



Policy Brief

#12, October 2008

The National Poverty Center's Policy Brief series summarizes key academic research findings, highlighting implications for policy.

The NPC encourages the dissemination of this publication and grants full reproduction right to any party so long as proper credit is granted the NPC. Sample citation: "Title, National Poverty Center Policy Brief #x".

Findings

- ♦ African-American businesses have lower sales and profits, hire fewer employees, have smaller payrolls, and have higher closure rates than white-owned businesses.
- ♦ Estimates from Census microdata indicate that Asian-American firms have higher sales and profits, are more likely to hire employees, and are less likely to close than white-owned firms.
- ♦ The most important factor contributing to worse average outcomes for black-owned businesses and better average outcomes for Asian-owned businesses is startup capital.
- ♦ Low levels of education contribute to worse outcomes for black-owned businesses and contribute to better outcomes among Asian-owned firms.
- ♦ The lack of prior work experience in a family business among black business owners negatively affects black business outcomes.

The Causes of Racial Disparities in Business Performance

Taken from Fairlie, Robert W. and Alicia M. Robb. *Race and Entrepreneurial Success: Black-, Asian-, and White-Owned Businesses in the United States*, Cambridge: MIT Press, 2008.

Background

Racial inequality in education, income, and wealth are well known; less understood are the large and persistent racial disparities in business ownership and performance in the United States. The lack of attention is surprising, given the magnitude of these racial differences and the importance of business ownership as a way to make a living for many Americans. Roughly 1 in 10 workers owns a business, but these 13 million business owners hold an amazing 37.4 percent of total U.S. wealth. Yet only 5.1 percent of African-American workers and 7.5 percent of Latino workers own businesses.

Although racial disparities in business ownership are troubling, perhaps a more important concern is that businesses owned by disadvantaged minorities tend to be smaller and less successful than non-minority-owned businesses. In particular, black- and Latino-owned businesses have lower sales, hire fewer employees, and have smaller payrolls than white-owned businesses, on average. Firms owned by African-Americans also have lower profits and higher closure rates than those owned by whites. For most outcomes, these disparities are large. For example, white-owned firms have average annual sales of \$439,579, compared with only \$74,018 for black-owned firms. In contrast to these patterns, Asian-American owned firms have average outcomes that in most cases are better than those of white-owned firms.

Data

The main analysis sample used in the book is taken from the confidential and restricted-access Characteristics of Business Owners (CBO), conducted by the U.S. Census Bureau. The dataset contains detailed information on both the characteristics of the owner and the firm. Although the CBO provides an excellent dataset for exploring the underlying causes of racial differences in business outcomes, it has been used by only a handful of researchers. The lack of use appears to be due primarily to difficulties in obtaining access, using, and reporting results from these confidential and restricted-access data. All research using the CBO must be conducted in a Census Research Data Center or at the Center for Economic Studies (CES) after approval by the CES and the Internal Revenue

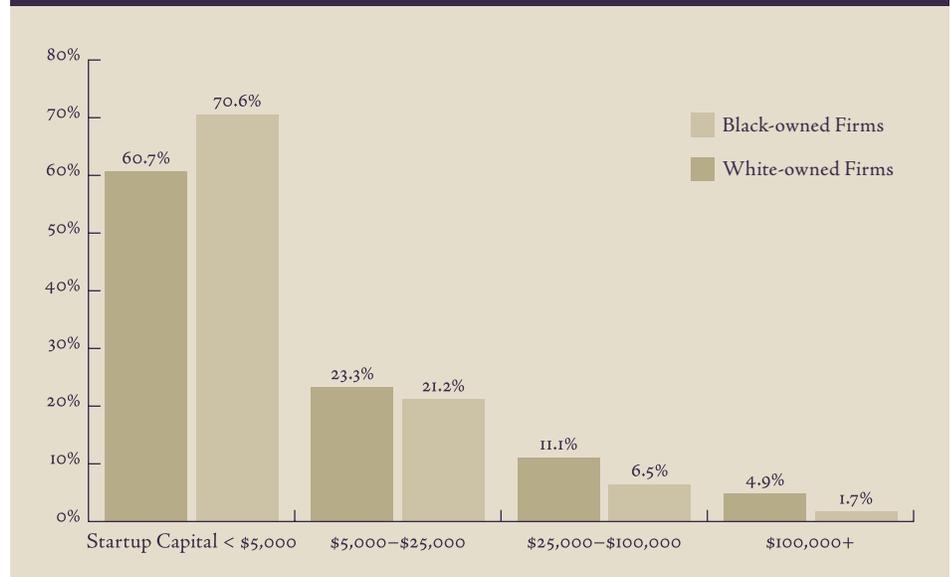
Service (IRS), and all output must pass strict disclosure regulations.

