Perspectives on Minority Business Development
Tuesday, April 20, 4:00-8:45 p.m. EDT

Session 2: Perspectives of a Leading Economist on Inequality
4:45 - 5:15 p.m. EDT

Discussion Leader: Barry W. Ickes, Professor of Economics and Head, Department of Economics, Penn State

Presenter: Robert Fairlie, Professor of Economics, University of California, Santa Cruz

Event Co-Chairs:

Samuel C. Thompson Jr.
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# Materials for: Session 2: Perspective of a Leading Economist on Inequality

**Discussion Leader:** Barry W. Ickes, Professor of Economics and Head, Department of Economics, Penn State  
**Presenter:** Robert Fairlie, Professor of Economics, University of California, Santa Cruz

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<td>DOC. 02B, <em>Did the $660 Billion Paycheck Protection Program and $220 Billion Economic Injury Disaster Loan Program Get Disbursed to Minority Communities in the Early Stages of COVID-19?</em>, Robert Fairlie and Frank M. Fos sen (December 2020)</td>
<td>2-15 through 2-38</td>
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<td>DOC. 02E, <em>Financing Minority Entrepreneurship</em>, Carlos Berdejo, JD, Harvard Law, PhD. Economics Harvard, Professor Loyola Law School, L.A, 2021 Wis. L. Rev. (Forthcoming). Professor Berdejo discussed his article in the second hour of the fourth class, and the recording of his discussion is available on the website for the course. Also, three slide presentations on the article, prepared by students, are included in the materials for that session.</td>
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**Session 2: Biographies**

2-i
The impact of COVID-19 on small business owners: Evidence from the first 3 months after widespread social-distancing restrictions

Robert Fairlie

Abstract

Social-distancing restrictions and health- and economic-driven demand shifts from COVID-19 are expected to shutter many small businesses and entrepreneurial ventures, but there is very little early evidence on impacts. This paper provides the first analysis of impacts of the pandemic on the number of active small businesses in the United States using nationally representative data from the April 2020 Current Population Survey—the first month fully capturing early effects. The number of active business owners in the United States plummeted by 3.3 million or 22% over the crucial 2-month window from February to April 2020. The drop in active business owners was the largest on record, and losses to business activity were felt across nearly all industries. African-American businesses were hit especially hard experiencing a 41% drop in business activity. Latinx business owner activity fell by 32%, and Asian business owner activity dropped by 26%. Simulations indicate that industry compositions partly placed these groups at a higher risk of business activity losses. Immigrant business owners experienced substantial losses in business activity of 36%. Female business owners were also disproportionately affected (25% drop in business activity). Continuing the analysis in May and June, the number of active business owners remained low—down by 15% and 8%, respectively. The continued losses in May and June, and partial rebounds from April were felt across all demographic groups and most industries. These findings of early-stage losses to small business activity have important implications for policy, income losses, and future economic inequality.

1 | INTRODUCTION

The widespread closing of stores and businesses in the United States and around the world due to the coronavirus is unprecedented. Stores, factories, and many other businesses have closed by policy mandate, downward demand shifts, health concerns, or other factors. Many of these closures may be permanent because of the inability of owners to pay ongoing expenses and survive the shutdown. The impact on small businesses around the world is likely to be severe.

The early effects of COVID-19 on small business and entrepreneurs are not well known because of the lack of timely business-level data released by the government. This paper addresses this limitation by creating estimates of the number of business owners from monthly Current Population Survey (CPS) microdata files. Using these timely data,
I examine how COVID-19 impacted small business owners in mid-April 2020—the first month to capture the widespread shelter-in-place restrictions in the United States. I then expand the analysis to include the next 2 months as many states that had restrictions started to relax those restrictions.

The CPS data are used by the Bureau of Labor Statistics (BLS) to track unemployment rates, and have been used in previous research to study determinants of business ownership (e.g., recently, Fairlie & Fossen, 2019; Levine & Rubenstein, 2017; Wang, 2019). The CPS captures the current work activity of the business owner, and whether that business owner is currently operating the business. Thus, the number of active business owners can be captured in the data, but there is no way of telling whether these are temporary or permanent business closures. Many of the inactive business owners, however, are likely to permanently close their businesses especially if the COVID-19 induced recession is prolonged. Even temporary closures caused by the pandemic are problematic because they reflect income losses to business owners in those inactive months.

This study provides the first estimates of the early-stage effects of COVID-19 on small business owners from April 2020 CPS microdata.

1 I find that the number of working business owners plummeted from 15.0 million in February 2020 to 11.7 million in April 2020 because of COVID-19 mandates and health- and economic-driven demand shifts. The loss of 3.3 million active business owners (or 22%) was the largest drop on record. When conditioning on working roughly 2 or 4 days/week, the losses are even larger (28% and 31%, respectively). Total hours worked by all business owners dropped by 29%. Although incorporated businesses are more growth-oriented and stable, they experienced a drop of 20% from February to April 2020.

Patterns across gender, race, and immigrant status reveal alarming findings. African-Americans experienced the largest losses, eliminating 41% of active business owners. Latinx also experienced major losses with 32% of business owners halting activity between February and April 2020. Immigrant business owners suffered a large drop of 36% in business activity, and female business owners suffered a disproportionate drop of 25%.

Building on these findings, this paper extends the analysis of COVID-19 impacts into the second and third months following widespread shelter-in-place restrictions across the country—May and June 2020. The analysis answers the question of whether there was further closing of small businesses or instead a partial rebound as small business owners tried to reopen or partially reopen. The findings indicate that there was a partial rebound from April 2020 numbers in May and an additional rebound in June. The number of active business owners bounced back by 7 percentage points resulting in a 15% drop in business activity from February to May 2020, and an additional 5 percentage points rebound in June resulting in an 8% drop in business activity from February to June 2020.

Patterns across gender, race, and immigrant status reveal that the disproportionate impacts from COVID-19 lingered into May and June. African-Americans continued to experience the largest losses, eliminating 26% of active business owners in May and 19% in June. Latinx also experienced major losses with 19% of business owners inactive in May and 10% inactive in June. Immigrant business owners suffered a large drop in business activity of 25% in May and 18% in June.

Most major industries faced large drops in the number of active business owners in April with the only exception being agriculture. Construction, restaurants, hotels, transportation, and personal/laundry services all faced large declines in the number of active business owners due to COVID-19. Simulations reveal that the concentrations of female, black, Latinx, and Asian businesses in industries hit hard by the pandemic contributed to why losses in business activity were higher for these groups than the national average loss in April. May and June brought a partial rebound for most industries.

Overall, these first estimates of impacts of COVID-19 on small businesses from the April 2020 CPS indicate that losses were spread across demographic groups and types of business—no group was immune to negative impacts of social-distancing policy mandates and demand shifts. But, they also reveal a partial bounce back for all groups. Although there is no way to know at this time if these business closures will be permanent each month of inactivity has an impact on the revenues, profits, and employees of these businesses.

These results build on the findings from a few related studies of the early effects of the coronavirus on small businesses in the United States.1 Employer business applications as measured by the U.S. Census weekly Business

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1The findings for April 2020 were initially released as a working paper in early May (Fairlie, 2020) and were covered widely in the press and news (e.g., Washington Post, NY Times, WSJ, PBS, CNBC, and BBC). The findings were also used in testimony to the U.S. Senate (Evans, 2020), Busby (2020), a new Senate Bill (U.S. Senate, 2020), arguments for the shop at black-owned businesses movement, and other policies.

2Estimates for Canada show a decrease in business ownership between February 2020 and May 2020 of 15% and 10% for incorporated and unincorporated businesses, respectively (Beland, Fakorede, & Mikola, 2020).
Formation Statistics (BFS) fell in the 5 weeks from mid-March to mid-April by over 27% relative to the previous year (Wilmoth, 2020). Examining more recent data from the BFS there is some evidence of a bounce back, but weekly estimates show a lot of variation (U.S. Census Bureau, 2020). Estimates from the weekly U.S. Census Small Business Pulse Survey indicate that roughly 50% of businesses report having a large negative effect from the COVID-19 pandemic and that only 15%–20% of businesses have enough cash on hand to cover 3 months of operations (Bohn, Mejia, & Lafortune, 2020; U.S. Census Bureau, 2020). Another weekly survey indicates that decreased demand is more problematic than supply factors, such as accessing materials and goods (Desai & Looze, 2020). Bartik et al. (2020) conducted a survey in late March of nearly 6,000 small businesses that were members of the Alignable business network. They find that 43% of businesses is temporarily closed, large reductions in employees, and the majority of businesses has <1 month of cash on hand. The Stanford Latino Entrepreneurship Initiative (2020) surveyed 224 high-revenue Latinx-owned businesses and found that 86% of respondents reported immediate negative effects, such as delayed projects and closure from the pandemic. This paper builds on the previous work by focusing on early-stage effects in April–June using CPS data, and by exploring differential effects for female, minority, and immigrant business owners, which is potentially important for targeting government aid to preserve small businesses and the jobs they create.3

2 | DATA

2.1 | Current Population Survey

Although research on small businesses and entrepreneurship is growing rapidly, there are very few national data sets that provide information on ownership with additional information on demographic characteristics of the owners. Using microdata from the basic monthly files of the CPSs, I measure self-employed business ownership at the individual owner level. These surveys, conducted monthly by the US Bureau of the Census and the US BLS, are representative of the entire US population and contain observations for more than 130,000 people.

The CPS has been conducted monthly since 1940 and is the underlying source of official government statistics on employment and unemployment. Data are collected by personal interviews. The data cover all persons in the civilian noninstitutionalized population of the United States living in households. The CPS is the only source of monthly estimates of employment, self-employed persons, wage and salary employees, and unemployment. Although the main purpose of the CPS is to collect information on the employment situation, a secondary purpose is to collect information on the demographics of the population.

Measures of business ownership are available from only a handful of other large, nationally representative government data sets, such as the Survey of Business Owners (SBO), Census PUMS files, and the American Community Survey (ACS). Measures of business ownership based on these cross-sectional data, however, cannot capture recent patterns because there is often a 1–2-year delay in release. The CPS releases microdata within a month of the survey week.

To estimate business ownership in the CPS data, I identify all individuals who own a business as their main job in the survey month (based on the class of worker question and monthly labor force recode). The main job is defined as the one with the most hours worked during the survey week. Thus, individuals who start side businesses will not be counted if they are working more hours on a wage and salary job. The CPS captures the current work activity of the business owner, and whether that business owner is currently operating the business. Thus, the number of active business owners can be captured in the data, but there is no way of telling whether these are temporary or permanent business closures. But, inactive business owners regardless of whether the business is temporary or permanently closed are suffering losses in business income during those months of nonoperation.

The measure of business ownership in the CPS captures all business owners including those who own incorporated or unincorporated businesses, and those who are employers or nonemployers. Although some business owners own large businesses the predominate types are small businesses. I interpret the data as predominately covering small business owners. In addition to providing information on business ownership and current activity, the CPS data include

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3 Large literatures explore the causes and consequences of disparities in ownership and success of minority-, female-, and immigrant-owned businesses. For broader discussions and reviews of these literatures, see, for example, Dávila and Mora (2013), Fairlie and Robb (2008), Jennings and Brush (2013), Fairlie and Loftstrom (2015), Kerr and Kerr (2020), and Parker (2018).
information on detailed demographic information, including gender, race, and immigrant status of the owner. The data also include information on the industry and incorporation status of the business. The CPS data have been used in previous research to study self-employment, business ownership, and entrepreneurship (e.g., see, Chatterji, Chay, & Fairlie, 2014; Fairlie & Chatterji, 2013; Fairlie & Fossen, 2019; Hipple & Hammond, 2010; Levine & Rubenstein, 2017; Wang, 2019).

2.2 | **Survey timing and social-distancing restrictions**

The CPS survey reference period is generally the calendar week that contains the 12th day of the month. The CPS survey reference period is generally the calendar week that contains the 12th day of the month. For April, the week was Sunday, April 12 through Saturday, April 18. The March survey reference week was March 8 through March 14. For May, the week was Sunday, May 10 through Saturday, May 16, and for June, the week was Sunday, June 14 to Saturday, June 20. Given that shelter-in-place restrictions started after this reference week, the April 2020 release is the first CPS survey fully covering the early-stage impacts of COVID-19. On March 16, 2020 San Francisco Bay Area imposed shelter-in-place restrictions followed by the State of California on March 19. New York State followed the next day. By early April most states imposed social-distancing restrictions. The analysis below mostly relies on comparisons between February 2020 (before social-distancing policy mandates) and April, May, or June 2020 (the first 3 months after policy mandates).4

3 | **RESULTS**

3.1 | **Number of business owners**

I first examine small business ownership patterns over time to determine the impacts of COVID-19. Long-term trends in the number of business owners are displayed in Figure 1 (and recent months in Table 1). The number of business owners actively working any amount is displayed in Figure 1. Over the past two decades, the number of active business owners in the United States has shown a relatively smooth pattern over time with a slight upward trend. What is clear, however, is the dramatic drop in the number of active business owners in April 2020 and the partial rebound in May and continuing rebound in June. The number of working business owners dropped from 15.0 million in February 2020 to 11.7 million in April 2020 because of COVID-19. March 2020 only shows a small drop in business owners likely because of the limited effect from shelter-in-place restrictions. May 2020 shows a partial rebound from April 2020 adding back 1.1 million active business owners (7 percentage points relative to February levels). The losses due to COVID-19 from February remain high at 15%, but the rebound suggests that not all of the losses of active business owners in April 2020 were permanent closures. June experienced a further rebound with business activity being down 8% from February levels.

The loss of 3.3 million active business owners (or 22%) from February to April 2020 was the largest drop on record. When conditioning on working at least 15 hr in the survey week, the losses were even larger. The choice of 15 hr is made to approximate 2 days/week and accommodate lumpy hours reporting (i.e., often 10, 15, 20, etc.). There were 13.6 million business owners working 15+ hours in February 2020 and only 9.8 million in April 2020. The drop of 3.8 million business owners or 28% was unprecedented. Conditioning on 30 or more hours worked results in losses of 3.4 million or 31% (see Table 1). The losses conditioning on hours worked were also larger in May relative to February (19% for 15+ hours and 21% for 30+ hours). Both measures, however, show partial rebounds in May from April 2020. From 9 to 10 percentage points of the drops in active business owners were added back in May. Further rebounds occurred in June with losses to 15+ hours worked business activity at 11% and 30+ hours worked business activity at 13%.

Table 1 also reports the total number of hours worked in the survey week among all business owners by month. Figures are reported in 1,000 s. From February to March there was a drop in total hours worked in businesses by owners of 29%. From February to May there was also a drop in total hours worked by business owners, but the drop was not as large at 20%. From February to June total hours worked dropped by 12%. These reductions in business hours worked

4In most analyses March 2020 is not included because of partial effects. On March 11, the World Health Organization (WHO) declared COVID-19 a pandemic which might have resulted in early demand shifts over health concerns predating shelter-in-place restriction policies.
have important ramifications for take home earnings for business owners. Business owners are likely to have experienced large reductions in income. Unfortunately, the CPS data do not provide information on these losses to income. The latest data available from the Census on business revenues indicate that average sales and receipts of businesses are $440,000/year (U.S. Census Bureau, 2016).

Separating the number of business owners into unincorporated and incorporated status indicates large drops in activity for both groups (see Table 1). Incorporated businesses are viewed as more growth-oriented, committed, procyclical, and entrepreneurial (e.g., Fairlie, Miranda, & Zolas, 2020; Levine & Rubinstein, 2017, 2018). The number of active unincorporated business owners dropped 28% from February to April but then rebounded 10 percentage points in May and a further 9 percentage points in June. Incorporated business owners realized a smaller drop in active business owners of 14% from February to April, and a smaller rebound of 3 percentage points in both May and June. The losses remain large, however, with 17% of unincorporated business owners and 11% of incorporated business owners not operating in May, and 9% of unincorporated and 7% of incorporated not operating in June.

### 3.2 Demographic patterns

The CPS data provide detailed information on gender, race, and immigrant status. Figure 2 (Table 2) displays the number of active female and male business owners in February, April, May, and June 2020. Female businesses were especially hit hard by COVID-19 in April. The number of active female business owners dropped from 5.4 million to 4.0 million in the crucial 2-month window. The decline of one-fourth of active female business owners is unprecedented.

### Table 1 Number of active business owners before and after COVID-19

<table>
<thead>
<tr>
<th></th>
<th>Worked in survey week</th>
<th>Percent change from Feb. 2020</th>
<th>Worked 15+ hours</th>
<th>Worked 30+ hours</th>
<th>Total hours worked in business (000 s)</th>
<th>Unincorporated</th>
<th>Incorporated</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 2020</td>
<td>13,794,081</td>
<td>−8</td>
<td>12,021,520</td>
<td>9,614,237</td>
<td>490,842</td>
<td>8,065,557</td>
<td>5,728,523</td>
</tr>
<tr>
<td>May 2020</td>
<td>12,809,946</td>
<td>−15</td>
<td>11,040,149</td>
<td>8,808,505</td>
<td>448,786</td>
<td>7,292,477</td>
<td>5,517,469</td>
</tr>
<tr>
<td>April 2020</td>
<td>11,710,360</td>
<td>−22</td>
<td>9,821,255</td>
<td>7,684,501</td>
<td>394,678</td>
<td>6,392,480</td>
<td>5,317,880</td>
</tr>
<tr>
<td>March 2020</td>
<td>14,475,704</td>
<td>−4</td>
<td>12,803,107</td>
<td>10,392,909</td>
<td>523,558</td>
<td>8,545,156</td>
<td>5,930,548</td>
</tr>
<tr>
<td>February 2020</td>
<td>15,012,692</td>
<td>0</td>
<td>13,582,876</td>
<td>11,086,054</td>
<td>558,440</td>
<td>8,828,513</td>
<td>6,184,179</td>
</tr>
<tr>
<td>January 2020</td>
<td>14,832,717</td>
<td>−1</td>
<td>13,293,991</td>
<td>11,093,877</td>
<td>551,153</td>
<td>8,649,659</td>
<td>6,183,059</td>
</tr>
</tbody>
</table>

Notes: Estimates from Current Population Survey (CPS) microdata. Monthly sample sizes are roughly 55,000 for the labor force and 5,000 for business owners.
Male business owners also suffered major losses in business activity with a reduction of 2 million representing 20% of previous levels.

Continuing into May, both male and female business owners were hit hard by COVID-19 relative to February levels, before the social-distancing restrictions. The number of active female business owners dropped from 5.4 million to 4.5 million (16%), and the number of active male business owners dropped from 9.6 million to 8.3 million (14%). However, both female and male business owners bounced back from April losses. Female business owners bounced back resuming work by 9 percentage points and male business owners bounced back by 7 percentage points. In June, the rebound for both female and male owners continued. The number of active business owners was down by 10% for women and 7% for men relative to pre-COVID levels.

In terms of the share of total active business owners, female business owners only experienced a slight loss in shares. Table 3 reports estimates of the share of total business owners represented by each demographic group. The female share of active business owners was 36% in February and declined slightly to 35% in April–June.

**Table 2** Number of active business owners by demographic group

<table>
<thead>
<tr>
<th>Group</th>
<th>Feb. 2020 Number</th>
<th>Apr. 2020 Number</th>
<th>May 2020 Number</th>
<th>June 2020 Number</th>
<th>Feb.–Apr. change Number</th>
<th>Feb.–Apr. change Percent</th>
<th>Feb.–May Percent</th>
<th>Feb.–June Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>15,012,692</td>
<td>11,710,360</td>
<td>12,809,946</td>
<td>13,794,081</td>
<td>−3,302,331</td>
<td>−22</td>
<td>−15</td>
<td>−8</td>
</tr>
<tr>
<td>Female</td>
<td>5,389,399</td>
<td>4,048,205</td>
<td>4,517,965</td>
<td>4,876,392</td>
<td>−1,341,194</td>
<td>−25</td>
<td>−16</td>
<td>−10</td>
</tr>
<tr>
<td>Male</td>
<td>9,623,293</td>
<td>7,662,156</td>
<td>8,291,981</td>
<td>8,917,689</td>
<td>−1,961,137</td>
<td>−20</td>
<td>−14</td>
<td>−7</td>
</tr>
<tr>
<td>Black</td>
<td>1,079,116</td>
<td>637,769</td>
<td>798,668</td>
<td>872,717</td>
<td>−441,347</td>
<td>−41</td>
<td>−26</td>
<td>−19</td>
</tr>
<tr>
<td>Latinx</td>
<td>2,070,896</td>
<td>1,412,925</td>
<td>1,668,254</td>
<td>1,855,026</td>
<td>−657,971</td>
<td>−32</td>
<td>−19</td>
<td>−10</td>
</tr>
<tr>
<td>Asian</td>
<td>888,528</td>
<td>657,896</td>
<td>700,393</td>
<td>798,811</td>
<td>−230,632</td>
<td>−26</td>
<td>−21</td>
<td>−10</td>
</tr>
<tr>
<td>White</td>
<td>10,553,415</td>
<td>8,761,531</td>
<td>9,373,304</td>
<td>10,001,462</td>
<td>−1,791,884</td>
<td>−17</td>
<td>−11</td>
<td>−5</td>
</tr>
<tr>
<td>Immigrant</td>
<td>3,120,275</td>
<td>2,009,597</td>
<td>2,329,820</td>
<td>2,545,926</td>
<td>−1,110,677</td>
<td>−36</td>
<td>−25</td>
<td>−18</td>
</tr>
<tr>
<td>Native</td>
<td>11,892,417</td>
<td>9,700,763</td>
<td>10,480,126</td>
<td>11,248,155</td>
<td>−2,191,654</td>
<td>−18</td>
<td>−12</td>
<td>−5</td>
</tr>
</tbody>
</table>

Note: Estimates are from Current Population Survey (CPS) microdata.
Turning to racial patterns, Figure 3 (Table 2) displays the number of active business owners by major racial groups. The findings are alarming. The number of African-American business owners plummeted from 1.1 million in February 2020 to 640,000 in April. The drop of 440,000 black business owners actively working in their businesses, representing 41% of the previous level, is disconcerting. Although there was a partial rebound, the number of actively working African-American business owners remains 26% lower in May than that in February 2020, which is the largest drop for any major racial/ethnic group. The implications for lost income from having 41% of business owners not working in April, 26% not operating in May, and 19% not operating in June will have longer-term negative consequences on savings and wealth. Average business sales and receipts among black-owned businesses are $58,000/year (U.S. Census Bureau, 2016).

Latinx business owners also suffered major losses in business activity. The number of active Latinx business owners dropped from 2.1 million to 1.4 million (32%) from February to March. These losses in business activity from COVID-19 continued into the second and third months after widespread shelter-in-place restrictions. The number of active Latinx business owners dropped by 19% from February to May and 10% from February to June. Although there was a partial

<table>
<thead>
<tr>
<th>Group</th>
<th>Feb. 2020 Share (%)</th>
<th>Apr. 2020 Share (%)</th>
<th>May 2020 Share (%)</th>
<th>June 2020 Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Female</td>
<td>36</td>
<td>35</td>
<td>35</td>
<td>35</td>
</tr>
<tr>
<td>Male</td>
<td>64</td>
<td>65</td>
<td>65</td>
<td>65</td>
</tr>
<tr>
<td>Black</td>
<td>7</td>
<td>5</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Latinx</td>
<td>14</td>
<td>12</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Asian</td>
<td>6</td>
<td>6</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>White</td>
<td>70</td>
<td>75</td>
<td>73</td>
<td>73</td>
</tr>
<tr>
<td>Immigrant</td>
<td>21</td>
<td>17</td>
<td>18</td>
<td>18</td>
</tr>
<tr>
<td>Native</td>
<td>79</td>
<td>83</td>
<td>82</td>
<td>82</td>
</tr>
</tbody>
</table>

Note: Estimates are from Current Population Survey (CPS) microdata.

TABLE 3 Share of active business owners by demographic group

FIGURE 3 Number of active business owners by race/ethnicity before and after COVID-19 [Color figure can be viewed at wileyonlinelibrary.com]
rebound from April, these losses continue to be large and contribute to lost income for owners. Average business sales and receipts among Hispanic-owned businesses are $143,000/year (U.S. Census Bureau, 2016).

Asian business owners suffered losses in business activity of 230,000 representing 26% of February levels. Even with the rebounds in May and June, the number of Asian business owners who were actively running their businesses dropped by 21% and 10%, respectively. Consumer discrimination against Asian-owned businesses was a concern because of the coronavirus first appearance in China (CDC, 2020a). The losses to revenues among Asian business owners are large with average sales and receipts of $365,000 (U.S. Census Bureau, 2016).

The drop in business activity from February to April for whites were also large at 1.8 million business owners, but smaller as a percentage of starting levels (17%). White business owners experienced declines in operating businesses of 11% in May and 5% in June. Average sales and receipts of white-owned businesses are $546,000 (U.S. Census Bureau, 2016).

The black and Latinx business owner shares declined from February to April by two percentage points (Table 3). Blacks represented 5% of active business owners in the nation in April and Latinx represented 12% of active business owners. The share bounced back but only partially by June (6% for blacks and 13% for Latinx). The Asian share remained relatively stable over the 4 months, whereas the white share of total business owners increased.

Focusing on immigrants, the number of active business owners dropped from 3.1 million to 2.0 million from February to April (Figure 4 and Table 2). The loss of over 1 million active immigrant business owners is alarming. It represents a drop of 36% from February levels. The losses in business activity continue to be large for immigrants with a 25% reduction in May and an 18% reduction in June. Although active business owner numbers partially bounced back in May and June relative to April for immigrants the levels did not return to anything close to pre-COVID-19 levels. For comparison, the number of active US born (native) business owners dropped by much lower levels during the first 3 months (18% in April, 12% in May, and 5% in June). These patterns led to the share of immigrant business owners dropping from 21% in February to 17%–18% in April–June (Table 3).

Comparing back to April 2019 levels, the conclusions do not differ. For all of the demographic groups, the number of business owners dropped precipitously from April 2019 to April 2020. In general, the number of self-employed business owners for each group does not change substantially over time especially during stable economic conditions, and thus February 2020 is an accurately captures previous levels. April 2020 is clearly an unprecedented shock to business owners that hit all groups hard throwing active business totals off relatively stable longer-term levels.

![Figure 4](https://example.com/figure4.png)  
**Figure 4** Number of active business owners by nativity before and after COVID-19 [Color figure can be viewed at wileyonlinelibrary.com]
Industry patterns

Table 4 reports estimates by major industry groups. Almost every industry experienced sizeable drops in the number of active business owners from February to April. The only exception was Agriculture for which the number of active business owners increased slightly.\(^5\) Construction which is one of the largest industries for business ownership experienced a major decline of nearly 670,000 (27\%) active business owners in the United States from February to April. Although Construction partially bounced back in May and June losses in business activity continued to be large. Although construction businesses experience a lot of swings in demand, it is not clear how many of these business owners will be able to come back over the next several months.

Store fronts across the country had been closed due to COVID-19 mandated restrictions especially in April. Retail trade showed a decline of 108,000 business owners in April representing 10\% of February 2020 levels. Active business owners in Retail Trade are only slightly down, however, in May and June. Restaurants experienced a decline of 22\% in April even though many of those remaining open turned to take-out or delivery services. The sector has experienced continuing low levels of business activity over the next 2 months. The broad sector of Arts, Leisure, and Accommodations was hit especially hard losing 35\% of active business owners in April and essentially no rebound in May or June.

Both high- and less-skilled services were hit hard by COVID-19. Personal and Laundry Services were especially hard hit with losses of 79\% of business owner activity in April and continuing losses of 48\% in May and 26\% in June. Transportation services which includes taxi and some uber drivers dropped by 22\% in April, but partially rebounded in subsequent months. Higher-skilled services, such as Financial Activities and Professional and Business Services, lost

\(^5\)Although farmers and other agricultural business owners might have continued to work during the pandemic they might have experienced large losses in sales and revenues due to supply chain shutdowns from the closing of regular buyers (e.g., schools and restaurants).
12% and 18%, respectively. Even health services experienced a drop of 16%. All three experienced partial rebounds in May and June.

It is also possible to categorize industries into essential versus nonessential according to state or local government guidelines, although there is a lot of variation across these guidelines in terms of specific industries. Delaware State provides the most detailed and comprehensive list of essential businesses at the 4-digit industry level and follows the same 4-digit industry codes as the CPS (North American Industry Classification System, NAICS).\(^6\) The classification is likely to be imperfect, however, because definitions, enforcement, business owner compliance, and health- and economic-related consumer reactions vary across the country. Using this categorization, “essential” industries comprise 76% of business owners. Losses in the number of active business owners are lower for essential industries at 17% in April compared with 38% among nonessential industries (as expected). Although both groups of business owners experienced partial rebounds, the number of active business owners in essential industries was down by 10% in May and 5% in June, and the number in nonessential industries was down by 28% in May and 17% in June.

### 3.3.1 Importance of industry distributions

Did the industry distribution of businesses owned by different demographic groups place them at a higher or lower risk of COVID related shutdowns? To explore this question I simulate the total number of business owners for each demographic group by switching their industry distribution for the US national industry distribution. The industry distributions are both measured in February 2020. The expression for the simulated change in the number of business owners for group \(j\) from February to April is

\[
\sum_{i=1}^{K} S_{i}^{\text{US}} (N_{i,j}^{\text{Apr}} - N_{i,j}^{\text{Feb}}),
\]

where \(S_{i}^{\text{US}}\) is the share of all business owners represented by major industry \(i\) using the US national industry distribution, and \(N_{i,j}^{\text{Month}}\) is the number of business owner for group \(j\), industry \(i\), and the defined month. The simulation essentially uses the national industry shares and multiplies them by the group-specific changes in the number of active business owners between the 2 months.

Table 5 reports estimates from the simulations. The number of active female business owners declined by 25% from February to April 2020. The industry distribution of female business owners was partly responsible for relatively large business activity losses from February to April. When switching to the US national industry distribution the decline in active business owners is lower at 19%. Thus, the female industry distribution was “unfavorable” in terms of placing them at a higher risk of business activity losses in April 2020. A similar finding holds for May and June. For both months, the drop in active business owners is smaller for women when switching to the US national industry distribution.

By definition, the opposite is true for male business owners. Relative to the US total (and thus female business owners), the male industry distribution partly protected them from larger losses due to COVID-19. Switching industry distributions to the national distribution results in a higher predicted decline in business owner activity of 23% in April, 15% in May, and 8% in June.

The industry distribution of black business owners placed them at a higher risk of business activity losses due to COVID-19. The percent change in the number of active black business owners becomes considerably smaller when simulations are run with the national industry distribution. The change is from a loss of 41% to 35% in April. The patterns are similar in May and less pronounced in June.

A similar pattern is found for Latinx. When switching the Latinx industry distribution to the US national industry distribution the predicted number of active Latinx business owners drops from 32% to 28% for April. Latinx business owners had an “unfavorable” industry distribution partly placing them at higher risk of business activity losses. For May and June, the “unfavorable” industry distribution also placed Latinx business owners at a higher risk of business activity losses.

