THE RACIAL WEALTH GAP
Narrowing the Racial Wealth Gap through Business Ownership
This brief focuses specifically on business owners and the racial wealth gap as related to African Americans and Latinos. As a group, Asian Americans face a smaller and narrowing wealth gap, and hold business and financial wealth at the same level as Whites. Native Americans face substantial challenges in creating income and wealth, but the distinct challenges regarding business ownership in Native and reservation communities merits a separate discussion. Despite the focus of this brief, many of the recommendations it presents could also benefit Asian Americans and Native Americans seeking to create and grow businesses.
The growing racial and ethnic wealth gap presents a challenge for funders striving to build assets and tackle inequality in the United States. One of the key reasons for the racial wealth gap is that African-American and Latino households hold lower levels of business and financial assets. This is one of the key reasons for the racial wealth gap, so it stands to reason that business ownership may be an important means to narrow the gap. However, people of color have historically been challenged to secure the resources—such as capital, education, and experience, as well as access to markets—needed to start and grow businesses. Micro- and small-business development strategies and programs have traditionally sought to engage underserved racial and ethnic groups as a means to opening opportunities for entrepreneurship. This paper examines the available research on business ownership, its connection to wealth creation for diverse populations, and identifies proven tools and strategies funders can employ to strengthen the access to and effectiveness of business ownership as a means to build wealth and reduce the racial and ethnic wealth gap.
As our nation becomes increasingly aware and concerned about the growth of inequality, among the more concerning statistics are those that show the dramatic disparities in wealth held by communities of color—and by African Americans and Latinos in particular.² Research by the Federal Reserve Board of St. Louis found that in 2013, the net worth of Latino families was about one-tenth that of White, non-Latino families, and the net worth of African-American, non-Latino families was even lower.³ Perhaps even more troubling is the finding that while the wealth of White and Asian families has begun to recover since the Great Recession, the wealth levels of African-American and Latino families continue to decline. The Federal Reserve’s analysis further found that one of the reasons for the gap in household wealth was that African-American and Latino families have lower rates of investment in financial and business assets, "which provide both asset diversification and higher average returns in the long run than a portfolio consisting mostly of tangible assets like a house, vehicles, or other durable goods."⁴

Although business ownership may be an important means to build wealth in our economy, African Americans and Latinos have encountered challenges in acquiring the capital, knowledge, and market access needed to grow their firms. Non-White entrepreneurs have historically had lower rates of self-employment and business ownership than Whites. This is partly due to the fact that they have fewer assets to invest. Research by Robert Fairlie, chair of the economics department at the University of California Santa Cruz, found that lower levels of assets among African Americans account for more than 15% of the difference between the rates of business creation among Whites and African Americans. In addition, Fairlie’s research also found that low levels of assets explain more than half of the business entry rate gap for Latinos.⁵
The good news is that in the years just prior to the recession (the period for which the most recent data is available), the rate of growth in the number of minority-owned businesses, at 107%, far outpaced the growth in non-minority firms, at 29%. Despite these promising figures, Latino and African-American owned firms face lower rates of business growth and survival, posing a challenge for wealth creation. The most recent available data indicates that on average, African-American and Latino-owned businesses have lower sales, hire fewer employees, and have smaller payrolls than White-owned businesses, and that firms owned by African-Americans also have lower profits and higher closure rates than those owned by Whites.

This research identifies three core causes for lower growth and success rates among African-American and Latino-owned businesses:

1. **FINANCING**: in terms of family wealth to invest, and the ability to access external sources of capital.
2. **LOWER LEVELS OF OWNER KNOW-HOW**: in terms of education levels and experience in family-owned businesses.
3. **MARKET ACCESS**: including the tendency of these firms to focus on co-ethnic rather than broader markets.

The research provides the guideposts for strategic philanthropic support aimed at addressing the barriers that African Americans and Latinos face in using business ownership as a means to generate wealth.
Grantmaking and investment strategies focused on micro- and small-business development can directly address the factors that inhibit business creation, growth, and survival by African-American and Latino entrepreneurs. And collective business ownership strategies—notably, worker-owned cooperatives—provide an opportunity for individuals who would not choose solo entrepreneurship to benefit from ownership of the firms where they work.