The book also provides a new compilation of estimates of racial patterns of business ownership rates and business outcomes from the most widely used and respected sources of government data. Estimates of business ownership rates and performance are generated from public-use and restricted-access microdata, taken from published sources, and obtained from special tabulations prepared for us by the U.S. Census Bureau.

Identifying the Barriers to Success: Financial Capital

In this book, we explore the factors associated with business success and the potential causes of racial disparities in closure rates, profits, employment, and sales. We focus on three potential barriers to successful minority businesses—financial capital, family business background, and human capital. The level of startup capital invested in the business is strongly associated with business success. Estimates from the CBO indicate that firms with higher levels of startup capital are less likely to close, have higher profits and sales, and are more likely to hire employees. Differences in startup capital may be due to differences in the personal wealth of the entrepreneur because this wealth can be invested directly in the business or used as collateral to obtain business loans. Personal wealth among African-Americans is one eleventh that of whites. The median level of net worth for black households is only \$6,166 implying that half of all black households have less than \$6,166 in total wealth. Part of these disparities in wealth are due to blacks being less likely to own homes, having lower home values, and having lower equity to debt ratios in their homes. Recent research also indicates that black businesses may

Figure 1. Startup Capital by Race Characteristics of Business Owners, 1992



face lending discrimination, and blacks may have less access to family wealth through inheritances, loans and equity investments. All of these factors may contribute to the substantially lower levels of startup capital among black business owners than among white business owners.

In contrast to the black experience, Asian-Americans have high levels of wealth and invested capital. The median level of net worth for Asian-American households is roughly similar to the white level of net worth. Asian-American businesses, however, start with substantially higher levels of capital. Using a special statistical decomposition technique that, we find that racial differences in startup capital are the single most important factor explaining why black firms are less successful and Asian-American firms are more successful.

Family Business Experience

More than half of all business owners had a self-employed family member prior to starting their business. Conditional on having a self-employed family member, less than half of small business owners worked in that family member's business. On the

other hand, we find that only 1.6 percent of all small businesses in the United States are inherited. An examination of the determinants of business outcomes reveals a nuanced role for the owner's family business background in contributing to success in business ownership. Simply having a self-employed family member has no significant effect on business outcomes. In contrast, working in that family member's business leads to a more successful business. Business outcomes are 11 to 38 percent better if the owner worked in a family business prior to starting his or her own business.

Black business owners have a relatively disadvantaged family business background compared with white business owners. Only 12.6 percent of black business owners had prior work experience in a family member's business compared with 23.3 percent of white business owners. We find that this lack of prior work experience in family businesses among blacks, perhaps by restricting their acquisition of general and specific business human capital, limits the successfulness of their businesses relative to whites.

Human Capital

There is a strong positive relationship between the education level of the owner and business performance. Although blacks have made substantial gains in education, large racial disparities remain. Roughly one-third of white business owners are college educated whereas only one quarter of black business owners have the same level of education. In stark contrast to these patterns, Asian-Americans have extremely high levels of education. Nearly 50 percent of Asian-American adults and 50 percent of Asian-American business owners have a college degree.

Lower levels of education among black business owners and higher levels of education among Asian business owners translate into disparities in business outcomes. Our decomposition estimates indicate that higher levels of education are a major reason that Asian-owned businesses are more successful than white-owned businesses and black-owned businesses in the United States.

