S. HRG. 111–1169

ASSESSING ACCESS: OBSTACLES AND OPPORTUNITIES FOR MINORITY SMALL BUSINESS OWNERS IN TODAY'S CAPITAL MARKETS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP
UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

APRIL 15, 2010

Printed for the Committee on Small Business and Entrepreneurship

Available via the World Wide Web: http://www.fdsys.gov

U.S. GOVERNMENT PRINTING OFFICE

71–269 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

ONE HUNDRED ELEVENTH CONGRESS

MARY L. LANDRIEU, Louisiana, *Chair*
OLYMPIA J. SNOWE, Maine, *Ranking Member*

JOHN F. KERRY, Massachusetts
CARL LEVIN, Michigan
TOM HARKIN, Iowa
JOSEPH I. LIEBERMAN, Connecticut
MARIA CANTWELL, Washington
EVAN BAYH, Indiana
MARK L. PRYOR, Arkansas
BENJAMIN L. CARDIN, Maryland
JEANNE SHAHEEN, New Hampshire
KAY HAGAN, North Carolina

CHRISTOPHER S. BOND, Missouri
DAVID VITTER, Louisiana
JOHN THUNE, South Dakota
MICHAEL B. ENZI, Wyoming
JOHNNY ISAKSON, Georgia
ROGER WICKER, Mississippi
JAMES E. RISCH, Idaho

DONALD R. CRAVINS, JR., *Democratic Staff Director*
WALLACE K. HSUEH, *Republican Staff Director*

C O N T E N T S

Opening Statements

Witnesses

Alphabetical Listing and Appendix Material Submitted

ASSESSING ACCESS: OBSTACLES AND OPPORTUNITIES FOR MINORITY SMALL BUSINESS OWNERS IN TODAY'S CAPITAL MARKETS

THURSDAY, APRIL 15, 2010

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The Committee met, pursuant to notice, at 10:09 a.m., in Room 562, Dirksen Senate Office Building, Hon. Mary L. Landrieu (chair of the committee) presiding.

Present: Senators Landrieu, Cardin and Snowe.

OPENING STATEMENT OF HON. MARY L. LANDRIEU, CHAIR, AND A U.S. SENATOR FROM LOUISIANA

Chair LANDRIEU. Good morning. Let me call the meeting of the Small Business Committee together this morning, welcome all of our witnesses, and say how pleased I am to call this meeting, "Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets."

Before I begin, I would like to just say thank you to those of us who joined some of the Committee members earlier this morning when we dedicated our new Small Business Committee hearing room in the Russell Building. We honored a really intrepid entrepreneur and extraordinary woman of history, Ida B. Wells, who was a small business owner, a journalist, a reporter and someone who has made a significant contribution to the effort of recording domestic terrorism and lynchings and tortures that took place in this country. But for her spirit of never giving up and trying to get it right and telling the truth, we honored her this morning.

Senator Snowe, thank you. We also had Senator Cardin and Senator Burris there with us, which is why we are a little late to this hearing, because we were wrapping up that reception and walking back over here.

We will be happy for the Small Business Committee to actually start having meetings in our regular committee room. So thank you all for the slight inconvenience of using another committee room this morning.

I am going to be introducing our panel in a moment, but I would like to give brief opening remarks and then call on my Ranking Member.

Again, thank you for joining us to discuss the obstacles and opportunities facing minority-owned small business today in America.

Since becoming Chair of this Committee, I have made access to affordable capital for all small businesses a top priority. The staff have been constantly updating me on how many banks are participating in the small business lending programs and how many banks and other institutions are being helped through the Department of Commerce as well.

We keep updated information about how many SBA loans are being made, and my staff says he gets so aggravated with me asking that question. He keeps the information on the back of his ID card.

I convened a roundtable with Senator Snowe on minority entrepreneurship on September 24th. We have had requests in to the Small Business Administration to give us an update on many of their initiatives, including the potential hiring of a new position that would fill the position for the Minority Small Business and Capital Ownership Development Officer, and I am looking forward to hearing about that this morning.

The current economic recession, as we know, has seen credit tightening drastically. Many banks have withdrawn or reduced their lending activities. Minority-owned and small businesses have even more difficulty in many neighborhoods and areas, accessing credit even under optimal economic conditions.

This is important because minority business development plays a crucial role in the economic vitality of America. These businesses are some of our nation's greatest assets. Diversity, we believe on this Committee, is a strength, not a liability, and we want to leverage all the strength that we have in this nation to the work ahead, which is to lead us out of a recession, and create the kind of jobs that our people need.

According to the most recent data available from the SBA, minority-owned businesses are among the fastest growing segments of the small business community. From 1997 to 2002, firms owned by African Americans grew by almost 45 percent, Hispanics by 31 percent, Asians by 24 percent and Hawaiian-Pacific Islanders by 49 percent. Minority-owned business enterprises account for more than 50 percent of the 2 million new businesses over the last 10 years. There are now more than 4 million minority-owned companies in the United States with sales totaling more than $700 billion.

One of the things we are going to review today is those accomplishments as well as the obstacles that still exist and what the Small Business Administration and the Department of Commerce can do in that effort, and then hear from some successful entrepreneurs their life stories about what it took for them to succeed. I will introduce them when I introduce the panelists.

Chair LANDRIEU. Let me now turn to my Ranking Member, Senator Snowe, for her opening remarks.

OPENING STATEMENT OF HON. OLYMPIA J. SNOWE, RANKING MEMBER, AND A U.S. SENATOR FROM MAINE

Senator SNOWE. Thank you, Chair Landrieu for your continued leadership in championing our nation's small businesses, especially during these precarious economic times, and I am very appreciative for your scheduling this hearing today to discuss the hurdles for our nation's small businesses. Certainly, so many in our underserved communities, are facing the tremendous impediment of accessing capital, which is obviously the economic lifeblood of our businesses and essential if they are to remain open and create jobs.

As you have said, Madam Chair, this has been a top priority in terms of capital access, and that has been indisputable in terms of your agenda before this Committee, and I am certainly appreciative of that.

I also want to thank our distinguished panelists who are here today, both from the Small Business Administration and the Minority Business Development Agency, as well as various segments of the private sector—entrepreneurs, academia, bankers—who will lend their expertise as we explore the root causes of why minority-owned small businesses continue to encounter unacceptable barriers in accessing affordable credit.

With unemployment still close to 10 percent, the regrettable reality is that the unemployment rate for minorities is much worse. Austan Goolsbee, a member of the President's Council of Economic Advisors, recently noted the alarming fact that unemployment in the African American community is at 16.5 percent. Among Hispanics, that number is 12.6 percent.

Imagine the strides we could achieve towards economic recovery, as opposed to the jobless recovery that we are now experiencing, if we could facilitate more access to capital for minority-owned firms.

To underscore this fact, the Bureau of Labor Statistics' recent unemployment data revealed that of the 114,000 private sector jobs created last month, 81,000 came from newly created small businesses. That means that over 71 percent of the private sector job growth came from those new small businesses.

For our nation's unemployment levels to drop, particularly in minority communities, small businesses must drive the economic recovery. In fact, we are depending on small businesses to lead us out of this recession and towards a strong economic recovery, as they have done in every previous downturn. Without them, we simply cannot make it happen.

The market for small business capital across all populations is still suffering through some of the worst effects of this recession. The Federal Deposit Insurance Corporation reported that in 2009 loan balances declined by $587 billion, or 7.5 percent. This is the largest drop in outstanding loan balances since 1942.

Providing access to capital is especially necessary for underserved communities because of the great disparities in capital financing. The Kauffman Foundation's February 2009 survey on patterns of financing, found that on average white-owned businesses started with $81,773, yet African American owned businesses started with an astonishing average of only $28,198. In addition, the survey also found that African American-owned businesses were more likely to tap higher interest credit sources such as credit cards, rather than lower interest business bank loans.

It is long past time we reverse this pernicious trend. That is why it is more imperative than ever that we improve access to affordable credit, and why Chair Landrieu and I have joined forces to increase the guarantee rate on SBA loans to 90 percent and reduce fees for small business borrowers. These proposals, which were enacted as part of the Recovery Act, have paid incredible dividends, and we have seen that with the guarantee in fee reduction that has driven lending across this country, up 90 percent since the passage of the stimulus.

In fact, these provisions have already been extended three times by Congress, but temporary extensions are not sufficient. With the 90 percent guarantee rate set to expire at the end of this month, and the funds for fee relief quickly dissipating, Congress must provide more certainty to small business owners through a longer-term extension of these key provisions.

Additionally, this Committee recently reported out another initiative that would increase capital to small businesses. The legislation will allow small business owners to access larger SBA loans, increasing 7(a) and 504 loans from $2 million to $5 million and microloans from $35,000 to $50,000.

While 18 percent of our nation's small businesses are minority-owned, they have received fully 23 percent of the SBA 7(a) and the 504 loans since the enactment of the stimulus, and for microloans, approximately 40 percent traditionally go to minority entrepreneurs.

In fact, today Mr. Hedgespeth will testify that the agency's SBA-backed loans are about three times more likely than conventional loans to go to minority-owned firms.

Just think about how much more powerful a tool these loans could be in helping minority-owned businesses if their levels were increased. This is particularly the case when considering, as our witness, Dr. Fairlie's research demonstrates, the vital need for startup capital within these minority communities.

Our legislation was resoundingly passed by this Committee. And just yesterday, Mark Zandi, who is the Chief Economist at Moody's Analytics, testified before the Finance Committee, reaffirming that larger SBA loan sizes would help drive SBA loan volume. In fact, he said that small businesses are imperative and crucial to an economic recovery and robust job creation.

While I am pleased that SBA loans are being utilized by minority-owned businesses, clearly much more can be done and must be done to address the problems that minorities face in accessing capital. That is why I am calling on the Administration to take several steps to address this issue. For instance, the SBA should examine the microloan program's successes and determine if there are ways to replicate them in other programs.

The agency must also reach into minority communities and open a dialogue with community bankers, like some of our witnesses here today, and with minority-owned businesses from whom we will be hearing from in the second panel, to develop strategies to increase the flow of capital to underserved communities.

Moreover, the SBA's entrepreneurial development partners need to work together with the Minority Business Development Agency to find ways to help level the playing field for minority entrepreneurs seeking capital.

So, Chair Landrieu, I thank you again for shedding light on this injustice and the chilling statistics that we have heard as well with respect to minority-owned businesses, and what we can do to make it better. I look forward to working with you to forge additional solutions to address this issue and to providing access to capital. Thank you.

Chair LANDRIEU. Thank you. I thank my colleague from the State of Maine.

And let's get right into our witnesses. Mr. Grady Hedgespeth is the Director of the Small Business Administration Office of Financial Assistance which oversees all of the small business lending programs. He is our first witness today. Mr. David Hinson is the National Director for U.S. Minority Business Development in the Commerce Department.

I know firsthand the Administration's commitment to both of these offices and the increase of funding that has changed, I think, a very detrimental trend from the past, to investing more in the SBA and the hiring of an extremely competent leader at the SBA and, both, at the Department of Commerce.

So if both of you would begin and of course limit your remarks to five minutes, thank you so much. We will start with you, Mr. Hinson.

STATEMENT OF DAVID HINSON, NATIONAL DIRECTOR, U.S. MINORITY BUSINESS DEVELOPMENT AGENCY

Mr. HINSON. Thank you very much. Good morning, Madam Chair Landrieu, Ranking Member Snowe and distinguished members of the Committee. Thank you for inviting the Minority Business Development Agency (MBDA) here today to discuss the capital access for minority businesses and to discuss the activities of MBDA.

My name is David Hinson, and I was appointed National Director of the Minority Business Development Agency by Commerce Secretary Gary Locke on July 15th, 2009.

It is abundantly clear that the financial environment and recession last year have created tight credit markets, a decline in housing values and swollen labor markets. For all businesses, especially minority-owned firms, having access to capital has always been the difference between success and failure for that particular business. While there are valuable lending and bonding programs available, minority owned businesses continue to face substantial barriers and disparities with respect to access to capital.

Last year, as a result of multiple stakeholder forums, MBDA commissioned a study to dissect the issues of access to capital. The results of this study are outlined in the MBDA reported entitled "Disparities in Capital Access Between Minority and Non-Minority-Owned Firms: The Troubling Reality of Capital Limitations Faced by MBEs."

I would like to highlight three key findings. Number one, minority-owned firms are less likely to receive loans than non-minority-owned firms. Number two, when minority-owned firms do receive financing, they are provided less money than non-minority-owned firms, regardless to the size of the firm. Number three, minority-owned firms pay higher interest rates than their non-minority counterparts.

I would like to take second and illustrate these findings:

The denial rate for firms with annual revenues of more than $500,000 is 14.9 percent for minority-owned firms, but only 8.4 percent for non-minority-owned firms.

For firms of the same size, the average loan is $150,000 for minority-owned firms, yet it is more than $310,000 for non-minority-owned firms.

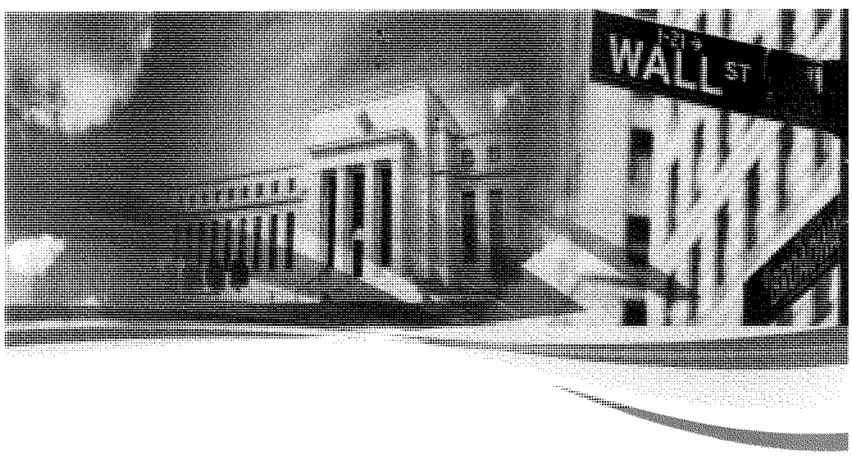
For firms earning under $500,000 in gross revenue, minority-owned firms paid on average more than 9 percent in loan interest rates, yet non-minority-owned firms secured interest rates at less than 7 percent.

I see that Dr. Fairlie, a co-author of the MBDA study, is scheduled to testify on the next panel. So, at this time, Madam Chair, I would like to request that the MBDA report in its entirety be entered into the hearing's official record.

Chair LANDRIEU. Without objection.

[The information follows:]

U.S. DEPARTMENT OF COMMERCE
MBDA
MINORITY BUSINESS DEVELOPMENT AGENCY



Disparities in Capital Access between Minority and Non-Minority-Owned Businesses:

The Troubling Reality of Capital Limitations Faced by MBEs

January 2010

Disparities in Capital Access between Minority and Non-Minority-Owned Businesses:

The Troubling Reality of Capital Limitations Faced by MBEs

U.S. Department of Commerce, Minority Business Development Agency

by
Robert W. Fairlie, Ph. D. and Alicia M. Robb, Ph.D.

January 2010

This report was developed under a contract with the U.S. Department of Commerce's Minority Business Development Agency, and contains information and analysis that was reviewed and edited by officials of the Minority Business Development Agency.

David Hinson
National Director
Minority Business Development Agency

Table of Contents

Preface

Capital access remains the most important factor limiting the establishment, expansion and growth of minority-owned businesses. Given this well established constraint, the current financial environment has placed a greater burden on minority entrepreneurs who are trying to keep their businesses thriving in today's economy.

In this study, Dr. Robert W. Fairlie and Dr. Alicia Robb provide an in-depth review and analysis of the barriers to capital access experienced by minority entrepreneurs, and the consequences that limited financial sources are placing on expanding minority-owned firms.

Minority-owned businesses have been growing in number of firms, gross receipts, and paid employment, at a faster pace than non-minority firms. If it were not for the employment growth created by minority firms, American firms, excluding publicly-held firms, would have experienced a greater job loss between 1997 and 2002. While paid employment grew by 4 percent among minority-owned firms, it declined by 7 percent among non-minority firms during this period.

Minority-owned businesses continue to be the engine of employment in emerging and minority communities. Their business growth depends on a variety of capital, from seed funding to establish new firms, to working capital and business loans to expand their businesses, to private equity for acquiring and merging with other firms.

Without adequate capital minority-owned firms will fail to realize their full potential. In 2002 there were 4 million minority-owned firms, grossing $661 billion in receipts and employing 4.7 million workers. If minority-owned firms would have reached parity with the representation of minorities in the U.S. population, these firms would have employed over 16.1 million workers, grossed over $2.5 trillion in receipts, and numbered 6.5 million firms. Increasing the flow of capital for minority-owned businesses must be a national priority to re-energize the U.S. economy and increase competitiveness in the global marketplace.

David A. Hinson
National Director
Minority Business Development Agency

Executive Summary

Minority business enterprises (MBEs) make a substantial contribution to the U.S. economy, generating $661 billion in total gross receipts in 2002. Minority-owned firms also employed 4.7 million people with an annual payroll totaling $115 billion. The growth rates in the total number of firms, employment and gross receipts of minority-owned businesses far outpaced non-minority-owned businesses between 1997 and 2002. Had minority-owned businesses reached economic parity, the U.S. economy would have recorded higher levels of key economic activity estimated at $2.5 trillion in gross receipts and 16.1 million employees. As defined by the Minority Business Development Agency, economic parity is achieved when the level of business activity of a business group is proportional to that group's representation in the U.S. adult population.[1]

Minority-owned firms are an engine of employment, with young firms creating jobs at similar rates as young non-minority firms. Greater capital access for minority-owned firms is essential to sustain their growth, reduce national unemployment levels, and in particular the high rate of unemployment in minority communities.

At the very time that broad economic productivity is critical to strengthening the economic foundation of the nation, the growth potential of minority-owned businesses is being severely hampered. Across the nation minority-owned businesses face the obstacles of access to capital, access to markets and access to social networks, all of which are essential for any business to increase in size and scale.

A review of national and regional studies over several decades indicates that limited financial, human, and social capital as well as racial discrimination are primarily responsible for the disparities in minority business performance. Inadequate access to financial capital continues to be a particularly important constraint limiting the growth of minority-owned businesses. The latest nationally representative data on the financing of minority firms indicates large disparities in access to financial capital. Minority-owned businesses are found to pay higher interest rates on loans. They are also more likely to be denied credit, and are less likely to apply for loans because they fear their applications will be denied. Further, minority-owned firms are found to have less than half the average amount of recent equity investments and loans than non-minority firms even among firms with $500,000 or more in annual gross receipts, and also invest substantially less capital at startup and in the first few years of existence than non-minority firms.

The current economic crisis is posing severe challenges for minority businesses to meet their potential of creating 16.1 million jobs and generating $2.5 trillion in annual gross receipts. Existing obstacles to greater minority business success challenge the realization of the American Dream of ownership and wealth creation. Unless immediate action is taken, minority communities will continue to lag behind their non-minority counterparts undermining the ability of the nation to quickly regain its economic footing.

[1] U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises, An Overview of the 2002 Survey of Business Owners, Number of Firms, Gross Receipts, and Paid Employees (2006).*

Key Findings

Job Creation

- **Young Minority-Owned Firms Create Jobs at Similar Rates as Young Non-Minority Firms** - Young minority firms created jobs at similar rates as young non-minority firms over the first four years of operations. Between 2004 and 2007, young minority firms created 3.1 jobs while young non-minority firms created 2.4 jobs during the same period according to an analysis of the Kauffman Foundation Survey.

- **Minority Businesses Create Jobs with Good Pay** - The average payroll per employee was not substantially higher among non-minority employer firms compared to that of minority-owned firms. In 2002, payroll per employee was $29,842 for non-minority employer firms compared to about $26,000 for minority-owned firms, according to data from the U.S. Census Bureau. Minority-owned firms are employing workers at similar wages as non-minority firms, and are the backbone of many minority communities across the nation.

- **2001 U.S. Recession Benefited from Minority Business Job Creation** - Between 1997 and 2002, total employment declined by 7 percent among non-minority firms, however total employment increased among minority firms during the same period. Total employment grew by 11 percent among Hispanic owned firms, by 5 percent among African American owned firms, and by 2 percent among Asian firms. For all minority firms employment increased by 4 percent during the same period. If not for employment growth among minority-owned firms over this period the loss in total employment would have been even larger: an additional 160,000 jobs would have been lost.

Faster Growth

- **Minority-Owned Firms Outpace Growth of Non-Minority Firms** - Between 1997 and 2002, minority-owned firms far outpaced non-minority firms in terms of growth in number of businesses total gross receipts, number of employees, and total annual payroll. Minority firms grew in number of firms by 30 percent and in gross receipts by 12 percent, compared with an increase of 6 percent in number of firms and 4 percent in gross receipts for non-minority firms. Total employment grew by 4 percent and annual payroll by 21 percent for minority-owned firms compared to a decline of 7 percent in total employment and an increase in annual payroll of 8 percent for non-minority firms during the same period.

- **Minority-Owned Firms Lag Behind in Size Compared with Non-Minority Firms** - Although minority-owned firms outpaced the growth of non-minority firms in several business measures, minority-owned firms are smaller on average than non-minority firms in size of gross receipts, employment, and payrolls. In 2002, average gross receipts of minority-owned firms were about $167,000 compared to $439,000 for non-minority firms. Average employment size of minority employer firms was 7.4 employees compared to 11.2 employees for non-minority employer firms in 2002. Average payroll of minority employer firms was about $200,000 compared to $333,000 for non-minority employer firms.

Capital Access Disparities

Loans

- **Minority-Owned Firms Are Less Likely To Receive Loans than Non-Minority Firms** - Among firms with gross receipts under $500,000, 23 percent of non-minority firms received loans compared to 17 percent of minority firms. Among high sales firms (firms with annual gross receipts of $500,000 or more), 52 percent of non-minority firms received loans compared with 41 percent of minority firms according to 2003 data from the Survey of Small Business Finances.

- **Minority-Owned Firms Receive Lower Loan Amounts than Non-Minority Firms** - The average loan amount for all high sales minority firms was $149,000. The non-minority average was more than twice this amount at $310,000. Conditioning on the percentage of firms receiving loans, the average loan received by high sales minority firms was $363,000 compared with $592,000 for non-minority firms.

- **Minority-Owned Firms Are More Likely To Be Denied Loans** - Among firms with gross receipts under $500,000, loan denial rates for minority firms were about three times higher, at 42 percent, compared to those of non-minority-owned firms, 16 percent. For high sales firms, the rate of loan denial was almost twice as high for minority firms as for non-minority firms.

- **Minority-Owned Firms Are More Likely To Not Apply for Loans Due to Rejection Fears** - Among firms with gross receipts under $500,000, 33 percent of minority firms did not apply for loans because of fear of rejection compared to 17 percent of non-minority firms. For high sales firms, 19 percent of minority firms did not apply for loans because of a fear of rejection compared to 12 percent of non-minority firms.

- **Minority-Owned Firms Pay Higher Interest Rates on Business Loans** - For all firms, minority firms paid 7.8 percent on average for loans compared with 6.4 percent for non-minority firms. The difference was smaller, but still existed between minority and non-minority high sales firms.

Equity

- **Minority-Owned Firms Receive Smaller Equity Investments than Non-Minority Firms** - The average amount of new equity investments was $3,379 for minority firms, which is 43 percent of the non-minority level. The average amount of new equity investments was $7,274 for minority firms with high sales, which was only 38 percent of the non-minority level according to 2003 data from the Survey of Small Business Finances.

- **Venture Capital Funds Focused on Minority-Owned Firm Investments Are Competitive** - Venture capital funds focused on investing in minority-owned firms provide returns that are comparable to mainstream venture capital firms. Funds investing in minority businesses may provide attractive returns because the market is underserved.

Financial Investment

- **Minority-Owned Firms Have Lower Loan and Equity Investments** - Investment disparities between minority and non-minority firms were larger for external debt (bank loans, credit cards) and especially external equity, compared to the disparity in personal or family loan investments. Minority firms averaged $29,879 in external debt compared with $36,777 for non-minority firms. Minority firms had the most trouble obtaining external equity with $2,984 on average compared with $7,607 on average for non-minority firms.

- **Disparities in Access to Financial Capital Grow after First Year of Operations** - Non-minority businesses invested an average of $45,000 annually into their firms, while minority-owned firms invested less than $30,000 on average after the first year of operation. The disparity in financial capital between minority and non-minority firms was much larger in percentage terms for the next three years in operation than their first year.

- **Lower Wealth Levels Are A Barrier to Entry for Minority Entrepreneurs** - Estimates from the U.S. Census Bureau indicate that half of all Hispanic families have less than $7,950 in wealth, and half of all African American families less than $5,446. Wealth levels among whites are 11 to 16 times higher. Low levels of wealth and liquidity constraints create a substantial barrier to entry for minority entrepreneurs because the owner's wealth can be invested directly in the business, used as collateral to obtain business loans or used to acquire other businesses.

- **Experience, Geographic Location, Lower Sales and Industry Sectors Partially Limit Capital Access for Minority Firms** - Minority-owned businesses had less business experience, lower sales, and less favorable geographical and industry distributions, all of which partially limited their ability to raise financial capital.

Introduction

Minority businesses enterprises (MBEs) contribute substantially to the U.S. economy. Businesses owned by minorities produced $661 billion in gross receipts in 2002, and their growth rate in total gross receipts far outpaced the growth rate for non-minority-owned businesses between 1997 and 2002.[2] In 2002, minority firms employed a workforce of 4.7 million people with an annual payroll of $115 billion. These jobs are located across the nation, many in emerging communities and employing a large proportion of minorities.[3] Another contribution that is often overlooked, however, is that minority business owners create an additional four million jobs for themselves.

Although minority-owned businesses contribute greatly to the macro-economy and many are extremely successful, there remains a sizeable untapped potential among this group of firms. If minority-owned firms would have reached economic parity in 2002, these firms would have employed over 16.1 million workers and grossed over $2.5 trillion in receipts.[4] As defined by the Minority Business Development Agency, economic parity is achieved when the level of business activity of a business group is proportional to that group's representation in the U.S. adult population.[5]

Minority-owned firms are smaller on average than non-minority-owned firms with lower gross receipts, survival rates, employment, and payrolls.[6] The disparities are extremely large: for example, Hispanic-owned firms have an average annual gross receipts level that is one-third the non-minority level, and African American owned firms have an average annual gross receipts level that is one-sixth the non-minority level. A growing number of studies indicate that limited financial, human and social capital, as well as racial discrimination are responsible for these disparities in business performance.[7] Inadequate access to financial capital is found to be a particularly important constraint limiting the growth of minority-owned businesses.

Given the current financial crisis, the credit markets have tightened and access to capital has being further restricted for MBEs. Moreover, the rapid decline in the housing, stock and labor markets in the past several months has taken a toll on an entrepreneur's personal and family wealth. This wealth is important because is frequently the primary source of capital entrepreneurs have for investing in their businesses. Likewise, the potential to receive outside equity funding from venture capitalists and angel investors has also dropped considerably in recent months. For example, the total amount invested by venture capitalists plummeted from $5.7 billion for 866 deals in the fourth quarter of 2007 to only $3.0 billion for 549 deals in the fourth quarter of 2008.[8]

[2] Robert Fairlie and Alicia Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States* (Cambridge: MIT Press, 2008). U.S. Department of Commerce, Minority Business Development Agency, The State of Minority Business (fact sheet), 2008 (accessed July 2009); available from http://www.mbda.gov/index.php?section_id=6&bucket_id=789#bucket_852.

[3] Thomas D. Boston, *The ING Gazelle Index, Third Quarter, 2003* (accessed July 2009); available from www.inggazelleindex.com. Thomas D. Boston, "The Role of Black-Owned Businesses in Black Community Development," in *Jobs and Economic Development in Minority Communities: Realities, Challenges, and Innovation,* eds. Paul Ong and Anastasia Loukaitou-Sideris (Philadelphia: Temple University Press, 2006). U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners* (Washington, D.C.: U.S. Government Printing Office, 1997).

[4] U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises, An Overview of the 2002 Survey of Business Owners, Number of Firms, Gross Receipts, and Paid Employees.*

[5] Ibid. Note: In 2002, minorities represented 29 percent of the U.S. adult population.

[6] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners (1997). U.S. Census Bureau, 2002 Economic Census, Survey of Business Owners* (Washington, D.C.: US Government Printing Office, 2006).

[7] U.S. Department of Commerce, Economics and Statistics Administration and the Minority Business Development Agency, *Keys to Minority Entrepreneurial Success: Capital, Education and Technology,* Patricia Buckley (2002). David G. Blanchflower, P. Levine, and D. Zimmerman, "Discrimination in the Small Business Credit Market," *Review of Economics and Statistics* 85, no. 4 (2003): 930-943. Ken Cavalluzzo, Linda Cavalluzzo, and John Wolken, "Competition, Small Business Financing, and Discrimination: Evidence from a New Survey," *Journal of Business 75*, no. 4 (2002): 641-679. Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

[8] PricewaterhouseCoopers and the National Venture Capital Association, *MoneyTree™ Report, 2009* (accessed October 2009); available from http://www.pwcmoneytree.com.

Banks and other lending institutions have also severely tightened lending standards and increased loan costs to small, medium and large businesses. In its annual survey of senior loan officers, the Federal Reserve found that 65 percent of domestic banks have "tightened lending standards on commercial and industrial loans to large and middle-market firms," and 70 percent of these banks tightened lending standards to small firms. In addition, "large fractions of banks reported having increased the costs of credit lines to firms of all size."[9] Banks are reluctant to lend to minority-owned firms and other businesses in the current economic recession because of concerns about the ability to repay loans. Additionally, the decline in the personal wealth of entrepreneurs has limited their ability to use this wealth as collateral or personal guarantees for loans. The secondary market for loans has dried up, and many banks, especially community banks, are struggling to have enough deposits to meet the demand for loans.

Diminishing credit access and higher borrowing costs will disproportionately impact the creation and growth of minority businesses across America. The recent unprecedented decline in the financial market combined with a severe drop in demand for goods and services resulting from the current economic recession may lead to many minority business failures. Anecdotally, business trade organizations and the Minority Business Enterprise Centers funded by the Minority Business Development Agency have reported that credit lines of viable minority-owned businesses have been closed down by their lending institutions. As a result of the existing financial constraints, the tremendous growth in number of firms, gross receipts and employment enjoyed by minority firms during the past decades could be halted with large negative consequences for the entire U.S. economy.

It is an important policy concern to ensure and ultimately improve the performance of MBEs in the United States. Business owners represent roughly 10 percent of the workforce, but hold nearly 40 percent of the total U.S. wealth.[10] Strong minority business growth directly impacts the reduction of inequality in earnings and wealth between minorities and non-minorities.[11]

Another concern is the loss in economic efficiency resulting from blocked opportunities for minorities to start, acquire and grow businesses. Among these barriers to business formation are liquidity constraints and unfair lending practices that result from structural inequalities or racial discrimination. Barriers to entry and expansion faced by MBEs are very costly to U.S. productivity, especially as minorities represent an increasing share of the total population. Additionally, by limiting the business success to only a few groups and not the broad range of diverse groups that comprise the United States we are constraining innovative ideas for new products and services, and access to global markets where many minority entrepreneurs have a competitive advantage based on cultural knowledge, social and familial ties, and language capabilities.[12]

In addition, barriers to business growth may be especially damaging for job creation in emerging communities.[13] Minority firms in the United States employed nearly 4.7 million paid workers in 2002,[14] a disproportionate share of them minorities and many of these jobs are located in minority and emerging communities. Without the continuing success and expansion of minority businesses the benefits of economic growth will be unevenly divided across the population.

[9] Board of Governors of the Federal Reserve System, *The January 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices, 2009* (accessed July 2009); available from http://www.federalreserve.gov/boarddocs/SnLoanSurvey/200902/default.htm.

[10] Board of Governors of the Federal Reserve System, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," *Federal Reserve Bulletin, Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore*, 2006 (accessed October 2009); available from http://federalreserve.gov/pubs/oss/oss2/2004/bull0206.pdf.

[11] William D. Bradford, "The Wealth Dynamics of Entrepreneurship for Black and White Families in the U.S.," *Review of Income and Wealth 49 (2003): 89-116.*

[12] John Owens and Robert Pazornik, *Minority Business Enterprises in the Global Economy: The Business Case. Prepared in collaboration with the Minority Business Development Agency* (Washington D.C.: Minority Business Development Agency, 2003).

[13] Thomas D. Boston, "Generating Jobs through African American Business Development," *Readings in Black Political Economy*, eds. J. Whitehead and C. Harris (Dubuque: Kendall-Hunt, 1999). Boston, "The Role of Black-Owned Businesses in Black Community Development."

[14] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners. U.S. Census Bureau, 2002 Economic Census: Survey of Business Owners.*

The State of Minority Business

To gain some perspective on the state of minority business in the United States we briefly discuss current business ownership and performance patterns. We first discuss estimates of minority business ownership created from microdata from the 2008 Current Population Survey (CPS). This survey is conducted by the U.S. Bureau of Labor Statistics and Census Bureau and contains the latest available national data on business ownership in the United States. Table 1 reports the business ownership rate, which is the ratio of the number of business owners to the total workforce. The CPS captures individuals who own all types of businesses including incorporated, unincorporated, employer and non-employer businesses although owners of side- and low-hours businesses are excluded.[15]

Table 1
Business Ownership Rates by Race/Ethnicity
Current Population Survey (2008)

	Business Ownership	
	Percent of Workforce	Sample Size
Total	10.1%	692,609
Non-Minority	11.3%	506,160
Native-American	7.6%	6,570
Asian/Pacific Islander	10.3%	33,700
Hispanic	7.9%	74,037
African-American	5.5%	61,957

Notes: (1) The sample consists of individuals ages 20-64 who work 15 or more hours per usual week. (2) Business ownership status is based on the worker's main job activity and includes owners of both unincorporated and incorporated businesses. (3) All estimates are calculated using sample weights provided by the Current Population Survey.

In the United States, 10.1 percent of the total workforce owns a business. Business ownership rates, however, differ substantially by race and ethnicity. Despite the growth in the number of minority firms between 1997 and 2002, minority business ownership rates as a percentage of the minority workforce lagged behind those of non-minorities. Business ownership rates are the highest for non-minorities (i.e. non-Hispanic whites) at 11.3 percent. Asians have the next highest rate at 10.3 percent, which is similar to findings in previous studies.[16] There are differences across Asian groups, however, with some groups such as immigrants from the Philippines having very low rates of business ownership.

[15] Owners of side- and small-scale businesses are excluded because business ownership status is defined for the main job activity and only workers with at least 15 hours worked in the survey week are included in the sample. Published estimates from the CPS only include unincorporated business owners and do not restrict the number of hours worked.

[16] Kwang Kim, Won Hurh, and Maryilyn Fernandez, "Intragroup Differences in Business Participation: Three Asian Immigrant Groups," *International Migration Review 23*, no. 1 (1989). Don Mar, "Individual Characteristics vs. City Structural Characteristics: Explaining Self-Employment Differences among Chinese, Japanese, and Filipinos in the United States," *Journal of Socio-Economics 34*, no.3 (2005). Robert W. Fairlie, *Estimating the Contribution of Immigrant Business Owners to the U.S. Economy, Final Report for U.S. Small Business Administration*, (2008).

Business ownership rates are lower among Native Americans, Hispanics and African Americans. The rate of business ownership among Native Americans is 7.6 percent, among Hispanics is 7.9 percent, and the African American business ownership rate is even lower at 5.5 percent.

Overall, minority business ownership is low relative to the size of the minority workforce. An analysis of trends over the past few decades does not reveal major changes in business ownership rates among minority groups.[17] The barriers to business formation responsible for these patterns are discussed in the next section. Existing barriers to business formation among minorities limit the nation's potential for economic growth and productivity.

Total Gross Receipts of Minority-Owned Businesses

Over the past two decades, growth in the total number of minority-owned firms and their annual gross receipts far outpaced the growth rate for non-minority-owned firms. Table 2 reports estimates of the number of businesses and total gross receipts by ethnic and racial group over the past two decades.[18] The statistics are from the most widely used and highly respected sources of data on minority-owned businesses – the Survey of Minority-Owned Business Enterprises (SMOBE) and the Survey of Business Owners (SBO), which are surveys conducted by the U.S. Census Bureau. Estimates are derived for non-minority-owned firms as outlined below.

Table 2
Sales and Receipts by Ethnicity and Race
Survey of Minority-Owned Business Enterprises (1982-1997) and Survey of Business Owners (2002)

		Includes C-Corps	All Firms	Non-Minority Owned Firms	Black-Owned Firms	Hispanic-Owned Firms	Asian and P.I.-Owned Firms	Native Amer./ Nat. Alaskan
Total number of firms	1982	No	12,059,950	11,318,310	308,260	233,975	187,691	13,573
	1987	No	13,695,480	12,481,730	424,165	422,373	355,331	21,380
	1992	No	17,253,143	15,287,578	620,912	862,605	603,426	102,271
	1997	No	18,278,933	15,492,835	780,770	1,121,433	785,480	187,921
	1997	Yes	20,440,415	17,316,796	823,499	1,199,896	912,960	197,300
	2002	Yes	22,480,256	18,326,375	1,197,567	1,573,464	1,132,535	201,387
Total sales and receipts ($1,000)	1982	No	$967,450,721	$932,996,721	$9,619,055	$11,759,133	$12,653,315	$495,000
	1987	No	$1,994,808,000	$1,916,968,057	$19,762,876	$24,731,600	$33,124,326	$911,279
	1992	No	$3,324,200,000	$3,122,188,579	$32,197,361	$76,842,000	$95,713,613	$8,057,003
	1997	No	$4,239,708,305	$3,904,392,106	$42,670,785	$114,430,852	$161,141,634	$22,441,413
	1997	Yes	$8,392,001,261	$7,763,010,611	$71,214,662	$186,274,581	$306,932,982	$34,343,907
	2002	Yes	$8,783,541,146	$8,055,884,659	$88,641,608	$221,927,425	$330,943,036	$26,872,947
Mean sales and receipts	1982	No	$80,220	$82,433	$31,204	$50,258	$67,416	$36,469
	1987	No	$145,654	$153,582	$46,592	$58,554	$93,221	$42,623
	1992	No	$192,672	$204,230	$51,855	$89,081	$158,617	$78,781
	1997	No	$231,945	$252,013	$54,652	$102,040	$205,151	$119,419
	1997	Yes	$410,559	$448,294	$86,478	$155,242	$336,195	$174,069
	2002	Yes	$390,722	$439,579	$74,018	$141,044	$292,214	$133,439

Sources: U.S. Census Bureau, Economic Census, Survey of Minority-Owned Business Enterprises (1982, 1987, 1992, 1997), U.S. Census Bureau, Survey of Business Owners (2002), and special tabulations prepared by the U.S. Census Bureau. Notes: (1) All firms excludes publicly held, foreign-owned, not for profit and other firms, which are not included in the estimates by race. (2) Estimates are not directly comparable over time. (3) The non-minority category is equal to all firms minus all minority firms for 1982, 1987 and 1992, and all white firms minus Latino-owned firms in 2002. (4) The most recently revised estimates are reported when applicable. (5) Native American/Native Alaskan estimates for 2002 do not include American Indian tribal entities making them not directly comparable to 1997.

[17] See Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States*, for more discussion on recent trends in business outcomes by race and ethnicity.

[18] The tables reported here represent a new compilation of data of recent trends in business outcomes by race. The data reported here are taken from government publications and special tabulations prepared for us by U.S. Census Bureau staff (see Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States* for more details). These data, however, experienced several changes in sample criteria and definitions making them not directly comparable over time. Estimates were also revised in many cases by the Census Bureau, and we attempted to find the most recently available data. The 2002 Survey of Business Owners (SBO) contains the most recent data. Preliminary data for the 2007 SBO will be published by the Census in 2010.

Data from the SMOBE and SBO indicate that the number of minority businesses grew rapidly over the past two decades. The growth rates and increases in the number of Asian- and Hispanic-owned businesses are large. Asian-owned businesses grew from 187,691 to more than 1.1 million in 2002, and Hispanic-owned businesses grew from 233,975 in 1982 to 1.6 million in 2002. Likewise, African American-owned businesses grew from 308,260 in 1982 to nearly 1.2 million in 2002. The total number of businesses and the number of non-minority-owned businesses also grew substantially over the period, but at much slower rates. For example, the total number of businesses in the United States grew by 86 percent from 1982 to 2002. On the other hand, growth rates for Asian and Hispanic business were the highest at 503 percent and 572 percent, respectively. The growth rate for African American-owned businesses was also high at 288 percent during the same period. One major factor spurring the rapid growth rates in the number of minority businesses is population growth, especially for Asians and Hispanics. In addition, growth rates are partly due to changes in the sample universe of businesses included in the SMOBE and SBO surveys. Because of sample changes, growth rates for total minority-owned firms may not be comparable over the past two decades.

If we focus on the most recent period available, 1997 to 2002, statistics for the total number of businesses including C corporations indicate rapid growth rates in the number of minority-owned businesses. Minority-owned firms grew in number of firms by 30 percent, from 3 million to 4 million firms during that period.[19] The number of Asian and Hispanic businesses grew by 24.1 percent and 31.1 percent, respectively. The number of African American-owned businesses grew faster, by 45.4 percent, from 1997 to 2002. In contrast, the number of non-minority businesses grew by 5.8 percent from 1997 to 2002. Although data from the CPS indicate slower rates of growth in the number of business owners, these data confirm the finding that the number of minority businesses increased much faster than the number of non-minority businesses over the past two decades.[20]

Total gross receipts for all minority-owned firms were nearly $700 billion in 2002. Native American owned firms grossed $27 billion in receipts. Asian-owned firms had the largest contribution among minority-owned firms at $331 billion. Hispanic-owned firms grossed $222 billion in receipts, and African American-owned firms had total gross receipts of nearly $90 billion.

Total gross receipts grew much faster for minority-owned firms than for non-minority-owned firms, by 12 percent from $591 billion to $661 billion.[21] The growth rate in total gross receipts for Asian-owned firms was 8 percent, and for Hispanic-owned firms 19 percent. African American-owned firms experienced the fastest growth rate in total sales at 24 percent from 1997 to 2002. In contrast to these high growth rates, total gross receipts grew by only 4 percent from 1997 to 2002 for non-minority firms. It is difficult to estimate growth rates for Native American firms because the 2002 data excluded Native American tribal entities more effectively than in 1997 and are therefore not comparable.

Total Employment and Payroll

Minority-owned firms also contribute substantially to greater employment in the U.S. economy. Minority-owned firms employed 4.7 million workers with a total annual payroll of $115 billion in 2002. Among specific groups, Native American firms employed nearly 200,000 paid workers, Asian firms 2.2 million paid workers, Hispanic firms more than 1.5 million paid workers, and African American firms over 750,000 paid workers. Table 3 includes the data.

[19] U.S Department of Commerce, Minority Business Development Agency, *The State of Minority Businesses.*

[20] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

[21] U.S Department of Commerce, Minority Business Development Agency, *The State of Minority Businesses.*

Table 3
Employment Statistics by Ethnicity and Race
Survey of Minority-Owned Business Enterprises (1982-1997) and Survey of Business Owners (2002)

		Includes C-Corps	All Firms	Non-Minority Owned Firms	Black-Owned Firms	Hispanic-Owned Firms	Asian & P.I.-Owned Firms	Native Amer./ Nat. Alaskan
Total number of firms	1982	No	12,059,950	11,318,310	308,260	233,975	187,691	13,573
	1987	No	13,695,480	12,481,730	424,165	422,373	355,331	21,380
	1992	No	17,253,143	15,287,578	620,912	862,605	603,426	102,271
	1997	No	18,278,933	15,492,835	780,770	1,121,433	785,480	187,921
	1997	Yes	20,440,415	17,316,796	823,499	1,199,896	912,960	197,300
	2002	Yes	22,480,256	18,326,375	1,197,567	1,573,464	1,132,535	201,387
Total number of employees	1982	No	N/A	N/A	121,373	154,791	N/A	N/A
	1967	No	19,853,333	19,016,850	220,467	264,846	351,345	8,956
	1992	No	27,403,974	25,531,104	345,193	691,056	N/A	N/A
	1997	No	29,703,946	27,122,185	378,346	838,738	1,224,733	202,535
	1997	Yes	58,901,412	54,084,357	718,341	1,388,746	2,203,079	298,661
	2002	Yes	55,368,216	50,429,209	753,978	1,536,795	2,243,267	191,270
Mean number of paid employees	1982	No	N/A	N/A	0.4	0.7	N/A	N/A
	1987	No	1.4	1.5	0.5	0.6	1.0	0.4
	1992	No	1.6	1.7	0.6	0.8	N/A	N/A
	1997	No	1.8	1.8	0.5	0.7	1.6	1.1
	1997	Yes	2.9	3.1	0.9	1.2	2.4	1.5
	2002	Yes	2.5	2.8	0.6	1.0	2.0	0.9

Sources: U.S. Census Bureau, Economic Census, Survey of Minority-Owned Business Enterprises (1982, 1987, 1992, 1997), U.S. Census Bureau, Survey of Business Owners (2002), and special tabulations prepared by the U.S. Census Bureau. Notes: (1) All firms excludes publicly held, foreign-owned, not for profit and other firms, which are not included in the estimates by race. (2) Estimates are not directly comparable over time. (3) The non-minority category is equal to all firms minus all minority firms for 1982, 1987 and 1992, and all white firms minus Latino-owned firms in 2002. (4) The most recently revised estimates are reported when applicable. (5) Native American/Native Alaskan estimates for 2002 do not include American Indian tribal entities making them not directly comparable to 1997.

Even more striking from the results reported in Table 3, however, are the relative patterns of employment growth. Total employment grew by 11 percent among Hispanic owned firms from 1997 to 2002, and by 5 percent among African American owned firms. For all minority-owned firms, employment increased by 4 percent between 1997 and 2002.[22] In contrast, total employment actually declined by 7 percent among non-minority firms from 1997 to 2002. *If not for employment growth among minority-owned firms over this period the loss in total employment would have been even larger: an additional 160,000 jobs would have been lost.*[23]

Minority-owned firms make major contributions to the total payroll of firms in the United States (see Table 4). Native American firms paid their employees a total of $5 billion in wages and salaries in 2002, Asian-owned firms paid their employees a total of $57 billion. Hispanic-owned firms had a total annual payroll of $37 billion, and African American-owned firms paid their employees a total of $18 billion. Total payrolls have been growing much faster among minority-owned firms than among non-minority firms. Asian-, Hispanic- and African American-owned businesses combined experienced an increase in total payroll of 23 percent from 1997 to 2002. The rate of growth in the total payroll among non-minority businesses was 8 percent.

[22] U.S. Department of Commerce, Minority Business Development Agency, *Characteristics of Minority Businesses and Entrepreneurs* (2008).
[23] Ibid.

Table 4
Employment Statistics by Ethnicity and Race for Employer Firms Only
Survey of Minority-Owned Business Enterprises (1992-1997) and Survey of Business Owners (2002)

		Includes C-Corps	All Firms	Non-Minority Owned Firms	Black-Owned Firms	Hispanic-Owned Firms	Asian & P.I.-Owned Firms	Native Amer./ Nat. Alaskan
Total number of employer firms	1982	No	N/A	N/A	37,841	39,272	N/A	N/A
	1987	No	3,487,454	3,239,305	70,815	82,908	92,718	3,739
	1992	No	3,134,959	2,823,264	64,478	115,364	N/A	N/A
	1997	No	3,277,510	2,860,580	63,010	151,571	185,357	26,075
	1997	Yes	5,027,208	4,372,817	93,235	211,884	289,999	33,277
	2002	Yes	5,172,064	4,512,577	94,518	199,542	323,161	24,498
Total annual payroll for employer firms ($1,000,000)	1982	No	N/A	N/A	$948	$1,240	N/A	N/A
	1987	No	$299,176	$289,667	$2,761	$3,243	$3,502	$109
	1992	No	$523,574	$495,037	$4,807	$10,768	N/A	N/A
	1997	No	$675,452	$628,500	$6,532	$15,391	$21,620	$4,108
	1997	Yes	$1,499,298	$1,395,150	$14,322	$29,830	$46,180	$6,624
	2002	Yes	$1,626,785	$1,504,917	$17,550	$36,712	$56,871	$5,135
Mean annual payroll for employer firms	1982	No	N/A	N/A	$25,055	$31,573	N/A	N/A
	1987	No	$85,786	$89,423	$38,990	$39,120	$37,770	$29,225
	1992	No	$167,011	$175,342	$74,547	$93,340	N/A	N/A
	1997	No	$206,087	$219,711	$103,673	$101,540	$116,642	$157,543
	1997	Yes	$298,237	$319,051	$153,615	$140,785	$159,240	$199,063
	2002	Yes	$314,533	$333,494	$185,680	$183,980	$175,984	$209,620
Payroll per employee for employer firms	1982	No	N/A	N/A	$7,812	$8,010	N/A	N/A
	1987	No	$15,069	$15,232	$12,524	$12,246	$9,967	$12,201
	1992	No	$19,106	$19,390	$13,924	$15,582	N/A	N/A
	1997	No	$22,739	$23,173	$17,266	$18,350	$17,653	$20,283
	1997	Yes	$25,454	$25,796	$19,938	$21,480	$20,961	$22,180
	2002	Yes	$29,381	$29,842	$23,277	$23,888	$25,352	$26,848

Sources: U.S. Census Bureau, Economic Census, Survey of Minority-Owned Business Enterprisas (1982, 1987, 1992, 1997), U.S. Census Bureau, Survey of Business Owners (2002), and special tabulations prepared by the U.S. Census Bureau. Notes: (1) All firms excludes publicly held, foreign-owned, not for profit and other firms, which are not included in the estimates by race. (2) Estimates are not directly comparable over time. (3) The non-minority category is equal to all firms minus all minority firms for 1982, 1987 and 1992, and all white firms minus Latino-owned firms in 2002. (4) The most recently revised estimates are reported when applicable. (5) Native American/Native Alaskan estimates for 2002 do not include American Indian tribal entities making them not directly comparable to 1997.

Minority-owned firms clearly make an important contribution to the U.S. economy as measured by total gross receipts, employment and total payroll. As discussed before, MBEs had total annual gross receipts of $661 billion, employed 4.7 million workers and paid them $115 billion in wages and salaries in 2002. *More importantly, however, minority-owned firms have far outpaced non-minority firms in terms of growth rates in the number of businesses, total gross receipts, number of employees, and total annual payroll.* In short, minority businesses continue to be a substantial part of the U.S. business force with the ability to do more.

Average Firm Performance

Minority-owned businesses contribute greatly to the U.S. economy, but there is sizeable untapped potential among these firms. *Although the growth in number of firms, gross receipts and employees of minority firms far outpaces that of non-minority firms, minority-owned firms are smaller on average than non-minority-owned firms in size of gross receipts, employment, and payrolls.* Tables 2-4 report estimates of average gross receipts, employment and payroll, respectively. We now briefly discuss these patterns.[24]

Minority-owned firms have lower average gross receipts per firm than non-minority-owned firms. In 2002, average gross receipts for minority-owned firms were about $167,000 per firm, compared to $439,000 for non-minority firms. Native American firms had average gross receipts of $133,439, about 30 percent of the average receipts of non-minority firms. Asian-owned firms also had lower average gross

[24] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

receipts than non-minority firms, but the difference is much smaller. Average annual gross receipts were $292,214 for Asian-owned businesses. But, for some groups included in the Asian category, average sales were much lower. Filipino-owned firms had average receipts of $113,110, Vietnamese-owned firms had average receipts of $105,501, and Native Hawaiian and Pacific Islander owned firms had average receipts of $147,837.[25]

Hispanic firms also had lower average gross receipts than non-minority firms. Average gross receipts of Hispanic firms were $141,044 in 2002.[26] Finally, African American-owned firms had the lowest average gross receipts among all reported groups at $74,018 per firm. These ethnic and racial disparities have also existed throughout the past two decades and trends in average gross receipts do not indicate recent improvements.

Data from the SBO and SMOBE also indicate that minority-owned firms employed fewer workers on average than non-minority firms. Levels of employment among Native American-, Hispanic-, and African American-owned firms are especially low. Native-American firms averaged 0.9 employees per firm. Asian, Native Hawaiian and Pacific Islander firms averaged 2 employees, Hispanic-owned firms averaged 1 employee, and African American-owned firms averaged 0.6 employees. In comparison, non-minority firms had a mean employment level of 2.8.

If we compare the average number of employees among employer firms the differences in employment between minority and non-minority firms are smaller. In 2002 minority-owned firms had on average 7.4 employees per employer firm, compared to 11.2 employees for non-minority firms.[27] Native American firms averaged 7.8 employees, Asian firms averaged 6.9 employees, Native Hawaiian and Pacific Islander averaged 7.9 employees, Hispanic-owned firms averaged 7.7 employees, and African American-owned firms averaged 8 employees.[28]

Conditioning on employment, racial patterns differ somewhat, and there is evidence that minority employer firms have gained some ground on non-minority employer firms. Table 4 reports estimates of mean annual payroll and payroll per employee by race for the subsample of employer firms. Minority employer firms have made gains relative to non-minority employer firms in recent years, although all four minority groups had lower average payrolls and payrolls per employee than non-minority employer firms. In 2002, all four minority groups had average payrolls that were roughly equal to or less than $200,000 compared with an average payroll of $333,494 among non-minority firms. Much of the difference is due to the number of paid employees. The average payroll per employee was not substantially higher among non-minority employer firms. Payroll per employee was $29,842 for non-minority employer firms compared with $26,848 for Native-American employer firms, $25,352 for Asian employer firms, $23,888 for Hispanic employer firms, and $23,277 for African American employer firms. *Minority-owned firms are employing workers at similar wages as non-minority firms, and are the backbone of many minority communities across the nation.*

[25] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

[26] Black and Hispanic firms are also found to be overrepresented at the bottom of the sales distribution and underrepresented at the top of the sales distribution compared to non-minority firms (Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States*). This finding indicates that higher average sales among non-minority-owned businesses are not being driven by a few businesses with very high revenues.

[27] U.S. Department of Commerce, Minority Business Development Agency, *Characteristics of Minority Businesses and Entrepreneurs.*

[28] Ibid.

The new compilation of Census Bureau data reported here and described more thoroughly in a recent publication[29] indicates that although minority firms make large contributions to the U.S. economy they have not achieved parity with non-minority firms. *Minority firms have made progress, but continue to have lower average gross receipts, employment, and total payroll than non-minority firms.* Under economic parity conditions, minority firms would have grossed about $2.5 trillion in receipts and employed 16.1 million workers.[30]

[29] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*
[30] U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises, An Overview of the 2002 Survey of Business Owners, Number of Firms, Gross Receipts, and Paid Employees.*

Previous Research on Constraints Faced by Minority-Owned Businesses

What are the barriers faced by minority-owned businesses limiting business ownership and performance? This section reviews previous studies exploring these constraints. We emphasize the role of financial constraints because of their importance.

Financial Capital Constraints

Financial constraints are the most significant issue affecting minority business ownership and business performance. The importance of personal wealth as a determinant of entrepreneurship has been the focus of an extensive body of literature. Numerous studies using various methodologies, measures of wealth and country microdata explore the relationship between wealth and entrepreneurship. Most studies find that asset levels (e.g. net worth) measured in one year increase the probability of starting a business by the following year.[31] The finding has generally been interpreted as providing evidence that entrepreneurs face liquidity constraints.

Do inequalities in personal wealth then translate into disparities in business creation and ownership? To get an idea of the importance of access to financial capital in contributing to racial disparities in business ownership, one only has to look at the alarming levels of wealth inequality existing in the United States. Estimates from the U.S. Census Bureau[32] indicate that half of all Hispanic families have less than $7,950 in wealth, and half of all African American families less than $5,446. Wealth levels among whites are 11 to 16 times higher. *Low levels of wealth and liquidity constraints create a substantial barrier to entry for minority entrepreneurs because the owner's wealth can be invested directly in the business, used as collateral to obtain business loans or used to acquire other businesses.* Investors frequently require a substantial level of owner's investment of his/her own capital as an incentive, commonly referred as "skin in the game."

[31] David S. Evans and Boyan Jovanovic, "An Estimated Model of Entrepreneurial Choice under Liquidity Constraints," *Journal of Political Economy 97*, no. 4 (1989): 808-827. David S. Evans and Linda S. Leighton, "Some Empirical Aspects of Entrepreneurship," *American Economic Review 79* (June 1989): 519-535. Bruce Meyer, "Why Are There So Few Black Entrepreneurs?" National Bureau of Economic Research, Working Paper No. 3537 (1990). Douglas Holtz-Eakin, David Joulfaian, and Harvey S. Rosen, "Entrepreneurial Decisions and Liquidity Constraints," *RAND Journal of Economics 25*, no. 2 (1994): 334-347. Thomas Lindh and Henry Ohlsson, "Self-Employment and Windfall Gains: Evidence from the Swedish Lottery," *Economic Journal* 106, no. 439 (1996): 1515-1526. Jane Black, David de Meza, and David Jeffreys, "House Prices, The Supply of Collateral and the Enterprise Economy," *The Economic Journal* 106, no. 434 (1996): 60-75. David G. Blanchflower and Andrew J. Oswald, "What Makes and Entrepreneur?" *Journal of Labor Economics* 16, no. 1 (1998): 26-60. Thomas A. Dunn and Douglas J. Holtz-Eakin, "Financial Capital, Human Capital, and the Transition to Self-Employment: Evidence from Intergenerational Links," *Journal of Labor Economics* 18, no. 2 (2000): 282-305. Robert W. Fairlie, "The Absence of the African American Owned Business: An Analysis of the Dynamics of Self-Employment," *Journal of Labor Economics* 17, no. 1 (1999): 80-108. John S. Earle and Zuzana Sakova, "Business Start-Ups or Disguised Unemployment? Evidence on the Character of Self-Employment from Transition Economies," *Labour Economics* 7, no. 5 (2000): 575–601. Edvard Johansson, "Self-Employment and Liquidity Constraints: Evidence from Finland," *Scandinavian Journal of Economics* 102, no. 1 (2000): 123-134. Mark P. Taylor, "Self-Employment and Windfall Gains in Britain: Evidence from Panel Data," *Economica* 68, no. 272 (2001): 539-565. Douglas Holtz-Eakin and Harvey S. Rosen, "Cash Constraints and Business Start-Ups: Deutschmarks versus Dollars," *Contributions to Economic Analysis & Policy* 4, no. 1 (2005). Robert W. Fairlie and Harry A. Krashinsky, "Liquidity Constraints, Household Wealth, and Entrepreneurship Revisited," Working Paper (2008).

[32] U.S. Census Bureau, *Wealth and Asset Ownership*, 2008 (accessed July 2009); available from http://www.census.gov/hhes/www/wealth/2002/wlth02-1.html.

Table 5
Median Household Net Worth by Ethnicity/Race, 2002

	Median Net Worth
Total	$58,905
Non-minority	$87,056
Asian or Pac. Islander	$59,292
Hispanic	$7,950
African-American	$5,446

Source: U.S. Census Bureau, Housing and Household Economic Statistics Division (2008).

Racial differences in home equity may be especially important in providing access to startup capital. Less than half of Hispanics and African Americans own their own home compared with three quarters of non-minorities. Asian Americans also have a low rate of home ownership at 57 percent.[33] The median equity of Hispanic and African American home owners is also substantially lower than for non-minorities ($49,000 for Hispanics, $40,000 for blacks, and $79,200 for whites). Homes provide collateral and home equity loans provide relatively low-cost financing. Without the ability to tap into this equity many minorities will not be able to start businesses.

Previous studies found that relatively low levels of wealth among Hispanics and African Americans contribute to their lower business creation rates relative to their representation in the U.S. population. Indeed, recent research using statistical decomposition techniques provides evidence supporting this hypothesis. Using matched CPS Annual Demographic Files (ADF) data from 1998 to 2003, Robert Fairlie found that *the largest single factor explaining racial disparities in business creation rates are differences in asset levels.*[34] Lower levels of assets among African Americans account for 15.5 percent of the difference between the rates of business creation among whites and blacks. This finding is consistent with the presence of liquidity constraints and low levels of assets limiting opportunities for African Americans to start businesses. The finding is very similar to estimates reported by Fairlie in a 1999 study[35] for men using the Panel Study of Income Dynamics (PSID). Estimates from the PSID indicate that 13.9 to 15.2 percent of the black/white gap in business start rates can be explained by differences in assets.

Fairlie also found that differences in asset levels represented a major hindrance for business creation among Hispanics.[36] Fairlie and Christopher Woodruff focused on the causes of low rates of business formation among Mexican Americans in particular.[37] One of the most important factors in explaining the gaps in rates of business creation between Mexican Americans and non-Hispanic whites is also assets. Relatively low levels of assets explain roughly one quarter of the business entry rate gap for Mexican Americans. Magnus Lofstrom and Chumbei Wang analyzed SIPP data and also found that low levels of wealth for Mexican Americans and other Latinos work to lower self-employment entry rates.[38] Apparently, low levels of personal wealth limit opportunities for Mexican Americans and other Latinos to start businesses.

[33] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States*, and U.S. Census Bureau, *Wealth and Asset Ownership*, 2008 (accessed July 2009); available from http://www.census.gov/hhes/www/wealth/2002/wlth02-2.html.
[34] Robert W. Fairlie, "Entrepreneurship among Disadvantaged Groups: An Analysis of the Dynamics of Self-Employment by Gender, Race and Education," in *The Life Cycle of Entrepreneurial Ventures, International Handbook Series on Entrepreneurship*, ed. Simon Parker (New York: Springer, 2006).
[35] Fairlie, "The Absence of the African American Owned Business: An Analysis of the Dynamics of Self-Employment."
[36] Robert W. Fairlie, "Entrepreneurship among Disadvantaged Groups: An Analysis of the Dynamics of Self-Employment by Gender, Race and Education."
[37] Robert W. Fairlie and Christopher Woodruff, "Mexican-American Entrepreneurship," University of California Working Paper (2009).
[38] Magnus Lofstrom and Chunbei Wang, "Hispanic Self-Employment: A Dynamic Analysis of Business Ownership," University of Texas at Dallas Working Paper (2006).

Although previous research indicates that low levels of personal wealth result in lower rates of business creation among minorities, less research has focused on the related question of whether low levels of personal wealth and liquidity constraints also limit the ability of minority entrepreneurs to raise adequate levels of startup capital. Undercapitalized businesses will likely have lower sales, profits and employment and will be more likely to fail than businesses receiving optimal levels of startup capital. Evidence on the link between startup capital and owner's wealth is provided by examining the relationship between business loans and personal commitments, such as using personal assets for collateral for business liabilities and guarantees that make owners personally liable for business debts. Robert B. Avery, Raphael W. Bostic and Katherine A. Samolyk[39] used data from the SSBF and Survey of Consumer Finances (SCF) and found that the majority of all small business loans have personal commitments. The common use of personal commitments to obtain business loans suggests that wealthier entrepreneurs may be able to negotiate better credit terms and obtain larger loans for their new businesses possibly leading to more successful firms.[40] Ken Cavalluzzo and John Wolken also found in their study[41] that personal wealth, primarily through home ownership, decreases the probability of loan denials among existing business owners. If personal wealth is important for existing business owners in acquiring business loans then it may be even more important for entrepreneurs in acquiring startup loans.

