# Minority Business Summit Report

**Thursday, December 8, 2005**

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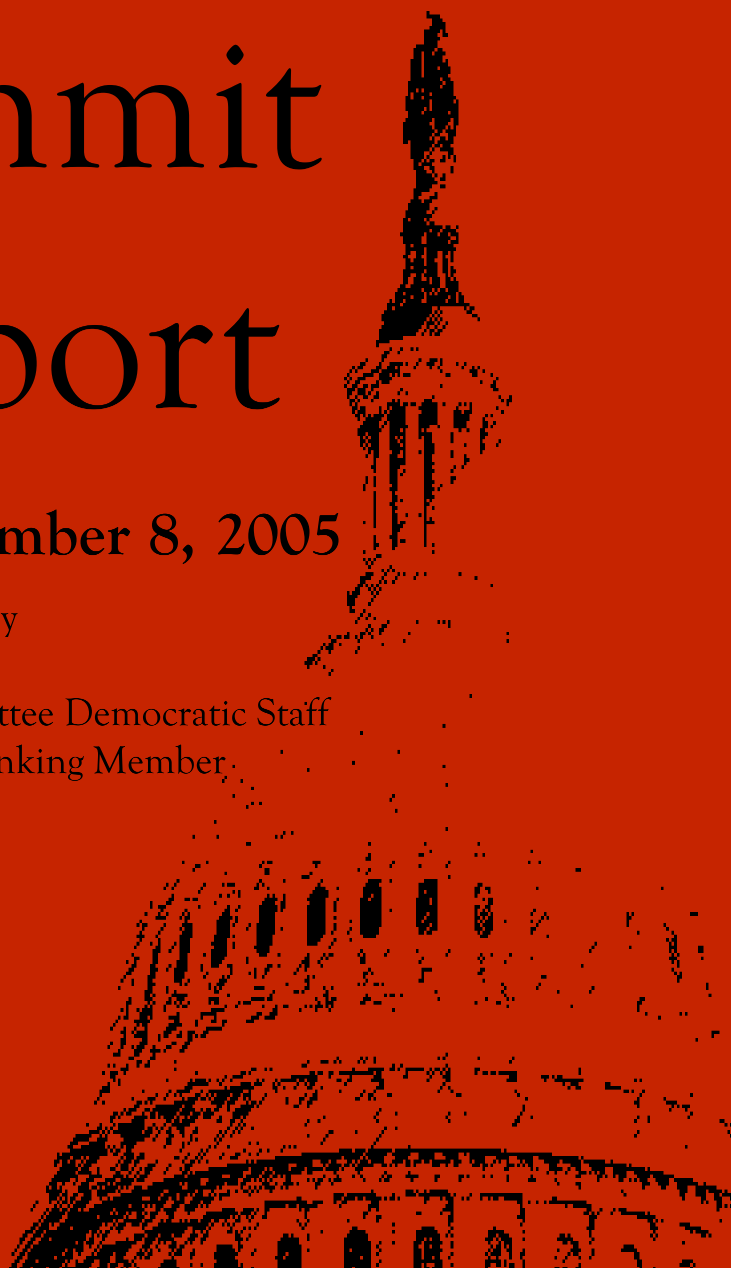

# Minority Business Summit 2005

In today's fast paced economy, minority businesses are steadily expanding their presence and are increasingly a driving force in the economy, playing a key role in job creation. Today, minorities own 4.1 million firms, generating nearly $700 billion in yearly revenue and employing over 7 million workers. Minorities across the country have embraced business ownership, and the path of entrepreneurship has allowed this sector to assert greater control over their financial future.

With minority entrepreneurs continuing to flourish in the United States it is important to take into consideration the unique challenges and barriers they face. To ensure Congress addresses these needs, Democrats on the House Small Business Committee have hosted an annual Minority Business Summit in conjunction with Minority Enterprise Development (MED) week. This event, held on Capitol Hill, provides an opportunity for minority entrepreneurs from all parts of the country and sectors of the economy, to engage, through various panels, in open discussions with Members of Congress about the most pressing issues facing their businesses today.

