



Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms

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This study examines racial and ethnic differences in financing patterns, access to capital, and credit market experiences among U.S. employer firms.¹ Using data from the U.S. Census Bureau's 2014 Annual Survey of Entrepreneurs (ASE), this report sheds light on the ongoing financing challenges facing minority entrepreneurs nearly a decade after the financial crisis. In particular, it highlights differences in financing amounts, financing sources, attempted funding relationships, avoidance of financing, and the impact of financing on firm profitability and closure across ethnic and racial demographics. This report was prepared for the Office of Advocacy by Alicia Robb, Ph.D., under contract number SBAHQ-16-M-0175.

Key Findings

Disparities in business ownership by race and ethnicity

The Census data analyzed in this report indicate that Hispanic and Black Americans² are underrepresented in business ownership compared with their shares of the gen-

eral population. Despite representing 17.6 and 13.2 percent of the U.S. population, Hispanics and African Americans own only 5.8 and 2.1 percent of employer businesses, respectively. In contrast, Whites and Asians are overrepresented in business ownership. While Whites make up 61.6 percent of the U.S. population, they own 86 percent of employer firms. Asians make up 5.6 percent of the U.S. population but own nearly 10 percent of U.S. employer firms.³

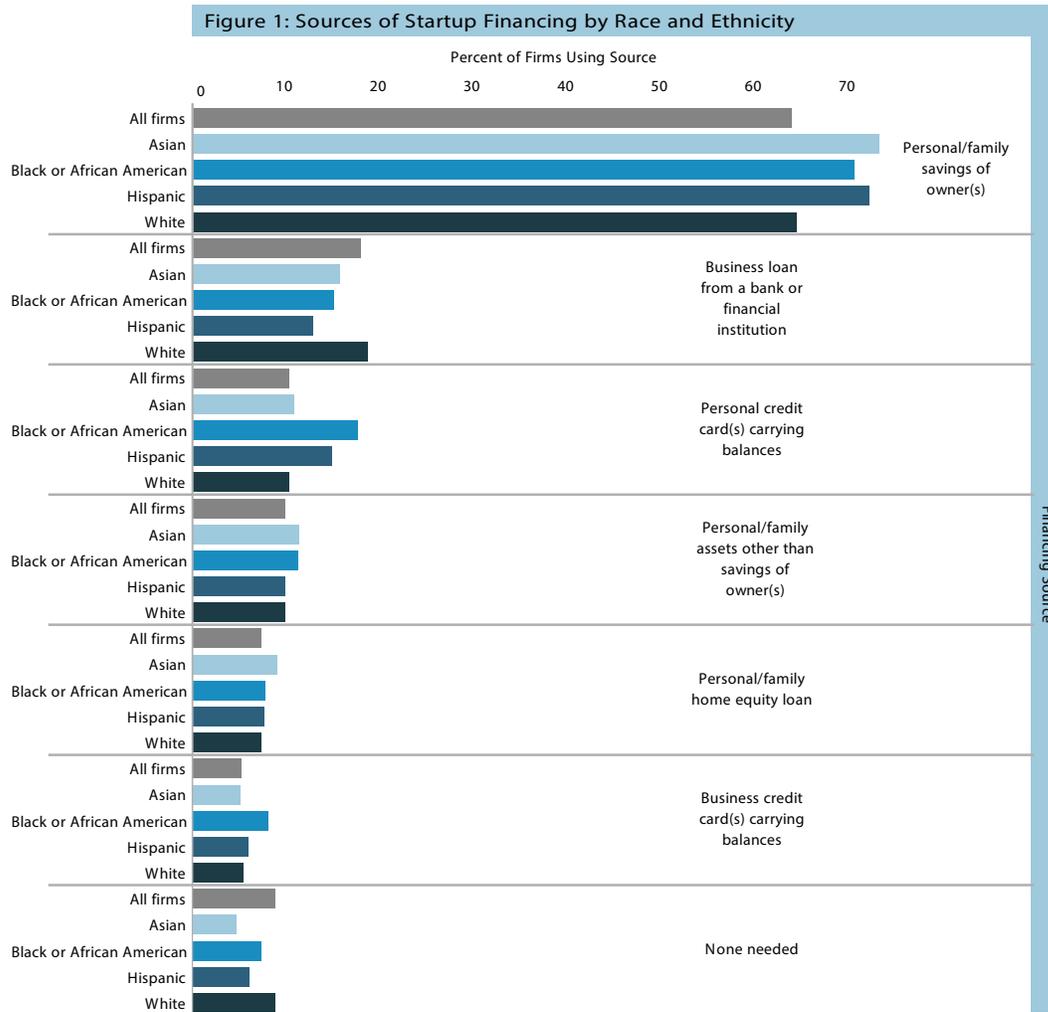
Sources and amounts of startup capital

The ASE asks business owners to identify the source and amount of capital used to start or acquire their business. As shown in **Figure 1**, the owner's personal or family savings was the most commonly relied upon source of startup capital, with 73 percent of Asians, 72 percent of Hispanics, 70 percent of Blacks or African Americans, and 65 percent of Whites relying on this source. The next most common source of startup financing came from business loans made by banks, credit unions, or other financial institutions, with 18 percent of all respondents stating that they used this source of capital. While nearly 19 percent of White business owners started their business with a business loan from a bank or other financial institution, only 15.2 percent of Black or African American business owners and 12.9 percent of Hispanic business owners relied on this source of financing. Importantly, Black and Hispanic business owners were more likely to rely on personal credit cards carrying balanc-

