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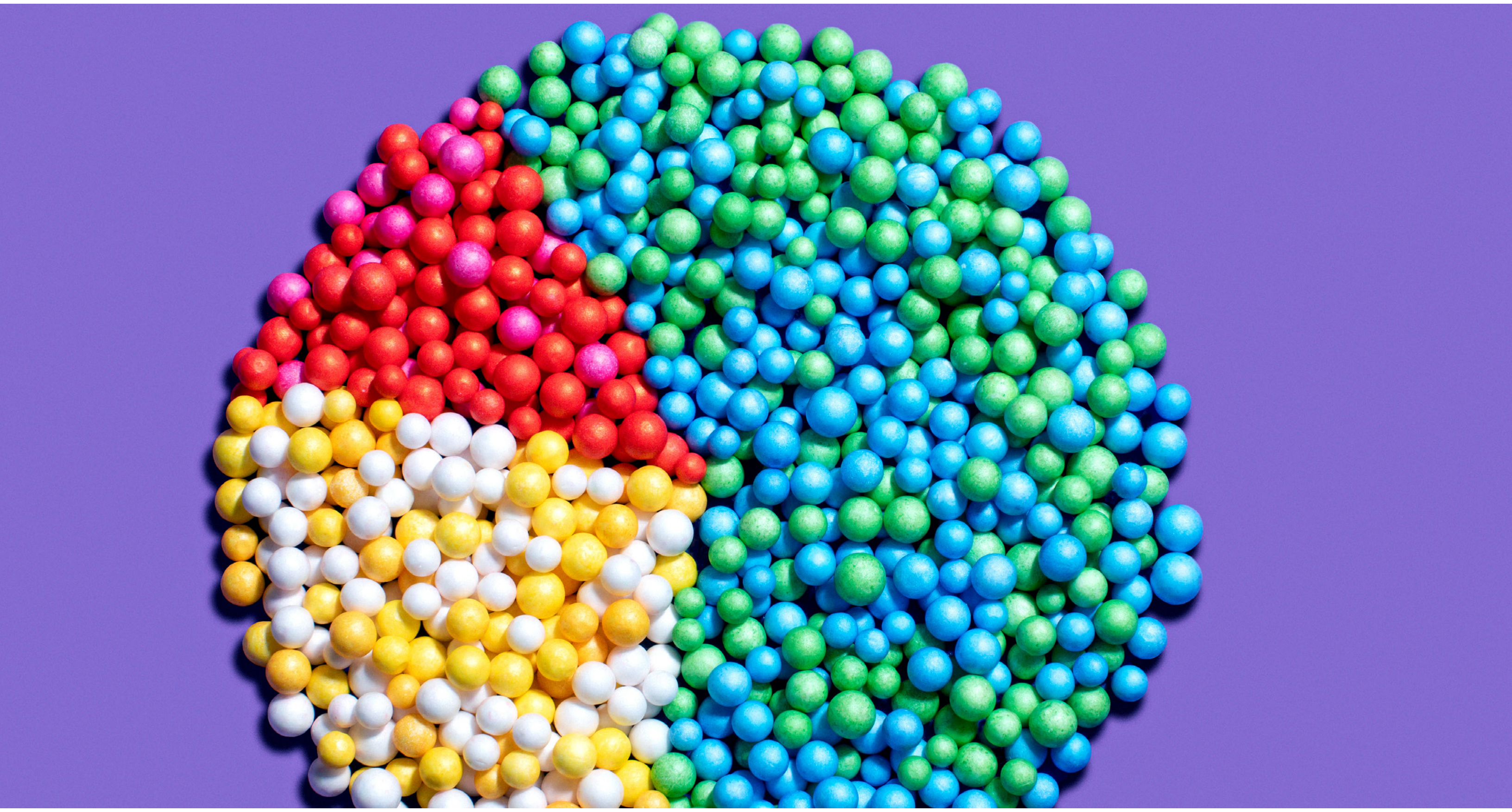
Private Equity Practice

