Barriers to Capital Flow for Black Female Entrepreneurs

A study by Foreign, Commonwealth & Development Office of UK Government (FCDO), Department for International Trade (DIT) and Palladium Impact Capital Limited

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Foreign, Commonwealth & Development Office

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Foreword

As a former venture capital investor and entrepreneur I've found reading this report both challenging and illuminating in equal measures. All entrepreneurial journeys are tough, but this data shows just how much tougher is it for people of colour and for Black Female Entrepreneurs in particular. But it also highlights how we can do better and sets out a plan to do just that. We have to tackle this together and with urgency.

Joe White

Consul General and Tech Envoy to the US, British Consulate-General San Francisco

My lens of the investment landscape has shifted and it's a change in perception I hope to share in the way the UK Government does business going forward; to consider the barriers that stand in the way of success both for entrepreneurs and investors and remove those ways of thinking that keep them apart.

Taking real action to implement the solutions proposed in the report through the diplomatic engagement of the British Consulate in San Francisco, as well as leading on equitable practice for HM Government in the United States as Tech Envoy, marks a chance to not only do better by the numbers, but to do better as people.

We are proud to lead on positive and just change, and I am proud to stand behind my staff, particularly women of colour, who have applied themselves to this crucial revolution in thinking and working.

Joe White,

Consul General and Tech Envoy to the US

This joint report, commissioned by the UK Department for International Trade and Foreign Commonwealth and Development Office, examines the profound effect that race and gender has on the experience of Black Female Entrepreneurs in both the US and the UK. Despite Black female entrepreneurs being one of the fastest growing entrepreneur groups in the US, they receive a disproportionately small amount of investment. As a Government, we are committed to closing that gender and ethnic equality gap in investment to realise the full potential of both the US and UK economies.

Tammy Sandhu

Deputy Consul General, British Consulate-General San Francisco

As the former Chair of the Foreign Commonwealth and Development Office's Race & Ethnicity Network, I wholeheartedly commend this data-driven report to help change assumptions, behaviours and practices in the financial services sector. The public and private sector need to work together to ensure fair access to investment for Black Female Entrepreneurs, to co-create a diverse and inclusive ecosystem where all businesses can thrive. Putting race and gender at the heart of our policy solutions is not just the right thing to do, it is the only thing to do.

Tammy Sandhu,

Deputy Consul General

We, Palladium Impact Capital, are delighted to submit this report to support FCDO on the critical advancement of access to capital for Black female entrepreneurs. We feel strongly about achieving racial justice by dismantling barriers to capital and opportunities for Black female entrepreneurs who remain underserved. At Palladium Impact Capital, we firmly believe in the need and the opportunity in creating markets that are more inclusive of underserved communities and markets. Black female entrepreneurs deserve fair access to resources and opportunities and have the potential to generate lasting positive change in our society.

Steven van Weede

Managing Director, Palladium Impact Capital

With our dedicated gender and racial equity investing experts, we regularly conduct market analyses that take into account both supply and demand for investment capital. We proudly trace our heritage back to ShoreBank, the US Community Development Finance Institution that pioneered financing for African-American businesses and individuals. Palladium Impact Capital continues to work with US CDFIs on strategy and funding, giving us a deep understanding of financing for underserved communities and businesses in the country.

We are grateful for the opportunity that FCDO has given us to do a deep dive into this specific issue. This is a theme where detailed data is hard to come by, and where our firm thus had to make a number of assumptions to quantify the scale of the issue. Although we appreciate that in many instances these numbers will not be precise, we believe that they are directionally correct and, in any event, helpful in underlining the size and nature of the issue. We very much hope that our work will play a role in improving access to capital for Black female entrepreneurs, and look forward to continuing to work with FCDO, and the wider market, to implement some of the proposed solutions.

Yours sincerely,

Steven van Weede

Managing Director, Palladium Impact Capital

Foreign, Commonwealth & Development Office

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Executive Summary

The number of women-owned businesses is rapidly growing. Amidst these increases, Black women have become one of the fastest growing segments of entrepreneurs in the US. Lack of access to finance and financial services is repeatedly identified as a major constraint for women business owners. The problem is further exacerbated for Black female entrepreneurs (BFEs) as they face barriers because of their race and gender.

Though there has been previous research to study the funding gap for women entrepreneurs or, separately, for racial or minority groups, there is limited research on the specific topic related to BFEs, with a particular focus on understanding the UK and the US markets. In late 2020, The Foreign Common & Development Office (FCDO)/ Department of International Trade (DIT) commissioned Palladium Impact Capital to work on a study that aims to build market understanding of this critical issue by estimating the investment gap (if any), identifying the barriers to capital flow, and proposing actionable solutions that can be implemented by FCDO and other stakeholders, with a goal to close the gender and ethnic equality gap in the investment space.

Key findings of the study as further described in this report, include:

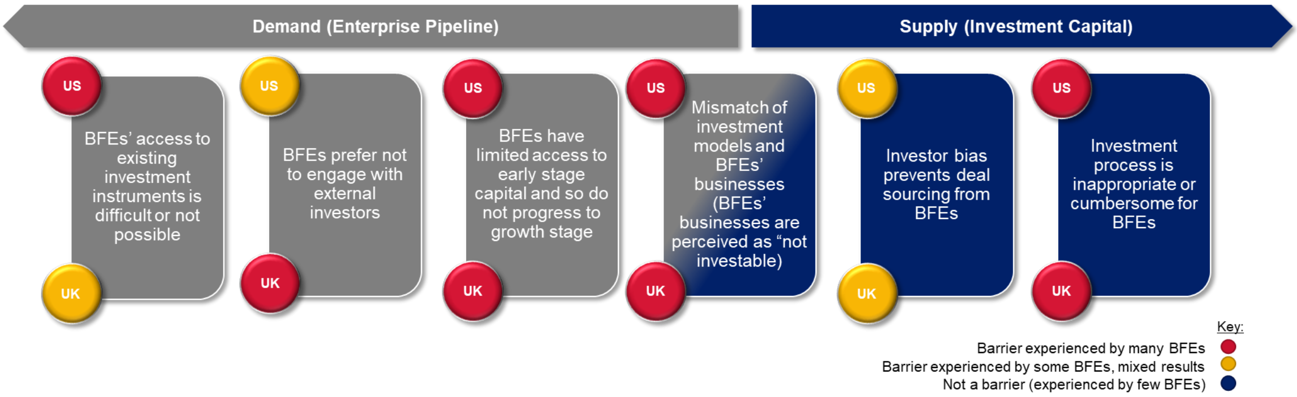
Market Size

In both the US and UK, there is a substantial gap between the capital demanded by BFEs and the investments actually made in them. That unmet demand for investment is widest for BFEs in comparison with other peer groups (women business owners, Black men business owners, minority business owners, etc.)

Palladium Impact Capital estimated total capital demand from US BFEs to be approximately **$13.7 billion** while supply is **less than 15% of their capital need.** For UK BFEs the capital demand was estimated at approximately **$2.7 billion,** and it was estimated that only **6% of this demand was met.**

Barriers

We identified several barriers that both the entrepreneurs and investors face, which results in the identified investment gap. We categorised the top barriers in 6 key categories, that Black female entrepreneurs and investors face:



On the demand side, we found that BFEs have difficulty accessing the most commonly available financing instruments for Micro, Small and Medium Enterprises (MSMEs). Meanwhile, some BFEs are not interested in taking outside capital or engaging with investors. The extent to which these two barriers affect BFEs in the US and UK is different, as may be expected by the differing histories and markets of the two countries. The study also showed that BFEs have limited access to early-stage capital which can hinder progress to "investment-readiness" for growth capital.

On the supply side, the mismatch of current common investment models and BFEs' businesses and needs stands in the way of deal-making, as observed with many MSME groups. There is mixed experience of outright conscious bias and discrimination, which has been faced by some BFEs and not by others. Nevertheless, unconscious investor bias such as an aversion or inability to assess unfamiliar business models and target markets, persists as a barrier. This can make the investment process even more cumbersome for BFEs than for the broader MSME group.

Solutions and Recommendations

Addressing the spectrum of barriers to investment flow, faced by both BFEs and investors, requires market-building solutions. These can be in the form of interventions or tools spearheaded by various stakeholders with the ability to drive systems change across an area. Some of the proposed solutions include:

Catalytic capital at the fund level

- Catalytic capital for first time fund managers, and investment to amplify and share the know-how of investors already paving the way.
- Early and involved anchor investors with capital for TA support.
- Capital for investment providers to expand and scale innovaitve early-stage options.

Capacity building of investors and Technical assistance for entrepreneurs

- Capacity building programmes for investors to build networks they lack to recognize a diverse set of business opportunities.
- LPs must make their expectations clear on diversity at the GP level, and evaluate fund managers' "process metrics" to ensure inclusive practices.
- Technical assistance for entrepreneurs on vetting investors prior to meeting them, business growth planning, financial forecasting, and due diligence processes.
- Leverage partners to create cross-border (UK-US) investor connections for BFEs.

Purposeful change in investors' investment processes

- Rebuild investment processes and requirements to enable greater inclusivity.
- Encourage more open conversations about investor bias to support understandings of perceived risks versus real risks.
- Increase Black representation, at customer facing and decision-making levels of investors and government bodies.
- Implement risk assessment based on alternative data sets that enable separation of perceived versus real risk and can support investment structures that are better aligned with BFEs' needs.

Data improvement and on-going management of impact

- Initiatives consolidating investment data for all MSMEs, disaggregate by gender and race, will allow for data-driven decisions that better target the recommendations outlined here.
- A number of data building activities are currently underway - these should be supported, rather than duplicated at the government level.

For this type of a systems change, an intentional and coordinated effort is needed by the ecosystem stakeholders. With the support of capacity providers, investors must do the work in analysing and changing investment practices towards greater inclusivity, while asset owners must set clear intentions for their capital and demand higher D&I standards from those they support.

The government can be a champion for change, leveraging catalytic capital in variety of ways to support the implementation of solutions above and sending a stronger signal through policy and regulatory actions to incentivize investors and asset owners to develop more inclusive investment practices. Finally, government can drive a more coordinated approach to data collection and analysis, to narrow the focus of action on most critical challenges and better evaluate the efficacy of solutions.

Introduction

If women and men participated equally as entrepreneurs, global GDP could rise by 3-6%, boosting the global economy by $2.5-$5 trillion[1]. When women work, they invest 90% of their income back into their families, compared with 35% for men.[2] By focusing on women's economic empowerment, organisations and businesses can spur economic progress, expand markets, and improve health and education outcomes for everyone.

The number of women owned businesses is growing globally and there is no denying the fact that women are an emerging force. 30% of formal Small and Medium Enterprises (SMEs) around the world are owned and run by women[3]. Nonetheless, women entrepreneurs face numerous challenges in becoming successful owners of growing enterprises. These challenges range from access to finance, legal and policy obstacles to business ownership and development.

Lack of access to finance and financial services is repeatedly identified as major constraint for women business owners. There are barriers on both the demand and supply side, which include knowledge about suitable financial products and how to access them, inadequate financial products for women-owned businesses, investors' lack of understanding and behavioral biases towards women business owners. This problem is further aggravated for BFEs as they are likely to be marginalised based on both race and gender.

BFEs are one of the fastest growing entrepreneur groups in the US yet they receive a disproportionately small amount of investment. In 2019, less than 9% of investment went to female founders, and less than 3% went to founders of colour in the US[4]. Though the number of BFEs is also increasing in the UK, only 0.5% of start-ups with European Black founders received venture capital (VC) investment[5].

The rise of sustainable and impact investing over the past several years has resulted in multitude of benefits for all stakeholders engaged. Racial equity investing is one type of sustainable and impact investing. Research shows, a diverse and inclusive business ecosystem is good for customers, entrepreneurs, businesses, investors, and society. However, investment rates and current trends suggest BFEs' equitable access to investment resources requires attention.

