Russell Reynolds Associates

Cracking the Code on Diversity, Equity, and Inclusion in Private Capital

Private capital needs to harness the power of diversity to further innovation

Private capital has been an important driving force for innovation, accelerating technology-enabled transformation, encouraging cross-sector collaboration, and investigating new methods of sustainable investment. In the past decade, the value of private capital assets under management (AUM) – in private equity, infrastructure, real estate, private credit, and venture and growth capital – has nearly tripled to $6.5 trillion and shows no signs of slowing, despite the pandemic.[1] New business models are emerging, with a purpose-driven goal of solving underlying societal challenges made more apparent by the pandemic. These business models are responding to changing demographics: the population of sub-Saharan Africa is likely to double, while the population of Europe is likely to shrink, and half of the global population growth is expected to come from only nine countries.[4]

Diversity, in both thought and experience, is crucial in creating nuanced and differentiated investment perspectives. Bringing diverse perspectives to the globally evolving, highly competitive deal-making environment allows investment teams to make strategic investment decisions and increase value creation. Harvard Business Review found that homogenous teams have worse investment outcomes: Investments (acquisitions and IPOs) made by partners with shared university/college backgrounds were 11.5% less successful than investments made by partners from different university/college backgrounds. The effect of shared ethnicity was even stronger, further reducing an investment's comparative success rate.[5]

To partner with, invest into, and generate returns for distinct business models that are addressing demographically driven business challenges, such as those in Figure 1, it is crucial for private capital firms to hire and retain leaders and stakeholders who can represent and understand diverse customer/consumer segments, bringing nuanced perspectives and unique understandings of these challenges to the table. However, private capital leadership falls behind in both gender and ethnic diversity. Russell Reynolds Associates' proprietary analysis of the top 25 global private capital firms by AUM found that on average, only 12% of executive teams are women. McKinsey's recent report showed that in 2020, investment deal teams were only about 2% Black in the United States, and leaders at the managing director level were only about 12% ethnically and racially diverse.[6] In the tangential space of venture capital, only 20% of venture capitalists are Asian men, 6% are Asian women, and 1% are Latinx men, with barely any representation from Latinx women.[7]

Figure 1: Demographically driven business challenges that require diverse perspectives

$3.6 billion

Opportunity for innovative solutions in the global women's health market

$1.4 trillion

Opportunity to invest into Latinx founded businesses; only 1% of the investments at top 25 firms were Latinx-owned

$300 billion

Opportunity to serve the Black American consumer, an important demographic that has been consistently overlooked

Source: MarketWatch, Bain & Company, Institutional Investor, McKinsey & Company

Engaging with diverse stakeholders and ecosystems

TPG launched TPG NEXT, with the focus of providing "flexible growth capital and operating resources to seed, support, and scale the next generation of diverse investors and entrepreneurs including women, people of color, and LGBTQ+." Since its founding, TPG NEXT has invested in LandSpire Group, a real estate investment fund focused on creating equitable growth and a sustainable ecosystem for under-resourced communities, and other groups, such as VamosVentures and Harlem Capital.

Evolving talent processes to build inclusive environments

In order to truly build an inclusive environment that allows underrepresented leaders to flourish and grow, private capital firms need to evolve both the ideal success profile and the hiring process. One prominent firm has truly embraced this in the way they evaluate and attract female leaders. Throughout the hiring process, the firm's leaders share more of themselves and their personal backstories. This enhances the leadership culture - these leaders are not only known for their credibility as a great investment leader based on returns, but they are also recognized for their vulnerable and authentic style of leadership.

Private capital firms are making progress in establishing DE&I leadership

Private capital firms recognize this gap and are beginning to establish the right tone at the top, intentionally hiring DE&I leaders with robust qualifications and a sharp focus. Of the top 25 global private capital firms by AUM, 40% have a dedicated diversity, equity, and inclusion (DE&I) leader (Figure 2).

