How Private Equity Can Catch Up on Diversity

JUNE 03, 2021

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Collectively, private-equity-owned firms make up a powerful economic force. In the US, they generate about 5% of GDP and in 2019 employed almost 9 million people. So in the push for business to increase diversity, equity, and inclusion (DEI), these firms could make a big difference. Yet PE-owned companies are behind their publicly traded counterparts in taking action. This needs to change.

PE-backed companies certainly have a significant opportunity to lead in diversity and inclusion. The nature of PE portfolio companies—their ownership structure, focus on near-term action, and smaller size, all of which allow them to be more nimble—could prove a big advantage in accelerating change.

In fact, when these firms do implement DEI programs, they have an even more positive impact on all employees than in publicly traded companies. For example, BCG analysis found that at PE-owned firms, about two times as many white men reported personal benefit from diversity initiatives than at publicly traded companies.

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Given the diversity dividends—from increased resilience to enhanced innovation—as well as the risks of inaction, such as reputational damage and an inability to retain top talent, PE firms need to lead the way.

A MOMENT FOR ACTION

Even in normal times, PE portfolio companies would have powerful reasons to pay more attention to diversity and inclusion. An abundance of research has confirmed that diverse teams increase companies' resilience and agility. And, as BCG has found, diversity in leadership teams boosts companies' ability to innovate and leads to tangible improvements in their financial performance.

But these are not normal times. The pandemic has disproportionately affected communities of color. Black employees have been laid off at higher rates and rehired at lower rates than their white counterparts, reducing diversity in the workforce—as happened during the Great Recession. In the shift to remote work and learning, women have shouldered more of the burden of caregiving and home responsibilities than men, driving female employees to leave the workforce at higher rates than their male counterparts.

Meanwhile, following the deadly spa shootings in Atlanta, anti-Asian racism—which has been growing at an alarming rate in recent years—has emerged as an issue that must be

urgently addressed.

And the US is not alone in needing to address injustice. In India, for example, the caste system continues to perpetuate social and economic inequality in much the same way as race does in the US. These caste-based discriminatory attitudes persist outside India and have been found in tech companies in the US. Similar problems are associated with China's treatment of its African migrant community and Europe's treatment of immigrant workers, who are often among the most vulnerable in the workforce and face challenges ranging from discrimination to language and institutional barriers. PE firms and their portfolio companies can play a role in preventing and reversing these inequities, fostering truly inclusive work environments, and standing out as employers of choice.

This environment has created a need for companies in every sector to take more drastic steps to increase diversity and inclusion internally, to act as a catalyst for change, and to lead in the movement to achieve equity in the workforce.

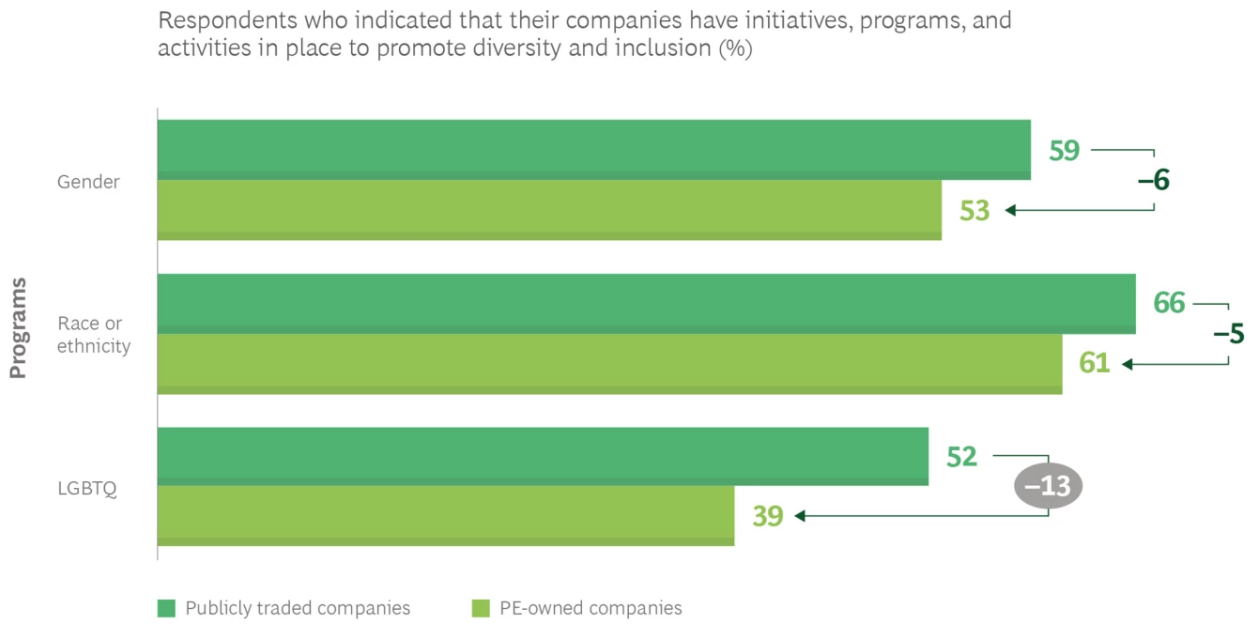
Over the past year, public announcements from large companies denouncing racism and promising to do better have, for example, been followed by commitments to racial equity of $66 billion. This suggests that when the corporate sector decides to move, it can do so at scale. So the question for PE firm leadership should be: When it comes to diversity, equity, and inclusion, how fast can the sector move the needle?