Despite media coverage on the theme over several years, there has been little improvement in the number of VC backed Black founders both in the US and the UK. Between 2018 and 2019, Black women-led companies raised approsimately $700 million in funding, representing a significant increase in overall funding from the previous two-year period – yet still accounting for only 0.27% of the $267.7 billion in VC investment for those same years[6], despite Black women representing 42% of net new women-owned businesses[7]. There is an enormous amount of

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[1] BCG, (2019), 'Want to Boost the Global Economy by $5 Trillion? Support Women as Entrepreneurs.'
[2] Clinton Global Initiative, 'Empowering Girls & Women.'
[3] We-fi, 'Our Mission.'
[4] CrunchBase, (2020), 'A Decade in Review: Funding to the Female Founders.'
[5] Atomico, (2019), 'The 2019 State of European Tech.'
[6] Digitalundivided, (2020), 'ProjectDiane 2020.'
[7] American Express, (2019), 'The 2019 state of women-owned businesses.'

untapped female entrepreneurial talent across the United States and United Kingdom, and investment in such talent represents a huge opportunity to build strong businesses with potential to grow and to construct a more diverse and inclusive business ecosystem to the greater benefit of the economy and society.

The Foreign, Commonwealth & Development Office (FCDO)/Department of International Trade (DIT) commissioned Palladium Impact Capital to conduct a market study examining the barriers to investment that BFEs experience in the UK and the US, and potential pathways to removing them.

The study focuses on "for-profit MSMEs owned by Black women". This study follows the US Census and UK government ethnicity classification and Longitudinal Small Business Survey[8] for further defining the target segment:

- US: an MSME with Black or African American woman/women owning ≥ 51% of the stock or equity in the business and at least 1 paid employee.
- UK: an MSME where woman/women who identify as having African, Caribbean, Black British, African Caribbean or any other Black, African or Caribbean background make up ≥ 50% of the management team of the business and the business has at least 1 paid employee.[9]

Though there has been previous research to study the funding gap for women entrepreneurs or, separately, for racial or minority groups, there is limited research on the specific topic related to BFEs in the UK and the US markets. Through this study, we aim to build market understanding of this critical issue by estimating the investment gap (if any), identifying the barriers to capital flow and proposing actionable solutions that can be implemented by FCDO and other stakeholders, with a view to close the gender and ethnic equality gap in the investment space.

Further we propose mechanisms to both track the effectiveness and impact of the proposed solutions, as well as identify pockets of opportunities by progressively building a more refined and granular data set.

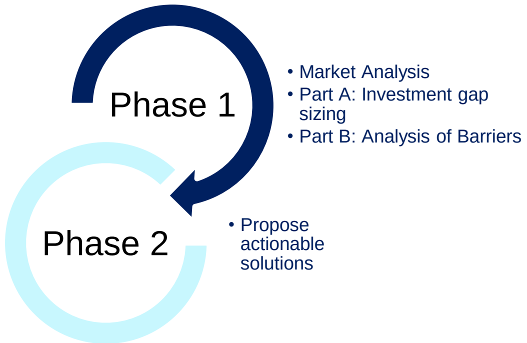
Palladium began working with FCDO/DIT on this study in November 2020 and the findings were shared via long-form report, currently available on the government website. The report was also discussed during a virtual panel discussion with a group of investors, entrepreneurs, and ecosystem stakeholders. FCDO/DIT and Palladium Impact Capital wish to further raise awareness about the barriers and galvanise solution implementation.

[8] It is important to note country differences, especially regarding government and market data used in credit gap sizing. In the US, data is available on women-owned enterprises. In the UK, data is available on women-led enterprises. Our report follows these conventions. We acknowledge the differences between women-owned and -led enterprises, and consider this in the market study.
[9] Note: This broad categorisation reflects the lack of ethnicity data available in relation to gender and business ownership.

Methodology and Approach

This study aims to identify barriers to investment for BFEs on the demand and supply sides of capital flow, what their potential causes are, and some potential pathways to removing them.

We adopted a phased and structured approach for this analysis. Phase 1 involved a) understanding the market size of the investment gap that BFEs face, and b) the barriers and systems biases BFEs face in accessing investment. Phase 2 involved developing a clear set of recommendations for various stakeholders to address the barriers identified in Phase 1.



We have used a combination of literature review, data analysis, and interviews with various stakeholders including entrepreneurs and investors to inform our findings.

Phase 1: Market Analysis

Part A: Investment gap sizing

We estimated the total demand of capital from BFEs and the current investment deployed to Black female entrepreneurs. The gap between these two metrics helped highlight the financing gap i.e. the part of demand for capital needed by BFEs that remains unaddressed through traditional sources of capital (debt and equity). At the next stage, the above-identified gap was contextualised, and their magnitude was compared to that of other minority groups, and the depth of imbalances in capital flows were analysed. For more details on methodology please refer to Annex 2.

Part B: Analysis of barriers to investment capital reaching BFEs

In Part B of Market Analysis, we moved from sizing the investment gap to understanding the barriers that contribute to it, we gathered and tested a broad set of hypothesis for barriers to investment on the demand and supply sides of capital flow and identified key barriers faced by the BFEs in the US and the UK. For more details on methodology please refer to Annex 2.

Phase 2: Propose clear, actionable solutions

Phase 2 involved developing recommendations of potential solutions to address the identified barriers that FCDO and other market stakeholders could implement. The solutions were identified through a combination of research, interviews and based on Palladium’s experience of mobilizing capital to underpresented groups. For more details on methodology please refer to Annex 2.

Market Study

Indicative Investment Gap Sizing

To understand the scale of challenges in accessing capital for BFEs, we estimated the current financing gap for BFEs in the UK and the US in 2018. We estimated the total investment demand by Black female-owned or led enterprises (BFEn) through two key inputs: (a) The number of BFEn, and their representation in business ownership relative to the percentage of adult population; (b) BFEn segmentation by business size. To ascertain the investment supply, we estimated the total debt and equity deployed to MSMEs using data from various sources. We further estimated the percentage of capital deployed to BFEn by instrument and capital provider to arrive at the total investment supply to our target group.

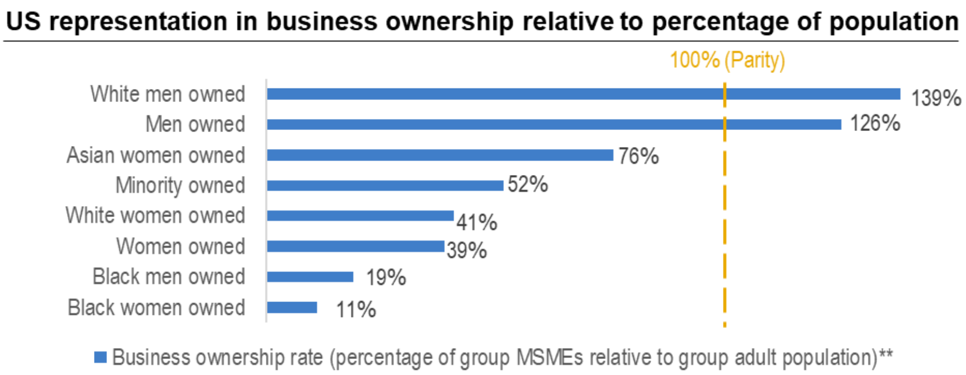
Further, we benchmarked both the overall investment gap and the two inputs for BFEn against the overall enterprise population, women-owned enterprises, minority-owned enterprises, Asian women-owned enterprises and Black men-owned enterprises. This benchmarking study makes apparent the significant challenges that BFEs face vs. any other peer groups. These findings are largely consistent across the US and UK:

1. BFEs are under-represented in business ownership relative to their population share, worst-off in all groups analysed (women-owned businesses, minority-owned business etc.)
2. BFEn are smaller on average, with a larger portion of micro and small businesses
3. While (1) and (2), mean the share of BFE driven capital demand is significantly smaller than their population share (both individual and enterprise), we still see the financing gap for this smaller demand to be the largest amongst all peer groups.

BFEn representation within MSMEs

US

Black females represent about **7% of the adult US population, while US BFEn account for only 0.77%** (about 44,000) of the MSMEs i.e. 11% business ownership rate.



Moreover, BFEs rank lowest in business ownership amongst all demographic groups considered. The difference is highlighted by comparisons with other under-represented groups, including minority-owned (35% of US population vs. 18% of MSMEs owned), women-owned (51% of the population vs. 20% of MSMEs owned), and Black men-owned (6% of population vs. 1.2% of MSMEs owned).Asian women account for 4% of the adult US population and own 2.27% of MSMEs, which is a better business ownership ratio than women owned and BFEn in particular. These findings are consistent with the literature review.

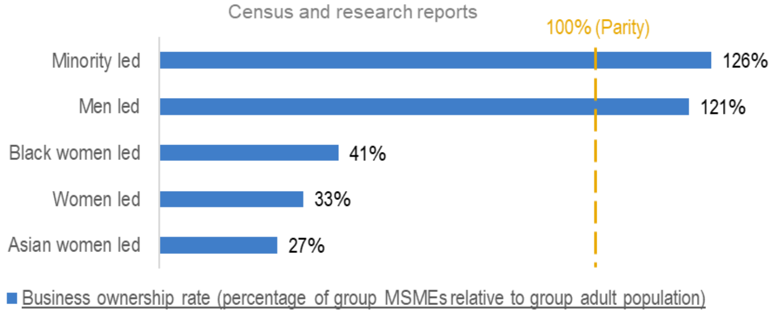
UK

Based on our estimates, **UK Black female-owned enterprises account for 0.63% of all MSMEs, while Black female adults make up 1.56% of total UK population**.

Only 8.6% of all women surveyed in the UK in the 2017 Global Entrepreneur Monitor Report planned to start a business, compared to 15% of women surveyed in the US. Overall, our literature review and interviews indicated that the UK Female entrepreneurship ecosystem may be less mature than the US ecosystem.

UK representation in business ownership relative to percentage of population

Source: Palladium's estimations based on 2018 UK Longitudinal Small Business Survey, UK 2011 Census and research reports



Minority led businesses are overrepresented compared to their percentage in population (126% vs 100% at parity). This is primarily driven by Asian led businesses (54% of total minority MSMEs, with Black-led being 15%). BFEn (1.6% of population vs. 0.6% of MSMEs owned) are better represented than overall women-led (51% of population vs. 17% of MSMEs owned) or Asian women-led (3.5% of population vs. 0.95% of MSMEs owned) ventures. However, it is clear that BFEs at 41% are still significantly behind parity (100%) and hence under-represented.

Average size of a BFEn within the MSME space

US

BFEn tend to be smaller compared to most peer group benchmarks. This is highlighted in the differing proportions of micro/small/medium enterprises and the difference in average annual sales within the medium enterprise segment.

Women are estimated to own about 1.1 million MSMEs of which about 226,500 are medium businesses (20% of women-owned MSMEs) with an average annual sale of $5.4M. In comparison, only 13% BFEs are medium, with an average sale of $3M.

The outcomes for Black women-owned businesses are likely to be worse due to the compound effects of both racial and gender discriminations. On the first factor, according to the National Advisory Council on Eliminating the Black-White Wealth Gap, Black-owned businesses are more likely to be smaller because of inequities in wealth and access to capital. According to Kauffman Foundation[10], White-owned businesses begin their ventures with about $107K, which is 3 times more capital than Black-owned businesses ($35K). Even if this gap decreased over time, the disparity is still present after seven years of operation.