Figure 2. Profile of a dedicated DE&I leader at a top global PE firm

DE&I role trends

- Average tenure is less than one year (0.9 years as of Jan 2022)
- **80%** women
- **100%** bring previous DE&I experience
- **90%** external appointments

This leader typically brings:

- A background in financial services and human resources or talent acquisition.
- An understanding of how to galvanize the troops.
- Relentless and clear communication, DEI championing, and strong presentation skills.
- An ability to be a trusted advisor who can partner with senior leadership.

A dedicated DE&I leader is a non-negotiable, especially when it comes to scaling efforts. This dedicated leader will be able to help tool the DE&I agenda, hold leaders and teams accountable, and drive a consistent heartbeat.

In addition, 64% of the top global private capital firms have a DE&I council, consisting of an average of 13.8 committee members, which is higher than the average of 8-10 committee members at public companies.[8] Publicly-traded private equity firms have also demonstrated DE&I commitment in response to institutional investors by publishing board diversity insights and measures and appointing gender, racial, and ethnic diverse board directors.

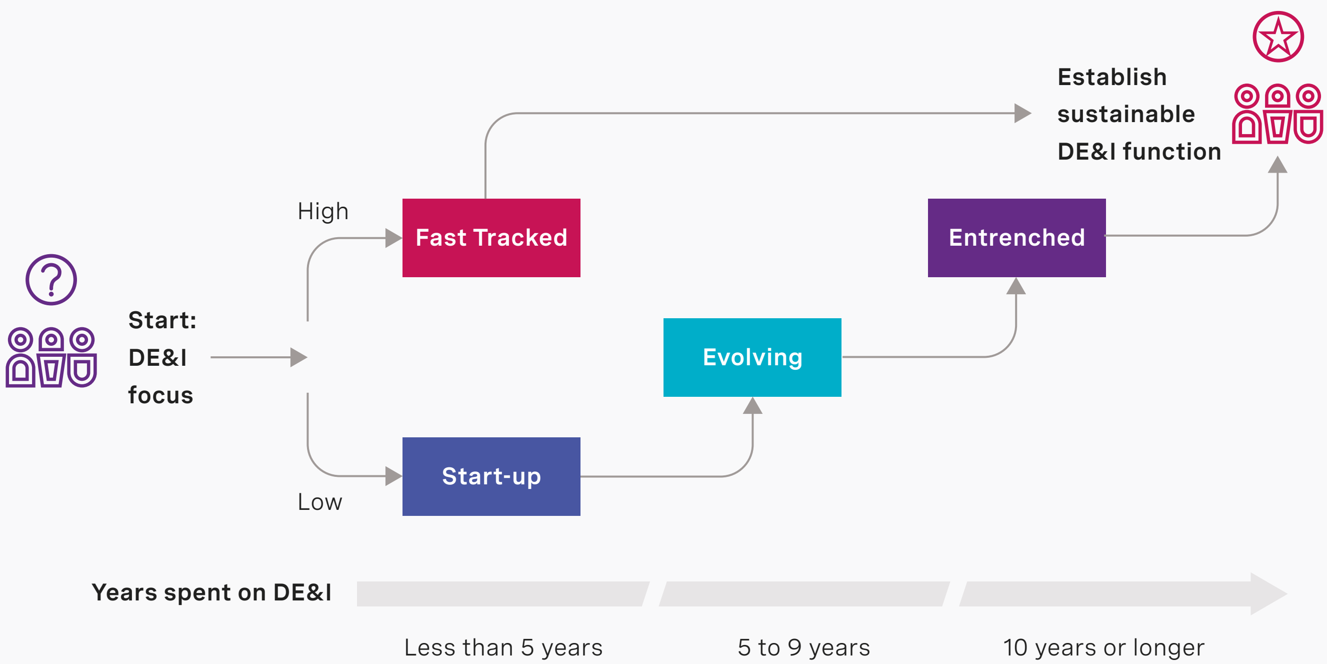
Firm-level DE&I initiatives are also starting to translate to the portfolio level. According to Russell Reynolds Associates' *2021 Global Leadership Monitor*—which surveyed nearly 200 portfolio company CEOs, C-suite leaders, and next-generation executives—58% of portfolio company leaders have already made diversity a core criterion to the hiring process for their teams in the preceding two years. More than half (54%) have also participated in training aimed at reducing unconscious bias.[9]

These are important first steps on the path to progress, though much more is required to achieve representative diversity and genuine inclusion.

