BRIDGES Fund Management

Financing diverse founders

Diverse entrepreneurs receive a disportionately small amount of venture funding. Rebalancing this injustice could be a huge economic growth opportunity

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VISIONS 20/30

N.B. This essay is an edited version of the transcript of Kim's 20/30 Visions interview, which you can watch at www.bridgesfundmanagement/2030Visions.

I started my first venture in 1996, back in the dotcom era. I come from a long line of engineers, so my plan at undergraduate school was to do what many of my classmates were doing: venture out and launch an innovative technology business. But it proved to be very difficult; because back in the mid-1990s, there were no obvious examples of women of colour launching tech businesses.

It took me eight years to figure it out. I realised that I would have find a different way to get funding: I would have to prove I could run a business that would deliver the same results – i.e. profitable, cashflow-positive – and that would give investors comfort that they could fund someone who didn't fit their standard model of an entrepreneur.

I raised over $20 million in capital for my first business. As a black woman running a tech company, I was 'cooking with gas', as my grandmother used to say. But if you look at Google and Amazon, which both launched within a year of my business, those guys raised $200m.

After I eventually sold that company, I figured that now I'd shown I could successfully launch and grow and sell a venture-backed company, I'd be accepted into the tech industry to run somebody's else company. But I soon realised that wasn't going to happen. So I went on to launch five other companies, four of them venture-backed. And during this time, I saw that even though the internet was evolving, this particular issue did not change at all for diverse founders.

By the time I launched my sixth company, I realised I had a unique experience that I could use to help solve this problem. I didn't come to this realisation alone: the group of investors that had supported me said I should consider being on the other side of the table, just as so many other tech entrepreneurs have gone on to be investors in other tech companies.

THE CAPITAL GAP

There is a significant capital gap when it comes to diverse founders.

In majority communities, for your typical white male entrepreneur, there's maybe a one in ten chance that they will have access to someone who can tell them who to connect with to fund a business, how to grow a business, and so on. There are established professional networks to guide them on how to do that. For people of colour, and women-led businesses, those same networks don't exist. They also don't have friends and family who can write four or five or six figure checks to help them get started.

Another challenge is that the predominant way of funding business via traditional debt is asset-backed finance – and you need some financial resources to have basic personal assets like a home or a car as collateral to pledge in exchange for debt. These resources have been less readily available in communities of colour. So given the prevalence of credit methodologies that take people's assets into account, it's harder for these communities to take advantage of those key credit products that are necessary to start a business. That's why most diverse founders start businesses with our own resources, our savings accounts, our 401k.

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"The average capital provided to a diverse founder is about $25,000 at best, which is about one-fifth of the equivalent figure for their white counterparts"

Diverse founders consistently receive a disproportionately small proportion of venture funding (Photo via Founders First)

which is about one-fifth of the equivalent figure for their white counterparts. Pre-pandemic, about 1% of the aggregate growth capital provided went to diverse founders. In the last few years, after the social reckoning that followed the death of George Floyd, this figure has grown to 2%. You might say it's doubled; but it's still atrocious.

It's important to recognise that these challenges exist, and that they make it really difficult. Because of this lack of capital, the vast majority of black and brown founders running businesses are self-employed or solopreneurs.

That's why I launched Founders First in 2015, with a goal of providing knowhow, resources, advocacy to help diverse founders understand how to access capital and grow sustainable businesses – but also being a direct capital provider, so I could help grow these businesses.

REVENUE-BASED FINANCING

When you take traditional equity, there are certain expectations that go along with it. When I looked at my friends and colleagues that had used alternative capital sources, especially those that used debt-related instruments, I saw that they ended up having a greater degree of wealth creation. And those that retained more ownership in the cap table had more influence in terms of bringing their vision to life. So I did some research into different capital models and came across the more revenue-based type of funding.

I also recognised that the type of businesses that were launched by diverse founders were not the next Facebook-type companies. They average annual top-line growth of about 30% (with the right growth capital). They're much more 'asset light'. I call them 'zebra businesses' rather than unicorn businesses: to use a baseball analogy, they may not be delivering the 'Grand Slams' that the unicorns were generating; but with the right capital, they can still deliver singles or doubles. And at the same time, they could create a significant amount of wealth for the founders, as well as the impact they have on job creation, and the representation of what's possible.

Many of these communities have not had financial institutions within them. And for diverse founders, there's a real lack of trust in financial services and capital providers, because of the absence of resources, and the lack of respect for their journeys and their communities.

So we have a market-building job to do: to build that trust, and help founders understand that not all financial products are the same – that there are people that have your best interest at heart, and recognise that by investing in your business and helping you grow, that it also helps the community and helps others see what's possible.

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SCALING UP

So how do we do this on a broader scale, both in the US and elsewhere?

Education is key: helping people understand that there is a network of people and resources and capital, and a pathway to grow. And for investors, it's about building awareness that you can do good and do well: that you can achieve a predictable income stream by investing in diverse founders.

The other priority is providing timely, transparent data around the positive impact of providing investment to grow these businesses – and how it helps the overall ecosystem, not just diverse founders.

There's so much evidence around the network effect of wealth creation. You can go all the way back to IBM, and the wealth that was created because of the innovation of IBM; then Microsoft in the next generation. The impact of innovation has been tremendous – but if you don't have access to the right capital and resources, you won't be able to take advantage of it.

People often seem to think that social and racial economic development or economic equity advancement is just a philanthropic issue, or that it's just for a certain subset of people. So they do something for a year or two, and then it goes back to business as usual – because we have this perception that it's not an economic win; it's just a philanthropic thing to do.

But when you look at other advancements like the internet – that was a collaborative effort of innovation and policies and practices, and there were huge benefits associated with that, which helped to spur further adoption. Now we need to use the same kind of policies and practices and resources to increase the number of sub-$5m businesses that go to the next level.

I started Founders First with a big audacious vision of being able to fund more than 1,000 companies over 10 years. And I definitely think that that's possible.

When the National Minority Supplier Development Council was started 50 years ago, black- and brown- led companies were less than 10% of the overall business economy. Now these diverse groups make up more like 30-40% of the economy, and that number is growing every day. That's a substantial segment of the marketplace. If we can help these companies to grow, that can have a substantial impact in growing our economy. As everyone knows, there's been a big slowdown in economic growth over the last decade. So this is a really big growth opportunity. The whole idea of an inclusive economy is not just good for diverse founders: it's good for everybody.

Kim Folsom is founder and CEO of Founders First Capital Partners, a firm providing revenue-based financing, term loans and business acceleration support to businesses led by women, people of color and military veterans, LGBTQIA+ and businesses located in low-to-moderate income areas as well as those dedicated to inclusive hiring practices.

Prior to launching Founders First, Folsom was a high-tech executive and serial entrepreneur with more than 25 years of experience growing innovative technology companies.

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20/30 Visions is a series of interviews with global thought-leaders, exploring how we build a more sustainable and inclusive world in the next decade

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