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Summary of Findings

Social scientists have repeatedly questioned the viability of the black business community. A recurring theme is the notion that black-owned businesses are heavily concentrated in several lines of small-scale service and retailing activity that hold minimal potential for growth. Indeed, the typical firm in the black business community has been the mom-and-pop food store, the beauty parlor, the barbershop. Such "traditional" lines of business, where most owners realize very low incomes, show definite signs of long-term decline.

Critics of minority business development programs have often assumed that emerging minority firms would be replicas of such common lines of business, but the evidence presented in this book largely refutes that notion. An emerging group of black entrepreneurs has been entering lines of business where minority representation has historically been minimal. This group is dominated by larger firms likely to serve a racially diverse clientele; increasingly, these firms sell to other businesses, including large corporations, as well as to the government.

Because my objective in writing this book was to analyze the role black-owned businesses can play in the economic development of urban minority communities, the emphasis here is on the most viable businesses—those relatively large-scale firms that are most likely to remain in

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operation and to create jobs. This profile, in fact, describes the emerging black business community. Unlike the traditional enterprises, where owners tend to have low levels of education and expertise and to invest little capital, among the emerging group the owners are likely to be college educated and to start their firms with relatively large financial investments. As a result of these differences, the emerging black firms prove to be larger in scale, have lower failure rates, and generate more jobs than their traditional counterparts.

Particularly rapid growth areas for this emerging group include wholesaling, general construction, and skill-intensive service industries, particularly finance and business services. The construction industry—certainly not a new line of black enterprise—is also evolving into an emerging line of business: growth in construction has been most rapid among the large-scale firms that do not rely primarily on minority clients. Opportunities offered by special corporate procurement and government minority business set-aside programs have also contributed heavily to the growth of these emerging entrepreneurs.

Black owners and whom they hire. This study clearly shows that in their hiring practices, white owners of small businesses continue to exclude minorities; black owners, by contrast, consistently hire minority workers. This pattern holds up regardless of the firms' location. White owners employ a predominantly—and often entirely—white work force even when their businesses are located in inner-city minority communities. By contrast, black-owned firms in the same communities utilize a labor force made up overwhelmingly of minority workers; only 3.2 percent of these firms employ a work force that is 50 percent or more white. Even outside minority neighborhoods, black owners continue to rely largely on minority workers, whereas most white-owned businesses have no minority employees at all.

In light of nonminority owners' aversion to employing blacks, an alternative strategy for opening up minority job

opportunities is to promote the creation and expansion of businesses among the single group—black employers—that has already demonstrated its commitment to minority hiring. With that aim in mind, this book proceeds to examine the lingering barriers—lack of financial capital, limited access to markets, and redlining among them—that hinder black entrepreneurship, especially in the emerging lines of business where the potential for expanding minority employment and stimulating the ghetto economy is the strongest. These barriers can be categorized under three headings: problems of capitalization, narrowing access to government contracts, and barriers associated with the geography and poverty of the urban ghetto.

Three major barriers. The major constraint on the formation, growth, and diversification of black business in the 1980s has been inadequate capitalization. Black entrepreneurs' low holdings of personal wealth, combined with discriminatory treatment by commercial banks, have meant continuing obstacles. *Secondly*, court challenges to the constitutionality of minority business assistance programs threaten to reverse important gains made in broadening the range of markets served by black firms.

The *third* major constraint is geographically specific: inner-city black communities are increasingly being left out of the process of business development. Whether they are minority- or nonminority-owned, all firms suffer in the ghetto milieu, but the black business community suffers disproportionately. Among black owners, all three elements essential for business viability—talented entrepreneurs, financial capital, and access to markets—are threatened: the exodus of better educated blacks drains the pool of entrepreneurial talent, bank redlining blocks or limits loans, and weak local markets make it hard to thrive. All of this contributes to the very slow (and sometimes nonexistent) growth of black-owned businesses in minority communities. (See chapters four and five.)

Facing severely limited access to financial capital and weak internal markets, the ghetto firms that most com-

monly survive are far smaller, in sales and employment, than their counterparts outside the ghetto. Increasingly, the more highly educated and trained black entrepreneurs are going outside minority communities to seek opportunities. In fact, those black establishments that do remain in business in the ghetto are more likely to be headed by high school dropouts than by college educated owners.

Influence of black mayors and set-asides. Of the 28 large metropolitan areas examined in this study, 10 depended on central cities governed by black mayors. Evidence from case studies had already indicated that black mayors place a high priority on municipal contracting with minority-owned businesses. A comparative analysis of the 28 areas was conducted to see if black business performance, as a whole, has been aided somehow by the presence of black mayors. The examination found that it has in fact been so aided. Compared with black-owned firms elsewhere, those located in black-mayor areas are (1) more likely to be run by college graduates, (2) started up with much larger financial investments by their owners, (3) much larger in sales and employment levels, and (4) characterized by lower rates of business failure. Progress is most apparent among the younger, emerging lines of black-owned business.

Policy solutions. The calculus of profit maximization dictates that the choicest urban business locations today are in either the affluent outlying (largely nonminority) neighborhoods or the central business district. The most promising minority businesses, therefore, are increasingly likely to be located at some remove from urban minority communities. Present public policies, which too often assist the weakest minority firms or favor firms already locked within the ghetto, do little to reverse that trend.

By contrast, policies that would successfully assist the more capable, viable black-owned businesses would produce a derivative benefit: job creation for the residents of minority communities. Even though these more capable

firms are locating outside the ghetto, the data in this study show that their geographic separation has not severed their employment link with black job seekers. In this vitally important sense, black enterprise does promote minority community economic development, quite irrespective of the employing firms' location.

The most prominent recent development in policy that threatens black business progress has been a judicial matter, specifically the U.S. Supreme Court's 1989 *Richmond* v. *Croson* decision declaring the minority business set-aside program in Richmond, Virginia, unconstitutional. Cities and states seeking to justify minority business preferential procurement programs must now be able to demonstrate that disparities exist between the minority business share of city (or state) contracts and the number of applicable minority firms willing and able to undertake such work. They must also demonstrate the presence of discriminatory barriers restricting the growth or performance of minority firms in the applicable fields. These two requirements can be met, in most cases, with readily available data sources. (Chapter seven discusses strategies cities and states can pursue to retain their procurement and set-aside programs in light of recent judicial constraints.)

Chapters three and five of this book show that commercial banks continue to redline black-owned businesses. This and other forms of lending discrimination serve to weaken black firms, in turn undercutting their ability to compete for government contracts. The practice of redlining is but one of a variety of barriers that local governments may cite to justify their minority business set-aside programs. Despite judicial challenges, therefore, it is possible that minority business assistance will continue to expand in the years ahead.

A final challenge is to bring inner-city minority communities into the economic development process. These communities need not be excluded from business growth if assistance programs can be reoriented, though admittedly that will be neither easy nor inexpensive. Key elements of a

viable ghetto economic development strategy would require: (1) relying heavily on non-ghetto sources for both markets and financial capital, and (2) attracting the most capable entrepreneurs into the inner-city milieu. (See chapter seven.)

Entrepreneurial ability is highly correlated with both education and income levels: successful business operators tend to be above average in both categories. When government assistance accrues to better-off, better educated black business owners, the question invariably arises, "Why help those who are already successful?"

This objection can be addressed at two levels. First, the record shows that programs which target assistance to lower income, less educated entrepreneurs simply produce mass business failure. Second, the most capable entrepreneurs are also the ones likely to achieve the broader goal of economic development for the community, provided that the other ingredients of business success (capital and markets) are present. It is the viable firms, after all, that permit further business expansion and job creation.

Moreover, the presence of business success stories lures younger, better educated blacks into self-employment, and this further promotes economic development. Similarly, existing firms in less profitable lines of business are motivated—by the success story phenomenon—to reorient their operations toward products and services that offer greater profit potential; once again, economic development is promoted.

Most important for members of the ghetto community, if business successes increase in their area the resulting economic development will tend to reverse the drain of resources that exacerbates their poverty. Profitable operations build up additional capital and reinvestment, greater ownership of businesses by local residents strengthens the flow of income within (rather than leakage out of) the ghetto, and capable business people are retained in the community where their enterprises create income and jobs.

