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Issue Brief

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Access to Capital for Women- and Minority-owned Businesses: Revisiting Key Variables

By Christine Kymn

At A Glance

Small business owners often struggle to find available credit. Empirical evidence indicates this struggle may be compounded for women and minority business owners, yet it is unclear as to what the explanation may be. Greater clarity may arise from a closer inspection of previously noted key variables, such as credit indicators, personal wealth, and social capital. Further, an overview of the available data may help to clarify both data limitations and opportunities for additional data collection.

Introduction

Small business owners contribute significantly to the U.S. economy, and women and minority business owners represent an important segment of these owners. Recent survey data indicate the percent of women business owners remains fairly stable at 36.0 percent in 2012, as compared to 35.9 percent in 2007.[1] Meanwhile, survey data indicate the relative share of minority business owners among respondents recently increased somewhat to 14.6 percent in 2012 from 11.5 percent in 2007.[2]

Despite their growing economic significance, women- and minority-owned firms tend to be smaller and less profitable; and they carry lower survival rates than their male or non-minority counterparts. One part of the puzzle of these disparate outcomes rests with available credit. Multiple studies have identified several variables significant to disparate credit outcomes for women and minority business owners. Delving further into these variables may provide both researchers and policymakers with additional insights.

Disproportionate Credit Outcomes

Minority small business owners are disproportionately denied credit when they apply for it even after controlling for other variables such as business credit scores, personal wealth, and revenues.[3] These findings hold true particularly for black and Hispanic business owners. Evidence is mixed on disproportionate credit denials to

1. U.S. Small Business Administration, Office of Advocacy. January 16, 2014. Demographic Characteristics of Business Owners, Issue Brief Number 2. *Available at* **www.sba.gov/sites/default/files/Issue%20Brief%202,%20Business%20Owner%20Demographics.pdf**. Hereinafter "Issue Brief 2."
2. *Id.*
3. See, e.g., Cole, R. 2014. Credit Scores and Credit Market Outcomes: Evidence from the SSBF and KFS. *Available at* **www.sba.gov/advocacy/7540/791501**. Hereinafter "Cole 2014"; Asiedu, E., Freeman, J., Nti-Addae, A. 2012. Access to Credit by Small Businesses: How Relevant Are Race Ethnicity, and Gender? *American Economic Review* 102, 532-537.

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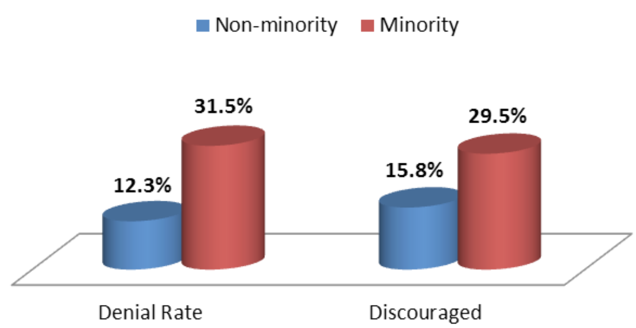
non-minority women small business owners and may vary based on data and year specifications.[4] Regarding fear of denial, prior studies have found that both minority and women small business owners feel disproportionately discouraged from applying for credit relative to their non-minority and male counterparts.[5] Figure 1 summarizes minority and non-minority loan denial and discouragement rates. In addition, U.S. Census data indicate women are less likely to start or acquire firms with business loans from banks or financial institutions (5.5 percent of women owners versus 11.4 percent of male owners).[6]

Figure 1. Loan Denials and Discouraged Applicants
U.S. Census Bureau, Survey of Small Business Finances , 2003
U.S. Department of Commerce,
Minority Business Development Agency



Credit Indicators

In empirical models, the appropriate designation of credit indicators can impact their relative significance as well as other demographic variables such as race or gender. If relevant variables are omitted or improperly approximated, results may not reflect the true population. The lack of transparency surrounding credit score derivations further complicates the appropriate designation of credit indicators. Generally, available personal credit history data contain self-reported indicators from small business owners rather than from financial institutions.

