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It's racial bias, not merely an issue of access

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Black fund managers must overcome racial bias to win institutional money and are judged more harshly as top performers, research finds.

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New research pokes holes in the theory that the lack of diversity in asset management is primarily a pipeline problem, caused by either a lack of access or outreach to minority talent in the field.

There are "systemic racial disparities in how investors evaluate funds and allocate money," a research paper published Aug. 12 by Stanford University and Illumen Capital, a venture capital and private equity firm in Oakland, Calif., found.

When institutional investors were asked to evaluate seemingly real "one-pagers," or summaries of venture capital teams led by white vs. black men with near identical credentials and track records, researchers found that top-performing funds led by black managing partners appeared to be "most harmed by racial bias," the paper said.

"Even when funds led by people of color possess identical, strong credentials as white-male-led funds, they are judged more harshly," the paper noted.

The new research on racial bias in institutional investing was published in the scientific journal Proceedings of the National Academy of Sciences and funded by Prudential Financial and the William and Flora Hewlett Foundation.

For the study, researchers asked 180 primarily white asset allocators to evaluate "one-pagers," which displayed four fictitious venture capital teams — two led by black male managing partners and two by white male managing partners. There was one weak and one strong performing fund for each group.

"To test for the presence of bias, we analyzed asset allocators' responses to the following: overall performance ratings of the team, evaluations of investment skills, attributions of competence, attributions of social fit, expectations of how much the fund would raise and the likelihood of taking a meeting with the team, beginning due diligence and investing in the team," the paper said.

Preliminary study first

Researchers first did a preliminary study before experimenting with the races of managing partners listed on the one-pagers, to make sure asset allocators would perceive both the two stronger funds as equal in quality, as well as the two weaker funds. For the main study, researchers used photos from the Chicago Face Database of the University of Chicago to create fund teams. Adobe Photoshop was used to superimpose solid-colored, button-down shirts on each person, while names were selected that were deemed ambiguous in terms of race and social class, and similar in terms of likelihood of being a fund manager, according to supplementary information published alongside the paper.

The paper, "Race Influences Professional Investors' Financial Judgments," was co-authored by Sarah Lyons-Padilla, Hazel Rose Markus, Ashby Monk and Jennifer L. Eberhardt at Stanford University, and Sid Radhakrishna, Radhika Shah and Norris A. "Daryn" Dodson IV at Illumen Capital.

"There is a bias that exists, and that is preventing a whole group of allocators from properly considering a full set of market opportunities," Mr. Monk, the executive and research director of the Stanford Global Projects Center, said in an interview about the findings. "Our data ultimately shows that asset allocators are leaving money on the table."

Mr. Dodson, who is a managing partner at Illumen Capital, said the research "helps put to rest the idea that it's only a pipeline problem," that affects how investors allocate capital to minority fund managers.

The study noted that less than 1.3% of the industry's $69 trillion in assets under management is managed by women and minorities.

"You can imagine across the country, there are hundreds of fund managers that are presenting to asset allocators and very few of them get investments," Mr. Dodson said. "They then ask themselves: 'What's wrong with me?'"

The research helps reframe the question in a powerful way, he said. It asks, "What's wrong with the process?"

According to Mr. Monk, the team selected venture capital for the study because "we did want a risky asset class (or) one people did perceive as risky, where you often assess very deeply the caliber of the managing partner."

‘Spot on'

Robert L. Greene, president and CEO of the National Association of Investment Companies, Washington, called the research "spot on" and "extremely consistent" with what he and member firms have experienced in the industry.

NAIC's members are diverse-owned private equity and venture capital firms as well as hedge funds collectively managing more than $100 billion in assets for institutional investors.

"The notion that the higher performing firms had even more challenges with market bias, we've observed that definitely," Mr. Greene said.

"We've found that unless institutional investors are intentional about identifying top-performing (diverse) managers and getting them into searches, they oftentimes don't come out with a diverse manager," he added.

