

# Accelerating Job Creation and Economic Productivity

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*“Expanding Financing Opportunities  
for Minority Businesses”*

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*Sponsored by:*

Minority Business Development Agency  
Ronald N. Langston, National Director





## ACKNOWLEDGEMENTS

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The Minority Business Development Agency (MBDA), U.S. Department of Commerce has brought together a unique group of financing experts and community leaders to help identify and expand the issues of access to capital for minority business enterprises. Through this process, MBDA sought both to highlight existing impediments to improving financing options and propose innovations to address these impediments. MBDA's objective was to build upon existing data pertaining to the capital needs of minority businesses, as well as to identify the lack of information on this sector of the business community.

MBDA wishes to express its gratitude to the following people for their participation and contribution to this effort. The report was prepared by MBDA with the intention of reflecting these discussions and those of the participants at the subsequent Roundtable and Summit on Minority Business Financing. The views expressed in this report are those of the individuals involved and do not represent the views of individual government agencies.

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## FOREWORD

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The Department of Commerce's mission is to promote job creation, economic growth and sustainable development of all Americans. Minority-owned firms, one of the fastest-growing sectors of the business community, are a key component to fostering better communities and sustaining U.S. economic development. Accordingly, I am excited about the new report from the Minority Business Development Agency, *Accelerating Job Creation and Economic Productivity: Expanding Financing Opportunities for Minority Businesses*. Access to capital is every entrepreneur's staple to success and one that cannot be ignored. This report presents recommendations on how to improve and identify financing opportunities for minority businesses. Together we can work toward producing favorable outcomes for a stronger America.

Donald L. Evans, Secretary  
U.S. Department of Commerce

## PREFACE

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On behalf of Secretary Donald L. Evans of the U.S. Department of Commerce, I would like to recognize the invaluable participation by the private and public sector members of the Steering Committee for the Summit on Minority Business Financing. Without your commitment to the minority business community and the contributions of your time and expertise, this report would not have been possible.

Given the ongoing U.S. demographic changes, it is critical that we use the entrepreneurial talent available from all communities to maintain an expanding national economy. Minority business enterprises (MBEs) have dramatically increased their participation in the free enterprise system. This is consistent with the dramatic increases in the minority population and minority purchasing power.

Minority firms continue to be underrepresented in the business community, when the number of firms, employees and gross receipts are compared with minority percentages of the population. While MBEs are projected to achieve entrepreneurial parity with respect to the numbers of firms in 2020 and employees in 2050, they may never achieve parity with respect to business revenues. They continue to face systemic barriers to accessing capital markets, which impede the efficient and productive flow of capital to them.

It is the mission of the Minority Business Development Agency to utilize its resources and those of its public and private sector partners to help MBEs obtain access to capital, perhaps the most important tool to sustain and expand their business growth.

We must continue to find ways to promote the creation and expansion of MBEs by lowering barriers to financial services and increasing financing opportunities. I look forward to working with you as we continue our efforts to build business relationships between the financial services sector and the emerging minority business enterprise market.

Ronald N. Langston, National Director  
Minority Business Development Agency  
U.S. Department of Commerce

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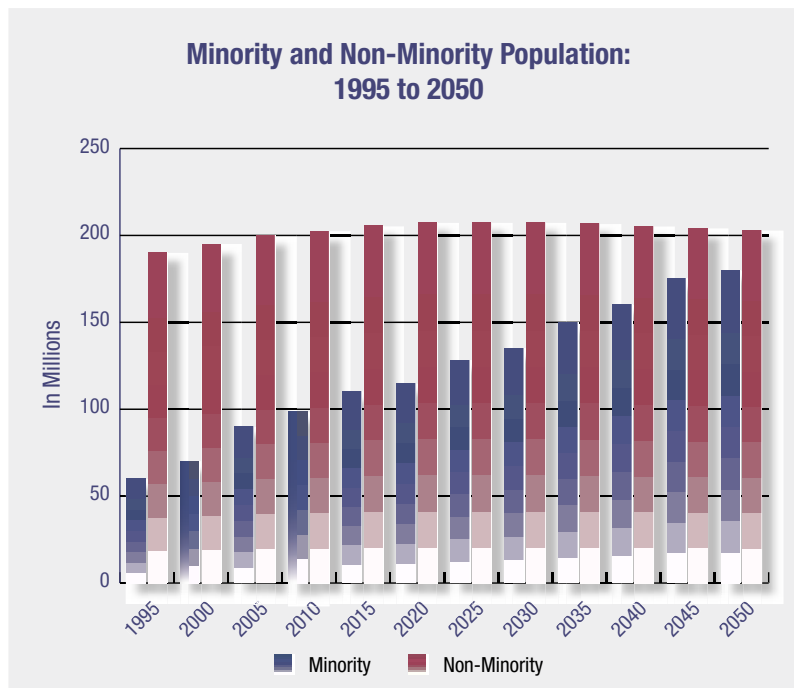
## EXECUTIVE SUMMARY

Minority-owned businesses present an historic and dynamic growth opportunity for the U.S. economy. Over the past several years, the growth rate for minority firms has exceeded those of all U.S. firms, both in the number of firms and revenues. Between 1992 and 1997, the number of minority-owned firms increased 29.6 percent, as compared to 3.9 percent for all U.S. firms. In 1997, there were more than 3 million minority firms. Of these, 84,000 have revenues in excess of \$1 million and many are in high-growth industries, such as technology and health services. Businesses of this size, representing 55 percent of the jobs and 65 percent of the revenues of minority firms, are an important component of local and regional economies and of overall U.S. economy.

The economic importance of minority firms becomes more compelling when considered in connection with U.S. population trends. Minorities, who now comprise nearly 30 percent of the U.S. population, will grow to more than 50 percent by 2050. From now until 2050, 90 percent of the growth in the U.S. population will be in the African-American, Hispanic, Asian-Pacific Islander or Native-American communities. This growth will be particularly concentrated in key geographic areas, such as California, New York, Texas, and Florida, increasing both the economic and political importance of these areas.

Since minority firms tend to hire a larger percentage of minority employees than do majority firms, these firms are integral to employment, revenue growth, and economic prosperity in these states. In California, where minorities comprise more than 50 percent of the population and 24 percent of all minority firms are located, the state government has recognized that strong minority businesses are key to strengthening and expanding the California economy. As a result, the state has implemented policy initiatives to increase investment in these firms. At the same time, banks and other financial institutions recognize the economic significance of minority firms and are increasing their efforts to penetrate this rapidly expanding market.

**FIGURE 1: MINORITY AND NON-MINORITY POPULATION, 1995 TO 2050**



Source: Minority Business Development Agency, U.S. Department of Commerce. September 1999. *The Emerging Minority Marketplace – Minority Population Growth: 1995 to 2050*, p. 3.

Nonetheless, the development of minority firms continues to present challenges. While minorities account for 30 percent of the population, minority firms constitute only 15 percent of all businesses, employ 4 percent of U.S. employees, and generate 3 percent of U.S. business revenues. The vast majority of these firms are micro-enterprises; 80 percent have revenues of less than \$100,000 annually. In addition, the majority of minority entrepreneurs are in non-asset based industries, such as services, construction, finance, insurance, and real estate, which often have lower start-up expenses than other industries. In sectors such as manufacturing, which generate greater wealth in the United States than many other industries, minority entrepreneurs are significantly under-represented.

There are many reasons for this discrepancy, but one is pervasive throughout all minority business sectors – lack of access to financing. Minority entrepreneurs continue to have difficulty obtaining the capital needed, whether debt or equity, to start and grow their businesses. To develop minority firms of the scale and size required to have significant economic impact, minority entrepreneurs must obtain the financing critical to expanding their businesses. Minority businesses continue to face systemic barriers to accessing the capital markets, barriers that impede the efficient and productive flow of capital to these firms.

The Minority Business Development Agency has reviewed the reasons for these impediments and proposed recommendations to improve financing options. Some of these proposals are simple, such as the recommendation to develop up-to-date information on minority firms to promote investment by the financial and corporate sectors. Others are more complex, such as the development of new financing programs. However, the economic imperative is clear; given the changing demographics and increasing importance of job creation, U.S. economic growth will be stymied by the failure to mobilize all of its business resources. To maximize the Nation's growth, including in consumption, Gross National Product, and tax base, U.S. policies must ensure that businesses owned by minority entrepreneurs are brought into the economic mainstream.

## FINANCING CHALLENGES FACED BY MINORITY BUSINESSES

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There are myriad reasons for the difficulties minority entrepreneurs face in accessing capital. In general, minority business enterprises (MBEs) are younger, with less revenues and employees than majority-owned businesses. These firms often are clustered in service industries, which lack the capital investment requirements of other industries, but provide limited business collateral, making debt financing difficult to obtain. Other reasons include:

- **Lack of Investment Performance Information.** Lack of performance information on loans and investments made to minority entrepreneurs results in the perception by financial institutions that these loans are riskier than those to other small business owners.
- **Consolidation of Financial Institutions.** The rapid consolidation of commercial banks over the last decade has resulted in the acquisition of a number of smaller banks that have been traditional lenders to small and minority businesses.
- **Ongoing Disparities in Lending.** Research indicates that banks deny financing to African-American and Hispanic borrowers more often than to majority entrepreneurs, even when controlling for differences between firms.<sup>1</sup>
- **Increased Use of Financial Technology.** Financial institutions are using technology to increase efficiency in loan processing, reduce transaction costs, maintain detailed databases of information on borrowers and loan performance, and generate credit-scoring models to assess risk. This has reduced relationship lending, traditionally a common financing methodology for MBEs.
- **Need for Mentoring and Technical Assistance.** Minority firms often need extensive mentoring and technical assistance services in addition to financing. For banking institutions, these services can raise the expense of making a loan.
- **Lack of Professional and Social Networks Between Minority Businesses and Investors.** One of the primary difficulties facing minority businesses is the lack of networks into the investment community. In particular, minority businesses often do not know venture capitalists or ways to penetrate the private equity community.

*“Investors and lenders need to understand that failure to recognize the profitable opportunities represented by minority enterprises not only harms these firms, it harms the lending institutions as well. Accordingly, we must make further progress in establishing business relationships between the financial services sector and the rapidly growing number of minority- and women-owned businesses.”* Remarks by Federal Reserve Chairman Alan Greenspan on January 10, 2002, at the Ninth Annual Economic Development Summit, The Greenlining Institute, Oakland, California

## RECOMMENDATIONS

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The recommendations developed by MBDA are consistent with and complementary to the Department of Commerce’s larger strategic goals. These recommendations highlight proposals that will support the development of minority businesses and result in job creation and other economic outcomes. Much of the Agency’s work focused on suggestions that would affect existing businesses, whether middle-market or larger businesses, as well as those firms with the most potential for growth. As indicated, these businesses are most likely to generate employment and revenues, yet often are overlooked by small business financing programs.

In particular, the recommendations emphasize the need to develop additional information on minority businesses. More than any other issue, the report highlights the lack of information on minority firms and reiterates the need for the Federal Government to develop and make this data available to the private sector. In general, the recommendations focus on the following four categories:

<sup>1</sup> Cavaluzzo, Ken and Linda Cavaluzzo. November 1998. “Market Structure and Discrimination: The Case of Small Business,” *Journal of Money, Credit and Banking*, Vol. 30 No. 4. See also Ken Cavaluzzo, Linda Cavaluzzo and John Wolken. October 2002. “Competition, Small Business Financing and Discrimination: Evidence from a New Survey,” *The Journal of Business*, Vol. 75, Number 4, page 657.

