

## THE RACIAL GAP IN BUSINESS DEVELOPMENT

### The Issue

Owning a business has been the most effective way to build wealth in America and the wealthiest individuals in communities of color have traditionally been business owners. Moreover, successful businesses in communities of color have provided employment for members of those communities. While most of these businesses operate within the confines of their own communities serving niche markets, when given the opportunity to expand, many minority firms prove to be solid competitors. Growing this sector is a critical strategy for reducing racial disparities.

Moreover, growing the minority business sector would not only benefit communities of color, it would benefit the nation as a whole. Since these businesses are more likely to employ people of color (an increasing share of U.S. consumers), expanding the minority business sector will generate additional income which can be spent throughout the economy thereby creating greater domestic demand for U.S. products. Moreover, minority businesses can increase U.S. competitiveness in world markets, specifically in the new consumer markets of emerging economies. A majority of these markets are in Asia, Africa, and Latin America where many people of color in the U.S. are likely to have a competitive advantage in their countries of origin.

Businesses owned by entrepreneurs of color are fewer in proportion to their populations compared to White businesses. They are also smaller and generate less revenue than their White-owned counterparts. In 2002, non-Hispanic Whites accounted for 68.2 percent of the population but owned 82.9 percent of the nation's non-public business firms. Conversely, racial and ethnic groups comprised 31.8% of the population, but only 17.1% of the non-public businesses. Self-employed and micro-businesses, individual and family owned enterprises with no paid employees, are the overwhelming norm in communities of color. One-quarter of the privately-owned firms are concentrated in six categories of low growth industries. Consequently, the revenue generated by minority firms was significantly lower than that generated by White-owned firms.<sup>1</sup>

### The Obstacles

Entrepreneurs of color in the U.S. face challenges both in starting and in growing their businesses. Structural barriers, primarily unequal access to capital resulting from discriminatory treatment in both the public and private sectors, cause minority firms to lag behind White businesses in the areas of capital financing, size, industry diversity and profit. Education, training, networking and mentorship opportunities are often absent or limited, making it hard for budding minority entrepreneurs to be on the cutting edge of business development. Weakened or poorly enforced public programs to promote minority business inclusion also keep entrepreneurs of color from moving to the next level.

Policymakers can create policies and programs that address these barriers and build on existing community practices and strengths, thereby expanding opportunities for existing businesses and providing avenues for people of color to move into entrepreneurship.

Access to capital and debt financing. The amount of start-up capital is one of the most important ingredients for business success, but minorities face a number of obstacles to obtaining capital. People of color often do not meet credit approval standards set by banks and governmental business loan initiatives, even though these standards may not accurately reflect their capacity to pay back loans.<sup>2</sup> “Redlining,” the discriminatory practice of banks and financial institutions refusing to lend necessary capital to racial and ethnic groups persists; and there are few minority-owned banks and credit unions that can form partnerships with entrepreneurs of color.

An alternative to bank financing is a publicly subsidized loan. But even here entrepreneurs of color are treated differently. While the average amount offered by the U.S. Small Business Administration (SBA) for a 7(a) loan is \$157,000, the average amount offered to an African-American business is only \$80,000 and the average for a Hispanic firm is \$123,000.<sup>3</sup> In addition, the SBA has significantly scaled back the Community Express Program which encouraged lending in communities of color. Between 2001 and 2004, minority-owned businesses received only 9.9 percent of the SBA financing outside of the SBA’s 7(a) and 504 loan programs.<sup>4</sup>

Business education, skill building, and entrepreneurship training. Gaps exist in business and market-based knowledge (planning, certification, procurement opportunities, etc.). Owners of existing businesses have only limited opportunities to upgrade their skills and become aware of new markets. Moreover, potential entrepreneurs are currently not being cultivated with the skills or knowledge necessary to produce another generation of minority business owners. There is an absence of vital supports for entrepreneurs of color including mentoring programs, networking opportunities and links between non-profits and minority businesses.

Weak support from Government. Supreme Court rulings in lawsuits such as *Adarand Constructors v. Peña* and *City of Richmond v. J.A. Croson Co* have dealt a blow to affirmative action initiatives. Many state and local governments have not replaced pre-ruling programs with ones that are compliant with these rulings but still supportive of emerging minority firms. This has been compounded by a lack of interest or “benign neglect” at the federal level during the past decade. Consequently, minority businesses are disconnected from the business supply chain and government procurement opportunities. Non-traditional enterprises such as co-ops and “women’s work” turned entrepreneurial are not receiving necessary attention or funding.