Tracking diversity, equity, and inclusion data in private markets

Institutional investors and private equity firms can implement some basic but crucial best practices to measure progress on diversity, equity, and inclusion.

by David Baboolall and Alexandra Nee



October 2022

Tracking diversity, equity, and inclusion (DEI) has gained traction among private equity (PE) firms and institutional investors (IIs). This development is part of a larger societal trend. In recent years, global social movements centered on DEI have sparked reexamination in every part of society, including business. And research shows that DEI is good for business, regardless of geography.[1] In the private markets industry, IIs are placing increasing importance on PE firms' diversity metrics in making allocation decisions. The PE industry is already making steady progress on improving the diversity of its workforce.[2]

Thanks to a partnership with the Institutional Limited Partners Association (ILPA), a trade association focused on serving IIs, we were able to benchmark the industry's performance on DEI data collection. The survey explored which diversity metrics IIs and PE firms gather and how they use these data to make progress on DEI goals. Specifically, we examined who collects DEI data, how the data are collected, and the cadence of this data tracking. Two hundred sixty-five private market firms participated in the survey, deployed across 2021 and 2022.

Our data reveal that two actions would benefit the industry's progress on DEI:

1. *Public commitment from PE firms and IIs to advance DEI goals.* Our data show that organizations that have made public commitments—independently or through industry consortiums such as ILPA—demonstrate greater progress on diversity than their counterparts.

2. *The standardization of data tracked by IIs.* Standardize the demographic data IIs ask for and track from PE firms and the frequency at which it is gathered. Increasing frequency and systematizing metrics gathered will not only make it easier for PE firms to comply with the data requests but also improve the fidelity of data comparison across firms.

These two actions could improve industry performance on diversity over time.

What IIs want and what PE firms collect

We surveyed IIs about the DEI metrics they evaluate when allocating to PE firms, and we surveyed PE firms about the kinds of diversity data they track and the types of DEI actions they are pushing within their portfolio companies. Since not all recipients of the survey were signatories of Diversity in Action, ILPA's DEI initiative, we also analyzed data from signatories and nonsignatories separately to identify any differences between the two groups (for more, see sidebar, "About the research").

IIs focus diversity requests on investment teams

IIs—also known as limited partners—are often the most immediate external consumers of PE firms' DEI data. They use DEI data from each firm as one of the inputs when making allocation decisions and as one proxy for the health of their investments. According to Jennifer Choi, acting CEO of ILPA, "The bottom line is that LPs [limited partners] and GPs [general partners] alike are increasingly prioritizing diversity, equity, and inclusion in their organizations and in their portfolios, and good data builds the foundation for meaningful action and engagement in this area."

Based on our survey, IIs are most interested in understanding diversity at the top. Survey results show that IIs most commonly collect diversity metrics for deal teams where they allocate money, followed by gathering data on the diversity of the boards of directors of portfolio companies (Exhibit 1).

[1] Sundiatu Dixon-Fyle, Kevin Dolan, Dame Vivian Hunt, and Sara Prince, "Diversity wins: How inclusion matters," McKinsey, May 19, 2020.
[2] Alexandra Nee and David Quigley, "The state of diversity in US private equity," McKinsey, March 30, 2022.

About the research

We designed a survey and administered it in conjunction with the Institutional Limited Partners Association (ILPA) to the organization's nearly 600 members around the world.

The survey results are based on 265 responses collected during fall 2021. Of the respondents, 162 were signatories to Diversity in Action, ILPA's DEI initiative,and 103 were nonsignatories (exhibit).[1]