- 1. Development of current and extensive governmental data to support investment decision-making and to identify market opportunities in the MBE community**
  - Implement an Annual Survey of Minority-Owned Businesses to provide up-to-date and accurate information on the minority business community. As of the date of the report, the President's fiscal year 2005 federal budget included funding for an annual survey.
  - Organize and fund a national minority financing network and data repository, which would compile information on the loan performance of this sector of the business community.
  - Partner with the National Association of Investment Companies to collect data on portfolio performance of minority-focused venture funds and develop institutional investor strategies.
- 2. Improvement of capital availability and accessibility through existing and new programs**
  - Continue ongoing federal financing programs, such as the Small Business Administration 7(a), 504 and CommunityExpress programs and the Department of the Treasury's Community Development Financial Institutions Fund that have increased capital accessibility for minority businesses and other under-served communities.
  - Implement a National Capital Access program, which allows banks and other financial institutions to make loans to higher-risk borrowers.
  - Develop a national mezzanine-financing program.
- 3. Provision of expanded access to management and technical assistance**
  - Tie existing and new financing vehicles to technical and management assistance appropriate for the type of firm receiving the financing.
  - MBDA should focus its provision of services on businesses with \$100,000 or more in annual revenues, as businesses of this size are responsible for approximately 95 percent of all employees retained by minority firms and nearly 92 percent of minority business revenues. As of January 1, 2004, MBDA has restructured its Minority Business Development Center program to focus on high-growth businesses.
  - Develop tiering mechanisms for provision of management and technical assistance services promoting increased efficiency and innovation within the minority business community.
  - Create best practices and performance measurements for service providers.
- 4. Integration of the investment community, minority entrepreneurs, and the Federal Government**
  - Coordinate federal programs supporting minority business financing and increase minority business utilization of these programs.
  - Support existing mechanisms for integrating entrepreneurs with financial institutions, especially with respect to venture capital.
  - Promote increased collaborations between institutions with experience and expertise investing and lending to the minority business community and mainstream institutions.

## OVERVIEW

MBDA has focused on the minority business community as an under-represented segment of U.S. resources and productivity, with the potential to produce significant long-term growth and stability. MBDA's goal is to maximize the role of minority businesses as a component of U.S. productive resources and enhance the consumption, savings, Gross National Product, and tax base of the Nation.

Located within the U.S. Department of Commerce (DOC), MBDA is the only federal agency created to foster the establishment and growth of minority-owned businesses in America. DOC's mission is to promote job creation and improve living standards for all Americans by creating an infrastructure that promotes economic growth, technological competitiveness, and sustainable development. The Department's strategic goals are to:

- Provide the information and the framework to enable the economy to operate efficiently and equitably,
- Provide infrastructure for innovation to enhance American competitiveness, and
- Observe and manage the Earth's environment to promote sustainable growth.<sup>2</sup>

The recommendations developed by MBDA are consistent with and complimentary to these goals. Minority businesses are one of the fastest growing sectors in the business community; however, long-standing and systemic difficulties in obtaining financing constrain the ability of these firms to play stronger and more vital roles in the U.S. and global economies. These impediments are likely to limit domestic growth, a limitation that will become greater as minority communities become a larger part of the U.S. population.

The findings in this report clearly indicate that, to maximize overall economic impact, minority entrepreneurs must increase the capacity of their businesses, and ensure the ability to access private sector, government, and consumer market opportunities. Across the board, minority firms are smaller, with less revenues and employees, than comparable majority firms. *For example, when comparing firms with paid employees, excluding C corporations (C corporations are often publicly traded companies), majority-owned firms in this category have average revenues of \$1,276,367 and employ 9.9 employees; the average minority-owned firm has revenues of \$641,629 and on average employs 6.2 employees.* Minority ownership is also concentrated in industries, such as services and retail trade, where U.S. average annual capital expenditures for equipment are very low. Low capital requirements are clearly an attractive feature for someone who wants to start a business but has very limited access to capital. Minority entrepreneurs are also under-represented in areas, such as manufacturing, which require greater capital investments.<sup>3</sup>

Resolving the financing impediments will begin to address these issues. MBDA's objective in undertaking this project was to identify and recommend solutions to existing capital barriers; its overall goal is to develop larger and healthier minority businesses. If these recommendations are implemented and capital flows more freely to minority businesses, more minority entrepreneurs will start and grow companies to significant sizes, creating jobs that reduce unemployment in minority communities. By becoming major shareholders in the American economy and society, minority entrepreneurs can create and share wealth, and in the process improve community well-being and enhance the quality of life for those with whom they work.

<sup>2</sup> U.S. Department of Commerce. 2001. "Charting Our Course for a Stronger America." FY 2001 Accountability Report, U.S. Department of Commerce.

<sup>3</sup> U.S. Department of Commerce, Economics and Statistics Administration and Minority Business Development Agency, "Keys to Entrepreneurial Success: Capital, Education and Technology," Patricia Buckley, Ph.D., September 2002.

## STEERING COMMITTEE, ROUNDTABLE, AND SUMMIT

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In spring 2002, MBDA began its planning for a Summit on Minority Business Financing, at which the Agency would present policy recommendations on improving financing options for minority business enterprises (MBEs). These recommendations were to be documented in a policy paper containing an action agenda that could be implemented by national and local policy-makers, as well as the private sector. MBDA's objective was two-fold: to develop administrative, legislative, and regulatory recommendations likely to have a significant impact on minority businesses, and to highlight, where there existed:

- Successful models that could be enhanced and replicated; and,
- Interest among opinion leaders to make the recommended changes or the likelihood of creating such interest.

MBDA obtained feedback from both the public and private sectors with respect to (1) how financing services could be focused to better satisfy the needs of the MBE community; and (2) MBDA's role in this effort. To obtain broad-based input on these issues, MBDA organized a diverse public/private sector Steering Committee (Committee) composed of representatives of: the federal government, including financial regulatory organizations; banks and other financial institutions; the minority business community; venture capitalists and venture capital organizations; and service providers. The Committee met regularly to assist MBDA in preparing for the Summit. To broaden its outreach, MBDA conducted an interim Roundtable in November 2002, with approximately 100 attendees, to obtain additional feedback into this report.

MBDA's recommendations were presented and discussed at the Summit on Minority Business Financing on April 14, 2003. The recommendations were released to the public in September and October 2003 via a *Federal Register* notice, when additional comments were solicited. This report reflects additional input that was received at the Summit and through the public comment process.

The recommendations contained in this report are not designed to be a comprehensive outline of all actions that could be taken; rather, MBDA has focused many of its recommendations on the expansion of successful models that currently exist.

## BACKGROUND ON MINORITY BUSINESSES

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America's entrepreneurs play a significant role in the prosperity of the U.S. economy. Entrepreneurs develop and commercialize innovative products and services; generate new industries and firms to replace those that have run their course; and create employment opportunities and wealth that is reinvested in new economic enterprises and in communities. Critical to entrepreneurial success is access to the financing necessary to grow and expand these businesses.

While improving financing options is important for all businesses, it is imperative for the minority business community. The 1997 Survey of Minority-Owned Business Enterprises Report (SMOBE Report)<sup>4</sup> indicates that minority businesses have dramatically increased their participation in the free enterprise system, and are a critical component of the U.S. business community. ***In fact, growth rates in both numbers and gross receipts of minority-owned firms substantially exceeded those of non-minority firms between 1992 and 1997.*** Specifically, between 1992 and 1997, the number of minority-owned firms increased by 29.6 percent, as compared to 3.6 percent for majority-owned firms. Even after accounting for high minority population growth over this period, growth in the number of minority-owned firms is still substantially higher (16.1 percent) than growth in majority-owned firms.<sup>5</sup>

<sup>4</sup> U.S. Census Bureau. July 2001. "1997 Census: Survey of Minority Owned Business Enterprises, Company Series Statistics," U.S. Department of Commerce, Economics and Statistics Administration. The Survey of Minority-Owned Business Enterprises is produced by the Census Bureau once every five years. The most recent Survey, released in 2001, covered business activity for 1997.

<sup>5</sup> U. S. Department of Commerce, Economic and Statistics Administration and Minority Business Development Agency. September 2002. "Keys to Entrepreneurial Success: Capital, Education and Technology," Patricia Buckley, Economics and Statistics Administration.

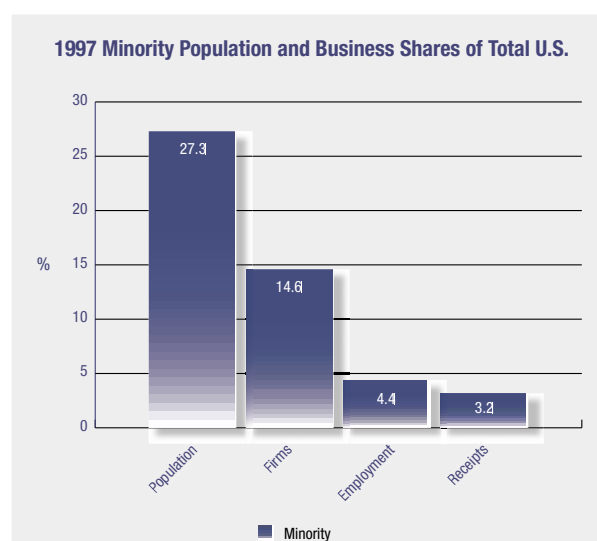
In addition, three of the four minority groups had revenue growth rates exceeding those of all U.S. firms. All U.S. firms grew revenues at a rate of 40 percent; American Indian businesses grew at 179 percent, Asian/Pacific Islander businesses at 68 percent and Hispanic businesses at 49 percent. Only African American-owned businesses had a gross receipts growth rate (33 percent) less than the all U.S. firm growth rate.

This becomes particularly significant when viewed with projections for the U.S. labor markets. Minorities comprise a significant portion of labor supply growth and are the source of potential labor productivity gains that drive economic growth. While the rate of total U.S. workforce growth has declined (falling from 2.7 percent in the 1970s to between 1.0 and 1.5 percent today<sup>6</sup>), minorities represent up to 70 percent of expected growth over the next 20 years.<sup>7</sup> Research demonstrates that minority and women-owned firms are most likely to hire this emerging workforce.<sup>8</sup> Without effective mechanisms and incentives for job creation, retention and capital formation among the rapidly diversifying labor force, U.S. productivity and economic growth will be constrained.

To promote the expansion of minority businesses, it is critical to address the financing challenges that impede MBEs' ability to grow and create jobs in minority communities.

- By most measures, minority firms continue to be underrepresented in the business community, when the number of firms, employees, and gross receipts are compared with minority percentages of the population. For example, in 1997, minorities accounted for 27 percent of the U.S. population, but only 15 percent of firms, 4 percent of employees and 3 percent of the nation's gross business receipts (figure 2).