\(^6\)Delaware’s list can be accessed at “List of Delaware Business Categories that are Essential and Non-Essential (March 22, 2020),” https://coronavirus.delaware.gov/resources-for-businesses/.
Asian business owners show a similar pattern in April, but not in May and June. For April, I also find that Asian business owners were more concentrated in industries placing them at a higher risk of losses in business activity. But, when switching to the national industry distribution in May and June Asian business owners are predicted to have larger losses in business activity, which implies the opposite pattern. In these months, business activity losses switched to industries that Asian business owners were less concentrated.

Interestingly, the large loss in the number of immigrant business owners does not appear to be due to a less favorable industry distribution. The loss of 36% of active immigrant business owners remains essentially unchanged when switching to the national industry distribution in April. The same pattern is found in June. For May there is some evidence of a less favorable industry distribution based on the losses in business activity in that month relative to February.

Another way to estimate industry impacts is to examine the percentage of each demographic group that is in “essential” industries. As noted above the classification is not perfect and other factors, such as differences in customer demand, enforcement, and compliance by businesses also influence whether they are open. The percentage of black business owners in essential industries is 66% which is lower than the national percentage of 76%, and consistent with the less “favorable” industry distribution placing them at higher risk of losses due to COVID-19. Similarly, female-owned businesses are less concentrated in essential businesses at 61%. On the other hand, using the Delaware codes, Latinx and immigrant business owners are slightly more likely to be concentrated in essential industries (79%–80%), and Asian business owners have the same concentration in essential industries as the national average (76%). The classification is likely to be imperfect and does not line up entirely well with patterns of group-specific losses.

**4 | CONCLUSIONS**

The first estimates of the effects of COVID-19 on the number of business owners from nationally representative April–June 2020 CPS data indicate dramatic early-stage reductions in small business activity. The number of active business owners in the United States plunged from 15.0 million to 11.7 million over the crucial 2-month window from February to April 2020. No other 1-, 2-, or even 12-month window of time has ever shown such a large change in business activity. For comparison, from the start to end of the Great Recession the number of active business owners decreased by 730,000 representing only a 5% reduction. In general, business ownership is relatively steady over the business cycle (Fairlie, 2013; Parker, 2018). The loss of 3.3 million active business owners (or 22%) was comprised of large drops in important subgroups, such as owners working roughly 2 days/week (28%), owners working 4 days/week (31%), and incorporated businesses (20%). When viewed as total hours worked by all business owners there was a drop of 29%.
Estimates from nationally representative May 2020 CPS data—the second month into social-distancing restrictions—continue to indicate large reductions in small business activity. The number of active business owners in the United States dropped by 15% from February to May. The number of business owners in May actually rebounded somewhat from the April low of 11.7 million. The partial rebound resulted in an increase of 1.1 million business owners or 7 percentage points from February levels. The rebound continued in June 2020 adding back another 7 percentage points. The decline in business owner activity from February to June is 8%. Although the rebound shows widespread reopening of small businesses, it continues to indicate an extremely large decrease in business activity over a short period of time. Importantly, the drops in business activity in April, May, and June represent large income losses to business owners that cannot be fully recovered.

African-American business owners were hit the hardest by COVID-19. The first estimates from April 2020 for black business owners in the United States indicate a massive drop of 41% in business activity. Black business owners were also disproportionately negatively affected in May and June relative to national levels with declines in business activity of 26% and 19%, respectively. Simulations indicate that the industry distribution of blacks was partly responsible, placing black business owners at greater risk of losses in business activity due to the pandemic. Latinx businesses were also hit hard by COVID-19 losing 32% of active business owners in April, 19% in May, and 10% in June. Asian business owners experienced a 26% decline in business activity over the critical 2-month window, and continued losses of activity of 21% in May and 10% in June. Simulation estimates also point to unfavorable industry distributions for Latinx, but the evidence is less clear for Asians. Immigrant business owners were also devastated with losses of 36% of business activity in April. Continued disproportionate losses were felt in May (25%) and June (18%). Although industry distributions placed some groups at higher risk of closures in the pandemic, differences in the scale of businesses are likely a major cause of disproportionate losses among minority-owned businesses, which are smaller on average (Fairlie & Robb, 2008; U.S. Census Bureau, 2016). Larger businesses are more likely to have the resources, business, and legal structure, and returns to scale to implement procedures to address social-distancing regulations for operating and reopening during the pandemic.

The negative early-stage impacts on minority- and immigrant-owned businesses, if prolonged, could be problematic for broader racial inequality because of the importance of small businesses for local job creation (disproportionately hiring other minorities), economic advancement, and longer-term wealth inequality (Boston, 1999, 2006; Bradford, 2003, 2014; Fairlie & Robb, 2008; Stoll, Raphael, & Holzer, 2001). With major losses in business activity in April and continued losses in May and June, even though these losses were smaller, business owners have already lost substantial amounts of income from their businesses. If a more complete rebound does not happen soon the long-term economic consequences could be severe. Many minority business owners will not have the resources to weather prolonged closures, reduced demand from health concerns, and a more comprehensive recession. The latest Census data indicate that the median level of wealth among black families is $13,000 and Latinx families is $20,000 compared with $139,000 among white families (U.S. Census Bureau, 2015).

The first estimates of early-stage impacts on active female business owners are also worrisome. Female business ownership is substantially lower than male business ownership and female-owned businesses have lower revenues, employees, and profits on average (U.S. Census Bureau, 2016). The disproportionate losses in the first 3 months to the number of active female business owners will only further increase gender inequality in business ownership and perhaps broader economic inequality.

The next important question is whether the shutdowns of small businesses are temporary or permanent. The government has been responding to concerns over longer-term effects on small businesses through several programs. The largest program is the Paycheck Protection Program (PPP) which has thus far allocated over $650 billion to help businesses. Another large program is the Economic Injury Disaster Loan program by the Small Business Administration, which provided over $150 billion as of July 2020. Foundations and private companies are also starting to contribute to relief efforts. For example, Magic Johnson Enterprises is providing a $100 million commitment to minority- and female-owned businesses left out of the PPP program. Another recent example, is that PayPal, in partnership with the Association for Enterprise Opportunity, created a $10 million fund to help black-owned businesses, and Google is pledging $175 million on financing and supporting black-owned businesses. Can these programs help small businesses survive the setbacks and shutdowns due to the coronavirus pandemic, or will more assistance be needed? More permanent mass closures of small businesses in the United States are likely to have a dramatic effect on employee job losses, further income inequality, and contributing to a prolonged recession. But, the tradeoffs from lifting restrictions on reopening of businesses on health impacts are unknown and of concern given that COVID-19 cases have been increasing over the summer (CDC, 2020b).
ACKNOWLEDGMENTS
I would like to thank participants at the remote PPIC California labor market workshop and the remote Kauffman Foundation Entrepreneurship Issue Forum for comments and suggestions. The research project has also benefited from numerous conversations with the press and policymakers.

DATA AVAILABILITY STATEMENT
The microdata used in the analysis are publicly available.

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REFERENCES


Did the $660 Billion Paycheck Protection Program and $220 Billion Economic Injury Disaster Loan Program Get Disbursed to Minority Communities in the Early Stages of COVID-19?

Robert Fairlie¹ and Frank M. Fossen²

December 2020

Abstract

Social distancing restrictions and health- and economic-driven demand shifts from COVID-19 shut down many small businesses with especially negative impacts on minority owners. Is there evidence that the unprecedented federal government response to help small businesses – the $659 billion Paycheck Protection Program (PPP) and the related $220 billion COVID-19 Economic Injury Disaster Loans (EIDL) – which had a stated goal of helping disadvantaged groups, was disbursed evenly to minority communities? In this descriptive research note, we provide the first detailed analysis of how the PPP and EIDL funds were disbursed across minority communities in the country. From our analysis of data on the universe of loans from these programs and administrative data on employer firms, we generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population or businesses, although funds flowed to minority communities later than to communities with lower minority shares. PPP loan amounts, however, are negatively related to the minority share of the population. The EIDL program, in contrast, both in numbers and amounts, was distributed positively to minority communities.

Keywords: Small business, entrepreneurship, business owners, self-employment, Paycheck Protection Program, PPP, Economic Injury Disaster Loans, EIDL, COVID-19, coronavirus, shelter in place restrictions, social distancing restrictions, minority business, racial inequality

JEL Codes: J15; L26

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We would like to thank Karen Mills and participants at the NBER Entrepreneurship Workshop, the PPIC California labor market workshop, and the Kauffman Foundation Entrepreneurship Issue Forum for comments and suggestions. The research project has also benefited from numerous conversations with the press and policymakers. Special thanks go to Zach Mider, Jason Grotto and Cedric Sam for discussions of the data and analysis, research assistance by Ian Allen and Ege Can, and thanks go to participants in the Axios/Google Small Business Matters Expert Panel and JPMorgan Chase Institute Data Dialogue meetings for their comments and questions.
1. Introduction

The widespread closing of stores and businesses in the United States and around the world due to the coronavirus is unprecedented. Stores, factories and many other businesses have closed by policy mandate, downward demand shifts, health concerns, or other factors. The number of working business owners in the United States plummeted from 15.0 million in February 2020 to 11.7 million in April 2020 and has only partially rebounded since then (Fairlie 2020).\(^1\) The impacts have also been disproportionately felt by race: business owner activity fell in the early-stages of the pandemic by 41 percent among African-Americans and 32 percent among Latinx compared with 17 percent among whites.\(^2\)

Given the impact of the pandemic the federal government provided a response of larger magnitude than ever seen before in terms of providing financial assistance to small businesses. The largest program providing funds to small businesses is the $650 billion Paycheck Protection Program (PPP).\(^3\) The Small Business Administration (SBA) administered program provides loans to small businesses through banks, credit unions, and other financial institutions with the stated goal of keeping small businesses open and retaining employees on the payroll. Loan amounts were generally equal to 2.5 months of average payroll costs, and can be forgiven if the business retains its employees. The program started providing loans on April 3, 2020, which was after most states imposed social distancing restrictions in response to COVID-19, and ran through August 8, 2020 providing more than 5 million total loans.\(^4\) The $220 billion Economic Injury Disaster Loan Program (EIDL) program, which is also administered by the SBA, is designed to provide either loans or advances to small businesses that are losing revenues and sales due to COVID-19. Nearly 3.6 EIDL loans for $200 billion and nearly 5.8 million EIDL advances for $20 billion have been provided to small businesses. EIDL loans can be used to cover up to 6 months of a wide array of

\(^1\) These findings prompted a large policy response, for example, new U.S. Senate bills (U.S. Senate 2020) and California State bills (Newsom 2020) to provide assistance to minority and small businesses during the pandemic.

\(^2\) Cash balances and revenues of small businesses also fell substantially in the early stages of the pandemic (Farrell, Wheat and Mac 2020).

\(^3\) The Coronavirus Aid, Relief, and Economic Security (CARES) Act also provided stimulus payments to households and expanded unemployment insurance benefits to households. See Bhutta et al. (2020) for an analysis of whether this cash assistance will help families cover expenses over a six month period of lost income (i.e. April through September 2020), relative to a counterfactual where families would have had to rely solely on their own liquid savings and standard UI benefits (e.g., benefits available in the absence of CARES).

\(^4\) On March 11, 2020, the World Health Organization (WHO) declared COVID-19 a pandemic. On March 16, the San Francisco Bay Area imposed the first shelter-in-place restrictions in the country followed by the State of California on March 19. New York State followed the next day. By early April most states imposed social distancing restrictions.
working capital and normal operating expenses, such as continuation of health care benefits, rent, utilities, and fixed debt payments. EIDL advances are grants and do not have to be repaid, but are for smaller amounts ($1,000 per employee up to a maximum of $10,000). EIDL advances are subtracted from the forgiveness amount of their PPP loan if they are received in addition to PPP loans.

One of the stated goals in the CARES Act which included the PPP and EIDL programs was to prioritize serving “underserved markets” and businesses owned by “socially and economically disadvantaged individuals” (U.S. Congress 2020). Did the PPP and EIDL programs, which provided 15 million loans or advances worth more than $850 billion to small businesses, get disbursed to minority communities benefitting the businesses and employees in those communities? Given the larger negative effects of COVID-19 on business inactivity among minority businesses (Fairlie 2020) targeting these relief funds to minority communities might be especially important.

In this descriptive research note we provide the first detailed analysis of how the PPP and EIDL funds were disbursed across minority communities in the United States. Using administrative data on the universe of PPP loans, EIDL loans, and EIDL advances, we explore whether loans and advances were evenly distributed or not. We find that minority communities received a large share of PPP loans. We generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population. There is some evidence, however, that the first round of funds was disproportionately disbursed to non-minority communities and the second round of funds was disproportionately disbursed to minority communities. When we focus on the minority share of employer businesses in an area we find similar results. Focusing on PPP loan amount per employee, however, we find a negative relationship with minority share of the population. In contrast, EIDL loans and advances, in both number and amounts, were provided positively to minority communities. We find a strong positive relationship in the receipt of these loans and advances by minority share of the population.

These results build on the findings from a few related working papers on the PPP program. Granja et al. (2020) find that the first round of PPP funds flowed to areas more adversely affected by the economic effects of the pandemic, but that the early PPP did not have a substantial effect on local economic outcomes. Neilson et al. (2020) report based on survey data that the smallest businesses were less aware of the PPP, less likely to apply, and conditional on applications filed
later, faced longer processing times, and were denied more often. Bartik et al. (2020) using firm-level data and an instrumental variables approach find that PPP loans led to an increase in a business’ expected survival, and a positive but imprecise effect on employment. Focusing on race, Lederer et al. (2020) conducted matched-pair audit testing of financial institutions in Washington, D.C. for PPP loans and find disparities between black and white testers in encouragement in applying for a loan, products offered, and information provided by the bank representative. Additionally, Erel and Liebersohn (2020) find that FinTech is disproportionately used to disburse PPP funds in high minority share ZIP codes. This paper builds on the previous research by providing the first comprehensive analysis of the relative disbursement of PPP and EIDL small business funds to minority communities, and the first study, to our knowledge, of the EIDL program. The findings are potentially important for future targeting and oversight of government aid to preserve minority businesses and the jobs they create.

2. Data

Partly in response to a Freedom of Information Act (FOIA) request and law suit threat by the media, the SBA released complete loan-level microdata for the PPP and EIDL programs. The PPP data cover the universe of loans provided through the program, which was from April 3, 2020 to August 8, 2020. The PPP is divided into two rounds. The first round ran from April 3 to April 16 and consisted of $342 billion across about 1.6 million loans. The second round ran from April 27 to August 8 and included more than 3.5 million loans with a total value of roughly $180 billion. In total there are 5.2 million loans and $522 billion.

The loan microdata include information on the amount of the loan for loans under $150,000 For larger loans, only ranges are reported ($150,000-350,000, $350,000-1 million, $1-2 million, $2-5 million, and $5-10 million). Geographical information down to the zip code is provided in the smaller loan data, whereas exact address and even the name of the business is included in the larger loan data. The data also include information on industry, business type, jobs retained

Alstadsæter et al. (2020) use Norwegian administrative data to simulate the effects of Norwegian government support and the U.S. PPP program to help businesses during the COVID-19 pandemic and find that these policies supporting payroll can be partly effective.

A large literatures explores the causes and consequences of disparities in ownership and success of minority-owned businesses. For broader discussions and reviews of these literature, see, for example, Davila and Mora (2013); Fairlie and Robb (2008); Kerr and Kerr (2020); Parker (2018). See Fairlie (2020) and Stanford Latino Entrepreneurship Initiative (2020) for evidence of COVID-19 impacts on minority-owned businesses.
reported by the business, and name of the lender. Information on the race, gender and veteran status of the owner are incomplete. The application did not ask for demographic information on the owners (see U.S. SBA 2020 for application form) and relied on banks to report the information. The result is that only 10 percent of loans provide race information, and these are heavily concentrated among a few banks.

The SBA also released loan and advance data from the EIDL program. The EIDL program data are separated into the loans and advances. There were 3.6 million loans and 5.8 million advances administered through the program. As of 9/14/20 $190 billion of the allocated $200 billion in loans have been handed out to small businesses. All of the $20 billion for EIDL advances has been provided to small businesses.

To normalize the number of PPP or EIDL loans by zip code we calculate loans per employer business. We use data from County Business Patterns (CBP) on business establishments with employees. The data are provided by the U.S. Census Bureau at the zip code level as well as other geographical levels. The CBP data on employer establishments do not include counts of farms and nonprofits. We acquire farm data by zip code from the U.S. Department of Agriculture’s National Agricultural Statistics Service (NASS). From the PPP loan data, we exclude nonprofit businesses, which represent 3.5 percent of loans, businesses with a nonclassifiable industry (1.7 percent of the loans), self-employed persons (4.5 percent), and independent contractors (3.0 percent).

To normalize loan amounts we calculate average loan amounts per business employee in each zip code. CBP data also includes employment levels for employer business establishments down to the zip code level. The normalization adjusts for loan amount differences due to differences in employment size by location, which is the general basis for loan amounts. Because only ranges are reported for larger loans in the PPP administrative data we use the midpoint of each range for each loan (e.g. we use $250,000 for a recorded range value of $150,000-350,000). Using alternative assumptions such as 1/3 the range instead of the midpoint does not change the relationship by minority share. EIDL loan and advance amounts are complete.

7 The top banks providing PPP loans were Bank of America (7%), JPMorgan Chase (5%), Cross River Bank (4%), Kabbage (4%), and Wells Fargo (4%).
We compare these measures of loan receipt per employer business establishment and loan amounts per employee to data from the Census of Population on the minority share of the population across communities. We measure minority share of the population primarily by zip code but also by county. In addition to analyzing the relationship between PPP and EIDL loan receipt per business by the minority share of the population we examine the relationship by minority share of employer businesses. We use data from the Annual Business Survey (ABS) on employer businesses at the county level to calculate the minority share of employer businesses in each location. Data from the ABS are not available at the zip code level.

Table 1 provides mean values (weighed by population and unweighted) for the main variables of interest. Across zip codes, the average number of PPP loans per employer establishment is 0.489. The average loan amount per employee (unconditional on receiving a loan) is $4,404. EIDL loan receipt and amounts are lower. EIDL advances went out to more firms but the amounts were much smaller than other funds. The minority share of the population across zip codes has a mean of 0.389 and the minority share of employer businesses has a lower mean of 0.180 reflecting substantially lower business ownership rates among minorities.

Table 1: Descriptive Statistics

<table>
<thead>
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<th>Weighted Mean</th>
<th>Unweighted Mean</th>
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<tr>
<td>PPP loans per employer estab.</td>
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<td>31,952</td>
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<td>PPP avg loan amount per emp.</td>
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<td>$4,892</td>
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<td>EIDL loans per employer estab.</td>
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<td>EIDL avg loan amount per emp.</td>
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<tr>
<td>EIDL advances per estab.</td>
<td>0.577</td>
<td>0.335</td>
<td>31,952</td>
</tr>
<tr>
<td>EIDL avg advance amount emp.</td>
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<td>$262</td>
<td>30,356</td>
</tr>
<tr>
<td>Minority share of the pop.</td>
<td>0.389</td>
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<tr>
<td>Minority share of pop. (count.)</td>
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</tbody>
</table>

Notes: The statistics are at the zip code level if not otherwise indicated. The weighted means are weighted by population. Areas with unobserved minority shares are excluded. The PPP average loan amount per employee excludes loans to agriculture due to a lack of data on farm employees.
3. Results

3.1 Regional Patterns in PPP Loans and EIDL

PPP loans were spread across the country and not limited to a few regions. Figure 1, Panel A, provides a state heat map of PPP loan receipt per employer business establishment. A few states had levels of above 0.55 loans per employer business and a few states had levels between 0.27 and 0.34 loans per employer business. States on the East Coast tended to have higher rates of loan receipt per business, and states in the Midwest tended to have lower rates of loan receipt per business. EIDL loan receipt per business (Panel B) also was generally spread across the country. The patterns are somewhat stronger regionally, however, with the coasts having higher levels of loan receipt per business than the middle of the country. EIDL advances (Panel C) show a somewhat similar pattern across states. The main takeaway from these figures, however, is that PPP loan, EIDL loan and EIDL advances receipt per business was spread across the country and not limited to only a few states or regions.

Figure 1: Distribution of loan receipts per employer establishment across states
Panel A: PPP loans
3.2 PPP Loan Receipt Patterns by Minority Communities

We turn to analyzing how PPP loan receipt was distributed across minority communities. Figure 2 displays PPP loan receipt per employer establishment by minority share of the population at the
zip code level. Panel A shows the relationship weighted by the total population and Panel B shows the relationship without population weights. The figure also includes plotted quadratic regression lines to help show the relationship. Before discussing the results, two important points are noted. First, we do not report confidence intervals (i.e. “whiskers”) because we use the universe of PPP loans and administrative data on employer firms based on the Census Business Register. Second, we focus on the raw relationship between PPP loan receipt and minority share of the population without controlling for other factors because we are trying to capture the influences of these neighborhood characteristics. For example, if minority communities have higher poverty rates and that is correlated with receipt of PPP loans then we want to include that in our measurement. Even if the driver of loan receipt is income it is reflected in race and that is what we are trying to capture.

**Figure 2: PPP loans per employer establishment by minority share**
Panel A: Weighted by population Panel B: Unweighted

![Bar charts showing PPP loans per employer establishment by minority share](image)

*Notes:* The charts show the mean number of PPP loans per employer establishment in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

The relationship appears to be mostly flat between loan receipt and minority population share. Both weighted and unweighted figures show a slight positive relationship between loan receipt per business and the minority share of the population across zip codes in the United States. Most of the averages by minority share fall within the range of half a standard deviation from the
median, as indicated by the double arrow on the Y-axis. Using the weighted figure, moving from the 25\textsuperscript{th} percentile minority share of the population (16 percent minority) to the 75\textsuperscript{th} percentile minority share of the population (59 percent minority) loan receipt only increases from 0.49 to 0.52 PPP loans per employer business establishment.

The PPP disbursed funds in two rounds with adjustments and awareness about the program changing between the two. The first round was April 3 to April 16, 2020 and consisted of 1.6 million loans. The second round ran from April 27 to August 8 and consisted of 3.6 million loans. Figure 3 displays the first round relationship, and Figure 4 displays the second round relationship. Different patterns are revealed when separating by rounds. In the first round, loan receipt went disproportionately to non-minority communities. The figure shows a stronger negative relationship, with a decline of 0.05 loans per business between the 25\textsuperscript{th} and 75\textsuperscript{th} percentiles in minority shares. The second round of funding, however, showed the opposite pattern. In this case, there is an unequivocal positive relationship between loan receipt and minority population share. Moving from the first quartile to the third quartile in minority share is associated with an increase of 0.08 PPP loans per firm.

Figure 3: PPP loans per employer establishment by minority share in the 1\textsuperscript{st} round
Panel A: Weighted by population
Panel B: Unweighted

Notes: The charts show the mean number of PPP loans per employer establishment in zip codes by minority share of the population in the first round of the PPP program (April 3-April 16, 2020). Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± $\frac{1}{2}$ standard deviation.
Figure 4: PPP loans per employer establishment by minority share in the 2\textsuperscript{nd} round

Panel A: Weighted by population  
Panel B: Unweighted

Notes: The charts show the mean number of PPP loans per employer establishment in zip codes by minority share of the population in the second round of the PPP program (April 27-August 8, 2020). Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

In terms of the different rounds of the PPP, the first $349 billion was exhausted after just two weeks of being available. Given unmet need by small businesses for assistance, Congress approved an additional $310 billion. The change in the slope of the relationship between the two rounds might be caused by a few factors. First, applying for PPP loans early on favored having long established relationships with banks which minority businesses were less likely to have (Mills 2020). Second, much of the early money flowed through smaller community banks which were often in rural areas because these banks were nimbler at accessing the aid (Bloomberg 2020). In the second round larger banks with more urban and racially diverse customer bases caught up. Third, minority-owned businesses tend to be smaller than non-minority-owned businesses (Census 2016; Fairlie and Robb 2008), and smaller businesses typically took longer to complete required paperwork because they often did not have in-house accountants, legal help, or other support. Finally, FinTech and other online lenders were brought in and approved by the SBA, and these lenders were often active in minority areas (Liu and Parilla 2020). It is unclear how costly the delay was in receiving loans to minority businesses and communities.
We turn to analyzing the relationship between PPP loans per business and the minority share of businesses in the community. To measure the minority share of businesses we use data from the Annual Business Survey (ABS) on employer businesses at the county level.\textsuperscript{8} Data are not available at the zip code level.\textsuperscript{9} Figure 5 displays the relationship. The unweighted numbers do not indicate a clear pattern and are mostly consistent with a flat relationship. The weighted numbers by population size indicate a slight positive relationship. The relationship is not strong however. For example, moving from the 25\textsuperscript{th} percentile of counties in the minority share of businesses (9 percent minority share) to the 75\textsuperscript{th} percentile (25 percent) is associated with an increase of 0.02 PPP loans per employer business.

**Figure 5:PPP loans per employer establishment by minority share of businesses**

Panel A: Weighted by population  
Panel B: Unweighted

\textit{Notes}: The charts show the mean number of PPP loans per employer establishment in counties by minority share of businesses. Loans to agricultural businesses are excluded. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the county level. For perspective, the double arrow on the Y-axis indicates the median $\pm \frac{1}{2}$ standard deviation.

\textsuperscript{8} We exclude PPP loans to agricultural businesses here due to a lack of data on the minority status of farmers.  
\textsuperscript{9} We also examine the relationship between PPP loans per employer business by minority share of the population at the county level. The results are similar to those at the zip code level.
Figures 6 and 7 display the relationship between loan receipt and minority business share for the first and second rounds, respectively. Similar to our findings using the minority share of the population, again we find that in the first round there appears to be a negative relationship between loan receipt and minority business share, and in the second round the relationship switches to being positive.

**Figure 6: PPP loans per employer establishment by minority share of businesses in the 1st round**
Panel A: Weighted by population
Panel B: Unweighted

Notes: The charts show the mean number of PPP loans per employer establishment in counties by minority share of businesses in the first round of the PPP program (April 3-April 16, 2020). Loans to agricultural businesses are excluded. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the county level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.
Figure 7: PPP loans per employer establishment by minority share of businesses in the 2nd round
Panel A: Weighted by population  Panel B: Unweighted

Notes: The charts show the mean number of PPP loans per employer establishment in counties by minority share of businesses in the second round of the PPP program (April 27-August 8, 2020). Loans to agricultural businesses are excluded. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the county level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

PPP Loan Amounts
The disbursement of PPP funds across communities by minority share might differ when measured by loan amounts instead of number of loans. Figure 8 displays average loan amounts per business employee by minority share in the population at the zip code level. We standardize the Y-axis by reporting the range of ± ½ standard deviations around the median loan size (cutting off at zero in case of the unweighted chart). We find a slight downward relationship with minority share. Moving from the 25th to the 75th percentile in minority share is associated with a decrease from $4652 to $4204 in average loan amount per employee.
**3.3 Economic Injury Disaster Loan (EIDL) Programs**

Although the PPP program has received a lot of attention, the federal government also approved the $220 billion EIDL program, which also provides aid to small businesses during COVID-19, but has received much less attention. There are two programs, EIDL loans and EIDL advances. EIDL loans are not forgivable and must be paid back in full. EIDL advances are grants and do not have to be repaid, but are for smaller amounts ($1,000 per employee up to $10,000 total).

Figure 9 displays EIDL loan receipt per employer establishment by minority share of the population across zip codes. The relationship between loan receipt and minority population share shows a clear upward pattern. If we move from the lowest quartile minority share (16 percent) to the highest quartile minority share (59 percent) loan receipt increases from 0.20 to 0.31 EIDL loans per employer business establishment.
Figure 9: EIDL loans per employer establishment by minority share
Panel A: Weighted by population  Panel B: Unweighted

Notes: The charts show the mean number of EIDL loans per employer establishment in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

Figure 10 displays EIDL advance receipt per employer establishment by minority share of the population in zip codes. The relationship between advance receipt and minority population share shows a similarly strong upward pattern. Movement from the lowest quartile to the highest quartile minority share loan receipt increases from 0.42 to 0.69 EIDL advances per employer business establishment.
**Figure 10: EIDL advances per employer establishment by minority share**

<table>
<thead>
<tr>
<th>Panel A</th>
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<tr>
<td>Weighted by population</td>
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Notes: The charts show the mean number of EIDL advances per employer establishment in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median $\pm \frac{1}{2}$ standard deviation.

**EIDL Loan Amounts**

Figure 11 displays EIDL loan amounts per employee by minority share of the zip code. Similar to the number of loans we find a positive relationship between loan amounts and minority share of the population based on the weighted chart. An increase in EIDL loans per employee from $1404 to $1624 is associated with the interquartile range in minority share across zip codes. Figure 12 displays EIDL advances per employee by minority share. We also find a positive relationship for EIDL advances increasing from a weighted average of $148 to $198 per employee when moving from the 25th to the 75th percentile in minority share.
Figure 11: EIDL loan amounts per employee by minority share
Panel A: Weighted by population  Panel B: Unweighted

Notes: The charts show the mean EIDL loan amounts per employee in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.

Figure 12: EIDL advance amounts per employee by minority share
Panel A: Weighted by population  Panel B: Unweighted

Notes: The charts show the mean EIDL advance amounts per employee in zip codes by minority share of the population. Panel A uses population weights, Panel B is unweighted. The dashed lines are from quadratic regressions at the zip code level. For perspective, the double arrow on the Y-axis indicates the median ± ½ standard deviation.
4. Conclusions

Given the shutdown of the economy to slow down the spread of the novel coronavirus Congress agreed to a massive level of expenditures in the 2020 CARES Act to help small businesses stay open and retain employees. Two components directly providing loan and grant assistance to small businesses, the PPP and EIDL programs, provided a total of nearly 15 million separate loans or advances, and a staggering level of expenditures of roughly $850 billion. The total number and amount of support for small businesses in the United States is unprecedented. Given that the programs were to help disadvantaged businesses (U.S. Congress 2020) we provide the first study of whether loans and advances from these programs were indeed distributed positively to minority communities.

Using administrative data on the universe of PPP loans, EIDL loans, and EIDL advances, we explore how loans and advances were distributed. We find that funding from these programs both flowed to minority communities and away from minority communities. Focusing first on PPP loans, we generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population. There is some evidence, however, that the first round of funds was disproportionately disbursed to non-minority communities and the second round of funds was disproportionately disbursed to minority communities. When we focus on the minority share of employer businesses in an area we find similar results: slightly positive relationship but differential relationships by disbursement rounds. Focusing on PPP loan amount per employee we find a negative relationship with minority share of the population. EIDL loans and advances, in both number and amounts, were provided positively to minority communities. We find a strong positive relationship in the receipt of these loans and advances by the minority share of the population.