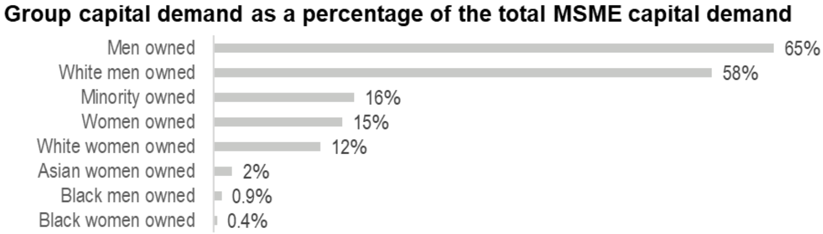
When compared to men-owned businesses, BFEn under-index on proportion of medium enterprises (30% medium for men vs 13% for BFEn). Further, the average annual sales for medium men-owned MSMEs is $8M compared to only $3M for medium US BFEn. The lower annual sales of medium US BFEn is consistent with US BFEn being more likely to be smaller and have fewer employees.

[10] Kauffman Foundation, (2019), 'The State of Access to Capital for Entrepreneurs: From Barriers to Potential.'

Capital Demand Sizing

US

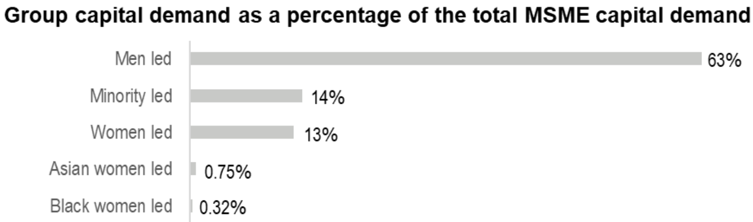
We estimate total capital demand from US BFEn to be approximately **$13.7 billion** (US census data). **81%** of this demand stems **from medium sized businesses**. This is expected. In absolute numerical terms, medium businesses represent only 13% of US BFEn, (small (57%), micro (31%)). However, the contribution is larger as we have defined that micro, small and medium businesses, respectively, have a capital demand of $10K, $100K and $2M.[11] For details, please refer to Annex 3.



In the US, Black female-owned or led enterprises represent 0.4% of the total MSME capital demand, in line with BFE under-representation in business ownership on a per capita basis and the relatively smaller average size of BFEn.

UK

Using an estimated number of UK BFEn, we calculated a **total capital demand from UK BFEn of approximately $2.7 billion (0.32% of total capital demand for all MSMEs)**. In the UK, BFEn represent 0.63% of the total MSME capital demand. We used the 2018 Longitudinal Small Business Survey and indications (such as the percentage of women-led MSMEs out of all EML MSMEs and the percentage of Black women-led MSMEs out of all women EML MSMEs)[12] [13] to estimate the number of UK BFEs in 2018. For the size segmentation, we applied the US market proportions to the UK given data on annual sales were not available. We recognised that the US and the UK are not the same and acknowledge that this proxy alters data quality. For details, please refer to Annex 3.



Capital Supply sizing and resulting Financing Gap

US

The total capital supply for BFEn in the US includes capital supply into two main instruments: debt and equity. We further categorised debt capital supply into four main components; Bank SME loans, Small Business Administration (SBA) Loan programme, Alternate Lending, and Credit Union small business loans. The categorisation enabled us

[11] We use proxies such as MSMEs loan size classification from IFC to define these numbers.
[12] MSDUK, OPEN, (2021), 'Minority businesses matter.'
[13] FSB, CREME, (2020), 'Unlocking opportunity: the value of ethnic minority firms to UK economic activity and enterprise.'

to focus on key debt sources for small business in the US and provided a clear way to assess each category[14]. For equity supply to our target group, we relied solely on venture capital as an asset class.

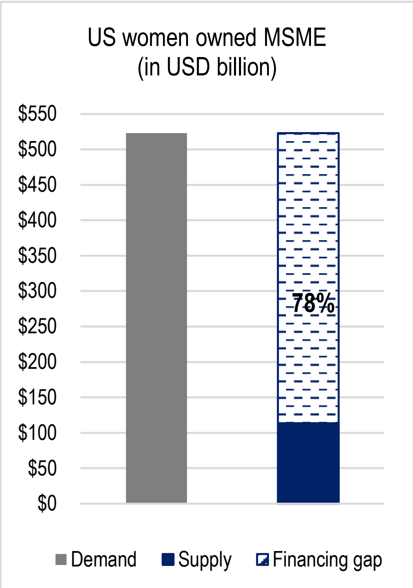
Capital supply sizing

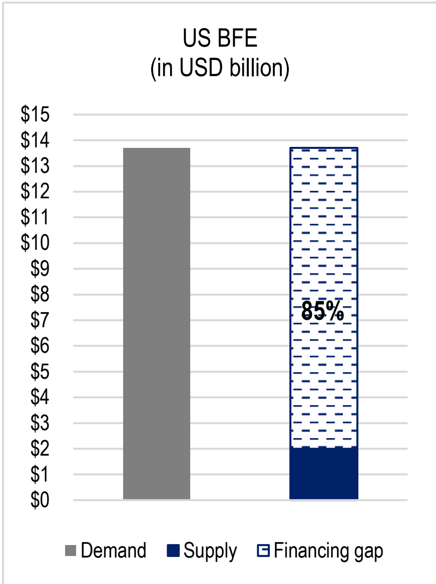
Total capital supply to US BFEn for 2018 was approximately $2 billion ($0.39 billion (19.5%) from equity and $1.61 billion (80.5%) from debt). This represents only a fraction **(<0.2%)** of total capital supply to MSMEs. Worryingly, none of the sources analysed fare better than 0.2% in terms of funding penetration by BFEn. Bank SME loans represent the major source (53.5%) of financing for Black female entrepreneurs. VC funding penetration was even lower at 0.14%. For more details please refer to Annex 3.

The Financing Gap

US BFE capital supply represents 2% of US women-owned MSME capital supply (vs 3% of MSME women-owned demand) and **is less than 15% of their capital need.**

BFEs in the US received less than 15% of capital demanded to start and grow their enterprises. **This is lower than the parallel 22% in the related US Women benchmark group,** indicating capital flow to BFE is constricted.





UK

Similar to the US, to ascertain the total capital supply for BFEs in the UK, we estimated capital supply into debt and equity respectively. We further grouped debt capital supply into three main categories: Bank SME loans, Alternate Lending and Community Development Finance Institution (CDFI) SME loans[15]. We relied on reports by Extend Ventures for data on VC funding in the UK.

Capital supply sizing

Total capital supply to UK BFEs for 2018 was approximately $170.5 million. This represents a minuscule portion **(<0.07%)** of total capital supply to MSMEs. 98.4% of the aggregate supply was through debt (vs 81% in the US).

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[14] We have employed data from several sources to estimate the total size of each category. These sources include US Federal Reserve, OECD Library, Annual Business Survey, Small Business Administration (SBA) and Credit Union National Association (CUNA). Relying on available quantitative and qualitative data, we made assumptions about proportions of these debt instruments that went to Black women led businesses in the US. We used proxies in categories where data on our target group was limited or unavailable.

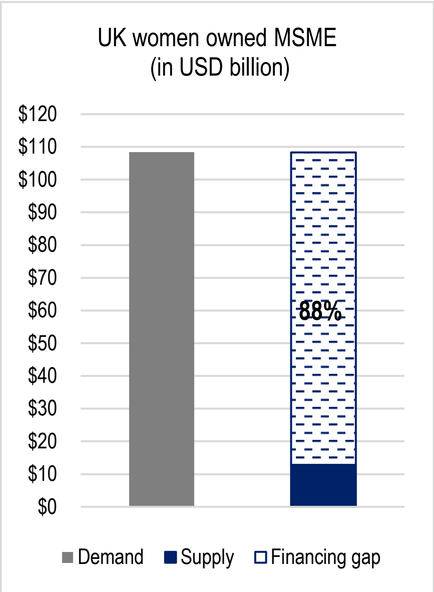
[15] The classification enabled us to focus on key debt sources for small business in the UK and provided a clear way to assess each category. We employed data from several sources to estimate the total size of each category. These sources include OECD Library, England and Wales 2011 Census, Cambridge Centre for Alternate Finance and Extend Ventures' Diversity Beyond Gender report. At present, the UK lacks comprehensive data on BFEs, as such, significant reliance on quantitative and qualitative data from existing reports were applied as proxies to deduce proportions of the various instruments used by BFEs.

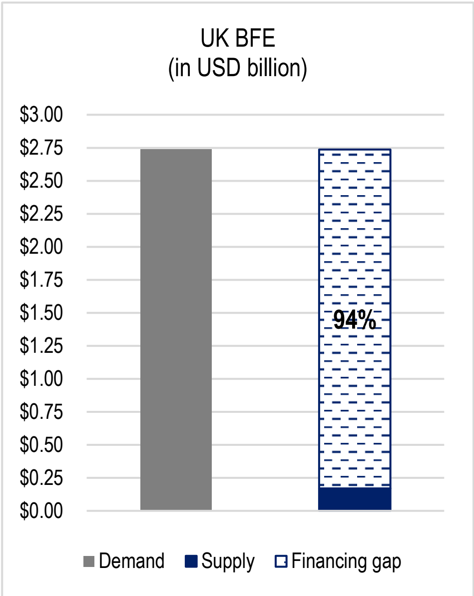
From our analysis, we can infer figures for capital supply to Black female-led enterprises in the UK is disproportionately low. For more details please refer to Annex 3

The Financing Gap

UK BFE capital supply represents **1.3%** of UK women-owned MSME capital supply (vs 2.5% of MSME women-owned demand) and **is only 6% of their capital need.**

BFEs in the UK received 6% of capital demanded to start and grow their enterprises, half of the proportion (**12%) received in overall women.**





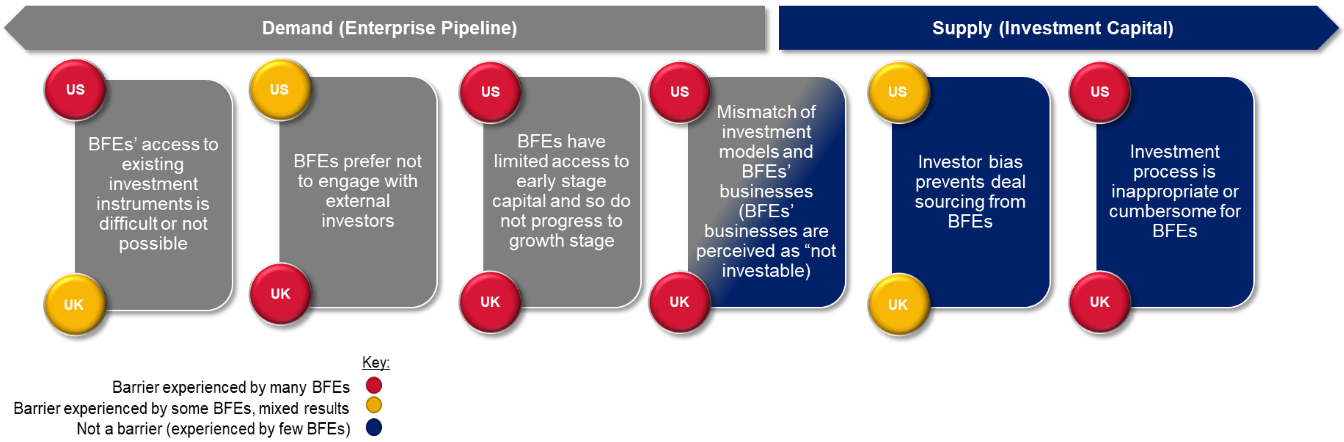
System Biases and Barriers

In our analysis we considered all barriers to capital flow common for any underserved group. We then developed a "tree structure," organising the top line barriers and elucidating the potential causes of those barriers underneath each.

