be made as to which portfolio companies are backed and more influence can be had on priorities within the companies such as diversity.

At Fairview Capital, we are extremely proud of our track record and leadership role in diversifying private equity and venture capital, and we fully intend to continue to lead by example going forward.