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New Venture Funds Focus on Diversity

Startups founded by women and people of color tend to struggle for funding. What can change that?



Arlan Hamilton's Backstage Capital firm has launched a \$36 million fund for black women entrepreneurs. PHOTO: MARK KAUZLARICH/BLOOMBERG NEWS

By Yoree Koh

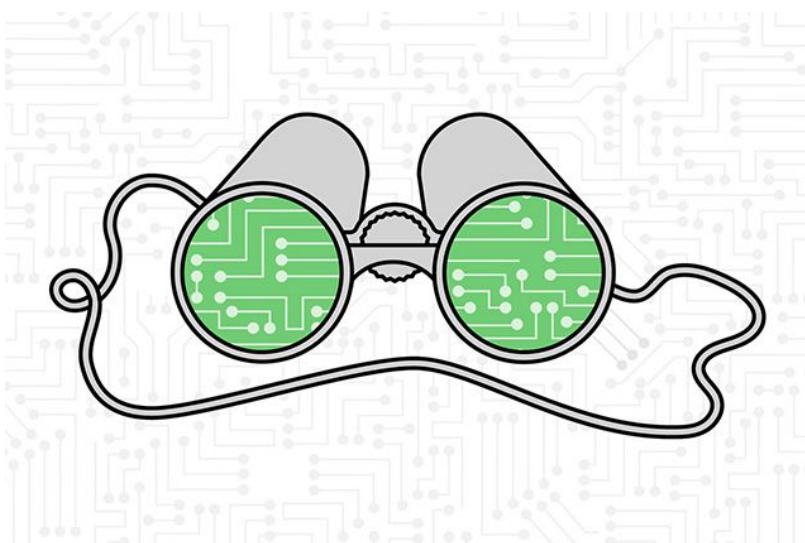
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As venture capitalists try to find the next Facebook, they may unconsciously be scanning for someone who looks like Mark Zuckerberg — male and white.

“So much of venture capital is about comfort. Am I comfortable giving this person a check?” says Charles Hudson, founding partner of Precursor Ventures, a \$15.3 million fund based in San Francisco that invests in companies just starting out, at the so-called pre-seed stage. This is especially the case in early fundraising rounds, he says, where there are few, if any, business metrics to judge a company on.

That’s a problem for women and people of color, Mr. Hudson says, because venture capitalists most often are white men, and people tend to be most comfortable with people who are the most like them. According to funding-data provider Crunchbase, women accounted for just 9% of U.S.-based venture-capital partners at the end of last year, and a 2015 analysis of more than 200 firms by then Venrock Vice President Richard Kerby found that black investors made up 1.5% of the venture-capital industry.

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That may be part of the reason more than \$68 billion in venture funds went to startups founded by men in 2017, versus \$14.2 billion that went to companies started by at least one woman, according to PitchBook Data Inc., which tracks venture-capital dollars. Similar recent data based on ethnicity or race isn't available.

The tendency for people to be more comfortable with others who are most like them becomes less of an issue in funding when a company gets bigger, Mr. Hudson says, but many women and

people of color don't get to that stage because they've been overlooked earlier on. Precursor Ventures is among those that are trying to give those people a better shot at funding. As a rule, a quarter of Precursor's portfolio companies must have a female founder, and another quarter must have at least one person of color.

No more waiting

Some investors have narrowed their focus even more. In May, Backstage Capital announced a \$36 million fund that will invest solely in black female entrepreneurs, writing \$1 million checks at a time.

As of November 2017, 34 black women had raised \$1 million or more in venture funding for their startups since 2009, according to ProjectDiane, a research initiative conducted by DigitalUndivided, an Atlanta-based startup accelerator that focuses on black and Hispanic entrepreneurs. In comparison, PitchBook says there were 5,447 U.S.-based startups that raised \$1 million or more in 2017 alone. Numbers like those disappoint Arlan Hamilton, founding and managing partner of Los Angeles-based Backstage.

“Things just weren’t moving fast enough,” she says. “We can’t just be expected to sit around and wait for other people to understand us.”

Black women “are going to go on to do what venture capital was made for—to innovate and scale,” Ms. Hamilton says. “I want to be financially part of that so I can get their return.”

Backstage also plans to start to raise \$100 million by the end of 2020 to fund founders of other underrepresented backgrounds, she says.

Credentials fail

Ysaira Jimenez’s frustration in trying to raise money in the early days of her company was typical for female entrepreneurs. She discovered that having attended the type of elite college that many venture capitalists graduated from—usually a major plus in an industry where such connections can be the key to gaining access to investors—wasn’t a surefire path to funding.

Ms. Jimenez thought a master’s degree in business administration from the Massachusetts Institute of Technology and an undergraduate degree from Columbia University would give her the academic credentials for fundraising to go “fast and big” when she started seeking outside investors in 2014 for her startup, LaborX, which matches job seekers from nontraditional backgrounds with employers. But she struggled, while many of her male peers from MIT raised millions in a matter of months.

“I was losing a lot of the people I was in front of” because they couldn’t relate to her, she says. Her sense was that her alma maters checked the right box but that the potential investors she met with couldn’t identify with her in the way they might see a younger version of themselves in white male entrepreneurs.

Unable to find any venture capital, Mr. Jimenez eventually raised \$515,000 from 2014 to 2017 from angel investors, grants and others. The company is still in business, and she is preparing to try again for venture funding.

Hurdles and progress

Melinda Gates, co-chair of the Bill and Melinda Gates Foundation, says venture capitalists who overlook women and people of color are hurting themselves. “They’re missing valuable opportunities and leaving money on the table,” says Ms. Gates. She says her investment and incubation company, Pivotal Ventures, focuses on diversity in its investments in startups and in acting as a limited partner in venture funds led by women.

One hurdle to be cleared for things to change: The rarity of high-profile tech success stories from a founder who isn’t a white male has reinforced the idea among venture capitalists that what they’ve been doing is working, says Lo Toney, founder of Plexo Capital, a new \$50 million fund



Yscaira Jimenez, with degrees from Columbia and MIT, turned to angel investors and grants after striking out with venture capitalists. PHOTO: TOMAS QUIÑONES-RIEGOS

that will be a limited partner in seed funds run by people of color and women.

Still, there has been some progress. The persistent spotlight on the tech industry's overall lack of diversity and a string of sexual-harassment scandals have prompted several top venture-capital firms to start changing. Over the past year, at least half a dozen firms, including Benchmark and Union Square Ventures, have added a woman to their partner ranks for the first time. And groups like Founders for Change, whose membership has ballooned to more than 700 startup founders since it formed in March, are keeping up the pressure on VC firms to diversify their ranks. In a pledge, the group's members say the diversity of a VC firm will be an "important consideration" when they decide who to accept money from.

Then there are the smaller firms, like Backstage, Plexo and others that have emerged in recent years, formed specifically to fund those the venture industry has largely neglected.

Others, like Jyoti Bansal, co-founder of the \$160 million seed fund Unusual Ventures, are simply determined to be open to all potential investments. "We are completely agnostic to what your background is," says Mr. Bansal. "If you look like Mark Zuckerberg and you have a great idea, we welcome you. If you don't look like Mark Zuckerberg and you're not a white guy who went to Harvard, we still welcome you."

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