**FIGURE 2: 1997 MINORITY POPULATION AND MINORITY BUSINESS PERCENTAGE OF TOTAL U.S. FIRMS, EMPLOYMENT AND RECEIPTS**



Source: Minority Business Development Agency, U.S. Department of Commerce. July 2001.  
*The State of Minority Business, 1997 Survey of Minority-Owned Business Enterprises.*

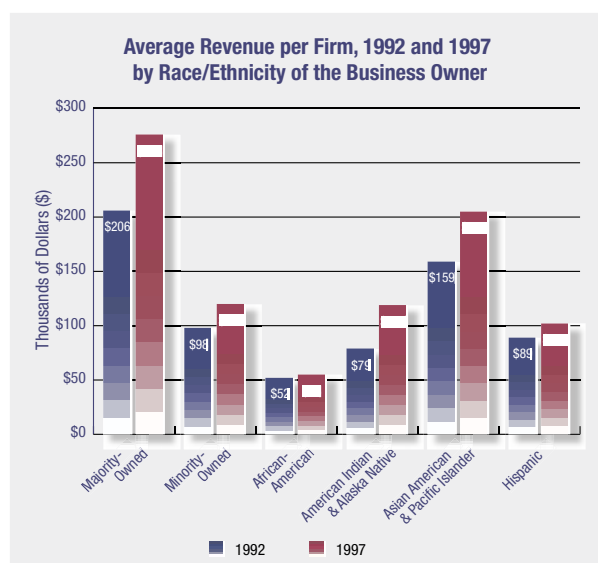
<sup>6</sup> Yago, Glenn and Aaron Pankratz. September 2001. "The Minority Business Challenge: Democratizing Capital for Emerging Domestic Markets." Minority Business Development Agency, U.S. Department of Commerce and The Milken Institute.

<sup>7</sup> Percentages derived from data from the Bureau of Labor Statistics, U.S. Department of Labor and the U.S. Census Bureau, U.S. Department of Commerce.

<sup>8</sup> Bates, Timothy. 1999. "Viewing Minority Business Assistance as a Job Creation Strategy," *The Black Worker in the 21st Century*, ed. Wilhemina Leigh & Margaret Simms, Washington, DC. Joint Center for Political and Economic Studies.

- When C Corporations are excluded from the 1997 SMOBE information<sup>9</sup>, revenue growth for minority-owned businesses was significantly less than that of their majority-owned counterparts (figure 3). The average revenue per firm of minority-owned businesses rose by \$22,000 or 22 percent; however, this was much lower than the \$70,000 or 34 percent growth experienced by majority-owned businesses. As a result, in 1997, the average revenue of majority-owned firms was 2.3 times as large for minority-owned firms, up from 2.1 percent in 1992.

**FIGURE 3: AVERAGE REVENUE PER FIRM, 1992 AND 1997 BY RACE/ETHNICITY OF THE BUSINESS OWNER**



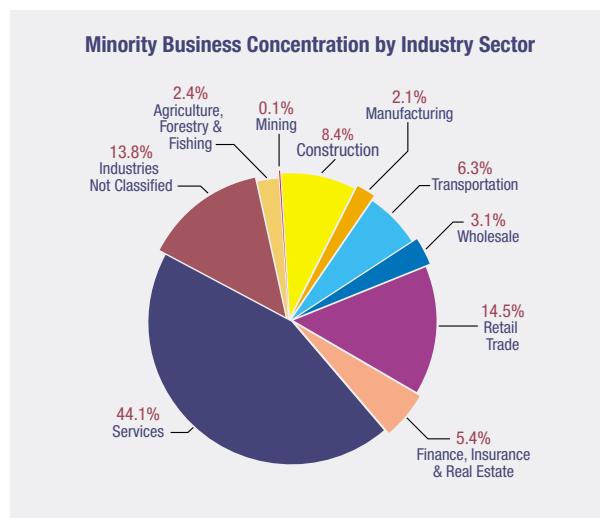
Source: U.S. Department of Commerce, Economics and Statistics Administration and the Minority Business Development Agency. September 2002. *Keys to Minority Entrepreneurial Success: Capital, Education and Technology*, p. 4.

<sup>9</sup> "Keys to Minority Entrepreneurial Success: Capital, Education and Technology", p. 4. In the report, Dr. Buckley excluded C Corporations from her analysis to obtain comparability between minority-owned and majority-owned companies. C Corporations were not included within the minority-owned business data, but were included within the data for majority-owned business.



- Minority businesses are concentrated in the retail and services industries, where U.S. average annual capital expenditures for equipment are very low (figure 4). Low capital requirements are an attractive feature for start-up businesses, but with limited collateral to secure loans, these businesses often have difficulty obtaining financing.

**FIGURE 4: MINORITY BUSINESS CONCENTRATION BY INDUSTRY SECTOR**



Source: U.S. Census Bureau. July 2001. 1997 Economic Census, Survey of Minority-Owned Business Enterprises, Company Statistics Series. U.S. Department of Commerce, Economics and Statistics Administration.

- The vast majority of firms in the United States are small and in 1997 only 25 percent of U.S. firms had employees. However, for minority businesses, the numbers are even lower – 20 percent. The following table illustrates the discrepancies in average revenues and employees between minority and majority-owned businesses in the same sectors (table 1).

**TABLE 1: DISTRIBUTION OF MINORITY-OWNED FIRMS WITH REVENUE AND EMPLOYEES PER FIRM BY INDUSTRY, EXCLUDING C-CORPORATIONS, 1997 (FIRMS WITH PAID EMPLOYEES)**

Firms	Minority-Owned			Majority-Owned	
Group	Distribution of Minority Firms across Industries	Average Revenue per Firm	Average Number of Employees per Firm	Average Revenue per Firm	Average Number of Employees per Firm
All Firms		\$641,629	6.2	\$1,276,367	9.9
Services	39.8%	\$383,010	6.5	\$614,621	9.5
Retail Trades	31.1%	\$604,535	6.1	\$1,338,759	11.4
Construction	10.3%	\$471,283	4.3	\$965,513	6.3
Wholesale Trade	5.2%	\$3,183,630	7.2	\$4,804,937	10.7
Finance, Insurance & Real Estate	4.4%	\$420,525	2.9	\$868,370	5.2
Transportation, Communication & Utilities	3.8%	\$465,502	5.8	\$1,279,313	10.5
Manufacturing	3.5%	\$1,739,748	14.2	\$3,381,969	24.2
Agriculture, Forestry, Fishing, Mining	2.1%	\$194,490	3.9	\$529,399	5.4

Source: U.S. Census Bureau. July 2001. *1997 Economic Census, Survey of Minority-Owned Business Enterprises, Company Statistics Series*, U.S. Department of Commerce, Economics and Statistics Administration.

- Business participation rates (the number of business owners in a particular ethnic group for every 1,000 persons of the same ethnic group) for each minority group falls below both the non-minority business participation rate and the national average (table 2).

**TABLE 2: BUSINESS PARTICIPATION RATES (PER 1,000 INDIVIDUALS)**

	All U.S. Population	Non-Minority Population	Minority Population	African-American Population	Hispanic Population	American Indian & Alaska Native Population	Asian & Pacific Islander Population
National Average	78	91	42	24	41	85	90
State Maximum	115	203	148	59	175	512	156
State Minimum	61	62	21	17	21	16	42

Source: Minority Business Development Agency, U.S. Department of Commerce. July 2001. *The State of Minority Business, 1997 Survey of Minority-Owned Business Enterprises*, p. 11.

This information illustrates the ongoing discrepancies between minority and majority-owned businesses. Minority businesses are significantly smaller, with less employees and revenues, than comparable majority-owned businesses. Access to financing, education, and technology are critical to creating parity between these business communities.

## FINANCING ENVIRONMENT

The likelihood of a new business surviving, growing, and creating jobs is related to the availability of capital. Minority firms have ongoing difficulties in accessing financing, inhibiting both firm start-ups and expansion. For example, minority firms received only between 3-4 percent of Small Business Investment Company funds (SBICs are an important source of equity financing for high-growth businesses) and private equity firms targeting minority companies are estimated to have only 2-3 percent of all venture capital funds under management.<sup>10</sup> With respect to loans, banks make smaller loans to start-ups in minority areas than in non-minority communities and to minority-owned firms than non-minority owned firms, even when controlling for equity capitalization, owner education, race, age, and experience. In one independent study of a limited scope, an analysis of loan applications indicated a higher denial rate for African American and Hispanic-owned businesses even after accounting for differing firm characteristics.<sup>11</sup>

In addition, there are other issues that inhibit the ability of minority businesses to obtain financing:

- **Lack of Investment Performance Information.** Lack of performance information on loans and investments made to minority entrepreneurs results in financial institutions perceiving them as riskier than other small business loans.
- **Consolidation of Financial Institutions.** The rapid consolidation of commercial banks over the last decade resulted in the acquisition of a number of smaller banks that have been traditional lenders to small businesses. Frequently, when larger financial institutions acquire smaller ones, the combined institution tends to move away from small business lending. This concentration in the financial markets has eliminated a significant source of financing in minority communities.
- **Increased Use of Automated Financial Technology.** Financial institutions have rapidly moved to use technology to improve loan processing and reduce transaction costs, maintain detailed databases of information on borrowers and loan performance, and generate credit scoring models. The use of electronic systems of underwriting loans has resulted in a severe reduction of relationship lending. Minority entrepreneurs, who often don't have the credit records to receive top scores under these electronic models, may find it difficult to access commercial lenders.
- **Need for Mentoring and Technical Assistance.** Minority firms often need extensive mentoring and technical assistance services in addition to financing. For financial institutions, the cost of making a loan may be increased by the need for mentoring and/or technical assistance.
- **Lack of Professional and Social Networks Between Minority Businesses and Financial Institutions.** Minority entrepreneurs often lack the professional and social networks into financial institutions. Minority business owners frequently have no connections with the private equity community, which is relationship-driven and can be difficult to penetrate.

While these impediments present financing challenges, minority businesses provide lucrative investment opportunities. Recent research conducted for the National Association of Investment Companies (the trade organization representing minority-focused venture capital firms) indicates that when minorities start high-growth companies, their rates of return are comparable to all companies in this class. More importantly, this research also shows that investment funds targeted primarily at minority businesses perform at comparable levels to non-targeted funds. *Investment firms targeted at minority firms had median internal return rates of 19.5 percent and a mean of 23.9 percent. By way of comparison, Venture Economics reported that, as of 2001, their Private Equity Performance Index (1,400 U.S. venture fund capital and buyout funds) generated a ten-year average annual return of 20.2 percent.*<sup>12</sup> This data strongly supports a recommendation to encourage and increase investment in funds that focus on minority businesses.

<sup>10</sup> Yago, Glenn and Michael Harrington. 1999. "Mainstreaming Minority Businesses: Financing Domestic Emerging Markets." The Milken Institute.

<sup>11</sup> Yago, Glenn, Betsy Zeidman and Bill Schmidt. 2003. "Creating Capital, Jobs and Wealth in Emerging Domestic Markets: Financial Technology Transfer to Low Income Communities." The Milken Institute and the Ford Foundation.

<sup>12</sup> Bates, Timothy and William Bradford. "Minorities and Venture Capital: A New Wave in American Business." Kauffman Foundation, 2003. See also Christopher William Barrons, "Managing Change: Minority Funds Deliver Steady Returns," The Wall Street Journal Europe, June 6, 2000.

