

**Written Testimony for “A New Start: Opportunities and Barriers to Entrepreneurship for Returning Citizens and Justice Impacted Individuals.” Scheduled for July 27, 2022.<sup>1</sup>**

Senate Committee on Small Business and Entrepreneurship (Sen. Cardin, Chair; Sen. Paul, Ranking)

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Thank you for this opportunity to share the latest research on this important topic. I am a professor at the Wharton School of Business with over twenty years of experience including previous positions at Columbia University and the University of Chicago. One of my areas of expertise is the relationship between employment and entrepreneurship, with a specific focus on returning citizens and justice-impacted communities. In 2016 I founded a program at Columbia University where MBA students go inside prisons to teach business skills – including entrepreneurship. The program, called REAP (ReEntry Acceleration Program)<sup>2</sup> launched five years ago in partnership with Resilience Education<sup>3</sup> and has touched hundreds of individuals. A key reason we teach entrepreneurship was that our focus groups with returning citizens revealed their desire for these skills. REAP is rooted in research that I conduct with my collaborator Kylie Hwang (Ph.D.). This research, in addition to recent scholarship by Hwang, will be the focus of my testimony.

## **THE CHALLENGE**

With over 2.2 million people incarcerated as of 2018, the United States has the highest incarceration rate in the world. This has led to more than 600,000 people per year reentering society from incarceration. Successful reentry is the exception however, with the Bureau of Justice Statistics noting that over two-thirds of returning citizens are rearrested within three years of reentry.<sup>4</sup>

The First Step Act of 2018 represents an important legislative achievement that will benefit individuals and communities. At the same time, one of the persistent factors thwarting successful reentry is the discrimination in the labor market faced by returning citizens. As of 2018, returning citizens suffer from an unemployment rate of 27.3% compared to 5.8% for the general public.<sup>5</sup> A recent Bureau of Justice Statistics study on returning citizens from federal prisons found that a third of them found no employment at all over the first four years post release. Moreover, no more than 40% of this cohort was employed at any one time during this four-year window.<sup>6</sup> And while one potential explanation is differences in human capital, academic scholarship that adjusts for human capital differences continue to find that not only are returning

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<sup>1</sup> This testimony shares collaborative work with Kylie Jiwon Hwang (Ph.D.), who is currently a Postdoctoral Fellow at Stanford Graduate School of Business (<https://kyliehwang.com/>) as well as independent work by Hwang, K.J. (2022, forthcoming): "From Prison to Entrepreneurship: Can Entrepreneurship be a Re-entry Strategy for Justice-Impacted Individuals?", *The ANNALS of the American Academy of Political and Social Science*.

<sup>2</sup> <https://www8.gsb.columbia.edu/socialenterprise/initiatives/reap>

<sup>3</sup> <https://resilience-education.org/>

<sup>4</sup> Alper M, Durose MR, Markman J. 2018 update on prisoner recidivism: A 9-year follow-up period (2005-2014). Washington, DC: US Department of Justice, Office of Justice Programs, Bureau of Justice Statistics; 2018 May.

<sup>5</sup> Couloute, L. and Kopf, D. 2018. "Out of Prison & Out of Work: Unemployment among formerly incarcerated people." <https://www.prisonpolicy.org/reports/outofwork.html>

<sup>6</sup> <https://bjs.ojp.gov/content/pub/pdf/eprfp10.pdf>

citizens less likely to be hired by employers, but those who are hired earn lower wages and experience less wage mobility.<sup>7</sup> This unemployment and underemployment in turn, fuels recidivism.<sup>8</sup>

## **RESEARCH ON RETURNING CITIZENS AS ENTREPRENEURS**

In recent research, Kylie Hwang and I examined a potentially critical alternative to traditional labor market participation: entrepreneurship. Entrepreneurship can be a response to labor market discrimination, where justice-involved individuals start businesses in part to overcome barriers to employment.<sup>9</sup> Our key study has four notable findings: (1) returning citizens start businesses at a higher rate than Americans who have never been incarcerated; (2) labor market discrimination is one key reason why returning citizens move into entrepreneurship; (3) returning citizens earn more as entrepreneurs than they do as employees; and (4) returning citizens have lower recidivism rates as entrepreneurs than they do as employees.

