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Statement of Record

U.S. Senate Committee on Small Business & Entrepreneurship Reauthorization of SBA's Small Business Investment Company Program

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Good afternoon Chairman Rubio, Ranking Member Cardin and members of the Committee on Small Business and Entrepreneurship, my name is Banu Ozkazanc-Pan. I'm an associate professor of management at the University of Massachusetts and a visiting associate professor of sociology at Brown University. Over the course of my career, I have examined diversity and inclusion in the context of organizations and entrepreneurship. With grant funding from the Ewing Marion Kauffman Foundation, I've had the opportunity to examine entrepreneurial ecosystems in different U.S. cities to understand inclusion dynamics. Recent grant-funded research has focused on the venture capital industry and helped support the founding of the Venture Capital Inclusion Lab at Brown University's Jonathan M. Nelson for Entrepreneurship. The Lab, in partnership with Crunchbase and Aleria Tech, continues to examine industry dynamics in venture capital, focusing on issues of decision-making, networking and deal flow among other considerations. My testimony here today will provide an overview of the venture capital industry, speak to challenges facing women and minorities as investors and as entrepreneurs and examine the importance of achieving diversity and inclusion for the U.S. economy based on emergent trends and research. Thank you for the opportunity to share my research and contribute to this hearing.

State of the Venture Capital Industry

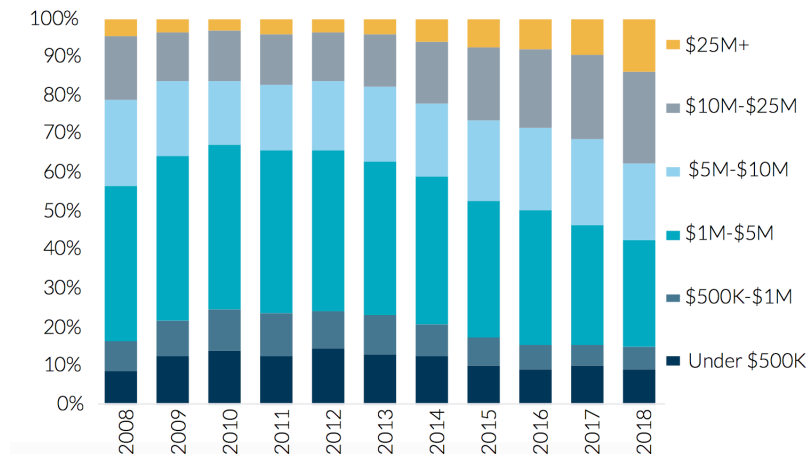
In 2018, the venture capital (VC) industry invested around \$130.9 billion across 8,948 deals and raised \$55.5 billion across 256 funds, representing record amounts compared to the dot com boom¹. During this time, angel and seed investments declined while around 62% of total invested capital was due to deals sized \$50 million or larger. Venture capital mega-funds, or those raising \$500 million or more, accounted for %57 of all capital raised. Unicorn firms, or those with valuations of \$1 billion or more, captured around 34% of all

¹ https://files.pitchbook.com/website/files/pdf/4Q_2018_PitchBook_NVCA_Venture_Monitor.pdf

venture capital investments, raising \$44.5 billion. This period was also marked by large deal sizes particularly in the early stages and higher firm valuations. In fact, at least half of early stage deals were valued at \$5 million or more (see figures below²).

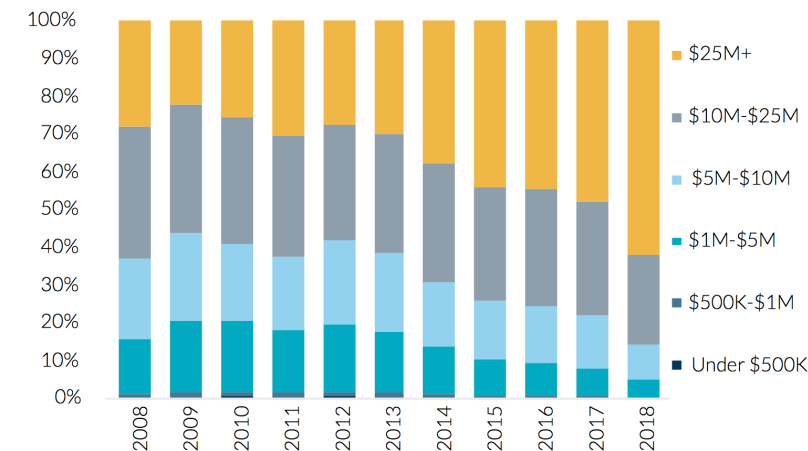
Nearly half of early-stage deals sized at least \$5M