To support continued and sustainable DE&I leadership, private capital needs to strengthen accountability

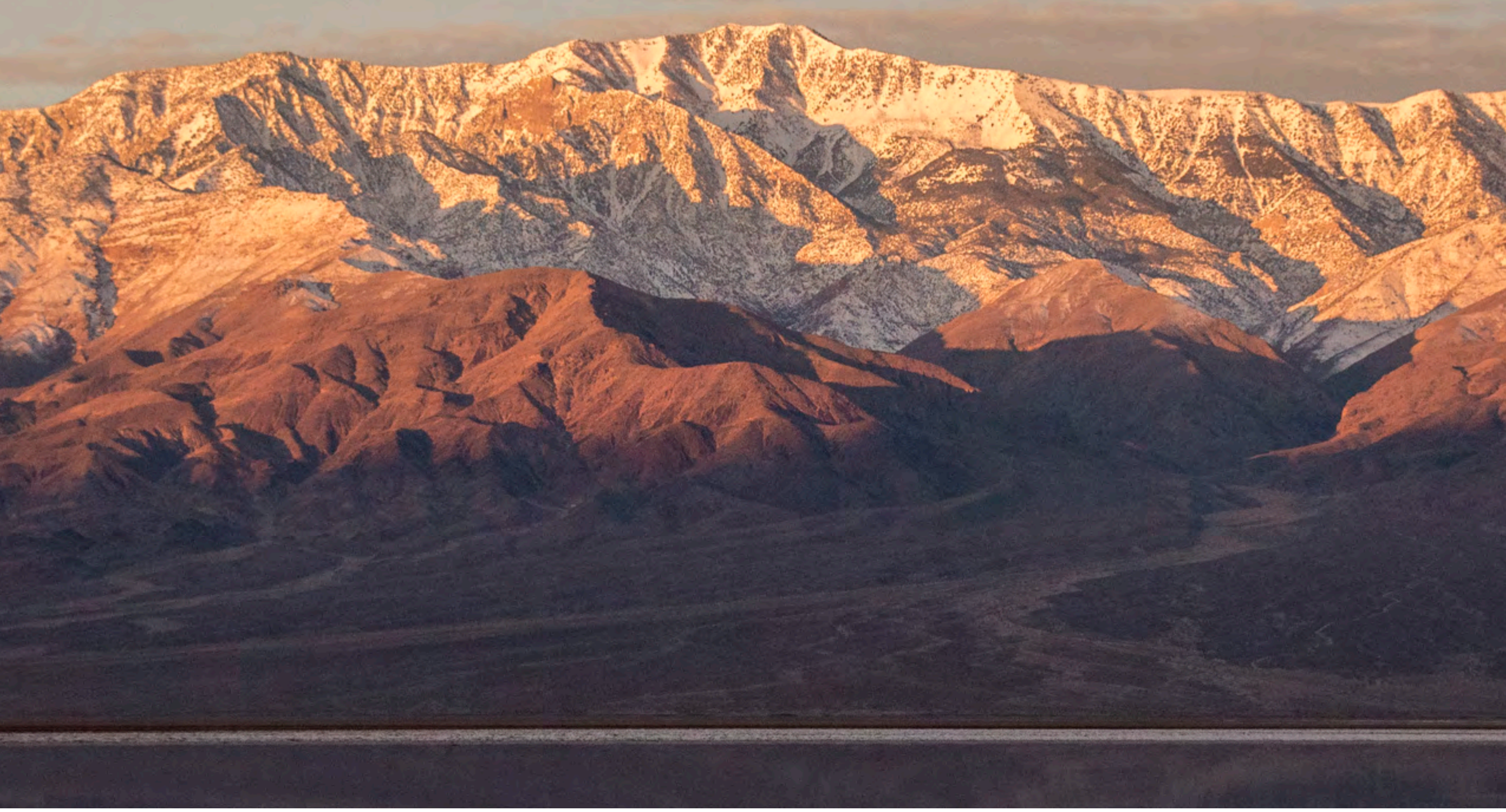
As private capital firms build out their DE&I functions, they face numerous decisions about how to structure them, how quickly to move, and how to achieve meaningful progress. Russell Reynold Associates' benchmarking study of more than 150 senior DE&I leaders across industries shows that while most organizations follow a progressive path from "start up" to "entrenched," there are a handful of organizations that are ambitiously "fast-tracking" the standard path, moving promptly to establish a sustainable DE&I function in their organizations (Figure 3).[10]

