No. 11-16228

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

ASSOCIATED GENERAL CONTRACTORS OF AMERICA,
SAN DIEGO CHAPTER, INC.,

Plaintiffs-Appellants

v.

CALIFORNIA DEPARTMENT OF TRANSPORTATION, *et al.*,

Defendants-Appellees

COALITION FOR ECONOMIC EQUITY;
NATIONAL ASSOCIATION FOR THE ADVANCEMENT OF COLORED PEOPLE,

Intervenor-Defendants-Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

BRIEF FOR THE UNITED STATES AS *AMICUS CURIAE*
SUPPORTING APPELLEES

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STATEMENT OF THE ISSUES

1. Whether AGC has established standing.

2. Whether California provided a record sufficient to implement the United States Department of Transportation's Disadvantaged Business Enterprise program constitutionally.

INTEREST OF THE UNITED STATES

This case involves the California Department of Transportation's (Caltrans) implementation of the United States Department of Transportation's (USDOT) Disadvantaged Business Enterprise (DBE) Program. This program is critical to the federal government's attempts to counter the ongoing effects of discrimination on the ability of racial minorities and women to compete for federally-funded contracts.

Congress enacted and has repeatedly reauthorized the DBE program for nearly 30 years in response to decades' worth of evidence of pervasive and ongoing discrimination in the transportation contracting arena. The United States has a significant interest in ensuring that States are able to vindicate the federal interest in ensuring that public dollars are not spent in a manner that perpetuates the effects of discrimination. The United States has regularly participated in litigation involving challenges to USDOT's DBE program. See, *e.g.*, *Western States Paving Co.* v. *Washington State Dep't of Transp.*, No. 03-35783 (9th Cir.).

STATEMENT OF THE CASE

1. The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), 23 U.S.C. 101, *et seq.*, authorizes USDOT to distribute funds to States to finance state transportation-related projects. SAFETEA-LU is the latest in a series of transportation funding statutes authorizing

the DBE program and directing the Secretary of Transportation to seek to ensure that at least 10% of funds given to States and localities are expended through DBEs. The program does not guarantee contracts to any business, nor does it provide bid discounts. Rather, it aims to ensure that DBEs are provided an equal opportunity to compete for USDOT-assisted contracts. 49 C.F.R. 26.1(b).

a. Federal regulations guide States' implementation of the federal DBE program. Under those regulations, a DBE is a small business owned and controlled by one or more individuals who are socially and economically disadvantaged. 49 C.F.R. 26.5(2). A number of racial and ethnic minorities, and women, are presumed to be socially and economically disadvantaged, 49 C.F.R. 26.67(a); 49 C.F.R. 26.67(b) (presumption rebutted where, *inter alia*, business owner's net worth exceeds $1.32 million).

States receiving federal funding must establish overall goals for DBE participation that reflect the level of DBE participation one would expect absent the effects of discrimination. 49 C.F.R. 26.45(b). After first determining the availability of DBEs in its jurisdiction, 49 C.F.R. 26.45(c), a State may adjust that figure to account for (1) the capacity of DBEs to perform work on USDOT-related contracts; (2) factors affecting "opportunities for DBEs to form, grow and compete," such as discriminatory barriers in accessing bonding, financing, and insurance; and (3) "demonstrable evidence" of other "continuing effects of past discrimination." 49 C.F.R. 26.45(d). After comparing these data regarding the availability of DBEs (including any adjustments) to the actual use of those enterprises within the State, a State establishes an overall goal for the year to address any significant disparities that exist between the availability of DBEs and their actual use. 49 C.F.R. 26.45(e).

In striving to meet their goal, States must use race-neutral means to the maximum extent possible, but may also use race-conscious means if necessary. 49 C.F.R. 26.51(a)-(f).[1] The primary race-conscious means the DBE regulations authorize is the setting of contract-specific DBE subcontracting goals on federally-assisted prime contracts. 49 C.F.R. 26.51(d)-(e). The State sets subcontracting goals on those prime contracts that present reasonable opportunities for DBEs to perform subcontracts, and requires prime contractors to make good faith efforts to achieve these goals. See 49 C.F.R. 26.53. Unless States fail to administer their program in good faith, USDOT imposes no penalties for failing to meet their overall DBE goal. 49 C.F.R. 26.47(a). Every three years, recipients of federal

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[1] In this brief, we use the term "race-conscious" to mean both race- and gender-conscious, and the term "race-neutral" to mean both race- and gender-neutral. Although gender classifications are judged against a less demanding standard than racial classifications, *United States* v. *Virginia*, 518 U.S. 515, 532-533 & n.6 (1996), it is unnecessary for this Court to analyze the race- and gender-conscious provisions of the DBE program separately, where, as here, both satisfy strict scrutiny. See *Western States*, 407 F.3d at 991 n.6.

funds must submit their overall DBE goal methodology and plan for meeting that goal to USDOT. 49 C.F.R. 26.45(f)(1).

b. This Court has upheld the validity of the federal DBE program. *Western States Paving Co.* v. *Washington State Dep't of Transp.*, 407 F.3d 983, 995 (9th Cir. 2005). Applying strict scrutiny, this Court concluded that the evidence before Congress demonstrated a nationwide compelling interest in remedying the effects of past and present discrimination that limit the opportunities for DBEs to compete on a level playing field in transportation contracting. *Id.* at 990-993. Moreover, this Court found the federal DBE program narrowly tailored because, through USDOT regulation, it is flexible and time-limited, provides for race-conscious elements only where race-neutral efforts alone are insufficient, and minimizes any burden on third parties. *Id.* at 993-995.

This Court, however, ruled in favor of the plaintiff, a non-minority-owned business, on its challenge to Washington State's implementation of the federal DBE program. *Western States,* 407 F.3d at 1003. While agreeing that Washington State need not demonstrate its own compelling interest in the DBE program independent of the nationwide effects of discrimination that Congress found existed, this Court required the State to produce evidence regarding "the presence or absence of discrimination in the State's transportation contracting industry" to demonstrate narrow tailoring. *Id.* at 997-998. Finally, a remedial program would be deemed "narrowly tailored," this Court held, only if "its application is limited to those minority groups that have actually suffered discrimination." *Id.* at 998. Finding Washington State's statistical analysis wholly inadequate, and its remaining evidence insufficient, the Court deemed its implementation of USDOT's DBE program unconstitutional. *Id.* at 1002.[2]

2. Caltrans has awarded billions of dollars in federally-assisted contracts since the passage of SAFETEA-LU. E.R. 202.[3]

a. Prior to 2006, Caltrans included race-conscious elements in its federal DBE program. After *Western States*, California halted use of such race-conscious measures. On May 1, 2006, Caltrans announced that it would implement a purely race-neutral program while it gathered evidence pursuant to USDOT guidance. Caltrans commissioned a disparity study from BBC Research and Consulting

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[2] Shortly thereafter, USDOT provided guidance to the States in this Circuit on how to comply with *Western States* while still participating in the USDOT program. See Disadvantaged Business Enterprises; Western States Guidance for Public Transportation Providers (*Western States* Guidance), 71 Fed. Reg. 14,775 (Mar. 23, 2006). USDOT instructed funding recipients to examine available evidence of discrimination and its effects to determine whether the evidence met the *Western States* standard. If it did, recipients were to continue to submit race-conscious goals under the federal regulations; if not, recipients were to submit a race-neutral plan for fiscal year (FY) 2006, together with a description of plans to study the issue further. *Id.* at 14,776-14,777.

[3] "E.R. __" refers to pages in Appellant's Excerpts of Record. "S.E.R. __" refers to pages in Appellees' Supplemental Excerpts of Record. "I.S.E.R. __" refers to pages in Intervenor-Defendants-Appellees' Supplemental Excerpt of Record. "Doc. __" refers to documents on the district court docket sheet.

(BBC), which was published in June 2007.[4]

Disparity studies have been used for decades to "determine the presence of discrimination or its effects." *Western States* Guidance, 71 Fed. Reg. at 14,777; see also *City of Richmond* v. *J.A. Croson Co.*, 488 U.S. 469, 509 (1989) (opinion of O'Connor, J.) (discussing disparity studies). After controlling for factors like business age and experience, disparity studies produce a number, called a disparity index, representing the use of minority- and women-owned businesses relative to their availability in a particular market. An index of 100 indicates statistical parity between relative utilization and availability, whereas a number below 100 indicates underutilization. An index below 80 is viewed as a substantial disparity.

b. BBC's lengthy disparity study examined the transportation-related construction and engineering industry in California to determine the availability of minority- and women-owned businesses to perform work on Caltrans contracts. See generally Caltrans' Br. 13-19; Intervenors' Br. 13-20. Based on its review of publicly available data, interviews, assessments of whether a firm should be considered available for Caltrans prime contracts and subcontracts, and other

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[4] Caltrans' and Intervenors' briefs describe BBC's methodology in greater detail. See Appellees' Response (Caltrans' Br.) 13-19; Intervenor-Defendants-Appellees' Opening Brief (Intervenors' Br.) 13-20.

adjustments,[5] BBC determined that California Minority Business Enterprises (MBEs) and Women's Business Enterprises (WBEs) would be expected to receive 17.6% of prime contract and subcontract dollars from Caltrans' federally-funded transportation-related contracts. As a final adjustment, BBC removed as potential DBEs any MBE or WBE construction or engineering firm that exceeded or was close to exceeding the revenue size standards for DBE certification, and calculated base DBE availability as 13.5%.

Based on an examination of more than 10,000 transportation-related construction and engineering prime contracts and subcontracts awarded by Caltrans between 2002 and 2006, BBC performed a "utilization analysis," comparing Caltrans' actual utilization of MBEs and WBEs to their availability, to determine whether disparities existed. BBC ultimately published 123 different disparity tables in its report, considering factors such as the contracting agency, source of funding, type of work, timing of the contract, and region where the prime contract or subcontract was performed.

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[5] BBC examined, among other things, the specialization of work the firm performed; whether the firm had experience working as a prime contractor, a subcontractor, or both; where within California the firm performed work; and the size of the contracts on which the firm had bid or performed work. BBC compared these data against the data about each Caltrans prime contract and subcontract, and weighted the results by the size of each prime contract and subcontract. See Caltrans' Br. 14-16; Intervenors' Br. 14-16.

The disparity study examined federally-funded contracts during the period prior to *Western States* (2002 to April 2006), and state-funded contracts during a similar period (2002-2006). Although the two groups of contracts were similar in many respects, race-conscious goals were in place for the federally-funded contracts but not for Caltrans' entirely state-funded contracts. The study found that, for federally-funded contracts, the overall disparity index was 83, and for state-funded contracts, the disparity index was 59.

The comparison also revealed substantial disparities for African American-, Asian-Pacific American-, Native American-, and women-owned firms on Caltrans' state-funded contracts for 2002 through 2006, with disparity indices well below 80, further demonstrating the need for race-conscious goals. African American-owned firms received only 15% of the contract dollars expected based on their availability for Caltrans' state-funded contracts; Asian-Pacific American-owned firms received less than one-third of the contract dollars expected; women-owned businesses received less than half of the contract dollars expected; and Native American-owned firms received less than two-thirds of the contract dollars expected. The disparity index for Hispanic American-owned firms on Caltrans' state-funded contracts was 81, which indicates the existence of a disparity but is slightly above the threshold for demonstrating a substantial disparity. The only group without a disparity was Subcontinent-Asian Americans.

c. Following the release of BBC's analysis, Caltrans and BBC conducted 12 public hearings in California on BBC's findings. Caltrans received numerous letters from business owners and trade associations, and interviewed representatives of 12 trade associations and 79 owners/managers of local companies. MBEs and WBEs reported, among other things, that they were denied opportunities based on race or gender, and that prime contractors abused the "good faith efforts" process. BBC also examined various characteristics of minority- and women-owned firms in California, as well as the California marketplace, to explore any discriminatory barriers within local markets. BBC examined more than 70 surveys, studies, and reports, as well as information gathered from BBC's own survey, interviews and the public hearings. This provided substantial anecdotal evidence about discrimination that minorities and women face in education, employment, advancement in employment, business ownership, homeownership, insurance, bidding capacity, mortgage lending, business loans, bonding, business success, business closures, business expansion and contraction, and business earnings in California and elsewhere.

d. On August 1, 2007, after reviewing the study's results, Caltrans prepared a proposal for USDOT regarding its DBE Overall Annual Goal and Methodology for FY 2008, describing the information and methodology Caltrans employed to establish its annual overall DBE goal. A few months later, Caltrans submitted to

USDOT an amended proposal that recommended a 13.5% DBE goal, half of which Caltrans proposed to meet using only race-neutral measures. Caltrans also requested a DBE program waiver pursuant to 49 C.F.R. 26.15 to narrowly tailor the implementation of its program by setting contract goals only for those groups for whom substantial disparities were found. S.E.R. 10.

Over the next two years, USDOT and Caltrans engaged in negotiations regarding the DBE goals and which groups Caltrans' program should include. See Caltrans' Br. 22-24 (describing negotiations). During this discussion, Caltrans had no race-conscious goals in place (even though USDOT granted Caltrans a waiver in August 2008) and DBE participation dropped precipitously. In FY 2004 and 2005, when race-conscious goals were in use, Caltrans had achieved approximately 10.5% DBE participation. In FY 2008, without goals, DBE participation dropped to 4.56%. During these negotiations, USDOT expressed concern regarding this drop-off and noted that the preliminary FY 2009 data – only 2.7% DBE participation by that point in the year – suggested that the situation was only getting worse. I.S.E.R. 256-257.

In early 2009, USDOT conditionally approved Caltrans' 2009 Goal and Methodology along with its race-neutral and race-conscious projections for meeting its overall DBE goal. On March 4, 2009, Caltrans announced that it was re-implementing race-conscious elements to its DBE program for African

American-, Asian-Pacific American-, Native American-, and women-owned DBE firms. Caltrans' overall DBE goal was 13.5%, only 6.75% of which would be met by race-conscious means. On April 2, 2009, USDOT accepted Caltrans' plan.

