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MINORITY ACCESS TO CAPITAL

FIELD HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

MARCH 16, 2015

Printed for the Committee on Small Business and Entrepreneurship

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MINORITY ACCESS TO CAPITAL

MONDAY, MARCH 16, 2015

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Bowie, MD.

The Committee met, pursuant to notice, at 10:04 a.m., at the Picard Center/Bowie State University Student Center-Wiseman Ballroom, Bowie State University, Bowie, Maryland, Hon. Ben Cardin, presiding

Present: Senator Cardin.

Also present: Representative Edwards.

OPENING STATEMENT OF HON. BENJAMIN L. CARDIN, A U.S. SENATOR FROM MARYLAND

Senator CARDIN. Good morning, everyone. Let me welcome you all to this hearing for the Small Business and Entrepreneurship Committee.

I, first, want to thank Bowie State University for their hospitality. Dr. Brown has always been open to us.

We are very proud of the work that is done at Bowie. This is an incredible institution that provides an extremely important function for our community, as I think President Obama has recognized the importance of this particular campus. So we thank you for allowing the hearing to take place at Bowie State University.

I want to thank Senator David Vitter, the Chair of the Committee on Small Business and Entrepreneurship, for agreeing to allow this field hearing to take place on access for minority businesses to capital. I am the senior Democrat, the ranking Democrat, on the Small Business Committee, and he has authorized this hearing and for me to chair this hearing.

We will be joined by my colleague, Congresswoman Donna Edwards. She will be here, we believe, in about 30 minutes. When she gets here, I will recognize her and allow her to make some opening comments and join us in this very, very important hearing.

I want to acknowledge Kevin Wheeler, who is staff of the Small Business and Entrepreneurship Committee. I think she is around here, right there.

Kevin has been with the Committee for a long time, and if I get into trouble she is going to make sure I get back on track. So I appreciate that very much.

I also want to introduce Ann Jacobs, who is the Democratic Staff Director for the Small Business Committee, over there, on the corner.

Steven Umberger is here, who is the Maryland Director for the Small Business Administration, and has the State of Maryland except for the Washington suburban areas. And we have Mr. Doss here, who represents that part of the territory for the Small Business Administration, plus Northern Virginia and the District of Columbia.

The Small Business Committee is a committee that I wanted to serve on.

I also would like to recognize—I know Michele is here representing my colleague in the United States Senate, Senator Barbara Mikulski. I am going to be joining Senator Mikulski in a few minutes, in about an hour or so, in Baltimore with Vice President Biden, but Senator Mikulski is an incredible partner on the small business issues.

And Terrance is here representing Congressman Steny Hoyer.

So we have the full Federal delegation from Prince George's County. All four of us who represent will be participating in this hearing either through staff or through, Donna Edwards, in person. So I do appreciate all their help.

When I was elected to the United States Senate, the majority leader asked which committees I want to serve on. And there are obviously committees that are what we call the top-tier committees, such as the Finance Committee and the Foreign Relations Committee, Environment and Public Works Committee, and I am proud to serve on those committees.

But I asked the majority leader if I could serve on the Small Business and Entrepreneurship Committee. That was one of my top choices because I recognize that the economic engine of America is basically our small businesses. That is where you are going to get job growth. That is where you are going to get innovation. And, new ideas are going to come from small businesses.

And particularly in Maryland, I understand how important small businesses were to our state economy.

So the majority leader recommended my appointment, and I have been on the Small Business Committee now for eight years and am now the lead Democrat on the Committee.

So I wanted to take a look at how we can do things that are better, what we can do to help small business growth in our community. We need to do a better job for small businesses.

When I was first elected, I recognized the SBA needed additional resources. With President Obama's elections, I supported an amendment during the budget process that increased the funds going to the SBA so that they could have the capacity to help.

I brought the people in from the SBA when I was first elected and looked at the numbers as to how much aid was going, how many loans were being made to minority businesses, and I was pretty shocked by the low numbers. And we set out to do something about it, and we have improved those numbers.

And they are better today, but they are still not where they need to be. When we take a look at the numbers, we see that we could be doing a better job.

And, I had a chance to talk to Alejandra before we got on the—before we started the formal hearing.

But this is a matter of the values of America. We believe that everyone should have the opportunities of this country. So, therefore, it is a matter of our values that we make sure that those minority businesses and disadvantaged communities have the tools necessary to achieve our values, our opportunities, in this country.

It is a matter of basic fairness, but it is also a matter of our economic growth. If we deny a segment of our community its full potential, we lose the strength in our economy.

So we must do a better job, and that is one of the reasons for this hearing—is to take a look at how we can do a better job in allowing those creative individuals the opportunity to have the financing necessary to achieve their dream but at the same time to achieve the dream of America—the strength of our economy.

So since becoming ranking member of this Committee, I, along with other members of this Committee, have made it a top priority to focus on removing the barriers that still affect minority-owned small businesses. In some cases, those barriers are not unlike the barriers which plague all businesses, but in some cases the obstacles that minorities and small business owners face are very unique.

Minority businesses represent 35 percent of the population but only 22 percent of the businesses. This achievement gap results, in part, from the significant obstacles that minority business owners face in accessing capital.

If minority-owned businesses had a rate comparable to their share of their population, that would mean 2.3 million more minority-owned firms and 11.7 million jobs. You can see the impact it has on our economy.

Minority-owned businesses are two to three times more likely to be denied credit, more likely to avoid applying for loans based on the belief that they will be turned down, and more likely to receive smaller loans and pay higher interest rates on the loans that they do receive.

The recession hit all small businesses hard, but it hit minority-owned small businesses especially hard, and recovery has been uneven for different minority groups.

The Small Business Administration and the Minority Business Development Agencies have created various programs to improve access to capital.

I want to just, before I start with our panel—we will obviously focus on the tools we have in government and what we can do in government to make those tools more effective, but we also need to look at the private sector and what we can do to make sure that the private sector participation is open to minority businesses.

In many cases, it is a matter of just education and a matter of outreach, but we need to do a better job because it is not just the tools that are available in government. We have to make sure that all the partners that are important for economic growth are sensitive to the potential and fairness of our country.

Well, we have an excellent panel with us today to talk about these issues, and I thank each of them for being here at Bowie.

I will introduce the four witnesses that are here. We are still waiting for Shelly Gross-Wade. She indicates she will be here in about a half an hour.

But I think we will start with our witnesses:

Alejandra Castillo, who is the National Director of the Minority Business Development Agency. She works directly with minority businesses, and I thank her very much for being here.

Mr. Antonio Doss, who is the District Director Washington Metropolitan Area of the U.S. Small Business Administration representing Maria Contreras-Sweet, the Administrator of the Small Business Administration, who has been to Maryland several times and one of the most aggressive leaders I have ever seen on small business issues.

Mr. Doss, it is a pleasure to have you here. As I indicated earlier, you represent the area that we are here, Bowie, and the Washington suburbs as well as Northern Virginia and the District of Columbia.

Mr. Carl Hairston, the Administrative Vice President for M&T Bank, the National Capital Business and Professional Banking Regional Manager, which is one of the preferred lenders in the SBA programs and has been actively engaged—the bank actively engaged—in loans to small businesses.

And, Mr. Stanley Tucker, who is President and CEO of Meridian Management Group—30 years of experience in the business field in this area. He is a friend and an adviser and extremely active in minority business issues.

So we have an excellent panel, and Ms. Castillo, we will start with you.

[The prepared statement of Senator Cardin follows:]

Senator Benjamin L. Cardin
Opening Statement
Senate Small Business and Entrepreneurship Committee
"Minority Access to Capital" Field Hearing
March 16, 2015

Good morning and thank you for joining us for this very important hearing. The hearing will come to order.

Welcome to the Small Business and Entrepreneurship Committee hearing entitled, "Minority Access to Capital."

This hearing is being hosted by Senator Vitter, the Chair of the Senate Committee on Small Business and Entrepreneurship. Unfortunately, Senator Vitter was unable to be with us today, but we appreciate his interest in the subject.

I want to thank President Mickey Burnim of Bowie State University for allowing us to use the facility for the field hearing.

We have a distinguished panel of witnesses today, and I thank them all for making time to be here. I also want to thank all of the members of the public who have taken time out of their day to join us as we hear testimony on this important issue.

Since becoming Ranking member of this Committee, I, along with the other members of this Committee, have made it a top priority to focus on removing the barriers that still affect minority-owned small businesses. In some cases, those barriers are not unlike the barriers which plague all businesses. But, in some cases, the obstacles that minority small business owners face are very unique.

Minorities represent 35% of the population, but only 22% of businesses. This achievement gap results in part from the significant obstacles that minority business owners face in accessing capital. If minorities owned businesses at a rate comparable to their share of the population, that would mean 2.3 million more minority-owned firms and 11.7 million more jobs.

Minority-owned businesses are two to three times more likely to be denied credit, more likely to avoid applying for loans based on the belief that they will be turned down and more likely to receive smaller loans and pay higher interest rates on the loans that they do receive.

The recession hit all small businesses hard, but it hit minority-owned small businesses especially hard, and recovery has been uneven for different minority groups. The Small Business Administration and the Minority Business Development Agency have created various programs to improve access to capital.

Joining us today is Alejandra Castillo, the National Director for the Minority Business Development Agency for the Department of Commerce. She is tasked with helping to create and sustain U.S.

jobs by promoting the growth and global competitiveness of businesses owned and operated by minority entrepreneurs.

We also have Stanley Tucker, who is President and CEO of Meridian Management Group. Meridian Management Group is a professional asset manager for economic development and private equity funds. He has more than 30 years of diversified business experience, combining both lending and venture capital investing to develop socially or economically disadvantaged small businesses.

Additionally, we have Antonio Doss, the Small Business Administration District Director for the Washington Metropolitan Area. He oversees the delivery of SBA's small business financing products, contracting programs, and entrepreneurial coaching services in Washington DC, Northern Virginia, and suburban Maryland, including Bowie.

We also have Carl Hairston, the Administrative Vice President and Regional Manager of M&T Bank's National Capital Business and Professional Banking Group for the District of Columbia, Prince George's County, Arlington, Alexandria, and McLean, Virginia. He oversees both the lending and servicing team that supports the branch network where he is responsible for the loan and deposit portfolios as well as the development of new business, and the Diversity Business Group responsible for developing opportunities in diverse communities.

Finally, we have Shelly Gross-Wade, the President and CEO of FSC First. FSC First is a preferred alternative lender for SBA 504 Commercial Real Estate Loans, the SBA Community Advantage Loan Program, the State of Maryland Micro-Enterprise Loan Program, the City of Bowie Revolving Loan Fund, and the Prince George's County $50 Million EDI Fund.

I would like to now turn our attention to our first witness to hear her testimony.

STATEMENT OF ALEJANDRA Y. CASTILLO, NATIONAL DIRECTOR, MINORITY BUSINESS DEVELOPMENT AGENCY (MBDA), U.S. DEPARTMENT OF COMMERCE

Ms. CASTILLO. Thank you very much.

Good morning, Chairman Vitter, Ranking Member Cardin, and members of the Committee. I am Alejandra Castillo. I serve as the National Director of the Minority Business Development Agency, MBDA, at the U.S. Department of Commerce.

For the purpose of this hearing, I will focus on the continued challenges minority business enterprises, or MBEs, face in accessing a broad array of capital during their life cycle. My testimony highlights our research findings and underscores the actions we have taken to create a more robust and sustainable economic ecosystem for minority businesses to grow and thrive.

MBDA is the only Federal agency tasked to help MBEs realize their full economic potential through technical assistance, public and private contracting opportunities, advocacy, research, education, and strategic partnerships. This work is accomplished through our nationwide network of 44 business centers. Each center provides services that offer access to capital, access to contract, and access to new markets.

