

Racial Diversity in Private Equity Fundraising

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 - Contributes to disparities of wealth by race (Chetty et al. (2019))
 - Homophily in private capital markets (Ewens and Townsend (2020); Gompers et al. (2017))
 - Disparities in racial ownership may have substantial effects on what types of entrepreneurs get funded

To what extent do supply/demand factors explain this ownership gap

Our goal is a level of diversity in investment management firms that reflects the diversity in the world in which we live. As a starting point, I would like to emphasize the importance of entry-level positions. ... You will note that we are not asking about firm ownership as a factor in measuring diversity. Ownership per se does not necessarily relate to having a diverse investment team.

David Swensen, October 2020

While the systematic exclusion of people of color and women from the management of endowment assets has been a question of social justice over time, today it is for me a question of fiduciary responsibility. ... Study after study shows very high performing women and people of color, yet those same studies show under-utilization by asset allocators.

Rev. Al Sharpton, April 2020

What is/explains minority ownership in private equity?

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- We begin by demonstrating five key facts:
 - ① Black and Hispanic-owned groups (minority groups) represent a very modest share of the private capital pool
 - ② Minority groups raise smaller first-time funds
 - ③ Mixed evidence of performance
 - ④ Fundraising success of minority groups is more sensitive to performance
 - Particularly on the downside
 - ⑤ Minority groups are more likely to raise funds in periods of high racial awareness

We argue that limited representation of Black- and Hispanic-owned private capital firms stems at least partially from LP demand

Data

Burgiss: Data on 2,881 funds from investors in larger and more established funds (Brown et al. (2015))

- Burgiss sample:
 - 2,881 US funds, vintage 2000 or later — 40 minority owned
 - 22,059 deals, of which 10,815 exited — 257 by minority owned funds
- For fundraising analysis, construct a sample at the fund-quarter level:
 - A fund is included until the quarter in which a follow-on fund is raised, 10 years has passed since its inception, or Q2 2021
 - We compute intermediate Public Market Equivalents (Kaplan and Schoar (2005)) at the beginning of every fund-quarter
- For performance analysis, use deal-level data as of Q2 2021
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- We use PitchBook (larger sample) to confirm results from Burgiss and Form D for first-time group fundraising

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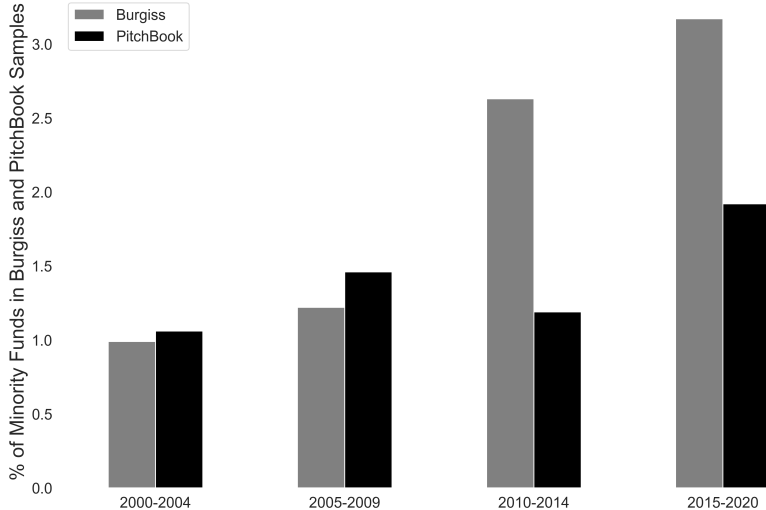
- ① We start with all private capital groups in PitchBook, Burgiss, and Form D filings (first-time groups)
- ② UpWorkers review each group's website twice to flag groups with suspected Blacks or Hispanics on team page
- ③ We additionally flag groups classified as minority-owned by Crunchbase, Preqin, pension funds, consultants, LPs, or media accounts
- ④ Authors verify ethnicity of partners and founders for each flagged group, using
 - ① Skin color or attendance at a HBCU (Blacks only)
 - ② Last name commonly associated with Hispanics (Census (2010))
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 - ③ Affinity groups in LinkedIn or news reports
- ⑤ A group is minority-owned if at least 50% of the founders or senior partners are Black or Hispanic (Ivashina and Lerner (2019) show that these senior members hold biggest ownership shares)

Findings

Few minority funds on a number (1.7%) and size-weighted basis (3.1%)



To what extent do minority groups struggle to enter the private equity industry?