1. This report relied on data from the Census Bureau's 2014 Annual Survey of Entrepreneurs. The 2014 ASE provided the most recent data available when this contracted report was being prepared.

2. This research summary and associated paper rely on the Census Bureau's race and ethnicity categories to describe demographic trends. Because the Census Bureau lists "Black or African American" as one classification, "Black" and "African American" are used both together and interchangeably in this paper. See <https://www.census.gov/quickfacts/fact/note/US/RHI425216> for more information.

3. Alicia Robb, *Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms*, SBA Office of Advocacy, 2017, p. 8.



Source: Alicia Robb, "Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms", p. 15, Table 2 (using data from ASE Table SE1400CSCB07).

es, a more expensive financing option than a traditional bank loan, than other groups. The data indicate that nearly 18 percent of Black or African American business owners and nearly 15 percent of Hispanic business owners relied on personal credit cards, compared to 10.3 percent of all firms.⁴

This study also identified striking differences across racial and ethnic groups with respect to the amount of capital used by entrepreneurs to start their businesses. As shown in **Figure 2**, Black and Hispanic business owners reported starting their businesses with less capital than their White and Asian counterparts. While 14.9 percent of all firms reported using less than \$5,000 to start or acquire their business, 19 percent of Black or African American business owners and 16 percent of Hispanic business owners reported startup financing of less than \$5,000.⁵

4. *Id.*, p. 15.

5. *Id.*, p. 19.

New funding relationships and unmet credit needs

The ASE data show that minority business owners, particularly Blacks or African Americans and Hispanics, were more likely than other groups to attempt to establish new funding relationships in 2014. They were also most likely to report unmet credit needs. Among all firms, the most commonly pursued new funding relationship was with banks, credit unions, and other financial institutions (13.1 percent of all firms). Notably, 17.8 percent of Black or African American business owners and 14.6 percent of Hispanic business owners attempted to establish a new