US early-stage deals (#) by size



\$25M+ deals now make up 61.2% of deals by value

US early-stage deals (\$) by size



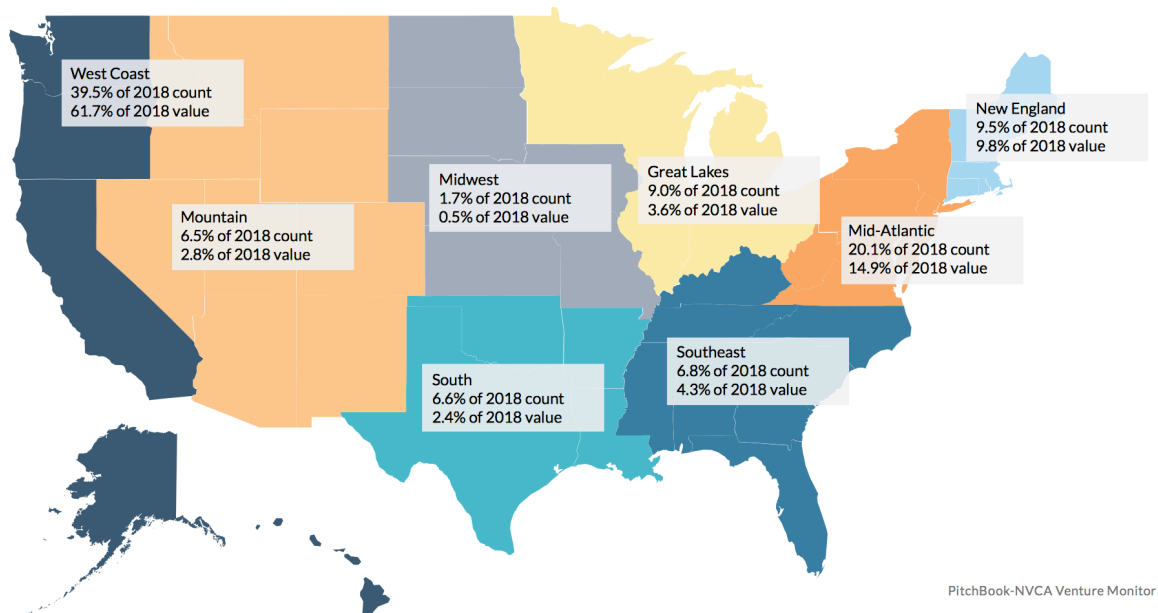
Both private equity and corporate VC also had a highly active year, investing in 792 and 1,443 deals respectively in mostly later-stage, large venture deals. Late-stage venture capital investments also saw impressive growth. Around 200 mega-deals (those over \$100 million) resulted in the investment of \$62 billion during this time. These mega-funds coupled with the trend of raising more VC rounds allows companies that want to remain backed by VC funds to do so for longer periods of time compared to previous years. 2018 also saw focused investments in pharma, biotech and software as the largest proportion of

² ibid, page 13

investments by VCs with software seeing record levels of capital investment (around 42% of all investments). Lastly, geography continues to be an important element of VC investments with West coast leading both in terms of count and value (see figure below³)

VC hubs outside Silicon Valley see greater proportion of VC

US VC deals by region (2018 total)



State of the Venture Capital Industry for Women and Minorities

A 2017 report⁴ by TechCrunch using Crunchbase data found women represent 8% of all partners in the top 100 venture firms (determined through their longevity, recent investment activity, number and size of funds led). Notably, women now represent 15% of all partners at accelerator and corporate venture firms. Between 2012 and Q3 2017, around 10% of all venture dollars went to start-ups with at least one female founder. The findings also suggest that between 2009 and 2017, the percentage of funded start-ups with at least one female founder increased from 9% to 17%. In examining whether firms with female investing partners are more likely to invest female founders, the research found no clear correlation over the long run but did find there are particular firms with female investors that have invested in women founded or co-founded firms at higher rates. The research also determined that new investment firms started by women investors are more likely to invest in start-ups with women founders. Going forward, these firms represent potential positive changes towards more funding of women founded or co-founded firms as well as an increase in the number of women investors in the VC industry.