Estimates from the 1992 CBO microdata indicate that Hispanic- and African American-owned businesses have very low levels of startup capital relative to non-Hispanic white-owned businesses.[42] For example, less than 2 percent of African American firms start with $100,000 or more of capital and 6.5 percent have between $25,000 and $100,000 in startup capital. Hispanic firms also have low levels of startup capital although the disparities are not as large. African American-owned firms are also found to have lower levels of startup capital across all major industries.[43] What are the consequences of these racial disparities in startup capital? Previous research indicates that the level of startup capital is a strong predictor of business success.[44] In turn, low levels of startup capital are found to be a major cause of worse outcomes among African American-owned businesses. Using earlier CBO data in his 1997 study, Timothy Bates found evidence that racial differences in business outcomes are associated with disparities in startup capital.[45] *More recent estimates indicate that lower levels of startup capital among African American firms are the most important explanation for why African American-owned businesses have lower survivor rates, profits, employment and sales than non-minority-owned businesses.*[46] *In contrast to these patterns, Asian firms are found to have higher startup capital levels and resulting business outcomes.*[47]

[39] Robert B. Avery, Raphael W. Bostic, and Katherine A. Samolyk, "The Role of Personal Wealth in Small Business Finance," *Journal of Banking and Finance* 22, no. 6 (1998): 1019-1061.

[40] Astebro and Berhardt (2003) found a positive relationship between business survival and having a bank loan at startup after controlling for owner and business characteristics.

[41] Ken Cavalluzzo and John Wolken, "Small Business Loan Turndowns, Personal Wealth and Discrimination," *Journal of Business* 78, no. 6 (2005): 2153-2177.

[42] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners.* Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

[43] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners.*

[44] Timothy Bates, Race, *Self-Employment & Upward Mobility: An Illusive American Dream* (Washington, D.C.: Woodrow Wilson Center Press and Baltimore: John Hopkins University Press, 1997), and Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States*, provide two recent examples.

[45] Bates, *Race, Self-Employment & Upward Mobility: An Illusive American Dream.*

[46] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

[47] Ibid.

Minority and non-minority entrepreneurs differ in the types of financing they use for their businesses. Previous research indicates, for example, that African American entrepreneurs rely less on banks than whites for startup capital.[48] African Americans are also less likely to use a home equity line for startup capital than are whites, which may be partly due to the lower rates of home ownership reported above. On the other hand, African American business owners are more likely to rely on credit cards for startup funds than are white business owners. In a few studies using the 1987 CBO, Bates[49] found large differences between African American and white-owned firms in their use of startup capital. African American firms were found to be more likely to start with no capital, less likely to borrow startup capital and more likely to rely solely on equity capital than white firms. Bates[50] also found that loans received by African American firms borrowing startup capital are significantly smaller than those received by white-owned firms even after controlling for equity capital and owner and business characteristics such as education and industry. Previous research also indicates that MBEs are more likely to use credit cards and less likely to use bank loans to start their businesses than non-minority-owned businesses.[51]

Additional evidence on racial differences in access to financial capital is provided by published estimates from the CBO.[52] The CBO questionnaire asks owners with unsuccessful businesses from 1992 to 1996 why their businesses were unsuccessful. African American business owners were two to three times more likely as all business owners to report "lack of access to business loans/credit" or "lack of access to personal loans/credit" as a reason for closure. Hispanic business owners were also more likely to report that lack of access to financial capital was a reason for closure.

Minority firms also have trouble securing funds from venture capitalists and angel investors. Private equity funds targeting minority markets are very small relative to the total, which is problematic because these funds appear to be important for success.[53] Minority angels comprise 3.6 percent of all angel investors, and MBEs comprise 3.7 percent of firms presenting their business ideas to potential angel investors.[54] The disparity in access to venture capital funds does not appear to be driven by performance differences. Bates and William D. Bradford[55] examined the performance of investments made by venture capital funds specializing in minority firms and found that these funds produce large returns. *Venture capital funds focusing on investing in minority firms provide returns that are comparable to mainstream venture capital firms.* Funds investing in minority businesses may provide attractive returns because the market is underserved.

---

[48] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners.*

[49] Bates, Race, *Self-Employment & Upward Mobility: An Illusive American Dream.* Timothy Bates, "Financing Disadvantaged Firms." *Credit Markets for the Poor*, eds. Patrick Bolton and Howard Rosenthal. (New York: Russell Sage Foundation, 2005).

[50] Bates, *Race, Self-Employment & Upward Mobility: An Illusive American Dream.*

[51] U.S. Department of Commerce, Minority Business Development Agency, *Characteristics of Minority Businesses and Entrepreneurs.*

[52] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners.*

[53] Milken Institute and the Minority Business Development Agency, *The Minority Business Challenge: Democratizing Capital for Emerging Domestic Markets,* Glenn Yago and Aaron Pankrat (2000).

[54] Jeffrey Sohl, "The Angel Investor Market in 2008: A Down Year In Investment Dollars But Not In Deals," Center for Venture Research, 2008 (accessed July 17, 2009); available from http://wsbe.unh.edu/files/2008_Analysis_Report_Final.pdf.

[55] Timothy Bates and William D. Bradford, "Venture-Capital Investment in Minority Business," *Journal of Money Credit and Banking* 40, no. 2-3 (2008): 489-504.

Evidence of Lending Discrimination

A factor posing a barrier to obtaining financial capital for minority-owned businesses is racial discrimination in lending practices. Much of the recent research on the issue of discrimination in business lending uses data from various years of the Survey of Small Business Finances (SSBF). The main finding from this literature is that MBEs experience higher loan denial probabilities and pay higher interest rates than white-owned businesses even after controlling for differences in credit-worthiness, and other factors.[56]

Cavalluzzo and Wolken[57] found in their study using the 1998 SSBF that *while greater personal wealth is associated with a lower probability of denial, even after controlling for personal wealth, there remained a large difference in denial rates across demographic groups.* African Americans, Hispanics, and Asians were all more likely to be denied credit, compared with whites, even after controlling for a number of owner and firm characteristics, including credit history, credit score, and wealth. They also found that Hispanics and African Americans were more likely to pay higher interest rates on loans that were obtained. They also found that denial rates for African Americans increased with lender market concentration, a finding consistent with G. Becker's classic theories of discrimination.[58] Using the 2003 SSBF, Blanchflower (2007)[59] also found Asian Americans, Hispanics and African Americans were more likely than whites to be denied credit, even after controlling for creditworthiness and other factors.

Using the 1993 National Survey of Small Business Finances (NSSBF), Cavalluzzo, Linda Cavalluzzo, and Wolken[60] found that all minority groups were more likely than whites to have unmet credit needs. African Americans were more likely to have been denied credit, even after controlling for many factors related to creditworthiness. In fact, denial rates and unmet credit needs for African Americans widened with an increase in lender market concentration. The fear of denial often prevented some individuals from applying for a loan, even when they had credit needs. Hispanics and African Americans most notably had these fears. David G. Blanchflower, P. Levine, and D. Zimmerman conducted a similar analysis with similar results, but did not have access to some of the proprietary information available to researchers from the Federal Reserve. However, they did find that African American-owned businesses were more likely to have a loan application denied, even after controlling for differences in creditworthiness, and that African Americans paid a higher interest rate on loans obtained. They also found that concerns over whether a loan application would be denied prevented some prospective borrowers from applying for a loan in the first place. The disparities between the denial rates between whites and African Americans grew when taking these individuals into consideration along with those that actually applied for a loan. R. Bostic and K. P. Lampani[61] include additional geographic controls and continue to find a statistically significant difference in approval rates between African Americans and whites.

[56] Lloyd Blanchard, John Yinger and Bo Zhao, "Do Credit Market Barriers Exist for Minority and Women Entrepreneurs?" Syracuse University Working Paper (2004). Blanchflower, Levine, and Zimmerman. Cavalluzzo, Cavalluzzo, and Wolken. Cavalluzzo and Wolken. Susan Coleman, "The Borrowing Experience of Black and Hispanic-Owned Small Firms: Evidence from the 1998 Survey of Small Business Finances," *The Academy of Entrepreneurship Journal 8*, no. 1 (2002): 1-20. Susan Coleman, "Borrowing Patterns for Small Firms: A Comparison by Race and Ethnicity." *The Journal of Entrepreneurial Finance & Business Ventures 7*, no. 3 (2003): 87-108. United States Small Business Administration, Office of Advocacy, *Availability of Financing to Small Firms using the Survey of Small Business Finances*, K. Mitchell and D.K. Pearce, (2005).
[57] Cavalluzzo and Wolken.
[58] G. Becker, *The Economics of Discrimination*, 2nd ed. (Chicago: University of Chicago Press, 1971).
[59] David G. Blanchflower, "Entrepreneurship in the United States," IZA Working Paper No. 3130 (2007).
[60] Cavalluzzo, Cavalluzzo, and Wolken.
[61] R. Bostic and K.P. Lampani, "Racial Differences in Patterns of Small Business Finance: The Importance of Local Geography," Working Paper (1999).

Other Types of Discrimination

Discrimination against minority businesses may occur before these businesses are even created. Previous research indicates that minorities have limited opportunities to penetrate networks, such as those in construction.[62] If minorities cannot acquire valuable work experience in these industries then it will limit their ability to start and operate successful businesses. There is also evidence in the literature indicating consumer discrimination against minority-owned firms. Minority firms may have difficulty selling certain products and services to non-minority customers limiting the size of their markets and resulting success. According to a study of microdata from the 1980 Census,[63] African Americans negatively select into self-employment, with the most able African Americans remaining in the wage/salary sector, whereas whites positively select into self-employment and negatively select into wage/salary work. These findings are consistent with discrimination by white consumers. Among African Americans low earners are the most likely to enter into business ownership, whereas both low and higher earning whites are the most likely to enter self-employment.[64] He notes that this finding is consistent with the theoretical predictions of consumer and credit market discrimination against African Americans.

More generally, minority-owned firms may face limited market access for the goods and services that they produce.[65] This may be partly due to consumer discrimination by customers, other firms, or redlining. But, it may also be due to the types, scale and locations of minority firms. Published estimates from the CBO[66] indicate that African American-, Hispanic-, and other minority-owned businesses are all more likely to serve a local market than the average for all U.S. firms. Minority firms are more likely than white firms to report that their neighborhood is the geographic area that best describes where the business's goods and services are sold. Furthermore, minority-owned businesses are much more likely to sell to a minority clientele than are white businesses, which may reflect more limited market access.

Human Capital Barriers

Education has also been found in the literature to be a major determinant of business ownership.[67] Lower levels of education obtained by Hispanics and African Americans partly limit their business ownership rates.[68] According to an analysis of CPS data by Fairlie,[69] 6.0 percent of the black/white gap in self-employment entry rates is explained by racial differences in education levels. Similar estimates from the PSID are reported in another study.[70] Mexican Americans have even lower levels of education than African Americans, which translate into a limiting factor for business creation. Estimates from the CPS indicate that education differences account for 32.8 to 37.9 percent of the entry rate gap for Mexican

[62] Timothy Bates, *Banking on Black Enterprise* (Washington, D.C.: Joint Center for Political and Economic Studies, 1993). Joe R. Feagin and Nikitah Imani, "Racial Barriers to African American Entrepreneurship: An Exploratory Study," *Social Problems* 41, no. 4 (1994): 562-585. Timothy Bates and David Howell, "The Declining Status of African American Men in the New York City Construction Industry," *Race, Markets, and Social Outcomes*, eds. Patrick Mason and Rhonda Williams (Boston: Kluwer, 1997).

[63] George Borjas and Stephen Bronars, "Consumer Discrimination and Self-Employment," *Journal of Political Economy* 97, no. 3 (1989): 581-605.

[64] Daiji Kawaguchi, "Negative Self Selection into Self-Employment among African Americans," *Topics in Economic Analysis & Policy* 5, no. 1 (2005): 1-25.

[65] Bates, *Race, Self-Employment & Upward Mobility: An illusive American Dream.*

[66] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners.*

[67] J. van der Sluis, M. van Praag and W. Vijverberg, *Education and Entrepreneurship in Industrialized Countries: A Meta-Analysis*, Tinbergen Institute Working Paper no. TI 03–046/3 (Amsterdam: Tinbergen Institute, 2004). Simon C. Parker, *The Economics of Self-Employment and Entrepreneurship* (Cambridge: Cambridge University Press, 2004). U.S. Small Business Administration, Office of Advocacy, *Educational Attainment and Other Characteristics of the Self-Employed: An Examination Using the Panel Study of Income Dynamics Data*, C. Moutray, Working Paper (2007).

[68] Minority business owners are found to be less likely to use technology which may be related to lower levels of human capital, U.S. Department of Commerce, Economic Statistics Administration and the Minority Business Development Agency.

[69] Fairlie, *Entrepreneurship among Disadvantaged Groups: An Analysis of the Dynamics of Self-Employment by Gender, Race and Education.*

[70] Fairlie, "The Absence of the African American Owned Business: An Analysis of the Dynamics of Self-Employment."

Americans.[71] Education is important in explaining differences in business creation rates between Mexican Americans and whites, as well as the types of businesses entrepreneurs are likely to pursue. [72] The high rate of business ownership by Asians is in part due to their relatively high levels of education.[73] These results, however, are for all Asians and some groups are less educated. Fairlie, Zissimopoulos, and Krashinsky find, for example, that Vietnamese immigrants have lower levels of education than the national average.[74]

Previous research indicates an even stronger relationship between the education level of the owner and business performance. Businesses with highly educated owners have higher sales, profits, survival rates, and hire more employees than businesses with less-educated owners.[75] The general and specific knowledge and skills acquired through formal education may be useful for running a successful business and the owner's level of education may also serve as a proxy for his/her overall ability or as a positive signal to potential customers, lenders or other businesses. The estimated relationships between owner's education and small business outcomes are strong even after controlling for family business background measures, startup capital levels and industries.

Lower levels of education may be challenging the business performance of some minority entrepreneurs, such as Hispanics and African Americans.[76] Mexican American business owners have lower incomes than non-Hispanic white business owners, and most of the difference is due to low levels of education among Mexican American owners.[77] Mexican American business owners, especially immigrants, have substantially lower levels of education. The single largest factor in explaining why Mexican immigrants and U.S. bom Mexican Americans have lower business income than whites is education. Lower levels of education account for more than half of the gaps in business income.

Another measure of human capital relevant for Hispanics is language ability. Limited English language ability may make it difficult to communicate with potential customers and suppliers, and learn about regulations. Previous studies provide some evidence that a better command of the English language is associated with higher business ownership rates.[78] But, the evidence linking language ability to business performance is even stronger. Fairlie and Woodruff found that one of the most important factors explaining low business incomes among Mexican American businesses is language ability. For Mexican immigrant men, limited ability to speak English explains roughly one third of the gap in business income.

---

[71] Fairlie and Woodruff.

[72] Lofstrom and Wang.

[73] Fairlie, *Entrepreneurship among Disadvantaged Groups: An Analysis of the Dynamics of Self-Employment by Gender, Race and Education.*

[74] Robert W. Fairlie, Julie Zissimopoulos, and Harry Krashinsky, "The International Asian Business Success Story? A Comparison of Chinese, Indian and Other Asian Businesses in the United States, Canada and United Kingdom," in *International Differences in Entrepreneurship*, eds. Joshua Lerner and Antoinette Schoar (forthcoming), (accessed October 2009); available from http://www.nber.org/chapters/c8221.pdf.

[75] Bates, *Race, Self-Employment & Upward Mobility: An Illusive American Dream.* U.S. Department of Commerce, Economic Statistics Administration and the Minority Business Development Agency. Astebro Thomas and Irwin Bernhardt, "Start-Up Financing, Owner Characteristics and Survival," *Journal of Economics and Business 55*, no. 4 (2003): 303-320. Alicia Robb, *The Role of Race, Gender, and Discrimination in Business Survival*, Doctoral Dissertation, (Ann Arbor: University of Michigan Press, 2000). van der Sluis, van Praag, and Vijverberg.

[76] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

[77] Fairlie and Woodruff. Magnus Lofstrom, and Timothy Bates, "Latina Entrepreneurs," *Small Business Economics* (2009) (forthcoming).

[78] Robert W. Fairlie and Bruce D. Meyer, "Ethnic and Racial Self-Employment Differences and Possible Explanations," *Journal of Human Resources 31*, no. 4 (1996): 757-793. Fairlie and Woodruff.

Family Business Background and Social Capital

Research also indicates that the probability of self-employment is substantially higher among the children of the self-employed.[79] These studies generally find that an individual who had a self-employed parent is roughly two to three times as likely to be self-employed as someone who did not have a self-employed parent. There is evidence that this strong intergenerational link in business ownership is detrimental to disadvantaged minorities. In a study by Michael Hout and Harvey S. Rosen[80] they note a "triple disadvantage" faced by African American men in terms of business ownership. They are less likely than white men to have self-employed fathers, to become self-employed if their fathers were not self-employed, and to follow their father in self-employment. Another study[81] provides evidence from the PSID that current racial patterns of self-employment are in part determined by racial patterns of self-employment in the previous generation.

Recent research indicates that family business backgrounds are also extremely important for the success of businesses.[82] More than half of all business owners had a self-employed family member prior to starting their business with many of these business owners working in those family businesses. Working in a family business leads to more successful businesses. Business outcomes are 15 to 27 percent better if the owner worked in a family business prior to starting his or her own business even after controlling for other factors. African American business owners have a relatively disadvantaged family business background compared with white business owners. African American business owners are much less likely than white business owners to have had a self-employed family member prior to starting their businesses and are less likely to have worked in that family member's business. Only 12.6 percent of African American business owners had prior work experience in a family member's business compared with 23.3 percent of white business owners. Hispanic business owners are also less likely to have self-employed parents and work in family businesses than non-minority business owners.[83] This lack of prior work experience in family businesses among future minority business owners, perhaps by restricting their acquisition of general and specific business human capital, limits the success of their businesses relative to whites. This creates a cycle of low rates of business ownership and relatively worse business outcomes being passed from one generation of minorities to the next.[84]

Related to the family business background constraint, previous research also indicates that the size and composition of social networks are associated with self-employment.[85] If minority firms have limited access to business, social or family networks or have smaller networks then they may be less likely to enter business and create successful businesses. These networks may be especially important in providing financing, customers, technical assistance, role models, and contracts, but it is difficult to identify their contributions to racial differences in business performance.[86] Limited networks manifest themselves in

[79] Bernard Lentz and David Laband, "Entrepreneurial Success and Occupational Inheritance among Proprietors," *Canadian Journal of Economics 23*, no. 3 (1999): 563-579. Fairlie, "The Absence of the African American Owned Business: An Analysis of the Dynamics of Self-Employment." Thomas A. Dunn and Douglas J. Holtz-Eakin, "Financial Capital, Human Capital, and the Transition to Self-Employment; Evidence from Intergenerational Links," *Journal of Labor Economics* 18, no. 2 (2000): 282-305. Michael Hout and Harvey S. Rosen, "Self-Employment, Family Background, and Race," *Journal of Human Resources 35*, no. 4 (2000): 670-692.

[80] Hout and Rosen.

[81] Fairlie, "The Absence of the African American Owned Business: An Analysis of the Dynamics of Self-Employment."

[82] Robert W. Fairlie and Alicia M. Robb, "Why are Black-Owned Businesses Less Successful than White-Owned Businesses: The Role of Families, Inheritances, and Business Human Capital," *Journal of Labor Economics 25* (2007): 289-323. Fairlie-Robb, *Race and Entrepreneurial Success: Black-,Asian-, and White-Owned Businesses in the United States.*

[83] U.S. Census Bureau, *1992 Economic Census: Characteristics of Business Owners.*

[84] Fairlie-Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*

[85] W. David Allen, "Social Networks and Self-Employment," *Journal of Socio-Economics 29,* no. 5 (2000): 487-501.

[86] These networks may also be important in forming strategic alliances with other firms as discussed in Leonard Greenhalgh, *Increasing MBE Competitiveness through Strategic Alliances* (Washington D.C.: Minority Business Development Agency, U.S. Department of Commerce, 2008).

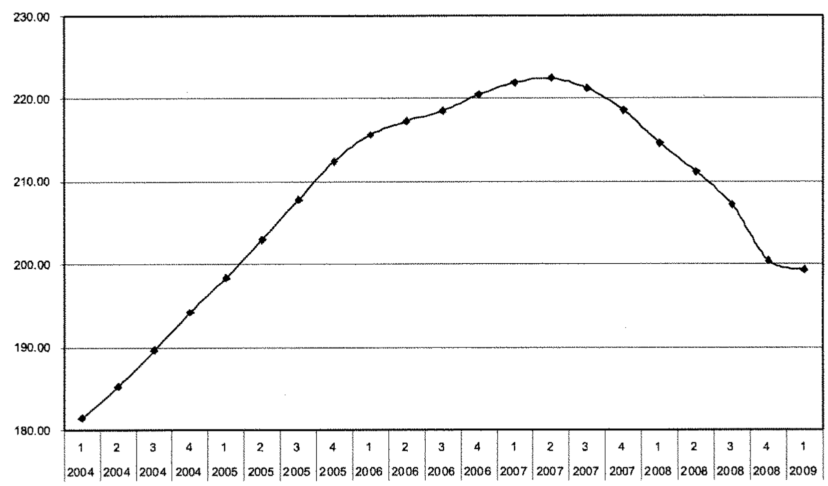
many of the factors listed below such as financial capital, discrimination, and human capital. For example, minority businesses are known to have limited networks in the investment community resulting in lower levels of capital use.[87] Given these interactions and the inherent difficulty of measuring networks, it is difficult to identify their effects on business performance.

[87] U.S. Department of Commerce, *Minority Business Development Agency, Accelerating Job Creation and Economic Productivity: Expanding Financing Opportunities for Minority Businesses* (2004).

The Current Financial Crisis

The current financial crisis creates special challenges to MBEs in securing financing. It is likely that the constraints mentioned in the previous section will probably get much worse. To get some insight into what is happening we investigate current trends in several measures. Although it is difficult to obtain recent data on the use of startup and expansion capital, we examine trends in related measures. We first focus on factors affecting the personal wealth of the entrepreneur.

Figure 1
Quarterly Housing Price Index, Federal Housing Finance Agency

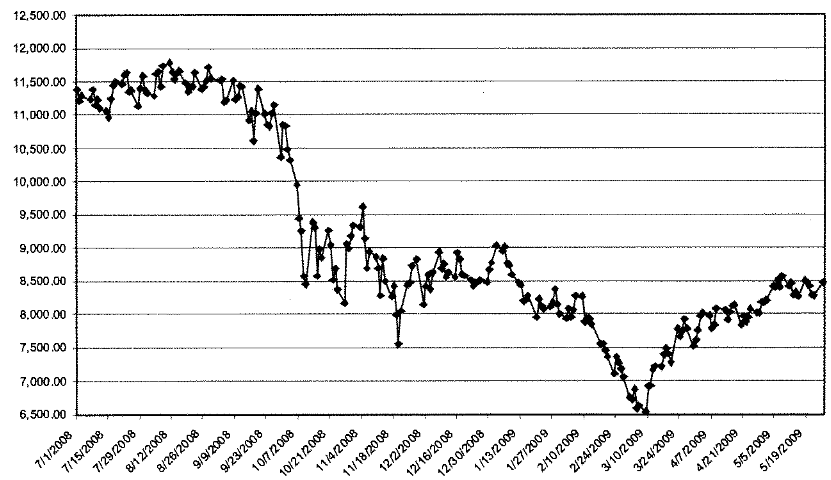


The largest single asset affecting personal wealth is home equity. Over the past two years housing values have dropped precipitously. Figure 1 displays the Monthly House Price Index from the Office of Federal Housing Enterprise Oversight from January 2004 to February 2009. The peak in the housing market was in the summer of 2007, but has steadily dropped since then with evidence of a slight rebound. The recent decline in housing equity does not bode well for access to financing. Home equity is found to be a major determinant of starting a business in the United States.[88] The decline in housing values is likely to further limit the amount of capital available to minority entrepreneurs.

[88] Fairlie and Krashinsky.

Stock market investments represent another component of personal wealth. The stock market has fallen considerably over the past few years. The Dow Jones Industrial Average dropped from over 11,000 in September 2008 to levels above 8,000 in May 2009 (Figure 2). The substantial drop in stock market wealth has undoubtedly resulted in less personal wealth to invest in businesses and use as collateral for loans for entrepreneurs.

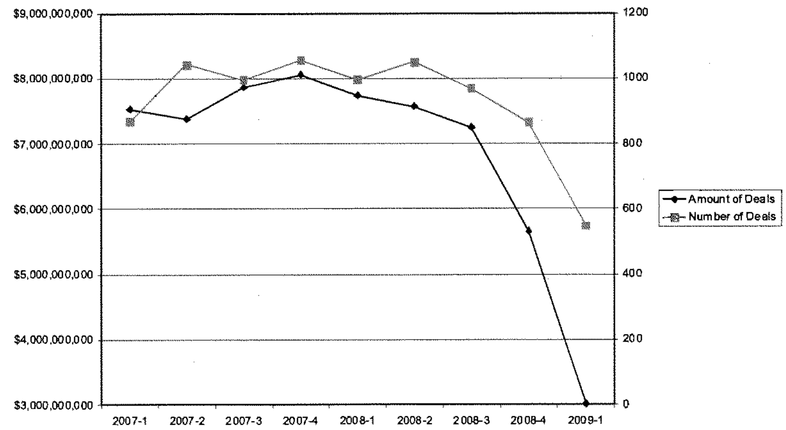
Figure 2
Dow Jones Industrial Average



More direct measures of access to capital are represented by the number of venture capital deals. Figure 3 displays the number of venture capital deals made in the United States over the past couple of years. The total number and amount of deals declined substantially since the second quarter of 2008. In the first quarter of 2009 there were only 549 venture capital deals in the United States worth $3 billion (Figure 3). These levels were half or less than half of what they were one year earlier. Additionally, estimates of the total amount of funding from angel investors dropped by 26.2 percent from 2007 to 2008 resulting in total investments of $19.2 billion.[89]

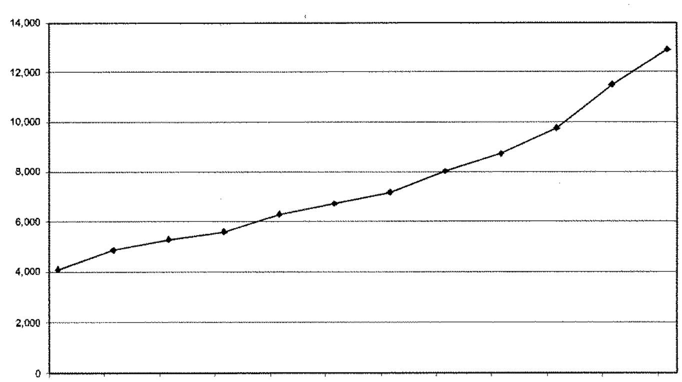
[89] Sohl.

Figure 3
Venture Capital Deals, PricewaterhouseCoopers/National Venture Capital Association MoneyTree Report



The decline in access to these potential sources of financial capital for businesses has resulted in a rapid rise in the number of business bankruptcy filings. Business bankruptcy filings have increased sharply in the last two quarters of 2008 (Figure 4). The number of bankruptcy filings increased to 12,901 in the fourth quarter of 2008 from 7,985 one year earlier.

Figure 4
Total Business Bankruptcy Filings
Administrative Office of the U.S. Courts



Surveys of financial institutions provide another well-cited barometer of current conditions in the financing market. A good summary of the overall climate for banking and finance is available in the Federal Reserve's "Beige Book." The report from April 2009 notes that credit availability remains "very tight." The report also notes deteriorating loan quality and rising delinquencies for all loan types and regions. Another widely read source of the state of financing in the United States is the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices. *The report from May 2009 also indicates that business lending policies remain very tight, although there is some evidence that the tightening is easing.* The report also notes a continuing weakening of demand for business loans. As of this publication, the CIT Group Inc., one of the nation's largest and publicly traded lending institutions to small and medium size enterprises, is facing a possible bankruptcy although it received funds from the Treasury last year as part of its rescue package. There have been many other banks declaring bankruptcy as a result of the current financial environment.

Surveys of small businesses indicate similar problems in the credit markets. A recent survey of small businesses from the National Federation of Independent Business indicates a sharp drop in reported loan availability over the past year. Small business owners were also more likely to report that they expected credit conditions to worsen over the next few months. Optimism among small business owners is also down considerably compared to a year ago. The American Express OPEN Small Business Monitor indicates a more optimistic outlook for small business owners, but also notes that capital investments are at their lowest level in the eight years surveys have been conducted. The Monitor's findings are based from a national semi-annual survey of 727 small business owners with fewer than 100 employees.

All of the recent trends presented here indicate worsening financial conditions. These trends and those in the overall economy do not bode well for minority-owned businesses. Because of the limited capital available to minority-owned firms, they are likely to be especially vulnerable in the current economic conditions. The gains experienced by minority firms in growth of number of firms, gross receipts and employment between 1997 and 2002 could be reversed if minority business owners do not have adequate access to capital.

New Empirical Analysis

In this section, we conduct a new empirical analysis of the barriers to financing faced by minority-owned firms. The findings provide a broader discussion of the barriers to financing faced by minority businesses and support some of the previous research discussed in Section 3.

Data Description

We use three sources of data for the analysis -- the Survey of Business Owners (SBO), Kauffman Firm Survey (KFS), and the Survey of Small Business Finances (SSBF). These are the most commonly used and respected sources of data on financing of minority-owned businesses. We briefly describe each of these data sources.

The SBO is conducted by the U.S. Census Bureau every five years to collect statistics that describe the composition of U.S. businesses by gender, race, and ethnicity. This survey was previously conducted as the Survey of Minority- and Women-Owned Business Enterprises (SMOBE/SWOBE). The universe for the most recent survey is all firms operating during 2002 with receipts of $1,000 or more that filed tax forms as individual proprietorships, partnerships, or any type of corporation. Businesses that are classified as agricultural production, domestically scheduled airlines, railroads, U.S. Postal Service, mutual funds (except real estate investment trusts), religious grant operations, private households and religious organizations, public administration, and government are excluded. The SMOBE and SBO data have undergone several major changes over time including the addition of C corporations and the removal of firms with annual receipts between $500 and $1,000 starting in 1997.[90]

The SBO and SMOBE/SWOBE surveys provide the most comprehensive data available on businesses by the race, ethnicity, and gender of the owners. Business ownership is defined as having 51 percent or more of the stock or equity in the business. Business ownership was categorized by: Gender (Male; Female; or Equally Male-/Female-Owned); Ethnicity (Hispanic, non-Hispanic); and Race (White; Black or African American; American Indian or Alaska Native; Asian; Native Hawaiian or Other Pacific Islander). The public use tables from the SBO/SMOBE are the most widely used source for tracking the number, performance, size, and industry composition of minority-owned businesses in the United States. In this section, we report detailed information on sources of startup and expansion capital by race from published sources. Unfortunately, microdata from the SBO are not publicly available and require an extensive application and disclosure process prohibiting additional analyses for this report.

To examine the use of capital among more established firms, we use microdata from the 2003 Survey of Small Business Finances (SSBF). The SSBF is one of the only business-level datasets that provides information on the owner, which is essential for identifying businesses owned by minorities. The SSBF is conducted by the Board of Governors of the Federal Reserve System every five years. The 2003 SSBF contains a large sample of 4,240 for-profit, non-governmental, non-agricultural businesses with fewer than 500 employees. The SSBF provides detailed information on many owner and firm characteristics, including credit histories, recent borrowing experiences, balance sheet data, and sources of financial products and services used.[91]

[90] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.*
[91] Board of Governors of the Federal Reserve System, "Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances," *Federal Reserve Bulletin,* Traci L. Mach and John D. Wolken (2006): 167-195 (accessed October 2009); available from http://www.federalreserve.gov/pubs/bulletin/2006/smallbusiness/smallbusiness.pdf.

To examine access to financial capital among businesses in their early, formative years of development we use confidential-access longitudinal microdata from the newly released Kauffman Firm Survey (KFS). The KFS tracks a panel of almost 5,000 firms from their inception in 2004 through 2007, providing information on sales, employment, and owner characteristics. Also, the survey offers unprecedented detail on the capital injections that these firms receive: not only when and how much capital they receive, but detailed information of each financial injection. It includes whether the capital comes from formal or informal channels, and whether it is equity or debt in the form of personal or business loans, credit cards, or from other sources. Information on up to ten owners includes age, gender, race, ethnicity, education, work experience, and previous startup experience with large subsamples of MBEs. The KFS is the only large, nationally representative, longitudinal dataset providing detailed information on new firms and their financing activities over time. Most previous datasets are cross-sectional and focus on older, more established firms.

Sources of Startup and Expansion Capital

We first examine sources of startup and expansion capital for minority-owned firms from the SBO. Estimates are taken from the U.S. Department of Commerce, Minority Business Development Agency.[92] We highlight some of the main findings here.

Table 6 reports sources of capital used to start or acquire the business by ethnic/racial group and sales level. We define high sales firms as firms with $500,000 or more in annual sales. This is consistent with MBDA's target market of MBE firms capable of generating significant employment and long-term economic growth. The most common source of funding for minority businesses is personal and family savings. More than half of all minority firms use this source of capital at startup. Among high sales firms a higher percentage of minority businesses report the use of personal and family savings (71.0 percent), which is higher than for high sales non-minority firms. In addition, related to this source of financing 14.0 percent of high sales MBEs used other personal and family assets as sources of startup capital. Overall, among firms with high-growth and employment potential, MBEs appear to be more reliant on personal equity for financing than non-minority firms. For all firms, they use these sources similarly.

[92] U.S. Department of Commerce, *Minority Business Development Agency, Characteristics of Minority Businesses and Entrepreneurs.*

Table 6

Sources of Capital Used to Start or Acquire the Business by Ethnicity/Race and Sales Level ($500,000 or more)

Survey of Business Owners (2002)

		Personal/ family savings	Other personal/ family assets	Personal/ business credit card	Business loan from government	Government guaranteed bank loan	Business loan from bank	Outside investor	None needed
American-Indian and	Total	51.9%	10.0%	12.2%	1.0%	0.8%	7.8%	2.0%	30.8%
Alaska Native	High Sales	66.8%	17.3%	12.0%	3.1%	3.9%	22.1%	5.7%	
	Low Sates	51.3%	9.6%	12.2%	0.9%	n/a	7.2%	1.9%	
Asian	Total	61.4%	8.9%	9.6%	1.0%	8.0%	10.2%	3.1%	22.6%
	High Sales	73.2%	13.7%	9.8%	2.2%	2.7%	25.7%	5.6%	
	Low Sales	60.2%	8.4%	9.5%	0.9%	0.6%	8.6%	2.8%	
Native Hawaiian and	Total	52.6%	10.3%	12.7%	2.3%	0.4%	5.2%	2.1%	29.9%
Other Pacific	High Sales	66.5%	15.8%	n/a	n/a	n/a	20.3%	4.0%	
Islander	Low Sales	51.9%	n/a	13.0%	n/a	n/a	n/a	n/a	
Hispanic	Total	51.2%	6.7%	9.4%	0.8%	0.4%	5.6%	1.8%	33.1%
	High Sales	69.0%	13.9%	11.6%	1.9%	2.3%	19.1%	4.4%	
	Low Sales	50.3%	6.3%	9.3%	0.7%	0.3%	4.9%	1.7%	
African-American	Total	50.2%	7.1%	10.1%	1.1%	0.5%	5.7%	2.1%	33.0%
	High Sales	68.2%	14.2%	13.2%	3.1%	4.1%	25.0%	4.9%	
	Low Sales	49.8%	6.9%	10.0%	1.0%	0.5%	5.2%	2.1%	
Minority	Total	54.1%	7.7%	9.8%	1.0%	0.6%	7.2%	2.3%	29.7%
	High Sales	71.0%	14.0%	n/a	n/a	n/a	23.3%	5.1%	
	Low Sales	53.1%	n/a	9.8%	n/a	n/a	n/a	n/a	
Non-minority	Total	55.6%	9.3%	8.8%	0.8%	0.7%	12.0%	2.5%	27.4%
	High Sales	64.9%	14.8%	n/a	n/a	n/a	29.2%	5.4%	
	Low Sales	53.5%	n/a	8.8%	n/a	n/a	n/a	n/a	
All Respondent	Total	54.6%	9.0%	8.8%	0.9%	0.7%	11.4%	2.7%	27.7%
Firms	High Sales	60.6%	13.7%	6.8%	1.9%	2.1%	27.6%	6.5%	
	Low Sales	53.9%	8.5%	9.0%	0.8%	0.5%	9.6%	2.3%	

Notes: (1) Source: 2002 Survey of Business Owners, as reported in U.S. Department of Commerce, Minority Business Development Agency (2008). (2) Businesses with $1,000 or more in receipts are included. (3) High sales firms are those with $500,000 or more in annual sales.

A source of financing that has attracted much discussion in the literature is bank financing. We discuss the use of bank financing by minority and non-minority firms in more detail below using the SSBF and KFS, but we first examine percentages of firms receiving this source of financing. Among all minority firms, 7.2 percent received a business loan from a bank compared with 12.0 percent of non-minority firms. High sales minority firms were more likely to receive bank loans with 23.3 percent receiving this source of startup capital. But, this level is lower than for high sales non-minority firms with 29.2 percent receiving bank loans. The disparities in amounts of bank loans and other features of the loan are larger as discussed below.

We also find that minority firms are more likely to rely on credit cards for startup capital, which is a high-costs source, but the difference is not large. Minority and non-minority firms are similarly likely to receive startup funding from outside investors.

Table 7 reports sources of capital used to finance expansion or capital improvement by race and receipts level. As expected the percentage of minority firms using personal and family saving and assets for expansion is lower than for startup. Among all minority firms 33.8 percent of firms reported these two sources of capital for expansion. Use of this source of capital was higher for minority firms than non-minority firms. High sales minority firms continue to rely more on credit cards than non-minority firms, although the difference is not overly large. Finally, both all and high sales minority firms are less likely to use bank loans to fund expansion than are their non-minority counterparts.

Table 7

Sources of Capital Used to Finance Expansion or Capital Improvement of the Business by Ethnicity/Race and Sales Level ($500,000 or more)
Survey of Business Owners (2002)

		Personal/ family savings	Other personal/ family assets	Personal/ business credit card	Business loan from government	Government guaranteed bank loan	Business loan from bank	Outside investor	None needed
American-Indian and Alaska Native	Total	30.8%	7.1%	15.5%	0.7%	0.3%	7.6%	1.3%	52.7%
	High Sales	28.1%	9.8%	13.0%	1.1%	n/a	29.7%	n/a	40.7%
	Low Sates	30.9%	7.0%	15.6%	0.7%	n/a	6.7%	1.3%	53.2%
Asian	Total	31.4%	5.3%	10.6%	0.6%	0.4%	7.3%	1.5%	53.6%
	High Sales	27.5%	6.7%	10.2%	1.2%	1.1%	22.6%	2.4%	47.2%
	Low Sales	31.8%	5.2%	10.7%	0.5%	n/a	5.7%	1.4%	54.3%
Native Hawaiian and Other Pacific Islander	Total	28.6%	5.6%	13.6%	1.2%	0.9%	5.6%	S	55.3%
	High Seles	27.4%	n/a	17.5%	n/a	n/a	23.4%	n/a	42.0%
	Low Sales	28.7%	n/a	13.4%	n/a	n/a	n/a	n/a	55.9%
Hispanic	Total	26.5%	4.4%	10.9%	0.5%	0.3%	5.2%	1.3%	58.4%
	High Sales	26.8%	6.7%	13.2%	1.6%	1.1%	27.4%	2.4%	41.8%
	Low Sales	26.4%	4.3%	10.8%	0.5%	0.2%	4.0%	1.3%	59.2%
African-American	Total	29.1%	4.8%	11.5%	0.7%	0.3%	4.1%	1.3%	56.3%
	High Sales	28.0%	6.5%	14.3%	1.8%	2.1%	24.7%	1.7%	43.2%
	Low Sales	29.2%	4.8%	11.5%	0.6%	0.2%	3.7%	1.3%	56.6%
Minority	Total	28.9%	4.9%	11.2%	0.6%	0.3%	5.7%	n/a	56.0%
	High Sales	27.4%	n/a	11.8%	n/a	n/a	24.7%	n/a	44.7%
	Low Sales	29.0%	n/a	11.2%	n/a	n/a	n/a	n/a	56.7%
Non-minority	Total	25.0%	5.1%	11.7%	0.5%	0.3%	9.7%	n/a	59.0%
	High Sales	21.2%	n/a	9.8%	n/a	n/a	30.2%	n/a	48.8%
	Low Sales	25.9%	n/a	11.9%	n/a	n/a	n/a	n/a	60.1%
All Respondent Firms	Total	25.5%	5.0%	11.4%	0.5%	0.3%	9.2%	1.2%	58.5%
	High Sales								
	Low Sales								

Notes: (1) Source: 2002 Survey of Business Owners, as reported in U.S. of Commerce, Minority Business Development Agency (2008). (2) Businesses with $1,000 or more in receipts are included. (3) High sales firms are those with $500,000 or more in annual sales.

The SBO data indicate some differences in the use of sources of startup and expansion capital between minority and non-minority firms even when we focused on firms with $500,000 or more in annual gross receipts. Minority firms generally rely more on personal and family equity and are less likely to obtain bank loans than non-minority businesses. There is also some evidence of slightly higher use of credit cards than non-minority firms.

Capital Use among More-Established Minority Firms

The SSBF provides information on older, more-established firms. Average sales and employment of firms in the SSBF are much higherthan the total for all firms as reported in the SBO. We examine recent equity investments and loans for these firms. Table 8 reports estimates for minority and non-minority firms and high and low-sales firms. We defined high sales similarly as having annual gross receipts of at least $500,000.

Table 8
Equity Investmensts and Loan Amounts
Survey of Small Business Finances (2003)

Group	Sales	Employees	Equity Investments Percent	Equity Investments Mean	Loans Percent	Loans Mean	N
Total							
Non-minority	$1,043,216	7.3	5.7%	$7,822	31.9%	$108,912	3,685
Minority	$992,207	6.5	5.1%	$3,379	23.6%	$46,514	555
Sales > $500,000							
Non-minority	$3,103,310	19.2	6.1%	$19,377	52.4%	$310,232	1,868
Minority	$3,409,946	18.0	5.4%	$7,274	41.2%	$149,354	248
Sales < $500,000							
Non-minority	$138,329	2.1	5.5%	$2,747	22.8%	$20,482	1,817
Minority	$116,392	2.3	5.0%	$1,969	17.2%	$9,261	307

Notes: (1) All estimates use survey weights provided by the SSBF. (2) The samples used to estimate mean equity investments and loan amounts include firms not receiving those sources of funding.

We first examine equity investments in the firm. The question in the SSBF asks about new equity investments from existing owners, new or existing partners, or new or existing shareholders (excluding retained earnings) during the past year. For all firms, minority businesses are less likely to receive new equity investments than are non-minority businesses, but the difference is not overly large. MBEs are less likely to receive equity investments even when conditioning on high sales firms. In all cases, however, only 5 to 6 percent of firms receive new equity investments each year.

The main difference between minority and non-minority firms is the amount of new equity investments. *Although minority firms are almost as likely to receive new equity investments they receive much smaller amounts of new equity.* The average amount of new equity investments in minority high sales firms is $7,274, which is only 38 percent of the non-minority level. The average amount of new equity investments in minority firms receiving equity investments is $3,379, which is 43 percent of the non-minority level. The differences in average amount of equity investment are striking especially when noting that average sales and employment levels are not that different between minority and non-minority firms (reported in Columns 1 and 2). Equity investments are notably lower in low-sales firms. Although not reported we also find that a very small share of firms receiving new equity financing receive it from venture capital firms or public offerings. In fact, no minority firms in the SSBF sample report either of these sources of financing.

We also examine minority/non-minority differences in loan usage. The SSBF questionnaire asks about business loans received during the past 3 years. Table 8 reports estimates of the percent of firms receiving loans. Minority firms are less likely to receive loans than non-minority firms. Among high sales firms, 52 percent of non-minority firms received loans compared with 41 percent of minority firms. The average loan amount for all high sales minority firms was $149,000. The non-minority average was more than twice this amount at $310,000. If we condition for only high sales firms receiving loans, the minority/

non-minority difference in average loans is smaller, but a large gap in loan amounts remains. *The average loan received by high sales minority firms is $363,000 compared with $592,000 for high sales non-minority firms.*

Although sample sizes are too small to report separate estimates, we find that there are substantial differences within racial groups. Hispanic and African American owned firms have much lower levels of loans than non-minority firms, and Asian and African American firms have much lower levels of new equity investments than non-minority firms.

As noted above in Section 3, the SSBF has been used extensively to study the experience of minority businesses in credit markets. We update the results of these studies using data from the 2003 SSBF. Table 9 reports estimates of loan denial rates, fear of applying, and interest rates for minority and non-minority firms and by sales size. *As found in previous studies, loan denial rates are much higher for minority firms than for non-minority-owned firms. This holds true for high sales firms and low-sales firms. For high sales firms, the rate of loan denial is almost twice as high for minority firms as for non-minority firms.*

Table 9

Loan Denial Rates, Fear of Applying, and Interest Rates
Survey of Small Business Finances (2003)

Group	Denial Rate	N	Did not Apply: Fear of Rejection	N	Interest Rate	N
Total						
Non-minority	12.3%	1,679	15.8%	3,685	6.4%	1,586
Minority	31.5%	218	29.5%	555	7.8%	175
Sales > $500,000						
Non-minority	8.4%	1,212	12.2%	1,868	5.9%	1,168
Minority	14.9%	132	18.8%	248	6.2%	123
Sales < $500,000						
Non-minority	16.0%	467	17.4%	1,817	6.9%	418
Minority	41.9%	86	33.4%	307	9.1%	52

Note: All estimates use sample weights provided by the SSBF.

Although a large percentage of minority firms that applied for loans were rejected even more might have been rejected if they had applied. Of course, it is impossible to measure how these firms would have been treated in they applied for loans. Instead, the SSBF provides related information on whether the firm did not apply for credit when it needed it because the firm thought that the application would be turned down (i.e. fear of rejection). Estimates reported in Table 9 indicate that minority firms are more likely to not apply for loans because of a fear of being rejected than non-minority firms. *For high sales firms, minority firms are much more likely to not apply for loans because of a fear of rejection than non-minority firms.*

Previous studies have also found that minority firms tend to pay higher interest rates on business loans than do non-minority firms.[93] We find similar evidence for minority firms. *For all firms, minority firms pay 7.8 percent on average for loans compared with 6.4 percent for non-minority firms.* The difference is smaller, but still exists for high sales firms.

[93] Blanchflower, Levine and Zimmerman. Cavalluzzo, Cavalluzzo and Wolken.

Overall, minority firms are more likely to be denied when applying for loans and are less likely to apply for loans because of a fear of rejection. When these firms do receive loans they are for smaller amounts and for higher interest rates than non-minority firms. These alarming differences in treatment in the lending market, however, may be due to differences in the size, creditworthiness and other characteristics of the owners and firms. This does not appear to be the case, however, as previous studies control for numerous owner and firm characteristics including the creditworthiness of the firm. We conduct a similar analysis including an even more extensive set of controls and continue to find that minority firms are more likely to experience loan denials, not apply for loans because of fear of rejection, and pay higher interest rates on loans. Any remaining negative racial or gender differences in lending outcomes are consistent with the existence of lending discrimination.[94]

Regression Analysis of Equity Investment and Loan Amounts

In this section we conduct a regression analysis to further investigate differences in equity investment and loan amounts between minority and non-minority businesses. We estimate several regressions using log equity investments and log loan amounts as the dependent variables. The main owner controls include female, education, age and experience, the main geographic controls include region and urbanicity, and the main business controls include number of owners, whether the business was purchased or inherited, firm age, legal form and industry. We also include log sales which controls for current and recent business performance. To control for the owner's creditworthiness we include whether the owner owns a home, home equity, and personal credit scores. Finally, to control for firm creditworthiness we include whether the firm filed for bankruptcy in the past. These represent detailed measures of what lenders and investors look for in making decisions about providing financial capital to firms.

Table 10 reports regression estimates for log equity investments and loan amounts for all firms and high sales firms. Results for log equity investments are discussed first. After controlling for detailed owner and business characteristics we find lower levels of equity investments in minority firms compared to non-minority firms, but the difference is not statistically significant. The education level of the owner and experience is strongly associated with receiving equity capital. Having more business owners also increases the amount of new equity investments in the firm. The sales level does not predict equity investments in the firm. This may be due to the fact that successful firms do not need as much in new equity as less successful firms, but less successful firms have more difficulty attracting new equity investments. In the end, the potentially offsetting factors may result in a flat relationship between business performance and new equity investments. Higher credit scores are associated with lower levels of equity investments which might partly reflect less need. We also estimate a regression including only firms with $500,000 or more in annual sales. The results are fairly similar.

[94] Ibid., 36

Table 10
Linear Regressions for Log Equity Investments and Loan Amounts
Survey of Small Business Finances (2003)

	Specification			
	Log Equity Investments		Log Loan Amount	
	(1)	(2)	(3)	(4)
Sample	All Firms	Hi-Sales	All Firms	Hi-Sales
Minority	-0.0916	-0.1616	-0.3499	-0.8365
	(0.0564)	(0.1053)	(0.1273)	(0.2356)
Female	-0.0689	-0.0397	-0.0965	-0.0071
	(0.0423)	(0.0793)	(0.0955)	(0.1775)
High school graduate	0.0305	0.1101	-0.9618	-0.6670
	(0.1506)	(0.2743)	(0.3401)	(0.6136)
Some college	0.1061	0.1239	-0.8729	-0.5122
	(0.1484)	(0.2699)	(0.3351)	(0.6037)
College	0.2942	0.2436	-0.9013	-0.4303
	(0.1500)	(0.2733)	(0.3388)	(0.6113)
Graduate school	0.3066	0.3538	-0.8277	-0.3871
	(0.1522)	(0.2790)	(0.3437)	(0.6240)
Age	-0.0073	0.0010	-0.0138	-0.0231
	(0.0024)	(0.0048)	(0.0055)	(0.0108)
Experience	0.0079	0.0008	-0.0068	-0.0051
	(0.0028)	(0.0052)	(0.0062)	(0.0115)
Number of owners	0.0606	0.0533	0.1049	0.0334
	(0.0120)	(0.0122)	(0.0271)	(0.0273)
Firm age	-0.0021	-0.0010	0.0103	0.0073
	(0.0026)	(0.0042)	(0.0058)	(0.0095)
Log sales	-0.0092	0.0173	0.5409	1.3669
	(0.0119)	(0.0392)	(0.0268)	(0.0877)
Log home equity	-0.0044	-0.0560	0.0080	-0.0663
	(0.0109)	(0.0210)	(0.0247)	(0.0470)
D&B credit score: 11-25	-0.1988	-0.3226	0.1070	0.3967
	(0.0847)	(0.1508)	(0.1913)	(0.3374)
D&B credit score: 26-50	-0.2667	-0.1648	0.2649	0.5181
	(0.0799)	(0.1419)	(0.1805)	(0.3174)
D&B credit score: 51-75	-0.3684	-0.3061	0.1353	0.4900
	(0.0773)	(0.1245)	(0.1745)	(0.2785)
D&B credit score: 76-90	-0.3502	-0.3519	0.1293	0.2503
	(0.0820)	(0.1312)	(0.1851)	(0.2935)
D&B credit score: 91-100	-0.3848	-0.2673	0.1829	0.2373
	(0.0927)	(0.1403)	(0.2094)	(0.3138)
Legal form of organization	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes
Region and urban	Yes	Yes	Yes	Yes
Mean of dependent variable	4.9640	5.0545	7.5048	9.4940
Sample size	4,240	2,116	2,516	2,116

Notes (1) OLS coefficient estimates and their standard errors (in parentheses) are reported.
(2) All estimates use sample weights provided by the SSBF.

What are the determinants of loan amounts? Specifications 3 and 4 in Table 10 report estimates. Minority firms receive smaller loan amounts than non-minority firms even after controlling for detailed business and owner characteristics. The differences are large and statistically significant. Among all firms, minority businesses have loan amounts that are 35 percent lower than for non-minority firms. The difference is even larger when focusing on loans received by high sales firms.

In addition to race, the number of owners and sales increase loan amounts. Although having more sales may reduce the need for loans it may have a much larger effect on the ability to obtain business loans. Also, higher credit scores are generally linked to the ability to obtain larger loans.

Decomposition Estimates

The regression analysis identifies several potential barriers to financing among minority businesses. For example, high credit scores are found to be an important determinant of obtaining business loans. If minority firms have low credit scores on average then this could limit their ability to obtain business loans. Lower sales levels among minority businesses may also limit their potential to obtain loans. The impact of each factor, however, is difficult to estimate. In particular, we want to estimate the contribution of differences between minority and non-minority firms in credit scores, sales, and other owner and business characteristics to the racial gaps in obtaining financing.

To explore the questions stated above further, we decompose inter-group differences in a dependent variable into those due to different observable characteristics across groups (sometime referred to as the endowment effect) and those due to different "prices" of characteristics of groups.[95] The Blinder-Oaxaca decomposition of the non-minority/minority gap in the average value of the dependent variable, Y, can be expressed as:

$$(1)\ \overline{Y}^W - \overline{Y}^M = \left[(\overline{X}^W - \overline{X}^M)\hat{\beta}^W\right] + \left[\overline{X}^M(\hat{\beta}^W - \hat{\beta}^M)\right].$$

Similar to most recent studies applying the decomposition technique, we focus on estimating the first component of the decomposition that captures contributions from differences in observable characteristics or "endowments." We do not report estimates for the second or "unexplained" component of the decomposition because it partly captures contributions from group differences in unmeasurable characteristics and is sensitive to the choice of left-out categories making the results difficult to interpret. We also weight the first term of the decomposition expression using coefficient estimates from a pooled sample of all groups.[96] The regression estimates are taken from Table 10. The contribution from racial differences in the characteristics can thus be written as:

$$(2)\ (\overline{X}^W - \overline{X}^B)\hat{\beta}^*.$$

Where $\overline{X}^j$ are means of firm characteristics of race *j*, $\hat{\beta}^*$ is a vector of pooled coefficient estimates, and *j=W* or M for non-minority (non-Hispanic white) or minority, respectively. Equation (2) provides an estimate of the contribution of racial differences in the entire set of independent variables to the racial gap. Separate calculations are made to identify the contribution of group differences in specific variables to the gap.

[95] Alan S. Blinder, "Wage Discrimination: Reduced Form and Structural Variables," *Journal of Human Resources*, 8, no. 4 (1973): 436-455. Ronald Oaxaca, "Male-Female Wage Differentials in Urban Labor Markets," *International Economic Review*, 14, no. 3 (1973): 693-709.

[96] Ronald Oaxaca and Michael Ransom, "On Discrimination and the Decomposition of Wage Differentials," Journal of Econometrics, 61, no. 1 (1994): 5-21.

Table 11 reports estimates from this procedure for decomposing the non-minority/minority gaps in levels of equity investments and loan amounts discussed above. The separate contributions from racial differences in each set of independent variables are reported. We focus on the main explanatory factors. Minority firms have a lower level of equity financing by 3.6 log points (or roughly 3.6 percent). The only factor contributing to the difference in log equity investments is experience. Minority business owners have less experience than non-minority business owners (16 years compared with 20 years of experience, respectively). The lower level of experience explains 3.0 percentage points of the 3.6 percentage point difference in log equity investments. This is a small contribution, however. Overall, the differences in log equity investments between minority and non-minority firms are not large and there are no factors that contribute strongly to the difference. Interestingly, differences in sales, home equity, credit scores, legal forms, and industries do not contribute to minority/non-minority differences in equity financing. When we focus on only high sales firms we find similar results (reported in Specification 2).

Table 11
Decompositions for Log Equity Investments and Loan Amounts
Survey of Small Business Finances (2003)

	Specification			
	Log Equity Investments		Log Loan Amount	
	(1)	(2)	(3)	(4)
Sample	All Firms	Hi-Sales	All Firms	Hi-Sales
Non-minority mean of dep var	4.9084	5.0064	6.6563	8.3738
Minority mean of dep. var	4.8722	4.9656	6.0736	7.5482
Non-min/min.difference	0.0362	0.0408	0.5827	0.8256
Female	0.0020	0.0013	0.0028	0.0002
Education	-0.0083	-0.0428	-0.0131	-0.0241
Age	-0.0241	0.0032	-0.0454	-0.0746
Experience	0.0297	0.0036	-0.0256	-0.0227
Number of owners	0.0000	0.0059	0.0000	0.0037
Firm age	-0.0075	-0.0050	0.0361	0.0347
Log sales	-0.0027	-0.0016	0.1600	-0.1226
Log home equity	-0.0031	-0.0154	0.0057	-0.0183
Credit scores	-0.0338	-0.0301	0.0084	0.0155
Legal form of organization	-0.0042	-0.0408	-0.0066	-0.0064
Industry	-0.0062	-0.0008	0.0228	0.1150
Region and urban	0.0000	-0.0186	0.0897	0.1156
Total explained	-0.0583	-0.1411	0.2349	0.0159

Notes: (1) See text for more details on decompositions.
(2) Coefficient estimates used in decomposition are reported in Table 10.

The minority/non-minority gap in financing is much larger for loan amounts. For all firms, we find a 58 log point difference between minority and non-minority loan amounts. A large part of the difference can be explained by minority/non-minority differences in log sales. Minority firms have sales levels that are 30 percent lower than non-minority firms, and this difference translates into a loan amount gap of 16 log points. Thus, roughly 16 percentage points of the gap in loan amounts is due to lower sales levels among minority firms, potentially limiting their ability to obtain bank loans.

Geographical differences also provide a large contribution to why minority firms obtain lower loan amounts (9.0 log points). Minority firms have a less favorable regional distribution in the country and are more likely to be located in urban areas, which have lower loan amounts all else equal. Surprisingly, credit scores are not a major factor only explaining a small amount of the differences in loan amounts.

If we focus on high sales firms, we find that industry and geographical differences are the two most important explanations for why high sales minority firms have roughly 80 percent lower levels of bank loans than high sales non-minority firms. Geographical differences explain 12 percentage points of the difference in loan amounts. Industry differences explain a similar amount of the difference. Minority firms are less concentrated in construction and manufacturing which tend to have higher loan amounts, and are more concentrated in retail trade, which tend to have lower loan amounts.

Overall, minority firms have lower equity investments and loan amounts than non-minority firms. Having less experience, lower sales, and less favorable geographical and industry distributions partially limit their ability to raise financial capital. On the other hand, business owner's education, home equity and credit scores do not appear to represent major barriers to raising either equity financing or loans for the larger, more established businesses represented in the SSBF. The findings for newly formed minority businesses may differ, however. We investigate this question next using data from the KFS.

Capital Use among Newly-Formed Minority Firms

The KFS provides information on businesses formed in 2004 and follows these new business ventures annually through 2007. The KFS, which only recently became available, provides the first evidence on the financing patterns of young minority firms. It is useful to examine disparities in financing at the early stages of firm growth to understand the life cycle of minority firms and how they compare to non-minority firms.[97] The KFS also provides the latest microdata on financing of minority businesses with estimates from 2007. Another major advantage of the KFS is that it provides a more accurate measure of sources and amounts of startup capital than commonly used data sources such as the CBO and SBO because the information is gathered in the first year of operations not retrospectively which for some firms could be 20 or more years ago.

Table 12 reports estimates for the percentage of minority and non-minority firms that use each source of financing, as well as the amounts of startup and subsequent capital by source. The sources of financing are aggregated into three broad categories: 1) internal financing (debt and equity financing by the owner(s) and insiders (friends and family), 2) external debt financing (bank loans, credit lines, credit cards, etc.), and 3) external equity financing (venture capital, angel financing, etc.). Estimates are for both start up capital (capital injections in 2004, the first year of operations) and for subsequent new financial injections (annual average based on 2005-2007). All dollar figures are reported in 2007 dollars.

[97] Andrew B. Bernard and Matthew J. Slaughter, *The Life Cycle of a Minority-Owned Business: Implications for the American Economy* (Washington: Minority Business Development Agency, 2004).

Table 12
Sources of Startup and Subsequent Capital for New Business Ventures
Kauffman Firm Survey (2004-07) (2007 Dollars)

Group	Internal Financing % of firms	Internal Financing Mean	External Debt % of firms	External Debt Mean	External Equity % of firms	External Equity Mean	Total Financial Capital Mean
Startup capital (2004)							
Non-minority	86.7%	$ 46,007	38.1%	$ 36,777	4.7%	$ 7,607	$ 90,391
Minority	87.8%	$ 41,154	33.6%	$ 29,879	3.5%	$ 2,984	$ 74,017
Subsequent capital (2005-2007)							
Non-minority	65.3%	$ 16,180	51.8%	$ 25,365	5.4%	$ 4,082	$ 45,627
Minority	68.4%	$ 13,604	48.2%	$ 13,783	6.7%	$ 2,059	$ 29,447

All estimates use survey weights provided by the KFS.

In the first year of operations, minority-owned firms invested nearly $75,000 into their businesses, while non-minorities invested more than $90,000. Internal financing was the most frequently used source of financing, with more than 85 percent of firms using internal financing for start up capital. It was also the largest source of capital for both groups, making up nearly 51 percent of non-minority start up financing and more than 55 percent of minority-owned business start up financing. Disparities between minority and non-minority firms were larger for external debt and especially external equity. Minority firms averaged $29,879 in external debt compared with $36,777 for non-minority firms. Minority firms had the most trouble obtaining external equity with $2,984 on average equity compared with $7,607 on average for non-minority firms. Very few firms used this type of financing though—just 4.7 percent of non-minority firms and 3.5 percent of minority-owned firms.

In terms of levels of subsequent financial injections, non-minority businesses continued to make larger capital investments. Non-minority businesses invested an average of $45,000 annually into their firms, while minority-owned firms invested less than $30,000 on average. This represents a key new finding provided by the KFS: *disparities in access to financial capital do not become smaller after startup, but instead grow in the years just after startup.* The minority/non-minority disparity in financial capital is much larger in percentage terms for the 2005-07 period than the 2004 year.

Subsequent financial injections displayed different patterns in terms of financing sources, most notably that internal financing dropped in importance. Although it was still the most common source used, only 65.3 percent of non-minority firms used internal financing and 68.4 percent of minority-owned firms. For non-minority firms, this source made up just over one third of their new financial injections, while for minorities it was closer to one half (46.2 percent). Young minority business owners are more reliant on using their own or family money to finance operations in the years just following startup than non-minority owners.

Minority and non-minority firms increased their use of external debt financing for subsequent capital injections. More than half of non-minority firms (51.8 percent) and nearly half of minority firms (48.2 percent) used external debt financing for subsequent financial injections. *As a percentage of the total invested, external debt financing became the most important source of financing, making up more than 55 percent of non-minority business financing and nearly 47 percent of minority business financing.* External equity continued to be the least important source, making up 9 percent of non-minority business financing and 7 percent of minority business financing. A slightly larger share of minority-owned firms used this source (6.7 percent), compared with non-minority firms (5.4 percent), but the average level of investment was half the amount used by non-minority firms.

Multivariate regressions on the log levels of start up capital are presented in Table 13. *Even after controlling for numerous owner and firm characteristics, including two-digit industry and credit score, minority-owned businesses were still more likely to have significantly lower levels of external debt financing and external equity financing.* These differences were statistically significant. The coefficient on the minority variable was also negative in the internal financing equation, but it was not statistically significant. The coefficient on female was negative and statistically significant in all three models. Owner age, education, start up experience, and hours worked were positively correlated with the levels of financing, while the owner's previous industry experience was negatively correlated. As far as firm characteristics, incorporation was positively associated with the levels of financing, while being home based was negatively associated with levels of financing. Levels of innovation, as measured by comparative advantage and intellectual property were mixed. Finally, having a high credit score was positively correlated with levels of financing and statistically significant in the external debt model, while having a low credit score was negatively associated with all three levels of financing and statistically significant in the internal and external debt financing models. The owner's credit rating is important for obtaining startup financing especially for external debt.

