THE HAMILTON PROJECT

Advancing Opportunity, Prosperity, and Growth

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Minority and Women Entrepreneurs: Building Capital, Networks, and Skills

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We believe that today's increasingly competitive global economy demands public policy ideas commensurate with the challenges of the 21st Century. The Project's economic strategy reflects a judgment that long-term prosperity is best achieved by fostering economic growth and broad participation in that growth, by enhancing individual economic security, and by embracing a role for effective government in making needed public investments.

Our strategy calls for combining public investment, a secure social safety net, and fiscal discipline. In that framework, the Project puts forward innovative proposals from leading economic thinkers — based on credible evidence and experience, not ideology or doctrine — to introduce new and effective policy options into the national debate.

The Project is named after Alexander Hamilton, the nation's first Treasury Secretary, who laid the foundation for the modern American economy. Hamilton stood for sound fiscal policy, believed that broad-based opportunity for advancement would drive American economic growth, and recognized that "prudent aids and encouragements on the part of government" are necessary to enhance and guide market forces. The guiding principles of the Project remain consistent with these views.

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Minority and Women Entrepreneurs: Building Capital, Networks, and Skills

America's small businesses drive job creation and form a foundational part of our country's dynamic economy. Small businesses can empower their owners, offering a source of income, independence, and economic mobility; they are an important source of employment in the broader economy; and they often provide the vehicles for innovation.

However, as minority groups and women constitute increasingly large shares of the workforce—now 47 percent and 35 percent, respectively, up from 38 percent and 14 percent in 1971—there is concern that their rates of small business creation have not kept pace. Although the number of businesses owned by these groups is growing, women and minorities are still substantially less likely to run their own businesses than are white, non-Hispanic men. In 2007 women owned just 29 percent of all small businesses, and those from minority backgrounds owned just 23 percent. Closing this gap in entrepreneurship is critical to the continued dynamism of our economy and economic growth for all its members, but it will not be easy.

Starting a new business can be a challenge for anyone. Would-be entrepreneurs may face a number of hurdles, including lack of access to capital, insufficient business networks for peer support, investment, and business opportunities, and the absence of the full range of essential skills necessary to lead a business to survive and grow. There is reason to think that racial and ethnic minorities and women are particularly likely to face such hurdles. For instance, minority- and women-headed households generally have lower levels of household wealth, which in turn can make internal investment and external borrowing more difficult. Other barriers that may reduce rates of business formation among minorities include lower average credit scores and educational attainment; geographic or societal isolation from other communities and persistent discrimination may also impede entrepreneurship among women and minorities.

In a new Hamilton Project discussion paper, Michael Barr of the University of Michigan suggests that programs to increase access to capital, business networks, and skill development can address some of the issues faced by women and minority business owners. Barr recommends specific ways for the federal government to accomplish these goals, both by improving on existing programs and by establishing new programs. Specifically, he proposes reauthorizing the State Small Business Credit Initiative and doubling its funding from $1.5 billion to $3 billion, making the New Markets Tax Credit permanent and expanding it to $5 billion per year, and allocating $500 million each to networking and skills-building initiatives. Together, these proposals may help to reduce the obstacles faced by women and minority entrepreneurs in establishing and expanding successful business ventures.

The Benefits of Entrepreneurship

New businesses, small businesses, and entrepreneurship offer a number of benefits for individual business owners as well as for society. Some small businesses tend to stay small, such as owner-operated service, retail, or hospitality businesses. These firms can still be important generators of jobs and economic security in their local communities; of the roughly 11 percent of workers who are self-employed, most fall into this group. Other small businesses have greater growth possibilities, and can in some instances help to promote large-scale job creation and expansive economic growth. After all, every large business was once a small business.

Entrepreneurship also has the potential to improve social mobility, especially for minorities. A recent study found that among African Americans, entrepreneurs were more likely than nonentrepreneurs to move into a higher income group. Perhaps most importantly, the study found that African American entrepreneurs were as likely to move into higher income groups as were white entrepreneurs, indicating that entrepreneurship could play a prominent role in reducing the wealth gap between whites and African Americans. Entrepreneurship may help close the gender wealth gap as well.

