THIRD WAY

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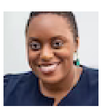
# Women Wanted: The Equity Gap in Venture Capital

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## Takeaways

Venture capital is a key part of the financial infrastructure that provides for innovation and wealth creation around the globe. Yet, despite a record year for venture capital, women and minority entrepreneurs reaped remarkably little benefit compared to white men in the industry.

- Black and Hispanic female entrepreneurs received just 0.43% of all venture capital investment in 2020.
- Higher rates of female and minority hires at VC firms are mostly in support and clerical roles.

- The small number of female-led venture firms have tiny portfolios compared to male-led venture firms.
- While important progress has been made to expand racial and gender equity in the industry, there is still far more to do.

Even through a global pandemic and with economic uncertainty weighing heavily over the capital markets, the venture industry in 2020 had its third consecutive year reaching record-breaking fundraising highs. In just one year, venture firms invested over $166 billion to seed, scale, and take public the next generation of innovative companies. [1] These investments are a positive step forward for our nation's recovery, and venture capital continues to be a key part of the financial infrastructure that provides for innovation and job growth. But a deeper look into the data reveals women, Black, and Hispanic entrepreneurs are seeing far less compared to non-minority counterparts in both accessing these dollars as founders and directing investment decisions as senior industry partners. As we show below, some progress has been made to expand equity in the industry, but there is still far more to do so the benefits of investing in women and minority founders are ubiquitous.

Entrepreneurial success is one of the greatest drivers of wealth creation and must be at the center of any national effort to create racial equity and expand economic opportunity. But if we want millions more women and people of color starting new businesses, scaling high-growth businesses, and exiting businesses to create new economic opportunities, we must understand and break down barriers standing in their way throughout the entire entrepreneurial ecosystem. In this report, we look specifically at equity in the venture capital space.

# Background: The Venture Capital Landscape

In simple terms, venture capital (VC) is a form of private financing where capital is invested into fast-growing, often disruptive and high-risk technologies that can't access traditional financing because of the nascent stage of the startup. Investments are made in exchange for partial ownership in that company. Venture capital firms raise money from Limited Partners—usually pension funds, endowments, and high net worth individuals. This capital is then managed and deployed by General Partners into businesses, with the goal of maximizing returns for investors and accelerating the expansion of companies in their portfolio.

Entrepreneurs seeking venture capital have unique needs that typically make them unsuitable customers for traditional financing institutions. Most successful startups require several multimillion-dollar rounds of funding, assistance in scaling the company's revenue, guidance about management and personnel, and industry-specific expertise and connections—resources that are often beyond what local banks and credit unions are able to provide. So, venture capital and the workforce that powers its ecosystem fill a crucial gap that enables the technologies and industries we engage in everyday to expand and move our economy forward.

# VC's Glass Ceiling

Like most of the financial services industry, the venture capital ecosystem has been dominated by men on both sides of the table. Whether you were an investor expanding your portfolio or a founder seeking financial support, chances are that you were a white, Ivy-league educated male.

Fortunately, more women have entered the workforce and the industry has begun to diversify. But there is still much room for improvement. For example, women make up 45% of the total venture capital workforce but in the key role of investment partner, industry surveys say only 5-16% of those positions are held by women. [2] While the proportion of women in senior positions has been trending upward in recent years, data from a survey of more than 370 VC firms show that, in 2020, men were still making partner at more than five times the rate of women. [3]

Among women of color, the figures are especially stunning. For example:

- Only 1% of Black women and 2% of Hispanic women in venture capital are partners at their firm. [4]
- One survey from the National Venture Capital Association found that, in 2020, only 7% of firms had Black partners, male or female. [5]
- It is far more likely to find women in administrative, operational, and support roles. Among Black venture capital professionals, women are five times more likely to work in support positions than serve as investment partners. [6]
- Only about 10% of female investment partners have held their position for 10 years or more, signaling that the advancement of women in the field is a recent phenomenon. [7]