AN UPHILL BATTLE

From a recent BCG survey of more than 4,000 employees in US-based firms, key findings emerge that illustrate why the PE sector has more work to do than others in addressing DEI in their organizations.

First, many firms are starting from a lower base. Compared with publicly traded companies, PE-backed firms have fewer programs, initiatives, and activities in place to promote DEI. (See Exhibit 1.) In our research, employees pointed to gaps in gender, race or ethnicity, and LGBTQ programming in areas such as mental health and wellness, flexible working, antidiscrimination initiatives, paid maternity leave, and clear criteria for performance reviews.

Exhibit 1 - PE-Backed Firms Are Less Focused on Promoting Diversity and Inclusion Than Publicly Traded Firms



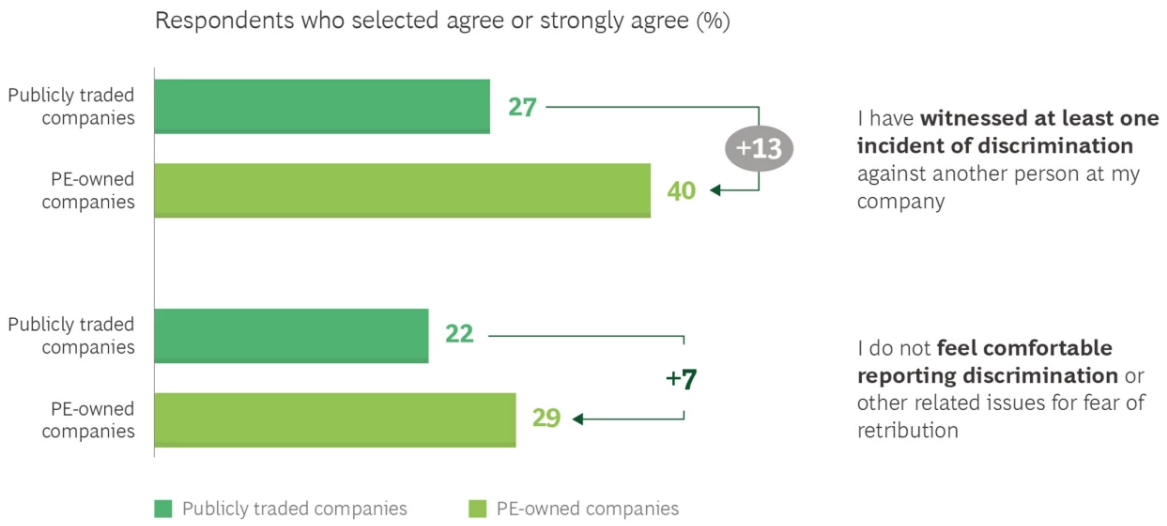
Sources: 2021 BCG US-Only Diversity Study; BCG analysis.

Note: Total PE-owned N = 217; total publicly traded N = 1,517.

In terms of the actions companies have taken to address racial and social equity, we found a 10-percentage-point gap between publicly traded companies and the PE sector, with only 55% of PE-backed firms having recently moved to address these issues. This lack of focus on DEI creates knock-on effects that could dent firms' bottom line and ability to compete.

In our survey, for example, the proportion of employees at PE-owned firms who said they had witnessed discrimination was 13 percentage points higher than at public companies. And while 22% of employees at public companies indicated they felt uncomfortable reporting such incidents, this rose to 29% among respondents from PE firms. (See Exhibit 2.)