While researchers saw evidence of bias against the funds led by black men — asset allocators did not rate the strong, black male-led teams as favorably as the strong teams led by white men — they also found that asset allocators could not distinguish between the stronger and weaker fund management teams led by black men.

Additionally, researchers noticed bias in favor of black male-led teams with weaker performance, the paper said. But institutional investors were not likely to invest in either black or white-led teams with weaker performance.

There are two possible explanations for the bias in favor of weaker performing black male-led teams.

Funds with white male leaders "who are stereotyped as competent, might be penalized more for underperforming in a domain where they typically succeed," the paper said.

"A second possibility is that asset allocators felt compelled to give black male-led teams the benefit of the doubt and felt morally credentialed by charitably rating the lower-performing black male-led team strongly, thereby relieving themselves of any sense of obligation to express serious intentions to invest."

Overall, the case study found that minority fund managers "are likely to encounter more bias as they achieve stronger credentials," researchers found.

Researchers likened the findings to the results of a March 2018 study by Natasha Quadlin of Ohio State University, which found that female job seekers with the strongest credentials were penalized substantially more than men and more than women with weaker credentials, the paper said.

Trained to overcome biases

The study suggests that asset owners should be trained "to overcome their biases by revamping their investment criteria and strategies, and ensuring they are knowledgeable about the success of firms led by people of color," the latest paper said.

Ms. Eberhardt, who is a social psychologist and professor in the department of psychology at Stanford University, noted the fact that most of the participants in the study were white has its own implications about the impact of underrepresentation on the investor side.

Out of 180 asset allocators who participated in the study, 131 were white, 15 East Asian, six South Asian, six multiracial, five Hispanic/Latinx, and five "other," while one was Middle Eastern and one black. Ten participants did not report their race or ethnicity, the paper said.

"That has a real impact on how people think … The disparities that you find in the system can also influence the bias that people carry around in their head, and it does so in a way that disparity is self-perpetuating," said Ms. Eberhardt, who is also the author of the book "Biased: Uncovering the Hidden Prejudice That Shapes What We See, Think, and Do."

JoAnn H. Price, co-founder and managing partner at Fairview Capital Partners Inc., a West Hartford, Conn.-based private equity and venture capital firm serving institutional investors, said the minority-owned firm wouldn't have been as successful without the network-building she and co-founder Laurence C. Morse set out to do.

"We (joined) non-profit boards and got to know people that we wouldn't have known otherwise," Ms. Price said. "We gave and contributed and built a network across the country."

Fairview has been in business for 25 years and has $9.7 billion in assets under management, she said.

‘A lack of knowledge'

Of the research paper, which showed more bias against strong-performing funds led by black managers, she noted: "I think part of the bias is a lack of knowledge, (such as) the connectivity to that particular group because you are calling for references."

"You are trying to check (as an investor), and you don't really know anyone that knows them," she added.

In her experience, investors might also question whether diverse managers' achievements are because of affirmative action programs.

"There's no reason to think that it wouldn't happen in private equity, if it happens in every other intersection in this country. There's a constant proving, and we have to spend more time proving than our counterparts," Ms. Price said.

Juan J. Martinez, vice president, chief financial officer and treasurer of the John S. And James L. Knight Foundation, Miami, which has $2.3 billion in assets, said there is a "cultural fallacy" of more risk associated with minority- and women-owned firms.

"It becomes sort of an inherent bias against people you don't think you have a lot in common with – and it's a risk-mitigation thing," he continued. "Part of the conversation should be how are we (as investors) being intentional as decision-makers that we have a variety of viewpoints around the table."

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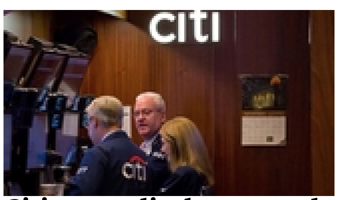

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