Intentionally embracing diversity enhances investment returns

By Jagdeep Singh Bachher and Richard Sherman

Six years ago, when the investments team at the University of California began crafting an ESG policy that required environmental, social, and governance risks to be incorporated into all our investment decision making, we laid bare an underlying and ignorant bias within the financial industry.

This ignorance sounded something like this. ESG issues were "soft," best left to investment dilettantes and political liberals. Since when did a good conscience lead to good returns? Fossil fuels powered the world and always would. And high-performance teams came from cohesive groups that thought and looked alike. Never mind what the data show – that diverse investment teams performed as well as or better than others – the "S" and the "G" of ESG were seen as particularly subjective and vague.

Today, as millions of Americans take to the streets to protest the racism still embedded within our national institutions, such ignorance persists. That costs lives, missed opportunities – and money.

UC Investments doesn't pretend to have all the answers. But as fiduciaries for the University of California, our duty is clear as we manage our $130 billion portfolio. We must always act in what we believe to be the best financial interests of our stakeholders, a mandate never more essential than during times of economic upheaval and stress. Our ESG policy, and the 10 pillars of the UC Investments Way, have charted our path forward. They make intentions clear.

As to the "E" in ESG, we asked a lot of questions over the past six years, collected data, and gauged risk. What we determined was that holding onto our fossil fuel assets didn't make financial sense for long-term investors such as ourselves. That's why today our pension, endowment, and working capital are fossil-free.

Now we have turned the full force of our attention to "S" and "G," the social and governance risks into which issues of diversity, equity, and inclusion fall. We have even given this effort a name: Diversified Returns. Our actions are premised on what we know to be true, that diverse teams lead to higher performance and better results. But it seems that the U.S. finance industry as a whole hasn't gotten the message yet. The latest data show that of some $69 trillion in assets under management, only 1.3 percent are managed by women and underrepresented minorities.

That's why last year UC Investments conducted its own demographic survey of the partners we invest with. We wanted to know what percentage of our assets were managed by women or underrepresented minorities and how many of our investment partners were firms owned by those same groups. With a survey response rate of 92%, we verified that 35 of these 106 investment partners are substantially or majority diverse or woman-owned. And while the survey results confirmed UC Investments was headed in the right direction, they also gave us fresh impetus to improve – which we have.

As of the end of 2019, we had invested $8.6 billion with women managers, $0.6 billion with Latinx owned firms, and $0.5 billion with Black-owned firms. Within the past six months alone, the amount we've invested with both Black and Latinx owned firms has doubled, to $1 billion each. The number of Black-owned firms we've invested with has doubled as well. And over the next four years, we will invest at least another $2 billion with emerging investment firms, in both the private and public realms.

Because we manage the money of the largest public research university in the nation, we are also able to connect promising students from different backgrounds with our most significant investment partners, firms that manage trillions of dollars in assets. We commit to that. We will work with the chancellors of our 10 campuses to create a pipeline of underrepresented talent, today's students who will become tomorrow's finance leaders and entrepreneurs.

UC Investments intends to increase our access to and inclusion of diverse talent when we invest, when we hire, and when we exercise our rights as a company shareholder. We will not let implicit or institutional bias hamstring our investment performance, and neither should anyone else.

Our success will not be summed up by a single metric; we will not chase arbitrary numbers or fill quotas. We have been transparent about our efforts in diversity and will continue to track and report our progress. Our success here involves people, and culture, and human relationships, and as such, no single static milestone can mark a victory. Our efforts and results will evolve.

But as we did with the "E" part of ESG, we have begun an intentional process that will lead us to answers on diversity, equity, and inclusion. Our bottom line will ultimately telegraph the measure of our success.

"Risk Rules" is one of the 10 pillars that guide our investment strategy, and navigating the financial landscape without accessing the full range of top talent would be akin to tying one hand behind our backs. That is a risk we are unwilling to take. Another pillar is "Creativity Pays." We will use innovative ways to find and support that top talent. The effective use of technology and data in these efforts is vital; what we call "Human Meets Machine." We will "Team Up" to ensure inclusion. And the endzone will be our "Centennial Performance." Our strategy and tactics to increase diversity, equity, and inclusion will help financially sustain the University of California for the next 100 years.

Too often, we've heard financial leaders ponder questions that lead to delays rather than action when it comes to diversity, equity, and inclusion. What will success look like? And how will we ever get there? To this, we offer some advice. Be intentional, check your biases, trust the data. Then act.

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