Table 13
Linear Regressions for Startup Capital
Kauffman Firm Survey (2004)

Coefficients	Log of 2004 Internal Financing	Log of 2004 External Debt Financing	Log of 2004 External Equity Financing
Minority	-0.0547 (0.0797)	-0.276*** (0.0965)	-0.0746* (0.0386)
Female	-0.161** (0.0755)	-0.168* (0.0889)	-0.133*** (0.0337)
Age	0.0338* (0.0195)	0.0515** (0.0231)	0.0244** (0.00969)
Age Squared	-0.000207 (0.000208)	-0.000427* (0.000248)	-0.000232** (0.000102)
HS Graduate	0.266 (0.262)	0.130 (0.292)	0.0210 (0.101)
Some College	0.333 (0.248)	0.0928 (0.278)	0.0958 (0.0985)
College Graduate	0.481* (0.252)	0.0818 (0.282)	0.0907 (0.101)
Graduate Degree	0.556** (0.259)	0.231 (0.292)	0.143 (0.106)
Hours Worked (weekly average)	0.0211*** (0.00150)	0.00945*** (0.00175)	0.00115 (0.000784)
Industry Experience (years)	-0.0128*** (0.00350)	-0.0139*** (0.00436)	-0.000499 (0.00218)
Start up Experience	0.0528 (0.0677)	0.0539 (0.0807)	0.0307 (0.0380)
Team Ownership	0.320*** (0.0885)	0.278** (0.110)	0.0878 (0.0608)
Partnership	0.177 (0.171)	-0.155 (0.197)	0.159 (0.116)
Limited Liability Corp.	0.500*** (0.0925)	0.446*** (0.108)	0.197*** (0.0494)
Corporation	0.446*** (0.0946)	0.369*** (0.112)	0.195*** (0.0502)
Home Based	-0.675*** (0.0732)	-0.536*** (0.0846)	-0.152*** (0.0396)
Comparative Adv.	0.146** (0.0701)	0.0555 (0.0825)	-0.0574 (0.0401)
Intellectual Property	0.178** (0.0851)	-0.0122 (0.101)	0.117** (0.0547)
High Credit Score	0.111 (0.122)	0.447*** (0.152)	0.0169 (0.0741)
Low Credit Score	-0.257*** (0.0724)	-0.303*** (0.0836)	-0.0242 (0.0403)
Constant	7.155*** (0.608)	6.286*** (0.720)	5.826*** (0.344)
Observations	3806	3806	3806
R-squared	0.234	0.122	0.051

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
2-digit industry dummies included

The decomposition exercise was repeated for average financial injections over the 2005-2007 period, with the addition of sales as a control variable. Results are presented in Table 14. In these models the minority coefficient was positive in all three cases, but only statistically significant in the internal financing model. The finding indicates that the disparities presented in Table 12 disappear after controlling for other factors. The coefficient on female was again negative and statistically significant in all three models. The coefficients on the sales dummies were positive and usually statistically significant in all three models, indicating a positive correlation between size and level of financing. Owner age and education were generally no longer significant predictors, while hours worked continued to be positive and strongly significant in all three models. Credit scores continued to be an important determinant of the amount of financial capital obtained by the firm although the effects appear to be smaller than for startup capital. A strong determinant of subsequent capital investments for most types of financing are the sales level of the firm. Higher sales levels in the early stages of firm growth increased the amount of financing used in the firm.

Table 14

Linear Regressions for Subsequent Capital
Kauffman Firm Survey (2005-07)

Coefficients	Log of Internal Financing	Log of External Debt Financing	Log of External Equity Financing
Minority	0.278***	0.0125	0.0283
	(0.0760)	(0.0807)	(0.0377)
Female	-0.201***	-0.242***	-0.0997***
	(0.0721)	(0.0782)	(0.0318)
Age	-0.00465	0.0401**	-0.00729
	(0.0186)	(0.0192)	(0.00836)
Age Squared	0.000150	-0.000329	0.000129
	(0.000198)	(0.000204)	(0.0000918)
HS Graduate	0.0598	-0.0992	-0.114
	(0.242)	(0.237)	(0.0791)
Some College	0.113	0.0206	-0.00951
	(0.231)	(0.223)	(0.0791)
College Graduate	0.0701	-0.107	0.0462
	(0.234)	(0.228)	(0.0831)
Graduate Degree	0.198	-0.138	0.112
	(0.242)	(0.235)	(0.0904)
Hours Worked (weekly average)	0.00948***	0.00553***	0.00155**
	(0.00149)	(0.00158)	(0.000791)
Industry Experience (years)	-0.00405	-0.0112***	0.000311
	(0.00330)	(0.00362)	(0.00180)
Start up Experience	0.256***	0.0629	0.0390
	(0.0638)	(0.0691)	(0.0321)
Team Ownership	0.0670	0.120	0.153***
	(0.0869)	(0.0917)	(0.0489)
Partnership	0.0393	-0.391**	-0.0493
	(0.155)	(0.153)	(0.0716)
Limited Liability Corp.	0.0775	0.166*	0.0623
	(0.0862)	(0.0951)	(0.0397)
Corporation	0.0626	0.228**	0.0983***
	(0.0923)	(0.0996)	(0.0375)
Home Based	-0.217***	-0.0877	-0.0326
	(0.0705)	(0.0755)	(0.0366)
Comparative Adv.	-0.106	-0.0805	0.0309
	(0.0649)	(0.0710)	(0.0287)
Intellectual Property	0.402***	0.145*	0.214***
	(0.0828)	(0.0881)	(0.0511)
High Credit Score	0.168	0.348***	0.0462
	(0.117)	(0.123)	(0.0664)
Low Credit Score	-0.137**	-0.160**	0.0203
	(0.0683)	(0.0737)	(0.0305)
Sales ($50-$18,000)	0.859***	0.439***	0.0436
	(0.0835)	(0.0838)	(0.0346)
Sales ($18,001-$52,000)	1.203***	1.028***	0.0271
	(0.0911)	(0.0947)	(0.0376)
Sales ($52,001-$121,000)	1.509***	1.633***	0.0267
	(0.102)	(0.108)	(0.0422)
Sales ($121,000+)	1.544***	2.301***	0.207***
	(0.114)	(0.118)	(0.0606)
Constant	6.766***	6.302***	6.248***
	(0.569)	(0.576)	(0.307)
Observations	3806	3806	3806
R-squared	0.203	0.264	0.077

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1
2-digit industry dummies included

We now turn to explaining differences in financing between minority and non-minority firms. The decomposition exercise described earlier was repeated with the KFS data. Results are presented in Table 15. Very little of the differences in start up capital are explained by racial differences in owner and firm characteristics, including credit scores. The owner's age provides the largest contributions to the gaps in internal financing and external debt at roughly 4 percentage points. This may partly capture the effects of owner's wealth on access to internal financing and use as collateral for obtaining loans. Minority owners tend to be younger and may have less personal wealth. Credit scores only explain a small amount of the gap in startup capital.

Table 15
Decompositions for Logs of Startup and Subsequent Capital
Kauffman Firm Survey (2004-07)

	Specification					
	Startup Capital			Subsequent Capital		
	Internal Financing (1)	External Debt (2)	External Equity (3)	Internal Financing (4)	External Debt (5)	External Equity (6)
Non-minority mean of dep var	9.2300	7.6700	6.4400	7.9900	7.8700	6.4000
Minority mean of dep. var	9.1600	7.3700	6.3400	8.0600	7.6100	6.4000
Non-min/min. difference	0.0700	0.3000	0.1000	-0.0700	0.2600	0.0000
Female	0.0016	0.0017	0.0013	0.0020	0.0024	0.0010
Owner Education	0.0089	0.0029	-0.0015	-0.0014	-0.0076	-0.0051
Owner Age	0.0455	0.0382	0.0098	0.0277	0.0307	0.0304
Industry and Start Up Experience	-0.0169	-0.0186	0.0013	0.0114	-0.0136	0.0032
Team Ownership	0.0032	0.0028	0.0009	0.0007	0.0012	0.0015
Legal form of organization	0.0105	0.0097	0.0040	0.0017	0.0033	0.0009
Comparative Adv & Intellectual Prop.	0.0088	0.0033	-0.0034	-0.0064	-0.0048	0.0019
Home Based	-0.0135	-0.0107	-0.0030	-0.0043	-0.0018	-0.0007
Credit scores	0.0176	0.0271	0.0018	0.0116	0.0166	-0.0003
Hours Worked (week)	-0.0639	-0.0286	-0.0035	-0.0287	-0.0168	-0.0047
Industry	-0.0079	-0.0180	0.0070	0.0073	0.0075	0.0090
Sales	n/a	n/a	n/a	0.1715	0.2256	0.0137
Total explained	-0.0061	0.0098	0.0146	0.1930	0.2427	0.0509

Notes (1) See text for more details on decompositions.

About a quarter of the differences in subsequent financial injections of external debt are explained by differences in sales. Surprisingly, only about two percent is explained by differences in credit scores. Just under 20 percent of the differences in internal financing injections after start up are explained. Again, the majority is explained by differences in sales. Only about five percent of the differences in external equity injections are explained. Sales only accounted for about one percentage point of the five percentage point difference.

The Employment Returns to Financing

A stated goal of the U.S. Small Business Administration (SBA) Certified Development Company/504 guaranteed lending program is to create or retain one job for each $50,000 provided by the SBA.[98] Small manufacturers have a $100,000 job creation or retention goal, and in the 2009 stimulus package the goal for the SBA program has been increased to $65,000 per job. A similar calculation can be made from the overall amount spent on the President's stimulus package. The total amount spent on the stimulus package is $789.5 billion with the goal of creating 3.5 million jobs. This translates into $225,000 of stimulus funds for each job created in the United States.

[98] U.S. Small Business Administration, CDC/504 Program (accessed July 2009); available from http://www.sba.gov/financialassistance/prospectivelenders/cdc504/index.html.

The SBA also provides information on the number of jobs created and retained from firms receiving funding from its 7(a) and 504 programs. As Table 16 indicates, the 7(a) program provides $18,000 in loans for every job created or retained by participant businesses. The 504 program provides $42,000 in funds for each job.

Table 16
Job Creation through Small Business Administration Loan Programs (2005-08)

	FY 2005	FY 2006	FY 2007	FY 2008
SBA 7(a) Program				
Total amount of loans ($000s)	$13,998,331	$13,447,225	$13,211,731	$11,675,399
Jobs created	155,821	206,608	265,095	200,081
Jobs retained	506,312	583,562	599,852	449,190
Investment per job created or retained	$21,141	$17,018	$15,275	$17,982
SBA 504 Program				
Total amount of loans ($000s)	$4,942,067	$5,610,828	$6,176,210	$5,117,079
Jobs created	85,540	89,601	97,280	79,274
Jobs retained	49,482	45,878	43,498	42,449
Investment per job created or retained	$36,602	$41,415	$43,872	$42,039

Source: U.S. Small Business Administration (2009)

Are these estimates in line with the amount of financing firms use and their resulting job creation? The data demands for such a calculation are great. A measure of each firm's investments through equity financing or loans over time is needed as well as a measure of the net number of jobs created over the same time period. Unfortunately, this level of detailed data is not readily available. There is one exception and that is for new firms that are measured in the KFS. Because the KFS captures firms from their initial startup to several years out, and records annual investment amounts from all sources, we can estimate the total amount invested in these young firms. We can also examine total net employment created by the firm in the last year of the survey. The main disadvantage of this approach is that it may understate the total employment returns to financing because it only measures employment four years after business inception. Firms starting in 2004 are followed through 2007 in the KFS. The return to financial investments at the earlier stages of firm growth may take longer to be realized.

Estimates from the KFS indicate that the average young firm invests $214,338 over the first four years of existence (see Table 17). The average firm by the end of this period has created 2.5 net new jobs. Thus, the average investment per created job for young firms is $85,055. Focusing on young minority firms, we find an investment of $52,374 per job. The non-minority average investment per job is $95,492.

Table 17
Financing per Job Created among Young Firms
Kauffman Firm Survey (2004-07)

	Total Financing 2004-2007	Employment Creation by 2007	Financing per Job
Minority	$162,358	3.1	$52,374
Non-Minority	$227,272	2.4	$95,492
Total	$214,338	2.5	$85,055

Source: Kauffman Firm Survey 2004-07.

Employment measures after only four years since business inception are likely to underestimate longer-term employment creation because of the short time frame. Longer-term job creation would result in a smaller level of financing per job than the estimates from the KFS sample of young firms. Although understated, the estimates from the KFS are in the same broad range as the new SBA goal of $65,000 per job created or retained.

It is important to note that this measure of the employment returns to financing does not represent the causal effects of financing on employment. Firms that receive substantial amounts of financing, for example, may have created a large number of jobs without these funds or with fewer funds. And, firms that have only obtained small amounts of financing may not have created a large number of jobs even if they had obtained substantially more financing. With these concerns in mind, the calculations here provide only an approximation to actual levels and some care is required in interpreting these results as the required amount of financing needed to create a job.

Table 17 also indicates that young minority-owned firms created jobs at similar rates than young non-minority firms. As discussed before, 2002 Census data showed that minority firms also paid similar wages compared to non-minority firms. According to the Bureau of Labor Statistics, the national unemployment rate reached 9.8 percent in September of 2009, and the unemployment rate of African Americans is even higher at 15.4 percent, followed by that of Hispanics at 12.7 percent. Greater capital access for minority-owned firms is essential to sustain their growth, reduce national unemployment levels, and in particular the high rate of unemployment in minority communities.

Conclusions

Minority business enterprises (MBEs) contribute substantially to the U.S. economy. The number of minority firms, their gross receipts, employment and payrolls are growing at a faster rate than for non-minority firms.

Moreover, young minority-owned firms created jobs at similar rates than young non-minority firms. Minority-owned firms are a critical component to reducing the national unemployment rate, especially the elevated unemployment in minority communities.

Inadequate access to financial capital is found to be a particularly important constraint limiting the growth of minority-owned businesses. Estimates generated for this report provide extensive evidence of the difficulties in obtaining financial capital among minority-owned businesses.

The current economic climate is only making the situation worse. All recent indicators of personal wealth and access to financial capital point to worsening conditions for entrepreneurs. Bankruptcy filings have increased dramatically over the past year and are likely to continue.

It is vital to the short-term survival and long-term success of MBEs that we aggressively address the liquidity constraints created by the current financial crisis. The resulting loss of MBEs will be very harmful for job creation, innovation, economic parity, and productivity in the country. There is a sizeable loss of efficiency in the overall U.S. economy imposed by the financing constraints faced by MBEs because of the large and growing share of all businesses owned by minorities. Barriers to ensuring access to capital and thus growth to any of the diverse sets of groups of businesses in the country limit total U.S. productivity in addition to contributing to economic inequality.

Bibliography

Allen, W. David. "Social Networks and Self-Employment." *Journal of Socio-Economics 29*, no. 5 (2000): 487-501.

American Express. "Entrepreneurs Say Managing Through Recession Makes Them Sharper Business Owners, *According To The American Express® Open Small Business Monitor.* 2009. Accessed October 2009. Available from http://home3.americanexpress.com/corp/pc/2009/mtr.asp.

Astebro, Thomas and Irwin Bernhardt. "Start-Up Financing, Owner Characteristics and Survival." *Journal of Economics and Business* 55, no. 4 (2003): 303-320.

Avery, Robert B., Raphael W. Bostic, and Katherine A. Samolyk. "The Role of Personal Wealth in Small Business Finance." *Journal of Banking and Finance 22*, no. 6 (1998): 1019-1061.

Bates, Timothy. *Banking on Black Enterprise.* Washington, D.C.: Joint Center for Political and Economic Studies, 1993.

Bates, Timothy. *Race, Self-Employment & Upward Mobility: An Illusive American Dream.* Washington, D.C.: Woodrow Wilson Center Press and Baltimore: John Hopkins University Press, 1997.

Bates, Timothy. "Financing Disadvantaged Firms." *Credit Markets for the Poor.* Eds. Bolton, Patrick and Howard Rosenthal. New York: Russell Sage Foundation, 2005.

Bates, Timothy, and William D. Bradford. "Venture-Capital Investment in Minority Business." *Journal of Money Credit and Banking* 40, no. 2-3 (2008): 489-504.

Bates, Timothy, and David Howell. "The Declining Status of African American Men in the New York City Construction Industry." In *Race, Markets, and Social Outcomes*, eds. Patrick Mason and Rhonda Williams. Boston: Kluwer, 1997.

Becker, G. *The Economics of Discrimination.* 2nd ed. Chicago: University of Chicago Press, 1971.

Bernard, Andrew B., and Matthew J. Slaughter. *The Life Cycle of a Minority-Owned Business: Implications for the American Economy.* Paper Prepared for National Minority Enterprise Development Week 2004 Conference September 7-10, 2004. Washington, D.C.: Minority Business Development Agency, 2004.

Black, Jane, David de Meza, and David Jeffreys. "House Prices, The Supply of Collateral and the Enterprise Economy." *The Economic Journal* 106, no. 434 (1996): 60-75.

Blanchard, Lloyd, John Yinger and Bo Zhao. "Do Credit Market Barriers Exist for Minority and Women Entrepreneurs?" Syracuse University Working Paper, 2004.

Blanchflower, David G. "Entrepreneurship in the United States," IZA Working Paper No. 3130 (2007).

Blanchflower, David G., P. Levine and D. Zimmerman. "Discrimination in the Small Business Credit Market." *Review of Economics and Statistics* 85, no. 4 (2003): 930-943.

Blanchflower, David G. and Andrew J. Oswald. "What Makes and Entrepreneur?" *Journal of Labor Economics* 16, no.1 (1998): 26-60.

Blinder, Alan S. "Wage Discrimination: Reduced Form and Structural Variables." *Journal of Human Resources* 8, no. 4 (1973): 436-455.

Board of Governors of the Federal Reserve System. *The January 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices*, 2009. Accessed July 2009. Available from http://www.federalreserve.gov/boarddocs/SnLoanSurvey/200902/default.htm.

Borjas, George, and Stephen Bronars. "Consumer Discrimination and Self-Employment." *Journal of Political Economy* 97, no. 3 (1989): 581-605.

Bostic, R. and K.P. Lampani. "Racial Differences in Patterns of Small Business Finance: The Importance of Local Geography." Working Paper, 1999.

Boston, Thomas D. "Generating Jobs Through African American Business Development." In *Readings in Black Political Economy*, eds. J. Whitehead and C. Harris. Dubuque: Kendall-Hunt, 1999.

Boston, Thomas D. "The ING Gazelle Index." Accessed July 2009. Available from www.inggazelleindex.com.

Boston, Thomas D. "The Role of Black-Owned Businesses in Black Community Development." *Jobs and Economic Development in Minority Communities: Realities, Challenges, and Innovation*, eds. Paul Ong and Anastasia Loukaitou-Sideris. Temple University Press, 2006.

Bradford, William D. "The Wealth Dynamics of Entrepreneurship for Black and White Families in the U.S." *Review of Income and Wealth* 49, no.1 (2003): 89-116.

Board of Governors of the Federal Reserve System. "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances." *Federal Reserve Bulletin*, Brian K. Bucks, Brian K., Arthur B. Kennickell, and Kevin B. Moore. Washington, D.C.: Board of Governors of the Federal Reserve System, 2006.

Cavalluzzo, Ken, Linda Cavalluzzo, and John Wolken. "Competition, Small Business Financing, and Discrimination: Evidence from a New Survey." *Journal of Business* 75, no. 4 (2002): 641-679.

Cavalluzzo, Ken and John Wolken. "Small Business Loan Turndowns, Personal Wealth and Discrimination." *Journal of Business* 78, no 6 (2005): 2153-2177.

Coleman, Susan. "The Borrowing Experience of Black and Hispanic-Owned Small Firms: Evidence from the 1998 Survey of Small Business Finances." *The Academy of Entrepreneurship Journal* 8, no. 1 (2002): 1-20.

Coleman, Susan. "Borrowing Patterns for Small Firms: A Comparison by Race and Ethnicity." *The Journal of Entrepreneurial Finance & Business Ventures* 7, no. 3 (2003): 87-108.

Dunn, Thomas A. and Douglas J. Holtz-Eakin. "Financial Capital, Human Capital, and the Transition to Self-Employment: Evidence from Intergenerational Links." *Journal of Labor Economics* 18, no. 2 (2000): 282-305.

Earle, John S. and Zuzana Sakova. "Business Start-Ups or Disguised Unemployment? Evidence on the Character of Self-Employment from Transition Economies." *Labour Economics* 7, no. 5 (2000): 575–601.

Evans, David S. and Linda S. Leighton. "Some Empirical Aspects of Entrepreneurship." *American Economic Review* 79, no. 3 (1989): 519-535.

Evans, David S. and Boyan Jovanovic. "An Estimated Model of Entrepreneurial Choice under Liquidity Constraints." *Journal of Political Economy* 97, no. 4 (1989): 808-827.

Fairlie, Robert W. "The Absence of the African American Owned Business: An Analysis of the Dynamics of Self-Employment." *Journal of Labor Economics* 17, no. 1 (1999): 80-108.

Fairlie, Robert W. "Entrepreneurship among Disadvantaged Groups: An Analysis of the Dynamics of Self-Employment by Gender, Race and Education." *The Life Cycle of Entrepreneurial Ventures, International Handbook Series on Entrepreneurship 3*, ed. Simon Parker. Springer: New York, 2006.

Fairlie, Robert W. *The Kauffman Index of Entrepreneurial Activity: 1996-2007.* Ewing Marion Kauffman Foundation: Kansas City, 2008.

Fairlie, Robert W. "Estimating the Contribution of Immigrant Business Owners to the U.S. Economy," Final Report for U.S. Small Business Administration, Office of Advocacy, Washington, D.C, 2008.

Fairlie, Robert W. and Harry A. Krashinsky. "Liquidity Constraints, Household Wealth, and Entrepreneurship Revisited," Working Paper, 2008.

Fairlie, Robert W. and Bruce D. Meyer. "Ethnic and Racial Self-Employment Differences and Possible Explanations," *Journal of Human Resources*, 31, no. 4 (1996): 757-793.

Fairlie, Robert W. and Alicia M. Robb. "Why are Black-Owned Businesses Less Successful than White-Owned Businesses: The Role of Families, Inheritances, and Business Human Capital." *Journal of Labor Economics* 25, no. 2 (2007): 289-323.

Fairlie, Robert W. and Alicia M. Robb. *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States.* Cambridge: MIT Press, 2008.

Fairlie, Robert W. and Christopher Woodruff. "Mexican-American Entrepreneurship." University of California Working Paper, 2009.

Fairlie, Robert W., Julie Zissimopoulos, and Harry Krashinsky. "The International Asian Business Success Story? A Comparison of Chinese, Indian and Other Asian Businesses in the United States, Canada and United Kingdom." In *International Differences in Entrepreneurship*, eds. Joshua Lerner and Antoinette Schoar (forthcoming), (accessed October 2009). Available from http://www.nber.org/chapters/c8221.pdf.

Feagin, Joe R. and Nikitah Imani. "Racial Barriers to African American Entrepreneurship: An Exploratory Study." *Social Problems* 41, no. 4 (1994): 562-585.

Federal Reserve System, Board of Governors. "Summary of Commentary on Current Economic Conditions by Federal Reserve Districts," *The Beige Book*, 2009.

Federal Reserve System, Board of Governors. *The April 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices*, 2009. Accessed October 2009. Available from http://www.federalreserve.gov/boarddocs/SnLoanSurvey/200905/.

Greenhalgh, Leonard. *Increasing MBE Competitiveness through Strategic Alliances*, Washington D.C.: Minority Business Development Agency, U.S. Department of Commerce, 2008.

Greenlining Institute. *Annual Report on Lending to Minority-owned Small Business: An Analysis of 2008 SBA Lending to Minorities*, 2008.

Holtz-Eakin, Douglas, David Joulfaian, and Harvey S. Rosen. "Entrepreneurial Decisions and Liquidity Constraints." *RAND Journal of Economics* 25, no. 2 (1994): 334-347.

Holtz-Eakin, Douglas and Harvey S. Rosen "Cash Constraints and Business Start-Ups: Deutschmarks versus Dollars." *Contributions to Economic Analysis & Policy* 4, no. 1 (2005).

Hout, Michael and Harvey S. Rosen. "Self-Employment, Family Background, and Race." *Journal of Human Resources* 35, no. 4 (2000): 670-692.

Johansson, Edvard. "Self-Employment and Liquidity Constraints: Evidence from Finland." *Scandinavian Journal of Economics* 102, no. 1 (2000): 123-134.

Kawaguchi, Daiji. "Negative Self Selection into Self-Employment among African Americans." *Topics in Economic Analysis & Policy*, Berkeley Electronic Press Journals 5, no. 1 (2005): 1-25.

Kim, Kwang, Won Hurh, and Marilyn Fernandez. "Intragroup Differences in Business Participation: Three Asian Immigrant Groups." *International Migration Review* 23, no. 1 (1989).

Lentz, Bernard and David Laband. "Entrepreneurial Success and Occupational Inheritance among Proprietors." *Canadian Journal of Economics* 23, no. 3 (1990): 563-579.

Lindh, Thomas and Henry Ohlsson. "Self-Employment and Windfall Gains: Evidence from the Swedish Lottery." *Economic Journal 106*, no. 439 (1996): 1515-1526.

Lofstrom, Magnus and Timothy Bates. "Latina Entrepreneurs." *Small Business Economics*, 2009 (forthcoming).

Lofstrom, Magnus and Chunbei Wang. "Hispanic Self-Employment: A Dynamic Analysis of Business Ownership." University of Texas at Dallas Working Paper, 2006.

Mach, Traci L. and John D. Wolken. " Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances." *Federal Reserve Bulletin* 87 (2006): 167-195.

Mar, Don. "Individual Characteristics vs. City Structural Characteristics: Explaining Self-Employment Differences among Chinese, Japanese, and Filipinos in the United States." *Journal of Socio-Economics* 34, no. 3 (2005).

Meyer, Bruce. "Why Are There So Few Black Entrepreneurs?," National Bureau of Economic Research, Working Paper No. 3537, 1990.

National Federation of Independent Business. *Small Business Economic Trends*, William C. Dunkelberg and Holly Wade, 2009. Accessed October 2009. Available from http://www.nfib.com/Portals/0/PDF/sbet/sbet200905.pdf.

Oaxaca, Ronald. "Male-Female Wage Differentials in Urban Labor Markets." *International Economic Review* 14, no. 3 (1973): 693-709.

Oaxaca, Ronald and Michael Ransom. "On Discrimination and the Decomposition of Wage Differentials," *Journal of Econometrics* 61, no. 1 (1994): 5-21.

Office of Federal Housing Enterprise Oversight. OFHEO House Price Index, 2009. Accessed July 2009. Available from http://www.ofheo.gov.

Owens, John and Robert Pazomik. *Minority Business Enterprises in the Global Economy: The Business Case*. Prepared in collaboration with the Minority Business Development Agency. Washington D.C.: Minority Business Development Agency, 2003.

Parker, Simon C. *The Economics of Self-Employment and Entrepreneurship*. Cambridge: Cambridge University Press, 2004.

PricewaterhouseCoopers (PwC) and the National Venture Capital Association. *MoneyTree™ Report*, based on data provided by Thomson Reuters, 2009. Accessed October 2009. Available from www.pwcmoneytree.com.

Robb, Alicia. *The Role of Race, Gender, and Discrimination in Business Survival.* PhD. Diss., University of Michigan Press, 2000.

Sohl, Jeffrey. "The Angel Investor Market in 2008: A Down Year In Investment Dollars But Not In Deals." Center for Venture Research, 2008. Accessed October 2009. Available from http://wsbe.unh.edu/files/2008_Analysis_Report_Final.pdf.

Taylor, Mark P. "Self-Employment and Windfall Gains in Britain: Evidence from Panel Data." *Economica* 68, no. 272 (2001): 539-565.

U.S. Census Bureau. *1992 Economic Census: Characteristics of Business Owners*. Washington, D.C.: U.S. Government Printing Office, 1997.

U.S. Census Bureau, *Wealth and Asset Ownership, 2008.* Accessed July 2009. Available from http://www.census.gov/hhes/www/wealth/2002_tables.html.

U.S. Census Bureau. *2002 Economic Census, Survey of Business Owners Company Statistics Series*. Washington, D.C.: U.S. Government Printing Office, 2006.

U.S. Department of Commerce, Minority Business Development Agency and Milken Institute. *The Minority Business Challenge: Democratizing Capital for Emerging Domestic Markets*. Research Report, Glenn Yago and Aaron Pankrat, 2000.

U.S. Department of Commerce, Economics and Statistics Administration and the Minority Business Development Agency. *Keys to Minority Entrepreneurial Success: Capital, Education and Technology*, Patricia Buckley, 2002.

U.S. Department of Commerce, Minority Business Development Agency. *Accelerating Job Creation and Economic Productivity: Expanding Financing Opportunities for Minority Businesses*, 2004.

U.S. Department of Commerce, Minority Business Development Agency. *The State of Minority Business Enterprises, An Overview of the 2002 Survey of Business Owners, Number of Firms, Gross Receipts, and Paid Employees*, 2006.

U.S. Department of Commerce, Minority Business Development Agency. *The State of Minority Business* (fact sheet), 2008. Accessed October 2009. Available from http://www.mbda.gov/index.php?section_id=6&bucket_id=789#bucket_852.

U.S. Department of Commerce, Minority Business Development Agency. *Characteristics of Minority Businesses and Entrepreneurs, An Analysis of the 2002 Survey of Business Owners*, 2008.

United States Small Business Administration, Office of Advocacy. *Availability of Financing to Small Firms using the Survey of Small Business Finances*, K. Mitchell, K. and D.K. Pearce, 2005.

U.S. Small Business Administration, Office of Advocacy. *Educational Attainment and Other Characteristics of the Self-Employed: An Examination Using the Panel Study of Income Dynamics Data*, C. Moutray. Washington, D.C Working Paper, 2007.

U.S. Small Business Administration. CDC/504 Program. Accessed October 2009. Available from http://www.sba.gov.

van der Sluis, J., van Praag, M., and Vijverberg, W. *Education and Entrepreneurship in Industrialized Countries: A Meta-Analysis*. Tinbergen Institute Working Paper no. TI 03–046/3, Amsterdam: Tinbergen Institute, 2004.

About the Authors

Dr. Robert W. Fairlie

Dr. Robert W. Fairlie is a Professor of Economics at the University of California, Santa Cruz, Director of the UCSC Masters Program in Applied Economics and Finance, and adjunct researcher at RAND. He was a Visiting Fellow at Yale University, Australian National University, and IZA, in Germany. His research interests include entrepreneurship, technology, inequality, labor economics, education, and immigration. He recently published "Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States" with MIT Press. He is also author of the Kauffman Index of Entrepreneurial Activity. He has published numerous articles in leading academic journals in economics, public policy, management and demography. He has testified to the U.S. Congress, U.S. Department of Treasury and the California State Assembly regarding the findings from his research. Dr. Fairlie holds a Ph.D. and M.A. in Economics from Northwestern University and a B.A. with honors from Stanford University.

Dr. Alicia M. Robb

Dr. Alicia M. Robb is a Senior Economist with Beacon Economics, specializing in minority entrepreneurship, small business outcomes, lending discrimination, government procurement, and economic development. She is currently a Senior Research Fellow with the Ewing Marion Kauffman Foundation. She is also the Founder and President of the Foundation for Sustainable Development, an international development organization working with local nonprofit organizations in six countries throughout Latin America, East Africa, and South Asia. She has worked as a staff economist for an economic consulting firm and as an economist for the Office of Economic Research in the Small Business Administration and for the Division of Research and Statistics at the Federal Reserve Board of Governors. She recently published "Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States" with MIT Press. She received her Ph.D. in Economics from the University of North Carolina at Chapel Hill, specializing in economic development and econometrics.

www.mbda.gov

Mr. HINSON. And now, with the Committee's approval, I would like to move on into some of the things that MBDA is doing to address some of these challenges.

As many of you know, MBDA has been in existence for over 40 years. The agency's mission is to foster the growth and global competitiveness of minority-owned and operated firms nationwide. Our goal is to create a new generation of businesses with $100 million or more in annual revenue, which in turn will generate higher economic activity and job creation.

MBDA's performance is evaluated annually on the number of new jobs created, the dollar value of contracts awarded and the dollar value of financing packages. Last year, MBDA executed on over $3 billion in contracts and financings, which equated to the creation of over 3,000 new jobs.

However, the potential for growth is largely untapped and unrealized. If the minority-owned business community reached economic parity, which is something we spend a lot of time talking about in our agency, this business sector would employ 16 million people and generate $2.5 trillion in gross receivables, thereby expanding the national tax base by billions of dollars.

Clearly, the growth of minority-owned firms can generate much needed employment, gross receipts, and add to the overall expansion of our national economy. Investing in firms owned by minorities not only makes good business sense, but it is an investment in the future of our nation.

MBDA is undertaking a variety of actions to improve access to capital. I would like to take a moment and just touch on several of these particular initiatives that we are focusing on.

Chair LANDRIEU. Try to wrap up in a minute, if you would.

Mr. HINSON. Okay, very good. The first one is a surety bonding initiative. Although minority-owned firms represent 12 percent of the total construction companies, typically they receive less than 1 percent of the government contracts. One of the things we are focusing on, Madam Chair, is to identify $100 million in private capital through a public-private partnership that will leverage up to a billion dollars to provide surety bonding access and capability for minority-owned and operated construction firms.

The second initiative that we are focusing on is a minority investment fund initiative. We are working with investment firms nationwide to pull together and coalesce capital around minority-owned and operated businesses in high-growth industries such as green technology, clean energy, health care infrastructure and broadband technology. And we believe that by coalescing capital around these particular key industries, that we can pull together over a billion dollars of wealth from private sources and institutional capital, to help address the issue of access to capital for minority firms within these key industries.

On a final note, Madam Chair, the Department of Commerce and MBDA are honored by this opportunity to testify before you and your distinguished colleagues. I respectfully request that my full written testimony be entered into the official hearing record.

We look forward to working with you to create an environment where minority firms have an equal opportunity to participate in every sector of the marketplace. Thank you.

[The prepared statement of Mr. Hinson follows:]

U.S. DEPARTMENT OF COMMERCE
MBDA
MINORITY BUSINESS DEVELOPMENT AGENCY

WRITTEN TESTIMONY OF DAVID A. HINSON, NATIONAL DIRECTOR MINORITY BUSINESS DEVELOPMENT AGENCY U.S. DEPARTMENT OF COMMERCE

Before the United States Senate
Committee on Small Business and Entrepreneurship

April 15, 2010

Opening

Good Morning Madam Chair Landrieu, Ranking Member Snowe, and distinguished Members of the Committee. Thank you for inviting the Minority Business Development Agency (MBDA) here today to discuss capital access for minority businesses and the activities of MBDA.

My name is David A. Hinson and I was appointed as the National Director of the Minority Business Development Agency by Commerce Secretary Gary Locke on July, 15, 2009.

Prior to assuming this position, I was the President and CEO of Wealth Management Network, Inc., a multi-million dollar independent, financial advisory boutique. I have also held a variety of senior-level and mid-management positions at Bank of America, Morgan Stanley & Company, First Chicago Bank (now JP Morgan Chase) and the Village Foundation.

Overview

As is abundantly clear, the financial environment and recession last year has created tighter credit markets, a decline in housing values and swollen labor markets. For all businesses, especially those that are minority-owned, having access to working capital – or capital that is used to keep operations going and pay bills – has always been, and continues to mean the difference between the success or failure of that business.

Firms also need capital to fund their growth and ability to perform on contracts. And still others – primarily those in the construction field – need bonds to fulfill contractual obligations. Capital access is, in fact, one of the most important challenge business owners face on a daily basis.

Access to capital for minority-owned businesses, however, is an issue today as it was in 1969 when the Minority Business Development Agency was established. While there are some valuable lending and bonding programs available, minority-owned businesses continue to face substantial barriers and disparities with respect to accessing capital.

Last year we conducted multiple stakeholder forums with minority businesses, financiers and minority business associations to dissect the issue and explore solutions. It was from these meetings that MBDA agreed a study about capital access between minority and non-minority-owned businesses was needed.

Key Findings from the MBDA Report

In the January 2010 study commission by MBDA and co-authored by Drs. Robert Fairlie and Alicia Robb, entitled *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations faced by MBEs*, we found that limited financial, human and social resources – as well as racial discrimination – are primarily responsible for the disparities in capital.

Some particular aspects of the findings include:

1. Minority-owned firms are less likely to receive loans than non-minority owned firms.

- The denial rate for minority-owned firms with **less than $500,000 in annual revenues** is 41.9% compared to 16% for non-minority-owned firms.[1]
- The denial rate for minority-owned firms with **more than $500,000 in annual revenues** is 14.9% compared to 8.4% for non-minority-owned firms.[2]

2. When minority-owned firms do receive financing, they are provided less money regardless of the size of their firm, and at a higher interest rate.
   - The average loan size for a minority-owned firm with **less than $500,000 in annual revenues** is just over $9,000 while the average loan amount for a non-minority-owned firm of the same size is more than $20,000.[3]
   - The same holds true for **firms with annual revenues exceeding $500,000**—the average loan amount for a minority-owned firm is approximately $150,000 compared to more than $310,000 for a non-minority-owned firm.[4]
   - Additionally, loan interest rates for minority-owned firms with gross revenues less than $500,000 exceed 9% while non-minority-owned firms of the same size are often able to secure interest rates at less than 7%.[5]
3. Minority-owned firms also receive smaller equity investments than non-minority-owned firms even when controlling for firm size.
   - The average equity investment in a minority-owned firm earning more than $500,000 just exceeds $7,000; yet for a non-minority-owned firm, the average investment is more than $19,000.[6]
4. Yet, this same report finds that venture capital funds focused on investing in the minority business community are highly competitive. [7]
5. Moreover, during the 2001 recession, employment at minority-owned firms increased by 4% while employment among non-minority firms declined by 7%.[8] So had it not been for the employment growth among minority-owned firms, the job loss during this period would have been even larger.[9]

I see that Dr. Fairlie is scheduled to testify and understand he will go into more details of the MBDA report in a later panel this morning. Thus, at this time, Madam Chair, I would like to request that the MBDA report, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations faced by MBEs*, in its entirety be entered in the hearing's official record.

And now, with the Committee's approval, I would like to move into some of the things MBDA is doing to address these challenges.

---

[1] U.S. Department of Commerce, Minority Business Development Agency, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs* (2010). The data source is the Federal Reserve System, Board of Governors, *2003 Survey of Small Business Finances.*
[2] Ibid.
[3] Ibid.
[4] Ibid.
[5] Ibid
[6] Ibid.
[7] Timothy Bates and William D. Bradford, "Venture-Capital Investment in Minority Business," *Journal of Money Credit and Banking* 40, no. 2-3 (2008): 489-504.
[8] U.S. Department of Commerce, Minority Business Development Agency, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs* (2010). The data source is the U.S. Census Bureau's Special Tabulation on Minority-Owned Firms issued for the Minority Business Development Agency (2007).
[9] Ibid.

Overview of MBDA

As many of you know, MBDA has been in existence for over forty years. We are authorized by Executive Order 11625, as amended, and receive annual appropriations from the Commerce, Justice, and State Appropriations Subcommittee. The Agency's mission is to foster the growth and global competitiveness of U.S. businesses that are minority-owned.

We work with minority-owned firms of all sizes during all stages of their business life cycle with a special focus on firms with annual gross revenues of at least one million dollars. Our goal is to create a new generation of businesses with $100 million in annual revenue which in turn will generate higher economic activity and job creation.

MBDA funds a nationwide network of approximately 45 centers, which are operated as public/private partnerships. The centers are staffed by professional consultants who have the knowledge and practical experience necessary to operate profitable businesses.

MBDA's Performance Accomplishments

MBDA's performance is evaluated annually on the number of new jobs created, the total dollar value of contract awards and the total dollar value of financing transactions generated by the Agency. Last year, MBDA helped firms access more than $3 billion in contracts and financing, of which $800 million was specifically working capital, equity investments and bonding. Additionally, the growth of these minority firms led to the creation of more than 3,000 new jobs.

Still, there is much work ahead of us.

Consider this: A special tabulation completed by the U.S. Census Bureau on the 2002 Survey of Business Owners, showed that the growth rate in the number of minority-owned firms far outpaced that of non-minority owned businesses. Minority-owned firms employed almost 4.7 million workers with an annual payroll of $115 billion.[10] And these firms generated $661 billion in annual gross receipts.[11]

Despite this success, the potential for growth among minority-owned firms is largely untapped and unrealized.

For example, if the minority-owned business community had reached economic parity with their population representation in 2002, minority-owned businesses would have employed more than 16 million workers and generated more than $2.5 trillion in gross receipts,[12] thereby expanding the national tax base by billions of dollars. Clearly, the growth of capable and qualified

---

[10] U.S. Department of Commerce, Minority Business Development Agency, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs* (2010). The data source is the U.S. Census Bureau's Special Tabulation on Minority-Owned Firms issued for the Minority Business Development Agency (2007).

[11] Ibid.

[12] Ibid. U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises, An Overview of the 2002 Survey of Business Owners, Number of Firms, Gross Receipts, and Paid Employees* (2006). U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises*,(Fact Sheet) (2008).

minority-owned firms is necessary and will generate much needed employment, gross receipts, and add to the overall expansion of our national economy.

Denying capital to minority-owned firms constrains innovation and job creation. Working together, we can close this opportunity gap. By providing adequate capital to the minority-owned business community, we can achieve our goals of domestic prosperity and global competitiveness.

Moreover, in light of the U.S. Census' projections that the U.S. population will be majority minority by 2042,[13] investing in firms owned by minorities not only makes good business sense, but it is an investment in the future of the U.S. economy.

MBDA Initiatives

In addition to our ongoing efforts to grow the dollar volume of financing awards that we facilitate for our clients, MBDA is undertaking two specific initiatives to improve access to traditional and non-traditional sources of capital:

1. Surety Bonding Initiative

   Although minority firms represent 12 percent of all firms in construction nationwide,[14] currently fewer than one percent of all Federal construction contracts go to minority contractors. One of the leading causes of this is these contractors' inability to obtain surety bonding.

   The inherent problem is twofold: 1) consolidation of the surety industry has restricted access to performance bonds by raising underwriting standards; and 2) minority contractors continue to face discriminatory barriers and often lack the capacity, both financially and in terms of human resources, to effectively navigate through the myriad Federal, state, insurance, surety company, and private technical assistance programs available to them.

   Our goal is to help to identify over $100 million in private capital through a public/private partnership and to grow that capacity to over $1 billion in surety bonding capacity over time.

2. Minority Investment Fund Initiative

   MBDA is also focused on assisting minority-owned businesses outside the construction industry gain greater access to capital.

   MBDA is currently exploring the viability of a privately managed investment fund that would target minority-owned businesses in high-growth industries including green technology, clean energy, health care, infrastructure and broadband technology.

[13] U.S. Census Bureau's 2000 Census projections for population (2008).
[14] MBDA industry analysis of data from the U.S. Census Bureau's Special Tabulation on Minority-Owned Firms issued for the Minority Business Development Agency (2007).

MBDA believes it is possible to spur the development of a privately managed investment fund that would attract $100 million dollars in private wealth and institutional capital and help to address some of the barriers minority owned firms face in obtaining capital from existing funds and lenders.

Conclusion

I would again like to thank you Madam Chair Landrieu, Ranking Member Snowe, and the entire Committee for allowing me to testify before you today. I respectfully request the Chair to enter my full written testimony into the official hearing record.

On a final note, Madam Chair, the Department of Commerce and MBDA are honored by this opportunity to testify before you and your distinguished colleagues. We look forward to working with you to create an environment where minority firms have an equal opportunity to participate in the marketplace. Thank you.

Chair LANDRIEU. Thank you very much, Mr. Hinson.

Mr. Hedgespeth.

STATEMENT OF GRADY HEDGESPETH, DIRECTOR, OFFICE OF FINANCIAL ASSISTANCE, OFFICE OF CAPITAL ACCESS, U.S. SMALL BUSINESS ADMINISTRATION

Mr. HEDGESPETH. Chair Landrieu, Ranking Member Snowe, thank you for the opportunity to discuss the access to capital for minority-owned small businesses.

At SBA, we understand the unique challenges that underserved communities face in the current economic environment. SBA's loan programs are designed to fill various market gaps, including those created by racial discrimination. Historically, small businesses in these underserved communities are among the hardest hit during tough economic times, and based on what we have seen, that is certainly the case in this recession.

As my counterpart, Director Hinson, points out, this recent MBDA study found that minority entrepreneurs face significant discriminatory barriers in the marketplace. Through our loan guarantee programs, a series of new targeted initiatives and our 8(a) Business Development Program, SBA is expanding its efforts to help these entrepreneurs overcome some of those barriers.

In terms of accessing capital, SBA has a proven track record of assisting minority-owned firms through our 7(a) and 504 guaranteed loan programs, as well as our microloan program. According to the study by the Urban Institute, SBA-backed loans are about three times more likely than conventional loans to go to minority-owned firms.

Also, minority small business loans constitute a percentage of our loan dollars that is five times greater than that of the private sector. In 2009, 22 percent of all SBA-backed loans were made to minorities. These are loans to minority firms that are good credit risks, pointing out the critical role that SBA plays in addressing the barriers these firms face in the private market.

As we move forward in addressing the specific barriers that underserved communities, particularly minority communities, face, SBA continues to explore ways to engage its partners that share in a commitment to this mission. SBA's microloan program is an important way that the agency focuses on underserved markets. SBA makes direct loans to nearly 180 community-based microloan intermediaries who provide both loans and technical assistance to small business borrowers. Since its inception, this program has made nearly $438 million of small business loans possible.

SBA also recognizes that many small businesses need more than just the loan. They need counseling and technical assistance to help strengthen their business plans and make them more bankable in this tight lending environment. To fill this need, SBA is working closely with its nationwide network of partners including about 900 small business development centers, 350 SCORE chapters and more than 100 women's business centers.

SBA is particularly excited about the results we are seeing from Emerging Leaders, formerly known as E–200, an intensive entrepreneurship training pilot for promising firms in our inner cities. In 2009, SBA provided training to businesses in New Orleans, Baltimore, Atlanta and several other cities: 62 percent of the participants were minorities, and early indicators show that 63 percent of participating companies hired new employees, of which 43 percent were hired from the local inner city communities.

In addition to our counseling and lending programs, SBA also provides support to minority-owned businesses through its 8(a) and HUBZone Business Development programs. However, a recent Federal Court ruling suggests that it would be useful to clarify and reiterate Congress's original intent that there should be parity among SBA's contracting programs. SBA hopes that Congress will act swiftly to resolve this issue, and we look forward to working with you and your counterparts in the House to confirm parity among SBA's contracting and business development programs.

SBA takes the issues of access to effective tools, including capital, contracts and counseling, very seriously because we know that minority and women-owned small businesses are among the fastest growing segments of our economy. At least they were until this recession.

We hope that this hearing will provide valuable insights into the challenges that the current economic climate poses for minority-owned businesses and underserved markets more broadly. We also hope this hearing will highlight the incredible potential these businesses have to help lead us into full economic recovery.

SBA thanks the Committee for inviting us to participate in this important discussion, and I am happy to take your questions and also ask that you permit us to submit more detailed testimony for the Committee record.

Chair LANDRIEU. Without objection, your testimony can be submitted.

[The prepared statement of Mr. Hedgespeth and the Compelling Interest brief follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Testimony of Grady Hedgespeth
Director of Financial Assistance
Office of Capital Access
U.S. Small Business Administration

Before the

Committee on Small Business & Entrepreneurship
United States Senate

Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets

April 15, 2010

Chair Landrieu, Ranking Member Snowe and members of the Committee, thank you for the opportunity to discuss access to capital for minority-owned small businesses. At SBA we understand the unique challenges that underserved communities face in the current economic environment. SBA's loan programs are designed to fill various market gaps, including those created by racial discrimination. Historically, small businesses in these underserved communities are among the hardest hit during tough economic times, and based on what we've seen, that is certainly the case in this recession. However, SBA remains fully committed to helping small businesses in these underserved communities obtain the financing they need to start and grow successful small businesses.

That commitment is evidenced by SBA's proven track record of assisting minority-owned firms through our 7(a) and 504 guaranteed loan programs, as well as our microloan program. According to a study by the Urban Institute, SBA-backed loans are about three times more likely than conventional loans to go to minority-owned firms. Also, minority small business loans constitute a percentage of our loan dollar volume that is about 5 times greater than that of the private sector. In 2009, 22% percent of all SBA-backed loans were made to minorities.

As we move forward in addressing the specific barriers that underserved communities — particularly minority communities — face, SBA continues to explore ways to engage its partners that share a commitment to this mission.

SBA's Microloan program is an important way that the Agency focuses on underserved markets. SBA makes direct loans to nearly 180 community-based microlender intermediaries who provide both loans and technical assistance to small business borrowers. Forty percent of SBA microloans are made to minorities. The Recovery Act temporarily increased funding for this program. As a result, SBA has engaged 20 new microlending partners this year and continues to expand the reach of this program.

SBA also recognizes that many small businesses need more than just a loan—they need counseling and technical assistance to help strengthen their business plans and make them more "bankable" in this tight lending environment. To fill this need, SBA is working closely with its nationwide network of partners, which includes about 900 Small Business Development Centers, 350 SCORE chapters, and more than 100 Women's Business Centers. These partners, and other organizations that receive SBA PRIME grants, work to assist small businesses in underserved markets.

SBA is particularly excited about the results we are seeing from emerging leaders (formerly E-200), an intensive entrepreneurship training pilot for promising firms in our inner cities. In 2009, SBA provided training to businesses in New Orleans, Baltimore, and Atlanta, among other cities. Sixty-two percent of the participants were minorities. Our early indicators show that 63 percent of participating companies hired new employees, of which 43 percent were hired from the local inner-city community. This initial data is one reason the President's FY11 budget asks for funding to expand this program. SBA will continue to track the correlation between firm participation and hiring to help improve the program and determine its impact.

In addition to our counseling and lending programs, SBA also provides support to minority-owned small businesses through its 8(a) and HUBZone business development programs. These programs help qualifying small businesses compete in the federal procurement marketplace. But a recent federal court ruling suggests that it would be useful to clarify and reiterate Congress's original intent that there be parity among the SBA's contracting programs.[1] SBA hopes that Congress will act swiftly to resolve this issue, and we look forward to working with you and your counterparts in the House to confirm "parity" among SBA's contracting and business development programs.[2]

SBA takes the issue of access to effective tools, including capital, contracts and counseling, very seriously because we know that minority and women-owned small businesses are among the fastest growing segments of our economy. We hope this hearing will provide valuable insights into the challenges that the current economic

[1] Mission Critical v. U.S., (09-864 C, Ct. of Fed Claims, Feb. 26, 2010).

[2] SBA strongly supports legislation to clarify and reiterate Congress's original intent not to prioritize one small business development program over another.

climate poses for minority-owned businesses and underserved markets more broadly. We also hope this hearing will highlight the incredible potential these businesses have to help lead us into full economic recovery.

SBA thanks the Committee for inviting us to participate in this important discussion. I am happy to take your questions.

####

Compelling Interest for Race- and Gender-Conscious Federal Contracting Programs: An Update to the May 23, 1996 Review of Barriers for Minority- and Women-Owned Businesses

I. Introduction

Barriers to access to capital for minority- and women-owned small businesses must be viewed in the broader context in which these firms conduct business. As detailed below, race and gender discrimination — of which discrimination in access to capital is just one example — remain a significant obstacle for minority and women entrepreneurs, and federal programs continue to have a critical role in addressing it.

In *Adarand Constructors, Inc.* v. *Peña*, 515 U.S. 200 (1995) (*Adarand III*), the Supreme Court held that federal race-conscious classifications "are constitutional only if they are narrowly tailored measures that further compelling governmental interests." *Id.* at 227. In *United States* v. *Virginia*, 518 U.S. 515 (1996), the Court made clear that gender-conscious classifications must be substantially related to an important governmental objective.

Following *Adarand*, the government recognized that, in order to establish a compelling interest to support its race-conscious procurement programs, it must show with specificity how race discrimination and its effects diminished contracting opportunities for minorities. In 1996, the Department of Justice summarized and published in the Federal Register[1] an extensive body of evidence — including Congressional reports and hearings, academic research, state and local government disparity studies and testimony — which identified discriminatory practices affecting racial minorities that act as barriers to their participation in federal contracting. This evidence helped explain the compelling interest behind Congress's adoption of race-conscious contracting programs, such as the Small Business Administration's 8(a) program and the Department of Transportation's Disadvantaged Business Enterprise (DBE) program. A year later, this same document was presented to Congress and entered into the Congressional record.[2]

Since *Adarand*, a number of federal courts have cited that document when holding that Congress had a compelling interest justifying its race-conscious procurement programs.[3]

---

[1] *The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey*, 61 Fed. Reg. 26,050 (May 23, 1996). This report summarized more than 50 documents and 30 congressional hearings between 1980 and 1996.

[2] *Unconstitutional Set-Asides: ISTEA's Race-Based Set-Asides After* Adarand: *Hearing Before the Subcomm. on the Constitution, Federalism, and Property Rights of the S. Comm. on the Judiciary*, 105th Cong. 27-80 (1997). See also 144 Cong. Rec. S1493 (daily ed. Mar. 6, 1998) (statement of Sen. Lieberman).

[3] *Western States Paving Co.* v. *Washington State Dep't of Transp.*, 407 F.3d 983, 991-993 (9th Cir. 2005) (quoting *Adarand III*, 515 U.S. at 223); *Adarand Constructors, Inc.* v. *Slater* (*Adarand VII*), 228 F.3d 1147, 1167-1176 (10th Cir. 2000), cert. dismissed, 534 U.S. 103 (2001); *id.* at 1176 ("[W]e conclude that the evidence cited by the government and its amici, particularly that contained in *The Compelling Interest*, 61 Fed. Reg. 26,050, more than satisfies the

(continued...)

Specifically, these courts recognized that the vast body of evidence before Congress, much of which was summarized in the Department of Justice's 1996 memorandum, provided a "strong basis in evidence for [Congress's] conclusion that [race-conscious] remedial action was necessary."[4]

Since 1996, a significant body of new data has been generated that bears directly on the inquiry of whether race- and gender-conscious[5] procurement and business development programs remain necessary. This includes: Congressional hearings and reports that address the barriers faced by minority- and women-owned businesses; government-produced and government-sponsored reports on the characteristics and dynamics of minority- and women-owned small businesses; academic literature by social scientists, economists, and other academic researchers that focuses on the manner in which various forms of discrimination act together to restrict business opportunities for minorities and women; and disparity studies commissioned by state and local governments to determine whether there is evidence of racial discrimination in their contracting markets. Much of this evidence is already before Congress; additional evidence is discussed in this statement and submitted along with it.[6]

(...continued)

government's burden of production regarding the compelling interest for a race-conscious remedy."); see also *Sherbrooke Turf, Inc.* v. *Minnesota Dep't of Transp.*, 345 F.3d 964, 970 (8th Cir. 2003). In 2008, the Court of Appeals for the Federal Circuit invalidated the contracting program authorized under 10 U.S.C. § 2323, holding that the evidence before Congress was not sufficiently current to provide the compelling interest necessary to support the program. *Rothe Dev. Corp. v. U.S. Dep't of Def.*, 545 F.3d 1023 (Fed. Cir. 2008). This memorandum responds to that decision, demonstrating that Congress does currently have ample evidence to demonstrate that race-conscious contracting programs are narrowly tailored to serve a compelling government interest and that gender-conscious programs are substantially related to an important governmental objective.

[4] *Adarand VII*, 228 F.3d at 1174-1175 (holding that "the government has met its initial burden of presenting a 'strong basis in evidence' sufficient to support its articulated, constitutionally valid, compelling interest"); see also *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 204 (2009) (Opening Statement of the Hon. James L. Oberstar, Chairman and Rep. from Minnesota) ("Since *Adarand*, every federal court that has reviewed the DOT's DBE program has found it to be constitutional.").

[5] Although gender-conscious remedial programs were not the focus of the 1996 memorandum, which addressed the impact of the *Adarand III* decision and therefore dealt with the race-conscious provisions at issue in that decision, the present memorandum addresses both kinds of programs. See 15 U.S.C. 637(m)(2) (giving agencies the authority to "restrict competition for any contract for the procurement of goods or services by the Federal Government to benefit small business concerns owned and controlled by women" under certain circumstances).

[6] Between 2006 and the end of 2009, Congress conducted thirty-six separate hearings concerning public procurement and minority- and women-owned business enterprises. See

(continued...)

This memorandum summarizes a sample of the extensive body of evidence generated since 1996 and builds on the evidence already before Congress at that time. That evidence clearly shows that discriminatory barriers continue to impede the ability of minority- and women-owned businesses to compete with other firms on a fair and equal footing in government contracting markets. Indeed, significant discrimination, in arenas such as access to capital and employment, limits the formation of these businesses in the first instance.[7]

As in 1996, these barriers "are real and concrete, and reflect ongoing patterns and practices of exclusion, as well as the tangible, lingering effects of prior discriminatory conduct."[8] The evidence discussed below confirms that many of the barriers identified more than a decade ago remain just as significant today. The government has a compelling interest in race- and gender-conscious federal procurement programs where necessary to ensure that it does not "perpetuat[e] the effects of racial discrimination in its own distribution of federal funds" and thereby become a "'passive participant' in a system" of racial or gender exclusion.[9] *Adarand Constrs, Inc.* v. *Slater*, 228 F.3d 1147 (10th Cir. 2000).

II.

Discriminatory Barriers to Contracting Opportunities for Minority- and Women-Owned Businesses

(...continued)
Appendix A for a list of Congressional hearings addressing this subject. Appendix B contains a list of academic studies and reports cited herein. Appendix C contains a list of recent disparity studies conducted by state and local governments.

[7] For these reasons, some metrics that have been used to measure discrimination in government procurement programs – such as bidders' lists or lists of registered contractors – likely understate the true continuing effects of discrimination.

[8] 61 Fed. Reg. at 26,051.

[9] The Supreme Court has recognized and approved the government's compelling interest in avoiding becoming a "passive participant" in marketplace discrimination. As the Supreme Court stated in *City of Richmond* v. *Croson Co.*, 488 U.S. 469, 492 (1989), for example:

> [I]f the city could show that it had essentially become a "passive participant" in a system of racial exclusion practiced by elements of the local construction industry, we think it clear that the city could take affirmative steps to dismantle such a system. It is beyond dispute that any public entity, state or federal, has a compelling interest in assuring that public dollars, drawn from the tax contributions of all citizens, do not serve to finance the evil of private prejudice.

Difficulties exist for any person interested in developing and sustaining a business that can compete for government contracts. First, a would-be business owner generally needs both experience and financial resources to create a viable enterprise. The practical experience needed to succeed in the government contracting market is often gained through prior employment in the targeted field, an informal apprenticeship in a family-run business, or membership in a professional trade union. The needed financial resources may come from personal wealth, commercial business loans, venture capital, or personal loans. And once a business is formed, access to working capital remains critical to both sustain and grow the business. Equally important is access to fair contracting opportunities, which means fair treatment by prime contractors and private sector customers, business networks, financial institutions, suppliers and bonding providers.

These are significant barriers, and they pose potential barriers to business formation and success for all businesses, regardless of the race or gender of their owners. But the evidence sampled in this memorandum shows that these barriers are substantially more difficult for businesses owned by minorities and women to overcome because of the widespread and systematic impact of race and gender discrimination that still exists in the economy generally and in the government contracting market specifically. The evidence shows that these barriers – whether the result of intentional discrimination or other activity that nonetheless perpetuates discrimination — often: (1) prevent minorities and women from forming businesses by denying them needed access to both experience and capital;[10] and (2) deprive minority- and women-owned businesses of fair access to contracting opportunities because of ongoing discrimination by prime contractors, business networks, financial institutions, suppliers, and bonding providers.

These types of disadvantages are in many ways precisely what the federal programs — like the U.S. Small Business Administration's 8(a) and Women Owned Small Business programs and the Department of Transportation's Disadvantaged Business Enterprise program — are designed to address. Each of these programs is designed to eliminate discriminatory barriers and help the development of small disadvantaged firms to enable them to gain a foothold in federal procurement contracting. In this way, the firms first gain access to relatively small contracting opportunities, which can then lead to success in larger federal contracts and the economy as a whole.

A. *Statistical Evidence Demonstrates the Existence of Discrimination.*

---

[10] *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 1 (2008) (statement of the Hon. John F. Kerry, Chairman and Sen. from Massachusetts) (explaining that the disparity between minority- and women-owned businesses on the one hand, and non-minority-owned businesses on the other, is "not due to any lack of motivation or determination on behalf of minorities and women," but is instead "due to the tremendous hurdles women and minorities must face each day to gain fair and adequate access to venture capital, credit and business and technical training").

1. *There Are General Disparities Between Minority- And Women-Owned Businesses Relative To Their Non-Minority, Male-Owned Counterparts.*

A primary objective of programs that consider race or gender as a factor in government contracting is to encourage and support the formation and development of minority- and women-owned businesses. This effort is a means to help remedy the effects of discrimination that have inhibited such business formation and success.[11] The most recent government statistics on minority- and women-owned businesses illustrate the disproportionately small share of the market these businesses currently occupy. For example, using data from the *2002 Survey of Business Owners,*[12] the U.S. Small Business Administration's Office of Advocacy prepared a report in 2007 entitled *Minorities in Business: A Demographic Review of Minority Business Ownership.*[13] The report analyzed information on minorities in the work force and minority-owned businesses, including statistics about the minority population, their labor force participation, age, education, occupation, work schedules, average personal and household income, business ownership, and business dynamics. The report focused on the growth of minority-owned businesses over recent years in relation to the growth of the minority populations in America during the same time period. Additionally, it analyzed revenue created by minority businesses in comparison to that created by non-minority-owned businesses. The report showed:

- Minorities (defined in the study as either Hispanic, Black, American Indian or Alaska Native, Asian, Native Hawaiian or other Pacific Islander) made up roughly 32% of the population, but owned only approximately 18% of firms.[14]

---

[11] *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 2 (2007) (statement of the Hon. John F. Kerry, Chairman and Sen. from Massachusetts) ("These programs to help minority and disadvantaged firms access Federal contracts are needed to help these firms break into the Federal market."); see also *id.* at 1-2 ("[W]hile the numbers of minority-owned businesses hold promise for the future, and obviously that growth is important, it is clear that much more needs to be done to encourage and strengthen the minority business community and to guarantee the opportunities within it. The potential for small business growth and entrepreneurship has simply not been fully tapped and barriers continue to exist for many minority business owners.").

[12] Census Bureau, *2002 Survey of Business Owners, Advance Report on Characteristics of Employer Business Owners: 2002*, available at http://www.census.gov/econ/census02/sbo/intro.htm (last visited April 29, 2010). This survey provides economic and demographic characteristics for the owners of businesses with paid employees operating in the United States and is the first survey requesting information about business owners since the 1992 Characteristics of Business Owners (CBO) survey.

[13] Ying Lowrey, *Minorities in Business: A Demographic Review of Minority Business Ownership*, 298 U.S. Small Business Administration (2007).

[14] *Id.* at 1, 3.