Prior credit access studies have found small business credit scores significantly impact credit outcomes to small business owners. Regarding the question of whether these credit scores are used in a discrimantory manner, a recent study finds no evidence of disparate application of credit scores to women or minority business owners.[7] Other findings indicate the credit market may also weigh consumer credit scores and other personal credit indicators in making loan decisions. Studies have shown that self-reported credit history indicators such as bankruptcy rates and personal delinquencies have impacted the relative importance of business credit scores in loan outcomes.[8]

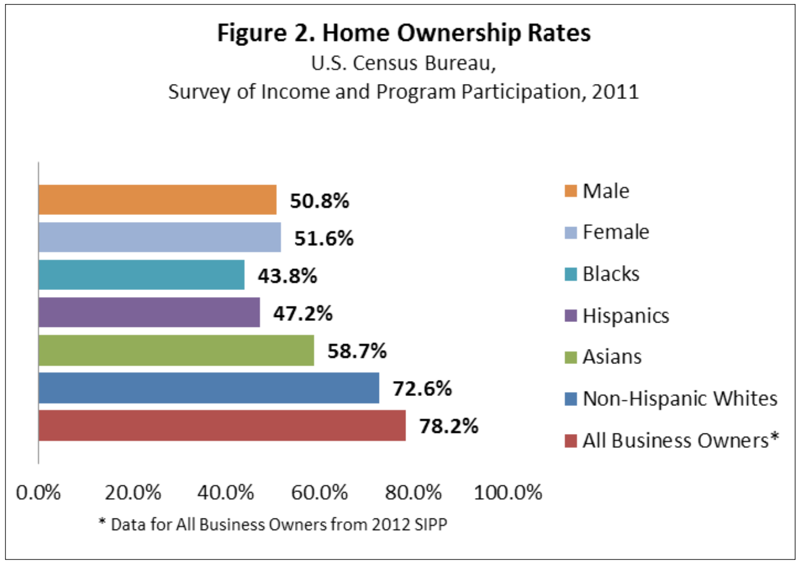
Personal Wealth

Previous research identifies personal wealth, particularly home ownership, as very significant to small business owners' financial health. Homes can provide collateral, and home equity can serve as a relatively low-cost

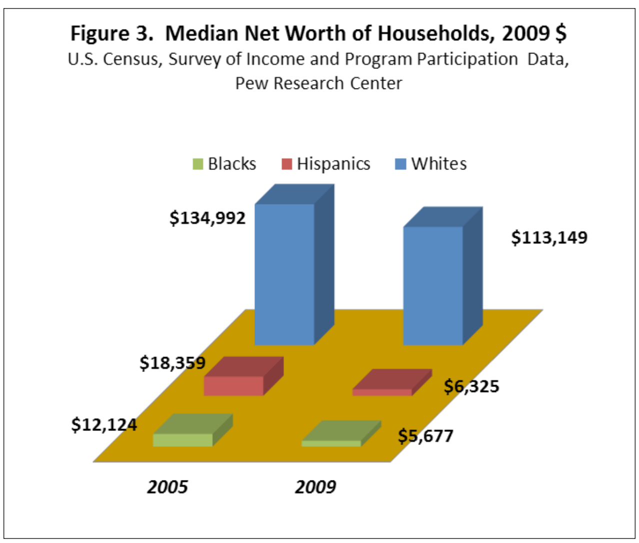
4. *Id.* See also, Robb, A. 2013. Access to Capital Among Young Firms, Minority-Owned Firms, Women-Owned Firms, and High-Tech Firms. *Available at* **www.sba.gov/advocacy/7540/584931**.
5. *Id.* See also, U.S. Department of Commerce, Minority Business Development Agency 2010. Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs. *Available at* **www.mbda.gov/node/483**. Hereinafter "MBDA."
6. U.S. Small Business Administration, Office of Advocacy. 2012. Gender Differences in Startup Financing. *Available at* **www.sba.gov/sites/default/files/files/Gender%20Differences%20in%20Startup%20Financings.pdf**.
7. Cole 2014.
8. See, e.g., Cavaluzzo K. and Wolken J. 2005. Small Business Loan Turndowns, Personal Wealth, and Discrimination. *Journal of Business* 78 (6), 2153-2177. Hereinafter "Calavuzzo & Wolken 2005."

financing alternative.[9] Figure 2 illustrates U.S. home ownership rates across race, ethnicity, gender, and business owner status. Still, perspective proves important in framing the relative impact of home ownership. Home ownership may provide an important catalyst to small business growth, but it may also serve as a barrier to entry for prospective entrepreneurs.

For instance, business growth can bridge the wealth gap between minorities and non-minorities and across gender.[10] Among existing businesses, home ownership significantly decreases the probability of loan denials and so can be critical to such growth.[11]



Existing business owners are more likely to be homeowners relative to the general U.S. population. U.S. Census data indicate 78.2 percent of business owners owned homes in 2012.[12] Minority business owners echo this relatively higher rate of homeownership relative to their population counterparts. Less recent data from the Survey of Small Business Finances indicates minority business owners in general own homes at a rate much closer to the overall average and to non-Hispanic whites.[13]



However, absence of home ownership may also serve as a barrier to entry for prospective women and minority entrepreneurs, since home ownership rates vary significantly across these groups. Further, previous studies have found that differences in asset levels explain differences in business creation rates between minorities and non-minorities more than other explanatory variables (see Figure 3).[14] This finding is particularly true for black and Hispanic business owners.