$$\text{Outcome}_f = \beta_1 \text{Minority Owned}_f + \Psi \text{Controls}_f + \lambda_t + \alpha_s + \varepsilon_f$$

Controls: Gender, Ln(# Executives), indicators for VC fund (buyout omitted), and Ln(Age = Years since group formation)

Outcomes: Percent Raised, Ln(Funding Raised), Ln(# Investors), I(Used Broker)

We can use Form D to fix amount the fund is looking to raise (1863 Venture Fund I)

Total Offering Amount \$20,000,000 USD or ☐ Indefinite
Total Amount Sold \$2,100,000 USD
Total Remaining to be Sold \$17,900,000 USD or ☐ Indefinite

$$\text{Percent Raised} = \frac{\text{Total Amount Sold}}{\text{Total Offering Amount}}$$

Minority groups struggle to raise first-time funds (Form D)

	Percent Raised	Ln(Funding Raised)	Ln(# Investors)	I(Used Broker)
Minority Owned	-21.375*** (6.657)	-0.702*** (0.266)	-0.572** (0.268)	-0.057** (0.027)
Observations	541	541	541	541
Adjusted R^2	0.061	0.036	0.060	0.038
Year FE?	X	X	X	X
State FE?	X	X	X	X

Founders of minority-groups are similar to founders of non-minority groups (same sample)

	Minority Owned	
Venture Capital Fund	0.038* (0.023)	0.038* (0.023)
Frac. Emp Grad	-0.004 (0.044)	-0.004 (0.045)
Frac. Emp Top 50	-0.064 (0.051)	-0.063 (0.054)
Frac. Emp Sup	0.072 (0.063)	0.073 (0.064)
Frac. Emp PE	-0.007 (0.036)	-0.006 (0.036)
Ln(Executives)	-0.002 (0.022)	-0.002 (0.022)
Ln(Experience)	-1.788 (2.599)	-1.755 (2.688)
Frac. Emp LP		-0.008 (0.090)

For the minority groups that raise a fund, we find mixed evidence on performance

	All Deals			Exited Deals			Non-Exited Deals		
Minority owned	-0.371*** (0.083)	-0.366*** (0.085)	-0.460*** (0.098)	0.027 (0.290)	0.155 (0.315)	-0.154 (0.311)	-0.543*** (0.189)	-0.588*** (0.166)	-0.562*** (0.110)
Observations	22,059	22,059	20,954	10,815	10,815	10,576	11,244	11,244	10,378
Adjusted R^2	0.015	0.018	0.021	0.006	0.015	0.028	0.031	0.035	0.033
Controls?			X			X			X
Deal Year FE?	X	X	X	X	X	X	X	X	X
Group State FE?		X	X		X	X		X	X

Why is minority-group performance lower for non-exited deals?

- ① Non-exited deals are lower-quality investments
- ② Minority group owners are more conservative — more likely to hold investments at cost
- ③ Non-exited minority deals have had less time to mature — more likely to be recent deals

Minority groups are more likely to hold non-exited deals at cost

Dependent Variable:	I(Deal TVPI= 1)					
	Non-Exited Deals					
Minority owned	0.351 (0.508)	0.240 (0.453)	0.382** (0.187)	0.344 (0.479)	0.247 (0.425)	0.393** (0.182)
(log) Time Since Investment	-1.288*** (0.114)	-1.341*** (0.086)	-1.363*** (0.065)			
Observations	10,698	10,627	10,308	11,227	11,153	10,291
Pseudo R^2	0.243	0.284	0.330	0.298	0.335	0.332
Controls?			X			X
Deal Year FE?				X	X	X
Group State FE?		X	X	X		X

To what extent does inflow-performance differ by minority-group ownership?

$$\begin{aligned} I(\text{Raised a follow-on fund})_{fgq} = & \beta_1 \text{PME}_{fg(q-1)} \times \text{Minority Owned}_g \\ & + \beta_2 \text{PME}_{fg(q-1)} + \beta_3 \text{Minority Owned}_g \\ & + \Psi \text{Controls}_{fgq} + \lambda_q + \alpha_s + \varepsilon_{fgq} \end{aligned}$$

Controls: Log fund sequence, first-time fund indicator, indicators for buyout and VC fund (growth omitted). We cluster standard errors by investment group