This was the fourth year for the summit, which reached record attendance with over 70 minority entrepreneurs, 45 of which were new participants. Minority businesses from across the nation were present, representing nearly 30 states from Hawaii to New Jersey. In addition, a number of business groups that work closely with Congress on behalf of minority entrepreneurs also participated. The summit attendees were from various fields and industries including retail, technology, manufacturing, construction and transportation.

The summit serves as an important vehicle to ensure the unique needs of minority entrepreneurs are taken into consideration, and that business owners are involved in the policy making process. While many business owners face the same types of challenges, minority entrepreneurs face their own set of barriers. In recognition of these unique circumstances, access to capital, venture capital, federal contracts, and the need for the modernization of the 8(a) program were among the issues discussed during the summit. Minorities continue to lag behind in receiving equitable treatment in the federal marketplace, and finding affordable and accessible capital, when compared to their mainstream counterparts.

With the vital role minority entrepreneurs play in today's economy – and the tremendous growth they are experiencing in business ownership – the event is a critical tool for allowing minority business owners to collaborate with policy makers on ways to overcome these obstacles. Past discussions have been crucial in facilitating the development of legislative solutions to address the unique needs of minority entrepreneurs – and will continue to serve the same role throughout the 109$^{th}$ Congress.

Despite their overwhelming growth, minority entrepreneurs face a myriad of challenges that hold them back from providing the economy with their maximum benefit. Minorities make up 30 percent of the U.S. population – yet, represent only 15 percent of all firms. The rate of minority business ownership has yet to keep pace with the fast growth of the minority population. Given these circumstances, the goal of the summit is to ensure changes are made that will allow minority business owners to start and expand their ventures.

With minority business ownership being a key component of the economy, forums such as the Minority Business Summit serve a unique role in helping the minority business community develop strategies for overcoming these challenges. Given their increasing importance, minority entrepreneurs continue forward as economic leaders in the United States. The success of this nation's economy will depend on the accomplishments of minority business owners for years to come.

## ACCESS TO CAPITAL – FINDINGS AND RECOMMENDATIONS

For minority-owned businesses access to affordable capital is essential. Whether it is start-up costs, expansion, purchasing or repairing equipment or even employee costs, there are always new expenses for minority entrepreneurs. Traditionally, minority-owned small businesses with fewer assets to pledge as collateral and uncertain earnings have had a more difficult time than larger businesses when it comes to securing necessary capital. Research has indicated that small businesses often fail because they lack sufficient access to capital at start-up or during key growth phases. That is why access to capital issues are so important to the survival of minority-owned small businesses.

Today minority entrepreneurs still face challenges in securing capital. In general, banks make smaller loans to minority firms than to non-minority owned firms, even when controlling for equity capitalization, owner education, race, age, and experience. Recent research suggests that African American and Hispanic-owned businesses are subject to a higher denial rate for loans than are non-minority entrepreneurs, even after controlling for differences between firms. In order for minority-owned small businesses to realize their full potential, these challenges must be overcome.

### FINDING #1 – MEET THE LENDING NEEDS OF MINORITY ENTREPRENEURS

Many minority-owned businesses providing goods and services to the domestic marketplace are privately held and, for the most part, family-owned. While operating in rapidly growing markets, these companies are often undercapitalized and lack the resources necessary to meet their fullest potential. The fast growth of minority business owners with proven track records represents an important pool of intellectual and entrepreneurial capital and, consequently, a source of investment opportunities.

Many minority entrepreneurs, however, still rely on self-financing – or that of friends and family – to start and grow their companies. It is the Small Business Administration (SBA) loan programs that step in to play an important role in filling the financing gap for minority-owned firms. Through public-private partnerships that share the lending risk, small businesses are able to tap into capital that is both affordable – and accessible. In these programs last year, $20 billion in capital, accounting for 40 percent of all long-term small business lending, was provided to this nation's entrepreneurs.

