EXHIBIT A

CAPITAL FORMATION AND INVESTMENT

IN MINORITY BUSINESS ENTERPRISES

IN THE TELECOMMUNICATIONS INDUSTRIES

THE UNITED STATES DEPARTMENT OF COMMERCE
THE NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION
OFFICE OF POLICY ANALYSIS AND DEVELOPMENT
14TH AND CONSTITUTION AVENUE, NW, ROOM 4725
WASHINGTON, DC 20230

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Staff Paper

NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION
OFFICE OF POLICY ANALYSIS AND DEVELOPMENT
MINORITY TELECOMMUNICATIONS DEVELOPMENT PROGRAM

Larry Irving, Assistant Secretary for
Communications and Information

AUTHORS
Raymond Suarez, President, Quality Management International

Robert Cull, Ph.D., Economist, OPAD

April 1995

FUNDED BY THE MINORITY BUSINESS DEVELOPMENT AGENCY OF THE U.S. DEPARTMENT OF COMMERCE

THE MINORITY TELECOMMUNICATIONS DEVELOPMENT PROGRAM

PROJECT DIRECTOR

Joann Anderson, Ph.D.

PROJECT TEAM

Louis M. Camphor, III

Robert Cull

Leslie Hagans

LaVern D. James

Shawna Jones

Raymond W. Suarez

Acknowledgements

The project team would like to extend special thanks to the following individuals for their expert advice and assistance in the production of this project.

Gavin Chen, Ph.D., Senior Advisor, Finance and Capital Markets, MBDA
Joanne Kumekawa, Special Assistant for International Affairs, NTIA
Timothy Robinson, Attorney Advisor, Office of the Chief Counsel
Timothy Sloan, Telecommunications Policy Specialist, OPAD
Michele Farquhar, Chief of Staff, NTIA

MTDP would like to thank all NTIA staff members who contributed to this effort.

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Executive Summary

This report, which examines capital formation and investment in minority enterprises in the telecommunications industries, was prepared by the Minority Telecommunications Development Program of the National Telecommunications and Information Administration of the U. S. Department of Commerce, and funded by the Minority Business Development Agency of the U. S. Department of Commerce. The objectives of this report are to identify the financial barriers faced by minority entrepreneurs and businesses seeking to compete in the telecommunications industries, to suggest possible solutions, and to stimulate efforts underway to address this critical issue.

The evidence presented in this report indicates that there are real barriers to minority participation in telecommunications, and that minorities often lack access to the types and amounts of capital required to form and expand telecommunications businesses.

The methodologies used in this report to research barriers to minority ownership in telecommunications businesses included: an extensive literature search; development of three case studies; original statistical research; and interviews with a resource group of entrepreneurs, financial professionals, telecommunications policymakers, and community representatives.

The telecommunications sector, on average, is more capital intensive than other businesses where minority enterprises have a historical presence. Therefore, minority access to substantial venture or startup capital is critical to greater minority participation in telecommunications and other technology-based enterprises. However, our research indicates that, comparatively, minorities have had little access to traditional venture capital sources.

Moreover, our research suggests that minority access to traditional sources of debt capital such as banks can be affected by factors such as discrimination. For example, our research showed that white entrepreneurs are more likely to receive capital from banks than their minority counterparts despite the same qualifying background and profile.

Another key finding regarding capital access by minorities is that educational attainment is a major factor in determining whether or not a minority entrepreneur will succeed in acquiring capital from traditional debt or equity sources.

In an effort to address the barriers that have prevented minorities from fully participating in capital intensive industries like telecommunications, this report identifies fifteen capitalization strategies that provide an alternative to traditional capital sources. These strategies, in conjunction with enhanced government initiatives, entrepreneurial education and training, minority employment, and appropriate business selection strategies will help promote minority ownership in telecommunications. To the extent that capital constraints present barriers, MTDP hopes that this report will provide information and data to spur minority entrepreneurial development and ownership in one of the most high growth sectors of our economy.

The following **FINANCING STRATEGIES** *(with examples)* are presented in this report and can be implemented at the specified stages of business formation:

Startup

ROTATING CREDIT ASSOCIATIONS *(Korean Keh)*

INVESTMENT CLUBS *(Washington Women's Investment Clubs, Family 7 Inc.)*

CHURCHES *(The First African Methodist Episcopal Church, Allen A.M.E. Church)*

MICROENTERPRISE PROGRAMS *(NCRED, Coalition for Women's Economic Development)*

STRATEGIC ALLIANCES *(BET, Genesis Communications)*

Acquisition

STATE SPONSORED SOURCES *(MSBDFA, DETROIT BIDCO)*

ACQUISITION TEAM/FUNDS *(TSG Ventures II)*

Expansion

FUND OF FUNDS *(Fairview Capital, L.P., Ark Capital Fund)*

COMMUNITY BASED BANKING *(South Shore Bank, The Development Credit Fund)*

INDUSTRIAL DEVELOPMENT BONDS *(Airlines, packaged good, franchises, retailers)*

CORPORATE SPONSORED INVESTMENT COMPANIES *(General Electric CSBD)*

ASSET SECURITIZATION *(The Money Store, Fremont Capital Partners, NC Dept. of Econ. Dev.)*