- Blacks constituted 11.8% of the total U.S. population, but owned only 5.0% of all firms, and accounted for less than 1% of total receipts.[15]

- Hispanics constituted 13.5% of the total population, but owned only 6.55% of all firms, and accounted for only 2.48% of total receipts.[16]

- More than half of Black-owned businesses had less than $10,000 in business receipts in 2002, compared with one-third of White-owned firms.[17]

- On average, a non-minority-owned employer firm (*i.e.*, a firm with one or more employees) had more than $1.6 million, while a Black-owned employer firm had just $696,158 in sales.[18]

- On average, for every dollar that a White-owned firm made, Pacific Islander-owned firms made about 59 cents, Hispanic-, Native American-, and Asian-owned businesses made about 56 cents, and Black-owned businesses made 43 cents.[19]

- Minority women owned 29% of Black employer firms and 47% of Black non-employer firms; non-minority women owned 17% of White employer firms and 31% of White non-employer firms.[20]

A 2006 report produced by the Minority Business Development Agency also finds that, while minority-owned businesses grew in number at a fast pace between 1997 and 2002, their growth in gross receipts and paid employment lagged behind the growth in number of firms.[21] In fact, the report finds that the gap between the share of gross receipts generated by minority businesses and the share of the minority population slightly widened during that period.[22] This disparity "underscores the opportunity gap that still exists in the U.S. economy."[23]

---

[15] *Id.* at 1.

[16] *Ibid.* Similarly, while Asian-owned firms accounted for 4.8% of all nonfarm businesses in the United States, these firms accounted for only 2.0% of nonfarm business employment and a scant 1.4% of their receipts. Census Bureau, *Survey of Business Owners – Asian-Owned Firms: 2002: Summary of Findings*, available at http://www.census.gov/econ/sbo/02/asiansof_all.html (last visited April 29, 2010).

[17] Ying Lowrey, *Minorities in Business: A Demographic Review of Minority Business Ownership*, 298 U.S. Small Business Administration 8 (2007).

[18] *Id.* at 7.

[19] *Id.* at 2.

[20] *Id.* at 4.

[21] U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises, An Overview of the 2002 Survey of Business Owners* (2006).

[22] *Id.* at 12.

[23] *The Minority Business Development Agency: Enhancing the Prospects for Success:*

(continued...)

Additional data from the Census Bureau's *2002 Survey of Business Owners* show that women-owned businesses account for just a fraction of the receipts of all non-farm businesses in the United States. For example, in 2002, there were 6.5 million women-owned firms in the United States, which accounted for 28.2% of all non-farm business in the United States but just 4.2% of their receipts.[24] Only 1.8% of women-owned firms had receipts of more than $1 million, and less than 0.1% had more than 500 employees.[25]

Government reports also show that minority-owned firms experience a higher failure rate than that of non-minority owned firms. For example, data based on the 1997 Survey of Minority-Owned Business Enterprises (SMOBE) show that, between 1997 and 2001, the survival rate for non-minority-owned employer establishments was 72.6%.[26] The survival rate of all minority-owned employer establishments was about 4 percentage points lower.[27] The survival rates for specific minority-owned employer establishments were as follows:

- Asian and Pacific Islander-owned employer establishments: 72.1%.[28]

(...continued)
Hearing Before the H. Subcomm. on Commerce, Trade, and Consumer Protection of the H. Comm. on Energy and Commerce, 111th Cong. (2009) (statement of David A. Hinson, National Director, Minority Business Development Agency) (testifying on the disparities between the minority population and the gross receipts generated by minority-owned businesses).

[24] Census Bureau, *Survey of Business Owners - Women-Owned Firms: 2002*, available at http://www.census.gov/econ/sbo/02/womensof.html (last visited April 29, 2010).

[25] Elaine Reardon, Nancy Nicosia and Nancy Y. Moore, *The Utilization of Women-Owned Small Businesses in Federal Contracting*, Kauffman-RAND Institute for Entrepreneurship Public Policy 14, 17 (2007). A report issued by the House Small Business Committee Democratic Staff shows that the federal government's failure to meet its own procurement goals of 5% contracting to women-owned businesses represented a cost of *$6 billion* in lost contracting opportunities for women-owned businesses in FY 2003. House Small Business Committee Democratic Staff, *Scorecard V: Dramatic Gains in the Federal Marketplace Fail to Result in Small Business Contracts* (2004) (noting that only 2.89% of contracts awarded throughout the entire federal government in FY 2003 went to women-owned businesses). For FY 2004, the estimated loss was *$5.5 billion*. *Id.* at 12. Contracts awarded to women-owned small businesses throughout the entire federal government in FY 2004 amounted to 3.03%; by 2008, that amount had increased very little, to 3.39%. Small Business Administration, *FY 2004 Official Goaling Report*; Small Business Administration, *Fiscal Year 2004: Small Business Prime Contract Goaling Achievements* (both documents available at http://www.sba.gov/aboutsba/sbaprograms/goals/index.html (last visited April 29, 2010)).

[26] Ying Lowrey, *Dynamics of Minority-Owned Employer Establishments, 1997-2001*, 251 U.S. Small Business Administration 10 (2005).

[27] *Ibid.*

[28] *Ibid.* Note, however, that Asian-American firms exhibited a slightly higher rate of contraction than non-minority owned firms (23% in comparison to 21%). *Ibid.* Also, a study of

(continued...)

- Hispanic-owned employer establishments: 68.6%.[29]
- American-Indian and Alaska Native-owned employer establishments: 67.0%.[30]
- African-American-owned employer establishments: 61.0%.[31]

Black-owned employer establishments also had the lowest expansion rate (26%) of all minority business groups.[32] Moreover, Black-owned firms and, to a lesser extent, Latino-owned firms, had lower sales, hired fewer employees, and had smaller payrolls than White- owned firms.[33]

A number of Congressional hearings have addressed disparities in business formation and success between minority-and women-owned businesses, on the one hand, and businesses owned by their non-minority, male counterparts,[34] on the other, as well as the specific barriers that minority- and women-owned businesses continue to face.[35] The evidence presented at these

(...continued)
the survival rate of Asian American firms in SBA's 8(a) program has shown that it is not statistically different from the business survival rates of other MBEs in the program. See Asian American Justice Center, *Equal Access: Unlocking Government Doors for Asian Americans: Public Contracting Laws and Policies* 28 (2008).

[29] Ying Lowrey, *Dynamics of Minority-Owned Employer Establishments, 1997-2001*, 251 U.S. Small Business Administration 10 (2005).

[30] *Ibid.*

[31] *Ibid.*

[32] *Id.* at 20.

[33] Robert W. Fairlie, *Minority Entrepreneurship*, The Small Business Economy, produced under contract with the SBA, Office of Advocacy 74 (2005).

[34] See, *e.g.*, *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 3 (2008) (statement of the Hon. John F. Kerry, Chairman and Sen. from Massachusetts) (finding generally that "women-owned businesses still lag behind their male counterparts in important areas," and finding specifically that "[w]omen-owned firms have lower revenues and fewer employees than their male-owned counterparts"); *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 2 (2007) (statement of the Hon. John F. Kerry, Chairman and Sen. from Massachusetts) (stating that "women owned small businesses still continue to have markedly lower revenue and fewer employees than firms, even comparable ones, owned by men"); *Access to Federal Contracts: How to Level the Playing Field: Field Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 4-8 (2007) (statement of the Hon. Benjamin L. Cardin, Sen. from Maryland).

[35] See, *e.g.*, *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs*

(continued...)

hearings shows that the disparities between the minority share of the business population and its share of business sales and receipts "are adverse, very large, and statistically significant."[36] Moreover, these disparities have been observed in all 50 states and the District of Columbia for all minority groups and for women.[37]

These studies and data of course provide a snapshot of firms at a particular period of time. But the data show that minority-and women-owned firms continue to have only limited success both in the larger economy and in the federal procurement market.

(...continued)
for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship, 110th Cong. (2007); *Access to Federal Contracts: How to Level the Playing Field: Field Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2007); *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2007); *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. (2008); *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the H. Subcomm. on Economic Development, Public Buildings, and Emergency Management Staff of the H. Comm. on Transp. and Infrastructure*, 110th Cong. (2008); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. (2009).

[36] *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 19 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting); see also *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 26-34 (2007) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

[37] *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 25 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting); see also *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 328 (2009) (statement of Jon Wainwright, Vice President, NERA Economic Consulting) (testifying that minority- and women-owned construction and construction-related professional service businesses earned on "average almost 25 percent lower than their non-minority male counterparts, again even when other attributes are held constant," and that the disparities are even larger for African American-, Native American-, and non-minority women-owned businesses).

2. *Discrimination Is A Basis For Identified Disparities Between Minority- And Women-Owned Businesses And Their Non-Minority, Male-Owned Counterparts:*

The findings outlined above are mirrored by the numerous studies commissioned by state and local governments that have identified stark and continuing disparities between the availability of minority- and women-owned businesses and the utilization of such businesses in state and local government procurement. The Supreme Court has held that such significant disparities can support an inference of "discriminatory exclusion."[38]

A list of approximately 70 recently conducted disparity studies is attached.[39] The studies show that "minority-owned businesses and women-owned businesses throughout the nation continue to face large disparities in almost every aspect of business enterprise activity that can be quantified"[40] in a pattern of discriminatory barriers that is repeated across the nation. Moreover, the findings confirm that the disparities "are symptoms of discrimination in the labor force that, in addition to its direct effect on workers, reduce[s] the future availability of [minority- and women-owned businesses] by stifling opportunities for minorities and women to progress through precisely those internal labor markets and occupational hierarchies that are most likely to lead to entrepreneurial opportunities."[41] The disparities identified in these state and local government studies "demonstrate the nexus between discrimination in the job market and reduced entrepreneurial opportunities for minorities and women."[42] Past hearings have identified similar disparities that exist in the federal contracting market.[43]

---

[38] *Croson,* 488 U.S. at 509.

[39] See Appendix C for a complete listing of these studies. The studies document evidence from 25 states and the District of Columbia, including: Alaska, Arizona, California, Colorado, Connecticut, Florida, Georgia, Idaho, Illinois, Kansas, Maryland, Massachusetts, Minnesota, Missouri, Nevada, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Tennessee, Texas, Virginia, Washington, and suburban Washington, D.C. Eighteen of these studies focus on disparities state-wide: Alaska, Arizona, California, Colorado, Idaho, Illinois, Kansas, Kentucky, Maryland, Minnesota, Missouri, Montana, Nevada, New Jersey, North Carolina, Oregon, Pennsylvania, and Virginia. See, *e.g.*, *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. (2009) (citing more than 20 disparity and utilization studies throughout); *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2008) (citing more than 12 different studies throughout).

[40] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 326 (2009) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

[41] National Economic Research Associates, Inc., *Race, Sex and Business Enterprise: Evidence from Memphis, Tennessee* 100 (2008).

[42] *Ibid.*

[43] *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small*

(continued...)

Academic research using a variety of publicly available statistical data confirms that these disparities remain large and statistically significant even when minority- and women-owned businesses are compared with otherwise similar (with respect to characteristics such as industry, geography, etc.) male- and nonminority-owned firms.[44] In reaching these conclusions, researchers controlled for factors such as industry, geography, education, age, and labor market status — even though minority- and women-owned businesses face demonstrable barriers to achieving parity in these areas — thus demonstrating that the remaining disparities likely result in large part from discrimination. Recent independent research has also concluded that the gap that exists between minority business owners and their non-minority counterparts "has not in any way been caused by a lack of effort on the part of minority entrepreneurs," but rather results in part because "discriminatory conditions that previously existed were deep and pervasive and have not been fully reversed."[45] In addition, some disparities are likely to be greater than data

---

(...continued)
Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship, 110th Cong. 2 (2007) (statement of the Hon. John F. Kerry, Chairman and Sen. from Massachusetts) (stating that firms owned by women "account for less than 3 percent of all Federal contracts even though they comprise 30 percent of all privately-held firms," and describing this as "an unacceptable ratio"); *Full Comm. Hearing to Consider Legislation Updating and Improving the SBA's Contracting Programs Before the H. Comm. on Small Business*, 110th Cong. 3 (2007) (statement of the Hon. Steve Chabot, Ranking Member and Rep. from Ohio) ("Despite the extra assistance from the SBA, small businesses owned by socially and economically disadvantaged individuals [and] women * * * do not receive their fair proportion of contracts to sell goods and services to the federal government."); *Federal Contracting: Removing Hurdles for Minority-Owned Small Businesses: Hearing Before the Subcomm. on Government Management, Organization, and Procurement of the House Comm. on Oversight and Government Reform*, 110th Cong. 3 (2007) (statement of the Hon. Edolphus Towns, Chairman and Rep. from New York) ("Although procurement provides the federal government with a potentially powerful tool for promoting minority opportunities and counteracting discrimination, there continues to be disparity in the allocation of government contracts to minority firms.").

44 Congress heard the results of academic studies that were based on data taken from the 2002 Survey of Business Owners (SBO) and the Public Use Microdata Sample (PUMS), which are both produced by the Census Bureau; the Current Population Surveys (CPS), which is produced jointly by the Census Bureau and the Bureau of Labor Statistics; and the Survey of Small Business Finances (SSBF), which is produced by the Federal Reserve Board and the SBA. See *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 30-34 (2007) (statement of Jon Wainwright, Vice President, NERA Economic Consulting); see also *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 328 (2009) (statement of Jon Wainwright, Vice President of NERA Economic Consulting).

45 Boston Consulting Group, *The New Agenda for Minority Business Development* 14

(continued...)

show; because the age and size of minority- and women-owned businesses may themselves have been limited by discrimination, current statistics likely understate the number and size of minority- and women-owned firms that might exist once the effects of discrimination no longer stifle their creation and expansion.[46]

Qualitative evidence from minority and women business owners gathered from surveys, interviews, and presented via Congressional testimony overwhelmingly support these findings.[47] For example, minorities and women business owners often report that they "encounter significant barriers to doing business in the public and private sector market[s], as both prime contractors and subcontractors," that are greater than those faced by their non-minority and non-female counterparts.[48] Minorities and women report that they "often suffer from stereotypes about their suspected lack of competence and are subject to higher performance standards than similar White men," and that they "encounter discrimination in obtaining loans and surety bonds; receiving price quotes from suppliers; working with trade unions; obtaining public and private sector prime contracts and subcontracts, and being paid promptly."[49] Indeed, Congress has repeatedly recognized that there is overwhelming evidence that shows that "considerable

(...continued)
(2005).

[46] *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 66-67 & n.2 (2008) (Statement of Anthony W. Robinson, President, Minority Business Enterprise Legal Defense Fund). Congress also heard testimony that discriminatory barriers impede the ability to measure the actual business capacity of MBEs because "[m]any, if not all, 'capacity' indicators are themselves impacted by discrimination. Therefore, it is not good social science to limit availability measures by factors such as firm age, revenues, or numbers of employees." *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 375 (2009) (statement of Jon Wainwright, Vice President, NERA Economic Consulting) "[F]ocusing on the 'capacity' of businesses in terms of employment, revenue, bonding limits, number of trucks, and so forth is simply wrong as a matter of economics because it can obscure the existence of discrimination. A truly 'effective' discriminatory system would lead to a finding of no 'capacity,' and under the 'capacity' approach, a finding of no discrimination." *Id.* at 376; see also *id.* at 10, 325 (*Rothe* court "made several serious errors in its economic reasoning, concluding, for example that factors such as firm size should be factored into study estimates of DBE availability"), 371 (proper statistical analysis "should not control for the variables affected by the behavior sought to be isolated").

[47] See, *e.g.*, *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 33-34 (2007) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

[48] *Ibid.*

[49] *Ibid.*

discrimination" exists throughout the federal contracting market that affects small minority- and women-owned businesses across the racial and ethnic spectrum.[50]

B. *Discrimination Affects the Formation and Development of Minority-And Women-Owned Businesses.*

The 1996 report prepared by the Department of Justice identified discrimination in two sectors of the national economy that accounted, at least in part, for diminished opportunities for minorities to form their own businesses: (1) discrimination by employers, which prevented minorities from acquiring necessary technical skills; and (2) discrimination by lenders, which prevented minorities from accessing much-needed capital to develop and sustain a business.[51] Discrimination in these same sectors of the economy persists and remains a significant barrier to the formation of viable businesses by minorities and women.

1. *Discrimination by Employers Results in a Lack of Human Capital.*

---

[50] *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform,* 110th Cong. 1-2 (2008) (statement of the Hon. William Lacy Clay, Chairman and Rep. from Missouri) ("There has been a large body of evidence concerning discrimination. Court cases, legislative hearings, quantitative studies and anecdotal reports detail the considerable discrimination based on race and national origin that confronts minority contractors in all parts of the country and in virtually every industry. The discrimination is not limited to one particular minority group, instead, evidence shows businesses owned by African-Americans, Latinos, Asians, Pacific Islanders and Native Americans all must overcome discriminatory practices in order to grow and prosper."); see also *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 3 (2008) (statement of the Hon. John F. Kerry, Chairman and Sen. from Massachusetts) ("In reviewing the last 20 years, it is disturbing to see that the issues that were hindering women entrepreneurs from achieving their full potential 20 years ago are still barriers today."); see also *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 204-205 (2009) (statement of the Hon. James L. Oberstar, Chairman and Rep. from Minnesota) ("The Committee has also received volumes of evidence, both empirical and anecdotal, about the discrimination that continues to impact minority and women business owners across this nation. This data demonstrates that it is difficult for small and disadvantaged businesses to compete — discrimination impacts minority and women owned businesses at many points in the contracting process, including obtaining credit, bonding, and insurance."); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 309 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) (noting that states and localities had reported to DOT that discrimination against women and minorities persists).

[51] *The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey*, 61 Fed. Reg. 26,050 (May 23, 1996).

Discrimination in the workplace may take many forms. It can be intentional and overt, as when employers purposefully treat employees and would-be employees differently based on their race or gender[52] or when others in the business community explicitly state their preference *not* to work with minorities and women.[53] It can involve explicit harassment by employers or co-workers that gives rise to a hostile work environment[54] or can take a more subtle, yet no less

---

[52] See, *e.g.*, *EEOC* v. *Area Erectors, Inc.*, No. 1:07-cv-02339 (N.D. Ill. May 27, 2009) (construction company settling lawsuit for $630,000 where group of African-American employees were terminated because of their race); *EEOC* v. *Marjam Supply Co.*, No. 7:03-cv-5413 (S.D.N.Y. April 14, 2009) (building materials supplier settling lawsuit for $495,000 where African-American employees were subjected to differential discipline and termination); *EEOC* v. *Michigan Seamless Tube*, No. 2:05-cv-73719 (E.D. Mich. June 5, 2007) (steel tubing company settling lawsuit for $500,000 after refusing to hire a group of African Americans who were former employees of its predecessor company); *EEOC* v. *S & Z Tool & Die Co.*, No. 1:03-cv-2023 (N.D. Ohio Aug. 16, 2006) (metal manufacturing firm settling lawsuit for $850,000 where it refused to hire women and African-American applicants because of their gender and race, respectively); *EEOC* v. *Optical Cable Corp.*, No. 7:00-cv-00757 (W.D. Va. Feb. 20, 2002) (fiber-optic cable manufacturer settling lawsuit for $1 million after failing to hire African-American applicants for a ten year period, and assigning women to lower-paying positions than their similarly situated male counterparts); *EEOC* v. *Landis Plastics, Inc.*, No. 5:00-cv-01874 (N.D.N.Y. Dec. 8, 2000) (settling lawsuit for $782,000 after discriminating against women on the basis of gender in the assignment of jobs and in promotions).

[53] See, *e.g.*, *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 39 (2007) (statement of Anthony W. Robinson, President, Minority Business Enterprise Legal Defense and Educational Fund) (relating experience of an African-American business owner who was told by a potential business partner that he "[doesn't] like doing business with you people"); see also *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 42 (2008) (statement of Kerstin Forrester, President, Stonebridge Precision Machining & Certified Welding) (testifying that when she first purchased her business, two former customers told her "outright that they would not do business with a woman," and that one engineer told her that "machining was nothing that a woman could understand").

[54] See, *e.g.*, *EEOC* v. *Brand Energy Solutions, LLC*, No. 2:08-cv-00305 (S.D. Tex. May 30, 2009) (construction contractor settling sexual harassment and retaliation lawsuit for $175,000 where female employee was forced to quit her job when company failed to take appropriate remedial action after she was subjected to repeated unwelcome physical contact, sexual advances and comments, and threatening behavior); *EEOC* v. *Ceisel Masonry, Inc.*, No. 06-cv-2075 (N.D. Ill. May 22, 2009) (construction company settling lawsuit for $500,000 where Hispanic employees were called racially derogatory terms by their supervisors and routinely exposed to racist graffiti); *EEOC* v. *Talbert Building Supply, Inc.*, No. 1:08-cv-00707 (M.D.N.C. May 26, 2009) (North Carolina lumber and hardware retailer settling race discrimination lawsuit for $80,000 where employee was subjected to explicit racial slurs as well as racial jokes and

(continued…)

damaging, form.[55] It can result from practices that, although facially neutral, unjustifiably and disproportionately exclude groups of employees or applicants based on their race, national origin or sex.[56] Regardless of the form, race and gender discrimination in the workplace have a devastating effect on the ability of minorities and women to develop and sustain their own businesses. In particular, they result in a marked decrease in human capital — the experience necessary to create a viable new business in today's markets.

This historical discrimination in employment limited — and continues to limit — the advancement of minorities and women to higher level positions in the workforce, and thus their opportunity to gain the skills, experience, and business contacts necessary to develop a successful business model. Among other things, historical discrimination prevented many

---

(...continued)
derogatory stereotypes about African Americans on an almost daily basis for two years); *EEOC* v. *Wheeler Construction, Inc.*, No. 2:07-cv-01829 (D. Ariz. March 5, 2009) (construction company settling lawsuit for $325,000 where Mexican employees were harassed based on their national origin).

[55] See, *e.g.*, CRA International for the San Mateo County Transit District and thePeninsula Corridor Joint Powers Board, *Measuring Minority- and Women-Owned Construction and Professional Service Firm Availability and Utilization* 95 (2008) (discussing study in which researchers sent fictitious resumes that included randomly assigned "white- and black-sounding" names to help-wanted ads in Boston and Chicago, and finding that resumes with "white-sounding" names received 50% more callbacks for interviews than did the resumes with "black-sounding" names); see also *Section 15: Race and Color Discrimination*, EEOC Compliance Manual, § 15-I (2006), available at http://www.eeoc.gov/policy/docs/race-color.html (last visited April 29, 2010) (citing a 2003 study in Milwaukee finding that Whites with a criminal record received job call-backs at a rate more than three times that of Blacks with the same criminal record, and even at a rate higher than Blacks *without* a criminal record; a 2003 study in California finding that temporary agencies preferred White applicants three to one over African American applicants; and a 2002 study in Boston and Chicago finding that résumés of persons with names common among Whites were 50 percent more likely to generate a request for an interview than equally impressive résumés of persons with names common among Blacks); cf. *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 44 (2008) (statement of Sharon Green, President, Custom Copper and Slate, Ltd.) (testifying to her experience that decision making officials prefer talking to a man, not a woman, regarding construction projects).

[56] 42 U.S.C. Sec. 2000e-2(k)(1)(A) (prohibiting employment practices that have a disparate impact on the basis of race, color, religion, sex or national origin); see, *e.g.*, *Griggs* v. *Duke Power Co.*, 401 U.S. 432 (1971) (recognizing that "good intent or absence of discriminatory intent does not redeem employment procedures or testing mechanisms that operate as 'built-in headwinds' for minority groups and are unrelated to measuring job capability"); *EEOC* v. *Dial Corp.*, 469 F.3d 735, 742-743 (8th Cir. 2006) (upholding district court's finding that a physical strength test had an unlawful disparate impact on female employees).

minorities and women from forming businesses and passing them on to their children; as a result, many would-be minority and female business owners of today never had the opportunity to work in a family-run business and thus gain skills to develop a successful business in today's markets.[57] Indeed, minority business owners state that they face an initial barrier stemming from a lack of familiarity about running a business.[58]

Academic research confirms that the lingering effects of discrimination can extend across generational lines. For example, one researcher found that black business owners face three different hurdles in comparison to their white counterparts: they are less likely to inherit businesses, and thus need to raise their own capital to start a business; they are less likely to be employed by family members who own small businesses, thus missing out on gaining first-hand business experience; and they are less likely to have family members who own small businesses, thus lacking ready access to business mentors.[59] Thus, not only are minorities statistically less likely to start a business due to historical and current patterns of lower self-employment, they are also less likely to have had the opportunity to learn the skills necessary to run a successful business.[60] As one researcher concluded, "the lack of prior work experience in family businesses among future black business owners, perhaps by restricting their acquisition of general and specific business human capital, limits the successfulness of their businesses relative to whites."[61] Women business owners have also reported fewer opportunities to learn the skills necessary to run successful businesses.[62]

---

[57] *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship,* 110th Cong. 3 (2008) (statement of Margaret Henningsen, Vice President, Legacy Bank) (explaining that many would-be minority entrepreneurs are first generation entrepreneurs who "do not have the benefit of family members handing down a business or providing them with the necessary training and coaching that is so crucial for business success").

[58] *Access to Federal Contracts: How to Level the Playing Field: Field Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 71 (2007) (statement of Wayne Frazier, Sr., President, Maryland-Washington Minority Contractors Association) (testifying that the majority of minority business owners do not have family members who have owned a business, and therefore have little if any understanding of how to run a business).

[59] Robert W. Fairlie and Alicia M. Robb, *Why are Black-Owned Businesses Less Successful Than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital*, 25 Journal of Labor Economics 289, 295 (2007) (Table 2).

[60] Michael Hout and Harvey S. Rosen, *Self-Employment, Family Background and Race*, 35 Journal of Human Resources 670-692 (2000).

[61] Robert W. Fairlie and Alicia M. Robb, *Why are Black-Owned Businesses Less Successful Than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital*, 25 Journal of Labor Economics 289, 308 (2007).

[62] For example, one researcher testified before Congress that, based on a national study by the Center for Women's Business Research, women business owners of fast-growth companies reported that, unlike their male counterparts, role models and mentors "[weren't] really available to them." *Women in Business: Leveling the Playing Field: Roundtable Before*

(continued...)

Current discrimination in hiring and promotions by employers can also severely limit the opportunities for minorities and women to build the human capital necessary for future business success. In 2008, women comprised 46.5% of the U.S. labor force, yet held only 15.2% of US Fortune 500 directorships.[63] In addition, although women account for 51% of all workers in high-paying management, professional, and related occupations, of the top ten occupations of women workers, senior manager and middle manager did not make the list.[64] At a recent workshop on transition points in women's careers (*e.g.*, moving into more senior levels and assuming leadership roles) held by the National Academies Committee on Women in Science, Engineering, and Medicine (CWSEM), several women's professional societies referred to surveys and studies in which women identified their work environments as hostile.[65] Such conditions act as a barrier to advancement – or even continued employment – within a company.

Thus, minorities and women often lack equal access to the two central means of gaining the experience needed to operate a business. A history of discrimination in employment opportunities provided significantly fewer opportunities for minorities and women to develop businesses to pass on to their children or to teach their children business-development skills.[66] And the continued discrimination by employers and would-be business partners against minorities and women severely limits their development of those skills and their entry into the

(...continued)

the S. Comm. on Small Business and Entrepreneurship, 110th Cong. 8 (2008) (statement of Teri Cavanagh, Principal, Teri Cavanagh and Associates).

[63] Ernst & Young, *2008 Catalyst Census of Women Board Directors of the Fortune 500*, at 1. *Quick Stats on Women Workers, 2008*, United States Department of Labor, available at http://www.dol.gov/wb/stats/main.htm (last visited, April 29, 2010). See also Siri Terjesen, Ruth Sealy and Val Singh, *Women Directors on Corporate Boards*, 17 Corporate Governance: An International Review 325, 320-337 (2009). In addition, in 2008, only 15.7 % of corporate officers of Fortune 500 companies were women. Ernst & Young, *2008 Catalyst Census of Women Corporate Officers and Top Earners of the Fortune 500*, at 1. A study controlling for organization and director characteristics found that women directors are less likely than men to be on the executive committee and more likely to be on the public affairs committee. See Craig A. Peterson and James Philpot, *Women's Roles on U.S. Fortune 500 Boards: Director Expertise and Committee Memberships*, 72(2) Journal of Business Ethics 177, 179 (2007).

[64] *Quick Stats on Women Workers, 2008*, United States Department of Labor, available at http://www.dol.gov/wb/stats/main.htm (last visited, April 29, 2010).

[65] *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 56 (2008) (statement of Cat Shrier, Ph.D., P.G. Watercat Consulting LLC).

[66] Robert W. Fairlie, *Minority Entrepreneurship*, The Small Business Economy, produced under contract with the SBA, Office of Advocacy 97 (2005) (identifying one of the major barriers to minority-owned business as relatively disadvantaged family business backgrounds which "appear to limit entry and success in small business").

business markets today.[67]

2. *Discrimination Limits Access To Capital.*

Access to financial capital is absolutely essential for business formation and development.[68] However, lack of access to capital is the most frequently cited obstacle among minority and women business owners to developing and growing their businesses.[69] A critical question, then, is the extent to which their lack of equal access to capital, which can prevent minority- and women-owned businesses from forming, developing, and succeeding in today's markets, is a result of discrimination in lending practices.[70]

Numerous studies that address the question have reached the same conclusion: minority and women small business owners routinely face discrimination in the lending market. Relying on data from the *National Survey of Small Business Finances* (SSBF), Jon Wainwright, Vice President, NERA Economic Consulting, found that "African-American-owned firms, Hispanic-owned firms, and to a lesser extent other minority-owned firms are substantially and statistically significantly more likely to be denied credit than are White-owned firms," even when controlling for firm size and credit history.[71] Other researchers have made similar findings.[72] One study

[67] See, *e.g.*, *supra* notes 59-62.

[68] See, *e.g.*, *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 110 (2008) (report by the National Association of Women Business Owners Procurement Task Force, submitted by Gayle Waldron, President & Owner, The Management Edge, asserts that "[a]ccess to capital has been, and remains, a critical issue for emerging and growing businesses, particularly those owned by women and minorities").

[69] *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 20 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting); see also Robert W. Fairlie, *Minority Entrepreneurship*, The Small Business Economy, produced under contract with the SBA, Office of Advocacy 97 (2005) (identifying one of the major barriers to minority-owned businesses as relatively low asset levels, which limit business entry and lead to higher rates of business closure, lower sales and profits, and less employment).

[70] *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 3 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

[71] *Id.* at 4.

[72] See, *e.g.*, David G. Blanchflower, Phillip B. Levine, and David J. Zimmerman, *Discrimination in the Small-Business Credit Market*, 85(4) Review of Economics and Statistics 930, 942 (2003) (finding that "loan denial rates are significantly higher for black-owned firms that for white-owned firms even after taking into account differences in an extensive array of measures of creditworthiness and other characteristics"); Lloyd Blanchard, Bo Zhao, and John

(continued...)

concluded that personal wealth plays an important role in predicting loan turndown rates, but that even *after* controlling for personal wealth, large differences in loan turndowns between African-American-, Hispanic-, and Asian-owned small businesses relative to those of whites remain.[73] Minority business owners who *do* receive loans often are required to pay higher interest rates on their loans than are charged to comparable white business owners.[74]

Indeed, the U.S. Small Business Administration recently concluded that the restrictions minorities face in gaining access to credit are "consistent with prejudicial discrimination against African-American and Hispanic firm owners."[75] The same has been found for women-owned firms.[76] Given their personal experience, or that of their colleagues, in being denied credit for

(...continued)

Yinger, *Do Credit Market Barriers Exists for Minority and Women Entrepreneurs?* 14 Center for Policy Research, Maxwell School, Syracuse University, Working Paper No. 74 (2005) (finding that African-American- and Hispanic-owned firms face a higher probability of loan denial than that of white-owned firms even when controlling for a number of relevant variables); Myron Quon, *Discrimination Against Asian American Business Enterprises: The Continuing Need for Affirmative Action in Public Contracting*, Asian American Policy Review 41, 43, 46 (2008) (mentioning a study showing that Asian-American owned firms are denied loans at a rate 50% higher than white-owned companies and pay higher interest rates than comparable white-owned firms); Susan Coleman, *Access to Debt Capital for Women and Minority Owned Small Firms: Does Educational Attainment Have an Impact,* 9(2) Journal of Developmental Entrepreneurship 127, 132-133 (2004) (finding that firms owned by African-American, Hispanic, and Asian men were significantly more likely to be denied their most recent loan requests than white men); Jonathan Taylor, *Income and Wealth Transfer Effects of Discrimination in Small Business Lending*, 32(3/4) Review of Black Political Economy 87, 88-90 (2005) (finding evidence that African-American business owners face a higher probability of loan denial).

[73] Ken Cavalluzzo & John Wolken, *Small Business Loan Turndowns, Personal Wealth, and Discrimination*, 78(6) Journal of Business 2153, 2170 (2005).

[74] *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 4 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting); see also *ibid.* (Testimony of Margaret Henningsen, Founder Legacy Bank)(discussing her bank's successful business serving minority entrepreneurs who had been denied loans by larger financial institutions); see also David G. Blanchflower, Phillip B. Levine, and David J. Zimmerman, *Discrimination in the Small-Business Credit Market*, 85(4) Review of Economics and Statistics 930, 941 (2003) ("Even among a sample of firms with no past credit problems, black-owned firms pay significantly higher interest rates.").

[75] Karlyn Mitchell & Douglas K. Pearce, *Availability of Financing to Small Firms Using the Survey of Small Business Finances*, 257 U.S. Small Business Administration 46 (2005).

[76] *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 4 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

perceived discriminatory reasons, many minority and women business owners expect to be turned down and simply do not apply for financing.[77]

In addition to the academic and government-commissioned studies discussed above, numerous disparity studies conducted by state and local governments have also concluded that minorities and women face discrimination in the lending market. For example, one study found that African-American-, Hispanic-, and female-owned businesses reported loan denial rates of 47%, 39%, and 26%, respectively, in contrast to 21% for non-minority male-owned firms, even after controlling for creditworthiness and other related variables.[78] A disparity study conducted for San Mateo County, using data from the 1998 and 2003 Survey of Small Business Finances (SSBF), concluded that loan denial rates are much higher for similarly situated minority firms than for non-minority firms — both at the national level and for the Pacific region.[79] At the national level, African-American- and Hispanic-owned firms that did receive loans received much smaller amounts than non-minority-owned firms.[80] Moreover, the minority-owned firms receiving loans paid higher interest rates than did non-minority-owned firms.[81]

There is also evidence that minority- and women-owned businesses are less likely to secure outside investment revenue. The results from a 2001 study prepared for the U.S. Small Business Administration show that women-led firms received just 4.1% of all venture capital investments in 1998.[82] This suggests that women may be left behind in the asset creation process, limiting their opportunities to develop and grow their businesses. The study also states that "[m]inority women seeking capital may have greater barriers than white women or minority men."[83] One possible cause for the disparity between the access to outside capital of male-owned and female-owned firms is the "gender dominance" in the venture capital industry[84] and

---

[77] *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 14 (2008) (statement of the Center for Women's Business Research). The Center concluded that the "expectation of being turned down is especially prevalent among women business owners of color." *Ibid.*; see also David G. Blanchflower, Phillip B. Levine, and David J. Zimmerman, *Discrimination in the Small-Business Credit Market*, 85(4) Review of Economics and Statistics 930, 942 (2003) (finding that concerns about being turned down due to prejudice or discrimination prevent more African-American-owned firms from applying for loans).

[78] Griffin & Strong, P.C., *City of Atlanta Disparity Study: Executive Summary* 7 (2006).

[79] CRA International, *Measuring Minority- and Women-Owned Construction and Professional Service Firm Availability and Utilization* 82 (2008).

[80] *Id.* at 85.

[81] *Ibid.*

[82] Candida G. Brush et al., *An Investigation of Women-Led Firms and Venture Capital Investment* 14 (2001).

[83] *Id.* at 16.

[84] *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 10-11 (2008) (statement of Laila Partridge, CEO, Cover4me) (explaining that women are not well-represented in venture capital firms and

(continued...)

the perception among many women and minorities that venture capitalists focus on pre-existing relationships or networks to which women and minorities do not have access.[85]

Without access to traditional sources of financing, minority- and women-owned businesses are often forced to forgo opportunities or rely on higher cost capital to support their businesses.[86] For example, a survey conducted by Women Impacting Public Policy showed that 66% of the respondents, women-owned businesses, relied on bank financing that was backed by home equity loans and 49% used credit card financing.[87] Another 36% received their funding from family and friends.[88] And while some business owners may be able to rely on personal wealth to fund and support their businesses, research shows that the lower median net worth of African-American households compared to white households (*e.g.*, \$6,166 v. \$67,000 in 2005, based largely on the net worth of homes owned by the households) translates into lower levels of start-up capital among African-American business owners than among white business owners.[89]

(...continued)

therefore they lack an opportunity to develop relationships with firms looking to invest in small businesses); see *id.* at 10 ("Having spent 10 years in venture capital and working with larger firms, you * * * never see women in those firms."); see also *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 114 (2007) (statement of Ann Marie Ameida, President and CEO, Association of Women's Business Centers) (explaining that "the majority of venture capital deals are made through referrals via a fairly closed system of networks" to which women business owners do not have access).

85 *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 4 (2008) (statement of Donald T. Wilson, President and CEO, Association of Small Business Development Centers); see also *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 11 (2008) (statement of Laila Partridge, CEO, Cover4me) (explaining that the people who funded her business were people who knew her, had worked with her, and who understood what she could do).

86 *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 1 (2008) (statement of Don O'Bannon, Chairman, Airport Minority Advisory Council (AMAC)).

87 *Opportunities and Challenges for Women Entrepreneurs on the 20th Anniversary of the Women's Business Ownership Act: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 31-32 (2008) (statement of Ann Sullivan, Women Impacting Public Policy).

88 *Ibid.*

89 Robert W. Fairlie and Alicia M. Robb, *Why are Black-Owned Businesses Less Successful Than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital*, 25 Journal of Labor Economics 289, 309-311 (2007).

These findings are borne out in a 2008 report published by the Minority Business Development Agency, which examined many of the challenges faced by minority-owned businesses that contribute to their lower survival rates when compared to non-minority businesses.[90] The report found that "a greater proportion of minority businesses operating in 2002 used more expensive sources of capital, such as credit cards, to start or acquire the business, compared to non-minority businesses. Minority firms were also less likely to use bank loans to start, acquire, expand or finance capital expansions of the business compared to non-minority firms."[91] Differences in capital usage between minority firms and non-minority firms still existed when data were segregated for firms with gross receipts of $500,000 or more.[92] The findings suggest minority-owned firms may be faced with a larger financial burden when starting and expanding their businesses because credit cards often carry higher costs compared to business loans that generally have more favorable terms.[93]

Finally, Congressional hearings provide specific examples of how lending discrimination plays out in the real world. Testimony from minority and women business owners has provided egregious examples of racial and gender discrimination by lenders. For example, one minority contractor with solid financial data was denied a loan only to have one of his white employees take the same financial data to the same loan officer, receive a loan, and be told that he was "the kind of businessman [the bank was] looking for."[94] After that experience, the contractor never went into a bank without a white employee accompanying him. Other testimony revealed that some women business owners are repeatedly asked to have a man co-sign their business loan applications, even when the men are not affiliated with the business and have lower credit scores or lower personal incomes than the women seeking the loans.[95] According to one witness, after a female applicant in that situation explained to the loan officer that her husband had no involvement with her company or the construction industry and that he had a lower credit score than the applicant, the loan officer nonetheless stated that the bank would be "a lot more

[90] U.S. Department of Commerce, Minority Business Development Agency, *Characteristics of Minority Businesses and Entrepreneurs, An Analysis of the 2002 Survey of Business Owners* (2008).

[91] *Id.* at 54.

[92] *Id.* at 26-27.

[93] *Id.* at 54.

[94] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 311 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT).

[95] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 299 (2009) (statement of Joann Payne, President, Women First National Legislative Committee); see also *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 25 (2008) (statement of Margot Dorfman, CEO, U.S. Women's Chamber of Commerce) (relaying experience of woman business owner who was told she would need her husband to co-sign her loan application because the lender did not believe that the applicant had a higher salary than her husband).

comfortable with a man's name on the application."[96]

C. *Discrimination Limits Access To Contracting Markets.*

Even when women and minorities are able to form and develop businesses, they often continue to experience discrimination that impedes their ability to compete equally for government contracts.[97] This discrimination takes many forms, including discrimination by prime contractors, exclusion from business networks, and discrimination by bonding companies and suppliers.[98]

---

[96] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 299 (2009) (statement of Joann Payne, President, Women First National Legislative Committee).

[97] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 309 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) ("The Department believes strongly that, while substantial progress has been made, discrimination and its effects continue to exist today and to distort contracting opportunities for DBEs."); *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 8 (2008) (statement of Virginia Littlejohn, Co-Founder and CEO, Quantum Leaps, Inc.) ("Access to federal procurement remains a huge area of underachievement, and is one of the biggest structural impediments to the economic advancement of women owned businesses in the US.").

[98] See *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 27 (2007) (statement of Jon Wainwright, Vice President, NERA Economic Consulting) (discussing findings from thousands of surveys and interviews that show that, throughout the country, and within both the public and private sector marketplaces, minorities report similar instances of negative stereotyping regarding their qualifications, double standards about their performance, and discrimination by bonding companies and suppliers); *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 28 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting) (concluding that "minorities and women reported that they still encounter significant barriers to doing business in the public and private sector market places, as both prime contractors and subcontractors" and "continued operation of federal, state, and local efforts to ensure equal access to the public contracting process is essential to the competitive viability of minority-owned and women-owned business enterprises."); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 223 (2009) (statement of Julie Cunningham, President and CEO, Conference of Minority Transportation Officials) (testifying that "discrimination is still a serious problem" and citing "use of antiquated 'old boy networks,' exclusion of DBEs from business opportunities, discrimination in credit lending, bonding and insurance, attempts to induce DBEs

(continued...)

1. *Discrimination By Prime Contractors Creates Obstacles.*

Discrimination by prime contractors poses a very significant and continuing obstacle to contracting for minority- and women-owned businesses. In the past, evidence before Congress has shown that "minority-owned firms are seldom or never invited to bid on projects that do not contain affirmative action requirements."[99] This remains true today for both minority- and women-owned firms.[100] A recent study that included surveys and interviews of hundreds of Disadvantaged Business Enterprises (DBEs) found general agreement among them "that without the use of affirmative remedies such as the USDOT DBE Program, minorities and women would receive few if any opportunities [— either as prime contractors or as subcontractors[101] —] on government contracts."[102] That study's author testified before Congress that, through his research, he has repeatedly found that contractors who use minority- and women-owned businesses on projects with goals "rarely use [those businesses] — or even solicit them — in the absence of such goals."[103]

(...continued)
to act fraudulently as 'fronts' and discriminatory application of procurement and contracting rules"); see also *id.* at 328 (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

[99] 61 Fed. Reg. at 26,058.

[100] *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 86 (2008) (statement of Anthony Brown, Chair, Government Affairs Committee of the AMAC, Senior Associate Partner, MGT of America) ("I can say in the many offices that I have held in airports, it has been very frustrating when you have contracts that are of a particular size and you will come in contact with very qualified, very capable minority business owners who have been limited in their abilities and their business's ability to grow, not due to their vision, not due to their hard work, not due to their ability, but simply due to the fact that no one will give them the opportunity to do the work because of what their racial or ethnic background is or their sex.").

[101] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 331 (2009) (statement of Jon Wainwright, Vice President, NERA Economic Consulting) ("In general, minorities and women reported that they still encounter significant barriers to doing business in the public and private sector market places, as both prime contractors and subcontractors.").

[102] *Ibid.*; see also *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 27 (2007) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

[103] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 331 (2009) (statement of Jon Wainwright, Vice President, NERA Economic Consulting)

The discriminatory attitudes of some prime contractors towards minority- or women-owned firms are demonstrated by prime contractors who cynically use minority- or women-owned firms to get lower prices from non-minority subcontractors, or even to win the prime contract itself, with no intention of ever actually using the minority- or women-owned firms. In "bid shopping," a prime contractor solicits a bid for subcontract work from minority- or women-owned firms in order to qualify for a contract goal, but then, rather than using the minority-or women-owned business, shares those bids with non-minority subcontractors so the non-minority businesses can submit a lower bid.[104] In Pima County, Arizona, for example, 19% of Caucasian women business owners and 25% of Hispanic business owners experienced pressure to lower quotes on a bid because of bid shopping by prime contractors.[105]

Another questionable practice is the "bait and switch," in which a contractor commits to using a minority- or woman-owned business to win a contract that contains race- or gender-conscious goals for subcontractors, but then never actually gives the minority- or woman-owned firm the promised work. For example, after receiving a complaint from a DBE owner who alleged that a large prime contractor had used the DBE to secure a contract without generating work for the DBE, the DOT investigated and learned that the prime contractor had falsely represented to the DOT that it had met its DBE requirements.[106] Another time a DBE alleged that it had been included on the prime's original contract but was replaced by a non-DBE contractor *after* the contract had been awarded to the prime.[107] A number of state and local

---

[104] For example, one witness testified before Congress that a Hispanic construction subcontractor was informed by a large majority owned prime contractor that they would use him on a job to fulfill a contract goal, but they in fact "shopped" his bid to a much larger majority subcontractor and removed the minority subcontract from the contract. *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 60 (2008) (statement of Anthony Brown, Chair, Government Affairs Committee of the AMAC, Senior Associate Partner, MGT of America). The subcontractor also reported that, based on his 25 years of experience in the industry, he feels "there is significant racial animus against Hispanic owned companies." *Ibid.* See also *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 43 (2007) (letter from Rita Baslock, President, Max Electric, Inc.).

[105] D. Wilson Consulting Group, *A Comprehensive Study of the Pima County MWBE Program* 9-11 (2008).

[106] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 313 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT).

[107] *Ibid.* See also *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 57 (2007) (statement of Wendi Goldsmith, President,

(continued...)

disparity studies have concluded that this practice is a major problem facing minority- and women-owned businesses.[108]

The prevalence of discrimination comes starkly into focus in jurisdictions that recently have discontinued race-conscious programs. For example, Congress heard testimony that less than a year after Michigan discontinued its affirmative action contracting program, the percentage of state-funded highway construction projects performed by DBEs *fell to zero*, even though their participation in the federal program was 13%.[109] Other states also experienced dramatic decreases in the participation of minority- and women-owned businesses when race- and gender-conscious remedies were abandoned.[110] Indeed, research shows that the disparity in

---

(...continued)

Bioengineering Group) ("In many cases, small firms are recruited onto teams to help win work as called for in contract solicitations. We appear in the proposals, often at great expense to the small and minority and women-owned businesses due to the work related to researching and compiling proposal materials, only to never actually receive work under the contract. I cringe to recount how many times that happened to my firm and to tally how much money, namely hundreds of thousands of dollars my firm involuntarily contributed in order to help other firms win and perform work, while we received none or sometimes a token amount."); see also *Access to Federal Contracts: How to Level the Playing Field: Field Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 172 (2007) (statement of Women Impacting Public Policy (WIPP)) (explaining that prime contractors often list women-owned business on their bid, but then revert to using "the same old subcontractors they have used in other bids" after winning the contract).

[108] See, *e.g.*, CRA International for the San Mateo County Transit District and the Peninsula Corridor Joint Powers Board, *Measuring Minority- and Women-Owned Construction and Professional Service Firm Availability and Utilization* 139 (2008) (finding that, in many cases, minority- and women-owned businesses were considered by prime contractors bidding for government jobs merely "for cosmetic purposes related to compliance with suggested or required good faith efforts"); Mason Tillman Associates, Ltd., *State of New Jersey Construction Services Disparity Study, 2000-2002* at 2-34 (2005) ("Many [minority and women business owners] reported that prime contractors have purposely used tactics to circumvent the [DOT DBE program's 'good faith effort'] requirements. For example, some prime contractors will seek to obtain [minority- and women-owned] business names and certification numbers without intending to use them on their projects."). One DBE in New Jersey explained that majority-contractors frequently get a minority business to bid on a project just "so they can say they [have] a minority bid" but do not actually consider subcontracting with the minority-owned firm. *Id.* at 2-36.

[109] *The Department of Transportation's Disadvantaged Business Enterprise Programs: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 301 (2009) (statement of Joann Payne, President, Women First National Legislative Committee).

[110] In Idaho, for example, the rate of minority- and women-owned business participation remained steady at just above 6% from 2004 through 2006 under a goal-based program. When Idaho switched to a race-neutral program in 2007, their participation rate dropped to below 4%.

(continued...)

contracting between minority- and majority-owned businesses is "markedly greater in jurisdictions where there [is] no goals program in place."[111] Joann Payne, President of Women First National Legislative Committee, told Congress that based on "history and present DBE participation percentages on state funded projects," absent race- and gender-conscious remedies, "participation [in government contracting] of women and minority owned businesses will drop nationally to approximately 2[%]."[112]

Academic studies have also found that the presence of race- and gender-conscious programs significantly improves minority- and women-owned businesses' ability to develop and participate in government contracting. For example, one study found that the gap between white and minority self employment rates narrowed during the 1980s "when affirmative action programs were implemented by many public sector jurisdictions."[113] The same study found that the gap began to widen again when the number of race-conscious contracting programs was reduced after the Supreme Court's decision in *Croson*,[114] and then narrowed again after 2000 once courts began to declare race-conscious contracting programs constitutional.[115] Another study found similarly that when race-conscious "programs are removed or replaced with race-neutral programs the utilization of minorities and women in public construction declines rapidly."[116] That study concluded that affirmative action programs appear to work but have not

(...continued)

Ibid. The same thing happened in California: DBE participation in federally funded contracts was 9% between 2002 and April 2006, but dropped to less than 5% in May 2006 after the state discontinued setting DBE goals. *Ibid.* The participation rate for women-owned businesses was just 0.1%. *Ibid.*

111 *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 3 (2007) (statement of Anthony W. Robinson, President, Minority Business Enterprise Legal Defense and Educational Fund).

112 *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 302 (2009) (statement of Joann Payne, President, Women First National Legislative Committee).

113 David G. Blanchflower, *Minority Self-Employment in the United States and the Impact of Affirmative Action Programs*, National Bureau of Economic Research, Working Paper 13972, at 17 (2008).

114 *City of Richmond* v. *J.A. Croson, Co.*, 488 U.S. 469, 492 (1989) (holding that the City of Richmond had failed to demonstrate a compelling interest to justify its race-conscious contracting program).

115 David G. Blanchflower, *Minority Self-Employment in the United States and the Impact of Affirmative Action Programs*, National Bureau of Economic Research, Working Paper 13972, at 17 (2008).

116 David G. Blanchflower and Jon Wainright, *An Analysis of the Impact of Affirmative Action Programs on Self-Employment in the Construction Industry*, National Bureau of Economic Research, Working Paper 11793, at 24 (2008) ("The evidence we have available to us suggests that very rapidly after the race and gender conscious programs were removed the utilization of

(continued...)

yet achieved their objectives "because they have not been allowed to work by non-minority contractors and by the courts."[117]

Congress has also heard testimony reporting a general "unwillingness [by prime contractors] to use minorities and women on jobs where there is no [minority- or women-owned business contracting] goal" even though "[t]here are a significant number of minority/women small business contractors who have the capability and proven experience to perform."[118] One witness testified that many prime contractors maintain a "mentality of exclusion" with respect to subcontractors, and explained that contractors exhibiting this mentality believe that "minority- and women-owned businesses don't belong at the table."[119]

DOT's recent experience in administering its DBE program provides further evidence of the lasting effects of discrimination in contracting and the continuing need for race- and gender-conscious programs to address those effects. DOT's program requires states to use the "best evidence available to estimate the DBE participation they could expect to obtain if there were a nondiscriminatory level playing field."[120] This "evidence-based estimate" then becomes the state's goal for DBE participation.[121] States are required to "achieve as much as possible of that annual goal through * * * 'race-neutral' means," including "[o]utreach, technical and bonding

(...continued)

firms owned by women and minorities collapsed."); see also Insight Center for Community Economic Development, *The Impact of State Affirmative Procurement Policies on Minority- and Women- Owned Businesses in Five States, Best Practices, Imperfections, and Challenges in State Inclusive Business Programs* iv (2007) (concluding that "when affirmative procurement policies end or are interrupted, MBEs and WBEs do not grow as fast as similar businesses in other states" and that these "slower business growth rates are not usually made up later, indicating the importance of the consistent presence of affirmative procurement programs").

[117] *Ibid.*

[118] *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 43 (2007) (letter from Rita Baslock, President Max Electric, Inc.).

[119] *How Information Policy Affects Competitive Viability in Minority Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 85 (2008) (statement of Anthony Brown, Chair, Government Affairs Committee of the AMAC, Senior Associate Partner, MGT of America).

[120] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 308 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT); see also 49 C.F.R. 26.

[121] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 308 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT).

assistance, unbundling of contracts, and small business programs."[122]

What DOT found is that, between 2004 and 2008, states that received federal transportation dollars had to resort to race-conscious measures to meet their DBE participation goals 81% of the time.[123] The magnitude of this finding was not lost on DOT officials: "This means that, eight out of ten times, [DOT funding] recipients, if denied the availability of race-conscious goals, would have left unremedied the effects of discrimination on small, disadvantaged business."[124] Perhaps even more revealing is that "in 69 percent of these cases, the race-conscious component of the goal was needed to make up the majority of the entire overall goal."[125] These facts led DOT to conclude that "in the absence of race-conscious goals, the gap between a level playing field and the reality facing DBEs trying to find work with [DOT funding] recipients would have been significantly larger."[126]

That conclusion was proven in jurisdictions that have suspended the use of race-conscious measures. These jurisdictions have experienced declines in DBE participation and have not been able to meet their participation goals. For example, Congress heard testimony that after jurisdictions discontinued the use of race-conscious measures, following the Ninth Circuit's decision in *Western States Paving Co.*,[127] the results were striking. Arizona's DOT set overall goals of 9.1% in 2007 and 9.9% in 2008, but only achieved 3.8% and 3.1%, respectively; California's DOT set goals of 10.5%, 10.5% and 13.5% for 2006-2008, but was only able to achieve 8.2%, 6.6% and 4.6% participation by DBEs during those years; Sound Transit in

---

[122] *Ibid.*

[123] *Id.* at 309.

[124] *Ibid.*

[125] *Ibid.*

[126] *Ibid*; see also *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 292 (2009) (statement of Don O'Bannon, Chairman, Airport Minority Advisory Council) ("One study found that DBE participation dropped to virtually zero on federally-assisted contracts during a time when the program was enjoined. Researchers stated that 'it appears that the mere fact of adopting a DBE program — whether or not goals are being set on any given contract — increases DBE participation.'").

[127] *Western States Paving Co., Inc.* v. *United States and Washington State Dep't of Transp.*, 407 F.3d 983 (9th Cir. 2005). In *Western States Paving Co.*, the court concluded that DOT's race-conscious contracting program — the Transportation Equity Act for the 21st Century — is constitutional on its face. The evidence before Congress established a compelling interest for the program, *id.* at 991-993, and — because race-conscious measures are used only when race-neutral means prove ineffective, and are employed in a flexible manner for a limited duration — the program is narrowly tailored, *id.* at 993-996. But the court determined that the program was unconstitutional as applied in Washington state because – the court concluded – the State failed to proffer "evidence of discrimination within its own contracting market and * * * thus failed to meet its burden of demonstrating that its DBE program is narrowly tailored." *Id.* at 1003.

Washington state set goals of 15% in 2007 and 13% in 2008, but only achieved 8.6% and 6.8% participation; Portland's airport set goals of 7.3% and 4% for the years 2007 and 2008, but only achieved 2% and 1.1% participation in those years.[128] From the reduction in the use of DBE programs following the *Western States Paving Co.* decision, DOT concluded that without the ability to use race conscious measures, states that are DOT funding recipients cannot, in many cases, "ensure [that] their Federally-assisted contracting programs provide nondiscriminatory access to business opportunities on a level playing field, as defined by their overall goals."[129] One DBE contractor "told State officials, since 'there's no DBE participation goal, our phones have stopped ringing . . . we don't get calls any more.'"[130]

These data — which reveal the significant downturn in contracts and dollars won by minority- and women-owned firms when race- and gender-conscious programs are eliminated — demonstrate more than just that these programs present opportunities. They establish that without such programs, minority- and women-owned firms are left with significantly less business than they actually can perform. When race- and gender-conscious programs are in place, minority- and women-owned firms secure, and perform, many more contracts than they secure without such programs. This certainly demonstrates that the amount of business these firms can handle is not defined by their success when these programs are not in place; rather, their capacity to perform work outstrips what they are hired to do in the absence of goals and in any event expands as contracts become available to them.

The evidence before Congress also contains many examples of blatant and egregious discrimination against minorities and women:

- One Alaskan-Native construction specialty contractor was regularly told by a prime contractor that he was only hired because he is a minority.[131] The prime contractor also

[128] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 310 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT). See also *id.* at 31 (statement of Joann Payne, President, Women First National Legislative Committee) (noting that in Idaho, the rate of minority- and women-owned business participation remained steady at just above 6% from 2004 through 2006 but dropped to below 4% in 2007 and that DBE participation in federally funded contracts was 9% between 2002 and April 2006, but dropped to less than 5% in May 2006).

[129] *Id.* at 310 (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT).

[130] *Ibid.* A DOT official relayed additional stories of DBE contractors following the *Western States Paving Co.* decision: one DBE contractor reported a 50% drop in calls following the decision; and a woman business owner reported that "where there are no goals, I can tell you that the fax machines stop . . . the next day I got no faxes, the phone didn't ring, asking for my bid. I used to get maybe 20 faxes a day . . . now I might get three a week." *Ibid.*

[131] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 292-293 (2009)

(continued...)

explicitly expressed his view that "minority businesses [are] not qualified."[132] At this same job site, the Alaskan Native's "company's equipment was regularly turned on during the night, causing the batteries to die and the project to be delayed. No non-minority contractors experienced this problem."[133]

- A Hispanic contractor was told by a general contractor that he "did not want any Mexicans on the job."[134] On other job sites, that same Hispanic contractor "has been called 'Wetback,' 'brown like s**t,' 'dumb Mexican,' 'little Mexican,' [and] 'my little Mexican friend.'"[135]

- A DBE owner in Delaware had a disagreement with one of her prime contractors, who insisted on speaking with her male foreman whenever he called her office.[136] Despite the male foreman's insistence that the prime needed to speak with his female boss, the prime called the boss's home — *and left a message for her husband*, who was not involved in the project.[137] In the message to the husband, the prime explained that he wanted to resolve the issue through a meeting but that "we don't have to have your wife

(...continued)
(statement of Don O'Bannon, Chairman, Airport Minority Advisory Council).

132 *Ibid.*

133 *Ibid.*

134 *Ibid.*

135 *Ibid.*; see also *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 311 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) (relaying incident where a Hispanic contractor "was not allowed to provide a proposal on a private contract because of ethnicity").

Congress has heard many other reports of direct discrimination by prime contractors against minorities. One minority contractor reported not being given a seat at the table for a presentation to a general contractor during which the general contractor "joked and laughed about the fact that he believed he had a way of 'getting around' the DBE ordinance." *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 294 (2009) (statement of Don O'Bannon, Chairman, Airport Minority Advisory Council). An African-American contractor reported that he encounters people who assume he does not understand fairly simple work-related matters because of his race. *Id.* at 293. Another minority contractor reported encountering the attitude, among other contractors, that "minorities are better-suited to be janitors or plumbers than architects." *Id.* at 294. That contractor also reported "that his firm gets less credit than non-minority owned firms when projects are successful, and disproportionate criticism when projects are not successful." *Ibid.*

136 *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 299 (2009) (statement of Joann Payne, President, Women First National Legislative Committee).

137 *Id.* at 299-300.

involved."[138] When the prime finally met with the female owner of the company, the first thing he said to her was "I am sorry this has taken so long but I don't like dealing with women."[139]

Similar evidence of discrimination by prime contractors against minorities and women is recounted in local disparity studies. For example, when a female contractor attempted to collect money she was owed on a subcontract from the prime contractor, the prime contractor refused to pay her, saying "no woman [should] make that kind of money."[140]

Another particularly egregious example of discrimination by a prime contractor occurred

---

[138] *Id.* at 300.

[139] *Ibid.* Another woman told of an instance "when a project's resident engineer [would not] speak to [her] on the job site but direct[ed] all his comments to the (male) foreman standing two feet to [her] left." *Id.* at 299. Similarly, another woman reported getting calls asking for the man in charge; the caller simply hung up after finding out that the person in charge was a woman. *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 214 (2009) (statement of Katherine M. Cloonen, President and Owner, JK Steel Erectors, Inc.). Cloonen also reported that when she was starting out, she was not taken seriously and was sent the worst workers from the union. *Ibid.* Other women complained that they frequently encounter people who assume that they are "fronts" for the man who really owns the business. *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 293, 299 (2009) (statement of Joann Payne, President, Women First National Legislative Committee & statement of Don O'Bannon, Chairman of the Airport Minority Advisory Council).

[140] Mason Tillman Associates, Ltd., *State of New Jersey Construction Services Disparity Study, 2000-2002*, Vol. 1 at 2-11 (2005); see also BBC Research & Consulting for the Washington Suburban Sanitary Commission, *WSSC 2005 Disparity Study – Summary and Recommendations*, § 3 at 17 (2005) (African-American business owner in the Washington, D.C., area reported that he lost work when a client learned of his race; officials in charge of the project indicated that they loved his company's proposal but then used a white-owned company instead after learning that his firm was minority-owned); MGT of America, Inc., *The City of Phoenix Minority-, Women-Owned and Small Business Enterprise Program Update Study* 6-22 (2005) (minority contractor reported that "[t]here have been incidents where I've been on the job site and the General [Prime Contractor] won't talk to me, they will go to the white foreman and talk to the foreman"); Washington Suburban Sanitary Commission by BBC Research & Consulting, *WSSC 2005 Disparity Study – Summary and Recommendations*, § 4 at 21 (2005) (Hispanic owner of a construction firm recounting experience where three white men at an industry conference pointed to his friend, an African-American man, and started making racist comments and using racial slurs); University of Minnesota Disparity Study Research Team, *Analysis of Essex County Procurement and Contracting: Final Report* 91 (2005) (recounting racially and gender motivated harassment experienced by minorities and women at job sites).

on a government contract in Iraq. Worldwide Network Services (WWNS), an African-American-owned firm, was awarded a subcontract to perform communications work on two security-related contracts for DynCorp International.[141] DynCorp was initially satisfied with WWNS's work and rated it as "exceptional" and "very good."[142] But in 2005, DynCorp began discriminating against and exhibiting racial animus toward WWNS in a number of ways, including: excluding WWNS from planning meetings, failing to respond to WWNS's requests for information and assistance, refusing to provide WWNS employees with security badges they needed in order to perform their work, and refusing to make or process payments on WWNS's invoices.[143] These actions "effectively put WWNS * * * out of business."[144] The jury found that DynCorp's conduct was motivated by racial animus. DynCorp's IT manager referred to WWNS as "kaffirs," a derogatory term for black South Africans, and also made many other derogatory comments.[145]

2. *Discrimination By Business Networks Limits Opportunities.*

As the Department of Justice explained in 1996, access to informal business networks is essential to survival in contracting because these networks "serve as conduits of information about upcoming job opportunities and facilitate access to the decisionmakers."[146] These same networks and contacts "can help a business find the best price on supplies, facilitate a quick loan, foster a relationship with a prime contractor, or yield information about an upcoming contract for which the firm can prepare — all of which serve to make the firm more competitive."[147]

Race- and gender-conscious contracting programs have helped some women and minorities break into these networks. Indeed, a DOT official recently testified before Congress that "possibly the most important function" the DBE program has performed over the last 30 years "is to address the lack of access by minority and women contractors to these crucial

---

141 *Worldwide Network Services, LLC* v. *DynCorp International, LLC*, No. 1:07-cv-627, Doc. 459 at 6 (E.D.V.A. Sept. 22, 2008).