Figure 2: Amounts of Startup Financing by Race and Ethnicity

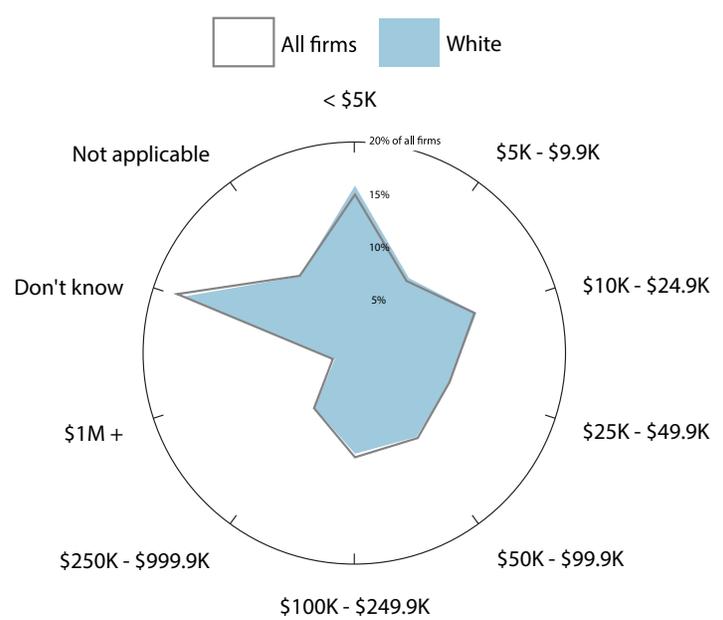