Public Market

PRIVATE PLACEMENTS/LIMITED PARTNERSHIPS *(Pine Cobble Partners)*

TARGETED MUTUAL FUNDS *(Atlanta Growth Fund)*

INITIAL PUBLIC OFFERINGS *(BET, Candy's Tortilla Factory, Envirotest Systems, Granite Broadcasting, Latin Foods Int'l.)*

Chapter One

INTRODUCTION

This report, which examines capital formation and investment in minority enterprises in the telecommunications industries, was prepared by the Minority Telecommunications Development Program (MTDP) of the National Telecommunications and Information Administration (NTIA) of the U. S. Department of Commerce, in cooperation with the Minority Business Development Agency (MBDA) of the U. S. Department of Commerce. The objectives of this report are to identify the financial barriers faced by minority entrepreneurs and businesses seeking to compete in the telecommunications industries, to suggest possible solutions, and to stimulate efforts underway to address this critical issue. In particular, this report identifies fifteen capital development strategies of potential use to minority business owners in their formation, growth and exit stages.

The telecommunications and information (hereinafter "telecommunications") industries encompass and affect increasingly important and expanding sectors of the American economy. According to government and industry sources, telecommunications companies generated $556 billion in revenue in 1993.[1/] As technology and consumer demand continue to drive these industries, and services, markets and relationships continue to evolve, telecommunications offers ever increasing business opportunities for American companies and entrepreneurs.

There is reason for concern, however, as to whether such opportunities are within reach of all Americans. A 1991 study conducted for the Minority Business Development Agency (MBDA) of the U.S. Department of Commerce found that less than one percent of all telecommunications companies, including telephone related and mass media firms, were minority owned.[2/] Capital was cited as the most significant barrier to minority business ownership in telecommunications.

In 1993, the Federal Communications Commission's (FCC) Small Business Advisory Committee (SBAC) held hearings with industry leaders and others interested in personal communications service (PCS) technologies. One of the major findings from those hearings was that opportunities for small service providers have been constrained in existing telecommunications markets by undercapitalization, concentration of ownership, and other

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1/ *International Trade Administration, U.S. Department of Commerce, U.S. Industrial Outlook, 1994. Standard and Poor's, Leisure Time and Media Industry Surveys, 1994.*

2/ *Symbiont, Inc., A Market Analysis of the Telecommunications Industry-Opportunities For Minority Businesses, Developed for U.S. Department of Commerce, Minority Business Development Agency (August 20, 1991).*

conditions contributing to the underrepresentation of businesses owned by minorities and women. The SBAC found that capital formation is the major economic barrier to full participation by small and minority owned businesses.

Historically, minority owned businesses have been underrepresented in the telecommunications industries. If America is to derive maximum economic and social benefit from growth in the telecommunications industries, ownership opportunities must be available to all Americans. Evidence indicates, however, that one principal barrier to greater participation by minorities in telecommunications ownership is a persistent lack of access to the types and amounts of capital required to form and expand viable businesses. Telecommunications ownership will not be possible for minorities in a significant way if most continue to lack access to financial resources that make successful business ownership possible.

METHODOLOGY

MTDP employed four approaches to gather data on minority owned telecommunications companies and their capitalization, including:

EXTENSIVE RESEARCH of existing writings and sources on these and related topics;

CASE STUDIES which examine the capital formation strategies employed by current minority telecommunications business owners;

A STATISTICAL STUDY of minority broadcasters (the largest identifiable segment of minority owners in telecommunications), their capital requirements, and factors which appeared to affect the decisions of participating financial sources, and;

A RESOURCE GROUP of financial professionals, telecommunications policymakers and entrepreneurs, and community representatives who provided insight and expertise that contributed to the formulation of approaches to resolve the problem of access to capital for minorities in telecommunications.

From this research, MTDP developed fifteen possible financing strategies. Each strategy has been grouped according to the specific business formation stage at which it is most likely to be useful (i.e., startup, acquisition, expansion and growth, and exit) to respond to the wide range of capital needs that businesses encounter. Following is a summary of the strategies and their respective business stages.