During the past five years, the SBA has made smaller and smaller loans to entrepreneurs, while the cost of operating a business has greatly increased. This has left minority-owned firms without sufficient resources to carryout their business plans. According to SBA's own data, the average 7(a) loan amount to a minority-owned small business declined from a high of nearly $290,000 in 2000, to just over $168,000 in 2005, a decline of more than 40 percent. In addition, racial disparities exist in SBA's portfolio. While the average overall loan size for a 7(a) loan is $157,000; the average for an African-American firm is only $80,000 and the average for a Hispanic firm is $123,000. Making this situation worse is SBA's decision to significantly scale back the Community Express program – a key initiative that encourages lending in minority communities. As a result of these developments, minority-owned small businesses must seek alternative, more costly sources of funds to make up for the shortfall not provided by the SBA.

**RECOMMENDATIONS:**

- SBA should adopt national minority-lending goals based on dollar volume for major access to capital programs, such as the 7(a) and 504 programs.
- To ensure that SBA is held accountable for its minority lending, require the SBA to formally report to Congress regarding its lending to minorities on a biannual basis.
- To continue channeling lending to minority communities, make permanent the Community Express program.
- To meet the needs of growing minority-owned businesses, increase the maximum loan size of 7(a) loans.

## FINDING #2 - ENSURE THAT SBA'S LOAN PROGRAMS ARE FULLY FUNDED

Without adequate funding, even SBA's flagship 7(a) loan program has difficulty achieving its mission. A lack of funding for the 7(a) program would leave minority-owned small businesses locked out of SBA's programs, which should be the most accessible and affordable. Recent developments in the 7(a) loan program have highlighted the need for increased support for this important lending initiative.

The fees and costs associated with the 7(a) program are becoming prohibitively expensive for both small business borrowers and lenders. For FY 2005, the full cost of the program was shifted to small businesses and their lenders through a series of fee increases. As a result, small businesses are being forced to pay substantial upfront fees to use the program – more than $2,000 for a small loan and nearly $16,000 for a mid-size loan. For smaller loans of less than $150,000, fees are doubled, which translates into nearly $1,500 more in upfront closing costs for entrepreneurs. For a loan of $700,000, this increase would raise the fees by approximately $3,000, and for larger loans this fee can approach $50,000.

Exacerbating these rising program costs has been the recent string of interest rate increases. Because interest rates for commercial loans are variable, rather than fixed, these higher interest rates are being passed onto business owners. As a result of these fee increases and the rising interest rate environment, many small businesses are unable to access the capital they need to hire new employees or expand their operations.

In addition, the administration continues to advocate eliminating the Microloan program, which plays an important role in enabling minority entrepreneurs, especially low-income entrepreneurs, to start and maintain a business. In 2004, the Microloan program provided $26.5 million in very small loans and $15 million in associated technical assistance – of which more than 50 percent went to minority entrepreneurs, providing them with more than $13 million in capital. Although the program has been a great success, the administration has proposed to eliminate the program – wrongly contending that very small loans are more widely available now than they were a decade ago when the SBA began the Microloan program.

**RECOMMENDATIONS:**

- To enable minority entrepreneurs to access the capital they need, funding for the 7(a) loan program must be restored;

- The Microloan should not be terminated and the program should be fully funded; and

- To make loans more affordable for minority-owned small businesses, the borrower fees associated with the 7(a) program must be lowered, while ensuring that sufficient lending volume is available.

## FINDING #3 – INCREASE SBA'S COMMITMENT TO MINORITY EQUITY CAPITAL FORMATION

Venture capital investment has been credited with aiding in the small business boom of the 1990's. This was especially critical in the high tech arena, dominated by entrepreneurs who went from the garage to Fortune 500 in a short period of time. While this has been a successful avenue for many small businesses, minority-owned businesses have, for the most part, been unable to tap into this lucrative form of financing. Current studies have shown that minority businesses get less than two percent of all venture capital.

Increasing access to this form of capital is critical for small businesses to move from a role in local economies to a more visible role in the national economy. SBA's Small Business Investment Company (SBIC) program was developed to address this issue. However, only a small fraction – less than 6 percent by dollar amount – of the SBIC financings find their way to minority-owned small businesses: 1.4 percent of the program's investment went to black-owned firms; 1.7 percent to Hispanic-owned firms; one-tenth of a percent to Native American-owned firms; 0.9 percent to Asian Pacific-owned firms; and 1.1 percent to Sub continental Asian-owned firms.