The fact that women and minorities are often not well-represented at the General Partner (GP) level does not come as a total surprise. GPs are industry veterans with significant business, analytical, and entrepreneurial experience that makes them valuable to their firm and the companies they invest in. GPs also undertake enormous financial risk by investing in startups that operate pre-revenue for years at a time. Often, GPs are forgoing a personal salary for several years and are expected to commit personal funds in addition to locking in fundraising from Limited Partners. These are extraordinary pledges to ask of women and people of color that face long-standing obstacles in securing economic security. Between low levels of individual wealth, difficulty making connections with established operators, and meeting the needs of daily life like affording child care, it is little wonder why more people from these communities are not able to step into the influential role of GP.

Yet, strides have been made in the industry. One study reports a 7-percentage point increase of women in junior investment roles in the last four years. [8] The same report shows a 2% increase in Black junior investors and 5% for Asian and Pacific Islanders in these roles. [9] Firms are also recognizing their efforts to diversify their workforce in the past were leaving many behind. That has led to a growing number of venture firms which have begun to deploy human capital strategies that place a greater emphasis on diversity and inclusion. [10] The more intentional approach to recruitment, promotion, and retention practices is a welcome sign that the tide is beginning to turn.

## Women-led VC Firms Are Ushering in the 'New Majority' of Entrepreneurs

Melissa Bradley started 1863 Ventures two years ago to reduce the "friction" she experienced in the process of launching her first company, Ureeka. Today, the firm has helped more than 2,500 early-stage companies harness their growth potential, train their business leaders, and access capital to multiply their operations and impact. [11]

Bradley is a prominent example of the increasing number of firms led by women to uplift communities that have historically faced barriers as they've tried to launch, fund, and run their companies.

These firms are transforming the current structure of the venture community, particularly since the number of women in senior investment roles at top-rated funds has remained despairingly stagnant for the last decade. Despite the positive trend, venture capital firms led by women make up just a small segment of all VC firms in the marketplace, and their assets under management are a fraction of the capital controlled by male VCs. [12] A recent survey by a venture capital professional network, BLCK VC, confirms the same is true for minority-owned venture firms. Their *State of Black Venture* report found that funds raised by Black VCs are 45% smaller than the industry average. [13]

However, the rise of female- and minority-led firms shows that VC investing is not what it was 20 years ago. Success is no longer limited to upper echelon investors and established funds. According to global investment firm, Cambridge Associates, new and emerging managers are consistently among the top performing. [14] And with 90% of all women-led funds falling into the emerging manager category, this continues to be a bright spot for the industry.

