The Power of Diversity: Why Homogeneous Teams in Venture Capital Are Bad for Business

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V1.0
Executive Summary

A steady stream of evidence has emerged since 2013 indicating that when startup teams and venture investing teams embrace differences of gender, race, ethnicity, educational background, and/or professional experience, these heterogeneous teams are correlated with better financial outcomes than homogeneous teams.

This white paper, “The Power of Diversity: Why Homogeneous Teams in Venture Capital Are Bad for Business,” synthesizes proof points published across the financial services industry by established banks, consulting companies, investment firms, venture capital partnerships, industry associations and academic institutions, all of which had invested in the kind of robust, thorough analysis that defensibly and objectively informs and supports financial decision-making. A pattern has emerged:

- **Diverse founding teams create more innovation and better business outcomes, and result in superior performance over the long-term, including overall financial performance,** and valuation increases, and multiples on invested capital (MOIC) when companies are acquired or go public.

- **The venture investing teams most likely to fund diverse founders also tend to be diverse,** as indicated by data on gender-diverse investing teams.

- **Diverse investing teams are correlated with better returns for investors,** and multiple studies directly note the negative effects of homogeneity on individual investment exits and overall fund returns.

Since our partnership coalesced around diversity as a core value, a global pandemic, a U.S. recession, and the murders of George Floyd, Breonna Taylor, and uncounted others have re-surfaced how systemic racism and sexism continue to steal lives, dreams, and economic opportunity. The ongoing, disproportionate suffering and inequality experienced by most Black Americans has forced a reckoning for the VC community. As described in further detail below, even as venture capital has generated more economic and employment growth in the U.S. than any other investment sector in recent decades, sources estimate the number of Black and Latinx investors at just 3% of venture capitalists, respectively; only 1.8% of venture-backed founders are Latinx and 1% are Black.

“Diversity, in fact, is not only a moral obligation; it is a fiduciary one—leading to fewer losses and better performance,” wrote the authors of a 2019 Illumen Capital – Stanford SPARQ study. 

WRG formed a diverse partnership of experienced investors and c-level operators specifically to win at what we do. As this white paper shares, we know from experience how well diverse teams work, and we see how our intentionally diverse partnership already has expanded our pipeline, potential for fund performance and deal flow. As investors, we are excited to find so many data demonstrating the financial value created by diverse leadership; As citizens, we believe these data chart a path to a more equitable world.

WRG plans to update the URL biannually with sourced findings; we welcome inquiries regarding new sources of information. To reflect our values, WRG commits to collecting and sharing data in a way that applies a more inclusive and intersectional lens to diverse leadership in investing (see “3. Conclusion…” below). With this overview, we hope to find collaborators who will invite us to join your conversations, as we invite your comments and suggestions.

Curated by Lisa Stone, Managing Director, September 21, 2020
The Power of Diversity: Why Homogeneous Teams in Venture Capital Are Bad for Business

https://wrg.vc/diversity

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1. Diverse Investing Teams

Diverse founding teams with more than one (>1) gender and/or >1 race or ethnicity represented have:
- 30% higher MOIC upon exit for ethnically- and gender-diverse teams vs. homogeneous teams (2), (3)
- Better business value:
  - 63% higher with 1+ female founder vs. all-male founders (4)
  - 65% higher with 1+ ethnically diverse c-team member vs. all-white c-teams (3)

2. Diverse Founders

Gender-diverse investing teams with more than one (>1) gender are:
- >3x more likely to invest in a female CEO (1)
- 2.6x more likely to invest in women-led entrepreneur teams. (1)
- 2x more likely to invest in gender-diverse founders vs. all-male founders (1), (2)

3. Better Returns for Investors

Better Returns for Investors are correlated with diverse investing teams, who are more likely to invest in diverse founders

69.2% of the top-scoring U.S. venture funds and angel groups 2009-2018 had female investors. As recently as last year, women represented only about 1 in every 8 VCs, or 12% of venture investors. (5)

Gender-diverse investing teams with more than one (>1) gender had:
- 9.7% more profitable exits for U.S. firms that added female partners (6)
- 20% higher net internal rates of return (IRRs) in global emerging markets (7)

Non-diverse investing teams had:
- 5.8% lower success rates for investments by VCs with shared ethnicity (6)
- 11.5% lower success rates for investments by VCs with shared school backgrounds (6)

These data are excerpted from a white paper synthesizing proof points published across the financial services industry by established banks, consulting companies, investment firms, venture capital partnerships, industry associations and academic institutions, all of which invested in the kind of robust, thorough analysis that defensibly and objectively informs and supports financial decision-making.

