

# The Missing Element of Private Equity: Best Practices to Improve Boardroom Diversity



Corporate boards are vital in helping companies maintain a longer-term focus while executing on shorter-term priorities. And a board's unique stature, sitting atop the organization, allows it to shape corporate culture while guiding long-term strategy through a mix of mix of encouragement, guidance, and a healthy dose of skepticism. This role is consistent regardless of the ownership structure of the company—be it publicly held or privately controlled.

In 2018 FCLTGlobal embarked on in-depth research to identify the [long-term habits of highly effective corporate boards](#).<sup>1</sup> We found four characteristics consistent across successful public companies:

- they spend more time on strategy;
- they ensure that directors have a stake in the long-term success of the company, often by encouraging board members to hold company stock through and beyond their tenure;
- they communicate directly with long-term shareholders; and
- they have a diverse board to bring differing perspectives and backgrounds for the benefit of the company.

Portfolio companies controlled by private equity firms have a unique structure. Their boards typically include representatives of the controlling private equity firm or firms; management of the company; outside/independent directors (who may not be independent under the public company definition); and sometimes representatives of the limited partners, with either voting or observer status.

The boards of private equity—backed portfolio companies are already well versed in many of the key positive habits outlined above. We know from prior research and from conversations with our Members that portfolio company boards already spend more time on strategy than their

public peers. And the directors of private equity-backed portfolio companies often have meaningful stakes in the success of the business, as they represent the primary shareholders of the firm and are naturally already “communicating directly” with those same shareholders.

That leaves one potentially missing element for private equity-owned companies: *board-level diversity*.

Research shows that diversity at the board level adds meaningful long-term value for companies and their owners. Data from [Predicting Long-term Success for Corporations and Investors Worldwide](#) shows that the most diverse boards added 3.3 percent to return on invested capital as compared to their least diverse peers.<sup>2</sup> Additional research confirms this trend—a 2015 study from [McKinsey & Company](#) found that companies in the top quartile for racial and ethnic diversity are 35 percent more likely to have financial returns above their respective national industry medians, indicating that diversity can be a strong differentiator that shifts market share toward more diverse companies over time.<sup>3</sup>

In addition to improved performance, diverse boards consistently [invest more in research and development](#) and demonstrate an [increased capacity for innovation](#), giving their companies a meaningful competitive advantage.<sup>4,5</sup> A multifaceted team fosters not only creative innovation

<sup>1</sup>Ariel Babcock et al., *Long-term Habits of Highly Effective Corporate Boards* (Boston: FCLTGlobal, 2019), <https://www.fcltglobal.org/resource/the-long-term-habits-of-a-highly-effective-corporate-board/>.

<sup>2</sup>Bhakti Mirchandani et al., *Predicting Long-term Success for Corporations and Investors Worldwide* (Boston: FCLTGlobal, 2019), <https://www.fcltglobal.org/resource/predicting-long-term-success-for-corporations-and-investors-worldwide/>.

<sup>3</sup>Vivian Hunt et al., *Why diversity matters* (McKinsey & Company, 2015), <https://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters#>.

<sup>4</sup>Gennaro Bernile et al., *Board diversity, firm risk, and corporate policies* (2018), <https://www.sciencedirect.com/science/article/abs/pii/S0304405X17303215>.

<sup>5</sup>*Embrace the Business Imperative of Diversity* (BCG, 2020), <https://www.bcg.com/en-us/featured-insights/winning-the-20s/embrace-business-imperative-of-diversity>.

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but also resilience, and [lower volatility of returns](#).<sup>6</sup> Diverse perspectives and ideas keep companies flexible and better able to navigate, or rebound from, unexpected obstacles.