Since 2009, MBDA has assisted clients in accessing nearly $26 billion in contracts and capital while creating and retaining 87,000 jobs. Celebrating 45 years of service, MBDA has been working aggressively to expand the economic footprint of MBEs.

According the U.S. Census Bureau's 2007 Survey of Business Owners, MBEs contributed more than $1 trillion in total economic output and employed nearly 6 million Americas. These findings highlight the direct and significant contribution of minority firms to the national economy.

In addition, we know that the face of America is changing. We only need to look at the demographic changes occurring throughout the country. By 2020, more than half of the nation's children are expected to be part of a minority group or ethnic group. By 2043, the minority population will be the majority group in this country.

This data translates equally in the business community, with over 5.8 million MBEs, and growing, delivering goods and services.

It is, therefore, important to note that if the U.S. hopes to remain globally competitive engaging MBEs is no longer a moral or civic imperative, it is a strategy, economic, and business imperative, too.

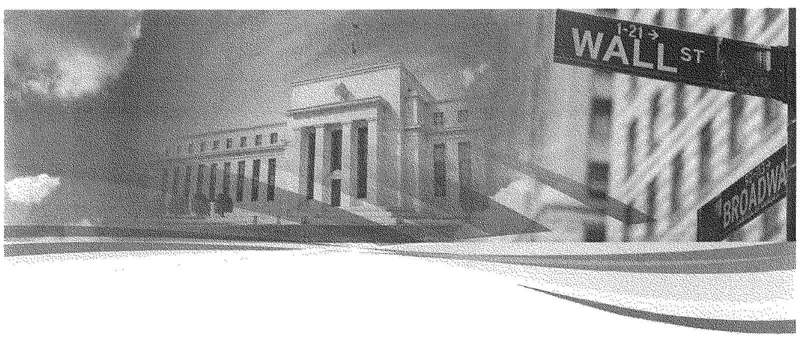
Opportunity abounds for the development, growth, and diversification of industries for MBEs. MBEs are sources of job creation and economic development for many communities around the country. However, they continue to encounter barriers in accessing capital, contracts, and export markets.

In 2010, MBDA released a report titled "Disparities in Capital Access." Here are just two of the many key findings: Minority-owned firms received lower loan amounts than non-minority-owned firms by almost 50 percent. Minority-owned firms are three times more likely to be denied loans than nonminority firms.

Chairman Vitter and Senator Cardin, I ask that MBDA's "Disparities in Capital Access" report be added to the written testimony at this time.

Senator CARDIN. Without objection, it will be included.
[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

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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]

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[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
	1987	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	1.6	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 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.

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.*

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[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]

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[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.

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[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.

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[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. born 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.

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[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).

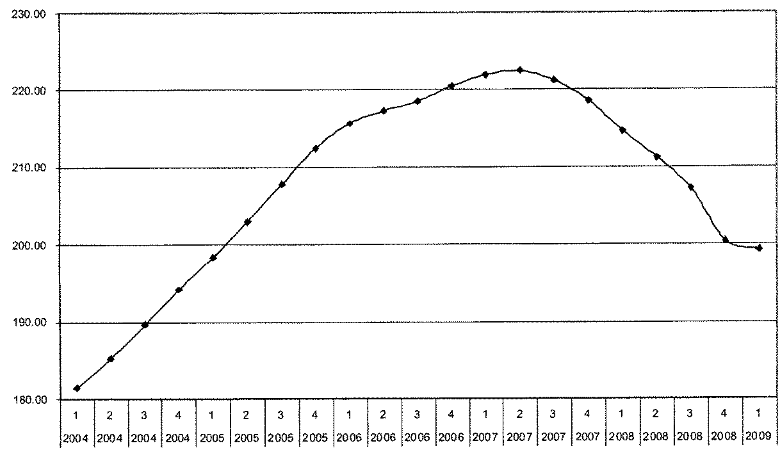
many of the factors listed below such as financial capital, discrimination, and human capital. For example, minority businesses are known to have limited networks in the investment community resulting in lower levels of capital use.[87] Given these interactions and the inherent difficulty of measuring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

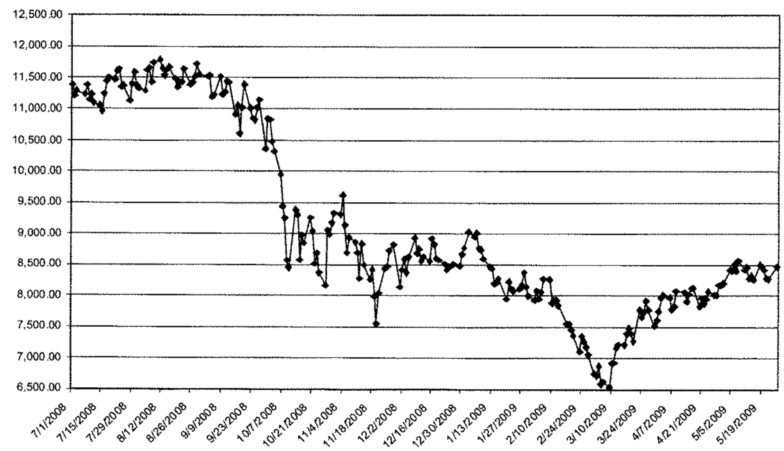


The largest single asset affecting personal wealth is home equity. Over the past two years housing values have dropped precipitously. Figure 1 displays the Monthly House Price Index from the Office of Federal Housing Enterprise Oversight from January 2004 to February 2009. The peak in the housing market 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.[68] The decline in housing values is likely to further limit the amount of capital available to minority entrepreneurs.

[68] 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.

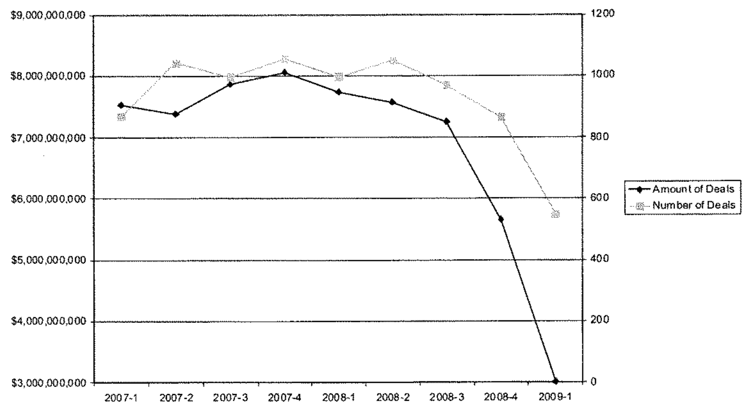
Figure 2
Dow Jones Industrial Average



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]

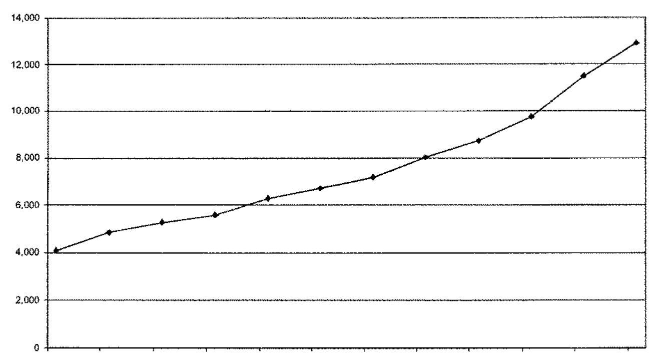
[89] Sohl.

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 Alaska Native	Total	51.9%	10.0%	12.2%	1.0%	0.8%	7.8%	2.0%	30.8%
	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 Other Pacific Islander	Total	52.6%	10.3%	12.7%	2.3%	0.4%	5.2%	2.1%	29.9%
	High Sales	66.5%	15.8%	n/a	n/a	n/a	20.3%	4.0%	
	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 Firms	Total	54.6%	9.0%	8.8%	0.9%	0.7%	11.4%	2.7%	27.7%
	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 Sales	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)

			Equity Investments		Loans		
Group	Sales	Employees	Percent	Mean	Percent	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)

	Internal Financing		External Debt		External Equity		Total Financial Capital
Group	% of firms	Mean	% of firms	Mean	% of firms	Mean	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	-0.276***	-0.0746*
	(0.0797)	(0.0965)	(0.0386)
Female	-0.161**	-0.168*	-0.133***
	(0.0755)	(0.0889)	(0.0337)
Age	0.0338*	0.0515**	0.0244**
	(0.0195)	(0.0231)	(0.00969)
Age Squared	-0.000207	-0.000427*	-0.000232**
	(0.000208)	(0.000248)	(0.000102)
HS Graduate	0.266	0.130	0.0210
	(0.262)	(0.292)	(0.101)
Some College	0.333	0.0928	0.0958
	(0.248)	(0.278)	(0.0985)
College Graduate	0.481*	0.0818	0.0907
	(0.252)	(0.282)	(0.101)
Graduate Degree	0.556**	0.231	0.143
	(0.259)	(0.292)	(0.106)
Hours Worked (weekly average)	0.0211***	0.00945***	0.00115
	(0.00150)	(0.00175)	(0.000784)
Industry Experience (years)	-0.0128***	-0.0139***	-0.000499
	(0.00350)	(0.00436)	(0.00218)
Start up Experience	0.0528	0.0539	0.0307
	(0.0677)	(0.0807)	(0.0380)
Team Ownership	0.320***	0.278**	0.0878
	(0.0885)	(0.110)	(0.0608)
Partnership	0.177	-0.155	0.159
	(0.171)	(0.197)	(0.116)
Limited Liability Corp.	0.500***	0.446***	0.197***
	(0.0925)	(0.108)	(0.0494)
Corporation	0.446***	0.369***	0.195***
	(0.0946)	(0.112)	(0.0502)
Home Based	-0.675***	-0.536***	-0.152***
	(0.0732)	(0.0846)	(0.0396)
Comparative Adv.	0.146**	0.0555	-0.0574
	(0.0701)	(0.0825)	(0.0401)
Intellectual Property	0.178**	-0.0122	0.117**
	(0.0851)	(0.101)	(0.0547)
High Credit Score	0.111	0.447***	0.0169
	(0.122)	(0.152)	(0.0741)
Low Credit Score	-0.257***	-0.303***	-0.0242
	(0.0724)	(0.0836)	(0.0403)
Constant	7.155***	6.286***	5.826***
	(0.608)	(0.720)	(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)	(0.226)	(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	0.186*	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)	(0.0684)
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***	0.0287
	(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	External Debt	External Equity	Internal Financing	External Debt	External Equity
	(1)	(2)	(3)	(4)	(5)	(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.

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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.

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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.

Ms. CASTILLO. Thank you.

The good news is we are making significant inroads. In 2014 alone, MBDA helped secure over $2 billion in capital and financing. The creation of MBDA's new Access to Capital Team is helping us introduce our clients not only to traditional lending sources but also to alternative ones.

Our work is twofold—to educate and prepare our MBE clients and firms about the type of financing available, and to advocate and educate a broad array of capital and lending institutions about the growth potential of MBEs.

While debt capital, bank lending, continues to be the primary source of financing for small and minority-owned firms, we also know that in order for these firms to grow they need to explore equity capital as well. Once again, MBDA is focused on finding ways to unleash a broad spectrum of capital opportunities.

This past October, I spoke at the Minority Finance Forum hosted in partnership with the Association for Corporate Growth in Chicago. I addressed over 800 investment bankers, private equity groups, bank fund managers, family offices, mergers and acquisitions companies, and encouraged them to look at MBEs as possible partners.