Seen in this context, the question, "Why help those who are successful?" really boils down to the question of whether the policy's goal is to promote economic development in minority communities.

1 INTRODUCTION

Overview: Why Black Business Ownership Matters

In an era when small businesses are creating a growing share of all net new jobs, access to employment in this sector is important to black economic well-being. In the dominant, nonminority-owned business community, however, the employment of minority workers is widespread only in blue-collar and service occupations. It is possible that minority hiring could improve as various antidiscrimination and other policies take effect. But affirmative action policies have never focused on access to jobs with small businesses, and equal employment opportunity laws and policies, by their very nature, are not designed to assist the black worker seeking employment in this milieu.

Consider, for example, the landmark Executive Order 11246, handed down in 1965, which established rules for nondiscrimination by federal contractors, subcontractors, and construction projects enjoying federal assistance. By this law, contractors with 50 or more employees and contracts of $50,000 or more are required to develop and submit affirmative action compliance programs with goals and timetables for the hiring and promotion of minorities. The key phrase here is "with 50 or more employees," which cuts out small enterprises. Moreover, in the watered-down, "race-neutral" form that they have begun to

assume in the post-Reagan era, equal opportunity policies hold very little promise as a tool for widening job access for black workers. Yet one straightforward change in the small-business universe does have the demonstrated potential to turn this sector into a powerhouse of minority job creation: expanded minority ownership.

Poverty and unemployment among urban blacks have been worsening in recent years: wages among the least educated and skilled have been dropping and labor force participation declining. Within the black community, income inequality has been widening. At the top of the ladder, the percentage of black families with incomes above $50,000 (in 1990 constant dollars) is up substantially—from 8.3 percent in 1969 to 14.5 percent in 1990. During the same years, however, the proportion of black families with incomes below $10,000 also grew. Hardest hit have been the least educated and skilled members of the black work force; between 1969 and 1984, the real weekly earnings of black men who dropped out of high school fell by 32 percent, from $312 to $213.[1] If government relief agencies existed for the purpose of alleviating economic hardship, their assistance could have offset much of the suffering produced by falling real earnings and declining employment. In fact, low-income household heads generally receive no unemployment insurance benefits at all.[2]

In this tragic environment of growing ghetto poverty and declining government transfer payments, the only hope lies in increased employment opportunities. Blue-collar employment has been shrinking at the nation's largest corporations, just as the interrelated employment of less skilled workers has been shrinking in manufacturing generally. But in the small-business arena, net creation of low-skilled and blue-collar jobs has been pronounced.

Why does black ownership matter? Because the data clearly show that hiring practices among white owners of small businesses continue to exclude black workers, workers whom black owners nevertheless consistently hire. Even those white employers whose firms are physically

located in inner-city minority communities hire a work force that is predominantly white; roughly a third of all such firms employ no minorities whatsoever. By contrast, 96 percent of black-owned firms operating in urban minority neighborhoods employ a labor force that is largely minority. Even outside minority neighborhoods, in areas where most white-owned businesses have no minority workers at all, black firms rely on these workers heavily. (These data are analyzed in chapter five.)

As pointed out earlier, affirmative action policies are of little help in combating the aversion of nonminority small-business owners to employing blacks. An alternative strategy for opening up jobs in this sector is to promote the creation and expansion of firms owned by the single group—black employers—that has already demonstrated its commitment to minority hiring. This book undertakes a close examination of the lingering barriers to black entrepreneurship—lack of financial capital, redlining, limited access to markets, and the like—in the hope that appropriate strategies for easing those barriers and strengthening black firm ownership can be devised.

The Crisis of Urban Black Poverty

The recent National Research Council study, *A Common Destiny: Blacks and American Society,* has documented the accentuated differences in economic status among blacks, "especially during the past 25 years."[3] Particularly among black men, earnings inequality has grown substantially since the 1960s. Between 1969 and 1984, the fraction of black men (aged 25-55) earning less than $10,000—an amount insufficient to maintain a family of four above the federal poverty threshold—grew from 25 percent to 40 percent (measured in 1984 constant dollars).[4] Rising unemployment and detachment from the labor force are partly responsible for these large earnings losses. According to *A Common Destiny,* "Between 1979 and 1985, the expected years of work for a white man fell from 39 to 36, but for a black man the change was from 36 to 29 years."[5]

Assistance for the working poor and the unemployed poor has become more meager over the years. A study by Sheldon Danzinger and Peter Gottschalk (1986) has found that in 1984 only 28 percent of unemployed household heads who had previously earned less than $5.50 per hour received unemployment benefits. Poor two-parent families with children qualify for little assistance other than food stamps. Family assistance benefits—virtually confined to single-parent families—have contracted even as black poverty has increased, their real value having fallen by at least 30 percent since 1973.[6]

The authors of *A Common Destiny* concluded that—barring changes in present conditions—prospects for blacks in the near future are bleak. Among the likely negative developments they foresee are a growing U.S. population of poor and undereducated citizens who will be disproportionately black and minority, a continuing division of social status within the black community, and further deterioration in the relative employment and earning status of black men.[7] What could be done to alter the "present conditions" and hence prevent these negative developments? According to the authors, "There are no satisfactory substitutes for a vigorous and expanding economy and an effective public school system to achieve an educated and employed work force."[8] Promoting a vigorous and expanding black business community is a complementary strategy.

This study of black business was initially motivated by my desire to identify the characteristics of businesses that have created jobs in ghetto areas and are capable of remaining in business. Particularly in the urban poverty ghetto, I sought to identify the kinds of firms most capable of contributing to economic development.

The Ghetto's Business Economy

Race and income are the chief defining characteristics of urban ghettos, but the geographic boundaries defined by race and income do not coincide. As we move out from

the inner core of the typical racially segregated central city, the population thins out and its income and education levels rise. On the ghetto's outlying edges, the economic and social characteristics of the minority population are often indistinguishable from those of the surrounding white population. The mix of blue-collar and white-collar employment is similar, and unemployment rates are approximately equal. Neighborhood segregation is also less severe. The outlying edge of the ghetto differs greatly from the intensely poor and segregated cores of both the ghetto and the city. The racial ghetto and the poverty ghetto therefore do not coincide but, instead, overlap. (Throughout the remainder of this book, the term *ghetto* will be used to denote the overlapping area that is characterized both by poverty and by minority concentration.)

My initial search for black business success stories in the poverty ghettos of large urban areas was frustrated by the paucity of viable, job generating firms. Despite isolated instances in the ghetto of successful businesses, the overall pattern that emerged was something of a disaster. Highly educated black managers and professionals starting firms in major metropolitan regions are increasingly locating their businesses in nonminority areas, and they are catering to nonminority clients. By contrast, those firms that operate within the ghettos face weak internal markets and are severely redlined by commercial banks. All the key ingredients that promote business development—capable entrepreneurs, access to financial capital, access to markets—are in very short supply. Lacking these ingredients, the ghetto really has no prospect of generating the internal small-business development that could produce jobs and incomes for its residents.

Most fundamentally, the state of black-owned ghetto enterprises reflects the economic circumstances of their clientele. Weak internal markets reflect the obvious fact that poor people possess minimal purchasing power. It is true that the plentiful supply of cheap labor is an advantage to certain kinds of ghetto businesses such as building maintenance services, a labor intensive field in which

urban black enterprises have steadily expanded. These firms draw heavily upon a low cost, blue-collar labor force to wash the windows, haul the trash, and perform other maintenance tasks. But in spite of the ghetto's cheap labor pool, most businesses cannot thrive there because of the weak market and the shortage of financial capital for investment. There are other obstacles as well: high insurance rates, high incidence of economic crime, decaying infrastructure, and poor public services—to name a few. In sum, the problems of markets and capital, in combination with these other ghetto attributes, severely limit the potential of a black business community that is oriented toward servicing a ghetto clientele.

Why Focus on Small Business?