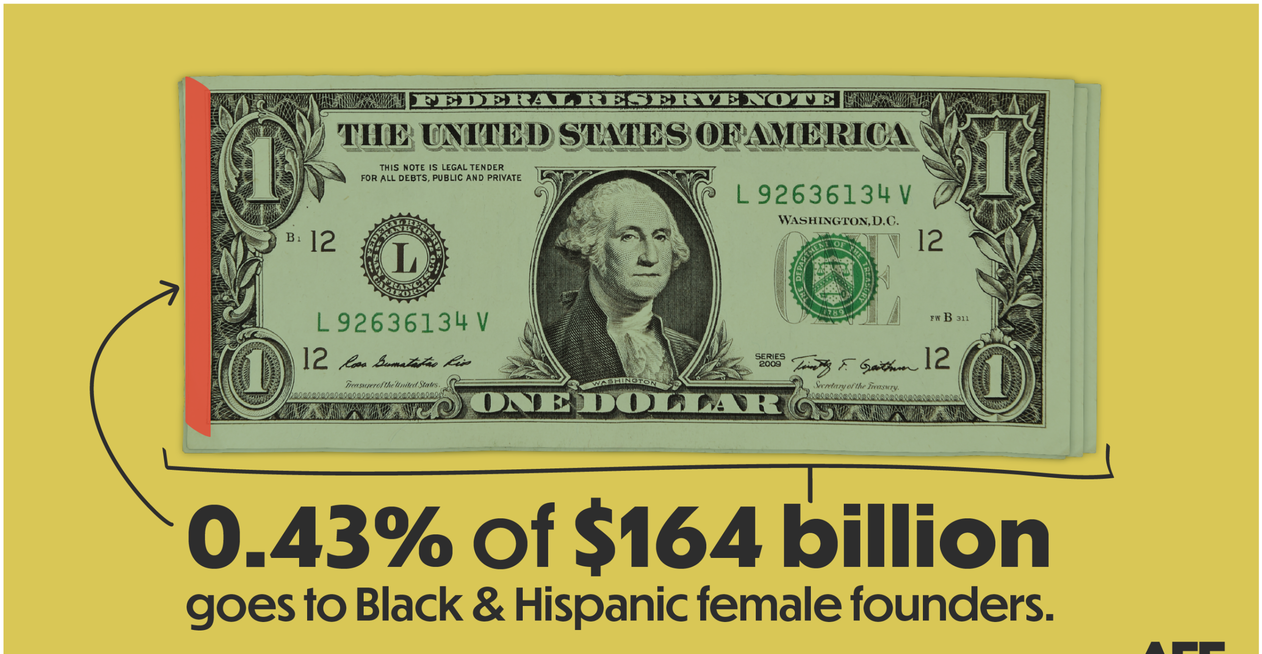
The University of Chicago Booth School of Business found that 140 women-led investment funds were launched in the last four years. [15] A survey of Black and Latina investors and founding partners conducted by the NYC-based firm, Harlem Capital, found that 44% of respondents were strategically backing diverse founders by writing checks with an inclusive thesis.[16] And although not all funds started by women of color in recent years have a gender- or ethnicity-specific investment philosophy, these firms are proving to be more diverse both in their hires and portfolio investments.

Minority women are the fastest growing group of entrepreneurs in the United States. As Limited Partners who funnel dollars into the top of the VC ecosystem continue to broaden their investments to prioritize these businesses, our economy will continue to grow and become more representative of the talent throughout our nation.

## Flowing Downstream: Businesses and Networks

General Partners are among the most powerful players in the VC industry. They are the gatekeepers who write checks, lead deals, and sit on boards.[17] They influence whether, and how much, money flows into the next generation of highly successful companies. Alongside GPs, Limited Partners have an arguably greater say in ebb and flow of financing, as they determine which GPs are funded. Understanding who these asset allocators are and how they deploy capital can help diverse founders overcome hurdles that have held them back from tapping into venture as a source of financing.

Research on the subject has proven that the scarcity of female and minority checkwriters has a profound impact on the amount of venture capital that is passed on to entrepreneurs and founders. Despite a year of unprecedented fundraising, Black and Hispanic female founders received less than half a percent (0.43%) of all venture capital investment in 2020.[18] In a 2019 study of venture capital investors, Morgan Stanley found that just 13% of white male VCs surveyed prioritized investments in multicultural founders, and just one-third prioritized companies founded by women. These percentages stand in stark contrast to the women and non-white males that were surveyed, who were twice as likely to prioritize founders from diverse backgrounds.[19] Other studies show that female VC partners are more than three times as likely to invest in startups with female CEOs.[20]



Source: Digital Undivided. Still Building: Project Diane 2021 Update. April 2021.

For GPs, having a steady stream of investment opportunities—or deal flow—is an essential part of the business. A recent study from researchers at the Harvard Business Review found that investors source a third of their deals through their professional network and nearly another third of leads are generated from referrals by investors or portfolio companies. [21] In order to be successful, investors are continually challenged to expand their networks and reach new communities. Doing this intentionally is the only way they will be able to find the hidden gems founded by people of diverse backgrounds.

However, it can be difficult for entrepreneurs from underrepresented communities to find themselves members of the right social and professional circles to gain access to investment partners with the ability to steer funding their way. Additionally, the low relative wealth among the social networks of minorities means that founders of color have a more difficult time raising money in the pre-seed round that usually relies on friends and family. As a result, more of these entrepreneurs have a greater dependence on debt financing, slowing the growth that is possible by reinvesting earnings in the company rather than paying down interest. For women and people of color to receive a larger share of the pie, there needs to be more opportunities to forge important networks with venture partners that are likely to invest with them.