We are making inroads here in Maryland. One success is that of our Baltimore Business Center and their work with M. Luis Construction, Inc., the only minority and woman-owned asphalt manufacturer in the nation. The Baltimore Business Center's consulting services led to $27 million in procurement and $21 million in surety bonding for M. Luis Construction. We are pleased to be part of their success.

Our mission is to champion minority businesses nationwide. We are unyielding in this pursuit.

On behalf of MBDA and the U.S. Department of Commerce, thank you, Mr. Chairman and the Committee, for the opportunity to testify.

Understanding that the changing role of minority businesses in our nation's economic future is mission-critical and supporting their growth through access to capital is paramount. Now, more than ever, our nation's diversity translates into economic advantages in domestic and global marketplaces.

We salute the Committee, the Committee's work in addressing obstacles to capital faced by minority businesses.

I welcome the opportunity to discuss further MBDA's efforts to encourage the full spectrum of financing and capital access. I am happy to answer any questions.

Thank you very much.

[The prepared statement of Ms. Castillo follows:]

Written Testimony of Alejandra Y. Castillo, National Director
Minority Business Development Agency
U.S. Department of Commerce
Before the
U.S. Senate Committee on Small Business and Entrepreneurship

"Minority Access to Capital" Field Hearing
March 16, 2015
Bowie State University
Bowie, Maryland

Introduction

Good Morning Chairman Vitter, Ranking Member Cardin, and Members of the committee. I am Alejandra Castillo, and I serve as the National Director for the Minority Business Development Agency, also known as MBDA, at the U.S. Department of Commerce.

My testimony will outline MBDA's mission and vision in assisting minority-owned firms to gain greater access to capital, contracts and markets. For the purpose of this hearing, I will focus exclusively on the continued challenge of access to capital to sustain not just the start of minority business enterprises (MBEs), but more importantly the growth of these firms. My testimony today will highlight the research findings and underscore the actions that we are taking to create a more robust and sustainable eco-system that will help minority businesses obtain capital for their current and future needs. In addition, I will review some specific areas where we have achieved success right here in Maryland.

Role of MBDA

Our U.S. Department of Commerce Secretary, Penny Pritzker, has laid out an aggressive "Open for Business Agenda" that highlights the critical need to focus on trade and investment, innovation, data, and the environment in order for the United States to be successful in the twenty-first century global economy. The Commerce Department's "Open for Business Agenda" focuses on entrepreneurship and innovation which drives the central purpose of my agency's work to ensure that America's minority business community continued to grow in size and scale and continue to drive value and global competitiveness.

For over forty-five years, MBDA has been working aggressively to expand the economic footprint of MBEs. According to the U.S. Census Bureau's 2007 Survey of Business Owners, these MBE firms contributed $1 trillion in total economic output and employed nearly six million Americans.[1] These findings highlight that the economic contribution of minority firms has a direct and significant impact on the national economy, and more recent Census reports demonstrate that this impact is continuing to grow.

[1] U.S. Census Bureau, 2007 Survey of Business Owners, June 2010.

The demographic data is clear; America's population make-up is changing. By 2020, more than half of the nation's children are expected to be part of a minority race or ethnic group,[2] by 2043, the minority population will be the majority group in this country. Therefore, as the demographic composition of our country changes, so too does the face of our business community. With over 5.8 million MBEs, and growing, the U.S. Business community is transforming, and the way we do businesses in America is changing. Not just in terms of its consumers, but also in terms of the growing number of minority firms that are delivering the goods and services of today's economy.[3] Engaging MBEs is essential to support the future of American business and ensure the U.S. remains globally competitive.

The growth in the number of minority-owned firms is a positive trend. However, there are improvements that can be made, as these firms seek to expand in size and scale. It is critical that we create and foster an eco-system that allows for growth of these firms. Unfortunately, MBEs continue to encounter many obstacles that include barriers to accessing capital, contracts, and export markets.

MBDA serves as the only federal agency tasked to help MBEs realize their full economic potential through technical assistance, public and private contracting opportunities, advocacy, research, education, and by serving as a strategic partner for growth and development.

The bulk of this work is accomplished through our nationwide network of MBDA Business Centers. Each center provides services that assist businesses in accessing capital, contracts, and new markets, as well as helping them to grow in size and scale. Since 2009, MBDA has assisted clients in accessing nearly $26 billion in contracts and capital, while helping them create and retain over 87,000 jobs.

Success in Maryland

In the fall of 2013, MBDA opened a business center in Baltimore, Maryland, operated by the City of Baltimore Mayor's Office of Minority and Women-Owned Business Development. Since opening, the center has been engaged with M. Luis Construction Inc., a nationally recognized small business with more than 200 employees and the only Minority Business Enterprise and Women's Business Enterprise asphalt manufacturer in the nation. The Baltimore MBDA Business Center has played a role in M. Luis Construction's continuing success through assisting public and private relationship management and navigating procurement opportunities across the state of Maryland. MBDA's Baltimore Business Center efforts have led to over $27 million in procurement, and brought $21 million in surety bonding.

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[2] Frey, William H., *"Census Projects New Majority Minority" Tipping Points*. State of Metropolitan America. The Brookings Institution, 3 December 2012.
[3] U.S. Census Bureau, 2007 Survey of Business Owners, June 2010.

Research Findings

While the success of M. Luis Construction is impressive and representative of the types of business development assistance that MBDA delivers its clients across the country, this type of success is far too uncommon in the minority business community as a whole, despite our best efforts, due to continued institutional and systematic barriers. In 2010, MBDA released a report titled "Disparities in Capital Access."[4] Some of the key findings include:

- Minority-owned firms receive lower loan amounts than non-minority firms – While the average loan amount for all high-sales minority firms was $149,000, non-minority firms received an average of $310,000 or more than twice the amount.
- 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 compared to those of non-minority-owned firms. 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 receive lower loan and equity investment amounts - 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.
- 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 non-minorities are 11 to 16 times higher. Low levels of wealth and liquidity constraints in turn 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.

In order to expand on these findings, MBDA has recently commissioned a study to examine the use of alternative financing solutions, including crowd funding, peer-to-peer lending, and family office investment networks. The upcoming report will highlight financing solutions used by minority-owned businesses in high-growth industries.

In 2013, the Selig Center for Economic Growth released the "Multicultural Economy" report, which focused on the economic buying power of minorities. One of the boldest findings is that by 2018, the combined buying power of African Americans, Asians, Pacific Islanders and Native Americans will be $2.6 trillion.[5] This combined buying power will account for 16.4 percent of the nation's total buying power.[6] MBEs have the

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[4] 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).
[5] Selig Center for Economic Growth, Terry College of Business, The University of Georgia, June 2013.
[6] Ibid.

highest understanding and connection to this large and high-growth segment of the economy; and by working to support their business efforts, the U.S. Department of Commerce can capitalize on these new domestic markets. In addition, we know that MBEs are also twice as likely to export as non-minority firms.[7] Therefore, the potential growth of MBEs through exports is also a fast growing segment of their business operations.

Access to Capital for Minority-owned Businesses

In 2014, MBDA helped to secure over $2 billion in capital and financing for clients. In addition to traditional sources, we created a new Access to Capital Team to introduce our clients to alternative capital sources. This work has been two-fold: to educate clients and firms about the types of alternative financing available, and to advocate on their behalf with the kind of resource partners that minority owned firms cannot access. Minority firms lack access to many of the types of people that are in the room today: venture capitalists, angel investors, mergers and acquisitions firms, firms with internet-based platforms, and the many other firms that act as ever more important alternative sources of capital.

This past October, I had the opportunity to speak at the Minority Finance Forum, hosted in partnership with the Association for Corporate Growth in Chicago. I addressed over 800 investment bankers, private equity groups, bank fund managers, family offices, merger and acquisition companies, and banks in expressing the need for minority-owned firms to play a role in the middle market and break the barrier in accessing capital- and they all agreed. MBDA will continue to engage firms like these to help expand access for minority owned firms.

Debt capital (bank lending) is the primary source of financing for small and minority owned firms and plays a vital role in purchasing new inventory, hiring, and maintaining cash flow to grow their businesses. Forty-eight percent of business owners report a major bank as their primary lending source and thirty-four percent report a regional and community bank.[8] MBDA advocates for MBEs in the traditional banking space through relationships with national level banks and countless community banks through MBDA's national network of business centers. We are also working with SBA on increasing opportunities for MBEs to pursue micro lending opportunities.

MBDA is also engaged in the use of alternative finance through partnerships with a large portfolio of alternative capital providers including internet based lenders, angel investor networks, micro lenders, Community Development Financial Institutions, and other investors in the middle-market space.

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[7] U.S. Department of Commerce, Minority Business Development Agency, Fact Sheet: *Minority-Owned Firms Lead the Nation in Exporting* (2012).

[8] Mills, Karen and McCarthy, Brayden, *The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game* (July 22, 2014). Harvard Business School General Management Unit Working Paper No. 15-004.

There is a rising class of fund managers in minority and women managed hedge funds. Many states, including Maryland, have policies to consider minority and women owned firms in the allocation process to ensure that the make-up of firms managing pension assets mirrors the employee and customer base, and to provide opportunities to managers that have historically been underrepresented in the investment management arena.

These fund managers, called emerging managers, have the potential to outperform established hedge funds due to their ability to stay nimble, access less crowded trades, and focus on performance. Utilizing emerging managers also goes a long way in helping to bridge the wealth gap.

Conclusion

I want to thank you and this Committee for the opportunity to speak with you today. Understanding the growing role of minority businesses in our Nation's economic future is critical; however, being able to support and enhance their growth through access to capital is paramount. We welcome this committee's work in addressing these current challenges. As we move forward, MBDA will continue to highlight the strategic importance that MBEs play in the American economy and to find solutions to address the continued challenges that MBEs face when it comes to being "Open for Business." On behalf of MBDA and the U.S. Department of Commerce, I welcome the opportunity to discuss MBDA's commitment to strengthening the minority business community. I am happy to answer any questions you may have.

Senator CARDIN. Thank you very much for your testimony.
Mr. Doss.

STATEMENT OF ANTONIO DOSS, DISTRICT DIRECTOR WASHINGTON METROPOLITAN AREA, U.S. SMALL BUSINESS ADMINISTRATION

Mr. DOSS. Good morning, Ranking Member Cardin and Congresswoman Edwards.

Administrator Contreras-Sweet sends her regards and regrets as she could not attend today's hearing.

I am Antonio Doss, and I serve as District Director of the U.S. Small Business Administration's Washington Metropolitan Area District Office.

I am joined today by my colleague, Steve Umberger, the District Director of SBA's Baltimore Office, which supports entrepreneurs and Maryland's small business owners who reside outside of Prince George's and Montgomery Counties.

As you know, SBA's mission is to strengthen the nation's economy by enabling the establishment and vitality of small businesses. Underpinning all of our efforts is this notion of inclusive entrepreneurship. By this, I mean we work to ensure that SBA products and services are available to small business owners regardless of age, race, gender, geography, or socioeconomic status.

My testimony today will focus on our lending programs, but I would be remiss if I did not mention government contracting because of the essential role it plays in the Capital Region and throughout Maryland.

SBA programs, like the 8(a) Business Development Program and HUBZone, help ensure that underserved small businesses receive their fair share of the Federal pie. Last year, we were pleased to join Senator Cardin and the NASA administrator to announce that the Federal Government met our statutory goal of awarding at least 23 percent of all Federal contracts to small businesses.

But on the topic of today's hearing, providing more capital to underserved and minority small businesses, this has been a particular focus of Administrator Contreras-Sweet.