Figure 3: Pathways to establishing a sustainable DE&I function



Start-up	Evolving	Entrenched	Fast Tracked
< 5 years	**5 to 9 years**	**10+ years**	**< 5 years**
Operating without a strategic plan or outlined objectives	Defined DE&I basics, including a strategic plan	Full-fledged DE&I structure with structure, governance and accountability built out	DE&I strategy, structure, governance and accountability are built from the start

Source: Russell Reynolds Associates, Is There a Fast Track to DE&I Maturity?



The nine key elements that differentiate the DE&I function archetypes on the path to a sustainable DE&I function can be grouped under strategy, structure, governance, and accountability.

These organizations set up the appropriate governing structure in tandem with how DE&I needs to be prioritized according to their business context; a key aspect here is CEO involvement.

Strategy	All fast-tracked organizations have a DE&I strategic plan and are executing against this plan.
Structure	The majority of these organizations (62%) have a dedicated DE&I leader and are structured within a hybrid model with both centralized and decentralized functions to support firm-level and regional or business unit specific DE&I initiatives (85% of fast-track organizations follow this model).
Governance	All fast-tracked organizations have a DE&I Council, most (92%) have established employee resource groups (ERG), and the majority (67%) have positioned senior leaders to sponsor the ERGs.
Accountability	Over half (54%) of fast-tracked organizations connect DE&I with performance reviews or executive bonuses.

Organizations on the fast-track journey differentiate themselves by focusing on five key areas:

1. Always take the time to take stock. In the fast-paced private capital world, there are always urgent matters to attend to. Intentionally taking the time to prioritize DE&I will be invaluable in the long-term.
2. Show commitment through budget. Private capital firms can take the first step by linking DE&I with financial incentives, and then allocating a budget to support its data-driven initiatives.
3. Champion DE&I by establishing the tone at the top - leaders have to own and drive the DE&I agenda and ensure it is embedded in the organization.
4. Ensure employees have voice and influence. Employees need to feel safe and heard, reassured that feedback provided will not lead to retribution.
5. Accountability is essential for intentions to become reality. It is crucial for private capital firms to collect accurate DE&I data in order to strengthen accountability.

Figure 4: Fast Track DE&I operating model

Marked items are focus areas for this archetype

Strategy		Structure			
Strategic Plan & Progress	Focus Areas	Average No. of DE&I Staff	DE&I Leadership	CDO Reporting Relationship	Degree of Centralization/ Decentralization
Have a strategic plan	CSR	5	CDO	Report to CEO	Centralized
Made progress on the plan	ESG	6	DE&I Council	Report to other executive leader	Hybrid 1: mostly centralized
	Wellness	7			Hybrid 2: evenly split
	Innovation	8			Hybrid 3: mostly decentralized
	Marketing	9			Decentralized
	Talent Mgmt.	10			
	Compliance				

Governance			Accountability			
DE&I Council Membership	DE&I Council Frequency	ERGs	Metrics Used	Metrics Review Frequency	Tracking	Incentives
CHRO	Inconsistent	Women	Recruiting	Irregularly	HR Records	Executive Bonuses
CDO	Annually	LGBTQ	Hiring	Annually	Exit Interviews	Performance Reviews
Business Unit Head(s)	Quarterly	African American /Black	Workforce Stats	Quarterly	Online Dashboard	
Functional Head(s)	Every other month	Veterans	Promotion	Bi-monthly	Focus Groups	
CEO	Monthly	Latinx	Retention/ Turnover	Monthly	Employee Surveys	
	Every other week	Asian American/ Pac Islander	Climate			
	Weekly		Compensation			

Source: Russell Reynolds Associates, Is There a Fast Track to DE&I Maturity?