Critics of small-business development strategies caution against relying too much on the small-business sector for employment gains.[9] The crux of their objections is concern that the jobs produced are lacking in quality and duration.[10] Although these concerns are often valid, the more relevant question is this: aren't jobs in small business—even though characterized by low wages, instability, and low fringe benefits—better than no jobs at all? Furthermore, the fact that wages, working conditions, and opportunities for advancement are on average less attractive in small business than elsewhere does not imply that employees in this sector are doomed, en masse, to a life of working poverty. Work in small business includes a variety of well-paid, skilled occupations—from auto mechanic to plumber to software supplier.

Structural changes in the urban economy are causing minority workers to rely ever more upon small-business employment. This trend has been caused in part by declining employment in manufacturing, offset by a rise in the service producing sector.[11] A growing body of evidence suggests that in recent years the small business sector has yielded the bulk of all new jobs. The highly publicized research of economist David Birch proclaims

that firms employing fewer than 20 workers "have created about 88 percent of all net new jobs nationwide in the 1980s."[12] More credible studies have pegged the small-business share of all new jobs at 51 to 56 percent.[13] Whatever the precise figure on job generation, it is clear that urban black workers—particularly men in blue-collar occupations—are increasingly limited to employment (and underemployment) with small business.[14]

The decline of manufacturing jobs. On balance, the large enterprises that serve national and international markets have not added blue-collar employees to their payrolls in recent years. In large manufacturing firms today, growth in production depends less on the number of employees than on technical progress and improvements in physical capital per worker. A technologically advanced, capital-intensive production process now typifies large corporations. Their mode of production—and this applies equally to smaller firms operating on the technological frontier—stresses the combination of skilled labor and technically advanced equipment. Because firms in this sector are becoming more likely to grow by combining additional skilled white-collar workers with additional units of advanced equipment, output is often expanded even as jobs for less skilled blue-collar workers are cut back. The displaced workers naturally seek employment in small business because it is the only sector actively hiring people with blue-collar skills. For the same reasons, it is increasingly difficult for those seeking work for the first time to find high-wage employment in large corporations if they are not college educated. Those so affected, particularly young people and women, are therefore often more dependent on jobs with small businesses.

Until the 1970s, penetration into blue-collar manufacturing had been responsible for widespread income gains among less skilled workers, especially among black men. This traditional route to upward mobility has been lost. Worse yet, the massive losses in blue-collar manufacturing jobs over the past two decades have effectively reversed

many of the black employment gains.[15] Between 1969 and 1984, the proportion of all employed black men who were working in manufacturing, mining, or construction dropped from 41.3 to 33.6 percent. Looking at occupational categories, the proportion of employed black men working as operatives dropped from 28.3 to 22.6 percent; young black workers have suffered disproportionately from this trend. Labor-intensive manufacturing has been especially hard hit. These job losses have been most noticeable throughout the Frost Belt, disproportionately hitting the older manufacturing states.

Regional trends in black income clearly reflect the impact of these job losses. Median black family income in the highly industrialized Midwest was $23,671 in 1970, which was 73.4 percent of the median white family income in that region. By 1987, however, the Midwest had been transformed from the *highest* median income region for blacks (in 1970) to the *lowest*. Black family income in 1987 had sunk to $16,755 (in constant dollars), which was only 52.1 percent of the comparable income for whites. High-wage jobs in manufacturing had been heavily displaced, and the only categories for black male workers registering substantial growth were service employment, unemployment, and labor force nonparticipation. The single line of service employment that grew most rapidly in the Midwest was also the least stable and offered the lowest wages: employment in restaurants and bars.[16]

Meanwhile, in many cities where manufacturing jobs losses have been pronounced, highly educated blacks have continued to gain managerial and professional employment. It is precisely in the older industrial cities, such as Chicago, Cleveland, and Pittsburgh, where the contrast between the haves and the have-nots is sharpening most rapidly.

Why Focus on Businesses Owned by Blacks?

Equal employment opportunity policies have traditionally been designed to improve the access black workers

have to the higher-wage sectors of the economy—particularly government and big business. In the pre-1970s era, when these sectors were expanding their blue-collar ranks, this policy emphasis also benefited less-skilled black workers.[17] But in an era of declining blue-collar employment at large corporations, equal opportunity policies have become relevant primarily to the white-collar portion of the labor force, because it is here that big business continues to generate job opportunities.

Employment discrimination is certainly not permitted by law in the small-business sector, but it is not outlawed effectively. The structure of small-scale competitive industry usually makes litigation to enforce nondiscrimination employment prohibitively expensive. A further problem is the frequent inapplicability of affirmative action concepts: a goal of 20 percent minority employment does not fit the situation of a small business with two paid employees. Finally, even where the laws are applicable, enforcement agencies rarely pay attention to the practices of the multitude of tiny firms.

Largely unprotected by antidiscrimination safeguards, black workers competing for jobs in small business must contend with institutionalized practices that tend to undercut their chances of being hired. Small businesses large enough to utilize paid employees are overwhelmingly owned by nonminorities. Among the very small firms in this category, employees are most commonly either members of the owner's immediate family, relatives, or friends. In short, because employees are likely to belong to nonminority social networks that are family based, blacks are likely to be excluded.

A number of studies have found that young blacks and whites tend to use different job search techniques. While blacks tend to walk in and apply, whites are more often referred by friends or relatives.[18] A study by Henry Braddock and James McPartland (1987) found that the quality of employment blacks obtain correlates directly with the racial composition of their social networks. They found that blacks who attended racially mixed high schools were

more likely to live in racially mixed neighborhoods and work in racially mixed job settings. Segregated networks lead to poor paying, more segregated jobs, they concluded, and "desegregated networks lead to better paying, less segregated work".[19]

This pattern of social networks helps explain why the racial composition of the work force employed by black small-business owners differs so profoundly from that employed by nonminority owners. Small firms tend to draw their employees from family-based networks. For essentially the same reasons, nonminority-owned firms primarily hire nonminority workers and black-owned firms employ a labor force consisting almost entirely of minority workers.

Recognizing the Potential of Emerging Black Businesses

Social scientists have repeatedly questioned the viability of the overall black business community, and they have often attacked government loan assistance and procurement programs as wasteful and ineffective.[20] A recurring theme is the notion that black-owned businesses are heavily concentrated in small-scale services and retailing, activities that hold little potential for growth. Most of these firms have no employees, annual sales below $25,000, and very high failure rates.[21]

In his influential early writings on black self-employment, economist Andrew Brimmer argued that the typical black-owned business lacked the technical, managerial, and marketing competence needed to compete successfully in the mainstream business world.[22] The state of black business in today's urban poverty ghetto provides little basis for refuting Brimmer's view of the ability of black enterprise to compete.

Looking beneath the aggregate statistics, however, one finds that the black business community falls into two very distinct groups. The first consists of the more numerous traditional lines of business, such as small-scale retailing

and personal services. This group continues to be dominated by less educated owners whose firms bring in small earnings, and it shows definite signs of long-term decline. But there is also an emerging group of self-employed black entrepreneurs who are entering lines of businesses where minority presence has historically been scarce. These include wholesaling, business services, finance, manufacturing, general contracting, and professional services.

Critics of minority business development programs have often assumed that the black firms that continue to emerge would be replicas of the existing species—that the black business community would primarily yield more small retail and personal-service firms.[23] Evidence presented in this volume largely refutes that notion; the new and expanding black businesses do not conform with the stereotype of the past. The lines of black enterprise with the best prospects, however, are increasingly situated in nonminority locations. Among black-owned firms in such locations, the evidence (elaborated in chapter five) shows that more than half the owners starting firms have attended college, and that the businesses most likely to remain active are those (1) started by owners with four or more years of college, (2) having larger investments of financial capital, and (3) appealing to a racially diverse clientele.

It would be a mistake, therefore, to focus too narrowly on ghetto poverty areas in the effort to understand the contribution black business development may make to the overall economic well-being of minority communities. The growing, viable lines of black business—the ones that are most actively creating jobs—are disproportionately located not in the ghetto but in the central business districts and affluent outlying neighborhoods of large metropolitan areas. Moreover, the employment link between black-owned firms and the minority community is quite strong irrespective of where the firms themselves are located. As mentioned earlier, most white-owned small businesses in nonminority neighborhoods employ no minority workers whatsoever; by contrast, in 1982 fully 97 percent of black employers in these same areas utilized

minority workers (and in most cases minorities made up over 75 percent of the labor force). In short, their geographic separation from ghetto areas has not severed the employment link between black-owned businesses and black job seekers.