The benefits of small businesses for the economy are also substantial. The Small Business Administration (SBA) estimates that small businesses accounted for 63 percent of net new jobs between 1993 and 2013. Young firms are the primary source of this growth, with start-ups representing 3 percent of employment in the United States but 20 percent of gross job creation. Though many of these firms fail, the survivors still generate jobs at a rate that is significantly higher than older firms. Small businesses are also loci of innovation: they introduce new processes and organizational models for business operations, they expand the range of choices for consumers, and they pursue new lines of research and development. For example, patenting small businesses produce sixteen times as many patents per employee as large patenting businesses. Given the potential of women- and minority-owned firms as well as the benefits of entrepreneurship to business owners and the broader economy, our country stands to gain from reducing the hurdles faced by these groups in creating and expanding their businesses.

The Challenge

Despite these benefits, Barr argues that there are three distinct challenges facing minority and women entrepreneurs: limited access to capital, limited access to business networks, and limited opportunity for business skills development.

Access to Capital

According to a recent nationally representative survey, African American– and Hispanic-owned businesses start with about half as much capital as nonminority-owned firms. Women also start with just a little more than half of the capital with which men start. These initial disparities persist and can even grow over time, as limited capital can constrain a business's ability to grow.

Minority-owned businesses rely significantly more on personal wealth and investments from family members than on external debt or equity. Some minority entrepreneurs raise capital by tapping into the resources of their respective communities, but these sources may be limited. Estimates from the U.S. Census Bureau indicate that nonminorities have wealth eleven to sixteen times that of African Americans and Hispanics. Women similarly suffer from the wealth gap, owning only 36 percent as much wealth as men.

Lack of personal wealth is doubly disadvantageous: not only does it constrain the ability of entrepreneurs to directly invest in their own ventures, but it also makes it more difficult for these entrepreneurs to obtain loans. Minority-owned businesses are approximately three times as likely to have a loan application rejected as are nonminority businesses. Furthermore, minority-owned businesses that do receive loans are granted less credit at higher interest rates. In 2003 the average loan amount for a minority-owned small business was about $9,300, compared to $20,500 for a nonminority business. Minority businesses paid 7.8 percent interest, compared to 6.4 percent for nonminority businesses. Women-owned businesses face similar challenges. Although they make up almost 30 percent of small companies, they account for only 16 percent of conventional small business loans and 4.4 percent of the total dollar value of these loans. It is of little surprise, then, that minority and women business owners are less likely to apply for credit; in fact, African American and Hispanic business owners are 37 percent and 23 percent less likely to apply than their white counterparts.

Finally, both women and minorities receive less in equity investments: minority-owned businesses receive on average less than half the equity investment that nonminority businesses receive. In addition, in 2001 women received only 5 percent of all venture capital investments.

Access to Business Networks

In many ways, the importance of business networks and contacts is obvious. Although it is difficult to find concrete evidence on the impact of business networks, it is widely accepted that they can provide participants with information and advice, knowledge of new business opportunities, and relationships that may prove useful in operating a business. Minorities and women often cannot easily tap into these networks, however. This may be in part because professional networks disproportionately consist of people with similar backgrounds; because there are fewer successful businesses led by minorities or women, it makes it more difficult for would-be entrepreneurs in these groups to gain advice, connections, or funding.

This case can be illustrated by the historical lack of venture capital invested in women- and minority-owned firms. Because angel networks are often built informally between investors with a history of doing business with each other, minorities may not have as much access to this form of capital. Similarly, the increase in the number of women-owned firms has accompanied the growth in venture capital available to these firms. Venture capital networks also tend to be geographically based. To the extent that minority entrepreneurs seek to launch businesses in areas of high minority concentration and not in areas where venture capital investors are concentrated, geographic isolation may reinforce exclusion from these networks.

Access to Skill Development

Studies consistently find that the education level of a business owner is positively correlated with entrepreneurship and entrepreneurial success. Businesses with highly educated owners have higher sales, profits, and survival rates, and hire more employees than businesses with less-educated owners. Thus, the lower levels of education and experience among racial minorities may be a barrier to entrepreneurship. Indeed, one report estimated that 6 percent of the gap in self-employment entry rates between African Americans and whites, and 30 percent of the gap between Hispanics and whites, could be explained by differences in education levels. While women are increasingly more educated than men, another study has noted that education is more important for women entrepreneurs, with the rate of self-employment for women rising with education faster than it does for men.

Aside from education, women and minorities also face a gap in relevant experience and the skills it brings. Women business owners tend to have fewer years of industry and start-up experience compared with men, and African Americans and Hispanics have slightly lower average industry experience and significantly less start-up experience compared with nonminorities. Additionally, as previously noted, the more limited access to business networks for women and minorities means that they have less access to mentors that can impart knowledge and skills necessary for entrepreneurial development. Furthermore, one study has found that minority business owners are less likely to use technology than are nonminority business owners, which may imperil their business success.