The private capital DE&I operating model (Figure 5) shows promising signs of being on the fast track to DE&I maturity, having been established in less than five years with a strong focus on strategy and structure. However, a closer look highlights gaps in strategy, governance, and, particularly, accountability.

- **Strategy:** Private capital firms have been focusing on DE&I mainly through the lenses of Environmental, Social, and Governance (ESG) initiatives, talent management, and compliance. To develop DE&I maturity, private capital firms need to create a clear delineation between ESG and DE&I, as well as expand this perspective to other important functions such as wellness and innovation.
- **Structure:** As mentioned earlier, private capital firms have begun establishing a DE&I structure - 40% have a dedicated DE&I leader and many are implementing both firm-level and portfolio initiatives. To continue to make progress against the strategic plan, the DE&I leader needs to have close connectivity to the CEO and build out their own DE&I staff. As a benchmark, the Financial Services DE&I operating model shows an average of 7 people on DE&I staff.
- **Governance:** Of the large global private capital firms with a DE&I council, only a third are led by the CEO; the majority are led by either the CHRO or another senior executive. It is also unclear how often leadership and/or the DE&I council meets to discuss DE&I initiatives. DE&I is an evolving topic; continual progress requires CEO involvement and consistent, frequent, and integrated meetings.
- **Accountability:** Lack of data and disconnect from compensation are by far the biggest challenges for private capital firms to overcome. Private capital firms have only begun tracking gender diversity; there is a lack of data around ethnic diversity. Initial benchmarking strategies could include exit interviews, focus groups, and employee surveys. Leadership and/or the DE&I council should then meet consistently to discuss results, brainstorm relevant, data-driven initiatives, and next steps, following up on implementation. Ideally, the topic of DE&I would be integrated into standard meetings with the board (where applicable), among the management team, and throughout portfolio operations.

DE&I initiatives and targets need to be linked with compensation and financial incentives for firms to embed DE&I into their DNA. Organizations pay to build upon their priorities and to further demonstrate commitment. Kara Helander, managing director, chief diversity, equity, and inclusion officer of The Carlyle Group recently shared information on Carlyle's DEI Incentive Awards and how its CEO's compensation is tied to progress on DE&I: "You pay for what you care about and what matters. We've given $2 million to 50 of our colleagues who have gone above and beyond in driving DEI in the firm." Currently, on the portfolio company front, only 4% of executives have compensation tied to their impact on diversity and inclusion outcomes.

Private capital firms and their portfolio companies can begin by collecting data through human resources records, conducting quarterly reviews around retention, and linking through human resources records, quarterly reviews around retention, and linking performance reviews to financial incentives.

Figure 5: Large global private capital firms, DE&I operating model

Marked items are focus areas for this archetype

Strategy		Structure			
Strategic Plan & Progress	Focus Areas	Average No. of DE&I Staff	DE&I Leadership	CDO Reporting Relationship	Degree of Centralization/ Decentralization
Have a strategic plan	CSR	5	CDO	Report to CEO	Centralized
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	Every other week	Asian American/ Pac Islander	Climate			
	Weekly		Compensation			

Source: Russell Reynolds Associates

How private capital can implement measurable and meaningful changes

1. Collect accurate data

To measure change and stay accountable to consumers, employees, and shareholders, private capital firms need to understand what the beginning benchmarks are, establish realistic goals reflective of their business, investments, and stakeholders, and show evidence-based progress. Collecting accurate data is key to solving one of the biggest challenges: demonstrating quantitatively how differentiated teams generate differentiating returns. Being able to understand the value of diversity through metrics and clear evidence will allow investment teams to adjust decision-making processes to include new perspectives and fine-tune incentive models.