Identifying the Barriers to Black Business

After the 1960s, the traditionally "backward" black business community started to diversify and expand in response to an influx of entrepreneurial talent and financial capital. Opportunities created by policies such as set-asides and preferential procurement programs have induced better educated younger blacks to create and expand firms in new lines of business including wholesaling, contracting, and skill-intensive services. Aggregate figures on black-owned businesses understate this progress because they fail to separate two divergent trends: absolute decline in many traditional lines of business and real progress in emerging fields.

This book identifies three major barriers to the progress of emerging black businesses. The most serious constraint on the formation, growth, and diversification of black business has been rooted in problems of capitalization. Taken together, lack of personal wealth holdings and discriminatory treatment by commercial banks have produced an enormous obstacle to existing as well as potential black entrepreneurs. Second, challenges to the constitutionality of minority business assistance programs now threaten to reverse many of the gains made in broadening black enterprises' markets. If minority business set-asides at the state and local levels are to survive, they will need to be reoriented in light of the judicial constraints imposed by the Supreme Court's 1989 *Richmond* v. *Croson* ruling.

A third major constraint on black business viability is geographically specific. Black communities in the inner city are being left out of the business development process. In the inner-city milieu, all three requirements of business viability—financial capital, markets, and talented

entrepreneurs—are threatened: banks redline, local customers have little purchasing power, and better educated entrepreneurs are pulling out. It may yet be possible to reorient minority business assistance so that ghetto communities can enjoy business growth and investment, but doing so will be neither easy nor inexpensive.

A Better Direction for Public Policy

Discussions of policy options for assisting minority-owned businesses are sterile in the absence of clearly specified goals. Is the goal to promote black business ownership as an end in itself, or is black enterprise envisioned as a catalyst for the ghetto's economic development? Another question that must be answered at the outset if conflict is to be avoided concerns the target recipients: should they be the most "deprived" minorities who (for that reason) need the help most, or should they be those who have better prospects for success in self-employment? Typically, government assistance focuses on only one of the three essential elements of viability—either financial capital or markets. Some programs even perversely insist that the third element—entrepreneurial talent—be treated as grounds for *denying* financial or market assistance. The failure of such programs is well documented.[24]

Entrepreneurial ability is highly correlated with both education and income levels: successful business operators tend to be above average in both categories. The question that invariably arises when government assistance accrues to wealthier, better educated black entrepreneurs is "Why help those who are already successful?" This objection can be addressed at two levels. First, programs that target assistance to lower-income, less educated entrepreneurs simply produce mass business failure. Second, only the more capable entrepreneurs are likely to contribute to the larger goal of economic development, provided, of course, that the other ingredients of business success (capital and markets) are present. It is among these viable firms, after all, that further business expansion

and job creation take place. The presence of business success stories lures younger, better educated blacks into self-employment, and this further promotes the goal of economic development. Finally, existing firms in less profitable lines of business become motivated—by the success story phenomenon—to reorient their operations toward products and markets that offer greater profit potential. Once again, economic development is promoted.

If business success is achieved on a wider scale in urban minority communities, the process of economic growth will tend to reverse the resource drains that exacerbate ghetto poverty. Profitable operations will create additional capital and attract reinvestment; the ownership of local businesses by local residents will strengthen flows of income within the ghetto; and the most capable business people will be more willing to remain in the minority community, where their own enterprises can create yet further income and jobs. In this context, the question "Why help those who are successful?" really boils down to the question of whether the policy goal is to promote minority communities' economic development.

Concluding Comments

My emphasis throughout this book has been to identify the most viable black-owned businesses—those large-scale firms that are most likely to remain in operation and to create jobs. This emphasis is dictated by my choice of policy objectives—enabling black-owned businesses to fulfill their potential as catalysts of economic development in minority communities. The policy discussions in chapter seven are similarly shaped by my premise that economic development is the appropriate objective for government efforts that seek to assist the black business community.

Current public programs (such as most enterprise zone efforts) often fail because their emphasis on ghetto locations means minority firms with the best potential are left out. During the 1980s, the successful black firms that were most capable of generating economic development in-

creasingly chose not to locate in inner-city minority communities. Their calculus of profit maximization has shown them that the choicest urban business sites are either in affluent outlying (largely nonminority) areas or in the central business district. Present public policies have not reversed this geographical preference. Policies that would successfully assist the more capable businesses, on the other hand, would yield the derivative benefit of minority job creation. As noted before, geographic separation has not severed the employment link between black job seekers who live in the ghetto and black business located well outside the ghetto.

Critics of small-business assistance are right to point out that this sector of the economy offers lower wages and narrower room for advancement. Mere reliance upon small business to absorb the less educated and skilled members of the labor force cannot, by itself, be an effective long-run strategy for alleviating poverty and underemployment. Blacks remain overrepresented in the ranks of those lacking educational credentials and job specific skills.[25] The government's investment in basic education and job training must be strengthened so that young minority workers will have the skills they need to rise out of the lower depths of the job market.

The more traditional approach to improving black economic well-being has stressed programs for equal employment opportunity and affirmative action. Between 1964 and 1981, the federal government actively pursued such programs, bringing significant gains to blacks and other minorities: many individuals were freed thereby to move upward in government, educational institutions, the professions, and corporate enterprise. Today such programs are in a general state of decline. While the goals themselves still exist, compliance with them increasingly became voluntary in the 1980s. Moreover, recent Supreme Court rulings have narrowed the scope of equal opportunity laws, and "race neutral" policies appear to be preferred by the post-Reagan federal judiciary. Fighting for the retention of equal opportunity

policies is certainly still worthwhile; continuing earnings disparities between whites and blacks with similar educational and work backgrounds indicate that discrimination in the labor market persists.

The equal opportunity strategy is based on the assumption that one's position and rewards are the results of individual ability and effort. It assumes that if the race is fair the swift will win. Unfortunately, a narrowly conceived, race-neutral equal opportunity agenda may well be exploited as a rationale for not attacking the fundamental causes of poverty and racial inequality. An expansion of opportunities for some people is quite consistent with further losses for most people. Indeed, the last two decades—an era of widening professional opportunities for minorities—have also been a time when the gap between the haves and the have-nots has been growing.

The present day's equal opportunity strategy is not enough. Ghettos, if they ever do cease to exist in the nation, will do so because their residents are fully employed at a living wage. Strategies that create jobs and enhance worker productivity, affecting small businesses as well as large and touching the lives of minority workers at all skill levels, could do much to move society in that direction.

3 Why Black Firms Fail

While the trajectory of black businesses—moving toward larger firms in more diverse industries—is narrowing the gap in self-employment earnings between blacks and whites,[1] parity is not close at hand. The black business community, in its emerging as well as its traditional areas of enterprise, lags behind the nonminority community, with firms that tend to be smaller, less profitable, and more prone to failure. Among the CBO businesses analyzed in chapter two, mean 1982 sales were $138,030 for white firms but for black firms only $55,402.

By themselves, of course, those sales figures do not convey much useful information. To grasp the causes of the enduring racial inequalities in the success of small businesses, we need a broader analysis of firm and owner traits. This chapter therefore looks closely at the characteristics that distinguish weak, failure-prone firms from the larger, more growth-oriented lines of business. The relative importance of firm age, capitalization, and access to credit is explored, business survival rates over time are measured, and the differing traits of the people who own firms are identified in some detail.

The evidence suggests that highly educated owners, irrespective of race, invest larger amounts of financial capital into their small businesses and are more likely to create larger scale, lasting firms than are their poorly

educated peers, whose financial resources are less bountiful. Given that pattern, the weaker posture of black businesses is predictable. On average, black owners possess less of the requisite financial equity and education associated with business viability. And their access to debt capital is more restricted than that enjoyed by nonminority loan applicants. Smaller financial investments by black owners at the point of business startup—less equity to begin with as well as less access to debt—clearly lead to the creation of black businesses that are smaller and have lower chances of survival.