### ***The Prevalence of Entrepreneurship for Returning Citizens***

First, using data on thousands of Americans drawn from the U.S. National Longitudinal Survey of Youth (NLSY97), we found that 18.61% of the returning citizens in our sample started businesses compared to 11.48% for those who had never been incarcerated. These results complement a recent RAND study, which finds that over 1.1 million business owners in the U.S. have a criminal record. Moreover, over 1.7 million employees are affiliated with businesses owned by someone with a criminal record.<sup>10</sup>

### ***Entrepreneurship as a Response to Employment Discrimination***

Second, we examined the relationship between entrepreneurship and employment discrimination by looking at how entrepreneurship rates change when employment discrimination varies. We found that when returning citizens experienced greater employment opportunities through lower discrimination, they were less likely to start businesses. However, when employment discrimination was higher, entrepreneurship rates increased. We also found that this effect is strongest for Black returning citizens.

### ***Entrepreneurship and Income***

Third, to determine the economic viability of entrepreneurship for returning citizens, we compared incomes that returning citizens obtain from entrepreneurship to incomes from employment. Our research revealed that returning citizens earn more as entrepreneurs than they do as employees. Specifically, we found that returning citizen entrepreneurs had 11.4% greater hourly earnings compared to returning citizens in employment. This finding is consistent with the argument that entrepreneurship mitigates the income inequality that returning citizens experience in paid employment, as entrepreneurship provides greater opportunities to earn based on one's true productivity rather than depending on an employer's biased assessment of their productivity.<sup>11</sup> And while returning citizens may also face barriers in entrepreneurship,

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<sup>7</sup> Western, B. 2002. The Impact of Incarceration on Wage Mobility and Inequality. *American Sociological Review* 67 (4): 526–46. Sugie, N.F. 2018. Work as foraging: a smartphone study of job search and employment after prison. *American Journal of Sociology*, 123(5), pp.1453-1491. Harding, D.J., Morenoff, J.D. and Wyse, J.J., 2019. *On the outside: Prisoner reentry and reintegration*. University of Chicago Press.

<sup>8</sup> <https://www.science.org/doi/10.1126/sciadv.abj6992>

<sup>9</sup> Hwang, K.J. and D.J. Phillips. "Entrepreneurship as a Response to Labor Market Discrimination for Formerly Incarcerated People" Conditionally Accepted at *American Journal of Sociology*.

<sup>10</sup> Bushway, Shawn D., Dulani Woods, Denis Agniel, and David M. Adamson, Small Businesses, Criminal Histories, and the Paycheck Protection Program. Santa Monica, CA: RAND Corporation, 2021. [https://www.rand.org/pubs/research\\_reports/RRA1295-1.html](https://www.rand.org/pubs/research_reports/RRA1295-1.html).

<sup>11</sup> Lippmann, S., Davis, A. and Aldrich, H.E. 2005. Entrepreneurship and inequality. *Research in the Sociology of Work*, 15, pp.3-31. Hegde, Deepak and Justin Tumilson 2018, Asymmetric Information and Entrepreneurship, Working Paper.

these barriers are not as overwhelming as the stigma of an incarceration record in the labor market. Overall, our research suggests that entrepreneurship does more to reduce income inequality than employment for members of the returning citizen community.

### ***Entrepreneurship and Recidivism***

Finally, we found that entrepreneurship decreases the likelihood of re-incarceration compared to employment (and compared to unemployment), supporting the view of entrepreneurship as a way for returning citizens to successfully reenter the society. In our study recidivism in the first year dropped by 12.6% for those entering entrepreneurship (compared to unemployment), compared to a drop of 10.8% for those who were employees. This difference grows over time. For example, by year five recidivism for those entering entrepreneurship dropped by 13.5% compared to a 7.9% drop for employment. These findings were especially pronounced for Black returning citizens. Combined with the results on income, these findings on recidivism suggest that entrepreneurship not only helps returning citizens improve their economic well-being but also social integration. Our findings are consistent with the idea that entrepreneurship yields greater economic and social incentives, such as responsibility, work satisfaction, and the sense of publicly “making good”.<sup>12</sup> The combination of these incentives reduces criminal activity.

