981

THE MINORITY BUSINESS SECTOR: A VEHICLE FOR REGIONAL GROWTH

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

FIRST SESSION

NOVEMBER 16, 1979

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THE MINORITY BUSINESS SECTOR: A VEHICLE FOR REGIONAL GROWTH

FRIDAY, NOVEMBER 16, 1979

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 340, Cannon House Office Building, Hon. Parren J. Mitchell (member of the committee) presiding.

Present: Representative Mitchell and Senator Sarbanes.

Also present: David W. Allen and M. Catherine Miller, professional staff members; Mark R. Policinski, minority professional staff member; and Betty Maddox, administrative assistant.

Representative MITCHELL. I'll ask the hearing to come to order.

Before making an opening statement, let me make an apology to the witnesses this morning, and those in attendance. The House is now in session. Normally, during hearings, I try to avoid breaking up hearings to go over and vote; this morning I will not be able to avoid that, so after we get started, in the event that a witness is testifying, and if no other members are here, I will simply have to recess the hearing briefly to run over and make my vote and then come back, and it should not consume more than 15 minutes.

It's quite possible that we can avoid that, because five other members of the Joint Economic Committee are scheduled to participate in the hearing this morning, and if they show, we can rotate so we won't have to interrupt testimony.

OPENING STATEMENT OF REPRESENTATIVE MITCHELL, PRESIDING

Today we shall hold hearings to discuss the potential of minority business enterprise as a vehicle for the growth and development of the minority business community.

The participation of minority entrepreneurs in the economic mainstream has been generally dismal, and when I make that statement, it is not to deprecate the efforts that many people have made in this Congress and outside of this Congress. Certainly the picture is very much different from the picture that we had 10 years ago when I first came to the Congress. Despite that kind of progress, though, the picture still is relatively dismal.

I would indicate that the President had asked for a tripling of the minority business participation in Government contracts. That goal was not met, and the President made the announcement it was not met, but he intends to redouble his efforts.

As we now stand, it's my distinct impression that minority businesses get less than 2 percent of the total volume of Government contracts in procurement and other fashions, and that is rather dismal.

The 100 largest black- and Hispanic-owned companies generated receipts of $870 million—that was the blacks—and $876 million, respectively, in 1977. If you added all of the gross sales receipts of the minority-owned businesses in America, they would total less than the gross sales receipts of the 271st largest business in the Fortune 500, and that's rather grim.

Put in another perspective, if the Bank of America liquidated less than 1 percent of its assets, it could buy all of the minority-owned businesses in America. This illustration, that displays a lack of participation of the minority business community, is the topic of today's hearing.

I am very delighted that we have two very distinguished gentlemen to join us this morning. These are witnesses who have conducted research in the field of minority business.

Mr. William Scott is an associate professor of finance at the University of Texas at San Antonio, and he has written extensively about Hispanic participation in the business sector and, indeed, in your research I think you have identified factors that have inhibited the growth and development of Hispanic businesses.

In his work with Mr. Furino, also at the University of Texas at San Antonio, he has served to assist in the efforts of the Small Business Committee in developing a more viable Hispanic business sector.

Mr. Ed Irons, my friend of long standing, and a gentleman called upon time and time again over the last decade to give me assistance and guidance and so forth in economic development, is a professor of banking at Atlanta University, and he has served, really, in the vanguard of the intellectual pursuit on the issues of black business participation in the economic mainstream.

Mr. Iron's research of the last decade has been the foundation for many of the advances of the black business community and, certainly, if we achieve any successes in the Congress, as a Member of Congress, and because of my involvement in economic development—if indeed, we have achieved some success, I must indicate publicly and proudly that Mr. Irons has made major contributions.

Gentlemen, we have heard the testimony of witnesses who have espoused the small business sector as the growth sector of the economy in the next decade. This morning we would like to hear from you exactly what the prospects are for the minority business subset of the small business sector.

If you will both come to the witness table, I would suggest that you both give your testimony and then we can start the questioning.

Before you start giving your testimony now, I would like to indicate that this week the House of Representatives marked up the EDA bill. During the latter part of that debate, Congressman Ashbrook of Ohio introduced an amendment on the floor which would have eliminated the 10-percent set-aside for minority businesses under the local public works programs.

Congressman Roe and I responded to that amendment in opposition and, quite fortunately, were able to have it voted down.

But I cite that as the kind of climate that we have to deal with on behalf of minority business.

In addition to that, on November 27, the Supreme Court will hear the case of *Fullilove* versus *Kreps*. I shall be at the Supreme Court hearing. This is, again, a challenge to the 10-percent set-aside that was so tremendously beneficial to minority business.

The challenge has come from one of the members of the Association of General Contractors, I believe.

So, not only in the legislative arena, but in the judicial arena, there are attempts being made which, in my opinion, are invidious attempts to stifle the future growth of minority business.

Having given you those two reports, as we say, we defeated the Ashbrook amendment, and I am confident that we will win in the Supreme Court; it's merely to keep us all alert as to the kinds of attacks that the programs we both fight for are under.

Whoever wants to lead off, fine.

STATEMENT OF WILLIAM L. SCOTT, ASSOCIATE PROFESSOR OF FINANCE, UNIVERSITY OF TEXAS AT SAN ANTONIO

Mr. SCOTT. Congressman Mitchell, members of the committee, I appreciate the opportunity to testify before this committee and hope my remarks will be helpful to its deliberations.

This testimony will concentrate heavily upon the results obtained from a major research study of minority businesses. That study is the first nationwide study of minority business, which calls upon a large data base of financial information, and I served as the principal investigator on the research.

The research grant was funded by the Office of Minority Business Enterprise, U.S. Department of Commerce, in contract with the University of Texas at San Antonio. You should have received a summary of the study prior to this hearing. Nevertheless, I will summarize some of the important findings during this testimony.

To date, the serious research on minority business has been woefully inaccurate, the principal result of the limited data base on minority firms. It seems important, though, that public policy be based upon knowledge of the minority business sector and how it operates.

The dollars spent for research may be considerably less than the cost of funding programs which have limited success.

This testimony will not evaluate the success of Government programs for minority businesses. It will, however, reveal some very encouraging results about the performance of the minority business sector.

I would briefly summarize the important findings of the study.

This research project was undertaken to provide valuable information about the profit, risk, and financial characteristics of minority-owned business firms. And I should add that in the study we are speaking of all minority groups, not simply Hispanic.

It is the first major study using a nationwide financial data base, in order to gain insight on the performance characteristics of minority firms and thereby provide a basis for establishing Government policy.

Extensive financial data is analyzed—data which covers over 6,000 business firms in the eight States with the highest concentration of minority-owned firms. Balance sheet and income data are available as of 1978 for each firm, being supplied by Dun & Bradstreet, Inc., under contract with the U.S. Department of Commerce.

The data are broken into three major groups of about 2,000 firms each: Minority firms which are assisted by the Office of Minority Business Enterprise, nonassisted minority firms, and nonminority firms which form a basis of comparison. The study seeks to find differences in the performance characteristics across these three groups of firms, differences that are important and predictable, and differences that are important and predictable, and differences that are not due to sampling errors.

Moreover, differences across the groups must arise from factors other than the size of firms, the industry composition, and the age of firms.

Nevertheless, there are two basis limitations of the study. First of all, since the Dun & Bradstreet data would seem to largely include the more mature and creditworthy firms, the data may be not entirely appropriate for analysis of newly started minority firms, many of which are recipients of Government assistance.

Second, since the data consist of financial information as of a particular date, it does not offer the opportunity to study changes in the characteristics of minority firms over time. As a result, the response of minority firms to a particular form of Government assistance, or to the prevailing economic climate, cannot be measured. Nevertheless, the study is able to identify the potential for minority firms in general, and some problems that even the mature minority-owned firms must face.

Furthermore, the study provides direction to future research in the area. Perhaps that will be one of the more important facets of the study.

The findings are basically as follows: Minority firms which are not assisted by the Office of Minority Business Enterprise, firms that are on their own, are found to display virtually the same profit characteristics, in an overall sense, as nonminority firms.

I should add, when I use the term "profit characteristics," what I'm speaking of is profitability as measured by return on assets. What you find is that the frequency of distribution, or the way the profit rate is distributed, is virtually the same in appearance for the nonassisted minority firms as for the control group of nonminority firms.

The minority firms which are assisted by the Office of Minority Business Enterprise are those which would seem most likely to find the help useful, although OMBE is certainly not helping the weakest of minority firms. OMBE-assisted firms are slightly less profitable, on average, but knowing whether or not a minority firm is assisted by OMBE has no value whatsoever in predicting the profit performance.

Let's put it this way to describe the difference—the non-OMBE-assisted minority firms had a return on assets of about 15 percent, on the average, while the OMBE-assisted minority firms had a return of 3 or 4 percent less. Nevertheless, though the difference shows up, if you look at the distribution of return on assets of nonminority and minority firms, you find that return on assets literally goes all over the map for both groups of firms.

So this difference in terms of overall variability is not so substantial, and by and large, the OMBE firms are no more likely to show losses, it appears, than the minority firms which are not assisted by OMBE. Of course, this is what we find in this sample of more mature firms, and that might possibly be at odds with what we might find for less mature, newly started firms which, by virtue of being young, might experience higher failure and loss rates.

Minority firms in the wholesale trade industry are found to have some trouble with profitability, and minority firms in the State of New York are found to underperform their counterparts in other States. However, the effects there are not significant enough to affect the performance over all industries and in all States.

Minority firms which are assisted have more debt than nonassisted minority firms and nonminority firms. This, in part, may be due to the nature of their assistance. I should say that it may be indicated that a lot of the firms that OMBE assists are firms that need assistance in the form of capital.

Minority firms seen to receive bank loans with the same frequency as nonminority firms, but nonminority firms are observed to be most likely to receive larger loans, based upon cash flow from future profits. This observation may be explained by minority firms seeming most risky to bankers and private lenders, who may prefer to base loans upon collateral and outside guarantees.

However, many of the minority firms themselves may not seek loans with repayments based upon future cash flow. Among the assisted minority firms, the least profitable firms are found to have the largest bank loans, presumably many of which carry Small Business Administration (SBA) guarantees. The least profitable minority firms—those that are in most need of working capital—may be the firms most likely to apply to OMBE for assistance in receiving loans.

And I should add here that we are looking at current profitability. Even if less profitable OMBE firms are the ones that receive the largest bank loans, those firms may have submitted a business plan and therefore have been able to demonstrate that future profits are expected to be greater than current profits. This is something that has to be taken into consideration.

There are several suggestions for public policy toward minority-owned firms which emit from this study.

First of all, encouraging the growth of the minority business sector would certainly seem to be in the public interest, since minority firms in the sample are observed to make an economic contribution equal to that of their nonminority counterparts. This demonstrates the potential for minority firms.

Second, improvement in assistance to minority firms would seem to arise from the tailoring of assistance according to the type of minority firm under consideration. The Government might offer assistance in gaining operating funds to the newly started minority firms—those that may not have ready access to private capital markets.

For established minority firms that are having operating difficulties, assistance might focus upon direct help to managers and owners. This would seem to be more beneficial than simply supplying loans which replenish a deteriorating working capital position.

Finally, the established minority firms which are having no serious managerial difficulties might benefit most by gaining access to private sources of capital. If these minority firms could be mainstreamed into private capital markets, Government policy could concentrate upon those firms which need direct assistance and also use its limited resources to help obtain loans for those firms private markets may be less-able to accommodate, particularly the newly established minority firms which might appear to be most risky to private lenders.

There are some directions for future research. This study strongly suggests three basic directions for future research which is necessary in the formulation of public policy.

First, the unique characteristics of newly formed minority firms should be explored using a data base specifically containing such firms. That would mean, of course, that we would have to get such data. This current study employs the first data base of this magnitude that has ever been made available. It's a sizable job to come up with a usable data base for studies of this nature.

Having a data base from newly formed minority firms, Government policy can focus upon the specific problems of new minority firms and devise ways to identify and meaningfully assist the most promising minority firms.

Second, a longitudinal study should be undertaken which observes the performance of minority firms over time, in order to see how they react to specific Government policies and external economic events. Such a study could form a basis for recurring research which serves to monitor the progress of minority firms, particularly those which receive Government assistance.