Yet the message of this chapter is not a pessimistic one. The nature of the black business community is profoundly different today from what it was 25 years ago. The size and scope of the black business community have expanded; industry diversity has flourished; highly educated entrepreneurs are the norm in many lines of business; bank credit is more widely available. Overall, black emerging businesses are progressing rapidly. But they must still contend with a range of problems that plague small business in general, as well as additional problems that affect black firms disproportionately.

Defining Small Businesses

Too often, our perceptions of minority enterprises and their status have been clouded by both a lack of consistent definitions and a lack of comparable data on nonminority firms.

Until 1987, comprehensive self-employment data were available only on minorities and women, but not on nonminority males.[2] While these sources did provide hard evidence of the very small size of minority firms, they were often misinterpreted as evidence of minority firms' distinct nonviability[3] and led many to believe that only minority- and women-owned businesses were dominated by tiny firms. This unbalanced picture was finally corrected in 1987 when comprehensive information on self-employed white males was published as part of the Census Bureau's

Characteristics of Business Owners (CBO) survey data. (See appendix A for details on the CBO data.) Table 2.2 in chapter two indicates that in 1982 large portions of white-owned firms as well reported annual sales of under $10,000.

Any insightful analysis of enterprise behavior must also begin with some clear definition of what a small business is. In government statistics, anyone filing a schedule C, form 1040 (sole proprietorship) federal income tax return is counted as a small business. This includes Avon ladies, college professors earning honoraria for occasional speeches, and millions of other Americans earning income through part-time self-employment.

That definition, accepted by many social scientists as well as by the government, flies in the face of the common conception of small business. Because of this definition, casual self-employment engaged in only when normal, full-time work is slack (such as a carpenter's moonlighting in home repair when building contracting is down) is later labeled as a business "discontinuance" when it is dropped; this occurs even though it may well be dropped because full-time employment has picked up again. Clearly, many business "failures" are not failures.[4]

There are several ways of separating "real" small businesses from casual ones, though none is perfect. The approach used throughout this study defines small businesses as those listed in the CBO data base for which (1) there was *some* investment of financial capital (greater than zero dollars) and (2) annual 1982 sales were at least $5,000.

Employers vs. nonemployers. Before proceeding with that definition, it is worthwhile to review what is revealed by using one popular alternative definition, defining meaningful businesses as *all firms with paid employees.*

Dividing the CBO data into employer and nonemployer groups is insightful. The firms thus described (listed in appendix B, table B.1) consist of 1,202 employers and 3,681 nonemployers among black firms, as well as 2,751

employers and 5,056 nonemployers among white male firms. Mean 1982 sales volumes for these CBO firms were:

Mean sales, 1982		
Employers	Black firms	$138,030
	White male firms	$378,549
Nonemployers	Black firms	$28,421
	White male firms	$47,268

For these same firms, the percentages falling into selected 1982 sales categories were:

		Employers	Nonemployers
Black Firms	Sales under $25,000	16.0	69.2
	Sales of $50,000-plus	62.6	12.4
White Firms	Sales under $25,000	7.2	54.7
	Sales of $50,000-plus	80.2	24.2

The 1,202 black employers identified in the CBO data employed 3,640 workers as of March 1982, and most of those employees worked for firms whose 1982 sales exceeded $100,000.

The employer-nonemployer distinction offers insight into who is most apt to possess the two traits—higher financial investment and better educated owners—that so consistently delineate stronger firms from those prone to failure. Relative to firms with no employees, employer firms are larger in scale, are run by more highly educated owners who make much larger financial investments in them, and are more likely to remain in business:

	Employers	Nonemployers
Percentage of owners with four-plus years of college	29.0%	23.0%
Total financial capital (mean)	$28,095	$11,929
Percent of firms still in business (1986)	82.0%	72.9%

That employer firms have better survival rates than nonemployers and that they are associated with more years of owner education should not be surprising. College graduates rarely enter such traditional fields as personal services, a field in which black-owned firms rarely utilize paid employees. Instead, highly educated owners invest in larger scale industries such as wholesaling where growth prospects are greater, owner remuneration is above average, and use of paid employees is the norm. In those rare instances where college graduates do enter into small-scale traditional lines of business, they are no more likely to establish lasting firms than high school dropouts.

Separating out businesses through this employer definition not only highlights the impact minority employers have on minority labor, but also highlights the correlations between owner education, owner investment, the use of employees, and firm survival. Nevertheless, while job creation and the racial makeup of the labor force are major concerns of this study, defining small businesses as employer firms alone would be too restrictive.

As noted earlier, more than 30 percent of the black firms without employees reported 1982 sales of $25,000 or more, and many of these small firms are operating in the emerging lines of business that have large potential for growth. Understanding the forces shaping these small firms will be just as important as understanding the forces shaping black firms with paid employees. The remainder of the study therefore assumes the broader sales and investment definition of small businesses.

Entrepreneurial Behavior That Shapes Small Businesses

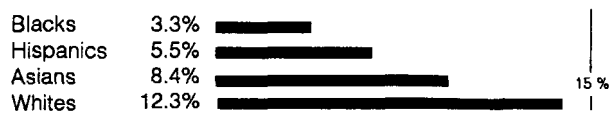
Before examining the patterns of success among various kinds of firms, it would be useful to know whether potential entrepreneurs themselves start out on a level playing field, or even on the same playing field. Part of the uniqueness of the black entrepreneurial pool lies in the fact that the proportion of the black labor force pursuing

self-employment is quite low, relative to whites. Why do blacks, as a whole, differ from other minorities and from whites in their likelihood of starting up enterprises?

The following discussion seeks to answer this, at least in part, by examining how entrepreneurs judge the costs and benefits of starting a business. It also looks at the influence of new and experienced owners' varying degrees of confidence and at the difference between taking ownership through a buyout and starting a firm from scratch.

As of 1976, among adult (over 21) members of the labor force, whites were more than three times as likely as blacks to be self-employed, according to national data.[5] At that time, the breakdown (including those under age 21) was as follows:

Incidence of self-employment, 1976



Peter Bearse (1984) has identified several traits that explain why the incidence of self-employment is higher for whites and Asians than for other minority groups, including higher educational attainment and greater wealth holdings. In wealth holdings, Bearse found that blacks lagged behind other groups.

Weighing opportunity costs. Another reason blacks enter business less frequently than Asians and Hispanics has to do with the perceived "opportunity costs" of engaging in small-business ownership. Particularly in high-wage areas of the country, self-employment will not be pursued unless it is sufficiently remunerative to compete with the wages available in the local labor markets. Highly educated and skilled people are particularly sensitive to such opportunity costs; they commonly have to

sacrifice high-wage positions as employees in order to start small businesses as full-time ventures.

In an earlier study, the author found that Asians and Hispanics pay much less attention to the opportunity costs of enterprise than blacks do.[6] Small-business owners from these two ethnic backgrounds are much more likely than blacks to cling to self-employment in high-income metropolitan areas, even if the income from their businesses is low. In part, this reflects the barriers of language that restrict employment options for many Asian and Hispanic immigrants.

This is illustrated by recent trends in Asian-owned retail operations. Even though firm profitability is lower in retailing than in any other line of Asian-owned business, highly educated Asian immigrants entered the retail trade in very large numbers during the 1980s, crowding into the smaller-scale, less profitable lines such as food stores and restaurants. Educated Asians have been forced to enter such low-yielding enterprises by a combination of language barriers and financial capital constraints. For the same reasons, they have remained underrepresented, relative to nonminorities, in larger-scale retail lines such as new car dealerships and stores selling appliances and building materials. Predictably, mean 1982 sales for newer Asian-owned retail firms (formed between 1976 and 1982) lagged behind those of nonminority retail enterprises, $137,369 as compared with $175,509.[7]

These facts somewhat contradict the popular notion that Asian immigrants today, as a rule, are exceptionally successful entrepreneurs. Many of the low-yielding Asian businesses fail outright shortly after their creation. And even the "successful" operations do not tend to retain their founders. As English fluency improves and assets accumulate, the barriers that dictated self-employment in retailing ease. Once successful, the owners often leave retailing, opting for new work that permits them to make better use of their knowledge and skills and, generally, to earn more. The exception to this pattern is found in areas such as professional services, which offers Asian owners both the

opportunity to utilize their professional skills and training and the possibility of high earnings.