Although analyzing patterns of PPP and EIDL funding receipt across minority communities by using the universe of loan-level data across minority communities is important, the loan-level data are limited by not having information on loan receipt by race and ethnicity. To be sure, there is some information in the PPP loan data, but only 10 percent of loans include race and ethnicity (and in a non-representative way by lender), and none of the loans in the EIDL data provide information on race and ethnicity. There is always the possibility that minority businesses did not evenly receive loans in geographical areas even with high minority shares of the population or high minority shares of businesses. The federal government has been criticized heavily for not
collecting this information and plans on collecting demographic information when processing forgiveness on the PPP loans. Future research needs to address this critical question.

Another criticism of the programs is that there was no collection of information on applications for loans that were denied. There is no way to gauge demand and unmet need for these loans by minority businesses and in minority communities. Although there is currently no information by race, the Census Bureau’s Small Business Pulse Survey indicates that by early August most businesses in their survey who asked for PPP or EIDL funds reported receiving them (U.S. Census Bureau 2020). But, this is an important concern. There might exist large disparities by race, and there is a major difference in potential policy response between whether minority businesses needed these loans but faced barriers (e.g. lack of established bank relationships, lack of information about loans, digital divide, or discrimination) or if they did not need loans or needed smaller loans. Another concern is that many minority businesses did not have employees and the programs were primarily focused on serving employer businesses. Finally, many minority businesses might have been reluctant to apply for PPP loans because of uncertainty over future revenues due to entering the pandemic in a weakened position (Mills and Battisto 2020).

The findings presented in this research note have implications for trends in broader inequality. Minority-owned businesses are important for local job creation (as minority owners disproportionately hire minority workers), economic advancement, and longer-term wealth inequality (Boston 1999, 2006; Stoll et al. 2001; Bradford 2003, 2014; Fairlie and Robb 2008). With major losses in business activity among minority businesses in the early stages of the pandemic (Fairlie 2020) minority business owners have already lost substantial amounts of income from their businesses. If the pandemic continues over a long period of time the long-term economic consequences on minority businesses could be severe. Many minority business owners will not have the resources to weather prolonged closures, reduced demand from health concerns, and a more comprehensive recession. Just prior to the pandemic when small business owners were asked what actions they would take if faced with a two-month revenue loss roughly half said they would use their own funds and 17 percent said they would close or sell the business (Mills et al. 2020). But, the latest Census data indicate that the median level of wealth among black families is $13,000 and Latinx families is $20,000 compared with $139,000 among white families possibly making it difficult to use their own funds for an extended period of time (U.S. Census Bureau 2015).
The government just passed a new $892 billion COVID relief package, and private foundations and companies are promising to help. Can these programs help small businesses survive the setbacks and shutdowns due to the coronavirus pandemic, or will more assistance be needed? Furthermore, will an added shift in consumer behavior away from large online retailers towards small businesses be needed? In light of the Black Lives Matter movement there has been an unprecedented push to support black-owned stores around the country, and states have promoted shopping local (e.g. California’s #ShopSafeShopLocal). In the end, getting the virus in check and restoring customer, owner and employee confidence in health risks is likely the first real step to a full recovery for small businesses.
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COVID-19, Small Business Owners, and Racial Inequality

Robert Fairlie

The widespread closing of businesses in the United States and around the world due to the coronavirus has been unprecedented. Stores, factories, and many other businesses have closed as a result of policy mandates, downward demand shifts, health concerns, or other factors. Although many have reopened since social distancing restrictions were relaxed, the revenues lost from the closures, the limited scale of current reopenings, and the potential for further closures in the future may lead to a wave of permanent small business closures with disproportionate impacts by race, gender, and nativity.

In several recent papers, I examine the impacts of COVID-19 on small business owners, using timely microdata from the Current Population Survey (CPS) and administrative data from the Small Business Administration. These new papers build on my longstanding research agenda on entrepreneurship, racial inequality, and small business policy. This summary reviews selected papers from both recent and earlier work.

Early Stages of the Pandemic

On March 19, 2020, the state of California imposed shelter-in-place restrictions, with New York State following the next day. By early April, most states had imposed social distancing restrictions that closed “nonessential” businesses and added to consumer health concerns in the emerging pandemic. Using CPS microdata, I examine how COVID-19 impacted small business owners in mid-April, the first month to capture these changes. Figure 1 shows that the number of working business owners plummeted from 15 million in February 2020 to 11.7 million in April 2020, the largest drop ever; the entire Great Recession only resulted in a drop of 5 percent. Even incorporated business owners, who tend to be more stable and growth-oriented than unincorporated owners, experienced a drop in work activity of 20 percent from February to April 2020.
Losses for businesses owned by women, racial minorities, and immigrants were especially severe [Figure 2]. African Americans experienced the largest losses: a 41 percent drop in the number of active business owners. Latinx business owners also experienced major losses: 32 percent. Immigrant business owners suffered a 36 percent drop, and female business owners 25 percent. Concentrations of female, Black, Latinx, and Asian businesses in industries hit hard by the pandemic, such as personal services, partly explain why the losses were higher for these groups than the national average. Extending the analysis into the second and third months following widespread shelter-in-place restrictions — May and June 2020 — business owner activity partially rebounded, but the disproportionate impacts from COVID-19 by gender, race, and immigrant status lingered. African Americans continued to experience the largest losses, with 26 percent of formerly active business owners still not reactivated in May and 19 percent not active in June. Job losses were also higher for minority workers.²
Overall, these early estimates of the impact of COVID-19 on small businesses indicate that losses were spread across demographic groups and types of business — no group was immune — but some groups were hit harder than others. Although there is no way to determine at present whether these business closures will be permanent, each additional month of inactivity has an impact on the revenues, profits, and employees of these businesses, and on their likelihood of ever reopening.³

**Policy Response to COVID-19**

Given the severity of the pandemic, the federal government provided more financial assistance to small businesses than ever previously seen. The largest programs providing funds to small businesses were the $660 billion Paycheck Protection Program (PPP) and the $220 billion Economic Injury Disaster Loan (EIDL) program. One of the goals stated in the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which included the PPP and EIDL programs, was to prioritize assistance to underserved markets and disadvantaged business owners.
But did the PPP and EIDL programs get disbursed to minority communities? Frank Fossen and I explore this question using administrative data on the universe of PPP loans, EIDL loans, and EIDL advances.\textsuperscript{4} We generally find a slightly positive relationship between PPP loan receipt per business and the minority share of the population. There is some evidence that the first round of funds was disproportionately disbursed to nonminority communities and that the second was disproportionately disbursed to minority communities. Focusing on PPP loan amounts per employee, we find a negative relationship with the minority share of the population. In contrast, EIDL loans and advances, in both number and amounts, were provided positively to minority communities.

**Ties to Broader, Long-Term Racial Inequality**

In earlier research, I explore the link between racial inequality in business outcomes and broader racial inequality. Research on earnings inequality almost exclusively focuses on the wage and salary sector and ignores the other major way to make a living — owning a business. Ten percent of the workforce, or 12 million people, own a business rather than holding a wage or salaried job. These owners hold a disproportionate amount of total wealth and create jobs for others.

Racial disparities in business formation raise concerns about lost economic efficiency. If minority entrepreneurs face liquidity constraints, discrimination, or other barriers to creating new businesses or expanding current ones, there will be efficiency losses in the economy. Barriers to entry and expansion are potentially costly to productivity and local job creation, especially as minorities represent a growing share of the population.

In a series of papers, I use various datasets to study the causes of racial and ethnic disparities in business ownership, formation, and outcomes, focusing on the constraints that limit productivity and cause inefficiencies in the economy. Work with Alicia Robb draws on confidential, restricted-access, business-level data from the US Census Bureau to explore why Asian American-owned firms perform well in comparison to White-owned businesses, while Black-owned firms typically do not.\textsuperscript{5} We find differential access to financial capital to be the largest factor. Family business experience also plays a role in explaining differences in outcomes. In more recent work, I examine potential barriers created by human capital, wealth, demographic, geographic, and industry constraints for each group using CPS and American Community Survey data.\textsuperscript{6} I find that low levels of wealth contribute to lower rates of Black and Latinx business ownership, and that high levels of wealth increase Asian business ownership rates. Low levels of education contribute to lower business income for Blacks and Latinx, and high levels of education increase Asian business income. The Black, Latinx, and Asian populations are all relatively young compared to the White population; this also contributes to lower business ownership rates in these groups.

Using confidential and restricted-access panel data from the Kauffman Firm Survey, along with matched administrative data on credit scores, Robb, David Robinson and I explore disparities in capital use between Black- and White-owned startups.\textsuperscript{7} We find
that Black-owned startups start smaller and stay smaller over the first eight years of their existence. Black startups face more difficulty in raising external capital, especially external debt. We find that disparities in creditworthiness constrain Black entrepreneurs; perceptions of treatment by banks also hold them back. Black entrepreneurs apply for loans less often than White entrepreneurs largely because they expect to be denied credit, even when they have a good credit history and in settings where strong local banks favor new business development.

Christopher Woodruff and I study why Mexican-American entrepreneurship is low in the United States even though self-employment rates are very high in Mexico.\(^8\) We find that low levels of education and wealth explain the entire gap between Mexican immigrants and non-Latinx Whites in business formation rates; together with language ability, these factors explain nearly the entire gap in business income. Legal status represents an additional barrier for Mexican immigrants.

Using census microdata from the United States, Canada, and the United Kingdom, Harry Krashinsky, Julie Zissimopoulos and I provide the first comparative examination of the education levels, business ownership, and business performance of Asian immigrants.\(^9\) We find that business ownership rates of Asian immigrants in the United States and Canada are similar to the national averages, and in the UK they are substantially higher than the national average and the highest among the three countries. Asian immigrants even from the same source country are generally much more educated in the United States than in Canada or the United Kingdom. Although there are many institutional, structural, and historical differences between the countries that might be responsible, one possibility is that the higher returns to education in the United States result in a more selective immigrant pool. Bruce Meyer and I study how groups interact in business ownership and find evidence of crowd-out between immigrant and native owners.\(^10\)
Governments and donors spend billions of dollars subsidizing entrepreneurship training and development programs around the world. Arguments for subsidizing training are manifold, and span theories of allocative and/or redistributive frictions in credit, labor, insurance, and human capital markets. Dean Karlan, Jonathan Zinman and I explore the effectiveness of entrepreneurship training programs by working with US Department of Labor data from the largest random experiment ever conducted evaluating entrepreneurship training.\textsuperscript{11} After controlling for selection into training, we find that entrepreneurship training has a sizable short-term impact on increasing business ownership and reducing unemployment, but no effect on business ownership or any business outcome such as sales, exit rates, profits, or employment in the medium and long term.

Policymakers have sought to improve success among minority business owners. In the United States, for example, although they are sometimes controversial, a variety of federal, state, and local government programs offer contracting goals, price discounts, and loans to businesses owned by minorities, women, and other groups that are
historically underrepresented among business owners. Aaron Chatterji, Kenneth Chay and I examine the effectiveness of affirmative action contracting programs for businesses owned by African Americans by using the staggered introduction of these contracting programs across cities in the 1980s. Black business ownership rates increased significantly after program initiation. On average, the Black-White gap fell 3 percentage points. Black gains were concentrated in industries heavily affected by contracting programs, and they mostly benefited those who were better educated.

NBER Today

Nikhil Agarwal, Analyzes the Trade-Offs Between Vaccine Targeting and COVID-19-Related Mortality
Lessons from Pandemic-Related Debt Forbearance
Robert Fairlie is a professor of economics at the University of California, Santa Cruz and an NBER research associate affiliated with the Economics of Education and Productivity, Innovation, and Entrepreneurship Programs. He is a regular participant in the Entrepreneurship Working Group and Economics of Education meetings, and plans on participating in the new Race and Stratification in the Economy Working Group.
Fairlie’s research interests include entrepreneurship, education, racial inequality, information technology, labor economics, and immigration. Recent research projects explore questions around causes and consequences of racial inequality, barriers to business creation and growth, whether technology helps students, constraints in higher education, whether there have been disproportionate impacts of COVID-19 by race and gender, and water conservation policy.

Fairlie received his PhD and MA from Northwestern University and BA with honors from Stanford University. He has held visiting positions at Stanford, Yale University, UC Berkeley, and Australian National University. He has received funding for his research from numerous government agencies and foundations and has testified to the US Senate, US House of Representatives, the Department of Treasury, and the California State Assembly regarding the findings of his research, and received a joint resolution of appreciation from the California legislature. He is regularly contacted by major news media to comment on economic, small business, inequality and policy issues.

Footnotes


Racial inequality in business ownership and income

Robert Fairlie*

Abstract: The large and persistent racial and ethnic disparities found in business ownership and performance contribute to broader economic inequality. Using the latest US Census household microdata and statistical decomposition techniques, I explore several potential barriers to minority business ownership and income. I examine patterns for the four major racial and ethnic groups in the United States: African-Americans, Latinos, Asians, and non-Latino whites. I find that low levels of wealth contribute to why blacks and Latinos have lower business ownership rates, and high levels of wealth increase Asian business ownership rates. Low levels of education contribute to why blacks and Latinos have lower business income, and high levels of education increase Asian business income. Blacks, Latinos, and Asians are relatively young compared to whites, reducing business ownership rates.

Keywords: entrepreneurship, race, ethnicity, self-employment, business ownership, inequality, diversity

JEL classification: J15, L26

I. Introduction

Income inequality is one of the most pressing societal issues. A major component of income inequality that has been documented and studied extensively is earnings inequality by race and ethnicity (Altonji and Blank, 1999). Recent estimates from the US Bureau of Labor Statistics (BLS), for example, indicate that African-American workers earn 77 per cent of white workers, and Latino workers earn 72 per cent of white workers.

Racial differences in business ownership and income also contribute to income inequality and in many cases are larger than income differences (Fairlie and Robb, 2008). Although these disparities have received much less attention in the literature, they are alarming because of their magnitude and the importance of business ownership as a way to make a living. Roughly one out of 10 workers, or 12m people, in the United States are self-employed business owners. These 12m business owners hold roughly 40 per cent of total US wealth (Bucks et al., 2006).

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I would like to thank Ken Mayhew for helpful comments and suggestions on the manuscript.

doi:10.1093/oxrep/gry019

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Policy-makers have been concerned for many years about improving success among minority business owners. In the United States, for example, although they are sometimes controversial, a variety of federal, state, and local government programmes offer contracting goals, price discounts, and loans to businesses owned by minorities, women, and other disadvantaged groups (Joint Center for Political and Economic Studies, 1994; Boston, 1999; Chatterji et al., 2014). One of the goals of these programmes is to foster minority business development, which may have implications for reducing earnings and wealth inequality (Bradford, 2003). Disadvantaged business owners have more upward income mobility and experience faster earnings growth than disadvantaged wage and salary workers (Holtz-Eakin et al., 2000; Fairlie, 2004). It has also been argued that some disadvantaged groups historically facing discrimination or blocked opportunities in the wage/salary sector, such as Chinese, Greek, Italian, Japanese, and Jewish people, have used business ownership as a source of economic advancement.1

Another concern is the loss in economic efficiency resulting from blocked opportunities for minorities to start and grow businesses.2 Business formation is associated with the creation of new industries, innovation, job creation, improvement in sector productivity, and economic growth (Reynolds, 2005). If minority entrepreneurs face liquidity constraints, discrimination, or other barriers to creating new business or expanding current businesses, there will be efficiency losses in the economy. Although it would be difficult to determine the value of these losses, barriers to entry and expansion that minority-owned businesses face are potentially costly to productivity, especially as minorities represent a growing share of the population in many industrialized countries. Barriers to business growth may be especially damaging for job creation in low-income neighbourhoods (Boston, 1999, 2006).

In this paper, I use the latest available microdata from the US Census Bureau to document business ownership and income patterns across the four major racial and ethnic groups in the United States: African-Americans, Latinos, Asians, and non-Latino whites. I next explore the causes of disparities in business ownership and income. Using statistical decomposition techniques, I examine potential barriers created by human capital, wealth, demographic, geographic, and industry constraints for each group.

The paper provides three main contributions to the previous literature on the potential barriers limiting business ownership and performance among minorities. Previous studies have identified wealth disparities, access to financial capital, discrimination in lending, other types of discrimination, human capital, family business background, social capital, and other factors as limiting minority business creation and success.3 First, instead of focusing on one or two hypothesized constraints, I use one overarching model to estimate the separate and independent contributions of several potential barriers. This is important because many potential factors (e.g. education, wealth, age, geography) are correlated with each other, and thus a separate analysis could be misleading. Second, much of the previous evidence focuses on constraints particular to

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1 See Glazer and Moynihan (1970), Loewen (1971), Light (1972, 1979), Baron et al. (1975), Bonacich and Modell (1980), and Sowell (1981).

2 Hsieh et al. (2016) find that falling occupational barriers for minority workers may explain one-fourth of aggregate growth in per capita GDP from 1960 to 2010.

3 For broader discussions and reviews of this literature, see Fairlie and Robb (2008), Bates (2011), Dávila and Mora (2013), for example.
African-American entrepreneurs, with fewer studies focusing on constraints faced by Latino entrepreneurs, and even fewer studies focusing on Asian entrepreneurs. In this paper, I use the same model to simultaneously examine constraints faced by African-Americans and Latinos and whether they mirror possible advantages experienced by Asians in business ownership and outcomes. The analysis of all four major racial and ethnic groups sheds new light on barriers to successful business ownership.

Third, I use the most recent data and an extremely large dataset to examine whether wealth, education, and other constraints identified in the previous literature continue to bind. The 2011–15 American Community Survey (ACS) includes a nationally representative sample of nearly 10m observations providing extremely precise estimates for all analyses.

The remainder of the paper is organized as follows. The next section describes the ACS data used in the analysis. Section III documents business ownership and income patterns among blacks, Latinos, Asians, and whites. Section IV provides estimates of the contributions of Latino entrepreneurs to the US economy. Section V concludes.

II. Data

The dataset used in this study is the latest 5-year sample of the American Community Survey (ACS), 2011–15. The ACS is a household survey and provides information on business ownership, income, and industries at the owner level. The ACS also provides information on immigration status. The ACS is one of the only nationally representative Census Bureau datasets that provides a large sample size of black, Latino, and Asian business owners.

The ACS includes over 9m observations for working-age adults (ages 20–64). Even after conditioning on business ownership, the sample size is very large, allowing one to explore the causes of differences in net business income. The ACS includes more than half a million observations for business owners.

In the ACS microdata, business ownership is measured by using the class-of-worker question that refers to the respondent’s main job or business activity (i.e. activity with the most hours) at the time of the interview. Business owners are individuals who report that they are (i) ‘self-employed in own not incorporated business, professional practice, or farm’, or (ii) ‘self-employed in own incorporated business, professional practice, or farm’. This definition includes owners of all types of businesses—incorporated, unincorporated, employer, and non-employer firms. The samples used in this analysis include all business owners aged 20–64 (i.e. working-age adults) who work 15 or more hours per week in their businesses. To rule out very small-scale businesses, disguised unemployment, or casual sellers of goods and services, only business owners with 15 or more hours worked are included. Fifteen hours per week is chosen as the cut-off because it represents a reasonable amount of work effort in the business (roughly 2 days per week). Note that self-employed business ownership is defined as the individual’s main job activity, thus removing the potential for counting side businesses owned by

---

4 Some unemployed individuals may report being self-employed if they sell a small quantity of goods or services while not working at their regular jobs.
wage-and-salary workers. Also, estimates are reported with and without the 15-hour restriction to show the robustness of disparities in business ownership rates. Finally, the self-employment information is self-reported and not based on tax or business registration filings, and thus may capture a wide range of self-employment activities depending on the respondent.5

Business income is calculated from survey questions about income sources. The main question used is: ‘Self-employment income from own nonfarm businesses or farm businesses, including proprietorships and partnerships. Report NET income after business expenses.’ Most business owners report this type of income, but incorporated business owners report their earnings from the business as wage and salary earnings. For simplification and consistency in treatment the responses to self-employment income and wage and salary earnings are combined for all business owners. The questions refer to annual income and capture the past 12 months.

The ACS provides the most comprehensive data available on business owners by the race and ethnicity of owners.6 The four major racial and ethnic groups are defined for comparison: blacks, Latinos, Asians, and non-Latino whites. Multiple race individuals are included in each racial and ethnic category.

III. Business ownership and income patterns

Estimates of the number of business owners, business ownership rates, and business income are first presented. All estimates are from the ACS (2011–15), which as noted above is the latest available household data from the US Census Bureau on business ownership and income. Table 1 reports estimates for blacks, Latinos, Asians, and non-Latino whites. There are roughly 800,000 black and Asian business owners in the United States, and 1.8m Latino business owners. In comparison, there are nearly 9m non-Latino white business owners. The total number of business owners is 12.2m.

Blacks are the most underrepresented group in business ownership. Out of the population only 3.0 per cent of blacks own a business. Latinos have the next lowest level of business ownership relative to population at 5.8 per cent. The Asian business ownership to population rate is 6.6 per cent and the non-Latino white rate is 7.3 per cent.

Focusing on business owners with a work commitment of 15 or more hours worked per week, the total number of business owners is lower, but not substantially lower. There are roughly 700,000 black business owners, 1.7m Latino business owners, 750,000 Asian business owners, and 8.3 million white business owners after using this restriction. The total number of business owners in the United States that work 15+ hours per week is 11.4m. Imposing the hours-worked restriction is useful for removing individuals who might be partly unemployed and just have part-time self-employment work as a method of generating some income.

5 There also could be underreporting of self-employment activities in the ACS.
6 It is assumed that undocumented immigrants are captured in the ACS. The ACS immigrant population is compared to Department of Homeland Security data to estimate the size of the undocumented population in the United States (see Hoefer et al., 2012, for example).
Another commonly used measure of the rate of business ownership conditions on being in the workforce. The percentage of the workforce that owns a business is 4.5 per cent among blacks and 7.9 per cent among Latinos. The business ownership to workforce rates are higher for Asians (9.0 per cent) and non-Latino whites (9.6 per cent). For all groups conditioning on being in the workforce increases business ownership rates, but the rankings across groups does not change. In particular, the relatively low rates of business ownership among blacks and Latinos are not due to higher levels of unemployment or not being in the labour force, but instead are driven by lower propensities to own businesses.

(i) Business income

Among business owners there are large disparities in business income across racial and ethnic groups. Table 2 reports estimates of business income across groups. Blacks and Latinos have substantially lower levels of business income than Asian and non-Latino whites. Mean business income is $34,475 for Latinos and $39,170 for blacks. The mean level of business income for Latinos is roughly $30,000 lower than mean business income among non-Latino whites. Black business owners have an average business income that is roughly $25,000 lower than the white level. The disparity in business income is much larger than the disparity in business ownership rates for blacks and Latinos.

When comparing parts of the distribution, blacks and Latinos are disadvantaged in business income. Table 2 also reports the median, 25th percentile, and 75th percentile levels of business income. For all three points along the distribution, black and Latinos have lower business income levels than do whites.

### Table 1: Business ownership rates by race and ethnicity, ACS 2011–15

<table>
<thead>
<tr>
<th>Group</th>
<th>Black</th>
<th>Latino</th>
<th>Asian</th>
<th>Non-Latino whites</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (ages 20–64)</td>
<td>25,570,220</td>
<td>31,247,449</td>
<td>12,004,998</td>
<td>121,520,318</td>
</tr>
<tr>
<td>Business owners</td>
<td>773,448</td>
<td>1,817,236</td>
<td>794,606</td>
<td>8,820,771</td>
</tr>
<tr>
<td>Percentage of population</td>
<td>3.0</td>
<td>5.8</td>
<td>6.6</td>
<td>7.3</td>
</tr>
<tr>
<td>Workforce (15+ hours/week worked)</td>
<td>15,686,385</td>
<td>21,320,868</td>
<td>8,323,278</td>
<td>86,387,463</td>
</tr>
<tr>
<td>Business owners (15+ hours)</td>
<td>709,536</td>
<td>1,692,007</td>
<td>751,493</td>
<td>8,277,854</td>
</tr>
<tr>
<td>Percentage of workforce (15+ hours)</td>
<td>4.5</td>
<td>7.9</td>
<td>9.0</td>
<td>9.6</td>
</tr>
</tbody>
</table>

### Table 2: Business income by race and ethnicity, ACS 2011–15

<table>
<thead>
<tr>
<th>Group</th>
<th>Black</th>
<th>Latino</th>
<th>Asian</th>
<th>Non-Latino whites</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business owners</td>
<td>773,448</td>
<td>1,817,236</td>
<td>794,606</td>
<td>8,820,771</td>
</tr>
<tr>
<td>Mean business income</td>
<td>$39,170</td>
<td>$34,475</td>
<td>$60,950</td>
<td>$63,329</td>
</tr>
<tr>
<td>75th percentile</td>
<td>$45,070</td>
<td>$37,558</td>
<td>$63,563</td>
<td>$70,088</td>
</tr>
<tr>
<td>Median</td>
<td>$23,608</td>
<td>$20,192</td>
<td>$31,297</td>
<td>$35,335</td>
</tr>
<tr>
<td>25th percentile</td>
<td>$10,429</td>
<td>$16,096</td>
<td>$10,429</td>
<td>$18,672</td>
</tr>
<tr>
<td>Business owners (15+ hours)</td>
<td>709,536</td>
<td>1,692,007</td>
<td>751,493</td>
<td>8,277,854</td>
</tr>
<tr>
<td>Mean business income (15+ hours)</td>
<td>$41,694</td>
<td>$36,246</td>
<td>$63,492</td>
<td>$66,618</td>
</tr>
<tr>
<td>75th percentile</td>
<td>$48,289</td>
<td>$40,051</td>
<td>$66,083</td>
<td>$73,815</td>
</tr>
<tr>
<td>Median</td>
<td>$25,442</td>
<td>$20,857</td>
<td>$33,893</td>
<td>$37,558</td>
</tr>
<tr>
<td>25th percentile</td>
<td>$12,303</td>
<td>$18,023</td>
<td>$12,015</td>
<td>$18,672</td>
</tr>
</tbody>
</table>
Low mean business income among blacks and Latinos is also not driven by business owners working few hours. Table 2 also reports mean business income conditioning on working 15+ hours per week. Using this restriction, mean business income among Latinos is $36,246 and $41,694 for blacks. Mean business income among non-Latino whites is $66,618. Using both measures, Asian mean business income is only slightly lower than white levels.

IV. Potential explanations for differences in business ownership rates and income

To investigate what causes differences in business ownership rates I first examine differences in population characteristics. Differences in population characteristics such as education and wealth levels may explain why blacks and Latinos have much lower business ownership rates than whites. Furthermore, differences in these same characteristics among business owners might explain why blacks and Latinos have lower business income. Some of these characteristics may be more important in contributing to the disadvantages for blacks than for Latinos or vice versa.

(i) Differences in education, wealth, and other characteristics

Table 3 presents differences in education, wealth, and other characteristics for the working-age population by ethnic/racial group. There are major differences in characteristics across racial and ethnic groups.

Latinos are younger on average than non-Latino whites. Blacks and Asians are also younger on average, but the differences from white levels are smaller. This pattern of a younger average age poses a disadvantage because business ownership has been found
to be positively associated with age. The only age difference that appears to be large, however, is the one between Latinos and whites.

Latinos are less educated: only 10 per cent have a college degree (without a further degree) and 4 per cent have a graduate degree, whereas 21 per cent of whites have a college degree and 10 per cent have a graduate degree. The percentage of high school drop-outs among Latinos is 31 per cent, which is considerably higher than for whites. Blacks also have lower levels of education, with 13 per cent high school drop-outs and only 12 per cent with a college degree and 6 per cent with a graduate degree. Among non-Latino whites only 6 per cent are high school drop-outs and 22 per cent have college degrees and 11 per cent have graduate degrees. Asians, however, have the highest levels of higher education degrees, with 30 per cent having a college degree and 20 per cent having a graduate degree.

Another major difference across racial and ethnic groups is wealth. The ACS includes information on home ownership, house values, and interest/dividend income. Home values represent the largest component of wealth for most individuals. Interest and dividend income represents another good measure of wealth. Blacks and Latinos are much less likely than whites to own houses, and the houses they own have lower values on average. The disparities are substantial, with only 43 per cent of blacks owning a house with those houses being worth $190,266 on average. In contrast, 70 per cent of whites own a house and those houses are worth $273,811 on average. Latinos also have low rates of home ownership (48 per cent) and home values (at $227,229). Both black and Latinos have much less interest and dividend income than whites. Asians have lower rates of home ownership (70 per cent) and interest income ($1,050), but much higher average home values (at $439,066).

Another major difference across racial and ethnic groups is their geographical concentrations across the country. The majority of blacks live in the South, whereas the South captures no more than 37 per cent of the population for any other group. Nearly half of all Asians live in the West, and 40 per cent of Latinos live in the West. The Midwest captures 26 per cent of the white population, which is the highest of all groups.

Focusing on family characteristics, marriage rates are substantially lower among blacks than whites. Latinos also have lower marriage rates than whites, but Asians have higher rates. The average number of children is higher among Latinos than other groups. Both marriage and children have been found to be associated with business ownership.

Overall, there exist major differences in education, wealth, geography, and other characteristics across racial and ethnic groups. Both blacks and Latinos generally have disadvantaged socioeconomic characteristics. Previous research, which is discussed below, indicates that many of these characteristics are important in determining business ownership and outcomes.

7 The survey question asks about income from: ‘Interest, dividends, net rental income, royalty income, or income from estates and trusts. Report even small amounts credited to an account.’
Industry distributions of business owners differ across racial and ethnic groups. Table 4 reports industry distributions for business owners. Latino business owners are concentrated in construction (23.4 per cent), professional services (20.8 per cent), and other services (19.5 per cent). The distribution across industries is not substantially different from the distribution across industries for non-Latino white men. The main exception is that only 10.8 per cent of white business owners are in other services. Black business owners are less concentrated in construction (11.9 per cent) and more concentrated in transportation (10.5 per cent), health care and social assistance (14.7 per cent), and other services (18.0 per cent). Asian business owners have the most dissimilar industry distribution, with much higher concentrations in retail (14.3 per cent) and accommodation, recreation, and entertainment (13.7 per cent), and a much lower concentration in construction (5.1 per cent).

The patterns across industries might contribute to differences in mean business income. The decompositions presented in the next section shed direct light on this question.

Decomposition technique

The comparison of average characteristics across ethnic/racial groups identifies several potential barriers to business ownership and income. Although there are large differences in many of these characteristics we do not know how much they contribute directly to business ownership and income disparities. To explore this question I perform a decomposition technique that allows one to estimate the separate contributions from differences between groups in education, home ownership, and other characteristics to the racial and ethnic gaps in business ownership rates and income.

