

Beyond Unprecedented: The Post-Pandemic Economy **Episode 4: “Nothing Ventured, Nothing Gained”**

[00:00:01] **Alejandro Guerrero:** Venture capitalists are the folks who control the money and, ultimately, the people who help make dreams become reality.

[00:00:07] **Talia Gillis:** When so much hinges at a stage where we don’t have anything concrete to catch onto, stereotyping might play a role.

[00:00:14] **Guerrero:** Who we’re talking with, who gets to be a part of these networks, is both what caused this problem, but it’s also going to be part of what’s going to solve this problem.

[00:00:21] **[Music and media clips of journalists saying “unprecedented”]:** The coronavirus pandemic has tanked the global economy with unprecedented speed. The steepness of the decline here is unprecedented. This is a crisis that is unprecedented. It is unprecedented, and we just don’t know.

[00:00:35] **Eric Talley:** This is *Beyond Unprecedented: The Post-Pandemic Economy* from Columbia Law School and the Ira M. Millstein Center for Global Markets and Corporate Ownership. I’m Eric Talley, Sulzbacher Professor at Columbia Law School and co-director of the Millstein Center.

[00:00:50] **Kate Waldock:** And I’m Kate Waldock, a research fellow at the Millstein Center and a 2L at Columbia Law. Throughout the pandemic, we’ve become very well acquainted with Zoom and staring at people in little boxes on our screens for hours every day. Zoom launched in 2013, and the company is a great example of how venture capital financing can fuel growth, get new firms off the ground, and lead to innovations in our economy. Venture capital, or V.C., is high risk, and most startups fail in the first few years. But when one hits it big like Zoom, it can mean a major payout to those early investors.

[00:01:29] **Talley:** Traditionally, though, V.C. investors have been overwhelmingly white and male, and they tend to fund startups whose founders look conspicuously like them. Less than 3% of all V.C. funding went to founders of color last year, and only about 2% of venture financing in the U.S. went to female founders. In this sense, Zoom is a V.C. outlier. The company’s founder, Eric Yuan, is Asian-American.

[00:01:52] **Waldock:** Today, we'll look at implicit bias and double standards in venture capital and how to mitigate them. And we're going to explore that by focusing on the cornerstone of V.C. deals: the term sheet. It may seem niche, but the way V.C. deals are set up at the beginning has enormous and lasting effects for investors, founders, and the way economic success can be shared beyond the "white boys club."

[00:02:15] **Talley:** That's why in this final, supersized director's cut episode of the series, we're talking with two guests with very different perspectives, because access to capital is critical for creating an equitable society, and yet the barriers that exist are persistent and longstanding. First, we'll be speaking to Alejandro Guerrero, a venture capitalist who's doing deals with a contractual tool known as the diversity rider as a way to get more investors of color a seat at the table. And then we'll be joined by Columbia Law Professor Talia Gillis, who's examining whether the few women founders who get V.C. funding are funded on different or less favorable terms than men.

[00:03:15] **Waldock:** We're very lucky to be joined by Alejandro Guerrero, who is the co-founder and general partner at Act One Ventures, a community focused, early-stage venture capital firm. He is the creator of the Diversity Term Sheet Rider for Representation at the Cap Table and the *Diversity Riders* podcast. Welcome, Alejandro.

[00:03:34] **Guerrero:** Hello. What's up, Kate? What's up, Eric? It's really nice to be here with the both of you.

[00:03:39] **Waldock:** Great to have you on the show. Can you start out by telling us a little bit about how a typical V.C. deal works and how the diversity rider fits into that?

[00:03:48] **Guerrero:** Sure. Just in terms of how venture and all of it works, we manage a pool of capital. So we go out, and we raise money from what's called limited partners [LPs]. These are individuals who have created a sort of wealth for themselves, either through family businesses or investments or income, whatever may have you, and are looking to invest, looking for money managers, looking for places to put a portion of their net worth into assets that can deliver returns to them over a set period of time. And then there's the institutional investors, which are more along the lines of pension funds, university endowments, etc. Our job as the general partners is, we have the fiduciary responsibility of going out and investing in a certain set of companies because we have this set of expertise to be able to both find these companies, invest in them, and then support them through the journey of the company's growth. And so our job is getting the money from LPs to be able to deploy, finding the right founders that fit our thesis, being able to invest the right amount of money for our model to work, and then supporting them along the journey throughout the way. So that's the general overview of how venture works. And then if you start getting one layer lower, then we start talking about the term sheet.

[00:05:01] **Talley:** What is a term sheet?