In addition, research on community banks suggests that business lending in low and moderate income (LMI) areas is no riskier than standard commercial bank lending. A 2002 study by the National Community Capital Association indicated that lending of community development financial institutions (CDFIs) certified by the Community Development Financial Institution Fund<sup>13</sup> is as safe as commercial bank lending with comparable net charge-offs and delinquency rates.<sup>14</sup> With its rapid growth rates, the minority business community presents attractive investment opportunities for those institutions with the commitment and creativity to assess and understand the environment.

## PROFILE OF FIRMS CONSIDERED

In this report, the term “minority businesses” refers to firms that are owned or controlled by African-Americans, Asian-Americans, Hispanic-Americans and Native-Americans/Alaska Natives<sup>15</sup>. Under federal, state, and most private sector minority certification programs, minority-owned firms are required to be 51 percent owned by a minority entrepreneur or group of entrepreneurs. This requirement was designed to prevent the use of “front” businesses in government and private sector contracting – those businesses in which the senior executives are minorities, but where the firm is, in actuality, majority-owned. As a growing number of minority firms have obtained equity capital, this definition does not always reflect marketplace realities. Given the way in which equity transactions are structured, an entrepreneur seeking early stage venture capital will have difficulty retaining a 51 percent ownership interest in his or her business. In response to the needs of its minority business constituency, the National Minority Supplier Development Council (NMSDC) has developed a certification category that allows for minority certification where businesses are 30 percent owned by one or more minority entrepreneurs, provided the individual or group of entrepreneurs retains “control” of the business.

The definition of “minority businesses” must reflect marketplace realities and not preclude minority entrepreneurs from accessing innovative financing tools and products. This is an important issue within the minority business community, a subject that requires serious thought and creative solutions. MBDA recognizes that it is critical for high-growth minority firms to obtain venture financing; businesses that receive private equity investment grow much more quickly and employ more people than businesses financed through debt. Accordingly, MBDA has included minority entrepreneurs who have received equity financing from the discussion contained within this report.

With respect to size, business enterprises have been divided into three basic categories. The categories are based in part on current size or revenue of the firms – *but, as importantly – on an entrepreneur’s commitment to structure the capitalization, governance, and operations of his or her business to grow and develop*. Different firms, all initially quite small, may have very different revenue and employment potentials and consequently require different operational and capital structures to support their growth and development. The company’s revenue potential has far greater impact on the appropriate types of capital to be sought by a firm than its current revenues. Similarly, different types of management and technical support are required by firms based on their revenue potential.

*To develop recommendations with the potential to impact the U.S. economy and those of minority communities, MBDA focused on firms with growth potential and the ability to create employment. Feedback indicated that there was a market gap with respect to high-growth firms. As a result, the recommendations emphasize firms with the ability to significantly expand both revenues and employment, regardless of the current size of the business. Even when focusing upon microenterprises, the recommendations are geared to those firms with the objective and commitment to grow beyond this stage.*

<sup>13</sup> There also are community development financial institutions that are not certified by the Community Development Financial Institutions Fund. In this paper, they will be referenced as ‘other CDFIs.’

<sup>14</sup> National Community Capital Association. November 2002. “CDFIs: Bridge Between Capital and Communities.”

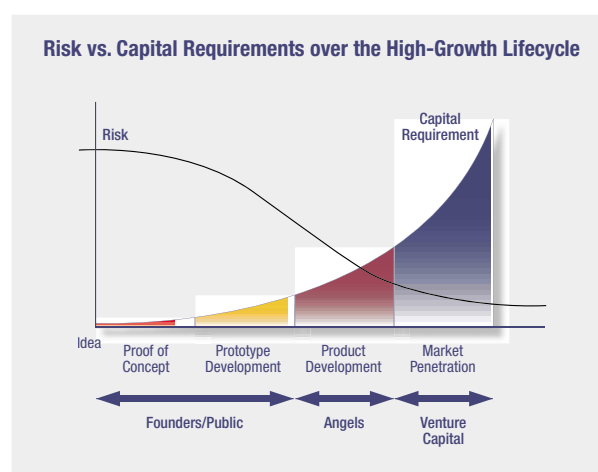
<sup>15</sup> Hasidic Jews are considered to be a minority group as defined by MBDA; however, no information is available per “The Emerging Minority Marketplace – The Minority Population Growth: 1995 – 2050, issued September 1999.

## HIGH-GROWTH COMPANIES

These companies produce products and services that compete nationally and internationally. Prosperity and growth are heavily driven by these firms.<sup>16</sup> The average venture-backed firm employs nearly 100 workers within five years and creates almost twice as many jobs as its non-venture backed peers.<sup>17</sup> These companies are frequently technology-based and usually have significant intellectual property that provides them with a strategic advantage and market protection.

High-growth firms may initially be capitalized by private or “angel” investors and then funded by professional venture capitalists. These investors, who take significant risks, purchase equity in the companies in which they are investing. Investors anticipate that if the company is successful, it will either be able to go through an initial public offering or be acquired by a larger corporation, at which time the initial equity investment will result in significant returns. Figure 5 demonstrates a common cycle, as the technology or concept of these high-growth companies mature, that there is a dramatic reduction in the risk associated with the invention.<sup>18</sup> The figure also shows that, as the risk declines, the requirement for capital increases as more funding is needed to finance expansion and marketing.

**FIGURE 5: RISK VS. CAPITAL REQUIREMENTS OVER THE HIGH-GROWTH LIFECYCLE**



Source: Abigail Barrow, von Liebig Center for Entrepreneurship, University of California San Diego, 2003.

A source of early funding for many companies of this type are grants given out under a variety of federal programs, including the Small Business Innovation and Research (SBIR), Small Business Technology Transfer (STTR) and Defense Advanced Research Projects Agency (DARPA) programs. This type of funding enables these high-growth companies to do initial proof-of-concept research and early development work without giving up equity to outside investors.

<sup>16</sup> Porter, Michael E. 2001. "Clusters of Innovation Initiative." *Council on Competitiveness*.

<sup>17</sup> Yago, Glenn and Betsy Zeidman. 2001. "Capital Access for Minority Business," prepared for the Minority Business Roundtable, *The Joint Center for Political and Economic Studies*.

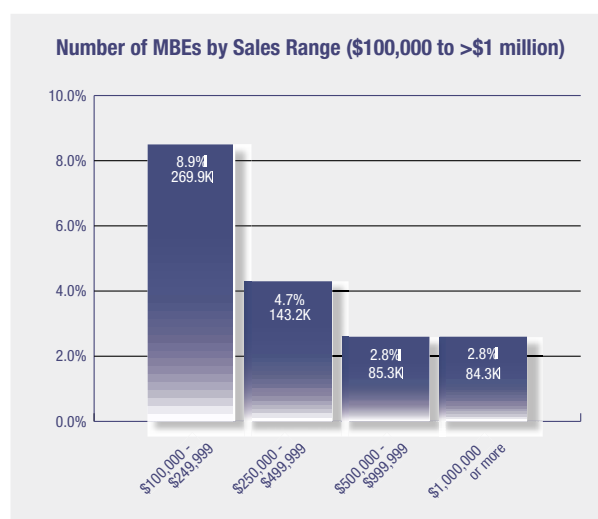
<sup>18</sup> Barrow, Abigail, von Liebig Center for Entrepreneurship, University of California San Diego, 2003.

It is important to remember that very few firms are successful candidates for venture capital. By way of example, of the 20 million firms in existence in 2001, only approximately 5,400 received investments from private equity firms.<sup>19</sup> Due to lack of data, researchers are uncertain of the number of minority firms that are included within these businesses.

## EMERGING MINORITY COMPANIES

These firms are usually small to medium-sized companies. Firms in this category rarely have intellectual property or a protectable market but rather produce goods and services tied to the domestic market. In an average region, these companies account for roughly two-thirds of employment.<sup>20</sup> Typically these companies have annual revenues between \$100,000 and \$10 million and assets of under \$3 million. Within the minority business community, firms with greater than \$100,000 in annual revenues constitute 20 percent of all minority-owned firms, but are responsible for 94.6 percent of all employment and generate 91.8 percent of all revenues.

**FIGURE 6: NUMBER OF MBES BY SALES RANGE (\$100,000 TO >\$1 MILLION)**



Source: U.S. Census Bureau. July 2001. *1997 Economic Census, Survey of Minority-Owned Business Enterprises, Company Statistics Series*. U.S. Department of Commerce, Economics and Statistics Administration.

Many of these companies are started through self-funding by the founder. However, for minority entrepreneurs, the lack of personal capital is an impediment to the establishment, survival and growth of minority businesses. For this reason, the availability and accessibility of capital is of particular importance to emerging minority businesses.<sup>21</sup> The following types of funding are frequently used to start or grow emerging minority companies:

- Debt of greater than \$50,000 and under \$1 million such as that provided by the SBA's 7(a) program;
- Debt over \$1 million, such as that provided by the SBA's 504 program; and
- Mezzanine funds.

<sup>19</sup> National Venture Capital Association. 2002. "2002 National Venture Capital Association Yearbook."

<sup>20</sup> Porter.

<sup>21</sup> See in particular "Mainstreaming Minority Businesses," Milken Institute Policy Brief, 1999.

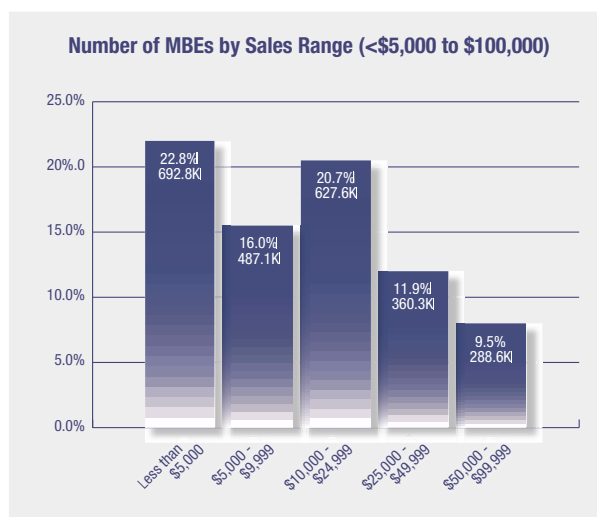
Other federal programs are often important to support these firms during their establishment and early growth. The most prevalent of these programs is the SBA's 8(a) program, which certifies companies owned by socially and economically disadvantaged individuals, including minorities. These companies can receive "sole source" contracts (not exceeding \$3 million for goods and services and \$5 million for manufacturing) and bid for "set-aside" contracts.<sup>22</sup>

## MICROENTERPRISES

These are very small businesses. They often have very few employees – frequently only one. These businesses are established by their founders as a primary source of income or to supplement a regular salaried position. The creation of a business enables entrepreneurs to "be their own boss" - perhaps to work from home. This is often the primary motivation for founders to start these companies, rather than wealth creation. A majority of these businesses are home based. These firms are usually very low growth – and frequently "no growth."

Companies considered in this category predominantly have less than \$100,000 in annual revenues. In addition, most of these firms take little or no capital investment to start. However, when financing is required, these types of firms are usually funded through micro-loans or equity investments of less than \$50,000.

**FIGURE 7: NUMBER OF MBES BY SALES RANGE (<\$5,000 TO \$100,000)**



Source: U.S. Census Bureau. July 2001. *1997 Economic Census, Survey of Minority-Owned Business Enterprises, Company Statistics Series*. U.S. Department of Commerce, Economics and Statistics Administration.