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(2) Kauffman Fellows Research Center (presentation by Nihar Neelakanti) to All Raise Summit in Sedona, Arizona, Jan 2020.
(3) Kauffman Fellows Research Center, MaC Venture Capital: “Deconstructing the Pipeline Myth and the Case for More Diverse Managers,” Feb 2020

Inquiries invited regarding new sources of information, comments and suggestions.
Better Outcomes at Public Companies: The Innovation Economy Replaces Traditional Institutions and Homogeneous Hierarchies

Over the past 20 years, capital has shifted from traditional institutions to an “innovation” dominated market. Industrial companies that used to lead the S&P 500—Exxon Mobil, General Electric, Pfizer, Walmart, even Cisco—have been out-innovated and displaced by companies like Alphabet, Amazon, Apple, Berkshire Hathaway and Microsoft. Traditional industries continue to be transformed by profit-producing juggernauts, from video entertainment (Netflix as a sequel to Blockbuster), to private transportation (Uber accelerated past taxis), to music (Spotify replaced Tower Records) and even brick-and-mortar spaces like the traditional diner (Starbucks).

During the same period, each of WestRiver Group’s managing directors founded, invested in, and/or operated companies across the Innovation Economy. Together our leadership represents a combined [240] years of operating experience, from successful startups to public companies, such as eBay, Dell Computer, Blue Cross, BlogHer, Coherus and Topgolf. Collectively our partners have led the sale or IPO of [52] separate companies totaling more than [$200B] in aggregate enterprise value.

These experiences taught us that diverse leadership teams drive better performance. We found that the more diverse our teams were, the more innovative our thinking became, the better we executed on ideas, and the more revenue we generated. Were we or were the companies we led outliers, we wondered? The answer is yes and no.

Yes, because we worked on leadership teams where heterogeneous groups of people were proactively recruited, welcomed and included—and therein lies the homogeneous venture industry’s challenge: Teams using the same old passive, personal-network-based, recruitment and pipeline development processes risk being out-innovated themselves by companies that prioritize diversity and inclusivity in hiring and decision-making.

No, because a growing number of published reports show diverse leadership teams tip the scales toward innovation and revenue with better financial outcomes—including in venture investing.

Financial Performance: Gender- and Ethnically-Diverse Leadership Teams Outperform

The trickle of reports correlating public company financial outperformance with diverse leadership teams has grown into a steady stream of evidence. In each of three global surveys of more than 1,000 publicly-traded companies conducted since 2014, McKinsey & Company has reported that public companies led by the most diverse boards and executive teams are more likely to financially outperform than companies led by the least diverse executive teams: 24

- Companies with the most gender-diverse executive teams (categorized as >30% women) are 48% more likely to financially outperform the least diverse teams (those with <10% or zero (0) women) as measured by earnings before income and taxes (“EBIT”) margin and as compared to the national industry median. Conversely, the more gender-homogeneous the executive team, the greater the likelihood of underperformance on profitability. 24
• Above-average profitability for diverse executive teams has accelerated since 2014, McKinsey reports. Today above-average profitability is:
  o **36% more likely** for racially- and ethnically-diverse teams
  o **25% more likely** for gender-diverse teams

**The business case for diversity in executive teams remains strong.**

**Likelihood of financial outperformance**, %

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<thead>
<tr>
<th></th>
<th>Bottom quartile</th>
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<tr>
<td><strong>By gender diversity</strong></td>
<td></td>
<td></td>
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<tr>
<td>Why diversity matters</td>
<td>+15%</td>
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<td>Delivering through delivery</td>
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<td>Diversity wins</td>
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<td>2014</td>
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<tr>
<td>2019</td>
<td>43</td>
<td>59</td>
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1 Likelihood of financial outperformance vs the national industry median; p-value <0.05, except 2014 data where p-value <0.1. 2 n=383; Latin America, UK, and US; earnings before interest and taxes (EBIT) margin 2010-13. 3 n=991; Austria, Brazil, France, Germany, India, Japan, Mexico, Nigeria, Singapore, South Africa, UK. 4 n=364; Latin America, UK, and US; EBIT margin 2010-13. 5 n=589; Brazil, Mexico, Singapore; South Africa, UK, and US; EBIT margin 2011-15. 6 n=533; Brazil, Mexico, Nigeria, Singapore, South Africa, UK, and US, where ethnicity data available in 2019; EBIT margin 2014-18.