Finally, research into the efficiency of private capital markets as they accommodate the credit needs of minority firms is indicated as important by the results of this study. There may be reason to suspect that private lenders and minority firms do not have the same interchange that private lenders have with nonminority firms.

That concludes my formal oral testimony. Thank you, Congressman Mitchell.

[The study referred to by Mr. Scott in his oral statement follows:]

KEY BUSINESS RATIOS OF MINORITY-OWNED BUSINESSES
Analysis and Policy Implications

A Study Prepared

for

OFFICE OF MINORITY BUSINESS ENTERPRISE
U. S. DEPARTMENT OF COMMERCE

Project Directors:	Antonio Furino (Nov. 1977-Jan. 1979) Sam Gould (Jan. 1979-Nov. 1979)
Principal Investigator:	William L. Scott
Co-Investigators:	Antonio Furino Eugene Rodriguez, Jr.

Center for Studies in Business, Economics, and Human Resources
College of Business
University of Texas at San Antonio

November, 1979

EXECUTIVE SUMMARY

Nature of the Study

This research project was undertaken to provide valuable information about the profit, risk, and financial characteristics of minority-owned business firms. It is the first major study using a nationwide financial data base, in order to gain insight on the performance characteristics of minority firms and thereby provide a basis for establishing government policy.

Data and Method of Approach

Extensive financial data is analyzed, data which covers over 6,000 business firms in the eight states with the highest concentrations of minority-owned firms. Balance sheet and income data as of 1978 are available for each firm, being supplied by Dun and Bradstreet, Inc., under contract with the U. S. Department of Commerce. The data is broken into three major groups of about 2,000 firms each: minority firms which are assisted by the Office of Minority Business Enterprise, non-assisted minority firms, and non-minority firms which form a basis of comparison. The study seeks to find differences in the performance characteristics across these three groups of firms, differences that are important and predictable, and differences that are not due to sampling errors. Moreover, differences across the groups must arise from factors other than the size of firms, the industry composition, and the age of firms.

Limitations of the study

There are two basic limitations of the study. First, since Dun and Bradstreet data would seem to largely include the more mature and creditworthy firms, the data may be inappropriate for analysis of newly started minority firms, many of which are recipients of government assistance. Secondly, since the data consists of financial information as of a particular date, it does not offer the opportunity to study changes in the characteristics of minority firms over time. As a result, the response of minority firms to a particular form of government assistance--or to the prevailing economic climate--cannot be measured. Nevertheless, the study is able to identify the potential for minority firms in general, and some problems that even the mature minority-owned firms must face. Furthermore, the study provides direction to future research in the area.

Important Findings

Minority firms which are not assisted by The Office of Minority Business Enterprise are found to display virtually the same profit characteristics, in an overall sense, as non-minority firms. Those minority firms which are assisted by The Office of Minority Business Enterprise are those which would seem most likely to find the help useful, although OMBE is certainly not helping the weakest of minority firms. OMBE assisted firms are slightly less profitable on average, but knowing whether or not a minority firm is assisted by OMBE has no value whatsoever in predicting profit performance. Minority firms in the wholesale trade industry are found to have some trouble with profitability; and minority firms in the state of New York are found to underperform their counterparts in other states.

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Nevertheless, weaker profit performance by minority firms in wholesale trade and by minority firms in New York is not sufficiently important to cause differences across all industries and all states.

Minority firms which are assisted have more debt than non-assisted minority firms and non-minority firms. This, in part, may be due to the nature of their assistance. Minority firms seem to receive bank loans with the same frequency as non-minority firms, but non-minority firms are observed to be most likely to receive larger loans based upon cash flow from future profits. This observation may be explained by minority firms seeming most risky to bankers, who may prefer to base loans upon collateral and outside guarantees. However, many of the minority firms themselves may not seek loans with repayments based upon future cash flow. Among, the assisted minority firms, the least profitable firms are found to have the largest bank loans, presumably many of which carry SBA guarantees. The least profitable minority firms, those that are in most need of working capital, may be the firms most likely to apply to OMBE for assistance in receiving loans.

Public Policy Recommendations

There are several suggestions for public policy toward minority-owned firms which emit from this study. First of all, encouraging the growth of the minority business sector would certainly seem to be in the public interest, since minority firms in the sample are observed to make an economic contribution equal to that of their non-minority counterparts. This demonstrates the potential for minority firms. Secondly, improvements in assistance to minority firms would seem to arise from the tailoring of assistance according to the type of minority firm under consideration. The government might offer assistance in gaining operating funds to the newly started minority firms, those that might not have ready access to private capital markets. For established minority firms that are having operating difficulties, assistance might focus upon direct help to managers and owners. This would seem to be more beneficial than simply supplying loans which replenish a deteriorating working capital position. Finally, the established minority firms which are having no serious managerial difficulties might benefit most by gaining access to private sources of capital. If these minority firms could be "mainstreamed" into private capital markets, government policy could concentrate upon those firms which need direct assistance, and also use its limited resources to help obtain loans for those firms private markets may be less able to accommodate--particularly the newly established minority firms which might appear risky to private lenders.

Directions for Future Research

This study strongly suggests three basic directions for future research which is necessary in the formulation of public policy. First, the unique characteristics of newly formed minority firms should be explored using a data base specificaly containing such firms. By doing so, government policy can focus upon the specific problems of new minority firms and devise ways to identify and meaningfully assist the most promising minority firms. Secondly, a "longitudinal" study should be undertaken which observes the performance of minority firms over time, in order to see how they react to specific government policies and external economic events. Such a study could form a basis for recurring research which serves to monitor the progress of minority firms, particularly those which receive government assistance. Finally, research into the efficiency of private capital markets, as they accommodate the credit needs of minority firms, is indicated as important by the results of this study. There may be reason to suspect that private lenders and minority firms do not have the same interchange that private lenders have with non-minority firms.

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CHAPTER I

INTRODUCTION

Background of The Project

In November, 1977 the University of Texas at San Antonio entered into a contract with the Center for Community Economic Development of the City of Cambridge, Massachusetts, an Office of Minority Business Enterprise funded agency, to investigate the cost of doing business for minority-owned firms.

The study was to be based upon a reliable sample of minority-owned businesses from available national data, and involved the development of appropriate questionnaires, the collection of the data through two professional associations of minority CPA's, the transferal of the data to a computer readable form, the analysis of the data, and several indepth interviews with the proprietors or the executives of a small sample of minority businesses.

Negotiations with the members of the two major professional associations of minority CPA's, the American Association of Spanish Speaking Certified Public Accountants, and the National Association of Minority Certified Public Accountants, began immediately and continued through February 1978.

A questionnaire of the needed information was prepared by the UTSA research team and reviewed by the Boards of the associations. The UTSA project director, during several sessions with the Executive Directors of the associations, Ms. Lidia Hall (NAMCPA), Mr. Daniel Archuleta (AASSCPA), discussed the finalized procedure for the data collection.

Unfortunately, some of the attorneys consulted by the two boards advised the associations against disclosing clients' data even though all guarantees for the confidential treatment of the data had been provided.

Additional negotiations were, then, undertaken with the Internal Revenue Service (IRS) for disclosure of tax return information adequately aggregated to protect the confidentiality of the data. After intense negotiations with Mr. Earl Klema of the IRS Disclosure Operations Division and his associates, the conclusion was reached that to retrieve the information needed from the IRS records would be more time consuming and more expensive than this study could afford, and a third possibility was explored.

The Dun and Bradstreet Company was contacted to explore the possibility of retrieving from the Dun and Bradstreet files selected records among those collected by the company for their financial and credit reports. Dun and Bradstreet was able to match firms in its records with a list of minority firms supplied by OMBE. Moreover, Dun and Bradstreet created a reference group of non-minority firms which would serve to make comparisons among minority and non-minority firms.

The Data Sample

The data made available by Dun and Bradstreet initially derives from 1978 financial statements supplied by the firms in their records. In the data sample, there are no firms for which the credit reporter estimated financial data. Dun and Bradstreet is careful to insure the accuracy of its data, and if there are errors, there is reason to assume that they are equally distributed among minority and non-minority firms.

There are three basic groups in the data sample: (1) minority-owned business firms which are not assisted by OMBE (minority firms), (2) Minority-owned business firms which are assisted by OMBE (client firms), and (3) nonminority firms which form a basis of comparison to minority firms (control firms). There are approximately 2,000 firms in each group. Initially there was some overlap in the groups, particularly among assisted and nonassisted minority firms. However, any overlap was removed from the data files before statistical tests were performed. The nonassisted minority group selects firms from only eight states, but the client and control groups contain firms from other states. This does not present a problem, as the statistical modeling was able to control on states. The eight states are New York, Pennsylvania, Georgia, Florida, Ohio, Illinois, Texas and California. These states have a high concentration of minority firms. Industries are four-digit SIC codes.

Table 1-1 breaks down the groups by state and industry group, and can be compared to census data. As can be seen, the data sample stretches broadly over states and industries. It should not concern the reader if the percentages for states and industries vary across groups and relative to census data. As stated before, the effect upon performance of state and industry are effectively controlled upon.

The nonassisted minority firms in the sample average about 12 years old; client firms, 11 years old; and control firms, 19 years old. The two minority groups are quite close in size; however, control firms cover a large spectrum of sizes, some of which are quite large.

TABLE 1-1
Sample of Firms, By
Group, Industry, and State

Industry Group*	Minority	Client	Control
Construction	15.6%	20.6%	18.1%
Manufacturing	23.1%	14.8%	18.3%
Transportation	4.5%	4.2%	6.0%
Wholesale Trade	11.2%	15.2%	14.0%
Retail Trade	26.7%	31.5%	30.4%
Finance, Insurance, Real Estate	1.3%	.1%	1.5%
Services	17.7%	13.3%	11.8%
State*			
New York	12.3%	10.4%	8.2%
Pennsylvania	9.3%	2.11%	1.2%
Georgia	5.0%	1.6%	2.2%
Florida	23.7%	5.2%	3.3%
Ohio	6.9%	4.5%	5.0%
Illinois	7.3%	2.9%	2.7%
Texas	11.4%	14.5%	9.4%
California	24.1%	17.2%	13.8%
Other States	0%	41.7%	53.9%
Total Firms	2,171	2,091	2,044

* As a percent of this sample; totals may not add exactly to 100% due to rounding.

TABLE 1-2

1972 Census of Minority-Owned Firms

Industry Group	
Construction	15%
Manufacturing	2%
Transportation	8%
Wholesale Trade	2%
Retail Trade	34%
Finance, Insurance, Real Estate	4%
Services	28%
Other	7%

State*	
New York	6.2%
Pennsylvania	2.3%
Georgia	2.3%
Florida	4.2%
Ohio	3.1%
Illinois	4.1%
Texas	10.6%
California	19.2%

* Firms in a particular state, as a percent of the U. S. total; therefore percentages will not add to 100%.

Appropriateness of the sample

The Dun ad Bradstreet sample is most useful in observing the performance characteristics of firms which are most likely to be mature and credit-worthy. Many of these firms have survived in business, and therefore have come into a sufficient prominence to apply for credit from private financial institutions. As such, the sample may not be representative of newly started firms, particularly those that are owned by entrepreneurs entering business for the first time. Nevertheless, the sample allows studying the potential for new firm starts in particular states and industries, and offers some evidence regarding the strengths and weaknesses of minority firms. Furthermore, analysis of the sample data can offer some insights as to how minority firms are financed, and how the credit market operates for them.

CHAPTER II

REVIEW OF THE LITERATURE

History of Minority Business Enterprise

There is some recorded history of minority businesses, and that history focuses considerably upon black businesses. Black business enterprise has experienced its historical development in industries where whites have shown little interest. Black businesses have traditionally concentrated in hauling, coal yards, personal services, barbering and hair preparations, restaurant and hotel-keeping, and ethnic products like hair-preparation and cosmetics. Racial prejudice is allreged to discourage blacks from areas of commerce with the general public, employing restrictive covenants in real estate and licensing provisions, and by using restrictive social customs in trade.[1] In Chicago, a city having a large concentration of blacks, black business was virtually wiped out by The Great Depression. The only business which endured was a gambling game known as "Policy." The "Policy Kings", as they were called, emerged as the only businessmen with the financial capabilities to re-structure black businesses. These men have invested in legitimate businesses, which became a large percentage of ghetto business.[2]

There is also some history of Oriental businesses. Due to discrimination in labor markets in the late nineteenth century and early

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[1] Robert J. Yancy, Federal Government Policy and Black Business Enterprise (Cambridge, Massachusetts: Ballinger Publishing Company, 1974), p. 18.