The advantage of this technique is that it allows for a precise estimate of how much a factor contributes to the disparity. For example, the technique can answer the question of what percentage of the gap in business ownership between blacks and whites is due

<table>
<thead>
<tr>
<th>Group</th>
<th>Blacks</th>
<th>Latinos</th>
<th>Asians</th>
<th>Non-Latino whites</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of businesses</td>
<td>709,422</td>
<td>1,691,501</td>
<td>751,358</td>
<td>8,273,387</td>
</tr>
<tr>
<td>Agriculture/extraction (%)</td>
<td>0.7</td>
<td>1.3</td>
<td>1.0</td>
<td>5.9</td>
</tr>
<tr>
<td>Construction (%)</td>
<td>11.9</td>
<td>23.4</td>
<td>5.1</td>
<td>17.7</td>
</tr>
<tr>
<td>Manufacturing (%)</td>
<td>1.6</td>
<td>2.2</td>
<td>3.2</td>
<td>3.9</td>
</tr>
<tr>
<td>Wholesale (%)</td>
<td>1.2</td>
<td>1.9</td>
<td>3.8</td>
<td>2.5</td>
</tr>
<tr>
<td>Retail (%)</td>
<td>5.6</td>
<td>6.8</td>
<td>14.3</td>
<td>7.7</td>
</tr>
<tr>
<td>Transportation (%)</td>
<td>10.5</td>
<td>5.3</td>
<td>5.8</td>
<td>3.5</td>
</tr>
<tr>
<td>Information/finance (%)</td>
<td>8.0</td>
<td>4.9</td>
<td>7.3</td>
<td>10.0</td>
</tr>
<tr>
<td>Professional services (%)</td>
<td>19.7</td>
<td>20.8</td>
<td>16.1</td>
<td>21.7</td>
</tr>
<tr>
<td>Educational services (%)</td>
<td>1.7</td>
<td>0.8</td>
<td>1.8</td>
<td>1.7</td>
</tr>
<tr>
<td>Health care and social assistance (%)</td>
<td>14.7</td>
<td>7.8</td>
<td>11.9</td>
<td>8.4</td>
</tr>
<tr>
<td>Accommodation, recreation, and entertainment (%)</td>
<td>6.4</td>
<td>5.4</td>
<td>13.7</td>
<td>6.2</td>
</tr>
<tr>
<td>Other services (%)</td>
<td>18.0</td>
<td>19.5</td>
<td>16.0</td>
<td>10.8</td>
</tr>
</tbody>
</table>
to education disparities. Similarly, the technique can estimate this percentage for each of the other factors included in the multivariate regression model.

The decomposition technique is extremely useful for identifying causes of group disparities in outcome variables such as business ownership and income. Specifically, we ‘decompose’ inter-group differences in a dependent variable into those due to different observable characteristics across groups (sometime referred to as the endowment effect) and those due to different ‘prices’ of characteristics of groups (see Blinder (1973) and Oaxaca (1973)). The Blinder–Oaxaca decomposition of the white/minority gap in the average value of the dependent variable, $Y$, can be expressed as:

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

Similarly to most recent studies applying the decomposition technique, I focus on estimating the first component of the decomposition that captures contributions from differences in observable characteristics or ‘endowments’. I do not report estimates for the second or ‘unexplained’ component of the decomposition because it partly captures contributions from group differences in unmeasurable characteristics and is sensitive to the choice of left-out categories, making the results difficult to interpret. I also weight the first term of the decomposition expression using coefficient estimates from a pooled sample of all groups (see Oaxaca and Ransom (1994), for example).

It is becoming increasingly popular when studying racial differences to use the full sample of all races to estimate the coefficients, instead of one group such as whites (see Fairlie (2017) for more details). It is advantageous in that it incorporates the full market response and does not exclude rapidly growing groups of the population (i.e. Hispanics and Asians). It is also advantageous in situations with multiple group comparisons because it creates a common base.

The contribution from ethnic/racial differences in the characteristics can thus be written as:

$$
(\bar{X}^W - \bar{X}^M) \hat{\beta}^W
$$

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

The Blinder–Oaxaca decomposition represented in equation (2) is used to identify the causes of differences in business income. For business ownership, which is equal to 0 or 1, an alternative non-linear decomposition technique is used (Fairlie, 1999).

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9 Dummy variables for each race/ethnic group are also included in the underlying regression.

10 In the Blinder–Oaxaca technique the contribution estimates are insensitive to the choice of the left-out category. For example, the percentage explained by education would be the same if the lowest education category is the left-out category in the underlying regressions or if the highest education category is the left-out category in the underlying regressions.
(iv) Decomposition results for business ownership

Table 5 reports estimates from the procedure for decomposing gaps in business ownership between whites and blacks, Latinos, and Asians separately. The decompositions provide estimates of how much each gap is due to differences in characteristics between whites and the minority group of comparison. Column 1 reports estimates for the factors contributing to the difference in business ownership rates between non-Latino whites and blacks. For convenience, the first two rows repeat group business ownership rates previously reported in Table 1. The black business ownership rate is 2.8 per cent and the white rate is 6.8 per cent, forming a gap of 4.0 percentage points. The decomposition reveals that one of the most important contributing factors is wealth. Relatively low levels of wealth among blacks explains 0.86 percentage points (or 21.2 per cent) of why business ownership rates are lower for this group.

Another important factor is age. The younger average age of blacks in the working-age population contributes to why they have lower business ownership rates than whites.

Table 5: Decompositions of business ownership rate gaps

<table>
<thead>
<tr>
<th></th>
<th>Blacks</th>
<th>Latinos</th>
<th>Asians</th>
</tr>
</thead>
<tbody>
<tr>
<td>White business ownership rate</td>
<td>0.0681</td>
<td>0.0681</td>
<td>0.0681</td>
</tr>
<tr>
<td>Minority business ownership rate</td>
<td>0.0277</td>
<td>0.0541</td>
<td>0.0626</td>
</tr>
<tr>
<td>White/minority group gap</td>
<td>0.0404</td>
<td>0.0140</td>
<td>0.0055</td>
</tr>
<tr>
<td>Contributions from racial differences in:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Age</td>
<td>0.0039</td>
<td>0.0069</td>
<td>0.0042</td>
</tr>
<tr>
<td></td>
<td>(0.0000)</td>
<td>(0.0000)</td>
<td>(0.0000)</td>
</tr>
<tr>
<td></td>
<td>9.7%</td>
<td>49.2%</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>–0.0004</td>
<td>–0.0009</td>
<td>0.0003</td>
</tr>
<tr>
<td></td>
<td>(0.0000)</td>
<td>(0.0001)</td>
<td>(0.0000)</td>
</tr>
<tr>
<td></td>
<td>–1.1%</td>
<td>–6.7%</td>
<td></td>
</tr>
<tr>
<td>Wealth</td>
<td>0.0086</td>
<td>0.0068</td>
<td>–0.0067</td>
</tr>
<tr>
<td></td>
<td>(0.0001)</td>
<td>(0.0001)</td>
<td>(0.0001)</td>
</tr>
<tr>
<td></td>
<td>21.2%</td>
<td>48.7%</td>
<td></td>
</tr>
<tr>
<td>Region</td>
<td>–0.0007</td>
<td>–0.0010</td>
<td>–0.0004</td>
</tr>
<tr>
<td></td>
<td>(0.0000)</td>
<td>(0.0000)</td>
<td>(0.0001)</td>
</tr>
<tr>
<td></td>
<td>–1.8%</td>
<td>–7.1%</td>
<td></td>
</tr>
<tr>
<td>Family characteristics</td>
<td>0.0028</td>
<td>–0.0014</td>
<td>–0.0017</td>
</tr>
<tr>
<td></td>
<td>(0.0000)</td>
<td>(0.0000)</td>
<td>(0.0000)</td>
</tr>
<tr>
<td></td>
<td>7.0%</td>
<td>–9.9%</td>
<td></td>
</tr>
<tr>
<td>All included variables</td>
<td>0.0141</td>
<td>0.0104</td>
<td>–0.0042</td>
</tr>
<tr>
<td></td>
<td>35.0%</td>
<td>74.1%</td>
<td></td>
</tr>
</tbody>
</table>

Notes: (i) All decomposition specifications use pooled coefficient estimates from the full sample of all races (and include a full set of race dummies in the logit models). (ii) Sampling weights are used in all specifications. (iii) Standard errors are reported in parentheses below contribution estimates.

11 See Appendix Table 1 for underlying logit regression estimates.
12 There is also evidence from different data that minority businesses experience higher loan denial probabilities and pay higher interest rates than white-owned businesses, even after controlling for differences in credit-worthiness, and other factors (Cavalluzzo et al., 2002; Coleman, 2002, 2003; Blanchflower et al., 2003; Mitchell and Pearce, 2004, 2011; Cavalluzzo and Wolken, 2005; Blanchard et al., 2008; Bates and Robb, 2015).
whites. Business ownership increases with age as individuals gain experience and general skills. Family characteristics also contribute to the gap in business ownership rates between whites and blacks. Low marriage rates and a positive association between marriage and business ownership partly contributes to why blacks have lower business ownership rates.

Interestingly, education disparities do not contribute to why blacks are less likely to own businesses. This is because higher education is not found to be a strong predictor of business ownership rates. It is important to keep in mind that these results hold for business ownership which for many individuals captures a form of ‘necessity’ employment. Many individuals turn to business ownership when they cannot find a job in the wage and salary sector. The results differ for business income, as shown below.

For Latinos the decomposition reveals that the most important contributing factor is wealth. Relatively low levels of wealth among Latinos explain 0.68 percentage points (or 48.7 per cent) of why business ownership rates are lower for this group. Another very important factor for Latinos is age. The younger average age of Latinos in the working-age population contributes to why they have lower business ownership rates than whites.

Both regional and family characteristic differences are favourable for Latinos relative to whites, as evidenced by the negative contribution estimates. The contribution estimate of –0.14 percentage points (or –9.9 per cent) for family characteristics indicates that Latinos have higher marriage rates and marriage is positively associated with business ownership. Thus, this characteristic is favourable for Latinos relative to whites. Also, it suggests that the gap between Latino and white business ownership rates would be 0.14 percentage points higher if Latinos had similar marriage rates as whites. Latinos also have a ‘favourable’ regional distribution, living in regions of the country that have higher than average business ownership rates. For example, Latinos are much more likely to live in the West which has relatively high business ownership rates.

The results are generally consistent with previous research that decomposes gaps in business ownership or transitions into and out of business ownership for blacks and Latinos. Fairlie (1999), using the Panel Study of Income Dynamics, finds that wealth and education disparities are important for black men. Fairlie and Woodruff (2010), using the Current Population Survey and earlier ACS data, find evidence that low Mexican-American business ownership and formation are partly due to education and wealth disparities. Lofstrom and Wang (2009), using Survey of Income and Program Participation data, also find that low levels of wealth for Mexican-Americans and other Latinos works to lower self-employment entry rates. Interestingly, using the same underlying regression coefficients, the contribution for African-Americans is higher for wealth than the contribution for Latinos. But, because the gap is smaller for Latinos, wealth disparities explain a higher percentage of the gap.

Column 3 reports decomposition estimates for Asians. There is essentially no business ownership gap between whites and Asians (and thus percentage contributions are not reported because of the small base). Although there is no gap to ‘explain’ from group differences in characteristics, nevertheless decomposition results can be informative about advantages and disadvantages faced by Asians relative to whites. The most important factor relevant for this exercise is wealth. The large negative contribution estimate on wealth indicates that Asians have an advantage in that they have higher
wealth on average than whites. The contribution estimate implies that without this wealth advantage the Asian business ownership rate would be 0.67 percentage points lower. On the other hand, the working-age Asian population is younger than the white working-age population, holding business ownership rates down by 0.42 percentage points.

(v) Decomposition results for business income

I now turn to discussing the decomposition results for business income. The business income gaps were consistently large. Table 6 reports estimates from the procedure for decomposing the white-minority group gaps in business income into differences in characteristics. The included variables are the same as before with two important exceptions. First, wealth is not included in the models for business income because more successful business owners are likely to accumulate more wealth. Thus, this reverse causality would create a problem for estimating the effects of differences in wealth on differences in business income. Second, industry was not included in the models for business ownership because starting a business and its industry is a joint decision, whereas for business income the decision has already been made and there are important differences in income levels across industries. The decompositions include the same 12 industry classifications as listed in Table 4.

Column 1 reports estimates for blacks. The underlying regression models estimated for the decompositions use log business income which is common in working with earnings or income data because it improves the fit of the model and limits the influence of large outliers. The log business income of blacks is 9.92 which is 42 log points (or roughly 42 per cent) lower than the white level of 10.33. The most important factor explaining the business income difference is education. Low levels of education among black business owners explain 7 log points (or 18 per cent) of the gap in business income. The next largest contribution is from family characteristics. Relatively low marriage rates among black business owners explain part of the gap in business income. Industry differences explain 5 per cent of the business income gap. Black business owners are concentrated in lower-income industries, although the explanatory power of industry differences is not large.

Among Latinos mean log business income is 9.89, which is 44 log points (or roughly 44 per cent) lower than the white level. The most important factor explaining the business income difference is education. Low levels of education among Latino business owners explain 20 log points (or 46 per cent) of the gap in business income. Industry concentrations make a small contribution to the gap (5 per cent). The finding for industry is important and suggests that business income is not low overall among Latino

---

13 See Appendix Table 2 for underlying linear regression estimates.
14 One problem, however, with using logs is that very small and zero income observations tend to overly influence the estimates. To address this issue I right and left censor the data at + or – $1,000. Thus, any business income value from 0 to 1,000 is given a value of log(1,000) and from –1,000 to 0 is given a value of –log(1,000). Negative values of income are reversed in sign prior to taking logs to avoid problems with taking logs of negative values (e.g. –10,000 would be –log(10,000)). In no case do I remove any business income observations. The general idea is that a business owner with less than $1,000 in business income has business income that is indistinguishable from $0. I find that using alternative cut-offs does not change the results.
business owners because they are concentrated in a few industries. As noted above, Latinos are younger than non-Latino whites on average. The relative youth of Latinos contributes to the gap in business income, explaining 4.4 per cent of the gap. Regional differences and family characteristics differences do not contribute to the gap in business income.

Column 3 reports decomposition estimates for Asians. There is essentially no business income gap between whites and Asians (and thus per cent contributions are not reported because of the small base). Although there is no gap to ‘explain’ from group differences in characteristics, nevertheless decomposition results can be informative about relative advantages and disadvantages faced by Asians relative to whites. The two factors that are relevant for this exercise are education and industry. The negative contribution estimate on education indicates that Asians have an advantage in that they are more educated on average than are whites. The contribution estimate implies that without this educational advantage Asian business income would be 4.9 log points lower. On the other hand, Asian business owners are concentrated in lower-income industries, holding business income down by 5.7 log points.

Education differences are the most important factor across all major racial and ethnic groups in explaining business income patterns. Low levels of education among blacks and especially among Latinos explain a part of why these groups have lower business income. In this case, the explanatory power of education disparities is larger in both absolute and percentage terms for Latinos compared to African-Americans. Working in the opposite direction, higher levels of education among Asian business owners place upward pressure on their business income relative to whites.
The results are generally consistent with findings from the previous literature. For example, Fairlie and Woodruff (2010) find that Mexican-American business owners have lower incomes than non-Latino white business owners, and that most of the difference is due to low levels of education among Mexican-American owners. Fairlie and Robb (2008) find, using the 1992 Characteristics of Business Owners (CBO) data, that African-American-owned businesses are less successful, partly because of lower owner education levels, and Asian-owned businesses are more successful, partly because of higher owner education levels.

V. Conclusions

The analysis of the latest available household microdata from the US Census Bureau provides several new findings on racial and ethnic disparities in business ownership and income. Minority groups make up large numbers of business owners in the United States and other countries. There are 600,000 black business owners, 1.8m Latino business owners, and 800,000 Asian business owners in the United States. Total business income generated by these businesses is $30 billion for black business owners, $63 billion for Latino business owners, and $48 billion for Asian business owners.

Using a decomposition technique that simultaneously explores various potential barriers to minority business ownership and income, I find that wealth is the most important factor contributing to racial and ethnic patterns in business ownership. Across the three measures of wealth used here, blacks have 16–69 per cent of white levels. Wealth disparities alone (controlling for everything else) explain 0.86 percentage points (or 21 per cent) of the gap in business ownership rates between blacks and whites. Latinos also have low levels of wealth, ranging from 20 to 83 per cent of white levels, which explains 0.68 percentage points (or 49 per cent) of the gap in business ownership. Asians, on the other hand, have relatively high levels of wealth increasing their business ownership rates (0.67 percentage points).

Education is the most important factor explaining racial and ethnic patterns in business income. Only 18 per cent of blacks and 14 per cent of Latinos have a college or higher degree. Asians have the highest college graduate rate at 50 per cent (whites have a college graduate rate of 33 per cent). Putting these patterns together, low levels of education hold blacks and Latinos back in business income, but high levels of education increase business income among Asians. Using the same underlying model, I find that educational disparities are the most detrimental for Latino business income.

Age is also found to be an important factor in the decompositions for business ownership and to a lesser degree business income. Older workers have more work and business experience which is valuable in business ownership and outcomes. Blacks, Latinos, and Asians have younger population distributions than whites, representing a disadvantage faced by all three minority groups relative to whites. But, age differs from traditional constraints related to inequality, such as financial capital and human capital. Further research needs to uncover why age is important to guide policy solutions.

15 Minority-owned businesses also represent a large and rapidly growing share of businesses in many other developed countries. For example, minority-owned businesses grew by 84 per cent from 2002 to 2012 in Germany (compared with non-minority growth rate of 5 per cent (Fossen, 2015). In the United Kingdom, the ethnic minority share of businesses was 7 per cent for employers and 5 per cent for non-employers (UK Department for Business, Innovation & Skills, 2015).
These findings across the three major minority groups in the United States are important and novel because the separate group contributions are estimated within the same embedded model. Thus, the scale of contributions can be compared directly. For example, I find that educational disparities have a nearly three times larger explanatory power for Latinos than for blacks in contributing to business income differences. In contrast, most of the previous research on minority entrepreneurship focuses on one group, making it difficult to compare results across groups because it requires also making comparisons across different studies, datasets, models, and definitions. More research taking a comparative race approach instead of narrowly focusing on one group is needed to better understand what drives entrepreneurial inequality.

To reduce racial and ethnic disparities, policies to improve wealth, credit scores, and the general financial health of minority business owners may be helpful. Wealth inequality may be directly addressed through expanding asset building programmes such as financial education programmes, individual development accounts (IDAs), and first-time home ownership programmes. Access to financial capital can be increased through government programmes and community banks. Policies to promote educational attainment in general and among business owners more specifically would also be helpful. Programmes targeted at increasing educational opportunities for minorities may result in better business outcomes among minority business owners. These policies are also likely to have an indirect long-term effect on business ownership and success through reducing wealth inequality. Higher levels of education are associated with higher levels of wealth. More research on the impacts of specific educational programmes, however, is needed. But certainly any policies that increase high school and college graduation rates will not only be useful in increasing business income directly, but also indirectly through their impacts on wealth.

### Appendix Table 1: Logit regressions for business ownership, ACS 2011–15

<table>
<thead>
<tr>
<th>Variable</th>
<th>Marginal effect</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Black</td>
<td>−0.0403</td>
<td>0.0003</td>
<td>−117.64</td>
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<td>Latino</td>
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<td>−11.32</td>
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<td>Native American</td>
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<td>0.0007</td>
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<tr>
<td>Other race</td>
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<td>0.0015</td>
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<td>0.0000</td>
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<td>0.0003</td>
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<td>&lt;.0001</td>
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<tr>
<td>Grad school</td>
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<td>−8.66</td>
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<tr>
<td>Home owner</td>
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<td>House value squared</td>
<td>−0.0004</td>
<td>0.0000</td>
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<tr>
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<td>0.0000</td>
<td>−20.36</td>
<td>&lt;.0001</td>
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<tr>
<td>Midwest</td>
<td>0.0029</td>
<td>0.0003</td>
<td>10.51</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>South</td>
<td>0.0081</td>
<td>0.0002</td>
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<tr>
<td>West</td>
<td>0.0068</td>
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<tr>
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<td>0.0002</td>
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<tr>
<td>Children squared</td>
<td>−0.0004</td>
<td>0.0000</td>
<td>−10.87</td>
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**Notes:** (i) The sample size is 9,086,560. (ii) The dependent variable is business ownership (0,1). (iii) Sampling weights are used in all specifications.
Appendix Table 2: Regressions for log business income, ACS 2011–15

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard error</th>
<th>T-statistic</th>
<th>P-value</th>
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<td>Asian</td>
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<td>0.0015</td>
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<td>-0.2810</td>
<td>0.0223</td>
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<tr>
<td>Other race</td>
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</tr>
<tr>
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<td>0.0020</td>
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<td>&lt;.0001</td>
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<tr>
<td>Age squared</td>
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<td>0.0000</td>
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<td>HS graduate</td>
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<td>0.0100</td>
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<td>&lt;.0001</td>
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<tr>
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<td>0.2661</td>
<td>0.0100</td>
<td>26.53</td>
<td>&lt;.0001</td>
</tr>
<tr>
<td>College</td>
<td>0.5905</td>
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<tr>
<td>Grad school</td>
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<td>90.55</td>
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<tr>
<td>Midwest</td>
<td>-0.1395</td>
<td>0.0087</td>
<td>-16.13</td>
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<td>South</td>
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<td>0.0076</td>
<td>-9.85</td>
<td>&lt;.0001</td>
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<tr>
<td>West</td>
<td>-0.0760</td>
<td>0.0081</td>
<td>-9.36</td>
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<tr>
<td>Married</td>
<td>0.1703</td>
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<tr>
<td>Children</td>
<td>0.0485</td>
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<td>9.51</td>
<td>&lt;.0001</td>
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<td>Children squared</td>
<td>-0.0045</td>
<td>0.0012</td>
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<td>Construction</td>
<td>0.1133</td>
<td>0.0138</td>
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<td>Manufacturing</td>
<td>0.1042</td>
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<tr>
<td>Wholesale</td>
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<td>0.0210</td>
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<tr>
<td>Retail</td>
<td>-0.1793</td>
<td>0.0155</td>
<td>-11.57</td>
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<tr>
<td>Transportation</td>
<td>0.2459</td>
<td>0.0176</td>
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<tr>
<td>Information</td>
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<td>0.0249</td>
<td>0.02</td>
<td>0.9833</td>
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<td>Finance</td>
<td>0.2585</td>
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<tr>
<td>Professional services</td>
<td>0.0927</td>
<td>0.0138</td>
<td>6.72</td>
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<tr>
<td>Educational services</td>
<td>-0.4493</td>
<td>0.0244</td>
<td>-18.40</td>
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<tr>
<td>Health care and social assistance</td>
<td>0.0299</td>
<td>0.0156</td>
<td>1.91</td>
<td>0.0556</td>
</tr>
<tr>
<td>Accommodation, recreation, and entertainment</td>
<td>-0.1959</td>
<td>0.0161</td>
<td>-12.16</td>
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<tr>
<td>Other services</td>
<td>-0.2880</td>
<td>0.0144</td>
<td>-20.00</td>
<td>&lt;.0001</td>
</tr>
</tbody>
</table>

Notes: (i) The sample size is 572,350. (ii) The dependent variable is log business income. (iii) Sampling weights are used in all specifications.

References


FINANCING MINORITY ENTREPRENEURSHIP

CARLOS BERDEJÓ*

Racial disparities pervade America’s socioeconomic fabric: minorities lag in educational attainment, employment, income, and wealth. Minorities are also underrepresented in the entrepreneurial space. For example, although minorities account for thirty-eight percent of the population, they own just nineteen percent of businesses. Despite numerous initiatives to promote minority business ownership, racial disparities in entrepreneurship have been stubbornly persistent over time.

This Article analyzes one of the major barriers that minorities face in undertaking entrepreneurial ventures. Informational asymmetries are especially pronounced when entrepreneurs attempt to raise money for their nascent businesses. Traditionally, social networks have offered an effective way to address the informational asymmetries that potential investors face when evaluating startup investments. Most minority entrepreneurs, however, lack access to these kinds of helpful social networks.

Recognizing the links between startup financing, information asymmetry, and social networks offers an analytic framework that can explain why minority entrepreneurs struggle in financing their businesses. This framework also suggests why current programs designed to address racial disparities in entrepreneurship have failed and offers guidance for new kinds of programs that are more likely to succeed in facilitating the financing of minority-owned businesses.

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* Professor of Law and J. Howard Ziemann Fellow, Loyola Law School, Los Angeles. I would like to thank Brian Broughman, Benjamin Edwards, Ofer Eldar, Michael Guttentag, Justin Levitt, Elizabeth Pollman, and Lauren Willis for their extremely valuable and helpful comments on earlier drafts and the members of the Wisconsin Law Review for their wonderful editorial assistance. All errors and omissions are my own.
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INTRODUCTION

Racial disparities pervade the socioeconomic fabric of twenty-first century America: minorities lag in educational attainment, employment, income, and wealth.¹ The average net worth of white households ($139,300) is over ten times the average net worth of African American households ($12,780) and almost seven times that of Hispanic households

($19,990). White households are over 50% more likely to own equity in their own homes than African American or Hispanic households. Unemployment rates also vary substantially along racial lines: the unemployment rate for African Americans (7.5%) is twice that of whites (3.8%), with Hispanics (5.1%) in between these two groups. Individuals belonging to minority groups are less likely to have a bachelor’s degree: while 40% of white individuals graduate from four-year colleges, only 30% of African Americans and 20% of Hispanics do.

Disparities along racial lines also characterize the entrepreneurial space, where minorities are significantly underrepresented. This is evident not only in disparate business ownership rates but also in the share of the self-employed population and in the comparative success rates of entrepreneurial ventures. According to census data, minorities, which form 38% of the U.S. population, own just 19% of businesses. This gap is more pronounced in inner cities, where minorities make up 67% of the population but own 23% of businesses. Self-employment statistics provide a similar perspective: the self-employment rate among whites


3. Id. According to census data, 71.2% of white households own equity in their own home, which is substantially higher than the 40.7% and 46.6% ownership rates of African American and Hispanic households. Id. On average, white households own $100,000 in home equity, while African American and Hispanic households own $56,000 and $65,000, respectively. Id.


5. Id. at 3.

6. For a description of the most influential definitions of entrepreneurship, see D. Gordon Smith & Darian M. Ibrahim, Law and Entrepreneurial Opportunities, 98 Cornell L. Rev. 1533, 1540–45 (2013).


9. Id.

10. Id.
(10.9%) is twice that of African Americans (5.2%). Notably, there are significant differences in entrepreneurship across minority groups, as African Americans tend to have the lowest self-employment rates, followed by Hispanics and Asians.

Not only are minorities less likely to start and own their own businesses, but those who do financially underperform their non-minority counterparts. Minority-owned firms earn, on average, less than half of the revenue earned by non-minority firms, are less profitable, and experience higher failure rates. As with startup rates, there are notable differences in the financial performance of small businesses across minority groups. Despite numerous initiatives to promote minority


12. See Hipple & Hammond, supra note 11 (reporting self-employment rates of 9.6% and 8.3% for Asians and Hispanics, respectively); Rafael Efrat, Minority Entrepreneurs in Bankruptcy, 15 Geo. J. On Poverty L. & Pol’y 95, 98 (2008) (“The largest discrepancy exists among Blacks, who make up 12% of the general population but less than 4% of all businesses in the United States. Similarly, Hispanics make up almost 11% of the general population but less than 5% of all businesses. In contrast, Asian Americans have representation in business greater than their proportion in the general population.”); ICIC Report, supra note 8, at 3 (“African Americans are still less likely to start a business than non-minorities and some other minority groups.”).

13. See Fairlie & Robb, supra note 7, at 292–93 (“Black-owned firms have worse outcomes than white-owned firms.”).

14. See Hipple & Hammond, supra note 11; Fairlie & Robb, supra note 11, at 13 (reporting average gross receipts of $167,000 for minority-owned firms and $439,000 for non-minority firms).

15. See ICIC Report, supra note 8, at 3 (reporting that minority-owned businesses earn 44% of the profits earned by non-minority-owned firms); Fairlie & Robb, supra note 7, at 293 (“[O]nly 13.9 percent of black-owned firms have annual profits of $10,000 or more, compared to 30.4 percent of white-owned firms.”).

16. See Fairlie & Robb, supra note 7, at 293 (finding that 40% of Black-owned firms had negative profits and that the average probability of business closure was 26.9% for Black-owned firms compared to 22.6% for white-owned firms); Efrat, supra note 12, at 99 (“Minority-owned businesses not only are underrepresented in the entrepreneurial sector, but also tend to have a higher failure rate relative to White-owned businesses.”).

17. See Fairlie & Robb, supra note 11, at 14 (reporting average annual gross receipts of $292,214 for Asian-owned businesses, $141,044 for Hispanic-owned businesses, and $74,018 for African American-owned firms).
What explains the long-standing comparative difficulties faced by minorities in succeeding in entrepreneurial ventures? One of the major hurdles faced by minority entrepreneurs is access to capital, a challenge also faced by non-minority entrepreneurs but to a lesser degree. This Article explores why financing new businesses may be especially challenging for minority entrepreneurs. First, it describes why minority-owned startups are especially likely to face informational asymmetry problems when raising capital. Second, it expands on a theory grounded in behavioral economics literature that highlights the importance of social networks in addressing the informational asymmetries inherent in the financing of small businesses, particularly minority-owned ones. Third, it reviews evidence that many minority entrepreneurs have been excluded from crucial social and professional networks. Building upon these three insights, the Article proposes a policy intervention to facilitate minority entrepreneurs' access to capital.

The framework developed in this Article also explains why private markets have been unable to meet the financing needs of minority-owned businesses and why government programs meant to facilitate minority entrepreneurs’ access to capital have instead fallen short. This Article shows that these programs have failed for two reasons: their reliance on debt as a financing mechanism and their reliance on large, hierarchical institutions as gatekeepers, despite those institutions’ inability to confront certain types of informational asymmetries. Although private equity’s organizational structure and investment strategies are ideally suited for addressing the informational asymmetries associated with investing in minority-owned businesses, the lack of diversity in their ranks has rendered these tools ineffective, leaving fund managers to fall prey to implicit biases. Crowdfunding, which many had hoped would level the

18. See Efrat, supra note 12, at 98 (“[M]inorities remain significantly underrepresented in the self-employment sector.”); Fairlie & Robb, supra note 7, at 291 (“The 3 to 1 ratio of white to black self-employment rates noted above has remained roughly constant over the past 90 years.”); Fairlie & Robb, supra note 11, at 14 (“These ethnic and racial disparities have also existed throughout the past two decades and trends in average gross receipts do not indicate recent improvements.”).
19. See infra Section I.B.3.
20. See infra notes 82–92 and accompanying text.
21. See infra notes 93–99 and accompanying text.
22. See infra notes 100–105 and accompanying text.
23. See infra Part III.A.
25. See infra notes 103–104, 208–211 and accompanying text.
playing field, has also failed because well-intentioned investors seeking a financial return cannot individually overcome informational issues.\textsuperscript{26}

The Article proposes a program that addresses the shortcomings of prior initiatives in this area through the creation of venture capital style funds (referred to as Local Impact Small Business Investment Companies or LISBICs) that focus their investment efforts on minority-owned businesses and the geographical areas where they are often located. To promote the development of these LISBICs, this Article proposes a series of policy interventions grounded on the existing regulatory framework of the Small Business Administration’s Small Business Investment Company program (SBIC). The proposed LISBIC program borrows various elements from former SBIC initiatives, which should facilitate its implementation both from an administrative and political standpoint.