Source of data illustration: McKinsey & Company

“In the COVID-19 crisis, diversity and inclusion matter more than ever,” McKinsey noted in May 2020:

“Research indicates that diverse teams are more innovative—stronger at anticipating shifts in consumer needs and consumption patterns that make new products and services possible, potentially generating a competitive edge. For example, one study found that over a two-year period, companies with more women were more likely to introduce radical new innovations into the market. A separate study found that businesses run by culturally diverse leadership teams were more likely to develop new products than those with homogeneous leadership.”

**Innovation-Linked Revenue: More for Companies with Diverse Leadership Teams**

To assess the value of diverse leadership teams in boosting innovation, another global consulting firm, Boston Consulting Group (BCG), employed an expanded definition of diversity across six areas—gender, age, nation of origin, career path, industry background, and education—to survey 1,700 companies of various sizes and industries in eight countries.

BCG reported that companies with diverse leadership teams responded faster to market changes and made significantly more money from innovations developed in just the prior three years than did companies with below-
average leadership diversity. Companies led by teams with above-average diversity scores drove on average 45% (nearly half) of total revenue from such innovation versus companies with below-average diversity scores, where the average percentage of revenue driven by such innovation was 26%:

![Companies with More Diverse Leadership Teams Report Higher Innovation Revenue](chart)

 saja

In other words, nearly half the revenue of companies with more diverse leadership comes from products and services launched in the past three years,” BCG reported, adding that the more diverse organizations also reported better overall financial performance via EBIT margins that were nine (9) percentage points higher. “In an increasingly dynamic business environment, that kind of turbocharged innovation means that these companies are better able to quickly adapt to changes in customer demand.”

**Innovation-Linked Market Share: Effects of Homogeneity and Heterogeneity**

Among dozens of reports and articles correlating serial innovation with diverse teams, one paper’s authors directly identified homogeneity and conformity as threats to revenue-generating innovation. Authors Sylvia Ann Hewlett, Melinda Marshall and Laura Sherbin with Tara Gonzalves reported for the Center for Talent Innovation (CTI) in 2013 that the most effective leaders were characterized by two kinds of diversity: Innate and acquired. 27 “Innate” diversity is defined as gender, race, age, religious background, socioeconomic background, sexual orientation, disability and/or nationality; “acquired” diversity is defined as cultural fluency, generational savvy, gender smarts, social media skills, cross-functional knowledge, global mindset, military experience and/or language skills. Hewlett *et al* warn:

“[W]hen leadership lacks innate or acquired diversity, or fails to foster a speak-up culture, fewer ideas with market potential make it to market. Ideas from women, people of color, LGBTs, and Gen-Ys are less likely to win the endorsement they need to go forward because 56% of leaders don’t value ideas they don’t personally see a need for—a veritable chokehold when an organization’s leaders are predominantly Caucasian, male, and heterosexual, and come from similar educational and socioeconomic backgrounds. In short, the data strongly suggest that homogeneity stifles innovation.”
Employees at publicly-traded companies where leaders have both innate and acquired diversity are 70% more likely than employees at non-diverse publicly traded companies to report that their firm captured a new market in the past 12 months, and 45% more likely to report that their firm improved market share in that same time-frame, according to CTI.

**Better Outcomes at Venture Portfolio Companies: Higher Levels of Diversity Correlate With Financial Outperformance**

Many data published on financial performance by venture-funded companies and venture funds focus discussions of diversity on gender identity, typically using a binary lens; a growing number of reports in the past decade have begun to include race and ethnicity, revealing the barriers to participation by Black and Latinx investors and entrepreneurs alike. Within these limitations, we researched whether we could connect diversity data on startup outperformance with fund outperformance. Proof points emerged that we find meaningful.