<sup>22</sup> For more information on the 8(a) program see [http://www.fedaccess.com/8\(a\)program.htm](http://www.fedaccess.com/8(a)program.htm)

*Firms in this size range constitute 80 percent of all minority businesses and are responsible for 5.4 percent of the employment and 8.3 percent of revenues generated by minority firms.* While many micro-companies never grow beyond \$100,000 in annual receipts, there is a significant subset that can and does grow into emerging minority companies. It is extremely important to give these companies technical support and enhance their access to capital to enable them to make this transition.



## SECTION 2

## RECOMMENDATIONS IMPACTING ALL MINORITY - OWNED BUSINESSES

This report focuses on the financing needs of minority businesses with the potential to grow beyond the microenterprise stage. MBDA, while it will continue to serve the needs of the broader minority business community, also must support the efforts of minority-owned firms that can generate significant revenues and employment in minority communities, as consistent with the Department of Commerce's mission to promote job creation and improve living standards for all Americans.

The recommendations below apply to all firms, regardless of their size or growth potential. In several cases, these policy recommendations are expanded upon later in the text with specific examples of how they can be developed to have greater impact for each type of company.

- **Develop better data on minority businesses, their investment needs, and their performance.** All types of investment and financial assistance to minority entrepreneurs are limited by the lack of data on the minority business community. The problem is by no means limited to minority businesses. In *American Formula For Growth: Federal Policy and the Entrepreneurial Economy*, 1958-1998, a publication of the National Commission on Entrepreneurship, the authors call upon policy makers to "Invest in a system to collect and disseminate business statistics that accurately describe the entrepreneurial economy in real time. Government data currently available to policymakers regarding the entrepreneurial economy are dated, incomplete, and off-target."<sup>23</sup>

For minority entrepreneurs, the lack of current and up-to-date information is a severe impediment to a community already facing long-term and significant financing constraints; as a result, many minority businesses pay more for the loans or investments that they receive. With enhanced data, credit scoring, and analytical techniques used in the financial services sector could be applied to increase access and reduce the cost of loans to minority businesses.

- ✓ **Annual survey of minority owned businesses.** There is no question that an annual survey of minority owned business enterprises or similar instrument would greatly improve the availability of data on minority businesses. Currently, markets marginally utilize the SMOBE data collected by the Bureau of Census through a survey that takes place every five years, with a release date two-three years subsequent to the survey.<sup>24</sup> Up-to-date data would increase the interest of the business community in identifying market opportunities, and partnering with and investing in minority businesses. In particular, private-sector participants in MBDA's process indicated that this impeded their ability to understand and partner with minority firms. As of the date of this report, the President's proposed budget for the 2005 fiscal year includes funding for an annual survey of minority firms.
- ✓ **National minority financing network and data repository.** Develop an effective mechanism for the financial services industry to reasonably and efficiently assess minority business risk and enable investors to make improved, information-based decisions about financing. Given the current fragmentation in the existing data pools, it is critical to create a repository of information on minority businesses and their loan performance and share this information with financing institutions. Creation of such a repository would facilitate critical data assembly, reduce the cost of information management, and potentially create a pool of loans that could be securitized and sold into the secondary markets.<sup>25</sup>

<sup>23</sup> National Commission on Entrepreneurship. October 2002. "American Formula for Growth: Federal Policy & the Entrepreneurial Economy, 1958-1998," page 7.

<sup>24</sup> In an unpublished 2002 MBDA/Capital Access Group/Milken Institute study, financial institutions cite the lack of information on the minority business community and financing performance as a major impediment to moving more aggressively in this marketplace. In general, financial institutions indicated that the lack of reliable historic information on minority business loans and investments make it difficult for banks to evaluate and price the risk of loans to minority firms. Similarly, the absence of well-organized information (both formal and informal) on minority firms (by industry, geography, and size) means that potential lenders incur large costs in identifying minority firms.

<sup>25</sup> This concept was recently proposed by Glenn Yago, Betsy Zeidman and Bill Schmidt in "Creating Capital, Jobs and Wealth in Emerging Domestic Markets," page 70.

This repository could be initiated with information obtained from the Small Business Administration (SBA) and the Community Development Financial Institutions Fund (CDFI Fund), both of which facilitate small business loans. The CDFI Fund is building a system to collect transaction-level data on CDFI and Community Development Enterprise (CDE) loans. This data shall include borrower characteristics as well as loan performance. The CDFI Fund expects to begin collecting transaction-level data in the first quarter of FY 2004.

An alternative could be to create an independent network of participating banks, both large and small, which have significant portfolios in minority markets. The information could be used to develop other products, credit enhancements, and liquidity mechanisms in this market. If a loan pool of sufficient size is collected, the data could be used to create credit-scoring mechanisms reflective of minority markets.

- ***Develop equity investment performance history.*** MBDA should partner with interested organizations, such as the National Association of Investment Companies, to develop ongoing information on the performance of equity investments in minority businesses. If such information is developed, it can be used to develop an advocacy strategy to promote increased investment by institutional investors into minority-targeted funds. MBDA could undertake the research required for this, as well as serve as an advocate to potential limited partners for venture funds, particularly public pension funds.
- ***Improve the coordination of federal agencies' efforts regarding minority business finance.*** There is minimal coordination among federal agencies that provide financing to minority businesses. All federal agencies should ensure that personnel in charge of programs that provide financing or technical support to minority businesses collaborate and coordinate with their counterparts in other federal programs. Funding programs at federal agencies should also take full advantage of private-sector programs that assist minority businesses in publicizing their programs. Best practices can be seen in the Department of Agriculture, which works closely with the SBA, the CDFI Fund, Economic Development Administration, U.S. Department of Commerce (EDA) and other federal agencies to leverage their programs.

Currently, the CDFI Fund and its Community Development Advisory Board are exploring the creation of an Interagency Collaborative on Community and Economic Development, whose purpose would be to coordinate the federal government's economic development, housing, and community improvement policies, activities, and initiatives in distressed communities and targeted populations for maximum economic stimulus efficiency and impact. This Collaborative, which would include federal agencies involved in community economic development (Treasury, Commerce, SBA, Housing and Urban Development, Agriculture, and Interior) would aim to improve coordination among federal programs that support community economic development, develop common measures of success, and produce a single report on the impact of federal government community economic development programs.

MBDA can play a critical role by:

- ✓ Coordinating those agencies with a significant focus on financing minority businesses through a Working Group that meets quarterly, composed of representatives of the SBA, Department of the Treasury, Department of Agriculture, Department of Housing and Urban Development, and federal research and development grant programs. Such a Working Group could be a part of, or should closely collaborate with the Interagency Collaborative described above.
- ✓ Electronically inventorying and updating information about financing programs.
- ✓ Most importantly, effectively communicating this information to the broader minority business community and assisting minority businesses in accessing these programs. MBDA could provide this information on its Internet Portal and disseminate updated information regularly to minority business advocacy organization and minority businesses via an electronic newsletter.

- ***Develop best practices of management assistance.*** Much of the feedback MBDA received indicated that, regardless of the stage or size of a company, technical assistance plays a critical role in capital access enhancement. Furthermore, available technical assistance services should be practical and strategic – not theoretical or conceptual. MBDA recommends creating best practices templates for assistance services and developing benchmarks to measure the effectiveness of the programs. The objective is to develop standards and measures for the programs but not to advocate for a standardization of services.

## SECTION 3

## RECOMMENDATIONS FOR HIGH GROWTH/VENTURE CAPITAL FUNDED COMPANIES

Supporting the growth of companies in this category was of paramount importance to participants at the Committee meetings, Roundtable, and Summit. These processes identified a lack of networks between minority entrepreneurs and the private equity community as one of the primary impediments to improving access to equity financing. Venture capital networks are generally informal; transactions are reviewed by venture capitalists based upon personal recommendations, which excludes many minority entrepreneurs, who often don't have access to these networks. In addition, even minority entrepreneurs who had been successful in raising equity indicated that their deals must be "spotless" and were held to a higher standard than those of majority-owned businesses. As a result, many recommendations in this section focus upon systematizing MBEs' access to these networks. Based on the feedback, MBDA can function as a core facilitator, connecting minority business enterprises with the proper service or capital providers, and working with existing organizations to avoid duplication of efforts. MBDA should also encourage capital providers to seek out minority-led firms that meet their lending/investment criteria.

In addition, MBDA is in position to facilitate relationships with community organizations to assist with mentoring minority businesses through partnerships with senior executives, including retired executives, venture capitalists, and successful minority entrepreneurs.

### RECOMMENDATIONS FOR IMPROVEMENT OF CAPITAL AVAILABILITY AND ACCESSIBILITY

Venture capital markets are, by nature, involved in risk management. Private equity investors take higher risks than banks and lending institutions, with the expectation of higher rewards. To spread their risk, venture capitalists, in many cases, will co-invest with other professional venture capital firms.<sup>26</sup> The requirements of venture investing present special challenges for minority businesses, given the specialized nature of the industry. To begin to address these issues, the following should be implemented:

- ***Integrate the investment and minority business communities.*** The private equity community is fundamentally a private network of high net worth individuals, venture capital funds, and institutional investors. These are communities that minority businesses, historically, have not been able to penetrate. In addition, managers of minority-owned venture capital funds have indicated the need to increase their access to the public/private pension fund community.

The integration of these communities is vital, now more than ever. Minority entrepreneurs must be able to forge relationships with the established private equity networks. Minority operated and focused venture capital funds must obtain capital infusions into their reserves for continued growth. These entities need access to private/public pension and insurance fund managers.

MBDA should support advocacy activities that bring together emerging and established financial communities (i.e. venture capital funds, private equity pools, and others). Furthermore, MBDA should encourage programs that foster and expand relationships in these communities.

<sup>26</sup> 2002 National Venture Capital Association Yearbook Executive Summary, p. 4.

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## MODEL PROGRAM FOR INTEGRATING COMMUNITIES

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### Emerging Venture Network

The mission of the Emerging Venture Network (EVN), a non-profit organization, is to stimulate the growth of high-impact companies led by minority entrepreneurs by providing access to education, training, and venture resources. EVN's programs help minority entrepreneurs meet with investors and venture resources. Conversely, investors learn about the potential of minority firms.

EVN has indicated that the "equity gap" for high-growth businesses - high numbers of minority business sales with low numbers of minority equity capital - signals a tremendous amount of unrealized potential in the minority community.

In addition, anecdotal evidence suggests minority participation in venture financing is small. As the venture capital industry tracks the number, industry, size, location, etc. of equity capital transactions, no data is currently collected about the race or ethnicity of the entrepreneur(s). EVN believes that expanded research can contribute to an improved understanding of minority businesses and their investment potential. EVN intends to establish the baseline for where the market is today and track emerging entrepreneurs' ability to gain increased access.

EVN is committed to educating investors and entrepreneurs so the potential of emerging firms can be fully realized. Examples include: creation of i-DealFlow Forum 2001, the first-of-its-kind minority venture capital forum; EVN's Angel Investor Training; and one-day educational seminars that focus on high-potential growth businesses.

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- ***MBDA should partner with the SBA and the CDFI Fund to increase the outreach of the investment programs to high-growth minority businesses.***<sup>27</sup> SBICs, licensed by the SBA, are privately owned and managed investment firms. They are participants in a vital partnership between government and the private sector economy. With their own capital and with funds borrowed at favorable rates through the federal government, SBICs provide venture capital to small independent businesses, both new and already established. In 2003, the SBA was authorized to invest \$7 billion, making the SBIC program one of the largest venture capital investors in the country.