[2] St. Clair Drake and Horace R. Cayton, Black Metropolis: A Study of Negro Life in a Northern City, Volume 2 (New York: Harper and Row, 1962), p. 86.

twentieth century, Orientals sought self-employment in areas of restauranting, laundries, and goods catering to Oriental cultural needs.[3]

There has been some academic interest in the development of immigrant businesses, for example, Oriental business, as a model for contemporary ghetto business development. The conditions that poor urban ethnics face today, nevertheless, differ considerably from those faced by the earlier immigrant groups. When those groups were arriving, retailing consisted mainly of small stores--as opposed to the competititon of large chain establishments. Moreover, the immigrant businessmen had a virtual monopoly in supplying ethnic foods and cultural items. Furthermore, they spoke the same language and had the same cultural values of their fellow immigrant customers. Today, however, cultural and ethnic ties have not isolated the minority businessman from the competition of nonminority entrepreneurs.[4]

There is an emerging history of Hispanic-American owned businesses in the U. S. As of 1972 there were more than 120,000 businesses owned by persons of Spanish origin. Moreover, the total was 20% greater than the census data taken in 1969. More important, gross receipts for these firms increased 58% during the same period. In terms of metropolitan concentrations of Hispanic firms, Los Angeles-Long Beach led the list, followed by Miami, San Antonio, New York, San Francisco-Oakland, Houston, El Paso, South Texas Valley Area, San Jose, and Dallas-Fort

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[3] Ivan H. Light, Ethnic Enterprise In America (Berkeley, California: University of California Press), Chapter 1.

[4] On this point see Elliot D. Sclar, "The Case for Community Economic Development," in Doctors, op. cit., p. 56.

Fort Worth. The Hispanic firms are highly concentrated in retail and selected services, which accounts for 61% of firms. However, the greatest growth in receipts has been in manufacturing and construction. (See "Hispanic-owned businesses in U. S. Gain in Numbers, Gross Receipts" Commerce Today, June 1975.

Characteristics of Minority Businesses

Minority business firms are typically very small firms, in terms of both gross receipts and number of employees. The highest concenttrations of minority firms are in retail trade and personal services. Most of these firms are sole proprietorships. In a 1969 study, Albert J. Reiss found that in his random sample of tax returns, minorities owned only 3.7% of the total businesses selected, with blacks owning 2.3% and other minorities owning 1.4%.[5] A 1969 study by Flournoy Coles, focusing upon black businesses located in Atlanta, Cleveland, Durham, Jackson, Los Angeles, Norfolk, and Richmond, found concentrations in retail and personal services, and warns that profit figures reported may not reflect adequate compensation for depreciation, debt amortization, taxes, and bad debts. Furthermore, he finds the minority firms to be high risk enterprises in low income neighborhoods, being too small to enjoy scale economies.[6] A related study by Andrew Brimmer offers that "federal funds are being expended to finance blacks

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[5] Yancy, op. cit., Chapter 7.

[6] Flournoy A. Coles, Jr., An Analysis of Black Entrepreneurship in Seven Urban Areas (Washington, D. C.: The National Business League, November, 1969.

in businesses where they have little chance for growth and success, and the status of black businesses vis a vis the total business environment will not be materially improved until blacks are supported in industries where there exists potential for capital accumulation on a large scale as well as new expanding market opportunities.[7] Sharon Lockwood, however, disagrees with Brimmer, and alleges that the economic environment is in fact improving for black businesses. She cites construction, plastics, apparel, and food processing as new areas of commerce and production entered by black entrepreneurs.[8]

There are two recurring themes in minority capitalism: that minority businessmen are both under-financed and under-trained. A study of Harlem businesses by Caplovitz has shown that black merchants have more trouble getting loans than white merchants. The blacks are "less likely to have ever borrowed, more likely to have been refused loans, and less likely to have obtained loans from banks."[9] Resultingly, Harlem blacks are more likely to deal with jobbers than with wholesalers and manufacturers, paying C.O.D. and dealing with less economical suppliers. Caplovitz finds that both black and white merchants have trouble getting insurance, and therefore protecting the value of collateral for secured

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7 Andrew F. Brimmer and Henry S. Terrell, "The Economic Potential of Black Capitalism" (Paper presented to the American Economic Association, December 29, 1969, New York City).

8 Sharon Lockwood, "An Analysis of Governor Brimmer's Paper Entitled, 'The Economic Potential of Black Capitalism'". (An unpublished position paper prepared for the President's Advisory Council on Minority Business Enterprise, January 1970.)

9 David Caplovitz, The Merchants of Harlem (Beverly Hills, California: Sage Publications, 1973).

loans. From the lender's point of view, lending to minorities, besides being viewed as risky, provides other problems. First of all, it is costly to lend in the ghettos. Promotional costs are high, as people have to be educated to use financial institutions; there is a demand for small loans which have a high cost of producing and servicing; and high salaries may have to be paid to attract a competent staff. A second problem is that downtown bankers may get "loan shy" to minorities, fearing the possible repercussions of calling a loan on a minority.[10]

The other recurring theme in minority capitalism is the low skill level of minority entrepreneurs. Venable has observed that "the white youngster begins to learn the language and procedures of this system (business) as routinely as he learns to ride a bike. It is a part of his everyday environment,. the dinner table conversation, his older brother's accounting textbook, the visit to his Uncle's Textile plant. Just as routinely, the black youngster is excluded from this experience."[11] In a study of Harlem merchants, Caplovitz found white merchants to have much more experience than black merchants, and for whites, business experience was most closely correlated with success.[12]

A final observation about minority firms, particularly in merchandising, is that minority firms are less likely to extend credit than non-minority firms. This means that minority firms would be less able to serve their customers by extending credit toward the purchase of

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[10] Theodore L. Cross, Black Capitalism: Strategy for Business in the Ghetto (New York: Atheneum, 1971), p. 54.

[11] Abraham S. Venable, Building Black Business: An Analysis and a Plan (New York: Earl G. Graves Publishing Company, Inc., 1972).

[12] Caplovitz, op. cit., p. 43.

high-ticket items.[13]

Performance Studies of Minority Firms

There have been only a few performance studies of minority firms, and none is far-reaching enough to encompass a nation-wide, comprehensive study over all major industry groups represented. The studies which do exist are discussed in the previous section, being mainly descriptive rather than analytical. There are, however, some analytical studies with a particular emphasis: studies of the impact of government lending programs and studies of black banking.

A study by Robert Yancy compared black business development in Atlanta among recipients and non-recipients of SBA loans. The study found little or no difference between the two groups and concluded that SBA lending seemed to be having no appreciable effect on black business development in Atlanta.[14] Another study, by the SBA, has concluded that the business discontinuance rate for minority enterprise borrowers was similar to that of the general business community.[15] On a more negative note, however, an econometric study by Timothy Bates analyzed 400 black businesses that were recipients of SBA loans in Boston and New York. He found over 50% of these businesses were not meeting their repayment

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13 Caplovitz, op. cit., p. 75.

14 Robert Yancy, Federal Government Policy and Black Business Development (Doctoral Dissertation, Northwestern University, 1973).

15 U.S. Small Business Administration, Study of Minority Borrowers and Firms Prior and Subsequent to SBA Assistance, June 1974.

obligations and over 33% were being liquidated.[16] Another study by Bates found a high delinquency rate on the SBA's Economic Opportunity Loans, and argues that the SBA might be financing the creation and perpetuation of marginally viable and unviable firms.[17] Doctors and Lockwood examined SBA lending nationally and found that minority firms experience financial problems with loans five to six times as often as non-minorities. Also, most of the loans were made to low growth, low profit businesses.[18]

There has been considerable interest in the growth and development of black banks, not only from the standpoint of the performance of that particular minority business itself, but also because that business has the potential to help other minority businesses in other industries. It has been believed that minority banks would accomplish the needed capital flow into the ghetto to serve minority business development. A study by Andrew Brimmer analyzed 22 black banks relative to other similar sized banks. Brimmer found black banks to be one-fourth to one-third as profitable as other banks, due to high operating costs, low efficiency, and greater relative loan losses. Black banks experience such great loan losses that their income is cut to more than one-half the level it might otherwise reach. Brimmer concludes that black

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[16] Timothy Bates, "An Econometric Analysis of Lending to Black Businessmen" (Paper presented at the 1971 meeting of the Econometric Society).

[17] Timothy Bates, "Government as financial, intermediary for Minority Entrepreneurs: An Evaluation," Journal of Business (October, 1975).

[18] Samuel Doctors and Sharon Lockwood, SBA DATA Study for the President's Advisory Council on Minority Business Enterprise (unpublished, 1972).

reach. Brimmer concludes that black businesses in the ghetto are not sufficiently stable and profitable to support black banks.[19] In a related study Edward Irons accuses Brimmer of making evaluations based on past performance of black banks with little or no regard for current black banking trends. Irons finds that the status of black banking in recent years was vastly improved over prior years. However, he finds black banks to have high expenses as does Brimmer, and to be less profitable. Irons feels the minority banks do not adequately meet the needs of the ghetto communities, but they do attempt to relieve some of the capital starvation.[20]

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[19] Andrew Brimmer, "The Black Banks: An Assessment of Performance Prospects" Journal of Finance (May, 1971).

[20] Edward D. Irons, "Black Banking: Problems and Prospects" Journal of Finance (May, 1971).

CHAPTER III

FINDINGS PROVIDED BY THE STUDY

A Layman's Guide to Statistical Methodology Employed

The general purpose of this study is to observe any differences in the operational and financial performance characteristics of nonassisted minority-owned business firms, as compared to nonminority firms and minority firms which receive government assistance. The study employs four basic approaches to analyzing and reporting the performance characteristics of minority business firms. First, there is the descriptive approach: are there observable differences in the performance of minority and non-minority firms? Second, there is the causal approach: are the observed differences in minority and non-minority firm's performance due to a true minority effect, or are they due to other factors that fall unevenly upon the two groups of firms? For example, a firm may perform poorly relative to another firm, but the performance difference may result from its smaller size, younger age, and poorer industry and location, rather than from the minority/non-minority designation. In the analysis, factors other than minority/non-minority must be accounted for, in order to isolate the unique performance characteristics of minority firms. In the statistical models undertaken in the study, the influences of firm size, age, and industry are held constant to pinpoint the true minority effect. Third of all, there is an inferential approach: Does knowing whether or not a firm is minority-owned predict performance? Of all the factors that would seem to predict performance, what percent of importance is the minority effect? Finally, there is the sampling approach: Would the observed differences hold up if a larger sample were taken?

In order to say that minority firms perform differently from non-minority firms, there must be (1) an observable difference; (2) that difference must be attributed to factors other than size, age, and industry; (3) the minority effect must be important in that it stands out sufficiently among the other determinants of performance; and finally, (4) the difference must be expected to hold if a larger sample were taken.

Profitability and Risk of Minority-Owned Firms

How profitable are nonassisted minority firms in comparison to their nonminority peers?

Minority-owned firms which are not assisted by OMBE are found to be just as profitable, in an overall sense, as non-minority firms. The profitability criterion reported in Table 2-1 is "return on assets", or profit as a percent of assets. Essentially, that ratio measures the level of profits relative to the asset base used to produce those profits. Return on assets is a good overall measure of profitability, since it summarizes the effects of cost control, product pricing, and efficiency in the use of assets, as determinants of profits. Another commonly used measure of profitability is "profit margin", or the percent that profit is of a dollar's sales. Nevertheless, while profit margin is useful for evaluating cost control and product pricing, it ignores other efficiencies which bear upon profitability such as efficiencies in production, inventory control, and working capital management. (Profit margin figures are reported in Table 4.)

In Table 2-1, minority firms are observed to have a mean return on assets of about 17%, as compared to 14% for control firms. Furthermore, minority firms experiencing losses are 12% of the total, as compared to about the same percent for control firms (11%). The same results hold if the firms are young firms, as can be seen in Table 2-1. Statistical models which account for influences upon performance such as size and age, and which also account for sampling errors, also show no meaningful differences in the profitability of the two groups. Moreover, whether or not a firm is a minority firm is found to have no predictive value for profitability.