Under Caltrans' program, race-conscious subcontracting goals are not set on all prime contracts; Caltrans may set a low DBE subcontracting goal or no subcontracting goal whatsoever when presented with a prime contract that may offer only limited subcontracting opportunities for DBEs. In determining whether a prime contract should include subcontracting goals, Caltrans relies on information contained in its database of certified DBEs, as well as its experience with past contract goals. When a race-conscious subcontracting goal is used, prime contractors must either meet the goal or show that they have made "good faith efforts" to do so. In addition to race-conscious measures, Caltrans also uses a wide variety of race-neutral methods to encourage DBE participation, including free Caltrans project plans and specifications, training on access to capital, and counseling.

3. Two months after Caltrans announced that it would reinstate race-conscious measures as part of its USDOT DBE program, the San Diego chapter of Associated General Contractors of America (AGC) sued, alleging that Caltrans' actions violated 42 U.S.C. 1981 and 1983, Title VI of the Civil Rights Act, 42 U.S.C. 2000d, *et seq.*, and the Equal Protection Clause of the Fourteenth

Amendment.[6] AGC's complaint neither addressed any specific contract nor identified any particular member who had or would bid on a Caltrans contract. AGC sought declaratory and injunctive relief preventing California from adopting and implementing either its current DBE program or any future program that made use of race-conscious measures. Doc. 41 at 19-20. In late 2009, the Coalition for Economic Equity and the National Association for the Advancement of Colored People, San Diego Chapter (Intervenors) intervened to defend Caltrans' DBE program.

In early 2011, all parties filed motions for summary judgment. On March 23, 2011, after hearing the parties' arguments, the district court granted Caltrans' and Intervenors' motions for summary judgment from the bench. The court stated, "Caltrans took heed of the Ninth Circuit's requirements, acknowledged what was missing in their own studies, and went forward and did exactly what the Ninth Circuit required." E.R. 58.

SUMMARY OF ARGUMENT

AGC's failure to identify a specific member of its association harmed by Caltrans' race-conscious measures in its DBE program raises issues of Article III jurisdiction. This Court has an obligation to determine whether the party invoking federal court jurisdiction pled, and ultimately established, the facts needed to

[6] AGC has not challenged the constitutionality of the federal DBE program.

satisfy the jurisdictional threshold. *Summers* v. *Earth Island Inst.*, 555 U.S. 488, 493 (2009). AGC has failed to do so here.

Turning to the merits, AGC, relying on an over-reading of *Western States*, asks this Court to impose upon States a burden that they do not, and should not, have to bear when implementing a federal DBE program – the burden of establishing an independent compelling interest in eradicating discrimination within its particular jurisdiction. In stark contrast to *Western States*, where the plaintiff challenged the poor statistical analysis offered by Washington State, in this case AGC has not challenged the soundness of the disparity analysis BBC performed. Unable to challenge the study itself, AGC argues instead that the only evidence a State can present to defend the use of race-conscious measures is "identified discrimination" (Appellants' Opening Brief (AGC Br.) 28), by which AGC means "specific discriminatory behavior by a Caltrans employee or prime contractor that lead[s] to a willing, qualified, and able minority- or women-owned business being deprived of a contract." AGC Br. 38.

This is not correct. Once Congress has proven the existence of a compelling *national* interest in addressing the widespread effects of discrimination, a State that participates in the federal initiative to ameliorate this problem need not develop the kind of extensive evidence that would be necessary for the State to establish the existence of its *own* compelling interest for its own program. Rather, where, as here, a State produces sound statistical evidence showing that the effects of that nationwide discrimination are, in fact, being felt within the State, and where that State provides competitive advantages to only those disadvantaged groups that the study demonstrates continue to be underutilized, that statistical evidence is sufficient to satisfy the narrow tailoring analysis. This Court thus should make clear that, even under the rule announced in *Western States*, a State that bases its actions and goals on the results of a sound disparity study showing substantial underutilization of minority- and women-owned businesses need not produce anecdotal evidence to satisfy narrow tailoring. In any event, Caltrans developed a record containing not only a methodologically sound disparity study, but also ample anecdotal evidence.

AGC discounts the BBC study by characterizing its findings as merely evidence of "societal discrimination," and therefore irrelevant to the constitutionality of Caltrans' implementation of USDOT's DBE program. This is clearly incorrect. Courts of appeals unanimously have credited precisely this kind of evidence in holding that Congress has established a nationwide compelling interest in addressing discrimination and its effects on public contracting, and in ensuring that government funding does not unwittingly subsidize a private-sector system distorted by practices that continue to exclude women and racial minorities. Caltrans' ability to implement the federal DBE program constitutionally is not contingent on an admission of discriminatory conduct by government officials, or on the identification of specific discriminatory acts within California. This Court should affirm the district court's holding that the record amply demonstrates that Caltrans has implemented the USDOT DBE program in a constitutional manner.

ARGUMENT

I

AGC HAS NOT SUBMITTED EVIDENCE SUFFICIENT TO SHOW THAT IT HAS ARTICLE III STANDING

Before turning to the merits, this Court has an obligation to determine whether the plaintiff established standing to invoke federal jurisdiction. While neither of the defendants contested AGC's standing below, "the jurisdictional issue of standing can be raised at any time." *Center for Biological Diversity* v. *Kempthorne*, 588 F.3d 701, 707 (9th Cir. 2009) (citation omitted).

In order to establish standing to seek injunctive relief, a plaintiff must show, among other things, "that he is under threat of suffering 'injury in fact' that is concrete and particularized[,] * * * actual[,] and imminent." *Summers* v. *Earth Island Inst.*, 555 U.S. 488, 493 (2009). While "[i]t is common ground that [an] organization[ ] can assert the standing of [its] members," *id.* at 494, the organization must put forth "specific allegations establishing that *at least one identified member* [has] suffered or would suffer harm." *Id*. at 498 (emphasis added). This threshold requirement ensures that a plaintiff has "such a personal stake in the outcome of the controversy as to warrant *his* invocation of federal-court jurisdiction." *Id.* at 493 (internal quotation marks and citation omitted). Allegations of generalized harm are insufficient.

AGC has not made the requisite showing. First, it failed to identify a specific member that has suffered or will suffer imminent harm as a result of Caltrans' DBE program. Rather, the only evidence AGC put forth is that "AGC San Diego's members have submitted bids in the past, and they are ready, willing, and able, and are continuing to submit bids for present and future contracts that are, or will be, subject to Caltrans' DBE Program." E.R. 333; see also E.R. 331. See generally Caltrans' Br. 29-30 (discussing lack of evidence to support standing).

AGC's assertion that DBEs make up less than 25% of AGC's membership is likewise insufficient. See Doc. 46-5 at 5-6. In *Summers*, the Court specifically rejected the suggestion that associations like AGC need demonstrate only that there is a high probability that its members would be negatively affected by some unidentified future application of the challenged activity. To the contrary, the Supreme Court refused to adopt a standard that would ask only "whether, accepting the organization's self-description of the activities of its members, there is a statistical probability that some of those members are threatened with concrete injury." *Summers,* 555 U.S. at 497. Such a rule, the Court held, conflicts with "prior cases, which have required plaintiff-organizations to make specific allegations establishing that at least one identified member had suffered or would suffer harm." *Id.* at 498.

AGC has also failed to identify any specific contract on which an identified AGC member either has or would bid but for Caltrans' use of race-conscious measures. As the Court stated in *Summers*, it is not enough for AGC to allege that its members intend to bid on some unidentified contracts at some unidentified point in the future: "such 'some day' intentions – without any description of concrete plans, or indeed any specification of when the some day will be – do not support [standing]." 555 U.S. at 496 (citation omitted).

"[T]he requirement of injury in fact is a hard floor of Article III jurisdiction," *Summers*, 555 U.S. at 497, and for good reason. As the Supreme Court has explained,

> [i]t would exceed [Article III's] limitations if, at the behest of Congress and in the absence of any showing of concrete injury, we were to entertain citizen suits to vindicate the public's nonconcrete interest in the proper administration of the laws. … [T]he party bringing suit must show that the action injures him in a concrete and personal way.

Ibid. (citation omitted).

Regardless of whether AGC's proffer would be sufficient to establish standing under *Associated General Contractors of California, Inc.* v. *Coalition for Economic Equity*, 950 F.2d 1401, 1407-1408 (9th Cir. 1991), this Court must determine whether AGC has satisfied the specific requirements of *Summers*. Particularly where, as here, "*the trial is over, judgment has been entered, and a notice of appeal has been filed*," this Court must seriously consider whether this case may proceed further. *Summers*, 555 U.S. at 500.[7]

II

CALTRANS' DBE PROGRAM IS OPERATED IN A FULLY CONSTITUTIONAL MANNER

Should this Court determine that it has jurisdiction to review this case on the merits, it should affirm the district court's determination that Caltrans produced sufficient evidence to demonstrate the DBE program's constitutionality.

1. In reviewing the constitutionality of race-conscious contracting programs, the Supreme Court has stated that Congress "is not disqualified from acting in response" to "both the practice and the lingering effects of racial discrimination against minority groups in this country." *Adarand Constructors, Inc.* v. *Peña*, 515 U.S. 200, 237 (1995). Such programs are constitutional where Congress has a

[7] *Summers* also makes clear that litigants have the burden of demonstrating standing "for each type of relief sought." 555 U.S. at 493 (citing *Los Angeles* v. *Lyons*, 461 U.S. 95, 105 (1992)). Here, AGC seeks an injunction that extends beyond the 2009 DBE program to include any "subsequent and similar discriminatory Caltrans DBE program." Doc. 41 at 19. Whether or not AGC lacks standing to challenge the 2009 DBE program due to its failure to identify a particular aggrieved member, AGC clearly fails to demonstrate standing to pursue relief extending to all future unidentified versions of the DBE program that Caltrans might choose to adopt "some day." *Summers*, 555 U.S. at 496 (citation omitted).

"strong basis in evidence" of a compelling interest that is sufficient to justify its use of race-conscious remedial efforts and where the programs are narrowly tailored to achieve that interest. *City of Richmond* v. *J.A. Croson Co.*, 488 U.S. 469, 500 (1989) (opinion of O'Connor, J.) (citation omitted).

Even where the federal government has not itself engaged in discriminatory conduct, the Court has held that Congress may take steps to ensure that its own actions do not perpetuate the discriminatory conduct of others. See *Croson*, 488 U.S. at 492 (opinion of O'Connor, J.) ("It is beyond dispute that any public entity, state or federal, has a compelling interest in assuring that public dollars, drawn from the tax contributions of all citizens, do not serve to finance the evil of private prejudice."). Consequently, courts have repeatedly affirmed that Congress has authority under the Constitution to take race (and gender) into account when necessary to fulfill its duty to avoid entangling the federal government in private bias or its ongoing effects. See, *e.g.*, *Adarand Constructors, Inc.* v. *Slater*, 228 F.3d 1147, 1164 (10th Cir. 2000) (*Adarand VII*) ("[T]he Fourteenth Amendment permits race-conscious programs that seek both to eradicate discrimination by the governmental entity itself and to prevent the public entity from acting as a passive participant in a system of racial exclusion practiced by elements of the [private sector] by allowing tax dollars to finance the evil of private prejudice.") (citation and internal quotations omitted).

In *Western States*, this Court joined other circuits in holding that Congress had a strong basis in evidence for concluding that, "in at least some parts of the country[,] discrimination within the transportation contracting industry hinders minorities' ability to compete for federally funded contracts." *Western States Paving Co.* v. *Washington State Dep't of Transp.*, 407 F.3d 983, 993 (9th Cir. 2005); *id.* at 992-993 (citing with approval *Sherbrooke Turf, Inc.* v. *Minnesota Dep't of Transp.*, 345 F.3d 964, 970 (8th Cir. 2003), and *Adarand VII*, 228 F.3d at 1175-1176)). While acknowledging the ample statistical and anecdotal evidence before Congress regarding the ongoing existence of discrimination and continuing effects of past discrimination, this Court reiterated that it was not necessary for Congress to "possess evidence that minorities suffer discrimination in *every* State's public contracting market" in order for Congress to conclude that discrimination continues to be a national problem warranting a nationwide remedy. *Id.* at 992 (emphasis added); see also *Oregon* v. *Mitchell*, 400 U.S. 112 (1970).

This Court also agreed with its sister circuits that USDOT's DBE program, including its implementing regulations, is a "narrowly tailored means of remedying the effects of race- and sex-based discrimination within the transportation contracting industry." *Western States*, 407 F.3d at 995. In reaching this conclusion, the Court emphasized that USDOT's implementing regulations require States "to establish a DBE utilization goal that is based upon the proportion of ready, willing, and able DBEs in the State's transportation contracting industry," *ibid.* (citing 49 C.F.R. 26.45(b)). These data "ensure[ ] that each State sets a minority utilization goal that reflects the realities of its own labor market." *Ibid.* (citing *Sherbrooke Turf*, 345 F.3d at 972 ("DOT has tied the goals for DBE participation to the relevant labor markets.")).

2. With respect to the question whether a particular State's program implementing the federal DBE initiative satisfies constitutional scrutiny, the courts of appeals have all agreed that a State implementing USDOT's DBE program need not demonstrate its own compelling interest. Rather, Congress's nationwide compelling interest in remedying discrimination provides the compelling interest for the State's limited use of race or gender in contracting. See *Western States*, 407 F.3d at 997 ("We agree with the Eighth Circuit that Washington need not demonstrate an independent compelling interest for its DBE program. * * * [T]he State's implementation of [USDOT's DBE program] * * * rests upon the compelling nationwide interest identified by Congress."); *Northern Contracting, Inc.* v. *Illinois*, 473 F.3d 715, 722 (7th Cir. 2007); *Sherbrooke Turf*, 345 F.3d at 973-974.

As for what a State must show when implementing the federal program in order to satisfy the narrow tailoring prong of strict scrutiny analysis, this Court has held that a State must produce evidence showing both that discrimination or its effects are "present" in the State and that its program is a narrowly tailored response to that discrimination. *Western States*, 407 F.3d at 997-998. After reviewing the record in *Western States*, this Court ruled that Washington State's proffered evidence failed to demonstrate that the effects of discrimination against minority- and women-owned businesses were actually being felt in Washington State. This Court cited the lack of any meaningful statistical analysis demonstrating that DBEs were underutilized, as well as the lack of any anecdotal evidence of discrimination in transportation construction to support the need for race-conscious remedies. *Id.* at 999-1002. Consequently, this Court found that Washington State had "failed to meet its burden of demonstrating that its DBE program is narrowly tailored to further Congress's compelling remedial interest." *Id.* at 1003.