While this program is not targeted to fund either minority-led businesses or minority business focused funds, MBDA can work closely with the SBA to ensure that the managers of this program invest in new funds, which are being established to specifically focus on funding minority businesses. The SBIC program should also promote minority-led businesses as possible investments to their entire investment portfolio.

MBDA also should collaborate with the CDFI Fund to increase minority businesses' awareness of CDFIs and CDEs that provide venture capital and equity-like products.

- ***Consider the development of programs focused on domestic emerging markets.*** Federal and state governments have played and continue to play a strong role in financial markets. Existing programs help the venture capital market by mitigating risk and leveraging funds/benefits/rewards through tax credit incentives. At present, there is minimal funding for equity programs which focus on domestic emerging markets, including businesses located in low income areas and minority-led firms. Some private-sector participants at the Summit recommended that the federal government should pilot and implement innovative programs which make much-needed equity available to these under-served businesses.

<sup>27</sup> Today there are two types of SBICs - the original, or "regular" SBICs and SSBICs - Specialized Small Business Investment Companies. Specialized SBICs invest in small businesses owned by entrepreneurs who are socially or economically disadvantaged, and are mainly members of minority groups. The Small Business Program Improvement Act of 1996 repealed Section 301(d) and, as a result, no new SSBIC licenses are being issued. With few exceptions, the same rules and regulations apply to both "regular" SBICs and SSBICs. Therefore, in general, the SBIC name is used to refer to both SSBICs and "regular" SBICs simultaneously.

- ***Consider the use of credit enhancements and liquidity facilitation.*** Use of guarantees and capital reserves, as well as the Community Reinvestment Act, can reduce risk through the government's participation in minimizing private sector risk. An initial push may come from government funding followed by private investments. However, reporting and restrictions currently imposed by the government often serve as a disincentive to investors and ultimately impedes the expansion of capital solutions to the MBE community.

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## RECOMMENDATIONS FOR TECHNICAL AND MANAGEMENT ASSISTANCE

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Although many public sector programs are designed to serve microenterprises and start-ups, virtually no emphasis is placed on mid-size and larger minority businesses in federal, state, or local programs. This is a critical gap in the current business environment and, from an economic perspective, governmental services and resources directed toward businesses in this category should be increased. In general, there was perceived to be a significant unmet need in this area; input from all sources indicate that MBDA be positioned to better serve this business niche.

- ***MBDA should support the development of venture-sensitive management and technical assistance practices.*** Minority firms need institutionalized programs that access established venture capital networks. This process is critically necessary to increase the number of minority businesses financed with equity.

In the last few years, several organizations have been developed to improve the training and coaching available to minority firms in their efforts to raise venture capital. The two model programs discussed here, the Emerging Venture Network and MECA, have made significant efforts in this area. As these programs grow in number and maturity, MBDA must ensure that appropriate assessment tools are developed for use by these programs. MBDA should support the development and sharing of best practices amongst these groups and their peer groups that support general entrepreneurship. For these initiatives, MBDA could seek sponsorship from foundations that support entrepreneurship.

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## MODEL PROGRAM FOR SUPPORTING TECHNICAL AND MANAGEMENT ASSISTANCE

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### **MBDA Equity Capital Access (MECA) Program**

MECA provides highly specialized management and technical assistance not offered in other government-funded programs to minority firms. MECA was part of the National Minority Enterprise Development (MED) Week 2002 held in Washington, DC, September 24-27. This effort represented an enhancement of MBDA's current capabilities in successfully linking minority entrepreneurs with start-up and growth capital. MECA included:

- A nationwide business plan search for high-growth minority entrepreneurs.
- A "boot camp" training program at MED Week 2002 for selected finalists.
- A panel presentation and pitch session at MED Week 2002 for all participants.

Within a six-week period, nearly 450 entrepreneurs applied for the opportunity to receive a business plan review and an invitation to the one-day boot camp training session. One hundred and eighty minority entrepreneurs received a free business plan evaluation, which provided them with detailed comments on the strengths and weaknesses of their plan. The top 45 candidates from across the United States completed a face-to-face interview and final evaluation process. Of these, 25 were invited to attend the MED Week boot camp. These firms all were:

- Seeking over \$1 million in equity funding.
- Companies in high-growth industries, primarily biotechnology, software development, security, networking and equipment, telecommunications, financial services, media and entertainment, and retailing/distribution, but highly qualified applicants in other industries have been considered.
- Businesses with defined exit strategies that have the potential to return 4-10 times the investment in 3-6 years.

Five of the selected 25 candidates presented their business models to a panel of venture capital firms. The presentations were conducted in front of an audience of nearly 1,000 people. The entrepreneurs spoke for eight minutes each and were followed by ten-minute panel feedback sessions that explored the strengths, opportunities, and weaknesses of each presentation.

As of February 2004, nearly a quarter of these companies have been successful in raising approximately \$10 million in financing.

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## SECTION 4

## RECOMMENDATIONS FOR EMERGING MINORITY COMPANIES

The companies that fall into this category are heavily reliant upon loans to fund their establishment and expansion. Since minority entrepreneurs often lack extensive personal assets to fund their company's start-up and expansion, the availability of debt capital is of paramount importance to the company's growth and survival. Participants on the Committee and at the subsequent meetings suggested that a proper role of government, in addition to the development of information, is to provide liquidity programs and mitigate risk by providing credit support in the form of guarantees or other credit enhancements.

### RECOMMENDATIONS FOR IMPROVEMENT OF CAPITAL AVAILABILITY AND ACCESSIBILITY

**A. Continue to fund successful federal programs.** To bridge the financing gap, federal and state governments should support programs that have increased capital available for MBEs.

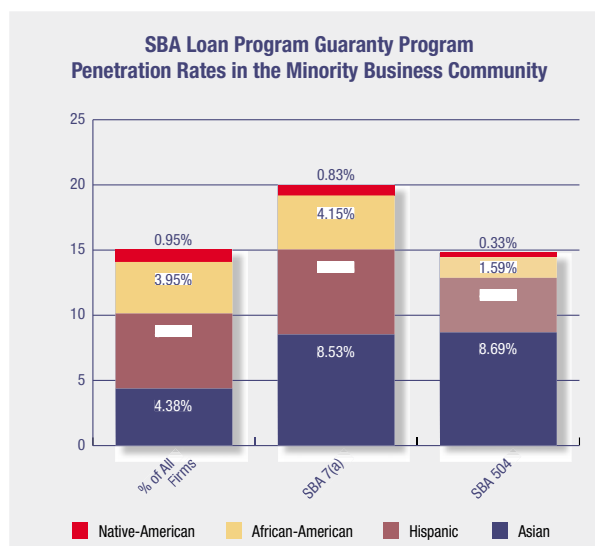
- **SBA Credit Programs:**

1. **7(a) and 504 Loan Program.** While neither the U.S. Small Business Administration 7(a) nor the 504 loan (which provides long-term, fixed rate financing for major fixed assets) programs are new, both programs have been effective as sources of financing for minority firms. These programs provide loan guarantees to small businesses throughout the country; the maximum amount of a 7(a) loan is generally \$1 million and the maximum on the 504 program is \$1.3 million.

As shown in Figure 8, over a ten-year period (1990-2000) minority firms have received 20 percent of total 7(a) loans and 15 percent of 504 loans. On an annualized basis this equates to \$1.7 billion for 7(a) loans and \$230 million for the 504 loan program. Cumulative value of loans during this period was \$85.1 billion for the 7(a) and \$15.3 billion for the 504 loan programs.



**FIGURE 8: SBA 7(A) AND 504 LOAN GUARANTY PROGRAM  
PENETRATION RATES IN THE MINORITY BUSINESS COMMUNITY**



Source: U.S. Small Business Administration, Office of Advocacy

2. **CommunityExpress Program.** The CommunityExpress program combines small business loan guarantees from the U.S. Small Business Administration and targeted lending by select banks along with combined pre- and post-loan technical assistance from independent local National Community Reinvestment Coalition members. The program targets two markets: low and moderate-income geographies and women and minority-owned businesses, regardless of geography or income.

The critical element of the program is the mandatory integration of pre-loan and post-loan technical assistance into the loan process. This acts to reduce risk by strengthening the borrower's management skills, and the probability of business success. The value-added technical assistance provided by NCRC member organizations acts as a collateral enhancement and offers participating banks more flexibility in adopting bank-defined underwriting criteria.

To qualify for the program, a business must meet the SBA's size standards and fall within specific geographic areas, usually low and moderate-income areas. The size standards are based on the average number of employees over the preceding 12 months or the average sales over the previous three years.

CommunityExpress contains the following components:

- ✓ Has a maximum loan amount of \$250,000,
- ✓ Uses the standard SBA 7(a) guaranty (SBA was willing to raise the normal SBA Express guarantee from 50 percent to the 7(a) level of 75-80 percent, depending on loan size) and
- ✓ Offers technical assistance arranged/provided by lenders.

*The CommunityExpress Program, although relatively small (as of December 31, 2003, the loan portfolio was \$213 million), makes the majority of its loans (68 percent) to minority businesses.*

- **Community Development Financial Institutions Fund.** The Community Development Financial Institutions Fund (Fund) is a federal program that works in market niches that have been under-served by traditional financial institutions. The Fund's primary mission is community development; it accomplishes this through increasing the availability of credit, investment capital, and financial services in distressed urban and rural communities. The Fund provides relatively small infusions of capital to institutions that serve distressed communities and low-income individuals. The Fund's activities leverage private-sector investments from banks, foundations, and other funding sources. Since the Fund's creation in 1994, it has made more than \$534 million in awards to community development organizations and financial institutions.

Community Development Financial Institutions (CDFIs) are for-profit and non-profit, regulated and non-regulated private sector entities, and include community development banks, credit unions, loan funds (business, microenterprise, and others), and venture capital funds. Of more than 600 CDFIs operating in every state and the District of Columbia, 261 provide business financing. CDFIs provide a wide range of financial products and services, including commercial loans and investments to start or expand small businesses, and financial services needed by low-income households and local businesses. In addition, all certified CDFIs provide services that help ensure that credit is used effectively, such as pre-and post-loan technical assistance to small businesses. The CDFI Fund reports that 47 percent of CDFIs' business loans go to minority-owned businesses.

- B. Implement a national capital access program.** Capital Access Programs (CAPs) are small business lending programs available in 21 states and two cities. These programs are available for transactions that do not meet conventional lending guidelines and hold particular appeal for borrowers in emerging domestic markets. There have been over \$1.2 billion of such loans issued as of November 1999, with average default rates of 3.1 percent.<sup>28</sup>

Under a CAP, the bank and the borrower pay a combined up-front insurance premium, typically between 3-7 percent of the loan amount at the bank's discretion, which goes into a reserve fund, held at the originating bank. The state matches the combined bank and borrower contribution with a deposit into the same reserve fund. The CAP reserve fund allows a lending bank to make slightly higher risk loans than conventional underwriting, with the protection of the reserve fund for its entire pool of CAP loans.<sup>29</sup>

Although there is no national capital access program currently in existence, there are many programs that utilize this concept on a state/regional level.<sup>30</sup> Where CAP programs track the ethnicity of borrowers, a significant number of borrowers under these programs are minority entrepreneurs.