**INDIVIDUAL BUSINESS OWNERSHIP: MICROENTERPRISE AND SMALL-BUSINESS PROGRAMS**

Micro- and small-business development programs address the very issues that have been identified as contributing to the lower growth and success rates of African-American and Latino-owned firms—helping entrepreneurs to secure financing, strengthen their business knowledge and skills, and access markets. Microenterprise development programs (MDOs) in particular have traditionally focused on serving non-White clients: In 2013, 74% of the clients served by MDOs that reported detailed data on client race and ethnicity to FIELD’s U.S. Microenterprise Census were non-White.

Data suggests that the services MDOs provide are addressing challenges faced by entrepreneurs of color. Research conducted by FIELD with 24 microenterprise organizations in 2012 found the following outcomes for non-White individuals who received assistance from the organizations:

- 95% business survival rate.
- 64% business start rate.
- 54% of businesses employed paid workers, an average of 2.89 jobs per business.
- Workers were paid a median hourly wage of $15.16.
- Median business revenues were $45,000.
- Business revenues increased by $12,777.
- Median owners’ draw was $10,000.

In comparison to White-owned firms that received assistance from these microenterprise programs, non-White clients had similar business start and survival rates. And while non-White owned firms interviewed had lower revenues and revenue growth than those owned by Whites, they had more paid workers, were more likely to have full-time (versus part-time) workers, and paid out more in wages to workers on an annual basis.

**CREATING WEALTH AND OPPORTUNITY: LATINO ECONOMIC DEVELOPMENT CENTER (LEDC)**

Although it was formed more than 20 years ago, the story of the creation of the Latino Economic Development Center (LEDC) holds great relevance today. In spring 1991, Washington, D.C. experienced several days of violent clashes and substantial property damage in the wake of the shooting of a Latino man by a police officer. Community leaders who came together after the “Mount Pleasant riots” concluded that the community’s reaction to the shooting stemmed in large part from the lack of opportunities open to Latino immigrants—many of whom had come to the U.S. seeking an escape from the civil wars and lack of opportunity in their native countries. These leaders came together with the District of Columbia government to create the LEDC as a means to build ownership and enable civic participation by Latino residents.

Small and microbusiness assistance has been a core element of LEDC’s work since its inception. Still based in Washington, D.C., LEDC provides loans, Spanish-language training on business-related topics, coaching on issues such as financial management, and assistance with credit coaching and credit building. In 2012, 60% of LEDC’s clients were Latino, and 20% were African-American. In 2013, LEDC provided 132
loans totaling almost $2 million to more than 1,500 individuals, helping to create 85 new businesses, generate 301 jobs, and retain 566 jobs.

LEDC is funded with a mix of support from local government, foundations and corporations, and income from its lending activities. In 2014, the Maryland-based Abell Foundation provided LEDC with $95,000 to fund the hiring of staff and create a loan loss reserve that enabled the organization to expand its microlending operations in Baltimore City.

For more details: http://www.ledcmetro.org.

**COLLECTIVE BUSINESS OWNERSHIP: WORKER COOPERATIVES**

Worker cooperatives are an alternate structure that can be used to open business ownership opportunities to people of color. As businesses owned and managed by the employees, worker cooperatives tend to serve low-income communities, invest locally, and on average, provide higher wages, better job stability, and more benefits than traditional firms. While worker cooperatives are not widespread (in the United States there are roughly 350 worker cooperatives averaging 11 workers each), they have a long history in the United States, particularly in the African-American community. In every period of American history, African Americans combined resources to tackle personal, family, social, political, and economic problems. Toward the end of the Civil War, free African Americans pooled resources to buy operating farms in order to own land and support themselves financially. This business model is gaining increasing traction in community development circles, in part due to the emergence of a growing support infrastructure that includes nonprofits providing technical and financial support to cooperatives, and local policy and government efforts.