In fiscal year 2014, we made loans more affordable by waiving fees on all 7(a) loans under $150,000. As a result, minority lending under $150,000 increased 23 percent in fiscal year 2014. We are encouraged by these results and plan to continue the fee waiver in fiscal year 2016.

The micro loan program is another key piece in our underserved strategy. It helps ensure that borrowers have the support and technical assistance they need. The micro lending program provides funding for loans up to $50,000 through nonprofit lenders.

Over half of all micro loans have been awarded to minority-owned businesses. Nearly 30 percent of all micro loans were awarded to African-American business owners.

Another effective program for underserved borrowers is our community advantage program. This program allows our micro lenders, CDCs, and other non-bank lenders to offer 7(a) loans up to $250,000. The program also helps meet the credit management and technical assistance needs of small businesses in underserved markets that might not quality for traditional financing.

SBA approved a record $19.2 billion in lending under the 7(a) program last year. We are on track for another record-breaking total this year.

Maryland small businesses received $245 million in SBA-supported loan approvals under the 8(a) program. Maryland's minority-owned businesses accounted for 38 percent of the number of 7(a) guaranteed loans by SBA in the State and 44 percent of the dollar value.

We have made progress on underserved lending, but we know more must be done to achieve our vision. We are taking steps to do more by making SBA loans easier to access, quicker to process, more affordable, and less cumbersome to originate.

This spring, we will roll out SBA One, a revamped lending platform that will serve as a one-stop shop for all steps of the loan process, from determining eligibility through closing out the loan.

In another effort to streamline the SBA process, last year we rolled out a new SBA predictive credit scoring model for loans $350,000 or less. It puts greater emphasis on a borrower's business score.

Finally, we are making it easier to connect with SBA lenders. Just last month, we introduced a new web-based tool called LINC. It allows prospective borrowers to fill out a simple online form and get connected with interested SBA lenders within 48 hours.

LINC began by connecting small business owners with micro lenders and nonprofit lenders. Later this year, we plan to add banks and conventional commercial lenders.

SBA remains committed to helping current and aspiring entrepreneurs secure the financing and the support they need to start, sustain, and grow their businesses. The new tools we have implemented are designed to get more credit in the hands of small businesses from all walks of life. We are committed to innovations that will allow us to serve and assist minority-owned businesses in Maryland and across America.

Thank you for the opportunity to provide this testimony, and I welcome your comments and questions.

[The prepared statement of Mr. Doss follows:]

U.S. Small Business Administration
Washington, D.C. 20416

TESTIMONY of

ANTONIO DOSS
District Director, Washington Metropolitan Area
U.S. Small Business Administration

U.S. Senate Small Business and Entrepreneurship Committee
Monday, March 16, 2015

Good morning, Ranking Member Cardin, and members of the committee. Administrator Contreras-Sweet sends her regards and regrets that she could not attend today's hearing.

I am Antonio Doss, and I serve as District Director of the U.S. Small Business Administration's Washington Metropolitan Area District Office. Our office is one of 68 district offices located in major markets around the country. Although based in the District of Columbia, we support the small business community in Prince George's County, Montgomery County, Northern Virginia and Washington, D.C.

I am joined today by my colleague, Steve Umberger, the District Director of the SBA's Baltimore District Office, which supports entrepreneurs and Maryland small business owners who reside outside of Prince George's and Montgomery Counties.

As you know, the SBA's mission is to strengthen the nation's economy by enabling the establishment and vitality of small businesses. We help create an environment whereby entrepreneurs and small business owners have unmatched federal support to innovate, launch, hire and grow – and in so doing, become critical drivers of their local economies.

Underpinning all of our efforts is the notion of inclusive "entrepreneurship." By this I mean that we work to ensure that SBA products and services are available to small business owners regardless of age, race, gender, geography or socioeconomic status. Indeed, our current Administrator has placed a special emphasis on strategies that enable us to better reach underserved and economically challenged segments of our market.

My testimony today will focus on our lending programs, but I would be remiss if I did not mention government contracting, because of the essential role it plays in the capital region and throughout Maryland. Government contracts provide billions of dollars in revenue for local small businesses. SBA programs like the 8(a) business development program and HUBZone help ensure that underserved small businesses receive their fair share of the federal pie.

Last year, we were pleased to join Senator Cardin and the NASA Administrator to announce that the federal government met our statutory goal of awarding at least 23 percent of federal contracts to small businesses. This was an important achievement that meant more than $83 billion flowed to small firms, which create nearly two out of three net private-sector jobs in America.

Providing more capital to underserved and minority small businesses has been a particular focus of Administrator Contreras-Sweet. She was a commercial business banker in Los Angeles specializing in minority lending before joining President Obama's cabinet. She has a unique understanding that many minority communities were hit especially hard in the recession, and the SBA plays a special role to serve these communities since our charter is to fill in the gaps of commercial lending.

In FY 2014, we made loans more affordable by waiving fees on all 7(a) loans under $150,000. As a result, minority lending under $150,000 increased 23 percent in FY 2014. We are encouraged by these results, and plan to continue the fee waiver in FY 2016.

The microloan program is another key piece in our underserved strategy. It helps ensure that borrowers in all communities have the support and technical assistance they need to start a business, grow, and ultimately achieve long-term success. The microloan program provides funding for loans up to $50,000 through non-profit lenders. Over half of all microloans have been awarded to minority-owned businesses; nearly 30 percent of microloans were awarded to African-American business owners. This community was hit particularly hard by the economic crisis.

Another effective program for underserved borrowers is our Community Advantage Loan Program. This program allows our microlenders, CDCs, and other non-bank lenders to offer 7(a) loans up to $250,000. The program also helps meet the credit, management, and technical assistance needs of small businesses in underserved markets that might not qualify for traditional financing.

SBA approved a record $19.2 billion in lending under the 7(a) program last year. We expect another record-breaking total this year based on the escalating demand for SBA financing. Last year, $5.5 billion dollars – or 29 percent of all 7(a) loans – were awarded to minority borrowers. Maryland small businesses received $245 million in SBA-supported loan approvals under the 7(a) program. Maryland's minority-owned businesses accounted for 38 percent of the number of loans guaranteed by SBA in the state and 44 percent of the dollar value.

We have made progress on underserved lending, but we know more must be done to achieve our vision. We are taking steps to do more by making SBA loans easier to access, quicker to process, more affordable, and less cumbersome to originate.

SBA partners with 80 active lenders serving Maryland businesses, and we are working to expand that number through an aggressive loan modernization program. This spring, we will roll out SBA One, a revamped lending platform that will serve as a one-stop shop for all steps of the loan process, from determining eligibility through closing out the loan.

In another effort to streamline the SBA loan process, last year we rolled out a new SBA predictive credit scoring model for loans $350,000 or less. It puts greater emphasis on a borrower's business credit score, so those who incurred personal debt during the downturn can still qualify for a small business loan. These reforms are dramatically cutting the time and cost of receiving SBA-backed financing.

Finally, we are making it easier to connect with SBA lenders. Just last month, we introduced a new Web-based tool called LINC. It allows prospective borrowers to fill out a simple online form and get connected with interested SBA lenders within 48 hours. LINC will roll out in waves. It began by connecting small business owners with microlenders and nonprofit lenders. Later this year, we plan to add banks and conventional commercial lenders.

SBA remains committed to helping current and aspiring entrepreneurs secure the financing and support they need to start, sustain, and grow their enterprises. The new tools we have implemented are designed to get more credit in the hands of small businesses from all walks of life. We are committed to innovations that will allow us to serve and assist minority-owned business in Maryland and across America.

Thank you for the opportunity to provide this testimony, and I welcome your comments and questions.

Senator CARDIN. Thank you very much for your testimony.
Mr. Hairston.

STATEMENT OF CARL L. HAIRSTON, ADMINISTRATIVE VICE PRESIDENT, M&T BANK, NATIONAL CAPITAL BUSINESS AND PROFESSIONAL BANKING REGIONAL MANAGER

Mr. HAIRSTON. Good morning. Thank you, Senator Cardin, for hosting this meeting, and as well to Congresswoman Edwards in her absence. On behalf of our Chairman and CEO, Robert Wilmers, of M&T Bank, we appreciate the opportunity to testify this morning.

We are very committed as a bank to small business lending throughout all of our geographies. We continue to be committed to small business lending. We are one of the 20th largest banks in the country, but we are the 6th largest Small Business Administration lender in the country. So we continue to be very committed.

When you look at—and I will speak on both our commitment to the Baltimore District Office of the SBA as well as the Washington District Office of the SBA. And just to share some figures, we continue to be the number one SBA lender in volume in both districts. So when you look at the Maryland area, we continue to drive the most small business lending volume through the SBA in these geographies.

One thing that I wanted to highlight in addition to the written testimony that I already provided, when you look in the Baltimore District, of the SBA loans that we issued, 29 percent of those loans were issued to minorities in the Baltimore District.

When you look at the Washington District Office, 45 percent—of the loans that we extended in the most recent fiscal year ending September 30, 2014, 45 percent of those loans were extended to minorities.

When you look and include females, white females in that number, in the Washington District, it actually totals 56 percent, and in Baltimore it totals almost 45 percent.

So our commitment is very sound.

With that, we still continue to see challenges in working with minorities, and that is why we have partnered with organizations such as the Bowie BIC here in Prince George's County, to further strengthen opportunities to work with minority businesses, as well as other organizations across the region.

To highlight some of the challenges we continue to see when we look at some of the lending volume, both SBA and non-SBA, many of the challenges surround equity injection challenges, with minority borrowers being able to meet equity injection requirements.

And then also, when we think about the most recent downturn and some of the regulatory changes that many financial institutions have to address and have to speak to with borrowers, is liquidity. So even after a minority borrower has brought forth the required equity injection, we also look at what resources do they have to fall back on should they encounter a challenge or difficulty with either their startup or their existing business.

And the biggest thing that we see is really collateral shortfalls. When you look here in Prince George's County, prior to the downturn, we saw minority businesses making even greater strides prior to the downturn. What many lenders were able to leverage towards lending to minority borrowers then was the equity that existed in their residences.

So when you look at this geography, many of the businesses tend to be more service business-oriented. So they are not capital-intensive. They do not really have the fixed assets that you can typically fall back to serve as collateral. Being that they are more service-oriented, the collateral challenges with lending to those types of businesses are even greater.

We absolutely leverage the Small Business Administration, but even leveraging the Small Business Administration, we still typically do not have enough collateral to shore up what that gap may be between what the guarantee will be provided by the SBA versus the assets that a minority borrower has to fall back on for collateral purposes.

So when we look, we see those as some of the challenges we continue to try to overcome when we are lending to minority borrowers.

We are very committed in working with all of the partners in addition to the SBA to find ways to extend more loans to minority borrowers, and we are interested in continuing the dialogue and being a part of any further discussions to support minority business lending in this region.

Thank you.

[The prepared statement of Mr. Hairston follows:]

Written Statement of Carl Hairston of M&T Bank
Small Business & Entrepreneurship Committee Field Hearing
"Minority Access to Capital"
March 16, 2015

Thank you, Senator Cardin, for the opportunity to speak today on small business financing in general and minority access to capital in particular. These are very important topics.

My name is Carl Hairston. I am the Administrative Vice President & Regional Manager of M&T Bank's National Capital Business & Professional Banking Group. I cover the District of Columbia, Prince George's County, Arlington, Alexandria and McLean, Virginia. In my role as VP and Regional Manager, I oversee the lending and servicing team that is responsible for the loan and deposit portfolios as well as the development of new business.