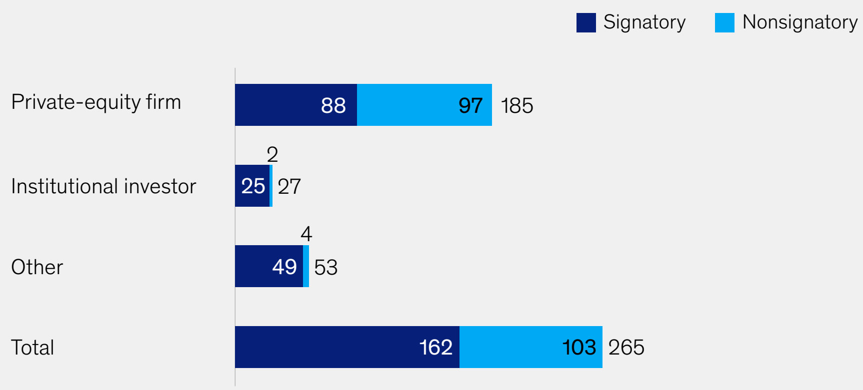
Because ILPA members include both signatories and nonsignatories to ILPA's DEI initiative, each group received slightly different survey questions. Nonsignatories answered 21 questions; signatories answered 26 questions, five of which were specific to signatories.

Respondents answered questions about the data they collected internally and for investment partners, their perceptions of the importance of workforce diversity metrics, their DEI goals, and any DEI strategies they have in place.

Exhibit

The 265 respondents to the survey were a mix of signatories and nonsignatories to ILPA's diversity initiative.

Diversity, equity, and inclusion (DEI) survey respondent breakdown, # of firms



Source: McKinsey DEI Initiative Survey (n = 265)

[1] "Diversity in Action," Institutional Limited Partners Association (ILPA), accessed October 19, 2022.

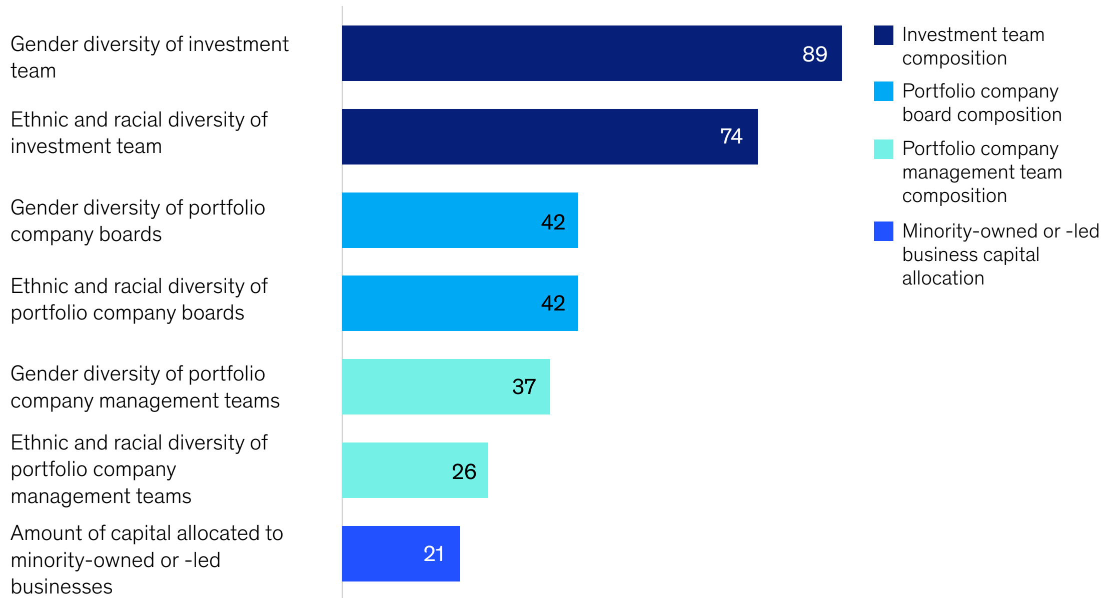
'The bottom line is that LPs [limited partners] and GPs [general partners] alike are increasingly prioritizing diversity, equity, and inclusion in their organizations and in their portfolios.'

–Jennifer Choi, acting CEO of ILPA

Exhibit 1

Institutional investors are most interested in diversity among funds' investment teams and portfolio companies' boards.