3. The robust statistical analysis missing in *Western States* is present here. The government is concerned, however, that district courts may be misapplying *Western States* as imposing a greater burden on States than this Court intended. Specifically, even under the standard announced in *Western States*, a State does not start "from scratch" when it seeks to defend its implementation of USDOT's DBE program. Rather, where, as here, a State is implementing a program that advances a compelling federal interest, the fact that the State is acting as an instrument of federal policy must have some bearing on the analysis when the State's program is

challenged. A holding that States must essentially establish their own compelling interest, even where Congress has already done so, would strip Congress's determination of any practical significance.

We do not believe that this is what the Court intended when it rejected Washington State's DBE program. This Court should clarify, consistent with its ruling in *Western States*, that a State that develops a race-conscious program in order to implement a congressional initiative to combat a nationwide problem of discrimination does not bear the same evidentiary burden that would be imposed on a State defending a race-conscious program developed wholly independent of, and untethered to, a congressional initiative that has already survived constitutional review – *i.e.*, a showing of *both* compelling interest and narrow tailoring. Compare *H.B. Rowe Co.* v. *Tippett*, 615 F.3d 233, 243-246 (4th Cir. 2010) (examining state-specific evidence offered by North Carolina to demonstrate a statewide compelling interest in defense of its DBE program). And here the BBC study is more than sufficient to demonstrate that the effects of nationwide discrimination are manifested in California.[8]

[8] There may be circumstances in which anecdotal evidence describes discrimination that is so widespread and endemic within a State that statistical analysis may not be required to demonstrate that the effects of discrimination are being felt within that State. That issue, however, is not presented here, as Caltrans has prepared a sound statistical analysis showing that the effects of discrimination are present.

a. In *Western States*, this Court emphasized that Washington State failed to present sound statistical analysis, or strong anecdotal evidence, to demonstrate the existence of the effects of discrimination in Washington. 407 F.3d at 999-1002. In that case, however, Washington State *conceded* that it had not developed anything even close to the kind of statistical analysis present in this case. *Id.* at 1000 ("Washington has conceded that 'there's [sic] no statistical studies done by the state to try to establish the existence of discrimination in the highway contracting industry that are completed or that are valid.'") (quoting district court transcript). In light of Washington State's failure to develop the appropriate analysis prior to implementing its program, this Court examined the evidence produced at the eleventh hour by Washington State with skepticism. *Id.* at 1001-1002. Not surprisingly, this Court deemed Washington State's evidence insufficient to demonstrate that its program was a narrowly tailored implementation of the federal DBE initiative.

Washington State represents one end of the spectrum, where a State has utterly failed to develop the kind of methodologically sound disparity analysis the Supreme Court contemplated in *Croson* and this Court wanted in *Western States*, 407 F.3d at 999-1002 (identifying numerous flaws with the methodology used by Washington State to develop its DBE goals); California clearly falls on the other end on that spectrum. As the Court explained in *Croson*, a State may rely on the existence of "a significant statistical disparity between the number of qualified minority contractors willing and able to perform a particular service and the number of such contractors actually engaged by the locality or the locality's prime contractors" to justify the use of race- (and gender-) conscious measures in public contracting. *Croson*, 488 U.S. at 509 (opinion of O'Connor, J.). As this Court made clear in *Western States*, a disparity study must do more than simply provide a "head count" of businesses in a State; rather, a meaningful disparity analysis must account for factors like the availability and capacity of DBEs to actually perform projects of appropriate size and complexity. 407 F.3d at 1000; see also 49 C.F.R. 26.45(b) (describing factors that disparity studies should consider when assessing DBE availability). Where, as here, a State produces a disparity study using a methodology whose validity is not only uncontested but also indisputably takes into account the considerations identified by USDOT regulations,[9] and where that study "establish[es] a DBE utilization goal that is based upon the proportion of

[9] As demonstrated by *Western States* itself, not all "disparity studies" are equally methodologically sound. See 407 F.3d at 999-1001. In this case, however, AGC does not challenge the methodology BBC used. AGC only argues that any disparity study that fails to identify particular acts of discrimination and specific bad actors within the State is insufficient to support the use of race-conscious measures. In light of *Croson*'s specific reference to the relevance of "significant statistical disparit[ies,]" 488 U.S. at 509 (opinion of O'Connor, J.), it comes as no surprise that no court to date has credited AGC's argument on this point. See discussion page 30, *infra*.

ready, willing, and able DBEs in the State's transportation contracting industry," *Western States*, 407 F.3d at 995 (citing 49 C.F.R. 26.45(b)), no more should be required of that State.

Disparity studies are an important and well-established tool that States can, and should be encouraged to use both to determine the extent to which the effects of past and present discrimination continue to inhibit the contracting opportunities of racial minorities and women in their jurisdiction, and to develop specific goals reflecting the level of DBE utilization that would be expected in the absence of the effects of discrimination. Through multivariate regression analysis, studies like the BBC report can control for factors other than race or gender that might be contributing to the underutilization of MBEs and WBEs, such as business age or experience. See S.E.R. 297-305 (explaining BBC's methodology). By controlling for these factors, the BBC study captures the extent to which disparities in business utilization can be reasonably attributed to race or gender. See *Adarand VII*, 228 F.3d at 1173-1174 & n.14 (discussing utility of disparity studies and explaining why across-the-board objections to disparity studies as unreliable cannot be reconciled with *Croson*).

Where States wish to participate as partners in a federal DBE program that has already satisfied constitutional requirements, in our view courts must take into account the work that Congress has already done to establish the importance of the federal interest at stake. Accordingly, the government urges this Court to clarify that even under *Western States,* States are acting in a constitutional manner when they (1) produce a sound and thorough statistical analysis revealing underutilization of DBEs in a jurisdiction, and (2) then craft a program that responds to those disparities.

In this case, the district court found that the disparity study relied on by Caltrans "was much more comprehensive" than the study found lacking by the Ninth Circuit in *Western States.* E.R. 60. Unlike the "oversimplified" study presented by Washington State, Caltrans' disparity study "[took] into account factors that may affect the relative capacity of DBEs to undertake contracting work." E.R. 60. Moreover, as reflected in the hearing transcript, the district court reviewed not only the BBC report itself, but also declarations from two additional experts who confirmed that the conclusions outlined in the report were sound. E.R. 40-41. Although AGC would have this Court believe that the district court did nothing more than simply rubber stamp the disparity study without any meaningful assessment of whether the study satisfied the criteria outlined in *Western States*, the record plainly reflects otherwise.

b. Anecdotal evidence can often be useful in terms of identifying the ways in which discrimination continues to manifest itself. For this reason, USDOT encourages States to incorporate such evidence where available. See *Western*

States Guidance, 71 Fed. Reg. at 14,776-14,777. Should this Court determine (incorrectly in our view) that a State *must* produce anecdotal evidence to defend its implementation of the federal DBE program regardless of the quality of its statistical analysis, we agree with Caltrans and the Intervenors that the evidence compiled by Caltrans satisfies this requirement. See Caltrans' Br. 45-48; Intervenors' Br. 52-53.

In light of the fact that the district court found that Caltrans presented both statistical and anecdotal evidence to support its DBE program, this Court should affirm the district court's grant of summary judgment under any reading of *Western States*. Nevertheless, for all of the reasons outlined above, we urge this Court to hold that the statistical analysis relied on by Caltrans in this case was sufficient to satisfy its constitutional burden.

4. AGC is also incorrect when it argues that Caltrans' evidence in support of its implementation of USDOT's DBE program is irrelevant to the extent that it fails to identify specific acts or perpetrators of discrimination. See, *e.g.*, AGC Br. 28 ("Caltrans must show 'identified discrimination' with specificity."); AGC Br. 38 (criticizing declarations in the record as "fail[ing] to identify any specific discriminatory behavior by a Caltrans' employee or prime contractor").

As the Tenth Circuit has explained, disparity studies need not be "discounted because they fail to specifically identify those individuals or firms responsible for the discrimination." *Concrete Works of Colorado, Inc.* v. *City and County of Denver*, 321 F.3d 950, 974 (10th Cir. 2003). No court to date has required a State to produce evidence of overt, intentional acts of race- or gender-based discrimination by particular bad actors. Rather, under *Croson* and its progeny, a State may infer discrimination where, as here, significant statistical disparities exist. See, *e.g.*, *Adarand VII*, 228 F.3d at 1172-1173.

In addition, AGC's argument that evidence of discrimination in "education, employment, advancement, business formation and ownership, rates of business closure, access to capital, business capital from home equity, business loans, bonding, insurance, bids of minority/women-owned firms, and business earnings" should be dismissed as "societal discrimination" and therefore beyond the power of the government to address (AGC Br. 31) is also clearly incorrect. Congress has relied extensively on precisely this kind of evidence when examining the ways in which the effects of racial- and gender-based discrimination impair the ability of racial minorities and women to start and grow their business. See *The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey,* 61 Fed. Reg. 26,050 (May 23, 1996) (Compelling Interest Report) (discussing evidence presented to Congress in over thirty hearings); see also *The Compelling Interest For Race- and Gender-Conscious Federal Contracting Programs: An Update to the May 23, 1996 Review of Barriers for Minority- and Women-Owned*

Businesses, provided at *Minority Contracting: Opportunities and Challenges for Current and Future Minority-Owned Business*: *Hearing before Subcomm. on Gov't Mgmt., Org. and Procurement of the House Comm. on Oversight & Gov't Reform*, 111th Cong., 2d Sess. (2010) (testimony of David A. Hinson, National Director, Minority Business Development Agency, U.S. Dep't of Commerce) (Addendum 10-65).[10]

This Court and every court of appeals that has reviewed this issue have already held that evidence of these forms of discrimination provides Congress with the compelling interest necessary to support efforts like USDOT's DBE program. *Western States*, 407 F.3d at 992-993 (discussing evidence contained in Compelling Interest Report); see also *Adarand VII*, 228 F.3d at 1167-1175; *Sherbrooke Turf*, 345 F.3d at 970; cf. *Northern Contracting, Inc.* v. *Illinois*, No. 00-C-4515, 2004 WL 422704 at *26-34 (N.D. Ill. March 3, 2004). Although this evidence is not required for narrow tailoring, the results of the BBC study are probative to show that the discrimination that Congress is addressing through the DBE program is, unfortunately, prevalent in California. For this reason, this Court should reaffirm

[10] The testimony and attachments Mr. Hinson presented to Congress are contained in the addendum to this brief. His testimony is also available at <http://oversight.house.gov/index.php?option=com_content&view=article&id=987%3A09-22-10-government-management-qminority-contracting-opportunities-and-challenges-for-current-and-future-minority-owned-businessq&catid=16&Itemid=1> (last visited February 9, 2012).

its prior precedent recognizing not only the relevance but the persuasive value of this kind of evidence when assessing the constitutionality of race-conscious remedial programs.

CONCLUSION

This Court must determine whether jurisdiction exists. If it continues to the merits, however, it should affirm the district court's order granting summary judgment for Caltrans.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that the foregoing Brief for the United States as *Amicus Curiae* Supporting Appellees:

(1) complies with Federal Rules of Appellate Procedure 29(d) and 32(a)(7)(B), because it contains 6977 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii); and

(2) complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in a proportionally spaced typeface using Word 2007, in 14-point Times New Roman font.

s/ Sharon M. McGowan
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Dated: February 9, 2012

CERTIFICATE OF SERVICE

I hereby certify that on February 9, 2012, I electronically filed the foregoing Brief for the United States as *Amicus Curiae* Supporting Appellees with the Clerk of the Court for the Ninth Circuit Court of Appeals via the CM/ECF system. I further certify that service will be accomplished by the appellate CM/ECF system for those counsels who are registered CM/ECF users.

Additionally, I certify that on February 9, 2012, an identical copy of the foregoing Brief for the United States as Amicus Curiae Supporting Appellees was served by certified, First Class Mail, postage prepaid, on the following counsel of record:

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ADDENDUM

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MBDA
MINORITY BUSINESS DEVELOPMENT AGENCY

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

Before the U.S. House Committee on Oversight and Government Reform

Subcommittee on Government Management, Organization, and Procurement

September 22nd, 2010

Chairwoman Watson, Ranking Member Bilbray, and Members of the Subcommittee:

Thank you for inviting the Minority Business Development Agency (MBDA) to appear before the Subcommittee to discuss the important issues surrounding minority contracting opportunities in the federal marketplace. I request that my entire written statement, including the attachments, be entered into the official hearing record.

I. Overview

MBDA has been in existence for over forty years, originally established as the Office of Minority Business Enterprise by President Nixon on March 5, 1969, pursuant to Executive Order 11458. On October 13, 1971, President Nixon issued Executive Order 11625, as amended, which clarified the Agency's authority and expanded the scope of its operations. MBDA is the sole federal agency dedicated exclusively to promoting equal economic opportunities for the nation's minority business enterprises (MBEs) and accomplishes its mission through programs and activities designed to foster MBE growth and global competitiveness. Today, MBDA continues as the sole federal agency dedicated to fostering minority business growth and global competitiveness.

By establishing a federal agency dedicated exclusively to promoting equal economic opportunities for MBEs, President Nixon recognized the crucial impact of minority businesses on the nation's economy. In 1969, there were approximately 322,000 minority businesses generating $10.6 billion in annual gross receipts.[1] More recently, according to the preliminary findings of the *2007 Survey of Business Owners,* there were about 5.8 million minority-owned firms.[2] These firms employed approximately 5.9 million persons and generated approximately $1 trillion in total gross receipts for the national economy.[3]

It is this potential for continued growth that mandates a positive regulatory and political climate in which MBEs can flourish. Based on U.S. Census Bureau data, minorities represented approximately 35 percent of the total U.S. population in 2009.[4] It is estimated that by 2050 minorities will represent approximately 54 percent of the total U.S. population.[5] With those estimates, ensuring that minority-owned firms are given equal economic opportunities to participate in the domestic and global marketplaces is an imperative. I would also like to point out that if minority-owned firms were to able to

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[1] U.S. Department of Commerce, U.S. Census Bureau, *Minority-Owned Businesses: 1969* (Washington, DC: US Government Printing Office, 1971).