I also lead M&T's Diversity Business Group, which was established in 2006 to provide access to senior leaders of the Bank to business executives and key community stakeholders in order to increase the Bank's market share in diverse business communities as well as leads the Bank's African-American Recruitment and Retention Committee.

I am proud to say that M&T is the most active SBA 7(a) lender in Maryland as well as the Washington Metropolitan District of the SBA in loan volume and have been for the past five years consecutively. In 2014, M&T processed 297 loans to local businesses, totaling $37.6 million in FY14 (average loan size of $126,000) in the Baltimore District of the SBA and 128 loans to local businesses, totaling $18.8 million in FY14 (average loan size of $147,000) in the Washington Metropolitan District of the SBA. In addition to SBA loans, M&T offers many business credit products, from lines of credit to term loans where our average loan size is approximately $158,000.

Thank you again for the opportunity to speak today and tell M&T's story about small business lending and my experiences with the diversity business group. I look forward to answering any questions you may have.

Senator CARDIN. Thank you very much for your testimony.
Mr. Tucker.

STATEMENT OF STANLEY W. TUCKER, PRESIDENT AND CEO, MERIDIAN MANAGEMENT GROUP, INC.

Mr. TUCKER. Senator Cardin, thank you so much for being—inviting me here to testify.

I am actually wearing two hats this morning. I am wearing the hat as President of Meridian Management Group, where we manage several funds, but I am also representing the National Association of Investment Companies, which is a trade association that focuses on providing equity capital to minority- and women-owned businesses.

Meridian Management Group—actually, at one point, I was a state employee, but then we privatized.

We manage actually several funds. We manage the Maryland Small Business Development Financing Authority. We manage Invest Maryland, which is an equity capital for early stage funds. We manage another fund called Maryland Casino Business Investment Fund, where we can provide debt and equity. And, we also manage Community Development Ventures, Inc.

And our strategy, Senator, over the years was that we wanted to be able to provide a continuum of financing products, if you will, where we can actually birth a company and be involved with them, taking them all the way public, and we have done that for several years.

What is important is what is the return. I am specifically talking about the State of Maryland. When you look at the kind of investments in lending that we are involved with in Maryland, you look at the economic impact that we are providing. And we do an economic impact every five years.

In the last five years, the deals that we did generated about $3.4 billion in sales, about $1.04 billion in income, generated and created about 3,007 full-time jobs, and also created and generated about $109 million in state and personal income taxes and about another $31 million in other income taxes, which totaled about $140 million in taxes.

And if you look at the investment that the State made over that period of time, it is about $21 million they invested in the Maryland Small Business Development Financing Authority.

However, if you look at the return, they are getting 8 to 1 return on investment. If you factor in a loan loss, it becomes a 6.6 to 1 return on investment. So, a tremendous investment that the State is realizing as a result of investing in the Maryland Small Business Development Financing Authority.

Also, if you look at the demographics, as we know, demographics drive everything. In Maryland right now, as we speak, K through 12 is majority minority. So if you project out, Senator, you will see that the employment, the jobs, the workers, etc., school-age, college-age, it is going to be majority minority.

And so what we have found is that if we can, in fact, grow these minority- and women-owned businesses because there is a direct correlation between the growth of these businesses and who they are, minorities hire minorities; women hire women.

And particularly, what is a very key point that we found in our analysis is that minority businesses are more susceptible to hiring ex-offenders, and that is very, very important because we know the challenge ex-offenders have once they are released. I mean, they are literally cut off from everything, if you will.

But we have found that they are, in fact, really more susceptible. Why do they do it is because most of them have relatives and friends and neighbors, and what not, that they know that they need a job. They are good people. They have made a mistake, but they need to have a second chance.

I have been testifying in the legislature this year and last year about second chance, expungement, etc., because it is very, very important.

So the growth of these businesses is very, very important. So we are developing this strategy and have been developing this strategy to grow these businesses.

Obviously, access to capital is a critical, critical part of not just debt but also equity.

Changing hats for a minute, the National Association of Investment Companies is a trade association that provides particularly equity financing for small minority, and particularly minority, and women-owned businesses.

Senator, this is very, very important. I have several reports here, if you will, and with regard to the returns that these funds that focus on minority businesses provide to their investors. And their returns are actually superior to the general private sector market, if you will.

But there was this kind of opinion that because we were investing in minority- and women-owned businesses that our return would not be as high. That is absolutely not the case. We have independent studies here that were done by KPG and others, showing the return.

However, even with those returns, obtaining funds from the pension funds around the country is challenging. Why? Well, pension funds have these consultants which they call gatekeepers, if you will.

And the gatekeepers do not want to get out of their comfort zone, if you will, because, to be quite candid with you, there is this bias because they feel as though that if they are investing in minority- and women-owned businesses the returns are not going to be the same. Well, the studies absolutely show that is not the case.

And so we do these studies so we can talk with the gatekeepers but also talk with those that are making the decisions at the board levels as well as to really what can happen if, in fact, these funds can go into these firms that are investing in minority- and women-owned businesses.

If you look at the size of the funds, the average minority-owned venture capital fund or private equity fund is about $150 million; the average fund in the other areas is close to a half a billion dollars. And so there is a huge disparity there in terms of the capital that is needed to invest in these.

But we have shown that we have given the returns. We have shown that we are taking companies public. We do not know what else to do, and so we really need some assistance in making that happen.

I will stop there and be happy to answer any questions.

[The prepared statement of Mr. Tucker follows:]

Testimony of Stanley W. Tucker

before the

U.S. Senate Committee on Small Business & Entrepreneurship

Field Hearing Regarding Access to Capital for Minority-Owned Businesses

My name is Stanley W. Tucker, President of Meridian Management Group, Inc. At the request of the Honorable Senator Ben Cardin, I am here today to provide testimony on the lack of access to capital by minority-owned businesses.

Meridian Management Group, Inc. ("MMG"), formed in 1995, is a private for-profit fund development and management firm with particular expertise investing in small, minority, women and veteran-owned business markets. Our management team has more than 200 years combined expertise in the market, long-standing working relationship among its partners, a proven track record of success and a commitment to underserved markets.

Our mission is to create wealth via the efficient deployment of capital to under-served markets. MMG creates and manages innovative debt and equity funds that target small, minority, women and veteran-owned businesses. We also provide management and technical assistance as an integral part of our underwriting and portfolio management process.

MMG currently manages the following funds:

- Maryland Small Business Development Financing Authority ("MSBDFA");
- A portion of the Invest Maryland program;
- Maryland Casino Business Investment Fund ("MCBIF") which is one of the Video Lottery Terminal Funds administered by the State of Maryland;
- Community Development Ventures, Inc. ("CDV"); and
- MMG Ventures, LP, a specialized small business investment corporation.

Through its family of funds, MMG offers various forms of debt, bonding and equity financing. These funds are designed to complement each other.

Stanley W. Tucker, President

Meridian Management Group, Inc.

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Debt	Bonding	Equity
MSBDFA Contract Financing	MSBDFA Surety Bonding	MSBDFA Invest Maryland Program
MSBDFA Long Term Guaranty		MSBDFA Equity Participation Investment Program ("EPIP")
MSBDFA Equity Participation Investment Program ("EPIP")		Community Development Ventures ("CDV")
Maryland Casino Business Investment Fund ("MCBIF")		MMG Ventures

The growth and development of socially or economic disadvantaged firms has always been vital to strengthening the state's economy. MSBDFA is the State of Maryland's primary vehicle for providing financing to minority and women-owned businesses. MSBDFA has provided over 80% of its debt, bonding, loan guarantees and equity financing to minority and women-owned businesses in Maryland. During the past 5-year period, MSBDFA provided $37.5 million in financing to 111 transactions. Its total exposure was $29.2 million. 80% of the number of financings, or 73% of the dollars were provided to minority-owned businesses. 24% of the number of financings were provided to women-owned businesses, while 18% of the dollars were used to assist those businesses.

During the 10 year period from 2000-2009, the state invested $21 million into MSBDFA. This investment generated $140 million in local and state tax revenues. This is a return on investment, after loan losses, in excess of 600% or 6.6 times the investment. The estimated Economic Impact on Maryland was:

1. $3.4 billion in sales;
2. $1.04 billion in income;
3. 3,007 full-time equivalent jobs;
4. $109.0 million in state sales and personal income taxes; and
5. $31.0 million in local personal income tax receipts - a combined total of $140.0 million.

Demographic Trends for Minorities in the Maryland:

According the Maryland Department of Planning, the total population in Maryland in 2010, was 5.7 million. By 2015, it is projected to increase by 4% to 6 million. By 2020, it is projected to increase an additional 4% to 6.2 million. The ethnic minority population in Maryland in 2010 was 45%. By 2015, it is projected to increase to 48%. By 2020, it is projected to be 50%. By 2025, it is projected to be 52%. The Maryland K through 12 public school enrollment is currently majority minority. The female population over 16 years of age in Maryland in 2010 was 42%. Through 2025, it is projected to remain 42%.

We must pay attention to the new demographics. These demographic trends impact critical areas such as education, employment, housing, income and businesses.

Current Status of Minority Business Enterprises (MBEs):

Based on the latest census, there are 509,273 firms in Maryland, of which 32.2% (164,130) are minorities. The gross domestic product (GDP) in Maryland for all firms in 2013 was $342.3 billion, of which minority businesses represent 9.6% ($32.7 billion) of the GDP. There is a major difference between the number of minority firms and their percentage of the GDP.

Importance of MBEs to the State:

According to the Governor's Office of Minority Affairs 2013 Economic Impact Report, the contract payments from the State to MBEs have:

- Created or saved 26,796 jobs
- Generated $1.1 billion in wages and salaries
- Generated $88.9 million in state and local tax revenues

If we double the GDP percentage generated by minority-owned firms, it is estimated it that MBEs would generate:

- $32 billion to the Maryland economy
- 53,592 new jobs, the majority of which would benefit the minority community
- $177.8 million in tax revenues

As we grow these businesses we strengthen the economy and strengthen the economic base of minority communities by hiring people from minority communities.

Access to Capital:

Minority-owned businesses continue to be the engine of employment in emerging and minority communities. For minority-owned firms to flourish there is a strong need for adequate capital for the firms to realize their full potential.

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.

Numerous disparities studies have shown that Minority and women-owned firms are less likely to receive loans than majority owned firms and receive lower loan amounts than majority owned firms.

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 also receive smaller equity investments than non-minority firms. The average amount of new equity investments was $3,379 for minority firms with low sales, 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 is 38 percent of the non-minority level. (The source of this data is the Minority Business Development Agency).

Conclusion:

Minority-owned firms are less likely to receive loans than non-minority firms and receive lower loan amounts than non-minority firms.

Maryland's minority and women-owned business community has a positive economic impact that provides a great return on the State's investment.

Minorities are becoming a majority of the Maryland population. This is a nationwide trend.

Research shows that minority-owned businesses hire a larger percentage of minorities. Minority businesses are also more receptive to employing ex-offenders.

As the minority population steadily increases, the number of minority-owned firms will flourish as well. Due to this growth, there is a strong need for adequate capital for the firms to realize their full potential.

Senator CARDIN. Let me acknowledge that I am joined by my colleague, as I indicated earlier, Donna Edwards. She is an incredible effective, active person in the House of Representatives on these issues. She has been fighting for minority financing and for economic development in distressed areas as one of the national leaders on the Transportation Committee and in the leadership of the House of Representatives.

Congresswoman Edwards, would you like to make a comment.

OPENING STATEMENT OF HON. DONNA EDWARDS, A U.S. REPRESENTATIVE FROM MARYLAND

Representative EDWARDS. Well, first of all, thank you very much, Senator Cardin, for being here, and particularly in Prince George's County, and to our witnesses today.