Current events have added to the urgency of addressing racial disparities in entrepreneurship. The COVID-19 pandemic has devastated small businesses and local communities.\textsuperscript{27} To survive in a post-pandemic world, minority-owned businesses’ access to capital will need to improve considerably.\textsuperscript{28} Encouraging the survival and growth of minority-owned businesses would also help rebuild low-income minority communities and address some of the long-standing racial injustices highlighted by recent events.\textsuperscript{29} More generally, this Article illustrates how long-standing racial

\textsuperscript{26} See infra notes 251–257 and accompanying text.


\textsuperscript{28} See Fairlie, supra note 27, at 5 (finding that the number of African-American and Hispanic business owners dropped by 41\% and 32\%, respectively); Kristopher J. Brooks, 40\% of Black-Owned Businesses Not Expected to Survive Coronavirus, CBS News (June 12, 2020), https://www.cbsnews.com/news/black-owned-businesses-close-thousands-coronavirus-pandemic [https://perma.cc/SCE2-GXHJ] (describing the difficulties faced by African-American owned businesses during the COVID-19 pandemic, including their inability to raise capital).

\textsuperscript{29} See, e.g., James Thorne, Funds, Recruiting and Support: VCs Address Diversity and Inequality, PitchBook (June 8, 2020), https://pitchbook.com/news/articles/vcs-address-diversity-institutional-bias [https://perma.cc/TT39-W8NL] (“Against a backdrop of widespread protests over the killings of black Americans, the venture capital industry has been forced to reckon with its own staggering lack of diversity.”); Zoë Bernard & Kate Clark, As Silicon Valley Turns Attention to Race, Black Entrepreneurs Detail Prejudice, The Info. (June 11, 2020),
disparities and inequities in society migrate into the entrepreneurial space—a process that feeds into the cycle of poverty that continues to shatter minority communities.\(^{30}\)

This Article proceeds as follows. Part I summarizes the existing evidence describing the causes and effects of racial disparities in entrepreneurship, highlighting the critical role of access to capital and the reasons why minority entrepreneurs may struggle to finance their businesses. Building upon this evidence, the Article develops a theoretical framework centered on informational asymmetries and the “soft” nature of information relevant to many minority businesses to explain observed disparities. Part II describes existing programs and initiatives that seek to facilitate minority entrepreneurs’ access to capital and uses the framework developed in Part I to explain why these have generally been unsuccessful. Informed by this application of the theoretical framework, Part III proposes a policy initiative that addresses the key shortfalls of the programs discussed in Part II and discusses the potential challenges raised by its implementation.

I. THE STATE OF MINORITY ENTREPRENEURSHIP

This Part first describes the critical role of entrepreneurship in society and its untapped potential to develop the economies of distressed minority communities. It then discusses the main challenges faced by minority entrepreneurs, particularly in raising capital, and develops a framework to explain the racial disparities that characterize the entrepreneurial space. This framework is then used to evaluate existing initiatives in Part II and to inform the policy proposals outlined in Part III.

A. Why Minority Entrepreneurship Matters

The benefits to society and the economy from entrepreneurship are well documented: new businesses generate employment and income, introduce innovative products and services, and can act as engines of

\(^{30}\) See Michael B. Teitz & Karen Chapple, The Causes of Inner-City Poverty: Eight Hypotheses in Search of Reality, 3 CITYSCAPE 33, 56 (1998) (“There is little doubt that an entrepreneurship and business deficit exists and is related to poverty in the inner cities.”); MAURICE KUGLER, MARIOS MICHAELIDES, NEHA NANDA & CASSANDRA AGBAYANI, U.S. SMALL BUSINESS ADMIN., ENTREPRENEURSHIP IN LOW-INCOME AREAS 6 (2017) (“[L]ow-income urban neighborhoods face a similar continuing cycle of poverty and social problems due to the lack of profitable businesses and jobs.”).
social change. Nationally, minority-owned businesses play these macro-economic roles, contributing to income and employment, as well as introducing new products and services. But, minority-owned businesses also play a key role in developing local economies and improving neighborhoods, especially in socioeconomically distressed areas where poverty and unemployment levels are historically higher than the national average, like inner cities. In these communities, entrepreneurship presents an alternative means to generate and accumulate wealth, thus providing a mechanism to bridge the wealth gap.

At a personal level, entrepreneurship is critical for individuals for whom self-employment represents the most attractive employment option. Self-employment is especially attractive for groups that have traditionally faced obstacles in pursuing advanced degrees, that have suffered discrimination in the labor market, and whose social networks lack those connections that can serve as sources of job opportunities.

This source of economic growth and social development has remained untapped due to the relatively low number of minority-owned businesses and the exceptional difficulties faced by minorities that engage in the entrepreneurial space. As noted earlier, the self-employment rate among whites is twice that of African Americans. Not only are minorities less likely to start their own businesses, but minority-owned businesses also tend to be less profitable than non-minority businesses and experience 31. See C. Mirjam van Praag & Peter H. Versloot, What Is the Value of Entrepreneurship? A Review of Recent Research, 29 SMALL BUS. ECON. 351, 351–52 (2007).


33. See KLOOSTERMAN & RATH, supra note 32, at 2–3; ICIC REPORT, supra note 8, at 3.

34. See ICIC REPORT, supra note 8, at 3.

35. See Ivan Light, Disadvantaged Minorities in Self-Employment, 20 INT’L J. COMPAR. SOCIO. 31, 35–38 (1979); Pyon Gap Min & Mehdi Bozorgmehr, United States: The Entrepreneurial Cutting Edge, in IMMIGRANT ENTREPRENEURS 17, 30 (2003) (noting that labor market disadvantages stimulate minority members to become self-employed); cf. Rachel S. Shinnar & Cheri A. Young, Hispanic Immigrant Entrepreneurs in the Las Vegas Metropolitan Area: Motivations for Entry into and Outcomes of Self-Employment, 46 J. SMALL BUS. MGMT. 242, 244 (2008) (noting the relationship between factors that push individuals to self-employment, such as discrimination and inadequate education, as well as factors that pull individuals to self-employment, such as higher earnings and enhanced professional standing).

36. See supra note 30 and accompanying text.

37. See supra notes 8–11 and accompanying text.
higher failure rates. The next section discusses how scholars have grappled with these disparities.

B. Challenges Faced by Minority Entrepreneurs

This section explains why minority entrepreneurs are, on average, less successful than non-minority entrepreneurs. It begins by discussing how an entrepreneur’s socioeconomic characteristics (such as human capital and wealth) and the nature of the businesses they operate can affect their fortunes. These two factors interact between themselves and are also closely related to the third, and most critical, factor: access to capital.

1. ENTREPRENEUR CHARACTERISTICS

Some scholars have sought to explain racial disparities in entrepreneurial outcomes by focusing on socioeconomic variables, arguing that underlying disparities in human capital and wealth between minority and non-minority entrepreneurs lead to differences in entrepreneurial success. This has led some to conclude that addressing these underlying disparities is the best way to bridge the entrepreneurial gap, though there is no universal consensus as to the true explanatory power of these demographic variables.

a. Human Capital

Starting and operating a business is not a trivial endeavor. An entrepreneur must have a good understanding of the relevant product and geographic market, be able to negotiate with suppliers, customers and investors, and, most importantly, have the capacity to make effective managerial decisions in a fast-moving environment rife with uncertainty. These complexities explain why an entrepreneur’s formal education is a key determinant of the entrepreneur’s ability to successfully start and operate a business and why those with lower levels of education are consequently disadvantaged. Education might also indirectly affect

38. See supra notes 13–16 and accompanying text.
40. See id. at 456–58; infra notes 45, 56.
42. See FAIRLIE & ROBB, supra note 11, at 22 (“Education has . . . been found in the literature to be a major determinant of business ownership.”); Rafael Efrat, The Tax Burden and the Propensity of Small-Business Entrepreneurs to File Bankruptcy, 4 HASTINGS BUS. L.J. 175, 176 (2008) (“[W]hereas a quarter of the general population earned a bachelor’s degree or more, small-business owners are twice as likely to have earned the degrees.”).
entrepreneurial success by facilitating the development of valuable social and professional networks that improve future access to business and financing opportunities.\textsuperscript{43} The fact that minorities tend to have lower levels of education than non-minorities can thus explain part of the racial disparities in entrepreneurship rates and firm performance.\textsuperscript{44} Some scholars, however, question the importance of education as a determinant of entrepreneurial success and the extent to which racial disparities in the entrepreneurial space are the result of an educational gap.\textsuperscript{45}

Like formal education, prior business experience is a key determinant of entrepreneurial success.\textsuperscript{46} The knowledge gained from prior business exposure helps an entrepreneur evaluate the financial risks associated with starting a company.\textsuperscript{47} Limited business experience can lead to over-optimism and unrealistic expectations regarding risks and financial adversities.\textsuperscript{48} Equally important in this sense is an individual’s informal exposure to business experience via family and social networks.\textsuperscript{49} Since individuals belonging to minority groups are less likely to have a self-employed family member or acquaintance, they have limited opportunities

\textsuperscript{43} See Miller McPherson, Lynn Smith-Lovin & James M. Cook, \textit{Birds of a Feather: Homophily in Social Networks}, 27 ANN. REV. SOCIO. 415, 426–27 (2001) (explaining why individuals tend to have relationships with others of the same level of education); \textit{infra} note 100 and accompanying text.

\textsuperscript{44} See Fairlie & Robb, \textit{supra} note 7, at 297 (noting that small business outcomes are positively associated with the owner’s education level and that Black business owners generally had lower education levels); Fairlie & Robb, \textit{supra} note 11, at 22–23 (arguing that lower levels of education limit minority business ownership rates by “challenging the business performance of some minority entrepreneurs”).


\textsuperscript{46} See Efrat, \textit{supra} note 42, at 179; Harner, \textit{supra} note 41, at 485.

\textsuperscript{47} See Harner, \textit{supra} note 41, at 478 (“Identifying and properly assessing these multi-faceted risks would be difficult for even the most sophisticated risk managers. The task often is Herculean for small business entrepreneurs either because of their lack of experience, resources or professional guidance; or . . . their entrepreneurial characteristics.”).

\textsuperscript{48} See id. at 479–80 (“Overconfidence is one of several cognitive biases that commentators suggest can affect decision-making and, consequently, success in the business context.”).

\textsuperscript{49} See Fairlie & Robb, \textit{supra} note 11, at 24 (stressing the importance of family business backgrounds and composition of social networks in determining self-employment and that “the probability of self-employment is substantially higher among the children of the self-employed”); Fairlie, \textit{supra} note 45, at 84 (“[T]here is a strong intergenerational link in self-employment due to the transmission of informal business or managerial experience.”).
to receive the type of informal training that takes place in a family business and its related social networks.  

*b. Wealth*

Starting and operating a business requires money. The primary building blocks of an entrepreneur’s investment capital are the entrepreneur’s own personal assets, followed by those of family and friends. As noted earlier, minorities, particularly Hispanics and African Americans, have lower levels of wealth and own fewer financial assets than non-minorities. Not only do minorities have fewer liquid assets that can readily be used as startup capital, but they also lack non-liquid assets, such as real estate, that could be used to secure a line of credit. Scholars have found that these economic disparities are likely to be a major factor in explaining low startup rates among minority entrepreneurs, though there is no universal consensus on whether differences in wealth are a major determining factor of entrepreneurial disparities.

2. Business Characteristics

The size and form of minority-owned businesses can also help explain their relatively poor performance. Smaller businesses are more likely to perform poorly than bigger ones, and minority-owned businesses are, on average, smaller than non-minority-owned businesses,

50.  See Fairlie & Robb, supra note 7, at 297–99 (arguing that black business owners’ disadvantaged family and business background and their lack of family business experience contributes to their relative lack of success); Fairlie & Robb, supra note 11, at 24 (“African American business owners are much less likely than white business owners to have had a self-employed family member prior to starting their businesses and are less likely to have worked in that family member’s business.”).

51.  See infra notes 62–63 and accompanying text; Kauffman Report, supra note 7, at 11–12.

52.  See supra notes 2–4 and accompanying text.

53.  See Fairlie & Robb, supra note 11, at 18 (noting that “[l]ess than half of Hispanics and African Americans own their own home compared with three quarters of non-minorities” and that these disparities “in home equity may be especially important in providing access to startup capital”).


55.  See Erik Hurst & Annamaria Lusardi, Liquidity Constraints, Household Wealth, and Entrepreneurship, 112 J. POL. ECON. 319, 321 (2004) (finding that the relationship between wealth and entry into self-employment is generally insignificant); Lofstrom & Bates, supra note 45, at 76 (“[T]he consensus view that nonminority whites achieve higher entry rates than African Americans because they are relatively wealthier and better educated . . . is simplistic.”).

56.  See Efrat, supra note 12, at 101; Efrat, supra note 42, at 205–06.
both in terms of the number of employees and revenues. Business organization also appears to correlate with the success of an enterprise: incorporated businesses tend to outperform sole proprietorships, and minority-owned businesses tend to be organized as the latter.58

Macro-economic factors also explain the relative underperformance of minority-owned businesses. Minority entrepreneurs are generally more likely to engage in low-value and non-growth industries, like services and retail, that are less profitable and more prone to failure. Moreover, minority entrepreneurs tend to operate in low-income neighborhoods with a less affluent client base and, as a result, generate lower profits, are more prone to failure, and have less ready access to financing.61

3. ACCESS TO CAPITAL

Accessing capital is a critical challenge faced by all small businesses. Entrepreneurs need capital to fund operations, inventory, wages, and other

57. See Efrat, supra note 12, at 101–02.


59. See Efrat, supra note 12, at 102 (“[M]inority entrepreneurs would seem to be more prone to business failure compared to White entrepreneurs because minority entrepreneurs are underrepresented in the high-value and growth industry sectors.”); Fairlie & Robb, supra note 7, at 311 (noting that black-owned businesses appear to be overrepresented in less successful industries relative to white-owned businesses); Efrat, supra note 42, at 178 (noting that business failure is more common in the retail and service industry). It could be that minority entrepreneurs focus on these industries because these are not capital intensive and so their lack of access to capital is less of a barrier. See ICIC REPORT, supra note 8, at 8 (“Entrepreneurs of color are also more likely to enter industries with low capital requirements and high failure rates instead of high-growth sectors.”); Lofstrom & Bates, supra note 45, at 83–84.

60. See Timothy Bates & Alicia Robb, Analysis of Young Neighborhood Firms Serving Urban Minority Clients, 60 J. ECON. & BUS. 139, 144–46 (2008) (finding that businesses that serve local minority communities were substantially more likely to close, possibly because their clientele may have less access to outside capital); FAIRLIE & ROBB, supra note 11, at 22 (“[M]inority-owned businesses are all more likely to serve a local market . . . and are much more likely to sell to a minority clientele than are white businesses, which may reflect more limited market access.”).

expenses associated with starting and operating a business. Since early-stage businesses are not likely to generate these funds internally, securing external debt or equity financing becomes crucial especially if the entrepreneur lacks adequate personal financial resources. Raising capital presents an even bigger challenge for businesses owned by minority entrepreneurs for several reasons.

Minority businesses are more likely to be denied credit than non-minority businesses. These disparities in loan denial rates are robust even when controlling for personal and business factors that affect an applicant’s creditworthiness, such as wealth and credit history. Those minority-owned businesses that are approved for credit are still at a disadvantage: loans received by minority-owned businesses are smaller than those received by non-minority businesses and often carry higher interest rates, even after controlling for factors affecting applicants’


63. Cf. id.

64. See Shinnar & Young, supra note 35, at 247 (“Obtaining financing for start-up and capital for growth has been listed as one of the biggest challenges for minority-owned businesses.”); Fairlie & Robb, supra note 11, at 17 (“Financial constraints are the most significant issue affecting minority business ownership and business performance.”); Kauffman Report, supra note 7, at 10 (“Capital access is also marked by striking differences across racial and ethnic groups . . . . Minority-owned firms are found to face significant barriers to capital.”); Michael Porter, The Competitive Advantage of the Inner City, 73 HARV. BUS. REV. 55, 64 (1995).

65. See Mels de Zeeuw, Fed. Rsrv. Bank of Atlanta, Small Business Credit Survey: 2019 Report on Minority-Owned Firms iv–v (finding that approval rates for loans or lines of credit sought by minority-owned firms at small banks or online lenders were lower than those for white-owned firms); FAIRLIE & ROBB, supra note 11, at 20; ICIC Report, supra note 8, at 8. But see Robert Watson, Kevin Keasey & Mae Baker, Small Firm Financial Contracting and Immigrant Entrepreneurship in IMMIGRANT BUSINESS 70, 80 (Jan Rath ed., 2000).

66. See Ken S. Cavalluzzo, Linda C. Cavalluzzo & John D. Wolken, Competition, Small Business Financing, and Discrimination: Evidence from a New Survey, 75 J. BUS. 641, 676 (2002) (“We found evidence of substantial differences across demographic groups . . . . even after controlling for a broad set of characteristics describing the firm and owner.”); Ken Cavalluzzo & John Wolken, Small Business Loan Turndowns, Personal Wealth and Discrimination, 78 J. BUS. 2153, 2154 (2005); David G. Blanchflower, Minority Self-Employment in the United States and the Impact of Affirmative Action Programs, 5 ANNALS FIN. 361, 386–87 (2009) (finding that minority-owned firms are more likely to be denied credit and be charged higher interest rates, a pattern that is only partially explained by creditworthiness); Minority Entrepreneurship: Assessing the Effectiveness of SBA’s Programs for the Minority Business Community: Hearing Before the Comm. on Small Bus. & Entrepreneurship, 110th Cong. 27 (2007) [hereinafter Senate Hearings] (statement of Jon Wainwright, Vice President, National Economic Research Associates, Inc.) (“[M]inority-owned firms are substantially and statistically significantly more likely to be denied credit than are white-owned firms with similar balance sheets and similar credit histories.”).
Minority entrepreneurs also face difficulties in obtaining equity financing from venture capital firms and angel investors, despite the fact that funds specializing in minority firms provide returns that are at least as large as those offered by mainstream funds.68

As a result, minority and non-minority businesses are financed quite differently.69 Minority entrepreneurs rely less on formal funding sources like banks and private equity financing for their startup capital and instead turn to informal funding sources, such as personal savings, loans from friends and family, and credit card debt.70 These sources, however, tend to be limited and expensive, making it more difficult for minority entrepreneurs to start their businesses.71 Moreover, the resulting undercapitalization reduces the ability of new minority businesses to thrive and survive.72

67. See ICIC REPORT, supra note 8, at 8; FAIRLIE & ROBB, supra note 11, at 20–21; Senate Hearings, supra note 66, at 27 (statement of Jon Wainwright, National Economic Research Associates, Inc.) (“When minority-owned firms do receive loans, they are obligated to pay higher interest rates than comparable white-owned firms.”); Alan Greenspan, Chairman, Bd. of Governors of the Fed. Rsrv. Sys., Keynote Address: Changes in Small Business Finance, in Summary: Business Access to Capital and Credit, March 8–9, 1999, at 39, 43 (noting that higher denial rates for minority-owned businesses are not “readily explained by income, balance sheet factors, or credit histories”).

68. See infra notes 200–205 and accompanying text.

69. See FAIRLIE & ROBB, supra note 11, at 20 (“Minority and non-minority entrepreneurs differ in the types of financing they use for their businesses.”); KAUFFMAN REPORT, supra note 7, at 10 (“Owner equity for black owners is more than half of total financial capital while white owners put up less than one-third. Outside equity accounted for 1.5 percent and 17 percent of total financial capital in black- and white-owned new businesses, respectively. And, outside debt accounted for close to one-third and more than half of total financial capital in black- and white-owned new business, respectively.”).

70. See Shinnar & Young, supra note 35, at 247 (“Hispanic entrepreneurs tend to rely on informal funding sources for business start-up rather than banks and venture capital. . . . This reliance on informal sources may be attributed to the higher rates of denials for Hispanic loan applicants, which may deter individuals from approaching financial institutions in order obtain loans.”); FAIRLIE & ROBB, supra note 11, at 20 (“African American entrepreneurs rely less on banks than whites for startup capital” and that “African American business owners are more likely to rely on credit cards for startup funds than are white business owners.”); DE ZEEUW, supra note 65, at IV–V (reporting that minority owners relied to a greater extent on personal funds); KAUFFMAN REPORT, supra note 7, at 10 (noting that minority entrepreneurs have to rely more on credit cards to fund their businesses and that high interest rates on credit cards make them a costly form of capital).

71. See DE ZEEUW, supra note 65, at V (reporting that minority-owned firms more frequently applied for potentially higher-cost and less-transparent credit products, such as merchant cash advance and factoring).

72. See Efrat, supra note 12, at 100 (“[M]inority entrepreneurs’ higher failure rate has been blamed on limited access to credit. . . . Higher levels of capitalization have a positive effect on survival rates of small businesses.”); FAIRLIE & ROBB, supra note 11, at 19 (“Undercapitalized businesses will likely have lower sales, profits and employment and will be more likely to fail than businesses receiving optimal levels of startup capital.”).
C. Overcoming Informational Asymmetries

What explains the lack of outside financing available to minority entrepreneurs? The studies cited in the previous section suggest that non-economic factors certainly play an important role. Even though the existence of racial bias is undeniable, the full picture is likely more nuanced and complex. This section tries to untangle this complexity by exploring the role of informational asymmetries in racially disparate access to capital.

Investing in young, small businesses is risky: the vast majority of startups fail. This high rate of failure, coupled with the lack of easily available information about these businesses, subjects potential investors to significant risks. Though the use of collateral by borrowers can

73. See supra notes 66–67 and accompanying text (providing evidence that racial disparities in financing are present even after controlling for various entrepreneur characteristics); Efrat, supra note 12, at 100 (“The limited access to financial capital is partly due to the lower asset levels the minority entrepreneurs have accumulated, the discrimination they face from some financial institutions, fewer ties to financial institutions, lower loan application submissions, and a higher financing rejection rate.”); Watson, Keasey & Baker, supra note 65, at 79–80; Fairlie & Robb, supra note 11, at 21 (“A factor posing a barrier to obtaining financial capital for minority-owned businesses is racial discrimination in lending practices.”); Cavalluzzo & Wolken, supra note 66, at 2154 (arguing that lending patterns are consistent with a finding of racial discrimination in the credit market by banks).


75. See KAUFFMAN REPORT, supra note 7, at 12 (“The persistence of information asymmetry in capital markets between the supply of capital (investors) and the demand for capital (entrepreneurs) gives rise to barriers faced by entrepreneurs.”).


77. See Watson, Keasey & Baker, supra note 65, at 77; Claudia Lin-Yung Zhang, How to Solve the Dilemma of Small Business Finance: A Proposal for Creditors’ Statutory Information Right, 13 U.C. DAVIS BUS. L.J. 128, 129–30 (2012) (noting that small businesses have difficulties communicating value to potential lenders because their contracts are generally not publicly available and they lack audited financial statements).
reassure potential creditors, this use does not effectively solve the inherent informational asymmetry problems, and the resulting overleveraging can adversely impact a business’s performance and development. Loan applications by small startups are often denied as a result. For these same reasons, raising capital via equity can also be prohibitively expensive and often is not a realistic alternative for many small enterprises. The discussion that follows explains how the effects of these informational asymmetries are exacerbated in the context of minority-owned businesses.

1. UNTANGLING “SOFT” INFORMATION

This high degree of informational asymmetries is due to the lack of reliable and verifiable information about young, small businesses: there are no detailed financial statements about past performance, for example. Individuals and entities investing in these businesses must then rely on subjective or “soft” information, “information that cannot be directly verified by anyone other than the [person] who produces it.” For example, “knowing” that a firm manager is honest and hardworking is an intangible fact that can be gained through personal experience, but one that cannot be as easily documented and credibly communicated as a financial report, a resume, or another form of “hard,” “objective,” or “verifiable” information. The critical role of soft information in the assessment of the

78. See Zhang, supra note 77, at 137 (“Collateral is also a useful way to deliver private information and overcome borrower/lender incentive conflicts.”).
79. See id. at 136 (“Collateral may impose opportunity costs on borrowers by drying up assets that might otherwise be put into more productive uses.”); Efrat, supra note 42, at 178 (noting that small firms that receive financing can fail because they tie up their assets or the debt overwhelms them).
80. See infra note 190. See also Watson, Keasey & Baker, supra note 65, at 80; Zhang, supra note 77, at 130 (“The information costs, with the concomitant free-rider problem, severely impair small banks’ lending ability, especially when they are new entrants in the local market.”).
81. See Nancy Huyghebaert & Linda M. Van de Gucht, The Determinants of Financial Structure: New Insights from Business Start-Ups, 131 EUR. FIN. MGMT. 101, 110 (2007) (“Start-ups, however, cannot access public equity and . . . are also not likely to attract venture capital.”); Stewart Myers, The Capital Structure Puzzle, 39 J. FIN. 574, 584–85 (1984) (arguing that the value of debt, by virtue of being a more senior security than equity, is less sensitive to private information); FAIRLIE & ROBB, supra note 11, at 17.
82. See Hédia Fourati & Habib Affes, The Capital Structure of Business Start-Up: Is There a Pecking Order Theory or a Reversed Pecking Order?, 4 TECH. & INV. 244, 247 (2013) (noting that due to their lack of historical and reputation effects, new firms are informationally opaque, which reduces the availability of external finance).
84. See Stein, supra note 83, at 1892.
risks and prospects of investing in a small business explains several patterns documented in the corporate finance literature.\textsuperscript{85}

Loan applications by small businesses are more likely to be approved by lenders that operate within a decentralized decision-making system, like one where local branch managers make approval decisions.\textsuperscript{86} Studies that have examined lending patterns of big and small banks indicate that small, local banks have a comparative advantage in lending to small businesses based on soft information, while big banks prefer to lend to larger businesses and rely on hard information to make their lending decisions.\textsuperscript{87} As it turns out, “soft information loans” can be profitable for the banks that are able to make them—these loans do not have higher default rates, and the borrowers are as productive as other firms.\textsuperscript{88} Unfortunately, the continuing trend of bank consolidation and concentration has complicated matters for small businesses, as small local banks are disappearing and being replaced by bigger banks less suited to deal with soft information.\textsuperscript{89}

The importance of soft information in assessing small businesses also explains patterns in equity investments. Individuals active in the public

\textsuperscript{85} See Fourati & Affes, supra note 82, at 247 (noting that credit relationships are “based on ‘soft’ information generated by the banking experience with the lender and by a continuous contact”); Allen N. Berger & Gregory F. Udell, Small Business and Debt Finance, in HANDBOOK OF ENTREPRENEURSHIP RESEARCH 299, 300 (Zoltan J. Acs & David B. Audretsch eds., 2003).

\textsuperscript{86} In a hierarchical setting, soft information loses its value as local managers cannot credibly transmit the information to their decision-making superiors and thus have less incentive to produce it. See Stein, supra note 83, at 1893; Jose M. Liberti & Atif R. Mian, Estimating the Effect of Hierarchies on Information Use, 22 REV. FIN. STUD. 4057, 4060 (2009) (finding that sensitivity of credit decisions to objective information is higher at higher levels of approval, while sensitivity to subjective information is lower); Atif R. Mian, Distance Constraints: The Limits of Foreign Lending in Poor Economies, 61 J. FIN. 1465, 1467–68 (2006) (finding that greater cultural and geographical distance between a bank’s headquarters and its local branches leads to less lending to informationally difficult yet fundamentally sound firms requiring relational contracting, such as small firms).

\textsuperscript{87} See Allen N. Berger, Nathan H. Miller, Mitchell A. Petersen, Raghuram G. Rajan & Jeremy C. Stein, Does Function Follow Organizational Form? Evidence from the Lending Practices of Large and Small Banks, 76 J. FIN. ECON. 237, 240–41 (2005). A study using data from the National Survey of Small Business Finance (which covers firms with fewer than 500 employees and a median asset value of $680,000) found that large banks lend primarily to larger firms with good accounting records while smaller banks lend to businesses for which creditworthiness is more difficult to assess with “hard” information. Id. Large banks lend at a greater distance, interact more impersonally, and have shorter and less exclusive relationships than smaller banks. See id.

\textsuperscript{88} See Mian, supra note 86, at 1498–99.

\textsuperscript{89} See Stein, supra note 83, at 1891; Cavalluzzo, Cavalluzzo & Wolken, supra note 66, at 643 (“The level of concentration in banking markets is of particular interest because small businesses tend to borrow locally, rather than nationally. A recent and continuing wave of mergers in the banking industry suggests that these local markets are becoming more concentrated.”).
equity markets tend to invest more in nearby companies. This local bias is stronger for small and highly leveraged companies that produce locally consumed goods and services, exactly the type of firm that one expects local investors to have better access to soft information and for which this information would be most valuable. More generally, private equity investors rely heavily on relationship-driven and geographically focused screening and monitoring mechanisms, as well as sophisticated contractual provisions, to gather and exploit soft information when investing in small, young businesses.

2. MINORITY-OWNED BUSINESSES AS SOURCES OF SOFT INFORMATION

For minority entrepreneurs, informational asymmetries present an even greater obstacle to raising capital. Minority entrepreneurs often cannot take advantage of traditional strategies used to mitigate investors’ informational concerns, as these strategies require personal wealth and resources that minority entrepreneurs often do not have. For example, personal assets can serve as collateral in securing a loan or a home equity line of credit can be obtained using the entrepreneur’s house. Relatedly, outside equity investors prefer that the entrepreneur has some “skin in the game” by investing enough personal resources as firm capital.

90.  See Gur Huberman, *Familiarity Breeds Investment*, 14 REV. FIN. STUD. 659, 660–61 (2001) (finding that investors are more likely to hold shares of their local regional phone company than of any other regional phone company); Joshua D. Coval & Tobias J. Moskowitz, *Home Bias at Home: Local Equity Preference in Domestic Portfolios*, 54 J. Fin. 2045, 2047 (1999) [hereinafter Coval & Moskowitz, *Home Bias*] (finding that fund managers invest in companies which are around 10% closer than the average firm they could have held); Joshua D. Coval & Tobias J. Moskowitz, *The Geography of Investment: Informed Trading and Asset Prices*, 109 J. POL. ECON. 811, 812–13 (2001) (finding that mutual fund managers outperform in their local investments and concluding that there is some valuable information about these firms that these managers are getting on the ground).


