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Small Business Research Summary

Advocacy: the voice of small business in government

April 2013 No. 406

Venture Capital, Social Capital and the Funding of Women-led Businesses

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[30 pages]. Under contract number SBAHQ-10-R-0023

Purpose

Entrepreneurs need access to financial resources to fund their ventures, and those with marketable products may seek financing from venture capitalists (VCs). This study focuses on women entrepreneurs' access to equity funding and the influence of social networks on venture capital investment decisions.

Background

Women-owned businesses accounted for 28.7 percent of all businesses nationwide, and women were partners in 45.7 percent of businesses (2007 Survey of Business Owners). Women-led businesses (WLBs)—defined in this study as companies with a woman on the management team—are one of the fastest growing groups of entrepreneurial firms, yet few of these firms receive private equity funding. One consistent finding in researching VC firms is that WLBs receive less outside funding than businesses led by men. Some reasons given for this disparity include women's lack of education in high technology, their underrepresentation among investors, or a lack of experience required by venture investors. Other research sources show that VCs typically invest in high-growth companies in growing markets, and that WLBs tend not to be in these markets. Earlier studies addressed the equity funding gap from the demand perspective, but this study investigates WLB funding from the supply side, with a focus on social capital and performance.

Overall Findings

The analysis finds that VC firms' social capital influences their investments in WLBs, but in different and sometimes conflicting ways. Generally, VC firms are risk averse and tend to invest within familiar social networks. VC firms with long-term relationships that regularly invest together as a group (syndicated deals) with the same VC firms tend to invest in a higher percentage of WLBs, since they are able to share the risk. The more autonomous VC firms, which co-invest with other VC firms that do not regularly co-invest with one another, tend to invest less in women-led businesses. This finding is similar to other research which finds that these less embedded VC firms choose investments that are perceived to be "safer."

The study finds that VC firms that did invest in WLBs saw an improvement in their VC firm's performance, which means that investments in WLBs are successful, leading to a positive return on the VC firm investments.

Implications and Policy

The lack of adequate venture capital and social capital has a number of implications:

- WLBs may hold untapped potential for innovation, job creation, and other economic contributions that may be limited only by access to VC funding.
- The lack of investment in women-led ventures diminishes the opportunity for women to grow their businesses and create wealth through entrepreneurship, and the overall health of WLB companies may be less robust.
- Investors who rely solely on their personal contact networks may be missing good opportunities to invest.

Some policy suggestions that may help bridge the VC equity gap for WLBs include:

- supporting mentoring programs that will prepare women for leadership;
- encouraging women entrepreneurs to identify critical networks, or to be engaged in the right social networks;
- encouraging investors to consider investing in women-led ventures.

Scope and Methodology

The study utilized Thomson Reuters Private Equity VentureXpert database and studied the years 2000 through 2010. The data covered all investments by U.S. based VC firms in U.S.-based companies. The study tested three hypotheses related to VC investment in WLBs and the effect of such investments on VC performance. The first step was gender identification within the management teams. A multi-step process was used to assign gender to non-gender-specific names. Each portfolio company was classified as a women-led business if a female was on the management team. The control variables were firm age and firm location. Dummy variables were used for five states (Massachusetts, New York, California, Texas, and Illinois) where venture capital investments were high for 2000-2010. To test the model, a system of two simultaneous equations was used.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research by email at **advocacy@sba.gov** or by phone at (202) 205-6533.

Additional Information

The full text of this report and summaries of other studies of the U.S. Small Business Administration's Office of Advocacy are available at **www.sba.gov/advocacy/7540**.

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