³ *ibid*, page 17

⁴ <https://news.crunchbase.com/news/announcing-2017-update-crunchbase-women-venture-report/>

At the same time, a report⁵ examining nearly 10,000 founders, 4,475 start-ups and 135 of the most active venture capital firms by RateMyInvestor and Diversity VC found that around 66% of all start-ups have teams of two or three people. However, in VC-backed founding teams, only 9.2% of founders are female and three-quarters are white. All male teams represent 82% of all VC-backed start-ups while all female teams represent 6%. Blacks represent 1%, Latinos represent 1.8%, Asians represent 17.7% and Whites represent 77.1% of VC-backed founders⁶.

Based on this same report, geography again plays an important role in these outcomes: around 42% of funded teams are in Silicon Valley, around 20% of funded teams are spread across the U.S., 14% are in NYC, and around 7% are in the Los Angeles area. About 27% of invested capital goes to founders who attended Ivy League universities. In fact, a little more than half of firms in the study had their 25-50% of their portfolios represented by Ivy League founders.

Overall, this research shows that the typical (or most oft-occurring) team is comprised of two White males in Silicon Valley, educated at a U.S. university. In fact, research has demonstrated that 40% of all venture investors attended either Stanford or Harvard⁷.

Expanding on this work, research undertaken by The Information shows that VCs invest in teams who have the same gender as well as the same educational and location background as themselves⁸. This study also provides information about the lack of representation of women, minorities and minority women in VC investment firms. In the survey⁹ of 110 women in VC firms, there was only one Hispanic woman partner, one Native American partner and no Black women partners. The remainder of women were White (71 individuals) and Asian (37 individuals).

Additional research by The Information focusing on race/ethnicity found that only 1% of the surveyed 713 VC firms had Black decision-makers (total of 7 individuals) while 1.5% had Hispanic decision-makers (total of 11 individuals). Asians represented 24% of decision-makers (total of 170 individuals) while 73.4% of all decision-makers were White. The research found, that overall, 85% of decision-makers in the U.S. VC industry are male and 73% are White¹⁰.

digitalundivided, a tech accelerator focused on Black women and Latina entrepreneurs, carried out a survey titled #ProjectDiane to understand the intersections of gender and race on funding and tech entrepreneurs' experiences¹¹. Their research demonstrates that while Black women are the fastest growing segment of entrepreneurs in the U.S., the average Black woman tech founder raised \$36,000 while the average amount raised by a

⁵ <https://www.graphicsprings.com/founders-funding-and-exit-ranking-usa>

⁶ Ibid.

⁷ <https://blog.usejournal.com/where-did-you-go-to-school-bde54d846188>

⁸ <https://www.theinformation.com/articles/silicon-valleys-most-and-least-diverse-venture-capital-firms?>

⁹ Ibid.

¹⁰ Ibid.

¹¹ <https://www.digitalundivided.com/project-diane-2016-report>

failed (mostly) White, male led start-up was \$1.3 million. Of the 88 women of color in the research study, 92% had an undergraduate degree, 60% were alumni of Top 20 ranked schools and 67% of founders who raised more than \$1 million in funding were Ivy League graduates¹². In general, funding for Black women owned start-ups comes from angel investors, accelerator programs and smaller sized venture firms (less than \$10 million under management). In fact, less than 1% of Black women receive VC funding¹³. Thus, Black women owned start-ups in the tech sector remain undercapitalized.

Despite these challenges, about 40% of all current businesses in the U.S. are women owned. In fact, women owned businesses in the U.S. grew 58% between 2007 and 2018 while all other businesses grew by 12% while women of color owned businesses grew 163% during the same time based on the State of Women Owned Business Report by American Express¹⁴. Put another way, there were 1,821 net new women-owned businesses added to the economy per day between 2007 and 2018. 1,612 of these were women minority-women owned businesses¹⁵.

Disaggregating the data further, the American Express report finds that Black women owned businesses grew at the fastest rate of any business during this time: an impressive 172%. Similarly, Latina owned businesses grew by 164% between 2007 and 2018. Despite the growth, revenues generated by women of color owned businesses dropped from \$84,100 in 2007 to \$66,400 in 2018—by contrast, non-minority owned business revenue grew from \$181,000 in 2007 to \$212,300 in 2018¹⁶. The report notes, “if revenues generated by minority-women owned businesses matched those currently generated by all women-owned businesses, they would add four million new jobs and \$1.4 trillion in revenues to the U.S. economy”¹⁷.

While in general women and minority owned businesses are less likely to be employer firms, focusing on women-owned businesses with revenues above \$1 million paints a very different picture. These firms represent a small fraction of all firms at 1.7% but compared to all other firms, there has been an increase of 46% in such firms (versus 12% in general for all firms between 2007 and 2018)¹⁸. Employing a little over 6 million people, these firms represent about 68% of total employment for women-owned firms. Total employment for these firms since 2007 represent a 30% growth compared to a 0.8% decline for all businesses (see figure below)¹⁹. In 2018, they generated about \$1.2 trillion in revenues and represent 69% of all revenues for women-owned firms.