142 *Id.* at 6-7.

143 *Id.* at 7-8.

144 *Id.* at 8.

145 *Id.* at 7.

146 61 Fed. Reg. at 26,059. See also *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 57 (2007) (statement of Wendi Goldsmith, President, Bioengineering Group) ("It is virtually impossible to win work through a competitive process without a level of comfort that comes through personal relationships, * * * long-term relationships — going to school together, working together or what have you.").

147 61 Fed. Reg. at 26,059; see also *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 57 (2007) (statement of Wendi Goldsmith, President, Bioengineering Group) (discussing the importance of networks).

informal networks."[148] The official explained that the program requires prime contractors, who may not normally socialize with minority or female contractors, to make an effort to involve minority- and women-owned firms as subcontractors.[149] This, the official explained, "is a very beneficial way of introducing prime contractors to DBEs and, hopefully, beginning to create business relationships that will lead to opportunities for DBEs to get the work they need to succeed."[150]

But progress for minorities and women attempting to break into established business networks has been slow, and more work needs to be done.[151] Opening business networks to minority- and women-owned businesses "doesn't happen by accident and * * * doesn't happen without help."[152] DOT still considers lack of access to business networks and to the information those networks provide to be "[o]ne of the most important barriers to participation [in contracting]" that minorities and women face.[153]

Many minorities and women still find themselves excluded from informal business networks today. Congress has heard a significant amount of testimony about the continued prevalence of "old boys' networks" and the difficulty minority and women business owners face in attempting to break into these networks.[154] Likewise, many state and local disparity studies

---

[148] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 312 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT).

[149] *Ibid.*

[150] *Ibid.*

[151] Anthony Brown, Chair of the Government Affairs Committee of the AMAC, testified about the importance of "help[ing] majority firms move beyond their established networks to give previously excluded businesses the opportunity to prove themselves." *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 58-59 (2008) (statement of Anthony Brown, Chair, Government Affairs Committee of the AMAC, Senior Associate Partner, MGT of America). But Brown said effecting this change is "hard" because of "[t]he mentality of exclusion can exist in contractors and public contracting officials." *Id.* at 55.

[152] *Id.* at 59.

[153] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 311 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT).

[154] *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 15 (2008) (statement of the Center for Women's Business Research) ("Acceptance into industry networks is often difficult, especially for women of color. Even when they join the meetings, they are not welcomed nor are they part of the activities."); *id.* at 18 (statement of Lisa Dolan, President, Securit) ("[B]eing in a male-dominated field in security, I am usually the only woman at the table and not taken seriously."); *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the*

(continued...)

reveal that minorities and women still face barriers to participation in business networks.[155]

When minority- and women-owned businesses are excluded from business networks, they are cut off from information and decision-makers and, as a result, are placed at a serious disadvantage. As one minority business owner told Congress: "One of the major problems that we face is the overall inability to have access to decision makers as we are unable to gain access to their many formal and informal networking activities." [156] A DOT official relayed to

(...continued)
Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship, 110th Cong. 43 (2007) (letter from Rita Baslock, President, Max Electric, Inc.) ("MBEs experience difficulty breaking into old-boy networks of general contractors. Because of the monetary and time consumption of the construction business for small businesses, many small minority and women subcontractors do not have the social connections, money, or time to effectively network in the old boy system."); *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 43 (2008) (statement of Kerstin Forrester, President and Owner, Stonebridge Precision Machining & Certified Welding) ("There is still very much an 'old boys' network in place."); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 208 (2009) (statement of Gilbert Aranza, CEO, Stars Concessions, Ltd.) ("I wish I could report that the Good Ol' Boy Network no longer exists, but I am afraid that I run up against it all the time."); *id.* at 312 (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) (quoting one business owner as stating, "An Idaho Hispanic contractor described the network there as 'white guys that have been running around with the same white guys that have controlled the money * * * for [many] years.'"). See also Michael Bonds, *Looking Beyond the Numbers, The Struggles of Black Businesses to Survive: A Qualitative Approach*, 37 Journal of Black Studies 581, 595 (2007) (concluding that "racism seems to play a major role in limiting African American business opportunities"); *id.* at 598 ("Black business owners expressed their frustration with their inability to break in to the old boys' network, being denied business loans, having to constantly prove themselves to White business owners, or being held to a higher performance standard than Caucasian firms.").

155 For example, a New Jersey disparity study found that both "new and established minority and women business owners report difficulties breaking into the contracting network." Mason Tillman Assocs., *State of New Jersey Construction Services Disparity Study, 2000-2002*, Vol. 1 at 2-25 (2005). That study also found that some minority- and women-owned businesses that "have been in been in operation for more than 20 years * * * are still excluded from job opportunities because they are not included in the social and business networks with those in positions of power in their respective fields." *Ibid.* Another study reported that many female and some minority business owners interviewed "were especially vocal about the 'good ole boy' system." CRA International for the San Mateo County Transit District and the Peninsula Corridor Joint Powers Board, *Measuring Minority- and Woman-Owned Construction and Professional Service Firm Availability and Utilization* 140 (2008).

156 *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the*
(continued...)

Congress minority and women business owners' concern about lack of access to important information: "There's still very much an old boy network . . . and if you're not an old boy, you're not in that network [and] there's a lot of information you don't get."[157]

In some places, minorities are still excluded from the social clubs that are a primary site for business networking.[158] More commonly, exclusion of minorities and women may be the result of non-minority contractors being comfortable with existing homogeneous networks, rather than overt discrimination.[159] That is one reason why programs that require majority-owned businesses to reach outside of their comfortable networks are so essential. If a contractor has a positive experience with a minority- or women-owned business, that may, over time, open the door to a continuing business relationship. That is precisely what has happened for Katherine M. Cloonen, the president and owner of JK Steel Erectors, Inc., who told Congress that the DBE

(...continued)
Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship, 110th Cong. 46 (2007) (letter from Bobby E. Henderson, President, Anlab Environmental).

[157] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 311 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT); *ibid.* (relating comment from a DBE firm owner, who noted that the "number one thing [that] puts DBEs at a disadvantage is lack of access to decision makers, who maybe . . . go out to drinks every once in a while . . . or see each other on the golf course"); *id.* at 311-312 (relating comment from a trade association representative, who stated: "Lots of things get done with back slapping and who knows who and if you're not in that group you might as well not come to the party."); see also MGT of America, *Broward County Small Disadvantaged Business Enterprise (SDBE) Study* 6-97 (2001) (quoting a business owner explaining that white owners enjoy certain advantages because "[t]hey play golf together and their kids go to the same schools").

[158] Chuck Covington, CEO of People's Transit, told Congress that in Michigan, where he does business, the Eagles Club is a primary hub for networking. *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 5 (2009). This club has an unwritten rule excluding African Americans. *Ibid.* Covington said the club's rule "sickens" him, "[b]ut the fact that it impacts my ability to conduct business is reprehensible." *Ibid.* Summarizing the problem, Covington said, "If people do business with the people they are comfortable with, and if I am denied opportunities to sit down and get to know people — based on nothing more than my race — it automatically puts me and my business at a disadvantage." *Ibid.*

[159] *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 15 (2007) (statement of Professor Candida Brush, Paul T. Babson chair-professor of entrepreneurship, Babson College) ("[W]e know from what is called the theory of homophily that people like to do business with people who are like themselves. So if you have this very homogeneous group, if you happen to be different in some way, it is going to be hard for you to get over that barrier.").

program has allowed her to slowly break into business networks.[160]

3. *Discrimination In Bonding And By Suppliers Burdens Disadvantaged Firms.*

Many contracts, both public and private, require bidders to secure a surety bond. Accordingly, success in contracting depends not only upon a firm's ability to do the work at a good price, but also on the firm's ability to obtain quality services from bonding companies. Any discrimination that exists in the bonding market makes fulfilling this requirement much more difficult for minority- and women-owned firms.[161]

A surety bond is required "[b]efore any contract of more than $100,000 is awarded for the construction, alteration, or repair of any public building or public work of the Federal Government."[162] As the Department of Justice explained in 1996,[163] our country's history of discrimination often lands minority- and women-owned businesses in a vicious cycle: they cannot get bonding because they lack experience, yet they cannot get experience because they lack bonding.[164] A 2006 report of the National Association of Women Business Owners

---

[160] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 213-214 (2009) (statement of Katherine M. Cloonen).

[161] See, *e.g.*, *The Department of Transportation's Disadvantaged Business Enterprise Programs: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 2 (2009) (statement of the Hon. James L. Oberstar, Chairman and Rep. from Minnesota) ("This data demonstrates that it is difficult for small and disadvantaged businesses to compete – discrimination impacts minority and women owned businesses at many points in the contracting process, including obtaining credit, *bonding*, and insurance.") (emphasis added).

[162] 40 U.S.C. 3131.

[163] 61 Fed. Reg. at 26,060.

[164] See, *e.g.*, *Access to Federal Contracts: How to Level the Playing Field Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 132 (2007) (statement of Randy McRae) ("[B]onding has been a cruel Catch-22 for [DBEs]. These struggling firms either can't afford a bond or can't persuade bonding companies to guarantee their performance. But without a bond, they can't bid on many jobs in the public or private sector, limiting their growth."); *id.* at 48 (statement of Wayne Frazier, Sr., President, Maryland-Washington Minority Contractors Association) ("Small businesses dealing with the Federal Government cannot get surety bonding. Again, no financing, no bonding, no contract, no award, no way to compete."); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 311 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) (relating comment from a female contractor in California who stated that "minorities and women have a much harder time getting capital, getting bonding, getting insurance … in bonding … women are still asked to have their husbands sign at the bank"); see also Washington Suburban Sanitary Commission by BBC Research & Consulting, *WSSC 2005 Disparity Study – Summary and Recommendations*, § 4 at 19-20 (2005)

(continued…)

Procurement Task Force, which was submitted to Congress, concludes that "[b]onding requirements and other financial tests can impose an insurmountable barrier to [women-owned small businesses] seeking federal contracts."[165] Where prime contractors set the bonding requirement at an unnecessarily high level, moreover, it effectively excludes a greater percentage of minority- and women-owned businesses because those businesses are more commonly unable to secure the necessary levels of bonding due to the variety of discriminatory barriers that have been discussed thus far.[166]

Moreover, their inability to secure bonding prevents minority- and women-owned businesses from growing their companies to the point where they can take on the role of prime contractor. One congressional witness explained: "You have to have proof that you are capable and have the capacity to deliver to large scale-projects if, in fact, you want to be a prime. As a result of the inability to be bonded, you end up being a subcontractor, which limits your growth opportunities."[167]

State and local disparity studies also identify bonding requirements as a major obstacle to success for minority- and women-owned businesses. For example, one study found that "[o]btaining sufficient bonding (or bonding at all) is frequently cited as a major barrier" to

(...continued)
(minority business owner reported that MBE firms get charged a higher rate for the same bonding as compared to white competitors).

165 *Opportunities and Challenges for Women Entrepreneurs on the 20th Anniversary of the Women's Business Ownership Act: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 67 (2008) (report of the NAWBO Procurement Task Force, February 2006).

166 *How Information Policy Affects Competitive Viability in Minority Contracting Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 92 (2008) (statement of Anthony Brown, Chair, Government Affairs Committee of the AMAC, Senior Associate Partner, MGT of America); *The Department of Transportation's Disadvantaged Business Enterprise Programs: Hearing Before the H. Comm. on Transportation and Infrastructure*, 111th Cong. 311 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) ("Several California [DBE] contractors mentioned that prime contractors often imposed higher bonding or insurance requirements than the state required, blocking them from participation.").

167 *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 26 (2008) (statement of Eydie Silva, Executive Director, State Office of Minority and Women Business Assistance); see also Kevin O'Brien, Ph.D., Bernard Goitein, Ph.D., and Camden Bucey, *Disparity Study for the City of Peoria* 32, 36 (2004) (concluding that lack of access to bonding was a factor that helped to explain why, from 1992-2001, no African-American-owned business in Peoria was able to obtain a contract as a prime contractor in any of the City's 136 contracting projects; and there was only one project where a women-owned business was the prime contractor).

contracting for minority- and women-owned businesses.[168] Specifically, that study concluded that "[m]inority firms often have difficulty obtaining bonding because they lack the experience bonding companies require."[169]

Discrimination by suppliers is also still a problem. If a supplier charges minority- or women-owned businesses a higher price than it charges a majority-owned business, then the minority- and women-owned firms will have to include the higher price of supplies in their bid. This in turn limits the minority- and women-owned businesses' ability to compete.[170] The problem has a significant effect on minority- and women-owned businesses. For example, a disparity study in Memphis, Tennessee, found that 21.6% of the minority- and women-owned businesses surveyed stated that they had experienced at least one instance of discrimination by a supplier in the last five years.[171] Another study found that women-owned businesses reported "that they were often given a higher price for materials than their male-owned counterparts, and they believe that the higher prices were related to their gender."[172]

Congress has also heard testimony about supplier discrimination. One egregious example occurred in Michigan: An African-American employee of a minority-owned business obtained a quote of $613 per tire for 16 new tires.[173] The minority business owner discovered that a white business associate had paid only $400 per tire.[174] He then called the supplier and "put on a white voice" and was quoted $400.[175] Congress also heard about an African-American mechanical contractor who solicited a quote for equipment from his non-minority-owned supplier which he then included in his bid.[176] He then received a fax from the supplier that was intended for his

---

[168] Pennsylvania Advisory Comm. to the U.S. Comm'n on Civil Rights, *Barriers Facing Minority- and Women-Owned Bus. in Pa.* 18 (2002).

[169] *Id.* at 19.

[170] See National Economic Research Associates, Inc., *Race, Sex, and Business Enterprise: Evidence from Memphis, Tennessee* 103 (2008) (concluding that "discrimination by commercial customers and suppliers against [minority- and women-owned businesses] operates to increase input prices and lower output prices for" those businesses).

[171] *Id.* at 259.

[172] CRA International for the San Mateo County Transit District and the Peninsula Corridor Joint Powers Board, *Measuring Minority- and Woman-Owned Construction and Professional Service Firm Availability and Utilization* 139 (2008).

[173] *The Department of Transportation's Disadvantaged Business Enterprise Programs: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 217 (2009) (statement of Chuck Covington, CEO, People's Transit).

[174] *Ibid.*

[175] *Ibid.*

[176] *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 39 (2007) (statement of Anthony W. Robinson, President, Minority Business Enterprise Legal Defense and Educational Fund).

non-minority-owned competitor, quoting the competitor a lower quote.[177] When the minority business owner requested the lower price quote provided to his competitor, the supplier responded that it reserved the right to provide better pricing to their better customers.[178] Obviously — as a minority business owner testified — "no businessperson, no matter how talented, can succeed if they are paying a race-based mark-up on supplies."[179]

III.

Conclusion

The discussion above surveys only a portion of the evidence that demonstrates that the race- and gender-based barriers facing minority-and women-owned firms still exist. While some progress has been made, the U.S. Small Business Administration's 8(a) and Women-Owned Small Business programs, the DOT's Disadvantaged Business Enterprise program, and similar programs are still critical to prevent the federal government from becoming a "passive participant" in a system infected by race and gender discrimination. The government's obligation to ensure that tax money is spent fairly and equally requires these programs.

[177] *Ibid.*

[178] *Ibid.* See also Mason Tillman Assocs., *State of New Jersey Construction Services Disparity Study, 2000-2002*, Vol. 1 at 2-7 (2005) (African-American business owner reported that one supplier demanded that she pay up front or pay a certain amount of money down before checking her business's credit rating; the supplier openly stated that the reason for this requirement was that his business was minority-owned and the supplier claimed to have "had prior experience with a minority vender that had not paid them").

[179] *The Department of Transportation's Disadvantaged Business Enterprise Programs: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 218 (2009) (statement of Chuck Covington, CEO, People's Transit).

Appendix A

Congressional Hearings Between 2006 and 2010
Addressing Public Procurement and Minority- and Women-Owned Business Enterprises

- *Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets, Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 111th Cong. (2010)

- *Infrastructure Investment: Ensuring an Effective Economic Recovery Program: Hearing Before the H. Comm. on Transportation and Infrastructure*, 111th Cong. (2009)

- *The Federal Aviation Administration Reauthorization Act of 2009: Hearing Before the H. Subcomm. on Aviation of the H. Comm. on Transportation and Infrastructure*, 111th Cong. (2009)

- *Full Committee Hearing on the State of the SBA's Entrepreneurial Development Programs and Their Role in Promoting an Economic Recovery: Hearing Before the H. Comm. on Small Business*, 111th Cong. (2009)

- *Full Committee Hearing on Oversight of the Small Business Administration and its Programs: Hearing Before the H. Comm. on Small Business*, 111th Cong. (2009)

- *The Department of Transportation's Disadvantaged Business Enterprise Programs: Hearing Before the H. Comm. on Transportation and Infrastructure*, 111th Cong. (2009)

- *The Role of Small Business in Recovery Act Contracting: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 111th Cong. (2009)

- *Trends Affecting Minority Broadcast Ownership: Hearing Before the H. Judiciary Comm.*, 111th Cong. (2009)

- *Roundtable on Healthcare Reform: Small Business Concerns and Priorities: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 111th Cong. (2009)

- *Doing Business with the Government: The Record and Goals for Small, Minority and Disadvantaged Businesses: Hearing Before the H. Comm. On Transportation and Infrastructure*, 111th Cong. (2009)

- *Minority Entrepreneurship: Evaluating Small Business Resources and Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 111th Cong. (2009)

- *The Minority Business Development Agency: Enhancing the Prospects for Success: Hearing Before the H. Subcomm. on Commerce, Trade, and Consumer Protection of the H. Comm. on Energy and Commerce*, 111th Cong. (2009)

- *Full Committee Hearing on SBA's Progress in Implementing the Women's Procurement Program: Hearing Before the H. Comm. on Small Business*, 110th Cong. (2008)

- *Holding the Small Business Administration Accountable: Women's Contracting and Lender Oversight: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2008)

- *Diversity in the Financial Services Sector: Hearing Before the H. Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services*, 110th Cong. (2008)

- *Military Base Realignment: Contracting Opportunities for Impacted Communities: Hearing Before the H. Subcomm. on Government Management, Organization, and Procurement of the H. Comm. on Oversight and Government Reform*, 110th Cong. (2008)

- *Community Reinvestment Act: Thirty Years of Accomplishments, But Challenges Remain: Hearing Before the H. Comm. on Financial Services*, 110th Cong. (2008)

- *Doing Business with the Government: The Record and Goals for Small, Minority, and Disadvantaged Businesses: Hearing Before the H. Subcomm. on Economic Development, Public Buildings, and Emergency Management of the H. Comm. on Transportation and Infrastructure*, 110th Cong. (2008)

- *Subcommittee Hearing on Oversight of the Entrepreneurial Development Programs Implemented by the Small Business Administration and National Veterans Business Development Corporation: Hearing Before the H. Subcomm. on Rural and Urban Entrepreneurship of the H. Comm. on Small Business*, 110th Cong. (2008)

- *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2008)

- *Subcommittee Hearing on Minority and Hispanic Participation in the Federal Workforce and the Impact on the Small Business Community: Hearing Before the H. Subcomm. on Regulations, Health Care, and Trade of the H. Comm. on Small Business*, 110th Cong. (2008)

- *Opportunities and Challenges for Women Entrepreneurs on the 20th Anniversary of the Women's Business Ownership Act: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2008)

- *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2008)

- *How Information Policy Affects Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the H. Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. (2008)

- *Full Committee Field Hearing on Participation of Small Business in Hurricane Katrina Recovery Contracts: Hearing Before the H. Comm. on Small Business*, 110th Cong. (2007)

- *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2007)

- *Full Committee Hearing on the Small Business Administration's Microloan Program: Hearing Before the H. Comm. on Small Business*, 110th Cong. (2007)

- *Increasing Government Accountability and Ensuring Fairness in Small Business Contracting: Hearing Before the S. Comm. on Small Business & Entrepreneurship*, 110th Cong. (2007)

- *Diversifying Native Economies: Oversight Hearing Before the H. Comm. on Natural Resources*, 110th Cong. (2007)

- *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2007)

- *Federal Contracting: Removing Hurdles for Minority-Owned Small Businesses: Hearing Before the H. Subcomm. on Government Management, Organization, and Procurement of the H. Comm. on Oversight and Government Reform*, 110th Cong. (2007)

- *Full Committee Hearing to Consider Legislation Updating and Improving the SBA's Contracting Programs: Hearing Before the H. Comm. on Small Business*, 110th Cong. (2007)

- *Mortgage Lending Discrimination: Field Hearing Before the H. Comm. on Financial Services*, 110th Cong. (2007)

- *Access to Federal Contracts: How to Level the Playing Field: Field Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2007)

- *Preserving and Expanding Minority Banks: Hearing Before the H. Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services*, 110th Cong. (2007)
- *Reauthorization of Small Business Administration Financing and Entrepreneurial Development Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 109th Cong. (2006)
- *Northern Lights and Procurement Plights: The Effect of the ANC Program on Federal Procurement and Alaska Native Corporation: Joint Hearing Before the H. Comm. on Government Reform and the H. Comm. on Small Business*, 109th Cong. (2006)
- *Diversity: The GAO Perspective: Hearing Before the H. Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services*, 109th Cong. (2006)
- *Strengthening Participation of Small Businesses in Federal Contracting and Innovation Research Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 109th Cong. (2006)

Appendix B

Studies and Reports

- Frances Amatucci, *Women Entrepreneurs Securing Business Angel Financing: Tales from the Field*, Venture Capital (2004)
- Ana Aparicio, *Hispanic-Owned Business Enterprises in the Construction Industry of Greater Chicago: Responses and Personal Perspectives*, for the City of Chicago M/WBE Program (2009)
- Ana Aparicio, *Women-Owned Business Enterprises in the Construction Industry of Greater Chicago: Responses and Personal Perspectives*, for the City of Chicago M/WBE Program (2009)
- Asian American Justice Center, *Equal Access: Unlocking Government Doors for Asian Americans: Public Contracting Laws and Policies* (2008)
- S. Ann Becker and Donn Miller-Kermani, *Women-Owned Small Businesses in the Federal Procurement Market*, Journal of Contract Management 131 (2008)
- Dana Bible, Kathy Hill, *Discrimination: Women in Business,* Journal of Organizational Culture, Communications and Conflict, Volume 11, No. 1 (2007)
- Lloyd Blanchard, Bo Zhao, and John Yinger, *Do Credit Market Barriers Exists for Minority and Women Entrepreneurs?*, Center for Policy Research, Maxwell School, Syracuse University, Working Paper No. 74 (2005)
- David. G. Blanchflower and Jon Wainwright, *An Analysis of the Impact of Affirmative Action Programs on Self-Employment in the Construction Industry*, National Bureau of Economic Research, Working Paper 11793 (2008)
- David G. Blanchflower, Phillip B. Levine, and David J. Zimmerman, *Discrimination in the Small-Business Credit Market*, 85(4) Review of Economics and Statistics 930 (2003)
- David. G. Blanchflower, *Minority Self-Employment in the United States and the Impact of Affirmative Action Programs*, National Bureau of Economic Research, Working Paper 13972 (2008)
- Boston Consulting Group, *The New Agenda for Minority Business Development* (2005)
- Candida G. Brush et al., *An Investigation of Women-Led Firms and Venture Capital Investmen,* Prepared for the U.S. Small Business Administration, Office of Advocacy (2001)

- Ken Cavalluzzo & John Wolken, *Competition, Small Business Financing, and Discrimination: Evidence from a New Survey*, 75(4) Journal of Business 641 (2005)
- Ken Cavalluzzo & John Wolken, *Small Business Loan Turndowns, Personal Wealth, and Discrimination*, 78(6) Journal of Business 2153 (2005)
- Susan Coleman, *Access to Debt Capital for Women and Minority Owned Small Firms: Does Educational Attainment Have an Impact*, 9(2) Journal of Developmental Entrepreneurship 127 (2004)
- Susan Coleman, *The Borrowing Experience of Black and Hispanic-Owned Small Firms: Evidence from the 1998 Survey of Small Business Finances*, 8 The Academy of Entrepreneurship Journal (2002)
- Susan Coleman, *Is There a Liquidity Crisis For Small, Black-Owned Firms*, Journal of Developmental Entrepreneurship (2005)
- Ernst & Young, *2008 Catalyst Census of Women Corporate Officers and Top Earners of the Fortune 500*, available at http://www.catalyst.org/file/241/08_census_cote_jan.pdf (last visited, April 29, 2010)
- Robert W. Fairlie and Alicia M. Robb, *Minority Business Development Agency Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs*, Prepared for the U.S. Department of Commerce (2010)
- Robert W. Fairlie and Alicia M. Robb, *Why are Black-Owned Businesses Less Successful Than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital*, 25 Journal of Labor Economics 289 (2007)
- Robert W. Fairlie, *Minority Entrepreneurship*, The Small Business Economy, produced under contract with the SBA, Office of Advocacy (2005)
- Cedric Herring, *Barriers to the Utilization of Targeted Program Contractors: Results from Interviews of African American Contractors*, for the City of Chicago M/WBE Program (2009)
- Michael Hout and Harvey Rosen, *Self-Employment, Family Background, and Race*, 35 Journal of Human Resources 671(2000)
- Insight Center for Community Economic Development, *The Impact of State Affirmative Procurement Policies on Minority- and Women- Owned Businesses in Five States, Best Practices, Imperfections, and Challenges in State Inclusive Business Programs* (2007)
- Yvonne M. Lau, *Profiles on Asian Americans in Construction -A Study for the City of Chicago M/WBE Sunset Project*, for the City of Chicago M/WBE Program (2009)

- Sang-Suk Lee and Diane Denslow, *A Study on the Major Problems of U.S. Women-Owned Small Businesses*, Journal of Small Business Strategy, 15 (2) (2005)
- Ying Lowrey, *Minorities in Business: A Demographic Review of Minority Business Ownership*, 298 U.S. Small Business Administration (2007)
- Ying Lowrey, *Dynamics of Minority-Owned Employer Establishments, 1997-2001*, 251 U.S. Small Business Administration (2005)
- Karlyn Mitchell & Douglas K. Pearce, *Availability of Financing to Small Firms Using the Survey of Small Business Finances*, 257 U.S. Small Business Administration (2005)
- Pennsylvania Advisory Comm. to the U.S. Comm'n on Civil Rights, *Barriers Facing Minority- and Women-Owned Bus. in Pennsylvania* (2002)
- Craig A. Peterson and James Philpot, *Women's Roles on U.S. Fortune 500 Boards: Director Expertise and Committee Memberships*, 72 Journal of Business Ethics 177 (2007)
- Myron Quon, *Discrimination Against Asian American Business Enterprises: The Continuing Need for Affirmative Action in Public Contracting*, Asian American Policy Review 41 (2008)
- Howard Rasheed, *Capital Access Barriers to Government Procurement Performance: Moderating Effects of Ethnicity, Gender, and Education*, Journal of Developmental Entrepreneurship (2004)
- Elaine Reardon, Nancy Nicosia and Nancy Y. Moore, *The Utilization of Women-Owned Small Businesses in Federal Contracting*, Kauffman-RAND Institute for Entrepreneurship Public Policy (2007)
- Alicia M. Robb, & Robert Fairlie, *Access to Financial Capital Among U.S. Businesses: The Case of African American Firms Constraints*, 613 Annals of the American Academy of Political and Social Science (September 2007)
- Hal Salzman and Signe-Mary McKernan, *Capital Access for Women, Profile and Analysis of U.S. Best Practice Programs*, The Urban Institute (2007)
- Jonathan Taylor, *Income and Wealth Transfer Effects of Discrimination in Small Business Lending*, 32(3/4) Review of Black Political Economy 87 (2005)
- Siri Terjesen, Ruth Sealy and Val Singh, *Women Directors on Corporate Boards: A Review and Research Agenda*, 17 Corporate Governance: An International Review 320 (2009)
- Jon Wainwright, *Disparity Study Methodology*, National Cooperative Highway Research Program Report (2010)

- U.S. Census Bureau, *2002 Survey of Business Owners, Advance Report on Characteristics of Employer Business Owners: 2002*, available at http://www.census.gov/econ/census02/sbo/intro.htm (last visited April 29, 2010).
- U.S. Census Bureau, *Survey of Business Owners - Women-Owned Firms: 2002*, available at http://www.census.gov/econ/sbo/02/womensof.html (last visited April 29, 2010)
- U.S. Department of Commerce, Minority Business Development Agency, *Accelerating Job Creation and Economic Productivity: Expanding Financing Opportunities for Minority Businesses* (2004)
- U.S. Department of Commerce, Minority Business Development Agency, *Characteristics of Minority Businesses and Entrepreneurs, An Analysis of the 2002 Survey of Business Owners* (2008)
- U.S. Department of Commerce, Minority Business Development Agency, *The State of Minority Business Enterprises, An Overview of the 2002 Survey of Business Owners, Number of Firms, Gross Receipts, and Paid Employees* (2006)
- U.S. Department of Commerce, Minority Business Development Agency, *Accelerating Job Creation and Economic Productivity: Expanding Financing Opportunities for Minority Businesses* (2004)
- U.S. Department of Commerce, Economics and Statistics Administration and the Minority Business Development Agency' *Keys to Minority Entrepreneurial Success: Capital, Education and Technology* (2002)
- United States Department of Labor, *Quick Stats on Women Workers, 2008*, available at http://www.dol.gov/wb/stats/main.htm (last visited April 29, 2010)

Appendix C

A Sample of State and Local Government Disparity Studies

Alabama

- *City of Birmingham: Disparity Study Report*, Prepared by Pendleton, Friedberg, Wilson & Hennessey, P.C. for the City of Birmingham, Alabama (2007)

Alaska

- *Alaska Disadvantaged Business Enterprise Study – Availability and Disparity*, Prepared by D. Wilson Consulting Group, LLC for the Alaska Department of Transportation and Public Facilities (2008)

Arizona

- *A Comprehensive Study of the Pima County MWBE Program*, Prepared by D. Wilson Consulting Group, LLC for the Pima County Procurement Department (2008)

- *A Comprehensive Disparity Study of the City of Tucson MWBE Program*, Prepared by D. Wilson Consulting Group, LLC for the Pima County Procurement Department (2008)

- *Availability Analysis and Disparity Study for the Arizona Department of Transportation: Final Report*, Prepared by MGT of America for the Arizona Department of Transportation (2009)

- *The City of Phoenix Minority-, Women-Owned, and Small Business Enterprise Program Update Study*, Prepared by MGT of America, Inc. for the City of Phoenix (2005)

California

- *San Francisco Bay Area Rapid Transit District, Availability and Utilization Study*, Final Report, Prepared by Mason Tillman Assoc. for the San Francisco Bay Area Rapid Transit District (2009)

- *Statistical Disparities in Minority and Female Business Formation and Earnings In and Surrounding San Francisco, California*, Prepared by NERA Economic Consulting for the City of San Francisco, CA (2003)

- *Availability and Disparity Study for the California Department of Transportation*, Prepared by BBC Research & Consulting for the California Department of Transportation (2007)

- *Measuring Minority- and Woman-Owned Construction and Professional Service Firm Availability and Utilization*, Prepared by CRA International for the San Mateo County Transit District and the Peninsula Corridor Joint Powers Board (April 14, 2008)

- *Measuring Minority- and Woman-Owned Construction and Professional Service Firm Availability and Utilization*, Prepared by CRA International for the Santa Clara Valley Transportation Authority (December 14, 2007)

- *Alameda County Availability Study*, Prepared by Mason Tillman Associates, Ltd. for the County of Alameda (October 2004)

Colorado

- *Colorado Department of Transportation Statewide Transportation Disparity Study*, Prepared by D. Wilson Consulting Group, LLC for the Colorado Department of Transportation (2009)

- *Race, Sex, and Business Enterprise: Evidence from Denver, Colorado*, Prepared by NERA Economic Consulting for the City and County of Denver, Colorado (2006)

- *Colorado Department of Transportation Disparity Study Update*, Prepared by MGT of America for the Colorado Department of Transportation (2001)

Connecticut

- *The City of Bridgeport Disparity Study Regarding Minority Participation in Contracting*, presented by Mason Tillman Associates, Ltd. for the City of Bridgeport Connecticut (August 2005)

Florida

- *Statistical Disparities in Minority and Female Business Formation and Earnings In and Surrounding Jacksonville, Florida*, Prepared by NERA Economic Consulting for the City of Jacksonville, FL (2003)

- *Multi-Jurisdictional Disparity Study Consultant Services: Hillsborough County Aviation Authority and City of Tampa*, Prepared by Mason Tillman Associates, Ltd. for the Hillsborough County Aviation Authority Office and City of Tampa, Florida (April 2006)

- *Broward County Small Disadvantaged Business Enterprise (SDBE) Study*, Prepared by MGT of America for the Broward County Board of Commissioners (2001)

Georgia

- *Race, Sex, and Business Enterprise: Evidence from Augusta, Georgia*, Prepared by NERA Economic Consulting for August-Richmond County Georgia (2009)

- *Consortium Disparity Study Update*, Prepared by BBC Research & Consulting for the City of Albany, Georgia; Dougherty County, Georgia; Dougherty County School System; Albany Water, Gas & Light Commission; and Albany Tomorrow, Inc. (2008)

- *City of Atlanta Disparity Study*, Prepared by Griffin and Strong for the City of Atlanta (2006)

- *Georgia Department of Transportation Disparity Study*, Prepared by Boston Research Group for the State of Georgia (2005)

Idaho

- *A Study to Determine DBE Availability and Analyze Disparity in the Transportation Contracting Industry in Idaho*, Prepared by BBC Research & Consulting for the Idaho Transportation Department (2007)

Illinois

- *Disadvantaged Business Enterprise Availability Study*, Prepared by NERA Economic Consulting, for the Illinois Department of Transportation (2004)

- *Report on the City of Chicago's MWBE Program*, Prepared by David Blanchflower, Ph.D., for the City of Chicago M/WBE Program (2009)

- *Disadvantaged Business Enterprise Study*, Prepared by NERA Economic Consulting, for the Northeast Illinois Regional Commuter Railroad Corporation D/B/A Metra (2000)

- *Disparity Study for the City of Peoria*, Prepared by Kevin O'Brien, Ph.D., for the City of Peoria (2004)

- *Race, Sex, and Business Enterprise: Evidence from the State of Illinois and the Chicago Metropolitan Area*, Prepared by NERA Economic Consulting for the Illinois State Toll Highway Authority (2004)

Iowa

- *City of Davenport Disparity Study Regarding Minority and Women Participation in Contracting*, Prepared by Mason Tillman Associates, Ltd. for the Davenport, Iowa (2009)

Kansas

- *Kansas Department of Transportation Availability and Goal Setting Study*, Prepared by MGT of America for the Kansas Department of Transportation (2001)

Kentucky

- *Disparity Study for the Commonwealth of Kentucky*, Prepared by Griffin and Strong for the Commonwealth of Kentucky (2000)

Maryland

- *Race, Sex, and Business Enterprise: Evidence from the City of Baltimore*, Prepared by NERA Economic Consulting for the City of Baltimore, MD (2007)
- *Disadvantaged Business Enterprise Availability Studies Prepared for the Maryland Department of Transportation, State Highway Administration, Maryland Transit Administration, Maryland Aviation Administration*, Prepared by NERA Economic Consulting for the Maryland Department of Transportation (2006)
- *The Prince George's County Government: Disparity Study Final Report*, Prepared by D.J. Miller & Associates, Inc. for the Prince George's County Government (2006)
- *Race, Sex and Business Enterprise: Evidence from the State of Maryland*, Prepared by NERA Economic Consulting for the Maryland Department of Transportation (2006)

Massachusetts

- *Race, Sex and Business Enterprise: Evidence from the Commonwealth of Massachusetts*, Vol. I, Prepared by NERA Economic Consulting for the Massachusetts Housing Finance Agency (2006)

Minnesota

- *A Disparity Study for the City of Saint Paul and the Saint Paul Housing and Redevelopment Authority, Saint Paul, Minnesota*, Prepared by MGT of America for the City of Saint Paul and the Redevelopment Authority of Saint Paul (2008)

- *Race, Sex and Business Enterprise: Evidence from the State of Minnesota*, Prepared by NERA Economic Consulting for the Minnesota State Department of Transportation (2005)

Missouri

- *Race, Sex, and Business Enterprise: Evidence from the St Louis Metropolitan Statistical Area 1979-2004*, Prepared by NERA Economic Consulting for the Bi-State Development Agency (2005)

- *Disadvantaged Business Enterprise Availability Study, for the Missouri Department of Transportation*, Prepared by NERA Economic Consulting for the Missouri State Department of Transportation (2004)

Montana

- *Disparity Study for the Montana Department of Transportation: Final Report*, Prepared by D. Wilson Consulting Group, LLC for the Montana Department of Transportation (2009)

Nevada

- *Availability and Disparity Study for the Nevada Department of Transportation*, Prepared by BBC Research & Consulting for the Nevada Department of Transportation (2007)

New Jersey

- *State of New Jersey Construction Services: Disparity Study 2003-2004*, Prepared by Mason Tillman Associates, Ltd. for the New Jersey Disparity Study Commission (2006)

- *State of New Jersey Construction Services: Disparity Study 2000-2002*, Prepared by Mason Tillman Associates, Ltd. for the New Jersey Disparity Study Commission (2005)

- *State of New Jersey Disparity Study of Procurement in Professional Services, other Services, and Goods and Commodities*, Prepared by Mason Tillman Associates, Ltd. for the New Jersey Department of State (2005)

- *Analysis of Essex County Procurement and Contracting: Final Report*, Prepared by the University of Minnesota Disparity Study Research Team for the County of Essex Disparity Study Commission (2005)

New York

The State of Minority- and Women-Owned Business Enterprises: Evidence from New York, Prepared by NERA Economic Consulting for the New York State Department of Economic Development (2010)

- *The City of New York Disparity Study*, presented by Mason Tillman Associates, Ltd. for the City of New York (2005)

North Carolina

- *North Carolina Department of Transportation Second Generation Disparity Study*, Prepared by MGT of America, Inc. for the State of North Carolina (2004)
- *Measuring Business Opportunity: A Disparity Study of NCDOT's State and Federal Programs*, Prepared by Equant for the North Carolina Department of Transportation (July 27, 2009)

Ohio

- *State of Ohio Predicate Study, Final Report*, Prepared by D.J. Miller and Assoc. for the State of Ohio (2001)
- *A Second-Generation Disparity Study*, Prepared by MGT of America, Inc. for the City of Dayton, Ohio (2008)

Oregon

- *Disadvantaged Business Enterprise Disparity Study*, Prepared by MGT of America, Inc. for the Oregon Department of Transportation (2007)

Pennsylvania

- *Minority Business Shares of Prime Contracts Approved by the Board of Pittsburgh Public Schools, January-September 2005*, Prepared by the University of Pittsburgh Center on Race and Social Problems (June 2006)
- *Commonwealth of Pennsylvania Department of General Services: Disparity Study in Building Construction and Building Design*, Prepared by Mason Tillman Associates, Ltd. for the Commonwealth of Pennsylvania Department of General Services (August 2007)
- *City of Philadelphia Fiscal Year 2006 Annual Disparity Study*, Prepared by Econosult Corporation for the City of Philadelphia Department of Finance (May 30, 2007)

- *Disadvantaged Business Enterprise Availability Study: Purchasing*, Prepared by NERA Economic Consulting for the Southeastern Pennsylvania Transportation Authority (2000)

- *Disadvantaged Business Enterprise Availability Study: Construction and Professional Services*, Prepared by NERA Economic Consulting for the Southeastern Pennsylvania Transportation Authority (2000)

-

South Carolina

- *A Business Underutilization Causation Analysis Study for the City of Columbia*, Prepared by MGT of America, Inc. for the State of South Carolina (2006)

Tennessee

- *Race, Sex, and Business Enterprise: Evidence from Memphis, Tennessee*, Prepared by NERA Economic Consulting for the Memphis-Shelby County Airport Authority (December 18, 2008)

- *State of Tennessee Department of Transportation*, Prepared by Mason Tillman Associates, Ltd. for the Tennessee Department of Transportation (December 11, 2007)

- *Final Report for Development and Revision of Small, Minority and Women Enterprise Program, Nashville International Airport*, Prepared by Griffin & Strong, P.C. for the Metropolitan Nashville Airport Authority (September 19, 2007)

- *Metropolitan Government of Nashville and Davidson County: Disparity Study Final Report*, Prepared by Griffin and Strong for Nashville and Davidson County (December 15, 2004)

Texas

- *A Historically Underutilized Business Disparity Study of State Contracting 2009 Final Report*, Prepared by MGT of America, Inc. for the State of Texas (2010)

- *The City of Houston Disparity Study*, Prepared by Mason Tillman Assoc., Ltd. (2006)

- *City of Dallas Availability and Disparity Study*, Prepared by Mason Tillman Assoc., Ltd. (2002)

- *Quantitative Analysis of the Availability of Minority- and Women-Owned Businesses and their Utilization by the Corpus Christi Regional Transportation Authority*, Prepared by Jim Lee, Ph.D., for the Corpus Christi Regional Transportation Authority (November 2007)

- *Race, Sex, and Business Enterprise: Evidence from the City of Austin*, Prepared by NERA Economic Consulting for the City of Austin, TX (May, 2008)

- *San Antonio Regional Business Disparity Causation Analysis Study*, Prepared by MGT of America for the City of San Antonio, Texas (April 6, 2009)

Utah

- *Race, Sex, and Business Enterprise: Evidence from the State of Utah*, Prepared by NERA Economic Consulting for the Salt Lake City Departments of Airports (2009)

Virginia

- A *Procurement Disparity Study of the Commonwealth of Virginia,* Prepared by MGT of America, Inc. for the Commonwealth of Virginia (2004)

Washington

- *Race, Sex and Business Enterprise: Evidence from the State of Washington*, Prepared by NERA Economic Consulting for the Washington State Department of Transportation (2005)

Washington, D.C.

- *Washington Suburban Sanitary Commission 2005 Disparity Study: Summary and Recommendations*, Prepared by BBC Research & Consulting for the Washington Suburban Sanitary Commission (2005)

Wisconsin

- *City of Wisconsin,Study to Determine the Effectiveness of the City's Emerging Business Enterprise Program*, Prepared by Mason Tillman Associates, Ltd. For the City of Milwaukee, Wisc. (2007)

Chair LANDRIEU. Let me begin, Mr. Hinson, with you. You mentioned in your testimony that you are considering the viability of a private managed investment fund. You touched on that briefly. Will you take this opportunity to go into a little bit more detail about how the Department of Commerce is contemplating this effort? Is it precedented in any way, and if so, what is the precedent?

Mr. HINSON. Right. Madam Chair, thank you for that question.

In the capital markets, there are a number of private equity funds. There are a number of institutional investors that focus on the market for investing in minority-owned companies. What we are contemplating is really coalescing sources of capital that to date have not coalesced around these particular companies and these unique industries. Through the structure of a public-private partnership, we look to bring these people together under the auspices of the Department of Commerce, to get them focused and in relationship with the companies that have a need for that capital.

So what we are looking at is a public-private partnership structure, and we are still in the design phases of that right now. But the idea is simply to take sources of capital that to date do not necessarily focus on these particular market sectors and expose them to the economic value proposition of investing in these companies.

Chair LANDRIEU. Thank you.

Mr. Hedgespeth, the Small Business Investment Companies, SBICs, are supposed to bridge some of the gaps, as you know, between minority and non-minority businesses seeking venture capital.

You mentioned this, but it is worth repeating. There is an alarming trend in lack of access and decline in the SBIC venture capital going to minority and women-owned businesses. In 1998, the percentage was 26 percent. The most recent data, it has dropped to 7.19 percent. In the same timeframe, for women as well it dropped from 6 percent to 2.8 percent.

How do you explain this trend by the SBIC program in making investments to minority and low income areas, and what steps is the SBA taking to address this trend, try to reverse it and move it in the opposite direction?

Mr. HEDGESPETH. Those trends are in fact partly reflective of the fact that SBICs have been trending towards larger investments in their investment companies. One of the things that we have done to try and offset this trend, because very often the minority firm is at an earlier stage in their capital need than the typical majority firm that is looking for mezzanine financing, is we have in recently promulgated regulations required that 25 percent of SBIC investments go towards lower dollar investments.

We are also going to be continuing our efforts to broaden the outreach of our SBIC program in finding funds that specifically work with, and target, the areas that are comparable and complementary to our mission of increasing access to underserved markets and minority entrepreneurs.

Chair LANDRIEU. Both of you may want to comment about this. The Senator from Maine and I have a bill pending, with unanimous support from this Committee—I believe it is unanimous—to raise the limits for small loans from $35,000 to $50,000. The current limit for the express loans is $35,000. Do you think that that will help, and if so, would you care to comment if that is the right amount, or should we be pushing it even higher?

Maybe, Mr. Hinson, we will start with you and then Mr. Hedgespeth.

Mr. HINSON. There is certainly no doubt that increasing the loan amount is helpful. Anecdotally, though, $35,000 as a base is generally ineffective in helping the firms get through tough economic times and certainly grow. Many of these firms are operating very leanly. So they do not necessarily generate, in and of themselves, enough capital to add an additional person. So they are not necessarily going to stimulate job growth.

From our perspective, a $50,000 level would be a welcome addition. But practically speaking, I would recommend and propose that you consider something more along the lines of a $100,000 level, possibly even a $200,000 level, so firms can obtain the capital to not only continue to function during times when credit is very tight, but also be in a position to add on that additional employee today that they anticipate they will need for tomorrow.

Chair LANDRIEU. Mr. Hedgespeth.

Mr. HEDGESPETH. Well, as the Administration has proposed raising the limit in our microloan program from $35,000 to $50,000, and we are delighted by the support it enjoys from this Committee. We think it is a very, very critical evolution of our microloan program that especially reflects the current reality where many businesses that were bankable 2 years ago, that need that $35,000 to $50,000 of capital, businesses, landscaping companies employing 10, 20 people, who had a banking relationship and now do not have one, are increasingly turning to our microloan intermediaries for that working capital gap. And we would like to be able to allow them to meet that need.

Chair LANDRIEU. Finally, if I could, Mr. Hedgespeth, I sent a letter to Administrator Mills, asking for her to give consideration to fill the position of Associate Administrator for Minority Small Business and Capital Ownership, considering the importance based on testimony from both of you with the focus of getting capital into the hands of minority-owned businesses, current businesses as well as potentially new businesses. Increased capital access could help create jobs. We could use those jobs right now in the United States of America and particularly use them in the communities and neighborhoods that have experienced even a sharper economic downturn.

So what do you have to report to me about the opportunity to potentially fill this position and even get a sharper focus? Not that I do not believe the Administrator is herself focused, and you and this Administration, that have surely demonstrated their commitment, but this would give the extra push from a specific focus. And what do you think about the filling of this position as a possibility?

Mr. HEDGESPETH. Well, Administrator Mills did receive your letter, and shares your concern and interest in moving very swiftly to fill this position. While I cannot speak to details at the moment, I can inform you that we believe we have an extremely qualified candidate identified, and you should be looking forward to some direction or some announcements in the near future.

Chair LANDRIEU. Thank you.

Ranking Member Snowe.

Senator SNOWE. Thank you.

Mr. Hedgespeth and Mr. Hinson, do you ever coordinate between SBA and your agency, especially when it comes to the Small Business Development Centers and Minority Business Development Centers? I know we have more than a thousand nationwide under SBDCs. So is anything happening in that regard, so we can coordinate, not duplicate, efforts, that might provide a synergy that would be important?

Mr. HINSON. Thank you, Senator Snowe.

Yes, we do collaborate quite a bit. Oftentimes, many of the 8(a) firms, while they are still in 8(a) status, will come to us. We work together on various events.

Certainly, we have worked very closely together when it comes to the economic stimulus activity relative to minority-owned firms. We have done quite a number of joint events. We have reached out to the various Federal agencies as a team. I work very closely with Associate Administrator Joe Jordan in that respect.

So our activities are very coordinated. Taking into consideration, though, that we do have different business models and different structures, I think we have done a very good job at coordinating our activities.

Senator SNOWE. But it is not formalized, I gather. Is it done on an ad hoc basis?

Mr. HINSON. It is not formalized to the extent that we have necessarily signed MOUs, if you will. We are actually looking at some formalization from our side, and I think that SBA is looking at formalization from their side too. Interesting, we are moving in that direction.

Senator SNOWE. Yes. Do you analyze the cost of creating a job with each of your agencies? I know there are different numbers with respect to that, but I do not know whether the goals are different that account for the cost per job to create.

Mr. HEDGESPETH. That is not something that I think we have focused on. We have really focused on ways to be more efficient and making sure that the firms that we do touch really are supported by all the programs offered by both SBA and the Commerce Department, and being much more intentional about tracking the success of our firms as they move through our counseling process, contracting opportunities and also then opportunities for capital support.

Mr. HINSON. From our vantage point, we actually can give a number of the cost per job. We focus, our operation focuses on return on investment. Right now, our ROI is 94 times. That means for every dollar of taxpayer money that goes into our agency, we produce $94 of economic output.

We track very closely new job creation. We do not track yet, but we are going to begin to track, jobs saved. So it is an easy calculation for us relative to determining the cost per job.

Senator SNOWE. I would appreciate those numbers for the Committee, if you have the numbers of jobs created. I mean that would be helpful as a measurement. Do you have them, Mr. Hedgespeth?

Mr. HEDGESPETH. We certainly have numbers, in fact, of how much it costs for us to deliver our services.

Senator SNOWE. You do? Yes. I think that would be helpful to sort of guide us in how things are working in that respect.

Mr. HEDGESPETH. We will provide you with that information.

Senator SNOWE. Okay. I appreciate that.

Mr. HEDGESPETH. Thank you so much.

Senator SNOWE. Now in terms of the existing programs under SBA, we have the microloan program and now you have indicated that we should increase the amount to maybe $100,000, $200,000 because the accumulation of wealth is an issue with minority-owned businesses and also, obviously, having the funds to sustain it. So you think it would be worthwhile in that regard to increase the loan limit, at least for a temporary period of time, for example? Do you think that would be helpful?

Mr. HINSON. I think it would be helpful. Many of the minority firms—let me give you a scenario. We have firms, for example, that get government contracts from certain cities. Because of the issues that cities face with their specific budgets, they may not pay these firms for six months. Okay? So imagine you had done the work today, but you do not get your money for six months. In the absence of having working capital available, which banks are not necessarily providing to this sector of companies, these companies go out of business.

So the very entity that should be supportive is actually running them out of business, and this particular funding mechanism provides a necessary bridge to make them—if the size is large enough, it provides them a bridge to keep their operation going while they are waiting to execute on their receivables.

Mr. HEDGESPETH. If I could follow on, on that, Senator Snowe, there has been a proposal from the Administration to increase, temporarily increase the size of our SBA Express Loan to a million dollars. That is perfectly complementary with what my colleague here says in terms of providing a key source of working capital to that larger firm that is trying to bridge those contracting payment issues, which is really critical right now in terms of adding jobs and keeping jobs.

Senator SNOWE. So what could happen in terms of the 7(a) and the 504 loan programs to improve the amount, or the percentage, going to minority-owned businesses?

Obviously the microloan program has worked in providing access to capital to minority communities. So we can build on that. But what about the fact that 24 percent of all 7(a) and 504 loans go to minority-owned businesses? What more can we do to increase that number?

Mr. HEDGESPETH. Well, as you mentioned in your opening remarks, sustaining the Recovery Act fee relief and higher guarantees is a very important thing to do.

We are also just strongly focused on increasing the number of points of access for borrowers. The number of participating lenders, as a result of the Recovery Act initiatives, has grown substantially. Over a thousand lenders, I believe at our last count, are making SBA loans who were not making SBA loans just a couple of years ago.

We continue to look for outlets in credit unions, ways to work increasingly with the CDFI fund and our colleagues there, to increase the number of those mission-focused lenders who already carry a double bottom line of serving underserved communities and doing so profitably.

Trying to find ways for our 7(a) program, not just the microloan program, to work more effectively with those partners, those are the things we are doing.

Senator SNOWE. Yes, I know, to that point, lenders that have not been participating in the SBA programs have now come back into the program, and I congratulate you and the Administrator for making that happen.

If there are 16,000 institutions, between banks and credit unions, what more can be done to attract and to target new lenders into the market? I mean how many lenders do we have overall in the SBA programs?

Mr. HEDGESPETH. Lenders that currently have an executed agreement with us in 7(a) number about 5,000. Some of those are really not focused on small business lending, but many are, and we are working along with trade associations that reflect the broader banking community to try and reach those institutions.

But, more importantly, we really want to try and work with institutions who already serve the minority and inner city neighborhoods and underserved markets, where there really is the sweet spot for SBA programs, and be much more intentional about identifying them and working to bring them back into the fold. Our field operation is very focused on this. It is their number one objective for the year. We are extending our outreach to community credit unions because we believe they have already proven to be a good source for making inroads into these communities, recognizing that community banks have a critical role to play in making more capital accessible to minority communities.

Senator SNOWE. Thank you.

Chair LANDRIEU. Can I just interrupt here?

I know that you all think I was kidding about this, but we actually carry this number with us. It should motivate us to do more because actually there are 7,544 credit unions in the United States and there are 7,948 Federally chartered banks, which is 15,000 plus roughly. There are only 2,200 SBA lenders.

In Louisiana, where I carry these numbers, there are 232 credit unions, there are 156 banks, and only 38 SBA lenders. I have my staff keep a map of Louisiana up, showing what banks in our state are SBA lenders and where they are, where those loans are being made, and there are huge geographic areas that are not even touched.

This is something that I am going to really drill down on with this Committee because when we look out at what both Commerce and the SBA do, their jobs and missions are to use the framework and the skeleton that is out there, which are the banks, and the credit unions.

When you lay on top of that all of the financing that we have given to minority business centers, our women-owned business centers, the volunteer SCORE chapters that are out there, many organizations that we do not directly fund, but indirectly encourage. For example, chambers of commerce, minority business councils, and city halls. You have departments at the state level. We really have to think about how we can push through some of these programs and funding to reach the network that is out there, to reach where the businesses are, in small places, neighborhoods, rural areas and urban centers.

So I thank my staff for keeping this. I am going to provide it to all the members of our Committee.

And yes, you are correct, we have a thousand new lenders since the Ranking Member and I led the effort to eliminate the fees and increase the loan rate. While we have gone up 1,000 the number is actually down from 1999. I think we now may be getting back up to that level. We have to figure out a better way to get our banks involved, particularly our community banks, in this effort, and we are going to work on that.

Any further comments?

We will get our second panel. Okay, thank you all very much, and we appreciate your testimony.

If our second panel will please come forward, and to save time I am going to introduce them as they are moving to the table.

Our first witness is Mr. Robert Johnson, the Chairman and Founder of RLJ Companies, an innovative business network which owns or holds interests in a diverse portfolio of companies in banking, private equity, real estate, hospitality, professional sports, film production, et cetera. He has been named by USA Today as one of the most influential black leaders in the past 25 years, and of course, Founder of BET.

Ms. Natalie Cofield, President of NMC Consulting Group, will be our next witness. Ms. Cofield operates a boutique consulting firm with the mission of increasing entrepreneurship and business development opportunities and improving business programs for aspiring business owners.

Ms. Margaret Henningsen, the Founder and Vice President of Legacy Bank, is our next witness. An advocate for empowering women and minorities, Legacy Bank provides services to thousands of the underserved, has funded more than a thousand small business, commercial and economic development loans, or has processed those loans.

Mr. Paul Hudson is Chairman and CEO of Broadway Federal, the largest and only publicly owned African American bank west of the Mississippi. We are excited to have you here, Paul, to hear from you.

And finally, Dr. Robert Fairlie, Professor of Economics at the University of California in Santa Cruz, who has done extensive research on entrepreneurship technology, inequality, and labor economics. Thank you for joining us. We have a copy of your book, and our staff has been using that to prepare for this hearing.

If we can begin with Mr. Johnson and we ask you to limit your testimony to five minutes each, and then we will have a round of questions.

Mr. JOHNSON.

STATEMENT OF ROBERT L. JOHNSON, FOUNDER AND CHAIRMAN, THE RLJ COMPANIES

Mr. JOHNSON. Good morning, Madam Chairwoman Landrieu and Ranking Minority Member Snowe. I appreciate the opportunity to appear before the Committee to discuss the challenges and opportunities minority small business owners face in today's economic climate.

As an entrepreneur, I know firsthand the challenges minority entrepreneurs face. I also know the talent, dedication, determination and vision that minority entrepreneurs possess in their desire to become a part of, and a contributor to, the American dream. But the simple fact of economic reality in America is that minority Americans are significantly and disproportionately underrepresented in access to capital to start and fund entrepreneurial enterprises due to years of racial and economic discrimination.

The Committee should make note of a recent study by the Economic Policy Institute which found that the medium net worth for African Americans was $11,800 compared with $118,000 for whites. When home equity was subtracted, African Americans had $300 in net assets while whites had $36,000. This gap is likely to widen as unemployment stagnates and as the mortgage crisis costs some black families their home.

Without question, the lack of access to capital and capital formation are the principal factors holding back opportunities for minority businesses and, as a consequence, wealth and job creation within the minority community.

In my opinion, there are two crucial political and philosophical issues that first must be confronted and resolved before capital can be effectively directed to minority Americans in this society.

The first question is: Why do federal, state governments and major U.S. corporations define minority ownership as owning or holding 51 percent equity? The answer usually offered is a 51 percent equity climate prohibits so-called minority front companies, or shams, from gaining access to government preferences.

But why do we assume minority companies are fronts? The answer is painfully obvious, and it is partially why we are all here today. We know that minorities as a whole lack access to capital and therefore are unlikely to raise sufficient equity capital to control a company without outside financial assistance. But whose fault is that?

Think about this for a moment. As a business person, your goal is to grow in scale and value. How do you accomplish this if your company cannot raise outside equity, if it exceeds your 51 percent ownership requirement.

Why not the debt market, you might ask. Lenders have only one goal—a repayment of debt with interest as quickly as possible. On the other hand, and I know this to be a fact, strategic equity partners seek to combine investment and operational synergies with the minority company to maximize long-term growth in value.

I suggest we let the market relationship decide and base ownership not only on equity control but other factors. Such other factors could be: Is the minority the founder of the company? Is the minority the key revenue driver of the company based on his or her intellectual capital, so-called sweat equity? What about considering voting control in different classes of stock to give more votes to the minority, or board control where the minority has the right to appoint the board majority?

Or, simply drop the equity requirement from 51 percent to 10 percent to recognize what we all agree is the true problem: the disparity in capital access that minorities face when launching a business.

This leads me to my second point. Is there a compelling national interest for helping minority business and what are its limitations?

If the goal is to foster minority business as opposed to just small businesses, how do we address the Supreme Court's compelling national interest test? The Court ruled that any government-sponsored economic preference to minority businesses should be narrowly tailored so as not to cause reverse discrimination. Justice O'Connor, writing for the majority in the Adarand case, stated that there was no compelling national interest in favoring a minority contractor for highway construction jobs over a majority. If this precedent dictates our approach to minority business development, it will forever, in my opinion, restrict minority access to government-sponsored business opportunities.

We agree that due to past discrimination minorities cannot compete on capital formation, on experience or scale without capital and are unlikely to win most competitive bids without an advantage or a preference.

In conclusion, let me state that I do not have ready a politically acceptable answer to these philosophical quandaries, but I am enough of a business person to know that the free marketplace, left to its own devices, will not solve this problem.

I do not believe the government can promote minority ownership by placing restrictions on their startup potential, by requiring an unconditional 51 percent ownership.

I do not believe that government can say it is critically important to have minority business succeed in the marketplace and, on the other hand, declare there is no compelling national interest to favor these businesses.

I hope that I provided some framework for a debate, and I know I am committed to work with this Committee to achieve a viable consensus on how to grow and expand minority business ownership and opportunities in America. Thank you.

[The prepared statement of Mr. Johnson follows:]

theRLJ companies

Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets

Testimony before the U.S. Senate
Committee on Small Business & Entrepreneurship
April 15, 2010

Robert L. Johnson
Founder & Chairman, The RLJ Companies

Good Morning Madam Chairwoman Landrieu, ranking minority member Snowe and distinguished members of the Committee, my name is Robert Johnson and I appreciate the opportunity to appear before the Committee to discuss the challenges and opportunities minority small business owners face in today's economic climate.

Many of you may know me as the entrepreneur who founded and built Black Entertainment Television (BET) on a $500,000 investment. When I created BET, I did so because I saw an opportunity to provide consumers with programming content that was not available on existing cable channels. Since selling BET in 2001 to Viacom for $3 billion, I have focused my attention on and invested in industries where minority ownership and the opportunity to create value in the urban market is warranted.

As an entrepreneur, I know first-hand the challenges minority entrepreneurs face. I also know the talent, dedication, determination and vision that minority entrepreneurs possess in their desire to become a part of and a contributor to the American Dream.

But the simple fact of economic reality in America *is* due to years of racial and economic discrimination minority Americans are significantly and disproportionately underrepresented in access to capital to start and fund entrepreneurial enterprises.

This Committee should know and make note of these compelling statistics: A recent study by the *Economic Policy Institute* found that the median net worth for African Americans was $11,800 compared with $118,000 for whites. When home equity was subtracted, African Americans had $300 in net assets while whites had $36,000. In metro Orlando, where my bank Urban Trust is headquartered, about 47 percent of African Americans are homeowners, compared to 74 percent of whites. This gap is likely to widen even more as the mortgage crisis costs black families their homes.

Without question the lack of access to capital and capital formation are the principal factors holding back opportunities for minority businesses and as a consequence wealth creation within the minority community.

Please note that I said "capital access" and not capital itself. As we all know, there is an abundance of investment capital in the U.S. economy and when minorities have access to capital on competitive terms and conditions they have proven to be quite successful.

Therefore, if we stipulate that access to capital is a core business necessity in the creation of value, wealth, and jobs, then the critical question is what is the political philosophy which underpins how and why we should direct capital to minority enterprises?

In my opinion, there are two crucial political and philosophical issues that first must be confronted and resolved before capital can be effectively directed to minority Americans in this society.

The first philosophical question is: Why do the Federal Government, state governments and major U.S. corporations define minority ownership as owning or holding 51% equity ownership in a company in order to be defined as a minority-owned enterprise?

The answer that is usually offered is this 51% structural requirement prevents so-called minority "front companies or shams" from gaining access to government subsidies or set-asides. But why do we assume minority companies are fronts? The answer is painfully obvious and it is partially why we are all here today. We *know* that minorities as a whole lack access to capital and therefore are unlikely to raise sufficient equity capital to control a company without outside financial assistance. But whose fault is that?

The 51% minority ownership provision is a true contradiction or a *catch-22*. In other words, the government and major corporations in an effort to ensure that minority companies are "true minority companies" place a barrier to their growth based on the fact that to be a minority company you must control and own 51% of the equity.

Think about this for a moment: As a minority business person your goal is to grow in scale and value. How do you accomplish this if your company cannot raise outside equity if it exceeds your 51% ownership requirement?

Raising equity capital, as we all know, requires that you give up commensurate equity to the outside investors based on the value of the company. If minorities are constrained in their equity raise they are therefore limited in their potential to obtain outside growth capital.

You might ask, why not raise capital in the debt market. If minority companies are forced by the 51% rule to raise debt to preserve their equity stake it is likely to be more expensive than equity capital and it further deprives the minority owner from seeking strategic partners who would be aligned in an equity raise.

Lenders have only one goal, a repayment of debt with interest as quickly as possible. On the other hand, strategic equity partners seek to combine investment and operational synergies with the minority company to maximize long-term growth and value.