**Portfolio Companies with Gender-Diverse Founders and Executive Teams Outperform All-Male Teams**

Companies with gender-diverse founders and executive teams are significantly more likely to deliver stronger financial results than all-male founders and executive teams, according to multiple reports:

Investments in startups with at least one female founder were valued 63% better than investments in all-male founder teams, reported First Round Capital in 2015, after analyzing their 10 year investment record in 300 companies and ~600 founders. ³

Valuations at startups with gender-diverse executive teams were 64% larger at first funding and 49% larger at last funding, according to Babson College’s The Diana Report, which evaluated 6,793 U.S. companies receiving venture capital funding between 2011 and 2013. ²

Startups with gender-diverse founding teams achieve a 30% higher realized MOIC when they are acquired or go public, according to Kauffman Fellows Research Center, based on an analysis of 90,000 U.S. venture-backed startups going back to 2001. ⁵
Gender-Diverse Founding and Executive Teams Outperform All-Male Teams

<table>
<thead>
<tr>
<th>Company Valuations</th>
<th>Valuations for Companies with 1+ Female Founders</th>
<th>Valuations for Companies with all Male Founders</th>
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<td></td>
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<td>63%</td>
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<tr>
<th>MOIC When Startups Are Acquired or Go Public</th>
<th>Gender Diverse Founders</th>
<th>All Male Founders</th>
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<th>Median Valuation Increases for Portfolio Companies</th>
<th>Gender-Balanced Leadership</th>
<th>Single Gender Leadership (All Male or All Female)</th>
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<td></td>
<td>25%</td>
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Source for Company Valuations: First Round Capital
Source for MOIC: Kauffman Fellows Research Center
Source for Media Valuation Increases: Babson College's The Diana Report

“Companies with women on their founding teams are likely to exit at least one year faster compared to the rest of the market, and the number of exits for companies with at least one female founder is growing at a faster rate [year-over-year] than exits for companies with only male founders,” wrote Jenny Abramson, Founder & Managing Partner, Rethink Impact, in “All In: Women in the Startup Ecosystem.”

Despite these data, Silicon Valley Bank reported in “Women in US Technology Leadership 2020”:

- The majority of US startups do not have a woman reporting to the CEO (58%)
- The majority of US startups do not have a woman on the board of directors (60%)

**Portfolio Companies with Ethnically-Diverse Founders and Executive Teams Outperform All-White Teams**

In response to the lack of “a thorough analysis of the influence of ethnicity in startup teams,” the Kauffman Fellows Research Center worked with MaC Venture Capital and facial recognition software Clarifai to analyze the profiles of 260,000 startup founders. “Deconstructing the Pipeline Myth and the Case for More Diverse Fund Managers,” by Collin West, Gopinath Sundaramurthy and Marlon Nichols was published in February 2020.

To perform the study, where the software algorithm was greater than 70% confident of a person's ethnicity, founders were placed in one of five perceived categories: White, Asian, Latinx, Black, and Other. If the algorithm charted less than 70% certainty of ethnicity, the company was removed from the data set. Combining all people of color into one category called “Ethnically Diverse,” the study reported diverse founders and executive teams significantly financially outperform all-White founding and executive teams:
• Ethnically-diverse executive teams that report to the CEO or “c-teams” deliver positive exits valued 65% **better** than all-White c-teams, earning a 3.3x realized MOIC compared to a 2.0x.

• Ethnically-diverse founders delivered **30% better returns on positive exits** than did all-White founders

**Realized Returns from Positive Exits**

![Chart showing realized returns from positive exits for ethnically diverse and all-white teams.]

The study also found that while all-White founding teams raise the majority of venture capital, ethnically-diverse founding teams raised significantly more venture capital per round when they do raise VC.

**Where Venture Capital is Invested: Who Gets Funded**

“No matter how you split it, female venture capital partners drive greater gender diversity at startups. Cognitive diversity, led by diverse VC teams, lead[s] to higher returns and equity in startups.”

— Kauffman Fellows Research Center, January 2020

**Venture Funding for Gender-Diverse Startup Teams**

Multiple studies, including those by Kauffman, Credit Suisse AG, and Babson College’s Diana Report, indicate that female investors are significantly more likely to know, network with, and invest in the gender-diverse entrepreneurs that drive better business outcomes.
Female leaders are deeply disadvantaged by their gender when pitching to all male venture partnerships, Babson College’s data confirm:

- **34% of firms** with a female partner invested in women-led entrepreneur teams compared to **just 13% of firms** without a female partner.²
- Companies led by female CEOs were **3x more likely** to secure capital when there are women on the VC/partner side (58% versus 15%).²

Data on 2019 venture deals and dollars invested show gender-diverse teams of founders and executives gaining some traction: According to the Pitchbook-NVCA Venture Monitor for Q4 2019, the number of gender-diverse founding teams (with at least one female founder) funded by U.S. VCs in 2019 increased 1.2% to 22.8%, and closed more than 3x as many deals as all-female founding teams (6.8% of founding teams).² Pitchbook also reported that median pre-money valuation for gender-diverse founder teams experienced the most rapid year-over-year growth, from $15 million to $20 million.