Private capital firms can begin to drive measurable improvements in the talent management cycle through insights from the following metrics:

Outcome, Talent & Business Metrics	Area of Focus	Success Metric		
Outcomes	Company Employees	Workforce DE&I scorecard progress		
	Business (including suppliers and clients)	BU/Regional DE&I scorecard progress	Supplier DE&I scorecard progress	Clients DE&I scorecard progress
	Board Diversity	% non-dominant board members		
Talent Acquisition	Applicants	% non-dominant applicants		
	Candidates	% non-dominant external candidates / slate		
	New Hires	% non-dominant hires		
Talent Management	Development	First year success rate / efficacy participation		
	Succession Planning	% non-dominant internal candidates / slate		
	Promotion Rates	Non-dominant vs. dominant promotion rates		
Diversity, Equity & Inclusion	Belonging	Survey gap by ERG vs. enterprise		
	Equity	Non-dominant vs. dominant equity perceptions		
	Turnover	Non-dominant vs. dominant turnover gap		
Partnerships	Supplier	$ invested in minority owned vendors		

Source: RRA DE&I Operating Model

Metrics that explicitly compare dominant groups to non-dominant groups are important. In this graphic, non-dominant groups refer to groups of individuals historically underrepresented, such as ethnic minorities and women in leadership.

Once success metrics are defined, benchmarked goals and subsequent responsibilities can be assigned to individuals, then measured via scorecards and other performance management tools.

2. Connect to compensation

Inclusive leadership is not a new concept. However, in order to establish DE&I as a priority and demonstrate commitment, private capital firms need to formalize inclusive leadership as a critical competency and connect it to compensation. This needs to be a top-down systematic implementation, beginning with the chief executive officer, managing partner(s), and the senior leadership team. Where applicable, it may be helpful to incorporate board involvement. It is also important that this process does not happen in a vacuum. This implementation needs to be supplemented with resources and additional workstreams, such as KPI development, cultural competency training, feedback systems, and continuous dialogue with diverse talent.

Tying DE&I to leadership competency and compensation

The Carlyle Group has demonstrated how crucial DE&I is to its business success: CEO Kewsong Lee's compensation is not only based on the firm's business performance, but also on the impact of its diversity and inclusion goals. The organization has also established inclusion as a core management and leadership competency at all levels. As part of the promotion process to Managing Director, leaders are evaluated in a 360-assessment that addresses inclusive leadership and management skills.

3. Create aspirational but accountable goals

Private capital leaders are constantly evolving investment processes to be reflective of the current business and societal landscape. As private capital leaders collect data to better understand the decision-making process, they will uncover deeper knowledge around the dynamics and the nuanced interactions between the investment team, the management team, board influence, and client relationships. This thought process should continue to capture feedback from representative groups to elevate DE&I - every private capital leader should now consider DE&I in all talent and business needs, helping centralize feedback, expanding DE&I aspirations, and keeping the broader team accountable.

Looking ahead

Private capital firms are at an exciting crossroad in their DE&I journeys. Having expressed commitment to these efforts, many firms are beginning to act, implementing DE&I operating models and empowering senior leaders who can credibly shape its agenda. Many organizations are also translating firm-level commitments into portfolio company initiatives, such as intentionally placing diverse board directors on portfolio companies. Though there is still work to be done, private capital firms are beginning to tap into the tools and buy-in needed to accelerate change.

To meaningfully move from intention to impact, private capital firms need to focus on collecting benchmark data that will enable them to measure change, stay accountable to stakeholders, and continue to demonstrate differentiating returns. Once this benchmark data is available and accurately interpreted, a critical focus should be on compensation, in order to incentivize leadership behaviors and motivations in the right direction. Public companies are already beginning to come under scrutiny for how they integrate diverse talent and inclusive behavior with leadership competencies and executive compensation. it will only be a matter of time for investors to ask the same thing of private capital firms and their portfolio companies.