[00:05:03] **Guerrero:** A term sheet is, the most simplest way to understand it is, it's sort of like a memorandum of understanding. It's not a legal contract. It's basically, usually a two-, maybe three-page document that essentially is lining up the terms of which we've agreed upon, both as investors and the founders of the company we're looking to invest in, in terms of what kinds of rights founders and the investors will have in exchange for a percentage of the company's equity. And so those rights can include something along the lines of having a board seat or having a board observer role, being able to invest more money in subsequent rounds. What I created, which is called the diversity rider, is a sort of language that I designed with the help of some other GPs and a few partner lawyers at the law firm Cooley. And this language that I designed last year in the summer was specifically made so that I could insert this language directly into the term sheet. It's a call to action, is how I refer to it. And essentially the language says, the founder and the investor is agreeing to work together to identify a co-investor of a diverse background, whether that's a woman, LGBTQ+, Black, brown, or any other underrepresented minority. We're pledging to work together to identify either individuals or a firm that are coming from these underrepresented backgrounds and that we're going to be allocating them. So we're going to leave some sort of room on the round for these diverse individuals. Now, whether that's a percentage of the round, whether that's a certain dollar amount of the round, those are both variables that I specifically designed to be left open because I didn't create this with the intent of telling anybody what to do. The intention of the diversity rider was so that the call to action was abundantly clear as to why we're inserting this, right, because we care. As investors, we care that this is a topic of importance for us, not only because it's the right thing to do but, frankly, also because there's just too much information out there at this point now that very clearly shows, if you want to build great companies that outperform others, then you need to have a diverse culture. And I believe that that begins not when you start hiring your first 10 or 15 employees but when you're doing your very first round of financing. Setting the precedent that this is something that is going to matter for the life of the company, and from the very beginning, we're going to be thoughtful about bringing in these kinds of diverse co-investors so that we get access to their networks, to their operational knowledge, to their experiences as different individuals, so that together we can work and help these founders build great companies that will endure whatever happens in the market rise that we're currently living through. But always with the intention of being a safe space for anyone of any kind of background who is looking to get into these high growth startups to be able to find a comfortable seat once they're joining these companies over the life of their existence.

[00:08:03] **Waldock:** How is asking for a diverse co-investor different than asking for, say, diverse directors or senior management?

[00:08:11] **Guerrero:** So the diversity rider isn't meant to replace a diverse director or a diverse hiring clause. No single director is going to change the outcome of a company, and no single, diverse C-level executive is going to do the same. This has got to be a

thoughtful, calculated approach in terms of how the company gets capitalized, who gets to participate in that, and how that sets the stage for all those other things, like the directors and the employees, going forward. It's so competitive in venture capital, and because it's so competitive, and we're trying to close out so rapidly, we sometimes forget that that's a moment in time where we can be thoughtful about making sure that the deal isn't exclusionary of underrepresented groups who can be very, very, very supportive and beneficial to the founders and the company over the growth of its life. Because if you want to create a company in today's world, you just can't go out and be three or four white guys, get money from a bunch of white guys, and only build a culture for white guys because eventually you will realize that you cannot hire women and people of color because nobody feels safe or comfortable in the environment that you've created. And so that's the reason for the co-investors. Having folks who are diverse have a seat at the table means that they are going to be privy to what's going on. It means that they're going to be able to help hold the founders accountable to all of the things that are imperative to get right at these earlier stages, only because it just gets so much harder to fix them if we're not thoughtful about them at the beginning, and that's really around like company culture. So to build a great company culture that is inclusive, that is diverse, you just have to do that from the beginning. Because once you start hitting those 10, 15, 20 employees, you can't start thinking about it then because then you're behind the eight ball. You're working your way back, you're having to solve things that are just naturally more difficult because now you've probably delivered a product, you probably got customers, you have other fire alarms going off. And so it just becomes more of a harder, much stressful situation to go back and figure out, well, how do I start to create a diverse culture in here? And so that's why. I'm trying to help folks be more thoughtful that these issues are going to exist—they will always exist—but if we're mindful about addressing them from the beginning with a diverse cap table, then you're going to have folks around the table who can help you manage that process as you continue to grow.

[00:10:48] **Talley:** Could you tell us a little bit about the uptake of diversity riders, and also within that set, how much diversity has there been within different types of diversity riders? I understand that there might be quantitative figures that might be put into the rider, maybe on percent of co-investors and so forth. But then also the level of effort that is required of the general partner to recruit these co-investors. You could have one that says, no, you shall do this; another one that says, well, you should use best efforts to do it. And I can imagine many different ways to slice and dice that. So how many startups have taken up the diversity rider, and then what kind of diversity inside those riders have you seen in practice?