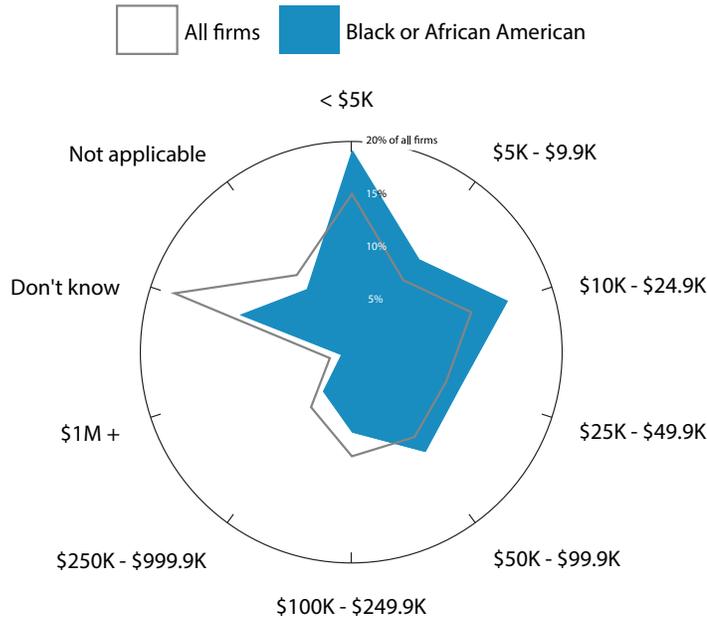
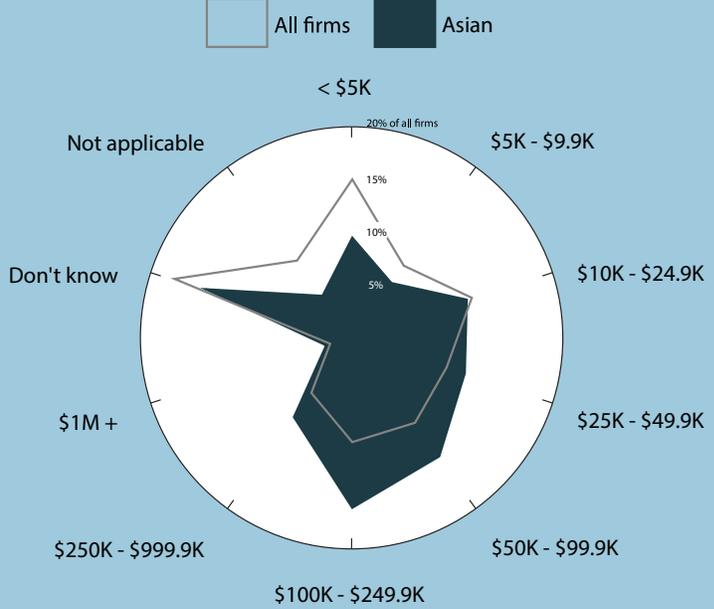
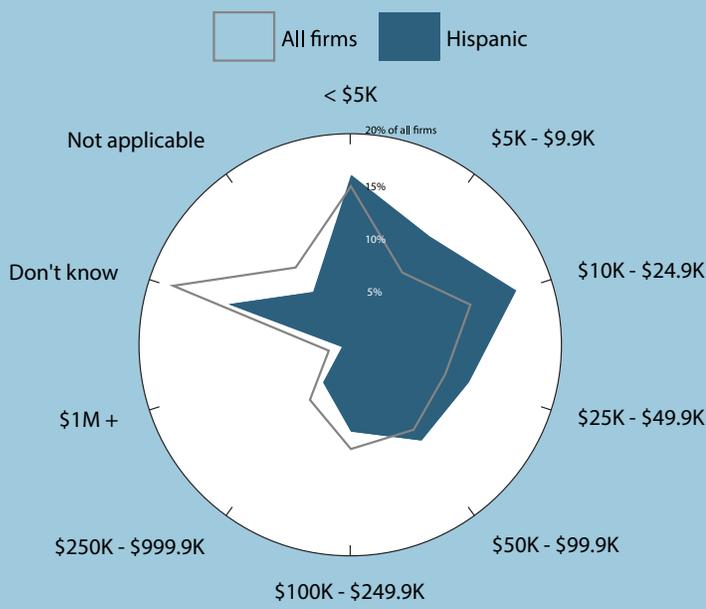
