

Written Testimony of Alejandra Y. Castillo, National Director
Minority Business Development Agency
U.S. Department of Commerce
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“Minority Access to Capital” Field Hearing
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Introduction

Good Morning Chairman Vitter, Ranking Member Cardin, and Members of the committee. I am Alejandra Castillo, and I serve as the National Director for the Minority Business Development Agency, also known as MBDA, at the U.S. Department of Commerce.

My testimony will outline MBDA’s mission and vision in assisting minority-owned firms to gain greater access to capital, contracts and markets. For the purpose of this hearing, I will focus exclusively on the continued challenge of access to capital to sustain not just the start of minority business enterprises (MBEs), but more importantly the growth of these firms. My testimony today will highlight the research findings and underscore the actions that we are taking to create a more robust and sustainable eco-system that will help minority businesses obtain capital for their current and future needs. In addition, I will review some specific areas where we have achieved success right here in Maryland.

Role of MBDA

Our U.S. Department of Commerce Secretary, Penny Pritzker, has laid out an aggressive “Open for Business Agenda” that highlights the critical need to focus on trade and investment, innovation, data, and the environment in order for the United States to be successful in the twenty-first century global economy. The Commerce Department’s “Open for Business Agenda” focuses on entrepreneurship and innovation which drives the central purpose of my agency’s work to ensure that America’s minority business community continued to grow in size and scale and continue to drive value and global competitiveness.

For over forty-five years, MBDA has been working aggressively to expand the economic footprint of MBEs. According to the U.S. Census Bureau’s 2007 Survey of Business Owners, these MBE firms contributed \$1 trillion in total economic output and employed nearly six million Americans.¹ These findings highlight that the economic contribution of minority firms has a direct and significant impact on the national economy, and more recent Census reports demonstrate that this impact is continuing to grow.

¹ U.S. Census Bureau, 2007 Survey of Business Owners, June 2010.

The demographic data is clear; America's population make-up is changing. By 2020, more than half of the nation's children are expected to be part of a minority race or ethnic group,² by 2043, the minority population will be the majority group in this country. Therefore, as the demographic composition of our country changes, so too does the face of our business community. With over 5.8 million MBEs, and growing, the U.S. Business community is transforming, and the way we do businesses in America is changing. Not just in terms of its consumers, but also in terms of the growing number of minority firms that are delivering the goods and services of today's economy.³ Engaging MBEs is essential to support the future of American business and ensure the U.S. remains globally competitive.

The growth in the number of minority-owned firms is a positive trend. However, there are improvements that can be made, as these firms seek to expand in size and scale. It is critical that we create and foster an eco-system that allows for growth of these firms. Unfortunately, MBEs continue to encounter many obstacles that include barriers to accessing capital, contracts, and export markets.

MBDA serves as the only federal agency tasked to help MBEs realize their full economic potential through technical assistance, public and private contracting opportunities, advocacy, research, education, and by serving as a strategic partner for growth and development.

The bulk of this work is accomplished through our nationwide network of MBDA Business Centers. Each center provides services that assist businesses in accessing capital, contracts, and new markets, as well as helping them to grow in size and scale. Since 2009, MBDA has assisted clients in accessing nearly \$26 billion in contracts and capital, while helping them create and retain over 87,000 jobs.

Success in Maryland

In the fall of 2013, MBDA opened a business center in Baltimore, Maryland, operated by the City of Baltimore Mayor's Office of Minority and Women-Owned Business Development. Since opening, the center has been engaged with M. Luis Construction Inc., a nationally recognized small business with more than 200 employees and the only Minority Business Enterprise and Women's Business Enterprise asphalt manufacturer in the nation. The Baltimore MBDA Business Center has played a role in M. Luis Construction's continuing success through assisting public and private relationship management and navigating procurement opportunities across the state of Maryland. MBDA's Baltimore Business Center efforts have led to over \$27 million in procurement, and brought \$21 million in surety bonding.

² Frey, William H., *"Census Projects New Majority Minority" Tipping Points*. State of Metropolitan America. The Brookings Institution, 3 December 2012.

³ U.S. Census Bureau, 2007 Survey of Business Owners, June 2010.

Research Findings

While the success of M. Luis Construction is impressive and representative of the types of business development assistance that MBDA delivers its clients across the country, this type of success is far too uncommon in the minority business community as a whole, despite our best efforts, due to continued institutional and systematic barriers. In 2010, MBDA released a report titled “Disparities in Capital Access.”⁴ Some of the key findings include:

- Minority-owned firms receive lower loan amounts than non-minority firms – While the average loan amount for all high-sales minority firms was \$149,000, non-minority firms received an average of \$310,000 or more than twice the amount.
- Minority-owned firms are more likely to be denied loans - Among firms with gross receipts under \$500,000, loan denial rates for minority firms were about three times higher compared to those of non-minority-owned firms. For high sales firms, the rate of loan denial was almost twice as high for minority firms as for non-minority firms.
- Minority-owned firms receive lower loan and equity investment amounts - Minority firms averaged \$29,879 in external debt compared with \$36,777 for non-minority firms. Minority firms had the most trouble obtaining external equity with \$2,984 on average compared with \$7,607 on average for non-minority firms.
- Lower wealth levels are a barrier to entry for minority entrepreneurs - Estimates from the U.S. Census Bureau indicate that half of all Hispanic families have less than \$7,950 in wealth, and half of all African American families less than \$5,446. Wealth levels among non-minorities are 11 to 16 times higher. Low levels of wealth and liquidity constraints in turn create a substantial barrier to entry for minority entrepreneurs because the owner’s wealth can be invested directly in the business, used as collateral to obtain business loans or used to acquire other businesses.