The market study tests both, if each is a barrier in the US and/or UK and why this barrier is a problem for BFEs or investors. We also consider whether this barrier to accessing capital is worse for BFEs than for MSMEs as a whole. Evidence for barriers comes from quantitative data analysis, literature review, and qualitative findings through interviews conducted.

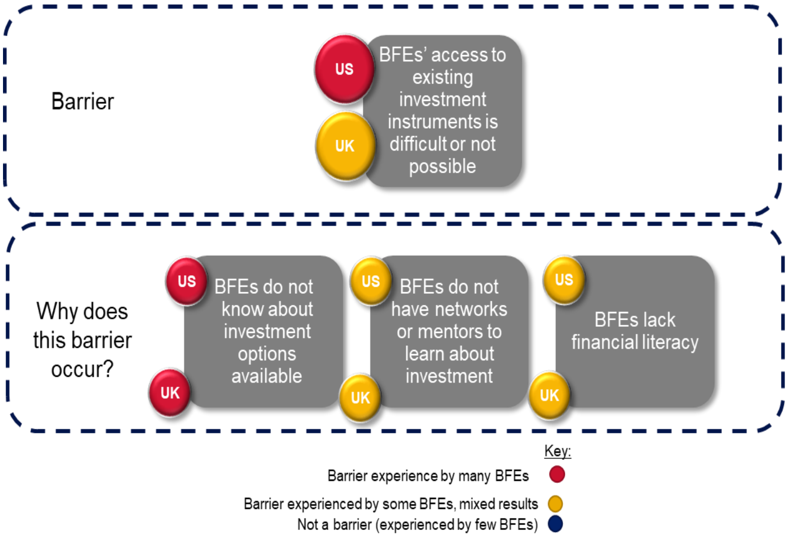
Barriers are included if they are judged to be relevant to most investors or BFEs. Barriers are also included if they are faced by a significant sub-set of BFEs or investors.

Barriers applicable to the US and/or the UK BFEs are shown below.



Demand Side barriers

1. BFEs access to existing investment instruments is difficult or not possible.



"How do we access these funding streams?"
Founder, UK

"I've tried so hard to pitch in front of investors. I've tried with the local accelerator to try and get some funding but when you do go out there and pitch to them, they say 'oh that's a really good idea lovely fantastic', but at the end of the day nothing comes back."
Founder, UK

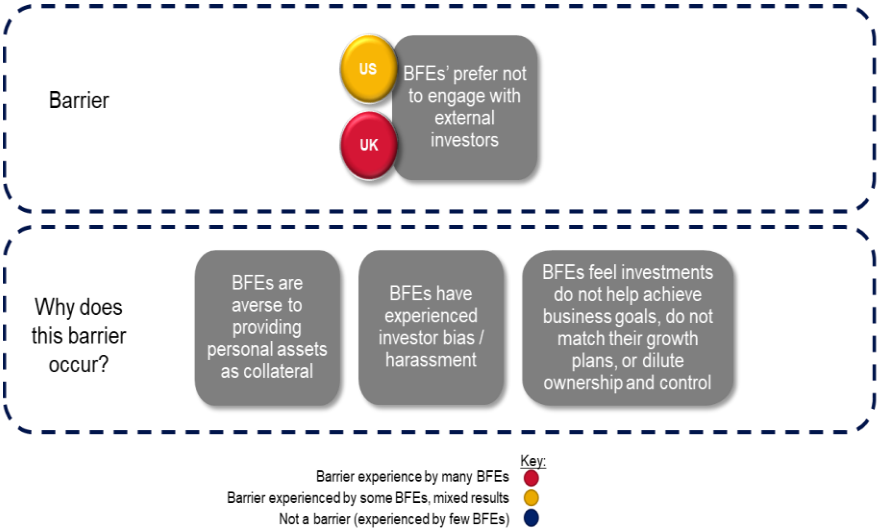
"Companies looking for seed financing generally work through local investor networks first, while later stages generally require large funding vehicles that may not be located nearby. The median distance between a target company and lead investor for late-stage deals in the U.S. notched over 400 miles…while the median distance for seed deals is just under 100 miles."
Kyle Stanford and Darren Klees
Can Patterns in VC Resources Help Pinpoint Underfunded Ecosystems?, PitchBook, 2019

Access is a significant barrier for BFEs in the US, while for BFEs in the UK, it is more evident outside of the Greater London area. The primary reason behind the existence of this barrier is limited awareness of financial instruments available and how to access them, as well as limited skills and knowledge to make an informed decision about which financial instrument is more suitable for various business and financial needs. There were mixed results around access to networks and mentors, which could introduce the entrepreneurs to capital providers or serve as a platform to learn about financial instruments.

While common across MSMEs, for some BFEs, these barriers appear compounded by additional social and economic challenges, e.g. income disparities, access to quality education, employment, community safety, and social support.

TA programmes often address these barriers by providing access to relevant information, however, these programmes are more limited outside of city hubs. Especially in the UK, where the current financial service focus on London makes it challenging for any MSME in other regions to access capital providers and TA services.

2. Historical interactions discourage BFEs from engaging with investors



"Black females are not just trying to build businesses they are trying to build power."
Investor and Founder, US

"They wanted $5,000 for me to have access to investors....when I googled it, you know to try and get feedback to see who did it before, that's when I figured out it was a scam."
Founder, US

"They will try to find an issue to not invest."
Founder, UK

BFEs in both the UK and the US are hesitant in exploring outside investment. Three key reasons fuel this barrier.

a. **Prior/peer investor experiences**: Some BFEs do not seek capital due to poor experiences with investors, repeated rejection, the perceived burden and biases in the diligence process, and exploitative terms that reveal a misalignment. This perception is validated by available data in the US, whereas Black African firms are 4x more likely than White firms to be denied a loan outright[16]. Even after accounting for other factors such as poorer credit, ethnicity remained a significant factor in discouragement.

b. **BFEs are averse to providing personal property as collateral, often required by early-stage debt investors:** BFEs identify high-interest debt options with collateral and covenant requirements that are challenging to meet and are burdensome alongside personal debt. Due to systemic injustices and discrimination, BFEs have lacked access to property and the opportunity to build wealth. Hence, there is a stronger aversion to providing personal property (where it exists) as collateral to financial institutions. In addition, personal debt burdens can make both BFEs and debt providers nervous about business debt. This is especially problematic in the US where education debt is common among Black women. Black Women Business Start-ups report confirmed that BFEs prefer not to engage with external investors - studies from the report showed that Black women in the US are less likely to apply for business funds because they were discouraged from borrowing.

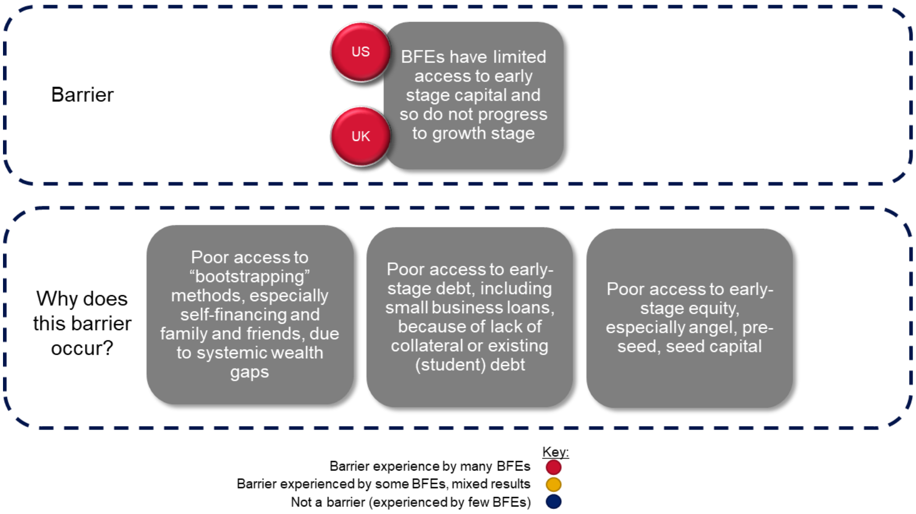
c. **Investors often fail to assess MSME's risk and success prospects properly** – discouraging BFE interest**.** Bank credit assessment models are often not suited for MSMEs, given collateral and cash flow requirements, while equity investors' perception of risk involved with BFEs are often not aligned, whereas investors may interpret BFEs' growth plans and market opportunities as risky rather than their business stage.

d. Finally, the external investment options are often deemed **inappropriate for an entrepreneur's growth strategy** by BFEs – an equity investment being highly dilutive to their ownership or moving their business towards an undesirable exit.

[16] Enterprise Research Centre, (2013), 'Diversity and SMEs.'

The misalignment in investment models with MSME and BFEn needs speicifcally is further commented on in the Supply Side barriers section. Given the factors above, BFEn often find alternative finance solutions, such as crowdfunding and alternative lending practices, more convenient and less time consuming compared to bank debt or traditional VC investments.

3. BFEs have limited ability to "bootstrap" or access early-stage capital



"You need to have money to get money"
Founder, UK

"Average network capital of a Black entrepreneur is $12K"
Founder, US

"Black founders have to show more [start up capital] to secure funding."
Investor, UK

"To keep going you have to keep self-funding and then obviously with the business building and getting sales and revenue you can then start to find extra business. Institutional racism is alive in the county where I live."
Founder, UK

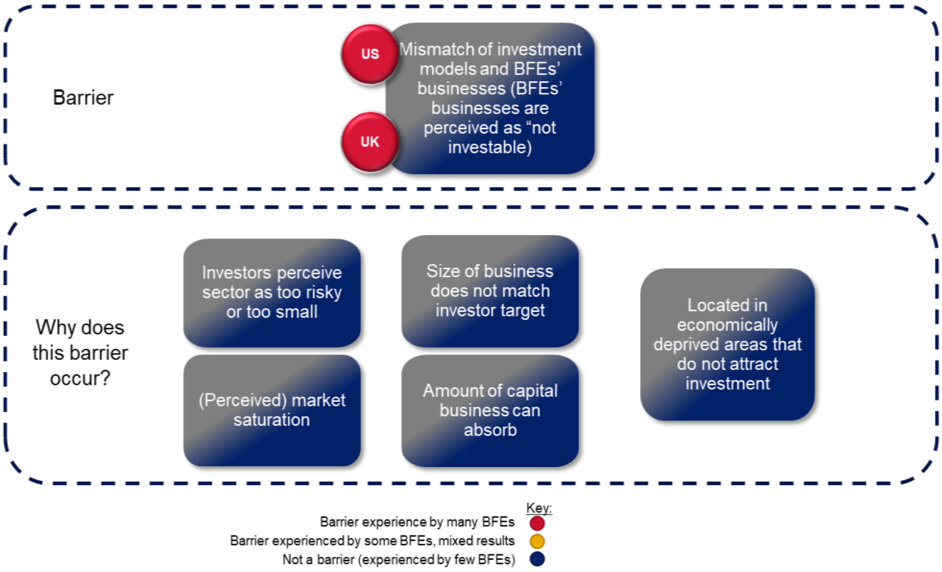
BFEs in both the US and UK face systemic barriers to "bootstrapping" and accessing early-stage capital. In addition, various reports for both the US and UK revealed that BFEs have limited access to seed capital, further barring them from proceeding to growth stage. This acutely relates to our findings in the market study where BFEs are under-represented in all major investment vehicles used for seed capital. The key reasons for this barrier include:

- BFEs are less likely to have enough wealth to inject capital in their ventures at the start and often lack networks of high-net-worth individuals to be able to fill the gap.
- The above disadvantage makes it harder to obtain a small business loan or seed capital as loan providers expect collateral, while equity providers expect traction built on a founder's own investments and expect founders to have secured a friend/family round.
- BFEs are more likely not to have relevant networks of capital providers, hence have reduced chance to get in front of investors willing to provide pre-seed and seed capital. In addition, location of investors and their narrow educational pedigree targets can generate unequal access to capital. Companies looking for seed financing mainly target local investors within 100 miles[17] in the US. In the UK, research shows that 43% of VC funds invested at seed stage in the UK are invested in graduates of elite universities[18].