**GOING GREEN: EVERGREEN COOPERATIVES**

A commonly cited example is the Evergreen Cooperatives of Cleveland, Ohio. The most well-established cooperative, Evergreen Cooperative Laundry (ECL), has 22 worker-owners. ECL employees are paid $8 an hour for the first six months and $10.50 per hour after workers are admitted as members. A typical Evergreen member could possess $65,000 in equity after eight years on the job.

The Cleveland Foundation played an important role in securing the success of the Evergreen Cooperatives by convening the city government, nonprofits, philanthropic groups, and community development associations to launch the Evergreen Cooperative. It awarded over $4 million in grants to the Evergreen Cooperative Development Fund.


**EMPOWERING LATINA WOMEN COLLECTIVELY: PROSPERA**

Founded in 1995, Prospera (formerly known as WAGES) partners with low-income Latina women to develop cooperatives. Its three-year program provides training, technical assistance, and leadership coaching. Prospera also promotes personal and professional growth, and has created a series of web-based tools. As of 2014, Prospera had supported the development of five successful eco-friendly house-cleaning cooperatives that collectively employ more than 100 women. On average, in 2013, worker-owners in the cooperatives had increased their incomes by 158% since joining a co-op and accumulated $8,700 in business assets, an amount 22 times their initial investment.

Foundations have played a central role in supporting Prospera’s expansion. The Friedman Family Foundation awarded Prospera with $30,000 in grants between 2012 and 2014 to support the cooperative development model. More recently, the Walter and Elise Haas Fund provided a $35,000 grant to Prospera to form a partnership with La Cocina to develop its latest venture—a food cooperative, which will make and sell Mexican popsicles called paletas.

WHERE TO FIND SMALL AND MICROBUSINESS LENDERS

Both the Opportunity Finance Network and FIELD’s microTracker.org websites have search features to help funders and investors locate business lenders in each state. MicroTracker.org includes information on the percentage of African-American and Latino clients served by many of the organizations listed on its site.

FUNDER RECOMMENDATIONS

INVEST IN KNOWN STRATEGIES

- Invest in Community Development Financial Institutions (CDFIs) and mission-based lenders that provide capital to firms and worker-owned cooperatives owned by African Americans and Latinos. Firms and worker-owned cooperatives owned by non-Whites face barriers in accessing traditional sources of financing. Mission-based lenders have stepped in to fill some of these financing “gaps.”

- Invest directly in cooperatives. Foundations can provide direct financial support to worker-owned cooperatives, through either grants or program-related investments (PRIs). Although some of the earliest enterprise-focused PRIs encountered challenges, much has been learned, and the growing infrastructure of support for worker co-ops should also strengthen the prospects for these investments.
Support business development services that advance the business ownership skills of African-American and Latino entrepreneurs, and expand their ability to access broader markets. The Y&H Soda Foundation in California has provided support for AnewAmerica Community Corporation and Centro Community Partners, two microenterprise organizations that assist entrepreneurs in building business skills and accessing markets. More than 70% of the clients of both organizations are either Latino or African-American.

Invest in incubators and co-working spaces for African-American and Latino entrepreneurs. These programs provide an environment that facilitates collaboration, networking, and mentoring, which are vital to the business growth process. Bowie Business Innovation Center in Prince George’s County and The Hive in Anacostia in Washington, D.C., are two incubators that focus on accelerating the growth of non-White small businesses.

Build the infrastructure to support the success and growth of worker cooperatives. The Surdna Foundation has provided funding to the Democracy at Work Institute, in support of its work to conduct research and provide information regarding best practices and technical assistance to worker-owned cooperatives.