Social Capital

Social capital represents the relationships and networks a business owner may access for professional contacts, financing, mentorship, or customers. Though

9. MBDA, pp. 17-18.
10. MBDA, p. 8 (citing to Bradford, W. 2003. The Wealth Dynamics of Entrepreneurship for Black and White Families in the U.S., *Review of Income and Wealth* 49, 89-116).
11. Calavuzzo & Wolken 2005.
12. Issue Brief 2. The U.S. Census Bureau, Survey of Income and Program Participation (SIPP) asks respondents to self-identify whether they are business owners. The SIPP does provide further detail on type or form of business owned.
13. Calavuzzo & Wolken 2005.
14. *Id.*

social capital has been identified as an important factor to establishing and building a business, it can be empirically difficult to measure. Previous research has identified several variables that might serve as proxies for social capital. Smaller surveys expressly track networking variables such as business or academic mentorship, while others attempt to measure community cohesion. On a broader scale, empirical results regarding relationship lending, business location, and industry sector choices may indirectly highlight social capital issues relevant to women and minority business owners.

Relationship Lending

Recent studies find that firm-lender relationships positively influence both the decision to apply for a loan and the outcome.[15] Small businesses with longer lender relationships prove less likely to be credit constrained. Black and Hispanic business owners have reported relatively shorter relationships with their primary financial institutions relative to non-minority owners.[16]

Neighborhood or Community

Generally, business owners tend to locate in metropolitan areas, but a closer inspection at the community or neighborhood level may signal relative differences in social capital across groups. In 2012, 79.4 percent of business owners were located in metropolitan areas.[17] U.S. Census and Kauffman Firm Survey (KFS) data reveal that most minority-owned businesses are located in minority neighborhoods while only a small percentage of minority-owned businesses operate in non-minority neighborhoods.[18] Entrepreneurship has been found to be relatively more enhanced among white, native-born, and long-term community members when compared to minority, immigrant, and recent-entrant community members.[19] Further, minority ownership was found to be less relevant to loan approval outcomes in minority neighborhoods but was a strong predictor of loan denial for minority-owned businesses located in urban areas outside minority communities.[20]

Industry Sectors

Women and minority owners may also have limited opportunities to enter profitable industry sectors. For example, African-American entrepreneurs may have less opportunity to penetrate profitable construction sector networks.[21] Further, women- and minority-owned businesses tend to concentrate in lower revenue sectors such as retail and personal services. These choices may reflect owner preferences or social capital constraints. Recent studies attempt to reach the sector choice and social capital question by focusing on determinants of female entrepreneurship in high-growth fields such as engineering.

Data Limitations

It is noteworthy that in addition to qualitative insights, opportunities remain for more representative data collections. The currently available data may favor certain subgroups of business owners, such as the Kaufman Firm Survey's young, innovative firms or the Federal Reserve Survey of Small Business Finances' (SSBF) more established businesses. Opportunities for more timely, periodic, or granular data also exist. For example, the U.S. Census Survey of Income and Program Participation provides current and time series data; but it does not collect detailed business ownership and financial data at the level of the SSBF, which ceased collection in 2003. In addition, smaller representation of minority firms among samples of small business owners can often

15. See, e.g., Cole 2014.
16. Cavalluzzo & Wolken 2005.
17. Issue Brief 2.
18. Bates T. and Robb A. 2013. An Analysis of Small-Business Viability in Urban Minority Communities. *Urban Studies Journal, Forthcoming*.
19. Kwon, et al. 2013. Community Social Capital and Entrepreneurship. *American Sociological Review* 78(6), 980-1008.
20. Bates T. and Robb A. 2013. Loan Availability among Small Businesses Operating in Urban Minority Communities. Conference paper, Federal Reserve System Community Development Research Conference, April 11, 2013.
21. *Id.*

reduce or eliminate the explanatory power of empirical results for specific races and ethnicities. Finally, the difficult task of empirically capturing the diverse spectrum of prospective entrepreneurs remains open to discussion of appropriate proxy and collection.

Conclusions

Multiple studies find disproportionate loan denials to minority business owners and disproportionately discouraged prospective applicants among women and minority business owners, despite controls for metrics of financial health. These results raise two important questions. First, do the results signal some form of systematic discrimination against women and/or minority business owners? Second, do previous models or available data fail to capture some other factor(s) significant to loan denial outcomes? The answers to these questions are not mutually exclusive but do merit further inquiry, which may begin with a closer examination of other established relevant factors such as credit indicators, personal wealth, and social capital, which are raised in this issue brief. However, data limitations require that careful framing of assumptions and caveats accompany empirical results.