Exhibit 2 - More Employees at PE-Owned Companies Have Witnessed Discrimination, but Fewer Feel Comfortable Reporting the Incidents



Sources: 2021 BCG US-Only Diversity Study; BCG analysis.

Note: Total PE-owned N = 217; total publicly traded N = 1,517.

Meanwhile, some 30% to 40% of diverse employees at PE-backed firms reported seeing obstacles to gender diversity and inclusion in their companies related to recruitment, retention, advancement, and a lack of leadership commitment to DEI. In the survey, this finding held true for respondents across all diversity groups—gender, LGBTQ, and race or ethnicity—and was 7 percentage points higher in PE-owned firms than in publicly traded companies.

Breaking this down, the biggest gap between the responses of employees at PE-owned firms and those at publicly traded companies emerged when respondents were asked about barriers to retention. Among gender-diverse respondents, 41% cited this as an obstacle (12 percentage points higher than in public companies) and among LGBTQ respondents, 32% did so (9% percentage points higher than in public companies).

Part of the reason for these disparities can be found in the nature of private equity. These firms are growing very rapidly, and their focus has been on scaling up the business rather than building the infrastructure that supports DEI.

THE COST OF DOING NOTHING

Whatever the underlying reasons, a poor performance on DEI can result in real costs to the business. Companies that are not doing enough to remove diversity-related barriers to recruitment will be forced to spend additional time and resources on hiring staff to replace those who have left.

Eliminating these obstacles is important not just because it's the right thing to do. Implementing comprehensive DEI strategies is also in PE companies' best financial interests.

PE firms are increasingly recognizing the need to help bring about change in their portfolio companies. In the past year, many have set board diversity as their first and most immediately actionable goal for the companies they own. A recent and highly innovative initiative is Carlyle's credit facility, which provides a financial incentive for companies in its portfolio to have diverse leadership.

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This is a good start. But much more can and should be done within portfolio companies. At the board level, diversity metrics should be measured and tracked. Succession planning of key leadership positions should aim to diversify management teams over time. And finally, PE firms should encourage and enable their portfolio companies to invest in high-priority DEI initiatives that will enable these companies to develop an inclusive culture while outperforming their peers.

Asset owners also have a role to play as limited partners to PE. While they have been public in calling for more action in this area, they have so far failed to hold general partners (GPs) accountable, primarily out of fear of disrupting their access to funds and

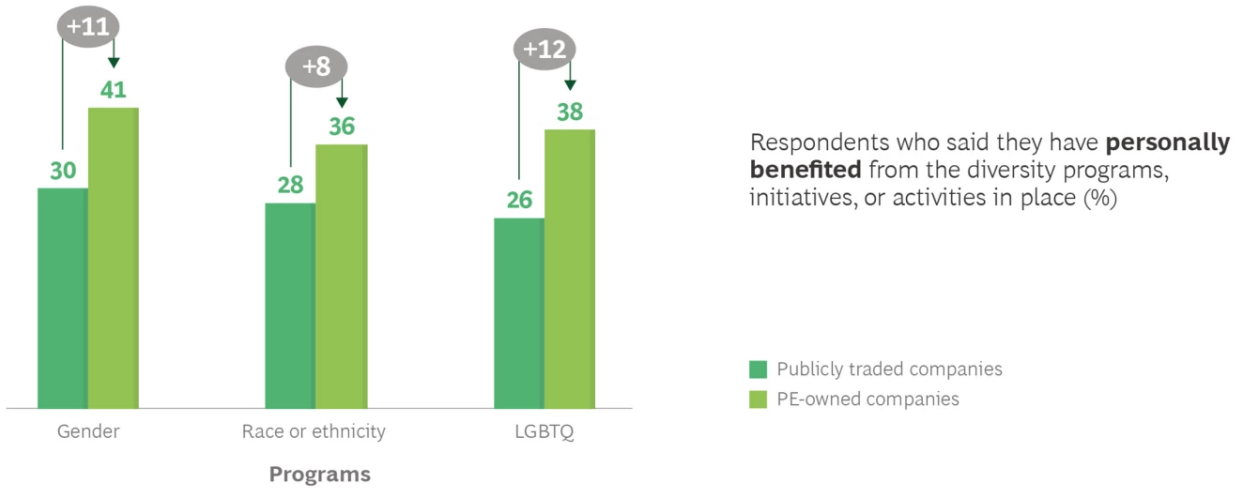
their ability to co-invest. But again, if GPs do care about their fiduciary responsibility, DEI is an important part of this.