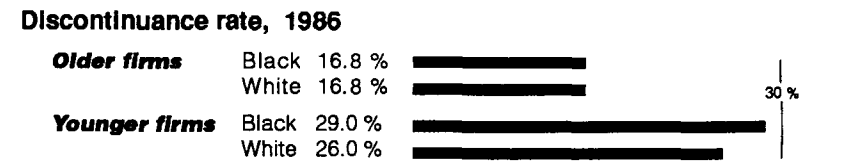
Experience and entrepreneurial confidence. Quite irrespective of entrepreneurs' education and financial assets, the dynamics of their success depend heavily on a variety of entrepreneurial skills and talents. Boyan Jovanovic has pointed out something less obvious but equally important: not only do people differ in the level of skills they possess, they also differ in their ability to gauge them accurately.

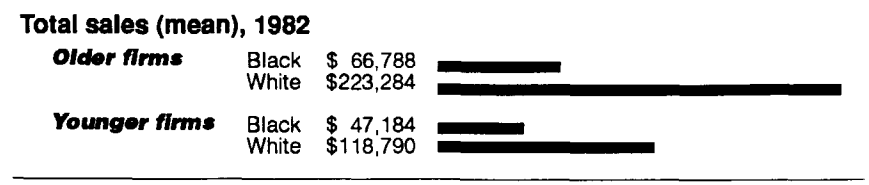
Jovanovic's popular model of small-business development stresses the length of time an owner has been pursuing self-employment. People gradually learn about their managerial abilities as they run a business and observe how well they do.[8] As they learn more about their abilities, their entrepreneurial behavior itself changes: those whose self-assessments grow stronger tend to expand the size of their firms, while those whose self-assessments grow weaker tend to contract their businesses or dissolve them.

Jovanovic's model helps explain why younger businesses are so much more apt to fail than older ones. Younger firms behave more inconsistently than mature firms, in part because their owners are relatively less certain about their own managerial abilities. They may overestimate themselves and fail by overreaching, or underestimate themselves and stagnate. Because younger firms are usually smaller, this inconsistency characterizes smaller firms more commonly than larger ones.

When we subdivide the businesses reviewed in this study (from the CBO sample) into younger and older firms, their corresponding survival rates and sales figures confirm Jovanovic's characterization (see table B.2 in appendix B, where detailed statistics on these and other findings discussed in this chapter are illustrated through supplementary tables). Older firms here are defined as those which by 1986 were more than 10 years old (started before 1976) and younger firms as those which by then

were from four to 10 years old (started during the 1976-1982 period). Regardless of the owners' race, younger firms consistently had lower annual sales in 1982 and were more likely to have discontinued[9] operations by late 1986, as the following figures show (figures for whites are limited to male owners):





For both blacks and whites, annual sales ranged across greater extremes for the younger firms.[10] Their behavior is clearly less settled than that of older firms, consistent with the finding that their owners are in the process of learning how to run a business.

An important unanswered question, however, concerns the causes of the disparities between the mean sales and discontinuance rates of white male firms and those of black firms. As a group, the black firms are slightly younger than the white sample, but the difference is not substantial (see table B.2 in appendix B). So while the maturity of firms has a great deal to do with their sustainability and output, it does not go far toward explaining the gap in success rates that still separates black firms from white ones. In fact, black firms' lower financial capital investments account more than any other factor for their dramatically lower sales levels as compared to white firms

and, among all younger firms, for black firms' higher rates of discontinuance.

Buyouts vs. newly formed businesses. If differences in firm maturity do not explain the racial disparity in sales volume, perhaps it can be explained by differences in the way new firms are obtained. Buyouts—businesses begun through the purchase of ongoing firms—may be contrasted with businesses started from scratch; buyouts may permit new owners to benefit from established managerial procedures and from some preexisting goodwill among clients.

Moreover, applying Jovanovic's thinking, a new owner who is unsure of his or her managerial abilities may reduce uncertainty by buying into a firm where the previous owner's practices are embodied in the operations. If such piggybacking on existing expertise succeeds, then the purchase of ongoing firms, other things being equal, should be associated with higher sales levels. The figures show, in fact, that buyouts generate much higher average sales than creating firms from scratch does, and they show that whites are slightly more likely than blacks to enter business via the buyout route: ongoing businesses accounted for 21.3 percent of the black CBO firms and 24.0 percent of the white firms.

Yet the huge disparity in sales that marks off black firms from white firms remains largely unexplained. The differences in firm age and frequency of buyouts, just discussed, could only be contributing in some small degree toward this disparity. It is noteworthy that the disparity widens among older black firms; this suggests that the higher incidence of *traditional* lines of business among black-owned firms is a contributing cause. While the mean annual sales of younger black firms were only 39.7 percent of white mean sales for younger black firms, among older black firms they were even weaker: 29.9 percent.

All of this suggests that entrepreneurial experience in and of itself cannot be assumed to be the deciding factor in explaining the weaker status of the black business

community. Once more this points to the pivotal role played by the *nature* of emerging businesses and the importance of the shift away from traditional black enterprises.

Explaining Black-White Differences in Business Size and Survival

The firms that are most likely to remain in business tend to be the larger-scale operations. Indeed, a major finding of this study is that stronger business startups have greater access to financial capital; the better capitalized operations, in turn, become larger in scale.

My investigation into the determinants of small-business viability has been guided by the findings of previous studies that have linked specific owner and enterprise traits to the likelihood of business discontinuance and survival. These traits fall under five headings.

First, whether measured by sales, number of employees, or total assets, it is the *larger-scale* firms that are most likely to survive.[11] Second, chances of remaining in business become stronger as firms grow *older;* as a rule firms are most likely to discontinue operations during their first few years.[12] Third, the owners most likely to establish lasting firms are those having *four or more years of college.*[13] Fourth, the owners most likely to survive also invest substantial amounts of *financial capital* into their businesses.[14] A fifth trait, though less influential than the first four, is that of firms purchased in *buyouts*; they are more likely to survive than those started from scratch.[15] In the following pages we explore the relative influence of these five broad traits in assuring business startups their best chances of success. It turns out that the greatest single disparity between the samples of young white and black businesses lies in the two groups' financial capital structures. Whites consistently command much more financial capital than black business owners at the point of business entry: differentials are widest for debt capital. The debt factor in turn is linked to other startup traits, of course, since firms that can leverage larger seed loans from

commercial banks are likely to be larger enterprises whose owners have strong resumés.

Firm size and firm age. That smaller firms, whether owned by blacks or whites, are consistently less likely to survive than larger firms is evident from the figures in table 3.1. Likewise, the table shows that younger firms are less likely to survive than older ones, and that this also holds true equally for blacks and whites and at every level of sales.

The pattern of firm survival is most readily apparent when one looks at the extremes of firm age and size. Among black firms, the percentage still in business in 1986 was 58.5 for young firms with sales under $10,000, but jumped to 86.7 for old firms with sales above $100,000. The same contrast holds for white male firms, which jump from 62.7 percent to 88.7 percent for those two sales/age categories. Another—and even more dramatic—way to

Table 3.1
Percentage of Firms Still in Business in 1986, by Sales Levels and Firm Age Group

	Black Firms			White Male Firms		
	Young[a] firms	Old[b] firms	All firms	Young firms	Old firms	All firms
$5,000—$9,999	58.5	78.9	65.7	62.7	70.0	64.9
10,000—24,999	67.4	82.0	73.0	68.4	78.1	72.1
25,000—49,999	72.8	85.6	78.7	75.7	84.8	79.6
50,000—99,999	82.7	85.1	83.8	81.0	84.9	82.8
100,000 and up	83.5	86.7	85.2	83.3	88.7	86.2
All sales levels	71.0	83.2	75.1	74.0	83.2	78.0

Source: CBO data on firms that were in business during 1982 (unpublished data).

[a] Young firms defined as those formed between 1976 and 1982.
[b] Old firms defined as those formed before 1976.