A New Approach

To address each of these three challenges, Barr offers specific policy proposals that can be implemented by the federal government. To combat the lack of access to capital, he advocates renewal and expansion of the State Small Business Credit Initiative and the New Markets Tax Credit. To tackle the lack of access to business networks, Barr recommends additional funding through the State Small Business Credit Initiative to support connections between small and larger businesses. To handle the development of business skills, Barr suggests again tapping the State Small Business Credit Initiative to fund accessible, tailored skills-development programs. Using these policies, which build on existing programs and evidence, the public sector could help to spur a more level playing field for all those who seek to start and run a business.

Credit Access: State Small Business Credit Initiative

One mechanism that Barr proposes to address the lack of access to capital is reauthorization and modification of the State Small Business Credit Initiative (SSBCI). Barr suggests that, with some adjustments in how it is administered, this program can provide an important source of funding for women and minorities.

Created within the U.S. Department of the Treasury (Treasury) in 2010, the SSBCI was tasked with the goal of strengthening existing state-level capital access programs and other initiatives that support lending to small businesses and manufacturers. The government-provided funds have been employed in a variety of ways, but they always leverage private funds, stretching the value of the money. For example, SSBCI funds can be used as part of a larger direct loan from a private lender, to invest in venture capital, or as part of a pool to cover lender losses. By the end of June 2014, Treasury had disbursed over two thirds of the $1.5 billion authorized. The first $590 million of funds supported an additional $4.1 billion in private sector lending to more than 8,500 small businesses, a 7:1 ratio of private-to-public funding. SSBCI funds are recycled as the original loans are paid off, and thus can be used to finance additional loans.

As of 2013 more than half of all SSBCI loans or investments had gone to businesses less than five years old, and 80 percent had gone to businesses with ten or fewer full-time employees. Approximately 40 percent of total loans or investments had gone to businesses operating in low- or moderate-income communities. Many of the loans and investments made to businesses in these communities operated through Community Development Financial Institutions (CDFIs), organizations dedicated to providing financial services to underserved communities and to promoting community development. These institutions made more than 3,600 loans or investments supported by SSBCI funds, totaling $231.3 million through 2013.

Business owners reported to Treasury that the expenditure of SSBCI funds will lead to the creation of 32,600 jobs and the retention of another 63,000 jobs. These results, however, are based on surveys, not on project evaluations. Barr proposes that new funding should be contingent on experimentation, robust data collection, and rigorous evaluation of outcomes.

He thus recommends reauthorizing the SSBCI with $3 billion in funding, a $1.5 billion increase from the 2010 congressional allocation. Barr argues that funding should be awarded to CDFIs and other local organizations based on demonstrated past performance and well-developed plans for targeting the funds, and not just on state economic conditions. Criteria would include how well the plans have targeted women and minority groups, leveraged federal funding, improved data collection, and supported evaluation of results. States would be encouraged to continue working with partner organizations and advocacy groups to reach minority- and women-owned small businesses.

The evaluation component is essential for Barr's proposal. He suggests that Treasury and states jointly improve data collection on funding recipients, their payrolls, and their revenues to improve program evaluation. As a result, policymakers will be able to better understand the needs of underserved groups, the needs of small businesses as a whole, and the effectiveness of different funding models.

Credit Access: New Markets Tax Credit

Barr proposes to increase access to credit for minority- and women-owned businesses through the New Markets Tax Credit (NMTC). This program, also administered by Treasury, uses tax credits to make private dollars available for investment to organizations, including small businesses located in low-income communities. Based on data collected through 2007, 13 percent of NMTC recipient projects were owned or controlled by minorities, and 10 percent were owned or controlled by women.