More than 85% of the $136.5 billion in venture capital invested in the U.S. went to all-male teams in 2019. The actual dollars invested in gender-diverse founding teams increased by 1.4% to 14.2% of all venture dollars and increased just 0.5% to 2.7% of venture dollars all-female founding teams. In 2019, “decisionmakers at venture capital firms were still more than 90% male,” reported Kate Clark in TechCrunch.²⁹ “The venture capital industry, as it stands, is still a boy’s club.”

### Venture Funding for Ethnically-Diverse Startup Teams

While gender is tracked in a number of non-academic reports on venture-funded entrepreneurs by the venture industry, the categories of race and ethnicity are relatively new. Two surveys--“Diversity in US Startups,” published in January 2017 by RateMyInvestor, in partnership with Diversity VC,¹⁹ and Kauffman’s “Deconstructing the Pipeline Myth...” study published in February 2020, confirm that the grand majority of venture funding is invested by primarily White funders into White founders, suggesting race-based selection bias limits investment by venture capitalists in ethnically-diverse founding and executive teams.⁵,¹⁹
Sources estimate the number of Black and Latinx investors at 3% of venture capitalists; of venture-backed founders, only 1.8% are Latinx and 1% are Black. As a result, at a typical startup, White and Asian founders and executives are overwhelmingly overrepresented as a percentage of the U.S. population, and Black and Latinx founders and executives are, in Kauffman’s words, “woefully underrepresented.”

These findings were echoed in Morgan Stanley’s report, “Beyond the VC Funding Gap,” a survey of nearly 200 U.S.-based VCs and entrepreneurs. The authors noted a marked difference between the enthusiasm VCs expressed for investigating and taking calculated risks on new, never-before-seen technologies, and their resistance to investigating and taking risks on new introductions to diverse humans. Despite the multi-trillion-dollar markets represented by Black and Latinx consumers, as well as female consumers who control and/or influence 83% of household spending, Morgan Stanley reported:

“We found that the VC industry has yet to prioritize investing in women and multicultural founded startups, despite acknowledging the opportunity that they could be missing, and when they do encounter a woman or multicultural founder, VCs are rigid in applying their definitions of “fit” and are unlikely to educate themselves about the product, market segment or opportunity before them.”

The resulting damage to the prospects of female entrepreneurs of color has been profound. For a deeper investigation of intersectional bias, see digitalundivided’s pioneering, proprietary research initiative, ProjectDiane. This biennial demographic study reports that, of the $424.7 billion in technology funding since 2009, venture capitalists have invested only 0.0006% in Black women and just 0.4% in Latinx women.

Diverse Venture Investing Teams Are Correlated With Better Returns for Investors

By the numbers: Who controls the majority of venture capital today?

The overwhelming homogeneity of U.S. venture capital investors is demonstrated by a searchable database of more than 200 U.S. firms and their 2,700 employees published by the 2018 NVCA-Deloitte Human Capital Survey.

<table>
<thead>
<tr>
<th>As a % of Investment Partners (n=414)</th>
<th>All</th>
<th>White</th>
<th>Asian/Pacific Islander</th>
<th>Black or African American</th>
<th>Hispanic or Latinx</th>
</tr>
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<tbody>
<tr>
<td>All Genders</td>
<td>100%</td>
<td>80%</td>
<td>15%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Men</td>
<td>84%</td>
<td>83%</td>
<td>13%</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>Women</td>
<td>16%</td>
<td>65%</td>
<td>25%</td>
<td>6%</td>
<td>5%</td>
</tr>
<tr>
<td>Transgender</td>
<td>Too few to calculate</td>
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To state the obvious, there are not more than five times as many males enrolled for master of business administration (MBA) degrees as females in the U.S., nor are there ten times as many White women as Black and Latinx women living in the U.S.: In fact, 64% of new women-owned businesses were started by women of color in 2019. The NVCA-Deloitte data begin to illustrate the homogeneity of the U.S. venture community by gender and race.
Does limiting investing decision-making to one gender and one race constrain outcomes?

Are investment outcomes affected when, as in 2019, more than 85% of venture capital invested in the U.S. goes to all-male, primarily White teams?