What diversity, equity, and inclusion (DEI) metrics do you collect from your private markets managers today?, % of institutional investor respondents



Source: McKinsey DEI Initiative Survey (n = 265)

Data collection practices vary

The private markets industry does not yet have commonly accepted standards for DEI data. Data collection practices therefore vary widely among survey respondents. Some respondents collect in-depth data on an ongoing basis; others do no DEI tracking at all.

Signatories to ILPA's DEI initiative behave differently from nonsignatories. Predictably, signatories are more likely than nonsignatories to collect data on both their own organizations and portfolio companies, with nearly all signatories collecting their own DEI metrics, while less than three-quarters of nonsignatories collected these data (Exhibit 2).

Moreover, regional differences play into data collection practices. Seventy-three percent of all respondents globally collect gender and ethnicity or race data on their employees. Yet, for instance, 75 percent of nonsignatories based in Europe collected data only on gender.[3]

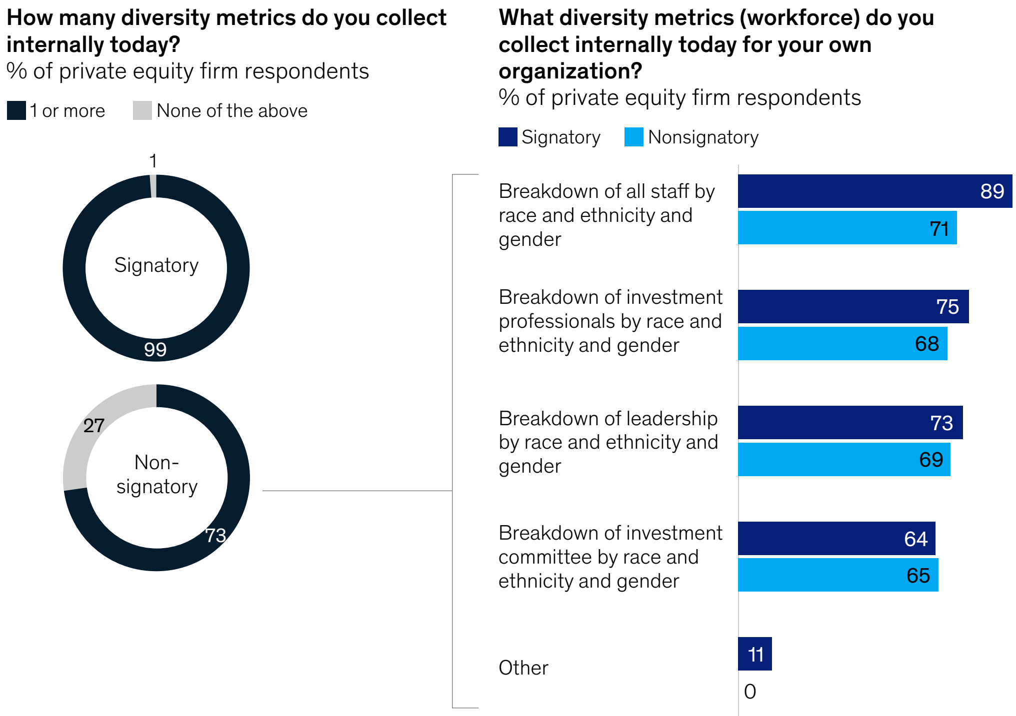
Collection frequency and methods vary

In addition to variations in data collection practices, collection frequency, timing, and method differ as well. When it comes to the collection frequency of PE internal metrics, the majority (44 percent) collect employee diversity metrics only during the onboarding process. However, many firms—46 percent of survey respondents—are moving beyond

[3] Some of the European-based, nonsignatory firms had offices globally, which led to approximately 25 percent of the respondents collecting ethnicity and racial data in addition to gender data.

Exhibit 2

Signatories to ILPA's diversity initiative are more likely than nonsignatories to collect data.



Source: McKinsey DEI Initiative Survey (n = 265)

collecting demographic data at onboarding and toward more frequent tracking.