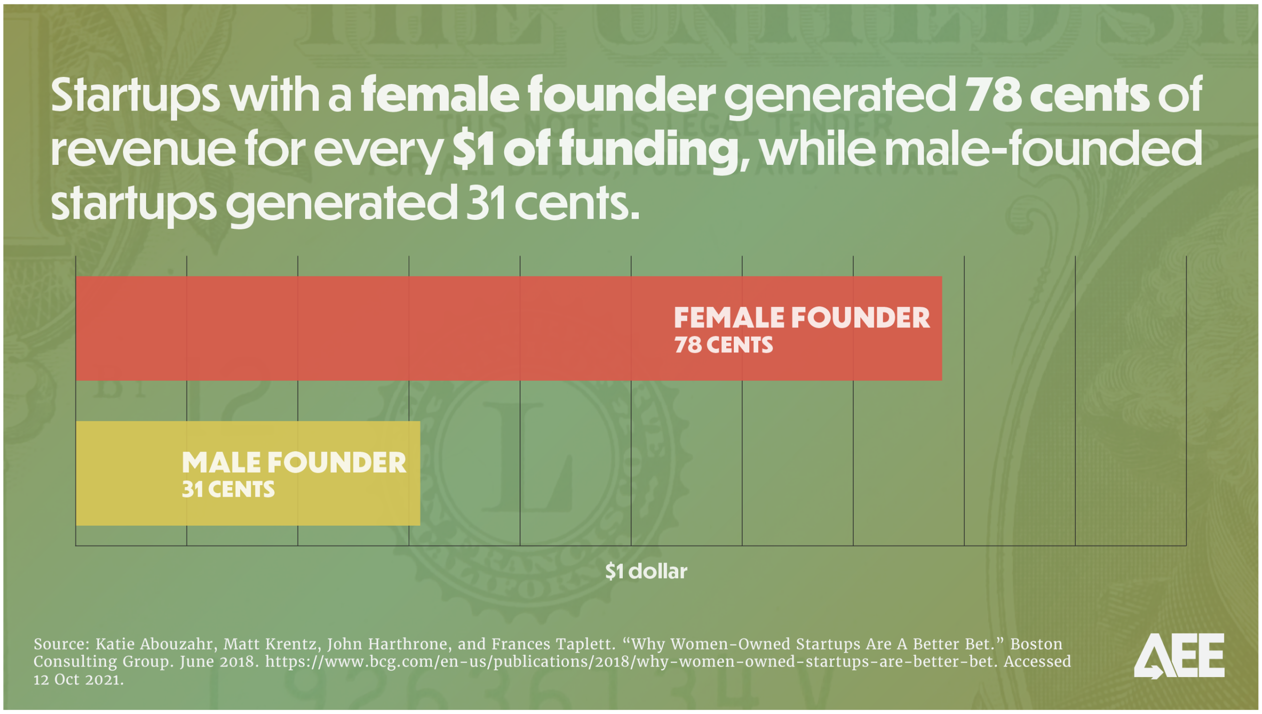
And where do the VCs themselves go to build networks and find community? This was one of the primary concerns for Cheryl Campos as she was forming her own network, VC Familia. As a Hispanic woman in the industry, Campos often felt isolated because a space for VCs with similar backgrounds to meet and share experiences was lacking. [22] For example, one study found that 86% of venture capital firms have no Hispanic employees on their investment team. [23] As a result, Hispanic founders have a more challenging time finding connections to investors with similar backgrounds. VC Familia leverages the networks of its members to support current and emerging VCs and to bring new companies to the attention of potential investors. Almost half of the group's members are women, outpacing the industry and demonstrating that minority and female VCs are hiding in plain sight.