[00:11:37] **Guerrero:** When we started the rider last year in the summer, we launched with 10 firms originally. So this was designed specifically so that venture capitalists themselves could have a tool to insert in their term sheet that would give them a moment in time to open up a conversation that could be challenging or uncomfortable for some—and this is around inclusion, diversity, and equity. It was specifically designed for venture capitalists, one because I'm a V.C., and I'm on this side of the table, but also because I know that

V.C.s are the gatekeepers. Venture capitalists are the folks who control the money, who are responsible to deploy that, and who ultimately are the people who helped make dreams become reality. And so there's just a lot of power that rests on these investors for multiple different reasons. And so I believe that it is on the investors to be mindful of that and find a way to make sure that anytime we're doing a deal, we're cognizant about having that conversation. And so the rider language, just to be clear, has nothing in it where it is enforceable, meaning it is not a contractual binding set of language, it does not say it has to be a certain percentage or a certain dollar amount. It has no teeth, in essence. And why did I do that? I did that because as I was designing it, I realized that in order for this to come out into the world, it had to be shaped in a way where the call to action was clear, but that I wasn't telling anybody what to do. And then it made sense because as I went and had conversations, particularly with the much larger firms who have been around doing this for a while, I could sense a set of reluctance. "Well, you know, it's really hard for me to get to my averages, and so I don't know if I could do this. Well, I don't have a diverse network." I mean, trust me, I heard every possible excuse you can think of and then, like, 10,000 other ones. And what I did was I took all of that back and created the language so that this call to action was clear, that it helped you have that conversation, but I left the variables open so that each deal could be figured out as to what's appropriate for that particular founder and that particular company and that particular fund in that particular moment in time. When we launched it, I was able to get ourselves, Act One Ventures, and nine other firms to join us on that launch. And that, basically, was a commitment that all of us were inserting this standard boilerplate language into our term sheets in perpetuity. We are now at over 80 firms that are using the diversity riders language standard in their term sheets.

[00:14:16] **Waldock:** Just to clarify that, so you're not saying that the diversity rider has been inserted in 80 deals. You're saying that it's actually 80 venture capital funds that consistently put this rider in all of their deals.

[00:14:27] **Guerrero:** Correct. But it's been utilized hundreds of times now across venture capital over the last year and a half. Part of that has been driven by the firms who have been using it. But part of it was also driven by Cooley, itself, making this a standard part of their term sheet generator, both internally and externally at Cooley Go. And so that level of institutionalization, if you will, quote unquote, has really helped to drive this a lot faster. The message has just really very much resonated, and it's grown way beyond myself, where there's just so many people using it that I have no idea who I am, what I do, where I created it from. It has just taken on a life of its own, and it is being utilized both by investors but also by founders who have heard about it and who are now basically demanding that it be used. I didn't invent the light bulb, right? It's not like I invented something that didn't exist in the world. I just found a way to create language that was impactful. And I did it at the right moment in time that I knew was unlike anything else, which was, the world paused once George Floyd was murdered, and we all took a step back to realize that we are absolutely living in a completely, systematically racist environment in pretty much any institution you can think of. And it's time for us to address

that openly and find material ways to start to change that. With all the funds that are now using this, we're nearing close to \$8 billion in total assets under management of all of the funds that are using it.

[00:16:04] **Talley:** Alejandro, what sort of pushback have you seen against the widespread adoption of the diversity rider as just a standard term in every deal?

[00:16:14] **Guerrero:** So one of them was, the industry doesn't need this, this isn't a problem. Venture capital is just part of capitalism, and you either make it or you don't, and that's on you. The other one was, oh, you know, I really can't bring in a diverse, or just a co-investor period, because we never have room. Rounds are too competitive, and we can't get to our averages, and so, you know, I just don't see our ability to really make room for anybody else, even at a nominal amount of money. One that was pretty prominent, I think, is a big part of what holds back a lot of funds, which is, I don't have a diverse co-investor network. I just don't know women and people of color who are part of my network or who are working in the kinds of industries that I'm investing in, and so I wouldn't even be able to fulfill the directive of the rider because I just don't have that network. And then there was the usual folks who were looking for literally any reason on the planet to just not do something that is progressive because they don't want to change. There's just a group of folks who very much have benefited from the incumbent system. And when you look at it, what incentive do they have to change? For them, life is good. They were born the right gender or the right color of skin for America. They were born into some sort of generational wealth or some sort of legacy somewhere. And not that they didn't work hard, but I'm not going to sit here and say that they work just as hard as somebody who comes from a very poor, first-generational family who has no inroads to an Ivy League institution or some sort of top banking or whatever have you. My job was to take all of that, compartmentalize that, cried through some of it because of how messed up some of it was, and then find my way to edit and come back and go forward.

