U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF ADVOCACY
REGULATION • RESEARCH • OUTREACH

Research Summary

Minority-Owned Employer Businesses and their Credit Market Experiences in 2017

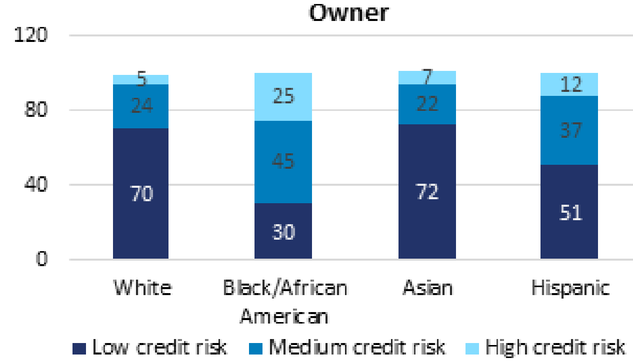
By Alicia Robb, Robb Consulting, Longmont, CO. 58 pages.
Under contract number 73351018P0090.

July 2020 No. 451

While minorities make up 40 percent of the U.S. population, they currently own only about 20 percent of employer businesses in the U.S. In terms of sales, payroll, and employment, their shares are much lower. Limited access to capital still disproportionately affects minority-owned businesses, especially those owned by Blacks and Hispanics. Understanding the dynamics and participation of these businesses in the credit market has become increasingly important. Using data from the Federal Reserve's 2017 Small Business Credit Survey, this study examines the landscape of minority-owned employer businesses and their experiences in the credit market in 2017.

The data provides demographic information on firm performance, firm age, financial patterns, outcomes, and challenges for minority and nonminority businesses. While important factors such as wealth levels are not included in the data, credit risk is included, which is an essential component of credit applications. Chart 1 shows White-owned businesses and Asian-owned businesses are more than twice as likely as Black-owned businesses and almost 50 percent more likely than Hispanic-owned businesses to be in the lowest risk category. Black and Hispanic-owned businesses are more likely to be in the high credit risk category compared with White-owned businesses.

Chart 1: Credit Risk by Race/ethnicity of Owner



Source: 2017 SBCS.

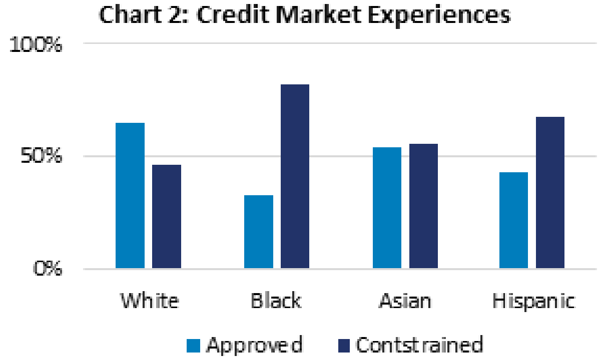
Key Findings

Differences in financial challenges among demographic groups are partly due to differences in credit risk. However, after controlling for credit risk and other factors, important gaps in credit outcomes remain. This study finds differences in credit market experiences among demographic groups, and that minority-owned businesses continue to face greater challenges accessing financial capital and are more likely to be financially constrained when compared to their non-minority counterparts.

- Credit market experiences vary by ownership demographic. Experiences applying for credit, such as whether business applicants were approved or denied, are different across owner demographic groups and statistically significant, especially for Black-owned firms and Hispanic-owned firms. While Black and Hispanic businesses apply for funding at the same rates, their outcomes differed when compared to White businesses. Minority-owned businesses are more likely to have been denied credit and are less likely to receive the full requested amount.

- Loan approval rates differ for young firms and minority firms. The study confirms prior findings that differences in loan approval rates exist for minority businesses. A similar pattern existed for young minority businesses. Even after controlling for other variables, minority-owned businesses were less likely to have some or all their loan application funding approved, compared with businesses owned by Whites (Chart 2). While Asian and Hispanic-owned firms tend to receive more funding as they get older, this finding persists for Black-owned businesses operating for over a decade.
- Minority firms received less funding than requested. Businesses owned by Blacks, Asians, and Hispanics were all less likely than those owned by Whites to receive most or all of the funding requested. Businesses owned by Blacks and Hispanics were more likely than businesses owned by Whites to have their loan applications rejected.

Chart 2: Credit Market Experiences



Source: Authors calcuations of 2017 SBCS.

Policy Implications

The author suggests a few policy recommendations to help improve lending outcomes for minority firms.

- **Improve minority-owned business credit scores.** Financial literacy training, wealth building, and better access to affordable credit options could all improve credit scores for minority firms. Affordable credit options could also improve the bottom lines of these companies, which would boost profitability.
- **Support lenders already reaching minority business borrowers.** While Blacks and Hispanics are more reliant than Whites on lenders such as community development financial institutions (CDFIs) and credit unions, they use them at far lower rates than conventional banks. CDFIs and credit unions should be encouraged to more deeply engage with these borrowers. Additionally, lenders that successfully reach minority firms should be encouraged to expand their services to these businesses.
- **More creative thinking around new programs and the need for financial innovation.** For instance, banks could partner with CDFIs so they can better match borrowers with lenders that have missions to lend to them.
- **Encourage large banks to lend to minority-owned businesses.** Given that large banks are the most common source of financial capital to small businesses, policymakers could consider ways to encourage large banks to lend to minority-owned businesses. There could be special Community Reinvestment Act credits or tax incentives for increased lending to minority-owned businesses and rewards for the top performers of all banks, regardless of size.

Scope and Methodology

This research uses microdata from the 2017 Small Business Credit Survey (SBCS), a one-year snapshot of financing activity. The SBCS had the participation of all 12 banks in the Federal Reserve System, with samples drawn from all 50 states and the District of Columbia. This SBCS is an employer firm survey, which asks respondents about their companies and their credit market experiences over the prior 12-month period. The SBCS provides owner demographic and firm characteristic information, including firm age.

Limitations to the data are: the data are a cross section of firms at one point in time, so they are not examined longitudinally; factors such as wealth, work experience, and previous entrepreneurial experience may be influencing outcomes but are not available in the dataset and cannot be controlled for in this analysis; and the data is a convenience sample of establishments, not a randomized sample. However, the SBCS does employ weights to reflect the full population of small businesses in the United States.

The businesses in the SBCS were classified by the race, gender, or ethnicity of the owner(s) defined by the "owner(s) with more than 50% controlling interest is (are) of that race, ethnicity, or gender." Descriptive and multivariate analyses are used to examine the data while controlling for owner and firm characteristics such as firm age, firm revenue, industry, credit risk, geographic location, firm size, profitability, and gender of owner. The credit market experiences examined are whether owners were approved, denied, discouraged from applying, and financially constrained. Four main groups are compared: Non-Hispanic Whites, Non-Hispanic Blacks, Non-Hispanic Asians, and Hispanics (of all races).

This report was peer reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the Director of Economic Research at advocacy@sba.gov or (202) 205-6533.

READ THE FULL REPORT ONLINE

This report is available on the Office of Advocacy's webpage at **https://advocacy.sba.gov**. To stay informed of Advocacy's research, visit **https://advocacy.sba.gov/subscribe.** By selecting the Small Business Regulation & Research category, you can choose to receive email notices of Advocacy research, regulatory communications, or The Small Business Advocate newsletter.