U.S. SMALL BUSINESS ADMINISTRATION
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Research Summary

African-American Entrepreneurs: Contributions and Challenges

By Xopolis LLC., Reston, Va. 154 pages.
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African-Americans are underrepresented among self-employed workers. When African-Americans own firms, they are less likely to have employees. African-American firms also operate with less financing and African-American owners are more likely to have become discouraged enough to forgo applying for loans when they need them. Using a collection of large government datasets, this study builds on previous literature to explore long term trends in African-American entrepreneurship. The study provides in-depth analysis of racial gaps in business characteristics, financing patterns, and innovative behavior.

Despite the challenges they face, African-American owned businesses are strong contributers to job creation and innovation. The analysis controls for firm and owner characteristics to determine the main reasons for gaps in financing. Additionally, the research investigates how African-American firms compare to White-owned firms on issues such as innovation and the makeup of ownership.

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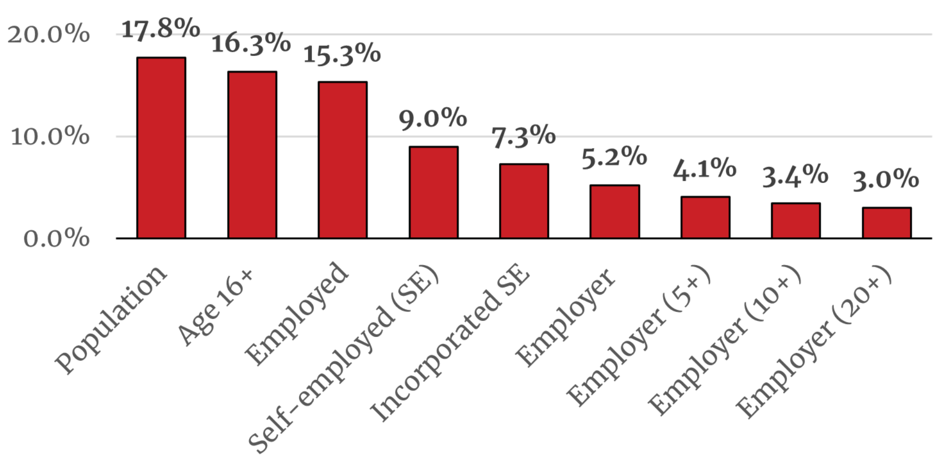
Figure 1: Share of African-Americans in the Population, Employment, and as Employers by Employment Size



This document is a summary of the report identified above, developed under contract for the Small Business Administration, Office of Advocacy. As stated in the report, the final conclusions of the full report do not necessarily reflect the views of the Office of Advocacy. This summary may contain additional information, analysis, and policy recommendations from the Office of Advocacy.

Key Findings

As Figure 1 shows, African-Americans are underrepresented as business owners. The gap gets larger as the venture size increases. After controlling for factors like firm age, firm industry, the local economy the firm resides in, and owner education, financing is at the center of the shortfall.

- While relationships between race, education, and self-employment shifted over time, there is a clear connection between having more education and being self-employed.
- The African-American self-employment rate in 2018 (6 percent) was half that of the White rate (12 percent). From 1970 to 2018, the self-employment and education gap for African-Americans has barely converged.
- There are many variables where African-American and White-owned firms are similar. Key differences, such as African-American firms skewing younger or having a differing industry distribution, can lead to differing firm performance. African-American firms lean towards health care while White firms lean towards construction, manufacturing, and wholesale and retail trade.
- 34 percent of African-American owners of firms with employees have advanced degrees, compared to 23 percent of White owners. But 32 percent of White owners have prior business experience, compared to only 27 percent of African-Americans.
- African-Americans are less likely to be members of multi-owner teams when owning a firm with employees. African-American businesses have two to four owners 29 percent of the time versus 38 percent for Whites. Whites are also nearly twice as likely to own firms with more than 4 owners.
- The role of African-American firms with various measures of innovation is mixed. African-American-owned firms are more active in both product and process innovation activities but they are less likely to introduce a completely new product to market.
- African-American firms do not do as well under the current financing system. African-Americans have less financing at start-up, and a relative lack and size of bank loans later in the firm life cycle. As a result, African-Americans are more likely to use personal assets and credit cards to fund their small business (75 and 20 percent, respectively vs. 68 and 12 percent for White-led firms). Only 15 percent of African-Americans have bank loans versus 19 percent for White-led ventures.
- 15 percent of African-American entrepreneurs report that they did not apply for credit because they expected to be rejected, compared to 4 percent of White entrepreneurs. African-American entrepreneurs report that their profitability was negatively affected by problems in accessing finance.
- African-American-owned firms are more likely than White-owned firms to receive SBA loans but, on average, they receive smaller loans. It is unclear if smaller loan size is from African-American firms being discouraged into asking for lower amounts or if banks are reducing original requests before approving the loans.
- The Community Reinvestment Act results in a 3 to 6 percent increase in employment for African-American owned businesses as they receive better access to finance. This increase illustrates that African-American firms face greater financial constraints relative to their White counterparts.

Policy Implications

African-American firms have the same capabilities as other firms, but this research indicates that they experience worse financing outcomes and bank relationships. This research suggests a better financing solution is needed for African-American firms to reach a form of parity in numbers and firm size.

Despite the financial constraints facing African-American owned firms, when they do receive financing, they do more with less to grow and create jobs. For example, the Community Reinvestment Act contributes more toward increasing financing and employment for African-American firms compared to other firms. Targeted finance programs toward African-American firms would be more efficient in creating jobs than finance programs geared toward all firms that may not need increased financial access.

Data and Methodology

The study asks and answers a series of questions using government data, observing trends, and employing econometric techniques with available controls on firm/owner characteristics. The evaluation period often uses data covering the periods 1970 to 2018 and 2014 to 2018 depending on the question asked.

Data mainly came from the U.S. Census Bureau and include the Decennial Census, American Community Survey, Current Population Survey (especially Outgoing Rotation Groups), Annual Social and Economic Supplement, Longitudinal Business Database, and Surveys of Business Ownership. Non-Census data include the Community Reinvestment Act and SBA 7(a) and 504 loans. Microdata and linking data sources were used where possible.

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.

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