

Venture capital and ethnic integration: better together

Diversity is one thing, integration another, according to an empirical study of the impact of venture capital in the U.S. IESE's Sampsa Samila finds a one standard deviation increase in racial integration increased the positive outcomes associated with VC by at least 30 percent.



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A [new study](#) finds that racial integration amplifies the economic benefits that come from venture capital (VC) investments, creating more jobs and more wealth — locally.

Research by IESE's [Sampsa Samila](#), with Olav Sorenson, asserts that VC investments are

good for a community, but not uniformly so. Crunching data from the U.S. census and other sources, they find that racial integration *significantly* increases the benefits of VC investments. In sum, "a one standard deviation increase in racial integration in a region increased the positive outcomes associated with the supply of venture capital by 30 to 100 percent." That means more patents, more startups, more jobs and more wealth for a region.

Knowing Different Things, and Sharing Them

Why is racial integration good for a local economy? On the one hand, people from different ethnic backgrounds tend to bring different perspectives to their communities. Previous research has found racially diverse teams to perform higher on tests of their combined knowledge because they searched more to discover what other team members knew. Meanwhile, teams without racial differences tended to be less inquisitive of each other and did not perform as well on the same tests.

Cities, however, can be diverse without being integrated if the ethnic communities live separately from each other. Local interactions between people of different ethnic backgrounds, which are more likely in integrated areas, are the linchpins in this study. As Samila explains, "It's not about the presence of diverse information and ideas, but about the physical proximity of those ideas to each other." Innovation may come from contact with new and recombined ideas.

Yet, in the absence of VC, the link between integration and the economic benefits of innovation did not hold strong. VC money acts as a catalyst turning innovation ideas into viable businesses — "bringing them from the lab or the mind of an inventor to the consumer," as the co-authors write.

Where VC Investments Benefit the Most

The United States' more integrated urban areas include San Jose, Minneapolis-St. Paul and San Francisco. Meanwhile, its more segregated metro areas include Detroit, Chicago, St. Louis — and even New York City is below the study's benchmark, Boston.

So why might VC funding have more positive impact in San Francisco, compared with, say, racially diverse but not-so-integrated Chicago? Again, it seems to be about the local proximity to a wide variety of ideas, sparking innovation, measurable in patents, startups and more. It's about opportunities for contact and interaction. "Even among friends and relatives, people interact more frequently with those who live and work near them," the co-authors

summarize.

A notable feature of this research is that the co-authors look at the opportunities for interracial interaction using U.S. census data, rather than the relationships themselves. That makes the impact of integration easier to study empirically. Basically, the level of integration within a metro area serves as a proxy for how likely people were to have relationships that cross ethnic lines.

But is a place like Silicon Valley so successful that it distorts the VC statistics? To make sure, the co-authors removed California, Massachusetts and Texas — the three U.S. states receiving the most VC funding — to see if the pattern held. It did: VC benefits were still amplified by a region's racial integration.

More Jobs — and Better Jobs

Naturally enough, venture capitalists rely on their friends and contacts to help assess untested entrepreneurs and their ideas. They can't just google the next Google. And when they invest locally, as they usually do, they then help encourage more entrepreneurial activity. But the regional economic impact of their investments varies widely, and the degree of racial integration of where they are investing seems to help explain some of that variance.

Over the long term, for a city one standard deviation more integrated than the average, the same VC investment translates into six more patents, 2,100 more jobs, and \$180 million in added payroll with a doubling in venture capital over 10 years. Not only were more jobs created, but well-paid jobs at that.

For a short animated video, prepared with Yale School of Management's Olav Sorenson, see ["Why Integrated Cities Produce More Startups."](#)

Methodology, Very Briefly

The empirical analysis looks at metropolitan statistical areas (MSAs) "because they offer the finest-grained regions that one might reasonably consider independent with respect to economic activity." For each MSA, the co-authors assembled information from sources that included the U.S. Census Bureau, the Office of Advocacy of the Small Business Administration (SBA), U.S. Patent and Trademark Office (USPTO), Thomson Reuters' ThomsonOne database, CrunchBase, and *The Chronicle of Higher Education* from 1990 to 2002. They use these data to examine the influence of two independent variables -- venture capital and ethnic

integration -- on four outcomes: innovation, entrepreneurship, employment levels, and regional income. For ethnic integration, the Theil Index, available from the Census Bureau, is used, which tracks changes in an area's integration levels.

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