TABLE ONE

ALTERNATIVE FINANCING STRATEGIES AT VARIOUS STAGES OF BUSINESS DEVELOPMENT		
FINANCING STAGE	**FINANCING STRATEGY**	**EXAMPLE**
STARTUP	Rotating Credit Associations	Korean Keh, West Indian Susu
	Investment Clubs	Washington Women's Investment Clubs Family 7, Inc.
	Churches	The First African Methodist Episcopal Church Allen A.M.E. Church
	Microenterprise Programs	NCRED, Coalition for Women's Economic Development
	Strategic Alliances	BET, Genesis Communications
ACQUISITION	State Sponsored Sources	MSBDFA, DETROIT BIDCO
	Acquisition Teams/Funds	TSG Ventures II
EXPANSION	Fund of Funds	Fairview Capital, L.P., Ark Capital Fund
	Community Based Banking	South Shore Bank, The Development Credit Fund
	Industrial Development Bonds	Airlines, packaged goods, franchises, retailers
	Corporate Sponsored Investment Companies	General Electric CSBD
	Asset Securitization	The Money Store, Fremont Capital Partners, North Carolina Dept. of Economic Development
PUBLIC MARKET	Private Placements/Limited Partnerships	Pine Cobble Partners
	Targeted Mutual Funds	Atlanta Growth Fund
	Initial Public Offerings	BET, Candy's Tortilla Factory, Envirotest Systems, Granite Broadcasting, Latin Foods International

This report defines the telecommunications and information industries broadly to include: telephone, cable, electronic information, data processing, network and computer professional services; telecommunications, audio, video, and computer equipment and peripherals; radio and television broadcasting; motion pictures; home video and video games; and packaged computer software. For convenience, all references to "telecommunications" throughout this report shall also include "information." Table Two summarizes these industry segments by revenue in 1993.

TABLE TWO

TELECOMMUNICATIONS AND INFORMATION INDUSTRY	
BUSINESS	(BILLIONS)
Telephone Services	$ 179.4 (revenue)
Computers and Peripherals	62.5 (value)
Computer Professional Services	60.8 (revenue)
Computer Software	52.4 (revenue)
Data Processing/Network Services	46.4 (revenue)
Telecommunications Equipment	35.5 (shipments)
Television Advertising	28.1 (revenue)
Cable Television	26.3 (revenue)
Home Video	14.0 (sale/rentals)
Electronic Information Services	13.6 (revenue)
Prerecorded Music	11.2 (sales)
Radio Advertising	9.4 (revenue)
Audio and Video Equipment	7.4 (shipments)
Movies	5.1 (receipts)
Video Games	4.0 (sales)
TOTAL REVENUE	$ 556.1 (TOTAL)

Source: International Trade Administration, U.S. Department of Commerce, U.S. Industrial Outlook, 1994. Standard and Poor's, Leisure Time and Media Industry Surveys, 1994.

This report uses "Black," "Hispanic," "Asian American" and "Native American" to refer to the nation's predominant minority groups. "Asian American" includes Asian Americans and Pacific Islanders. "Minority" refers to all of these groups collectively. Unless otherwise stated, "minority owned" denotes minority control of an enterprise. In a stock corporation, "minority control" is defined as minority ownership of greater than fifty percent of the corporation's voting stock. In a partnership, "minority control" is defined as minorities having greater than fifty percent of the partnership's voting interests.

Research on minorities in some areas of this study did not always provide comparative data. For example, data on business ownership and investment for Blacks and Hispanics was more readily available than for Asian Americans and Native Americans. Statistics on business ownership for white males were available through the Bureau of the Census. Business ownership statistics for white females were grouped by the Bureau of the Census with minority females, but were not separately available.

Chapter One of this report introduces the topic, offers an overview of minority business ownership in the United States, discusses minority business ownership and participation in the telecommunications industries, and provides the context for the report and its conclusions. Additionally, Chapter One explains the methodology used in writing this report and outlines the capital development strategies which will be discussed in Chapter Three.

Chapter Two examines the problem of capital formation and investment for minority enterprises, sources of capital for minority businesses, and financial and nonfinancial factors which appear to influence capital investment decisions. In addition, this chapter contains case studies, resource group discussions, and an econometric study of capital allocation among existing minority broadcasters.

Chapter Three presents fifteen strategies for aggregating and investing capital in minority telecommunications companies in the formation (startup and acquisition), expansion (growth) and exit (public market) stages.

MINORITY BUSINESS IN THE U.S.

The prospects for minority businesses in telecommunications must be understood in the context of minority business in the U.S. generally.

TABLE THREE

MINORITY ENTERPRISE IN THE U.S.						
Minority Group	Population		Firms[3/]		Total Revenue	
	Mil.	%	Thous.	%	$ Bil.	%
BLACK	30.0	12	424.2	3.1	19.8	1.0
HISPANIC	22.3	9	422.4	3.1	24.7	1.2
ASIAN AMERICAN	7.3	3	355.3	2.6	33.1	1.7
NATIVE AMERICAN	2.0	1	21.4	.2	.9	.1
TOTAL MINORITY	61.6	25	1,223.3	9.0	77.8	4.0
TOTAL U.S.	248.7	100	13,695.5	100	1,994.8	100

Source: U.S. Department of Commerce, 1987 Survey of Minority-Owned Business Enterprises

As Table Three demonstrates, minority business remains underrepresented in relationship to minority populations. While minorities comprise approximately twenty-five percent of the U.S. population, minority firms represent only nine percent of U.S. businesses.