Meaningful DE&I metrics may evolve as new business models develop. It will be important for firms to keep an open dialogue, grow and shift appropriately, and continue to proactively welcome diverse perspectives.

This is a critical moment, one that requires private capital firms to actively invest in governance and accountability for DE&I. In doing so, private capital firms and their portfolio companies will elevate innovation, continue to generate successful returns, and lead purposefully.

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Russell Reynolds Associates is a global leadership advisory and search firm. Our 470+ consultants in 47 offices work with public, private and nonprofit organizations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic and political trends that are reshaping the global business environment. From helping boards with their structure, culture and effectiveness to identifying, assessing and defining the best leadership for organizations, our teams bring their decades of expertise to help clients address their most complex leadership issues. We exist to improve the way the world is led.

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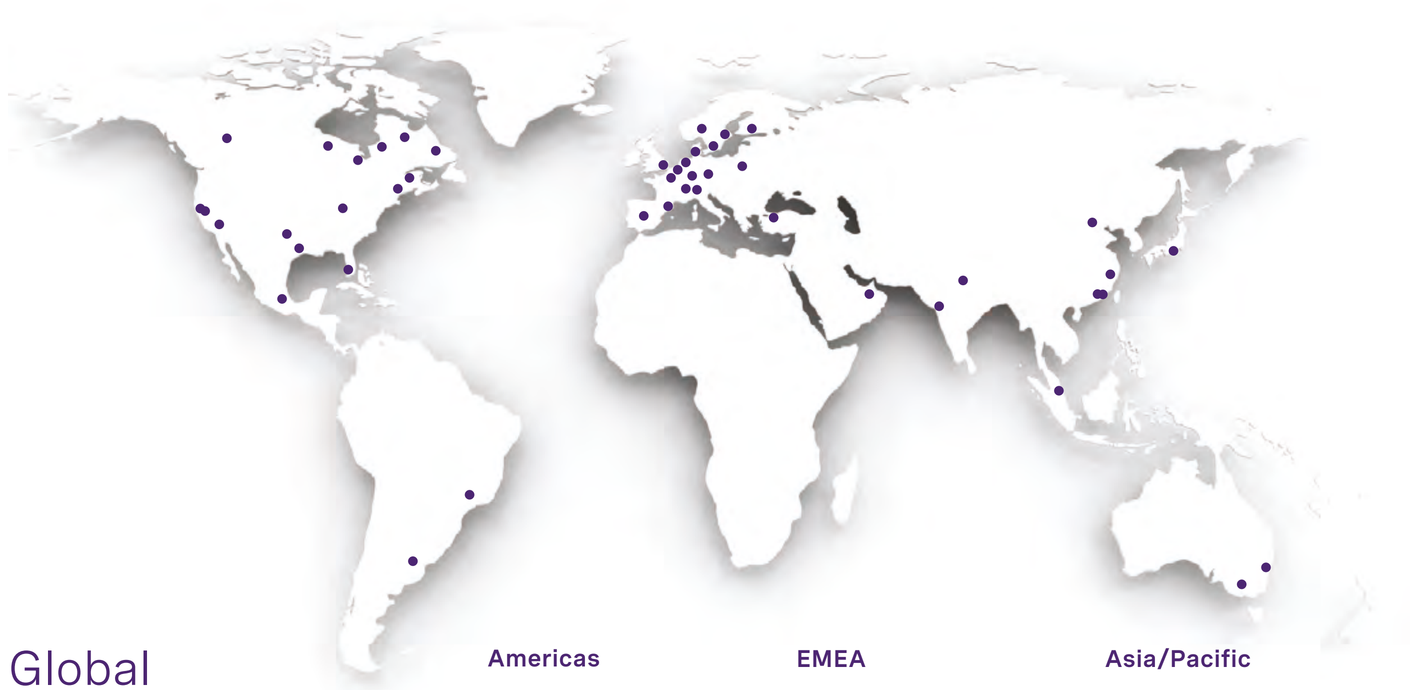

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