The data indicate yes: Limiting investment to a single gender and single race damage innovation and risk limiting outcomes. “The difference is dramatic,” reported Authors Paul Gompers and Silpa Kovvali in Harvard Business Review in July – August 2018. “Along all dimensions measured, the more similar the investment partners, the lower their investments’ performance.”

The average success rate of acquisitions and IPOs for venture investments, Gompers and Kovvali reported was:

- **11.5% lower** for investments by VCs with shared school backgrounds
- **5.8% lower** for investments by VCs with shared ethnicity

Conversely, Gompers and Kovvali reported, VC firms that increased the proportion of female partners benefited with:

- **1.5% “spike”** in overall fund returns annually for firms that added female partners
- **9.7% more** profitable exits for firms that added female partners

“All In: Women in the Startup Ecosystem” by Pitchbook, All Raise and Goldman Sachs, also reported “a correlation between hiring female decision-makers at the investment level and outperformance at the fund level” specifically for U.S.-based venture funds:

- About **12%** of U.S. VCs had women in decision-making roles at the investment level in 2019
- **69.2%** of U.S. VCs that scored a top-quartile fund between 2009 and 2018 had women in decision making roles

Even in emerging economies, gender-balanced investment teams (with between 30% and 70% women investors) are correlated with **a 20% higher** net internal rate of return (IRR) than funds dominated by one gender, according to “Moving Toward Gender Equity In Private Equity and Venture Capital” by Oliver Wyman, RockCreek and International Finance Corporation, a member of the World Bank Group.
The report analyzes 591 venture and private equity funds for performance and gender data, the majority of which are male dominated, and includes 46 gender-balanced firms. The positive correlation between gender-balance and performance holds when controlling for investment strategies, geographies, and fund size, the report notes, and quotes an advisory member; In the words of Claudia Zeisberger, Founder and Academic Director, Global Private Equity Initiative, INSEAD, an advisor to a on gender equity in emerging global markets:

“Why deny yourself alpha-generating diversification by ignoring half the work-force?”

Morgan Stanley’s survey of 200 U.S. venture partners and funded entrepreneurs confirmed that VC firms with diverse partnerships, when looking at either gender or race, have a higher percentage of diverse founders in their portfolios, and concluded:

“The bottom line: VCs who aren’t actively pursuing investments in women and multicultural founders may be leaving money on the table.”

**Should Diverse Investing Teams Be A Consideration in the Fiduciary Standard?**

“**Limited partners (LPs) must invest in diverse VC teams in order to achieve greater returns.**”

– Kauffman Fellows Research Center, January 2020

If the goal of venture investing is superior returns, the emerging empirical evidence correlating diverse investment teams with better financial performance suggests that LPs who invest in venture funds should at least require gender and racial and/or ethnic diversity on teams in which they invest, and seriously consider differences of educational background, industry experience, functional expertise and life paths. Venture investing teams should consider the same requirement for the founding and executive teams of their portfolio companies.

**Who Decides Who Gets Funded?**

“Institutional investors—foundations, family offices, college endowments, pension funds, insurance companies—it’s now up to you!” wrote Ilene H. Lang and Reggie Van Lee in Harvard Business Review on August 27, 2020:

“Large institutional investors are the lifeblood of venture capital. They can and should leverage their outsized resources and unique position to hold venture capital funds accountable for addressing race and gender gaps in their investment portfolios.”

Of the $69.1 trillion belonging to these institutional investors—governments, universities, charities, foundations and companies—98.7% are managed by White men, and 1.3% are managed by women and/or people of color, according to research developed by Illumen Capital and Stanford SPARQ in August 2019.

The report found racism so ingrained in investing that “asset allocators might be violating their fiduciary obligations (i.e., to generate the highest possible returns for their investors) by not investing in funds led by people of color that could produce returns as high or higher than White-male–led funds,” wrote Authors Jennifer L. Eberhardt, Sarah Lyons-Padilla, Hazel Rose Markus, Ashby Monk, Sid Radhakrishna, Radhika Shah and Norris A. “Daryn” Dodson IV:
“Given their power and influence, it is critical to understand how these asset allocators deploy capital and make investment decisions. In today’s market, investments begin with these asset allocators and flow through professional money managers before taking root in companies and projects. As such, if asset allocators set incorrect or biased incentives, the entire capitalist system will reflect and reinforce these biases…Consequently, racial bias could potentially result not only in the unfair treatment of fund managers of color and their grantees, but also in leaving significant financial opportunities on the table, thus hurting the entire financial ecosystem. …Diversity, in fact, is not only a moral obligation; it is a fiduciary one—leading to fewer losses and better performance.”