[2] U.S. Department of Commerce, U.S. Census Bureau, 2007 Survey of Business Owners, Preliminary Estimates of Business Ownership by Gender, Ethnicity, Race and Veteran Status, 2010 (accessed July 20, 2010); available from http://www.census.gov/econ/sbo/.)

[3] Ibid

[4] U.S. Department of Commerce, U.S. Census Bureau, Table 3. Annual Estimates of the Resident Population by Sex, Race, and Hispanic Origin for the United States: April 1, 2000 to July 1, 2009 (NC-EST2009-03), 2010 (accessed June 23, 2010); available from www.census.gov.

[5] U.S. Department of Commerce, U.S. Census Bureau, *An Older and More Diverse Nation by Midcentury* (Press Release), 2008; available from www.census.gov

generate total gross receipts in relation to the adult minority population in 2007, which represented 13 percent that year, such firms would have enjoyed an estimated additional $2.4 trillion in annual gross receipts.[6] MBDA defines entrepreneurial parity as reaching proportionality between the adult minority population and business development measures such as numbers of firms, gross receipts and employees of Classifiable firms (excludes publicly held).

Moreover, MBEs have the potential to have a major impact in the global marketplace as they are twice as likely to generate sales through exports as non-minority firms.[7] More than 70 percent of the world's purchasing power and 95 percent of its population is beyond US borders.[8] With their ability to break down cultural and linguistic barriers, minority-owned firms can lead the way to tapping global markets and aid in reducing the U.S. trade deficit.

However, while the recent Census numbers show overall growth and expansion for minority firms, there is still work left to be done. The average gross receipts of minority-owned firms increased to just over $178,000 in 2007 from $167,000 in 2002, but still well below the gross receipts for non-minority-owned firms which had average gross receipts of $490,000 in 2007[9] and $439,000 in 2002.[10]

Furthermore, discriminatory barriers continue to persist, which impede the ability of MBEs to access the marketplace on fair and equal footing with non-minority-owned businesses; thus, preventing MBEs from realizing their full economic potential. I am submitting for the record, as Attachment A to my testimony, a document entitled *The Compelling Interest for Race- and Gender Conscious Federal Contracting Programs: An Update to the May 23, 1996 Review of Barriers for Minority and Women-Owned Businesses*, along with a disk that contains all of the disparity and academic studies referenced in that document. The *Compelling Interest* document was compiled by the Department of Justice with input from SBA, the Department of Commerce, the Department of Transportation, the Department of Defense, and other federal agencies, and was previously submitted to the Senate Small Business and Entrepreneurship Committee by SBA on June 2, 2010. The study and appendix

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[6] U.S. Department of Commerce, Minority Business Development Agency (MBDA) analysis of data from the 2007 Survey of Business Owners and Population Estimates, both from the U.S. Census Bureau. (Accessed September 20, 2010; available from http://www.mbda.gov/sites/default/files/MinorityBusinessGrowthandGlobalReach.pdf)

[7] U.S. Department of Commerce, Minority Business Development Agency, *Characteristics of Minority Businesses and Entrepreneurs* (2008), available from http://www.mbda.gov/index.php?section_id=6&bucket_id=16#bucket_120

[8] U.S. Department of Commerce, MBDA, Characteristics of Minority Businesses and Entrepreneurs, An Analysis of the 2002 Survey of Business Owners (March 2008)

[9] U.S. Department of Commerce, Minority Business Development Agency (MBDA), *Minority-Owned Businesses Growing at Twice the National Average* (Press release), 2010, available from www.mbda.gov

[10] U.S. Department of Commerce, U.S. Census Bureau, 2002 Survey of Business Owners, 2007 (Accessed July 20, 2010); available from http://www.census.gov/econ/sbo/.)

reference 75 recent disparity studies from 33 states and regions detailing the local effects of discrimination on minority and female contractors. Nearly all of these disparity studies and reports have already been submitted to Congress over the last several years. The *Compelling Interest* document also refers to quite a few congressional hearings held over the past several years that explore the existing barriers to the ability of disadvantaged businesses to compete equally for federal contracts. It also reviewed nearly 40 academic articles investigating and detailing the various sources and effects of the discrimination. This document, which is a thorough discussion of some of the extensive body of evidence generated in the last decade which has already been placed before the Congress, clearly shows that discriminatory barriers continue to impede the ability of minority and women-owned businesses to compete with other firms on a fair and equal footing in government contracting markets. Indeed, significant discrimination, in arenas such as access to capital and employment, limits the formation of these businesses in the first instance.

Though MBDA is not a regulatory or enforcement agency, the Agency plays an active role in the federal marketplace. We are working to eliminate these barriers acting as both an advocate and facilitator for minority-owned firms seeking to gain greater access to the marketplace, including but not limited to procurement, grant and other opportunities with the Federal Government.

II. MBDA and the Federal Marketplace

A great deal of our work on behalf of MBEs takes place in the 46 MBDA minority business centers located across the country and in Puerto Rico. Each center provides MBEs with a wide range of business consulting services to assist in the growth and competitiveness of MBE firms. On the contracting front, our centers provide technical assistance to improve MBE competitiveness at securing both public and private contracts in addition to promoting joint ventures and teaming arrangements as we recognize some contracts are simply too large for one firm to compete for alone. The professional business consultants who staff MBDA centers work to keep MBEs abreast of state and federal contracting opportunities in the pipeline. We currently have two centers in the Los Angeles area that service a number of the Chairwoman's constituents. In calendar year 2009, these two centers assisted in the generation of over $116 million in contracts for MBEs and the creation of 292 new jobs. As a whole, in FY 2009, MBDA helped generate $2.2 billion in contracts and helped create 3,858 new jobs. MBDA's performance far and away exceeds The Agency's FY 2009 goals of $900 million in contracts and 3,000 new jobs created.

MBDA works to match MBEs with contracting opportunities that fit each firm's profile and capabilities. This is accomplished through a number of ways but two of the more prominent are our Business-to-Business (B2B) Linkage Forums and our online Phoenix-Opportunity Database. MBDA hosts B2Bs throughout the year and across the country aimed at matching MBEs with both public and private contracts ready to be let. During the B2Bs, MBEs have an opportunity to meet one-on-one with interested contract officers from all levels of government and the private sector across industry sectors to examine the possibility of doing business together. For example, at this year's National Minority Enterprise Development Week Conference held last month here in Washington, DC, MBDA presented more than $30 billion in public and private sector forecasted contract opportunities. Our B2B sessions also seek to match MBEs with prime contractors holding federal contracts looking for potential subcontractors.

The online Phoenix-Opportunity Database, which is linked to FedBizOpps, helps to match MBEs registered with MBDA to available public and private sector contracting opportunities. Using this system, MBEs input their profiles into the system accessible on the MBDA website (www.mbda.gov). Contracting officers throughout the Federal, state, and local Government as well private sector procurement officers can use this system to upload notices of their contract opportunities into the MBDA Opportunity database. The system then matches each contract opportunity with MBEs meeting the requirements of the solicitation. After a match is made, the system generates an e-mail notification to each of the matched minority companies. This notice will provide the MBEs with all of the relevant information including: name and contact information for the contracting officer, a brief description of the project, and the open/close dates. Another e-mail containing a list of the matched MBEs is sent to the contracting officer. Presently, MBDA has over 77,000 registered users of the system with over 14,000 opportunity companies including private sector, state, and federal organizations.

MBDA also works with MBEs to secure critical financing needed to grow and perform on awarded contracts. The lack of access to capital has long plagued MBEs and often inhibited their ability to compete for federal contracts. In January of 2010, MBDA released a report, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: the Troubling Reality of Capital Limitations Faced by MBEs.* This report accompanies my testimony as Attachment B. Some of the key findings of the report include:

1. Minority-owned firms are less likely to receive loans than non-minority owned firms regardless of firm size. According to an analysis of data from the Survey of Small Business Finances, for firms with gross receipts over $500,000, 52 percent of non-minority-owned firms received loans compared to 41 percent of minority-owned firms. [11]
2. When minority-owned firms do receive financing, it is for less money and at a higher interest rate than non-minority-owned firms regardless of the size of the firm. Minority-owned firms paid an average of 7.8 percent in interest rates for loans compared to 6.4 percent for non-minority-owned firms. Among firms with gross receipts under $500,000, minority-owned firms paid an average of 9.1 percent in interest rates compared to 6.9 percent for non-minority-owned firms. [12]
3. Minority-owned firms receive smaller equity investments than non-minority owned firms even when controlling for firm size, yet venture capital funds focused on investing in the minority business community are highly competitive. The average amount of new equity investments

[11] U.S. Department of Commerce, Minority Business Development Agency, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs* (2010)
[12] Ibid

in minority-owned firms receiving equity is 43 percent of the average of new equity investments in non-minority-owned firms. [13]

Federal construction contracts are a major source of revenue for many construction firms -- minority and non-minority alike. Capital in the form of surety bonds is required for federal construction contracts. However as credit markets tighten and minority-owned firms continue to face the barriers outlined above, obtaining the necessary bonding has become even more difficult for most and impossible for some. If an MBE cannot secure the requisite bonding, they lose contracts otherwise awarded on merit. MBDA has taken an aggressive approach on this issue. Last year MBDA was able to help MBEs access approximately $800 million in working capital, equity investments, and bonding. This year, MBDA is working on a Surety Bonding Initiative with a goal of identifying over $100 million in private capital through a public/private partnership and to eventually grow that capacity to over $1 billion over time.

On April 26th of this year, President Obama issued a memorandum establishing the Interagency Task Force on Federal Contracting Opportunities for Small Businesses[14] which MBDA, along with my colleagues on this panel, is a part of. The Task Force is charged with providing proposals and recommendations to the President to help ensure that small businesses, including businesses owned by minorities, women socially and economically disadvantaged individuals and service-disabled veterans, have fair access to federal contracting dollars. These recommendations included addressing the issues of contract bundling, strengthening small business subcontracting plans, and identifying ways to increase small business utilization in prime contracting. MBDA was honored to serve on this task force and we will continue to work with our federal colleagues to implement the recommendations put forth.

III. <u>ARRA-related Activities</u>

On February 17, 2009, the American Recovery and Reinvestment Act of 2009, Public Law 111-5 (ARRA), was signed into law by President Obama. This bill provided $787 billion in spending and tax cuts to stimulate the economy. Though MBDA did not receive any ARRA funds, the Agency continues to play an active role in facilitating ARRA procurement and grant opportunities for MBEs.

President Obama, Vice President Biden, and Commerce Secretary Gary Locke have all taken an intense interest in ARRA contracting opportunities. The President and the Vice President tasked the Department of Commerce (DOC), along with the Small Business Administration (SBA) with leading the government's effort to ensure minority-owned and small businesses have equal opportunities to participate in ARRA funding both at the federal and state levels. For its part, MBDA used its network of 46 centers to guide MBEs into the arena. We continue to provide our usual range of services in addition to now conducting numerous networking and educational outreach events across the country to bring together MBEs and agencies that have received ARRA funds on all levels of government. MBDA centers have conducted and/or participated in over 115 events reaching approximately 28,000 people with a majority being

[13] Ibid

[14] *See* 75 FR 22499 (April 29, 2010).

minority businesses and minority business stakeholders. Recognizing that a great deal of ARRA funding has gone to projects on state and local levels, MBDA regional offices and local centers have been working diligently to build relationships with relevant contracting officials on those levels in every state.

The efforts of MBDA centers to increase minority participation have yielded significant results. I would like to share an ARRA success story from one of our centers located in South Carolina. Brix Stone, LLC, an African-American-owned development firm based in Columbia, SC, sought and received matchmaking assistance from our South Carolina minority business center. With this assistance, Brix Stone was able to successfully enter into a mentor-protégé agreement with the City of Columbia and ultimately received a contract award worth $10 million in ARRA funds via the Columbia Housing Authority. As a result of this award 30 new jobs were created.

To expand our outreach efforts in support of ARRA, last year MBDA redirected $900K of its FY 2009 appropriation to fund augmentation grants to seven minority business centers. These included our centers in Philadelphia, Detroit, New Orleans, Mesa, Bismarck, Raleigh-Durham, and San Jose. The grants were generally used to hire expert consultants to provide advocacy, partnership development, networking, and other services to minority-owned firms specifically on ARRA opportunities.

In an effort to address concerns voiced over the lack of transparency in the procurement process, MBDA developed a customized suite of technology products to track federal prime and sub- recipient contract and grant data with emphasis on ARRA transactions. This unprecedented proprietary system, titled the MBDA National Tracking System (NTS), is the first Federal system of its type. It allows MBDA to track government contracts and grants obtained by MBEs at Federal, state and local levels. The MBDA NTS heeds the President's call for greater transparency and efficiency throughout government and DOC leadership's call for greater innovation.

IV. Conclusion

Looking ahead, I can assure this Subcommittee that MBDA will continue to take an active role in eliminating discriminatory and other barriers faced by MBEs and in facilitating equal economic opportunities for MBEs in the domestic and global marketplaces, including but not limited to federal procurements. MBDA to this end is creating a Government Contracting Unit under its Office of Business Development. This new unit will be comprised of experts in government contracting specifically focused on assisting minority-owned firms access federal, state and local contracting opportunities. We anticipate having this unit fully operational in the very near future.

In addition, on August 10, 2010, MBDA launched the Global Construction Program for Minority Contractors (GCP), together with the Tutor-Perini Corporation, the Department of Commerce's International Trade Administration (ITA), the University of Southern California, Ralph Moore & Associates and Next Level Diversity Consulting LLC. This historic public-private partnership is designed to assist MBEs navigate the international marketplace as it relates to competing for construction contracts. Through the GCP, three classes of 50 participants each will receive training tailored specifically to contracting on international federal projects, thereby positioning them to successfully compete for construction contracts, including an estimated $1 billion (or more) in contract opportunities from the Tutor-Perini Corporation over the next four years.

As I mentioned at the onset of my testimony, MBDA has a mission of fostering the growth and global competitiveness of the nation's MBEs. Unlike the SBA, we work with MBEs of all sizes and not just MBEs that are deemed "small" under the applicable SBA size standards. Our goal is help create a new generation of MBEs capable of doing $100 million in revenue per year. If this goal is obtained, more MBEs would be capable of seeking federal dollars not as subcontractors, as so many are now, but as primes. However, even if there is only a ten percent increase in both the number of MBEs and the average number of employees per firm, we will have assisted in the creation of one million new jobs.[15]

MBEs are a critical part of this country's economic infrastructure and it is in federal contracting dollars that many will find avenues for growth and continued existence and future growth. MBDA looks forward to working with Congress to help create more entry points into the federal marketplace for MBEs. I would like to again thank Chairwoman Watson, Ranking Member Bilbray, and the entire subcommittee for allowing MBDA to appear before you today and look forward to answering any questions you may have.