Are there any apparent differences in the profitability of non-assisted minority firms, as compared to non-minority firms, at the industry level?

From Table 2-3, it can be seen that minority firms in both groups are performing approximately as well as or better than control firms in all industries, except one, wholesale trade. In the other industries, return on assets is quite similar among the groups, falling mainly in the 10% to 20% range. Statistical models confirm this finding: allowing for sampling errors and the influence upon performance of size and age, there are no statistical differences in profitability among the groups in all industries excepting wholesale trade. Furthermore, in these industries, whether or not a firm is a minority firm has no predictive importance for profitablity. In wholesale trade, however, the results are different: Both non-assisted and assisted minority firms are under-performing control firms. In Table 2-3 minority firms

TABLE 2-1

Return on Assets, by Group,

Percent of firms in each return category

Return on Assets	Minority	Client	Control
20% and over	29%	29%	20%
11 to 19%	20%	21%	18%
0 to 10%	39%	36%	51%
-1 to -10%	7%	9%	8%
-11 to -19%	2%	2%	1%
-20% and under	3%	3%	2%
Mean	17.293	14.504	13.913
Median	10.250	10.375	7.663
Standard Deviation	43.410	46.306	36.493
Number of firms	934	1147	1301

which are not assisted have an average return on assets of 14.4% as compared to 18.5% for control firms. In Table 2-4 which reports average profit margin, or profit as a percent of sales, non-assisted minority firms report negative mean profit margins in wholesale trade. These results also are confirmed by statistical models, which allow for sampling errors and the effects of size and age. Finally, those models show an important minority effect in wholesale trade, and knowing whether or not a firm is a minority firm has about a 10% predictive power for profitability.

Are there any differences in the profitability of OMBE's Client minority firms as compared to Non-Assisted Minority firms?

In Table 2-1 non-assisted minority firms are observed to somewhat outperform client minority firms. Non-Assisted minority firms show an average return on assets of about 17%, as compared to client firms average of 14.5%. Statistical analysis indicates that despite other factors influencing performance, such as size and age, and allowing for sampling errors, client firms slightly underperform non-client minority firms. From a descriptive point of view, on average, a client minority firm would have a return on assets of 10% when a similar (in size and age) non-client firm has a return on assets of 14%. However, the client effect has less than 1% explanatory power; knowing whether or not a firm is assisted by OMBE provides less than 1% of the information necessary to predict profit performance. As a result, the observed difference in the groups is not important when one considers the extent of profit

TABLE 2-2

Return on Assets

Firms, 5 Years of Age or under, by Group

Percent of firms in Each Return Category

Return on Assets	Minority	Client	Control
20% and over	35%	34%	28%
11 to 19%	18%	21%	18%
0 to 10%	34%	30%	39%
-1 to -10%	7%	8%	9%
-11 to -19%	2%	3%	3%
-20% and under	4%	4%	3%
Mean	17.896	12.966	15.774
Median	11.275	11.975	9.200
Standard Deviation	37.503	52.866	28.311
Number of Firms	279	467	234

TABLE 2-3

Average Return on Assets

By Group and Industry

	Minority	Client	Control
Construction	17.3%	18.9%	11.70%
Manufacturing	16.8%	11.3%	12.0%
Retail Trade	18.6%	13.0%	15.7%
Services	19.3%	19.9%	15.7%
Transportation	13.4%	19.9%	5.1%
Wholesale Trade	14.4%	6.6%	18.5%

TABLE 2-4

Average Profit Margin, by Group and Industry

	Minority	Client	Control
Construction	6.8%	7.5%	13.4%
Manufacturing	5.1%	5.6%	5.5%
Retail Trade	15.2%	5.9%	5.4%
Services	8.5%	7.8%	13.3%
Transportation	5.3%	4.1%	2.4%
Wholesale Trade	-2.4%	2.4%	5.2%

variability in each group. In the samples for both groups, return on assets ranges from about -60% all the way to a +60%, even excluding the extreme outliers that may result from accounting quirks and erroneous data.

To summarize, if need is a criterion for assistance, on the average, OMBE assists the minority firms that should receive help: OMBE's firms, overall, perform a little below non-client minority firms. However, the assisted minority firms by and large are profitable, and there is no indication that OMBE is picking the worst of minority firms to assist.

Are There Any Differences in OMBE Client and Non-Client Firms at the Industry Level?

There is no perceptible industry effect which is important and statistically meaningful in all industries except wholesale trade (See Table 2-3). In that industry, client minority firms are observed to underperform non-client minority firms. Client minority firms have a mean return on assets of 6.6% as compared to 14.4% for non-assisted minority firms. There is explanatory power in knowing whether or not a firm is a client firm, but the differences in mean profit performances could arise from sampling error. From a policy viewpoint, however, client firms in wholesale trade, like non-client firms, are underperforming control firms and therefore need attention from OMBE.

Are There Differences in the Profitability of Minority Firms Across the States Surveyed?

Non-Assisted minority firms were compared to non-minority firms at the State level. Non-assisted firms were chosen in order to avoid the bias upon performance arising from assistance. It is important to see the potential for a minority firm, on its own, in a particular state. Of the States surveyed, in only one is there any meaningful difference. That State is New York, where minority firms are underperforming non-minority firms, and knowing whether or not a firm is minority-owned has some importance in predicting profitability.

Are Minority Firms, As a Group, More Risky Than Non-Minority Firms?

Suppose a lender were to randomly select a firm out of each group of firms. Would he be more likely to select a firm showing losses--and therefore be more likely to fail--out of the minority groups? In Table 2-1, it is seen that 12% of the non-assisted minority firms show losses and 14% of the client firms show losses, as compared to 11% for control firms. The loss rate, then, is quite similar for all groups. But in observing the higher performance category, 20% return on assets or better, it is seen that more minority firms appear here than non-minority firms. Approximately the same results hold for young firms most prone to failure (See Table 2). Of the minority firms, 13% experience losses, and of the client firms, 15% experience losses, compared to 15% for control firms. Moreover, more minority and client firms fall in the highest return on assets category than the control firms. Consequently, as a group, minority firms appear no more risky than control firms.

Sources of Funds For Minority Owned Firms

Are Minority Firms More Likely To Rely Upon Debt Than Equity As A Source of Funds?

Since saving is allegedly difficult to generate in the minority community, then there may be few dollars available to invest in equities of minority businesses. Therefore, minority firms may be undercapitalized and more in debt than non-minority firms.

In Table 2-5 minority and client firms are compared to control firms on the basis of the debt to equity ratio, or total indebtedness expressed as a percent of total owner's equity. Looking first at non-client minority firms as compared to control firms, it is noted that non-client firms have higher debt ratios in construction, retail trade, transportation, and wholesale trade. However, in manufacturing and services, non-client firms have lower debt ratios. With the exception of transportation, though, the ratios are not markedly different, and statistical models indicate that when sampling errors are allowed, over all industries no meaningful statistical differences are observed.

A different picture emerges for client firms as compared to non-client minority firms. Client firms have considerably higher debt ratios than non-client minority firms in manufacturing, retail trade, and wholesale trade, and in only one industry do client firms show a

TABLE 2-5

Average Debt to Equity
Ratio, by Group
and Industry

	Minority	Client	Control
Construction	173.6%	173.4%	158.2%
Manufacturing	129.1%	181.0%	132.6%
Retail Trade	140.2%	195.1%	135.8%
Services	152.6%	151.2%	171.6%
Transportation	274.5%	228.6%	199.7%
Wholesale Trade	161.6%	197.7%	150.3%

significantly lower debt ratio: Transportation. These results are statistically significant over all industries and hold up when sampling errors are allowed. The fact that client firms are those with highest debt ratios may partly reflect the nature of the assistance provided them: assistance in obtaining government guaranteed loans.

In terms of the liquidity of a firm, or the ability to satisfy short-term claims, client firms underperform similar non-client firms. Current ratios are lowest in the client group (current ratios express short-term assets as a percent of short-term liabilities). The notion is that short-term assets can be quickly liquidated to satisfy short-term claims when they come due.

How Do Minority-Owned Firms Fare In Receiving Bank Loans?

In the Dun and Bradstreet data, the incidence of reported bank loans is as follows: 18% of control firms report bank loans, 24% of client firms report bank loans, and 24% of minority non-client firms report bank loans. Therefore, in the sample, minority firms in both groups are just as likely, and perhaps more so, to receive bank loans. One might be cautious, however, in generalizing those results to the case of all minority firms, not just those in the Dun and Bradstreet files. Being in Dun and Bradstreet files, in itself, is evidence that a firm is somewhat credit-worthy and is seeking credit accommodation.

The size of the bank loan is somewhat different among the groups, however, with client firms receiving the largest loans. The ratio of bank loans to assets averages 13% for non-client minority firms and 17% for control firms, as compared to 33% for client firms. Again, assistance in receiving guaranteed loans is indicated in the client group.

The most remarkable finding pertains to the determinants of the size of bank loans. That finding is discussed below.

Are Different Lending Criteria Seemingly Applied By Banks in Lending To Minority Firms?

Whether or not banks racially discriminate against minority firms is not the point of this question. What is being asked is whether or not banks might view minority-owned firms as being more risky than non-minority firms, and as a result, apply different lending criteria. All things equal, lending is more risky when loans are based upon assets whose collateral values are uncertain, and when loans are based upon cash flows from future profits which are uncertain. If the assets of minority firms are seen as risky; e.g., questionable receivables and inventory, and real estate in declining neighborhoods, then loans based upon assets will be scaled down as a percent of assets. Moreover, if minority firms appear as unproven business entities, loans based on future cash flow from profits will be small or non-existent.

In Table 2-6 the size of the bank loan, or the percent of assets that are financed by bank loans (the ratio of bank loan amount to asset size), is compared to a measure of current profitability, return on assets. If current profitability signals future profitability, banks seem more willing to make loans on that basis if the borrowing firm is not minority-owned. For the more profitable firms, those with a return on assets of 15% or more, bank loans are 2.7 times larger for non-minority firms than for non-assisted minority firms. However, in the less profitable category, both groups of firms do equally well, and one might suspect that many of the loans to non-assisted minority firms are based upon SBA guarantees. These results are statistically significant, and the minority effect is observed as being important.

An interesting observation is to note that the client firms of OMBE tend to receive larger loans if they are in the lower profitability category (See Table 2-6). This result is found to be significant and important. The least profitable client firms may be most likely to approach OMBE for the largest loans, as those firms are in most need of liquidity and working capital. Remember that OMBE's clients were found to be lowest in liquidity among the groups.

There is no real evidence that banks purposefully discriminate against minority-owned firms in their lending practices. However, banks might view minority firms as more risky and prefer to base loan amounts upon outside guarantees, namely that of the U. S. Government. This is unfortunate, since most non-assisted minority firms in the sample perform just as well as non-minority firms. As a result, it would seem important to demonstrate to banks the credit potentials of a whole new market--minority firms..

Finally, it is not entirely realistic to view this credit phenomena as the result of banker's decisions. To do so would be to entirely focus attention upon the supply side of the credit market. An important question is whether or not minority firms approach banks for loans based upon future profitability. Such firms may believe that banks would not make loans to them based upon values other than collateral, and furthermore, may not know how to effectively apply for such loans.

TABLE 2-6

Bank Loans as a Percent
of Assets, by Group
and Return on Assets

Group	Return on Assets: Less than or equal to 15%	Return on Assets: Greater than 15%
Minority	12.75%	14.38%
Control	.13.5%	38.35%
Client	39.8%	13.3%

<u>Congress has recently passed the Community Reinvestment Act, and that act would seem to have some bearing upon bank credit to minority-owned firms. How would that act apply to the case of minority firms, and what promise does it have for them?</u>

The Community Reinvestment Act (CRA) which has recently passed Congress should have a significant impact upon the plight of minority firms. The Act is a legislative reaction to "redlining", an alleged practice of financial institutions desiring not to lend to certain groups and neighborhoods. The legislation seeks to insure that financial institutions will serve all their representative communities, not only by accepting deposits, but also be reinvesting those deposits in the form of lending. A principle political interest of the CRA is mortgage loan practices, although the Act covers all types of lending. Since minority-represented communities are addressed by the Act, and since minority businesses are a major force in the economic vitality of those communities, then The Act would seem to have considerable application to the credit arrangements of minority business enterprises as well.