Oliver Wyman et al. reported that about 65% of LPs consider an investment team’s gender diversity “important, very important, or a top priority when committing capital to funds” but that GPs surveyed said only about 25% of LPs ask about gender diversity of investment teams when conducting due diligence.

What do Next Generation LP Investors Want?

Morgan Stanley reports that the individual millennial investor whose capital is put to work by institutional investors expects both superior ROI and sustainable growth for society:

- 88% of investors now believe it’s possible to balance financial gains with a focus on social and environmental impact
- 84% of investors – and 91% of Millennials – want a report on the impact of their investments

“The capital that institutional investors manage ultimately belongs to individuals, who expect them to make smart investment decisions that reflect their needs, perspectives and values,” Morgan Stanley reported. “These investors have a responsibility to consider social issues when they invest their assets under management. Working with VCs who invest in more women and multicultural entrepreneurs will help to meet this expectation.”

An upcoming massive shift in the resources controlled by young women may help spur discussion toward diversified partnerships as well:

- Millennial women will inherit the majority—70%—of $30 trillion over the next 25 years
- Women align values with money. According to Citi, 90% of women surveyed want to invest a portion of their wealth according to their values and are statistically significantly more inclined than men to want this service.

Most of this $30 trillion in inheritances is likely to go to White women, which is why renewed calls for anti-racist policies and support of the Black Lives Matter movement offer an important view into the strongly-held values of younger, White Americans. In June, 2020, Pew Research Center reported that two-thirds of Americans on average support this movement, including the majority of all Americans of all races—Black, White, Hispanic, and Asian. Adults under 30 were 3x as likely as adults 30 or older to report contributing money to an organization that focuses on race or racial equality in the last month (21% vs. 7%).

What do Next Generation Founders Want?

As Millennials found companies, some of these entrepreneurs are asking potential investors for—and expecting to see—diverse investing teams. One reason for VC partnerships to diversify is to expand their insights into unmet needs in the marketplace, another is to successfully attract entrepreneurs that want investment from diverse investment partners. The movement Founders for Change grew out of the All Raise community specifically “to pressure the venture capital industry to diversify its ranks” as reported in a March 20, 2018 article in The New York
In the article, one of the 1,000+ founders who signed the pledge, Sarah Nahm, CEO of Lever, a software startup, described deliberately choosing to raise some of her $73 million in funding from a VC who is a woman. 38

“[V]enture capital is the slowest part of the tech industry to bring change,” Nahm told Reporter Pui-Wing Tam. “Unless investors are hearing it from companies, they are not going to think that changing is critical. We want people to realize they can get started today.”

WRG’s Commitment to Investing Leadership

WRG managing directors bring diversity of gender, race and ethnicity, age, operating experience, industry knowledge, and functional expertise to our investments. When WestRiver Group began executing on our strategy to leverage diversity as a key competitive advantage toward return on investment (ROI), our leadership structure was explicitly designed to maintain gender balance from the outset. Every managing director has equal responsibility, equal carry, equal equity ownership and equal voting rights. Each of our sectors—healthcare, experience and technology—is co-led by managing directors who identify as women and as men, and all serve on our investment committee.

There is no hidden inequality in the fund’s ownership structure; All investments must be approved by both co-leads in a sector, plus a majority of managing directors, and all managers have equal upside. 35 The WRG Equity Funds’ gender balance is not about optics – it is not a rote matching of the number of men and women on the team. Instead, the WRG approach aims to leverage gender-diverse perspectives on all investment decisions.

This strategy already has expanded WRG’s pipeline of opportunities and tapped new potential for fund performance, creating larger networks of former CEOs, C-suite executives and successful entrepreneurs, deal flow, and assistance for portfolio companies, as demonstrated by WRG’s Technology practice, headquartered in the Pacific Northwest:

Case study: WRG Pacific Northwest Technology Sector

While the fund vintage is too young to report outcomes, our belief that a more diverse and inclusive investing team would beget more diverse and inclusive founding and leadership teams is proving to be true. Of the sector’s nine investments and 254 team members, senior leadership teams include ~33.3% (17 executives) who identify as women and ~ 66.7% (34 executives) who identify as men. 39 According to the FundersClub.com 2017 US Startup Team Gender Diversity Study, these WRG portfolio companies are more than 2x as gender inclusive as typical VC-backed startups led by founders who identify exclusively as men. 40

Moving forward, we plan to evangelize diversity in investing teams, as well as inclusivity training and leadership skills at the companies in which we invest, to help accelerate the kind of innovative thinking that in our experience—and as supported by the data—can turbo-charge innovation and transform performance and financial outcomes.