[15] Fairle, Robert, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States* (Cambridge, MA: MIT Press, 2008) at page 176.

List of Attachments

Attachment A: *The Compelling Interest for Race- and Gender Conscious Federal Contracting Programs: An Update to the May 23, 1996 Review of Barriers for Minority and Women-Owned Businesses*, along with a disk that contains all of the disparity and academic studies referenced in that document.

Attachment B: U.S. Department of Commerce, Minority Business Development Agency, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs* (2010).

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

I. Introduction

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

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

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

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

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

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

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

(continued…)

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

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

(…continued)
that contained in *The Compelling Interest*, 61 Fed. Reg. 26,050, more than satisfies the government's burden of production regarding the compelling interest for a race-conscious remedy."); see also *Sherbrooke Turf, Inc.* v. *Minnesota Dep't of Transp.*, 345 F.3d 964, 970 (8th Cir. 2003). In 2008, the Court of Appeals for the Federal Circuit invalidated the contracting program authorized under 10 U.S.C. § 2323, holding that the evidence before Congress was not sufficiently current to provide the compelling interest necessary to support the program. *Rothe Dev. Corp. v. U.S. Dep't of Def.*, 545 F.3d 1023 (Fed. Cir. 2008). This memorandum responds to that decision, demonstrating that Congress does currently have ample evidence to demonstrate that race-conscious contracting programs are narrowly tailored to serve a compelling government interest and that gender-conscious programs are substantially related to an important governmental objective.

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

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

[6] Between 2006 and the end of 2009, Congress conducted thirty-six separate hearings
(continued…)

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

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

(…continued)
concerning public procurement and minority- and women-owned business enterprises. See Appendix A for a list of Congressional hearings addressing this subject. Appendix B contains a list of academic studies and reports cited herein. Appendix C contains a list of recent disparity studies conducted by state and local governments.

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

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

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

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

II.

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

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

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

These types of disadvantages are in many ways precisely what the federal programs -- like the U.S. Small Business Administration's 8(a) and Women Owned Small Business programs and the Department of Transportation's Disadvantaged Business Enterprise program -- are designed to address. Each of these programs is designed to eliminate discriminatory barriers and help the development of small disadvantaged firms to enable them to gain a foothold in federal

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

procurement contracting. In this way, the firms first gain access to relatively small contracting opportunities, which can then lead to success in larger federal contracts and the economy as a whole.

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

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

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

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

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

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

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

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

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

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

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

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

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

A 2006 report produced by the Minority Business Development Agency also finds that while minority-owned businesses grew in number at a fast pace between 1997 and 2002, their growth in gross receipts and paid employment lagged behind the growth in number of firms.[21]

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

[15] *Id.* at 1.

[16] *Ibid.* Similarly, while Asian-owned firms accounted for 4.8% of all nonfarm businesses in the United States, these firms accounted for only 2.0% of nonfarm business employment and a scant 1.4% of their receipts. Census Bureau, *Survey of Business Owners – Asian-Owned Firms: 2002: Summary of Findings*, available at http://www.census.gov/econ/sbo/02/asiansof_all.html (last visited April 29, 2009).

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

[18] *Id.* at 7.

[19] *Id.* at 2.

[20] *Id.* at 4.

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

In fact, the report finds that the gap between the share of gross receipts generated by minority businesses and the share of the minority population slightly widened during that period.[22] This disparity "underscores the opportunity gap that still exists in the U.S. economy."[23]

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

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

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[22] *Id.* at 12.

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

[24] Census Bureau, *Survey of Business Owners - Women-Owned Firms: 2002*, available at http://www.econ.census.gov/econ/sbo/#women.

[25] Elaine Reardon, Nancy Nicosia and Nancy Y. Moore, *The Utilization of Women-Owned Small Businesses in Federal Contracting*, Kauffman-RAND Institute for Entrepreneurship Public Policy 14, 17 (2007). A report issued by the House Small Business Committee Democratic Staff shows that the federal government's failure to meet its own procurement goals of 5% contracting to women-owned businesses represented a cost of *$6 billion* in lost contracting opportunities for women-owned businesses in FY 2003. House Small Business Committee Democratic Staff, *Scorecard V: Dramatic Gains in the Federal Marketplace Fail to Result in Small Business Contracts* (2004) (noting that only 2.89% of contracts awarded throughout the entire federal government in FY 2003 went to women-owned businesses). For FY 2004, the estimated loss was *$5.5 billion*. *Id.* at 12. Contracts awarded to women-owned small businesses throughout the entire federal government in FY 2004 amounted to 3.03%; by 2008, that amount had increased very little, to 3.39%. Small Business Administration, *FY 2004 Official Goaling Report*; Small Business Administration, *Fiscal Year 2004: Small Business Prime Contract Goaling Achievements* (both documents available at http://www.sba.gov/aboutsba/sbaprograms/goals/index.html (last visited Oct. 14, 2009)).

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

[27] *Ibid.*

- Asian and Pacific Islander-owned employer establishments: 72.1%.[28]
- Hispanic-owned employer establishments: 68.6%.[29]
- American-Indian and Alaska Native-owned employer establishments: 67.0%.[30]
- African-American-owned employer establishments: 61.0%.[31]

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

A number of Congressional hearings have addressed disparities in business formation and success between minority-and women-owned businesses, on the one hand, and businesses owned by their non-minority, male counterparts,[34] on the other, as well as the specific barriers that

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[28] *Ibid.* Note, however, that Asian-American firms exhibited a slightly higher rate of contraction than non-minority owned firms (23% in comparison to 21%). *Ibid.* Also, a study of the survival rate of Asian American firms in SBA's 8(a) program has shown that it is not statistically different from the business survival rates of other MBEs in the program. See Asian American Justice Center, *Equal Access: Unlocking Government Doors for Asian Americans: Public Contracting Laws and Policies* 28 (2008).

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

[30] *Ibid.*

[31] *Ibid.*

[32] *Id.* at 20.

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

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

(continued…)

continue to face minority- and women-owned businesses.[35] The evidence presented at these hearings shows that the disparities between the minority share of the business population and its share of business sales and receipts "are adverse, very large, and statistically significant."[36] Moreover, these disparities have been observed in all 50 states and the District of Columbia for all minority groups and for women.[37]

These studies and data of course provide a snapshot of firms at a particular period of

(…continued)
Hon. Benjamin L. Cardin, Sen. from Maryland).

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

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

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

time. But the data show that minority-and women-owned firms continue to have only limited success both in the larger economy and in the federal procurement market.

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

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

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

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

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

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

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

reduced entrepreneurial opportunities for minorities and women."[42] Past hearings have identified similar disparities that exist in the federal contracting market.[43]

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

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[42] *Ibid.*

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

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

part because "discriminatory conditions that previously existed were deep and pervasive and have not been fully reversed."[45] In addition, some disparities are likely to be greater than data show; because the age and size of minority- and women-owned businesses may themselves have been limited by discrimination, current statistics likely understate the number and size of minority- and women-owned firms that might exist once the effects of discrimination no longer stifle their creation and expansion.[46]

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

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[45] Boston Consulting Group, *The New Agenda for Minority Business Development* 14 (2005).

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

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

[48] *Ibid.*

[49] *Ibid.*

repeatedly recognized that there is overwhelming evidence that shows that "considerable discrimination" exists throughout the federal contracting market that affects small minority- and women-owned businesses across the racial and ethnic spectrum.[50]

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

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

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

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

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

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

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

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

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

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

This historical discrimination in employment limited — and continues to limit — the advancement of minorities and women to higher level positions in the workforce, and thus their

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2009) (North Carolina lumber and hardware retailer settling race discrimination lawsuit for $80,000 where employee was subjected to explicit racial slurs as well as racial jokes and derogatory stereotypes about African Americans on an almost daily basis for two years); *EEOC* v. *Wheeler Construction, Inc.*, No. 2:07-cv-01829 (D. Ariz. March 5, 2009) (construction company settling lawsuit for $325,000 where Mexican employees were harassed based on their national origin).

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

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

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

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

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

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

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

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

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

[62] For example, one researcher testified before Congress that, based on a national study

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

Thus, minorities and women often lack equal access to the two central means of gaining the experience needed to operate a business. A history of discrimination in employment opportunities provided significantly fewer opportunities for minorities and women to develop businesses to pass on to their children or to teach their children business-development skills.[66]

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by the Center for Women's Business Research, women business owners of fast-growth companies reported that, unlike their male counterparts, role models and mentors "[weren't] really available to them." *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 8 (2008) (statement of Teri Cavanagh, Principal, Teri Cavanagh and Associates).

[63]. Ernst & Young, 2008 Catalyst Census of Women Board Directors of the Fortune 500, at 1. *Quick Stats on Women Workers, 2008,* United States Department of Labor, available at http://www.dol.gov/wb/stats/main.htm (last visited, April 22, 2010). See also Siri Terjesen, Ruth Sealy and Val Singh, *Women Directors on Corporate Boards,:* 17 Corporate Governance: An International Review 325,320-337 (2009). In addition, in 2008, only 15.7 percent of corporate officers of Fortune 500 companies were women. Ernst & Young, 2008 Catalyst Census of Women Corporate Officers and Top Earners of the Fortune 500, at 1 . A study controlling for organization and director characteristics found that women directors are less likely than men to be on the executive committee and more likely to be on the public affairs committee. See Craig A. Peterson and James Philpot, Women's Roles on U.S. Fortune 500 Boards: Director Expertise and Committee Memberships, 72(2) Journal of Business Ethics 177, 179 (2007).

[64] *Quick Stats on Women Workers, 2008,* United States Department of Labor, available at http://www.dol.gov/wb/stats/main.htm (last visited, April 22, 2010).

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

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

And the continued discrimination by employers and would-be business partners against minorities and women severely limits their development of those skills and their entry into the business markets today.[67]

2. *Discrimination Limits Access To Capital.*

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

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

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

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

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

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

[71] *Id*. at 4.

[72] See, *e.g.*, David G. Blanchflower, Phillip B. Levine, and David J. Zimmerman, *Discrimination in the Small-Business Credit Market*, 85(4) Review of Economics and Statistics 930, 942 (2003) (finding that "loan denial rates are significantly higher for black-owned firms

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

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

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

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

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

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

[76] *Business Start-Up Hurdles in Underserved Communities: Access to Venture Capital*
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perceived discriminatory reasons, many minority and women business owners expect to be turned down and simply do not apply for financing.[77]

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

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

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and Entrepreneurship Training: Hearing Before the S. Comm. on Small Business and Entrepreneurship, 110th Cong. 4 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

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

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

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

[80] *Id.* at 85.

[81] *Ibid.*

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

men."[83] One possible cause for the disparity between the access to outside capital of male-owned and female-owned firms is the "gender dominance" in the venture capital industry[84] and the perception among many women and minorities that venture capitalists focus on pre-existing relationships or networks to which women and minorities do not have access.[85]

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

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[83] *Id.* at 16.

[84] *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 10-11 (2008) (statement of Laila Partridge, CEO, Cover4me) (explaining that women are not well-represented in venture capital firms and therefore they lack an opportunity to develop relationships with firms looking to invest in small businesses); see *id.* at 10 ("Having spent 10 years in venture capital and working with larger firms, you * * * never see women in those firms."); see also *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 114 (2007) (statement of Ann Marie Ameida, President and CEO, Association of Women's Business Centers) (explaining that "the majority of venture capital deals are made through referrals via a fairly closed system of networks" to which women business owners do not have access).

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

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

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

[88] *Ibid.*

based largely on the net worth of homes owned by the households) translates into lower levels of start-up capital among African-American business owners than among white business owners.[89]

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

Finally, Congressional hearings provide specific examples of how this problem plays out in the real world. Testimony from minority and women business owners has provided egregious examples of racial and gender discrimination by lenders. For example, one minority contractor with solid financial data was denied a loan only to have one of his white employees take the same financial data to the same loan officer, receive a loan, and be told that he was "the kind of businessman [the bank was] looking for."[94] After that experience, the contractor never went into a bank without a white employee accompanying him. Other testimony revealed that some women business owners are repeatedly asked to have a man co-sign their business loan applications, even when the men are not affiliated with the business and have lower credit scores or lower personal incomes than the women seeking the loans.[95] According to one witness, after a

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

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

[91] *Id.* at 54.

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

[93] *Id.* at 54.

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

[95] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 299 (2009) (statement of Joann Payne, President, Women First National Legislative Committee); see also *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business*

(continued…)

female applicant in that situation explained to the loan officer that her husband had no involvement with her company or the construction industry and that he had a lower credit score than the applicant, the loan officer nonetheless stated that the bank would be "a lot more comfortable with a man's name on the application."[96]

C. *Discrimination Limits Access To Contracting Markets.*

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

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and Entrepreneurship, 110th Cong. 25 (2008) (statement of Margot Dorfman, CEO, U.S. Women's Chamber of Commerce) (relaying experience of woman business owner who was told she would need her husband to co-sign her loan application because the lender did not believe that the applicant had a higher salary than her husband).

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

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

[98] See *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 27 (2007) (statement of Jon Wainwright, Vice President, NERA Economic Consulting) (discussing findings from thousands of surveys and interviews that show that, throughout the country, and within both the public and private sector marketplaces, minorities report similar instances of negative stereotyping of their qualifications, double standards about their performance, and discrimination by bonding companies and suppliers); *How Information Policy Affects the Competitive Viability of Small and Disadvantaged Business in Federal Contracting: Hearing Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 28 (2008) (statement of Jon Wainwright, Vice President, NERA Economic Consulting) (concluding that "minorities and women reported that they still encounter significant barriers to doing business in the public and private sector market places, as both prime contractors and
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1. *Discrimination By Prime Contractors Creates Obstacles.*

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

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subcontractors" and "continued operation of federal, state, and local efforts to ensure equal access to the public contracting process is essential to the competitive viability of minority-owned and women-owned business enterprises."); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 223 (2009) (statement of Julie Cunningham, President and CEO, Conference of Minority Transportation Officials) (testifying that "discrimination is still a serious problem" and citing "use of antiquated 'old boy networks,' exclusion of DBEs from business opportunities, discrimination in credit lending, bonding and insurance, attempts to induce DBEs to act fraudulently as 'fronts' and discriminatory application of procurement and contracting rules"); see also *id.* at 328 (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

99 61 Fed. Reg. at 26,058.