More importantly, if minority companies can *only* grow through debt instruments, they run the risk of losing their company entirely if there are significant swings in interest rates or if debt covenants are so restrictive that they retard growth.

I suggest we let market relationships decide if a minority company is real or not and base the test of ownership not on equity control but other factors that determine true control in a business. Such factors could be: Is the minority the founder of the company? Is the minority the key revenue driver in the company based on his or her intellectual capital, *i.e.* Oprah Winfrey?

What about considering such factors as voting control in different classes of stock that give more votes to the minority? Board control where the minority has the right to appoint the majority of the board members is another example. Or we could simply drop the equity requirement from 51% to say 10%.

This would recognize something we all agree is the *true* problem which is the disparity in capital access that minorities face when launching a business. We could also use a combination of the aforementioned factors to define minority ownership if we insist on having minority-ownership criteria.

Placing a 51% equity hurdle rate on minority companies retards their ability to grow and could restrict their value at sale or exit. For example, if we imply that 51% minority ownership adds value, could a non-minority argue that they should pay less for the company because upon acquisition it loses its status as a minority company? Or conversely, could a white-owned company argue that a minority acquirer should pay more because the minority will get the benefit of changing the company's status to a minority-owned company?

As you can see, the arbitrary 51% equity requirement for minority companies is *politically* based, not market-place based and needs to be thoroughly reexamined and/or eliminated.

This leads me to my second and final point. **Is there a compelling national interest for helping minority businesses and what are its limitations?**

If the goal is to foster minority businesses as opposed to small businesses, irrespective of race or net worth, how do we address the Supreme Court's compelling national interest test? The Court has ruled that any government-sponsored economic preference to minority businesses should be "narrowly tailored" so as not to cause reverse discrimination. This ideology was embedded in law in the 1995 Supreme Court decision in the so-called *Adarand*[1] case.

[1] *[Adarand Constructors, Inc. v. Peña, 63 U.S.L.W. 4523 (U.S. June 12, 1995)] - under strict scrutiny, a racial or ethnic classification must serve a "compelling interest" and must be "narrowly tailored" to serve that interest.*

Justice O'Conner, writing for the majority, stated that there was no compelling national interest in favoring a minority contractor for a highway construction job over a majority company. If that Court precedent dictates our approach to minority business development it will forever, in my opinion, restrict minority access to government-sponsored business opportunities.

We agree that due to past discrimination minorities can't compete on capital formation, can't compete on experience or scale without capital, and are therefore unlikely to win most competitive bids when there is no advantage or preference given to being a minority enterprise.

If we *truly* want to create more minority companies of size and scale then we must confront this compelling national interest test.

You may not agree, but I can make a *number* of cases where there are compelling reasons why minority companies should be granted government advantages. For example, there are *no* large minority banks of national reach, yet minorities represent the largest group of the unbanked and underbanked and those most in need of transparent financial products and services at reasonable costs and financial literacy.

There is no national mortgage loan servicer that is minority-owned. Think what this could mean today if there was an experienced minority loan servicer company. It is possible this company would likely understand the challenges of minority homeownership and could engage these consumers in positive mortgage modification efforts and foreclosure prevention. Without question, sustaining and increasing minority homeownership is, in my opinion, a compelling national interest.

The film production industry is one of the few areas where we have a positive trade balance with the rest of the world; yet, there are no major minority film companies exporting film content. Why not use the tax preferences to favor minority film companies to aid the exportation of American culture from a minority point of view to the rest of the world. I find that a compelling national interest since African Americans have a *huge* influence on overall U.S. culture, and I believe the world would benefit from exposure to that culture.

I could provide other examples, but the fundamental question is **how will we define whether or not it is in our country's best interest to make minority businesses a *true* participant in the U.S. economy?**

In conclusion, let me state that I don't have a ready politically acceptable answer to these philosophical quandaries, but I am enough of a business person to know that the market place will not resolve them without defining the role of government in fostering minority ownership. The free marketplace left to its own devices simply will not solve this problem.

I don't believe the government can say we want minority companies to grow as large as possible and then place restrictions on their growth potential by requiring an "unconditional 51% ownership." I don't believe the government can say it's critically important to have minority businesses succeed in this society and on the other hand declare there is no compelling national interest to favor these businesses.

I hope that I have provided some framework for a debate and I *know* I am committed to work with this Committee to achieve a viable consensus on how to grow and expand minority business ownership and opportunities in America.

Thank you.

# # #

Chair LANDRIEU. Thank you, Mr. Johnson. As usual, you have accomplished the mission you set out to do. Do not worry.

Ms. Cofield, we would love to hear from you, and I want to recognize that your family is from Natchitoches and you are a graduate of Southern University. We are very proud to have you today.

STATEMENT OF NATALIE COFIELD, PRESIDENT, NMC CONSULTING GROUP, INC.

Ms. COFIELD. Good morning, Chairwoman Landrieu and Ranking Member Snowe.

My name is Natalie Madeira Cofield, President of the NMC Consulting Group, headquartered in Washington, D.C. Thank you for the opportunity to testify on behalf of aspiring and existing entrepreneurs of color, more specifically those who seek or have sought to obtain financing. It is an honor and a privilege to serve as a voice of millions of American minority business owners who struggle with the harsh reality that business ownership or expansion may not be an option for them due to undercapitalization, lack of social capital and lack of financing.

As a champion for small business, I would be remiss if I did not highlight the contribution that the more than 4 million minority-owned businesses make to the U.S. economy, employing more than 4.7 million and producing more than $668 billion in annual gross revenues. What these statistics do not show, however, is the overarching impact that these business owners have on their communities—providing valuable support, examples of success and philanthropic investments, all of which support more viable and economically self-sufficient neighborhoods and ethnic groups.

Unfortunately, the number of businesses owned by Americans classified as minority is not as many as it could or should be. More specifically, only 18 percent of all U.S. firms are classified as minority-owned, and when considering African Americans, this number is roughly 5.3 percent for a population that represents 12 percent of the country.

This is not solely due to incomplete business plans or unfeasible concepts, but because of factors that have made the playing field inequitable. It makes it necessary that government programs exist and critical that these programs are improved.

I have identified three factors that I believe have impact on issues for access to credit disparities:

Insufficient capital infusion—an historical disparity in the sufficient disposable income that weakens the ability to provide initial business seed capital and results in the immediate need for financing.

Insufficient access or social capital—a social relationship or bond between people, personal or professional, that transfers into human or economic capital. Minorities have often had a dearth of more developed social networks that makes accessing angel investment from family, friends, colleagues and external private investors increasingly difficult, as many people do not have access to someone who has legacy or substantial existing disposable assets.

Then insufficient or inadequate financing—historical antagonistic practices in the areas of lending, such as excessive interest rates, higher required down payments, higher fees, higher declinations and lower approved amounts.

This is shown in a case study of a client of mine. These obstacles have been evidenced by Jennifer King. She is an African American woman and disabled veteran who served proudly in the U.S. Navy. The daughter of a low income single mother who came from generations with minimal financial access, she was the only one of her four siblings to attend college.

After college, she joined the Navy where she was exposed to various cultures that led her to devise a concept for her business. In 2006, she incorporated, and with a 740 credit score rating and a completed plan, was denied a meeting with a major bank because of the amount of capital that she requested—$500,000 with a $100,000 capital injection.

She was an African American woman who was fluent in Arabic, who wanted to create a business marketed toward the diplomatic community. It was too difficult to sell. She met with Federal credit unions and was denied an SBA loan because she could not come up with the required 25 percent down payment, and this is during a time where even home mortgages were going for zero percent down. This was compounded by the fact that her home equity line of credit was not permissible to cover the 25 percent down payment, working capital that she would need to actually obtain this loan, and this was to be her only source of financing.

She met with the Veterans Corporation and was informed that they did not offer loans, though their web site stated so in 2008. She submitted her information for the SSBIC and never heard back as of April 12th. She even tried to pay for social capital by hiring someone to find angel investment, but the monthly retainer was too significant to afford. She did not qualify for MBDA and, most disappointedly, was told by SCORE that it was their job to convince her not to start her business in an attempt to weed out the serious entrepreneur.

In an effort to improve her standing and the possibility of starting her business, she enlisted the partnership of another woman veteran. Her white business partner's experience was the opposite. She came from a family with a legacy of home ownership, investments and financial access.

And I would like to actually just point out that based on a study from the Insight Center for Community and Economic Development, the median wealth for single black women is only $100. For single Hispanic women, it is $120. This compares to over $41,000 for single white women.

This support allowed her to bring to the concept $100,000 in non-debt-backed assets at the onset. Then the economic recession began. Unfortunately, five years later, the lack of sufficient capital, lack of social capital, insufficient financial terms coupled with the recent economic downturn and its impact on her biggest asset, her home, has stalled her significantly. Today, she is a participant in my PROSPECTUS program.

This is not unlike thousands of African Americans and other minorities pushing toward the pursuit of entrepreneurship.

Chairwoman Landrieu, as a young woman, if she came to you for your advisement, you would have advised her to go to college and graduate school, to serve her country proudly, to purchase a home, to maintain stellar credit and to dream of an opportunity to leave her legacy. You would have encouraged her to participate in the American dream—all things that she did. If she cannot break the generational issues of lack of financial access, then who can?

Furthermore, we must ask ourselves, what could this one woman do with her dream if only she was able to obtain financing? She could be one more person who could create new jobs. She could be one more person to inspire those depressed by past and current conditions. And she could be one more person to testify that the American dream is obtainable and real.

[The prepared statement of Ms. Cofield follows:]

Fm:MyFax - Natalie Cofield To:NMC Consulting Group Testimony (12022245819) 11:57 04/14/10GMT-04 Pg 02-07

NMC Consulting Group, Inc.

Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets

Testimony to the US Senate Committee on Small Business & Entrepreneurship

Natalie M. Cofield, MPA
President,
NMC Consulting Group, Inc.

April 15, 2010

NMC Consulting Group | 1875 I St. NW | Suite 500 |Washington, DC 20006

04/14/2010 12:00PM

Good Morning Chairwoman Landrieu, Ranking Member Snow and fellow esteemed members of the US Senate Committee on Small Business & Entrepreneurship. My name is Natalie Madeira Cofield, President of the NMC Consulting Group, headquartered in Washington, DC.

Thank you for the opportunity to testify on behalf of aspiring and existing entrepreneurs of color-more specifically, those who seek or have sought to obtain financing. It is an honor and a privilege to serve as the voice of millions of American minority-business owners who struggle with the harsh reality that business ownership or expansion may not be an option for them due to under-capitalization, lack of social capital and lack of financing.

The NMC Consulting Group, Inc. is a boutique consulting firm that operates with the mission of increasing entrepreneurship and business development opportunities and improving economic programs targeted toward people of color, women and youth.

As a champion for small business, I would be remiss if I did not highlight the contribution that the more than four (4) million minority-owned businesses make to the US economy –employing more than 4.7 million and producing more than $668 billion in annual gross revenues[1].

What these statistics do not show however, is the overarching impact that these business owners have on their communities; providing valuable support, examples of success and philanthropic investments – all of which support more viable and economically self-sufficient neighborhoods and ethnic groups.

Unfortunately, the number of businesses owned by Americans classified, as minority is not as many as it could or should be. More specifically, only 18% of all US firms are classified as minority owned and when considering African-Americans this number is roughly 5.3% for a population that represents 12% of the country[2].

This is not solely due to incomplete business plans or unfeasible concepts, but because of factors that have made the playing field inequitable, and makes it necessary that government programs exist and critical that these programs are improved.

---

[1] All data: US Department of Commerce Minority Business Development Agency. *The State of Minority Business Report.* August 2006.

[2] US Department of Commerce Minority Business Development Agency, 2006. *The State of African American Business Report.* 2008.

THREE FACTORS FOR ACCESS TO CREDIT DISPARITIES

1. **Insufficient Capital Infusion (Wealth):** A historical disparity in sufficient disposable income that weakens the ability to provide initial business seed capital and results in the immediate need for financing or credit.
2. **Insufficient Access (Social Capital):** A social relationship or bond between people (personal or professional) that transfers into human or economic capital[3]. Minorities have often had a dearth of more developed social networks that makes accessing angel investment from friends, family, colleagues and external private investors increasingly difficult, as many individuals do not have access to people who have legacy or substantial existing disposable assets.
3. **Insufficient or Inadequate Financing:** Historical antagonistic practices in the areas of lending such as excessive interest rates, higher required down-payments, higher fees, higher declinations and lower approved loan amounts – that result in significant disparities in access to and obtaining equitable financing

CASE-STUDY OF MINORITY CAPITAL ACCESS DISPARITY[4]

These obstacles are evidenced by the story of an NMC Consulting Group client, Jennifer King, an African-American woman and disabled-veteran who served proudly in the US Navy.

The daughter of a low-income single mother, who came from generations with minimal financial access, she was the only one of her four siblings to attend college. After college she joined the Navy where she was exposed to various cultures that lead her to devise the concept for her business.

[3] Cofield, Melody A. Building Social Capital in Multi-cultural Community: The Process and Related Outcomes Produced. Diss. St. John Fisher College, 2010. Print.

[4] Case study based on multiple interviews conducted beginning March 20 – April 12, 2010. Case study based on the experiences of Jennifer King.

In 2006 she incorporated her company. And, with a 740-credit score rating[5] and a completed plan she was declined a meeting with a major bank because of the amount of capital that she requested, $500,000 with a $100,000 capital injection[6]. She was an African American woman who was fluent in Arabic, who wanted to create a business marketed toward the diplomatic community- it was too difficult a sell.

She met with federal credit unions and was declined an SBA loan because she could not come up with the required 25%[7] down payment – an unfavorable rate during a time when even home mortgages were 0% down. This was compounded by the fact that a home equity line of credit was not permissible to cover the 25% down payment (working capital) required for an SBA loan. This was to be her only source of financing.

She met with The Veteran Corporation and was informed that they did not offer loans though their website in 2008 explicitly stated so.

She submitted her information to the SSBIC and never heard back[8].

She even tried to pay for social capital by hiring someone to find angel investment but the monthly retainer was too significant to afford[9].

She did not qualify for the Minority Business Development Agency and most disappointingly, was told by SCORE that it was their job to convince her not to start her business in an attempt to weed out the serious entrepreneur.

In an effort to improve her standing and the possibility of starting her business she enlisted the partnership of another woman veteran. Her white business partner's experience was the opposite; she came from a family with a legacy of

---

[5] Credit scores above 700 are typically viewed as good credit ratings. The range for credit is between 450 – 850 (based on experian.com)

[6] Between 2006 – 2007 the financial request was $500,000 - $800,000 ($100,00 in capital injection). In 2008 this increased to $2M based on partnership and increased capital injection.

[7] Loan financing terms vary by financial institution. Loan to value terms average between 10% - 30% minimum requirements (dependent upon loan size and institution).

[8] As of April 12, 2010

[9] $2,500 monthly retainer fee

homeownership, investments, and financial access[10]. This support allowed her to bring to the concept $100,000 in non-debt backed assets at the on-set.

Then the economic recession began.

Unfortunately, roughly five years later, lack of sufficient capital infusion, lack of social capital, insufficient financial terms coupled with the recent economic downturn and its impact on her biggest asset, her home, has stalled her significantly. Today she is a participant in PROSPECTUS the NMC Consulting Group's nine-week entrepreneurship-training program and business competition because she has not given up her dream.

CONCLUSION

This is not unlike thousands of African Americans and other minorities pushing toward the pursuit of entrepreneurship. Minority firms are awarded fewer loans (17% vs. 23% for non-minority firms) are awarded smaller loans ($149,000 vs. $310,000) and as demonstrated by this example are denied at higher rates with almost half of all loans being declined (42%)[11].

Chairwoman Landrieu, as a young woman if she came to you for your advisement you would have encouraged her to go college and graduate school, to serve her country proudly, to purchase a home, to maintain stellar credit, and to dream of an opportunity for her to leave a legacy. You would have encouraged her to participate in the American Dream. All things she did.

If she can't break the generational issues of lack of financial access, then who can?

---

[10] Related Statistics: The median wealth for single black women is only $100; for single Hispanic women, $120. This compares to just over $41,000 for single White women. Married rates are $167,00 to $31,500 (Black) and $18,000 (Hispanic).

Chang, Mariko. "Lifting as We Climb: Women of Color, Wealth and America's Future". Insight Center for Community & Economic Development, March 2010.

[11] Fairle, Dr. Robert and Alicia M. Robb, Ph.D, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBE.* US Department of Commerce, Minority Business Development Agency, January 2010.

And furthermore, we must ask ourselves, what could this one woman do with her dream if only she was able to obtain financing?

She could be one more person who could create new jobs. She could be one more person to inspire those depressed by past and current conditions. She could be one more business owner contributing to the tax base in her state and in this country to support the social service programs that exist. She could be one more person to testify that the American Dream is obtainable and real.

Again, thank you for this opportunity to speak today and I am happy to asnswer any questions.

Chair LANDRIEU. Thank you, Ms. Cofield, for your passionate and compelling testimony. We really appreciate it, and it will be a very important part of this record.

Ms. Henningsen.

STATEMENT OF MARGARET HENNINGSEN, FOUNDER AND VICE PRESIDENT, LEGACY BANK

Ms. HENNINGSEN. Good morning, Chair Landrieu, Ranking Member Snowe and members of the Committee. I am Margaret Henningsen, Vice President and Founder of Legacy BanCorp and Legacy Bank. I welcome the opportunity to speak to the Committee on assessing access and opportunities and obstacles for minority small business owners.

I will share with you how we grew and how the success of the small businesses we finance makes Legacy Bank successful. I will also speak to how those same small businesses are now struggling to survive and thus affecting the success of Legacy Bank. My testimony will also focus on the need for capital to keep those businesses going and how the current economic conditions could very well signal the end of a decade of strong growth in minority business communities. In the two years since I last testified before this Committee, the situation facing minority businesses has drastically changed.

I began thinking about starting a bank in the mid-nineties as a result of the lack of capital for minority entrepreneurs who were seriously underserved and a significant number of people who were underbanked in Milwaukee. I was joined in this effort by co-founders Deloris Sims and Shirley Lanier.

We were three black women in our fifties who recognized the need for greater access and pent-up demand for commercial capital, for minority and women-owned businesses in our target market. Our research supported our contention that the opportunities were out there, and there was a need for a bank that could guide those entrepreneurs to the right resources for success.

Legacy is a State charter commercial bank located in Milwaukee. Our charter was granted in July of 1999 by the Wisconsin Department of Financial Institutions after we raised $7.5 million in capital. We were the first women in the history of the state to form a bank holding company and charter a commercial bank. Our bank provides financing for existing and startup businesses, commercial real estate, home purchases, home equity loans and a variety of retail products, including products for underbanked and unbanked consumers.

Ironically, we celebrated our 10th Anniversary in 2009 with assets of over $225 million during 1 of our nation's worst economic downturns. This was no small feat, as some predicted that we would not survive given the location of our bank and the market we wanted to serve. For six of our nine years, Legacy Bank achieved nearly double-digit growth every year and consistently exceeded our annual goals for net income. Our growth has been fueled by the never-ending demand for loans in our community and surrounding areas as more people, particularly minorities, strive to achieve their dream of being an entrepreneur and having a successful small business.

Many of the major businesses around today were small businesses that a financial institution took a chance on. Even some of the largest financial institutions started out as small community bank servicing a niche market, in particular, underserved neighborhoods that needed financial services and the opportunity to access capital. This is the model for Legacy Bank.

We have a niche market in an underserved community and have been touted as a national model for community banking in underserved areas. Until the last 13 months, we were growing by providing financial services to that community and beyond. That growth has come to a standstill as the economic conditions have made it nearly impossible for us to continue financing in our market.

Our existing customers who took advantage of every opportunity we could offer, have used up all of their resources as well as whatever we could provide. It is inevitable that those same successful businesses will not survive. As the credit crunch has accelerated, we have seen a major increase in the number of existing and start-up businesses, especially minorities, coming to Legacy, needing capital to survive. For the first time, we have had to turn down some of those customers, both existing and new.

The need for capital must be addressed. It must be swiftly developed and available to those once successful businesses that are now struggling in minority and underserved communities. To ignore the lack of opportunity that now exists would be devastating as the opportunities for employment and economic success have all but disappeared. In the same fashion that large banks and financial institutions and major corporations have received relief, small businesses must be included in that plan. It is a major issue that opportunities being publicized by the Small Business Administration are too little too late.

The loan requirements for collateral and cash from borrowers who need the most help are unrealistic when the businesses are struggling to survive, yet being asked to meet credit and cash requirements that are nearly impossible. We encouraged and educated our customers to be prepared, but nothing could have prepared them for this economic crisis that was not of their doing.

Data demonstrate the fact that many minorities who become, or want to become, small business owners are often first general entrepreneurs. These enterprising owners did not have the benefit of family members handing down a business or providing them with the necessary training and coaching that is so crucial for business success. At Legacy, we have found that when financial training and business coaching are provided, along with funding, businesses can succeed. The process of working with owners to strengthen their business is part of our banking model, but we have been unable to overcome the credit crunch that is so adversely affecting our customer base.

Many banks argue that small business loans are too small, but that not enough money can be made from them, they involve too high of a risk, or that the borrowers lack the skills or are unprepared to run a successful firm.

What we have found is that many of our customers have excellent ideas, good locations, a customer base, and the drive and tenacity to make their businesses succeed, plus a Plan B in case A does not work. Once they are given the opportunity, access to capital, training, coaching to make these businesses work, they have been successful, as supported by our double-digit growth serving this customer base.

There is risk involved. There is no doubt about that. But that is true no matter who is borrowing the money, as evidenced by the number of corporations that are failing, struggling and/or being bailed out.

Let me share lending data with you.

Chair LANDRIEU. Please wrap up in about 30 seconds, if you do not mind.

Ms. HENNINGSEN. Oh, okay. Well, one thing I do want to say that is really important is in the last 15 months our lending has declined to less than $2 million, in the last 2 quarters, down from about $34 million in the year prior to that. In the first quarter of 2010, we did no new lending, only renewals. Much of our time and funding has gone to our existing customers, trying to keep them in business.

[The prepared statement of Ms. Henningsen follows:]

TESTIMONY FOR MARGARET HENNINGSEN

Founder, Vice President, Legacy Bank, WI

Before the

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets

April 15, 2010

Chairman Landrieu, Ranking Member Snowe, and members of the Committee, I am Margaret Henningsen, Vice President and Founder of Legacy Bancorp and Legacy Bank. I welcome the opportunity to speak to the Committee on assessing access and opportunities and obstacles for minority small business owners. I will share with you how we grew and how the success of the small businesses we finance make Legacy Bank successful. I will also speak to how those same small businesses are now struggling to survive and thus affecting the success of Legacy Bank. My testimony will also focus on the need for capital to keep those businesses going, and how the current economic conditions could very well signal the end of a decade of strong growth in minority business communities. In the two years since I last testified before this committee, the situation facing minorities businesses has drastically changed.

I began thinking about starting a bank in the mid 90s as the result of the lack of capital for minority entrepreneurs, who were seriously underserved, and a significant number of people who were under-banked in Milwaukee. I was joined in this effort by co-founders Deloris Sims and Shirley Lanier. We were three Black women in our 50s who recognized the need for greater access, and pent up demand for commercial capital for minority and women owned businesses in our target market. Our research supported our contention that the opportunities were out there and there was a need for a bank that could guide those entrepreneurs (both existing and future) to the right resources for success.

Legacy is a state chartered commercial bank located in Milwaukee, Wisconsin. Our charter was granted in July of 1999 by the Wisconsin Department of Financial Institutions after we raised seven and a half million dollars in capital. We were the first women in the history of the state to form a bank holding company and charter a commercial bank. Our bank provides financing for existing and start-up businesses, commercial real estate, home purchases, home equity loans and a variety of retail products including products for under-banked and unbanked consumers. Ironically, we celebrated our tenth anniversary in 2009 with assets of over two hundred and twenty five million during one of our nation's worst economic downturns. This was no small feat as some predicted that we would not survive given the location of our bank and the market we wanted to serve.

For six of our first nine years, Legacy Bank achieved nearly double digit growth every year and has consistently exceeded our annual goals for net income. Our growth has been fueled by the never ending demand for loans in our community and surrounding areas as more people, particularly minorities, strive to achieve their dream of being an entrepreneur and having a successful small business. Many of the major businesses around today were small businesses that a financial institution took a chance on. Even some of the largest financial institutions started out as small community banks serving a niche market in particular underserved neighborhoods that needed financial services and the opportunity to access capital. That is the model for Legacy Bank. We have a niche market in an underserved community and have been touted as a national model for community banking in underserved areas. Until the last thirteen months we were growing by providing financial services to that community and beyond. That growth has come to a standstill as the economic conditions have made it nearly impossible for us to continue financing in our market. Our existing customers, who took advantage of every opportunity we could offer, have used up all of their resources as well as whatever we could provide. It is inevitable that those same successful businesses will not survive. As the credit crunch has accelerated, we have seen a major increase in the number of existing and start-up businesses, especially minorities, coming to Legacy needing capital to survive. For the first time, we have had to turn down some of those customers – both existing and new.

The need for capital must be addressed. It must be swiftly developed and available to those once successful businesses that are now struggling businesses. In minority and underserved communities to ignore the lack of opportunity that now exists would be devastating as the opportunities for employment and economic success have all but disappeared. In the same fashion that large banks/financial institutions and major corporations have received relief, small businesses must be included in that plan. It is a major issue that opportunities being publicized by the Small Business Administration is too little too late. The loan requirements for collateral and cash from borrowers who need the most help are unrealistic when the businesses are struggling to survive yet being asked to meet credit and cash requirements that are nearly impossible. We encouraged and educated our customers to be prepared. But nothing could have prepared them for this economic crisis that was not of their doing.

Data demonstrates the fact that many minorities, who become or want to become small business owners, are often first generation entrepreneurs. These enterprising owners do not have the benefit of family members handing down a business or providing them with the necessary training and coaching that is so crucial for business success. At Legacy, we have found that when financial training and business coaching are provided along with the funding, businesses can succeed. The process of working with owners to strengthen their business is part of our banking model – but we have been unable to overcome the credit crunch that is so adversely affecting our customer base.

Many banks argue that small business loans are too small, that not enough money can be made from them, that they involve too high of a risk, or that the borrowers lack the skills, or is unprepared, to run a successful firm. What we have found is that many of our customers have excellent ideas, good locations, a customer base and the drive and tenacity to make their businesses succeed plus a Plan B in case A does not work. Once they are given the opportunity, access to capital, training, coaching to make these businesses work they have been successful as supported by our double digit growth serving this customer base. There is risk involved – but that is true no matter who is borrowing the money as evidenced by the number of corporations that are failing, struggling and/or being bailed out.

Let me share lending data with you. From July 2007 to June 2008 Legacy Bank financed 392 loans. Of those, 269 were loans categorized as minorities and or loans in underserved areas. The dollar volume of those loans was almost $35 million. Do the math – we made and continue to make money from minority and underserved lending. These loans are good investments in solid companies. More than half of these loans went to start-ups or newer businesses needing capital to grow. From March 2008 thru June 2008, our loan numbers spiked as fewer lenders would take a look at small business loans and so more of these businesses came to us. Legacy bank loaned money to 122 businesses during that time period. The last fifteen months our lending has declined to less than two million in the last two quarters of 2009 and the first quarter of 2010. Much of our time and funding has gone to our existing customers trying to keep them in business and for the first time in eight years, we operated at a loss.

Our loan losses and delinquency rate have grown at a rate much faster than we anticipated. We find ourselves struggling right along with our customers. At Legacy we say "No margin, No mission." We strive to maintain a balance between the margin and the mission but it has become a challenge.

Despite the challenges we are facing, we still believe that lending to minorities and doing business in underserved communities is good. We provide customers with the training they need to be successful and we are rewarded with our own success. However, during this economic crisis their remains a great need for relief for small businesses.

Legacy and other banks like Legacy cannot do this alone. Help, support, and resources, in the form of more funding for entrepreneurial training and lending programs that support underserved communities, MUST be a priority for this Committee. The micro loan program; a streamlined application and approval process for SBA loans; rethinking the requirements related to assets and collateral in underserved markets, grants for training as well as other financial support to minorities and underserved communities will increase the capacity and survival of small businesses.

Employment in our target market increases because of our small business lending with more than 2,500 jobs being created or sustained by Legacy Bank customers. This creates economic development, generates taxes, and is good for the city, county and state.

Our companies provide their employees with money to spend on needed services, buy homes, acquire other assets, and build wealth. All of which strengthens a community and turn it from underserved to a productive and thriving area.

Senator Landrieu, Ranking Member Snowe, and members of the Committee, I appreciate the opportunity to testify here today and would be glad to answer any questions.

Chair LANDRIEU. Thank you very much for that real-life, up-to-date and compelling testimony.

Mr. Hudson.

STATEMENT OF PAUL HUDSON, CHAIRMAN AND CEO, BROADWAY FEDERAL BANK

Mr. HUDSON. Thank you, Chairwoman Landrieu and Ranking Member Snowe and Senator Cardin. Thank you for inviting me to appear before you today.

Minority small business owners use the term capital even when they are really talking about debt financing. I have heard that today a lot. This word capital has got many meanings. This is based on certain realities in our community which include the following:

The primary source of funds to finance minority business operations and expansion is often in the form of debt, short-term debt. These sources include credit card debt, loans collateralized by personal and business assets which is most often the business owner's personal residence, and loans from family members and friends.

Capital, on the other hand, is a foreign commodity in minority communities. The lack of capital in minority communities results from past discriminatory policies and practices that created a wealth gap. Minorities have substantially less wealth than the rest of Americans. The lack of wealth accumulation within minority communities has resulted in limited investable capital from local sources for minority business owners.

As a result of this broader definition of capital within minority communities, I have found that minority business owners often blur the distinction between short-term debt and longer-term equity. For purposes of this statement, I will address both the access to both sources of financing.

For all my adult life, minority business owners have complained about the obstacles to capital, to accessing capital. Based on my experience, there are five major obstacles:

The lack of wealth accumulation within minority communities—this has meant limited opportunities to access local sources of capital. Local networks of friends, associates and organizations are often the connectors between business owner and investor. The lack of local sources of capital has historically contributed to the unequal access to capital by minorities.

Redlining—and I know Dr. Fairlie is going to talk about redlining extensively, and a lot of people have talked about redlining, but it is clear that minorities have a different standard when they face bankers today.

The third factor is minority business owners do not have a nexus to investment networks, which is another byproduct of discrimination and segregation. I am often asked about making an equity investment in a small business even though we are a bank, not a private equity fund. The financial network of most borrowers does not extend to angel investors and more traditional equity funds outside minority communities. Thus, Broadway Federal Bank, the local community bank, is the logical and often the only financial option.

The fourth factor, minority businesses are often not organized or structured in a way that facilitates investment. Many small minority business owners are organized as sole proprietorships with a strong preference for ownership control, which gets back to Mr. Johnson's point.

Finally, some minority business owners lack the financial sophistication to source investment opportunities, prepare investment materials and structure investment terms, which I know the SBA has the wealth centers that are working on that, with technical assistance.

In addition to the above obstacles, the current economy has weakened the balance sheets and income statements of minority small businesses, and the depressed economy, as Senator Snowe, has resulted in the steepest lending since 1942.

Broadway Federal Bank, as a small minority business, provides a case study of the possibilities and creative solutions to providing capital opportunities for minority small businesses. In the last 30 years, minority businesses have grown larger and more mature. Broadway is 63 years old, with assets slightly in excess of $500 million, annual gross revenues of close to $30 million.

Minority businesses make an important contribution to the economy and job creation. Broadway is a Certified Community Development Financial Institution based on its delivery of financial services and products to underserved communities.

Thirdly, but the most important part of this case study or example, is that the U.S. Treasury invested $15 million of capital—not loans, not debt—$15 million of capital in Broadway under the Troubled Asset Relief Program in the form of preferred shares at a dividend of 5 percent. That additional capital support net lending in 2009 of $109 million—$15 million of capital, $109 million of loans primarily invested in commercial operations in urban minority communities.

I make the following recommendation for the Committee's consideration: I think the TARP program provides an excellent example of what can be done in America and how government can play a role in supporting the rebound of this economy. Allocate $10 billion of stimulus funds to the Small Business Administration for capital investments in small minority businesses. The capital fund investment should be targeted to support job creation and economic growth in low and moderate income communities. The SBA should develop investment criteria to maximize job creation and minimize investment default.

And I think it is important that the SBA contract with minority asset managers to help source and manage small business investments, and to provide the technical assistance and business education.

I thank you for your interest in the plight of minority small business owners and for your commitment to identify and implement solutions to the obstacles to accessing capital and technical assistance by small businesses.

I appreciate the opportunity to contribute. Thank you.

[The prepared statement of Mr. Hudson follows:]

U.S. Senate Committee
Small Business and Entrepreneurship

PAUL C. HUDSON
Chairman, CEO
Broadway Federal Bank, Los Angeles, CA
Statement Submitted
Thursday, April 15, 2010

Chairman Landrieu and Committee members, thank you for inviting me to appear before you today and for the opportunity to provide my perspective on both the obstacles and opportunities that minority small business owners have in accessing capital and technical assistance.

Capital

Minority small business owners use the term capital, even when they are really talking about debt financing. This is based on certain realities in our community, which include the following.

1. The primary source of funds to finance minority business operations and expansion is often in the form of debt. These sources include credit card debt, loans collateralized by personal and business assets, which is most often the business owner's personal residence and/or loans from family members and friends.
2. Capital is a foreign commodity in minority communities. The lack of capital in minority communities results from past discriminatory policies and practices that created a wealth gap. Minorities have substantially less wealth than the rest of

Americans.[1] The lack of wealth accumulation within minority communities has resulted in limited investable capital from local sources for minority business owners.

As a result of this broader definition of capital within minority communities, I have found that minority business owners often blur the distinction between short term debt and longer term equity. For purposes of this statement, I will address access to both sources of financing.

Access to Capital

Obstacles

For all of my adult life, minority business owners have complained about the obstacles to accessing capital. Based on my experience, there are five major obstacles.

1. The lack of wealth accumulation within minority communities. This has meant limited opportunities to access local sources of capital. Local networks of friends, associates and organizations are often the connectors between business owner and investor. The lack of local sources of capital has historically contributed to the unequal access to capital by minorities.
2. Redlining of minority communities and minority business owners by financial institutions due to race and income and collateral disparities caused by discriminatory practices. Many studies have shown that African American borrowers and small businesses owned by African Americans were less likely than

[1] Meizhu Lui, March, 2009, "Laying the Foundation for National Prosperity. The Imperative of Closing the Racial Wealth Gap."

their white counterparts to have their commercial loans approved, even when borrower traits, including credit history were controlled for statistically.[2]

3. Minority business owners do not have a nexus to investment networks, which is another by product of discrimination and segregation. I am often asked about making an equity investment in a small business, even though we are a bank not a private equity fund. The financial network of most borrowers does not extend to angel investors or more traditional equity funds outside the minority community. Thus, Broadway Federal Bank (Broadway), the local community bank, is the logical and often only finance option.
4. Minority businesses are often not organized or structured in a way that facilitates investment. Many small minority businesses are organized as sole proprietorships with a strong preference for ownership control, which limits the investment vehicles and opportunities.
5. Some minority business owners lack the financial sophistication to source investment opportunities, prepare investment materials and structure investment terms. This impairment coupled with limited access to a network of financial resources also impacts their ability to identify and retain consultants and advisors to assist them. The lesser degree of financial literacy

[2] Faith Ando, 1988, "Capital Issues and Minority-Owned Business", The Review of Black Political Economy; Ken and Linda Cavalluzzo, 2002, "Competition, Small Business Financing, and Discrimination: Evidence from a New Survey." Journal of Business 75(4): 641-79; David Blanchflower, Philip Levine, and David Zimmerman, 2003, "Discrimination in the Small Business Credit Market." Review of Economics and Statistics.

is not due to a lack of ability or intelligence, but reflects limited access to financial education and technical assistance.

In addition to the above obstacles, the current economy has weakened the balance sheets and income statements of minority small businesses, thereby reducing the number of investment grade opportunities. The depressed economy has also contributed to the steepest drop in lending since 1942, exacerbating the problem of access to credit for minority small businesses.[3]

Opportunities

Broadway, as a small minority business, provides a case study of the possibilities and creative solutions to providing capital opportunities for minority small businesses.

1. In the last thirty years, minority businesses have grown larger and more mature. Broadway is 63 years old with assets slightly in excess of $500 million and annual gross revenues of close to $30 million.
2. Minority businesses make an important contribution to the economy and job creation. Broadway is a certified Community Development Financial Institution based on its delivery of financial services and products to underserved communities and its support of economic development in minority communities.

[3] Whitehouse, Mark, March 15, 2010, Wall Street Journal, "Loan Squeeze Thwarts Small-Business Revival"

3. The U.S. Treasury invested $15 million of capital in Broadway under the Troubled Asset Relief Program in the form of preferred shares at a dividend of 5%. The additional capital supported net new lending in 2009 of $109 million, the majority of which was invested in commercial operations in urban minority communities. If the capital is not repaid in five years, then the dividend yield increases to 9%.

Recommendations

I make the following recommendations for the Committee's consideration.

1. Allocate $10 billion of Stimulus Funds to the Small Business Administration (SBA) for capital investments in small and minority businesses (the "Capital Fund"). The Capital Fund investments should be targeted to support job creation and economic growth in low to moderate income communities.
2. SBA should develop investment criteria to maximize job creation and minimize investment default.
3. In lieu of a minimum number of years in operation, require applicants with less than the minimum operational history to accept technical assistance training and business education prior to receipt of funds.
4. SBA should receive a current dividend and participate in the appreciation of the business' value that results from the SBA

investment. SBA should incorporate many of the characteristics of Treasury's investment model.

5. Contract with minority asset managers to help source and manage small business investments and to provide technical assistance and business education.

Thank you for your interest in the plight of minority small business owners and for your commitment to identify and implement solutions to the obstacles to accessing capital and technical assistance by small businesses. I appreciate the opportunity to contribute to this important conversation.

Chair LANDRIEU. Thank you, Mr. Hudson.
Dr. Fairlie.

STATEMENT OF ROBERT W. FAIRLIE, PH.D., PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, SANTA CRUZ

Dr. FAIRLIE. Yes, thank you, Chair Landrieu, Ranking Member Snowe and Senator Cardin. It is an honor to testify before you on the important topic of access to capital for minority businesses.

I am a Professor of Economics at the University of California, Santa Cruz, and I have studied small business and entrepreneurship for nearly 20 years. I have been asked to briefly discuss the findings of my research on this topic. As we will see, I am going to present a number of numbers that have been discussed sort of briefly, from other panelists and also from members of the Committee.

The U.S. economy has lost more than 8 million jobs since the start of the recession in December, 2007. The national unemployment rate is hovering around 10 percent now which is surprising because only a couple of years ago it was down around less than 5 percent.

Small businesses have been hit extremely hard by the downturn. The rate of businesses filing for bankruptcies in the U.S. increased by more than 150 percent since mid-2007. The financial crisis certainly contributed to the rapid increase in business closings over this period. All indicators, including the recent survey of loan officers by the Federal Reserve, indicate extremely tight credit conditions for small businesses and entrepreneurs. Minority-owned businesses are being hit especially hard by the current financial crisis.

Extensive research of mine and others indicates that minority businesses face substantial barriers to entry, growth and survival even in more promising or favorable economic conditions. Minority firms are more vulnerable because they are generally smaller and have fewer resources to draw on in difficult economic times. The average minority-owned business has revenues of $170,000 per year, which is only about 38 percent of the level for non-minority businesses. Minority-owned businesses also hire fewer employees and have lower profit levels on average.

Of the many factors responsible for these disparities in business performance, access to financial capital is perhaps the most important. A large number of studies show that limited access to capital hinders the formation and growth of minority-owned businesses. One of the major roots of the problem is the extremely high level of wealth inequality between minorities and non-minorities.

Estimates of median net worth from the Census Bureau here are displayed in Figure 1. As you can see from this figure, half of all African American families have less than $5,500 in total wealth, and half of all Latino families have less than $8,000. If you look at the red column here, that shows you the level of wealth among non-minority owned families, which is 11 to 16 times higher at $87,000.

These disparities in wealth are also substantially higher than disparities in total income. So African American and Latino families have income levels that are 60 to 70 percent of non-minority levels.

Now why are these levels of wealth important, these disparities in wealth? Well, these low levels of wealth among minorities translate into fewer startups and undercapitalized businesses because an entrepreneur's wealth is important because it is often invested directly into the business or used as collateral to obtain business loans. Entrepreneurs also frequently are required by investors to invest their own money in the business as an incentive.

Further limiting the ability of minority entrepreneurs to obtain financial capital is racial discrimination in lending markets. Several studies have examined whether minority firms face discrimination in obtaining business loans. The main finding from this literature is that minority-owned businesses are more likely to experience loan denials, pay higher interest rates and are less likely to apply for loans because of a fear of rejection.

Using the latest data from the Federal Reserve, I conducted a similar analysis recently. You can see in this figure, Figure 2 here, that minority firms are twice as likely to be denied a loan application, they are twice as likely to not apply for a loan out of fear of rejection on that loan, and minority firms that do obtain loans pay 1.5 percentage points higher interest rates on those loans than non-minority firms.

These disparities do not disappear even after controlling for the age, experience and education of the owner of the firm, the creditworthiness, size, industry, age and location of the firm, which is consistent with the existence of lending discrimination.

The end result is that minority-owned businesses have substantially lower levels of financial capital in their businesses. Figure 3 displays estimates from Federal Reserve data indicating that minority firms have much lower levels of equity investments and loan amounts than non-minority firms. Minority-owned businesses have an average of $3,400 of equity investments in their business and $46,500 in loans; non-minority businesses have values of equity and loan investments that are more than twice that level.

Again, these disparities do not disappear even after we control for the characteristics and owner of the firm.

I have used data from other sources and find similar patterns of low levels of financial capital among minority businesses.

Minority-owned businesses contribute greatly to the U.S. economy. Businesses owned by minorities produce nearly $700 billion in total sales. Minority firms employ 5 million workers with an annual payroll of $120 billion. These jobs are located across the nation, with many of them located in minority and economically depressed communities.

Often overlooked, however, is that minority business owners also create a job for themselves. When added up, that represents an additional 4 million jobs that are created by these businesses in the economy.

In closing, although minority-owned businesses contribute greatly to the economy, there remains a lot of untapped potential among this group of firms. As I have discussed, minority entrepreneurs are constrained by limited wealth, high loan denial rates, high interest rates and lending discrimination. Barriers to growth such as these, for any group of business owners in the country, limit total U.S. productivity. These barriers have a negative effect on job creation and innovation, and will restrict our country's ability to move out of the recession and remain competitive in the global economy.

Thank you for the opportunity to present the findings from my research. I look forward to hearing your comments and questions.

[The prepared statement of Dr. Fairlie follows:]

Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets

U.S. Senate Committee on Small Business & Entrepreneurship

April 15, 2010

Testimony by:

Robert W. Fairlie
Professor of Economics
University of California, Santa Cruz

Thank you, Chair Landrieu, Ranking member Snowe, and members of the Committee. It is an honor to testify before you on the important topic of access to capital for minority businesses. I am a Professor of Economics at the University of California, Santa Cruz and have studied small businesses and entrepreneurs for almost 20 years. I have been asked to briefly discuss the findings from my research on the topic.[1]

Financial Crisis and Recession

The U.S. Economy has lost more than 8 million jobs since the start of the recession in December 2007. The national unemployment rate is hovering around 10 percent, which is twice as high as it was only a couple of years ago. Small businesses have been hit extremely hard by the downturn. The rate of businesses filing for bankruptcies in the United States increased by more than 150 percent from the rate in mid 2007.

The financial crisis has certainly contributed to the rapid increase in business closings. An extensive body of research shows that access to financial capital is paramount to the success of small businesses. Although downward trends have been slowing, all indicators continue to reveal extremely tight credit conditions for entrepreneurs. In its latest survey of lending officers, the Federal Reserve reports that commercial banks "have yet to unwind the considerable tightening that has occurred over the past two years."[2] Home equity, often used to help finance business starts, has also declined substantially because of the drop in housing prices.

The State of Minority-Owned Businesses

Minority-owned businesses are being hit especially hard by the current financial crisis and recession. Extensive research of mine and others indicates that minority businesses face substantial barriers to entry, growth and survival even in more favorable economic conditions. Minority firms are more vulnerable because they are generally smaller and have fewer resources to draw on in difficult economic times. The average minority-owned business has revenues of $170,000 per year, which is only 38 percent of the level for non-minority businesses. Minority owned firms also hire fewer employees and have lower profit levels.

Barriers Faced by Minority-Owned Businesses

Of the many factors responsible for these disparities in business performance, access to financial capital is perhaps the most important. A large number of studies show that limited access to capital hinders the formation and growth of minority-owned businesses. One of the major roots of the problem is the extremely high level of wealth inequality

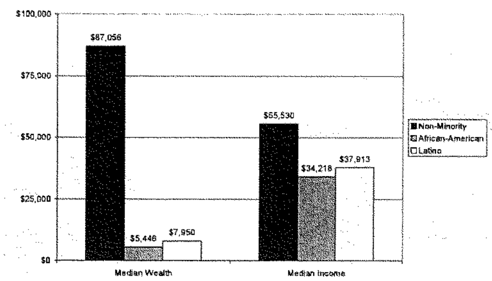
---

[1] The findings presented here are summarized from Robert Fairlie and Alicia Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States* Cambridge: MIT Press (2008). Robert Fairlie and Alicia Robb, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs.*, U.S. Department of Commerce, Minority Business Development Agency, January 2010.

[2] Board of Governors of the Federal Reserve System, *The January 2010 Senior Loan Officer Opinion Survey on Bank Lending Practices* (2010).

found between minorities and non-minorities. Estimates of median net worth from the Census Bureau are displayed in Figure 1.

Figure 1: Median Household Wealth and Income
U.S. Census Bureau, 2004, 2008



Half of all African-American families have less than $5,500 in total wealth, and half of all Latino families have less than $8,000. These levels of wealth are one-eleventh to one-sixteenth the levels of wealth held by non-minorities ($87,000). These disparities in wealth are also substantially larger than disparities in income. African-American and Latino income levels are 60 to 70 percent of non-minority levels.

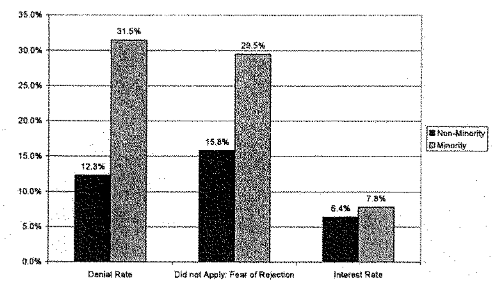
These low levels of wealth among minorities translate into fewer startups and undercapitalized businesses because an entrepreneur's wealth is often invested directly in the business or used as collateral to obtain business loans. Entrepreneurs are also frequently required by investors to invest their own money in the business as an incentive.

Further limiting the ability of minority entrepreneurs to obtain financial capital is racial discrimination in lending practices. Several studies have examined whether minority firms face discrimination in obtaining business loans.[3] The main finding from this

[3] David G. Blanchflower, P. Levine, and D. Zimmerman, "Discrimination in the Small Business Credit Market," *Review of Economics and Statistics* 85, no. 4 (2003): 930-943. Ken Cavalluzzo, Linda Cavalluzzo, and John Wolken. "Competition, Small Business Financing, and Discrimination: Evidence from a New Survey," *Journal of Business* 75, no. 4 (2002): 641-679. Ken Cavalluzzo and John Wolken, "Small Business Loan Turndowns, Personal Wealth and Discrimination," *Journal of Business* 78, no. 6 (2005): 2153-2177. Lloyd Blanchard, John Yinger and Bo Zhao, "Do Credit Market Barriers Exist for Minority and Women Entrepreneurs?" Syracuse University Working Paper (2004). Susan Coleman, "The Borrowing Experience of Black and Hispanic-Owned Small Firms: Evidence from the 1998 Survey of Small Business Finances," *The Academy of Entrepreneurship Journal* 8, no. 1 (2002): 1-20. Susan Coleman, "Borrowing Patterns for Small Firms: A Comparison by Race and Ethnicity." *The Journal of Entrepreneurial Finance & Business Ventures* 7, no. 3 (2003): 87-108. K. Mitchell and D.K. Pearce, *Availability of Financing to Small Firms using the Survey of Small Business Finances*, U.S. Small Business Administration, Office of Advocacy (2005). R. Bostic and K.P. Lampani,

literature is that minority-owned businesses are more likely to experience loan denials, pay higher interest rates, and are less likely to apply for loans because of a fear of rejection. Figure 2 reports estimates from an analysis that I conducted with Federal Reserve data.

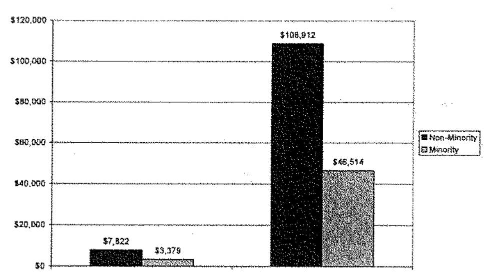
Figure 2: Loan Denial, Fear of Applying for Loans, and Interest Rates
Federal Reserve, Survey of Small Business Finances, 2003



These data show that minority firms are twice as likely to be denied a loan application and are twice as likely to not apply for a loan because of a fear of rejection. Minority firms that do obtain loans pay one and half percentage points higher interest rates on those loans than non-minority firms. These disparities do not disappear even after controlling for the age, experience and education of the owner, and the creditworthiness, size, industry, age and location of the firm, which is consistent with the existence of lending discrimination.

The end result is that minority-owned businesses have substantially lower levels of financial capital invested in their businesses. Figure 3 displays estimates from Federal Reserve data indicating that minority firms have much lower levels of equity investments and loan amounts than non-minority firms.

Figure 3: Average Equity Investments and Loan Sizes
Federal Reserve, Survey of Small Business Finances, 2003



"Racial Differences in Patterns of Small Business Finance: The Importance of Local Geography," Working Paper (1999).

Minority-owned businesses have an average of $3,400 of equity investments and $46,500 in loans. Non-minority owned businesses have values of equity and loan investments that are more than twice as large. Again, these disparities do not disappear after controlling for the characteristics of the owner and firm. I have used data from other sources and find similar patterns of low levels of financial capital among minority-owned businesses.

The Potential of Minority-Owned Businesses

Minority-owned businesses contribute greatly to the U.S. economy. Businesses owned by minorities produce nearly $700 billion in total sales. Minority firms employ 5 million workers with an annual payroll of $120 billion. These jobs are located across the nation with many of them located in minority and economically-depressed communities. Minority business owners also create jobs for themselves. When added up that represents an additional 4 million jobs in the economy.

In closing, although minority-owned businesses contribute greatly to the economy, there remains a lot of untapped potential among this group of firms. As I have discussed, minority entrepreneurs are constrained by limited wealth, high loan denial rates, high interest rates, and lending discrimination. Barriers to growth, such as these, for any group of business owners in the country limit total U.S. productivity. These barriers have a negative effect on job creation and innovation, and will restrict our country's ability to move out of the recession and remain competitive in the global economy.

Thank you for the opportunity to present the findings from my research on this topic. I look forward to hearing your comments and questions.

178

Race and Entrepreneurial Success

Black-, Asian-, and White-Owned Businesses in the United States

Robert W. Fairlie and Alicia M. Robb

The MIT Press
Cambridge, Massachusetts
London, England

For information about special quantity discounts, please e-mail ⟨special_sales@mitpress.mit.edu⟩.

This book was set in Palatino on 3B2 by Asco Typesetters, Hong Kong.
Printed and bound in the United States of America.

Library of Congress Cataloging-in-Publication Data

Fairlie, Robert W.
Race and entrepreneurial success : Black-, Asian-, and white-owned businesses in the United States / Robert W. Fairlie and Alicia M. Robb.
p. cm.
Includes bibliographical references and index.
ISBN 978-0-262-06281-7 (hardcover : alk. paper)
1. Minority business enterprises—United States. 2. African American business enterprises. 3. Asian American business enterprises. 4. Entrepreneurship—United States. 5. Small business—United States. 6. Success in business—United States. I. Robb, Alicia M. II. Title.
HD2358.5.U6F35 2008
338.6′420890973—dc22 2008005535

10 9 8 7 6 5 4 3 2 1

Contents

Preface

Interest in entrepreneurship is growing around the world. Although our understanding of what leads to entrepreneurial success has improved, we know less about why some racial groups succeed in business while others struggle. In writing this book, we were interested in figuring out why Asian American-owned businesses perform relatively well on average and the businesses owned by African Americans typically do not perform as well. An important concern is whether these racial patterns in business performance are both a symptom and cause of broader racial inequalities in the United States. Along the way, we also became very interested in exploring the more general question of why some small businesses succeed and others fail and how success is related to the human-capital, financial-capital, and family-business background of the entrepreneur.

The main goal of the book is to provide a comprehensive comparative analysis of the performance of African American-, Asian American-, and white-owned businesses in the United States. We hope that it will serve as a useful informational source for policymakers and business leaders as well as a valuable research and instructional tool for professors and students. In researching the book, we were surprised to learn that there were no studies or reports in the literature that provided thorough information on recent trends in minority-business ownership rates and outcomes. We present a new compilation of data on minority entrepreneurship over the past few decades as well as a detailed analysis of confidential data from the U.S. Census Bureau. We hope that anyone interested in learning more about racial trends in business ownership and outcomes, the determinants of successful entrepreneurship, and the causes of racial disparities in business performance will find what they need in this book.

We started this research project many years ago when we applied to the Center for Economic Studies to use the confidential and restricted-access Characteristics of Business Owners data. Given a project of this length, there are many people to thank for providing comments, suggestions, and criticisms. We thank Timothy Bates, Ken Brevoort, Anthony Caruso, Ken Couch, Mark Doms, Tom Dunn, Lingxin Hao, Brian Headd, James Jarzabkowski, Leora Klapper, Lori Kletzer, Rebecca London, Ying Lowrey, Justin Marion, Kevin Moore, Richard Moore, Chad Moutray, Charles Ou, Robert Strom, Valerie Strang, Kathryn Tobias, John Wolken, and Donald Wittman.

We also thank participants at the numerous conferences, workshops, and seminars at which we presented the research discussed in this book. They include the American Economic Association Meetings; Baruch College; Board of Governors of the Federal Reserve System; California State University Moss Landing Marine Laboratory; Consulate General of Sweden at the University of Southern California; Dartmouth College; Federal Reserve System's Community Affairs Research Conference; Harvard University; National Academy of Sciences Panel on Measuring Business Formation, Dynamics, and Performance; National Bureau of Economic Research Workshop on Entrepreneurship; United States Association for Small Business and Entrepreneurship Meetings; RAND; United States Small Business Administration; SBA and the Kauffmann Foundation Conference on Entrepreneurship in the Twenty-first Century; University of Amsterdam Entrepreneurship and Human Capital Conference; University of California at Santa Barbara; University of California at Santa Cruz; University of Maryland; University of North Carolina Minority Entrepreneurship Boot Camp; University of North Carolina Research Conference on Entrepreneurship among Minorities and Women; University of Washington Business Diversity Conference; Urban Institute; Yale University.

We thank Bill Koch, Garima Vasishtha, Oded Gurantz, and Matt Jennings for providing excellent research assistance. We are also grateful for funding from the Russell Sage Foundation and Kauffman Foundation. The views expressed here are solely ours and do not necessarily reflect the views of either foundation. Finally, we thank Rebecca London, Zoe and Jessica Fairlie, and Mark Doms for their patience and support during the past several years of writing this book.

Race and Entrepreneurial Success

4 Why Are African American-Owned Businesses Less Successful?

African Americans are less likely to own businesses than whites, and their businesses are less successful on average than are white-owned businesses. The evidence presented in chapter 2 indicates that black businesses have lower revenues and profits, hire fewer employees, and are more likely to close than white-owned businesses. In most cases, the disparities are large. For example, average sales among black firms are roughly one fourth that of white firms, and black firms hire one third the number of employees on average as white firms. The relative underperformance of black-owned businesses is alarming because of the implications of successful business ownership for economic advancement, job creation, and income equality.

In the previous chapter's exploration of the determinants of business outcomes, several owner and firm characteristics are identified as predictors of success. Human capital, financial capital, and family-business backgrounds are found to improve business outcomes. Do black business owners have lower levels of education, less access to startup capital, and more disadvantaged family backgrounds than white business owners? Can these factors explain why black-owned businesses have lower survival rates, profits, employment, and sales than white-owned businesses?

The single most important factor determining business success is startup capital. We find that higher levels of startup capital are associated with lower closure probabilities, higher profits and sales, and more employment. Therefore, less access to capital for black business owners compared with white owners may partly explain why black-owned businesses have worse outcomes than white-owned firms, on average. Previous research indicates that low levels of wealth limit business creation among blacks (Fairlie 1999, 2006) and low levels of startup capital increase closure rates among black-owned businesses

(Bates 1997; Robb 2000). There is also a large body of evidence indicating that black businesses face lending discrimination (Blanchflower, Levine, and Zimmerman 2003; Cavalluzzo, Cavalluzzo, and Wolken 2002). Given these findings, we suspect that racial differences in wealth and startup capital contribute substantially to differences in business outcomes, but we do not know the extent of their contribution.

Another determinant of success in small business is the owner's education level. After controlling for other factors, firms with more highly educated owners have lower closure probabilities, higher profits and sales, and more employment. Therefore, if black business owners have lower education levels than white business owners, disparities in education levels could explain why black-owned businesses underperform relative to white-owned firms, on average.

Building on the finding in the previous literature that the children of business owners are more likely than the children of nonbusiness owners to become business owners, we examine whether the businesses created by the children of business owners are also more successful. In the previous chapter, we find that previous work experience in a family member's business and previous work experience in a business providing similar goods and services have large positive effects on business outcomes. These findings suggest that the lack of opportunities for black owners to acquire important general and specific business human capital may limit their ability to create successful businesses. In fact, there is evidence in the previous literature indicating that current differences between blacks and whites in business ownership rates are partly determined by racial differences in business ownership in the previous generation (Fairlie 1999; Hout and Rosen 2000). Although the intergenerational transmission of business ownership is important in creating racial disparities in rates of business ownership, we do not know if it also contributes to racial disparities in business outcomes conditioning on ownership. In particular, can these disparities explain why black-owned businesses lag behind white-owned businesses in survival rates, profits, employment, and sales?

Several recent studies have examined the reasons behind the lack of black-owned businesses and find that relatively low levels of education, assets, and parental self-employment are partly responsible (see Bates 1997, Fairlie 1999, and Hout and Rosen 2000 for a few examples reviewed in chapter 2). Although these results are informative, they do not shed light on why the average performance of black-owned firms lags behind that of white-owned firms. We know much less about why black-owned firms have lower outcomes relative to white-owned businesses. This is partly due to the small number of datasets that identify the race of the owner, additional owner characteristics, and business outcomes.

We use data from the Characteristics of Business Owners (CBO) to examine the role that financial capital and human capital play in contributing to racial disparities in business outcomes, such as closures, profits, employment size, and sales. We also examine the role that intergenerational links in self-employment play in contributing to racial differences in business outcomes. Do black business owners have limited opportunities for the acquisition of general and specific business human capital from working in family-owned businesses and the receipt of business inheritances, in addition to less education and access to financial capital? We build on findings from the previous chapter on the determinants of business success and use a special decomposition technique to identify the underlying causes of differences in outcomes between black and white firms. The decomposition technique identifies whether a particular factor is important and identifies how much it explains of the gap in a particular outcome. This allows the relative strengths of the factors to be compared.

The confidential and restricted-access CBO microdata are useful for this analysis because they are one of the only nationally representative datasets containing a large enough sample of black firms and detailed information on family-business backgrounds. For example, the CBO appears to be the only nationally representative dataset containing information on previous work experience in businesses owned by family members. Overall, the detailed information on both the characteristics of the owner and the business available in the CBO is important for exploring additional potential causes of the racial differences in business outcomes.

Racial Differences in Education

Over the twentieth century, blacks made considerable progress in educational attainment. Figure 4.1 displays estimates of the percentage of black and white adults age twenty-five and over who have completed four or more years of high school. In 1940, only 7.7 percent of blacks completed four years of high school or more. By 2004, more than 80 percent of blacks had high school educations. The percentage of blacks who completed at least four years of college also increased markedly

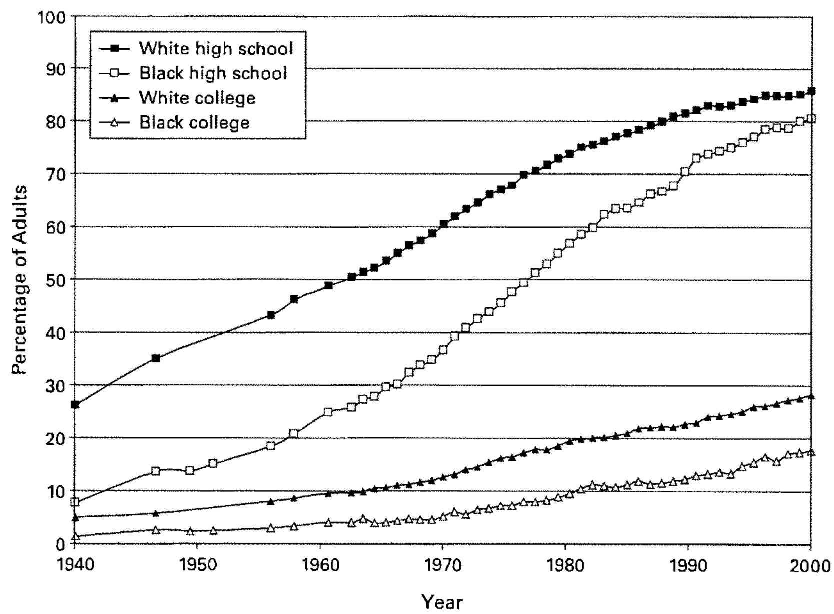


Figure 4.1
Educational attainment by race, U.S. Census Bureau estimates (1940 to 2004)

over the period. Only 1.3 percent of blacks were college educated in 1940, but nearly 20 percent were college educated by 2004. Although blacks have made considerable progress both in absolute terms and relative to whites, large disparities in educational attainment remain. In 2004, 85.8 percent of whites had at least four years of high school, and 28.2 percent had at least four years of college. Racial parity in educational attainment has not yet occurred.

Racial disparities in educational attainment are smaller for business owners than the general population but remain large. Figure 4.2 displays estimates of educational attainment by race from CBO microdata. Black business owners are more likely to be high school dropouts and are less likely to be college graduates. Black business owners, however, are equally likely to have graduate school degrees as white business owners. Overall, 26.2 percent of black business owners have at least a college education compared with 33.3 percent of white business owners.