While these studies, and others, focused on the benefits of board diversity for public companies, there is no reason to believe that the same value-creation potential would not exist for those that are privately held—and data from The Carlyle Group confirms that view. In a 2020 study of its portfolio companies, [Carlyle found](#) that firms with two or more diverse board members recorded 12 percent higher annual earnings growth than companies with fewer diverse directors.<sup>7</sup>

Despite the evidence of the benefits of increased diversity, progress at private companies has been slow. A [2019 Crunchbase study](#) of the boardrooms of the most heavily funded private companies revealed that just 7 percent of board seats were held by women, and 60 percent of companies did not have a single woman on their board.<sup>8</sup> There is little reason to believe that the numbers are any better for people of color or those

representing other dimensions of diversity.

As private equity–backed companies comprise a significant and growing proportion of the economy, the diversity of their boards is receiving increased attention and provides an opportunity to promote diversity, equity, and inclusion (DE&I) alongside long-term value creation.

The best practices listed on the pages that follow are meant to serve as suggested behaviors to help general partners (GPs) and limited partners (LPs) increase diversity in their portfolio company boards. These suggestions were collected from leading GPs and LPs that have begun making strides in DE&I in their own portfolios. We recognize that many GPs and LPs are at different stages of this process and expect these best practices can serve as a starting point for some and offer a few new ideas for others. Some ideas may be more, or less, relevant for certain jurisdictions, geographies, or segments of the market and are included here for consideration at the user’s discretion.

Guidance for GPs And LPs As Direct Private Equity Investors or Co-Investors	Actions for Operationalizing Guidance
<p><b>Build senior support and oversight</b> Outspoken support from senior management helps remove barriers to change.</p>	<ul style="list-style-type: none"> <li>• Ensure that improving portfolio company (portco) board diversity aligns with or is reflected in the GP CEO’s goals.</li> <li>• Have GP senior management’s vocal support for portco board diversity (who is accountable?).</li> <li>• Clearly articulate the value proposition of diversity to ensure firmwide buy-in, and transform the conversation from “need” to “want” diversity on boards.</li> <li>• Put resources behind the portco board diversity initiative by giving it a budget.</li> <li>• Collect the detailed data required to track progress, as legally permitted by the relevant jurisdiction.</li> </ul>

<sup>6</sup>Gennaro Bernile et al., *Board diversity, firm risk, and corporate policies* (2018), <https://www.sciencedirect.com/science/article/abs/pii/S0304405X17303215>.

<sup>7</sup>*Better Businesses Have Diverse Teams* (Carlyle, 2020), <https://www.carlyle.com/impact/diverse-teams>.

<sup>8</sup>Gené Teare, *2019 Study of Gender Diversity In Private Company Boardrooms* (Crunchbase, 2019), <https://news.crunchbase.com/news/2019-study-of-gender-diversity-in-private-company-boardrooms/>.