The U.S. Commission on Minority Business Development reports that from 1982 to 1987, minority businesses grew at an average annual rate of 10.4%, from 741,640 enterprises to 1,213,750. Gross revenue for minority enterprises increased at an average annual rate of 17.5% over that same period, from $34.8 billion to $77.8 billion, but still represented only four percent of total U.S. business revenue. Average gross receipts for minority businesses in 1987 were $64,132 (ranging from $42,610 for Native Americans to $93,222 for Asian Americans), or thirty-four percent of the $189,000 averaged by firms owned by White males.[4/] Minority businesses were nearly two and one-half times less likely to earn revenue of $1,000,000 or more than White male owned firms, and five times less likely to have 100 or more employees.[5/]

From 1960 to 1980, the industry distribution of minority firms increasingly shifted to resemble that of nonminority firms. During this twenty-year period, minority businesses diminished or stabilized their representation in competitive, slow growth sectors such as personal services (down 49% as a percentage of all minority firms) and retailing (no change);

3/ *"Firms" in this most recent available study of minority business include corporations, partnerships and sole proprietorships.*

4/ *Final Report of the United States Commission on Minority Business Development (1992) at 4 (Commission on Minority Business)*

5/ *Economics and Statistics Administration, Bureau of the Census, U.S. Department of Commerce, 1987 Economic Censuses, Characteristics of Business Owners Pub. No. CBO87-1 (1992) (Business Owners).*

grew moderately in slower growth sectors such as manufacturing (up 46%); and expanded more dramatically in growth sectors such as business services (up 175%), wholesaling (up 112%) and communications, transportation and utilities (up 54%).[6]

Strategic partnerships and government procurement have contributed to minority business diversification and growth. Participating in larger, more complex business sectors, maturing minority businesses have increasingly entered into strategic relationships with nonminority corporations. The Wall Street Journal reported that major U.S. companies purchased a total of $103 billion in goods and services from minority businesses in the twenty years spanning 1972 to 1991. Minority companies sold major corporations goods and services equalling $20 billion in 1991 alone, up thirty-three percent annually from $86 million in 1972.[7] The Federal government purchased an additional $9.1 billion in goods and services from minority businesses in 1990, up 10.9% annually from 1988.[8]

Collectively, minority businesses have grown larger in scale. They are also competing more frequently in skill intensive nontraditional industries, serving more nonminority markets, operating more often from central business and metropolitan suburban locations, investing greater amounts of capital, experiencing lower failure rates, and following more conventional growth and exit patterns than in the past.[9] As minority populations in the U.S. continue to grow and obtain greater access to educational, professional and managerial experience, the foundation for advancing minority business enterprise will strengthen.

Research suggests that the historic underrepresentation of minorities in business ownership is more attributable to lower minority business formation rates than to higher failure rates in comparison with nonminorities.[10] According to the Hudson Institute, minorities will constitute twenty-nine percent of all new entrants to the U.S. job markets between 1985 and 2000, and with women and immigrants, will comprise five-sixths of the

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6/ *Timothy Bates, Banking on Black Enterprise 28 (1993) (Banking on Black Enterprise).*

7/ *Udayan Gupta, Affirmative Buying, The Wall Street Journal, April 3, 1992, at R12 (Affirmative Buying).*

8/ *Commission on Minority Business, supra note 4, at 34.*

9/ *Banking on Black Enterprise, supra note 6, at 11.*

10/ *Richard L. Stevens, Frank A. Fratoe, Gavin M. Chen, Minority Business and Entrepreneurship, Small Business in the American Economy, U.S. Small Business Administration, Office of Advocacy (1988), at 167 (Minority Entrepreneurship).*

net additions to the workforce.[11] By increasing skills, expertise and income through greater representation in the national workforce, minorities should expect to increase their participation in self employment and business ownership.

MINORITY OWNERSHIP IN TELECOMMUNICATIONS

Given the low representation by minority companies involved in the ownership of telecommunications businesses, we attempted to evaluate their status by identifying and analyzing available listings of the largest of such companies. In this regard, Black Enterprise and Hispanic Business magazines annually list the nation's largest Black and Hispanic businesses.[12] From these lists, telecommunications companies were identified and analyzed as a benchmark in determining the status of minority firms in telecommunications. Table Four profiles Black Enterprise 100 (BE 100) companies operating in the telecommunications industries from 1992 through 1994.[13]

TABLE FOUR

TELECOMMUNICATIONS COMPANIES IN THE BLACK ENTERPRISE 100 1992 to 1994				
Year	Number of Companies	Total Employees	Average Years of Experience	Total Revenues($ millions)
1992	33	10,821	13.3	1,348.7
1993	29	10,076	14.8	1,361.6
1994	28	10,007	14.9	1,406.9

Source: Black Enterprise.