[17] Office of the Advocate for Small Business Capital Formation, (2020), 'Annual Report for Fiscal Year 2020.'
[18] Extend Ventures, (2020), 'Diversity Beyond Gender Report.'

Supply Side barriers

1. Investment models are not aligned with BFEs' business needs



"COVID is showing us that it is possible to grow a business outside NYC and San Francisco."
Investor, US

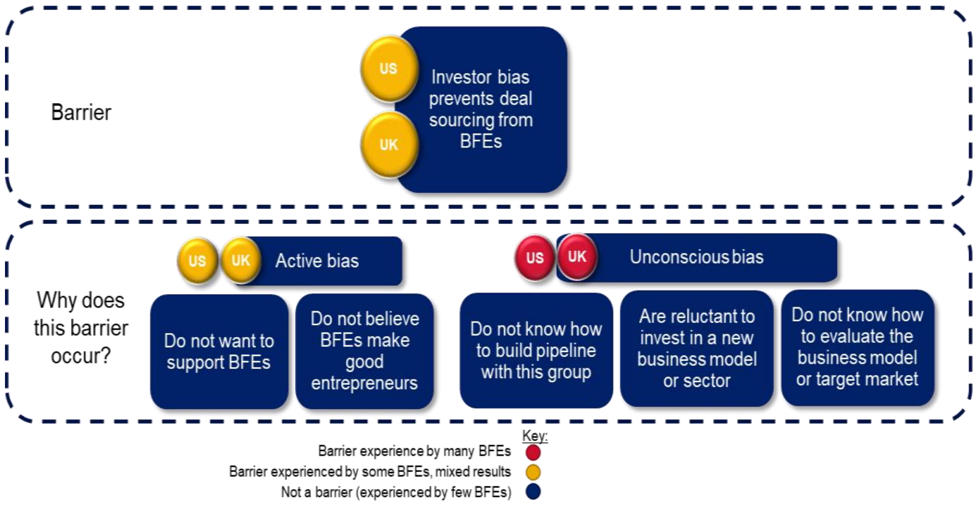
"I have not needed [investment] because of the growth of the company. However, now we are set to scale up considerably we are considering that."
Founder, UK

"The biggest issues are around transparency. We think [about] access to finance, access to bank accounts, access to banking services, access to banking products…if you look on that level – let alone looking at what goes on in the world of VCs, where that is way less transparent…let's put it like that: it enables a culture of exclusion."
Founder, UK

The mismatch between the most commonly available investment models and BFEs' business needs is a barrier to investment in both the US and the UK. Investors in both countries target a narrow profile of businesses, which unintentionally excludes many growth-oriented BFE businesses. Concerningly, many investors do not recognise this gap in the existing processes or the missed market opportunity. Nearly eight in ten investors say that multicultural and female entrepreneurs receive the right amount, or more, of capital than their business model deserve. Yet, these same investors dramatically underinvest in this population. Key roadblocks that drive the barrier include:

- BFE's businesses often do not have **the credit or financial history** that "traditional" investment models rely on.
- **Investors do not recognise the market potential of BFEs' businesses and so are not designing investment processes or structures for it.** There is limited experience on the part of investors in segments that BFEs operate in and often may not be able to identify opportunity due to unfamiliarity with the target market.
- **Most capital providers have models and incentive structures that are misaligned with BFE's needs.** VC models are driven by need for exits - pushing founders to raise more equity and dilute their ownership. CDFIs are suited to address micro businesses but lack capacity for larger loans to SMEs. There is a **missing middle** in terms of supply options that would best cater to BFE's loan size request. BFEs require alternative solutions that provide patient capital, structured exits that are designed around cash flows and specific business needs.

2. Investors harbour unconscious bias due to lack of knowledge



"Address bias from start, then policy can follow."
Investor, US

"Elevate and collaborate with those already working in the space."
Investor, US

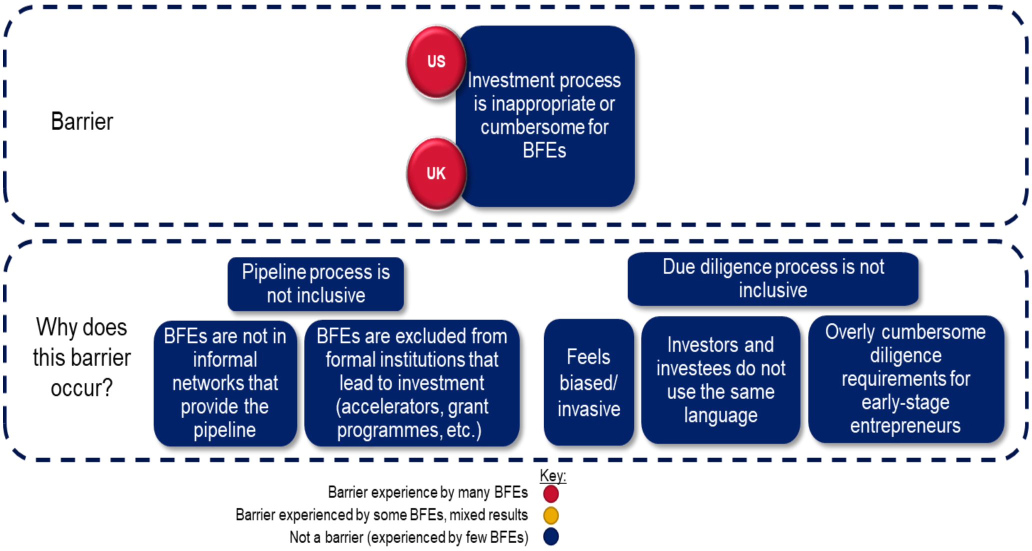
"Lenders' internalized bias can make them believe the status quo is fine."
Investor, UK

"I'm excited investors are on this journey. It might make some of us uncomfortable, but we are doing it anyway."
Investor, Outside US/UK

Some BFEs have experienced active bias from investors, and some have not. However, many BFEs and investors identify issues of unconscious bias: specifically, the lack of investor willingness or ability to evaluate business models of BFEs. A few findings that help highlight the reason behind this barrier include:

- **Even after attending renowned accelerators, when pitching many BFEs experienced investor biases and lack of knowledge.** Investors' lack of exposure to diversity can lead them to perceive higher risk and to ask a different set of questions of women and minorities.
- **Some investors express doubt that BFEs have high growth aspirations,** as compared with other groups, VC firms are trying to find the next unicorns ("the next Facebook"), so they tend to favour businesses that would best realise this goal; some investors are not confident BFEs have these growth goals.
- **White men dominate investment committees; this is reflected in the type of founders that get through the door.** To recruit talented founders, we need diversity in investment committees and in investment teams.
- **Black investors working at VCs can feel pressure when investing in Black founders,** but other staff do not. This stems from the possibility of taking blame if the investment fails and reinforcing biases**.**

3. Investors' due diligence process is cumbersome



"The effort to engage in a due diligence process can be a hurdle"
Founder, UK

"Firms invest in White men based on potential, but women and people of colour based on performance."
Founder, US

"You can never over-prepare a founder for how complex the investment process will be."
Investor, UK

Difficulty and length of the due diligence (DD) process was identified as a barrier by both entrepreneurs and investors. Investors and entrepreneurs do not use the same language, which inadvertently creates a gap in communication, proving problematic for investors who require detailed information on entrepreneurs and their businesses before progressing with investments. These requirements can be complex and technical in nature, making it difficult for entrepreneurs to navigate. These barriers apply to BFEs as they do to most MSMEs.

Additional barriers specific to BFEs can result from pipeline and due diligence processes as these do not target diverse investee groups. These are:

- **Credit assessment processes that are complex and inherently biased against BFEs.** Reliance on credit score can marginalise BFEs as they may be unable to meet criteria for credit due to business size, stage and access to collateral.
- **Investment process is rigorous with no centralised system to assess information on funding options.** The investment process is lengthy, taking anywhere from several weeks to several months, and **can be lengthier for minority entrepreneurs** than entrepreneurs on average. Female founders are likely to have additional demands on their time due to family care compared to male counterparts. These time constraints make meeting lengthy diligence process requirements more challenging.

Solutions and Recommendations

We have used a system's thinking approach to analyse the barriers to capital flow and arrive at our recommendations. Systems thinking looks at how and why systems behave the way they do by examining their parts, relationships, and resulting behaviours and how those elements change over time. Please see Appendix 1 for more on system's thinking.

We have focused on interventions that can be implemented by investors, governments and intermediaries in order to move us toward the vision of the desired future system, where all types of MSMEs have equitable access to adequate capital.

Key solutions identified

Addressing the spectrum of barriers to investment flow faced by both BFEs and investors requires market-building solutions. For the success of these solutions multiple actors, including FCDO and other government bodies, investors, capacity building intermediaries and technical assistance providers, will have to play a role.

To address the identified barriers, changes across various systems that influence capital moving from investors to enterprises will be required. Sustainable change requires an implementation of solutions across dimensions of the system. These can be in the form of interventions or tools spearheaded by various stakeholders with the ability to drive systems change across an area.

1

Catalytic capital at the fund level

- Capital for investment providers to expand and scale innovative early stage options that can include grants, seed equity, patient debt, convertible notes, and mezzanine debt (revenue share options), providing alternatives to bootstrapping and friends & family rounds.
- Catalytic capital for first time fund managers, and investment to amplify and share the know-how of those already paving the way.
- Early and involved anchor investors with capital for TA support as needed for new fund managers, to signal confidence and leverage further investment.

2

Pipeline support through capacity building of investors and technical assistance for entrepreneurs

- Capacity building programmes for investors to build networks they lack to recognize a diverse set of business opportunities.
- LPs must make their high expectations clear on diversity at the GP level, and evaluate fund managers' "process metrics" to ensure inclusive practices.
- Technical assistance for entrepreneurs on vetting investors prior to meeting them, business growth planning, financial forecasting, and due diligence processes.
- Leverage partners to create border match-making opportunities that include BFEs.

3

Purposeful change in investors' investment processes

- Rebuild investment processes and requirements to enable greater inclusivity.
- Open conversations about investor bias are supporting new understandings of perceived risks.
- Recruit diverse staff, implement scouting programmes that are aligned with the fund vision to develop more diverse portfolios.
- Implement risk assessment based alternative data sets that enable separation of perceived versus real risk and can support investment structures that are better aligned with BFE needs.