The set of organizations providing support for the development of worker cooperatives includes:

- Federation of Southern Cooperatives/Land Assistance Fund
- Paraprofessional Healthcare Institute (supporting the development of cooperative home care companies)
- The Evergreen Cooperative Initiative (supporting the development of varied cooperative enterprises in Cleveland, Ohio)
- The Democracy at Work Institute (a program of the U.S. Federation of Worker-Owned Cooperatives)
- Prospera (formerly WAGES, supporting the development of cooperatives in Oakland, California)
- The Democracy Collaborative

Local government efforts to stimulate and support worker cooperatives include those in New York City, New York; Oakland, California; Austin, Texas; Cleveland, Ohio; Madison, Wisconsin; and Richmond, California.
Examine and develop strategies for expanding exposure to small business among targeted communities and groups. Research indicates that having worked in a family member’s business is one success factor for small businesses. A lower percentage of African Americans have family members who have owned a business. Research by FIELD indicates that some workers choose to work at microbusinesses in order to build experience and industry contacts to use in launching their own business.20 Funders may want to explore investing in research, and potentially the development of program models, that enable aspiring entrepreneurs to gain experience and build networks and contacts by working in small or microbusinesses.

Fund research aimed at gaining a deeper understanding about the role of both individual and collective models of business ownership in building assets among people of color. Although there is a growing body of research that documents the role of micro- and small-business programs and worker cooperatives in providing jobs and income to low- and moderate-income families, there is limited information on the extent to which these strategies build household balance sheets and wealth over time. Growing the base of research in these areas could help funders, policymakers, and practitioners to strengthen programs or policy, and better understand the value (and/or limits) of the microenterprise strategy in building wealth.

Support the development of models that promote savings and build credit for potential entrepreneurs. Greater availability of liquid and longer-term savings, as well as stronger credit profiles, may also be critical to increasing the growth and success of African-American and Latino-owned firms. Research by Fairlie and Robb (2009, 2013) found that the lower levels of startup capital among African-American entrepreneurs was the single most important factor explaining why their firms were less successful. Among the factors inhibiting access to startup capital by both African-American and Latino entrepreneurs may be that their household balance sheets are relatively illiquid and have higher levels of debt,21 as well as their generally lower credit scores or thin credit profiles.22 Thus, strategies that build liquidity and savings, address higher levels of debt (through financial and credit education, and the provision of better-designed and priced credit products), and build credit may be critical tools in strengthening business success among these populations.

Support policy efforts that seek to address lending practices resulting in disparate outcomes and access to loans and capital, channel public support to CDFIs and community-based lending organizations, and open access to government contracting opportunities.

LOWER LEVELS OF STARTUP CAPITAL among African-American entrepreneurs is the single most important factor explaining why their businesses are less successful.
Widening inequality and the growing lack of opportunity are undermining too many of our families and communities. The racial wealth gap is exacerbated by barriers that have inhibited the formation and growth of businesses owned by African Americans and Latinos. Because business ownership plays a critical role in generating wealth in our economy, addressing the disparities on the level of business assets owned by African Americans and Latinos must be a central element of our nation’s efforts to narrow the racial wealth gap.

Micro- and small-business development programs, and worker-owned cooperatives, are showing promise as strategies that allow Latinos and African Americans to enter into and succeed in business ownership. Grantmakers have an important role to play in investing in the research, programs, and policies that can allow communities of color to realize the wealth-building potential of becoming business owners.
THOUGH THE UNITED STATES IS BECOMING MUCH MORE RACIALLY AND ETHNICALLY DIVERSE, it's becoming more unequal in terms of wealth and income. The Kellogg Foundation’s support for microenterprise enables more people of color to launch and grow businesses that can increase their income and generate wealth that benefits both current and future generations.”

CARLA D. THOMPSON
W.K. KELLOGG FOUNDATION
ASSET FUNDERS NETWORK (AFN)

The Asset Funders Network (AFN) is a membership organization of national, regional and community-based foundations and grantmakers strategic about using philanthropy to promote economic opportunity and financial security for low and moderate income Americans.

AFN works to increase the capacity of its members to effectively promote economic security by supporting efforts that help low to moderate income individuals and families build and protect assets.

Through knowledge sharing, AFN empowers foundations and grantmakers to leverage their resources to make more effective and strategic funding decisions, allowing each dollar invested to have greater impact.
To learn more and to become involved in advancing the field, please visit AFN at www.assetfunders.org.