As the industry diversifies, more of these social and professional networks are popping up. All Raise helps to connect female founders and funders, equipping them with access, guidance, and support to accelerate their success. Venture Forward offers programming, research, and resources to foster a stronger and more inclusive community in the venture ecosystem. Latinx VC is a network of professional investors and operators in the venture industry who aim to increase the number of Latino and Latina investors and improve their access to capital. Black (or BLCK) VC is another one of these organizations whose mission is to increase diversity, equity, and inclusion in the industry. BLCK VC is creating a network and curriculum for Black operators to gain access, skills, and community that will help them excel in their roles as investors, scouts, or venture professionals. These groups are making it easier for women and people of color to become the architects of venture deals. Because of their work, and others like them, we can hope to see more women of color ringing the bill at the next billion-dollar Nasdaq IPO.

## The Opportunity Cost of Homogeny

At the end of the day, all investment capital is aimed at generating superior returns. That is why venture firms must continue to recognize the huge upside to adding more women and people of color to their boardrooms and company portfolios. A 2020 Goldman Sachs study examining nearly 500 large equity funds in the United States found that female-only and mixed-gender investment teams outperformed teams run entirely by men. [24] PitchBook fund performance data shows that 69% of venture firms that scored in the top-quartile between 2009 and 2018 had women in decision-making roles. This indicates a strong correlation between hiring female investors and generating strong returns. [25]

More than 70% of startups that raise venture capital have a white male co-founder who went to Stanford or Harvard. [26] When you couple the lack of gender and racial diversity in VC boardrooms with the lack of variety in educational background, you end up with teams that often think in a similar fashion and solve problems at a slower rate. A recent study found that homogeneity has negative effects on investment exits and overall fund returns, including 6% lower success rates for investments by VCs with shared ethnicity and 12% lower success rates for VCs with shared school backgrounds. When diversity is not at the table, we miss out on the value other perspectives bring to teams and their abilities to solve the world's problems in a unique way.




When women and minorities are underrepresented as investment partners, our economy reaps just a fraction of the full potential that could be gained from companies founded by these communities. In 2018, startups with a female founder generated 78 cents of revenue for every $1 of funding, while male-founded startups generated 31 cents. [27] Investing in women and minorities can be a strategic advantage for VC firms. A recent study by Morgan Stanley found that 83% of VCs recognized the decision to invest in diverse companies and maximize profits was not mutually exclusive. [28] According to the same study, investors risk leaving as much as $4 trillion on the table by not investing in women and other underrepresented entrepreneurs. So, why aren't more firms taking a risk on the emerging market right before their eyes?

# Conclusion

Policymakers and federal regulators have an important role to play in reducing barriers to entry for women and minorities looking to enter the venture capital ecosystem, and there are a series of immediate steps they can take. Prioritizing access to financial and investment education for girls and students of color at an early age is central to ensuring there is a robust pipeline of entrepreneurs and venture professionals ready to step into partner-level positions. Reducing barriers that limit the participation of women and minorities, such as the high cost of child care and networking with established VCs, will help promote new entrants into the industry. Finally, requiring firms to track or disclose demographic data connected to their hiring, promotion, and deal sourcing practices can boost accountability and communicate a firm's priorities. These initial policies will help ensure the government is a productive partner with the firms that want to set the industry on a more inclusive path and add a measure of accountability for those firms that are more resistant to change. Either way, women founders and founders of color are redefining what entrepreneurship looks like and would be best served by a venture industry that is ready to meet their needs.

In all, venture capital is a key part of the financial infrastructure that is ushering in innovation and wealth creation around the world. And while important progress has been made to expand racial and gender equity in the industry, there is still far more to do. Increasing representation can be challenging for venture firms since they tend to be small and turnover among senior level positions can be low. Large financial returns can also take a decade or more for firms to realize, so hedging risk remains a key priority. Even so, many firms are finding ways to diversify their own ranks, nurture multi-ethnic talent among employees, and develop inclusive portfolios. We need to keep this progress up, and policymakers should encourage the private sector to continue reporting on these efforts and their results, so public data can follow the impact of these programs that are currently in their nascent stages.

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## ENDNOTES


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