Even though the SBIC program has fallen short in serving minority businesses, the recent termination of a major component of the program - the participating securities program – will make it more difficult for minority-owned firms to access venture capital. In 2004, 11 percent of the number of SBIC program financings totaling $148 million went to minority-owned firms. An erosion of participating securities program, which is responsible for nearly half of the SBIC program's investment, will likely lead to further decline in the investment in minority-owned firms.

To complement the SBIC program, the New Markets Venture Capital (NMVC) program was created as the primary conduit for delivering equity investment to low-income areas. Under the NMVC program, SBA funds New Markets Venture Capital companies throughout the nation, requiring that each NMVC invest principally in small businesses located in low- and moderate-income areas. The businesses located in these areas are the ones that are the least attractive to traditional private investment, but need this type of investment the most. Since its enactment in 2001, the SBA has designated just six NMVCs. The SBA has repeatedly obstructed the program's development, including delaying its implementation, burdening program participants, and, ultimately, not requesting any funds for its operations. By not supporting this program, the SBA is undermining an initiative that could become a major source of equity financing for minority-owned businesses.

**<u>RECOMMENDATIONS:</u>**

- To expand the reach of the equity and venture capital industry to minority communities, open a dialogue between minority-owned businesses, the SBA, venture capital firms, and key regulators; and

- To ensure increased attention on equity investment for minority businesses, create an office of minority equity investment outreach within SBA's Investment Division.

- SBA should reopen the SBIC program, which would ensure that seed capital for startup firms remains available.

- SBA should draw more minority-owned firms into the SBIC program and increase the level of SBIC investment in minority communities, and;

- To reinvigorate the government's commitment to low-income communities and economic development, the NMVC program should be strengthened and broadened.

## FINDING #4 – SPUR THE DEVELOPMENT OF A MINORITY ANGEL INVESTMENT COMMUNITY

Institutional venture capital has been glamorized in the press and academic research as the primary source of outside equity finance. However, many studies estimate institutional venture capital contributes less than half of the total equity financing for new firms. The less well known, yet equally important, source of start-up capital is the informal venture capital market, known as angel investors and angel networks. The creation of minority angels and minority angel networks would enhance capital availability for many of our nation's minority-owned small businesses.

In general, angel investors are high net-worth individuals who invest in entrepreneurial companies, usually at an early stage. Like institutional venture capital firms, many angel investors provide cash to starting entrepreneurs and take equity in return. One difference is that angel investors typically invest smaller amounts of money in individual companies than venture capitalists do, making them a possible resource for minority-owned firms that have exhausted their "friends and family" financing options but are not ready to approach venture capital or equity investment firms for capital. Angels serve as a primary source for seed and early stage investing.

Over the years angel investing has become more prominent as a source for funding for the next generation of minority companies. Going forward, it is likely that angel investment will continue to grow, as high net worth individuals seek more opportunities to diversify their investments, as well as the hope for higher returns, community involvement, and social camaraderie. Public policies that encourage angel investment can further alleviate capital constraints that many minority-owned small firms face, in particular those in need of seed and start-up capital.

**Recommendations:**

- Introduce legislation that would create an Angel Investment program in the Small Business Administration, permitting angel networks to leverage their privately raised capital.

- Spur the development of minority angel networks throughout the country and establish incentives for individual investment in early stage companies.

- Create a national registry that would permit the business community to more readily access the angel community.

Even in this era of relatively low interest rates and widely available financing options, minority entrepreneurs still face several challenges in securing the capital they need. Until these challenges are overcome, minority-owned businesses will be unable to achieve their full potential, leaving a void in many communities. By implementing the recommendations contained in this report, minority firms will be better able to startup and grow, create new jobs, and contribute more to the U.S. economy.