In 1993 and 1994, there were downward trends in the number of Black telecommunications companies in the BE 100. The number of employees at these companies also declined. From 1992 to 1993, four telecommunications firms dropped from the BE 100, reducing the number of telecommunications companies in the rankings from thirty-three to twenty-nine. Telecommunications revenue fell from seventeen percent to fifteen percent of total BE 100 revenue ($9.0 billion), and the number of telecommunications employees decreased by 745. In 1994, the number of telecommunications companies in the BE 100 dropped again by one from twenty-nine to twenty-eight. Telecommunications revenue remained at fifteen percent of total BE 100 revenue ($10.3 billion), and telecommunications employees decreased by sixty-nine. In dollar terms, BE 100 telecommunications company revenue increased three percent from $1.36 billion to $1.4 billion.

11/ *Hudson Institute, WORKFORCE 2000 89 (June 1987) (Workforce).*

12/ *Comparable sources for Asian and Native American businesses were not obtainable.*

13/ *To be included in the Black Enterprise 100 ("BE 100"), a company must have been fully operational in the previous calendar year, and at least fifty-one percent Black owned.*

Table Five profiles Hispanic owned telecommunications companies for 1992 through 1994, based upon Hispanic Business magazine's annual survey of the 500 largest Hispanic owned companies (HB 500).[14/] This more extensive profile captures companies that are smaller in size, and may illustrate the significance of smaller minority companies in the telecommunications industries.

TABLE FIVE

TELECOMMUNICATIONS COMPANIES IN THE HISPANIC BUSINESS 500 1992 to 1994				
Year	Number of Companies	Total Employees	Average Years of Experience	Total Revenues($ millions)
1992	36	4,642	11.7	471.3
1993	43	5,475	11.6	685.8
1994	51	7,128	13.8	963.6

Source: Hispanic Business.

In 1993 and 1994, there were dramatic upward trends relating to Hispanic telecommunications companies and the economic gains they generated. From 1992 to 1993, the number of Hispanic owned telecommunications companies increased from thirty-six to forty-three, or from 7.2% to 8.6% of the HB 500. Telecommunications revenue increased forty-six percent, with employment up eighteen percent. From 1993 to 1994, the HB 500 telecommunications companies grew to fifty-one, or 10.2% of the HB 500. Telecommunications revenue increased forty-one percent to nine percent of total HB 500 revenue ($11.0 billion), and telecommunications company employees increased by 1,653 positions or thirty percent.

Examining the impact of "smaller" HB 500 businesses (those not among the largest one hundred) revealed that they contributed much to the growth in Hispanic telecommunications companies, employees and revenues. In 1994, these smaller firms accounted for 28% of total Hispanic telecommunications companies on the HB 500 (up from 22% in 1992), 56% of total telecommunications employees in the HB 500 (up from 18% in 1992), and 43% of total telecommunications revenues in the HB 500 (up from 12% in 1992). Comparable data for smaller Black telecommunications companies, if such were available, may have revealed similar trends. Unfortunately comparable data for Asian American or Native American telecommunications companies was also unavailable.

Changing the frame of reference to the broadcast sector, however, statistics compiled by the U.S. Department of Commerce place minority broadcast ownership for Blacks at 193 commercial broadcast stations (1.7% of the total in the U.S.), for Hispanics at 120 (1.1% of the total), Asian Americans at 5 (.2% of the total) and Native Americans at 5 (.2% of the total).[15/]

14/ *To be included in the Hispanic Business 500, a company must be at least fifty-one percent U.S. Hispanic owned.*

15/ *MTDP, Analysis and Compilation by State of Minority-Owned Commercial Broadcast Stations (September 1994).*

Chapter Two

CAPITALIZING MINORITY ENTERPRISES

The significant issues concerning the problems of minority capital formation and investment in telecommunications that will be discussed in this section of the report include:

- Size and performance of minority businesses, generally, are diminished by a lack of capital. Small businesses, particularly, are most likely to survive if their owners receive access to investment capital. As a result, prospective owners who can attract institutional financing may be best positioned to launch viable ventures.

- Telecommunications ventures may require more capital than other small businesses, but consolidation in the telecommunications industry is stiffening barriers to entry for new entrants.

- Commercial banks, when accessible, have been the primary source of borrowing for minority businesses. For at least one form of institutional capital-- bank loans -- lender discrimination is a significant problem for Black entrepreneurs. Blacks, Hispanics and Asian Americans are less likely to receive venture capital for startup companies.

- To some extent, difficulties in accessing bank loans or venture capital are mitigated if a minority entrepreneur is highly educated, can invest a substantial amount of personal equity capital and has significant management experience.

- Managerial experience, owner equity, seller financing, internal growth, minority tax certificates, SBA 8(A) certifications and strategic partnering have aided minority firms in securing financing, participation and growth in telecommunications.

- In broadcasting, institutional capital sources have relied on minority owner characteristics (such as levels of education or experience) to signal creditworthiness, independent of whether the subject broadcast property was new or unprofitable. Prospective owners with less attractive track records relied more on the track record of the station acquired.