In the previous chapter, we find that the education level of the owner is an important predictor of business success. Therefore, the

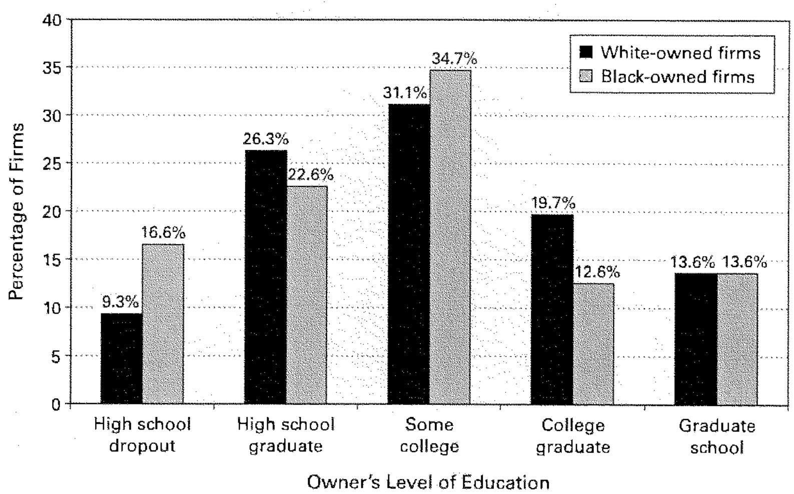


Figure 4.2
Owner's education level by race, Characteristics of Business Owners (1992)

racial disparities in education levels displayed here suggest that differences between black and white owners in education levels may contribute to racial differences in business outcomes. Boyd (1991) finds that close to one third of the gap in the earnings between self-employed Asian Americans and blacks is explained by disparities in education levels. Blacks may have less of the general and specific knowledge and skills that are useful for running a successful business because of lower levels of formal education. Lower levels of education among blacks may also limit business opportunities because they provide less of a positive signal to potential customers, lenders, or other businesses. The decomposition technique employed below will allow us to examine whether and how much racial differences in education can explain of racial disparities in the business outcomes available in the CBO.

Family-Business Background

Regression estimates from the CBO indicate that family-business backgrounds are important for small business success. In particular, working in a family member's business, perhaps through the acquisition of general and specific business human capital, improves the future success of businesses owned by these individuals. The estimated effects are large in magnitude: they increase outcomes anywhere from 15 to 40 percent. Given these results and the extensive literature addressing concerns with the African American family (Wilson 1987; Tucker and Mitchell-Kernan 1995; Wilson 2002), it is useful to explore the relationship between race, families, and business success.

Recent estimates indicate that blacks are 40 percent less likely to be married than are whites and that black women are nearly 80 percent more likely to have a nonmarital birth than are white women (U.S. Census Bureau 2001; National Center for Health Statistics 2003). As a result, 53.3 percent of black children live with only one of their parents compared with 21.5 percent of white children (U.S. Census Bureau 2001). The high incidence of single black parents is likely to have adverse educational, economic, and emotional outcomes for this group of children (McLanahan and Sandefur 1994; Seltzer 1994; Amato 2000). The loss of resources associated with having one parent missing from the household may be especially detrimental to the future outcomes of black children.

One area in which the lack of exposure to both parents may be limiting is in business ownership. As noted above, previous research indicates that the probability of self-employment is substantially higher among the children of the self-employed than among the children of the non-self-employed (Lentz and Laband 1990; Fairlie 1999; Dunn and Holtz-Eakin 2000; Hout and Rosen 2000). These studies generally find that an individual who had a self-employed parent is roughly two to three times as likely to be self-employed as someone who did not have a self-employed parent. The high incidence of growing up in a single-parent family and the strong intergenerational link in self-employment may limit business ownership opportunities for blacks. If black children are less likely to live with both parents, they will have a lower likelihood of being exposed to a self-employed parent and fewer chances to work in a family business.

Although the high rates of black children currently growing up in single-parent families may have a detrimental effect on future business ownership rates and business outcomes, historical estimates of single-parent family rates contribute to current differences in business outcomes. The earliest reported data from the U.S. Census Bureau, which are for 1960, indicate that black children were more than twice as likely to live in single-parent families as white children. In 1960, 21.9 percent of black children lived in single-parent families compared with 7.1 percent of white children (U.S. Census Bureau 2005b). On average, these children would be forty-two years old at the time of the CBO survey. Nearly half of the sample of black business owners in the CBO is under the age of forty-five, suggesting that historically high levels of single-parent households may be contributing to the lower outcomes of the current generation of business owners. Marriage rates among current black business owners are also lower than marriage rates among white business owners: 77 percent of white owners are married compared with 68 percent of black owners.

Concerns about the negative consequences of weak family ties on business opportunities among blacks are not new. In fact, nearly forty years ago, Nathan Glazer and Daniel Patrick Moynihan made the argument that the black family "was not strong enough to create those extended clans that elsewhere were most helpful for businessmen and professionals" (Glazer and Moynihan 1970, p. 33). More recently, Hout and Rosen (2000) note a "triple disadvantage" faced by black men in terms of business ownership. They are less likely than white men to have self-employed fathers, to become self-employed if their fathers were not self-employed, and to follow their father in self-employment. Furthermore, Fairlie (1999) provides evidence from the Panel Study of Income Dynamices (PSID) that current racial patterns of self-employment are in part determined by racial patterns of self-employment in the previous generation. Thus, there is some concern that the lack of a strong family-business background may limit opportunities for black business success.

Racial Differences in Family-Business Experience

Previous research indicates that the relatively low likelihood of having a self-employed parent limits blacks' chances of becoming a self-employed business owner. We know less, however, about whether blacks and whites differ in prior work experience in family businesses and their likelihood of receiving business inheritances and whether these patterns contribute to the lower outcomes by black firms relative to white firms, on average. Black and white business owners indeed have different family-business backgrounds. Table 4.1 reports the percentage of owners who had a family member who was a business owner and the percentage of owners who worked for that family member.[1] More than half of all white business owners had a self-employed family member owner prior to starting their business. In contrast, approximately one third of black business owners had a self-employed

Table 4.1
Family business background by race, Characteristics of Business Owners (1992)

	All Firms	White-Owned Firms	Black-Owned Firms
Had a self-employed family member prior to starting firm	51.6%	53.1%	33.6%
Previously worked in that family member's business (conditional)	43.6%	43.9%	37.4%
Previously worked in a family member's business (unconditional)	22.5%	23.3%	12.6%
Inherited their businesses	1.6%	1.7%	1.4%
Sample size	38,020	15,872	7,565

Notes: (1) The sample includes businesses that are classified by the IRS as individual proprietorships or self-employed persons, partnerships, and subchapter S corporations, have sales of $500 or more, and have at least one owner who worked at least twelve weeks and ten hours per week in the business. (2) All estimates are calculated using sample weights provided by the Characteristics of Business Owners.

family member. Black business owners are much less likely to be part of a family with business experience.

Although family members may include spouses and siblings in addition to parents, these results are consistent with Hout and Rosen's (2000) finding of a lower probability of self-employment among the children of self-employed parents (the "intergenerational pickup rate with respect to self-employment") for blacks than for whites. As mentioned previously, this represents one of the three disadvantages in business ownership faced by blacks, according to Hout and Rosen.

To see the similarity with Hout and Rosen's finding, we can use equations (3.1) and (3.2) from this chapter's appendix and evidence on long-term trends in black and white self-employment rates. As displayed in figure 2.2, business-ownership rates have not changed substantially over time and thus across generations for either whites or blacks. This implies that self-employment rates are roughly in a long-term steady-state relationship in which the current generation's self-employment rate is similar to the previous generation's self-employment rate. If we also assume that there exists a one-to-one matching of parents to children, the intergenerational pickup rate equals the probability of a business owner having a self-employed parent as indicated in equation (3.2). Using this equation, we find that the intergenerational pickup rate for blacks is approximately 0.330, whereas the intergenerational pickup rate is 0.531 for whites and 0.516 for all firms. The black/total ratio for the probability of having a self-employed family member is 0.632, which is in the range of Hout and Rosen's (2000) estimates. Therefore, the CBO data provide support for the hypothesis that blacks are less likely to become business owners than whites, even for those individuals who have self-employed parents.

Family businesses may provide important opportunities for acquiring general and specific business human capital (Lentz and Leband 1990). Estimates from the CBO indicate that conditional on having a self-employed family member, black business owners were also less likely to have worked for that person than were white business owners. As shown in table 4.1, 37.4 percent of black business owners who had a self-employed family member worked for that person's business, whereas 43.9 percent of white business owners who had a self-employed family member worked for that person's business.[2] Finally, black business owners overall were much less likely than white business owners to work for a family member's business. The unconditional rate of working in a family member's business was 12.6 percent for blacks and 23.3 percent for whites.

Black business owners were slightly less likely to inherit their businesses than were white owners: 1.4 percent of black owners inherited their firms compared with 1.7 percent of white owners. All rates of inheritance are very low and suggest that racial differences in inheritances cannot explain much of the gaps in small business outcomes. We also find that only 4.3 percent of white owners and 2.0 percent of black owners acquired the business through a "transfer of ownership/gift" and had a self-employed family member prior to starting their business. These upper-bound estimates of direct parent-to-child transfers or gifts of businesses that are not inheritances combined with the estimates of business inheritances suggests that only a small percentage of all existing businesses are acquired from parents. They are also confirmed by estimates from the 1998 Survey of Small Business Finances (SSBF), which indicate that 4.2 percent of whites and 4.0 percent of blacks inherited or received their business as a gift.

Overall, black business owners have a relatively disadvantaged family-business background compared with white business owners. The lack of family-business experience may contribute substantially to the relative lack of success of black-owned businesses because of limited opportunities to receive the informal learning or apprenticeship-type training that occurs in working in a family business. Family businesses provide an opportunity for family members to acquire general business human capital and in many cases also provide the opportunity for acquiring specific business human capital. The impact of racial differences in these opportunities on racial differences in small business outcomes will be explored using a special decomposition technique shown later in the chapter.

Racial Differences in Business Human Capital

Having prior work experience in businesses whose goods and services were similar to those provided by the owner's business is found to be an important determinant of business success. If blacks have less prior work experience in a similar business, then they may have had less of a chance to acquire the skills that are specific to a type of work or industry that are useful for running a successful business. Black business owners may also have less prior management experience than white business owners. The results from our regression analysis, however, do not provide clear evidence on the effects of having prior work experience in a managerial capacity on business outcomes.

Table 4.2 reports estimates of the percentage of black and white firms with owners who previously worked in a business with similar goods and services and who have previous work experience in a managerial capacity. Black business owners have less work experience in a similar business prior to starting or acquiring their businesses than whites. Half of all white business owners have this type of work experience, compared with 43.1 percent of black business owners. The dif-

Table 4.2
Types of prior work experience by race, Characteristics of Business Owners (1992)

	All Firms	White-Owned Firms	Black-Owned Firms
Previously worked in a business with similar goods/ services	50.1%	50.4%	43.1%
Previous work experience in a managerial capacity	55.2%	55.6%	47.1%
Sample size	38,020	15,872	7,565

Notes: (1) The sample includes businesses that are classified by the IRS as individual proprietorships or self-employed persons, partnerships, and subchapter S corporations, have sales of $500 or more, and have at least one owner who worked at least twelve weeks and ten hours per week in the business. (2) All estimates are calculated using sample weights provided by the Characteristics of Business Owners.

ference in prior work experience at a business with similar goods and services may translate into black owners having less specific business human capital than white owners on average.

Black business owners are also less likely to have prior work experience in a managerial capacity than are white business owners. The percentage of black business owners with prior managerial experience is 47.1 percent compared with 55.6 percent for whites. Although there is a racial difference in managerial experience, the findings from our regression analysis in chapter 3 are mixed on the importance of this type of experience in predicting business success. Thus, it is difficult to predict whether lower levels of prior managerial experience among black business owners lead to worse outcomes relative to white businesses.

Financial Capital

An important limiting factor for the performance of black firms may be access to financial capital. Relatively low levels of wealth among blacks and the existence of liquidity constraints in U.S. financial markets may limit the ability of black entrepreneurs to raise the optimal levels of capital needed to start businesses. As discussed in chapter 2, there is evidence in the literature that low levels of assets among blacks are one of the major causes of low rates of business creation. Estimates from both the CPS and PSID indicate that roughly 15 percent of the white/black gap in business entry rates is due to wealth disparities (Fairlie 1999, 2006).

Very little previous research focuses on the related question of whether low levels of personal wealth and liquidity constraints also limit the ability of black entrepreneurs to raise startup capital. Undercapitalization likely leads to lower survivability, profits, employment, and sales. Indeed, we find in the previous chapter that the level of startup capital is a strong predictor of business success. If startup capital levels are influenced by entrepreneurial wealth, then a strong link between racial inequality in wealth and racial disparities in business outcomes is expected. Related to this issue and potentially exacerbating the problem is that black entrepreneurs may face discrimination in the lending market, which would also limit their ability to invest in their businesses.

Racial inequality in wealth may also have an effect on the continuing success of businesses. If business owners cannot freely borrow to offset periods of low sales, then those owners with fewer financial resources may be more likely to close. In addition, access to personal or family wealth may allow owners to avoid potential liquidity constraints in expanding existing businesses. Even if black business owners are able to obtain adequate startup capital, future limitations in accessing financial capital may result in less successful businesses.

Some suggestive evidence on racial differences in access to financial capital is provided by published estimates from the CBO (U.S. Census Bureau 1997). The CBO questionnaire asks owners with unsuccessful businesses from 1992 to 1996 why their businesses were unsuccessful. Black business owners are twice as likely as all business owners to report "lack of access to business loans/credit" as a reason for closure (16.2 percent compared with 8.3 percent). They are also nearly three times more likely than all business owners to report "lack of access to personal loans/credit" as a reason for closure (8.8 percent compared with 3.3 percent). Capital constraints appear to be more relevant for black entrepreneurs than for white entrepreneurs.

To further explore this hypothesis, we first document and discuss the causes of racial differences in wealth in the United States. We next review the findings from the literature on lending discrimination against black-owned businesses. Finally, we present estimates of black/white differences in startup capital from the CBO. We argue that racial differences in startup capital capture racial differences in access to capital. Low levels of startup capital invested in black-owned businesses partly reflect racial inequality in personal and family wealth and may also result from discrimination in the lending market.

Black/White Differences in Wealth

Racial inequality in the accumulation of wealth in the United States stands in stark contrast to wage and earnings inequality. For example, median weekly earnings for full-time black workers are 80 percent of median weekly earnings of full-time white workers (U.S. Bureau of Labor Statistics 2004). The median net worth of whites, on the other hand, is nearly eleven times higher than the median net worth of blacks (see table 4.3). The median level of net worth, defined as the current value of all assets minus all liabilities on those assets, for black households is only slightly more than $6,000. Remarkably, that estimate implies that if you add home equity, savings, retirement accounts, mutual fund accounts, and other assets, 50 percent of all black households in the United States have less than $6,166 in net worth. The median level of net worth among white households is $67,000. Large racial dif-

Table 4.3
Median value of assets for households by race, U.S. Census Bureau Estimates (1983 to 2000)

	Total	White	White non-Latino	Black
1983	$32,667	$39,135		$3,397
1988	$35,752	$43,279		$4,169
1991	$36,623	$44,408		$4,604
1993	$37,587	$45,740		$4,418
1995	$40,200	$49,030		$7,073
1998	$41,681	$52,301	$59,700	$5,490
2000	$46,506	$58,716	$67,000	$6,166

Source: U.S. Census Bureau estimates from various years of the Survey of Income and Program Participation.

ferences in net worth are also found using other datasets and within age groups, education levels, and marital statuses (Blau and Graham 1990; Oliver and Shapiro 1995; Scholz and Levine 2004; Altonji and Doraszelski 2001).

Examining the full distribution of wealth reveals a more pronounced inequality than what is revealed by a comparison of medians (figure 4.3). Forty-five percent of blacks have net worth of less than $5,000. Less than one fifth of all whites have net worth below this level. At the top of the distribution, only 2.7 percent of blacks have a value of net worth that is at least $250,000. Among whites, 22.2 percent have values of net worth in this range. Comparing asset distributions makes it strikingly clear: most blacks have very low levels of wealth, and relatively few have high levels of wealth when compared with whites.

The single largest asset held by most households is their home. Estimates of home ownership reported in table 4.4 indicate that only 46.8 percent of all black households own their own homes. For whites, 73.0 percent own their own home. Among home owners, blacks have much less equity in their homes than whites. The median home equity among black homeowners is $35,000, whereas the median home equity among white homeowners is $64,200. Blacks are clearly less likely to own their own homes, and among those who own a home, they have less equity in their homes. This is due to a combination of lower home values and lower equity/debt ratios in their homes.

Estimates from the SIPP indicate that wealth inequality has decreased only slightly in the past two decades. In 1983, the white/

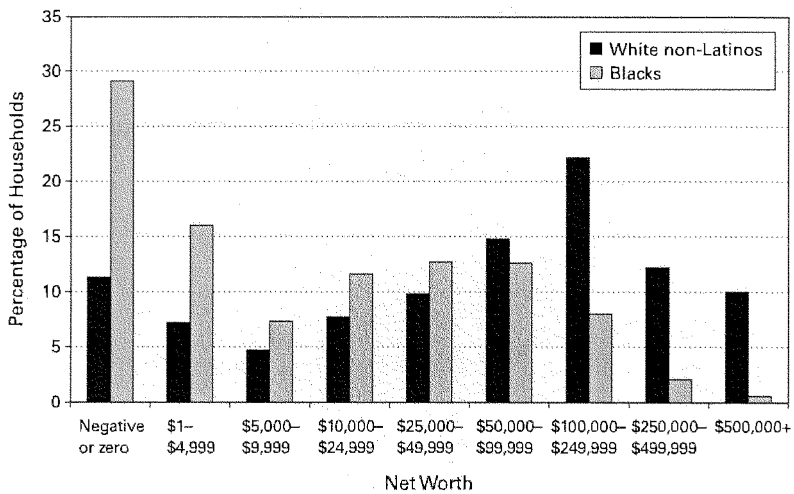


Figure 4.3
Distribution of net worth by race, U.S. Census Bureau Estimates, Survey of Income and Program Participation (2000)

Table 4.4
Home ownership and median home equity by race, U.S. Census Bureau Estimates from the Survey of Program and Income Participation (2000)

	Total	White non-Latino	Black
Percentage with own home	67.2%	73.0%	46.8%
Median equity in own home among homeowners	$59,000	$64,200	$35,000

Source: U.S. Census Bureau estimates from various years of the Survey of Income and Program Participation.

black ratio of median asset levels was 11.5. By 2000, the ratio dropped to 9.5. However, some of this decrease may have been due to the large increase in the white Latino population in the 1980s and 1990s. Latinos have very low levels of net worth, which are only slightly higher than black levels. If white non-Latinos are used to calculate the white/black ratio of median net worth, we find a ratio of 10.9. In either case, racial wealth inequality is extremely large and does not appear to be disappearing quickly.

As expected, a large percentage of the racial gap in wealth accumulation is due to differences in permanent or lifetime income, family composition, and other demographic characteristics. Income differences between blacks and whites alone explain a large part of the gap (Scholz and Levine 2004). Racial differences in inheritances and gifts also appear to contribute to the wealth gap measured in mean levels (Menchik and Jianakoplos 1997; Gittleman and Wolff 2004; Avery and Rendall 1997, 2002). The contribution to the racial gap in median levels of net worth is likely to be smaller, however, as most households do not receive inheritances (Scholz and Levine 2004). Other types of intergenerational transfers may also be important in contributing to the racial wealth gap. Racial differences in parental wealth explain part of the wealth gap (Conley 1999). Charles and Hurst (2002) find that 42 percent of white families receive assistance from their family for a down payment on a home compared with only 10 percent of black families.

Lower levels of asset accumulation among blacks may also be due to differences in investment types (Scholz and Levine 2004), lower rates of return on assets within asset types (Menchik and Jianakoplos 1997), and higher participation rates in welfare programs and public housing, which have asset restrictions. Finally, racial differences in self-employment partly explain racial differences in asset accumulation (Menchik and Jianakoplos 1997; Altonji and Doraszelski 2001). This finding, however, begs the question of whether self-employment increases asset accumulation or wealth increases self-employment as discussed in previous chapters.

The consequences of racial wealth inequality are severe. Low asset levels affect the ability of black families to smooth their consumption over fluctuations in income due to job loss and other negative labor-market outcomes. Wealth inequality also translates into political, social, residential, and educational inequality. Current asset levels, and not only current and future income, are important for home purchases and financing education. Through inheritances and intergenerational transfers, black/white wealth inequality is also transmitted to future generations.

Racial inequality in wealth is also likely to have negative consequences for business formation and success through its effects on access to financial capital. Clearly, lower levels of wealth among blacks are likely to translate into less access to startup capital. Business creation is often funded by owner's equity, and investors frequently require a substantial level of owner's investment of his or her own capital as an incentive and as collateral. Racial differences in home equity may be especially important in providing access to startup capital.

Homes provide collateral for business loans, and home equity loans can provide relatively low-cost financing.[3] Thus, lower levels of wealth can lead to inadequate access to financial capital, which in turn can both limit business creation and result in undercapitalized businesses.

Family Wealth

Lower levels of parental wealth may also limit access to financial capital for black entrepreneurs. Black families have less to pass on to their children through inheritances. This in turn will result in lower wealth holdings and access to startup capital among the current generation of blacks. The lower likelihood of receiving inheritances and the smaller amount of inheritances that are received may also have a direct effect on business success for blacks. The receipt of inheritances among business owners is associated with higher survival rates and higher sales among surviving businesses (Holtz-Eakin, Joulfaian, and Rosen 1994a).

Business owners also turn to family members for loans and equity financing. Family members may provide business loans with favorable terms. From the other side, investing in a child's, sibling's, or relative's business may be an attractive option because of the extra information and trust.

The CBO includes information on whether owners receive personal loans from family members to finance their business ventures.[4] Estimates from our CBO sample indicate that family loans are not a common source of startup capital among small business owners. Only 6.4 percent of all owners borrowed capital from their family for starting or acquiring the business. Furthermore, a similar percentage of black and white owners borrowed from their families. Given that startup capital levels are lower for black businesses as noted below, this implies that black owners borrow a smaller total amount from family members than white owners.

Bates (1997) provides estimates of borrowing startup capital from family members from the 1987 CBO. Among firms that borrow startup capital, he finds that 21.2 percent of black firms borrow from family members and that the average amount borrowed is $18,306. A larger percentage of white borrowers obtained loans from family members (26.8 percent) and for a higher average amount ($35,446). However, for capital needs of established firms, evidence from the SSBF paints a different picture. Over 10 percent of firms owned by blacks obtained loans from family and friends, compared with less than 6 percent of white-owned businesses (Bitler, Robb, and Wolken 2001).

Lower levels of family wealth among blacks may limit their ability to obtain sufficient startup capital or ongoing financing. Consequently, blacks may start fewer businesses, and for those black businesses that do start, they may be smaller than what would be optimal.[5] Thus, racial differences in family wealth may contribute to racial differences in business outcomes.

Lending Discrimination

An additional factor that might explain differing rates of startup capital by race is lending discrimination. Much of the recent research on the issue of discrimination in business lending uses data from the Survey of Small Business Finances (SSBF).[6] The main findings from this literature are that minority-owned businesses experience higher loan denial probabilities and pay higher interest rates than white-owned businesses even after controlling for differences in credit-worthiness and other factors (Cavalluzzo, Cavalluzzo, and Wolken 2002; Blanchflower, Levine, and Zimmerman 2003; Coleman 2002, 2003; Blanchard, Yinger, and Zhao 2004; Cavalluzzo and Wolken 2005; Robb and Fairlie 2006).

Using the 1993 National Survey of Small Business Finances (NSSBF), Cavalluzzo, Cavalluzzo, and Wolken (2002) find that black business owners are more likely than whites to have unmet credit needs and more likely to have been denied credit, even after controlling for many factors related to creditworthiness. Blanchflower, Levine, and Zimmerman (2003), using the 1993 SSBF and 1998 SSBF, find that blacks pay a higher interest rate on loans obtained. They also find that concerns over whether a loan application would be denied prevented some prospective borrowers from applying for a loan in the first place. The disparities between the denial rates between whites and blacks are greater when including these individuals with those that actually applied for a loan. Bostic and Lampani (1999) include additional geographic controls but also find a statistically significant difference in approval rates between blacks and whites.

Using the 1998 SSBF, Cavalluzzo and Wolken (2005) find substantial unexplained differences in loan denial rates between African American- and white-owned firms. They also find that while greater personal wealth is associated with a lower probability of denial, a large difference in denial rates between blacks and whites remains, even after controlling for personal wealth. Finally, they find that denial rates for blacks increase with lender-market concentration, which is consistent with Becker's (1971/1957) classic theories of discrimination.

Cavalluzzo and Wolken (2005) estimate the magnitude of contributions from group differences in characteristics to racial gaps in loan denial rates and find that group differences in credit history differences explain most of the difference in denial rates. When examining specific loan types, Mitchell and Pearce (2004) find that black firms faced significantly greater loan-denial probabilities than white-male-owned firms on both relationship bank loans and transaction bank loans.

Using the 1998 SSBF, Robb and Fairlie (2006) focus on more established businesses—those five years and older. They find that established black-owned business are still significantly less likely than white-owned businesses to be approved for loans, to pay a higher rate of interest on approved loans, and not to apply for credit when needed because of fear that the loan application would be denied. They also find that blacks are more likely than whites to be denied trade credit and to rely on credit cards for borrowing purposes. Older, more-established black-owned businesses appear to also face significant barriers in accessing financial capital.

Although it is difficult to prove without a doubt that lending discrimination exists, the evidence from the literature is consistent with the existence of continuing lending discrimination against black-owned firms. Black firms are more likely to be denied loans and pay higher interest rates and are less likely to borrow from banks for startup or continuing capital. Lending discrimination may have a direct effect on business outcomes because it limits access to loans that can help a business "weather a storm" or diversify into new products or markets.

Although most of the evidence from this literature focuses on existing black businesses, lending discrimination may also severely limit access to startup capital, discouraging would-be minority entrepreneurs and jeopardizing the scale and longevity of their businesses.

Differential Types of Financing

Black and white entrepreneurs differ in the types of financing they use for their businesses. Although these differences are likely to be caused by many factors, they may be partly due to differences in personal wealth and lending discrimination. Focusing on startup capital differences, there is evidence of less use of banks by black entrepreneurs for startup capital. Published estimates from the CBO indicate that only 6.6 percent of black firms received business loans from banking or commercial lending institutions (see table 4.5). Nearly twice that

Table 4.5
Sources of borrowed and equity capital by race, Characteristics of Business Owners (1992)

	Percentage		
	All Firms	White-Owned Firms	Black-Owned Firms
Sources of borrowed capital for owner:			
Personal loan using home mortgage/equity line of credit	5.0%	5.0%	3.5%
Personal credit card	3.0	2.9	3.8
Personal loan from spouse	1.2	1.1	1.5
Personal loan from family	6.1	5.8	4.6
Other personal loan	7.1	7.1	5.6
Sources of nonborrowed capital for owner:			
None (100 percent borrowed capital)	6.6	6.8	4.4
Use of owner's personal/family physical assets (building, motor vehicle, equipment, etc.)	18.5	19.1	14.1
Proceeds from the sale of owner's personal assets	2.5	2.4	1.7
Owner's personal/family savings	40.7	40.5	35.1
Other source	3.9	3.7	7.7
Sources of borrowed capital for firm:			
Business loan from banking or commercial lending institution	11.7	12.1	6.6
Government-guaranteed business loan from banking or commercial lending institution	0.4	0.4	0.7
Business loan from federal, state, or local government	0.3	0.3	0.3
Business loan from investment company/profit or nonprofit private source	0.6	0.6	0.5
Business loan from previous owner	1.9	1.9	0.6
Business trade credit from supplier	0.9	0.9	0.6
Other business loan	1.6	1.6	0.9

Source: Characteristics of Business Owners (1992) are reported in U.S. Census Bureau (1997).
Notes: (1) The sample includes businesses that are classified by the IRS as individual proprietorships or self-employed persons, partnerships, and subchapter S corporations and that have sales of $500 or more. (2) White category is equal to the total minus all minority groups. (3) More than one source of capital can be reported for each firm.

percentage of white firms received bank loans for startup capital. Blacks are also less likely to use a home equity line for startup capital than are whites, which may be partly due to the lower rates of home ownership reported above. Blacks are also less likely than whites to use equity or nonborrowed sources of startup capital and to have loans from other sources (except government-backed loans). On the other hand, black business owners are more likely to use credit cards for startup funds than are white business owners.[7]

In studies using the 1987 CBO, Bates (1997, 2005) conducts a thorough comparison of differences between black and white firms in their use of startup capital. Bates finds that black firms were more likely to start with no capital, less likely to borrow startup capital, and more likely to rely solely on equity capital than white-owned firms. In his sample of male-owned firms started in the past ten years, he finds that 29 percent of black firms used borrowed funds for startup capital compared with 37 percent of white firms. Focusing on startup funding from financial institutions, he also finds that black-owned firms receive less in startup capital from banks on average than white-owned firms. Among firms borrowing startup capital, he estimates that the average black firm borrowed $31,958 from financial institutions compared with $56,784 for white firms.

Bates also explores whether disparities in levels of startup capital are partly due to differences in equity startup capital. He finds that black firms receive $2.69 per dollar of equity capital invested in loans from financial institutions. This is lower than the $3.10 per dollar of equity investment for white firms. After controlling for other owner and business characteristics, he finds a roughly similar-sized difference between black and white debt per equity dollar invested. These differences are not large, however, suggesting that an important hurdle to obtaining loans from financial institutions for black entrepreneurs is low levels of equity financing in addition to differential treatment by financial institutions (Bates 2005). In fact, from a pooled sample of black and white firms, Bates (2005) finds that loans received by black firms borrowing startup capital are significantly smaller than those received by white firms even after controlling for equity capital and owner and business characteristics such as education and industry. Racial differences in personal wealth, which are not measured in the CBO, may be a key factor in explaining the remaining black/white differences in business loans.

For older, more established firms, these racial differences in financing patterns continue. Using data from the 1998 SSBF, Robb and Fairlie (2006) find that black firms are less likely than white firms to have credit lines, equipment loans, business mortgages, motor vehicle loans, or trade credit. They are also less likely to use business credit cards, use personal credit cards for business purposes, or hold checking accounts. In fact, the only types of loans that they hold more frequently than white firms are capital leases and a catch-all category of "other" loans. Blacks are more likely than whites to borrow through the use of credit cards and trade credit (carrying balances on those lines of credit and paying interest on those balances), which often have higher interest rates than conventional loans.

Overall, these racial differences in types of financing for startup or continuing capital may be the result of many different factors. For example, we cannot rule out the possibility that the lower likelihood of acquiring capital from financial institutions among black businesses is due to a lower evaluated probability of success for these businesses. However, the patterns are consistent with large racial differences in personal wealth and lending discrimination.

Racial Differences in Startup Capital

Black-owned businesses have very low levels of startup capital relative to white-owned businesses (figure 4.4). Fewer than 2 percent of black firms start with $100,000 or more of capital, and 6.5 percent have between $25,000 and $100,000 in startup capital. Nearly two thirds of black businesses have less than $5,000 in startup capital. Although a large percentage of white firms also start with little capital, a higher percentage of white firms start with large amounts of capital than black firms.

Racial disparities in startup capital may reflect differences in the potential success of firms and thus ability to raise capital by firms. In other words, some black entrepreneurs may have difficulty raising capital because their businesses are predicted to be less likely to succeed. If so, banks and other investors will rationally decline to invest in these businesses. Of course, an alternative explanation is that black business owners invest less startup capital in their businesses because they have less access to capital. This may be due to having lower levels of personal and family wealth to borrow against or use as equity financing but may also be due to lending discrimination. Evidence favoring these

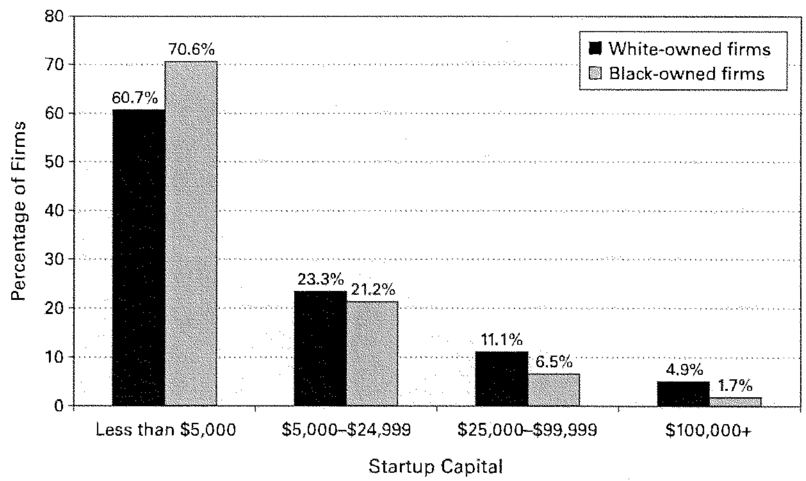


Figure 4.4
Startup capital by race, Characteristics of Business Owners (1992)

explanations is provided by the finding that black-owned firms have lower levels of startup capital across all major industries (U.S. Census Bureau 1997). Thus, racial disparities in startup capital do not simply reflect racial differences in the industries of these firms. In addition, the finding that personal wealth decreases the probability that an existing firm is denied a loan is consistent with racial disparities in wealth contributing to racial differences in startup capital.

What are the likely consequences of these racial disparities in startup capital? The literature on minority business ownership provides evidence that access to financial capital limits opportunities for blacks to start businesses as discussed in chapter 2. A much smaller literature indicates that racial differences in wealth or startup capital affect business success. Using earlier CBO data, Bates (1989, 1994, 1997) finds evidence that black-owned businesses have substantially lower levels of startup capital than white-owned businesses. He also finds that startup capital levels are strongly positively associated with business survival. These two findings indicate that racial disparities in startup capital contribute to racial differences in survival.

Robb (2000) provides additional evidence on the importance of startup capital using employer firms from the 1992 CBO linked to the 1992 to 1996 Business Information Tracking Series (BITS). Estimates from regression models indicate that the level of startup capital has a negative and statistically significant effect on the probability of business closure. Black-employer firms are also found to have substantially lower levels of startup capital than white-employer firms. Thus, racial disparities in the amount of capital used to start the business result in higher closure rates among black-employer firms relative to white-employer firms.

Our estimates also indicate that racial disparities in startup capital contribute to worse outcomes among black-owned businesses. In the multivariate regressions reported in chapter 3, we find a strong positive relationship between startup capital and business success. Higher levels of startup capital are associated with lower closure probabilities, higher profits, more employment, and higher sales. In addition, estimates from the 1992 CBO indicate that blacks have substantially lower levels of startup capital. Thus, black/white differences in startup capital appear to contribute to racial disparities in business outcomes. What we do not know from these findings, however, is how much these racial differences in startup capital contribute to differences in business outcomes relative to racial differences in other factors such as education, business human capital, and family-business backgrounds.

Using individual-level data, Fairlie (1999, 2006) provides some evidence on this question. Focusing on the causes of the higher annual rate of exit from self-employment for blacks than whites, estimates from the CPS indicate that racial differences in personal wealth explain 7.3 percent of the gap. Estimates from the PSID indicate that 1.8 to 11.1 percent of the male black/white gap in exit rates from self-employment is explained by differences in asset levels. The use of individual-level data, the focus on transitions out of self-employment, and the inclusion of personal wealth, however, make it difficult to draw conclusions about whether racial disparities in access to startup capital contribute to racial differences in business outcomes. The decompositions estimated below provide evidence on the relative importance of racial differences in startup capital to racial disparities in business outcomes.

Industry Differences

Racial differences in industry distributions may also contribute to differences between blacks and whites in small business outcomes. Some industries, most notably retail and services, have higher business turnover rates than others (Robb 2000; Reynolds and White 1997). Those

Table 4.6
Industry distribution by race, Characteristics of Business Owners (1992)

	White-Owned Firms	Black-Owned Firms
Agricultural services	2.7%	1.7%
Construction	12.5%	7.1%
Manufacturing	3.4%	1.7%
Wholesale trade	3.6%	1.1%
Retail trade	14.7%	14.5%
Finance, insurance, and real estate	10.1%	6.1%
Transportation, communications, and public utilities	3.9%	8.5%
Personal services	25.9%	32.8%
Professional services	19.3%	20.8%
Uncoded industry	3.9%	5.7%
Sample size	15,872	7,565

Notes: (1) The sample includes businesses that are classified by the IRS as individual proprietorships or self-employed persons, partnerships, and subchapter S corporations, have sales of $500 or more, and have at least one owner who worked at least twelve weeks and ten hours per week in the business. (2) All estimates are calculated using sample weights provided by the Characteristics of Business Owners.

with higher capital requirements for entry, such as manufacturing and wholesale, typically have lower turnover rates. Estimates from the CBO reported in chapter 3 indicate differences in business outcomes across industries, although the differences are somewhat mixed in the regression models that control for other owner and firm characteristics. One consistent result, however, is that firms in personal services have worse outcomes.

Black and white firms concentrate in different industries. Table 4.6 reports estimates of industry distributions by race from CBO microdata. Black firms are underrepresented in construction, manufacturing, wholesale trade, agricultural services and finance, insurance, and real estate relative to white firms. Black firms are more concentrated in transportation, communications and public utilities, and personal services than white firms. These industries generally have worse business outcomes than the previous industries, but as noted above the regression results provide mixed evidence on which industries are associated with worse outcomes.

Black and white firms may concentrate in different industries for several reasons. First, capital constraints may limit which industries an individual can enter due to higher capital requirements of certain industries (Bates 1997). In addition, industry choice may be constrained due to a lack of relevant skills and discrimination (Boden 1996; Boden and Nucci 2002; Robb 2000). Discrimination may occur directly in self-employment through limited opportunities to penetrate networks, such as those in construction (Bates 1993a; Feagin and Imani 1994; Bates and Howell 1997). While differences in entrepreneurial ability may lead to different choices of industries, differences in industry concentrations may simply reflect differences in preferences.

Overall, the estimates presented here suggest that black/white differences in industry distributions may contribute to racial differences in business outcomes. However, these industry differences may result from different constraints, preferences or abilities, which affect the interpretation of our results. A concern is that industry choice may simply be a measure of business success, implying that black firms have limited entry into certain industries because they are less successful and not because the industry concentration of black firms leads to less success.

Identifying the Causes of Black/White Differences in Business Outcomes

The estimates reported above indicate that black business owners have less family-business experience, lower levels of education, and lower levels of startup capital than white business owners and differ along several additional dimensions. These owner and firm characteristics are important determinants of small business outcomes. Taken together, these results suggest that racial differences in family-business background, education, and startup capital contribute to why black-owned businesses have worse outcomes on average than white-owned businesses. The impact of each factor, however, is difficult to summarize. In particular, we want to identify the separate contributions from racial differences in the variables included in the regressions.

The most common approach used to quantify these contributions is the technique of decomposing racial differences in mean levels of an outcome into those due to different observable characteristics or "endowments" between racial groups and those due to different effects of characteristics or "coefficients" of groups. The technique is commonly attributed to Blinder (1973) and Oaxaca (1973). The Blinder-Oaxaca decomposition technique is especially useful for identifying and quantifying the separate contributions of group differences in measurable characteristics, such as education, experience, and geographical location, to racial gaps in outcomes. The technique is easy to apply and requires only coefficient estimates from linear regressions for the outcome of interest and sample means of the independent variables used in the regressions. We use this technique for the log sales specification, which is estimated using a linear regression.

The Blinder-Oaxaca technique, however, cannot be used without modification to decompose racial differences in the three other outcomes—closure, profits, and employment. This is because each of these business outcomes is binary (they take on the values of either 0 or 1), and their specifications are estimated with logit regressions instead of linear regressions. Instead, we use a decomposition technique that takes into account the nonlinearity of the logit regressions used to estimate the other outcomes. This technique is described in the appendix to this chapter and Fairlie (1999, 2005) in more detail.

Table 4.7 reports estimates from this procedure for decomposing the black/white gaps in small business outcomes (see also Fairlie and Robb 2007). We first discuss the results for the more simplified model that does not include startup capital or industry. The underlying regression estimates are taken from table 3.5, and the means for black and white firms are reported in table 4.A. The separate contributions from racial differences in each set of independent variables are reported. As noted above, the black/white gaps in small business outcomes are large. Black firms are more likely to close and have lower profits, employment, and sales than white firms. Racial differences in the male/female ownership of the firm contribute significantly to the gaps in small business outcomes. The large contributions are the result of a higher percentage of black-owned firms than white-owned firms also being female-owned and of female-owned firms having lower business outcomes than male-owned businesses, on average. Similar to the previous chapter, we calculate separate decompositions by gender and discuss the results below.

Lower marriage rates among blacks also contribute to the black/white gaps in small business outcomes. Sixty-eight percent of black owners are married compared with 77 percent of white owners. Spousal income may act as a buffer against downturns in sales for the business and allow the owner to stay in business longer.

Although racial disparities in education are smaller for business owners than for the general population, low levels of education among

Table 4.7
Decompositions of black/white gaps in small business outcomes, Characteristics of Business Owners (1992)

	Specification			
	(1)	(2)	(3)	(4)
Dependent variable	Closure	Profits	Employer	Ln Sales
Black mean	0.2696	0.1410	0.1121	9.4241
White mean	0.2282	0.3004	0.2067	10.0680
Black/white gap	−0.0414	0.1594	0.0946	0.6439
Contributions from racial differences in:				
Sex	−0.0032	0.0253	0.0083	0.0689
	7.7%	15.9%	8.8%	10.7%
Marital status	−0.0037	0.0044	0.0042	0.0166
	8.9%	2.8%	4.4%	2.6%
Education	−0.0027	0.0056	0.0023	0.0156
	6.5%	3.5%	2.4%	2.4%
Region	−0.0033	0.0032	−0.0050	0.0139
	8.0%	2.0%	−5.3%	2.2%
Urban	−0.0026	−0.0060	0.0051	−0.0154
	6.3%	−3.8%	5.4%	−2.4%
Prior work experience	0.0011	−0.0017	−0.0008	−0.0011
	−2.7%	−1.1%	−0.8%	−0.2%
Prior work experience in a managerial capacity	0.0061	0.0016	0.0042	0.0178
	−14.7%	1.0%	4.4%	2.8%
Prior work experience in a similar business	−0.0025	0.0036	0.0017	0.0277
	6.0%	2.3%	1.8%	4.3%
Have a self-employed family member	−0.0037	0.0017	−0.0004	−0.0070
	8.9%	1.1%	−0.4%	−1.1%
Prior work experience in a family member's business	−0.0048	0.0027	0.0053	0.0412
	11.6%	1.7%	5.6%	6.4%
Inherited business	−0.0002	0.0005	0.0002	0.0021
	0.5%	0.3%	0.2%	0.3%
All included variables	−0.0200	0.0409	0.0251	0.1910
	48.3%	25.7%	26.5%	29.7%

Notes: (1) The samples and regression specifications are the same as those used in table 3.5. (2) Contribution estimates are mean values of the decomposition using 1,000 subsamples of whites. See text for more details.

black business owners relative to white business owners appear to have a negative effect on business outcomes. As noted above, the differences are large. For example, 27 percent of black business owners have a college education compared with 33 percent of white business owners. These educational differences, however, do not translate into very large effects: racial differences in the education level of the owner explain from 2.4 to 6.5 percent of the black/white gaps in business outcomes. Black business owners are less educated on average than are white business owners, but these educational differences do not appear to be an extremely large hindrance to operating successful businesses.

Although black-owned businesses have a different regional distribution and are more likely to be located in urban areas than are white-owned businesses, racial differences in geographical locations do not appear to contribute substantially to the gaps in small business outcomes. Racial differences in the amount of prior work experience and management experience have either small effects or mixed effects on gaps in the different business outcomes.

As reported in table 4.1, black business owners are much less likely to have a self-employed family member than are white business owners. This difference, however, does not contribute to racial disparities in profits, employment, and sales. The only exception is that racial differences in having a self-employed family member explain about 9 percent of the black/white gap in closure rates. The contribution of group differences in parental self-employment to racial differences in small business outcomes appears to be smaller than the contribution to rates of self-employment and entry into self-employment. Estimates from the PSID indicate that racial differences in the probability of having a self-employed father explain 8 to 14 percent of the black/white gap in the entry rate into self-employment and 4 to 6 percent of the gap in the self-employment rate (Fairlie 1999).

The explanatory power of racial differences in prior work experience in a family member's business is stronger. With the exception of the profits specification, racial differences in this variable explain 5.6 to 11.6 percent of the black/white gaps in small business outcomes. Apparently, the lack of work experience in family businesses among future black business owners, perhaps by restricting their acquisition of general and specific business human capital, limits the successfulness of their businesses relative to whites.

Racial differences in prior work experience in a business providing similar goods and services consistently explain a small part of the gaps in outcomes. Although the coefficient estimates in the small business outcome regressions are generally similar in magnitude to coefficient estimates on the family-business work-experience variable, the contributions from racial differences are somewhat smaller. The racial disparity in the percentage of owners who worked in a family member's business is larger than the disparity in the percentage of owners who worked in a business with similar goods and services. Black owners appear to acquire less specific business human capital from working in similar business prior to starting their own businesses.

Black-owned businesses are less likely to be inherited than white-owned businesses, and inherited businesses are generally more successful than noninherited businesses, but racial differences in business inheritances explain virtually none of the gaps in small business outcomes. The overall likelihood of business inheritances (1.6 percent) is too small to play a major role in explaining racial differences in business outcomes.

This finding is interesting in light of the finding in the literature that blacks are less likely to receive inheritances and typically receive much smaller inheritances than whites. As noted above, there is recent evidence suggesting that the lack of inheritances among blacks is an important factor explaining why blacks have asset levels that are substantially lower than white levels (Menchik and Jianakoplos 1997; Gittleman and Wolff 2000; Avery and Rendall 1997, 2002). Furthermore, the receipt of inheritances is a major determinant of starting and remaining in business (Holtz-Eakin, Joulfaian, and Rosen 1994a, 1994b; Blanchflower and Oswald 1998), suggesting that lower levels of inheritances among blacks contribute to lower rates of business ownership. With regard to business inheritances, however, they are apparently not very important in explaining differences in business outcomes.

Differences between Male and Female Business Owners

We also investigate whether the causes of racial differences in business outcomes are similar for male- and female-owned businesses. As noted in chapter 3, male firms tend to have lower closure rates, higher profit rates, higher employer rates, and more sales than female firms. In terms of owner characteristics, however, there are many similarities between the sexes. We also found that estimates from separate sets of business outcome regressions that the determinants of business outcomes do not differ substantially between men and women. The remaining question then is whether the explanations for black/white disparities in business outcomes differ between male- and female-owned businesses.

Tables 4.8 and 4.9 report estimates from separate decompositions for racial differences in business outcomes for men and women, respectively. Mean characteristics are reported in table 4.10. Estimates from the CBO indicate that black firms have higher closure rates, have lower profits, are less likely to have employees, and have lower sales than white firms for both male- and female-owned businesses. These disparities in outcomes are large for both sexes.

Turning to the explanatory factors, we find that lower levels of education among blacks explain part of the gaps in business outcomes for men but not for women. In contrast, estimates from the decompositions indicate roughly similar patterns for the family-business-background variables. Racial differences in having a self-employed family member explain very little of the gaps in business outcomes, whereas having prior work experience in a family member's business explains part of the gaps. Racial differences in business inheritances explain virtually none of the gap for either men or women.

For additional explanatory factors, we find that racial differences in management experience continue to have inconsistent explanatory power across specifications. Racial differences in prior work experience in similar businesses contribute to the black/white gaps in business outcomes for men but not to the gaps for women. Racial differences in marital status explain a much larger portion of the disparities in business outcomes for women than for men. Black female business owners are less likely to be married than are white female business owners, and this marital status is associated with better business outcomes. The contribution estimates from racial differences in region and urban status are similarly inconsistent across specifications.

Overall, the decompositions indicate some differences in the results for men and women, but the main findings for the family-business-background variables are similar. Racial differences in prior work experience in family businesses explain part of the gaps in business outcomes, whereas racial differences in having self-employed family members and business inheritances have little explanatory power. We continue to group men and women in the remaining analyses. A more extensive analysis of these patterns, however, is beyond the scope of the current analysis.

Table 4.8
Decompositions of black/white gaps in small business outcomes for men, Characteristics of Business Owners (1992)

	Specification			
	(1)	(2)	(3)	(4)
Dependent variable	Closure	Profits	Employer	Ln Sales
Black mean	0.2496	0.1902	0.1310	9.6709
White mean	0.2189	0.3661	0.2311	10.3259
Black/white gap	−0.0306	0.1759	0.1001	0.6550
Contributions from racial differences in:				
Marital status	−0.0005	0.0007	0.0004	−0.0034
	1.7%	0.4%	0.4%	−0.5%
Education	−0.0065	0.0086	0.0038	0.0315
	21.1%	4.9%	3.8%	4.8%
Region	−0.0009	0.0020	−0.0024	0.0265
	3.0%	1.1%	−2.4%	4.1%
Urban	−0.0032	−0.0067	0.0059	−0.0141
	10.5%	−3.8%	5.9%	−2.1%
Prior work experience	0.0000	−0.0034	−0.0005	−0.0023
	0.0%	−1.9%	−0.5%	−0.4%
Prior work experience in a managerial capacity	0.0094	0.0023	0.0047	0.0206
	−30.7%	1.3%	4.7%	3.2%
Prior work experience in a similar business	−0.0040	0.0067	0.0022	0.0355
	13.2%	3.8%	2.2%	5.4%
Have a self-employed family member	−0.0002	0.0017	−0.0001	−0.0113
	0.7%	1.0%	−0.1%	−1.7%
Prior work experience in a family member's business	−0.0057	0.0016	0.0052	0.0416
	18.5%	0.9%	5.2%	6.4%
Inherited business	−0.0003	0.0006	0.0014	0.0057
	0.8%	0.4%	1.4%	0.9%
All included variables	−0.0119	0.0142	0.0206	0.1304
	38.8%	8.1%	20.5%	19.9%

Notes: (1) The samples and regression specifications are the same as those used in table 3.8. (2) Contribution estimates are mean values of the decomposition using 1,000 subsamples of whites. See the text for more details.

Table 4.9
Decompositions of black/white gaps in small business outcomes for women, Characteristics of Business Owners (1992)

	Specification			
	(1)	(2)	(3)	(4)
Dependent variable	Closure	Profits	Employer	Ln Sales
Black mean	0.2968	0.0767	0.0865	9.0901
White mean	0.2475	0.1693	0.1563	9.5221
Black/white gap	−0.0494	0.0926	0.0697	0.4321
Contributions from racial differences in:				
Marital status	−0.0120 24.2%	0.0061 6.6%	0.0091 13.0%	0.0364 8.4%
Education	0.0048 −9.8%	0.0024 2.6%	−0.0001 −0.2%	0.0183 4.2%
Region	−0.0070 14.1%	0.0038 4.1%	0.0007 1.0%	−0.0040 −0.9%
Urban	0.0001 −0.2%	−0.0054 −5.8%	0.0030 4.3%	−0.0189 −4.4%
Prior work experience	0.0016 −3.2%	−0.0016 −1.7%	−0.0022 −3.2%	−0.0047 −1.1%
Prior work experience in a managerial capacity	0.0012 −2.5%	0.0007 0.7%	0.0046 6.6%	0.0103 2.4%
Prior work experience in a similar business	0.0002 −0.5%	−0.0003 −0.4%	−0.0002 −0.2%	0.0078 1.8%
Have a self-employed family member	−0.0122 24.6%	0.0025 2.7%	−0.0010 −1.4%	−0.0005 −0.1%
Prior work experience in a family member's business	0.0003 −0.7%	0.0045 4.8%	0.0050 7.2%	0.0353 8.2%
Inherited business	0.0006 −1.2%	0.0002 0.2%	−0.0017 −2.4%	−0.0050 −1.2%
All included variables	−0.0222 44.9%	0.0128 13.9%	0.0171 24.6%	0.0752 17.4%

Notes: (1) The samples and regression specifications are the same as those used in table 3.9. (2) Contribution estimates are mean values of the decomposition using 1,000 subsamples of whites. See the text for more details.

Table 4.10
Means of selected variables by gender, Characteristics of Business Owners (1992)

	Male		Female	
	White-Owned Firms	Black-Owned Firms	White-Owned Firms	Black-Owned Firms
Firm no longer operating in 1996 (closure)	0.2189	0.2496	0.2475	0.2968
Net profit of at least $10,000	0.3661	0.1902	0.1693	0.0767
One or more paid employees	0.2311	0.1310	0.1563	0.0865
Log sales	10.3319	9.6719	9.5245	9.09
Female-owned business	0.0000	0.0000	1.0000	1.0000
Married	0.7850	0.7240	0.7540	0.5750
Never married	0.1014	0.0892	0.1040	0.1293
High school graduate	0.2678	0.2135	0.2597	0.2357
Some college	0.3013	0.3384	0.3350	0.3476
College graduate	0.1864	0.1150	0.2165	0.1484
Graduate school	0.1450	0.1490	0.1153	0.1366
Northeast	0.0665	0.0191	0.0597	0.0198
Midatlantic	0.1493	0.1368	0.1420	0.1244
East North Central	0.1699	0.1347	0.1598	0.1479
West North Central	0.0861	0.0353	0.0817	0.0299
South Atlantic	0.1501	0.3215	0.1794	0.3319
East South Central	0.0519	0.0892	0.0517	0.0656
West South Central	0.1031	0.1496	0.0934	0.1371
Mountain	0.0650	0.0168	0.0713	0.0156
Urban	0.7251	0.8756	0.7556	0.9040
Prior work experience: 1 year	0.0673	0.0785	0.0776	0.0539
Prior work experience: 2 to 5 years	0.1651	0.1536	0.1621	0.1451
Prior work experience: 6 to 9 years	0.1525	0.1500	0.1471	0.1372
Prior work experience: 10 to 19 years	0.2936	0.3096	0.3047	0.3206
Prior work experience: 20 years or more	0.2661	0.2396	0.2407	0.2389
Prior work experience in a managerial capacity	0.5707	0.4776	0.5231	0.4594
Prior work experience in a similar business	0.5420	0.4611	0.4226	0.4005
Have a self-employed family member	0.5289	0.3257	0.5113	0.3249
Prior work experience in a family member's business	0.2514	0.1392	0.2019	0.1092
Inherited business	0.0157	0.0109	0.0130	0.0162
Startup capital: $5,000 to $24,999	0.2596	0.2403	0.1919	0.1710
Startup capital: $25,000 to $99,999	0.1188	0.0780	0.0904	0.0463
Startup capital: $100,000 and over	0.0520	0.0187	0.0383	0.0143
Agricultural services	0.0312	0.0250	0.0176	0.0074
Construction	0.1712	0.1116	0.0351	0.0176

Table 4.10
(continued)

	Male		Female	
	White-Owned Firms	Black-Owned Firms	White-Owned Firms	Black-Owned Firms
Manufacturing	0.0352	0.0189	0.0281	0.0142
Wholesale	0.0388	0.0132	0.0302	0.0087
FIRE	0.0949	0.0598	0.1097	0.0616
Trans., communications, and public utilities	0.0459	0.1229	0.0240	0.0309
Personal services	0.2367	0.3287	0.3071	0.3280
Professional services	0.1771	0.1541	0.2269	0.2767
Uncoded industry	0.0407	0.0575	0.0364	0.0569
Sample size	7,425	4,588	6,857	2,243

Notes: (1) The sample includes businesses that are classified by the IRS as individual proprietorships or self-employed persons, partnerships, and subchapter S corporations, have sales of $500 or more, and have at least one owner who worked at least twelve weeks and ten hours per week in the business. (2) All estimates are calculated using sample weights provided by the CBO.

Contributions from Startup Capital and Industry Differences

Table 4.11 reports the results of decompositions that include startup capital and industry. We exclude these variables from the first set of decompositions because of concerns over endogeneity as discussed in chapter 3. The regression estimates are taken from table 3.14.

Black-owned firms clearly have less startup capital than white-owned firms. For example, 8 percent of black-owned businesses had at least $25,000 in startup capital compared with nearly 16 percent of white-owned businesses. These racial differences in startup capital explain a substantial portion of the black/white gaps in small business outcomes. The contribution estimates range from 14.5 to 43.2 percent for the different outcomes. Clearly, lower levels of startup capital among black-owned firms are associated with less successful businesses. These lower levels of startup capital are likely to be related to difficulty in obtaining funding because of low levels of personal wealth and possibly lending discrimination. Black levels of wealth are one eleventh white levels. The result is that black/white differences in startup capital are the single most important factor in explaining racial differences in business outcomes.

Black-owned businesses appear to be overrepresented in less successful industries relative to white-owned businesses. Racial differences

Table 4.11
Decompositions of black/white gaps in small business outcomes, Characteristics of Business Owners (1992)

	Specification			
	(1)	(2)	(3)	(4)
Dependent variable	Closure	Profits	Employer	Ln Sales
Black mean	0.2692	0.1414	0.1116	9.4221
White mean	0.2288	0.3003	0.2065	10.0615
Black/white gap	−0.0404	0.1590	0.0948	0.6394
Contributions from racial differences in:				
Sex	−0.0019	0.0231	0.0060	0.0562
	4.7%	14.6%	6.3%	8.8%
Marital status	−0.0030	0.0055	0.0041	0.0118
	7.5%	3.5%	4.3%	1.8%
Education	−0.0031	0.0045	0.0013	0.0066
	7.8%	2.8%	1.4%	1.0%
Region	−0.0031	0.0035	0.0010	0.0160
	7.6%	2.2%	1.0%	2.5%
Urban	−0.0012	−0.0078	0.0021	−0.0277
	2.9%	−4.9%	2.2%	−4.3%
Prior work experience	0.0014	−0.0021	−0.0010	−0.0032
	−3.5%	−1.3%	−1.1%	−0.5%
Prior work experience in a managerial	0.0065	0.0005	0.0018	0.0035
capacity	−16.1%	0.3%	1.9%	0.5%
Prior work experience in a similar business	−0.0029	0.0042	0.0022	0.0277
	7.1%	2.6%	2.3%	4.3%
Have a self-employed family member	−0.0032	0.0001	0.0009	−0.0128
	7.8%	0.0%	1.0%	−2.0%
Prior work experience in a family member's	−0.0032	0.0019	0.0033	0.0246
business	7.9%	1.2%	3.4%	3.8%
Inherited business	−0.0001	0.0005	0.0000	0.0007
	0.1%	0.3%	0.0%	0.1%
Startup capital	−0.0175	0.0231	0.0350	0.1512
	43.2%	14.5%	36.9%	23.6%
Industry	−0.0083	0.0112	0.0092	0.0633
	20.5%	7.0%	9.7%	9.9%
All included variables	−0.0395	0.0683	0.0658	0.3179
	97.7%	42.9%	69.4%	49.7%

Notes: (1) The sample and regression specifications are the same as those used in table 3.14. (2) Contribution estimates are mean values of the decomposition using 1,000 subsamples of whites. See the text for more details.

in industry composition explain from 7.0 to 20.5 percent of the black/white gaps in small business outcomes. In particular, black-owned firms are more likely to be located in personal services, which have worse outcomes on average than other industries. These findings are consistent with Robb (2000). The results are difficult to interpret, however, because of the joint decision between business ownership and industry.

Overall, racial differences in the explanatory variables explain a large percentage of the total black/white gaps in small business outcomes. They explain nearly 50 percent of the racial gap in profits and employment and nearly 70 percent of the total gap in log sales. Nearly 100 percent of the black/white gap in business closure rates is explained by racial differences in the explanatory variables. Although we employed relatively parsimonious specifications focusing on well measured and less endogenous owner and firm characteristics, our models performed quite well in explaining racial disparities in business outcomes. These factors are likely to be several of the most important inputs into the production process of the firm.

Although the decompositions explain most of the black/white gaps in business outcomes, it is useful to consider the remaining or "unexplained" portion of the gaps. The "unexplained" portion of the racial gaps may be due to lending discrimination and consumer discrimination against black-owned firms, the omission of important unmeasurable factors such as risk aversion, or the inability to accurately measure racial differences in access to capital. We now briefly discuss some of these factors.

Other Potential Explanations: Consumer Discrimination

Although the decomposition technique reveals several explanations for black/white differences in business outcomes, we discuss a few additional explanations, which are difficult to identify using the technique or cannot be measured with the CBO. One potential explanation for the remaining racial differences in business outcomes is consumer discrimination against black-owned firms. Black firms may have difficulty selling certain products and services to nonblack customers limiting the size of their markets and resulting success. Discriminating customers could be individuals, other firms or the government. Using microdata from the 1980 Census, Borjas and Bronars (1989) explore whether the large variance in self-employment rates across racial groups are partly due to consumer discrimination. They find that blacks negatively select into self-employment, with the most able blacks remaining in the wage and salary sector, whereas whites positively select into self-employment and negatively select into wage and salary work. These findings are consistent with the most-able minorities avoiding potential discrimination by white consumers by working in wage and salary jobs instead of starting businesses. Kawaguchi (2004) finds that among African Americans, low wage and salary earners are the most likely to enter into business ownership, whereas both low-and high-earning whites are the most likely to enter self-employment. He notes that this finding is consistent with the theoretical predictions of consumer and credit-market discrimination against blacks. However, in contrast to these results, Meyer (1990) does not find evidence supporting the consumer discrimination hypothesis. Using data from the 1987 Characteristics of Business Owners (CBO), he finds that black businesses are relatively more common in industries in which white customers more frequently patronize black businesses.

More generally, black-owned firms may face limited market access for the goods and services that they produce (Bates 1997). This may be partly due to consumer discrimination by customers, other firms, or the government in addition to redlining. But it may also be due to the types, scale, and locations of black firms. Published estimates from the CBO indicate that black-owned businesses serve smaller geographical areas than white-owned businesses on average (table 4.12). Black firms are more likely than white firms to report that their neighborhood is the geographic area that best describes where the business's goods and services are sold. Black owners are less likely to report larger geographical areas as markets for their goods and services. Furthermore, they are much more likely to sell to a minority clientele than are white businesses (figure 4.5), which may reflect more limited market access. As expected, market access or penetration is both a cause and consequence of success in business making it difficult to interpret racial differences in these measures. More successful black firms are likely to expand to larger market areas.

Networks

Racial differences in networks may also contribute to the lack of success among black businesses. Previous research indicates that the size and composition of social networks is associated with self-employment

Table 4.12
Market area of small businesses by race, Characteristics of Business Owners (1992)

	Percentage		
	All Firms	White-Owned Firms	Black-Owned Firms
Geographic area that best describes marketplace:			
Neighborhood	32.8%	31.6%	45.2%
City/county	53.8	54.1	51.9
Regional (adjoining counties or states)	24.5	25.7	14.7
National	6.8	7.0	4.7
International	2.0	1.8	1.3

Source: Characteristics of Business Owners (1992) as reported in U.S. Census Bureau (1997).
Notes: (1) The sample includes businesses that are classified by the IRS as individual proprietorships or self-employed persons, partnerships, and subchapter S corporations and that have sales of $500 or more. (2) White category is equal to the total minus all minority groups.

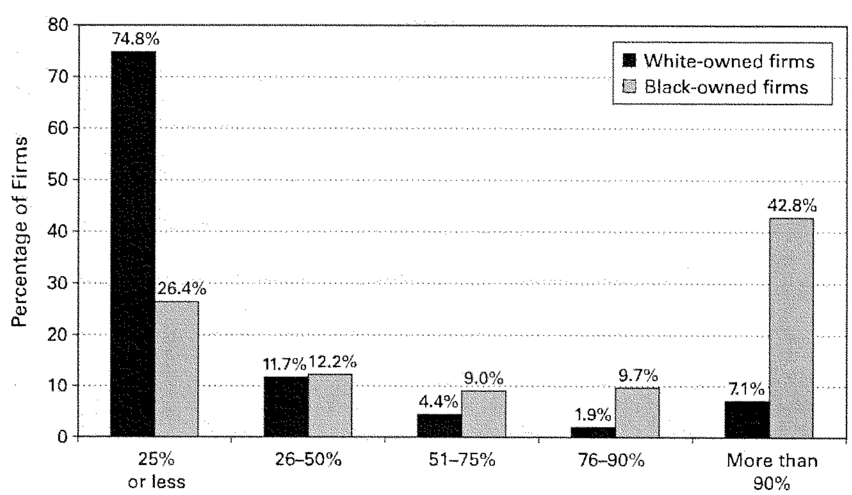


Figure 4.5
Minority customers served by the business (percentage), Characteristics of Business Owners (1992)

(Allen 2000) and that having close friends and neighbors in business and being a member of a business network are positively associated with outcomes among nascent entrepreneurs (Davidsson and Honig 2002). If minority firms have limited access to business, social, or family networks or have smaller networks then they may be less likely to enter business and create successful businesses. These networks may be especially important in providing financing, customers, technical assistance, role models, and contracts.[8] These same networks, however, are likely to also be useful for finding employment in the wage and salary sector creating a dampening effect on self-employment.