[00:18:05] **Talley:** How do you think of an investor, a limited partner that is not a natural person but is itself another company or an institution? And how and under what circumstances could a fund point to such an institutional company investor to say, oh yes, we are fulfilling our obligations, whether enforceable or not, under our diversity rider.

[00:18:29] **Guerrero:** This is the founders' call. No investor can tell the founder what to do, not in venture capital. In terms of what we're doing here, we're taking minority seats, we're helping them along the journey, and we're doing whatever we possibly can to have the greatest success that they can have and those outcomes. And so our job as investors is to coach them, support them, and encourage them to continue to be thoughtful about what it takes to win in the current environment. I will say that some folks have told me that they view what I designed as sort of like affirmative action for the venture industry, and I don't shy away from that at all. Yeah, I mean, it is, and I think it should have happened a long time ago. I know I've said a lot of things that can seem negative, but I'm an optimist at heart, and I say that because I'm encouraged by what I'm seeing on the ground level. I'm

seeing founders really taking this message to heart, truly being vocal about this, and it's forcing the people at the top to realize you cannot "thoughts and prayers" your way out of this. This is just us taking action in our own hands and saying, "If you want to continue to invest in the best companies led by diverse founders, then you better wake up to the reality that what's coming your way is a freight train, and you're either going to want to get on that train and be a part of the change, or you're going to watch that train run you over."

[00:19:47] **Talley:** You'd probably agree that in five, 10 years time, if the diversity rider will have proven to be a success, one of the markers for that success will be drawing more underrepresented groups, people of color inside the walls of the walled garden to be investors in this asset class. So the old statistic about how only one out of 10 venture backed companies actually succeed, and the rest have to basically fail miserably, or at least fail. And probably a sense that part of the reason for that return is that it's compensating for more risk that the investors are taking on. Is that something that keeps you up at night, or is it, no, this is how capital markets are supposed to work?

[00:20:35] **Guerrero:** Well, look, there's two reasons why companies die. It's because you are absolutely terrible at managing money, and you just spend too much and don't have control of that, or you build a crappy product that nobody wants to buy. And so part of the job is iterating and learning—listening to your investors, asking for help, looking for advice. When it comes to people investing their money, you always got to be mindful, and you always have to be thoughtful about, yeah, there's a chance you can lose money here. My personal take on this is that it's time to open up this asset class to a broader group of people. For too long, general retail investors, just individuals, have been locked out of this great asset class. And so we're seeing things like the Robinhoods of the world coming in and democratizing that access of the public markets. And that's great. But I'm going to tell you that I don't care about that because the reality is, for the small investors who are looking to get into these companies to create wealth, it ain't going to happen at the IPO. That's just not how it works. The wealth is created in the private markets. And I know that some of these rules were designed in order to help prevent folks from making the wrong mistakes. But at what cost? I think I read somewhere 10% of Americans own 89% of the value of the public stocks. So how are the rules helping anybody other than them? You can go to a liquor store and spend \$1,000 dollars on a lottery ticket, which has a way higher rate of failure than I would imagine these startups. But nobody sitting here walking around that because as long as poor people just go and do the things that don't compound well, that's all good for the wealthy. Let us make all the real generational money, and you guys just play these little games that don't move the needle. It's a total game of access, knowledge, and who gets it and who doesn't get it, and I'm here to break that all apart.

[00:22:29] **Waldock:** You talked about the idea for the diversity rider coming about last summer shortly after the murder of George Floyd. Do you think that the diversity rider could have existed without George Floyd?

[00:22:40] **Guerrero:** No. No, I do not, because that goes back to the same notion as if incumbents wanted to change, they would have changed. Nobody needs this language to go and invest in people of color and women. But the reality is, they're not mindful of it. Either they don't care, or they're not mindful, or they don't know how. And what I realized was, if we just create a tool and give people access to this tool, then those folks who care about this but maybe were struggling to find a way of how to do this appropriately, now they actually have a way to go and do that. They have something that allows them to have a conversation internally with their stakeholders. And then they figure out, well, hell, do we even have a diverse network? There is, in my opinion, no replacement for this. There is nothing you can tell me that you're doing in your business that will get me to say, oh, that means that you shouldn't bring co-investors in your cap table. Flat out, everybody needs to do this because the one thing that we can be sure of is that all of us will perish this Earth at some point, but the essence of doing deals will live on forever. And if we can get something that outlives all of us to continue on, then we can start to change the world, even when we're gone.