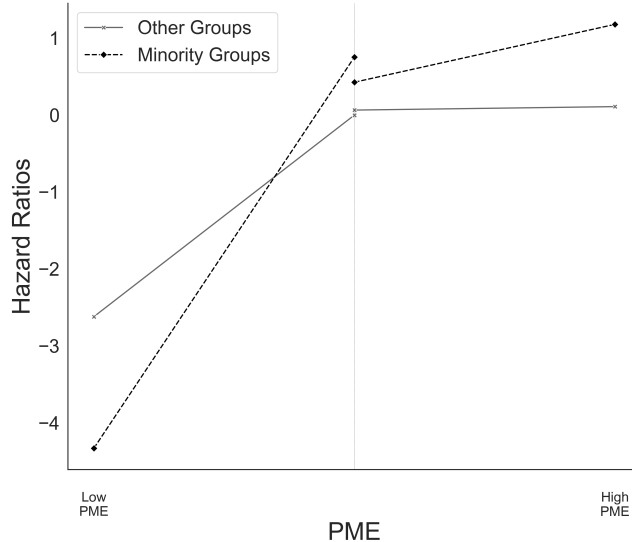
Inflow-performance sensitivity higher for minority groups

Dependent Variable:	I(Raised a follow-on fund)		
PME × Minority Owned	0.745** (0.292)	0.809*** (0.294)	0.677** (0.270)
PME	0.877*** (0.061)	0.862*** (0.064)	0.904*** (0.066)
Minority Owned	0.384* (0.197)	0.419*** (0.147)	0.426*** (0.155)

Sensitivity is concentrated within low-performing minority groups

Dependent Variable:	I(Raised a follow-on fund)		
PME \times Minority Owned \times High	-0.010 (0.665)	0.166 (0.518)	-0.063 (0.691)
PME \times High	0.165* (0.086)	0.159* (0.088)	0.266*** (0.092)
PME \times Minority Owned \times Low	1.847*** (0.193)	1.861*** (0.191)	1.919*** (0.183)
PME \times Low	1.847*** (0.193)	1.861*** (0.191)	1.919*** (0.183)

LPs appear more likely to punish low performance by minority groups



Disparate treatment of minority groups likely contributes to low minority ownership

- Investors appear less willing to tolerate failure of minority groups compared with non-minority groups
 - Terminate funding relationships with poor performing minority groups
 - Minority groups may thus exit industry during periods of low returns
- Interviews with industry practitioners corroborate this explanation
- Evidence from other academic studies is also consistent – gender (Niessen-Ruenzi et al. (2018)) and foreigners (Alok Kumar et al. (2015)) in the mutual fund industry

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- Nationwide measures of racial awareness coincide with other big events
- So we follow the sociology literature and use crowd-sourced data on fatal encounters between citizens and the police to proxy for racial awareness at a state level
- Identify 4600 fatal encounters between police and unarmed Black or Hispanic civilians between 2000 and 2020
- Weight by news stories in Lexis-Nexis
 - A case is mentioned in an average of 13.4 articles, but 66.3% have no coverage at all

Here are the top 10 fatal encounters by newspaper coverage

Name	Date	Number of Articles	Ethnicity	Age	Gender
George Floyd	May 25, 2020	37026	Black	46	M
Michael Brown	Aug 09, 2014	5937	Black	18	M
Daunte Wright	Apr 11, 2021	3144	Black	20	M
Walter Scott	Apr 04, 2015	1342	Black	50	M
Terence Crutcher	Sep 16, 2016	867	Black	40	M
Stephon Clark	Mar 18, 2018	828	Black	23	M
Jamar Clark	Nov 15, 2015	796	Black	24	M
Eric Garner	Jul 17, 2014	622	Black	43	M
Tony Robinson	Mar 06, 2015	451	Black	19	M
Atatiana Jefferson	Oct 12, 2019	387	Black	28	F

Fundraising likelihood higher during HRA periods

Dependent Variable:	I(Raised a follow-on fund)		
Minority Owned \times HRA	0.671*** (0.230)	0.676*** (0.198)	0.701*** (0.189)
Minority Owned	-0.193 (0.306)	-0.182 (0.255)	-0.192 (0.236)
HRA	-0.051 0.001	-0.085 -0.001	-0.098 -0.001

Conclusion: Limited representation of minority groups partially stems from investor demand

- What is/explains minority-ownership in private equity?
 - Minority-groups represent 1.7% of all private capital groups — 3.1% on a size-weighted basis
 - Minority-groups struggle to enter the private equity industry even though they appear to have similar characteristics
 - LP intolerance of poor-performing minority groups might lead these groups to exit industry during periods of low returns
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Work in progress:

- To what extent do minority public pension fund CIOs improve minority-group fundraising?
- To what extent do minority groups fund minority founders?

Thanks for your attention!