## **LOWERING BARRIERS TO ENTREPRENEURSHIP FOR RETURNING CITIZENS<sup>13</sup>**

Even though there are positive outcomes associated with entrepreneurship for returning citizens and their communities, it is important to recognize that they also face significant barriers in starting businesses. Due to these barriers, we may not be reaching the full potential of entrepreneurship as a path. In particular, one can consider three types of barriers: financial capital, human capital, and social capital.

### ***Financial Capital Related Barriers***

Limited access to financial capital or funding is a primary obstacle facing justice-impacted entrepreneurs. Funding can come from diverse sources, including personal funds, money from family and friends, credit cards, commercial bank loans, or government funds. Yet these sources are often unavailable to disadvantaged social groups. For example, justice-impacted entrepreneurs face obstacles to securing debt caused by the mark of criminal history and the collateral consequences of incarceration.<sup>14</sup> Moreover, people who have been incarcerated are more likely to have insufficient credit scores and interruption in work histories, both of which negatively impact the likelihood of qualifying for bank loans.<sup>15</sup> Justice-impacted individuals are also less likely to apply for bank loans than non-justice-impacted business owners because of their fear of rejection.<sup>16</sup>

People with criminal histories have also face challenges gaining federal support or loans from government agencies. For example, the Small Business Association (SBA), an important source of financing for many

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<sup>12</sup> Maruna, S. *Making Good: How Ex-Convicts Reform and Rebuild Their Lives*. American Psychological Association. Washington D.C.

<sup>13</sup> Research in this section draws from Hwang, K.J. (2022, forthcoming) "From Prison to Entrepreneurship: Can Entrepreneurship be a Re-entry Strategy for Justice-Impacted Individuals?", *The ANNALS of the American Academy of Political and Social Science*.

<sup>14</sup> Baskaran, P. (2019). Respect the hustle: Necessity entrepreneurship, returning citizens, and social enterprise strategies. *Maryland Law Review*, 78(2), 323-381.

<sup>15</sup> Aneja, Abhay P. and Carlos F. Avenacio-Leon, 2017. Credit-driven crime cycles: the connection between incarceration and access to credit. *Unpublished*. <https://static1.squarespace.com/static/59dc0ec564b05fea9d3dfce3/5/1513819887630>.

<sup>16</sup> Rieple, A. 1998. Offenders and entrepreneurship. *European Journal on Criminal Policy and Research*, 6(2), pp.235-256.

entrepreneurs, has a history of imposing restrictions on loans and other aids to business owners with criminal records.<sup>17</sup> Only in 2015 did the SBA Microloan Program change its criteria to allow loan applications from people on parole or probation.<sup>18</sup> More recently, the Paycheck Protection Program (PPP) initially disqualified businesses whose owners had recent criminal histories. This initial restriction not only hurt justice-involved entrepreneurs, but also those that these entrepreneurs employed.

In her doctoral dissertation, Hwang found that aspiring justice-involved entrepreneurs are more than 55% less likely to obtain financial capital through either financial institutions or the government compared to similar entrepreneurs with no justice involvement.<sup>19</sup> In particular, African American and Hispanic entrepreneurs with criminal records have the lowest rates of gaining capital from financial institutions or the government, suggesting that the intersection of minority race and incarceration causes further challenges. As a response to such financial barriers many justice-involved people resort to their personal savings or family and friends for the capital to start new businesses. However, personal savings and funding from family and friends is often constrained for justice-involved individuals due to poverty and low-income levels.<sup>20</sup> As a result, they often start businesses in industries that require minimal start-up capital and no physical office.

