Testimony of Himalaya Rao-Potlapally before the Senate Finance Committee
April 20, 2021

Chairman Wyden, Ranking Member Crapo, and members of the Committee — thank you for the opportunity to appear before you today.

My name is Himalaya Rao-Potlapally and I am the Managing Director of the Black Founders Matter Fund, an early-stage venture capital firm that operates out of Portland, Oregon and invests in Black entrepreneurs that are leading startups across several verticals within the United States.

You will probably notice that I don't represent the face of Venture Capital. On the surface, there are very few women in this space, and even less women of color. I am also a first-generation immigrant to this country and I started my career as a school social worker in the Bronx in New York City working in high-risk schools with children and families.

When I got my MBA, I was exposed to what entrepreneurship is and who could be an entrepreneur. Learning that it didn't have to be someone with several Ph.Ds or with generational wealth, my wife and I decided to try it for ourselves and started a company. I only started seeking out resources and knowledge about venture capital selfishly to understand how I would be judged if I ever raised capital. I fell into this world by accident, but as soon as I did, I realized the very specific need for me to be here.

There is a huge lack of representation when it comes to the investor makeup. Even when there are people of color or women in the space, most of them have come from generational wealth and a higher socioeconomic status. This inherently creates a space in which we have homogeneous thinking. To combat what I was seeing, I positioned my career in this space to first start as a venture capital consultant. I went into firms who had the willingness to diversify their dealflow but had seen no tangible differences in outcomes. In just one year of me being with several of these firms, I was able to significantly change their investment portfolio. As I analyzed why this was happening, I realized that even when there is a willingness to diversify deaflow, there are significant barriers that create unchanged outcomes. I cite three main reasons for this inequity; the underlying framework for evaluating potential startups, the homogeneous groupthink mentality, and the lack of an onramp to truly representative investors.

Barriers to investing in diversity and innovation:

1. The underlying framework for evaluating potential startups is based on pattern matching and a dataset of previous success attained by one demographic of founders.

The basis of evaluating startups is inherently biased. When investors look at startups, they are essentially evaluating companies compared to what already exists in the market and their own portfolio. We compare them to existing ventures as a way to determine their viability and propensity for success based on what we know already works. This pattern matching behavior[1] causes investors to look at startups and notice incremental improvements in the business model, team dynamics, or go-to-market strategy. While all three of those areas are fundamental to creating great ventures, exclusively looking at those factors creates a scenario where investors are missing a key element to an innovative venture. The word innovation is defined as the introduction of something new, whether it be a new idea, method, or device[2]. One of its synonyms is novelty.

The solutions we think of to problems are based on our framework of reality. Our reality is based on our subjective lived experiences that confirm or challenge what we already know[3]. When the experience or fact confirms what we already know, it strengthens that reality and locks it into place. A challenge to our existing reality, presents our mind with the opportunity to rationalize how the example is an outlier that should not to be considered, or establishes the example as part of a new pattern that requires us to rethink our logic framework. The result is that we all take in a series of objective experiences and facts and then internally process them through our own subjective view of reality, to come up with what is true and what is possible.

When we bring that back to venture capital, founders' reality and perceived notions of possibilities creates their varying approach to solving any small or systemic problem. BIPOC founders inherently experience the world and reality in a different way and therefore have a different set of norms and solutions they come up with. In our pattern matching evaluation framework, truly different ideas are impossible to compare. The result is that we evaluate all deals based on our historical dataset which is overwhelmingly composed of solutions presented by white founders. Because of their drastically different lived experiences, BIPOC founders largely present ideas that are incomparable to this existing dataset and are therefore overlooked; not because there is an overt want to exclude people based on their race or ethnicity, but because our existing methodology of success is essentially based on an algorithm that only takes its inputs from one group of lived experiences and potential solutions[1].

Innovation implicitly requires difference. But how can we ever filter or look for it when all our systems are designed to compare new ideas to existing benchmarks and metrics?

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2. We create homogenous groupthink in environments without the four types of diversity.

On top of an underlying biased framework, we have the problem of homogenous thinking. When we look at angel groups, venture capital funds, or private equity- there is a stark lack of diversity with regards to gender and racial equity. While demographic diversity (based on age, gender, ethnicity, and race) is foundational to creating representation, we run this risk of creating environments that have superficial diversity when we miss the intersectionality of age, gender, race, and ethnicity with concurring factors. A truly diverse environment consists of three other types of diversity in addition to demographic diversity.