In an earlier study, Fratoe (1988) finds that black business owners are less likely to have business role models, obtain loans from other family members, and use family members as unpaid labor. Social networks may be especially important in industries such as construction, where deals are often made in informal settings (Feagin and Imani 1994). If minorities are blocked from these industries perhaps due to discrimination, then their business networks may be restricted (Bates 1993b; Feagin and Imani 1994; Bates and Howell 1997). Examining the retail industry in New York, Rauch (2001) finds evidence that African American businesses were less able to organize "mutual self-help" than immigrant businesses.

Ethnic and racial groups may differ not only in the size of their networks but also in their ability to transfer information related to running a business among coethnics. There is evidence that experience as an employee of a small business and transfers of information are important (Meyer 1990). Strong patterns of industry concentrations for businesses owned by many ethnic groups are consistent with this explanation (Fairlie and Meyer 1996). The industry concentration of black businesses has become more similar to white businesses over time, however, while the there has been no convergence in rates of business ownership (Fairlie and Meyer 2000).

A major limitation of these explanations is that they are difficult to analyze empirically. The problem is that success in business for some groups may simply create larger and more efficient business and social networks. Thus, it is difficult to identify the direction of causation between networks and success. Coethnic networks may also create a multiplier effect whereby small differences in initial business success between groups may lead to large differences in future business success. This point is related to the argument noted above that the lack of black traditions in business enterprise is a major cause of current low levels of black business ownership (Du Bois 1899; Myrdal 1944; Cayton and Drake 1946; Frazier 1957).

Conclusions

African Americans have levels of wealth that are one eleventh those of whites. The median level of net worth, defined as the current value of all assets minus all liabilities on those assets, for black households is only $6,166. This disparity in personal wealth appears to have two major consequences for business success. First, low levels of wealth limit business formation among blacks. In fact, roughly 15 percent of the black/white gap in business creation rates is due to racial differences in assets (Fairlie 1999, 2006). Second, black entrepreneurs who do start businesses invest much less capital at startup on average than white entrepreneurs. For example, estimates from the CBO microdata indicate that the percentage of black-owned firms starting with at least $25,000 in capital is roughly half the percentage of white-owned firms starting with at least $25,000 in capital.

Lower levels of startup capital among black businesses limit their ability to grow and succeed. Specifically, we find that racial disparities in startup capital contribute to higher failure rates, lower sales and profits, and less employment among black-owned businesses. Estimates from nonlinear decompositions indicate that racial differences in startup capital explain from 14.5 to 43.2 percent of the gaps in small business outcomes. Startup capital disparities are the most important explanatory factor in contributing to racial differences in business outcomes. Limited access to financial capital among black entrepreneurs, which appears to be caused by wealth inequality and possibly lending discrimination, is a major reason for less successful black businesses.

Racial differences in family-business backgrounds are also an important factor. Previous research indicates that the probability of business ownership is substantially higher among the children of business owners than among the children of nonbusiness owners and that current racial patterns of self-employment are in part determined by racial patterns of self-employment in the previous generation (Lentz and Laband 1990; Fairlie 1999; Dunn and Holtz-Eakin 2000; Hout and Rosen 2000). The CBO microdata allow us to build on these findings by exploring whether the intergenerational transmission of business ownership is also important in creating racial disparities in business outcomes *conditioning* on ownership.

Estimates from the CBO indicate that black business owners have a relatively disadvantaged family-business background compared with white business owners. Black business owners are much less likely than white business owners to have had a self-employed family-member owner prior to starting their business and are less likely to have worked in that family member's business. Only 12.6 percent of black business owners had prior work experience in a family member's business compared with 23.3 percent of white business owners. Racial differences and overall rates of business inheritances are much smaller. The percentage of business owners inheriting their firms was 1.4 percent for blacks and 1.7 percent for whites.

Estimates from linear and nonlinear decompositions indicate that the lower likelihood of having a self-employed family member prior to business startup among blacks than among whites does not generally contribute to racial differences in small business outcomes. Instead, the lack of prior work experience in family businesses among future black business owners, perhaps by restricting their acquisition of general and specific business human capital, limits the successfulness of their businesses relative to whites. With the exception of the profits specification, racial differences in this variable explain 5.6 to 11.6 percent of the gaps in small business outcomes. Providing some additional evidence on the importance of limited opportunities for acquiring business human capital, racial differences in prior work experience in similar businesses also consistently explain part of the gaps in small business outcomes. Furthermore, the combination of these two factors suggests that racial differences in opportunities to acquire business human capital in general contribute substantially to the differential success of black- and white-owned businesses.

Inherited businesses are generally more successful than noninherited businesses, but racial differences in business inheritances explain virtually none of the gaps in small business outcomes. The likelihood of business inheritances among black and white owners (under 2 percent) is just too small to play a major role in explaining racial differences in business outcomes.

We also examine the contributions of other factors to racial differences in small business outcomes. Lower levels of education among black business owners relative to white business owners explain a modest but nontrivial portion (2.4 to 6.5 percent) of the black/white gaps in business outcomes. Although black-owned businesses have a different regional distribution and are more likely to be located in urban areas than are white-owned businesses, racial differences in geographical locations do not appear to contribute substantially to the gaps in small business outcomes. Racial differences in the amount of prior work experience and management experience have either small effects or mixed effects across specifications. Finally, racial differences in industry composition explain part of the gaps in business outcomes, but these results are difficult to interpret because industry differences may reflect different preferences or constraints on entry into more profitable industries.

Overall, the relatively simple empirical models of business outcomes do quite well in explaining the black/white gaps in business outcomes. Although there are many unmeasurable factors that may explain outcome disparities as discussed above, we explain 50 to 100 percent of the differences in business outcomes using the human capital, financial capital, family business background, and other owner and firm characteristics available in the CBO. In comparison, decompositions of earnings differences between blacks and whites typically explain no more than half of the gap unless a measure of ability is included (Altonji and Blank 1999).

Our estimates indicate that blacks are less likely than whites to have previous work experience in a family member's business and are less likely to have previous work experience in a similar business. The relative lack of opportunities for acquiring general and specific business human capital apparently has a negative effect on the outcomes of black-owned firms. This finding has important policy implications. Most minority-business-development policies currently in place, such as set-asides and loan-assistance programs, are targeted toward alleviating financial constraints not toward providing opportunities for work experience in small businesses. To break the cycle of low rates of business ownership and relatively worse business outcomes being passed from one generation of blacks to the next, programs that directly address deficiencies in family-business experience, possibly through an expansion of apprenticeship-type entrepreneurial training programs, may be needed in addition to programs focused on improving access to financial capital.

Appendixes

Nonlinear Decomposition Method

In this appendix, we describe the decomposition techniques used in this chapter to identify the causes of black/white differences in business outcomes. These techniques decompose intergroup differences in mean levels of an outcome into those due to different observable characteristics or "endowments" across groups and those due to different effects of characteristics or "coefficients" of groups. We describe the standard Blinder-Oaxaca technique, which is used for dependent variables that are estimated with linear regressions, such as log sales. An alternative nonlinear decomposition technique due to Fairlie (1999, 2005a) is also described. The technique is useful for decomposing racial differences in binary outcomes, such as closure, having profits of $10,000 or more, and having employees. Logit regressions are estimated to identify the determinants of these business outcomes. This nonlinear technique has broader applications for identifying the causes of racial, gender, geographical, or other categorical differences in any binary dependent variable in which a logit or probit model is used. SAS programs are available at ⟨people.ucsc.edu/~rfairlie/decomposition⟩, and Stata programs are available by entering "ssc install fairlie" in Stata.

For a linear regression, the standard Blinder-Oaxaca decomposition of the white/black gap in the average value of the dependent variable, Y, can be expressed as

$$\bar{Y}^W - \bar{Y}^B = [(\bar{X}^W - \bar{X}^B)\hat{\beta}^W] + [\bar{X}^B(\hat{\beta}^W - \hat{\beta}^B)], \tag{4.1}$$

where $\bar{X}^j$ is a row vector of average values of the independent variables and $\hat{\beta}^j$ is a vector of coefficient estimates for race j. Following Fairlie (1999), the decomposition for a nonlinear equation, such as $Y = F(X\hat{\beta})$, can be written as

$$\bar{Y}^W - \bar{Y}^B = \left[\sum_{i=1}^{N^W} \frac{F(X_i^W \hat{\beta}^W)}{N^W} - \sum_{i=1}^{N^B} \frac{F(X_i^B \hat{\beta}^W)}{N^B}\right] + \left[\sum_{i=1}^{N^B} \frac{F(X_i^B \hat{\beta}^W)}{N^B} - \sum_{i=1}^{N^B} \frac{F(X_i^B \hat{\beta}^B)}{N^B}\right], \tag{4.2}$$

where N^j is the sample size for race j. This alternative expression for the decomposition is used because $\bar{Y}$ does not necessarily equal $F(\bar{X}\hat{\beta})$.[9] In both (4.1) and (4.2), the first term in brackets represents the part of the racial gap that is due to group differences in distributions of X, and the second term represents the part due to differences in the group processes determining levels of Y. The second term also captures the portion of the racial gap due to group differences in unmeasurable or unobserved endowments. Similar to most previous studies applying the decomposition technique, we do not focus on this "unexplained" portion of the gap because of the difficulty in interpreting results (for more discussion, see Jones 1983 and Cain 1986).

To calculate the decomposition, define $\bar{Y}^j$ as the average probability of the binary outcome of interest for race j and F as the cumulative distribution function from the logistic distribution.[10] Alternatively, for a probit model F would be defined as the cumulative distribution function from the standard normal distribution.

An equally valid method of calculating the decomposition is to use the minority coefficient estimates, $\hat{\beta}^M$, as weights for the first term and the white distributions of the independent variables, $\bar{X}^W$, as weights for the second term. This alternative method of calculating the decomposition often provides different estimates, which is the familiar index problem with the Blinder-Oaxaca decomposition technique. A third alternative is to weight the first term of the decomposition expression using coefficient estimates from a pooled sample of the two groups (see Oaxaca and Ransom 1994, for example). We follow this approach to calculate the decompositions. In particular, we use coefficient estimates from a logit regression that includes a sample of all racial groups.

Using the pooled coefficients from a sample of all racial groups has the advantage over using the white coefficients because it captures the determinants for all groups and are more precisely estimated (because of the larger sample and more heterogeneity of firms). They are also preferred over the minority coefficients because they are less likely to be influenced by discrimination. The goal of the decomposition is to estimate how much differences in owner or firm characteristics explain of the racial gap in business outcomes given a nondiscriminatory environment.

The first term in (4.2) provides an estimate of the contribution of racial differences in the entire set of independent variables to the racial gap in the dependent variable. Estimation of the total contribution is relatively simple as one needs only to calculate two sets of predicted probabilities and take the difference between the average values of the two. Identifying the contribution of group differences in specific variables to the racial gap, however, is not as straightforward. To simplify, first assume that $N_B = N_W$ and that there exists a natural one-to-one matching of black and white observations. Using coefficient estimates from a logit regression for a pooled sample, $\hat{\beta}^*$, the independent contribution of X_1 to the racial gap can then be expressed as

$$\frac{1}{N^B}\sum_{i=1}^{N^B} F(\hat{\alpha}^* + X_{1i}^W\hat{\beta}_1^* + X_{2i}^W\hat{\beta}_2^*) - F(\hat{\alpha}^* + X_{1i}^B\hat{\beta}_1^* + X_{2i}^W\hat{\beta}_2^*).^{11} \qquad (4.3)$$

Similarly, the contribution of X_2 can be expressed as

$$\frac{1}{N^B}\sum_{i=1}^{N^B} F(\hat{\alpha}^* + X_{1i}^B\hat{\beta}_1^* + X_{2i}^W\hat{\beta}_2^*) - F(\hat{\alpha}^* + X_{1i}^B\hat{\beta}_1^* + X_{2i}^B\hat{\beta}_2^*). \qquad (4.4)$$

The contribution of each variable to the gap is thus equal to the change in the average predicted probability resulting from sequentially switching the white characteristics to black characteristics one variable or set of variables at a time.[12] A useful property of this technique is that the sum of the contributions from individual variables will be equal to the total contribution from all of the variables evaluated with the full sample.

In practice, the sample sizes of the two groups are rarely the same and a one-to-one matching of observations from the two samples is needed to calculate (4.3) and (4.4). In this example, it is likely that the black sample size is substantially smaller than the white sample size. To address this problem, first use the pooled coefficient estimates to calculate predicted probabilities, $\hat{Y}_i$, for each black and white observation in the sample. Next, draw a random subsample of whites with a sample size equal to N_B and randomly match it to the full black sample. The decomposition estimates obtained from this procedure depend on the randomly chosen subsample of whites. Ideally, the results from the decomposition should approximate those from matching the entire white sample to the black sample. A simple method of approximating this hypothetical decomposition is to draw a large number of random subsamples of whites, match each of these random subsamples of whites to the black sample, and calculate separate decomposition estimates. The mean value of estimates from the separate decompositions is calculated and used to approximate the results for the entire white sample. All of the decompositions reported in this chapter use 1,000 random subsamples of whites to calculate these means.

Table 4.A
Means of selected variables, Characteristics of Business Owners (1992)

	White-Owned Firms	Black-Owned Firms
Firm no longer operating in 1996 (closure)	0.2282	0.2696
Net profit of at least $10,000	0.3004	0.1410
One or more paid employees	0.2067	0.1121
Log sales	10.07	9.42
Female-owned business	0.3268	0.4261
Married	0.7650	0.6780
Never married	0.1020	0.1200
High school graduate	0.2651	0.2230
Some college	0.3123	0.3423
College graduate	0.1962	0.1292
Graduate school	0.1353	0.1437
Northeast	0.0643	0.0194
Midatlantic	0.1469	0.1315
East North Central	0.1666	0.1403
West North Central	0.0847	0.0330
South Atlantic	0.1597	0.3259
East South Central	0.0518	0.0792
West South Central	0.0999	0.1443
Mountain	0.0670	0.0163
Urban	0.7351	0.8877
Prior work experience: 1 year	0.0707	0.0680
Prior work experience: 2 to 5 years	0.1641	0.1500
Prior work experience: 6 to 9 years	0.1507	0.1445
Prior work experience: 10 to 19 years	0.2973	0.3143
Prior work experience: 20 years or more	0.2578	0.2393
Prior work experience in a managerial capacity	0.5552	0.4699
Prior work experience in a similar business	0.5030	0.4353
Have a self-employed family member	0.5231	0.3254
Prior work experience in a family member's business	0.2352	0.1264
Inherited business	0.0148	0.0132
Startup capital: $5,000 to $24,999	0.2374	0.2107
Startup capital: $25,000 to $99,999	0.1095	0.0645
Startup capital: $100,000 and over	0.0475	0.0168
Agricultural services	0.0269	0.0175
Construction	0.1261	0.0718
Manufacturing	0.0330	0.0168
Wholesale	0.0360	0.0112

Table 4.A
(continued)

	White-Owned Firms	Black-Owned Firms
Finance, insurance, and real estate	0.0987	0.0609
Transportation, communications, and public utilities	0.0389	0.0834
Personal services	0.2616	0.3287
Professional services	0.1937	0.2060
Uncoded industry	0.0391	0.0572
Sample size	14,282	6,831

Notes: (1) The sample includes businesses that are classified by the IRS as individual proprietorships or self-employed persons, partnerships and subchapter S corporations, have sales of $500 or more, and have at least one owner who worked at least twelve weeks and ten hours per week in the business. (2) All estimates are calculated using sample weights provided by the CBO.

Chair LANDRIEU. Thank you, Dr. Fairlie.

Let me just say I think this has been one of the most interesting, thought provoking panels and most professionally executed panels that I have ever heard in my time in the Senate. I have been here almost 14 years. I really appreciate the work that went into your presentations, to try to elicit the appropriate response from not only this Committee but the members of Congress.

I am going to start, Mr. Fairlie, with you because I was just sharing with Senator Cardin that I think Americans would be absolutely shocked to hear the statistic here, that average African American families have less than $5,500 in wealth compared to average white families, that have an average of $87,058. That is what you have testified.

Could you explain a little bit in more detail for people who, after hearing that, are still not going to want to accept that, a little bit more detail about it?

Are you talking about home equity and home ownership, or are you just talking about wealth in either the stock market or bank accounts, all of the above? Could you just give a little bit more clarification to that?

Dr. FAIRLIE. Yes, I would be happy to. I have studied this issue for numerous years. I actually found it one of the most depressing statistics, just kind of frankly, when I was doing research for a book of mine.

What I am referring to is total wealth as measured by the Census Bureau. It includes all of an individual's assets, subtracting off the debt that they own on it. So it would include their home, subtracting off the mortgage that is still owned on that home. It would include savings accounts, stock market accounts, things like that, minus any debt that you have on a credit card or anything else. So it basically includes the total wealth that is added up.

Now certainly there are a lot of very wealthy families that are minorities, but the median level I think is a very good statistic because it tells you the 50th ranked family for each group. So the 50th ranked family, if you kind of ranked all African Americans by wealth, comes out at $5,500. The average Latino family comes out at $8,000. So there are much, much lower levels, one-eleventh to one-sixteenth what you find for non-minority families.

I have also looked at kind of the historical patterns in this data. There are not clear trends showing gains in wealth accumulation among minorities relative to whites, and I found that is also a very sort of depressing and kind of surprising statistic.

Now the statistics only go back to 1984. That is when the Federal Government started collecting these data on wealth. So it is not that we have a long history of data in this area, but it just shows you we have not made a lot of improvement, at least over the kind of recent history, in terms of wealth.

Chair LANDRIEU. You also had some interesting statistics, I think in your research, about the level of education. It is in your book, "Race and Entrepreneurial Success." You mentioned you found evidence that a business owner's education level is an important determinant in business outcomes. Do you mind just elaborating on that?

Dr. FAIRLIE. Yes. So, in that research, what I found is when I focused specifically on African American business owners I found that about 20 percent of African American business owners had a college degree or higher education level, and among whites it was 28 percent that had a college degree or higher. So I thought, well, there are these big differences in education levels among the owners. Can they have an impact on the success of the business?

What I found is that education was one of the most important determinants of a firm in terms of the level of sales the firm has, the profit levels of the firm, whether or not the firm closes, and also whether or not the firm hires employees. So what I found, sort of putting all of that together, is that it was hindering African American growth in terms of the firms and their success.

Chair LANDRIEU. Ms. Cofield, your testimony was very compelling. Could you please describe a little bit in more detail your business and how many clients that you have?

You gave a very detailed description of one of your clients. Is that the nature of your business, to advise individual potential business owners and entrepreneurs?

Ms. COFIELD. Sure. Yes. My company is a boutique company here in Washington, D.C., and I actually have a program called PROSPECTUS which is a nine-week entrepreneurship training program for aspiring and existing entrepreneurs. In our cohort now we have a small cohort of 11 entrepreneurs, and they are at every stage from feasibility to actually looking for capital. And her case study is just one of the many that I have come across during my years as an entrepreneur, but also working in business development here in Washington, D.C. and in Los Angeles, as well as New York.

Chair LANDRIEU. Thank you.

Finally, to Mr. Johnson, you probably laid out one of the more compelling thoughts. Senator Cardin was not here when you did, but I know he is familiar with your testimony. You said that you really think the 51 percent requirement for equity, to determine whether the firm is truly a minority firm, actually is a great hindrance. Do you want to just elaborate on that? I know you did not have that much time in your testimony—because I am very interested and had not actually thought about that before, I have to say, and I think you have made an excellent point.

Mr. JOHNSON. Thank you, Senator. The 51 percent requirement is a political decision. It has nothing to do with the marketplace. If someone has a good business idea and they can attract capital, capital will flow to that idea and that opportunity. That is the way capital works.

But what happened when there was a move to create so-called black capitalism or the opportunities for minorities, the feeling came in some political quarters, we have to prevent so-called shams or fronts. So the idea was to put a threshold requirement of 51 percent on the assumption that no one would put money into a minority company if the minority controlled it because obviously you are not going to put money in a company you do not have any influence over.

So that level of threshold became the norm. It started with the government and then moved to corporations.

What that does, though, is it limits a minority's ability to attract investment capital because most investors, when they invest in a company have two things in mind. One, to grow the investment as large as they can, and obviously if they can acquire more equity in the company they would like to do so, particularly if the company is growing and if they bring some assets that help the company grow. At the same time, they also want to have an exit strategy in case they want to leave the company.

But if the company has this 51 percent minority requirement, it is going to always depress both the opportunity to attract outside equity and the ability to get an exit because who is going to buy into a company where they can never get a so-called path to control.

And my argument is go to the real marketplace. You take a person like Jamie Dimon at JPMorgan Chase, probably owns less than 1 or 2 percent of the stock, but you know he controls that company.

You take a person like Oprah Winfrey. She is the rainmaker for that company. Oprah could go public and sell 90 percent of her ownership of that company, and only with 10 you would know she would still be the controlling revenue force and leader of that particular enterprise.

So my argument is if we could eliminate as a controlling factor that 51 percent. Look to other factors. Two sources of voting control: Stock A and B, A votes 10, B votes 1. Board control where the minority can say I have gained board control from the investor, so I do have a significant control. Put these factors in or just simply go to 10 percent to reflect the economic reality where white Americans have about 90 percent more capital than African Americans.

But to continue that, in my opinion, will always limit minority companies to being small, and it would limit outside investors wanting to acquire a stake in a company they never control.

Chair LANDRIEU. It serves as a ceiling as opposed to a launching pad.

Mr. JOHNSON. Absolutely. I mean that is a problem.

Chair LANDRIEU. Senator Snowe.

Senator SNOWE. Thank you.

And I thank all of you. You are trailblazers in your respective spheres, and I appreciate your testimony very much. It is very helpful and illuminating and, as the Chair indicated, startling. It does provide, I think, a reinforcement of how we ought to do things better with respect to the resources that we have at the Federal level, and certainly through the SBA and the Commerce Department.

Mr. Johnson, to your point, because you made some interesting arguments about some of the criteria that are utilized in SBA programs—the SBA should respond to the questions you raised in your testimony.

Madam Chair, we ought to get a response from the SBA because these are issues that could be hindrances and barriers to opening the doors for entrepreneurship.

You have made a very compelling case in that regard.

Mr. JOHNSON. Yes, Senator, I think the issues I see are we have talked about raising the amount of lending that could go into a minority business. Have we always thought about raising the level at which you could qualify for an SBA loan?

I mean part of the problem is there is a cap on net worth. That may take out a lot of very competent minority business men and women who have succeeded despite the odds, but they are not eligible for any kind of Federal assistance because we have politically said, again, that: If you happen to be a $500,000 minority guy or woman, you have great business experience. You have succeeded against the odds. You are not eligible for any government assistance. But you are still a minority, and you still face many of the same things that the professor talked about—higher interest rates on whatever borrowing you might get, a limit on the amount you can borrow.

In some cases, because of net worth levels, like the 51 percent concept, we have taken some of the best players off the field.

And I think you could get a better result, and my feeling is that in terms of the SBA or the approach I would take if I were doing this I would simply take the level of money and create a private investment fund that would be charged, and they would get a fee for this, but they would be charged with making loans to minority business.

So you get really good people who know how—Natalie—to say, okay, I have got $2 million, or I have got $10 million or $100 million from the government. My job is to go to out a lot of micro businesses by investing in those companies.

That is the way I would approach it, rather than having in some cases the government do it. I am not a big fan of the government doing everything. So these are things that I think.

And then that goes to this other issue of this compelling national interest test on the court ruling. You cannot reverse discriminate. Well, if you do not reverse or at least preferences or advantages, you will forever limit the growth of minority business in terms of scale and size. They just will not get there.

Senator SNOWE. Well, that is very helpful in that regard. We will explore that. I think it is very useful.

You yourself started out in 1979, and that was just at the onset of another recession. What recommendations or what strategies did you use, and what would you recommend to entrepreneurs today, and small businesses, to survive, if not thrive?

Mr. JOHNSON. Senator, when I started, believe it or not, interest rates were around 18 percent.

Senator SNOWE. I know it well. It was my first time in the House, so it is etched in my memory.

Mr. JOHNSON. My story sort of comes under the exception to the rule. I mean I had a chance to be in an industry, the cable industry, at a time when it was coming out of the foothills and going into the urban markets and happened to meet a unique entrepreneur in the name of John Malone of Liberty Media, a cable company that really believed in backing entrepreneurs, and he backed myself, John Hendricks over at Discovery, even Ted Turner. But that was a unique opportunity and a unique relationship.

The problem is, and the tragedy of it is, it is almost impossible to duplicate and put into a sort of institutionalized process.

So what happened is I was able to get the social contact by working as a lobbyist at the National Cable Television Association. The industry was expanding into urban markets. I came up with the idea of Black Entertainment Television. The industry needed minority programming in urban markets. Malone was an entrepreneur who supported me, and I was able to grow with an industry from the bottom up and grow my company. So when I started BET on a half a million dollar loan from John Malone, I sold it in 2001 for $3 billion to Viacom because I grew with the industry.

At that particular point in time, that was the strategy of what I implemented—finding strategic partners. Every business I have now I have always taken this model. If most African Americans could find a strategic partner like a Malone, if we could go out and match up minority entrepreneurs with majority strategic partners and supporters, you could change dramatically the number of large-scale minority businesses.

Senator SNOWE. That is interesting, yes. And developing a network too, absolutely.

Mr. JOHNSON. That is exactly it.

Senator SNOWE. Well, Ms. Henningsen and Mr. Hudson, from your perspectives, listening to what Mr. Johnson has had to say, and from your experiences, what can we do through SBA to help target these resources more effectively for minority-owned businesses?

You have set a model, both in terms of the profitability and also the social responsibility. So what does that say to other lenders? What could we do to encourage other lenders to create similar systems?

Ms. HENNINGSEN. Well, the model is a simple one. First of all, we took the position that we wanted our businesses to survive. So we were a little bit rough and tough with them when they came in to get the financing, but I frankly believe that is the only reason some of our businesses are where they are now and are sort of surviving. But even our strongest businesses, we find are in trouble and need that extra boost. But the educational piece was extremely important in making sure that the small business owners knew what they were doing.

The partnering concept Mr. Johnson talked about, we are big with that. As a matter of fact, we have taken some of our most successful businesses, and when new entrepreneurs have come to us we have said we want you to sit down and talk to this business owner and get a feel for what you are facing. And as entrepreneurs ourselves, we have been able to say to them, these are the issues.

But at the end of the day, right now what our small businesses need is money to keep them going. We have a lot of businesses that had Plan B, but we are down to Plan Z now. I am not kidding. With the way these businesses are struggling, people's homes, their family's homes are tied up in some of these businesses.

As the founder of the bank, this has been the worst 15 months of my life because even though we have what I would describe as a good replicable model, I do not believe anyone was prepared for what we are going through right now, but the model does work.

Senator SNOWE. It does work. These are unusual times.

Mr. HUDSON. Just quickly, I would agree with I do not support a 51 percent requirement. I agree with joint ventures and partnerships. I even probably agree with the fact that asset limits, minimal asset limits or maximum asset limits, prohibit attraction of successful, potential successful businesses.

I think where you have to be concerned is that there is a nexus to low income communities, minority communities. There is some way you have to have a nexus to those investments and jobs and economic development in low income communities. So that is where you have to think through how do you ensure that your dollars are being reinvested and that the benefits are going back into low income communities.

Senator SNOWE. Thank you.

Chair LANDRIEU. Let me just say in conclusion that Ranking Member Snowe and I are going to be very influential in the building of this next Jobs 3 Bill. We had Jobs 1 and Jobs 2, and we will build a Jobs 3 bill.

Much of the testimony that you all have put on the table today, I will do my very best to have as a core and part of this Job 3 Bill as we focus on getting our eyes and our hearts on Main Street, from Wall Street, and get our hearts and minds on these neighborhoods that are chronically underserved, a community that still faces extraordinary discrimination. Even though it is a lot more subtle, it still exists, and it has to be corrected.

These capital markets must work for all Americans. They just have to.

While government does, Mr. Johnson, have a limited role, it could have a very muscular and important role to play in righting injustices.

So it has been very illuminating and instructive. I thank you very much, and the meeting has come to a close.

[Whereupon, at 11:45 a.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

Small Business Committee testimony for Warren Brown
04.15.10
warren@cakelove.com

Thank you for the invitation to address this committee. My name is Warren Brown, I am the founder and owner of CakeLove, a local chain of retail bakeries that specializes in cakes and cupcakes baked from scratch. Starting my business wouldn't have been possible without SBA loan guarantees for the financing I secured through a local community bank. CakeLove has grown from one to seven (7) retail bakeries over the past eight (8) years and I am thankful to the SBA for continuing to support my business's growth.

The background to my start-up includes an unusual career change that captured the attention of a lot of Washingtonians. Prior to opening my bakery, I was a litigator for the Office of Inspector General of the Department of Health and Human Services from 1998 to 2000. I left the practice of law to pursue my passion for baking and a dream of starting my own business.

I prepared myself for the difficult work of starting-up a business by covering all of the basics: I developed and wrote a business plan; I reached out to community resources like the SCORE program at the SBA for advice and critiques; I attended lectures on business and spoke with other entrepreneurs about the challenges common to any new business; and, I tested a lot of recipes.

Nothing is easy about starting a business, but if there is one area that's the biggest hurdle it's the financing. I spoke directly with lending officers at community banks to get an understanding of exactly what they required in order to evaluate my loan application. Having a law degree helped me navigate the somewhat complex network of people and institutions that exist to facilitate business growth and development. I hope that future generations of aspiring entrepreneurs learn the dynamics of business development and continue to have access to financing in order to pursue their dreams.

I am thankful that the SBA supported my business's growth over the past eight years—and I look forward to growing more with their support in the future. Without the SBA my business would not be where it is today. When I began my business, I didn't have collateral to back-up the loans that got my business off the ground. The SBA's guarantee offered the protection my bank needed to close the loan which launched my business.

Today CakeLove employees over seventy (70) people and operates seven (7) store front locations. Now we bake more cakes and cupcakes than ever before which has allowed me to grow beyond baking: I hosted a television show about desserts, I speak at colleges, high schools and conferences around the country about my entrepreneurial experience, CakeLove partnered with small IT companies to develop an online store and a Mobile App, and I've written two cookbooks—the latest celebrates regional baking around America.

CakeLove also enjoys being a supportive corporate citizen and proudly partners with charitable organizations to raise awareness and reach their fundraising goals. We support our local community with in-kind charitable contributions of baked goods, baking lessons, cash donations, and volunteer efforts.

I am thankful to the SBA for their assistance in helping me start CakeLove bakery. Their loan guarantees have helped me not just pursue my dream and passion, they helped launch a retail bakery that continues to grow and provide jobs and opportunity and inspire people to learn more about baking and following their own dream.

Testimonial of:

Mr. Nyein Min
President
Wunna Contracting Corporation
14811 Palmerston Sq
Centreville, VA 20120-1807
Tel: 703-996-8881
Email: nmin@wunnacontracting.com

For the hearing entitled
"Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets" on April 15, 2010 before the
United States Senate Committee on Small Business & Entrepreneurship

Submitted electronically to monisha.smith@sbc.sentate.gov on April 29, 2010

My name is Nyein Min and I am the President of Wunna Contracting Corporation (Wunna). I wish to share the following experiences with the United States Senate Committee on Small Business and Entrepreneurship to help draw attention to the discrimination that Asian American business owners, such as myself, continue to face.

I am a civil engineer. Wunna is a contracting company that I started in 2007. I came to the United States in 1986 from my native country of Burma, also known as Mynmar. I came to the United States for economic opportunity. I moved to northern Virginia in 1989.

I am a certified Disadvantaged Business Enterprise (DBE) through the Commonwealth of Virginia's Department of Transportation (VDOT). I worked for VDOT for 18 years. I decided to start my own company in 2007 because I saw how many contracting opportunities there are through VDOT. I formalized a group of Burmese engineers to do research work together and then ask for government grants. I have done some projects for the airport and also some highway projects.

As a business owner, I have faced discrimination in trying to get bank loans. I feel that I am not getting the loans because I am Asian American. I show the loan officers my balance sheets and accounting statements. They told me they don't understand me when I speak. When they tell me that, I don't know what else to say to them. Everything they need to know is in my accounting statements and balance sheets but they still won't give me a loan. I know my balance sheets and accounting statements are all accurate because I have multiple accountants examine them for me. I know White business owners who have the same qualifications as I do but they still manage to get the loans. Without a bank loan I cannot perform more contracts I have received through VDOT. To obtain and perform contracts there are man power, equipment, bonding and management requirements. These requirements can be very costly and will require financing. Right now I am able to get some loans from the Small Business Administration (SBA). Without the SBA loan I wouldn't have any financing at all. The Department of Transportation also has a short term loan assistance program that helped me start my business. I do not have any other connections for accessing working capital.

One difficulty that minority contractors face is that large federal highway contracts are often given to large unqualified corporations, such as Lockheed Martin and other engineering firms. Lockheed then gives lots of subcontracts to small minority firms, but these contracts are for very small amounts of money. Even minority firms that have the capability to perform these contracts don't get prime contracts.

Delta Railroad, due to a 30% DBE requirement, gave me a subcontract for VDOT Metro Tysons Project. From the contract, I received $6 million for concrete pouring and Delta received $75 million.

I had to apply for financing through the SBA because I was unable to get loans from banks. My white friends looked at the value of my contracts and advised me that I shouldn't have any problems getting the necessary loans.

When I went to the bank, I provided all of the required paperwork but was still denied the loan. I was told because I did not have enough years in the business, I did not have enough equity in my business, and I did not have enough cash in my balance sheet. The bank told me that they thought I was trying to expand my business too quickly and I responded that I see a lot of business opportunities and thought it was a realistic time to expand my business.

The bank also told me that I don't have enough cash flow in my business, but I do not think white businesses would have the same problem with the same cash flow as mine.

Because I am Asian American, I feel that the white companies don't want me in their territory. They often ask why I am bidding on these contracts and I answer, "Because I am qualified." White firms with more contacts, more resources, and more family businesses who have the same qualifications as me get a lot more contracts than I do. The only time I am approached by white companies is if the project has a DBE requirement.

I also feel discrimination on the Smithsonian Zoo project. I bid $620k, but Fort Myer, a white-owned firm, won the project with a bid of $820k. A bid depends on the technical proposal and the price proposal. The Smithsonian told me that Fort Meyer's technical proposal was better. I rebid with a revised technical proposal, but was told the same reason. Fort Myer got a contract more than $1 million.

I believe my technical proposal was good enough. The person who created my technical proposal has a PhD and Fort Meyer doesn't have anyone like that. I was very surprised by the rejection and so was my lawyer. It is very expensive for me to fighting, especially because I will probably lose anyways.

Sometimes I am told that I should change the name of my company. People have told me that "Wunna" is a funny name and I should pick a name that is more American. But I tell those people that Wunna is a Burmese name, and most importantly it is my son's name. Even if people don't know what Wunna means, they can look and see that I have a good business and that I am very qualified.

April 18, 2010

Senator Mary Landrieu
Chairperson
Senate Small Business Committee
Washington, DC 20500

RE: Submission to Record-April 15, 2010 Hearing

Senator Landrieu:

We applaud you and Ranking Member Senator Snowe on holding the hearing, "Assessing Access: Obstacles and Opportunities for Minority Small Business Owners in Today's Capital Markets."

Our firm has been embroiled in litigation with SBA and the SBIC program for seven years. The District Court ruled on March 29, 2010, that SBA could stand trial for discrimination in the SBIC program. The statistics you and Senator Snowe cited in your remarks and the lack of access to capital outlined in the hearing is one of high desperation in minority and underserved communities.

I thank God that at the same time you were holding hearings, District Judge Gladys Kessler was ordering SBA to mediate a settlement in this matter admonishing them to "get serious". The statistics should alarm and cause outrage to you and your colleagues on both sides of the aisle.

It is our hope that the mediation will permit our case to be a guide to you and the Committee and your colleagues to correct disparities that we have suffered seeking to be an SBIC and also correct the program with legislation that offers guidance to SBA arising for Judge Kessler's Order.

The Court has spoken and tremendous direct, indirect, and anecdotal evidence has been gathered.

We respectfully enter the attached ruling and Order for the record and ask that it be considered in your legislative deliberations. Also, we attach an article, for the record, that came out in the New York Times on the same day as the hearing.

Sincerely,

C. Earl Peek
Managing Partner

1701 Pennsylvania Avenue, Suite 300 Washington, DC 20006
Phone (877) 342-8227 Fax (202) 580-6559 www.DiamondVenturesLLC.com

The New York Times
You're the Boss
The Art of Running a Small Business
APRIL 15, 2010, 5:45 PM

S.B.A. Faces Potential Discrimination Trial

By ROBB MANDELBAUM

The Small Business Administration could be headed to court to defend itself against accusations of discrimination in its investment financing programs. On March 29, a federal judge in Washington ruled against the S.B.A.'s motion for summary judgment in a lawsuit filed by a would-be venture capital fund. The fund, Diamond Ventures, which is based in Atlanta and run by two African-American men, planned to invest in poor, largely black communities in the Southeast.

Diamond brought the lawsuit in 2003, after trying, unsuccessfully, for two years to win licenses to participate in the S.B.A.'s New Markets Venture Capital program, as well as to be a traditional small-business investment company. Both programs allow venture capitalists to leverage money borrowed at low rates from the federal government to make long-term investments in start-up companies. The New Markets initiative was created in 2000 to reach to low-income neighborhoods, but the Bush administration opposed it as redundant and it was defunded within a few years.

The S.B.A.'s mission, of course, is partly to extend opportunities for financing to companies that cannot otherwise get it, particularly in disadvantaged communities. And the agency has a strong track record in guaranteeing loans to low-income and minority borrowers. The agency rejected Diamond, however, ostensibly because its founders were unqualified to manage a venture fund, even though they had experience in commercial lending and community development.

Diamond, in its lawsuit, charges that the S.B.A.'s screening practices "discriminate on the basis of race by disproportionately eliminating qualified African-American-controlled S.B.I.C.'s and qualified African-American managers who would participate in S.B.I.C. management if not for the discriminatory practices."

The Supreme Court has ruled that in some circumstances, a practice need not be intentional to discriminate if it disproportionately, and adversely, affects minorities, which is known as having a "disparate impact." In opposing the

S.B.A.'s motion for a summary judgment, which could have ended the case before it had gone to trial, Diamond presented evidence that less than 1 percent of all licensed Small Business Investment Companies in 2003 were owned and controlled by blacks entrepreneurs. Moreover, black-owned S.B.I.C.s received only a small share of S.B.I.C. funding dollars.

In her March decision dismissing the agency's request, the federal judge, Gladys Kessler, did not assess the validity of Diamond's evidence. But she did conclude that the evidence was substantial enough that "a reasonable jury could conclude that defendant is liable for disparate impact discrimination on the basis of race."

For C. Earl Peek, one of Diamond's principals, the ruling, limited though it is, represents a significant victory in a legal battle to which he has devoted much of the last seven years. Mr. Peek, a C.P.A. by training (with a year and a half of law school under his belt), wrote the initial complaint himself. He eventually moved from Atlanta to Washington to more closely follow the lawsuit.

Mr. Peek said in an interview that the process of becoming an S.B.I.C. left minority (in the ethnic sense) investment managers defeated. "Women or minorities who are now in private equity but who wanted to be S.B.I.C.'s have totally disregarded the S.B.A. and either joined a larger firm or found money elsewhere," he said.

He also chided the agency's bureaucracy for having little taste for investing in poor communities. S.B.A. officials would testify before Congress about investing in low and moderate income communities, he said, "but in the depositions, the staff career people said that this was not the objective of the program." One agency analyst reviewing Diamond's paperwork, Mr. Peek claimed, "actually wrote in our application that investing in minority communities was not a viable strategy."

Mike Stamler, S.B.A.spokesman, declined to comment on the case and said by e-mail that the agency did not track how many S.B.I.C.'s were minority-owned because that "is not relevant to the qualifications for running a small business investment company." But he added that the "S.B.A. absolutely is committed to licensing minority applicants as S.B.I.C.'s, and is working diligently to expand growth of the program by attracting management teams from more locations and from teams that are more representative of the population."

According to Mr. Stamler, 20 percent of the S.B.I.C. portfolio's investments in 2009 were made in low- or moderate-income areas. Eleven percent of the investments financed businesses owned by women, minorities or veterans.

Diamond is seeking an S.B.I.C. license, access to the S.B.I.C. debentures it would receive upon raising private capital (in this case $100 million in government-backed loans), and damages of up to $17 million, according to Mr. Peek. It also wants changes in the way the S.B.A. evaluates S.B.I.C. candidates.

At a conference on Thursday, Judge Kessler ordered the parties into mediation, telling them, according to Mr. Peek, that it is "time to get serious." If the litigants cannot reach an agreement, the case could go to trial as early as this fall, Mr. Peek said.

Coincidentally, at the same time that lawyers for the S.B.A. and Diamond Ventures met in Judge Kessler's courtroom, the Senate Small Business Committee convened a hearing on "obstacles and opportunities for minority small-business owners in today's capital markets."

"Isn't God good?" Mr. Peek said.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

DIAMOND VENTURES, LLC,	:	
	:	
Plaintiff,	:	
	:	
v.	:	**CIVIL ACTION NO. 03-1449 (GK)**
	:	
SANDY K. BARUAH, ACTING ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION,	:	
	:	
Defendant.	:	

MEMORANDUM OPINION AND ORDER

In this case brought under the Equal Credit Opportunity Act ("ECOA"), Plaintiff, Diamond Ventures, LLC ("Diamond"), claims that the Small Business Administration ("SBA") discriminated against it as a minority-owned company when it failed to license it as a Small Business Investment Company ("SBIC"). Defendant moves for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure, which Plaintiff has opposed. Upon consideration of the parties' submissions and the entire record, and for the following reasons, the Court will **deny** Defendant's motion.

I. BACKGROUND

SBICs are privately owned companies the SBA licenses to provide financing and consulting services to small businesses. See 15 U.S.C. § 681 et seq. In December 2001, Diamond submitted to the SBA a Management Assessment Questionnaire ("MAQ") dated December 7, 2001, to obtain a Participating Securities SBIC license. Def's Mot., Declaration of Harry Haskins ("Haskins Decl.") [Dkt. No. 90-2] ¶ 20. The MAQ was referred to SBA Financial Analyst Karen Ellis for review. Id. Subsequently, Diamond submitted a revised or amended MAQ dated March 29, 2002. Id. ¶¶ 20-21.

Diamond proposed "to focus on funding businesses in inner city low income areas with high African American populations." 2nd Am. Compl. [Dkt. No. 47] ¶ 57. By letter of April 24, 2002, Diamond submitted another amended MAQ and requested the SBA to review Diamond as a Debenture Securities Licensee, rather than as a Participating Securities Licensee. Haskins Decl., Ex. 4 (sealed).

Ellis recommended against inviting Plaintiff for an interview, and on June 4, 2002, Defendant's Investment Committee unanimously adopted her recommendation, effectively rejecting Diamond's proposal for an SBIC license. Haskins Ex. 6; see 2nd Am. Compl. ¶ 14 ("The SBA does not accept SBIC license applications from those who have not been invited."). Defendant explained its decision in a detailed letter to Plaintiff dated July 23, 2002. Haskins Decl., Ex. 7. Following a meeting with Plaintiff in September 2002, Defendant agreed to review another MAQ submitted by Diamond, in October, 2002, Haskins Decl. ¶ 32, and assigned it to SBA Analyst Stephen Knott for review, Haskins Decl. ¶ 33. Knott also recommended against inviting Plaintiff for an interview, and the Investment Committee again unanimously adopted the recommendation. Id. ¶ 34. Defendant explained its decision in a detailed letter dated February 25, 2003. Haskins Decl., Ex. 11.[1]

Earl Peek, who was a member of Diamond's management team, filed this civil action pro se on June 30, 2003. His second amended complaint filed on December 12, 2003, substituted Diamond Ventures, LLC, as the proper plaintiff. The parties commenced discovery in June 2004 following the Court's denial of Defendant's Rule 12(b)(6) motion to dismiss on the ground that Defendant is

---

[1] In its first MAQ, Plaintiff applied for a Participating Securities License which allows SBICs "to invest SBA guaranteed funds and issue instruments based on an equity interest in its clients or 'portfolio' companies." 2nd Am. Comp. ¶¶ 12-13. In its third MAQ submitted on April 24, 2002, Plaintiff applied for a Debenture Securities License which allows SBICs to loan money to companies at "a stated rate of interest." Id. This was later clarified to mean a Debenture, not a Participating Securities, application. Plaintiff challenges Defendant's rejection of its application for a Debenture License. 2nd Am. Compl. ¶ 25.

not a creditor within the meaning of ECOA. See Memorandum Opinion and Order of June 8, 2004 [Dkt. No. 25]. Defendant has not renewed the foregoing argument as a basis for dismissal or summary judgment.

Defendant filed its Motion for Summary Judgment on October 30, 2008 and briefing was completed on March 26, 2009.

II. STANDARD OF REVIEW

Summary judgment is warranted only "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); see Celotex Corp. v. Catrett, 477 U.S. 317 (1986). As a general rule, "[i]n deciding whether there is a genuine issue of fact before it, the court must assume the truth of all statements proffered by the party opposing summary judgment." Greene v. Dalton, 164 F.3d 671, 674 (D.C. Cir. 1999). All reasonable inferences that may be drawn from the facts must be drawn in favor of the nonmoving party. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 255 (1986). The non-movant, however, "may not rest upon the mere allegations or denials of his pleading, but . . . must set forth specific facts showing that there is a genuine issue for trial." Id., 477 U.S. at 248.

"A dispute over a material fact is 'genuine' if 'the evidence is such that a reasonable jury could return a verdict for the non-moving party'. . . . Factual disputes that are irrelevant or unnecessary will not be counted." Arrington v. United States, 473 F.3d 329, 333 (D.C. Cir. 2006) (quoting Anderson, 477 U.S. at 248). A fact is "material" if it might affect the outcome of the case under the substantive governing law. Anderson, 477 U.S. at 248. When facts are not controverted in opposition to a summary judgment motion, the Court "may assume that facts identified by the moving party in its statement of material facts are admitted." Local Civil Rule 7(h). When facts are disputed, however, "credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts, are jury functions, not those of a judge." Anderson, 477 U.S. at 255. The Supreme Court has consistently emphasized that "at the summary judgment stage, the judge's function is not . . . to weigh the evidence and determine the truth of the matter, but to determine whether there is a genuine issue for trial." Id. at 248. Our Court of Appeals has warned that in cases alleging discrimination, summary judgment "must be approached with special caution." Aka v. Washington Hospital Center, 116 F.3d 876, 879-80 (D.C. Cir. 1997), rev'd on other grounds, 156 F.3d 1284 (D.C. Cir. 1998) (en banc) (citation and internal quotation omitted).

III. ANALYSIS

ECOA makes it unlawful for any creditor to discriminate against any application, with respect to any aspect of a credit transaction . . . on the basis of race. . . ." 15 U.S.C. § 1691(a). The purpose of ECOA is to prohibit "credit decisions based on factors such as . . . race which are irrelevant to creditworthiness." Miller v. Am. Express Co., 688 F.2d 1235, 1238 (9th Cir. 1982).

Pursuant to the Small Business Investment Act, the SBA licenses SBICs to "stimulate and supplement the flow of private equity capital and long-term loan funds" to small businesses. 15 U.S.C. § 661. In general, SBICs raise their own financing capital by, among other vehicles, issuing securities backed or guaranteed by the SBA. Thus, in the event an SBIC defaults on its commitment to security holders, the SBA guarantees payment and the SBIC becomes indebted to the SBA for repayment. Haskins Decl. ¶¶ 5-8. Upon receipt of an application for an SBIC license, the SBA Administrator must determine whether the applicant meets certain private capital requirements and whether its management "is qualified and has the knowledge, experience, and capability necessary to comply with this chapter." 15 U.S.C. § 681(c)(3). Consideration is given to "the need for and availability of financing for small business concerns in the geographic area in which the applicant is to commence business," the business reputation of the applicant's owners and management and the probable success of proposed operations, "including adequate profitability and financial soundness." Id.

The "first step" in the process is "the [applicant's] submission of an MAQ, which seeks information primarily on the proposed business strategy of the SBIC and the qualifications of the individuals who will manage the prospective SBIC." Haskins Decl. ¶ 12. If a majority of Defendant's Investment Committee votes in favor of the MAQ, the "prospective management team is invited for an interview. If that is successful, [the team] receives what is commonly referred to as a 'go-forth' letter formally inviting them to submit a formal SBIC License Application." Id. ¶ 15.

A. Disparate Impact Discrimination

The Supreme Court has ruled that "Title VII . . . prohibits . . . both intentional discrimination . . . as well as, in some case, practices that are not intended to discriminate but in fact have a disproportionately adverse effect on minorities (known as 'disparate impact')." Ricci v. DeStafano, __ U.S. __, 129 S. Ct. 2658, 2672 (2009) (parenthesis in original).[2]

To demonstrate disparate impact, Plaintiff "must offer statistical evidence of a kind and degree sufficient to show that the seemingly neutral practice in question has caused the exclusion of applicants for [credit] because of their membership in a protected group." Watson v. Fort Worth

---

[2] Because the District of Columbia Circuit has "express[ed] no opinion about whether a disparate impact claim can be pursued under ECOA," this Court will follow the D.C. Circuit's lead and "[a]ssum[e] without deciding that a disparate impact claim is cognizable under ECOA." Garcia v. Johanns, 444 F.3d 625, 633 n. 9 (D.C. Cir. 2006).

Bank and Trust, 487 U.S. 977, 994 (1988). Moreover, "a showing of a [specific or particular practice] is an integral part of the plaintiff's . . . case in a disparate-impact suit." Wards Cove Packing Company, Inc. v. Antonio, 490 U.S. 642, 657 (1989). Finally, as recently as last year, the Supreme Court re-affirmed that a defendant may be liable for disparate impact discrimination provided the plaintiff can prove that the challenged practice is not job related, is not consistent with business necessity, or that there existed an equally valid, less-discriminatory alternative that served defendant's needs but that it refused to adopt. Ricci, 129 S. Ct. at 2678.

Plaintiff can avoid summary judgment by presenting "data showing that the [SBA approved debenture licenses to African American owned businesses] at rates far below their numbers in the applicant pool and the general population." Holcomb v. Powell, 433 F.3d 889, 899 (D.C. Cir. 2006) (citations omitted). "Under Title VII disparate impact analysis, an employment test with an adverse impact on racial minorities is prohibited unless the test is 'demonstrably a measure of job performance.'" Rudder v. District of Columbia, 890 F. Supp. 23, 40 (D.D.C. 1995) (quoting Griggs v. Duke Power Co., 401 U.S. 424, 436 (1971)). On summary judgment, however, the question is not whether the practice is legitimate but rather "whether the plaintiff[] [has] cast such doubt on [defendant's] credibility that a reasonable juror could regard it as pretext and infer a discriminatory motive, or that a reasonable factfinder could conclude it was inconsistent with business necessity or achievable in a nondiscriminatory way." Anderson v. Zubieta, 180 F.3d 329, 345 (D.C. Cir. 1999).

B. Plaintiff's Allegations of Specific Practices Causing Disparate Impact

Plaintiff alleges that the SBA discriminated against it by denying its application for an SBIC Debenture License. The SBA denies such discrimination and responds, basically, that the License was denied because Plaintiff could not meet the agency's qualifications. In particular, the SBA claims that the Plaintiff lacked sufficient experience in the area of venture capital investments and exits from such investments, that there was inconsistency between Plaintiff's Business Plan and Investment Strategy, that Plaintiff's management team had not demonstrated a history of working together as a cohesive team on any venture related projects, and that only two of the four team members had worked together at all previously.

It is clear that the SBA has proffered legitimate, non-discriminatory reasons for its denial of Plaintiff's SBIC license application. Therefore, the question becomes whether Plaintiff has produced sufficient evidence for a reasonable fact-finder to conclude that the SBA's reasons were not the actual reasons, but only a pretext to mask intentional discrimination against Plaintiff on the basis of race. See Brady v. Office of the Sergeant at Arms, 520 F.3d 490, 494 (D.C. Cir. 2008).

Plaintiff proffers much evidence in opposition to Defendant's justification for denying its application, only some of which the Court need address at this time.

First, it offers the testimony of two qualified experts who have both rendered opinions that Plaintiff was in fact qualified to be licensed as an SBIC.[3] Expert Report of Dr. Timothy Bates ("Bates Report"), at 66, Ex. G to Declaration of Jaime W. Luse ("Luse Decl.") (Diamond "ranks as a particularly highly qualified SBIC applicant"); Expert Report of Edward Cleveland ("Cleveland Report"), Ex. H to Luse Decl. at 9 ("this team will be very successful and a model for the program in coming years").

Second, Plaintiff presents a comparison of the areas in Diamond's final MAQ which were criticized by Knott, with other applications that received go-forth letters or licenses and contained

[3] The question of the respective qualifications of Diamond's experts is one of the many disputed material acts which must be resolved by the jury.

material in their MAQs similar to that which Diamond presented, and were not criticized. In particular, Plaintiff asserts that this comparison shows that the SBA praised non-minority led firms planning to invest in LMI[4] areas that are not known to have high-minority populations and that Plaintiff was criticized for proposing to invest in LMI areas with high African American populations such as those in portions of the Southeast United States. Again, the accuracy of the facts relied upon--and/or ignored--in these comparisons, as well as the final conclusions to be drawn from the comparisons, are issues which only a jury can resolve.

Third, Plaintiff offers evidence that while venture capital and equity experience may be useful proxies (or substitutes) for race, there is no study validating them as a reliable predictor of success for SBICs.

Fourth, the main thrust of Plaintiff's argument is that the SBA's "five year rule"[5] (which the Court will assume is, in fact, either an absolute or de facto requirement)[6] results in a disparate impact on African American owned or managed firms, and that Defendant cannot prove that such requirement is job-related, or consistent with business necessity, or that there are no valid, less discriminatory alternatives. See Ricci, 129 S. Ct. at 2678.

When evaluating whether Plaintiff has sufficient evidence to survive summary judgment, it is necessary to view the SBA's insistence on meeting this "five year requirement" against what Plaintiff's expert has described as a "long, detailed history" of interacting with both African

---

[4] None of the papers submitted by the parties define the acronym "LMI."

[5] The SBA requires that each SBI applicant have at least two principals each of whom has five years or more of experience in venture capital investing.

[6] This assumption comports with the requirement that all inferences be drawn in favor of the non-moving party. See Anderson, 477 U.S. at 248.

American funds and minority-oriented venture capital funds in an atmosphere of "antagonism and distrust." Bates Report, at 54 (citing Final Report. An Analysis of the SSBIC Program: Problems and Prospects (Bates, 1995)).[7] See also, United States Commission on Civil Rights Evaluation Publication, Ten Year Check-Up: Have Fedcral Agencies Responded to Civil Rights (June 12, 2003).

In particular, Dr. Bates reports that the SBA is aware that only two African American controlled SBICs, both owned by one firm, have ever been licensed, out of a total of approximately 350 in existence in 2003. Batcs Report, at 47. Furthermore, thc SBA's own statistics show that in Fiscal Year 2002, "50% or morc Black-Owned" firms rcceived only 2.55% of total Regular SBIC financings, and 0.49 percent of funding from Regular SBIC funding dollars; and in Fiscal Year 2003, "50% or more Black-Owned firms received only 5.37% of total Regular SBIC financings and 1.64[%] of Regular SBIC funding dollars." Ex. R and S to Luse Decl. If these figurcs are correct, no more than 0.86% of SBICs in 2003 were African American owned and controlled.

Fifth, Plaintiff offers Dr. Bates' report as "reliable statistical disparate impact evidence" "to show that the seemingly neutral practice in question has caused the exclusion of applicants" because of their race. Watson, 487 U.S. at 994. In this case, the expert's task is made that much more difficult because of the failure of SBA to record the race of SBIC applicants who fail to obtain licenses. Because of that failure, it is virtually impossible to determine the number of minority and

[7] It should be noted that the SBA itself commissioned this Report from Dr. Bates who is the Distinguished Professor of Economics at Wayne State University. Both the SBA and the Department of Justice have retained Dr. Bates, at different times, to consult about the existence of racial discrimination in the marketplace.

non-minority applicants who applied to the program and were rejected.[8] However, the Supreme Court has spoken directly to this difficulty, stating that "in cases where [such] statistics will be difficult if not impossible to ascertain, . . . certain other statistics--such as measures indicating the racial composition of 'otherwise-qualified applicants' for at-issue jobs--are equally probative. . . ." Wards Cove, 490 U.S. at 651; see Malave v. Potter, 320 F.3d 321, 326 (2d Cir. 2003) (finding "error for the District Court to have rejected out of hand [plaintiff's] statistical analysis" where data on the number of qualified Hispanic applicants was not available to conform to "the *preferred* methodology described in Ward's Cove" (emphasis in original)).

Based on data gathered from surveying 24 minority venture capitalists who are members of the National Association of Investment Companies ("NAIC"), Bates Report at 12, Dr. Bates wrote that the SBA "require[s] principal work experience in investment banking and mainstream venture capital investing fields in which very few minorities were traditionally able to obtain such experience," id. at 72, "while downgrading the actual work experience" in "commercial banking and local economic development" that most "often typifies principals of minority-oriented [venture capital] funds." Id.[9] Dr. Bates concludes that the "result is a population of SBICs where only a fraction of 1% of the funds are owned and controlled by African Americans." Id. Dr. Bates

---

[8] While it is true that the SBA does keep statistics on the race of successful applicants, it is hard to believe that in this day and age any federal agency fails to keep statistics on those who apply and are not successful.

[9] There is no question that the SBA raises many challenges to the methodology used by Dr. Bates in his "comparability analysis." Both sides spend many pages in their briefs arguing about the analysis and the validity of the comparisons. Again, however, the evaluation of expert testimony is clearly within the province of the jury. No issue could be more "material" to the final verdict it will render in this case than the weight it does, or does not, accord to Plaintiff's statistical evidence--especially in light of the absence of relevant racial statistics from the SBA.

"believe[s] that nearly all of the profit-oriented [venture capital] funds serving black and Hispanic (but not Asian) firms are NAIC members." Bates Report at 12 (parenthesis in original). It appears that he identified 24 such firms as qualified SBIC applicants, see id. at 12-13 (excluding 12 "funds" that "were largely newer funds that had not completed or recently completed fundraising and had not yet made VC investments"). Dr. Bates reports that "[t]he 23 [sic] minority-oriented funds extensively discussed [] are run by principals of diverse racial backgrounds, but most are African Americans: 28 of the 39 principals were African Americans, three were Hispanic, three were Asian and five were white." Id. at 45.

Although Defendant has concluded that venture capital experience is part and parcel of running a successful SBIC, see Haskins Decl. ¶¶ 5, 13-15; Def.'s Ex. 4, Declaration of Darryl Hairston ("Hairston Decl.") ¶ 9, it has not proffered any empirical evidence linking the equivalent of ten years' venture capital experience (at least two principals each with five years' experience) to the success of an SBIC.

There is no question that "[u]nder Title VII disparate impact analysis, an employment test with an adverse impact on racial minorities is prohibited unless the test is 'demonstrably a measure of job performance.'" Rudder v. District of Columbia, 890 F. Supp. 23, 40 (D.D.C. 1995) (quoting Griggs v. Duke Power Co., 401 U.S. 424, 436 (1971)). The SBA has offered no such evidence. Indeed the SBA has acknowledged that "successful [SBIC] managers usually have many years of experience in venture capital or related fields." Hairston Decl. ¶ 9 (emphasis added). In addition, Hairston, SBA Deputy Associate Administrator for Management and Administration, who "was also involved in creating and implementing the initial versions of the [MAQ] process," Hairston Decl.

¶ 3, acknowledges the "relevan[cy]" to debenture SBICs of commercial lending and economic development experience. Id. ¶¶ 10-11.

Plaintiff has suggested that Defendant modify its evaluative criteria for SBICs to place work experience in the commercial banking and local development fields (where African Americans have had relevant experience) on equal footing with the venture capital experience that principals of African American firms have traditionally lacked. See Bates Report at 46 (prior to 1999, principals of only one minority-owned venture capital fund had prior work experience in investment banking prior to joining the minority fund). Summary judgment "is not appropriate" if, as here, Plaintiff shows "that there is an alternative that can satisfy the employer's need in a nondiscriminatory fashion." Anderson, 180 F.3d at 344. There is no evidence that Defendant has ever considered this, or any other alternative, to substitute for or alleviate the disparate impact of the "five year rule."

Sixth, Plaintiff offers the Report of the SBA Inspector General, issued March 20, 2003, concluding that "[t]he Division's evaluation of the application [of Diamond] and the decision to deny were not accomplished in accordance with the existing SBA procedures and criteria." OIG Report, Ex. CC to Luse Decl. at 2.[10]

Seventh, Plaintiff also offers the following evidence of what it calls "direct evidence of direct discriminatory conduct." While that evidence, by itself, would not suffice to convince a reasonable

---

[10] Presumably, the jury will also be informed that the Inspector General concluded that no decision made by SBA regarding Plaintiff was based on the race of Plaintiff's principals.

jury of direct discrimination,[11] it may still be presented to the jury for its consideration on the issue of disparate impact.

In view of Plaintiff's evidence that the challenged "five year rule" disproportionately excludes African American firms from securing SBIC licenses, the absence of any statistical or other kinds of evidence showing a "demonstrable relationship" between the challenged criteria and an SBIC's success, Plaintiff's suggested nondiscriminatory alternative solution, the SBA's history vis-a-vis involvement of African American owned funds into its programs, and the numerous material facts in dispute,[12] the Court finds that genuine issues of material fact exist with regard to Plaintiff's disparate impact claim and that Plaintiff has offered sufficient evidence from which a reasonable jury could conclude that Defendant is liable for disparate impact discrimination on the basis of race. Accordingly, it is

ORDERED that Defendant's Motion for Summary Judgment [Dkt. No. 90] is **denied**; and it is

---

[11] See, for example, the early comments of Leonard Fagan, whose job was simply to intake MAQs filed by email to the Investment Division, but e-mailed that the MAQ was "weak," and noted that Peak was a "frat brother" of another SBA employee who was African American, and the comments of Karen Ellis, who reviewed Plaintiff's first MAQ, that Peek "had a sense of entitlement about being in the program," and "knew that all along I didn't think he was going to get an interview [to receive a go-forth letter] . . . I had told them [Diamond] that probably since the day [I] started reviewing the MAQ," and her denials of knowing the race of the applicants when the MAQ she was reviewing contained that information.

[12] See Diamond Ventures's Statement of Genuine Issues and Statement of Facts [Dkt. No. 102].

FURTHER ORDERED that the parties shall appear for a Status Conference on **April 15, 2010, at 10:45 a.m.**

/s/
March 29, 2010
GLADYS KESSLER
United States District Judge

Copies via ECF to all counsel of record