[00:23:52] **Talley:** One thing that I should ask you, do you think we left out anything—a message that you'd like to get across?

[00:23:58] **Guerrero:** No, I just think for anyone who's listening to your podcast, first, go to Columbia Law School because, if you're listening, you definitely know that's where you need to go already. But second, I would just say, look, it's on you. Don't look to someone else to solve this problem. And I tell young people in college and graduate school, be mindful of that because the process to do that starts today. It's by who you're sitting next to in class, who you're willing and open to having a conversation with to get to know, being outside of your comfort zone, being thoughtful of the network you're building today because you are going to be tapping into that network for the rest of your life. And you don't want to be that gal or guy that looks up 10 years from now successful, but you're like, oh, crap, I have no diversity in my network. I have no idea how to bring a value to a world that is asking for this, but I was not mindful of that because I was just too busy only focusing on me. There is an element of, yes, work hard, but be mindful that there was a lot going on around us, and who we're talking with, who gets to be a part of these networks is both what caused this problem, but it's also going to be part of what's going to solve this problem going forward.

[00:25:08] **Waldock:** Alejandro, that was an amazing conversation. I've learned so much from you. Thank you so much for joining us on the show.

[00:25:14] **Guerrero:** Perfect. It was such a pleasure to be here. Thanks for having me on, Kate and Eric.

[00:25:18] **Talley:** That was brilliant. Thanks so much, Alejandro.

[00:25:26] **Waldock:** We've learned from Alejandro that the term sheet can help share the wealth with underrepresented investors. With our next guest, Talia Gillis, we'll talk about term sheets and gender bias and whether the few women founders who get V.C. funding are really getting a fair shot at success.

[00:25:42] **Talley:** Talia studies law and economics from a consumer market perspective. She's interested in household financial behavior and how consumer welfare is shaped by technological and legal changes. She has a Ph.D. in business economics pending from Harvard University and a doctorate from Harvard Law School. Talia joined the Columbia Law faculty in 2020. Welcome, Talia.

[00:26:03] **Gillis:** Hi, thank you for having me.

[00:26:05] **Waldock:** Talia, why do you think that we might expect to see more bias in terms of discrimination based on race or gender in an industry like V.C., as opposed to other industries?

[00:26:18] **Gillis:** One of the challenges when we think of the moment of investment, particularly the earlier stage is that a company might be funded, they're not the kind of traditional metrics, financial metrics in terms of revenue that we can use to evaluate the successful or potential of a company. And so, so much is going to hinge on the idea itself and also, to a large extent, the founders and the team and whether the V.C. views the founders and the team as a team that has promise for the future. When so much hinges at a stage where we don't have anything quite concrete to catch onto, then a lot of stereotyping of, "Is this person someone I can imagine leading a successful company?" might play a role. And to the extent that our ability to visualize a successful female entrepreneur or a successful entrepreneur who's a racial minority is harder because it's less prevalent, then that's going to play into whether we view this person or this team as someone we expect to lead a successful startup company.

[00:27:21] **Talley:** If we stick just to dollars invested and inflows into new start ups, is the fundraising environment getting any more accommodating toward women founders? The numbers I've seen have suggested that there may have been some tick up in the amount of funding that is being directed towards women-founded firms.

[00:27:42] **Gillis:** Yes. So we are seeing an uptick in the amount of female-founded companies that are receiving funding. Obviously, to be clear, the percentage of V.C. funding that are going to female-led companies is still far significantly lower than what we're seeing for male-led companies. So even with the uptick, there's still significant disparities. But from my perspective, part of what's interesting is not just the dollar amount that's going to female companies but also thinking about, what are the exact terms that are negotiated between V.C.s and female-funded companies? So the amount invested in the valuation is only one dimension along many dimensions that are part of the agreement between V.C.s and founders.

[00:28:23] **Waldock:** That's really interesting, and I think this is part of what makes your research agenda so interesting. Could you explain some of these non-price terms in a little more detail?

[00:28:33] **Gillis:** We can think of these various price terms as potentially doing two types of things. One is that they may play a distributional role in splitting the pie between V.C.s and founders. So, for example, if we think about liquidation preferences, which are about, essentially, who has preference over money at primarily the point of sale of a company—so say a company is quite successful and then is acquired—liquidation preferences will determine whether the V.C. gets some kind of preference in terms of being paid back for their investment before the rest of the money from the sale can be distributed to the other shareholders. And so we can think of something like a liquidation preference as directly impacting how well the founders of a company do at a point at which there's sale of the company. And the other types of provisions might be very much focused on the division of power and decision-making within a company. So, for example, determination of how many board seats are allocated to certain investors or a V.C., whether they have certain veto rights over decisions like, for example, when there's another round of capital or how much capital is raised in another round. So there are all kind of decision-making divisions between the V.C.s of the founders, and all these will be part of the term sheet that will accompany the investment offer from a V.C.