The Riegle Community Development and Regulatory Improvement Act of 1994, which was incorporated into the Community Development Banking and Financial Institutions Act of 1994, authorized the CDFI Fund to establish the Small Business Capital Enhancement Program. Through this program, which is not currently funded, the Fund may provide reimbursements to participating states for contributions made to reserve funds established to cover the loan losses of participating financial institutions. The amount of a state's contribution to the reserve funds and the amount of the CDFI Fund's reimbursement to a state is based upon prescribed formulas. The Act requires that the CDFI Fund receive a \$50 million appropriation before approving any state for participation in the program.

The following factors should be incorporated into any CAP program:

- ✓ Participation from both regional and national financial institutions to establish a reserve and allocation of losses based on the individual financial institution's loan experience rather than pooling all losses.
- ✓ Reserves may be covered by multiple funding sources, with less reliance on state funding.
- ✓ The program should have a minimum loan amount of \$250,000 to \$1 million or more.
- ✓ Financial institutions should track the loans made to minority firms. Currently, only 9 of 21 states with CAPs tracked loans to minority firms.<sup>31</sup>

<sup>28</sup> U.S. Department of the Treasury. November 1999. "Capital Access Programs: A Summary of Nationwide Performance."

<sup>29</sup> Ibid.

<sup>30</sup> Ibid. The list of state CAP programs includes: Arkansas, California, Colorado, Connecticut, Iowa, Illinois, Indiana, Maine, Massachusetts, Maryland, Michigan, Minnesota, Mississippi, New Hampshire, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Texas, Utah, Vermont, Virginia, West Virginia, and Wisconsin. There are also CAPs in specific city and town areas as well, such as New York, and New Bedford, Connecticut.

<sup>31</sup> Ibid.

Several private sector participants, including financial institutions, expressed strong support for a program of this type which allows more flexible underwriting than other federal programs. Although capital access programs are race-neutral, they are frequently used by and benefit minority borrowers. In future budget years, these participants recommended that full funding for the program should be considered.

- C. Expand mezzanine financing vehicles.** There is the need to identify and develop mezzanine financing or “patient capital” vehicles focused on lower loan size transactions (\$500,000 to \$1 million). Mezzanine financing is used to fill the void that can exist in a company’s capital structure between equity and senior secured debt. Generally it is structured as subordinated debt (capital exchanged for both an interest coupon and a share of future profits), or preferred stock with a common equity component provided through the use of warrants or a conversion feature.

This segment of the market is missed by the traditional debt providers and is not a focus area for angel (private) investors or venture capitalists. The technology and innovations of the mezzanine market remain largely underdeveloped for the emerging minority market segment. The increased availability of mezzanine capital would introduce needed flexibility to the capital structure of firms that are minority-owned and address a critical need faced by the growing number of emerging service businesses.

Privately managed, public-purpose equity/mezzanine funds could target business and project financings in the emerging minority business sector. Several model programs of successful public/private or co-lending programs exist that offer subordinated features and competitive terms. In some cases the funds are provided through private foundations, which are attracted by the opportunity to leverage their investments, as well as the creativity of these models. Banks, which often have more sophisticated financial knowledge, should also be encouraged to establish these types of funding mechanisms.

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#### MODEL MEZZANINE FINANCING VEHICLE – PRIVATE SECTOR CONSORTIUM

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##### California Economic Development Lending Initiative (CEDLI)

CEDLI, a statewide lending organization, was created in 1995 by over 30 California banks and corporate investors. CEDLI is a non-government, for-profit agency specializing in providing small business loans to near-bankable companies in California. CEDLI was originally capitalized by its investor banks and corporations with over \$5 million in equity and \$35 million in investment funds. CEDLI's current shareholders include 45 financial institutions and four corporations and its funds available for investment now exceed \$70 million. It has directly invested over \$80 million in its target markets over the last five years and through leverage has attracted another \$180 million in senior debt financing for its clients.

CEDLI's mission is to create jobs by providing financing to projects that fall outside of standard bank lending practices. Their co-lending programs for small businesses target loans to emerging business in both urban and rural areas that are currently unable to qualify for conventional bank financing. While all small businesses are eligible for CEDLI loans, women and minority-owned businesses are a high priority for financing.

CEDLI finances up to 50 percent as subordinated (mezzanine) debt; the remaining 50 percent is financed by the member bank that has a priority position on the assets. To serve more borrowers, CEDLI provides mezzanine financing, rather than venture capital, since most small firms will not grow at the rates required for venture capital. With CEDLI's mezzanine financing, for every dollar funded, an additional \$3 are created in senior debt.

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## MODEL MEZZANINE FINANCING VEHICLE – BANK

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### **FleetBoston Community Investment Commitment**

In 1999, in conjunction with the merger of Fleet Bank and BankBoston, the newly formed FleetBoston made an affirmative commitment to lend and invest in the communities it serves. The Community Investment Commitment is a \$14.6 billion, five-year initiative in nine states (New England, New Jersey, New York, Florida, and Pennsylvania). Approximately half of the Commitment is earmarked for small business lending, and there is a \$100 million commitment to business investments.

For small business lending, FleetBoston holds the primary debt and, when appropriate, uses its co-lending capacity through its bank-owned certified development corporation, Fleet Development Ventures, to hold subordinated debt. Although FleetBoston makes extensive use of the U.S. Small Business Administration programs, there is no requirement to use them. The bank has extensive CDFI activity, with investments in CDFIs in most of the nine states they serve.

The program has been very successful for FleetBoston so far. As of the end of the third year of the five year program, the bank had reached 134 percent of its commitment pace goal for the total program (\$12.6 billion). In equity investments, the program has reached \$89 million or 143 percent of their pace goal.

Fleet's methods can be replicated, relying on creative underwriting for business loans and investments with a strong understanding of the marketplace. Flexibility in products, co-lending, and the use of guarantees help the bank book loans that are near bank quality and mitigate certain identifiable weaknesses. However, the bank is quick to point out that creative products and underwriting cannot make a fundamentally unsound loan bankable .

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## MODEL BEST PRACTICES - BANK

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### Wells Fargo Minority Business Programs

Wells Fargo has committed \$6 billion dollars to minority businesses nationwide over a 10-12 year period. The company's reason for doing so is clear: While small business is projected to grow at a rate of 6 percent, minority-owned businesses are projected to grow at a rate between 16 and 30 percent, depending upon the particular minority group.

At Wells Fargo, the banking products for minority businesses are the same as for any business. Credit scoring and underwriting standards do not change for minority businesses. Guaranty programs, such as SBA, are used exactly as they are for non-minority business loans.

Wells Fargo's minority business programs differ only in the marketing and business assistance offered. These programs have their own collateral and marketing materials as well as their own information sections on Wells Fargo's Web site. In addition, Wells Fargo has established formal alliances with organizations representing minority businesses, such as the United States Hispanic Chamber of Commerce, and the Asian Business Association. Wells Fargo representatives attend meetings and events, communicate with local chapters, and generally get access to members of these organizations through the national organization. Wells Fargo is also working with the 100 Black Men organization in the San Francisco area and the California Black Chamber of Commerce, and is trying to work on the national level with these organizations.

In addition, Wells Fargo is committed to educating minority business owners. The company has a Business Resource Center on its Web site, and conducts educational programs designed to help minority business owners learn how to maximize their relationship with their banker.

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## RECOMMENDATIONS FOR TECHNICAL AND MANAGEMENT ASSISTANCE

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The Committee, Roundtable, and Summit attendees emphasized the role that technical assistance plays in capital access as established businesses seeking to significantly expand and grow their employees and revenues. It was suggested that MBDA focus on enhancing management and technical assistance services geared to these types of businesses.

*"I've seen small businesses grow or not succeed and fail, and it's really been [dependent on] the technical assistance piece. It's easy to make a loan. The tough thing is to live with that credit for five or ten or fifteen years...what kind of support you provide [to the businesses], what kind of providers they have to go to, what kind of resources they have...that to me is the most significant aspect of business survival."*

*- Gilbert Gonzalez, Committee Member*

- **Promote coordination and collaboration between federal providers of assistance to emerging minority businesses.** At present, minority firms are specifically served by MBDA programs like Minority and Native American Business Development Centers (MBDCs/NABDCs). However, technical assistance is available to them through many other agencies and providers, including the SBA through their Small Business Development Center program and through CDFIs certified by the CDFI Fund. MBDA should support the development of an inventory of services available and use this information to identify gaps in services and opportunities for collaboration between agen-

cies. In addition, the CDFI Fund's proposed Interagency Collaborative on Community and Economic Development could support this effort.

- ***MBDA should focus a larger portion of its service provision on emerging minority businesses.*** Traditionally, many of the clients served by MBDA's funded network of MBDCs/NABDCs are start-up and very small businesses, with a limited number of employees. There are a number of federally funded programs that focus on these businesses. Given MBDA's and Commerce's focus on job-creation, MBDA must begin to address the service gap facing emerging minority businesses – those with employees and revenues, but often without the knowledge and access to the information and capital to maximize their expansion. In addition, quantitative data and information should be developed on successful programs and the programs should be benchmarked. MBDA could explore this by funding several programs that are focused on the capital and business expansion needs of larger minority businesses. As of January 1, 2004, MBDA has restructured its Minority Business Development Center program to serve growing minority firms—ie., those with rapid growth potential and/or annual revenues in excess of \$500,000.
- ***Develop pre- and post-loan assistance programs.*** As discussed earlier, there is a gap in the provision of services to emerging minority businesses: the ability of these firms to gain access to pre-loan technical assistance and advisory services. Often this gap means that the loan applications submitted by emerging minority businesses are rejected. Pre-loan assistance can support the educational needs of minority entrepreneurs that lack business credit preparedness, and can provide assistance to help rejected loans applications be approved. There are a limited number of resources for pre-loan assessment and technical assistance; however, this may be the most critical assistance emerging companies can get to enable the firm to secure funding. While education is critical, the lender is generally unwilling to provide it for a variety of reasons, including lender liability.

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## MODEL TECHNICAL ASSISTANCE AND ASSESSMENT PROGRAM

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### **Business Resource Group (BRG)**

Business Resource Group is a private non-profit founded in 1996 to deliver business development assistance, training, education and capital access programs to minority and women-owned small businesses in California.

BRG uses a three-tiered small business technical assistance, assessment and integrated lending model that focuses on building capacity and strengthening mid-size and larger minority businesses, while delivering debt to support short-term growth. Participating minority business owners are enrolled into one of three pre-loan assessment and technical assistance programs: “Healthy Business Practices” (revenues under \$400K); “Bridges toward Growth” (revenues over \$400K and under \$1 million); and “The Financial Assessment and Capacity Enhancement (FACE) Program” (for businesses with revenues over \$1 million).

BRG uses the three-tiered business assessment/diagnostic processes to define business needs and develop a Business Technical Assistance Action Plan (BTAAP) for each company. BRG structures debt financing to fund into the company's management and operating weaknesses and support the next level of growth. BRG monitors the impact of combined capital and technical assistance services through a series of performance measures and tracking mechanisms.

The model has been very successful, achieving \$35 million in loans to minorities with less than 1.75 percent in program loan losses to-date. The program reports a three-year 90 percent loan approval rate. It is the integrated approach to business assessment, coupled with pre-and-post loan technical assistance, that drives the program's success.