Note: Firms have been excluded from this table (and from the remainder of this chapter) if (1) their 1982 total sales were under $5,000, or (2) no financial capital was initially invested in the firm.

grasp these differences is to look at business discontinuance, which for both races was *more than three times as likely* for the young, below-$10,000 group as for the old, $100,000-plus group (table 3.1).

Note too that overall survival rates for black and white firms, aggregated from all sales levels, are identical—at 83.2 percent—when one considers only the older businesses. And even among young firms, considering only those with $50,000 or more in sales, the black firms have a slightly higher survival rate (83.0 percent versus 82.3 percent) than corresponding white firms. In other words, when enterprises are sufficiently large and sufficiently mature, race plays no discernible role in longevity. Black businesses lag consistently behind white ones in survival rates only among young firms with annual sales below $50,000 (table 3.1).

The greater prevalence of very small businesses among black owners deserves some attention. Among all the young businesses, 61.8 percent of the white male firms had 1982 total sales below $50,000. But even this high incidence is vastly overshadowed by the incidence among black firms of 78.3 percent. The abundance of small black firms is partly rooted in the restricted amount of capital available to them as compared with white owners, limitations that work against the generation of higher sales volumes. Comparative figures on the relative sales and investment resources of young black and white firms (table B.2, appendix B) indicate the following:

	Young Black Firms	Young White Male Firms
1982 Sales (mean)	$47,184	$118,790
Total Financial Investment (mean)	$19,066	$ 44,552
Owners with four or more years of college	28.5%	35.3%

In chapter two we found that the rising frequency among black firms of large-scale businesses reflects the rising incidence of highly educated black entrepreneurs entering nontraditional fields. Yet a countervailing factor that continues to depress the size of black businesses is the paucity of financial capital available for business investment. Traditionally, personal wealth holdings are a major source of capital for small business creation and expansion, and it is here that black entrepreneurs suffer their most crippling financial disadvantage. Understanding this disparity is essential for understanding the broad patterns of black business development, so the issue receives its own discussion next.

Personal wealth: black and white. A study of nationwide wealth holdings in 1967 showed that, on average, black families had less than one-fifth the wealth accumulation of white families.[16] Figures for 1984 show that this enormous gulf has not been narrowed.

The forms in which wealth were held also differed dramatically, according to the 1967 study. Equity—in homes, cars, and trucks—accounted then for 64.4 percent of aggregate black wealth but only 37.4 percent of white wealth; conversely, financial assets, the form most readily available for business investment purposes, accounted for only 10.2 percent of holdings among blacks but 30.1 percent among whites. Finally, equity in small businesses accounted for 5.7 percent of wealth holdings among blacks but among whites 9.4 percent.

Looking at the value of those holdings once again makes clear the size of the disparity. Even if we exclude blacks in lower income brackets and focus on those earning over $20,000 annually in 1967, we find that their average wealth holdings were $30,195 per household, roughly 30 percent of the holdings reported by corresponding whites ($101,009). Overall, white households not only held on average five times as much wealth as blacks, they also held well over twice as much of that wealth in the most usable form, namely as business equity and financial assets (39.5

percent versus 15.9 percent for blacks). In sum, the average white household in 1967 held more than 12 times as much of this readily investable personal wealth as the average black household.

More recent data on family wealth holdings in 1984 indicate that this inequality still prevails. Black households in that year had a median net worth of $3,397, versus $39,135 for white households: for every dollar of wealth in the median white family, the median black family had nine cents.[17] While only 8.6 percent of white households had zero or negative net worth, 31 percent of black households held absolutely no wealth whatsoever.[18]

In 1984, small business equity was most likely to be held by black households whose incomes exceeded $24,000; namely by 3.5 percent of those in the upper-middle income bracket ($24,000 – $48,000) and by 14.0 percent of those in the high-income bracket. For white households, the fraction owning this kind of equity was 11.0 percent in the upper-middle bracket and 21.5 percent in the high bracket. The greatest disparity in business equity holdings, however, derived from the fact that higher-income households are much more numerous among whites than blacks.

Disparities in personal wealth holdings therefore continue to handicap black business startups. In the 1980s, just as in the 1880s, black business creation has been heavily concentrated in industries where formation has required relatively little financial capital. Lacking assets—and therefore lacking borrowing capacities—black entrepreneurs remain ill-equipped to cope with economic adversities and to exploit economic opportunities.

Owner Traits That Most Affect Firm Sales

Given the clear importance a firm's size has for its success, it is useful to know which factors most forcefully determine whether a young business will survive and grow to a viable size. Yet measuring the effect of these influences can be difficult: they are inextricably linked to one another and they operate simultaneously. To disen-

tangle these influences and measure their effect on such important outcomes as sales levels and business survival, in this section we employ a regression analysis that weighs each factor separately.

The analysis shows that of all the owner traits under consideration—the owner's education, entrepreneurial experience, own contribution of labor, et cetera—what most decisively accounts for the laggard performance of black firms is the investment of financial capital. This conclusion is accompanied by the finding that better educated owners are the ones investing larger amounts of financial capital in their businesses.

Owner's experience and owner's labor. In addition to such previously discussed traits as the firm's age and the owner's educational background, two other traits appear at first glance to be linked to firm viability. First, the owner's own labor—working full-time as opposed to part-time in his or her own small business—is expected to help in establishing larger scale, more successful ventures. The quantity of owner labor input is somewhat higher for whites, as these figures show:

Hours worked per week in own firm (average), 1982

Black owners	41.0
White male owners	45.8

Secondly, white owners had somewhat more managerial experience than blacks on the date when they entered self-employment:

Mean years of managerial experience, 1982

Black owners	3.7
White owners	5.6

Adding these two aspects of owner background into the list of factors covered so far, we now have five owner traits whose relative importance must be discerned. Are the lower sales levels that typify young black firms best explained by their owners' (1) smaller initial financial investments? (2) smaller number of hours put into their firms each week? (3) lesser amount of managerial experience? (4) generally lower levels of education? or (5) slightly lower likelihood of obtaining the firm through a buyout? (Buyouts accounted for 23.4 percent of the young black firms but 24.4 percent of young white businesses.)

To find out which of these may be the greatest cause of black firms' weaker performance, an econometric analysis based on multiple linear regression is used. This technique allows us to weigh separately a multiplicity of simultaneous factors in order to identify what weight each has—in this case, what weight each has in determining the size of a firm's sales. (No other statistical technique would permit the significance of a variety of factors to be weighed at one time.)

When the five owner traits listed above (as well as others) are considered simultaneously, it is found that the lagging sales of the young black-owned businesses are most decisively explained by the gap in financial investment.

The findings also indicate that the better educated owners investing larger sums in their businesses are the ones likely to establish firms with higher sales volumes. Other owner traits statistically linked to higher sales volumes are being in the 35–55 age bracket and working longer hours in one's business. (See table B.3 for detailed findings from this analysis.)[19]

The primary importance of financial investment is doubly confirmed by a further set of analyses. Two different econometric techniques—a multiple regression analysis and a multiple discriminant analysis—were employed to examine a pair of closely related dependent variables: firm size and the likelihood of firm survival. These differing techniques produced highly consistent findings, which may therefore be judged "robust" or reliable: that

the size of an owner's financial investment is the most powerful single determinant of both the size and the likely survival of a small business.

If the financial investment made in a new business is so critical to its success, certainly the access to loans that entrepreneurs have ranks closely in importance.

Traits That Determine Access to Credit

In recent decades, black firms' access to credit has expanded. Relative to the situation in 1944 that Pierce described (see chapter two), circumstances have improved greatly; the fact that more than 25 percent of the black businesses that began operations between 1976 and 1982 received commercial bank loans is noteworthy. But credit access is certainly not approaching parity with white businesses. Black college graduates are least disadvantaged relative to white business owners, but black firms as a group are still less likely to get loans, and the loans that are extended are much smaller than those accruing to their white counterparts.