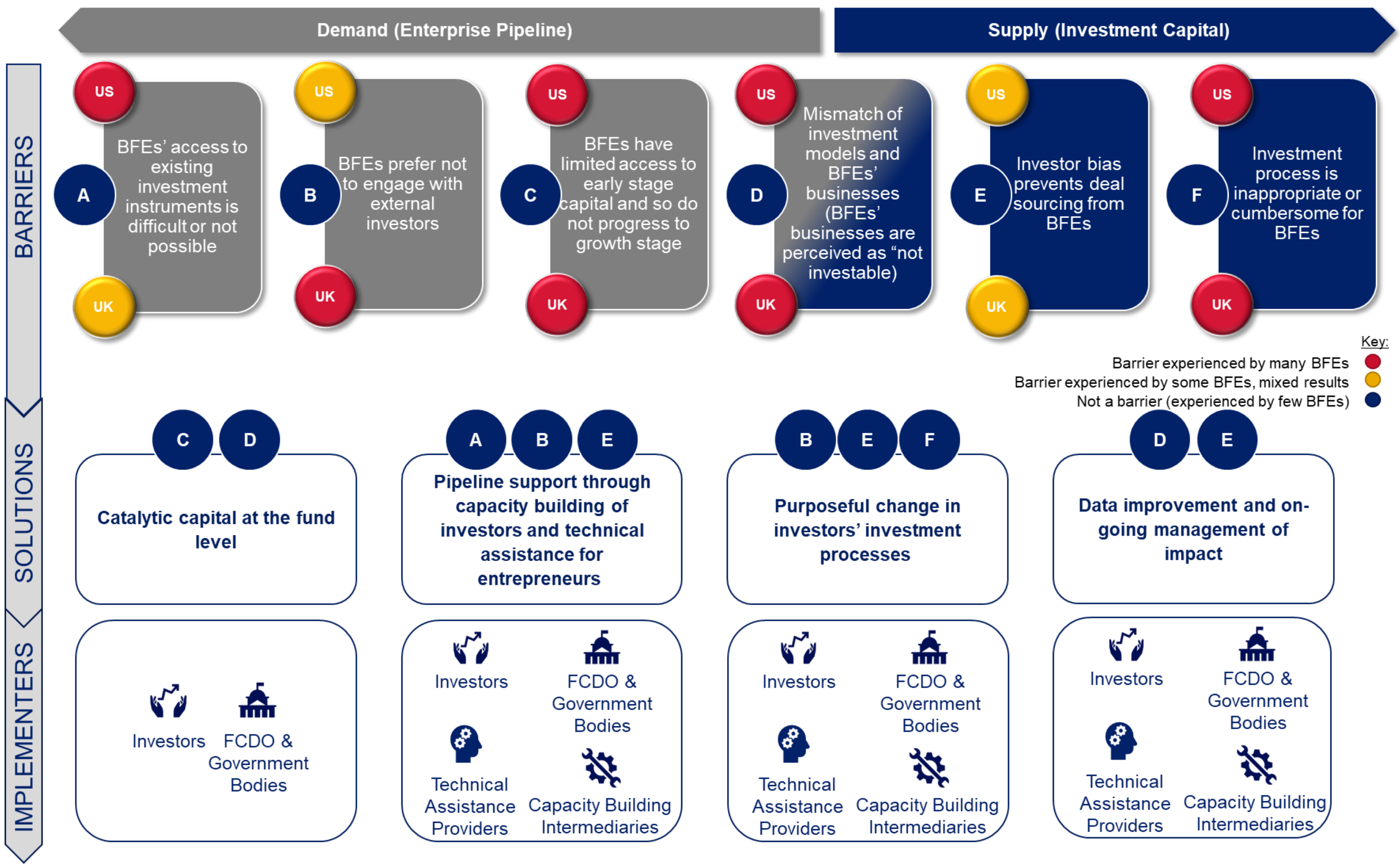
4

Data improvement and on-going management of impact

- The business case for investing in diverse leadership teams (both at fund manager and SME level) has been made, but detailed data about how and when capital reaches BFEs is incomplete, especially in the UK.
- Initiatives consolidating investment data for all MSMEs, disaggregated by gender and race, will allow for data-driven decisions that better target the recommendations outlined here.
- A number of data building activities are currently underway - these should be supported, rather than duplicated at the government level.

Foreign, Commonwealth & Development Office

Palladium
MAKE IT POSSIBLE



1. Catalytic capital at the fund level

The MacArthur Foundation defines catalytic capital as investment capital that is patient, risk-tolerant, concessionary, and flexible in ways that differ from conventional investment. Leveraging catalytic capital emerged as one of the recommended solutions for reducing the investment gap to BFEs.

Catalytic capital could either be provided to BFEs a) at seed stage by supporting the development of a wide spectrum of early-stage capital options, as alternatives to "bootstrapping" and sourcing capital from friends & family, b) or supporting first time fund managers that focus on BFEs and minority led businesses; such funding support would thereby amplify the work and knowledge of investors already working with BFEs and build the capacity of those who are interested in investing to address this problem.

Actors who need to play a role in this are: investors, FCDO and government bodies.

a) **Catalytic capital at seed stage:** Access to seed and early-stage capital was identified as one of the key barriers to enterprise success and ability to grow. Although the barrier is present for many MSMEs, it is particularly acute for BFEs according to our study, hence solutions to address this issue are an important aspect to focus on for investors and government bodies. Capital for investment providers to expand and scale innovative early-stage options include grants, seed equity, patient debt, convertible notes, and mezzanine debt (revenue share options). These options, can provide alternatives to bootstrapping and friends & family rounds). Recommendations to deliver this change are:

- **Utilise blended finance approaches** by leveraging **philanthropic capital** to validate business models and growth plans **and provide (recoverable) grants at the proof-of-concept stage,** followed by investment from early-stage investment firms.
- **Support and scale replicable models for seed equity** that have already been developed, such as crowdfunding, angel networks, and models such as Runway or CNote, in the US, which can be scaled to provide seed investment to a wider range of entrepreneurs.
- **Build regionally-targeted seed equity funds** to address the gap in early-stage capital by designing and investing in funds targeting seed-stage minority businesses in economically deprived areas to address the regional imbalances in funding for entrepreneurs.
- **Patient debt -** invest in and support debt vehicle structures that can provide patient debt with 5+ year maturities and rely on foreseeable cash flow rather than collateral in the form of entrepreneur-owned property.
- **Alternative exit structures -** invest using tailored instruments to address early-stage business needs and to enable BFEs to retain ownership and control of their businesses. These instruments can include convertible notes, mezzanine debt with revenue share repayment, redeemable equity, and other forms of capital.
- **Augment existing government funding pools** allocated for social and environmental programmes, such as amending allowable uses of the UK's "Dormant Assets", to **establish seed capital facilities, funding for technical advisors to work with community founder** scouts (funding schemes could encourage wage models rather than commission-based payment for scouts, see Recommendation 2) or to **incentivise financial institutions to expand their focus** on excluded geographies (such as regions within the North of England), using dedicated credit lines.

b) Catalytic capital at the fund level: Diversity-focused investors knowledgeable about evaluating BFE business models are paving the way, but many face their own capital challenges. First time fund managers also need support in the form of catalytic capital to attract funding and execute their strategies. Recommendations to deliver this change are:

- **Seek out and back fund managers with networks beyond** major financial and start-up hubs. Practical steps to improve diversity in fund management can be found in the Due Diligence 2.0 Commitment[19] for reducing systemic racial inequalities. Signal support through funding investors concentrated in underserved communities, especially inner-city and rural areas of the US, and outside of Greater London in the UK.
- **Back existing fund managers working with a diversity focus, amplify their success and know-how.** Many investors have been successfully deploying capital to BFEs for years.Their success must be amplified to attract greater amounts of capital to scale their investment models and support their portfolio companies as they grow. Existing programmes such as the British Business Bank's Future Fund can be scaled. Similar programmes can be started in collaboration with foundations focused on BFEs, BAME, or other diverse entrepreneur groups.

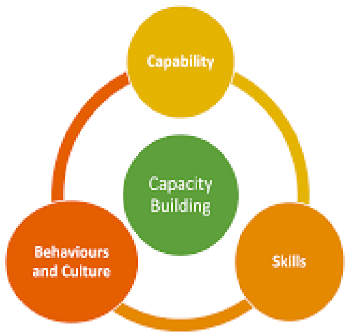
[19] Due diligence commitment, 'Due Diligence 2.0 Commitment.'

- **Hold financial institutions and General Partners accountable for applying a Diversity & Inclusion lens in their portfolios.** Government or non-profit organisations could publish diversity statistics on leadership, investment officer pools, and portfolios. More directly, Limited Partners should influence their General Partners to drive towards more transparency in Diversity & Inclusion reporting.

- **First-loss capital in the form of grants and guarantees** for new fund managers to overcome perceived risks of investing in BFE owned businesses and offer risk capital to better enable them to validate their diversity-focused investment approaches while taking appropriate amounts of risk across a range of business models in markets previously underserved by investors.

- **Innovate and standardise inclusive structures and terms**. Initiatives such as the Hogan Lovells and 2X Challenge[20] **creation of a legal toolkit of structures and terms** for embedding a gender lens could be supported by government and investors, whose participation can ensure an intersectional approach.

2. Pipeline support through capacity building of investors and technical assistance for entrepreneurs



Matching the appropriate types of capital to BFEn needs requires improved capacity on the part of both investors and entrepreneurs. Improvements will address investor bias and lack of market understanding that can prevent recognition of investment opportunities and low access to existing forms of capital for BFEs.

Actors who can play a role in this effort are technical assistance providers, investors, capacity building intermediaries, FCDO, and government bodies.

a) Capacity building for investors may include:

- **Technical assistance for fund manager accelerator programmes** that help fund GPs and support the development of more diverse new fund managers. Capria and I&P are example accelerator programmes to consider.

- **Capacity building programmes to build investor networks and expertise** to access and recognise a diverse set of business opportunities, including training on alternative risk assessment tools of new segments.

- Dismantling unconscious bias requires a **long-term commitment to building teams and team capacity**. To reap benefits, investors must prepare to change long-standing pipeline and investment practices. Government capacity building programmes can advance this in a harmonious way across investors, especially where programmes **target early-stage investors whose pipeline building (and DD) is relied on by co-investors** (e.g. The Growth Company's - GC Angels Network or Scottish Enterprise's work with VCs, and others). Diversity VC Standard is an assessment and certification process that sets a benchmark for best practices on Diversity & Inclusion (D&I) for VCs – assessments such as this can be applied by VCs and required by capital providers more widely.

[20] Hogan Lovells, (2021), 'Hogan Lovells and 2X Challenge launch Aurora: The Gender Lens Project.'

- Delivering **townhall sessions** to the investor community highlighting issues around access to finance and investment readiness of Black female businesses. Include diverse entrepreneurs in internal **speaker series** to help break the unconscious bias.

- Advocating that LPs make their high expectations on diversity and inclusion clear at the GP level, **and enforce their expectations with a clear set of metrics to evaluate fund managers' inclusivity practices**. Process metrics[21] are a good way to focus on what investors do and how investees react – metrics such as the percentage of documents offered in plain language or percentage of staff receiving anti-bias training.

b) Technical assistance for entrepreneurs

- Develop **a centralised resource hub**: a coordinated and consistent ecosystem of business support that helps entrepreneurs, including BFEs, prepare for and access investment, irrespective of location. A rich ecosystem of support exists for MSMEs in some urban areas yet is typically lacking in more rural locations. **Furthermore, programmes seeking to support minority-led businesses are particularly lacking in the UK.** Government can support entrepreneurship development programmes targeting barriers for BFEs and promote awareness of such programmes.

- Similar to other MSME entrepreneurs, BFEs can benefit from support in the following areas to be better equipped to access growth capital successfully: pitch practice and investor facing materials, financial planning and reporting, accessing new markets, industry expertise, accessing new markets, talent acquisition, term sheet negotiation and investment documentation.

- Technical assistance should also cover the **expectations of investors from entrepreneurs in a typical due diligence process** and on educating entrepreneurs on **how to access investor networks** whose interests align with business models of BFEs and **vet investors to ensure alignment** and save time. CASE at Duke University's Smart Impact Capital virtual course is one programme which addresses this alignment topic.

c) Create cross border match-making opportunities that include a more diverse set of businesses, including BFEn

- Leverage accelerator programmes and investment partners to **match US investors to UK BFEn and vice versa.** Scottish Enterprise provides an example of successfully doing so for UK entrepreneurs in industries such as health technologies. Scottish Enterprise works with partners to build pipeline and to conduct due diligence. TA should also be provided in preparing to present a business to investors in other national contexts, i.e. adjusting to US investor expectations.