While IIs typically capture less diversity data from their employees during onboarding than PE firms, they do collect the information with greater frequency. About 50 percent of IIs collect these data annually, 10 percent collect them quarterly, and 25 percent collect them only during employee onboarding. The remaining 15 percent collect employee data at a frequency ranging from every two years to an ongoing basis through their HR information systems (Exhibit 3).

Survey respondents also differ on how they collect DEI data. More than 60 percent of respondents in PE reported informally obtaining this information, meaning it was not systematically reported by employees at set intervals or collected during onboarding.

However, for those that systematically track the data, self-identification has become a commonly used tool for organizations that want to collect data more frequently and in more granular forms.[4] About one in four PE respondents use a portal to allow for easy self-reporting. Additionally, 16 percent of PE respondents use employee engagement surveys and third parties to capture internal diversity data (Exhibit 4).

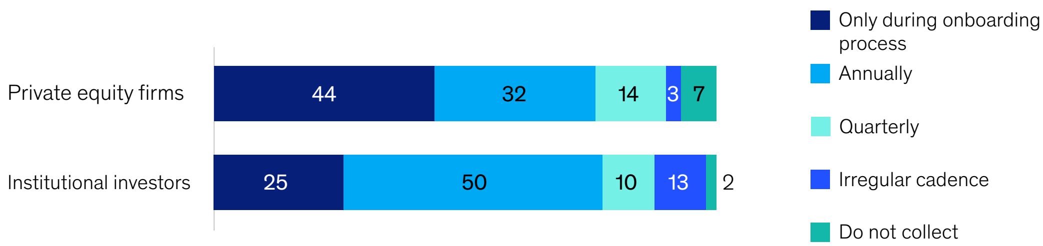
IIs are less likely than PE firms to track their employees' gender and ethnic and racial diversity, with only 20 percent of our surveyed IIs tracking

[4] For more, see "Encouraging self-identification," Employer Assistance and Resource Network (EARN), accessed October 19, 2022; James Heighington, "Using self-ID to create a more inclusive workplace," Google, accessed October 19, 2022; "Self-identification at Harvard," Harvard Office for Equity, Diversity, Inclusion & Belonging, accessed October 19, 2022.

Exhibit 3

Many private equity firms collect only diversity metrics during employee onboarding; 50 percent of institutional investors collect these data annually.

How frequently are you collecting diversity metrics internally today?
% of private equity firm respondents vs institutional investor respondents

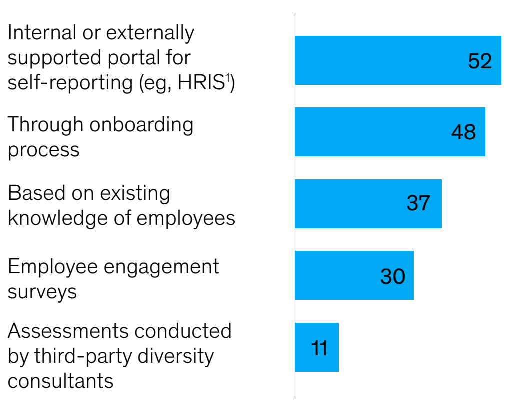


Note: Figures may not sum to 100%, because of rounding.
Source: McKinsey DEI Initiative Survey (n = 265)

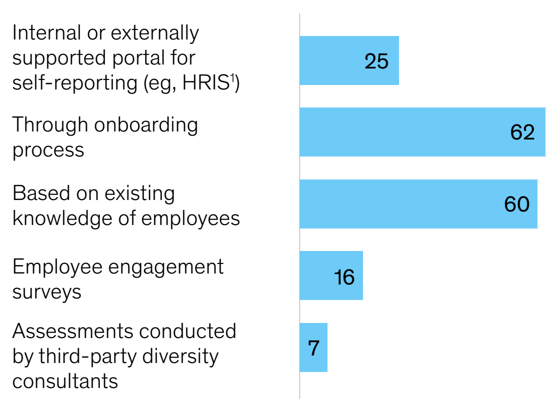
Exhibit 4

Institutional investors tend to rely on self-reporting for data gathering, while private equity firms use the onboarding process and existing knowledge.