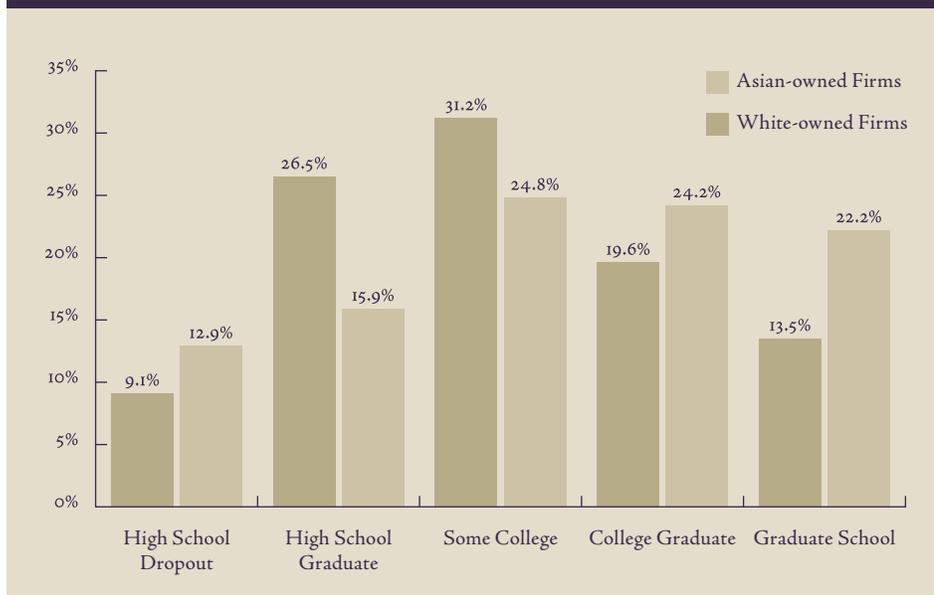
Conclusions

Overall, our findings indicate that large racial disparities exist in business ownership and business outcomes in the United States. Our analysis of the confidential and restricted-access CBO reveals several important determinants of success in small business ownership, and causes of racial disparities in business performance. The relative lack of success among black-owned businesses is attributable in part to their owners having less startup capital, disadvantaged family backgrounds, and less education. Conversely, the relative success of Asian-owned businesses in the United States appears to be mainly due to their relatively high levels of startup capital and owner's education.

Implications

Government contracting programs and related loan programs for minority-owned or disadvantaged businesses are targeted towards alleviating financial constraints, but these programs do not provide opportunities for obtaining relevant work experience. Clearly, improving access to capital for minority entrepreneurs is important, especially in light of the striking wealth inequality that exists in the United States. However, increasing opportunities for the acquisition of human capital and business human capital should also be viewed as vital goals for minority business development. In particular, governmental programs providing mentoring, internships or apprenticeship-type training may help to reduce historical inequalities in business performance. These policies may serve as a substitute for the lack of opportunities to work in family businesses for some disadvantaged groups. The potential benefits may be large because simply increasing the number and average employment of minority businesses by only 10 percent would result in the creation of 1 million new jobs for minorities.

Figure 2. Owner's Education Level by Race Characteristics of Business Owners, 1992



About the Authors

Robert W. Fairlie is Professor of Economics at the University of California, Santa Cruz, and a Research Affiliate at the National Poverty Center. Email: rfairlie@ucsc.edu

Alicia M. Robb is a Research Associate in Economics at the University of California, Santa Cruz, and a Senior Economist with Beacon Economics. Email: arobb@ucsc.edu

About the NPC

The National Poverty Center is charged with promoting high-quality research on the causes and consequences of poverty, evaluating and analyzing policies to alleviate poverty, and training the next generation of poverty researchers.

The NPC is directed by Sheldon H. Danziger.

Major funding for the National Poverty Center is provided by the Office of the Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services.

Any opinions, findings, conclusions, or recommendations expressed in this material are those of the author(s) and do not necessarily reflect the National Poverty Center or any sponsoring agency.



National Poverty Center
Gerald R. Ford School of Public Policy
University of Michigan
735 S. State Street
Ann Arbor, MI 48109-3091
734-615-5312
npcinfo@umich.edu