Several of our witnesses I have had an opportunity to work with over the course of several years on these very issues, both with minority-owned businesses at large but also women-owned businesses, Hispanic-owned businesses, where we know, as Mr. Tucker has already stated, that there clearly is a demonstrated record of success of these businesses. And so we have to get—we have a challenge of getting over the hurdle that does not enable minority-owned businesses to thrive in the same kind of robust way.

And how fitting, Senator Cardin, that we are here in Prince George's County because we know that there is robust small business development and entrepreneurship going on here in this county, and if we can figure out the way that we can take some of those businesses from the place that they are and really provide the kind of robust resources, technical development, that they need and that they want, and expose them to business opportunities that others of our businesses face, we know that that will double and result in a benefit both to our local economy, to our State's economy, and of course, to the national economy.

And so I want to thank you very much for bringing these important issues, and I look forward now to joining in some questions with Senator Cardin at the lead of our witnesses today.

Thank you very much.

Senator CARDIN. Well, thank you. I appreciate those comments.

Let me turn to Shelly Gross-Wade, the President and CEO of FSC First. FSC First is a preferred alternative lender under the SBA 504 Commercial Real Estate Loans, the Small Business Community Advantage Loan Program, the State of Maryland Microenterprise Loan Program, City of Bowie Revolving Loan Fund, and the Prince George's County $50 million EDI Fund.

It is a pleasure to have you with us.

STATEMENT OF SHELLY GROSS-WADE, PRESIDENT AND CEO, FSC FIRST

Ms. GROSS-WADE. Thank you, Senator, and my sincere apologies for being a little bit late.

I am indeed happy to be here to, first of all, as Congresswoman Edwards, welcome and thank you for bringing this opportunity to Prince George's County.

Secondly of all, I am very close to the grassroots businesses in Prince George's County. As a quasi-government agency, FSC First has just within the last week or so conducted a focus group of small businesses within Prince George's County. We extended the invitation to business owners who were familiar with, and unfamiliar with, the plethora of services that we offer at FSC First.

So I am happy to share with you some real-world feedback that we have just gleaned from these businesses based on where they are at this point in their business operations, as well as what they would like to see as resources available to them, so that they can continue and thrive and grow not only in Prince George's County but globally.

FSC First, as I have mentioned and as you have already noted, is a 37-year-old nonprofit organization in Prince George's County. We have had the distinct designations of being a CDFI through Treasury as well as a community development, or certified development, entity participating in the SBA 504 program.

When we look at the profile of businesses that we have assisted in their development, we have loaned funds to companies that are both startups as well as growing and expansion companies. We have helped those that are attracted to the county as well as those that are in a rapid growth mode and may be facing some challenges.

The difference between us and other lenders is that we spend a lot more time with these business owners, providing them with access to technical assistance as well as access to alternative sources of capital.

And one of the things that has become very evident to us is the business community, in particular, is in need of increased and enhanced business acumen. Our business owners know their products and services very well. They struggle with taking their business to the next level of growth, and that suggests to us that they are in need of technical assistance, more in-depth technical assistance.

And so we are familiar with, and have utilized, the SBA's funded small development services, center services. We also use other resource partners like the Maryland Women's Business Center, which is also federally funded. We have referred business to the Bowie Business Incubator.

And, however possible, we try to attract and partner with those technical assistance providers to make sure that businesses have access to subject matter experts that can help them delve a little bit deeper into connecting the dots from "I have a product or service to offer that generates revenues" to "How do I generate the next level of revenues and growth strategies for my company."

Interestingly enough, in the focus group, a couple of businesses mentioned that what they want and need more than anything else is business coaching, preferably from subject matter experts like the Service Corps of Retired Executives, SCORE, but more one-on-one type of assistance as opposed to classroom training. They really emphasized that coaching and mentoring is something that they feel very strongly would be the level of technical assistance that would help get them to the next level.

So where are we as far as providing access to capital? At FSC First, we make loans that range from $5,000 to $5.5 million, using the SBA 504 program.

However, the average loan that we have seen in our portfolio has been at $178,000, which suggests to us that we are meeting people at their point of need. We rarely see businesses that come to us that cannot meet the definition of small business as defined by SBA.

However, I would suggest that about 75 percent of those businesses that come to us on an annual basis would not be prepared to gain access to capital. They really do not understand the depth of capacity that they need to calculate the amount of funding that they need nor to calculate their ability to repay.

And so while we might have many, many different types of financing sources available—my colleague, Stanley Tucker, talked about making sure that there is equity funding available and making sure that the sources of venture capital are more—have a broader perspective on what they invest in.

We also see that those businesses that come to us could benefit from additional funding sources but are not yet prepared. And so the step for FSC First is to prepare them so that we can take advantage of where they are now and prepare them for greater funding as they move on to traditional lenders.

And I will stop there and save the rest of my remarks for the question and answer period.

[The prepared statement of Ms. Gross-Wade follows:]

SHELLY M. GROSS-WADE, PRESIDENT & CEO

Good Afternoon

I am Shelly Gross-Wade, President & CEO, of the Prince George's Financial Services Corporation (aka FSC First). For more than 37 years, FSC First has served as the premier lender of non-traditional financing for local small and minority-owned businesses in Prince George's County and indeed the State of Maryland.

It is my esteem pleasure to serve on today's panel at the invitation of Senator Ben Cardin, the Ranking Member of the U. S. Senate Committee on Small Business & Entrepreneurship. The timing of this presentation could not be better for our economic development finance organization and our business community.

Within the past week, the Board of Directors of FSC First hosted a Focus Group of Business Owners to identify some of the key challenges faced by small businesses in the County – not the least of which was their concern for access to capital. There is a perception that dealing with banks (lenders), in general, is an extremely protracted process. According to participants in the Focus Group which represented diversity by ethnicity as well as company revenue size, number of employees and revenue size; it was shared that in regards to banking, African American [business owners] are often paralyzed when it comes to accessing loans and other financial services from bankers.

One participant described their process as difficult to surge growth when it takes 6-9 months for a credit decision, especially when the decision is reached based more on the qualifications of the owner and less on the business, the industry, the services and needs being met in the marketplace. The other problem that was alluded to was gaining access to capital in general. Another business owner described the critical need for the lender to understand the business operating cycle and how important cash flow is to their sustainability – again, demonstrative of the need to change the paradigm for credit analysis so that it is more reliant on the future growth potential of the company rather than their past operating history – which is often indicative of inadequate capitalization. More importantly, all of the participants participating in the Focus Group expressed a need for business coaching and mentoring – what we in the economic development community refer to as Technical Assistance (to include training).

As a Community Development Finance Institution (CDFI) we, at FSC First, take pride in our ability to operate a nimble organization. CDFI's are encouraged to remove barriers to credit (to the extent possible) – to take on a little more risk, as well as implement innovative and creative approaches to providing access to capital in the community we serve. We operate a best-practice model for a public-private partnership in our approximately $4 million revolving loan fund. The loans offered through our revolving loan fund range from $25,000 to $350,000; at market rate and terms of up to 10 years, depending upon the use of loan proceeds.

As a Microfinance Lender, we offer loans that range from $5,000 to $25,000; with very creative terms, rates and conditions.

Also, we serve as a Lender Service Provider – offering loan administration services and for municipal and non-bank lenders. For example, we manage:

- **$200,000 City of Bowie RLF**
- **$200,000 MD DHCD MicroEnterprise Loan Fund (sustainable communities)**
- **$500,000 Economic Development RLF**
- **$8.5 MM HUD 108 RLF; and the County's signature program --**
- **$50 MM EDI Fund**

All of these programs are designed to work in tandem with each other and finance every conceivable capital need that a Minority Business might have: day-to-day working capital, marketing, payroll, modernization of the facility and upgrade of the equipment, acquisition of commercial real estate, land for expansion purposes. They are also designed to participate in a subordinated lien position with traditional lending products; thus allowing the lender to take a priority lien interest in the accesses of the business being financed.

At FSC First, these programs have been used to finance all types of industries and business sizes. We rarely decline a business because it does not meet the SBA definition of a small business – which varies from industry to industry, by NAICS Code.

Finally, as a Certified Development Company (CDC), we are designated by the U. S. Small Business Administration to market, analyze, underwrite, close, fund and service long-term fixed asset loans under the SBA 504 Real Estate Acquisition Loan Fund anywhere in the State of Maryland. This program is designed to assist any eligible company with transitioning from a leased facility to an owner-occupied facility. The benefits are tremendous – if you are buying fixed assets, e.g. machinery – the SBA 504 portion of the transaction has a fixed interest rate for 10 years. Of course, if you are buying a facility, and intends to occupy at least 50% of it for your revenue-generating business, you would benefit from a below market, fixed rate mortgage for 20 years. A major feature of this program is that the mortgage is assumable should you decide to sell the business assets. This program is great for building legacy wealthy for the business and its owners.

Recognizing that Minority Business Owners have been historically disadvantaged to meet the minimum equity requirement – typically 10% of the total project cost, FSC First will work with the business owner to identify additional forms of debt that will serve as the equity in the SBA 504 transaction.

We accept the challenge to identify other sources of capital that can be stacked to support the viability of the transaction.

Other forms of capital, that would need to subordinate to the SBA 504 portion of the loan transaction would include:

- **Sellers take-back note**
- **Owners equity**
- **Subordinated debt (public and private sources)**
- **Grants and Tax Credits**

<u>Creating Economic Impact</u>

- **$21.4 Million under management**
- **Less than 1% default ratio in the loan portfolios**
- **2,015 jobs supported over the past 4 years**
- **60% increase in Approved Loans/Pending Closing as of 6/30/14; totaling $13.5 Million**
- **43% increase in Loan Commitments over prior year; supporting new Commitments of $9.2 Million**

From the non-traditional lenders perspective, here are the challenges business owners present that impedes their ability to gain (timely) access to capital:

1. Lack of awareness of the availability of capital – sources and uses
2. Lack of preparedness to access the capital sources
3. Limited knowledge about threats and opportunities in the marketplace
4. Inability to maintain and share quality financial information on the business in a timely manner
5. Resistance to transparency
6. Inability to meet the lenders conditions to proceed to closing
7. Lack of performance (reporting conditions) post-closing
8. Lifestyle challenges

Non-bank lenders, like FSC First, serve to provide gap financing. We serve as your intermediary lender until such time as you are qualified for or can meet the performance requirements of a traditional lender, venture capitals or equity fund. Typical terms are 3-5 years; but terms may extend up to 10 years for non-real estate loan transactions and up to 20 years on commercial real estate.

Our goal is to serve as a mission-driven lender – with the primary mission being to provide access to capital (either directly or indirectly) to eligible businesses. We are committed to assisting the business owners with qualifying for traditional financing (extended lines of credit, letters of credit, term loans, first trust mortgages, etc.) at levels that sustain the growth of the company.

The advantage to working with a non-bank lender, like FSC First, is that you may also receive wrap-around, our holistic, services in the form of technical assistance, licensing and permitting, training, coaching and mentoring. Unlike an equity investor, we typically take no ownership interest in the business, but determine its viability based on the short- and long-term economic impact to be realized as a result of the funding we provide.

In conclusion, we welcome the opportunity to work with sustainable businesses and have a goal of lending $6.8 Million through June 30, 2015. FSC First is accessible in person, by voice, email and the worldwide web at www.fscfirst.com.

Senator CARDIN. Well, thank all of you for your comments. I think it has been extremely helpful.

And, as you know, the hearing record will be available to all the members of the Congress. So this will be part of the work of our Committee and part of the work of the House and the Senate.