Preliminary evidence following implementation of the tax credit shows promise. As of 2014, the fund that administers the NMTC has granted more than 800 awards totaling $40 billion in tax credit allocation authority; these allocations have leveraged an additional $30 billion in outside investments that are not subject to the tax credit. A study of early NMTC-financed investments found that between 30 and 40 percent of projects would not have proceeded without the program. The study also found evidence that the NMTC had encouraged investments in low-income areas that

Roadmap

- Congress will reauthorize the State Small Business Credit Initiative (SSBCI), currently scheduled to end in September 2017, with $3 billion in funding, twice its current level and the president's FY 2016 budget request. Funding will be distributed by the U.S. Department of the Treasury based on how programs have targeted underserved groups, leveraged federal funds, and executed data collection and evaluation procedures. The Department of the Treasury will ask that states continue to work with partner organizations to reach minority- and women-owned small businesses.
- Congress will permanently extend the New Markets Tax Credit to leverage $5 billion annually for businesses in underserved communities. The Internal Revenue Service will improve administration of the program by simplifying compliance for small businesses. The agency within the Department of the Treasury that administers the tax credit will reevaluate its criteria for granting credits, increasing the focus on equity investments in small businesses and on funding for women- and minority-owned businesses. That agency will improve its data collection and evaluation to uncover new best practices that it will then disseminate.
- The federal government will facilitate the creation of new, accessible business networks with an additional $500 million of funding through the SSBCI. These networks will be administered locally by a range of for-profit and non-profit entities, including local centers run by the Small Business Administration or the Minority Business Development Agency. These networks will be tailored to the needs of the local community, and funding for them will be contingent on experimentation with new methods of outreach, data collection, and project evaluation.
- The federal government will facilitate the creation of innovative business-skills training programs for women and minority entrepreneurs with another $500 million of funding through the SSBCI. Under SSBCI, funding would help to spur (a) an app for entrepreneurs featuring just-in-time training and advising, (b) projects that include rigorous experiments on skills delivery and data collection, and (c) support for developing innovative curricula and methods of instruction.

Learn More about This Proposal

This policy brief is based on “Minority and Women Entrepreneurs: Building Capital, Networks, and Skills,” which was authored by:

MICHAEL S. BARR
University of Michigan

otherwise would not have been made. All projects, and start-up entities in particular, have been successful in generating jobs.

Barr proposes the permanent authorization and expansion of the NMTC to leverage $5 billion in financing per year over ten years. According to Treasury, this would cost taxpayers $10.1 billion over the ten-year horizon. Barr also recommends that the Internal Revenue Service simplify the compliance process for the NMTC, increasing its accessibility for small businesses. He advocates targeting the NMTC to show greater preferential treatment for applications that support investments in small businesses, including those operated by women and minority owners. As with the SSBCI, detailed data on recipiency and business characteristics should be collected for program evaluation.

Business Network Access

To address another key barrier facing minority and female entrepreneurs, Barr proposes that the public sector help facilitate the creation and sustainment of business networks. While business networks should be based in the business community and be led by the private sector, the federal government can play a role in fostering and enhancing these networks, especially for minority and female entrepreneurs and for businesses in economically distressed communities.

One previous model of a federal government initiative worth revisiting is BusinessLINC (Learning, Information, Networking, and Collaboration). Established in 1998, BusinessLINC created a partnership between the SBA, Treasury, and the private sector. It was intended to foster mutually beneficial linkages between businesses: small businesses would get advice, training, and access to opportunities, and larger companies would use relationships with small businesses to access local markets and diversify supplier bases. The government’s role in this program was to create local connections between smaller and larger businesses, typically by establishing coalitions of business leaders chaired by local CEOs or by creating online databases of business community members.

Barr’s proposal calls for Congress to allocate $500 million through the SSBCI—on top of the doubled funding described above—to finance locally based business networks tailored to local circumstances. Networks would vary in scale, types of members, and methods of communication.

Some of these business networks might form around local chambers of commerce, while others might be built around financial institutions dedicated to community development. Such networks might also operate through Small Business Development Centers, run by the SBA; and through Women’s Business Centers, run by the Minority Business Development Agency within the U.S. Department of Commerce. Networks might be aimed at different stages of the entrepreneurial process: those just starting a business, those with a small but low-growth business, and those with a small business with potential for rapid growth.

Business Skills Development

Barr further suggests that skills attainment, through training and education, may help bridge the entrepreneurship gap. While most training programs have not been shown to have a clear effect on business outcomes, recent research suggests that the types of training offered by skills-building programs may be crucial. For example, some experts argue that training is ineffective when it provides massive amounts of information at once, as is commonly the case. Instead, training should focus on providing simple rules of thumb that students can implement consistently. It would also seem to be important to design programs to fit the needs and time constraints of entrepreneurs, but these nuances have not been carefully observed or studied.