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

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

102 *Ibid.*; see also *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and*

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research, he has repeatedly found that contractors who use minority- and women-owned businesses on projects with goals "rarely use [those businesses] — or even solicit them — in the absence of such goals."[103]

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

Another questionable practice is the "bait and switch," in which a contractor commits to using a minority- or woman-owned business to win a contract that contains race- or gender-conscious goals for subcontractors, but then never actually gives the minority- or woman-owned firm the promised work. For example, after receiving a complaint from a DBE owner who alleged that a large prime contractor had used the DBE to secure a contract without generating work for the DBE, the DOT investigated and learned that the prime contractor had falsely

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Entrepreneurship, 110th Cong. 27 (2007) (statement of Jon Wainwright, Vice President, NERA Economic Consulting).

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

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

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

represented to the DOT that it had met its DBE requirements.[106] Another time a DBE alleged that it had been included on the prime's original contract but was replaced by a non-DBE contractor *after* the contract had been awarded to the prime.[107] A number of state and local disparity studies have concluded that this practice is a major problem facing minority- and women-owned businesses.[108]

The prevalence of discrimination comes starkly into focus in jurisdictions that recently have discontinued race-conscious programs. For example, Congress heard testimony that less than a year after Michigan discontinued its affirmative action contracting program, the percentage of state-funded highway construction projects performed by DBEs *fell to zero*, even

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

[107] *Ibid.* See also *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 57 (2007) (statement of Wendi Goldsmith, President, Bioengineering Group) ("In many cases, small firms are recruited onto teams to help win work as called for in contract solicitations. We appear in the proposals, often at great expense to the small and minority and women-owned businesses due to the work related to researching and compiling proposal materials, only to never actually receive work under the contract. I cringe to recount how many times that happened to my firm and to tally how much money, namely hundreds of thousands of dollars my firm involuntarily contributed in order to help other firms win and perform work, while we received none or sometimes a token amount."); see also *Access to Federal Contracts: How to Level the Playing Field: Field Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 172 (2007) (statement of Women Impacting Public Policy (WIPP)) (explaining that prime contractors often list women-owned business on their bid, but then revert to using "the same old subcontractors they have used in other bids" after winning the contract).

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

though their participation in the federal program was 13%.[109] Other states also experienced dramatic decreases in participation of minority- and women-owned businesses when race- and gender-conscious remedies were abandoned.[110] Indeed, research shows that the disparity in contracting between minority- and majority-owned businesses is "markedly greater in jurisdictions where there [is] no goals program in place."[111] Joann Payne, President of Women First National Legislative Committee, told Congress that based on "history and present DBE participation percentages on state funded projects," absent race- and gender-conscious remedies "participation [in government contracting] of women and minority owned businesses will drop nationally to approximately 2[%]."[112]

Academic studies have also found that the presence of race- and gender-conscious programs significantly improves minority- and women-owned businesses' ability to develop and participate in government contracting. For example, one study found that the gap between white and minority self employment rates narrowed during the 1980s "when affirmative action programs were implemented by many public sector jurisdictions."[113] The same study found that the gap began to widen again when the number of race-conscious contracting programs was reduced after the Supreme Court's decision in *Croson*,[114] and then narrowed again after 2000 once courts began to declare race-conscious contracting programs constitutional.[115] Another

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

[110] In Idaho, for example, the rate of minority- and women-owned business participation remained steady at just above 6% from 2004 through 2006 under a goal-based program. When Idaho switched to a race-neutral program in 2007, their participation rate dropped to below 4%. *Ibid.* The same thing happened in California: DBE participation in federally funded contracts was 9% between 2002 and April 2006, but dropped to less than 5% in May 2006 after the state discontinued setting DBE goals. *Ibid.* The participation rate for women-owned businesses was just 0.1% . *Ibid.*

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

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

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

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

[115] David G. Blanchflower, *Minority Self-Employment in the United States and the Impact of Affirmative Action Programs* 17, National Bureau of Economic Research, Working

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study found similarly that when race-conscious "programs are removed or replaced with race-neutral programs the utilization of minorities and women in public construction declines rapidly."[116] That study concluded that affirmative action programs appear to work but have not yet achieved their objectives "because they have not been allowed to work by non-minority contractors and by the courts."[117]

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

DOT's recent experience in administering its DBE program provides further evidence of the lasting effects of discrimination in contracting and the continuing need for race- and gender-conscious programs to address those effects. DOT's program requires states to use the "best evidence available to estimate the DBE participation they could expect to obtain if there were a

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Paper 13972 (2008).

[116] David G. Blanchflower and Jon Wainright, *An Analysis of the Impact of Affirmative Action Programs on Self-Employment in the Construction Industry* 24 (National Bureau of Economic Research, Working Paper 11793 (2008) ("The evidence we have available to us suggests that very rapidly after the race and gender conscious programs were removed the utilization of firms owned by women and minorities collapsed."); see also Insight Center for Community Economic Development, *The Impact of State Affirmative Procurement Policies on Minority- and Women- Owned Businesses in Five States, Best Practices, Imperfections, and Challenges in State Inclusive Business Programs* iv (2007) (concluding that "when affirmative procurement policies end or are interrupted, MBEs and WBEs do not grow as fast as similar businesses in other states" and that these "slower business growth rates are not usually made up later, indicating the importance of the consistent presence of affirmative procurement programs").

[117] *Ibid.*

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

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

nondiscriminatory level playing field."[120] This "evidence-based estimate" then becomes the state's goal for DBE participation.[121] States are required to "achieve as much as possible of that annual goal through * * * 'race-neutral' means," including "[o]utreach, technical and bonding assistance, unbundling of contracts, and small business programs."[122]

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

That conclusion was proven in jurisdictions that have suspended the use of race-conscious measures. These jurisdictions have experienced declines in DBE participation and have not been able to meet their participation goals. For example, Congress heard testimony that after jurisdictions discontinued the use of race-conscious measures, following the Ninth Circuit's decision in *Western States Paving Co.*,[127] the results were striking. Arizona's DOT set overall

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

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

[122] *Ibid.*

[123] *Id.* at 309.

[124] *Ibid.*

[125] *Ibid.*

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

[127] *Western States Paving Co., Inc.* v. *United States and Washington State Dep't of Transp.*, 407 F.3d 983 (9th Cir. 2005). In *Western States Paving Co.*, the court concluded that DOT's race-conscious contracting program — the Transportation Equity Act for the 21st Century — is constitutional on its face. The evidence before Congress established a compelling interest for the program, *id.* at 991-993, and — because race-conscious measures are used only

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goals of 9.1% in 2007 and 9.9% in 2008, but only achieved 3.8% and 3.1%, respectively; California's DOT set goals of 10.5%, 10.5% and 13.5% for 2006-2008, but was only able to achieve 8.2%, 6.6% and 4.6% participation by DBEs during those years; Sound Transit in Washington state set goals of 15% in 2007 and 13% in 2008, but only achieved 8.6% and 6.8% participation; Portland's airport set goals of 7.3% and 4% for the years 2007 and 2008, but only achieved 2% and 1.1% participation in those years.[128] From the reduction in the use of DBE programs following the *Western States Paving Co.* decision, DOT concluded that without the ability to use race conscious measures, states that are DOT funding recipients cannot, in many cases, "ensure [that] their Federally-assisted contracting programs provide nondiscriminatory access to business opportunities on a level playing field, as defined by their overall goals."[129] One DBE contractor "told State officials, since 'there's no DBE participation goal, our phones have stopped ringing . . . we don't get calls any more.'"[130]

These data – which demonstrate the significant downturn in contracts and dollars won by minority- and women-owned firms when race- and gender-conscious programs are eliminated -- demonstrate more than just that these programs present opportunities. It demonstrates that without such programs, minority- and women-owned firms are left with significantly less business than they actually can perform. When race- and gender-conscious programs are in place, minority- and women-owned firms secure, and perform, many more contracts than they secure without such programs. This certainly demonstrates that the amount of business these firms can handle is not defined by their success when these programs are not in place; rather,

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when race-neutral means prove ineffective, and are employed in a flexible manner for a limited duration — the program is narrowly tailored, *id.* at 993-996. But the court determined that the program was unconstitutional as applied in Washington state because – the court concluded – the State failed to proffer "evidence of discrimination within its own contracting market and * * * thus failed to meet its burden of demonstrating that its DBE program is narrowly tailored." *Id.* at 1003.

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

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

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

their capacity to perform work outstrips what they are hired to do in the absence of goals and in any event expands as contracts become available to them.

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

- One Alaskan-Native construction specialty contractor was regularly told by a prime contractor that he was only hired because he is a minority.[131] The prime contractor also explicitly expressed his view that "minority businesses [are] not qualified."[132] At this same job site, the Alaskan Native's "company's equipment was regularly turned on during the night, causing the batteries to die and the project to be delayed. No non-minority contractors experienced this problem."[133]

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

- A DBE owner in Delaware had a disagreement with one of her prime contractors, who

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[131] *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 292-293 (2009) (statement of Don O'Bannon, Chairman, Airport Minority Advisory Council).

[132] *Ibid.*

[133] *Ibid.*

[134] *Ibid.*

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

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

insisted on speaking with her male foreman whenever he called her office.[136] Despite the male foreman's insistence that the prime needed to speak with his female boss, the prime called the boss's home — *and left a message for her husband*, who was not involved in the project.[137] In the message to the husband, the prime explained that he wanted to resolve the issue through a meeting but that "we don't have to have your wife involved."[138] When the prime finally met with the female owner of the company, the first thing he said to her was "I am sorry this has taken so long but I don't like dealing with women."[139]

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

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

[137] *Id.* at 299-300.

[138] *Id.* at 300.

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

[140] Mason Tillman Associates, Ltd., *State of New Jersey Construction Services Disparity Study, 2000-2002*, Vo1. 1 at 2-11 (2005); see also BBC Research & Consulting for the Washington Suburban Sanitary Commission, *WSSC 2005 Disparity Study – Summary and Recommendations*, § 3 at 17 (2005) (African-American business owner in the Washington, D.C., area reported that he lost work when a client learned of his race; officials in charge of the project indicated that they loved his company's proposal but then used a white-owned company instead after learning that his firm was minority-owned); MGT of America, Inc., *The City of Phoenix Minority-, Women-Owned and Small Business Enterprise Program Update Study* 6-22 (2005) (minority contractor reported that "[t]here have been incidents where I've been on the job site and the General [Prime Contractor] won't talk to me, they will go to the white foreman and talk to the foreman"); Washington Suburban Sanitary Commission by BBC Research & Consulting,

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

2. *Discrimination By Business Networks Limits Opportunities.*

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

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WSSC 2005 Disparity Study – Summary and Recommendations, § 4 at 21 (2005) (Hispanic owner of a construction firm recounting experience where three white men at an industry conference pointed to his friend, an African-American man, and started making racist comments and using racial slurs); University of Minnesota Disparity Study Research Team, *Analysis of Essex County Procurement and Contracting: Final Report* 91 (2005) (recounting racially and gender motivated harassment experienced by minorities and women at job sites).

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

[142] *Id.* at 6-7.

[143] *Id.* at 7-8.

[144] *Id.* at 8.

[145] *Id.* at 7.

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

which the firm can prepare — all of which serve to make the firm more competitive."[147]

Race- and gender-conscious contracting programs have helped some women and minorities break into these networks. Indeed, a DOT official recently testified before Congress that "possibly the most important function" the DBE program has performed over the last 30 years "is to address the lack of access by minority and women contractors to these crucial informal networks."[148] The official explained that the program requires prime contractors, who may not normally socialize with minority or female contractors, to make an effort to involve minority- and women-owned firms as subcontractors.[149] This, the official explained, "is a very beneficial way of introducing prime contractors to DBEs and, hopefully, beginning to create business relationships that will lead to opportunities for DBEs to get the work they need to succeed."[150]

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

Many minorities and women still find themselves excluded from informal business

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

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

[149] *Ibid.*

[150] *Ibid.*

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

[152] *Id.* at 59.

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

networks today. Congress has heard a significant amount of testimony about the continued prevalence of "old boys' networks" and the difficulty minority and women business owners face in attempting to break into these networks.[154] Likewise, many state and local disparity studies reveal that minorities and women still face barriers to participation in business networks.[155]

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[154] *Opportunities and Challenges for Women Entrepreneurs: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 15 (2008) (statement of the Center for Women's Business Research) ("Acceptance into industry networks is often difficult, especially for women of color. Even when they join the meetings, they are not welcomed nor are they part of the activities."); *id.* at 18 (statement of Lisa Dolan, President, Securit) ("[B]eing in a male-dominated field in security, I am usually the only woman at the table and not taken seriously."); *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 43 (2007) (letter from Rita Baslock, President, Max Electric, Inc.) ("MBEs experience difficulty breaking into old-boy networks of general contractors. Because of the monetary and time consumption of the construction business for small businesses, many small minority and women subcontractors do not have the social connections, money, or time to effectively network in the old boy system."); *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 43 (2008) (statement of Kerstin Forrester, President and Owner, Stonebridge Precision Machining & Certified Welding) ("There is still very much an 'old boys' network in place."); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 208 (2009) (statement of Gilbert Aranza, CEO, Stars Concessions, Ltd.) ("I wish I could report that the Good Ol' Boy Network no longer exists, but I am afraid that I run up against it all the time."); *id.* at 312 (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) (quoting one business owner as stating, "An Idaho Hispanic contractor described the network there as 'white guys that have been running around with the same white guys that have controlled the money * * * for [many] years.'"). See also Michael Bonds, *Looking Beyond the Numbers, The Struggles of Black Businesses to Survive: A Qualitative Approach* 595, 37 Journal of Black Studies 581 (2007) (concluding that "racism seems to play a major role in limiting African American business opportunities"); *id.* at 598 ("Black business owners expressed their frustration with their inability to break in to the old boys' network, being denied business loans, having to constantly prove themselves to White business owners, or being held to a higher performance standard than Caucasian firms.").