## **The Opportunities: Strategies and Policy Objectives**

Minority businesses have potential for high levels of growth, if given the opportunity. The following public initiatives would help these firms reach that potential and result in more employment and greater assets for communities of color. Moreover, society as a whole would benefit from the higher level of competition and innovation that would result from the expansion of business opportunity.

Meet the financing needs of minority entrepreneurs through a variety of methods including:

- Requiring the Small Business Association to report directly to Congress regarding its lending to minority entrepreneurs.<sup>5</sup>
- Increasing funding to programs that provide loans to minority entrepreneurs.
- Taking a firm stance against institutions that practice “redlining” and other unfair or discriminatory lending practices, including rolling back Regulation B of the Community Reinvestment Act which prohibits tracking of the race and gender of commercial loan recipients.

- Encouraging entrepreneurs of color to expand into little explored but quickly growing fields such as Information Technology (IT), financial and insurance services, pharmaceuticals, and green industries through targeted loans and grants.
- Ask lending institutions to allow alternative, culturally appropriate criteria for establishing creditworthiness, such as a lack of debt, participation in rotating savings accounts, or access to some capital through extended family, clan or other community structures.

Meet the training and networking needs of minority entrepreneurs, both current and future by:

- Linking minority businesses with growth potential to industry or sector clusters to promote their supplying bigger businesses.
- Expanding government support programs for medium and large sized minority firms in order to encourage growth.
- Ensuring that minority owned firms are part of the procurement process.
- Offering grants to allow minority business owners access to professional consultations, training seminars and national and global networking opportunities. These will play a key role in helping minorities develop the skills and connections to launch successful business ventures.
- Increasing federal funding to programs such as The National Federation for Teaching Entrepreneurship (NFTE) or the U.S. Hispanic Youth Entrepreneur Education (USHYEE) which cultivate an entrepreneurial spirit among disadvantaged youth.
- Incorporate entrepreneurship and business classes as early as junior high school in order to introduce students to key business concepts. In post-secondary schools, teach cutting edge practices including IT, green efficiency, and long range business sustainability planning.

The Insight Center for Community Economic Development is a national research, consulting and legal organization dedicated to building economic health in disenfranchised communities.

This Policy Brief was produced as part of our Closing the Racial Wealth Gap Initiative, a national effort to close the racial wealth gap for the next generation by injecting over 140 members of the Experts of Color Network into the national debate on America's future. Experts on this issue include Barbara Robles, Ph.D. (ASU), Paul Hudson (CEO, Broadway Federal Bank), Jessica Gordon-Nembhard, Ph.D., and Paul Ong, Ph.D. (UCLA), all members of the Experts of Color Network.

For more information please visit [www.racialwealthgap.org](http://www.racialwealthgap.org) and [www.expertsofcolor.org](http://www.expertsofcolor.org).

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<sup>1</sup> For further details on the size and composition of minority firms, see the Insight Fact Sheet on *The Racial Gap in Business Development* at [http://www.insightcced.org/uploads/CRWG/Fin%20Racial%20Gap\\_Bus%20Dev.pdf](http://www.insightcced.org/uploads/CRWG/Fin%20Racial%20Gap_Bus%20Dev.pdf)

<sup>2</sup> Salitzer, Maritza. (July 2007). The Effect of Wealth and Race on Start-up Rates. U.S. Small Business Administration. Retrieved January 18, 2009, from <http://www.sba.gov/advo/research/rs307.pdf>

<sup>3</sup> U.S. House Small Business Committee Democratic Staff. (2005, December 8). Minority Business Summit Report. Retrieved January 17, 2009, from <http://www.house.gov/smbiz/Reports/MBS2005.pdf>

<sup>4</sup> Temkin, K., Theodos, B., Gentsch, K. (January 2008). Competitive and Special Competitive Opportunity Gap Analysis of the 7(a) and 504 Programs. The Urban Institute. Retrieved January 18, 2009, from [http://www.urban.org/UploadedPDF/411596\\_504\\_gap\\_analysis.pdf](http://www.urban.org/UploadedPDF/411596_504_gap_analysis.pdf)

<sup>5</sup> U.S. House Small Business Committee Democratic Staff. December 8, 2005.