¹² Ibid.

¹³ <https://www.fastcompany.com/90214465/the-state-of-black-women-getting-funding-in-2018>

¹⁴ https://about.americanexpress.com/files/doc_library/file/2018-state-of-women-owned-businesses-report.pdf

¹⁵ Ibid.

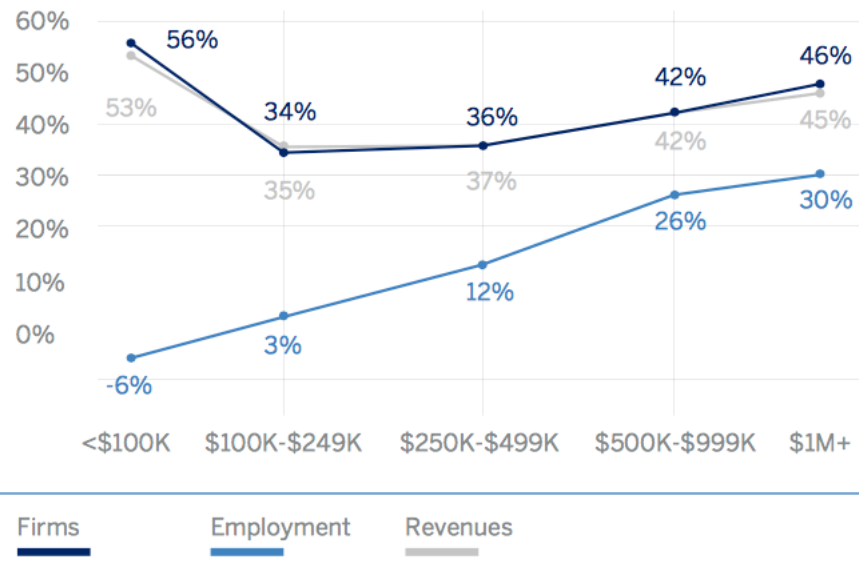
¹⁶ Ibid.

¹⁷ Ibid., page 5

¹⁸ Ibid.

¹⁹ Ibid, page 10

2007-2018 GROWTH RATES FOR WOMEN-OWNED BUSINESSES BY SIZE OF BUSINESS



As the American Express report indicates and is seen in the above graphic, growth in employment and revenues for women-owned businesses starts to rise exponentially when revenues reach \$250,000. Thus, supporting women-owned businesses during the \$100,000 to \$249,000 revenue stage and beyond can create positive returns for investments and the economy in terms of employment. Given that currently women-owned businesses account for only 8% of all employment and 4.3% of all revenues, investing and funding women-owned businesses is a smart strategy for economic growth.

Solutions

Given the challenges faced by women and minorities as investors and as entrepreneurs in relation to the venture capital industry, a number of solutions are presented below based on emergent trends and research. These solutions focus on making the investment field more diverse and inclusive and creating more equitable access to publicly funded/supported capital programs.

Fellowships and partnerships

Based on research at the Venture Capital Inclusion Lab at Brown University, emergent trends suggest that a small but growing number of VCs recognize the value of diversity and inclusion for their portfolios and returns. Such firms have started on-ramps for women and minorities into decision-making positions through fellowship and apprenticeships programs. This approach focuses on individuals who have several years of work experience and are looking to start a new career in investment. The program allows these individuals

to gain exposure to investors and the industry, build new networks, and learn investment skills.

These efforts are replicated in other parts of the economy by more established firms as they realize the potential of diversity and inclusion for the health and longevity of their businesses. Some examples from the city of Boston include Pacesetters, a program through the city's Chamber of Commerce that matches minority-owned businesses with established businesses. Through the initial matching, minority-owned businesses gain visibility and are able to secure further contracts with other organizations. More recently in Massachusetts, developers for the casino industry exceeded goals for minority, women and veteran contractors²⁰ through leadership, partnerships, and clear workforce goals on diversity and inclusion. By building accountability and transparency into the project, developers were able to attract more diverse candidates to work sites as they publicized diversity goals and outcomes. Lastly, an initiative at Eastern Bank titled the Business Equity Initiative works with Black and Latino/a owned businesses towards growth. Using a model similar to private equity, the program matches each business with a dedicated advisor, provides dedicated growth tools including growth capital as a way to address the large and growing economic inequalities in the state²¹.