92.  See supra notes 83–84 and accompanying text.

93.  See Fairlie & Robb, *supra* note 11, at 19 (“[L]ow levels of personal wealth and liquidity constraints also limit the ability of minority entrepreneurs to raise adequate levels of startup capital.”); Robert B. Avery, Raphael W. Bostic & Katherine A. Samolyk, *The Role of Personal Wealth in Small Business Finance*, 22 J. BANKING & FIN. 1019, 1021 (1998) (finding that the majority of all small business loans have personal commitments).

94.  See Fairlie & Robb, *supra* note 11, at 17 (“Low levels of wealth and liquidity constraints create a substantial barrier to entry for minority entrepreneurs because the owner’s wealth can be invested directly in the business, used as collateral to obtain business loans or used to acquire other businesses.”); Cavalluzzo & Wolken, *supra* note 66, at 2154 (finding that personal wealth, primarily through home ownership, decreases the probability of loan denials among existing business owners).

95.  See Fairlie & Robb, *supra* note 11, at 17 (“Investors frequently require a substantial level of owner’s investment of his/her own capital as an incentive, commonly referred as ‘skin in the game.’”).
Collecting and digesting available information thus becomes crucial for those seeking to invest in minority-owned businesses. In this respect, minority-owned businesses face two disadvantages relative to non-minority-owned businesses. First, soft information might be even more important for assessing a minority-owned business due to a greater unavailability of hard, verifiable information. Minority-owned businesses tend to be organized as sole-proprietorships rather than corporations and often lack a formal business plan. Such informality is not conducive to producing hard, verifiable information that can be easily accessed and assessed by investors. Second, investors might have a more difficult time producing and digesting soft information for minority-owned businesses, a premise explored next.

3. PROFESSIONAL INVESTORS AS RECIPIENTS OF SOFT INFORMATION

Large hierarchical institutions, a label that describes most banks and institutional investors, are ill-suited to make investment decisions based on soft information. Even in flat hierarchical settings, socioeconomic and cultural differences between investors and entrepreneurs complicate the production and digestion of soft information. For example, it is easier for an investor to uncover and interpret soft information when that investor enjoys cultural proximity with the entrepreneur. Common networks are also critical for the collection, dissemination, and interpretation of soft information, as many investors informally rely on acquaintances to act as “gatekeepers” for potential financings.

96. See Efrat, supra note 42, at 179; Shinnar & Young, supra note 35, at 247, 251. These disparities in business formalities suggest that there exists a role for pro bono or easily accessible legal services. Although some county bar associations have placed a focus on helping small businesses address legal issues, only a handful of these programs exist nationwide. See The ACBA Public Service Committee, Public Service Committee Starts Small Business Legal Assistance Program, LAW J., Sept. 20, 2013, at 4. Law school clinics could also step in to address these disparities. See generally Jared Nicholson, Offering Transactional Legal Aid to Low-Income Entrepreneurs, 6 Ind. J.L. & Soc. Equal. 1 (2018).

97. See Fourati & Affes, supra note 82, at 248 (“The legal form of organization provides . . . a signal that indicates credibility and formality of operations and ensures future growth . . . . There is, then, a positive correlation between debt and organization in incorporation.”); Gavin Cassar, The Financing of Business Start-Ups, 19 J. Bus. Venturing 261, 262, 268 (2004) (arguing that the fact that “both outside and bank finances appeared to increase as a result of the firm’s incorporation” evidences that incorporation is a signal that portrays credibility and formality of operations); Fairlie, supra note 27, at 5 (“Incorporated businesses are viewed as more growth-oriented, committed, pro-cyclical and entrepreneurial . . . .”).

98. See supra notes 85–89 and accompanying text.

99. See Watson, Keasey & Baker, supra note 65, at 79.

The fact that professional investors—most of whom are non-minority—and minority entrepreneurs belong to different networks increases the costs for the former in identifying, assessing, and monitoring businesses owned by the latter. Investors lacking the required knowledge and connections to assess soft information may resort to the use of heuristics, using, for example, an entrepreneur’s race (an observable attribute) as a proxy for business risk (an unobservable attribute). In this context, implicit biases can lead investors to make decisions that systematically disfavor minority entrepreneurs.

Recent Federal Reserve data on small business lending helps illustrate this point. Among low credit risk applicants, minority and identifying investment opportunities, conducting due diligence on those opportunities, and monitoring investment performance . . . .


102. See Rubin, supra note 100, at 824–25 (“Since traditional venture capitalists’ networks include few women and people of color, they have limited access to and understanding of companies owned by these populations. This translates into higher search costs in identifying, conducting due diligence on, and monitoring firms owned by women and people of color . . . .”).

103. For an overview of the sources of implicit biases, see Anthony G. Greenwald & Linda Hamilton Krieger, Implicit Bias: Scientific Foundations, 94 CALIF. L. REV. 945, 952–57 (2006); Christine Jolls & Cass R. Sunstein, The Law of Implicit Bias, 94 CALIF. L. REV. 969, 969–70 (2006) (providing examples of both explicit and implicit bias). Implicit biases are closely related to the concept of statistical discrimination. See Cavalluzzo, Cavalluzzo & Wolken, supra note 66, at 642 (“[L]enders may be unable to observe, or it may be costly to collect, economically relevant information that is correlated with demographic group. If these lenders use demographic attributes as a proxy for missing information, then the resulting disparate treatment has an economic basis. This form of disparate treatment is called statistical discrimination . . . .”); Kenneth Arrow, What Has Economics to Say About Racial Discrimination?, 12 J. ECON. PERSP. 91, 96–97 (1998) (describing the statistical discrimination model); Ian Ayres & Peter Siegelman, Race and Gender Discrimination in Bargaining for a New Car, 85 AM. ECON. REV. 304, 317 (1995) (“‘Statistical discrimination’ is based not on a psychological distaste for associating with blacks or women, but rather on sellers’ use of observable variables (such as race or gender) to make inferences about a relevant but unobservable variable.”).

104. See Daniel Applewhite, Founders & Venture Capital: Racism Is Costing Us Billions, FORBES (Feb. 15, 2018, 8:00 AM), https://www.forbes.com/sites/forbesnonprofitcouncil/2018/02/15/Founders-and-venture-capital-racism-is-costing-us-billions/?sh=1ab3726c2e4a [https://perma.cc/3CTT-53EE] (“Pattern recognition has enabled VC’s to mitigate risk but has also limited their profit potential and created an inherent funding bias. This bias stems from barriers to early-stage capital, a lack of representation in the investing space and is perpetuated by systems of racism that destroy opportunity within communities of color.”); Benjamin P. Edwards & Ann C. McGinley, Venture Bearding, 52 U.C. DAVIS L. REV. 1873, 1877 (2019) (“[U]ncorrected implicit biases pervade the business environment, tilting the investment decisions made by venture capitalists toward men. Because venture capitalists are overwhelmingly white and male, they may be particularly vulnerable to implicit bias in favor of white male founders in evaluating investment opportunities.”).

105. See DE ZEEUW, supra note 65, at 11.
white business owners are denied at the same rate (15%). Racial disparities arise once we look at riskier applicants for whom the available verifiable information by itself is not reassuring. In the pool of medium credit risk applicants, minority applicants are denied 34% of the time, while white applicants are denied 25% of the time—an eleven-point difference. Examining the riskier set of applicants reveals even greater disparities: white applicants are denied 46% of the time, while minority applicants are denied 73% of the time—a twenty-seven-point difference. The fact that race seems to play a role in situations where there is less reliable verifiable information about an entrepreneur suggests that an entrepreneur’s race is being employed as a proxy for business risk.  

II. WHY EXISTING PROGRAMS HAVE FAILED

This Part explores major initiatives aimed at helping small businesses raise capital and the manner in which these have been tailored to target minority-owned businesses. The federal government plays an important role in these initiatives, though its role and the nature of its involvement has varied from directly guaranteeing loans to indirectly enhancing access to capital by relaxing regulatory requirements.

A. Government-Led Programs

The U.S. Small Business Administration (SBA) directly supports entrepreneurs and small businesses through a three-pronged strategy. First, the SBA facilitates access to capital by providing a government-backed guarantee on loans granted by financial institutions to qualifying small businesses. Second, the SBA oversees the federal government’s efforts to deliver a percentage of federal contracts to certain small businesses.

106. These patterns produced by implicit biases have been observed in other areas where racial disparities in outcomes have been identified, such as in criminal law. See Carlos Berdejó, Criminalizing Race: Racial Disparities in Plea-Bargaining, 59 B.C. L. REV. 1187, 1240–41 (2018) (finding that racial disparities in plea-bargaining are driven by “low information” cases in which defendants have no prior convictions or are accused of less serious offenses and arguing that these patterns suggest that race is being used as a proxy for recidivism and inherent criminality).

107. The SBA is one of two U.S. government agencies that are involved in promoting minority-owned businesses. See Min & Bozorgmehr, supra note 35, at 34. The other agency, the Minority Business Development Agency (MBDA), is part of the Department of Commerce. See Eugene Boyd, Cong. Rsch. Serv., R45015, Minority Business Development Agency: An Overview of Its History and Current Issues 1 (2017). This Article will not focus on the MBDA for two reasons. First, this agency plays a limited role in financing, as it mainly provides technical and managerial support to minority-owned businesses. Id. at 6. Second, it primarily focuses on businesses with annual revenues of at least $1 million operating in high-growth areas, such as technology and biomedicine. Id.

108. See infra notes 120–126 and accompanying text.
Finally, the SBA provides counseling to small businesses via a network of local offices.

1. SBA BUSINESS DEVELOPMENT AND LOAN PROGRAMS

a. Business Development Programs

The SBA’s 8(a) Business Development Program provides support to small businesses owned by “socially and economically disadvantaged” individuals. Socially disadvantaged individuals are “those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities.” Members of certain designated groups, including African Americans, Hispanics, and Native Americans, are entitled to a rebuttable presumption of social disadvantage. Economically disadvantaged individuals include those “whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or similar line of business.” To initially qualify as economically disadvantaged, applicants must have a net worth lower than $250,000, among other requirements.

Businesses that meet the 8(a) Program’s eligibility requirements enjoy limited competition for federal government contracts known as set-aside and sole-source contracts. Participants in the 8(a) Program are also

109. See infra note 116 and accompanying text.
110. See infra notes 117–119 and accompanying text.
111. 13 C.F.R. § 124.101 (2020). For an overview of the 8(a) program, see ROBERT JAY DILGER, CONG. RSCH. SERV., R44844, SBA’S “8(A) PROGRAM”: OVERVIEW, HISTORY, AND CURRENT ISSUES (2019).
112. 13 C.F.R. § 124.103(a).
113. § 124.103(b).
114. § 124.104(a).
115. § 124.104(c)(2).
eligible to receive assistance through the 7(j) Management and Technical Assistance Program, be assigned a business opportunity specialist to help navigate federal contracting and obtain general business development assistance, and participate in a mentor-protégé program.

b. SBA Loan Guarantee Programs

The SBA does not act as a lender to small businesses but rather provides guarantees for small business applicants. Depending on the program, loans are provided by intermediaries such as banks (SBA 7(a) loans) or Certified Development Companies (CDCs) (SBA 504 loans) that interact with the small business applicant and make credit decisions. These two programs are available for small businesses that have a tangible net worth lower than $15 million and an average net income of $5 million or less for the preceding two years.

Amounts borrowed under the 7(a) loan program can be used for any business purpose, including working capital, inventory, financing leasehold improvements, and refinancing debt. Although borrowers may use the 7(a) program to fund capital investments, the SBA’s 504 loan program offers certain advantages for small businesses to fund these capital investments. The 504 program offers borrowers a fixed rate for 10 or 20 years, generally with lower fees than the 7(a) program, which typically have shorter maturities and variable interest rates.
under the 504 program require a down payment of 10%, whereas the 7(a) loan program requires certain loans to be fully collateralized.

The overall effectiveness of these SBA loan programs has been widely questioned. Some have argued that the policy rationales underlying these programs are unsound, highlighting the opaqueness of the selection process and maintaining that the ultimate winners are big banks who do not need financial support from taxpayers. Setting that policy question aside, it is debatable whether debt financing is the most appropriate vehicle to fund certain early-stage businesses, as it can be relatively expensive and cause undue financial strains in the short term. Indeed, for some early-stage businesses, the temporal flexibility of equity financing and the advice and involvement of equity investors often provide a more attractive alternative.

The performance of these SBA programs is even more troubling if we look at their effects on minority-owned businesses. SBA programs have not increased minority entrepreneurship. Minority-owned businesses are less likely to receive loans under the SBA programs, and those who do receive loans receive smaller loans relative to non-minority-owned businesses. The failure of these SBA lending programs is not surprising given the importance of soft information in assessing minority-owned businesses and the fact that most SBA lenders are large banks.

125. 504 Loans are typically structured with SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs, and the borrower contributing 10% of the project costs. See CRS 504 REPORT, supra note 121, at 1.

126. A small business borrower typically has to pledge all collateral available, including their personal residence, to secure the loan. See CRS 7(A) REPORT, supra note 121, at 6.

127. Senate Hearings, supra note 66, at 4 (opening statement of Hon. Olympia Snowe) (noting that “the effectiveness of [SBA] programs have been repeatedly called into question”).


129. See infra notes 187–192 and accompanying text.

130. See infra notes 193–199 and accompanying text.

131. See Min & Bozorgmehr, supra note 35, at 34–35 (summarizing the relevant literature).

132. Senate Hearings, supra note 66, at 2 (opening statement of Hon. John F. Kerry, Chairman) (“When we look at SBA lending, the share of loan dollars to minorities is largely stagnant. And more interestingly, minorities who have obtained SBA loans have seen their average loan size shrink by more than those to non-minorities.”).
precisely the type of institution that has a comparative disadvantage in that informational setting.\textsuperscript{133}

2. SMALL BUSINESS INVESTMENT COMPANIES

Small Business Investment Companies (SBICs) are privately-owned companies, licensed and regulated by the SBA, that make long-term investments in small businesses.\textsuperscript{134} To fund their investments, SBICs raise regulatory capital from private investors, generally institutional investors such as banks, insurance companies, pension funds, and university endowments, as well as high net-worth individuals.\textsuperscript{135} These funds are supplemented by the SBA mainly in the form of guaranteed debt: for every $1 an SBIC raises from a private investor, the SBA typically provides $2

\textsuperscript{133} See Editorial Board, supra note 128 (stating that lenders in the SBA programs are large banks); supra notes 98–106 and accompanying text (discussing the importance of soft-information and which institutions are best positioned to rely on it). Notably, the ever-growing concentration of the banking sector has rendered it even less able to meet the capital needs of minority-owned businesses. See supra note 89 and accompanying text; Cavalluzzo, Cavalluzzo & Wolken, supra note 66, at 676 (“Small businesses that were owned by African Americans were more likely to be denied credit and have unmet credit needs as the level of lender market concentration increased. In addition, African American owners were less likely to apply for credit with increases in lender market concentration.”).

\textsuperscript{134} See JOHN PAGLIA & DAVID T. ROBINSON, FED. R.SCH. DIV., LIB. OF CONG., MEASURING THE REPRESENTATION OF WOMEN AND MINORITIES IN THE SBIC PROGRAM 8 (2016) (“[T]he SBIC Program’s mission is to stimulate and supplement the flow of private equity capital and long-term loan funds for the growth, expansion, and modernization of small businesses for which such capital and loan funds are not available in adequate supply . . . .”); Ethan D. Dunn, Early Stage SBICs: A New Source of Capital for Private Investors, Equity for Start-Ups, and Possible Volker Rule Exemption for Banks, N.C. BANKING INST. 357, 361 (2013) (“[SBICs] lend or invest [a] mixture of private and SBA-guaranteed capital to early stage small businesses with hopes of profits above their borrowed rates. The availability of government-backed debt and equity improves small business access to long-term debt and private equity, in turn financing operations and expansion.”).

of debt capital, up to $175 million (“leverage capital”). Once capitalized, SBICs act as managed investment funds that invest capital raised from private investors in businesses operating in sectors and industries where the fund managers have expertise.

a. SBIC Programs

Active SBICs are licensed to participate in one of four main programs: the Debenture Program, the Participating Securities Program, the Bank-Owned/Non-Leveraged Program, and the Specialized SBIC Program. As of September 30, 2018, there were 305 licensed SBICs, of which 227 belonged to the Debenture program; 25 belonged to the Participating Securities program; 47 belonged to the Bank-Owned/Non-Leveraged Program; and 6 belonged to the Specialized SBIC Program.

Under the Debenture Program, an SBIC receives SBA leverage in the form of a guaranteed debenture (i.e., loan obligations), which allows the SBIC to borrow at favorable terms. There are a number of capital requirements that need to be satisfied by an SBIC participating in the Debenture Program, but a detailed discussion of these is not necessary for our purposes. Notably, Debenture SBICs can only invest in businesses with a tangible net worth under $19.5 million.


137. See id. SBICs can be organized under state law as corporations, a limited partnerships or limited liability companies. See id. at 4. SBICs are organized as limited partnerships with the SBIC managers acting as the general partner. See OCC SBIC Report, supra note 135, at 1.


140. CRS SBIC Report, supra note 136, at 1. When an SBIC wants to draw leverage, it notifies the SBA and issues a debenture, which the SBA temporarily holds (providing funds in the interim to the SBIC) and then sells the debentures to the public pooled with others (to receive the funds back). See U.S. Small Bus. Admin., Memorandum of Instructions Application for Commitment of SBIC Debentures 1, 7 (2016), https://www.sba.gov/document/policy-guidance--commitment-instructions [https://perma.cc/9M38-3XWS].

141. Debenture SBICs are required to have a private capital investment of at least $5 million. 13 C.F.R. § 107.210 (2020). At least 30% of a debenture SBIC’s regulatory and leverageable capital must come from three people unaffiliated with the fund’s management and unaffiliated with each other. § 107.150.

142. See Dunn, supra note 134, at 364; SBIC Overview, supra note 135, at 2.
The fixed and periodic nature of the payments that an SBIC must meet under the Debenture Program makes startup and early-stage businesses less attractive investment targets for SBICs as compared to older, more established businesses. Investing in young, small businesses generally requires the ability to purchase equity interests in them, interests which are unlikely to provide a predictable stream of returns. As a result, SBICs in the Debenture Program focus on debt instruments and mezzanine financing and prefer to invest in later-stage businesses with larger cash flows.

To facilitate the formation of SBICs that would make equity investments in startups and early-stage companies, the SBA established the Participating Securities Program in 1994. Unlike the Debenture Program, where the SBA is practically a creditor of the SBIC, the Participating Securities Program allows the SBA to guarantee equity-type securities, requiring SBICs to pay the SBA a prioritized payment (or preferred return) and a profit share when the SBIC realizes profits. Due to mounting losses associated with this Program, the SBA terminated it in October 2004 and stopped issuing new commitments for participating securities leverage or licensing new SBICs using that leverage. In the following years, congressional and market actors expressed interest in reviving a similar program to assist startup and early-stage small businesses.

One such program was part of the Obama Administration’s 2011 Startup America Initiative, under which the SBA established a five-year, $1 billion early-stage SBIC program. Early-stage SBICs were required to invest at least 50% of their financings in early-stage small businesses, businesses that have never achieved positive cash flow from operations in

143. Debenture SBICs must make semiannual payments to cover interest and other charges. See CRS SBIC REPORT, supra note 136, at 12.
144. See infra notes 189–191 and accompanying text.
145. See CRS SBIC REPORT, supra note 136, at 11; Dunn, supra note 134, at 365. Of the $5,159 million financed by SBICs in 2018, $3,221 million (66.33%) was in the form of straight debt, $945 million was in the form of equity (18.32%) and $791.8 million was in the form of hybrid securities (15.35%). See SBIC QUARTERLY REPORT, supra note 139, at 2.
147. Participating securities are redeemable, preferred, equity-type securities issued by SBICs in the form of limited partnership interests, preferred stock, or debentures with interest payable only to the extent of earnings. See CRS SBIC REPORT, supra note 136, at 7.
148. See id. at 7.
149. Id.
any fiscal year. In recognition of the higher risk associated with investments in these early-stage small businesses, the initiative included “several new regulatory provisions intended to reduce the risk that an early-stage SBIC would default on its leverage and to improve SBA’s recovery prospects should a default occur.” Since the program was not renewed, the SBA stopped accepting new applicants for the early-stage SBIC initiative in 2017.  

b. Efforts Targeting Minority-Owned Businesses

Two SBIC programs have sought to encourage SBIC investment in minority-owned businesses and facilitate the latter’s access to capital: the Specialized SBIC (SSBIC) Program and the Impact Investment SBIC Initiative. Although neither of these programs still exists, their history provides valuable insights for the design of alternative approaches to address minority entrepreneurs’ difficulties in accessing capital.

The SSBIC Program was designed to target small business entrepreneurs “whose participation in the free enterprise system is hampered because of social or economic disadvantage,” a category meant to capture minority-owned small businesses. The program, however, was repealed in 1996 and no new SSBIC licenses have been issued since. During the existence of the program, the SBA issued 288 SSBIC licenses. In 1997, there were 77 active SSBICs. As of 2018, only 6 remained. Some have argued that the decline of the SSBIC program resulted in a corresponding decline of SBIC financings to minority-owned small businesses.

151. See id. at 25,051–53.  
152. Id. at 25,043.  
155. CRS SBIC REPORT, supra note 136, at 3.  
156. See PAGLIA & ROBINSON, supra note 134, at 9.  
157. Id.  
158. See SBIC QUARTERLY REPORT, supra note 139, at 1.  
159. See PAGLIA & ROBINSON, supra note 134, at 9.
The Impact Investment SBIC Initiative was a $1 billion effort established by the SBA in 2011. Under the terms of the program, an impact investment SBIC was required to target at least 50% of their investments in “areas of critical national priority including underserved markets and communities facing barriers to access to credit and capital.” These areas initially included businesses located in underserved communities, as well as in sectors like education and clean energy. Nine impact investment SBICs were licensed, and, as of September 30, 2018, they managed $905 million in assets and had investments in 81 businesses.

Yet, this program was also short-lived. In September 2017, the SBA announced that it would no longer accept new applications for impact investment SBIC licenses and withdrew a proposed rule that would have provided impact investment SBICs additional benefits “to encourage qualified private equity fund managers with a focus on social impact to apply to the SBIC program.” The SBA indicated that the cost of the proposed additional benefits was “not commensurate” with the benefits, particularly because so few qualified SBICs had applied to participate in the program and that many of the program’s participants would have applied to the SBIC program regardless.

160. CRS SBIC Report, supra note 136, at 8.
164. Id.
166. See Impact SBICs Withdrawal, supra note 165 at 26,874–75. The SBA indicated that due to the risk associated with this class of SBICs the proposed rule was expected to increase the cost to all SBICs by increasing the annual fee by approximately 6.1 basis points. Id.
c. Assessing SBICs’ Performance

Overall, the SBIC program has been successful. From the SBIC Program’s inception to December 31, 2018, SBICs provided approximately $97.6 billion of funding in more than 181,185 financings to businesses, including companies like Amgen, Apple Computer, Costco, Federal Express, Intel, Tesla, and Whole Foods.167 The SBIC Program also laid the foundation for the modern venture capital industry, as the risk involved in these investments was quite substantial for the private sector to absorb without initial government support.168 More recently, however, SBIC programs have focused on providing debt financing to mid-stage companies, greatly neglecting the needs of small, early-stage companies.169 This neglect is primarily due to the type of leverage provided by the SBA: mainly debt, which induces SBICs to invest in debt instruments issued by relatively stable companies.170 Moreover, as discussed later, raising capital via debt is generally not the best choice for small, early-stage companies.171 Whether the SBIC program has helped develop minority businesses is debatable. At a 2007 congressional hearing, the SBA recognized that “minority representation in [the SBIC program] is low.”172 The situation has not improved since. As of 2018, Black- and Hispanic-owned businesses were involved in only 1.9% and 1.0%, respectively, of SBICs financings.173 Non-minority businesses, on the other hand, were involved in 95.2% of the financings.174 Looking at the aggregate amount of funds

168.  Rubin, supra note 100, at 829; Sean Silverthorne, Government’s Positive Role in Kick-Starting Entrepreneurship, HARV. BUS. SCH. (Dec. 7, 2009), http://hbswk.hbs.edu/item/6318.html [https://perma.cc/8MDK-MW8N] (citing Josh Lerner as stating that the SBIC program “led to the formation of the infrastructure for much of the modern venture capital industry”); JOSH LERNER, BOULEVARD OF BROKEN DREAMS 68–69 (Princeton Univ. Press 2009) (“[M]any pioneering venture funds have garnered . . . low [financial] returns” and “that no matter how promising the returns of entrepreneurial activity ultimately are, in a venture market’s early years, low returns are likely.”).
169.  See supra notes 143–145 and accompanying text.
170.  Id.
171.  See infra notes 189–199 and accompanying text.
173.  See CRS SBIC Report, supra note 136, at 23. Other minority groups have similar numbers: Asians (1.8%) and Native Americans (0.0%). Id.
174.  CONG. RSRCH. SERV., R41456, SBA SMALL BUSINESS INVESTMENT COMPANY PROGRAM 23 (2019) [hereinafter CRS SBIC Report 2019]. See also Paglia & Robinson, supra note 134, at 18 (finding that about 4% of the SBIC financings between June 1, 2013 and September 30, 2015 involved portfolio companies with a minority chief executive officer or president).
disbursed reveals a similar pattern. Black-owned businesses received 0.6% of the total disbursed funds, while Hispanic-owned businesses received 0.2%. Non-minority businesses, on the other hand, received a striking 97.6% of the total financing.

Although the SBA has acknowledged the problematic nature of these figures, it ultimately has no control over the SBICs’ decision-making process and cannot mandate racially-based investment quotas. Establishing programs to aid minority entrepreneurs is tricky, as the SBA does not have the statutory authority to proactively target racially diverse companies, and SBICs must provide financing to all qualifying small enterprises on an equal opportunity basis. As a result, the SBA instead focuses its efforts on encouraging SBICs to finance racially diverse portfolio companies and encouraging private equity funds with women or minority partners to apply to the SBIC Program.

That second effort is of particular interest, as funds led by minorities would be better suited to produce and digest the type of soft information necessary to invest in minority-owned businesses. As in private equity, the diversity of the SBIC investor base (i.e., the decisionmakers) mirrors the diversity of the businesses that receive funding. A 2016 study found that of the 303 active funds, 272 (89.8%) were non-racially diverse and 31 (10.2%) had at least one minority investment partner. Racially diverse SBICs were more likely to invest (and invest more) in minority-owned businesses than non-racially diverse SBICs. Despite these differences in their investment strategies, there were no significant differences in the financial performance of racially diverse and non-racially diverse SBICs.

175. CRS SBIC REPORT 2019, supra note 174, at 23.
176. Id. at 24.
177. See id. at 23–24.
178. See id. at 24–25.
179. See id. at 9.
180. This argument has been made by market actors, including the Small Business Investor Alliance (formerly known as the National Association of Small Business Investment Companies). See Full Committee Hearing on Increasing Capital for Small Business, Before the H. Comm. on Small Business, 111 Cong. 51–89 (Oct. 14, 2009).
181. See infra notes 208–211 and accompanying text.
182. Paglia & Robinson, supra note 134, at 17. These patterns are fairly stable across different types of funds. Of the 205 active debenture funds, only 21 (10.2%) were racially diverse. Id. To measure the racial diversity, the authors considered whether a SBIC’s investment team had at least one member from an ethnic or racial minority. Id. at 15.
183. Id. at 24–25.
184. See id. at 33 (concluding that “there is no apparent difference in performance between diverse SBIC funds and other funds”).
B. Broadening the Investor Base

Two common attributes of the government-sponsored programs discussed above render them ill-suited to meet the financing needs of small businesses, particularly those owned by minority entrepreneurs. First, these programs rely on large financial intermediaries to act as gatekeepers, and these types of institutions are not well adapted to collect and assess soft information from minority-owned businesses. The second limitation relates to each program’s heavy reliance on debt financing as a tool to promote entrepreneurship. As discussed below, for many small and young firms, debt is not necessarily the best source of financing. Moreover, innovative technological-driven schemes that were expected to help minority-owned businesses access equity financing have fallen short.

1. Private Equity

The first sources of financing used by entrepreneurs are personal funds (e.g., savings) and contributions from friends and family. Once these sources of capital are exhausted, the entrepreneur needs to seek external financing. Although established firms seeking outside financing often prefer to issue debt before equity, relying heavily on debt is often not the best choice for young firms. First, the cash-flow uncertainty faced by young businesses makes it difficult for them to commit to a schedule of fixed payments, as is expected under debt

185. See supra notes 83–87 and accompanying text.

186. The reliance on debt for the SBA’s loan programs flows directly from the SBA guarantee of the loans made by banks to small businesses. See supra Section II.A.1. The reliance on debt instruments by SBICs when investing in small businesses is the result of the manner in which SBICs are capitalized and leveraged. See supra Section II.A.2.

187. Pollman, supra note 83, at 170 (“[F]ounders often ‘bootstrap’ the business using their own funds, and those of family and friends, to finance development efforts and early operations.”); Fourati & Affes, supra note 82, at 247 (noting that due to their lack of “historical and . . . reputation effects,” new firms are “informationally opaque” and this complicates attracting external financing).

188. See Pollman, supra note 83, at 170 (noting that once personal funds are exhausted start-ups must seek alternate sources of capital).

189. See Stuart Paul, Geoff Whittam & Janette Wyper, The Pecking Order Hypothesis: Does It Apply to Start-Up Firms, 14 J. SMALL BUS. & ENTER. DEV. 8, 9 (2007) (“[I]n the majority of cases . . . entrepreneurs move from self-funding to external equity as a means of financing their businesses in preference to, or instead of, bank finance.”); Fourati & Affes, supra note 82, at 246 (“Literature has recently introduced a revised version of the [pecking order theory], where external equity is preferred over external debt in the case of innovative firms.”); Paolo Fulghieri, Diego Garcia & Dirk Hack Barth, Asymmetric Information and the Pecking (Dis)Order, 24 REV. FIN. 961, 968–73, 991–92 (2020) (presenting a model explaining why small firms may prefer equity over debt financing when informational asymmetries are severe).
instruments. Second, the type of informational asymmetries that characterize small, young firms can actually make debt more expensive than equity, a reversal of the traditional pecking order.