[00:29:55] **Talley:** I guess you could have a situation where a V.C. comes along and invests a very large amount of money in a startup, say, a startup founded by a woman. But then if you drill into some of these other terms, part of the reason the V.C. is investing so much is that they've basically taken control of the entire startup.

[00:30:16] **Gillis:** That's exactly right. When we think of the value of an investment then these terms have a direct impact on the actual value of that money being received. And to be clear, some of these terms might be just about the distribution between founders and V.C.s. Now we would also care about that. So, for example, if we believe that successful founders then become successful partners of V.C.s, then whether women are making the same types of profits from their endeavors, from their startups is going to very much matter for downstream equities in other financial sectors. It also might impact their ability to later on have found another company. So we definitely also care about the distribution of wealth between the founders and the V.C.s. But we might also care about the division of decision-making within a firm because that very often will translate into the success of the company over time, particularly with the ease at which a company can raise more capital, respond to challenges it might have with funding in the future. To the extent that those early-stage decisions with respect to power sharing then impact those later decisions, then we may see a divergence in the outcomes of these female-founded and male-founded companies because of these provisions that affected the decision-making within the company at early stages.

[00:31:37] **Talley:** What do we know about success rates, failure rates of women-founded startups versus other startups? How do we know what would cause that difference in success rates?

[00:31:50] **Gillis:** So part of the difficulty is that it seems to be nowadays that the types of companies that have female founders are quite different from the types of companies that have male founders. And so to the extent that we might see differences in ultimate success, a lot of that might be related to the different industries that we see female and male founders. Of course, part of the challenge of thinking about the ultimate outcomes of the startups, and part of my research challenge, or our research challenge, is the fact that if these initial terms differ for men and women, and they affect ultimate success, then we can't compare male- and female-founded companies based on their ultimate success if it's affected by these early differences along gender lines.

[00:32:32] **Waldock:** The three of us are economists, and so we would expect that if markets are rational, then if a female founder, for example, is being mistreated by one V.C. firm, then another V.C. firm seeing their potential should just step in and offer them better terms or lower prices. So why isn't that happening, or why might it not be happening?

[00:32:54] **Gillis:** Very often, founders not only care about the valuation and the actual investment amount, they care about the terms, but they'll also actually care very much about the V.C. that invests because V.C. investment often comes with benefits like connections, which, again, translate into the success of the company. So it's not that as a founder of a company, you're indifferent as to where your money comes from. So it will be pretty meaningful if a top tier of V.C. funding is hesitant to fund you, even if there's, perhaps, mavericks within the V.C. industry that are willing to invest to a broader range of investors than those more established V.C.s. Of course, the difficulty in this relates to a lot of what we know from discrimination literature. It's correlated, these stereotypes people have about founders, and so to the extent there's correlated expectations on who immediately jumps out as someone who fits the mold, we're going to see that decision-making correlated across many VCs.

[00:33:52] **Talley:** And so a lot of decision-making at the funder level might get proxied by certain types of social cues or common cultural references. And if that's true, does that bear on what the composition is of the V.C. fund as well? To date, the V.C. industry itself on the funding side has largely consisted of either well-established institutional investors or individuals who are pretty rich, pretty white, pretty male. I'm wondering what you think about barriers to entry or difficulty of women or other underrepresented groups getting membership into this sandbox. There's a growing trend towards diversity riders that certain limited partnerships that create V.C. funds are adopting, saying that they will commit or at least aspire to diversify their investor base. Do you think that those sorts of riders would have a positive effect in the evolution of this industry?

[00:34:53] **Gillis:** I think to the extent that they might be part of the decision-making for investments, I think that could have a positive impact on the diversity of what companies get funded. So we know, for example, when a V.C. has female partners, they're more likely to invest in female-founded companies, and they look at the impact of a male founder having a daughter increasing the chance that that male partner will then hire a female partner to join the V.C.¹ And that directly impacts the number of female-founded companies that then get funded. So I think there is that connection between not just where the money comes from but the decision-makers within the V.C. on what gets invested. But, of course, I don't think that that's just going to solve the whole issue. Even women have stereotypes about female founders, and that, to a large extent, is mostly corrected by just having more examples of salient female founders beyond those that potentially commit fraud.