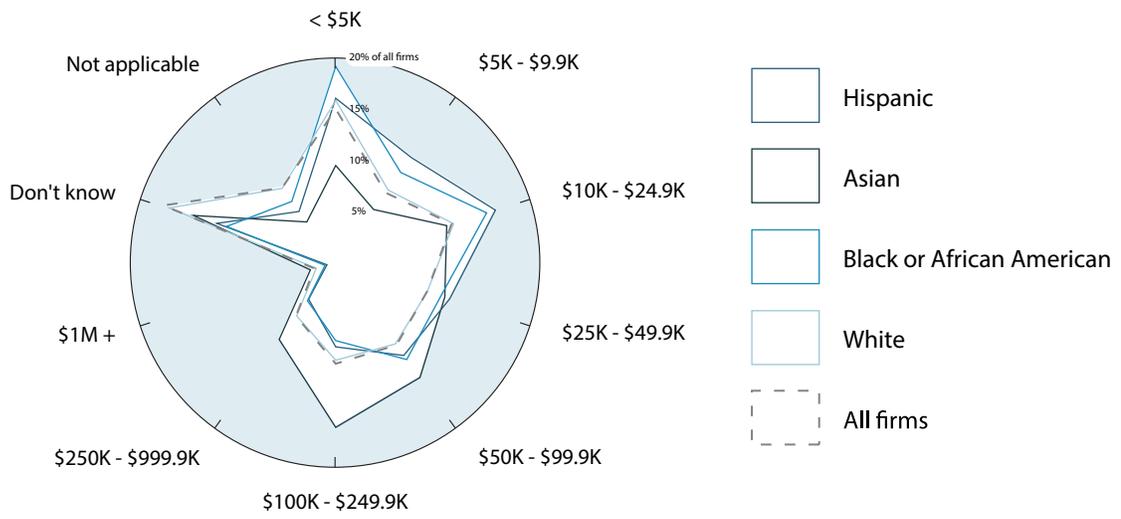
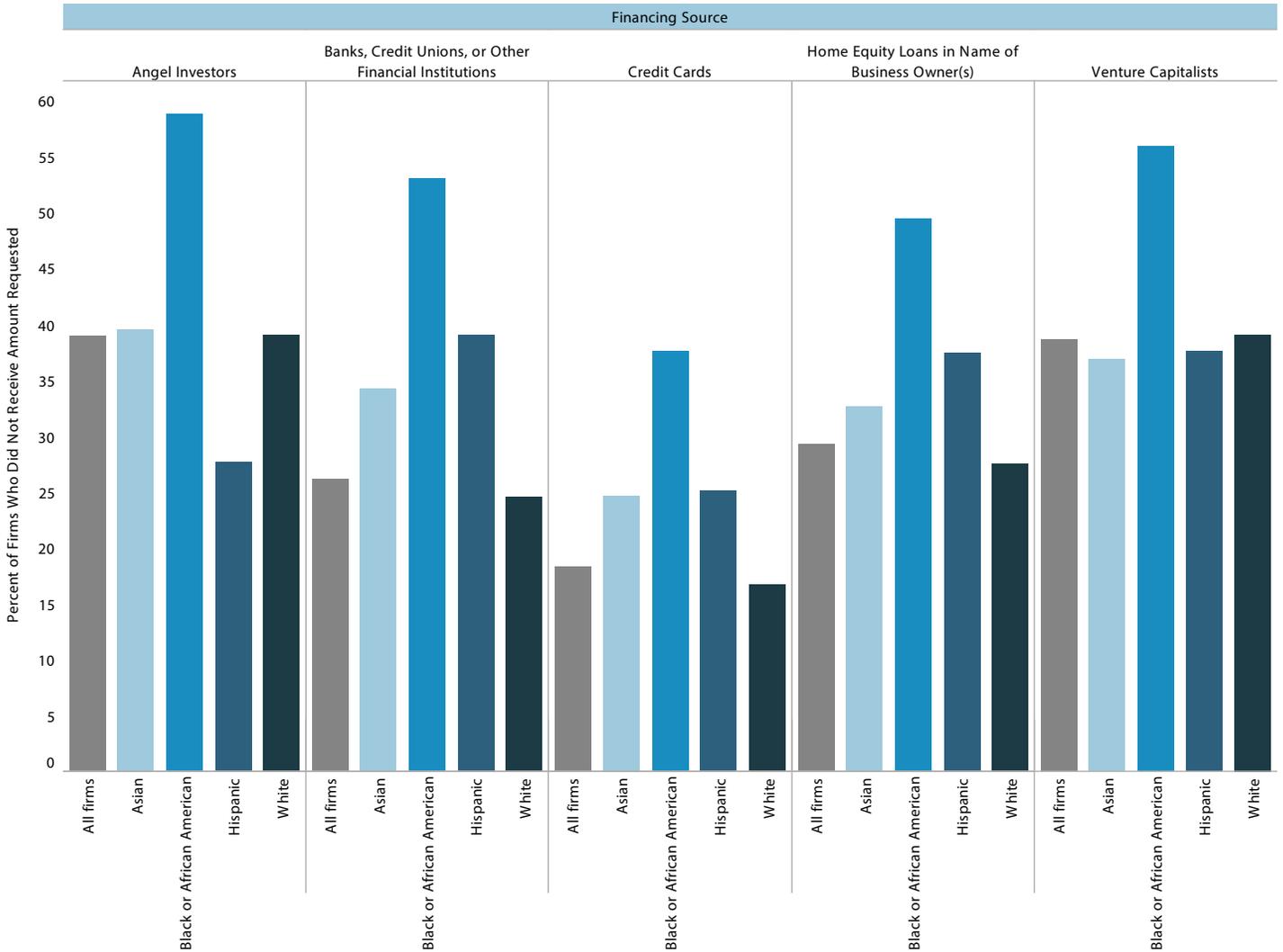


