What does California’s decision on diversity data mean for Europe?

A few weeks ago, Californian took a big step. In a move designed to boost the diversity of the notoriously homogenous world of venture-backed startups, the State’s Governor, Gavin Newsom, passed a law that means VCs in the state must report on the diversity of their portfolio companies.

Kicking in from 2025, *the new rules will see VC publicly share key info such as the gender and ethnicity breakdowns of the founders they’ve backed*. This is a huge moment for the VC industry. With the heart of the VC world – Silicon Valley – located in California, this new legislation is both a tangible and symbolic step.

For too long, both VCs and the companies they invest in have suffered from a severe lack of diversity.

Despite the best intentions of some (including a number of firms who have genuinely set a higher standard for inclusive investing), years of talking about the issue and promising to do better just hasn’t translated into impact across the board. And, during the current downturn, metrics are now going backwards.

In Europe, 87% of VC funding is still raised by men-only founding teams. The proportion of funding raised by women-only teams has *dropped from 3% to 1%*

since 2018. And whilst overall VC funding dropped by 36% in 2022, it fell by 45% for Black-owned businesses.

European VCs and policy makers should be looking closely at this news from California. Industry advocates and inclusion champions have spent years encouraging firms to change their habits, to little avail. This move from the States suggest a shift in approach – moving from the ‘carrot’ to the ‘stick’ – could characterise the next frontier for the push towards a fairer, more representative landscape.

If all European firms were required to disclose their diversity data each year, what would the impact be?

Firstly, I believe VCs would be confronted with the hard facts about their portfolio and, crucially, be able to see if things were trending in the right direction over time. Right now, not enough firms collect the right data on their portfolios. Armed with this knowledge (and knowing that it would be going into the public domain) would provide firms with a clear incentive to develop systems and processes that diversify how they source their investments.

Secondly, it would encourage funds to take action when it comes to their own teams. If you’re unable to find brilliant founders from a broader range of backgrounds, perhaps it’s because those looking for them are too similar to each other. Having a more diverse VC team, powered by a broader world-view and different perspectives, enables investors to spot a more diverse range of talent and opportunities. Those struggling to make improvements in their portfolio diversity would be encouraged to improve their own team structures.

There’s a lot of valid debate around whether mandates and laws are the right way to go about making change. Firstly, there are real concerns around how potentially sensitive information (such as sexual orientation or disability) should be collected and shared. The rights and preferences of those being surveyed – in this case, the founders – should always be protected. Quite correctly, the California law states that whilst VCs will be mandated to share their insights, founders will only be asked to provide information on a voluntary basis. There’ll be no penalty for non-disclosure on the startup side. This provision is essential, given the type of data involved.

Another area which is giving people pause for thought is the fact that, although this data collection would happen after investment has been made, the sad reality is that many founders may fear that disclosing the fact that they identify as LGBTQ+ or have a disability, for example, could create a barrier to raising investment in the future. Until we have a level playing field for all founders, many may be reluctant to share key details with their VCs. Empowering founders and protecting them and their data must not be minimised.

Likewise, some of the more overlooked areas of diversity – such as the socioeconomic background of founders – aren't currently covered by this bill, meaning we'll be given an incomplete data picture. This means we risk progressing in certain areas but neglecting others. This may well be because socioeconomic factors are tricker to measure; it's not as simple as ticking a box on a form. VCs and anyone collecting diversity data should therefore consider whether they want to go beyond the terms of any legislation and also collect wider data points. If so, it's essential to make sure processes are evidence-based and designed to capture as much nuance as possible.

Whilst California's move will continue to generate discussion as to whether this is the best path to choose and how the details of the rollout should be handled, it should serve as a moment to reflect on our progress in Europe and have an honest conversation about why we aren't doing better on diversity on this side of the pond.

Brave and bold VCs across the continent are already sharing their data and making public their plans to improve diversity and inclusion. Other firms should follow their lead. It's time to stop hiding behind rhetoric and make tangible steps towards creating a VC ecosystem that better reflects the societies it operates in. If the industry doesn't move things forward itself, firms might find similar legislation coming down the European track.

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