Given the lack of existing research about the skills needed to run a small business and how to teach such skills, Barr argues that this area is especially suitable for experimentation. He proposes that Congress appropriate an additional $500 million through the SSBCI to finance skills acquisition initiatives. (Note that this would bring total SSBCI funding to $4 billion.) These initiatives would consist of three components: (1) a grant challenge to develop an app for entrepreneurs that uses a mix of professionally developed just-in-time information and peer-to-peer just-in-time advising; (2) funding priority given to projects that include rigorous experiments and data collection and evaluation to determine effective methods to support skills acquisition; and (3) support for local SBA-affiliated and Minority Business Development Agency–affiliated centers, as well as community colleges, to experiment with entrepreneurial training curricula and methods.

Conclusion

Women and minorities represent a growing share of the workforce, and despite recent gains, are still less likely than men and non-minorities to own their own businesses. Given the dynamism of minority and women-owned businesses, it behooves law-makers to enact policies that may help to bridge the remaining entrepreneurship gap.

Such efforts should be sensitive to the various needs and goals of different entrepreneurs, and should address the higher barriers to entry faced by minority and women entrepreneurs. Barr identifies three primary challenges—access to capital, access to business networks, and access to business skills—that can be addressed in part by the public sector. Furthermore, Barr’s proposal expands the scale of existing programs. This expansion will make it easier to evaluate their success and fine-tune them to the benefit of future program participants.

Questions and Concerns

1. Are there other programs that could also be useful in improving access to capital for minority and women entrepreneurs?

Yes. This proposal is not meant to be an exhaustive list of programs for small businesses. For example, the SBA offers several services to small business owners, including a guaranteed loan program. Additionally, section 1071 of the Dodd-Frank Act amends the Equal Credit Opportunity Act to improve the collection and dissemination of data on small businesses. Specifically, the provision requires commercial loan applicants to report the race, gender, and other details of the business owner, data that were previously optional. This is a welcome improvement, as information regarding those communities that have substantial women and minority entrepreneurs and those that do not is lacking. This makes it difficult to target these groups with the limited funding currently available. Section 1071 will help to solve this information problem. Moreover, the government can make these data widely available to advance the ability of the private sector to serve small businesses, along the lines of recent efforts by the U.S. Department of Commerce and the SBA. The proposals discussed in this paper are meant to complement and reinforce these initiatives.

2. These proposals seek to promote business creation among women and minorities. What about business success?

It is often difficult to know in advance which businesses will succeed and which will fail. Government policies should increase the opportunities for women and minorities to open new businesses and to increase the likelihood of success of these firms. However, their ultimate success or failure, and their ability to generate job growth, is a result of factors far beyond any capital access, networking, or skills programs.

3. Isn't there a worry that these programs will encourage people to start businesses who would actually be better off working for a company rather than for themselves?

Entrepreneurship and small business ownership is not for everyone. But it is still likely that even some relatively marginalized, formerly unemployed workers could benefit from opportunities to open a small business, and many wage workers could usefully supplement their income with self-employment or small business ownership. Furthermore, removing barriers for women and minority entrepreneurs to open and grow their businesses is likely to benefit those who have the drive and ambition to become business owners. Even if many new businesses were to fail—as many do now—those that do succeed would benefit our economy as a whole.

Highlights

Michael Barr of the University of Michigan offers three proposals to lower the barriers for minority and women entrepreneurs, who represent a dynamic subset of business owners and a growing share of the workforce.

The Proposal

Access to Capital. The federal government would expand two of its vehicles for providing financing to small businesses—the State Small Business Credit Initiative (SSBCI) and the New Markets Tax Credit. Both of these programs would have their application procedures adjusted to focus further on minority- and women-owned small businesses, and both would require rigorous data collection and evaluation as a condition for funding.

Access to Business Networks. Congress would allocate an additional $500 million as a part of the SSBCI to create and expand business networks in states and local jurisdictions. These networks would link small business owners with established business leaders, providing opportunities for exchange of knowledge and information about new business opportunities. Funded networks would be subject to rigorous evaluation.

Access to Skill Development. Congress would allocate an additional $500 million as a part of the SSBCI to fund locally administered skills-building programs. These training initiatives would be designed with a focus on the needs and constraints of small business owners and aspiring entrepreneurs. Funded skills-building programs would be subject to rigorous evaluation.

Benefits

Small businesses provide benefits to their owners and to the economy as a whole. Ownership of a small business can provide financial stability and economic mobility, and can reduce income inequality. Small businesses, especially young businesses, foster job growth and facilitate innovation. By removing obstacles to entrepreneurship, these proposals would unlock all these benefits and promote economic growth.

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