For small, young businesses, raising equity capital from the public is not practical—the informational asymmetries and related transaction costs of a public offering are just too high. Entrepreneurs seeking external equity financing must thus turn to private equity investors, such as angel investors and venture capital firms, that specialize in funding startups. Sales of securities to these private equity investors are exempt from the registration requirements of securities laws, which reduces transaction costs. To manage the informational asymmetries involved in investing in a small business, private equity investors rely on informal relationship-based and geographically-focused screening and monitoring devices that are well-suited for the collection of soft information. Generally, these investors rely on their social and professional networks to identify and screen potential opportunities before personally assessing them, and then take an active role in managing their investments by providing contacts, strategic advice, and follow-on funding that can take a company

190. See George Deeb, Comparing Equity, Debt and Convertibles for Startup Financings, FORBES (Mar 19, 2014, 2:25 PM), https://www.forbes.com/sites/georgedeeb/2014/03/19/comparing-equity-vs-debt-vs-convertibles-for-startup-financings/#6bd21c6169ff [https://perma.cc/Q782-LGXH]; Pollman, supra note 83, at 170 (“Traditional banks do not lend to startups, particularly in their early stages, due to their lack of a track record, negative cash flow, lack of tangible assets, and high failure rate.”); Huyghebaert & Van de Gucht, supra note 81, at 110 (“The reason is that debt generally is not a suitable financing source for high-growth firms: to finance their growth, firms need to make large investments upfront whereas cash flows will only realise in the future. As a result, it is difficult for firms to pay off their debts from internally generated sources and equity is a more suitable financing source.”).

191. See Paul, Whittam & Wyper, supra note 189, at 9 (“The evidence presented shows that in the majority of cases a bridged pecking order applies in that entrepreneurs move from self-funding to external equity as a means of financing their businesses in preference to, or instead of, bank finance.”); Carmen Cotei & Joseph Farhat, The Evolution of Financing Structure in U.S. Startups, 19 J. ENTREPRENEURIAL FIN. 1, 12 (2017) (“In informationally opaque firms are less likely to use outsiders’ debt, credit line, credit card, and bank loan capital injections. . . . [Attributable to the fact that] informationally opaque firms are less likely to access debt financing due to severe frictions in the debt markets.”).

192. For a discussion of the rules governing the public offering process and their disparate impact on small businesses see infra notes 223–231 and accompanying text.

193. See Pollman, supra note 83, at 170 (“Two types of investors specialize in financing startups: angel investors and VCs.”).

194. See id. at 163–65.

195. See infra notes 223–231 and accompanying text.

196. See Pollman, supra note 83, at 171–73.

197. See supra notes 100–102 and accompanying text.
on an entirely different trajectory.\textsuperscript{198} This last point highlights a key advantage of having an equity investor for young, small businesses, as creditors lack the ability or incentives to provide the valuable ongoing business advice and networking opportunities that equity investors do.\textsuperscript{199}

Although private equity’s organizational structure and investment strategy are tailor-made for the collection and assessment of soft information—precisely the type of information that those seeking to invest in minority-owned businesses would need to rely on—minority entrepreneurs do not appear to enjoy ready access to this financing channel. Minority-owned startups are significantly less likely to obtain equity financing from venture capital firms and angel investors.\textsuperscript{200} Consequently, an extremely low percentage of minority businesses are backed by private equity: only 1\% of venture-capital-backed startups are led by African Americans.\textsuperscript{201} Remarkably, these racial disparities do not reflect the profitability of venture capital funds that specialize in minority-

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\item See Paul, Whittam & Wyper, supra note 189, at 9 (“Rather than the external equity being regarded as expensive, it is viewed as good value as a well-chosen investor can add business skills and social capital in the form of commercial contacts and access to relevant networks.”); Timothy Bates & William D. Bradford, \textit{Venture-Capital Investment in Minority Business}, 40 J. Money, Credit & Banking 489, 501–02 (2008) (finding that active guidance and assistance by minority-focused venture capital funds adds value to the portfolio company, thus increasing the funds’ rate of return).

\item See John K. Paglia & Maretno A. Harjoto, \textit{The Effects of Private Equity and Venture Capital on Sales and Employment Growth in Small and Medium-Sized Businesses}, 47 J. Banking & Fin. 177, 189 (2014) (finding that small and mid-sized minority-owned businesses were less likely to receive private equity (-21.7\%) and venture capital (-22.2\%) funding); ICIC REPORT, supra note 8, at 8 (“While a similar share of minority- and nonminority-owned businesses tried to raise capital, only half of the minority-owned businesses that tried to raise equity were successful, compared to 84 percent of nonminority-owned businesses.”).

\end{enumerate}
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owned businesses,202 which earn returns that are at least as large as those offered by mainstream funds.203 The undeniable reality, however, is that few private equity funds target minority-owned businesses.204 Even venture capitalists now acknowledge their failures to fund non-white enterprises and the resulting lack of diversity in their portfolio companies.205

Multiple factors explain why minority businesses are underserved by private equity. Minority businesses tend to be located in inner cities, geographically removed from venture capital networks, which complicates relationship-driven screening and monitoring.206 Moreover, the venture capital industry has traditionally focused on companies engaging in innovation or technology, not the types of activities generally pursued by minority entrepreneurs.207

A third explanation also fits within the framework developed in this Article. Private equity firms are not diverse themselves: racial disparities

202. The MESBIC program (the predecessor of the SSBIC) gave birth to a small minority-focused venture capital industry. See Bates & Bradford, supra note 199, at 492.

203. See Fairlie & Robb, supra note 11, at 20; Bates & Bradford, supra note 199, at 490 (“Overall, the measured investment returns generated by the minority-focused VC funds were broadly consistent with those of mainstream funds.”); Timothy Bates, William Bradford & Julia Sass Rubin, The Viability of the Minority-Oriented Venture-Capital Industry Under Alternative Financing Arrangements, 20 ECON. DEV. Q. 178, 186–87 (2006) (finding that minority-focused venture capital funds had financial returns that were comparable to or better than those of conventional venture capital); Rubin, supra note 100, at 824–25 (“These funds’ strong financial performance undermines the possibility that companies owned by entrepreneurs of color attract fewer venture capital investments because they do not represent a financially attractive investment opportunity.”).


207. See supra note 59 and accompanying text; Pollman, supra note 83, at 166 (“Early-stage startups are highly entrepreneurial and focused on innovation and technology.”); Gompers & Lerner, supra note 198, at 190 (“[Venture capitalists focus] on high-technology firms (e.g., communication, computers, electronics, biotechnology, and medical/health).”).
in venture capital financing mirror disparities in investors’ demographics. As a result, private equity investors—mostly white males—and minority-entrepreneurs belong to different social, cultural, and professional networks. These demographic differences increase the costs for investors to collect the soft information needed to identify, assess, and monitor minority-owned businesses, leaving them in a position where implicit biases may influence their decision-making. In sum, while investing in minority-owned businesses can be lucrative, success here requires specialized knowledge and unconventional research, placing most private capital funds at a competitive disadvantage because of their location, industry focus, and demographic makeup.

Small businesses that struggle to access outside equity are invariably placed in a situation where they either do not have enough external financing or must rely on excessive and expensive leverage that can put the operational and financial health of the business at risk. In recent years, the low proportion of minority individuals among angel investors is a problem. minority- entrepreneurs, hiring a white wing-man, is a strategy that addresses this informational problem. See Anand & McBride, supra note 205.

Anecdot al evidence indicates that funds focused on minority-owned businesses use unconventional, relationship-based networks to identify investment opportunities. See Timothy Bates & William Bradford, Traits and Performance of the Minority Venture Capital Industry, 613 ANNALS AM. ACAD. POL. & SOC. SCI. 95, 106 (2007); Rubin, supra note 100, at 825.

212. Susan Coleman & Richard Cohn, Small Firms’ Use of Financial Leverage: Evidence from the 1993 National Survey of Small Business Finances, 12 J. BUS. & ENTREPRENEURSHIP 81, 83–84 (2000) (noting that small firms generally cannot access equity capital and thus may overrely on debt which, can make them “susceptible to the problems of financial distress and failure”.

208. See Thorne, supra note 29 (noting lack of diversity in the venture capital industry). A survey of venture capital investors found that “87 percent were Caucasian, nine percent were Asian, two percent were African American or Latino, and two percent were of mixed race.” See NVCA Forms Diversity Task Force to Foster Greater Inclusion Across the Innovation Ecosystem, NAT’L VENTURE CAP. ASS’N BLOG, https://nvca.org/pressreleases/nvca-forms-diversity-task-force-foster-greater-inclusion-across-innovation-ecosystem/ [https://perma.cc/R3PS-U9DT] (last visited Feb. 20, 2021). The low rate of minority-owned business making their pitch to angel investors also reflects the low proportion of minority individuals among angel investors. See Jeffrey Sohl, CTR. FOR VENTURE RSC., THE ANGEL INVESTOR MARKET IN 2008: A DOWN YEAR IN INVESTMENT DOLLARS BUT NOT IN DEALS, https://scholars.unh.edu/cgi/viewcontent.cgi?article=1006&context=cvr [https://perma.cc/JYH7-7F6B] (noting that 3.6% of angel investors were minorities and that 3.7% of businesses pitching their business ideas to angel investors were minority-owned); Stricher, supra note 201.

209. See supra notes 99–102 and accompanying text.

210. See Barr, supra note 206, at 15–16 (“One likely reason that minorities are disproportionately underserved by institutional sources of venture capital may be an information failure that results from a lack of common networks.”); Rubin, supra note 100, at 824–25 (“Leaving aside possible discrimination, the most likely reason that minority and female entrepreneurs are disproportionately underserved by the venture capital industry is the information failure that results from a lack of common networks . . . .”). See also supra notes 103–104 and accompanying text. Notably, a piece of advice often given to black entrepreneurs, hiring a white wing-man, is a strategy that addresses this informational problem. See Anand & McBride, supra note 205.
years, technological and regulatory developments have spurred new financing channels that seek to remedy some of the difficulties faced by small businesses in raising equity capital and less-expensive debt capital. A common strategy is to minimize frictions by reducing the role of financial intermediaries that stand between the ultimate suppliers of capital and issuers. The rise of the internet has led to the development of online platforms that allow entrepreneurs to connect directly with both debt and equity investors, bypassing these financial intermediaries. For many, this made crowdfunding and other financial technology (FinTech) developments, such as online lending platforms, promising game-changers.

213. See Joern H. Block, Massimo G. Colombo, Douglas J. Cumming & Silvio Vismara, New Players in Entrepreneurial Finance and Why They Are There, 50 SMALL BUS. ECON. 239, 240 (2018) ("These new players and instruments have emerged, among others, because of the difficulties faced by entrepreneurs and early-stage new ventures in raising funds . . . ").

214. See id. at 247 ("[T]he value of intermediation is now questioned as innovations allow to by-pass intermediaries so that the participants at the end of the supply and demand chain (i.e., savers/investors and borrowers/fund raisers) meet directly.").

215. See id. ("[T]he development of online platforms has created new opportunities for entrepreneurs to raise seed capital and for non-professional investors to disintermediate their investments. By easing the manner in which demand for capital meets supply, recent financial innovations are expected to improve the efficiency of financial markets.").

216. Online lending platforms have recently become a source of debt financing for small business, particularly minority-owned, that have been underserved by traditional banking. See Usman Ahmed, Thorsten Beck, Christine McDaniel & Simon Schropp, Filling the Gap: How Technology Enables Access to Finance for Small- and Medium-Sized Enterprises, 10 INNOVATIONS 34, 35–36 (2016). A number of reasons may be driving this trend. Online platforms might use decision-making algorithms that consider hard, verifiable information in a more objective manner than a loan officer does (though attenuated biases do still remain). See Robert Bartlett, Adair Morse, Richard Stanton & Nancy Wallace, Consumer-Lending Discrimination in the FinTech Era at 6–7 (Nov. 2019), https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf [https://perma.cc/3A9C-62BN]. Various online lending platforms are marketed towards underserved populations. See Mark Schweitzer & Brett Barkley, Is “Fintech” Good for Small Business Borrowers? Impacts on Firm Growth and Customer Satisfaction 11 (Fed. Rsrv. Bank of Cleveland, Working Paper No. 17-01, 2017). Though promising, the effectiveness of such platforms in bridging disparities is an open question. First, these platforms focus only on debt (not on equity or hybrid instruments) and are not tailored to gather and assess soft information problems and provide advice to the business they invest in. See Block, Colombo, Cumming & Vismara, supra note 213, at 241–42, 246–47. The terms of these loans are also far from ideal. See Brett Barkley & Mark E. Schweitzer, The Rise of Fintech Lending to Small Businesses: Businesses’ Perspectives on Borrowing 18 (Fed. Rsrv. Bank of Cleveland, Working Paper No. 20-11, 2020). The size of loans disbursed by online lenders are smaller than those of traditional lenders. Id. at 18. Moreover, the unregulated nature of these markets subjects borrowers to potential abuses, including worse terms and higher interest rates than traditional banking. See Lenore Palladino, Another Risk for Small Business: Lightly Regulated Fintech Loans, BARRONS (April 21, 2020), https://www.barrons.com/articles/small-businesses-risk-predatory-loans-to-survive-51587492858 [https://perma.cc/R4F2-HRZJ]; Lenore Palladino, Small
2. CROWDFUNDING

Crowdfunding initially developed to support ventures by facilitating donations or product repurchases.\textsuperscript{217} The revolutionary feature of crowdfunding was empowering individuals to “directly” interact with members of the public via online platforms in order to raise funds, cutting out middlemen.\textsuperscript{218} Early funding platforms followed the reward and prepurchase models, where “investors” willing to fund a particular project would receive a copy of the product being created or a “reward” related to the funded project.\textsuperscript{219} Crowdfunding soon emerged as an alternative vehicle to raise relatively small amounts of capital from retail investors.\textsuperscript{220} Early microfinance portals allowed investors to lend money to microentrepreneurs for return of principal and nominal interest.\textsuperscript{221} The application of federal securities laws, however, limited the development of crowdfunding as a vehicle for more sophisticated debt instruments and equity investments.\textsuperscript{222}

\textit{a. The Evolution of Crowdfunding}

A business offering or selling securities must prepare a set of disclosure documents, including a registration statement (filed with the Securities and Exchange Commission, or SEC) and a prospectus to be distributed to investors.\textsuperscript{223} In addition, a set of “gun jumping” rules regulate the timing, manner, and form of communications made during the

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\textsuperscript{219} See Bradford, supra note 217, at 16–17.


\textsuperscript{221} See id. at 25–26.

\textsuperscript{222} See Bradford, supra note 217, at 29–31.

\textsuperscript{223} Thomas Lee Hazen, Federal Securities Law 2–3 (3d ed. 2011). The broad manner in which terms like “offer,” “sale,” and “securities” are generally construed makes the provisions of Securities Act of 1933 (Securities Act) far reaching. See Joan MacLeod Heminway & Shelden Ryan Hoffman, Proceed at Your Peril: Crowdfunding and the Securities Act of 1933, 78 TENN. L. REV. 879, 907 (2011) (noting broad sweep of Section 5 of the Securities Act).
offering process. Preparing the required disclosure documents and complying with the gun jumping rules is time consuming and costly. The significant fixed component of these compliance costs disproportionately affects smaller businesses.

To avoid these costs, issuers conduct exempt offerings. One of the most commonly used exemptions is Rule 506, under which an issuer may offer and sell, without registration, an unlimited aggregate principal amount of securities to any number of “accredited investors” so long as certain other conditions are met. However, the numerous conditions of Rule 506 limit the usefulness of this exemption for small businesses, especially those owned by minorities.

Exempt offerings generally involve accredited investors exclusively, and an entrepreneur who does not know or have ready access to these accredited investors will have a difficult time conducting a successful exempt offering.

The costs and difficulties faced by small businesses and minority-owned businesses in tapping accredited investors, who generally belong to a different social and professional network, made crowdfunding a

224. See Carlos Berdejó, Going Public After the JOBS Act, 76 OHIO ST. L.J. 1, 9–10 (2016). Non-compliance with any of the requirements contained in the rules can result in substantial liability for the issuer. Id. at 10.

225. Id. at 10.


227. See Berdejó, supra note 224, at 20. The primary statutory exemption for private placements is Section 4(a)(2) of the Securities Act, which exempts “transactions by an issuer not involving any public offering.” 15 U.S.C. § 77d(a)(2). Since the statute does not define “public offering,” see 15 U.S.C. § 77b, the SEC promulgated Regulation D to provide clarity and predictability in the use of this exemption. See Heminway & Hoffman, supra note 223, at 915–18 (highlighting clarifying purpose of Regulation D).

228. See Berdejó, supra note 224, at 28.

229. 17 C.F.R. § 230.506(b)(2)(ii) (2020). The term “accredited investor” includes institutional investors such as banks, insurance companies, registered investment companies, and SBICs, as well as individuals with a net worth over $1 million or annual income over $200,000. §§ 230.501(a)(1)–(6).

230. See § 230.506(b) (requiring businesses to meet all terms and conditions of §§ 230.501–502, not exceed the purchaser limit, and ensure purchasers have the requisite level of sophistication).

231. Reaching out to investors to attract their attention is not easy given that issuers cannot use “any form of general solicitation or general advertising” as part of an offering involving any non-accredited investors. § 230.502(c). This prohibits the use of advertising, newspaper or magazine articles, Internet websites, media broadcasts, email campaigns, and public meetings to promote an offering. See Berdejó, supra note 224, at 28–29.
revolutionary and exciting financing vehicle.\textsuperscript{232} As part of its efforts to facilitate capital raising by small issuers, the JOBS Act of 2012 created a new exemption under the Securities Act for capital raised through “crowdfunding,” enabling the use of the internet to pool small individual investments.\textsuperscript{233} These offerings are open to a wide variety of investors, not just accredited ones.\textsuperscript{234} The exemption’s set of relaxed requirements not only expands the pool of investors that small businesses can tap but also reduces the costs of raising capital by providing for scaled disclosure requirements, which vary according to the aggregate offering amount.\textsuperscript{235}

\textit{b. The Promise and Shortcomings of Crowdfunding}

The Obama Administration promoted the JOBS Act as a tool to improve access to capital for minority- and women-owned businesses,\textsuperscript{236} touting the important role of crowdfunding in “empower[ing] diverse entrepreneurs to launch successful businesses after traditional sources of


\textsuperscript{234} Sherwood Fouse, supra note 220, at 32. The Act limits the amount individuals may invest in crowdfunded offerings. These yearly limits are based on an investor’s income or net worth and range from $2,000 to $100,000. 15 U.S.C. § 77d(a)(6).


capital turned them down.” 237 The Administration’s optimism reflected the idea that crowdfunding could provide an avenue for the democratization of capital markets for small businesses, particularly minority-owned ones. 238 Many hoped that providing minority-owned businesses with direct access to individuals eager to invest in them would level the playing field. 239

A recent SEC report found that the number of crowdfunding offerings and the total amount of funding has been “relatively modest.” 240 Market participants have made a number of proposals to revitalize crowdfunding, including increasing the amount a company can raise during a 12-month

237 See Thomas Kalil & Doug Rand, The Promise of Crowdfunding and American Innovation (June 8, 2016), https://obamawhitehouse.archives.gov/blog/2016/06/08/promise-crowdfunding-and-american-innovation [https://perma.cc/9NDY-LST9]; Stricherz, supra note 201 (analyzing blog posts by the Obama Administration suggesting that crowdfunding under the JOBS Act was intended to help minority businesses).


period, increasing individual investors’ investment limits, and reducing the reporting and disclosure obligations that, as is, are too burdensome and costly for many of the small issuers that rely on the rule. The SEC has recently proposed a series of revisions to the existing rules to address many of these concerns.

Participation rates among traditionally underrepresented businesses have been discouragingly low during the early years of equity crowdfunding. Although some minority entrepreneurs have successfully employed crowdfunding to raise capital for their businesses, the existing evidence suggests that crowdfunding has not

241. See Lindsay M. Abate, U.S. SMALL BUS. ADMIN., OFF. OF ADVOCACY, ONE YEAR OF EQUITY CROWDFUNDING: INITIAL MARKET DEVELOPMENTS AND TRENDS 8, 13 (2018), https://www.sba.gov/sites/default/files/advocacy/Crowdfunding_Issue_Brief_2018.pdf [hereinafter SBA Study]; Policy Position Paper, ASS’N OF ONLINE INV. PLATFORMS (June 18, 2019), https://www.aoinaplatforms.org/official-positions [hereinafter AOIP Paper] (“The current $1.07 million cap is arbitrary and creates a negative selection bias for companies—as quality companies requiring larger amounts of capital are discouraged from utilizing Reg CF.”); SEC CF Report, supra note 240, at 37 (citing one platform as stating that “while few offerings reach the current limit, many issuers choose not to rely on the crowdfunding exemption because the limit is too low”). Proposals recommend limits ranging from $5 to $20 million, more in line with average early-stage funding of start-ups. Id. (citing recommended limits ranging from $5 million to $20 million); AOIP Paper, supra, at 1 (recommending limit be increased to $10 million while noting that the “average early-stage funding round is . . . $7 million”).


243. See id. at 3; SEC CF Report, supra note 240, at 24 (noting that the most costly portion of a crowdfunding campaign relates to disclosure). Other costs include the creation of a campaign page and other marketing expenses. See id. at 23 (“[T]he total cost of creating a campaign page, issuer disclosures, film, and video, and hiring a marketing firm, a lawyer, and an accountant amounts to approximately 5.3% of the amount raised.”).

244. See SEC Proposed CF Amendments, supra note 233, at 17,994 (proposing to increase the crowdfunding ceiling from $1.07 to $5 million and placing no limits on how much accredited investors invest in crowdfunded offerings).

245. See SBA Study, supra note 241, at 13 (noting that businesses in areas not already considered technology and finance hubs have struggled).

246. See, e.g., Brandon Andrews, The Best New Way for African Americans to Invest In or Start a Business: Equity Crowdfunding, BLACK ENTER. (Feb. 8, 2018), https://www.blackenterprise.com/equity-crowdfunding-black-investors-entrepreneurs/ [hereinafter Andrews] (providing examples of minority founders who have been successful in equity crowdfunding). Some of these success stories were publicized by the Obama administration as it promoted the JOBS Act. For example, the White House honored a minority female who was able to open a bookstore with the help of crowdfunding after banks had declined her loan applications. See Aurora Anaya Cerda, More than a Bookstore (June 6, 2013, 4:22 PM), https://obamawhitehouse.archives.gov/blog/2013/06/06/more-bookstore [hereinafter Cerda]; For other similar examples, see Emily Nunez, Taking ‘Made in the USA’ to the Next Level (June 6, 2013, 4:36 PM), https://obamawhitehouse.archives.gov/blog/2013/06/06/taking-made-usa-next-level [hereinafter Nunez].
been effective in reducing disparities in access to capital between minority and non-minority entrepreneurs. The prevalence of racial disparities in the crowdfunding space is consistent with discrimination in other FinTech markets, like online lending platforms, that have otherwise facilitated borrowings by small businesses.

What can explain the underwhelming performance of these promising game-changers? A recent study of crowdfunded equity offerings found that, even when minority entrepreneurs attract a higher number of investors, they are no more likely to secure their target funding. That is, minority entrepreneurs tend to attract “small investors” (who follow a “community logic”) rather than “professional investors” (who follow a “market logic”) and, as a result, raise less capital than their non-minority counterparts. Why are “professional investors” who follow a “market logic” hesitant to invest in minority businesses?

One leading theory is that implicit biases drive investors in the crowdfunding markets away from minority-owned businesses. This should not be surprising. Investing in small, minority-owned businesses requires the collection and analysis of soft information, and the collecting and analyzing of such information is not cost-effective for individual retail investors involved in crowdfunding. These unresolved informational asymmetries place these investors in a position where they can ultimately


250. See Cumming, Meoli & Vismara, supra note 249, at 16.

251. See generally Rhue, supra note 248, at 198–99.

252. See Rhue & Clark, supra note 247, at 2, 7, 11, 23 (finding that Black founders who conceal their race in their fundraiser photos perform better than campaigns where Black founders have Black fundraiser pictures); Younkin & Kuppuswamy, supra note 247, at 3274 (noting that in a setting where entrepreneurs can provide a picture, “projects from black founders continue to underperform projects from non-black founders and those without a founder picture”).
be influenced by their implicit biases, very much like banks and private equity investors so often are.\textsuperscript{253}

Some have argued that concealing the race of the entrepreneur is the most effective way to address investor biases and even the playing field.\textsuperscript{254} Other arguments acknowledge the role of implicit biases but suggest that alternative strategies, such as project promotion, are just as effective in addressing informational issues.\textsuperscript{255} Allowing promising projects to differentiate themselves from the “crowd” (i.e., allowing them to credibly signal their quality) could help minority entrepreneurs with good ideas raise capital and grow, which in turn may enhance the social perception of minority business.\textsuperscript{256} Differentiation can be a particularly powerful tool if minority businesses are (or are perceived to be) on average less profitable or present less opportunity for growth than non-minority businesses.\textsuperscript{257}

III. DESIGNING AN ALTERNATIVE APPROACH

A program that seeks to facilitate minority entrepreneurs’ access to capital must address the shortcomings of the initiatives discussed in Part II. First, it must enable the use of equity and hybrid securities to accommodate the operational needs of small businesses while alleviating informational asymmetry issues.\textsuperscript{258} Second, it must facilitate the production and analysis of soft information in a cost-effective manner by minimizing the level of hierarchies in decision-making.\textsuperscript{259} Third, it must present this soft information to potential investors in a credible manner to allow for differentiation.\textsuperscript{260} Fourth, it must provide an active role for

\textsuperscript{253} See supra notes 103–105 and accompanying text.

\textsuperscript{254} See Younkin & Kuppuswamy, supra note 247, at 3286. The nature of crowdfunding platforms makes it possible to conceal an entrepreneur’s race by not showing a picture of the entrepreneur or disclosing his or her race. See id. at 3283, 3286 (concluding that Black founders may improve their chances of success in raising money through crowdfunding by choosing a profile picture with race obscured or with a company logo). Similar concealment tactics are employed by female entrepreneurs to overcome gender biases. See Edwards & McGinley, supra note 104, at 1877, 1879 (describing techniques used by women in technology “to pass for an idealized masculine identity or to cover their otherwise stigmatized identities . . . for the purpose of accessing social and economic resources”).

\textsuperscript{255} Younkin & Kuppuswamy, supra note 247, at 3270. Project promotion may be more effective because it can be extremely difficult, if not almost impossible, to effectively conceal race since campaigns contain multiple racial signals, ranging from the entrepreneur’s name to project description. See Rhue & Clark, supra note 247, at 8, 13. Moreover, in a space where “authenticity leads to success,” anonymous campaigns could still face an uphill battle to be successful in attracting support. See id. at 2, 11.

\textsuperscript{256} See Younkin & Kuppuswamy, supra note 247, at 3270, 3285–86.

\textsuperscript{257} See id. at 3270–71, 3285–86.

\textsuperscript{258} See supra notes 188–212 and accompanying text.

\textsuperscript{259} See supra notes 93–100 and accompanying text.

\textsuperscript{260} See supra notes 255–257 and accompanying text.
investors in advising and counseling entrepreneurs on an ongoing basis.\textsuperscript{261} Fifth, it must be inclusive, enabling the participation of retail investors to further democratize the capital markets and provide a channel for grassroots efforts to address economic racial disparities.\textsuperscript{262}

Existing government programs have failed because of their reliance on debt as a financing mechanism and on large, hierarchical institutions that are ill-suited to navigate a niche imbued with soft information to act as gatekeepers.\textsuperscript{263} Crowdfunding’s disintermediation strategy has failed because well-intentioned investors seeking a financial return are unable to overcome informational asymmetries on an individual basis and fall prey to their own implicit biases.\textsuperscript{264} Although private equity’s organizational structure and investment strategy appear to be ideally suited for this task, the lack of diversity in its management ranks has rendered these tools ineffective in addressing the financing needs of minority-owned businesses.\textsuperscript{265} As leaders in the industry come to recognize the racial disparities in their portfolio companies and the need for change, we must figure out how to increase private equity participation in minority-owned businesses.\textsuperscript{266}

One possibility is to mandate such investments via regulatory mechanisms such as the Community Reinvestment Act.\textsuperscript{267} A similar possibility is to require that private equity funds increase the racial, industrial, and geographical diversity of their management ranks so that they are better positioned to successfully invest in minority-owned businesses.\textsuperscript{268} Coercive solutions like these, however, are unlikely to address the underlying structural problems and be sustainable in the long run. A wiser approach is to recruit private equity, not just as part of the solution, but as a partner in developing it alongside the government and members of the community. This can be achieved by channeling government and community efforts to provide actors in the private equity space the incentives to start investing in minority-owned businesses and retaining managers that are members of minority groups who can more

\textsuperscript{261} See supra note 199 and accompanying text.

\textsuperscript{262} See supra notes 236–239 and accompanying text.

\textsuperscript{263} See supra notes 127–133, 172–184 and accompanying text.

\textsuperscript{264} See supra notes 251–257 and accompanying text.

\textsuperscript{265} See supra notes 103–104, 208–211 and accompanying text.

\textsuperscript{266} See James Thorne, \textit{Funds, Recruiting and Support: VCs Address Diversity and Inequality}, PitchBook (June 8, 2020), https://pitchbook.com/news/articles/vcs-address-diversity-institutional-bias?sourceType=NEWSLETTER [https://perma.cc/6797-XF9L] (“Against a backdrop of widespread protests over the killings of black Americans, the venture capital industry has been forced to reckon with its own staggering lack of diversity.”).

\textsuperscript{267} See Rubin, supra note 100, at 829 (“The federal government also can increase private sources of subsidy by strengthening the [Community Reinvestment Act] and expanding its reach to more types of financial institutions.”).

\textsuperscript{268} See supra notes 208–211 and accompanying text.
effectively screen and monitor these investment opportunities. This sort of organic solution is more likely to motivate a positive feedback process, promote diversity within private equity ranks, and lead to the development of a self-sustaining industry, in a way much like how the early SBIC program gave birth to the venture capital industry.\(^{269}\)

The first section of this Part outlines the basic structure for such a program using existing and past government initiatives as building blocks. The second discusses how to overcome some of the legal and policy hurdles that might hinder its successful implementation. The last discusses fiscal strategies to help capitalize the program and spread the risks involved to facilitate private equity’s entry into this market.

A. Local Impact Small Business Investment Companies

The existing regulatory and market framework governing SBICs can provide the building blocks from which to design a new program. To facilitate our discussion, let us label a new type of SBIC, the “Local Impact Small Investment Company” (LISBIC). LISBICs will match investors (institutional and retail) seeking to finance minority-owned businesses with those businesses by raising capital from those investors through the issuance of LISBIC equity securities and then pool that capital to invest in minority-owned businesses.\(^{270}\) Properly vested with decision-making authority in a flat hierarchical structure, the LISBIC manager would be in a good position to collect soft information about potential investment opportunities and credibly signal this information to investors by its willingness to absorb some of the risks involved.\(^{271}\) The LISBIC manager would be able to negotiate terms with the issuer on behalf of all investors and structure these transactions by employing equity or hybrid securities.\(^{272}\) Post investment, the LISBIC can mentor the company on an ongoing basis and periodically decide whether additional amounts should be invested, subject to any regulatory ceilings.\(^{273}\)

The underwhelming history of Minority Enterprise SBICs (MESBICs) (and their successors, SSBICs) provide a cautionary tale of what happens when funds are unable to raise enough capital to cover operating costs and achieve a minimum size to diversify their portfolio and

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269. See supra notes 167–168 and accompanying text.