# The Missing Element of Private Equity: Best Practices to Improve Boardroom Diversity

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<p><b>Build senior support and oversight (continued)</b></p>	<ul style="list-style-type: none"> <li>• Set internal metrics that track total portco board diversity and spotlight the portfolio companies that are succeeding or falling short.</li> <li>• Have annual governance health checks and review tracking metrics at every portco.</li> <li>• Integrate diverse governance into the broader board strategy.</li> </ul>
<p><b>Have clear approval processes</b> A clear approval process for board appointments can clarify who among the senior leadership of the GP firm is held accountable for portco board diversity improvement.</p>	<ul style="list-style-type: none"> <li>• Have a formal process for portco board nominations and clarify who has the final say on appointments.</li> <li>• Avoid an ad hoc approach to nominations.</li> <li>• Build the diversity team internally at the GP (e.g., appoint a director of DE&amp;I) to serve as a resource when nominating new directors.</li> <li>• Include diversity progress and achievements in the performance evaluation of leaders responsible for approving portco board directors.</li> <li>• Use a skills matrix approach and select directors based on the skills identified in the matrix.</li> <li>• With every director appointment, prepare a memo to explain why that appointee meets the needs identified.</li> <li>• In every director interview, ask a standard question on DE&amp;I.</li> <li>• Provide a mechanism for anonymous feedback to improve the recruiting and nominating process.</li> </ul>
<p><b>Expand your network for sourcing board directors</b> Recruiting candidates beyond traditional talent pools can expand the company’s contacts and allow for diverse candidates to find directorship opportunities.</p>	<ul style="list-style-type: none"> <li>• Cultivate a network of diverse directors who can be recruited into board service.</li> <li>• Establish relationships with board recruiters who are well connected in communities that are less well represented and curate relationships with recruiting firms that focus on diverse candidates (make DE&amp;I a priority).</li> <li>• Work with preferred partners—subject matter groups or other external partners known for diverse talent pools that are in demand.</li> <li>• Sponsor events to meet new talent (e.g., speed networking sessions) and connect and expand the networks for sourcing talent.</li> <li>• Maintain a database internally of diverse board candidates to build a pool with critical mass.</li> <li>• Consider referrals from existing diverse directors when sourcing talent.</li> <li>• Consider the usefulness of directors who sit on boards in the customer segment the company sells to.</li> </ul>
<p><b>Rethink traditional definitions of “board ready”</b> Removing “shortcuts,” such as prior positions or titles held, can increase the pool of qualified candidates.</p>	<ul style="list-style-type: none"> <li>• Expand the criteria for how you define “qualified” by looking at the skill set you need rather than past positions or titles held.</li> <li>• Consider looking for individuals from outside the traditional business community to source specialty skills (e.g., people from academia, members of the military, scientists, executives of large nongovernmental organizations).</li> </ul>

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<p><b>Rethink traditional definitions of “board ready” (continued)</b></p>	<ul style="list-style-type: none"> <li>• Proactively filter the job criteria to ensure that the role is not mis-scoped, overly specified, or exclusionary.</li> <li>• Be open to first-time directors.</li> </ul>
<p><b>Make board seats attractive to diverse directors</b> Clearly articulating a detailed value proposition is critical for attracting diverse board candidates.</p>	<ul style="list-style-type: none"> <li>• Recognize that the war for talent extends to board candidates and compete to attract the best candidates.</li> <li>• Be able to articulate why a director would want to serve this company and, on this board, specifically at this time (value proposition of the portco).</li> <li>• Be able to articulate what skills the diverse candidate brings to the board and how you believe they will contribute beyond their diverse background.</li> <li>• Include opportunities for ongoing board service and networking with other directors (value proposition offered by affiliation with the GP).</li> <li>• Offer the opportunity to co-invest.</li> <li>• Consider at least two diverse directors for small boards and at least three for larger boards to ensure an inclusive environment.</li> <li>• In addition to recruiting diverse candidates, focus on retention and inclusion once they join.</li> </ul>
<p><b>Provide onboarding and development for all new board members</b> All new board members can benefit from a positive onboarding experience.</p>	<ul style="list-style-type: none"> <li>• All board members, whether diverse or not, may benefit from a positive onboarding experience.</li> <li>• Provide time and space for “courageous conversations” in which people can share their experiences relating to the impact of diversity and inclusion—or lack thereof—to broaden understanding and offer increased opportunity for collaboration.</li> <li>• Provide access to due diligence and corporate strategy materials to independent directors, as they are not often part of the deal process.</li> <li>• Assign each new board member a mentor on the board to serve as a resource during the onboarding process.</li> </ul>
<p><b>Provide ongoing development opportunities for all board members</b> All board members will benefit from ongoing development efforts.</p>	<ul style="list-style-type: none"> <li>• Offer continuing development opportunities, especially focused on equity and inclusion, for all directors.</li> <li>• Develop a process to support and prepare independent board directors so that they can be as well-resourced as GP directors.</li> <li>• Ensure that all directors are included in the “between board meetings” work—especially if an independent director is not on a committee.</li> <li>• Rotate agenda and meeting facilitation or committee chairs/roles in a preset way to refresh perspectives.</li> </ul>