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## MODEL ASSISTANCE PROGRAM

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### **Shorebank Neighborhood Institute**

Shorebank Neighborhood Institute (SNI) is the Chicago not-for-profit affiliate of Shorebank, the country's oldest and largest community development bank. Established in 1978, SNI's mission focuses on increasing economic opportunities for wealth creation, entrepreneurship, and employment in underserved communities on Chicago's South and West sides.

SNI's revolving small business loan fund assists qualified local businesses who are unable to secure financing to meet all of their needs from banking institutions or other loan funds. Loans ranging from \$20,000 to \$200,000 are available as primary debt or subordinate loan debt to finance acquisitions, turnarounds, or expansions.

Shorebank also has allocated monies for a growth fund and the organization is providing technical assistance to businesses in this category. The Shorebank Institute has a program called The Runners' Club. This program helps qualified African-American entrepreneurs increase their capacities to contribute to the local and national economy. A competitive class of business owners is selected to participate in a series of monthly classes.

These classes accelerate their companies' success through instruction and coaching by seasoned business leaders. Topics include: access to capital and investors, networks, and prospective partners; business plan refinement; and advisory board developments. The program is run and managed for SNI by The Marathon Group in Chicago.

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## MODEL CAPACITY BUILDING PROGRAM

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### California Resources and Training (CARAT)

California Resources and Training (CARAT), founded in 1994, is a private non-profit designed to enhance community economic development in California through integration and capacity building of business development organizations. CARAT's intent is to assist in building capacity and to encourage and stimulate partnerships between lending institutions and community development organizations. As a statewide initiative, CARAT has focused on enhancing the quality of technical assistance throughout California. A signature program of CARAT is the development of a technical assistance program designed to assess the quality of service delivery of business development organizations.

A few of the goals listed in CARAT's mission statement include: "Identify service gaps and implement programs with business assistance industry" and "Expand access to technical assistance for small business throughout the state, especially in under-served, low-income, rural and urban communities."

One of CARAT's accomplishments from last year was that it designed and implemented a 48-member Community Partners Program that has generated \$25 million in co-lending and real estate loans.

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- *MBDA should support efforts to strengthen links between assistance providers and banking institutions.* With the rapid growth in the number of MBEs, a larger pool of high-quality assistance providers will be required to guide business owners through the maze of capital access and credit preparedness. Relationships between the assistance community and banking institutions to facilitate the flow of MBEs to proper financial channels will be even more important. One strategy for developing these networks would be to encourage closer working relationships between organizations such as certified CDFIs, as well as other community lenders, and the commercial banking community. One organization that has been successful in accomplishing this, as well as building capacity in service providers, is the California Resources and Training program (CARAT). CARAT is unique in focusing on enhancing the quality of technical assistance throughout California. Many CDFIs and community lenders provide management and technical assistance, as well as financing. Institutionalizing linkages between community development and commercial lenders can result in a greater number of MBEs "graduating" to commercial loans, increasing commercial lending expertise in minority markets.



## SECTION 5 RECOMMENDATIONS FOR MICROENTERPRISES

Within this category, MBDA focused only on those businesses that have revenues of over \$50,000 and/or the clear objective of moving from being a microenterprise to either an emerging minority company or a high-growth company. In this area, there are several promising programs; however, greater research needs to be conducted.

### RECOMMENDATIONS

- ***Develop information and data on the success of microenterprise programs.*** The development of information and performance measurements to determine the success of microenterprise programs is critical. A preliminary review of these programs indicates that most have not tracked, over a period of time, their success by measuring such indicators as types or amounts of financing obtained by their clients, increase in number of employees and significant revenue growth. The primary objective of many microenterprise programs seems to be self-employment as a means of alleviating poverty, rather than developing businesses that have a significant economic impact in their communities (as measured through jobs generated, significantly expanded tax base, etc.). As many of these programs have not focused on transitioning microenterprises to the small business sector, determining their success in this area is quite difficult. Additional information and standardized measures would assist in this process.
- ***Promote the use of existing microloan programs.*** Information on existing microloan programs and services should be compiled and disseminated to the minority business community. Samples of these programs include:
  - ✓ ***Community development microlenders.*** There are a variety of microlenders, often certified through the Community Development Financial Institutions fund, or operating independently, that provide assistance to very small businesses.
  - ✓ ***Bank credit card and loan program.*** Certain financial institutions have a business credit card, which can be available to businesses without a credit history or to entrepreneurs with less than stellar history who would otherwise not qualify for business loans. When used properly, these can be very effective tools for developing or improving credit history, with the objective of moving the entrepreneur to a standard loan at a lower interest rate, as quickly as possible.

Some banks also have developed loan products for very small businesses. For example, Innovative Bank, based in Oakland, California, has developed a \$5,000 loan product, payable over 7 years, that is offered through its participation in the SBA CommunityExpress program. While clearly meeting the needs of a limited number of businesses, it provides streamlined approval, management and technical assistance, and competitive rates.
- ***Explore the success of business incubators.*** A review of the incubators serving minority entrepreneurs suggests that these institutions may provide a successful model for moving microenterprises into the emerging minority business category. According to the National Business Incubation Association, 87 percent of incubator graduates remain in business after graduation from incubators. Incubators focus on developing businesses by providing intensive management and technical assistance and guidance on financial reporting. Incubators often have sources of financing and networks into the local business community that can assist emerging minority businesses with financing requirements.

Successful incubators generally have the following common components:

- ✓ Extensive assessments of the business prior to acceptance into an incubator;
- ✓ Personalized consulting and coaching services;
- ✓ Regular benchmarking and review of business plan, including financial statements;
- ✓ Access to networks critical to a business' ability to expand; and
- ✓ A financial component, whether as an SBA intermediary or development of a separate financing program.

The Committee identified two incubators focused on minority businesses of the target revenue size: The Enterprise Center, located in Philadelphia, Pennsylvania, and the FAME/Renaissance incubator, located in Los Angeles, California. Both of these incubators are focused on entrepreneurs whose companies can generate at least \$100,000 after one year in the program, and ultimately generate more than \$1 million in annual revenues and at least 12 jobs. However, neither incubator has been in existence over an extended period of time and neither has long-term data on the success of its programs.

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### MODEL INCUBATOR PROGRAM

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#### **The Enterprise Center (EC)**

Founded in 1989 by the Wharton Small Business Development Center, the EC was developed as a vehicle to “stimulate economic growth in West Philadelphia through entrepreneurship.”

The EC offers intensive coaching and training in the core areas of business development: sales and marketing, financial management, human resources, technology deployment, and regulatory compliance. The EC's programs range across all stages of a business' development. Specifically related to financing, the EC Community Development Corp. focuses exclusively on investments in the neighborhood's real estate infrastructure as a means to attract new companies and create a magnetic environment – an environment with access to capital, technology, training, and a new generation of talent.

In addition, the EC holds an Annual Minority Business Plan Competition in which entrants to the competition must be a minority business enterprise, and be in business for three years or less, with less than \$250,000 in annual sales revenue. The winner receives a \$20,000 non-repayable grant.

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- ***Explore the success of innovative business development programs.*** In this field, there are both government (federal, state, county, and city) programs as well as many more that are non-profits. All of these different programs need to be evaluated in order to establish success metrics and also to identify model programs.

There are also programs, such as the Detroit Enterprise Institute and the FAME/Renaissance program (non-incubator), that are focused on developing minority businesses with the potential to have a significant economic impact on the surrounding community. These programs have many of the same components as incubators (extensive initial assessment, personalized consulting and coaching, financial benchmarking, and access to large networks, including financial institutions and other sources of capital). DEI also has conducted research on its impact on its client base.

- ***Assess the potential for standardization/certification of service delivery and the possible development of assessment tools.*** One of the issues that exists in the provision of management and technical assistance is the variation in the quality provided by service providers. There was particular concern with how financial statements and reporting are handled by microenterprises and small businesses. Additional work should be conducted in this area to determine the potential for these types of programs.

The Association for Enterprise Opportunity (trade organization of microenterprise providers) and the Aspen Institute's FIELD (Microenterprise Fund for Innovation, Effectiveness, Learning, and Dissemination) have developed a self-assessment and reporting process called MicroTest, a standardized tool designed to illuminate and improve the performance of the microenterprise development field. Specifically, this process is designed to:

- ✓ Improve quality and stability throughout the microenterprise industry,
- ✓ Increase the availability of efficient and effective services, and
- ✓ Assist investors and policy-makers to accurately discern exemplary achievement.

MBDA is interested in further exploring this process and whether or not it focused on microenterprise providers committed to graduating microenterprises.

- ***Develop a set of “best-practices” for microenterprise service providers.*** Many microenterprises are hampered in their growth by their lack of access to quality, trained service providers who can support the enterprises in their growth and development. In the microenterprise community, there is growing interest in the possibilities for ongoing training and assessment of providers. MBDA can support the development and use of “best-practices” among these service providers.

## CONCLUSION

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The purpose of this report is to chart the course for opportunities for a growing segment of America. The recommendations and initiatives outlined here focus on inclusion rather than displacement, expansion rather than restriction, and sustainability rather than transience for minority entrepreneurs who seek to start and grow their businesses.

Those who participated in researching the issues, assessing the data, and shaping this report share the conviction that by expanding access to financing for minority business entrepreneurs it is possible to create jobs, enhance productivity, and grow the economic pie for all Americans. The pursuit of opportunity is what the American dream has always been about; expanding opportunity for all businesses is not only right and fair, but also in the best economic and societal interests of our country.

Consequently, this report deals with the current disparities in financing minority businesses by emphasizing the importance of increasing the choices available to minority entrepreneurs. It emphasizes not only alternative sources of debt capital, but especially the importance of creating additional equity or near equity sources, such as venture capital, subordinated debt and business angels. The wider and more diverse the choices available to minority entrepreneurs, the more they will be able to grow sustainable enterprises that employ more people.

The measure of success of this document will be the degree to which minority entrepreneurs start companies, grow companies to significant sizes, and create jobs that reduce unemployment in minority communities. By becoming major shareholders in the American economy and society, minority entrepreneurs create and share wealth, and in the process improve community well being and enhance the quality of life for those with whom they work.

That's why these recommendations, policy changes, and initiatives are important. They point the way to make better and wiser use of our human capital, expand our economy, and further democratize access to financial resources for all Americans. Our companies, our communities, and our country all benefit from that.

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## GLOSSARY

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CAP	Capital Access Programs
CARAT	California Resources and Training
CDFI	Community Development Financial Institutions
CEDLI	California Economic Development Lending Initiative
CRA	Community Reinvestment Act
ECOA	Equal Credit Opportunity Act
EDA	Economic Development Administration, U.S. Department of Commerce
EVN	Emerging Venture Network
MBDA	Minority Business Development Agency
MBDC	Minority Business Development Center
MBE	Minority Business Enterprise
NABDC	Native American Business Development Center
NCRC	National Community Reinvestment Coalition
SBA	U.S. Small Business Administration
SBIC	Small Business Investment Company
SSBIC	Specialized Small Business Investment Company

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## SPECIAL RECOGNITION

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This report was prepared through a highly collaborative effort between the MBDA Steering Committee for the Summit on Minority Business Financing, the MBDA Office of Business Development, the Beyster Institute, and TerraCom, MBDA's event planning contractor. A special recognition goes out to these individuals for their hard work:

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