To build diversity and inclusion into existing VC firms, additional trends suggests that non-traditional backgrounds, such as doctoral degrees in life sciences, can bring about technical experience and knowledge (i.e., maternal health, fertility, targeted therapies, etc.) that is invaluable for securing new deal flow and engaging in due diligence^{22, 23}. Furthermore, a number of organizations have undertaken events to grow the networks and investment knowledge of women of color²⁴. These trends are underscored by the growth of investment firms and funds dedicated solely to women, to minorities or to minority women^{25, 26, 27, 28, 29}. Most notably, outspoken investors, such as Arlan Hamilton, the founder of Backstage Capital, have brought visibility to the challenges facing women and minority owned businesses while speaking about their important role for the U.S. economy.

In all, these success stories are based on intentional programs³⁰ (such as fellowships), strategic partnerships and knowledge sharing, and leadership and have worked to support

²⁰ <https://www.bostonglobe.com/opinion/2019/06/19/building-diverse-casino-industry/OC8DQalIEQroxZIZDDdCWM/story.html>

²¹ <https://www.easternbank.com/BEI>

²² See <https://www.westorg.org/2019-07-16-venture-capital-panel>

²³ <https://www.forbes.com/sites/matthunckler/2017/06/02/the-key-to-diversity-in-tech-diverse-investors-says-new-york-based-social-impact-vc/#456590087990>

²⁴ <https://www.womenofcolorandcapital.com>

²⁵ <https://philanthropynewsdigest.org/news/100-million-fund-for-women-entrepreneurs-of-color-launched>

²⁶ <https://www.businessinsider.com/female-founded-venture-capital-funds-startups-investments#forerunner-ventures-3>

²⁷ <https://femalefoundersfund.com>

²⁸ <https://www.inc.com/kimberly-weisul/fundery-finds-billions-invested-women-entrepreneurs.html>

²⁹ <https://medium.com/@AndysHVC/the-rise-of-diversity-focused-venture-capital-378d45390662>

³⁰ Ozkazanc-Pan, B., Knowlton, K., and Clark Muntean, S. Gender Inclusion Activities in Entrepreneurship Ecosystems: The Case of St. Louis, MO and Boston, MA (June 7, 2017). Available at SSRN: <https://ssrn.com/abstract=2982414>

women and minority owned businesses as well as increase their numbers in the VC industry.

While these trends towards diversity and inclusion in the VC industry are notable and important, they are not necessarily widespread or at scale. The changing demographic make-up of the U.S.³¹ will mean new consumers³². Coupled with the growth of women and minority owned businesses, these trends require new approaches to creating an economy that works for everyone.

The SBIC program provides important funding for creating new jobs and opportunities in the U.S.. Expanding access to capital provided through this program particularly for women and minority owned firms can create these much needed new jobs and opportunities, particularly given the growing role of global competition. Research suggests that if minority owned businesses were at entrepreneurial parity (parity defined as reaching proportionality between adult minority population and business measures), the U.S. would gain 1.9 million more firms, 13.2 million more employees, and an additional \$2.9 trillion in gross receipts³³. Similarly, gender parity achieved through capital investments can add around \$4.3 trillion in annual GDP to the U.S. economy by 2025³⁴. In all, investments into diversity and inclusion yield tremendous benefits for businesses and the U.S. economy.

Thank you again for the opportunity to share these points. I'm happy to answer any questions and address comments.

Regards,

Banu Ozkazanc-Pan

Banu Ozkazanc-Pan, Ph.D.

³¹ <https://www.brookings.edu/blog/the-avenue/2018/06/21/us-white-population-declines-and-generation-z-plus-is-minority-white-census-shows/>

³² <https://www.fastcompany.com/40422830/why-the-tech-industry-is-hurting-itself-by-not-funding-black-women-founders>

³³ https://www.mbda.gov/sites/mbda.gov/files/migrated/files-attachments/2012SBO_MBEFactSheet020216.pdf

³⁴ [https://www.mckinsey.com/~media/McKinsey/Featured%20Insights/Employment%20and%20Growth/The%20power%20of%20parity%20Advancing%20womens%20equality%20in%20the%20United%20State s/MGI-Power-of-Parity-in-US-Full-report-April-2016.ashx](https://www.mckinsey.com/~media/McKinsey/Featured%20Insights/Employment%20and%20Growth/The%20power%20of%20parity%20Advancing%20womens%20equality%20in%20the%20United%20States/MGI-Power-of-Parity-in-US-Full-report-April-2016.ashx)