### ***Human Capital Related Barriers***

Many justice-involved individuals lack the human capital necessary for entrepreneurship. The lack of formal education can prevent the successful launching a business, especially in knowledge-based industries. Consequently, individuals with criminal records start businesses where there is less need for advanced formal education (e.g., construction). In addition to formal education, people with criminal records have fewer opportunities to learn essential business skills such as economic literacy, skills in finance and accounting, and business planning skills. Previous research shows that work experience, particularly general full-time work experience and managerial experience, is one of the most important components of human capital for entrepreneurs.<sup>21</sup> As justice-involved individuals face even greater barriers to employment, they are often unable to acquire the proper work experience that would lead to the type of human capital associated with successful entrepreneurship. Thus, marginalization in the conventional employment market has a spillover effect to barriers to succeeding in entrepreneurship for justice-involved individuals.

### ***Social Capital Related Barriers***

Justice-impacted individuals aspiring to entrepreneurship also face challenges due to having fewer connections to role models or suitable business networks for peer support, investment, and business opportunities.<sup>22</sup> While the most helpful peers and mentors for potential entrepreneurs typically come from work and post-secondary school, returning citizens and justice-involved individuals face a disadvantage as

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<sup>17</sup> Bushway et al. (2021)

<sup>18</sup> Microloan Program Expanded Eligibility and Other Program Changes, 80 Fed. Reg. 34,043, 34,043 (June 15, 2015) (to be codified at 13 C.F.R. pt. 120)

<sup>19</sup> Hwang, K.J., 2021. *Entrepreneurship and incarceration* (Doctoral dissertation, Columbia University).

<sup>20</sup> Robb, Alicia. 2013. Access to capital among young firms, minority-owned firms, women-owned firms, and high-tech firms. *Office of Advocacy, U.S. Small Business Administration, Washington, DC*. Baskaran, P. (2019). Respect the hustle: Necessity entrepreneurship, returning citizens, and social enterprise strategies. *Maryland Law Review*, 78(2), 323-381.

<sup>21</sup> Kim, P. H., H. E. Aldrich, and L. A. Keister. 2006. Access (not) denied: The impact of financial, human, and cultural capital on entrepreneurial entry in the United States. *Small Business Economics*, 27: 5–22.

<sup>22</sup> Hwang, K.J. (2022, forthcoming) "From Prison to Entrepreneurship: Can Entrepreneurship be a Re-entry Strategy for Justice-Impacted Individuals?", *The ANNALS of the American Academy of Political and Social Science*.

many lack the educational networks or don't have a viable path to the types of jobs that build social capital for successful entrepreneurship. Families are another main source of social and cultural capital, however many returning citizens are from families where financial and social resources are lacking or unhelpful for entrepreneurship.

## **POLICY IMPLICATIONS**

Research points to positive consequences of entrepreneurship for returning citizens and other justice-involved individuals. At the same time, there are substantial barriers to entrepreneurship for these same individuals. Fortunately, there is a role that the federal government can play in helping to mitigate some of the barriers. Potential actions by government are discussed below, organized by financial capital, human capital, and social capital.

### ***Improving Financial Capital***

Members of the Senate Committee on Small Business and Entrepreneurship have actively sought ways to improve access to financial capital for small businesses, often with an eye to communities of color, rural communities, and other marginalized groups. Similar to the way that restrictions were adjusted to PPP loans in 2021,<sup>23</sup> and the Community Advantage Program in 2022, there is a continued role of government to mitigate financial barriers to entrepreneurship for people with criminal histories. Reducing or removing restrictions on government loans to people with criminal records would provide an important lifeline to a group of Americans who often lack other sources of financial support needed to start and sustain their businesses.

A second suggestion for improving access to financial capital is to consider tax incentives for investing in businesses founded by justice-impacted entrepreneurs. These incentives can take the form of a tax deduction through a non-profit vehicle. In this case, investors may be able to treat investments as a charitable contribution. These tax deductions could also be structured as a part of a microloan program. Another approach can be a tax incentive modeled on the way in which Qualified Small Business Stock (QSBS) limits the extent to which an investor is taxed for capital gains, but expanded to include the types of businesses that returning citizens are more likely to start (e.g., restaurants, smaller investment amounts). Under this second kind of incentive, taxes on capital gains could be reduced or eliminated for business with justice-involved owners. Correspondingly, tax law around losses on small business stock could be modified.