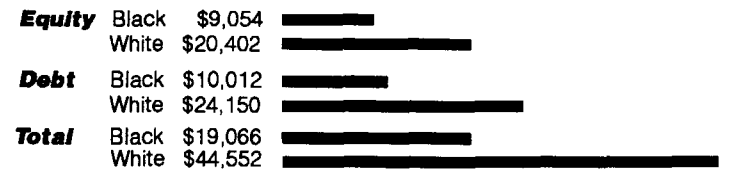
What are the underlying causes of this lingering disparity? Do blacks generally get smaller loans because their educational attainments, on average, lag behind those of white borrowers? Or is it their relative lack of owner equity that reduces loan size? Alternatively, perhaps black borrowers are restricted to smaller loans as a penalty for being black—?

To answer this, it is necessary to lay out the various forces at work and measure their separate influence through regression analysis. The following pages do this, and their conclusion is both simple and disturbing: statistically, blacks have been getting smaller bank loans than whites who possess identical traits as far as age, educational background, and possession of equity capital.

Debt vs. equity. When starting up a business, an entrepreneur's financial investment consists of two kinds of capital: debt capital, including both short- and long-

term indebtedness, and equity, which measures the net worth of the small business under consideration, including the cash value of nonfinancial tangible assets (such as equipment and tools) that the owner has contributed to the firm. For the 1982 CBO samples of young firms (table B.2), the mean values for debt and equity capital were as follows (figures for whites limited to male owners):

Mean debt and equity capital, young firms



As the figures show, the total financial investment at startup among white males was, on average, nearly two and a half times that among blacks.

The consequences of this huge disparity are profoundly important for explaining the generally laggard performance of black enterprise. The disparity is strongest in the case of debt, with the mean debt of black firms amounting to only 41.5 percent of the $24,150 figure for white businesses. (See table B.4 for details on the startup capital structure of young black and white male firms).

Commercial banks were the main source of debt capital, exceeding by far the combined total of debt extended to these firms by all other sources. Yet black bank borrowers reported mean debt inputs of $25,704, versus $55,803 for white firms (see table B.4; median values for debt reveal gaps of similar relative magnitudes). A racial disparity also persists in the proportion of firms obtaining bank loans, though it is much less severe than the disparity in amounts loaned: of the 4,429 young firms owned by white males (described in table B.2), more than 32 percent received bank loans, while the corresponding figure for blacks was 25.2 percent.

The importance of bank loans cannot be underestimated. For all of the firm samples—black and white—bank loan recipients began business with substantially larger amounts of both total financial capital and debt capital than firms not receiving bank loans began with. Among black firms, the mean financial investment was nearly five times larger for bank borrowers ($36,530) than it was for nonborrowers as a whole ($7,660).

Debt and equity are complements at the point of business startup. Among the white bank loan recipients, for example, the simple correlation between debt and equity was very high (+.62). One possible explanation for the differences in loan amounts obtained by blacks and whites may be that they reflect differing endowments of both human and financial capital. After all, blacks possess less equity capital than whites, on average; fewer black owners are college graduates; and white owners have more managerial experience. Banks are naturally willing to lend larger amounts to stronger borrowers, and white owners are more apt to have the traits, such as greater equity capital, that banks reward when they determine loan size. If differing loan amounts turned out to be based purely on these differing resumes, the disparities might be explained as a normal outcome of the process by which banks evaluate loans.

But the analysis does not show this. Rather, it shows that for each dollar of equity put in, banks provide the white business borrower with $1.83 in debt capital, all other things being equal, while providing the black business borrower with only $1.16. This finding, that banks treat white and black loan recipients differently even when their qualifications do not differ, emerged after determining the relative influence several factors had on the size of loans used to finance startups. The analysis, based on multiple regression equations, identified statistical linkages between the debt levels of bank borrowers and these types of owner traits: (1) the amount of equity capital invested, (2) the owner's educational background, and (3) demographic characteristics. In the end, the owner's race proved to be a significant factor in determining loan amount. (The applicable regression equations appear in the appendix; see table B.5).

Owner education and access to credit. While an owner's equity is the single most important determinant of bank loan size, his or her educational background ranks second. Among loan recipients, incremental loan amounts associated with having four or more years of college are $27,111 for black borrowers and $28,553 for white borrowers. College graduates face less discrimination from banks than do less educated black entrepreneurs. Among the owners of young black firms, 28.5 percent had attended four or more years of college (table B.2). These are the same owners that make up most of the emerging business subset of black enterprise, and they are the owners who have the greatest access to commercial bank loans.

The generally smaller loans to which black borrowers have access serve to restrict the size and scope of the firms they can create. This in turn leads to a greater hazard of business failure) The evidence discussed below demonstrates that size of financial investment is the single strongest determinant of business discontinuance: firms formed with minimal financial capital are commonly very small and they are the ones most likely to discontinue operations. Further evidence (chapter five) indicates that restricted access to credit is heavily rooted in the commercial bank practice of redlining firms that operate in urban minority communities.

Traits That Determine Business Longevity

Based on our earlier discussions of the traits that distinguish viable businesses generally, one should expect young black firms to lag behind young nonminority firms if they are deficient in those success traits. Specifically, the most successful black firms should be those that are

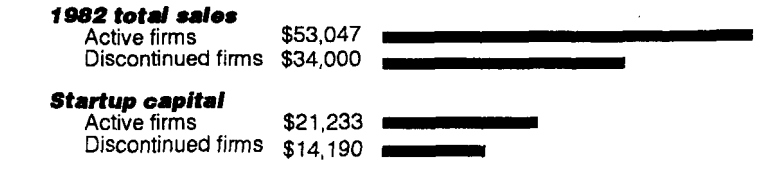
(1) older, established firms, (2) started with larger financial investments (including debt), and (3) obtained as buyouts rather than new businesses. One should further expect those firms to do well whose owners are (4) highly educated, (5) work full-time in the business, and (6) have greater managerial experience prior to self-employment.

This section reports on the findings of discriminant analyses designed to rank the relative significance of these determinants of black firms' survival. The results confirm most of the expected patterns, with financial investment looming largest in influence. Nonetheless, owners' education matters less than expected, while managerial experience has no clear-cut impact. And the buyout of ongoing businesses turns out to link more closely with discontinuances than with firm success.

Methodology. Discriminant analysis is a statistical method used to distinguish between two groups by discovering which of their shared traits most clearly set them apart. Upon mathematical analysis, the technique yields a "weight" (coefficient) for each of the traits (variables) being measured. Variables that turn out to have the largest weights will be those that best differentiate one group from the other. By distinguishing active, surviving black businesses from discontinued ones in this way, we obtain a better understanding of the root causes of black firms' success.

The CBO data base describes firms that were operating during 1982. In the discriminant analysis, a firm is defined as viable if it was still operating in late 1986. Businesses that were still operating are considered *active* firms; those that had closed down are considered *discontinued.*

Note too that discontinuance statistics apply to businesses rather than owners. Thus, a black-owned retail operation that was sold to an Asian is counted as an active firm as long as it was still being operated in late 1986. Mere departure of an owner is not equated with business discontinuance in cases where the firm continues to operate. Among the active and discontinued subsets of the black-owned young businesses, mean statistics on firm size and financial capital reveal major differences:



The discontinued firms are clearly the smaller operations that began business with smaller financial investment. Summary statistics such as these are illuminating, but their limitation is their inability to rank, simultaneously, the relative significance of many variables. That is the task of discriminant analysis.

Distinguishing among the factors at play. The explanatory variables measured in this analysis include two firm traits—year of business startup and buyout of ongoing firms—as well as numerous owner traits describing education and experience, financial investment, and demographic traits. (These variables are defined in detail in appendix B.)

The traits hypothesized to be the dominant causes of firm viability have already been discussed. By way of summary, they are higher levels of education, more hours of the owner's labor, larger financial investment, and more years of managerial experience. Owners at both ends of the age distribution—particularly those over age 55—are expected to be less likely to remain in business. One previous study by the author indicated that owners in their late 40s were most likely to operate successful businesses.[20]

Highly leveraged firms are also expected to be more successful, due in part to the limited access to debt that bars many weaker firms from utilizing borrowed capital. "Leverage" is, by definition, the ratio of owner debt to equity; a higher ratio indicates greater borrowing.