LACK OF CAPITAL ACCESS FOR MINORITY ENTREPRENEURS

Access to capital is a major barrier for minority companies. A Kessler Exchange survey reports nearly seventy percent of minority small business owners must use personal capital to finance a business, as compared with roughly half of all white entrepreneurs.[16]

16/ *Rhonda Reynolds, Small Businesses Get Shortchanged, Black Enterprise, November 1993, at 28 (Shortchanged).*

A 1992 Roper organization poll reported that ninety-two percent of its 500 Black entrepreneurs found raising capital a serious problem, and that seventy-five percent of that group said Black business owners become so discouraged by unfavorable experiences that many cease trying to raise capital.[17]

Traditionally, minority businesses suffer from both a lack of debt and equity capital. Dr. Timothy Bates of Wayne State University showed that size and performance of minority businesses are diminished by a lack of capital. Bates found that financial capital of Black firms averaged only thirty-eight percent of that in nonminority firms when neither group borrowed. When borrowing, Black firms had on average forty-nine percent of the equity of nonminority firms, and secured only $0.89 in borrowing per dollar of equity capital invested, compared to $1.79 for nonminority firms. At start-up, the disparities were more dramatic, with Black firms beginning with forty-four percent of the equity, forty-one percent of the debt and forty-three percent of the total capital of nonminority firms.[18]

Reinforcing Bates' analysis, 1987 census data revealed that businesses owned by White males were:

- four times more likely than Black or Hispanic businesses to secure $1,000,000 or more to start or acquire a business,
- three to six times more likely to secure $100,00 to $1,000,000, and two to three times more likely to secure $50,000 to $100,000
- two to three times more likely to receive financial assistance from a former owner to acquire a business;
- sixty-eight to eighty-four percent more likely to obtain commercial bank credit cards to capitalize their business;
- twice as likely to receive equity capital from partners and investors.[19]

These capital disparities between minority and nonminority firms are attributed in part to a lack of wealth creation and intergenerational wealth accumulation by minority communities. As Bates put it:

> White households (in 1967) 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...

17/ *Eugene Carlson, Turned Down, The Wall Street Journal, February 19, 1993, at R5 (Turned Down).*

18/ *Banking on Black Enterprise, supra note 6, at 49-50.*

19/ *Business Owners, supra note 5.*

> 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. While only 8.6 percent of White households had zero or negative net worth, 31 percent of Black households held absolutely no wealth whatsoever...
>
> Lacking assets - and therefore lacking borrowing capacities - Black entrepreneurs remain ill-equipped to cope with economic adversities or to exploit economic opportunities.[20]

Bates argues that capital constraints for minority businesses present clear implications for their participation in the high technology, capital intensive telecommunications industries:

> What kinds of industries are minorities most likely to be shut out of by capital constraints? Capital intensive ones, of course... Their representation in communications is so low that I could not even generate meaningful summary statistics on minority underrepresentation... Minorities generally, and African-Americans specifically are largely shut out by financial capital barriers, which force them to favor self-employment in less capital intensive service industries.[21]

TRADITIONAL SOURCES OF CAPITAL FOR MINORITY ENTERPRISES

COMMERCIAL BANKS: Commercial banks, when accessible, have been the main source of borrowing for minority businesses. Black entrepreneurs borrow nearly three times more from banks than from other sources.[22] In the 1992 Roper poll, seventy-three percent of the survey's 500 Black-owned businesses that succeeded in obtaining capital did so from banks.[23]

U. S. SMALL BUSINESS ADMINISTRATION (SBA): SBA backed funding, according to the Roper poll, ranked third (nine percent) behind commercial banks and private investors (fourteen percent) as a capital source for those who were surveyed and succeeded in

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20/ *Banking on Black Enterprise, supra note 6, at 44-5*

21/ *Timothy Bates, Testimony before United States House of Representatives Committee on Small Business (May 20, 1994) (Small Business Testimony).*

22/ *Banking on Black Enterprise, supra note 6, at 80.*

23/ *Turned Down, supra note 17, at R5.*

obtaining capital.[24] Less than one percent, however, of the Hispanic Business CEO's reported obtaining SBA loans in 1993.[25]

SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES ("SSBIC"): SSBICs are also an important capital source for minority businesses. SSBICs are independent, privately funded investment firms, certified by the Small Business Administration to provide financial assistance to small minority owned, or socially and economically disadvantaged businesses. However, SSBIC financing declined thirty-one percent from $150.4 million (1,495 transactions) in 1989, to $104.5 million (1066 transactions) in 1992.[26] Given the more than 1.2 million minority businesses in the United States and that twenty-five percent of the SSBIC transactions in 1992 involved existing investments,[27] it is evident the demand for minority venture capital far exceeds this supply.

