



PRIVATE EQUITY'S CHANCE TO STAND UP FOR DIVERSITY AND INCLUSION

By Lorena Buck, Tawfik Hammoud, and Vinay Shandal

AS PROTESTS ERUPTED OVER the death on May 25 of George Floyd, the latest Black American to be killed by a police officer while in custody, numerous CEOs stepped up to condemn police brutality and racism. Their expressions of outrage are welcome. But centuries of structural disadvantage, civil rights violations, and unjustified violence by agents of the state demands more from the private sector than words. Companies and investors must use this moment to ask how they as organizations can accelerate progress towards racial justice. And one group of investors that so far has been notably absent from the debate could make a big difference: private equity firms.

Individually, PE firms are small. But collectively they represent about 5% of America's GDP. In 2018 they employed almost 9 million people, and they are a rapidly growing part of our economy. Acting together, they could have an outsize positive social impact.

In light of the branding challenges that the sector has faced, this may be an opportuni-

ty to show leadership on the intertwined social justice issues of historically entrenched racism and white privilege. PE firms' playbook focuses on creating value by working with management to improve the companies they own. So why not put a diverse leadership team and an inclusive culture at the heart of that?

Change can occur at the general partner (GP) level—the level at which PE firms source, execute, and manage investments—and at the portfolio company level. Because GPs are not massive organizations, they can act nimbly. And the companies they own tend to be small and less burdened by the complex bureaucracies typical of public companies. The moral imperative to promote justice, equality, and human rights is reason enough to speak up against embedded structural violence and racism. But the PE sector should also take into account the compelling near-term strategic benefits of taking action.

Aside from reputational risk, inaction creates business risks in the form of lost op-

opportunities for value creation. Research has established that companies with diverse leadership teams and boards create disproportionate shareholder value. Diverse teams operating in an inclusive culture foster innovation, a critical capability at a time of extreme social and economic uncertainty. Emerging as a winner on the other side of COVID-19 will demand radically new ways of thinking and acting.

Moreover, to attract top talent, companies must foster a culture that enables people of color to bring their full, authentic selves to work and must draw an employee base that reflects the makeup of the population. Certainly, unconscious biases that surface in the workplace are real and difficult to tackle, but addressing them is essential.

PE firms can take a number of steps to confront and overcome racism—both at the GP level and in their portfolio.

In the short term, they must ensure that employees of color feel safe, heard, and respected during difficult times. Although everyone is feeling stressed and worried right now, employees of color may be disproportionately affected or may experience the strains related to the current upheavals in different ways. Leaders need to check in, listen, and resist the urge to impose their views when others are speaking to their pain. Just listen.

In the longer term, leaders should increase their firms' diversity at the GP level. This means creating truly representative leadership teams, deal teams, and operating teams. In their portfolio companies, they must install diverse boards and C-suites. Firms should look closely at their supplier diversity, set metrics, and pressure their advisors (including legal, accounting, financial, and commercial vendors) to bring diverse teams to the table.

Beyond holding themselves accountable on these measures, they should compete with other firms to lead the way—and since PE professionals are among the world's most competitive, rising to this challenge should come naturally.

Beyond that, we encourage GPs to direct their philanthropic programs to the broader community and enable employees to engage directly with historically marginalized groups. Most powerfully, PE firms can adapt their deal-sourcing processes to fuel the growth of Black-owned businesses, and thereby have a direct impact on the economic success of this community and beyond. Overall, as earlier BCG research has shown, companies with greater total societal impact performance across dimensions such as ethical capacity and access and inclusion can deliver better financial performance.

Still, installing diverse leadership teams and boards and adapting deal-sourcing practices are only part of the equation. Diversity without an inclusive culture is not enough. Until individuals of color can pursue their responsibilities in a truly inclusive environment that enables them to succeed, a company's work toward establishing a truly healthy and equitable business environment is not done.

PE firms should also treat diversity and inclusion as an opportunity to do more than catch up. Perhaps most promising aspect of the situation is the potential for the sector to multiply its impact. Given the success that PE firms have had in scaling their businesses, some of which exit into the public markets, private equity can have a ripple effect. PE can create a world that is diverse, equitable, and inclusive—while also taking a principled stand on a matter of immense and urgent importance.

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