- **Set up open house pitch days** with national and international TA providers and universities that have a racial equity focus.

- **Establish founder referral mechanisms** that encourage a diverse pool of candidates for programmes. Consider alternatives to commission compensation schemes to ensure those making referrals are not taken advantage of while being from and serving the very communities these initiatives seek to support.

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[21] Criterion Institute, (2020), 'Process Metrics that Analyze Power Dynamics in Investing.'

3. Purposeful change in investors' investment processes

Many investors do not have sufficient knowledge and understanding to evaluate BFE business models, target markets, or target geographies. And if they have the knowledge, their organisations often do not have adequate tools to evaluate BFE businesses for investment opportunities.

Actors who need to play a role in meeting this objective are technical assistance providers, investors, capacity building intermediaries, FCDO, and other government bodies.

a) Rebuild due diligence processes and requirements to serve inclusivity

- Expand criteria for assessing investment opportunities. This includes providing a fair assessment of the unique value propositions that BFEs possess, such as understanding the unique characteristics of the markets they serve, how they anticipate demand, and how they serve customers. Due diligence processes need to assess investment opportunities holistically, considering the nuance of the idiosyncratic challenges BFEn address. Investors may leverage others with knowledge to evaluate appropriately and access the right deals.

- Consider all aspects of due diligence requirements and their impact on diverse founders to rebuild a more inclusive process; this process must include incentives for the change and de-risking mechanisms, that are outlined in our catalytic capital recommendations.

- Incorporate Diversity & Inclusion training as part of corporate strategy.

- Leveraging catalytic capital as proposed earlier, will provide incentives to implement changes and validate the opportunities.

b) Recruit diverse staff

- Increase Black representation at decision-making levels of investors and government bodies.

- Introduce apprenticeship models and fellowships that open the door for people of colour to learn about venture capital. This can be done through scouting programmes that align the fund's vision and incentivise scouts to build a stronger diverse pipeline, and in turn, a portfolio of investments.

- Recruitment programmes for junior levels should emphasise diversity, particularly from economically or regionally marginalised communities where many excluded BFEs operate.

c) LPs can evaluate pipeline and due diligence processes differently to ensure they are aligned with the inclusive intentions of the GP. This may include:

- Assessment of investors pipeline development and investment processes, tracking metrics such as:
  - Number of Black females (or other target intersectional group) who are involved in investment decision-making
  - Percentage of easily accessible, non-technical documents in diligence and documentation process
  - Application support for first-time applicants referred by a values-aligned and vetted intermediary

- Or including a self-evaluation on gender and/or racial equity in pipeline and due diligence[22]. These approaches might include the SEAF Gender Equality Scorecard, MEDA Gender Equality Mainstreaming Framework, EDGE Certification, etc.

- Assessment of how investment strategies are created and influence pipeline building, e.g. measuring resources spent on research and community input on intersectional investment trends at the time of investment strategy creation or updates

d) Vet external partners for values-alignment on intersectional approaches to investment

- Many investors work with external partners who contribute to pipeline development and due diligence – accelerators, law firms, technical assistance providers, investment banks, etc. Vetting these firms for values alignment is just as important as internal change for the investor itself. Consider using tested processes for engaging partners, vetting for gender lens and adding an intersectional approach. The approach might include:
  - Identifying co-investor partners whose pipeline building staff members are trained on intersectional communities (especially if the investor is not)
  - Requesting gender and racial equity reporting on staff at third party service providers in the investor's value chain
  - Publishing partners' gender and racial equity policies and commitments on the investor's website or Annual Report materials

e) Consider alternative data sets to evaluate risk and support investment structures that are better aligned with BFE needs

- Many fintech lenders are already leveraging alternative behaviour data to evaluate customers' credit risk in emerging markets; using new behaviour data sets, rather than traditional credit history and borrower assets to evaluate risk, can reduce bias and inequities inherent to many of the old models of risk assessment.

4. Data improvement and on-going management of impact

There is limited data available, particularly in the UK, about capital flows to BFEn. Intersectional data (combining gender and ethnic/racial background) is especially lacking. This limits the depth of analysis any ecosystem player can perform. A consolidated data collection approach would provide more clarity about BFEn business models, capital needs and barriers.

Actors who need to play a role in this are: FCDO and government bodies, technical assistance providers, investors, and capacity building intermediaries.

a) Aggregate currently siloed data collection efforts (especially to address the siloing of data on gender of entrepreneurs and ethnicity/race), and support alternative means of data collection to plug data gaps

- Analysing Companies House data with a gender and ethnicity lens. In the UK, Companies House holds the most comprehensive data on businesses and their ownership, including ownership by gender. However, data on ethnicity is currently not collected.
- Government, together with private sector actors, can conduct a regular study of small businesses with proper categorisation of minority groups to improve data on business growth, equity changes, etc. Several private and public-private partnership initiatives are underway to analyse company and investment portfolio data using AI to proxy ethnicity/race where this information is not accessible, including the work of Open Network and Extend Ventures with Innovate UK.
- Leading organisations such as UK Finance and the British Business Bank can take the lead in gathering gender and ethnicity data on businesses.
- Review existing Bank of England Open Platform Database recommendations and incorporate ethnicity lens on collection of data about lending.
- Although having precise data on the business case for investing in a diverse portfolio of entrepreneurs is important to scaling meaningful solutions, that business case has already been made, intersectionally and across asset classes. While the ecosystem continues to build evidence, we must acknowledge that requiring very specific business cases with ever more proof has been used to avoid investment into marginalised groups - this same proof requirement is not typically made of historically privileged groups. Counting entrepreneurs is not the only, or even the most impactful, way to measure inclusivity. Efforts should be made to measure what investors do, as well as who entrepreneurs are and what they do.

b) Improving public record of businesses by demographic: Create transparency and consistency around ethnicity and gender data

- **Leverage third parties for implementation of any new data collection:** Bias checks on any new data collection should be carried out. In the UK, this can be done with the support of the Behavioural Insight Team[1]. Leverage data experts to help implement the integration of intersectional data.
- **Provide support to capital providers for implementing the new standards:** Support capital providers with training to implement this race/ethnicity and gender disaggregated data approach to ensure data will be consistent and easily transferable to a centralised government system.
- The US government currently collects national-level intersectional data in areas that help inform the industry understanding of (1) number and distribution of women and minority entrepreneurs, and (2) some types of early-stage capital that reach these entrepreneurs, especially CDFI and bank debt. However, the

data is not always as useful as it could be for intersectional analysis since many data sets only can be "cut" by gender or race/ethnicity, but not both.

- Systematically disaggregate population data by both gender and ethnicity to increase chances of better targeted and effective interventions.
- **Ethnicity and gender standardisation in the US** - Continue collection of national-level entrepreneurship data using widely recognised standards such as the OMB standards. Potential partners: IRS, National Corporation Directory, SEC, US Department of State registration offices by state, FRB, passport office

- UK Government currently has limited visibility of private sector intervention in relation to access to capital for BFEs. Similarly, the UK Government does not produce business statistics systematically disaggregated by gender and ethnicity. To limit less reliable reporting and align with the Smart Data ambition, a gathering exercise is required for a more accurate view of the landscape of businesses and capital received. In gathering primary data on ethnicity, reliability and rigor are built into future intersectional analysis, allowing for more targeted interventions

- **Population-specific analysis:** Using aggregated data limits the opportunity to capture nuances and unique challenges for the various population groups. Systematically disaggregating population data by gender and ethnicity will increase the chances of successful interventions.

- **Ethnicity and gender standardisation in the UK:**

  - Integrate the chosen ethnicity, gender and country of birth descriptors in all public data surveys and datasets on businesses
  - **Harmonise standards** that allow for more national-level collection and gender and racial/ethnic data (which are protected characteristics). **Potential partners:** VAT Return, Annual Returns submitted to Companies House, HMRC, GSS, Passport office, RDU, CDEI, The Equality Data Programme committee

- **Review legislation that may be unintentionally blocking data collection:**

  - Companies Act 2006 and forthcoming similar legislation: consider incorporating a clause specific to data collection of an individual's protected characteristics (as defined under section 4 of the Equality Act 2010) to ensure protection of an individual's rights against discrimination when going through approvals for financial products and services. If ethnicity data could be collected, targeted interventions to address intersectional capital flow challenges could be identified and improved. Currently, this data cannot be collected as it is not required information.

  - Equality Act 2010: Review the categories recognised under Act. To date there are no ethnicity groupings stated within the Act. To ensure all registered business accurately record ethnicity data for disaggregation at government level, consider amending requirements such that companies must align data categorisation on protected characteristics in accordance with the Office for National Statistics. If the relevant intersectional categories such as gender and race/ethnicity were stated in the Act, all industries acting under the UK law would have clarity and thus rigor would be built into data collection.
    - Public Disclosures Act 1998: consider including a mandate for the Financial Conduct Authority (FCA) to review companies' whistleblowing policies to ensure the policy captures complaints related to offences against protected characteristics as defined under the Equality Act 2010

Conclusion

In conclusion, we would like to acknowledge and appreciate the immensely valuable work that has already been undertaken on the issue by a variety of ecosystem players in both the UK and the US. We believe that there is sufficient evidence to prove the existence of racial inequity, and we as an ecosystem need to challenge the notion that further proof is needed. We pose that it is now time to move towards actionable solutions that create true change.

We would like to celebrate the success of the inspiring Black female entrepreneurs across the two countries who are fighting and triumphing in the face of persisting obstacles. We would also like to thank them for taking the time to speak with us and share their experiences. Although entrepreneurs in the UK were open to investing the time to tell us about their journey and needs, with an interest in getting their voices amplified and stories heard, in the US we heard a call to action loud and clear – that we need to move from ‘listening’ to ‘doing’.

We would also like to acknowledge the investors and other stakeholders who took part in this study, particularly those doing the real, hard work, asking the tough questions, and breaking the mould in mobilizing capital towards more inclusive investments.

Although challenges remain, we are hopeful about the possibility of implementing solutions to remove the barriers that continue to exist and close the investment gap. For this type of a systems change, an intentional and coordinated effort is needed by stakeholders across the finance and investment ecosystem.

With the support of capacity providers, investors must do the work in analysing how their pipeline development, due diligence and investment structuring processes may marginalise certain demographics of entrepreneurs, and adapt their processes to a lens of inclusivity. Asset owners must set clear intentions for their capital and demand higher D&I standards from the funds they support.

The government can be a champion for change, leveraging catalytic capital to support initiatives that work, from early-stage investment vehicles to first-time managers proving themselves in the market, to amplifying and scaling solutions that are effective in mobilizing capital to BFEs. Government can also create and support capacity building and TA programs driving towards solutions we described earlier in the report. Government can send a stronger signal through policy and regulatory actions to incentivize investors and asset owners to develop more inclusive investment practices. Finally, government can drive a more coordinated approach to data collection and analysis, to narrow the focus of action on most critical pain points and better evaluate the efficacy of solutions.

We hope the development and dissemination of this report will contribute to the much needed progress the world needs to make on achieving racial equity.

We look forward to working together to drive this change.

Annexes

Annex 1 - Key Definitions

A critical step in our approach was to first clearly define the ideas and concepts to be used in our research – beginning with the definitions of entrepreneurs and enterprises.

Black Female Entrepreneur (BFE): Within the scope of this research, we include any person that self-identifies as a Black female, and who owns, leads, founded, or intends to found a for-profit enterprise.

Black Female Enterprise (BFEn): The study focuses on for-profit MSMEs. For the purposes of this study, enterprises are included onlyt when they have at least 1 paid employee (“employer firms”). It is important to note country differences, especially regarding government and market data used in credit gap sizing. In the US, data is available on women-owned enterprises. In the UK, data is available on women-led enterprises. Our report follows these conventions. We acknowledge the differences between women-owned and -led enterprises, and consider this in the market study.