[155] For example, a New Jersey disparity study found that both "new and established minority and women business owners report difficulties breaking into the contracting network." Mason Tillman Assocs., *State of New Jersey Construction Services Disparity Study, 2000-2002,* Vo1. 1 at 2-25 (2005). That study also found that some minority- and women-owned businesses that "have been in been in operation for more than 20 years * * * are still excluded from job opportunities because they are not included in the social and business networks with those in positions of power in their respective fields." *Ibid.* Another study reported that many female and some minority business owners interviewed "were especially vocal about the 'good ole boy' system." CRA International for the San Mateo County Transit District and the Peninsula

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When minority- and women-owned businesses are excluded from business networks, they are cut off from information and decision-makers and, as a result, are placed at a serious disadvantage. As one minority business owner told Congress: "One of the major problems that we face is the overall inability to have access to decision makers as we are unable to gain access to their many formal and informal networking activities." [156] A DOT official relayed to Congress minority and women business owners' concern about lack of access to important information: "There's still very much an old boy network . . . and if you're not an old boy, you're not in that network [and] there's a lot of information you don't get."[157]

In some places, minorities are still excluded from the social clubs that are a primary site for business networking.[158] More commonly, exclusion of minorities and women may be the result of non-minority contractors being comfortable with existing homogeneous networks, rather than overt discrimination.[159] That is one reason why programs that require majority-

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Corridor Joint Powers Board, *Measuring Minority- and Woman-Owned Construction and Professional Service Firm Availability and Utilization* 140 (2008).

[156] *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 46 (2007) (letter from Bobby E. Henderson, President, Anlab Environmental).

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

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

[159] *Minority Entrepreneurship: Assessing the Effectiveness of SBA's Programs for the Minority Business Community: Hearing Before the S. Comm. on Small Business and*
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owned businesses to reach outside of their comfortable networks are so essential. If a contractor has a positive experience with a minority- or women-owned business, that may, over time, open the door to a continuing business relationship. That is precisely what has happened for Katherine M. Cloonen, the president and owner of JK Steel Erectors, Inc., who told Congress that the DBE program has allowed her to slowly break into business networks.[160]

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

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

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

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Entrepreneurship, 110th Cong. 15 (2007) (statement of Professor Candida Brush, Paul T. Babson chair-professor of entrepreneurship; division chair-entrepreneurship, Babson College) ("[W]e know from what is called the theory of homophily that people like to do business with people who are like themselves. So if you have this very homogeneous group, if you happen to be different in some way, it is going to be hard for you to get over that barrier.").

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

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

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

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

[164] See, *e.g.*, *Access to Federal Contracts: How to Level the Playing Field Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 132 (2007) (statement of Randy McRae) ("[B]onding has been a cruel Catch-22 for [DBEs]. These struggling firms either can't afford a bond or can't persuade bonding companies to guarantee their performance. But without a bond, they can't bid on many jobs in the public or private sector, limiting their growth."); *id.* at

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

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

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48 (statement of Wayne Frazier, Sr., President, Maryland-Washington Minority Contractors Association) ("Small businesses dealing with the Federal Government cannot get surety bonding. Again, no financing, no bonding, no contract, no award, no way to compete."); *The Department of Transportation's Disadvantaged Business Enterprise Program: Hearing Before the H. Comm. on Transp. and Infrastructure*, 111th Cong. 311 (2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) (relating comment from a female contractor in California who stated that "minorities and women have a much harder time getting capital, getting bonding, getting insurance … in bonding … women are still asked to have their husbands sign at the bank"); see also Washington Suburban Sanitary Commission by BBC Research & Consulting, *WSSC 2005 Disparity Study – Summary and Recommendations*, § 4 at 19-20 (2005) (minority business owner reported that MBE firms get charged a higher rate for the same bonding as compared to white competitors).

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

166 *How Information Policy Affects Competitive Viability in Minority Contracting Before the Subcomm. on Information Policy, Census, and National Archives of the H. Comm. on Oversight and Government Reform*, 110th Cong. 92 (2008) (statement of Anthony Brown, Chair, Government Affairs Committee of the AMAC, Senior Associate Partner, MGT of America); *The Department of Transportation's Disadvantaged Business Enterprise Programs Before the H. Comm. on Transportation and Infrastructure*, 111th Cong. 311 (March 26, 2009) (statement of Joel Szabat, Acting Assistant Secretary, Transportation Policy, DOT) ("Several California [DBE] contractors mentioned that prime contractors often imposed higher bonding or insurance requirements than the state required, blocking them from participation.").

167 *Women in Business: Leveling the Playing Field: Roundtable Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. 26 (2008) (statement of Eydie Silva, Executive Director, State Office of Minority and Women Business Assistance); see also Kevin

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State and local disparity studies also identify bonding requirements as a major obstacle to success for minority- and women-owned businesses. For example, one study found that "[o]btaining sufficient bonding (or bonding at all) is frequently cited as a major barrier" to contracting for minority- and women-owned businesses.[168] Specifically, that study concluded that "[m]inority firms often have difficulty obtaining bonding because they lack the experience bonding companies require."[169]

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

Congress has also heard testimony about supplier discrimination. One egregious example occurred in Michigan: An African-American employee of a minority-owned business obtained a quote of $613 per tire for 16 new tires.[173] The minority business owner discovered that a white

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O'Brien, Ph.D., Bernard Goitein, Ph.D., and Camden Bucey, *Disparity Study for the City of Peoria* 32, 36 (2004) (concluding that lack of access to bonding was a factor that helped to explain why, from 1992-2001, no African-American-owned business in Peoria was able to obtain a contract as a prime contractor in any of the City's 136 contracting projects; and there was only one project where a women-owned business was the prime contractor).

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

[169] *Id.* at 19.

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

[171] *Id.* at 259.

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

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

business associate had paid only $400 per tire.[174] He then called the supplier and "put on a white voice" and was quoted $400.[175] Congress also heard about an African-American mechanical contractor who solicited a quote for equipment from his non-minority-owned supplier which he then included in his bid.[176] He then received a fax from the supplier that was intended for his non-minority-owned competitor, quoting the competitor a lower quote.[177] When the minority business owner requested the lower price quote provided to his competitor, the supplier responded that it reserved the right to provide better pricing to their better customers.[178] Obviously — as a minority business owner testified — "no businessperson, no matter how talented, can succeed if they are paying a race-based mark-up on supplies."[179]

III.

Conclusion

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

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174 *Ibid.*

175 *Ibid.*

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

177 *Ibid.*

178 *Ibid.* See also Mason Tillman Assocs., *State of New Jersey Construction Services Disparity Study, 2000-2002*, Vo1. 1 at 2-7 (2005) (African-American business owner reported that one supplier demanded that she pay up front or pay a certain amount of money down before checking her business's credit rating; the supplier openly stated that the reason for this requirement was that his business was minority-owned and the supplier claimed to have "had prior experience with a minority vender that had not paid them").

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

Appendix A

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- *Increasing Government Accountability and Ensuring Fairness in Small Business Contracting: Hearing Before the S. Comm. on Small Business & Entrepreneurship,* 110th Cong. (2007)

- *Diversifying Native Economies: Oversight Hearing Before the H. Comm. on Natural Resources*, 110th Cong. (2007)

- *Expanding Opportunities for Women Entrepreneurs: The Future of Women's Small Business Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 110th Cong. (2007)

- *Federal Contracting: Removing Hurdles for Minority-Owned Small Businesses: Hearing Before the H. Subcomm. on Government Management, Organization, and Procurement of the H. Comm. on Oversight and Government Reform,* 110th Cong. (2007)

- *Full Committee Hearing to Consider Legislation Updating and Improving the SBA's Contracting Programs: Hearing Before the H. Comm. on Small Business,* 110th Cong. (2007)

- *Mortgage Lending Discrimination: Field Hearing Before the H. Comm. on Financial Services,* 110th Cong. (2007)

- *Access to Federal Contracts: How to Level the Playing Field: Field Hearing Before the S. Comm. on Small Business and Entrepreneurship,* 110th Cong. (2007)

- *Preserving and Expanding Minority Banks: Hearing Before the H. Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services*, 110th Cong. (2007)

- *Reauthorization of Small Business Administration Financing and Entrepreneurial Development Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 109th Cong. (2006)

- *Northern Lights and Procurement Plights: The Effect of the ANC Program on Federal Procurement and Alaska Native Corporation: Joint Hearing Before the H. Comm. on Government Reform and the H. Comm. on Small Business*, 109th Cong. (2006)

- *Diversity: The GAO Perspective: Hearing Before the H. Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services*, 109th Cong. (2006)

- *Strengthening Participation of Small Businesses in Federal Contracting and Innovation Research Programs: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 109th Cong. (2006)

Appendix B

Studies and Reports

- Frances Amatucci, *Women Entrepreneurs Securing Business Angel Financing: Tales from the Field*, Venture Capital (2004)
- Ana Aparicio, *Hispanic-Owned Business Enterprises in the Construction Industry of Greater Chicago: Responses and Personal Perspectives*, for the City of Chicago M/WBE Program (2009)
- Ana Aparicio, *Women-Owned Business Enterprises in the Construction Industry of Greater Chicago: Responses and Personal Perspectives*, for the City of Chicago M/WBE Program (2009)
- Asian American Justice Center, *Equal Access: Unlocking Government Doors for Asian Americans: Public Contracting Laws and Policies* (2008)
- S. Ann Becker and Donn Miller-Kermani, *Women-Owned Small Businesses in the Federal Procurement Market*, Journal of Contract Management 131 (2008)
- Dana Bible, Kathy Hill, *Discrimination: Women in Business,* Journal of Organizational Culture, Communications and Conflict, Volume 11, No. 1 (2007)
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Appendix C

A Sample of State and Local Government Disparity Studies

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Alaska

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Colorado

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Connecticut

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Georgia

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Idaho

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Illinois

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Kansas

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Kentucky

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Missouri

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- *Disadvantaged Business Enterprise Availability Study, for the Missouri Department of Transportation*, Prepared by NERA Economic Consulting for the Missouri State Department of Transportation (2004)

Montana

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Nevada

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- *The City of New York Disparity Study*, presented by Mason Tillman Associates, Ltd. for the City of New York (2005)

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Oregon

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South Carolina

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Utah

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

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

The Troubling Reality of Capital Limitations Faced by MBEs

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

The Troubling Reality of Capital Limitations Faced by MBEs

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

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

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Preface

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

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

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

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

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

David A. Hinson
National Director
Minority Business Development Agency

Executive Summary

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

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

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

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

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

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

Key Findings

Job Creation

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

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

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

Faster Growth

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

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

Capital Access Disparities

Loans

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

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

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

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

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

Equity

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

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

Financial Investment

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

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

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

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

Introduction

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

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

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

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

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

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

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

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

[6] U.S. Census Bureau, 1*992 Economic Census: Characteristics of Business Owners (1997). U.S. Census Bureau, 2002 Economic Census, Survey of Business Owners* (Washington, D.C.: US Government Printing Office, 2006).

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

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

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

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

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

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

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

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

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

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

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

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

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

The State of Minority Business

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

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

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

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

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

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

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

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

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

Total Gross Receipts of Minority-Owned Businesses

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

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

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

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

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

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

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

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

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

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

Total Employment and Payroll

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Average Firm Performance

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

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

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

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

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

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

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

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

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

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

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

[28] Ibid.

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

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

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

Previous Research on Constraints Faced by Minority-Owned Businesses

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

Financial Capital Constraints

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

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

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

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

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

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

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

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

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

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

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[33] Fairlie and Robb, *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States*, and U.S. Census Bureau, *Wealth and Asset Ownership*, 2008 (accessed July 2009); available from http://www.census.gov/hhes/www/wealth/2002/wlth02-2 html.

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

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

[36] Robert W. Fairlie, "Entrepreneurship among Disadvantaged Groups: An Analysis of the Dynamics of Self-Employment by Gender, Race and Education."

[37] Robert W. Fairlie and Christopher Woodruff, "Mexican-American Entrepreneurship," University of California Working Paper (2009).

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

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

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

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

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

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

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

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

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

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

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

[47] Ibid.

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

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

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

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

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

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

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

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

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

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

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

Evidence of Lending Discrimination

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

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

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

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[56] Lloyd Blanchard, John Yinger and Bo Zhao, "Do Credit Market Barriers Exist for Minority and Women Entrepreneurs?" Syracuse University Working Paper (2004). Blanchflower, Levine, and Zimmerman. Cavalluzzo, Cavalluzzo, and Wolken. Cavalluzzo and Wolken. Susan Coleman, "The Borrowing Experience of Black and Hispanic-Owned Small Firms: Evidence from the 1998 Survey of Small Business Finances," *The Academy of Entrepreneurship Journal 8*, no. 1 (2002): 1-20. Susan Coleman, "Borrowing Patterns for Small Firms: A Comparison by Race and Ethnicity." *The Journal of Entrepreneurial Finance & Business Ventures 7*, no. 3 (2003): 87-108. United States Small Business Administration, Office of Advocacy, *Availability of Financing to Small Firms using the Survey of Small Business Finances*, K. Mitchell and D.K. Pearce, (2005).

[57] Cavalluzzo and Wolken.

[58] G. Becker, *The Economics of Discrimination*, 2nd ed. (Chicago: University of Chicago Press, 1971).

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

[60] Cavalluzzo, Cavalluzzo, and Wolken.

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

Other Types of Discrimination

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

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

Human Capital Barriers

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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[71] Fairlie and Woodruff.

[72] Lofstrom and Wang.

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

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

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

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

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

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

Family Business Background and Social Capital

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

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

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

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

[80] Hout and Rosen.