[00:35:51] **Waldock:** I wanted to address the elephant in the room, which is Elizabeth Holmes. How do you think that the downfall of Theranos bears on the prospects for other female founders?

[00:36:02] **Gillis:** What's unfortunate about what we know of human behavior and human psychology is that we update differently based on whether we observe a behavior for a majority of minority group. And so, for example, if we see a female classmate who might be weak at math, we update with respect to how good women are at math as opposed to if we have a male classmate who's perhaps weak at math, and we only update with respect to him specifically and not the group itself. Given that it's not very common to see successful female entrepreneurs, the fact that the example that's become so salient recently is Elizabeth Holmes and the allegations of fraud, I think to some extent, subconsciously, allows people the stereotype of, oh, OK, this is what a successful female founder might be like. So, for example, in a recent episode of *Freakonomics Radio*, which discussed V.C.s and mentioned the fact that there's this lack of diversity in both the V.C. side but also in the companies that get founded by V.C.s, they discussed Elizabeth Holmes and how potentially, maybe one of the reasons that the story with Theranos took place is that the V.C.s so eager to invest in women were not careful enough in actually validating the technology. So you can see again, although the way that case was discussed in *Freakonomics* wasn't to say there's some connection between her gender and the fact that she's allegedly committing fraud, it's kind of framed in a way that V.C.s, part of their problem is that they perhaps have to be more careful when they look into female founders. So I think there's a lot of ways in which this example potentially creates impediments for future female-founded companies because of the fact that it's so salient and so an outlier, in a way, that she was a successful female entrepreneur.

¹Calder-Wang, Sophie and Gompers, Paul A., "[And the Children Shall Lead: Gender Diversity and Performance in Venture Capital](#)" (October 01, 2021). Harvard Business School Finance Working Paper No. 17-103, Harvard Business School Entrepreneurial Management Working Paper No. 17-103, Journal of Financial Economics (JFE), Vol. 142, No. 1, 2021.

[00:37:50] **Talley:** And I guess I'd like to add that even though we are three economists, we are housed in a law school, so formally, Elizabeth Holmes has been alleged to have committed fraud. And we'll see how that plays out. So let me ask you another legal crystal ball question, Talia. Certain states—I'm thinking about California—have recently passed legislation that would mandate both gender and racial diversity on boards of large companies both public and private, if they are headquartered in the state. Other states have started to emulate that. What do you think about that trend, and are some of the challenges to that trend going to be successful? Challenging it for, say, violations of the commerce clause of the internal affairs doctrine that would presumably keep certain states from regulating the internal affairs of companies that are incorporated in a different state.

[00:38:45] **Gillis:** Yeah. So there's obviously a lot of challenges when it's localized like, for example, in California. The fuller picture is that we see efforts that are not only the formal legislation, like the California example, but efforts of the Big Three to push diversity over boards.

[00:39:03] **Talley:** Who do you mean when you say the Big Three?

[00:39:06] **Gillis:** So the big three are the largest institutional investors that have a very large proportion of a lot of publicly traded companies. So that would be BlackRock, Vanguard, and State Street. And they have undergone an effort in the past few years of putting a lot of pressure on primarily public companies to increase the representation of women on boards.² Companies that have shares that are held to a significant amount by these big three did increase female representation. But part of what we've also seen as a result of that increase of representation is also a diversity of skills on boards. So where as it was traditionally if only people who have experience as a CEO who had more of a chance of being appointed to a board that obviously reproduced some of the gender disparity that we see because I think around 5% of publicly traded companies have a female CEO. What we've seen as a result of the increase of female representation of the board is also a broader range of backgrounds of the directors of these companies. To the extent that V.C.s are able themselves through this pressure, perhaps, to expand funding to women and to racial minorities, they might also learn that they have a range of backgrounds and a range of skills that make an entrepreneur successful beyond the narrow list that they previously had been looking to. And so I think the lesson we learned from expanding female representation on boards bears directly to this question of increasing what we believe to make a successful founder.

[00:40:37] **Talley:** Talia, can I bring you back to this funding side and reforms that might be possible. Within venture capital, as well as private equity, there's been a pretty significant move among some individuals, including senior policymakers, to open up investment in those markets into groups of people who have traditionally not had access to investing in

² Gormley, Todd A. and Gupta, Vishal K. and Matsa, David A. and Mortal, Sandra and Yang, Lukai, "[The Big Three and Board Gender Diversity: The Effectiveness of Shareholder Voice](#)" (July 31, 2021). European Corporate Governance Institute – Finance Working Paper 714/2020

those markets beyond pension funds, university endowments, and qualified rich people, basically. And maybe even allowing public market investors—people on Robinhood—to invest in a private equity company or a venture capital company. What do you think about that? Is that a good idea? Would it help catalyze some of these competitive forces that Kate was asking you about earlier?

