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Financials. Asset management

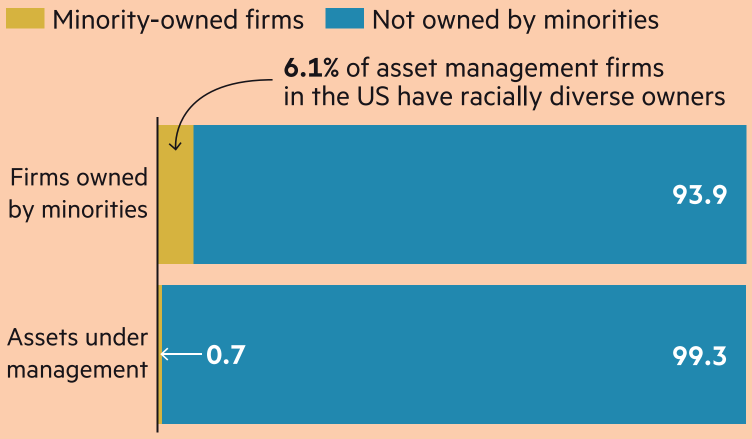
Trillions of dollars bypass black-run funds

Allocations continue to lag behind white counterparts, Ariel founder Rogers warns

MADISON DARBYSHIRE — NEW YORK

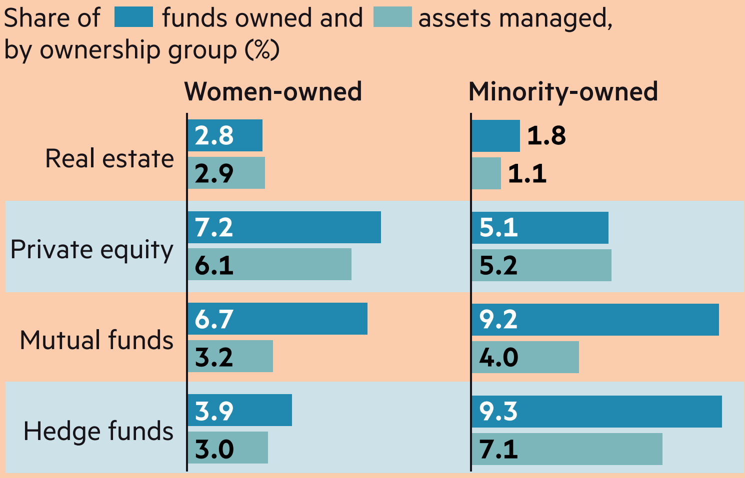
Racially diverse asset managers receive 0.7% of capital in the US

% of total



Source: Knight Foundation

Women and minorities under-represented and under-funded



Investment allocations to ethnically diverse managers are still lagging far behind their white counterparts, as racial bias and outdated practices persist in the US fund industry, says John Rogers, founder of $15bn fund Ariel Investments.

"People are used to thinking of minorities as experts in music or athletics, but not as mutual fund managers or investment bankers," Rogers, the founder of the first black-owned asset manager in the US, told the Financial Times.

The lack of allocations to minority-run firms poses a "huge problem" for minority owned asset managers, Rogers said. Small firms struggle to afford the same tech, compliance and training to develop future talent — the things required to be successful and compete against trillion-dollar managers.

And when non-white managers attract investment, they can run into a Catch-22 on size: too big to be considered for capital earmarked for "emerging firms" yet still too small to receive big tranches of capital required to scale, and shunted aside for their success.

"Years ago everyone told us 'you need to get to scale for us to hire you, you need a track record and you need all the expensive bells and whistles'. But once you get all the bells and whistles, they say 'You are too big'," said Rogers, who founded Ariel in Chicago in 1983. "It's so patronising."

"If you can't grow because they say you're already too big, then you go backwards, not forwards," he added.

While more than 6 per cent of US fund managers across asset classes are now minority-owned, they receive just 0.7 per cent of US dollars under management, according to a 2021 report by the Knight Foundation.

Allocation data is skewed by the presence of vast passive funds but data show racism is still a problem in the industry.

A Morgan Stanley survey from October found that 70 per cent of white investment decision makers in large US pension funds, endowments, insurance companies and foundations still believed that prioritising diversity in their investment management meant sacrificing returns.

"There is profound and persistent bias in the industry — an actual belief that people of colour cannot manage money at the highest levels," said Robert Raben, founder of the Washington DC-based Diverse Asset Managers Initiative and former US assistant attorney-general.

"There are black and brown managers, and we have data that shows they're high performing. But as long as the majority of people think it's a performance trade-off we will continue to have a huge demand problem," Raben said.

Two different studies by Harvard Business School and Bella Private Markets looking at returns from 2008-19, found that minority-owned firms either performed as well as, or outperformed, their white-owned peers.

"This is the ultimate country club. You can be a scratch golfer but you're not a club member," said one multibillion- dollar black asset manager who spent decades at a top private equity firm and who says he has to meet hundreds more investors than his white colleagues to raise similar amounts.

A 2019 study by Stanford University found that people of colour and women were not only expected to possess higher qualifications than their white male peers, they were also considered riskier investments. They were twice as likely to be predicted to underperform regardless of past outperformance. The top performing managers of colour were the most harshly judged by allocators, the study found.

The allocation gap is especially pronounced in the mutual fund industry, where more than 9 per cent of firms are minority-owned, yet receive less than 0.5 per cent of the more than $74tn in capital under management, according to the 2021 Knight Foundation report, which examined more than 10,000 firms and $82tn in total assets. Census estimates from 2020 found that at least 40 per cent of America identified as races other than white.

> 'If you can't grow because they say you're already too big, then you go backwards, not forwards'

Almost every big asset manager in the US promised to improve the diversity within its operations, but a report late last year by the House Financial Services committee found that little improvement had been made.

Among allocations, even pension funds, which are widely considered to be the most advanced in diversifying their external allocations, are lagging.

"After George Floyd's murder there's pressure to do the right thing, but there are so many giant [allocators] flying beneath the radar, and no one has thought to challenge them," said Rogers.

Small progress has been made — although the allocations they receive are small by comparison, diverse-owned funds are growing at a faster rate in some asset classes, such as hedge funds and private equity, Knight found.

However, consultants who help allocators decide on their investments say the wider problems are persistent and slow to change. "We have well intentioned rules of thumb about things like the number of years of a track record needed, minimum size, that it be a firm that you've worked with before," said Sam Austin, a partner at investment consultancy NEPC. "Those are all things that passively exclude people . . . and discount diverse talent."

"If you're a tiny firm . . . you're a rounding error compared to a BlackRock, or a Fidelity," said Rogers. "You have to just keep nudging. You want to do what [civil rights activist and former congressman] John Lewis says, when you see things that are not right you have to point it out.