Basically, the CRA directs banks and other financial institutions to (1) publically delinate the entire community served including lower income neighborhoods, (2) indicate the nature of the services offered to all groups in the community, and (3) maintain a file of complaints and reactions of members of the community to the particular institution's policies and actions. The regulatory authorities for financial institutions are to consider CRA compliance in making regulatory decisions such as merger approval, branching approval, etc. The regulatory agencies involved are The Federal Reserve System, the FDIC, the Office of The Comptroller of the Currency, and the Federal Home Loan Bank System*.

There are some important observations to make about the CRA and its implementation. First of all, since the issue of alleged redlining in residential lending was a main force behind the passage of the Act, that issue is retained as a major focus in the Act's implementation. While mortgage lending is an important and immediate concern of the Act, that type of lending is but one aspect of lending to communities. Equally important is the issue of loans to minority business firms. Real estate loans will probably be made to economically sound communities, but that soundness depends upon a strong business climate in the community. If minority businesses thrive in communities, then those communities will be in a better position for mortgage loans, by having borrowers with better collateral and financial capacity.

A second important issue is whether or not the Act will be successful in accomplishing its intended goals. In the case of the CRA, a simple legislative mandate may or may not bring about the changes it desires. What is important is how the Act is implemented. One might argue that the CRA's success depends upon "positive" regulation rather than punitive enforcement. For example, the Securites Acts provide for conviction and punishment of individuals engaging in fraudulent activities. The purpose of that Act is to cease an easily identifiable wrong-

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* For a good discussion of the Community Reinvestment Act, see Gregory E. Boczar, "What to Expect When the Bank Examiners Come--and Turn Their Attention to your CRA Records," American Banker's Association Journal, April 1979.

doing by a member of society. The CRA, however, must go beyond identifying and correcting isolated incidents of unacceptable social practice to be successful. The intent of the Act is broader than providing legal remedies to flagrant cases of social discrimination. Like the Employment Act of 1946, which acknowledged the federal government's responsibility in pursuing policies toward full employment in the economy, The CRA is as much a directive for positive action as it is a provider of negative responses to its offenders.

The Act instructs financial institutions to <u>show a positive initiative</u> toward lending in all communities. It does not instruct them to make token loans in communities, nor does it instruct them to make unsound loans. It does, however, admonish financial institutions to reach out to all their communities, and be as innovative in marketing and packaging their services to lower income neighborhoods as in the case of corporate customers.

Judging from a panel discussion recently held at a meeting at the Federal Reserve Bank of Chicago, the CRA may have some severe obstacles to overcome.* Since the legislation already exists, the bulk of the effort in overcoming obstacles will lie with the financial regulators. Some potential problems follow. Financial institutions may not be taking the Act seriously, viewing it as political motivated and as just another cost to bear. Furthermore, institutions may view it as punitive, and be quite uncertain as to how to comply with the Act. Preliminary efforts have been often directed towards establishing a legal

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* Annual Conference on Bank Structure and Competition, held at the Federal Reserve Bank of Chicago, May 1979. In attendance are authorities and economists from the major banking regulatory agencies.

posture. Financial institutions may go through the motions of establishing their CRA statements, but carefully guard those statements from misinterpretation by more vocal community advocates. In some cases, the services they advertise in their statements are deposit services, although lending services are the primary concern of the Act. For many institutions, legal counsel is said to advise that compliance is merely the absence of negative information in the institution's public file. Finally, there is little evidence that institutions in general are taking steps to learn about the special characteristics of heretofore overlooked neighborhoods, and therefore becoming innovative in developing and packaging services that are mutually beneficial for both parties. All in all, it will be up to the financial regulators to instruct institutions in what positive compliance is, and what private benefits in the form of new markets can accrue to those who comply. And it is quite possible that many financial institutions, in good faith, are waiting for the agencies to do so.

Representative MITCHELL. Thank you very much. It was a little difficult for me; the testimony raised so many questions, and I was following it closely and trying to scribble down my questions as they popped in my mind. It was very fascinating testimony, Mr. Scott.

Mr. SCOTT. Thank you.

Representative MITCHELL. Mr. Irons.

STATEMENT OF EDWARD D. IRONS, PROFESSOR OF BANKING AND FINANCE, ATLANTA UNIVERSITY, ATLANTA, GA.

Mr. IRONS. I would like to thank this committee for permitting me to share my views with respect to the issue of economic disparities in the American economy.

When you have asked me to focus on the disparities regarding minority enterprise, I am fully aware that frequently, disparity on the one hand, and preferential advantage on the other hand, are opposite sides of the same coin. Moreover, the subject of these disparities is not limited to minorities. With respect to unemployment, for example, unemployment does not exist in this country for the sole purpose of depriving minorities of their jobs; it is my view that if all minorities in the United States were replaced by newly immigrated Europeans next month, we would still have the same number of unemployed people in America that we have today.

The distribution of the unemployment would be free of racism as we know it today, but the number would be the same. And, parenthetically, it is my view that by mid-1980, the unemployment rate in this country will be 9 percent.

It is not uncommon in the annals of the developing history of the U.S. economy that when one industry or sector of the American economy benefits from special considerations of the American Government, that other sectors of the economy are negatively impacted by such treatment.

For example, there is a body of evidence that suggests that without Federal Government support systems, the agricultural sector of this country would still be relegated largely to the proverbial "100 acres and a mule."

Representative MITCHELL. Mr. Irons, may I interrupt you just a moment?

What I feared was going to happen has happened. I am delighted that Senator Sarbanes has joined us.

Do you want to take a recess while I make the vote, or do you want to continue with the hearing? It will take me 10 minutes to get over and vote and come back.

Senator SARBANES. Why don't you continue, sir, and I'll conduct the hearing until Congressman Mitchell returns. He has your statement, and he's a fast reader, so he's ahead of both you and me, I can assure you.

Mr. IRONS. All right.

Representative MITCHELL. Despite my advanced years, I can possibly do this in 10 minutes.

Mr. IRONS. I had just indicated that with the advent of a comprehensive program and technical assistance, together with capital for land, equipment and operating expenses, as well as price supports for their products, the agricultural sector of this country was transformed into the world's most efficient food-producing machine with only 3 percent of today's population producing the food for the other 97 percent, and with a significant portion of that food production being exported to foreign countries.

Thus, the agricultural sector has been built into a failsafe sector by Government-fostered programs. On the other side of that coin, the agricultural work force was driven off the farm for lack of employment opportunities into the American cities, where frequently they became the unemployed, the welfare recipients, and frequently, the criminals, out of necessity or frustration.

There were no programs in Government to rehabilitate those displaced farmworkers. Thus, a glaring disparity has been created in the support programs fostered by the Federal Government for the agricultural entrepreneuer. There are many such disparities in the evolution of the American industrial system. It seems unnecessary to delineate them here: I mention them only as a frame of reference for the observations which follow.

The remarks which follow espouse the thesis that it is in the national interest to bring the minority population fully into the productive machine of the American economy.

By "fully," I mean both the labor force and the business enterprise levels. The alternative, in my view, is the prospect of an ever-increasing and debilitating "drag" on the productivity and viability of the American economy. To treat one of these sectors of American life without similar attention to the other is not unlike a physician who prescribes a single vitamin to a patient who is suffering from a multiple vitamin deficiency. For it is well documented that traditional minority business still depends largely upon minority markets for their sales.

This should and is changing, but it is still largely true in the current social and economic environment.

The brief analysis which follows, will focus on the following factors: The environment within which minority enterprise must develop; the current stage of development of minority enterprise; the key constraints to minority enterprise, some evidence that minority enterprise can make a contribution to the American economy, given an opportunity; and several recommendations which in my opinion could facilitate the development of minority enterprise in the American economy.

Let's look at the environment. It is my view that minority enterprise, to be successful, must be fundamentally sound business on par with the competition within the industry of which it is a part. It must be, coincidentally, minority owned and managed. Its markets may include the minority population, but for long-range growth and development, it should consciously cultivate the general American market.

Now, under this premise, on matters of sound business, minority business must be indistinguishable from businesses generally, except in its ownership and control.

With this as a frame of reference, what is the environment within which minority enterprise must develop? At the risk of oversimplification, with one notable exception, it is the same as that for other businesses. Unfortunately, that notable exception has been the major deterrent to the orderly development of minority business in this country, in my opinion, and until we address it effectively, business success by minorities in this country will continue to be exceptions rather than the rule in the predictable future.

This exception manifests itself in a number of specific ways, which I will talk about briefly later, but basically, the key deterrent to minority business development in this country, in my opinion, is unyielding individual and institutional racism.

Given this assessment, what is the current profile of minority business in this country? As of 1972—the latest statistics available—the vast majority, or 94 percent, of minority enterprises, were sole proprietorships doing business largely in the retail and service industries. There were about 382,000 minority firms in the country by the end of 1972, generating about $17 billion in sales, or less than 2 percent of the sales of all the businesses in the United States. Only 16 percent of those businesses had paid employees; and the average number of employees was six.

The average sales for these businesses was $160,000 annually.

Now, let us look at the constraints. These statistics provide dramatic evidence that minority enterprise is not yet American enterprise, nor is it moving rapidly in that direction. As implied earlier in this brief analysis, the environment for minority enterprise is basically hostile. On a more concrete level, the barriers to entry into most industries are formidable.

Venture capital is almost nonexistent, and access to viable markets is the exception rather than the rule. With these fundamental criteria for success in business out of the reach of minorities in this country, is it any wonder that minority enterprise continues to languish on the periphery of the American enterprise system?

Now, as set forth above, it is not only important to examine the minority businesses themselves; it is equally important to examine the markets which, at least historically, have been the primary source of their sales. I refer specifically to what is happening to minorities in the U.S. jobs market.

Jobs are important in this context, not only as a means of creating viable markets for the goods and services of minority enterprise, but also as a means of generating meaningful experience and accumulating the necessary "nest egg" as a precedent to entering business.

In this context, what has happened to minorities in the jobs market in the past, and what is the prognosis for the predictable future?

To begin with, there is a fundamental, profound, and far-reaching change taking place in the structure of the U.S. labor market. This change involves the revolutionary participation rates of women in the labor force; as will be dramatically evident below, the principal victim of the increased participation of women in the labor force has been black men. Given the performance of the American economy and current public policy with respect to labor force participation, this was a predictable phenomenon, and was in fact, implicitly predicted in testimony before this committee several years ago by Lester Thurow, a well-known MIT economist.

Mr. Thurow stated in his testimony that "there is no way to employ more women into the labor force without unemploying more men," and he asked rhetorically "which men are to be thrown out of work to achieve work parity?"

Let's break down the labor force and examine this labor force participation by race and sex. During the 40-year period ending in 1979, black women increased their labor force participation by 32 percent, to a level of 50 percent, from 38 percent in 1940. White women, on the other hand, increased their labor participation by 104 percent during this same period, or from 24 percent in 1940 to 49 percent in 1979.[1]

Significantly, both white and black men decreased in the labor force during this period. White men decreased from 79 percent in 1940 to 72 percent in 1979; black men decreased more than twice as fast as white men in the labor force, dropping from 80 percent in 1940 to 63 percent in 1979.

It is clear from these statistics that Mr. Thurow was right in his prediction. The American economic system in recent years has elected to hire white women by a margin of 3 to 1 over black women, and by 5 to 1 over black men.

Clearly, black men are increasingly deprived of the opportunity to earn an honest living and to get the necessary experience so vital to business success in our society.

Now, what are the constraints to minority business? In spite of these formidable constraints, let's look at what minority business has achieved. There is recent and visible evidence that if given a chance, minorities can make a contribution to the business enterprise system in the United States.

For example, the top 100 black firms in the United States are significantly different than the traditional minority enterprise in the United States. Instead of $160,000 average annual sales, these firms generated an average of $9.2 million in sales per year. Instead of the average 6 employees, these firms average 124 employees, with total employees in some firms ranging up to 1,000 persons.[2]

Similarly, the top 10 minority firms averaged $23 million in annual sales, with average employees of 135. These firms are significant in two ways: Most are not more than 10 years old, and vary significantly from the industry profile of traditional minority enterprises.