[00:41:26] **Gillis:** Part of my concern perhaps is from a consumer protection perspective. The V.C.s, by definition, are meant to take upon themselves a significant amount of risk, and their success is judged across a portfolio and not a particular investment, and that's not typically how we think of retail investors, particularly those that are more liquidity constrained. With respect to the question of the diversity in the companies being founded, I think it's quite interesting because on the one hand, it, perhaps, breaks the monopoly of decision-making of funding from the industry that itself is pretty male and white dominated. So it suggests that when a broader range of people are making decisions, they'll make a decision with respect to a broader range of entrepreneurs and founders, the same way increasing female representation or female partnership within V.C.s will affect their investment decisions, the same way the general public is making these decisions. On the other hand, we also might think that perhaps these stereotypes will still play quite strongly even when it comes to retail investors making decisions. If us as retail investors, the salient examples we see of successful entrepreneurs are white men, then I think that that's a stereotype that's very hard to counter, even with respect to people who are not in the industry.

[00:42:48] **Waldock:** Looking ahead, how are you feeling about the prospects of change in V.C.? Are you feeling optimistic, pessimistic when it comes to promoting representation, diversity?

[00:42:59] **Gillis:** I think there are reasons to be optimistic. So to the extent that we're seeing an increase in investment in companies that are founded by women and an increase in funding for companies founded by racial minorities, I think that gives us a reason to be optimistic. But I think that we need to be particularly careful to make sure that the disparities aren't appearing somewhere else. So particularly as there's pressure on V.C.s to increase their investment in these companies, they could be shifting part of the inequity from the formal investment amount, which is the number that everyone's going to report, to these other aspects of the deal that are more hidden, perhaps only the V.C. and the founders themselves know that. So if the way we're investing more in female-founded firms is by putting far more restrictions on their decision-making within the firm and potentially restricting their upside or their gains from when there's a success, then the fact that we're increasing the number of firms may not translate to the same extent in actual success of these female-founded firms. And as I mentioned before, this idea that the fact that potentially the upside of a successful female entrepreneur is not just limited to that company themselves, but hopefully that will have a ripple effect in terms of them building wealth to either themselves become investors in the form of V.C. or an angel investor but more broadly the sharing of wealth in the industry. So I think there's reasons to be

cautiously optimistic, but I think we need a broader and more thorough understanding of what's going on beyond just focusing on this number statistic that the industry is enjoying and reporting recently.

[00:44:41] **Waldock:** I like that. Be optimistic, but be vigilant.

[00:44:45] **Gillis:** [Laughs] Yes.

[00:44:45] **Waldock:** Talia this has been fascinating. Thank you so much for joining us.

[00:44:49] **Gillis:** Thank you. Thank you so much for having me, Eric and Kate.

[00:44:54] **Talley:** Well, that's another wrap. This time for season two of *Beyond Unprecedented*. And I have to say, personally, Kate, this was amazingly fun for me because I had you at my side to join me for every one of these podcasts.

[00:45:09] **Waldock:** Aw, thank you, Eric. It's been so much fun being here. And not only have I learned a lot, but it's been really awesome actually getting to know some Columbia Law professors.

[00:45:18] **Talley:** I agree, even though I'm already on the faculty here.

[00:45:23] **Waldock:** [Laughs]

[00:45:23] **Talley:** We've thoroughly enjoyed these conversations, and we hope you have too. Find all episodes of the series wherever you get your podcasts, and please leave us a review to let us know what you think.

[00:45:35] **Waldock:** *Beyond Unprecedented* is brought to you by Columbia Law School and the Ira M. Millstein Center for Global Markets and Corporate Ownership. This podcast is produced by the Office of Communications, Marketing, and Public Affairs at Columbia Law School. Our executive producer is Michael Patullo. Julie Godsoe, Nancy Goldfarb, and Cary Midland are producers. Editing and engineering by Jake Rosati. Writing by Martha Moore. Production coordination by Zoe Attridge. Special thanks to Erica Mitnick Klein and Molly Calkins at the Millstein Center. If you like what you hear, please leave us a review on your podcast platform. The more reviews we have, the more people will listen. If you're interested in learning more about law, the economy, and society, visit us at law.columbia.edu or follow us on [Facebook](#), [Twitter](#), and [Instagram](#). Thanks so much for listening.