VENTURE CAPITAL: In the startup phase, minority businesses have relied on creativity to survive. In the Roper poll, only one percent of the businesses surveyed who succeeded in obtaining capital did so from venture capital firms or from friends and family.[28] Bates finds "black business borrowers more often use sources of consumer credit -- smaller, generally more expensive loans -- while whites use business loans more frequently to finance small business creation."[29] A Kessler Exchange survey indicates "(m)inorities may seek alternative sources of business financing, with 9% courting outside investors or venture capitalists. When all else fails, entrepreneurs eventually go home to ask for cash from family and friends."[30] Hispanic Business' 500 CEO's listed their own savings as their primary source of startup capital (fifty-six percent, up from forty-nine percent in 1993), followed by bank loans (twenty percent), personal loans (seventeen percent), venture capital (four percent) and private placements (three percent.)[31]

24/ *Turned Down, supra note 17, at R5.*

25/ *Hispanic Business, How Did These Entrepreneurs Fund Their Business Growth, June 1993, at 86.*

26/ *U.S. Small Business Administration, SBIC Program Statistical Package (March 1993) (SBIC Statistics).*

27/ *SBIC Statistics, supra note 29.*

28/ *Turned Down, supra note 17, at R5.*

29/ *Small Business Testimony, supra note 21, at 6.*

30/ *Rhonda Reynolds, Small Businesses Get Shortchanged, Black Enterprise, November 1993, at 28.*

31/ *Hispanic Business, Start-Up Financing, June 1994, at 58.*

Recent research indicates that a small business is most likely to survive if its owner receives substantial amounts of investment capital.[32] However, as startup capital requirements increase, fewer potential business owners can finance an acquisition solely with personal wealth or capital from friends, family, and acquaintances. As a result, prospective owners who can attract institutional sources of financing (such as bank loans or venture capital) are best positioned to launch viable ventures.

BARRIERS TO CAPITALIZATION

Many factors appear to affect whether an applicant receives a bank loan to start a business, or whether a budding entrepreneur receives funds from a venture capitalist. This section explores some research on factors, including discrimination, which impact capital investment decisions.

Generally, investors need assurance that a potential borrower has the acumen to create a business that will provide a return on their investment. Of course, investors cannot perfectly differentiate good credit risks from bad, and must rely on signals provided by the potential borrower. Such signals include: the borrower's previous business experience, level of educational attainment, the extent to which the borrower is willing to risk his or her own wealth in the venture, and the location of the proposed venture. Although it is important to know what factors will affect capital investment decisions, such knowledge alone will not predict who is most likely to attract institutional financing without also knowing how investors weigh these factors.

BARRIERS TO BANK FINANCING: Recent quantitative research on small business financing has helped to disentangle the many factors affecting institutional investment decisions.[33] Representative of this work is Bates' analysis of the size of bank loans to

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32/ *Timothy Bates, Small Business Viability in the Urban Ghetto, 29 J. of Reg. Sci., at 625-643 (1990) (Business Viability).*

33/ *Researchers use linear multi-variate regression analysis to estimate a statistical relationship between a dependent variable and a variety of explanatory variables. Regression analysis permits simultaneous weighing of a variety of factors which affect a dependent variable. The technique finds the set of weights for the explanatory variables that best fits the observed variation in the dependent variable. For a more rigorous discussion of multi-variate regression, see, J. Johnston, Econometric Methods, Chapter 5, pp. 161-200. (NY: McGraw-Hill) (1984). (Econometric Methods). Multi-variate regression enables an analyst to sort out the effects of variables that directly measure credit risk such as experience, education, or personal wealth, from those that do not, such as race and gender. For example, to the extent that Blacks receive significantly smaller bank loans than non-Blacks after adequately controlling for credit risk, we see statistical evidence of discrimination.*

small businesses.[34] Bates' research explains the amount of debt capital used by commercial bank loan recipients entering business in the period 1976 to 1982.[35]

As shown in Appendix A, Table 1, Bates estimated separate regression models for Black owned and White owned businesses. For both White and Black businesses, he found statistically significant linkages between the amount of bank debt obtained and both:

(1) the amount of equity capital invested by the owner, and
(2) the owner's educational background.

In short, wealthier owners who attended at least four years of college typically received larger amounts of debt capital.

Black and White owners did, however, differ in some respects. For example, among White owners, those acquiring ongoing businesses typically received a significant increase in debt financing. For Blacks, the relationship was not statistically significant. Clearly, the most significant disparity between the two groups was found in the leverage obtained on equity capital. The equity capital coefficients indicated that banks provide White borrowers with $1.83 in debt capital for each dollar of equity capital they invest in their businesses. Black borrowers, by contrast, receive only $1.16 for each dollar of equity capital. Bates concluded that, "banks treat Black and White loan recipients differently, even when their qualifications do not differ."[36]

Bates' data indicates that, for at least one form of institutional capital -- bank loans -- lender discrimination is a significant problem for Black entrepreneurs. Faith Ando's 1988 study, sponsored by the U.S. Small Business Administration, is corroborated by Bates' later findings.[37] Ando found that loan approval was positively linked to the owner's business experience and credit rating, the firm's size, and the owner's request for loans of shorter maturity. Loan approvals were negatively related to the owner's having a previous bankruptcy, a divorce, or the firm's being in a declining industry (i.e., manufacturing). Using these explanatory variables to control for credit risk, Ando found that Black borrowers were less likely to receive loan approval.

