Guest Column

Diversity in the Asset Management Industry: An Oxymoron

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By Pamela M. Harper, Esq.

Harvard Business School and Bella Research Group recently published the results of a study commissioned by the John S. and James L. Knight Foundation which chronicled the ownership of women and minority- owned firms in the asset management industry.

Examining the four asset classes of mutual funds, hedge funds, private equity, and real estate, the study found underrepresentation of women and minorities across all classes. This is neither news, nor regrettably surprising; however, it is symptomatic of a lack of parity within the industry as a whole.

The asset management landscape is underrepresented by women as well as minority- owned firms.

The study found that women and minority-owned firms comprised 8.8% and 7.4%, respectively, of the total of 1,448 mutual fund firms. Of the $47 trillion in mutual fund assets under management, women-owned firms managed $406 billion or 0.9% and minority-owned firms managed $160 billion or 0.3%.

In the hedge fund space, women-owned firms and minority-owned firms represented 4.3% and 8%, respectively, of the total number of 1,198 hedge funds. With women-owned firms managing $70.2 billion and minority-owned firms managing $40.1 billion, this represents less than 1% of the total $16.2 trillion in assets under management in the hedge fund industry, replicating the pattern found with mutual funds.

In terms of the absolute number of diverse private equity firms, the profile is similar to that of hedge funds in that the universe of firms in the dataset is relatively small with 52 women-owned firms and 98 minority-owned firms out of a total of 2,679 private equity firms. Respectively, women- and minority-owned firms managed $45 billion (1.5%) and $100 billion (3.4%) out of an industry total of $2.98 trillion. Absent real estate, it is the asset class with the lowest percentage of diverse ownership.

The study did acknowledge that "real estate is the asset class that suffers most from incomplete diversity data, so our measures likely understate the true representation of diverse owned real estate firms." The Final Report identified six women- owned real estate firms managing $3.4 billion, and 18 minority-owned firms managing $16.3 billion in AUM.

The evidence suggests that minority-owned firms clearly have more ground to make up, particularly in the mutual fund and hedge fund space.

At the most fundamental level, underrepresentation is the result of a confluence of factors ranging from a limited universe of players in the market to lack of sufficient infrastructure, and investor perceptions of heightened risk. These constitute, if not barriers to entry then, barriers to sustainability.

However, for those diverse firms that are already in the industry, consider the following:

1. **Diversify the client mix**. Within the mutual fund asset class, the largest allocations are generated by corporate clients and this is the market in which the disparity is greatest between women- and minority-owned firms. Historically, minority-owned firms tended to focus on public funds. It is difficult to truly grow a firm if public funds are the primary and/or only source of revenue generation. Expanding the portfolio of clients to include corporations is critical for firms scaling their business.

2. **Revisit the structure of emerging manager programs**. The lack of consistency in how emerging managers are defined continues to be problematic, therefore making the term a fungible concept. Definitions range, depending upon the jurisdiction, from less than $2 billion in assets under management to at least $10 million but less than $10 billion. Recognizing that there are multiple jurisdictions with multiple definitions, standardization and a structure similar to uniform certification would impose some discipline onto the process. For example, at a certain threshold, a system that allows for uniform certification of a woman- or minority-owned investment firm as an emerging manager and reciprocity among jurisdictions would mitigate a lot of confusion. As a public policy matter, this is the type of initiative that diverse firms, under the guidance of industry advocates, such as the National Association of Securities Professionals (NASP) and the National Association of Investment Companies (NAIC), could champion.

3. **Take compliance seriously**. Smaller firms in general, and women and minority firms specifically, are perceived as carrying a greater degree of risk. The vetting process, whether by corporate funds, public funds, endowments or managers-of-managers (MoM), is key and being prepared during that process is critical. It is not an ancillary exercise and diverse firms should not assume that the risk analysis during the vetting process is limited exclusively to portfolio and or fund risk. It is enterprise-wide and the ability to demonstrate that internal controls and protocols are in place provides a competitive advantage. Bottom line, neither a corporate client, public fund or MoM, wants to assume the reputational risk and fall out from a bad investment allocation decision. The burden is on women and minority-owned firms to give investors a compelling business reason, in addition to performance, to commit funds. Compliance serves that function.