Now, from these statistics, one can derive several conclusions: One, that minority enterprise has been systematically kept on the periphery of the American enterprise system; two, black men are increasingly being driven out or not allowed to enter the labor force, resulting in less viable markets for traditional minority enterprise, and less opportunity for meaningful experience for potential businessmen; three, there is evidence that, given a chance, minorities can develop viable business enterprises and become major employers.

If we are to make successful minority enterprise the rule rather than the exception, I would commend to you—this committee—several recommendations, which are neither profound, novel, or revolutionary in concept, but rather, they embrace the tried and true fundamentals of business success that made the American enterprise system what it is today. While these recommendations are not new, they require a new resolve that unfortunately has been lacking in the past, both in public and private sectors of the American economy.

It is this resolve that I would most fervently urge upon this committee as the only means of affecting change in the growth and development of minority enterprise.

Now, I have three recommendations which I would like to commend to this committee: To address the problem of racism, I would propose a Presidential commission, much like the Kerner Commission that

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[1] See table I, p. 52.
[2] See table II, p. 53.

would be empowered to assess the impact of racism on minority enterprise and the concomitant problem of diminution of black men in the labor force, and to make recommendations as to how it can be effectively neutralized.

This Commission could have a continuing responsibility of interfacing between the public and the private sectors, with respect to the development of minority enterprise into the American enterprise system. Such a Commission could be comprised of opinion leaders in business, education, labor, and the public sector.

The Commission could be required to make a report on their findings to the President and the Congress within 6 months following its creation, and to make annual reports of their progress.

This clearly is the most difficult of the problems of minority enterprise and it will yield the most grudgingly, in my opinion. But, in my view, there will be little change in the status of minority enterprise until this problem is effectively addressed.

The second recommendation is to address the obvious problem of lack of capital. I would recommend that the Federal Government create a capital infusion program geared to the problems of minority enterprise. This fund should have an initial capital fund of $1 billion, which should be used exclusively for equity capital and management and technical assistance. With adequate equity and management talent, most firms can attract debt from the private sector.

Now, the third and final recommendation: To address the market access problem, which in my view is one of the most important, I would recommend that the committee consider a tax-expenditure program that would provide a tax incentive for white Americans to sell their firms to minorities at such time as they are ready to sell them.

In this regard, thousands of firms change hands every year. This would be the most direct and risk-proof way to provide market access for minority enterprise while benefiting the sellers, and ultimately, the job rolls of this country for minorities.

Such a tax expenditure is already in limited use by the FCC; it is thus not new in concept. Such an incentive, to be effective, in my view, should provide about 15 to 20 percent less cash than would otherwise be paid under normal conditions for the seller. Since tax expenditures have long been in extensive use to achieve economic objectives in the American economy, this would not be a precedent if it were used for the first time in history to benefit minorities.

Thank you, Congressman Mitchell.

[The tables attached to Mr. Irons' statement, together with his prepared statement, follow:]

TABLE I.—LABOR FORCE PARTICIPATION BY RACE AND SEX

[Percent]

Sex and race	1940	1980 [1]	Percent change
Black men	80	63	(21)
White men	79	72	(9)
White women	24	49	+104
Black women	38	50	+32

[1] Figures were available through 1978. The 1980 figure is extrapolated utilizing the trend through 1978.

Source: Social and Economic Status of the Black Population of the United States. Special Studies Series P-23, No. 89, table 42, p. 65. U.S. Department of Commerce, 1978.

TABLE II.—TOP 100 FIRMS—BLACK FIRMS IN THE UNITED STATES, BY INDUSTRY, 1979

Classification	Firms	Number of employees	Percent	Sales (dollars)	Percent	Average number of employees	Sales (dollars)
Manufacturers	14	2,555	20.5	$129,546	14.1	183	$9.3
Wholesalers	18	1,338	10.7	207,783	22.6	74	11.5
Retail:							
1. Auto	39	1,410	11.3	255,181	27.7	36	6.5
2. Other	9	2,321	18.6	59,474	6.5	258	6.6
Construction	8	767	6.1	87.299	9.5	96	10.9
Service	4	2,395	19.2	26,727	2.9	599	6.7
Broadcast	3	475	3.8	71,742	7.8	158	23.9
Publishers	5	1,222	9.8	83,506	9.1	244	16.7
Total	100	12,483	100.0	921,258	100.0		
Average				9.2		124	

Source: Black Enterprise, July 1979.

TABLE III.—ANALYSIS OF TOP 10 BLACK FIRMS IN THE UNITED STATES, 1979

Industry	Number of firms	Number of employees	Percent	Sales (dollars)	Percent
Construction	1	150	18.8	$32,000	14.1
Retail:					
1. Auto	2	171	21.4	35,800	15.7
2. Other	1	550	68.8	48,000	21.1
Manufacturers	1	101	12.6	11,324	5.0
Service	2	300	37.5	58,000	25.5
Wholesalers	3	78	9.8	42,500	18.6
Total	10	1,350	100.0	227.624	100.0
Average		135		22.7	

Source: Black Enterprise, July 1979.

Prepared Statement of Edward D. Irons

BUILDING MINORITY ENTERPRISE INTO THE AMERICAN ENTERPRISE SYSTEM

Introduction

May I thank this committee for permitting me to share my views with it, with respect to the issue of economic disparities in the American economy. While you have asked me to focus on the disparities with respect to minority enterprise, I am fully aware that frequently, disparity on one hand and preferential advantage on the other hand are opposite sides of the same coin. Moreover, the subject of these disparities is not limited to minorities. With respect to unemployment, for example, it is my view that if all minorities in the U.S. were replaced by newly immigrated Europeans next month, we would still have the same number of unemployed people in America as we have today.

The distribution of the unemployment would be free of racism, as we know it today, but the number would be the same. And by mid-1980, in my view, that unemployment rate is likely to be at about 9 percent. It is not uncommon in the annals of the development history of the U.S. economy that when one industry or sector of the American economy, benefits from special considerations of the American Government, that other sectors of the economy are negatively impacted by such treatment. For example, there is a body of evidence that suggests that without Federal Government support systems, the agricultural sector of this country would still be relegated largely to the proverbial 100 acres and the mule. However, with the advent of a comprehensive program and technical assistance, together with capital for land, equipment and operating expenses, as well as price supports for their products, the agricultural sector of this country was transformed into the world's most efficient food producing machine with only three percent of today's population producing the food for the other 97 percent and with a significant portion of that food production being exported to foreign countries. Thus, the U.S. Government fostered a "fail-safe" agricultural sector. On the other side of that coin, the agricultural work force was driven off the farm for lack of employment opportunities to the American cities, where frequently they became the unemployed, the welfare recipients and frequently the criminals, out of necessity or frustration. There were no programs in government to rehabilitate these displaced farm workers. Thus, a glaring disparity had been created in the support programs fostered by the Federal Government for the agricultural entrepreneur. There are many such disparities in the evolution of the American industrial system. It seems unnecessary to delineate them here. I mention them only as a frame of reference for the observations which follow.

The remarks which follow, espouse the thesis that it is in the national interest to bring the minority population fully into the productive machine of the American economy. By fully, I mean both the labor force and the business enterprise levels. The alternative, in my view, is the prospect of an ever increasing and debilitating "drag" on the productivity and viability of the American economy. To treat one of these sectors of American life without similar attention to the other, is not unlike a physician who prescribes a single vitamin to a patient who is suffering from multi-vitamin deficiency. For it is well documented that traditional minority business still depends largely upon minority markets for their sales. This should and is changing, but is still largely true in the current social and economic environment.

The analysis which follows will focus briefly on the following factors: (1) The environment within which minority enterprise must develop; (2) the current stage of development of minority enterprise; (3) the key constraints to minority enterprise; (4) some evidence that minority enterprise can make a contribution to the American economy, given an opportunity; and (5) several recommendations which in my opinion, could facilitate the development of minority enterprise in the American economy.

The environment

It is my view that minority enterprise, to be successful, must be fundamentally sound business, on par with the competition within the industry of which it is a part. It must be, coincidentally, minority owned and managed. Its markets may include the minority population, but for long-range growth and development, it should consciously cultivate the general American market.

Now, with this premise, on matters of sound business, minority business must be indistinguishable from business generally, except in its ownership and control. With this as a frame of reference, what is the environment within which minority enterprise must develop? At the risk of oversimplification, with one notable exception, it is the same as that for other businesses. Unfortunately, that notable exception has been the major deterrent to the orderly development of minority business in this country, in my opinion, and until we address it effectively, business success by minorities in this country will continue to be exceptions rather than the rule in the predictable future. This exception manifests itself in a number of concrete and specific ways, which I will talk about later in this analysis, but basically the key deterrent to minority business development in my opinion, is unyielding individual and institutional racism.

THE CURRENT PROFILE OF MINORITY ENTERPRISE

Given this assessment, what is the current profile of minority business in this country? As of 1972, the latest statistics available, the vast majority, 94 percent, of minority enterprises were sole proprietorships doing business largely in the retail and service industries. There were about 382 thousand minority firms in the country by the end of 1972 which generated approximately $17 billion in sales, or less than two percent of sales of all busiesses in the U.S. Only sixteen percent of minority firms had paid employees by the end of 1972 with the average number of employees per firm being six. The average annual sales for the typical minority firm was $160 thousand.

THE KEY CONSTRAINTS TO MINORITY BUSINESS SUCCESS

The above statistics provide dramatic evidence that minority enterprise is not yet American enterprise, nor is it moving rapidly in that direction. As implied earlier in this brief analysis, the environment for minority enterprise is basically hostile. On a more concrete level, the barriers to entry into most industries are formidable. Venture capital is almost nonexistent and access to viable markets is the exception rather than the rule. With these fundamental criteria for success in business out of the reach of minorities in this country, is it any wonder that minority enterprise continues to languish on the periphery of the American enterprise system?

As set forth above, it is not only important to examine the minority businesses themselves, it is equally important to examine the markets which, at least historically, have been the primary source of their sales. I refer specifically to what is happening to minorities in the U.S. jobs market. Jobs are important in this context, not only as a means of creating viable markets for the goods and services of minority enterprise, but also, as a means of generating meaningful experience and accumulating the necessary "nest egg" as a precedent to entering the business.

In this context, what has happened to minorities in the jobs market in the past and what is the prognosis for the predictable future? To begin with, there is a fundamental, profound and far reaching change taking place in the structure of the U.S. labor force. This change involves the revolutionary participation rates of women in the labor force. As will be dramatically evident below, the principal victim of the increased participation of women in the labor force has been black men. This was a predictable phenonomen and was in fact implicitily predicted in testimony before this committee several years ago by Lester Thurow, a well known MIT economist. Mr. Thurow stated in his testimony that "There is no way to employ more women into the labor force without unemploying more men and he asked rhetorically which men are to be thrown out of work to achieve work parity?" Let's briefly examine Mr. Thurow's question. Over the last 28 years ended in 1978, the number of men in the labor force as a percentage of total labor force has dropped from 71 percent to 59 percent or by 17 percent. Women as a percentage of total labor force, have increased from 29 percent to 41 percent, for a 41 percent increase during this period. Another way of looking at this phenomenon is to examine the percentage of each sex as a percentage of that sex in the total population, that participates in the labor force. In this regard, in 1950 86 percent of all male civilians were in the labor force. By the end of 1978, only 78 percent of all males were in the labor force, a decrease of 9 percent during this period. Women, on the other hand, increase from 34 percent to 51 percent during this same period, for an increase of 50 percent.

Now let's examine labor force participation by race. During the 18 years ended 1978, white Americans increased their labor force participation from 54 percent to 59 percent, or by 9 percent during this period. Black Americans, on the other hand, decreased in participation from 55 percent to 53 percent, or by 4 percent during this period. Thus, while white Americans were increasing their labor force participation by 9 percent, black Americans decreased in the labor force by 4 percent, creating a 13 percent growth gap between the two groups in labor force participation, during this period. Now let's break down the labor force participation by race and sex.

During the 40 year period ending in 1979, black women increased their labor force participation by 32 percent, to a current level of 50 percent from 38 percent in 1940. White women, on the other hand, increased their labor force participation by 104 percent during this same period, or from 24 percent in 1940 to 49 percent in 1979. Significantly, both white and black men decreased in the labor force during this period. White men decreased from 79 percent in 1940 to 72 percent in 1979, or by 9 percent. Black men decreased more than twice as fast as white men in the labor force, dropping from 80 percent in 1940 to 63 percent in 1979 for a 21 percent decrease.