THE DIVIDENDS OF PROGRESS

Although PE-owned firms are currently behind their publicly traded peers, the good news is that PE companies that get it right on DEI have the potential to outpace their public counterparts.

As our research shows, PE-backed firms that have addressed these issues can reap the benefit of outsize employee impact compared with public companies. In PE-owned firms with DEI programs in place, the percentage of employees experiencing a positive impact from them is higher than at publicly owned companies. (See Exhibit 3.)

Exhibit 3 - Where Diversity and Inclusion Programs Exist at PE-Owned Firms, a Higher Percentage of Employees Consistently Benefit



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While these programs are designed to support diverse employees, everyone benefits. In the survey, for example, white males in PE-owned firms reported that they personally benefited from diversity programs at rates similar to those reported by diverse employees.

And these rates were 19 percentage points higher than among respondents working at publicly traded companies, something we found to be true not only in the Northeast or on the West Coast, but in all regions of the US, underscoring that our findings speak for the majority of employees in PE-owned companies.

One advantage for PE firms is that it's easier to achieve buy-in when implementing such programs in a smaller, more nimble company. Moreover, with a flatter organization structure, as is often found in PE-owned firms, the impact of DEI programs can be felt more quickly.

THE WAY FORWARD

Given clear evidence of the across-the-board advantages to PE firms from DEI initiatives, the question for their leaders is where they should start.

BCG has developed four "no regrets" strategies that, in our research, have consistently been deemed the most effective measures by all diversity groups. These come with little downside but have the potential to generate substantial value:

- **Inclusive Policies.** Implement antidiscrimination policies.
- **Career Transparency.** Establish clear performance review criteria and allow for regular formal feedback while providing coaching and professional development programs.
- **Work-Life Solutions.** Help employees manage family alongside their career; measures include offering paid parental leave and flexible work programs that allow employees to choose when and where they work.
- **Holistic Wellness.** Introduce programs that support employees experiencing physical or mental challenges and that foster good physical and mental health.

The way firms promote DEI must be carefully thought through, however, if unintended consequences are to be avoided.

For example, in the absence of a welcoming culture and transparent career paths, initiatives such as increasing the recruitment of a specific diversity group can backfire, turning the program into a revolving door that leaves the company less diverse than it was before.

And while giving women flexible work options may improve retention, if the corporate culture sees working mothers as less ambitious or motivated, it can hamper their opportunities for career advancement.

Moreover, although some might question the rationale for firm-wide initiatives—as opposed to those targeted at diverse employees—these more comprehensive programs have the advantage of creating benefits across the enterprise and not singling out an individual group.

For instance, clarifying performance review criteria benefits all staff. But for members of diverse groups, the advantages are far greater because diverse employees are less likely to receive actionable feedback. In addition, managers are more likely to adopt inclusive behaviors when applying an initiative consistently for all their direct reports rather than for just the one or two diverse employees on their team, accelerating progress on diversity across the organization.

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And finally, rather than focusing only on mothers, giving all parents extended leave and flexible work options changes work-life balance expectations for employees of all gender identities and helps create a culture where parental responsibilities are no longer at odds with career ambitions.

In other words, firm-wide initiatives can transform the entire culture of an organization in ways that disproportionately improve the engagement, retention, and promotion rates of

diverse employees.

THE PE DIVERSITY IMPERATIVE

The arguments for the PE sector to step up its action on DEI are compelling. For PE-owned firms, putting in place these strategies can be easier than it is for large corporate entities.

As smaller businesses, they tend to be less weighed down by the layers of bureaucracy and complex organization structures found in many publicly traded companies. Moreover, by prioritizing DEI, PE-owned firms can reap benefits internally, such as greater levels of innovation and an increased ability to attract top talent.

Because there are almost twice as many PE-owned firms as publicly listed companies in the US, these firms can have an even greater impact externally. If PE shareholders implement diversity initiatives throughout their portfolio, by the time portfolio companies are sold, the positive impact of those initiatives will have been felt and will likely persist, even if the companies are not ultimately PE owned.

We believe this is a moment of truth for private equity. By becoming part of a broader movement in the corporate sector, PE-owned firms can make a significant contribution to progress toward a more diverse and equitable world.

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