In order to expand on these findings, MBDA has recently commissioned a study to examine the use of alternative financing solutions, including crowd funding, peer-to-peer lending, and family office investment networks. The upcoming report will highlight financing solutions used by minority-owned businesses in high-growth industries.

In 2013, the Selig Center for Economic Growth released the “Multicultural Economy” report, which focused on the economic buying power of minorities. One of the boldest findings is that by 2018, the combined buying power of African Americans, Asians, Pacific Islanders and Native Americans will be \$2.6 trillion.⁵ This combined buying power will account for 16.4 percent of the nation’s total buying power.⁶ MBEs have the

⁴ U.S. Department of Commerce, Minority Business Development Agency, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs* (2010).

⁵ Selig Center for Economic Growth, Terry College of Business, The University of Georgia, June 2013.

⁶ Ibid.

highest understanding and connection to this large and high-growth segment of the economy; and by working to support their business efforts, the U.S. Department of Commerce can capitalize on these new domestic markets. In addition, we know that MBEs are also twice as likely to export as non-minority firms.⁷ Therefore, the potential growth of MBEs through exports is also a fast growing segment of their business operations.

Access to Capital for Minority-owned Businesses

In 2014, MBDA helped to secure over \$2 billion in capital and financing for clients. In addition to traditional sources, we created a new Access to Capital Team to introduce our clients to alternative capital sources. This work has been two-fold: to educate clients and firms about the types of alternative financing available, and to advocate on their behalf with the kind of resource partners that minority owned firms cannot access. Minority firms lack access to many of the types of people that are in the room today: venture capitalists, angel investors, mergers and acquisitions firms, firms with internet-based platforms, and the many other firms that act as ever more important alternative sources of capital.

This past October, I had the opportunity to speak at the Minority Finance Forum, hosted in partnership with the Association for Corporate Growth in Chicago. I addressed over 800 investment bankers, private equity groups, bank fund managers, family offices, merger and acquisition companies, and banks in expressing the need for minority-owned firms to play a role in the middle market and break the barrier in accessing capital- and they all agreed. MBDA will continue to engage firms like these to help expand access for minority owned firms.

Debt capital (bank lending) is the primary source of financing for small and minority owned firms and plays a vital role in purchasing new inventory, hiring, and maintaining cash flow to grow their businesses. Forty-eight percent of business owners report a major bank as their primary lending source and thirty-four percent report a regional and community bank.⁸ MBDA advocates for MBEs in the traditional banking space through relationships with national level banks and countless community banks through MBDA's national network of business centers. We are also working with SBA on increasing opportunities for MBEs to pursue micro lending opportunities.

MBDA is also engaged in the use of alternative finance through partnerships with a large portfolio of alternative capital providers including internet based lenders, angel investor networks, micro lenders, Community Development Financial Institutions, and other investors in the middle-market space.

⁷ U.S. Department of Commerce, Minority Business Development Agency, Fact Sheet: *Minority-Owned Firms Lead the Nation in Exporting* (2012).

⁸ Mills, Karen and McCarthy, Brayden, *The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game* (July 22, 2014). Harvard Business School General Management Unit Working Paper No. 15-004.

There is a rising class of fund managers in minority and women managed hedge funds. Many states, including Maryland, have policies to consider minority and women owned firms in the allocation process to ensure that the make-up of firms managing pension assets mirrors the employee and customer base, and to provide opportunities to managers that have historically been underrepresented in the investment management arena.

These fund managers, called emerging managers, have the potential to outperform established hedge funds due to their ability to stay nimble, access less crowded trades, and focus on performance. Utilizing emerging managers also goes a long way in helping to bridge the wealth gap.

Conclusion

I want to thank you and this Committee for the opportunity to speak with you today. Understanding the growing role of minority businesses in our Nation's economic future is critical; however, being able to support and enhance their growth through access to capital is paramount. We welcome this committee's work in addressing these current challenges. As we move forward, MBDA will continue to highlight the strategic importance that MBEs play in the American economy and to find solutions to address the continued challenges that MBEs face when it comes to being "Open for Business." On behalf of MBDA and the U.S. Department of Commerce, I welcome the opportunity to discuss MBDA's commitment to strengthening the minority business community. I am happy to answer any questions you may have.