It is clear from the above that Mr. Thurow was right in his prediction. Clearly black men are being increasingly deprived of the opportunity to earn an honest living and to get the necessary experience so vital to business success.

SOME SUCCESSES IN SPITE OF CONSTRAINTS

In spite of the formidable constraints set forth above, there is recent and visible evidence that given a chance, minorities can make a contribution to the business enterprise system of the U.S. For example, the top 100 black firms in the United States are significantly different than the traditional minority enterprise in the U.S. Instead of $160 thousand average annual sales, these firms generated an average of $9.2 million in sales. Instead of average of six employees, these firms averaged 124 employees with total employees per firm ranging up to 1,000 persons. Similarly, the top ten minority firms averaged $23 million in annual sales with average number of employees of 135. (See table III, p. 53.) These firms are significant in two ways. Most are not more than ten years old and they vary significantly from the industry profile of traditional minority enterprise.

MAKING MINORITY ENTERPRISE VIABLE

From the above statistics one can derive several conclusions: (1) That minority enterprise has been systematically kept on the periphery of the American enterprise system; (2) that black men are increasingly being driven out or not allowed to enter the labor force resulting in less viable markets for traditional minority enterprise and less opportunities for meaningful experience for potential business men; and (3) there is evidence that given a chance, minorities can develop viable business enterprises and become major employers.

If we are to make successful minority enterprise the rule rather than the exception, I would commend to you the several recommendations, which are neither profound, novel or revolutionary in concept. But rather they embrace the tried and true fundamentals of business success that made the American enterprise system what it is today. While these recommendations are not new, they require a new resolve that unfortunately, has been lacking in the past, both in public and private sectors of the American economy. It is this resolve that I would most fervently urge upon this committee, as the only means of affecting change in the growth and development of minority enterprise.

Recommendation No. 1

To address the problem of racism, I would propose a Presidential commission that would be empowered to assess the impact of racism on minority enterprise and to make recommendations as to how it can be effectively neutralized. This commission could have a continuing responsibility of interfacing between the public and private sectors with respect to the development of minority enterprise into American enterprise. Such a commission could be comprised of opinion leaders in business, education, labor and the public sector. The commission could be required to make a report of their findings to the president and the congress within six months following its creation and to make annual reports of their progress. This clearly is the most difficult of the problems of minority enterprise and it will yield the most grudgingly. But in my view, there will be little change in the status of minority enterprise until this problem is effectively addressed.

Recommendation No. 2

To address the obvious problem of lack of capital, I would recommend that the Federal Government create a capital infusion program geared to the problems of minority enterprise. This fund should have an initial capital fund of $1 billion dollars which would be used exclusively for equity capital, and management and technical assistance. With adequate equity and management talent, most firms can attract debt from the private sector.

Recommendation No. 3

To address the market access problem of minority enterprise, I would recommend that the committee consider a tax expenditure program that would provide a tax incentive for white Americans to sell their firms to minorities at such time as they are ready to sell. In this regard, thousands of firms change hands every year. This would be the most direct and risk proof way to provide market access for minority enterprise while benefitting the seller. Such a tax expenditure is already in limited use by the Federal Communication Commission. It is thus not new in concept. Such an incentive, to be effective, should provide 15 to 20 percent less tax than would otherwise be paid under normal conditions. Since tax expenditures have long been in extensive use to achieve economic objectives in the American economy, this would not be a precedent if it were used for the first time in history to benefit minorities.

Thank you Mr. Chairman.

Representative MITCHELL. Thank you very much, Mr. Irons. As usual, you have made a very cogent and compelling statement with very specific recommendations.

Mr. IRONS. Thank you.

Representative MITCHELL. I turn to Senator Sarbanes. I am sure that he is under a tight schedule.

Senator SARBANES. I appreciate that, Congressman Mitchell. In fact, I have just been handed a message as you said that.

Gentlemen, I want to thank you for your testimony. Professor Irons, I heard all of yours, and Mr. Scott, I have looked through the reports of the study.

Congressman Mitchell, I simply want to say that I think these hearings that you are holding are very important and I certainly want to commend you for your leadership in focusing attention on this area, and for your efforts to develop some meaningful recommendations that we can move forward with.

I think, as the Congressman has underscored in his statement, there is a tremendous opportunity in terms of growth and economic development for the Nation to be drawn from the minority sector of our economy. These hearings, I think, will focus the requisite attention on it.

I think we can develop recommendations and, hopefully, see some of them implemented in the law.

I have worked very closely with Congressman Mitchell on these problems; I am very frank to say that I don't think we could have a better champion in the Congress with respect to the cause that is before us, and I hope you will excuse me for leaving.

I think you have some appreciation of the conflicting pressures that we operate under.

Thank you, Congressman Mitchell.

Representative MITCHELL. Thank you for coming, Senator. We are friends, and that friendship has grown even better. I want to publicly thank Senator Sarbanes for the enormously effective role he played in helping the State of Maryland to secure its first black Federal judge, Judge Joseph Howard. There's no doubt in my mind but, had it not been for your toughness, we would not have had a black Federal judge, and I can't thank you enough, and every opportunity that I get to publicly or privately praise you, I am going to do it.

Senator SARBANES. Thank you, Congressman.

Representative MITCHELL. I'll probably put the questions to both of you gentlemen, because my questions seem to overlap with reference to both of the testimonies.

Both of you have touched upon the matter of the effectiveness of minority businesses in addressing the problem of black unemployment.

Am I correct in assuming that, in general, the rule of thumb would be for every minority small business that's created, you have the potential for at least four employees at a minimum? Is that generally an acceptable rule of thumb?

Mr. IRONS. Well, the average nationally is six, at least it was in 1972. It may be a little better now, but that's the range.

Representative MITCHELL. Around six? Well, then, I guess I'm correct in assuming that there is a correlation between the lack of minority small businesses and the minority unemployment rate that has remained twice as high as the white race since the end of World War II.

For almost 35 years, the black rate of unemployment in this country, in both good times and bad times, has been twice as high as the white rate. At the same time you have that condition prevailing, you have the exclusion, or the virtual exclusion of minority businesses from adequate participation in the economic system.

So, both of you are suggesting that the more effective utilization of minority businesses, and the strengthening and increasing thereof, could become a potent weapon in reducing black unemployment.

Is that a correct assumption on my part?

Mr. IRONS. Yes. In reaction to that, Congressman, let me answer that first; I would not like us to base any potential job-generating activity on the part of minority businesses on the current average—national average of six per firm as a basis of assessing their potential.

If we would have taken the base of the agricultural sector when the average farm was 50 acres, or 100 acres per farm, and put a mathematical model in trying to extrapolate it into the future where we are today. We could not have predicted the current farm profile from that base. It would have been the most erroneous conclusion of a potential of the agricultural sector that you could ever imagined.

So, what we have to do is to start where we are at this point, as they did in the agricultural sector, and say there are so many inadequacies, that unless we totally restructure what we must do for these organizations, that we will continue to languish at the current level, which is clearly inadequate.

In my view, if we look at what is happening to the newer nontraditional minority-controlled firms, you get a better insight into what is possible. I would much more prefer to leave open ended the number of firms—number of jobs that can be generated. It certainly ought to be many more than six employees per firm.

If we look at the experience of what I call the new, success stories in the top 100, because they average over 160 per firm—and I say that's possible across the board if we would take a comprehensive approach at this time.

And I would like to commend to you an overall master plan that recognizes the current deficiencies rather than starting from a base of six as a means of trying to extrapolate that into the future.

Representative MITCHELL. Thank you.

Mr. Scott.

Mr. SCOTT. Yes, I have some comments on that also. There are two ways that one may envision the increased employment in the minority sector.

One would be through an increase in the size of the minority-owned firms, and the other would be proportional to the change in the labor-capital ratio; that is, the way the firms produce. There may be some suspicion that many of the minority firms are quite labor intensive, but my suspicions on that are drawn from some observations that minorities have more trouble in obtaining capital for assets, and therefore may rely on working people to accomplish things more than machines.

So if minority firms are in fact more labor intensive than capital intensive, that might have the effect of producing a greater employment.

Of course, the question might become, if these firms are in fact labor intensive, is this the kind of employment you really want to have anyway?

So I'm not so sure that the issue of employment from the standpoint of labor-intensive firms is what is called for. I sort of share Mr. Irons' ideas about getting minority firms into the nontraditional areas they have not been in, to larger firms that are in cleaner industry, that can have more professional type employment, more professional-type salaries.

Representative MITCHELL. I agree. I think that's the objective, and a highly desirable objective.

But we face another reality right now. With reference to that present reality, the present status of minority business, I want to pursue a thought that occurred to me.

It would be my hunch that save for your top 100 or 300 minority businesses, the vast majority of minority businesses depend upon minority consumers.

Mr. IRONS. That is correct.

Representative MITCHELL. Then to the extent and the degree that is correct, and we agree that it is, the policy that has been in effect for 35 years, of keeping blacks with a much higher rate of unemployment, seriously impacts on minority business. Therefore, you would see these minority businesses going in for larger loans, or making requests for larger loans. You would see them being more precarious, in terms of whether or not they survive or do not survive. From one perspective, having relatively little to do with their capability, their management or anything else, but because their consuming population is placed in a position so that it can only minimally consume, these businesses fail.

Mr. IRONS. Well, that's absolutely correct, I tried to make that point as a part of my analysis, looking at the businesses themselves, as well as their markets. It is clear that something must be done to change job access levels to minorities, and especially black men.

I made that point as dramatically as I could. The facts stand for themselves. These are not opinions—that black men, of all the population sectors, are being either kept out initially—and that's young men—or unemployed, for people who may have been in the labor force—at higher rates of exclusion than any other sector.

And I think this is a profound and fundamental problem that needs to be addressed both in relationship to minority enterprise problems and, in and of itself, I think that is a very significant problem that needs a kind of crisis attention. We can't allow it just to drag on, in my view.

Representative MITCHELL. You're so right. But, tragically, we are going to do just the opposite. What the budget contemplates for fiscal 1980 is an increase in unemployment. There are some economists who are predicting that unless some miraculous things take place in the economy, these are the more pessimistic, I must confess, but they are saying unless something happens, we are going to have a 9-percent rate of unemployment by September of 1980.

There is no doubt in my mind that an increase in unemployment is going to fall disproportionately on those who are already disproportionately unemployed.

I don't want to get carried away, but I just wish there was some way we could hammer this message into all the Members of Congress who have voted for a budget which anticipates an increase in unemployment and, obviously, will have a negative, a very seriously negative, impact on minority business.

Mr. IRONS. I think one way to address that, Congressman, as I testified several months ago on a similar question, and in that particular testimony I showed the magnitude of the transfer payments that were going to minorities as a result of their inability to pull their own weight in the economic system, and I showed that this increasing magnitude of transfer payments in our Federal budget is inflationary because it causes deficit spending. It builds a permanent class of people who have to be supported.

It would seem to me, if you look at that side of the budget itself, that it is in the national interest to make these people productive. It is shortsighted to say we've got to leave them unemployed to save money. The long-term benefit for this country is to make these people productive, and to spend the money today to make them productive tomorrow.

That continued transfer payment which everybody hates—everybody—nobody likes these escalating transfer payments, and my feeling is that that kind of burden is far in excess of the investment necessary to make these people productive.

I think that's the approach that we're going to have to take in trying to sell it; it's in the national interest. It just doesn't benefit minorities.

Representative MITCHELL. Thank you. Mr. Scott, you took a look at some 6,000 minority businesses?

Mr. SCOTT. Yes.

Representative MITCHELL. And these were all minority-owned businesses?

Mr. SCOTT. Approximately, yes. There were 6,000 business firms, 4,000 of which were minorities. The data sample has broken up approximately 2,000 minority firms that were not assisted by OMBE, 2,000 minority firms that were assisted by OMBE, and then 2,000 nonminority firms to form the basis of comparison.

Representative MITCHELL. Of the 4,000 minority firms assisted and nonassisted, were you able to indicate how many jobs those 4,000 firms generated? Did you speak to that at all?