BARRIERS TO VENTURE CAPITAL FINANCING: Bates and William Bradford also explored whether the findings of discrimination with respect to bank financing extended to a

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34/ *Banking on Black Enterprise, supra note 6, at 45-51, 125-34.*

35/ *The variables used in Bates' study are described in Appendix A.*

36/ *Banking on Black Enterprise, supra note 6, at 50.*

37/ *Faith Ando, An Analysis of Access to Bank Credit, (UCLA Center for Afro-American Studies 1988).*

less conventional form of institutional financing -- venture capital.[38] The authors employed a logistic regression[39] using a variety of variables which controlled for credit risk to explain whether or not an owner received venture capital. As shown in Appendix A,Table 2, these explanatory variables were largely the same as those Bates used in his study of bank financing with some additions -- a dummy variable representing whether the owner and his/her family were entirely self-employed, and another representing whether the owner sold primarily to a minority clientele. Also, rather than estimate separate models for minorities and nonminorities, Bates and Bradford estimated one model using dummy variables for the race or ethnicity of the owner (a variable for Blacks, another for Asian Americans, and a third for Hispanics) to test for discrimination.

The results tend to confirm Bates' bank financing results. Credit risk variables accounting for the owner's level of education and degree of experience were all positively related to the probability that an owner received venture capital. Of these variables, the coefficients on Management, Age, and Education were most significant, indicating that the most experienced, best educated owners in the sample were most likely to receive venture capital. In addition, those owners buying an ongoing concern were statistically more likely to receive venture capital.

The coefficients on the dummy variables for race and ethnicity indicate that, other factors being equal, minorities are less likely than nonminorities to receive venture capital. This result holds for all three groups -- Blacks, Hispanics and Asian Americans. The model indicates that, as with bank financing, and after controlling for credit risk, minorities are discriminated against in the venture capital market. Interestingly, the coefficients suggests that Asian Americans are least likely to receive venture capital, followed closely by Blacks, then Hispanics.

In summary, whether the question is access to bank financing or venture capital, Blacks appear to be at a disadvantage vis-a-vis Whites, even when controlling for credit risk. Both Asian Americans and Hispanics appear to suffer similar discrimination with respect to venture capital acquisition. To some extent, these difficulties are mitigated if a minority entrepreneur is highly educated, can invest a substantial amount of personal equity capital in his/her business, and has significant management experience. In short, minority entrepreneurs who signal that they are good credit risks still face lending discrimination, but are more likely to receive institutional capital.

38/ *Timothy Bates and William D. Bradford, Business Viability and Venture Capital Financing, J. Small Bus. Finance (1990) (Venture Capital).*

39/ *Logistic regression enables the researcher to estimate a probability that a given firm falls into one category or another (in this case, received venture capital (1) or did not (0)) based on a set of explanatory variables. The regression calculates weights (coefficients) for the explanatory variables that best explain the observed variation in the dependent dummy variable.*

CAPITALIZING MINORITY TELECOMMUNICATIONS COMPANIES

The research cited above underscores the real barriers that minorities face in accessing capital, as compared to their White business counterparts. This section looks more closely at the telecommunications industry and highlights the fact that, unlike retail and personal service businesses in which minorities have a relatively strong presence, many telecommunications (and other technology based) ventures typically require substantial start-up capital investment.

According to the Census Bureau's Characteristics of Business Owners (CBO), the average financing received by small businesses at inception ranged from $32,178 for businesses owned by White males, to $15,908 for Black owned businesses.[40/] By contrast, in a survey for this report of minority broadcasters, *all* of those owners who furnished data required capital in excess of the CBO averages to finance their acquisitions.[41/]

For this report, MTDP employed multiple approaches to gathering data on minority owned telecommunications companies and their capitalization. Three case studies were researched which examined minority owned telecommunications businesses and their capital development strategies. Simultaneously, input from a resource group of financial professionals, telecommunications entrepreneurs, government and community representatives was obtained to help formulate approaches to addressing the problems of minority capital access. Finally, a statistical study of minority broadcasters (the largest identifiable segment of minority owners in telecommunications), their capital requirements, and the factors that appear to affect the decisions of financial sources was undertaken.

CASE STUDIES

The following case studies illustrate how three different minority entrepreneurs successfully financed their telecommunications ventures using a variety of capitalization strategies. These ventures required significant startup financing -- in the form of equity capital ranging from $9,000 to $100,000 -- and in additional up-front investments ranging from $64,000 to $4,100,000. Common denominators among these entrepreneurs are that they all had experience in their fields and had been well educated. The case studies present examples of how minority telecommunications entrepreneurs have blended traditional and nontraditional financing to overcome financial barriers and develop their businesses.

40/ *In the CBO database a business is considered small if its owner filed one of the following types of income tax forms in 1982: (1) Schedule C, Form 1040 (sole proprietorships); (2) Form 1065 (owners of partnerships); or (3) Form 1120-S (owners of Subchapter S business corporations).* Business Owners, *supra note 5.*

41/ *The telephone survey was conducted by Quality Management International May 22 - June 2, 1994.*