### ***Improving Human Capital***

Returning citizens also benefit from human capital for entrepreneurship. Returning citizens often report challenges due to the lack of knowledge around applying for a loan, incorporation, accounting, financial literacy, tax filings, as well as management and leadership skills when aspiring to start their own

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<sup>23</sup> The original PPP disqualified businesses if any owner with 20 percent or more equity is: presently incarcerated, on probation, on parole; subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction; or within the last five years, for any felony, has been convicted; pleaded guilty; pleaded nolo contendere; been placed on pretrial diversion; or been placed on any form of parole or probation (including probation before judgement). The SBA subsequently reduced the scope of these disqualifications to: any felony conviction in the past year or a felony conviction related to fraud, bribery, embezzlement, or a false statement on a loan or federal assistance application in the past five years; individuals starting probation/parole within the last year or individuals starting probation/parole for the same offenses previously listed in the past five years; and individuals presently charged with a criminal felony offense in June of 2020 (Small Business Administration 2020). In February 2021, the Biden administration eliminated the one-year restriction for those who were convicted but not incarcerated (The White House 2021).

businesses.<sup>24</sup> Therefore, government agencies can aim to create new avenues for entrepreneurial training, receive support services, and connections with funding opportunities. This should include in-prison opportunities for business training and education. Some recent policy initiatives, like the NEW START Act of 2019, seek to provide justice-involved individuals with entrepreneurial development assistance, including the disbursement of microloans.<sup>25</sup> The SBA is also collaborating with foundations such as the Aspire Entrepreneurship Initiative (“AEI”), which provides “entrepreneurial education and microloans for justice-involved individuals, with a specific focus on those who are parents.” The SBDC also has the expertise on starting and running businesses and can build more ties to community-based organizations to explicitly target justice-impacted entrepreneurs.

There has also been an increase of prison entrepreneurship training initiatives such as Texas’s PEP and joint programs with non-profits or universities such as Resilience Education based in Virginia, Columbia University’s REAP Program, and Georgetown University’s Pivot Program. These opportunities for entrepreneurial education are only available in a handful of prisons or jails in the United States. Efforts to provide more systematic, widespread, and continuous training inside prisons that is coordinated with additional training after release can help address the lack of human capital.

### ***Improving Social Capital***

Initiatives to help returning citizens build social capital to start and succeed in entrepreneurship can address the lack of connections to mentors, fellow entrepreneurs, customers, investors, and potential business partners. Many of the aforementioned programs that provide human capital also provide social capital (mentorship) as well. In addition, programs such as Defy Ventures and Inmates to Entrepreneurs, not only provide microloans and training, but also facilitate connections to a cohort of aspiring entrepreneurs with criminal records, mentors, and angel investors. Government support of initiatives to expand such programs, including partnerships with organizations already active in this regard, would amplify already successful entities (Resilience, Defy, PEP, Columbia) that seek to scale their successes.

### **A FINAL NOTE**

The work by the Senate Committee on Small Business and Entrepreneurship is critical to improving the fate of small business owners in general, and those with criminal records in particular. And while initiatives to promote and subsidize entrepreneurship as an alternative pathway for justice-impacted individuals is important, it is also essential to achieve a balance with more traditional efforts to aid employment for returning citizens. Entrepreneurship and employment are linked. One of the fundamental reasons why entrepreneurship is prevalent among justice-impacted individuals is because of the challenges associated with employment. Therefore, in addition to policies and programs to make entrepreneurship more accessible as a career choice for justice-involved individuals, continuous efforts to address the ongoing employment barriers and discrimination should be pursued with equal vigor.

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<sup>24</sup> Rieple, A. 1998. Offenders and entrepreneurship. *European Journal on Criminal Policy and Research*, 6(2), pp.235-256.

<sup>25</sup> Necessary Entrepreneurship Workshops via the SBA to Transform and Assist Re-entry Training Act of 2019 or the NEW START Act of 2019: This bill establishes a pilot program for providing entrepreneurial development assistance to justice-involved individuals including the disbursement of microloans.