### EXPANDING SMALL BUSINESS CONTRACTING OPPORTUNITIES AND MODERNIZING MINORITY BUSINESS PROGRAMS – FINDINGS AND RECOMMENDATIONS

The U.S. government, the largest buyer in the world – purchasing everything from food to road construction to aircraft – can offer an abundance of opportunity to small businesses. Having the federal government as a customer allows small firms to swiftly increase their profitability and growth. While the federal marketplace continues to grow at a rapid pace – this past year alone it increased by 3.4 percent to a total of approximately $295 billion – contracting opportunities for small businesses, particularly minority owned businesses, have not kept pace with the growth.

One of the main ways minority business owners are able to increase their presence and continue to grow is by doing business with the federal marketplace. Today, there is a five percent government-wide goal for contracting with minority-owned businesses; yet this goal has not been accomplished in over 15 years. In 2004, while the total dollar value of government contracts increased by three percent, the number of opportunities for minority entrepreneurs declined by nine percent – costing minority owned firms $3.5 billion in lost opportunity that could have resulted in jobs for 70,000 workers.

There are a myriad of challenges preventing minority business owners from receiving their fair share of the federal marketplace. In order to reverse these downward trends, there are a number of initiatives and policy changes that must be implemented to ensure minority entrepreneurs can access the marketplace.

## FINDING #1 – MINORITY BUSINESSES CONTINUE TO BE LOCKED OUT OF THE FEDERAL MARKETPLACE

The federal marketplace has grown by nearly 55 percent since 1999. A clear indicator of this remarkable growth is the Department of Defense (DOD) – the largest purchasing agency. Today DOD is a bigger buyer than the entire federal marketplace was just six years ago. Despite these increases, the small business goal achievement has not been accomplished for the past five years. Compounding the problem for minority entrepreneurs is the fact that the goal for minority business owners has not been achieved since its inception in 1988 – costing minority business owners billions of dollars in lost contracting opportunity.

One of the main issues arising today is that there is no penalty for an agency's failure to meet their minority-owned business contracting goals. The goals are set as minimum levels that the agencies can attain in order to ensure these businesses are receiving contracting opportunities. However, agencies know there are no ramifications if the goals are not met, resulting in over 15 years of lost opportunity for minority business owners.

Given the federal government's ongoing failure to meet the minority owned business contracting goal, the problem of counting large business contracts, as small, has become an issue in the federal marketplace. Often times, agencies have been found taking credit for contract awards to small businesses, when in reality they were awarded to large corporations. This practice accounted for $2 billion in miscoded contracts in 2002 alone, and remains a problem throughout federal agencies. The result of miscounting small business contracts is an inflated small business accomplishment, painting a false picture of where small firms stand within the federal marketplace.

Minority business owners continue to lose out on opportunities due to federal agencies' inability to meet the small business contracting goals, and the inaccurate tracking of contracts awarded. If changes are not made that hold federal agencies accountable for their failure to meet these goals, minority owned businesses will continue to lose out on billions of dollars in contracting opportunity.

### RECOMMENDATIONS:

- Penalties should be implemented for those agencies that fail to meet the statutory minimum contracting goals with minority business owners.

- Contracts awarded to small, and especially minority-owned companies, must be accurately reflected in national databases to ensure the participation of these companies are correctly accounted for.

## FINDING #2 – CONTRACT BUNDLING CONTINUES TO IMPEDE SMALL BUSINESSES FROM ACCESSING FEDERAL CONTRACTS

Federal agencies frequently consolidate contracts that small companies could perform into larger packages beyond the capacity of small businesses. These mega contracts, referred to as "bundled contracts," often force out small firms because of the size and overall scope. This practice offers no proven savings to the government, and no benefits to taxpayers. Bundled contracts are one of the biggest obstacles facing small businesses today – and is a major contributing factor in the declining number of contracts being awarded to minority owned businesses. For every increase in 100 bundled contracts, there is a decrease of 60 contracts to small business.