Last Friday, I was at the Census Bureau. I was there to support the President's request for the resources necessary that we have an accurate census and it is done in a most cost-effective way. You need information in order to be able to make the right decisions in not only our government but in our country. So the census work is critically important.

I say that because I was listening to your testimonies.

Ms. Castillo, you mentioned the fact that the private sector lending is equally important and, in some cases, more important than what is happening in the government sector.

Mr. Hairston, your comments sort of connected the dots for me about why our minority businesses are harder hit in recessions. And you pointed out—and I did not realize—that they are more dependent upon their personal residence equity for loans than the nonminority community.

Ms. CASTILLO. Right.

Mr. DOSS. Absolutely.

Senator CARDIN. And I wonder if we have really good data to show that.

And then, Mr. Tucker, your point about reentry really hit home. I mean, that is one of the high priorities of our country, and if we had that data to show, we may be able to get additional resources to minority businesses because of their activities in hiring ex-offenders.

So it seems to me having adequate useful information on minority businesses and small business activities is critical to make the right decisions.

And I know we have a lot of material that is made available, and I get a lot of reports. But is the data we currently have in the most useful form in order to help minority businesses gain access to the type of capital that they need?

Ms. CASTILLO. So if I may, Senator, as you know, the U.S. Department of Commerce Census Bureau, we do the survey of business owners. That is done every five years. The new data will be coming out in June, which is critical.

And the Department is working very diligently to see how we can actually roll out the data more quickly and is also partnering with the Kauffman institute in making sure that the data is provided in much more real time, if you will, because you are absolutely right. You can only—as the saying goes, you can only manage that which you measure, and measuring and being able to actually have much more robust information.

Now I will tell you that MBDA, as we commission different reports, it is precisely because of that—because we want to bring that data in a way that is more digestible and that really tells the story. So, when I talked about our disparity in access to capital report, that is the type of information that is gleaned through that type of much more in-depth research.

We are developing a three-year agenda, a research agenda that will help provide more information to all of these practitioners, if you will, and have more data that is more compelling. We know the information kind of instinctively, but when you see it, when you can actually see the charts, see the economic impact that this has, it is very persuasive.

Senator CARDIN. I think the more—I mean, showing how many minority businesses have to put their homes up for collateral, to me, would be a very telling situation.

Mr. TUCKER. Could I speak to that for a minute, Senator? You will find that is pretty high.

Ms. GROSS-WADE. Yes.

Mr. TUCKER. But let's talk about the data. I think the data is critical.

The data that Ms. Castillo talked about, the census data, etc., is very, very good data and what has been used over the years. But what happens with that data also is by the time they collect it and they actually publish it, there is an extensive period of time.

Let me suggest this: It is something that we are trying to do, and we have been working with Dr. Timothy Bates, who is probably the top person in the nation in this minority business piece. He has done extensive research in this area.

And Tim—I mean Dr. Bates—has said, and what we have been trying to do, is that the data that is collected nationally in the census, with regard to minority businesses and small business as well, that same data is actually collected annually at the state level. Okay?

And so what we are trying to do is get access to that data at the state level, and Dr. Bates is trying to get access to that data at the state level. They are looking at California and Maryland. I know because Tim and I go way back.

And so we are trying to modify the law in Maryland at the state level so we can get that same data annually, okay, because what happens is, and the challenge is, that these various minority business and women business programs—they are being challenged. And we must have the data, up-to-date data, okay, to beat back the challenges.

The census data is good. However, sometimes it is dated. Okay?

But if we could get this data—in Maryland, it is called ES–202. Okay? And we want to modify that language so we can get this data to the researchers.

As a matter of fact, Senator and Congresswoman Edwards, we were having some challenges and still have some challenges in Maryland, trying to modify this data.

So what happened—there is a gentleman at the Department of Labor, Bureau of Statistics who said—because they have so much confidence in the research of Dr. Bates and his team, said that they will cover the costs. It would not cost Maryland a dime to collect this data. That is how important they feel it is that we get access to that data.

This really needs to be done nationally. Okay? But we want to have some pilot projects.

And we need some assistance on that so we can get that language modified at the state level so that that data can be collected annually and then use that data to undergird, if you will, the minority business programs in Maryland but also use it as a model for the nation.

Representative EDWARDS. Senator Cardin, if I could follow up.

Senator CARDIN. Sure.

Representative EDWARDS. Let me just follow up with that because I remember when we passed the American Recovery and Reinvestment Act and a lot of that money went into research, went into transportation. One of the challenges that I found on our Transportation Committee is getting reports back about how much of those significant Federal dollars went down and out to minority- and women-owned businesses.

And one of the big challenges was that there was not a required reporting mechanism from the state to the Feds so that they could report back to Congress. And as a result, it was very difficult, except in some ways with states that were better at reporting than others, about where those resources went and how we could better direct some of them to minority-owned businesses.

And so I want to ask you, especially in some untraditional sectors, like transportation, like research and technology, how it is that we could function as a Federal Government in our oversight capacity in the Congress and try to tease out some of that data so that it becomes more useful for doing the right thing.

Mr. DOSS. If I could add just a moment on the same topic with data, at the Small Business Administration, of course, we have our Office of Advocacy, which works very closely with the Department of Census and collects and uses a lot of the information that is provided by the Census Department. It is valuable information for us, for our business owners, for the general public and our agency in terms of understanding what the needs are, what the situations are that exist with businesses, and we use that data on a regular basis. We have an annual update even to our small business profile.

We always will welcome the opportunity to have more data, particularly as it relates to minority and small businesses, as we try to better understand the impact of both of those groups on the economy because we are interested in growing the economy very much locally, whether it is here in Bowie or somewhere in Prince George's County or at the state level.

But being able to see what the impact of those small businesses is in terms of helping to drive the small business sector and the economy in general is something that we are interested in.

Representative EDWARDS. Because wouldn't it help if, for example, the SBA knows that we are doing a lot of job creation in the areas of research and technology, but our small business loans that are coming are in some of the service sectors?

Would it help you to be able to make an argument to an M&T Bank, for example, or to a venture capital investor that it makes sense to make loans in those sectors where we are growing the economy and we are growing resources so that we can then spread out some of those opportunities into the future?

And I would ask that of M&T Bank.

Mr. HAIRSTON. Sure.

Representative EDWARDS. What would you need to know to make a better business decision about making a loan to a small business?

Mr. HAIRSTON. Absolutely. We are fortunate now where we are able to get a sufficient amount of information from the Small Business Administration because we are literally able to see, by various minority categories and groups, what percentage of our lending is actually being directed to those respective groups.

To go back to one of the questions and the points prior, I think one of the pieces that it seems that the SBA would be able to provide is what percentage of those minority borrowers did we have to lever their personal residences. All that information is absolutely available.

When I look at this geography, I would definitely say whether it is minority borrowers or majority borrowers, having worked for M&T and other parts of our footprint where the businesses are more capital-intensive manufacturing, this geography—I will tell you, having been in the Mid-Atlantic with M&T, both in Baltimore and now in the National Capital area, it is absolutely a higher proportion, both minority and majority, where you have to lever their residences just based upon the larger percentage of the businesses being more professional services-oriented, whether they are government contractors or non-government contractors, because you do not really have other collateral that you can rely upon.

With that being said, I absolutely believe there are opportunities as you think about the technology. We have struggled with the technology piece because when we look at technology companies we sort of look at them on a continuum and many technology companies do not fall into that category in the early stages where they are targets for debt capital. They are largely looking for equity capital.

We challenge—we are challenged, you know, to really understand who are all the providers out there that can work with them.

Being a highly—being in a highly regulated industry, you know, we have to be able to—as Shelly referenced, we have to be able to show that—whether we are going to try to get an SBA guarantee, we still have to be able to show that they have got a track record or, if they do not have a record, that they have the ability to immediately generate revenue that will turn and provide an ability to pay whatever that debt is. That is typically a challenge for most of your technology-oriented companies in this geography.

So partnering and working with the types of organizations that can fill that equity gap is really still an area that is still not—and especially in the State of Maryland, I think there are some strides that have been made, but there are still significant challenges there.

Senator CARDIN. So let me follow up on these issues.

Mr. Doss mentioned many of the tools that the SBA has implemented in order to try to help minority businesses gain access to capital. So I particularly would be interested in, Ms. Gross-Wade and Mr. Hairston, since you work directly with borrowers, whether these tools are working as well as they could and the priorities.

Mr. Doss mentioned the fact that the SBA loans under 250—no. The SBA loans under—was it $150,000 where there is no fee?

Mr. HAIRSTON. Correct.

Senator CARDIN. Where the fees are actually subsidized by the other borrowers because this is a zero-sum game, if I understand correctly, but that that has increased the volume. So the initial costs being a little bit less has had an impact.

The micro loan program, which has a very high concentration within minority businesses.

The SBA Community Advantage Loan Program, which was a pilot initiation for loans.

The simplifications procedures through the internet, whether it is the LINC program or the SBA One that is going to be initiated this year and has not started yet.

The credit rating simplification.

And I have not mentioned the 504, the SBIC, and the other programs we have available.

Could you handicap for us whether—how effective these programs are and whether they could be more effective?

One of the things we have to talk about in government is that we just cannot layer program upon program upon program. We have got to make sure that we have the most effective use of the government tools to deal with the issues.

Which are worth further investments here?

Ms. GROSS-WADE. If I may, I think the Community Advantage Program is one of the best financing tools that have come out of the SBA in a very long time. It allows for us to put the money out on the street at a much faster pace than the traditional SBA products.

I think that the ability to know going into the deal that you are going to have an SBA guarantee at a certain level helps you in structuring the deal, as a non-bank lender.

And we are one of your CDFIs that is a Community Advantage Lender. We are just now getting ourselves up on the learning curve with how best to deploy that tool. We are striving to become a dedicated or designated Community Advantage lender, which would give us some unilateral authority in the types of loans that we underwrite and use the SBA guarantee on.

But is it efficient? Yes.

Is it effective? Absolutely. Everything that we are looking at now we are looking at first to see if it is going to qualify for Community Advantage.

I will also tell you that while you have standards for evaluating those credits there is a great deal of latitude given to the lenders on how to defend the request for the borrower.

So I am particular, both personally and professionally. I am a strong proponent of Community Advantage.

The range is from $5,000 to $250,000, and that seems to be our sweet spot, with us being a revolving loan fund.

Senator CARDIN. And that is so valuable because it streamlines and makes it faster and more predictable.

Ms. GROSS-WADE. Yes, yes. And the turnaround time for us has improved significantly. I mean, we are able to get those deals underwritten and transmitted electronically to the SBA so that we have a credit that is well-packaged, underwritten, approved, and received the SBA guarantee in less than two weeks, which means we can go to closing and fund in a much shorter period of time.

Mr. HAIRSTON. And I would add the complement to the Community Advantage Program, which is a program that the SBA rode out in the most recent fiscal year, is the Small Loan Advantage Program, which is designed for financial institutions, for credit requests as well, $5,000 up to $350,000.

I have to tell you we are huge fans of the Small Loan Advantage Program and the benefits, the efficiency of it, not just from the process time. The reality is we want to get the loans closed as quickly as we can.

And what you would see—and the data would show that many of the minority borrowers really fall into that space——

Ms. GROSS-WADE. Right.

Mr. HAIRSTON [continuing]. From a traditional lending standpoint, where the Small Loan Advantage Program really does adequately meet their borrowing needs under that program.

And when they do not, we can then go to the traditional 7(a) program, which—you know, they have streamlined it. With that being said, they continue to look for more opportunities to make that program even more efficient.

We are fortunate because we are a preferred lender. So we have the unilateral authority to act on behalf of the SBA.