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Guidance for GPs And LPs As Direct Private Equity Investors or Co-Investors	Actions for Operationalizing Guidance
<p><b>Rethink the number and allocation of board seats</b> Being strategic about the use of board seats allows for more access to new and diverse ideas.</p>	<ul style="list-style-type: none"> <li>• Ensure that boards are diverse from their earliest days, rather than trying to add diversity later in the portco’s life cycle, when inclusion becomes more difficult, let alone just prior to an initial public offering or exit.</li> <li>• Limit GP employees’ maximum number of boards to open seats for diverse directors.</li> <li>• Limit the maximum number of boards seats held by GP employees on any given portco board (e.g., if you have three seats to fill, two could be internal and the third must be external).</li> <li>• Consider whether directors, especially independent ones, are over-boarded.</li> <li>• Consider increasing the size of the board.</li> </ul>

LPs have a clear role to play in driving diversity on the boards of the portfolio companies in their chosen GPs’ funds, leading to better outcomes for both parties.

Guidance for LPs as Investors in a Fund	Actions for Operationalizing Guidance
<p><b>Have a plan</b> Having a clear purpose for collecting diversity data, including its impact on decision-making, will communicate the importance of this information.</p>	<ul style="list-style-type: none"> <li>• Ask yourself what you will do with the data after you obtain it.</li> <li>• Be prepared to articulate the answer to this question to GPs, including intentions and consequences, and the timeline for implementing those consequences.</li> </ul>
<p><b>Focus on investing with GPs that align with your diversity goals</b> Investing with forward-thinking GPs could lead to greater returns.</p>	<ul style="list-style-type: none"> <li>• Invest with GPs that align with your diversity goals.</li> <li>• Evaluate whether a GP is currently delivering the desired diversity outcomes.</li> <li>• Evaluate whether a GP is likely to deliver the desired diversity outcomes in the long term, based on progress.</li> </ul>
<p><b>Put diversity at the forefront</b> Incorporating evaluation of the diversity strategy into due diligence signals that it is a priority to the organization and not an afterthought.</p>	<ul style="list-style-type: none"> <li>• Ensure that senior members of LP organizations ask senior members of GP organizations questions on diversity, rather than leaving the issue to diversity professionals or the request-for-proposal process.</li> <li>• Ask for diversity information in the “Talent” section of the diligence memo, not in the back, to emphasize its importance.</li> <li>• Ensure that nondiverse decision makers are vocal about the importance of diversity when engaging with GPs.</li> </ul>
<p><b>Offer support to GPs in sourcing and hiring diverse directors</b> Expanding the network for GPs to tap helps accelerate progress and demonstrates LP commitment to diversity.</p>	<ul style="list-style-type: none"> <li>• Give GPs access to your talent-recruiting networks.</li> </ul>

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Guidance for LPs as Investors in a Fund	Actions for Operationalizing Guidance
<p><b>When nominating observers or nonvoting directors, consider diverse directors</b></p> <p>Even when they are nonvoting, the presence of diverse people in the boardroom can amplify the voices of voting members of the board, magnifying their influence and contributing to a more inclusive boardroom environment.</p>	<ul style="list-style-type: none"><li>• Use observers or nonvoting seats strategically to improve diversity in the room.</li></ul>

## RESOURCES FOR FURTHER DETAIL:

The [Roadmap](#) work by the Institutional Limited Partners Association

[50/50 Women on Boards](#)

[Ascend](#): Pan-Asian Leaders

[Catalyst](#): Women on Board Initiative

[Diligent](#): Board Diversity Network

[Equilar](#): Diversity Network

[Executive Leadership Council](#): Corporate Board Initiative

[Forte Foundation](#): Global Board Ready Women

[Harvard](#): WomenExecs on Boards

[Latino Corporate Directors Association](#)

[Out Leadership](#)

[Sigma Pi Phi Fraternity](#)

[Stanford Women on Boards: Board Match Service](#)

[Thirty Percent Coalition](#)

[Toigo](#): All A Board Initiative

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