While bundled contracts are becoming increasingly common, small companies lack any type of reciprocity in the process. As it stands today, entrepreneurs that lose work as a result of the consolidation have little right to appeal or object to the agency's business practices. In such instances, the SBA is supposed to be an advocate; however, its efforts have fallen short. This is in large part due to the agency's failure to provide adequate resources to monitor the true extent of the bundling problem. When contracts are bundled, the agency promoting the bundled contract is the final decision maker on whether or not the contract will move forward. This lessens the likelihood that the small businesses' perspectives will be represented, and ultimately decreases the chance that small firms will be able to repeal the bundled contract.

In order to ensure bundled contracts are not preventing small businesses from accessing federal contracts, SBA should intervene, and maximize their role as a watchdog for small firms. However, the agency lacks a review system to monitor bundled contracts. In addition, there is a shortage of personnel and management dedicated to assisting small businesses in accessing the federal marketplace, and in repealing contract bundles.

Bundled contracts have taken away a significant amount of contracting opportunity from small businesses, particularly minority owned firms. If bundled contracts are not more closely monitored, and ultimately broken up into more manageable sizes, minority entrepreneurs will be blocked from doing business with the federal government.

**RECOMMENDATIONS:**

- The SBA must be more proactive in challenging these contracts and ensuring they are broken into smaller pieces, and that small businesses are not being adversely impacted.

- Small companies should be given the ability to appeal an agency decision that consolidates their contracts into mega contracts to a non-biased third party.

- There should be penalties for the agencies that bundle contracts and then subsequently fail to achieve their small business contracting goals.
- Adequate resources need to be allotted to the SBA to ensure they are able to effectively assist small businesses in receiving contracts, and increase small firm participation in the federal marketplace.

**FINDING #3 – ENHANCE SUBCONTRACTING OPPORTUNITIES AND PROTECTIONS FOR MINORITY-OWNED COMPANIES**

As minority entrepreneurs find themselves pushed out of the federal marketplace in a prime contractor capacity, more emphasis must be placed on ensuring these companies are able to participate as subcontractors. While small businesses may not receive as many of the same benefits as they do from working on prime contracts, subcontracts also provide an opportunity for small businesses to increase profitability and growth. However, there are currently few protections in place for small firms working on a subcontract, which makes it a risky endeavor for many entrepreneurs.

Subcontractors often find themselves in a precarious position, not only when seeking an opportunity to be included in a project, but also when it comes to receiving a payment. More often than not, subcontractors only play a role in helping the prime contractor to actually attain the contract – and they never end up seeing the work in the end. There are no enforcements in place that require prime contractors to actually give the work to the subcontractor once the contract has been awarded. Often times, subcontractors find that the work has been hired out to either another entity, or that the prime has taken the job on itself.

There is also concern that when a job is contracted out to a small business from a prime, the firm infrequently receives prompt payments. While legislation exists to pay subcontractors quickly, there are a number of loopholes that enable prime contractors to either withhold substantive amounts or to bypass the rules altogether.

Subcontracting provides small businesses with experience and opportunity, and serves as a stepping stone toward work on prime contracts. However, protections need to be put in place to ensure small businesses receive timely payments, and are guaranteed a set amount of work.

**<u>RECOMMENDATIONS</u>:**

- Prime contractors should be required to contract out a certain percentage of the total dollar of the work to small business subcontractors.
- Agencies should be responsible for ensuring that prime contractors pay their subcontractors in a timely manner without exception.
- Prime contractors must be held responsible for ensuring that when a commitment is made to the subcontractor used in the application process, those subcontractors are guaranteed to receive a portion of the work in the final contract.

**<u>FINDING #4 – MODERNIZE THE 8(A) PROGRAM</u>**

The primary way minority entrepreneurs enter the federal marketplace is through the 8(a) program, which was created in the late 1960s to provide business development to promote the competitive viability of minority-owned companies. The program, administered by the SBA, has been allowed to deteriorate with no legislative updates for nearly 20 years, and as a result has reduced opportunity for the program's participants. From 2003 to 2004, contract dollars to 8(a) companies declined by nearly $2 billion. Clearly, there is a need to modernize this initiative in order to expand the access of minority-owned companies to the federal marketplace.