270. See supra note 262 and accompanying text.

271. See supra notes 259–260 and accompanying text. Requiring that LISBICs invest in local companies (i.e., located near the manager and investors) could facilitate achieving these objectives.

272. See supra note 258 and accompanying text; SEC CF Report, supra note 240, at 58.

273. See supra note 261 and accompanying text; SEC CF Report, supra note 240, at 58.
engage professional managers with the requisite expertise. 274 Minority-business focused venture capital funds provide us a sense of the required scale: their median capitalization is about $30 million, 275 and their preferred investment begins at the $1 million range. 276 LISBICs could initially tap three sources to obtain this level of required capital.

The first group would be institutional investors like pension funds, banks, and insurance companies that already provide the largest contributions to venture capital funds targeting minority-owned businesses. 277 Recruiting pension funds should not be complicated, as investing in minority-owned businesses fits their political strategy. 278 For banks, investing in a fund licensed as an SBIC is even more attractive as it provides a number of regulatory advantages over other investments. 279 To maintain the right perspective among the LISBIC investor base, LISBICs should raise a share of their capital from non-institutional investors in crowdfunding-style offerings. Including retail investors would help deliver crowdfunding’s promise of democratizing capital; provide an additional avenue for investors following a “community logic” to effectively support businesses they care about; and help ensure that

274. See Bates, supra note 61, at 354.
275. See Bates & Bradford, supra note 199, at 490 (“The minority-oriented funds are typically small relative to the VC industry mainstream, starting out with a median capitalization of under $30 million.”). See also Bates, supra note 61, at 354 (“Small-business investment companies typically benefit from operational scale economies if they have at least $20 million in assets.”).
276. See Bates & Bradford, supra note 199, at 499 (“Managers of the minority-oriented VC funds indicate that their preferred investment size is the $1 million to $2 million range, considerably more than the $747,517 mean . . . .”).
277. See id. at 492 (“The funds responding to our survey raised over $2.1 billion from institutional investors, the largest of which were public pension funds, commercial banks, and insurance companies.”).
278. See id. (“State pension funds that invest in minority VCs have high proportions of minority residents in their respective states: MBE-targeted in vesting is politically popular.”).
279. For example, through their SBIC investments, banks may own indirectly more than 5% of the voting stock of a small business and bypass general prohibitions from owning interest in or sponsoring a private equity fund. Compare 12 C.F.R. § 225.22(d)(5) (2020) (stating that acquisitions of less than 5% do not require Board approval), and 12 U.S.C. § 1843(c)(6) (stating that an ownership share of less than 5% is exempt from the prohibition on owning or controlling an entity that is not a bank), with 12 C.F.R § 225.11(b) (2020) (stating that a bank may acquire ownership or control of an SBIC subject to some limits). Additionally, banks receive Community Reinvestment Act credit for SBIC investments since these are presumed by regulatory agencies to be a “qualified investment” for such purposes. See OCC SBIC Report, supra note 135, at 4–5; SBIC Overview, supra 135, at 2. Participating in a LISBIC would also give banks the opportunity to establish relationships with companies that are not ready for “big bank debt” but that may be so in the future. See Stephen Newton, Demystifying SBICs for Community Banks, ABA BANKING J. (Oct. 9, 2017), https://bankingjournal.aba.com/2017/10/demystifying-sbic-for-community-banks/[https://perma.cc/W9C8-6LZK]; Rubin, supra note 100, at 829.
LISBICs are managed in a manner that promotes social change.\textsuperscript{280} The presence of a manager screening and monitoring portfolio companies would attract those retail investors who follow a “market logic” and who have so far been hesitant to support minority-owned businesses in crowdfunding offerings.\textsuperscript{281} Finally, the government could provide financial support to LISBICs directly via leverage (as it does with SBICs) or indirectly via tax exemptions.\textsuperscript{282}

\textbf{B. Implementation of the LISBIC program}

Organizing and operating a LISBIC in the manner envisioned above raises a number of legal questions. Facilitating access to capital is key, but the application of the Securities Act might increase the costs LISBICs face in raising capital. Registration and reporting obligations under the Investment Company Act of 1940 (ICA) could also increase the costs of organizing and operating a LISBIC.\textsuperscript{283} Protecting small, retail investors who are entrusting the LISBIC manager with their money and ensuring that the LIBIC manager adheres to the investment objectives of the LISBIC is another consideration.\textsuperscript{284} This section addresses these issues.

\textbf{1. Securities Act Considerations}

Relying on an intermediary introduces an additional securities transaction. First, the LISBIC must raise funds from the investors by issuing and selling security interests in the LISBIC. Once it has pooled such funds, the LISBIC would then invest in small businesses by purchasing securities issued by the latter. As those two sets of transactions are subject to the Securities Act, we need to find an exemption from registration that works for each.\textsuperscript{285} Obtaining an exemption for the second transaction is straightforward. The availability of Regulation D to exempt the sale of securities by a small business to the LISBIC hinges on the LISBIC’s status as an accredited investor, a term that explicitly includes licensed SBICs.\textsuperscript{286} Raising money from investors poses a less trivial question. Looking at the exemptions relied upon by SBICs is not very helpful, as these entities raise money via Rule 506 of Regulation D, which would be unavailable for LISBICs raising money from non-accredited

\begin{itemize}
\item \textsuperscript{280} See supra notes 236–238, 245–246 and accompanying text.
\item \textsuperscript{281} See supra notes 249–250 and accompanying text.
\item \textsuperscript{282} See infra Part III.C.
\item \textsuperscript{283} Investment Company Act of 1940, 15 U.S.C. §§ 80a-8, 80a-29, 80a-51.
\item \textsuperscript{284} See SEC CF Report, supra note 240, at 58–59.
\item \textsuperscript{285} See supra notes 223–231 and accompanying text.
\item \textsuperscript{286} See supra notes 227–231 and accompanying text; 17 C.F.R. § 230.501(a) (2020).
\end{itemize}
retail investors. Two alternatives designed to accommodate financing small, retail investors are considered below.

a. Crowdfunding

Existing crowdfunding regulations prohibit entities that qualify as investment companies from relying on the crowdfunding exception. As a result, a LISBIC would not be able to raise funds from non-accredited investors under the crowdfunding exemption if they qualified as investment companies. There are two ways of addressing this problem. First, LISBICs could be exempted from the definition of investment companies. Another option is to amend the crowdfunding rules to allow certain entities that would qualify as investment companies to instead rely on the crowdfunding exemption. In fact, various market participants and the SEC have already considered the possibility of amending the crowdfunding laws to allow certain special purpose vehicles organized to invest in a single company (which fall under the investment company exclusion) to be able to raise money using the crowdfunding exemption. Those modifications to the crowdfunding rules, which the SEC has now proposed, provide a springboard to the requisite exemptive language for LISBICs.


289. See infra Section III.B.2.

290. See SEC CF Report, supra note 240, at 57–58 (noting proposals that “recommended allowing the use of SPVs to promote simplification of the capitalization table by aggregating investors”); U.S. DEP’T OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES CAPITAL MARKETS 41 (2017) (recommending “allowing single-purpose crowdfunding vehicles advised by a registered investment adviser”); U.S. SEC. & EXCH. COMM’N., 2015 SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION FINAL REPORT 26–27 (2016) (recommending that the SEC permit investments by SPVs, including those that share an adviser, and determine that such SPVs are not “investment companies”). These proposals recommend the use of an SPV to address concerns that the large number of crowdfunding investors can become unmanageable and raise corporate governance and finance complications. See SEC CF Report, supra note 240, at 58; Nicholas Tommarello, Until Congress Acts, Don’t Invest in Startups to Make Money, FORBES (July 22, 2016), https://fortune.com/2016/07/22/equity-crowdfunding/ [https://perma.cc/A4NN-P5JK].

291. See SEC Proposed CF Amendments, supra note 229, at 17,997 (proposing “a new exclusion under the Investment Company Act for limited-purpose vehicles (‘crowdfunding vehicles’) that function solely as conduits to invest in businesses raising capital through the vehicle under Regulation Crowdfunding”).
Additional changes to the rules would also be necessary. The aggregate amount that an entity can raise over the course of 12 months (currently $1.07 million) needs to be revised.\textsuperscript{292} Raising this ceiling for individual issuers has been the subject of several proposals, and the SEC is considering raising it to $5 million.\textsuperscript{293} Even then, a fund that intends to invest in several businesses would likely need a more generous limit. Strict disclosure requirements for small businesses would not be necessary as the LISBIC could negotiate what the reporting obligations are, allowing requirements to vary from company to company. A more challenging question relates to the disclosure requirements that should be imposed on the LISBICs to protect its investors. Disclosure requirements under securities laws would depend on the exemption that the LISBIC (as the issuer) and LISBIC investors rely upon.\textsuperscript{294} Setting that consideration aside, SBIC rules provide for certain reporting obligations that are applicable to licensed SBICs, as discussed below.\textsuperscript{295}

\textit{b. Intra-State Crowdfunding}

Localized investing—where a LISBIC raises funds from investors located in the same region the LISBIC is headquartered and then also invests in businesses located in that region—would help achieve several of the LISBIC objectives outlined earlier.\textsuperscript{296} A LISBIC following this strategy could use the Rule 147A safe harbor, an issuing exemption that is loosely based on the intra-state exemption of Section 3(a)(11).\textsuperscript{297} Under that rule, a LISBIC would be deemed a resident of the state where its principal place of business is located.\textsuperscript{298} And as long as the issuer’s employees are based in that state or territory, it would also be deemed to be doing business in that state.\textsuperscript{299} Relying on that exemption, the LISBIC would then be able to sell securities without registration to investors whose principal residence is located in that same state.\textsuperscript{300} However, since Rule 147A is not available to an investment company registered or required to be registered under the ICA,\textsuperscript{301} the availability of this exemption would

\textsuperscript{292} See id. at 17,992.
\textsuperscript{293} See supra note 241–244 and accompanying text.
\textsuperscript{295} See infra notes 320–328 and accompanying text.
\textsuperscript{296} See supra notes 258–261 and accompanying text.
\textsuperscript{298} § 230.147A(c)(1).
\textsuperscript{299} § 230.147A(c)(2)(iv).
\textsuperscript{300} § 230.147A(d)(2).
\textsuperscript{301} § 230.147A(a).
hinge on the treatment of the LISBIC under the ICA or an enabling modification to Rule 147A.\textsuperscript{302}

2. INVESTMENT COMPANY ACT CONSIDERATIONS

The use of LISBICs would raise issues under the Investment Company Act of 1940\textsuperscript{303} (ICA) and the Investment Advisors Act of 1940.\textsuperscript{304} Investment companies are subject to a number of registration and periodic disclosure requirements under the ICA.\textsuperscript{305} Under the ICA, an investment company is “any issuer which is . . . engage[d] primarily . . . in the business of investing, reinvesting, or trading in securities,” the latter term being broadly construed.\textsuperscript{306} LISBICs would certainly appear to fall under this definition. Therefore, an exemption from registration under the ICA might be necessary for LISBICs to qualify for some of the Securities Act exemptions.\textsuperscript{307}

There are a number of exemptions available under the ICA,\textsuperscript{308} the most common being the “private investment company” exemptions under Section 3(c)(1)\textsuperscript{309} and Section 3(c)(7).\textsuperscript{310} These exemptions, relied upon by entities like SBICs and hedge funds, would not be of use to the LISBICs because of their limits on the number of investors and requirements

302. See infra Section III.B.2. Integration of a Rule 147A offering with a Rule 506 offering (targeted at institutional investors) that takes place more than six months after completion of the Rule 147A offering could raise additional issues. § 230.147A(g).


304. Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1–80b-2. Under the Advisors Act persons who manage the portfolios of registered investment companies must register with the SEC. Section 202(a)(11) of the Advisers Act generally defines an “investment adviser” as any person or firm that for compensation is engaged in the business of providing advice or making recommendations on securities, among other activities. § 80b–2(a)(11). Investment advisors must register with the SEC unless they are exempt from registration. § 80b–3(b). These exemptions cover investment advisors providing advise to private funds (such as hedge funds) or to SBICs. §§ 80b–3(b)(1), (7)(a).

305. See SEC ICA FAQs, supra note 287.

306. 15 U.S.C. § 80a–3(a)(1)(A). Investment securities are broadly defined to include “all securities” except a narrow set of securities that is not applicable. § 80a–3(a)(2).

307. See supra note 288, 301 and accompanying text.

308. See SEC ICA FAQs, supra note 287.

309. Section 3(c)(1) covers issuers whose outstanding securities are beneficially owned by not more than one hundred persons and that is not making or planning to make a public offering of its securities. § 80a–3(c)(1). This is the most commonly used exemption by SBICs. See James D. Miller, Small Business Investment Companies: Licensing, Tax and Securities Considerations, 36 BUS. LAW. 1679, 1689–90 (1981).

310. Section 3(c)(7) covers issuers whose outstanding securities are owned exclusively by qualified purchasers and that is not making or planning to make a public offering of its securities. § 80a–3(c)(1). The term “qualified purchaser” is defined in Section 2(a)(51) of the ICA. § 80a–2(a)(51).
relating to their wealth. However, the SEC does have broad statutory authority to promulgate additional exemptions as long as “such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the ICA].”

3. PROTECTING RETAIL INVESTORS

Unlike existing SBICs that raise funds exclusively from institutional and accredited investors, LISBICs contemplate the inclusion of small, retail investors. Due to their backgrounds and limited size of their individual investments, these investors might lack the knowledge, experience, and financial incentives to monitor LISBIC managers in order to ensure that these are not engaging in self-dealing transactions and are staying true to the fund’s purpose.

There are two possible solutions to the first agency problem. The larger institutional investors will have the ability and incentive to monitor the LISBIC manager’s financial performance. LISBIC’s managers will also have the incentive to protect their reputational capital with these institutional actors with whom they repeatedly interact. In addition, state law might impose additional disclosure and fiduciary requirements on the LISBICs and those managing them. LISBICs will need to be organized under state law as corporations, limited liability companies, or limited partnerships. This organizational choice will determine the default legal rights of investors and define the obligations and duties of the LISBIC manager. As many of these provisions are default rules that can be contracted around in a LISBIC’s organizational documents, regulatory provisions could mandate that LISBICs provide for a menu of statutorily-

311. § 80a–3(c)(1), 3(c)(7).
312. § 80a–6(c)(1).
313. See Marco Becht, Patrick Bolton & Ailsa Röell, Corporate Governance and Control, in HANDBOOKS IN ECONOMICS 1, 17 (Kenneth J. Arrow, Michael D. Intriligator eds. 2003) (explaining how dispersed shareholders with small equity interest have little incentive to incur management monitoring costs).
316. See supra note 297–302 and accompanying text.
317. See supra note 137.
mandated rights in these organizational documents to facilitate investor protection.\textsuperscript{319}

A second set of agency problems revolves around a LISBIC’s goal of investing in minority-owned businesses and providing them with active advice. Intermediary institutions, such as pension and mutual funds, have limited incentives to actively exercise governance rights in order to improve the performance of their portfolio companies, preferring instead to exit questionable investments.\textsuperscript{320} This can be true even when the investors funding the intermediary would be better off with the intermediary exercising its governance rights.\textsuperscript{321} This dynamic is unlikely to characterize a LISBIC’s management of its portfolio companies, however. Unlike traditional intermediaries, a LISBIC would not be competing against other funds invested in the same businesses and would therefore not be worried about others freeriding on its mentoring and assistance of a portfolio company. Another set of concerns relates to the selection process of LISBIC portfolio companies: will managers select investments that are consistent with a LISBIC’s non-monetary goals? The fact that for-profit organizations are often not in the best position to effectively pursue social goals heightens this concern.\textsuperscript{322}

SBA regulations provide a framework that we can employ to promote transparency and monitor the performance of LISBICs and their pursuit of non-monetary goals. SBICs must prepare an annual financial report for each fiscal year, audited by an independent certified public accountant.\textsuperscript{323} This report includes an assessment of the social-economic impact of each financing made by the SBIC, specifying its impact on job creation or retention, the revenues, and profits of the business, and taxes paid by the business and its employees.\textsuperscript{324} For each reporting period, SBICs must also prepare a valuation report that provides an estimate of the value of their loans and investments.\textsuperscript{325} Periodically, for each small business financing, SBICs submit a portfolio financing report.\textsuperscript{326} The SBA’s Office of Examinations annually reviews SBICs’ financial health and regulatory compliance and monitors the performance of SBICs through key

\begin{itemize}
\item \textsuperscript{319} See id.
\item \textsuperscript{321} See id.
\item \textsuperscript{322} See Ofer Eldar, \textit{Designing Business Forms to Pursue Social Goals}, 106 VA. L. REV. 937, 942–44 (2020) (explaining challenges faced by for-profit entities in pursuing social goals and proposing new legal forms that, with key structural elements, give managers the incentives and competence to accomplish such goals).
\item \textsuperscript{323} 13 C.F.R. § 107.630(a) (2020).
\item \textsuperscript{324} § 107.630(d).
\item \textsuperscript{325} § 107.650.
\item \textsuperscript{326} § 107.640.
\end{itemize}
metrics. These reports would also facilitate the involvement of LISBIC’s retail investors, who are more likely to care about a LISBIC’s social goals and so have the incentive to verify that the LISBIC is fulfilling such goals.

C. Fiscal Incentives to Capitalize LISBICs

Government involvement would be critical in the development of LISBICs. In addition to leading coordination efforts across government agencies and market actors, public financial support would spread the risks inherent in developing a new market and incentivize private equity funds to incur the initial expenses necessary to successfully enter this niche. The current socioeconomic climate and will to address racial economic disparities make outlays of this type more politically feasible than in the past. This section describes two possible forms of public financial support.

1. GOVERNMENT LEVERAGE

A new SBIC program could revitalize the diminishing role of the federal government in promoting and providing financial support to minority-owned businesses, but past mistakes should not be repeated. LISBICs should be afforded the regulatory flexibility and predictability that SSBICs never had. More importantly, debt should not be the primary leveraging mechanism. Since LISBICs would also be investing in the equity of young, risky firms, having a debt obligation might be

328. Another strategy to address this issue could involve a certification process that verifies a LISBIC’s investment strategy and social impact. See Eldar supra note 322, at 978–80 (describing the certification process for community development financial institutions).
330. See Bates & Bradford, supra note 199, at 492 (“The federal government as a VC funder is fading into insignificance, as neither the newer funds nor the older SSBICs are currently raising capital from this source.”).
331. See id. at 499–500 (“Fund status as an SSBIC requires adherence to restrictive and changing SBA regulations, which is costly to SSBICs . . . ”). For example, rules governing the information that SBICs must obtain from portfolio companies might need to be relaxed for LISBICs to reduce the burdens on minority-owned businesses. See 13 C.F.R. § 107.620 (2020).
332. See supra notes 188–212 and accompanying text.
unduly burdensome and undesirably restrict a LISBIC’s investing options.\textsuperscript{333}

In providing leverage to LISBICs, the SBA should pursue the policy goals of the now-defunct Specialized SBICs and Impact Investments SBICs but employ a funding mechanism more akin to the now-defunct SBA Participating Securities Program or the Startup America Initiative.\textsuperscript{334} Though these programs entail greater risk for the SBA, the amount could be capped and managed. Pursuing this alternative takes us closer to an initiative that is merely a pure hybrid of the SSBIC and Participating Securities programs. Though this is certainly an attractive and expedient approach to promote minority entrepreneurship,\textsuperscript{335} there is value to having small investors participate and set the tone as to the social and financial expectations of LISBICs’ investments, something that would be missing from a pure hybrid SBA program.

2.\textit{ Preferential Tax Treatment}

Providing either tax deductions based on amounts invested in LISBICs or a lower tax rate for income and capital gains derived from LISBIC investments would help LISBICs attract capital and provide incentives to private equity funds to establish these in the first place.\textsuperscript{336} Using the tax code to encourage investment in young and small businesses is not a novel idea. A number of programs in the U.K. offer favorable tax treatment to investors participating in crowdfunding issuances by small companies.\textsuperscript{337} These tax advantages have been identified as one of the

333. \textit{See supra} note 150 and accompanying text.

334. \textit{See supra} notes 146–161 and accompanying text.

335. This author also supports this hybrid approach and proposes it as an alternative to the LISBICs contemplated in this Article.

336. A similar tax preferential treatment strategy is employed by the New Market Tax Credit Program (NMTC Program), which provides investors a tax credit in exchange for making equity investments in Community Development Entities, specialized intermediaries that finance projects, such as the construction or rehabilitation of real estate, in low-income communities. See Eldar, supra note 322, at 978–80; Anna Kovner & Josh Lerner, \textit{Doing Well by Doing Good? Community Development Venture Capital}, 24 J. ECON. & MGMT. STRATEGY 643, 645–47 (2015). For an overview and assessment of the NMTC Program, see Martin D. Abravanel, Nancy M. Pindus, Brett Theodos, Kassie Bertumen, Rachel Brash & Zach McDade, U.S. Dep’T of the Treasury, New Markets Tax Credit (NMTC) Program Evaluation (2013).

337. The U.K. has two programs designed to boost innovation and entrepreneurship. The Seed Enterprise Investment Scheme (SEIS) and the Enterprise Investment Scheme (EIS) provide immediate tax deductions and no capital gain taxes to investors participating in qualifying offerings. See HM Revenue & Customs, \textit{Tax Relief for Investors Using Venture Capital Scheme}, Gov.UK (Jan. 25, 2019), https://www.gov.uk/guidance/venture-capital-schemes-tax-relief-for-investors [https://perma.cc/2VV4-TC4H]. For more information on the SEIS and EIS programs, see HM Revenue & Customs, \textit{Use the Enterprise Investment Scheme (EIS) to Raise Money for
reasons why the U.K. crowdfunding market has performed better than the U.S. market. An association of online platforms has recently proposed similar tax exemptions for investors participating in crowdfunding investments as a way to maximize the potential of crowdfunding to fuel business and economic growth. Some groups have proposed a more general tax credit specifically targeted to promote venture capital investments in minority businesses.

3. CONSTITUTIONAL CONSIDERATIONS

Any government program that seeks to specifically target minority-owned businesses for preferential treatment could be challenged under the Equal Protection Clause. Under Supreme Court precedent, strict scrutiny review applies to all preference programs based on racial classifications, thus requiring that such classifications be narrowly tailored to further compelling governmental interests. This section outlines two strategies to address these potential legal challenges.

One approach is to use the SBA’s 8(a) Business Development program’s definition of “socially and economically disadvantaged individuals,” which includes “those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities.” This statutory definition of “socially disadvantaged individuals” in the SBA Act has survived constitutional challenges.


339. See AOIP Paper, supra note 241, at 1, 3 (proposing reasonable tax credits or deductions to encourage private investments in small businesses).
343. See supra notes 111–115 and accompanying text.
The SSBIC Program, which was designed for small business entrepreneurs “whose participation in the free enterprise system is hampered because of social or economic disadvantage,” followed a similar strategy in targeting minority-owned small businesses.345

Another possibility is to focus on the geographical region where the business receiving the financing is located by designating certain zip-codes or census tracts. These types of “place-based incentive programs” are used by local governments to revitalize economically depressed communities by providing investors preferential tax treatment or financial assistance through low-interest rate loans.346 Such designations have also been employed under the Community Reinvestment Act and the Impact Investment SBIC program.347 A recent program enacted as part of the Tax Cuts and Jobs Act of 2017 provides investors temporary preferential tax treatment if they invest in real estate or equity located in an area designated as an opportunity zone, a community designated by the Internal Revenue Service as being “economically distressed.”348 Though the program’s implementation has been criticized,349 it provides an example of a

345. See supra note 154 and accompanying text; CRS SBIC Report, supra note 136, at 3, 23–24.
347. See supra notes 160–162 and accompanying text.
349. See, e.g., Simon, supra note 348 (discussing “impact washing” and the low multiplier effects of investments in low income communities); Alan Sage, Mike Langen & Alex Van de Minne, Where Is the Opportunity in Opportunity Zones? Early Indicators of the Opportunity Zone Program’s Impact on Commercial Property Prices (May 1, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3385502 (finding that opportunity zone designation did not impact all properties prices, but resulted in a 13.5% price increase for “redevelopment” properties and a 9.6% price increase for vacant development sites, which suggests that the program has primarily passed through the tax benefits to existing land owners, with limited evidence of additional value creation); Lisa Christensen Gee & Lorena Roque, Opportunity Zones Bolster Investors’ Bottom Lines Rather than Economic
politically viable “place-based incentive program” at the federal level used to target investors to help the development of minority communities.  

CONCLUSION

In light of recent political and economic events, removing the financial barriers faced by minority entrepreneurs is more crucial now than ever. Promoting the growth of minority-owned businesses is also sound policy, as it would have a considerable impact both at the local and national levels. Locally, it would help the economic development of minority communities in need of new jobs and better infrastructure. Diverting efforts and resources from redistributive transfer and relief to an initiative that mobilizes grassroots and private capital to help minority-owned businesses will strengthen a second front in the war against poverty by providing a market-based channel to remedy long-standing racial inequities.  

The aggregate economic effect of these efforts would also be felt nationally: due to discriminatory financing practices, our nation is losing over “1.1 million minority-owned businesses, and as a result, foregoing over 9 million potential jobs and $300 billion” in national income.  

The problem examined in this Article has been widely acknowledged; the body politic and market participants are more willing than ever to act. That past programs have been relatively unsuccessful should not be discouraging. Understanding why past programs have come up short helps us design ones better suited to solve the problem at hand. Finding the right approach, however, requires identifying specific processes that drive disparities. This Article starts that conversation by highlighting the importance of soft information for minority-owned businesses and explaining how related informational issues have kept mainstream investors away. Most of the ingredients for a successful program, such as the one proposed in the Article, are already in place. The key lies in


352. See Applewhite, supra note 104; Austin, supra note 340, at 3.

353. See supra notes 329, 340 and accompanying text.
coordinating different regulatory frameworks and administrative bodies
and involving private equity investors and members of the community.
The costs and risks involved are great, but the benefits are immeasurable.
Inequality in Business Ownership, Business Performance and Financial Capital

Perspectives on Minority Business Development
Penn State University
April 20, 2021

Robert W. Fairlie
University of California, Santa Cruz and NBER
Earnings Inequality – Bureau of Labor Statistics

<table>
<thead>
<tr>
<th>Weekly Earnings</th>
<th>White</th>
<th>Black</th>
<th>Latino</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>77%</td>
<td>72%</td>
</tr>
</tbody>
</table>
Business Ownership Inequality

- White: 40%
- Black: 78%
- Latino: 2-129
Business Sales Inequality

Average Sales

- **White**: 11%
- **Black**: 26%
- **Latino**: 2-130
Wealth Inequality

Net Worth

<table>
<thead>
<tr>
<th></th>
<th>White</th>
<th>Black</th>
<th>Latino</th>
</tr>
</thead>
<tbody>
<tr>
<td>6%</td>
<td>7%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Financial Capital Inequality

- White - Startup
- Black - Startup
- White - Years 1-3
- Black - Years 1-3

33% for White - Startup and Black - Startup vs 40% for White - Years 1-3 and Black - Years 1-3.
Number of Active Business Owners before and after COVID-19 (Racial Minority Groups)

- African-American: -41%
- Latinx: -32%
- Asian: -26%
Figure 1

October 2020
January 2021
## Change in Number of Active Business Owners in the United States

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
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<td>-6%</td>
<td>-4%</td>
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<tr>
<td>Apr. 2020</td>
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<td>-52%</td>
<td>-32%</td>
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<tr>
<td>May 2020</td>
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<td>-19%</td>
<td>-20%</td>
</tr>
<tr>
<td>June 2020</td>
<td>-19%</td>
<td>-28%</td>
<td>-10%</td>
<td>-8%</td>
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<tr>
<td>July 2020</td>
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<td>Aug. 2020</td>
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<td>-3%</td>
</tr>
<tr>
<td>Sept. 2020</td>
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<td>-6%</td>
<td>1%</td>
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<tr>
<td>Oct. 2020</td>
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<td>3%</td>
<td>-1%</td>
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<tr>
<td>Nov. 2020</td>
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<td>5%</td>
<td>-2%</td>
</tr>
<tr>
<td>Dec. 2020</td>
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<td>-12%</td>
<td>-3%</td>
<td>-7%</td>
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<tr>
<td>Jan. 2021</td>
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<td>-10%</td>
<td>-9%</td>
</tr>
<tr>
<td>Feb. 2021</td>
<td>0%</td>
<td>-10%</td>
<td>-12%</td>
<td>-16%</td>
</tr>
</tbody>
</table>

**Change in Number of Active Business Owners in the United States**
More Information

Research on business inequality:
https://people.ucsc.edu/~rfairlie/papers/

Ongoing Small Business Activity Tracking:
https://people.ucsc.edu/~rfairlie/recent/
Robert Fairlie, Professor of Economics, University of California, Santa Cruz

**Robert W. Fairlie** I am a Professor of Economics at the University of California, Santa Cruz and a member of the National Bureau of Economic Research (NBER). My research interests include entrepreneurship, education, information technology, racial and gender inequality, labor economics, and immigration. Publications from my research have appeared in journals such as the American Economic Review, Economic Journal, AEJ: Applied, AEJ: Policy, ReSTAT, JOLE, JAMA: Surgery, Nature: SoE, Management Science, JPAM and MIT Press (book). I received a Ph.D. and M.A. from Northwestern University and B.A. with honors from Stanford University. I have held visiting positions at Stanford University, Yale University, UC Berkeley, and Australian National University. I have received funding for my research from the National Science Foundation as well as numerous government agencies and foundations, and have testified to the U.S. Senate, U.S. House of Representatives, U.S. Department of Treasury, and the California State Assembly, and received a joint resolution from the California State Assembly. I am regularly interviewed by the media (e.g. NY Times, WSJ, Washington Post, NPR, PBS, CNN, CBS, NBC) to comment on economic, small business, inequality and policy issues.

Barry W. Ickes, Professor of Economics and Head, Department of Economics, Penn State

**Barry W. Ickes** I am Head of the Department of Economics at the Pennsylvania State University. I am also Professor of Economics and Director of the Center for Research on International Financial and Energy Security, and a Founder of The New Economic School in Moscow. Formerly, I was a Non-Resident Senior Fellow at the Brookings Institution. I am the past Chair of the Board of Directors of the National Council for Eurasian and East European Research. I was the President of the Association for Comparative Economic Studies during 2004.