Ethnic minority-led (EML) businesses: Where data is sufficiently robust, businesses are defined as ‘ethnic minority-led’ if ≥ 50% of their management team are from ethnic minorities, or if a person from an ethnic minority is in sole control of the business.

Micro, Small and Medium Enterprises (MSMEs):
UK: Business with less than USD $15m in annual sales and between zero to 249 employees.
US: Business with less than USD $15m in annual sales between zero to 499 employees.

Employer Firms: Companies with at least one paid employee.
Investment Capital: Investment capital within the scope of our research includes Debt and Equity investment instruments:

a) Debt such as small business loans, working capital loans, equipment loans, credit debt, and peer-to-peer loans; and

Equity coming from various types of capital providers such as friends and family, angel investors, venture funds, equity funds and other financial institutions and at various stages – Seed, Early Growth (Series A) and Growth Capital (Series B and beyond)
Investment Supply: Investment capital invested in businesses led by BFEsin the US and the UK.

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Annex 2 - Methodology

Phase 1: Market analysis

Part A – Investment gap

We based our research on a data-driven approach, geared to estimate the total size of the investment market and the financing gap that exists for Black female entrepreneurs. This entails estimating both the aggregate demand (Investment opportunity/need) as well as the aggregate supply (investment deployed), and the difference in the two leading us to the financing gap that exists for BFEs.

Demand: Investment opportunities

Objective: Estimate total capital demand by BFEs in the US and the UK

Approach:

3. **Estimate number of BFEs**
   - US: used Census data and the 2018-2019 Annual Business Survey (ABS).
   - UK: used the 2018 Longitudinal Small Business Survey and data indicators from other reports[2 3]
2. **Develop BFE segmentation by business size**
   - US: based on annual company sales provided by the 2018-2019 ABS and IFC MSME definition[4], determine business is micro, small, or medium.
   - UK: applied US market proportions to the UK market as data on annual sales were not available specifically for the UK.
3. **Estimate capital demand by segment**
   - Based on IFC MSME loan size proxies for micro, small and medium businesses, estimated the total capital demand in the

Supply: Investment deployed

Objective: Estimate total investment supply for BFEs in the US and the UK

Approach:

1. **Estimate total debt and equity supply to SMEs**
   - Used data from US Federal Reserve, National Venture Capital Association, Credit Union National Association Crunchbase, Bank of England and OECD library to estimate total investment by instrument and capital provider.
1. **Estimate percentage of capital invested in BFEs**
   - Used limited quantitative data available and qualitative data from literature review, to estimate percentage of capital deployed to BFEs by instrument and capital provider.
2. **Infer total investment supply**
   - Based on the estimates above, aggregated each category to infer total capital supply to BFEs.

Part B – Analysis of barriers to investment capital reaching BFEs

Palladium undertook a structural analysis of the barriers and biases faced by BFEs by examining the major barriers to business launch and, business growth and survival, with a focus on accessing finance. This was conducted by review of existing literature and data, complemented by a set of round table discussions and one-on-one interviews with a broad set of investors and selected Black female entrepreneurs, including those who have been successful in raising capital as well as those that have struggled.

Long list of possible barriers	Prioritise barriers most relevant for BFEs in US and UK	Final list of barriers through validation exercise
Objective: Identify possible hypotheses for barriers to investment **Approach:** Leverage Palladium's expertise in mobilising capital, particularly with a focus on gender and racial equity, to compile a long list of possible barriers to investment for BFEs from the point of view of demand (investment opportunities), and supply (investment capital deployed).	**Objective:** Prioritise hypotheses for further testing **Approach:** Use existing knowledge of the arket and a literature review to focus further research on those barriers that seem most likely to be relevant in this context.	**Objective:** Test the hypothesis and further prioritise and de-prioritise based on validation exercise **Approach:** Test the hypothesis by means of: 1. Roundtables and interviews (Qualitative) with investors and entrepreneurs 2. Literature review of third-party research and publications 3. Quantitative data analysis to further understand trends in capital flow to BFEs across business types and from a variety of investment sources.

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Phase 2. Proposing clear, actionable solutions

Systems Thinking

Elucidation of a vision of the desired future system with positive principles	Mapping and analysis of the system	Supporting high leverage interventions through the distribution of tools	Continuing to learn and adapt
A system where BFEn **access to capital is equitable and unbiased**. A system where **all types of MSMEs have equitable access to adequate capital**. In this system, capital providers will “meet the founders where they are” with capital that match MSMEs’ needs.	Within the parts of the system most closely surrounding MSMEs access to capital **we focused on the role investors, governments and intermediaries play in barriers to access.**	The following sections propose several **interventions targeting barriers in access to capital for BFEs,** that were identified and confirmed through our research, as shown earlier in the report. **Policy reform, investor advocacy, market solution development and entrepreneurship strengthening** are the strategic levers	Systems are dynamic and constantly evolve, therefore they **need ongoing assessment and adaptation**. This can be done by **setting metrics to track progress towards the future system vision** and adapting interventions as needed. On-going data collection is a critical aspect of progress tracking, and it is clear that

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Annex 3 – Market Size

US capital demand size

US Capital demand sizing model	
	2018*
Total number of micro businesses (annual sales below $100K) [1]	13,389
Total number of small businesses (annual sales between $100K-$3 million) [1]	24,786
Total number of medium businesses (annual sales between $3 million -$15 million) [1]	5,544
Total number of Black women owned MSMEs with at least 1 employee [1]	**43,719**
Micro businesses	
Total number of micro businesses (annual sales below $100K)	13,389
Capital demand per micro business[2]	$10,000
Total micro businesses capital demand	$133,890,000
Micro businesses capital demand in %	*1%*
Small businesses	
Total number of small businesses (annual sales between $100K-$3 million)	24,786
Capital demand per small business[2]	$100,000
Total small businesses capital demand	$2,478,600,000
Small businesses capital demand in %	*18%*
Medium businesses	
Total number of medium businesses (annual sales between $3 million -$15 million)	5,544
Capital demand per medium business[2]	$2,000,000
Total medium businesses capital demand	$11,088,000,000
Medium businesses capital demand in %	*81%*
Total capital demand	**$13,700,490,000**

UK capital demand size

UK Capital demand sizing model	
	2018
Total number of Ethnic Minority Led (EML) MSMEs [1]	946,392
% of women led MSMEs out of all EML MSMEs [2]	17%
% of Black women led MSMEs out of all women EML MSMEs [2]	26%
Proxy a - Proportion of EML MSMEs with at least one employee out of all EML MSMEs [1]	22.5%
Proxy b - Proportion of women led MSMEs with at least one employee out of all women led MSMEs	19%
Estimated proportion of Black women led MSMEs with at least one employee out of all Black women led MSMEs (average of proxy a and b)	21%
Total number of Black women led MSMEs with at least one employee	**8,754**
Micro businesses	
% of total Black women led MSMEs that are microbusinesses (US proportion applied)	*31%*
Total number of micro businesses (annual sales below $100K)	2,681
Capital demand per micro business[3]	$10,000
Total micro businesses capital demand	$26,810,248
Small businesses	
% of total Black women led MSMEs that are small businesses (US proportion applied)	57%
Total number of small businesses (annual sales between $100K-$3 million)	4,963
Capital demand per small business[3]	$100,000
Total small businesses capital demand	$496,316,987
Medium businesses	
% of total Black women led MSMEs that are medium businesses (US proportion applied)	13%
Total number of medium businesses (annual sales between $3 million -$15 million)	1,110
Capital demand per medium business[3]	$2,000,000
Total medium businesses capital demand	$2,220,270,616
Total capital demand	**$2,743,397,851**

US capital supply size

Debt	2018
Bank SME loans	
Total outstanding business loans, SMEs	$633,000,000,000[1]
Percentage that goes to Black businesses	2.00%[2]
Total bank loans that goes to Black businesses	$12,660,000,000
Proportion of Black businesses owned by women	36.00%[3]
Proportion of BFE that seek credit facilities	50.00%
Acceptance rate of Black founders for SME loans	47.00%[4]
Percentage of Bank loans that goes to BFE	0.17%
Amount directed to BFE	**$1,071,036,000**
SBA loan Program	
SBA loan program approved loans for BFE	**$334,100,000[5]**
Alternate Lending	
Alternate lending (P2P Business loans)	$36,528,000,000[6]
Proportion of P2P loans going to BFE	0.195%
Proportion directed to BFE	**$71,076,182**
Credit Union small business loans	
Credit union small business loans	$73,060,000,000[7]
Percentage that goes to BFE	0.186%
Amount directed to BFE	**$135,979,272**
Equity	2018
Total VC funding	$276,700,000,000[8]
Percentage that went to BFE	0.14%[8]
VC funding for BFE	**$387,380,000**
Total capital supply to BFE	**$1,999,571,454**

1. OECD Library 2. VEDC: Investing in the Success of African-American Owned Small Businesses 3. Annual Business Survey 4. US Federal Reserve: Availability of Credit to Small Business report 5. SBA.gov 6. Cambridge Centre for Alternative Finance: Global Alternative Finance Benchmarking report 7. Credit Union National Association 8. National Venture Capital Association

UK capital supply size

Debt	2018
Outstanding business loans, SMEs	$233,028,348,784[1]
Proportion of BFEs out of all SMEs with at least one employee	0.15%
Loan acceptance rate for BFE	47.00%
Proportion of SME loans to BFE	0.073%
Total bank SME loans to BFE	**$161,803,194**
UK P2P lending	$3,412,817,412[2]
Percentage growth applied to bank loan proportion	50.00%
Percentage to BFE	0.109%
Total P2P business lending to BFE	**$3,713,910**
Total CDFI SME lending	$114,201,263[3]
Percentage to BAME founders	16.00%
Percentage of BAME community that are Black	25.00%
Proportion of CDFI SME loans to Black business owners	4.00%[4]
Proportion of Black businesses that are women led	50.00%
Proportion of CDFI SME loans directed at BFE	2.00%
Total CDFI SME loans to BFE	**2,284,025**
Equity	2018
Total VC funding	$13,475,749,026[5]
Percentage that went to BFE	0.02%[5]
VC funding for BFE	**$2,695,150**
Total capital supply to BFE	**$170,496,279**

Annex 4 – Abbreviations and Acronyms

ABS	Annual Business Survey
AI	Artificial Intelligence
BAME	Black, Asian, And Minority Ethnic
BBBA	Black British Business Awards
BFE	Black Female Entrepreneur
BFEn	Black Female Owned Or Led Enterprises
BIPOC	Black, Indigenous, And People of Colour
BoE	Bank of England
CDEI	Centre for Data Ethics and Innovation
CDFI	Community Development Financial Institution
CREME	Centre for Research in Ethnic Minority Entrepreneurship
CUNA	Credit Union National Association
D&I	Diversity and Inclusion
DD	Due Diligence
EML	Ethnic Minority Led
FCDO	Foreign, Commonwealth and Development Office
FSB	Federation of Small Businesses
GDPR	General Data Protection Regulation
GP	General Partner
GSS	The Government Statistical Service
IFC	International Finance Corporation
IRS	Internal Revenue Service
LP	Limited Partner
MSME	Micro-small-and Medium-enterprise
NVCA	National Venture Capital Association
OPD	Open Platform Database
OECD	Organisation for Economic Co-operation And Development
OMB	Office of Management And Budget
PIC	Palladium Impact Capital
P2P	Peer to Peer
RDU	The Race Disparity Unit
SBA	Small Business Administration
SEC	Securities and Exchange Commission
SME	Small- And Medium-enterprise
UK	United Kingdom
US	United States
USD	United States Dollar
VC	Venture Capital

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