Figure 3: Unmet Credit Needs
Percent of firms who established new funding relationships but did not receive amount of funding requested



Sources for Figures 2 and 3:

Figure 2: Alicia Robb, "Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms", p. 19, Table 4 (using data from ASE Table SE1400CSCB08).

Figure 3: Alicia Robb, "Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms", p. 27, Table 9 (using data from ASE Table SE1400CSCB10).

relationship with a bank, compared to 13.2 percent of Whites and 12.2 percent of Asians. While 10.5 percent of all firms attempted to secure a credit card as a new source of funding, 15.8 percent of both Black and Hispanic business owners pursued this funding source (compared to 13 percent of Asians and just over 10 percent of Whites).⁶

In addition to being more likely to seek out multiple new funding sources in 2014, Blacks or African Americans and Hispanics were also more likely to demonstrate unmet credit needs than other groups (based on the percent of firms who established new funding relationships but did not receive the full amount of capital sought). As shown in **Figure 3**, African Americans were most likely to report unmet credit needs across every financing category. Most notably, 53 percent of Black or African American business owners reported not receiving the full amount requested from banks and other financial institutions, compared to 24.5 percent of White business owners.⁷

6. *Id.*, p. 25.

7. *Id.*, p. 27.

Avoidance of financing and reasons why

This study also examined the extent to which business owners chose not to apply for financing despite needing additional funds at some point in 2014. Among all firms, 9.6 percent of business owners indicated that they needed additional funds but chose not to apply.⁸ However, responses to this question varied dramatically by race and ethnicity, with about 26 percent of Black or African American business owners and 15 percent of Hispanic business owners saying they did not apply for financing despite needing the funds. Only 9.4 percent of Whites and 9.8 percent of Asians responded affirmatively to this question. Among Blacks or African Americans who chose not to apply for financing despite needing it, nearly 60 percent said they didn't apply because they didn't think they would be approved by the lender. Among all firms who didn't apply for financing despite needing it, the most common reason cited was not wanting to accrue debt (63 percent of firms). This was fairly consistent across all demographic groups. 64 percent of Whites, 59 percent of Asians, 56 percent of Blacks or African Americans, and 56 percent of Hispanics cited an aversion to debt as a reason for not applying.⁹

Impact of access to and cost of capital on firm profitability

The ASE data also shed light on which challenges entrepreneurs perceive as negatively impacting their firms' profitability. Among all firms, the most commonly cited sources of negative impact were taxes (48.8 percent of firms), followed by unpredictability of business conditions (43.9 percent of firms), and slow business or lost sales (43.8 percent of firms). While 11.3 percent of all firms cited the cost of financial capital as having a negative impact on firm profitability, 22.6 percent of Black or African American owned firms cited this as a source of negative impact. The disparities were even greater with respect to access to financial capital. 28.4 percent of Blacks and 17.5 percent of Hispanics said access to financial capital was a source of negative impact on their firms' profitability. Only 10.1 percent of

Whites and 13.9 percent of Asians cited access to capital as having a negative impact.¹⁰

Data, Methods, and Limitations

As noted above, this report relied on data from the U.S. Census Bureau's 2014 Annual Survey of Entrepreneurs (ASE), which was released to the public in limited form in September 2016. Covering more than 200,000 U.S. employer firms, this survey provides unprecedented detail about financing patterns and credit market experiences by both firm owner demographics (such as gender, race, and ethnicity), and firm characteristics (such as firm age and industry). Because the public use microdata were not available while this report was being developed, the contractor relied on the detailed tabular output released by the Census Bureau in advance of the full microdata. As a result of limited data availability, this report is descriptive in nature and causal inferences cannot be drawn with any statistical certainty. The full microdata will need to be analyzed to draw statistically significant conclusions about the highlighted differences in financing patterns and credit market experiences across demographic groups.¹¹

Discussion

Small businesses are an engine for job creation, innovation, and economic growth in the United States. In order to ensure their continued success and contributions to the U.S. economy, it is crucial to understand trends in small business finance and the specific challenges facing entrepreneurs of different races and ethnicities in terms of access to capital, credit market experiences, and financing patterns. The academic literature on these topics has consistently documented variations in financing and credit market experiences among different racial and ethnic groups, and this report, although descriptive in nature, appears to support previous findings. Specifically, it suggests that Black and Hispanic business owners are experiencing unique challenges in terms of wealth accumulation, access to capi-

8. *If business owners responded "yes" to the survey question about whether they needed additional funding but chose not to apply, they were then asked a follow up question about the reasons why. Respondents were instructed to select all reasons that applied from a list of nine options.*

9. *Id.*, p. 35.

10. *Id.*, p. 43.

11. *Id.*, p. 12.

tal from various sources, the cost of capital secured, and difficulties obtaining the full amount of funding sought. This report also sheds light on the real consequences of these obstacles, such as a decrease in firm profitability and even potential firm closure due to a lack of sufficient financial resources. While White and Asian business owners appear to be faring better in many respects, this report shows that they are not immune to credit and financing challenges.

This study yields powerful insights into the state of small business finance for different groups of entrepreneurs, as well as policy implications for ensuring that all credit-worthy firms have sufficient access to capital. In particular, it underscores the importance of equal access to credit and nondiscriminatory lending practices. For example, nearly 60 percent of Black or African American business owners and 53 percent of Hispanic business owners who indicated they chose not to apply for financing despite needing the funds said they did so because they did not think their business would be approved by the lender, compared to 47 percent of White business owners and 44 percent of Asian business owners. This suggests that there are still challenges to be overcome regarding both credit supply and perception of credit supply among minority entrepreneurs. Future research in this space may focus on trends in capital access for minority entrepreneurs over time, differences in unmet credit needs across funding sources, and the role of alternative finance and online lenders in expanding the credit supply to minority-owned small businesses.

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