How are you capturing internal workforce diversity metrics today for your own organization?
% of institutional investor respondents



How are you capturing internal workforce diversity metrics today for your own organization?
% of private equity firm respondents



[1]Human resources information system.
Source: McKinsey DEI Initiative Survey (n = 265)

these metrics today. However, those that do track the data leverage employee self-reporting and employee engagement surveys more than PE firms to understand their employees' diversity and inclusion sentiments (Exhibit 4).

DEI metrics within portfolio companies

PE investors' greatest influence may be over DEI within their portfolio companies. Fifty-five percent of the 185 general partners at PE firms surveyed currently collect metrics on the gender split of portfolio companies' C-suite leaders, with an additional 19 percent reporting a plan to collect this data point in the future (Exhibit 5).

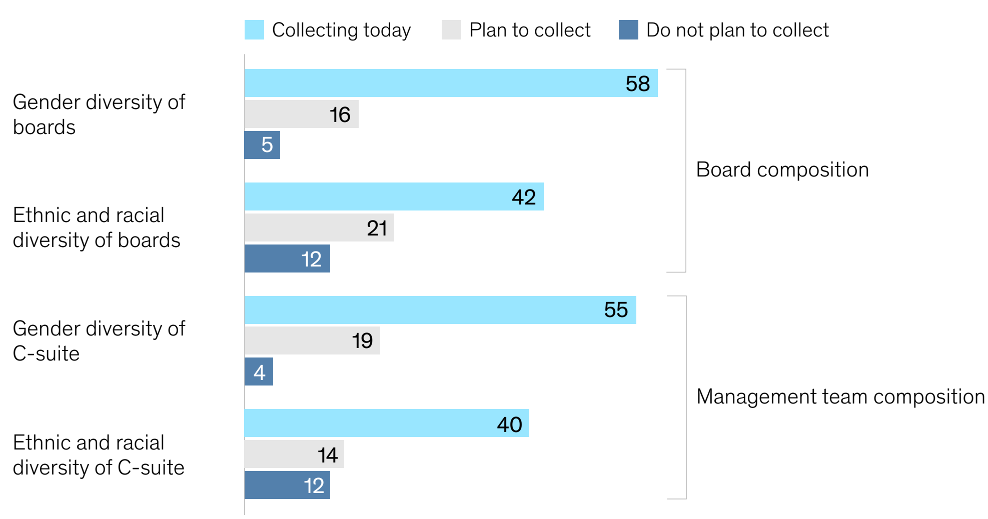
However, the frequency of this data collection is limited: 16 percent collect the data only once, during the due diligence process, and 38 percent of general partners collect the information annually. However, our survey data suggest that the industry is likely to increase frequency of data collection on portfolio company boards and top management teams in the future.

Similar to our earlier findings on the power of a public commitment to DEI, we found that signatories to ILPA's diversity initiative are more active collectors of portfolio companies' DEI data than nonsignatories. Fifty-nine percent of respondents who signed ILPA's DEI initiative collect DEI metrics from the majority (or all) of their portfolio companies. Signatories are also more likely than nonsignatories to have DEI requirements for portfolio companies' board seats. For instance, while more than half of nonsignatories have no goals for board-level diversity at their portfolio companies, 64 percent of signatories have DEI goals and requirements for their portfolio companies' boards.

Exhibit 5

Most participating private equity firms collect or plan to collect diversity, equity, and inclusion data from portfolio companies.

What diversity, equity, and inclusion (DEI) metrics do you collect from your portfolio companies today?
% of private equity firm respondents



Source: McKinsey DEI Initiative Survey (n = 185)

Basic DEI practices for IIs and PE firms

With DEI becoming increasingly important to both IIs and employees, particularly at portfolio companies,[5] leaders at IIs and PE firms should rapidly establish basic collection practices and decide which key DEI data to track.