But I would definitely tell you the Small Loan Advantage Program has been very beneficial. Our average loan size at M&T is about $148,000. So we really cater to your average, typical small business that has been in existence typically for three years or more, and that program really does meet the needs from that standpoint.

The challenge, once again, that even under that program that we still have is when there is a collateral shortfall and how do we fill that.

So, if we can work to partner with other organizations where we may have that collateral gap and fill those needs, I think that is an opportunity to really drive more of that minority lending, which is really necessary.

Representative EDWARDS. Let me just ask whether—on the 7(a) program, because those are loans that are under $150,000, how much the fee waiver provisions contributed to the increase in those loans and the ability to get those loans out.

Mr. HAIRSTON. Yeah. When it first rode out, during that initial fiscal year, we saw a 21 percent increase in volume in the space of $150,000 and under.

So we are absolutely proponents of it. We are strongly in favor of continuing the waiver because the reality is in the way that we manage this; those loans that are extended to those borrowers that are $150,000 and under, they are more like consumers. They think more like consumers.

So, when you approach them—and that guarantee fee under the express program could be, you know, I say as little as $750. But when you are talking to somebody who thinks more like a consumer and they can get a credit card where there is no up-front fee, it does not matter that the rate could be 18 percent all in.

And even on the SBA side, you can do prime.

And even, let's say on the high end as prime plus 5. Prime plus 5 would be 8 and a quarter.

Because they do not have to pay that up-front fee of $750, they will go with the credit card instead of going with the express loan.

Ms. GROSS-WADE. Right. That is an interesting point, if I may piggy-back on that.

Out of the focus group session that we had over a week ago, it was very insightful to us that most of the business owners were not at all adverse to having a higher interest rate. They wanted to know that the funds would be available at the time that they needed.

Mr. HAIRSTON. Yes.

Ms. GROSS-WADE. There was no criticism or concern at all about the cost of money.

And so that was a new reality for us, if I may put it that way, because the perception as a lender is that we try to be very cognizant of the fact that we are making loans to businesses that are, in most cases, pre-bankable. So we want to be very sensitive about what interest rate we give them.

And they are saying, we do not care what the interest rate is; we just need to have access to the money.

And the other reality is whatever the interest rate is that we propose to them as an SBA lender, as a government-backed lender, it is still going to be a lot less costly than a credit card rate. Yet, many of the businesses that we see come in with exorbitant credit card debt that they would like to have refinanced.

And those rates are almost prohibitive——

Mr. HAIRSTON. Yes.

Ms. GROSS-WADE [continuing]. For us to even take that debt out.

Representative EDWARDS. Thank you.

Ms. Castillo.

Ms. CASTILLO. I would like to join in and maybe broaden the conversation as well because MBDA focuses on growth. How do we get businesses, not just at the small end of the spectrum but also getting them, moving them, through the growth spectrum.

So going back to what Ms. Wade was saying, the lending tools are critical but making sure that these businesses are ready, that they understand all the financial that they need to have available.

I will also submit to you that lending also depends on the industry that you are in. Transportation, construction, for example, a surety bonding is a huge issue.

On the exporting side, we work very closely with Ex-Im Bank to make sure that we are getting more minority businesses, who, by the way, are twice as likely to export than nonminority firms, to access the opportunities that exist either through Ex-Im Bank, OPIC, or others.

So I just want to make sure that as we talk about minority businesses that we are looking at minority businesses just not at the small level but how do we help them grow. That is where the job creation comes in play. That is where the tax revenues are going to grow. And that is really where the future of the country is going.

It is making sure that we have all of those tools at every life—at every point of their life cycle.

Senator CARDIN. It is the reason why the SBA administrator is so much in favor of Ex-Im Bank reauthorization.

I was at a small business in Baltimore that is absolutely vital.

And your point about minority businesses and exports is a very good point. As we talked earlier, a lot deals with the fact of the diaspora community. They have contacts and can get—make those contacts work for commercial ties. And it is an area that is certainly underutilized and one that we need to move forward.

I have one last question, and then I will let Congresswoman Edwards talk about her issues.

That was a Freudian slip——

[Laughter.]

I better—for the sake of Chris Van Hollen, I better correct the record or I am going to get in trouble with my other colleagues.

There is—as you know, there is a desire to increase the cap on the 7(a) loans. It does not cost any money because they are offset with the cost. But it would go from about $18 billion to $23 billion, and I think all of us support that. The volume needs are there. Why don't we meet those needs?

I was just interested as to whether we have an indication whether by raising that cap it will be more beneficial to minority businesses than the general population of small businesses or whether it would probably have no major impact on how the allocations are being made between minority and nonminority small businesses.

Mr. HAIRSTON. I would immediately add, you know, if we look at the data for M&T just in the most recent fiscal year. So 45 percent of the loans that we extended in fiscal year 2014 went to minority borrowers. So, even if we just looked at that data.

And I remember when there was the potential for a delay with our SBA processing, and we literally, four weeks prior, sort of sent a message out throughout the institution. You know, try to push these loans through as fast as you can because, potentially, we may have a delay and we do not necessarily know how long that will last.

The reality is if we were consistent and we ran into an issue with the cap you could say that 45 percent of our borrowers would not be able to access capital.

Senator CARDIN. That is helpful.

Mr. TUCKER. Let me—two things, two points I want to make because we manage state funds.

And one of the things we did, it was somewhat—it is actually still unique in the country. We wound up privatizing the management of the fund, and when we privatized the management of it, it gave us a lot more flexibility in terms of bringing different kinds of capital to the table.

Then we were able to leverage some of our dollars, to leverage our specialized small business investment company.

We were able to—we came up with the idea of putting language in the gaming bill where 1.5 percent of the gross revenues would go to a fund to invest back into small minority- and women-owned businesses.

So we were able to do a number of things.

Actually, I made a recommendation to the SBA administrator about maybe 10 or 15 years ago. I said, you know what I think would be interesting? If you privatize SBA and see what happens and if folks have to really, really pay their own way, if you will, in terms of what they do.

But also, in terms of dealing with your question, one of the challenges minority- and women-owned businesses have is capacity, and the quickest way to get that capacity is to buy it. People do it every day.

Over the next 10 years, all the baby boomers in the country are going to sell their businesses. The question is, who are they going to sell them to?

So, in Maryland, we are looking at introducing legislation that says this:

If someone sells his or her business to a minority or a woman, one, the profits they make off of that sale, they would not have to pay state taxes, one.

Two, if someone makes an equity investment in the transaction, they will be able to get an investment tax credit up to a half a million dollars.

Three, if the owner hangs around and helps with the transition, whatever salary they receive, they will get a special tax treatment on that.

And, four, if the owner helps finance the transaction, they will get a special tax treatment on that.

So what are we trying to do? We know these businesses are going to sell because their wealth is tied up in these businesses. The question is, who are they going to sell them to?

So we want to create an environment where they will sell them to minority- and women-owned businesses. So now they get back a pass—and here's the other thing that's very important.

One, we keep those businesses in the State of Maryland. The sellers, usually when they sell, what they will do is they will go to Florida, establish residence, come back to Maryland, sell their business, and get the first plane back to Maryland—back to Florida.

So we want to keep them here. We want to keep those businesses here. And now as they become owned by minority- and women-owned businesses, they get the minority- and women-owned status. They can grow their businesses.

We have done several economic impact analyses which show that if, in fact, this legislation was in place it would be a net positive to the State of Maryland.

And SBA in acquisitions, SBUs and SBA with guarantees to banks and what not, help with financing these businesses. So access to capital, again, becomes a critical part of these acquisitions.

We are very excited about it. We think we are going to be able to get it through. We did not introduce it this year, but next year we probably will.

Senator CARDIN. Good point. Well, before I make some final comments, let me turn it over to the Honorable Donna Edwards.

[Laughter.]

Representative EDWARDS. Thank you very much, Senator Cardin. And I really do appreciate your being here today because I think over the course of my, you know, last several years of service in the Congress we have had a number of events in my congressional district that are really targeting various sectors of our widespread minority-owned business community and small business community.

And I think some of the challenges that I have heard are clearly the businesses that are on the smaller end. They are start-ups. They are the ones that Mr. Hairston referred to as sort of consumer-oriented. And so we have a set of programs that are important for those.

But I want to go back to Ms. Castillo's point, and it is that we have to also figure out a way that as we get these businesses, you know, started and they are growing and they are developing, what is the thing that we can do—what are the things that we can do that jumpstart those businesses, that take them to the next level, that makes them both regional and transnational competitors but also makes them global competitors?

And I have in my mind one small business that I—what started out to be a small business that I know really well. A couple of guys working in the space industry, who decided that they were going to jump off and start their own little firm, and they did. And so they became 8(a)-qualified, which was really great.

And then the challenge—and Mr. Doss knows this—was how do you go from there to competing in a wider marketplace and growing your business? And this business did that.

And I am not going to name the names because I think I am looking at him right outside my right eye.

But then they grew, and now they are transnational competitors, and they are global competitors. And they are minority-owned businesses—businesspeople. And they started out at the ground level, just with an idea of how to go to that next level.

That is what I would like to see for all of our small businesses.

And I think, you know, Senator Cardin—I know that Senator Cardin shares this.

And I know that here in this county and across our state we have, you know, people out there who have some great ideas. And they just need us to figure out ways to invest in those ideas, not to do the work for them, as you indicated, but to provide the tools, the mechanisms, the mentorship, Mr. Doss, that these businesses need, the investment that they need, whether it is equity, capital and venture funds, or it is an under $150,000 loan so that we can grow them.

This is the tool for our new economy. Senator Cardin knows this.

We know that in a world that is becoming increasingly diverse—and that is true for our state—that our job creation and our business creation is going to take place with these entrepreneurs.

And so I just want to thank Senator Cardin and thank each of you for being here today to help us figure out how we can jumpstart some of those businesses.

Thank you, Senator Cardin.

Senator CARDIN. Well, thank you very much. I really do appreciate that.

And I appreciate each of your participations here today, and I look forward to working with each of you as we try to sort out what we can do a better job on, helping minority small businesses.

Mr. Doss pointed out this is the—access to capital is the critical part of the equation; it is not the only part of the equation. We have government procurement, which is clearly an area that we have worked very, very hard on. We have technical assistance to help, regulatory relief, the tax code. And we go and on and on, on the different issues that affect small businesses and minority-owned businesses.

So the issue, though, of capital is a critical issue because, as has been pointed out by all of you, there have been extreme difficulties of minority businesses to get access to equity capital, to get access to capital during tough times, the options that they have that they can exercise. All that makes it a real challenge.

And as a result, we have not reached anywhere near our potential in this country for minority opportunity, which is a key value of our country, and we have denied our economy its full strength. And for those reasons, we have to pay greater attention to it.

I am encouraged by the testimonies today, and I am encouraged by the leadership at the SBA and Department of Commerce in providing where we can.

And in the private sector, Mr. Hairston, you were kind of modest when you said that you are the largest lender for small businesses. You are the dominant lender for small businesses in our State, and we appreciate that very much.

We want to take your best—I know you would like competition. So I know you want to get the other banks out there doing better; I know.

Mr. HAIRSTON. They are welcome.

Senator CARDIN. Yes, I understand. But we would like to take the best practices and share that so that we can get more activity and get more opportunity for small businesses and minority businesses to be able to take advantage of the opportunities of this country.

So this hearing was to explore ways that we can do that. I think it has been extremely helpful, and we will be following up to figure out how we can implement policies that can lead to the proper results for minority businesses in our community.

Thank you all.

With that, the hearing will stand adjourned.

[Applause.]

[Whereupon, at 11:20 a.m., the hearing was adjourned.]

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