This neglect has left participants at a competitive disadvantage in regard to receiving contracts. In order to truly excel and increase competition, minority-owned businesses need to receive technical assistance prior to receiving their first contract. A large number of minority entrepreneurs utilize the 8(a) program; however, there needs to be more flexibility in the types and sizes of contracts that are offered to participants. In its present form, the 8(a) program ultimately limits the success of it's' participants, rather than enhance their ability to access contracts in the federal marketplace. This must be changed.

Often times, after small firms graduate from the 8(a) program they are not immediately suited for competition outside of the program, and are unable to reap the benefits provided by the initiative. As the program is structured today, there is no transition period out of the program to allow participants time to truly adjust. Upon graduation, a company should be receiving post graduation assistance to ease their transition into the competitive federal marketplace.

The 8(a) program is a vital tool in increasing access to the federal marketplace for minority business owners. However, in order for the initiative to reach its fullest potential, the program must be modernized to best prepare minority entrepreneurs for doing business with the federal government.

## RECOMMENDATIONS:

- To promote business development, formalized training and technical assistance should be provided to prepare 8(a) companies for program participation before they receive their first contract.

- The 8(a) program needs to have equity with other small business programs to ensure minority business owners are receiving the same opportunities.

- The minimize size of the contract 8(a) companies are eligible to receive should be increased

- A post graduation transitional phase should be utilized in the 8(a) program to ensure participants are able to competitively bid on federal contracts.

## CONCLUSION

With the phenomenal growth of minority business owners in the United States, it has become clear that their needs cannot be overlooked. Minority entrepreneurs have increasingly played a critical role in spurring job creation and economic development over the past few years; however, they continue to face challenges. From accessing capital to breaking into the federal marketplace, barriers continue to impede minority entrepreneurs from further expanding their enterprises.

The discussion and dialogue that took place at this year's Minority Business Summit brought to light several of these very critical issues for minority entrepreneurs. While minority business owners continue to face obstacles in their ability to obtain capital, it is clear there are solutions that can address these needs. Legislation should be put in to place that will spur investment in minority owned firms and ensure SBA is accountable for minority lending.

A critical vehicle in ensuring minority owned firms receive capital is by guaranteeing vital lending programs are fully funded and in place. Time and time again, the administration has proposed to cut funding or eliminate these critical loan programs. However, these are all initiatives that play a significant role in ensuring minority firms have the tools they need to be successful in their business ventures. Not only is it important that lending programs are fully funded, but there also needs to be avenues for minority entrepreneurs to secure venture capital. In order to accomplish this, a greater commitment is needed at all levels in focusing greater venture capital investment in low income and minority communities.

One of the main issues coming out of this year's Minority Business Summit was the ongoing challenges minority entrepreneurs face in their ability to access the federal marketplace. Despite the continual setbacks this sector faces, there are clear steps that can be taken to reverse these trends. Congress needs to make increasing opportunities for minority owned businesses a top priority.

A major setback for minority firms trying to do business with the federal government is the fact that one of the main vehicles that enables minority entrepreneurs to enter the federal marketplace, the 8(a) program, has not been updated in nearly two decades. Minority entrepreneurs rely heavily on the 8(a) business development program, which aims to assist minority business owners in accessing the federal marketplace. The outdated components of the program have resulted in declined competitiveness. In order to increase participation in the federal marketplace for the minority businesses that use the 8(a) program, legislative improvements need to be put in place to modernize the program, and refocus it on business development to help minority entrepreneurs make their way in the federal marketplace.

The challenging state facing minority businesses today did not achieve this heightened level overnight, and the solutions that will rectify many of these shortcomings will take time. For minority entrepreneurs to reach their fullest potential, it is necessary that changes are made sooner rather than later that will foster the growth of minority business owners. If not, these ongoing barriers will only continue to dampen the ability of minority entrepreneurs to access capital, and break into the federal marketplace.

The discussion that took place at the 2005 Minority Business Summit is critical in ensuring the needs of minority businesses are taken into consideration in the development of these initiatives in 109th Congress – and for years to come. Implementing solutions to reverse these negative trends will ensure minority entrepreneurs are able to create jobs, spur economic development, and continue forward as leaders among the next generation of business owners in the U.S. economy.