Mr. SCOTT. These data that we have has some information pertinent to the number of jobs. I hoped to be able to look at it before I came up here, but it required some additional computing to do so. I'm a little bit concerned about the way these data are reported, because these data are reported in a number of employee categories rather than the actual number, so that I am not too sure of whether or not it would be meaningful.

Representative MITCHELL. Could you indicate what percentage of those minority firms, assisted and/or unassisted by OMBE, were family-run firms?

Mr. SCOTT. These data are not available. That's an important direction for future research, to know whether it's a sole proprietorship or other form of organization.

Representative MITCHELL. I was challenged by your testimony with regard to bank loans made available to minority businesses. It seems to me to fly right in the face of the overwhelming deluge of complaints that I get as a member of the Small Business Committee. It is difficult for minorities to get a loan. Even with a 90-percent guarantee, I have received so many complaints on this, I was forced 2 months ago to meet with Mr. Weaver to ask him to do a study on bank participation vis-a-vis minorities.

But your testimony would say that these complaints are not very valid; is that correct?

Mr. SCOTT. I don't think I would make my testimony that strong. This particular research, due to the nature of the sample, identifies the lending circumstances of a special category of minority firms. We have to remember that we are dealing with Dun & Bradstreet data, and the very reason a firm would seem to want to be in Dun & Bradstreet is that the firm has some desire to be creditworthy, and thinks that it is creditworthy, and perhaps already has some contacts toward the borrowing and lending decision. So that we may not be seeing in our sample the same firms that you are hearing from.

There is something interesting in our sample, and that is the suggestion that nonminority firms are able, more so, to borrow or size up their loans based upon profitability and expectation of future profit. It seems that in our data sample, that profitability does not size loans up for minorities as it does for nonminorities.

Representative MITCHELL. What does? What is the factor there that does?

Mr. SCOTT. Well, it seems to me that this is an interpretation of these data that are not qualified by the sort of research that would be necessary to answer this question precisely. But, I think it's interesting to try to find out whether or not the size of a loan to a minority firm is basically limited to collateral values and outside guarantees, like SBA's. Whereas for nonminority firms, there is a hint and a suggestion that those firms would be better able to have their loan sizes increased above collateral and outside guarantees on the basis of expected future cashflow from profits, to pay the loan back.

If this is true, it may indicate that the traditional private lenders—in this case bankers—are more reluctant to loan to minorities based upon future cashflow. It may not necessarily indicate discrimination. My own personal feeling or speculation is that it may indicate that if bankers see lending to minorities as more costly in terms of monitoring the loan, and they are not accustomed to dealing with minority firms, minority firms appear as risks to them, whether or not that should be the case. And, as a result, they prefer to make loans based upon collateral, and perhaps be more reluctant to make loans on future cashflow.

Representative MITCHELL. This is your area of expertise.

Mr. IRONS. Yes. I want to ask Mr. Scott a question on that, Congressman, if I may.

In drawing your conclusions on availability of loans to minorities, what was the basis of your inference? Did you have a direct question to these firms, asking them their experience, or did you have to infer from information on the financial statements, or what did you base it on?

Mr. SCOTT. I had to infer from information on the financial statement. What I did is have the computer select firms that had received a bank loan, regardless of the size, and then I looked at the incidence of reported bank loans.

Mr. IRONS. Well, I would, as you did, clearly have to qualify that kind of conclusion at this stage of the research as not definitive.

Mr. SCOTT. That's correct. In fact, in my research text, I indicated that these are reported loans, and this must be taken in light of the sample; and the Dun & Bradstreet sample would seem to me to prejudice this result and bias this result.

Representative MITCHELL. I would suspect, if we look at minority firms using a different procedure to select those firms, rather than Dun & Bradstreet, that the incidence of loans was less.

Mr. SCOTT. I'm not that at home with this finding in terms of being able to generalize it, and I wouldn't want to do so.

Representative MITCHELL. I would assume that the incidence would be lower and that the dollar volume would be significantly lower.

Mr. SCOTT. There is one thing I might add. One reason we might find that the incidence is higher, is that many of these loans probably carry SBA guarantees. So if you were to look at the requested bank loans by firms that would not ever see Dun & Bradstreet, and by firms that do not perceive themselves to be able to obtain an SBA guarantee for the bank, you might find a different circumstance.

Representative MITCHELL. Before pursuing my line of questioning, I'm going to do something rather unusual. This hearing will be published and, of course, distributed to all the members of the Small Business Committee and Members of Congress.

But I think it would be very appropriate if I could get permission from both of you gentlemen to insert your testimony into the Congressional Record as quickly as possible.

I am asking for that permission because, if you have been following the papers, you know that once again the attacks are being mounted against minority businesses and the Federal efforts to assist these businesses. I think your very positive statements would help to bring some sanity to the situation. Is sanity the word?

Mr. IRONS. Sensitivity; is that the word?

Representative MITCHELL. Some sanity into the whole business of just constantly attacking the Federal efforts to support minority business.

If I have your permission, I would like to submit that into the Congressional Record right after we get back from the Thanksgiving holiday. Is that all right?

Mr. SCOTT. Fine.

Mr. IRONS. I would be delighted to have that. I have some editorial work to do on my prepared statement which I would like to do before having it submitted.

In fact, I might have some supporting data which I just couldn't get.

Mr. SCOTT. I would follow Mr. Irons in that also. We did the typing on this rather quickly, so I think I would like to edit it.

Representative MITCHELL. Fine. If you will edit it, and then get them to me as quickly as possible, I'd appreciate it.

We are caught up in an unstated but ever-present policy conflict in Government right now with regard to minority business. On the one side there are those who would take the position that future efforts on the part of the Federal Government to help minority businesses should be predominantly or overwhelmingly geared toward strengthening and making more viable existing minority businesses in effect suggesting that we reduce the number of new minority business starts.

Obviously, there is the other position to be taken. We are woefully short in terms of minority business participation and it would be unwise to curtail new minority business starts, basically using Federal funds and Federal assistance.

Could I get both of you to comment? This is an issue that doesn't hit the press, but it has been raised on Capitol Hill for the last 18 months.

The question is: What posture should the Federal Government take?

Mr. IRONS. Congressman, I have given considerable thought to that particular issue, and I come out on the side of providing assistance to keep the new entry channels wide open. That's the conventional wisdom for the whole American economy. We cannot keep the economy viable by closing out new entries; why should we debate whether or not minority business entries ought to be essentially curtailed?

It just doesn't support the conventional wisdom in economic planning for the total system. If you look at the experience of the most successful businesses in the minority community, most of the success stories are less than 10 years old. If you proceed on the assumption that we should have put this policy into effect 15 years ago, 12 years ago, the success stories that we are able to crow about right now would not be in existence.

So I think, in the strongest possible terms that in no way should we gear our efforts to sustain the few that have made it through the gates at this point; that the system should be totally open for new entries to come in in a wide cross section of the entry classifications of this country, because we are still—minorities are still infinitesimally represented in the various classifications of the American industry, and to stop it now, in my view, would be a major mistake.

Representative MITCHELL. Mr. Scott.

Mr. SCOTT. I agree. I thought about this also. One thing that has been alleged about the minority business sector is that there is a concentration of minority firms in those industries that are alleged to have lower profit margins and overcompetition.

Mr. IRONS. And with little future.

Mr. SCOTT. And with little future. If that's the case, then I don't know that we would want to encourage entry of minority firms into those particular industries. But I do think we want to encourage the entry of minority firms into newer types of industries—manufacturing sector, et cetera.

One thing that I think may be showing up in my data is something that's been held by economists for a long time, and that is this thing of the "survivor principle"—that once a business firm is able to survive its critical years, and once that business firm is in fact on its own, then presumably that business firm's growth and what will happen to the firm would largely follow the demands of its market.

To me, Government's policy should look at new entrants and try to see if there is in fact a market for these new entrants where there would not be overcrowding.

With the energy crisis I suspect that there may be some movement toward a more appropriate type technology in smaller firms and a lower technological base. There also may be room for new, small firms to develop new energy-related products.

And so I agree with Professor Irons.

I agree, it's just ludicrous to stifle new entries into the marketplace.

My problem is, though I agree that new entries ought to be new nontraditional businesses that minorities have heretofore not been engaged in, you then run into the problem of access to capital.

If you start a grocery store or a liquor store where you require minimum capital, as opposed to a startup in an industrial sector you are confronted with a catch-22 situation. You really want minority businesses to break out of the traditional areas, we all agree to that; yet at the same time we have not been able to even dent the problem of access to venture capital and/or equity capital.

So my feeling would be that you almost have to solve the latter part of the problem first, before you would encourage a number of businesses to start in a new nontraditional area.

Mr. IRONS. This was the basis of my recommendation of the tax incentive. Thousands of people sell their businesses annually, for a number of reasons. Some of them are at retirement age, and some of them decide to go into other businesses—corporate spinoffs and things of that sort.

There are just literally thousands of them across the whole spectrum of American industry every year, and these leverage buyouts are usually financed by banks.

When a cashflow has been established for 15, 20, 25 years, you can predict it into the future for 10 years without any difficulty and, very frequently, businesses are bought on a leverage buyout with 100-percent borrowed money because the cashflow is predictable.

You see, that's different from a startup.

So all I'm simply saying, given that premise, is that there is little risk in buying a company that's 25 years old, that's already got a predictable cashflow and market in place. Therefore it would seem to me if the Federal Government decided it wanted to facilitate this, the tax incentive is the way to do it, and in my view, would minimize the risk involved, while getting minorities into all of these industries.

Representative MITCHELL. Someone would believe that we rehearsed this scenario. I wanted to move right into your recommendations, and you've gone into them.

Mr. Irons, you and I are generally together on most issues. I had some concerns about the creation of a commission because I am not enthralled by the idea of another commission that doesn't have power. Apparently what you are suggesting is a commission that studies and makes recommendations and does all sorts of good things. But, it wouldn't have the power, really, to implement any of those recommendations—I feel we need a commission that is comparable to some sort of regulatory commission, having the power to say: "OK, here's a fine thing, here's what needs to be done; now let's get it done."

Mr. IRONS. Well, now, I hadn't gone that far, and clearly I am openminded to modification of this kind of commission, but my intention was to focus as much attention as we can on the nature of the problem in objective terms.

It's all right for me to say, as a black man, that there's racism out there, and therefore that keeps black men out of the labor force, or that keeps black businesses from getting loans, because, you know, I'm on one side of the coin, so to speak.

What I think is needed is an objective committee that would have Presidential power and could respond to the moral leadership that's required to change this. Laws can't change attitudes; it takes a moral leadership of the Chief Executive, and key leaders of Congress to make something like this work, and so it was in this vein that I thought that something like this would make a contribution.

But I would not be averse to some powers that could also implement some of the recommendations. I had not gone that far in my initial thought process.

Representative MITCHELL. Without thinking on that a little bit more, I feel very frustrated. I've got an office full of reports from various commissions—commissions on youth, employment, and aging. All of it is good, helpful data with good recommendations. However, they do not move and I just am disenchanted with commissions that don't have powers.

Mr. IRONS. Of course, the tradeoff you have in creating a commission that has some implementation or regulatory power is that it may overlap responsibility spectrums of existing Government agencies. That's what I worried about and I did not quite know how to structure that in.

Creating a new agency, I think, might get more resistance than if we gave them the power to bring their national opinion power on an issue and then get the President to say: "Let's do this." This is the scenario that I have in mind for the commission up to this point.

Representative MITCHELL. I understand.

Gentlemen, this has been extremely helpful to me, and I am certain, as the other members of the full committee read this hearing, it will be helpful to them. I must say that I think the vast majority of the members of the House Small Business Committee have a commitment to minority business.

I really, in all candor, must say that our problem arises when we get to the floor with 434 other Members, and I would be less than candid if I did not say that I don't think that the same enthusiasm exists in the full House of Representatives.

Thank you very much. This has been instructive and helpful, and I am very appreciative, and we managed to get through without my having to run out for the second time. This is the adoption of the conference report on the military construction appropriations; don't ask me how I will vote on that.

Mr. IRONS. Thank you very much, Congressman.

Mr. SCOTT. Thank you, Congressman.

[Whereupon, at 11:25 a.m., the committee adjourned, subject to the call of the Chair.]

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