> It requires information diversity[4]. To achieve this, we need to look at sources that people are using to gather information. Is everyone looking at the same articles, publications, and datasets as a method of aggregating knowledge and creating a starting point? If so, all the inputs are identical and reinforce one another. This creates an environment where we are only surrounded by information that confirms what we already know and solidifies what we see as reality and possibilities.
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> We also need value diversity[5]. This relates to the core values and beliefs that people hold and use to navigate the world. This can be especially difficult in our current polarized society where we see things are being right and wrong instead of opinions that range on a spectrum informed by our contrasting and sometimes contradicting realities.
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> Finally, we need education diversity[6]. We need to ask if all the people in any given room have the same level and type of formal or informal education. If so, we've all been indoctrinated with the same information and knowledge and are more likely to participate in a homogeneous thought process. The type of education a person receives is also highly correlated with socioeconomic status and education diversity is one the most consistent types of diversities that is overlooked. Across the spectrum, from non-profit boards to government positions, to corporate leadership, we tend to see a lack of intersectionality between racial, educational, and socioeconomic diversity present in our leadership.

Without these four types of diversities present, we engage in and encourage superficial diversity that enables tokenization rather than impact-driven, sustainable change. We should instead strive to create environments where different perspectives are intentionally centered and heard.

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3. There is currently a lack of an onramp to greater participation by representative investors into small businesses and new ventures.

If we can agree that we need these four types of diversities present in any given environment, then the last major barrier to investment in innovation is the lack of an onramp to truly representative investors. To be a participant and decision maker in venture capital, you must be an accredited investor. As defined by the SEC[7], an accredited investor is an individual that makes $200,000 in annual income, $300,000 if have a combined couple income, or has $1,000,000 in net assets, excluding the primary residence. This definition alone excludes the majority of Americans from ever being able to participate as investors in venture capital. In the last couple of years, the accredited investor definition has expanded to include those who work within venture capital or have intimate knowledge of the inherent risks that come with venture investing[8]. While this was a great expansion, it's only the beginning. We need continued modifications to this definition as well as intentional initiatives, like tax incentives, to help drive participation into this historically closed loop activity. We all come with our own set of inherent biases and subjective realities. Creating environments where investors and founders are truly representative of one another is a way to mitigate confirmation bias that we use to evaluate success. These initiatives, like the one Senator Wyden has proposed[9], incentivize greater participation by different types of investors. When we are constructing initiatives, we must exercise caution to ensure that we are creating a catalytic environment that encourages participation of new and diverse investors into a broad range of diverse entrepreneurs and businesses.

Key recommendations:

Based on the previous discussion of barriers to investment in diverse entrepreneurs and innovation, the following constitute the starting points for effective change.

- Investor education that goes against the existing pattern matching behavior and instead upholds a holistic education framework that examines a person's unique experience and its contribution to metrics of a successful venture. The Black Founders Matter Fund has one such framework developed on the basis of Effectual Entrepreneurship[10] overlaid with a social work framework of Systems Theory[11].
- Incentive structures, including tax credits, student loan forgiveness, and stipends/vouchers, as a method of incentivizing non-monetary participation in leadership structures by diverse individuals. As an example, non-profit boards are usually comprised of individuals who have flexible work schedules, those who are retired, and

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those who have enough passive or generational wealth to allow flexibility to commit to a non-paid position. Creating structures that allow for stipends and/or vouchers that can be used for living expenses/health and wellness expenses can open doors for a broader range of individuals to participate in leadership and community development. Tax incentives and student loan forgiveness would also contribute to the long-term flattening of the wealth disparity in exchange for the inclusion of diverse voices in setting organizational strategies and solutions.

- Expansion of the accredited investor definition to allow greater participation by the majority of American citizens.
- Incentive programs, including tax credits and student loan credits, that accelerate and encourage participation of investment into new ventures and small businesses. Special consideration should be given to ensure that the resulting investment goes into a broad range of businesses and individuals to ensure diverse distribution of dollars.

Conclusion:

Creating environments that truly incentivize and encourage participation from a diverse set of individuals might seem difficult to achieve. But the lack of this environment and exclusively investing in one type of solution or founder creates ripple effects throughout our society. Here in the United States, we pride ourselves on being the global leader of progress and innovation. We must therefore look to solve this complex problem with a variety of different solutions to ensure that we can continue to remain competitive in the global landscape. This country is home to different cultures, identities, and ideologies. We need to find a way to harness the strength of our differences and diversity for a brighter, inclusive, and innovative future.

Thank you again for the opportunity to testify, and I look forward to your questions.

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