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

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

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

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

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

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

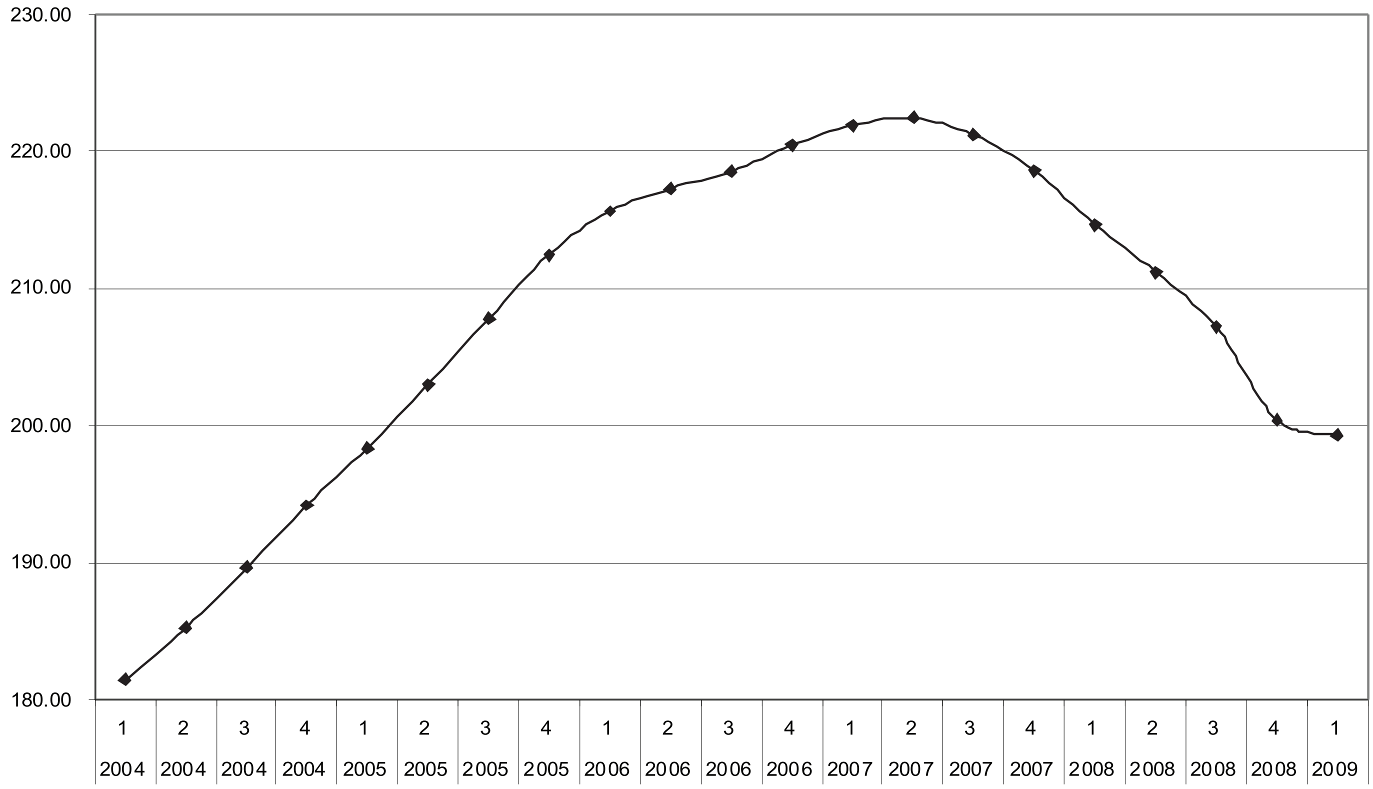
many of the factors listed below such as financial capital, discrimination, and human capital. For example, minority businesses are known to have limited networks in the investment community resulting in lower levels of capital use.[87] Given these interactions and the inherent difficulty of measuring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

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

The Current Financial Crisis

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

Figure 1
Quarterly Housing Price Index, Federal Housing Finance Agency

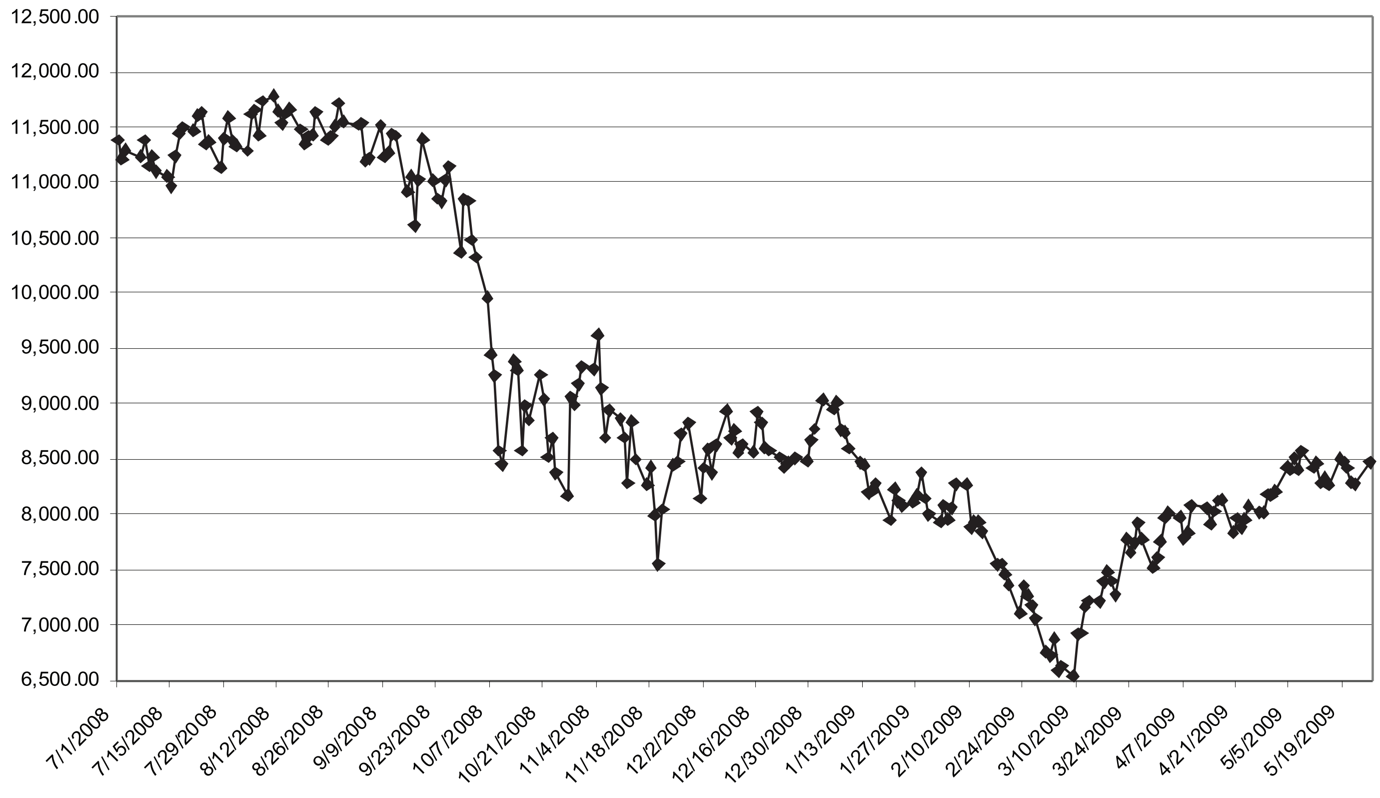


The largest single asset affecting personal wealth is home equity. Over the past two years housing values have dropped precipitously. Figure 1 displays the Monthly House Price Index from the Office of Federal Housing Enterprise Oversight from January 2004 to February 2009. The peak in the housing market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

[88] Fairlie and Krashinsky.

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

Figure 2
Dow Jones Industrial Average



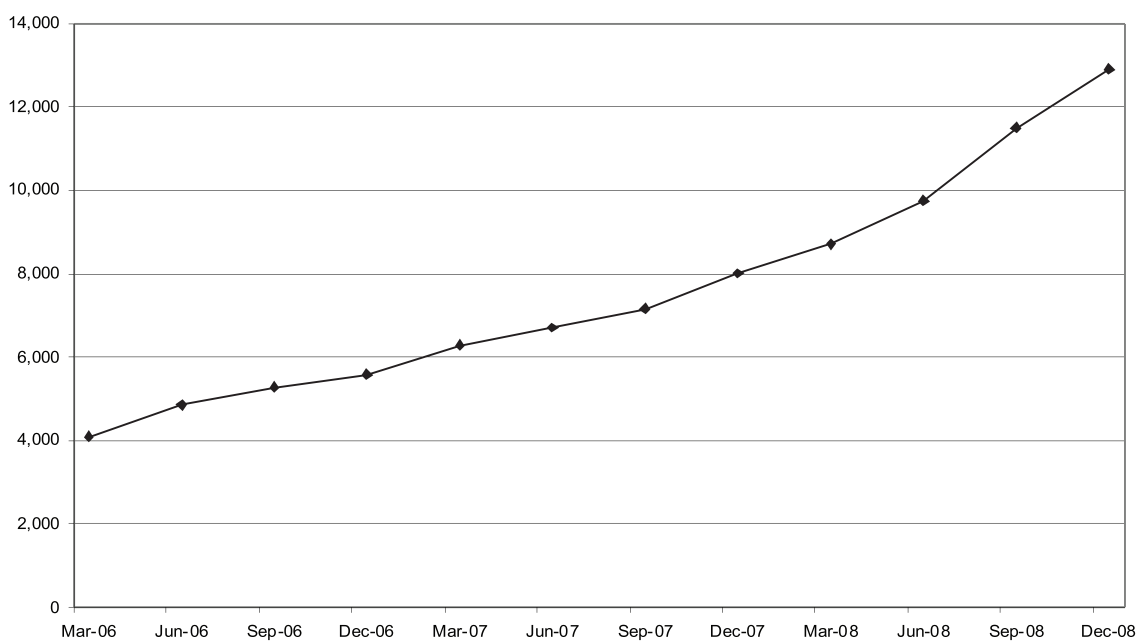
More direct measures of access to capital are represented by the number of venture capital deals. Figure 3 displays the number of venture capital deals made in the United States over the past couple of years. The total number and amount of deals declined substantially since the second quarter of 2008.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

[89] Sohl.

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

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

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



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

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

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

New Empirical Analysis

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

Data Description

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

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

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

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

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

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

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

Sources of Startup and Expansion Capital

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

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

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

Table 6

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

Survey of Business Owners (2002)

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

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

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

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

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

Table 7

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

Survey of Business Owners (2002)

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

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

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

Capital Use among More-Established Minority Firms

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

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

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

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

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

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

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

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

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

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

Table 9

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

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

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

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

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

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

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

Regression Analysis of Equity Investment and Loan Amounts

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

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

[94] Ibid., 36

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

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

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

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

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

Decomposition Estimates

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

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

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

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

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

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

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[95] Alan S. Blinder, "Wage Discrimination: Reduced Form and Structural Variables," *Journal of Human Resources*, 8, no. 4 (1973): 436-455. Ronald Oaxaca, "Male-Female Wage Differentials in Urban Labor Markets," *International Economic Review*, 14, no. 3 (1973): 693-709.
[96] Ronald Oaxaca and Michael Ransom, "On Discrimination and the Decomposition of Wage Differentials," Journal of Econometrics, 61, no. 1 (1994): 5-21.

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

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

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

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

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

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

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

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

Capital Use among Newly-Formed Minority Firms

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

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

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

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

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

All estimates use survey weights provided by the KFS.

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

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

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

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

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

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

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

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

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

Table 14

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

Coefficients	Log of Internal Financing	Log of External Debt Financing	Log of External Equity Financing
Minority	0.278***	0.0125	0.0283
	(0.0760)	(0.0807)	(0.0377)
Female	-0.201***	-0.242***	-0.0997***
	(0.0721)	(0.0782)	(0.0318)
Age	-0.00465	0.0401**	-0.00729
	(0.0186)	(0.0192)	(0.00836)
Age Squared	0.000150	-0.000329	0.000129
	(0.000198)	(0.000204)	(0 0000918)
HS Graduate	0.0598	-0.0992	-0.114
	(0.242)	(0.237)	(0.0791)
Some College	0.113	0.0206	-0.00951
	(0.231)	(0.223)	(0.0791)
College Graduate	0.0701	-0.107	0.0462
	(0.234)	(0.226)	(0.0831)
Graduate Degree	0.198	-0.138	0.112
	(0.242)	(0.235)	(0.0904)
Hours Worked	0.00948***	0.00553***	0.00155**
(weekly average)	(0.00149)	(0.00158)	(0.000791)
Industry Experience	-0.00405	-0.0112***	0.000311
(years)	(0.00330)	(0.00362)	(0.00180)
Start up Experience	0.256***	0.0629	0.0390
	(0.0638)	(0.0691)	(0.0321)
Team Ownership	0.0670	0.120	0.153***
	(0.0869)	(0.0917)	(0.0489)
Partnership	0.0393	-0 391**	-0.0493
	(0.155)	(0.153)	(0.0716)
Limited Liability Corp.	0.0775	0.186*	0.0623
	(0.0862)	(0.0951)	(0.0397)
Corporation	0.0626	0.228**	0.0983***
	(0.0923)	(0.0996)	(0.0375)
Home Based	-0.217***	-0.0877	-0.0326
	(0.0705)	(0.0755)	(0.0366)
Comparative Adv.	-0.106	-0.0805	0.0309
	(0.0649)	(0.0710)	(0.0287)
Intellectual Property	0.402***	0.145*	0.214***
	(0.0828)	(0.0881)	(0.0511)
High Credit Score	0.168	0.348***	0.0462
	(0.117)	(0.123)	(0.0684)
Low Credit Score	-0.137**	-0.160**	0.0203
	(0.0683)	(0.0737)	(0.0305)
Sales ($50-$18,000)	0.859***	0.439***	0.0436
	(0.0835)	(0.0838)	(0.0346)
Sales ($18,001-$52,000)	1.203***	1.028***	0.0271
	(0.0911)	(0.0947)	(0.0376)
Sales ($52,001-$121,000)	1.509***	1.633***	0.0287
	(0.102)	(0.108)	(0.0422)
Sales ($121,000+)	1.544***	2.301***	0.207***
	(0.114)	(0.118)	(0.0606)
Constant	6.766***	6.302***	6.248***
	(0.569)	(0.576)	(0.307)
Observations	3806	3806	3806
R-squared	0.203	0.264	0.077

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

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

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

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

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

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

The Employment Returns to Financing

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

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

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

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

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

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

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

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

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

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

Source: Kauffman Firm Survey 2004-07.

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

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

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

Conclusions

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

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

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

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

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

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