Set standards for data tracking

IIs and PE firms could commit to collecting a standard set of data at consistent intervals. Where practical and in compliance with local regulations, demographic information on ethnicity or race, gender identity, sexual orientation, and educational attainment, among others, could be collected to track the experiences of employees from different populations.

A minimum frequency of data collection—for instance, annually—can help keep data current and allow for effective industry-wide benchmarking and knowledge sharing. Data show that only 38 percent of PE firms today are collecting diversity data from portfolio companies annually.

Today, the most common methods of collecting DEI data among private market firms is reported to be during employee onboarding or based on HR's working knowledge of the employee populations, which leads to an incomplete—and at times unreliable—picture of the diversity of the employee base. Employees may refrain from disclosing invisible marginalized identities, such as ethnicity or sexual orientation, because of perceived professional—or even personal—risks, particularly at employee onboarding. However, employees may feel comfortable self-reporting more of these diverse categories with which they identify when they feel sufficiently established in their roles or learn more about the organization's culture.[6]

Publicly commit to DEI goals, ideally in partnership with industry peers

Partnerships, alliances, associations, and consortiums are proven to help participants in the private markets industry advance their DEI goals. These types of collectives can offer ways to centralize and share knowledge, provide benchmarks, and identify industry-specific best practices.

A public commitment to advance DEI goals leads to firms independently collecting—and often sharing—more data. For instance, our survey shows that firms that hold a controlling interest in the majority of their portfolio companies and have made a public commitment are more likely to collect DEI data from their portfolio companies. To make portfolio companies' DEI performance a more visible priority throughout the industry, PE firms could request DEI data from all their portfolio companies, even ones in which they own a minority stake.

Formally tracking the extent to which leaders mentor and sponsor colleagues of different backgrounds is a key way to encourage equitable sponsorship behaviors.

[5] Susan Caminiti, "Majority of employees want to work for a company that values diversity, equity and inclusion, survey shows," CNBC, April 30, 2021.

[6] Self-reported data may not always be reliable, particularly in settings where self-identifying as a minority could carry risk (even if the data are anonymized). Knowledge of regional and local dynamics may help senior stakeholders interpret their raw data.

For their part, IIs could publicly set ambitious targets for DEI metrics in areas such as the diversity of PE fund managers. Based on our survey findings, most IIs—85 percent—already ask about DEI when performing due diligence on new firms to allocate to. Communicating clear goals for the diversity of fund managers, portfolio company boards, or portfolio company C-suites could be a natural next step.

As industry participants pursue their DEI goals, an internal communications strategy can help convey their vision for DEI and keep it front and center as updated metrics are shared with the organization.

Go beyond obvious metrics

Organizations would ideally aspire to go beyond obvious demographic data collection to understand DEI within their companies. Going a level deeper could help organizations attract, retain, and continue to develop diverse talent and produce better business results over time.

While each firm may have different priorities within DEI, one area to track is sponsorship. As we've seen in other McKinsey research, the gap for minorities in PE investing occurs in the promotion rates to midtenure roles. Similarly, other data show that PE-backed portfolio companies' C-suites are typically less diverse than those of Fortune 500 firms.[7] Promotions into these ranks will occur only by increasing the opportunities to learn and lead. Formally tracking the extent to which leaders mentor (give advice to) and sponsor (give development opportunities to) colleagues of different backgrounds is a key way to encourage equitable sponsorship behaviors. Ideally, every employee would have clear sponsors.

Improving DEI also requires awareness of the company's culture. DEI champions could also combine employee morale data with diversity data to identify opportunities to fine-tune their organization's culture. Tracking and understanding which subsegments of the company are feeling included, heard, appreciated, and satisfied in their roles helps devise better corporate interventions to target talent retention, which has clear implications for cultivating a sense of inclusion.

Gathering data is a preliminary step, but it can be critical for benchmarking, accountability, and richer conversations about DEI in the industry going forward.

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[7] "Insights on portfolio company talent 2022," BoardEx, January 25, 2022.

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