When combined with our execution-value model thinking framework, we anticipate diversity will provide a key competitive advantage for WRG investors. To that end, we are focused on planning, voluntarily measuring and sharing portfolio performance as a way to demonstrate the value of WRG’s leadership on diversity in the investment community. We commit to:

- Introducing diversity riders in our term sheets, so that we can help expand the diversity and inclusivity of the larger venture investing community outside of WRG. Using the framework designed by Alejandro Guerrero and Michael Silton of Act One Ventures, 41 we’ll make every attempt to include as co-investor at least one additional investor who is from an underrepresented group, including, but not limited to, Black, Latinx, LGBTQIA and/or women co-investors.
● Offering to help develop a plan for diversity, equity and inclusion appropriate for the stage and strategy at each portfolio company toward a more societally representative spectrum of human diversity across gender identity, race, ethnicity, LGBTQIA, class, experience, and function, among others. 

● Delivering an invitation to participate—anonymously and voluntarily—in sharing diversity data, by WRG team members and WRG portfolio company team members, in a way that promotes inclusivity with the goal of expanding opportunities to a larger circle of investment professionals and entrepreneurs, at all levels of experience;

● Sharing these data in aggregate across the WRG portfolio on an annual basis;

● Offering ongoing continuing education to all WRG team and portfolio company team members on inclusivity, intersectionality and teamwork.

WestRiver Group believes in—and has experienced—the positive difference a diverse investment leadership strategy can make in our business. We’re not exploring how to position the firm for statistically stronger returns; we are executing. We know this model is a work in progress, and we are committed to learning and sharing our results, wins and challenges as a way to spark conversation, deeper thinking and drive real, sustained change within the venture arena—and beyond.
The Power of Diversity: Why Homogeneous Teams in Venture Capital Are Bad for Business

Endnotes


8 Source: September 2016, “The CS 3000: The Reward for Change,” Julia Dawson Richard Kersley Stefano Natella, Credit Suisse AG, page 48. (https://evolveetfs.com/wp-content/uploads/2017/08/Credit-Suisse-Reward-for-Change_1495660293279_2.pdf). Credit Suisse compares the investment records of 409 VC firms that did at least 45 deals each over a five-year period with 219 global VC firms with at least one female founding partner investor and where women make up more than 40% of the investing partnership. “On average these firms had 17.4% funding rounds going to female-owned start-ups. This is significantly higher than the 12% outlined above and supports again our hypothesis that women tend to help other women succeed,” the report notes.


11 Source: “Beyond the VC Funding Gap: Why venture capitalists are missing out on the opportunity to invest in diverse entrepreneurs, how it’s hurting their returns, and what to do about it,” Published Oct. 23, 2019 by Morgan Stanley. https://www.morganstanley.com/ideas/venture-capital-funding-gap


17 Source: “As the venture capital game gets bigger, the Midwest keeps missing out,” by John C. Austin, Brookings, June 6, 2019. https://www.brookings.edu/research/as-the-venture-capital-game-gets-bigger-the-midwest-keeps-missing-out/


20 Source: “Race influences professional investors’ financial judgments,” May 9, 2019, Produced by Stanford SPARQ and Illumen Capital; Authored by Jennifer L. Eberhardt, Sarah Lyons-Padilla, Hazel Rose Markus, Ashby Monk, Sid Radhakrishna, Radhika Shah and Norris A. “Daryn” Dodson IV. https://c13d9b40-51b9-4af8-8ce3-16538bed1724.filesusr.com/ugd/34f020_5dafb0523d8740d3a2c3ef497be5fcd.pdf


Source: Verified by WestRiver Group CFO Trent Dawson.


Source: Of portfolio companies in the WRG PNW Fund, these are total employee-reported gender percentages as of the date this data was gathered in H3 2020.


Source: By including diversity riders in term sheets, WRG is following the leadership of Act One Ventures and an initiative by Alejandro Guerrero and Michael Silton. https://www.actoneventures.com/diversity-rider
