# Remarks by Governor Roger W. Ferguson, Jr.

**At the National Black Business Council, Washington, D.C.**
**March 16, 1999**

## Small Business Access to Capital: Current Status and Initiatives

I am pleased to be here this evening and I wish to thank the National Black Business Council for inviting me to speak. I would like to focus my remarks on some recent research the Federal Reserve has sponsored on small business finances and on related efforts we make to help maintain small business access to capital and credit.

**The Role of Small Businesses in our Economy**

The Federal Reserve has long recognized the importance of small businesses and the access of small businesses to credit. In part, the Federal Reserve's ongoing interest in small business credit availability and its effects on economic growth stems from the fact that small firms play such a significant role in our dynamic economy. By some estimates, there are upwards of twenty-three million small businesses in the United States accounting for over 99 percent of all firms. Although a great number of these firms involve individuals who are self-employed or who have only a few employees, small businesses employ, collectively, more than half of the private sector work force. These firms also generate nearly half of the sales revenues of all U.S. firms.

Even these statistics, impressive as they are, belie the importance of small businesses in our economy. Small firms provide the entry point into our nation's work force for about two-thirds of all workers, providing them opportunities to gain workplace skills and to learn about and apply new technologies. Small businesses also are often at the leading edge of technological innovation, both pushing and pulling our economy in new directions. According to the U.S. Small Business Administration (SBA), for example, small businesses account for a little more than half of all the innovations in our economy and provide for nearly 30 percent of the jobs in the increasingly important high technology sector.

The current economic expansion has provided a favorable climate for small businesses generally and for minority-owned firms in particular. In 1996 alone, nearly a million new firms began operation. Moreover, in recent years, the number of minority-owned firms has been growing at a rate of three to four times that of other small businesses, though minority-owned firms still constitute only a small proportion of all small businesses. As of 1993, about 12 percent of all small businesses were minority-owned; about 3 percent were black-owned, 3.5 percent Asian-owned, 4 percent Hispanic-owned and 1 percent were owned by Native Americans.

Given the importance of small businesses to our economy, and their heavy reliance on credit to facilitate growth, the Federal Reserve has taken a leading role in efforts to improve understanding of factors that bear on the availability of funds to support business activity. We do that in two primary ways: through an active, ongoing program of data collection and research designed to help us understand credit activity and its impacts on small business; and through a comprehensive program of educational, information and technical assistance activities to help banks and their communities understand and address credit availability issues.

**Research and Access to Capital and Credit**

Let me first address some of our data collection and research efforts.

As in other areas, much of our involvement has focused on sponsoring special surveys of both businesses and creditors and supporting basic research. Just last week here in Washington, the Federal Reserve sponsored a major research conference on business access to capital and credit. Sixteen original research papers were presented, touching on many aspects of small business finance. These included the likely role newer developments such as credit scoring and securitization of business loans may have on small business lending in the future.

Much of the research presented at the conference drew on the Federal Reserve's 1993 National Survey of Small Business Finances. This survey collected detailed information on the financial and other characteristics of a nationally representative sample of small businesses. To help us gain a better understanding of the nature and needs of minority-owned firms, the survey over-sampled the number of firms owned by various minority groups. I might note that we currently are well along in our preparations for another survey later this year, which will include interviews with some 6,000 small businesses.

Three papers presented in the session on access to credit for minority- and female-owned businesses provide many insights, some of which I would like to share with you.

This research documented many similarities, as well as important differences, in financial and nonfinancial characteristics between minority- and white-owned firms and between those owned by males and females. For example, black-owned firms tend to be smaller (whether measured by assets or employees), newer, and more likely to be located in an urban area than their non-minority counterparts. Black-owned businesses also tend to be owned by a person with fewer years of business experience and to have poorer credit histories, but they are also more likely to be owned by a person having at least some college education. Finally, black-owned businesses are more likely to be a sole proprietorship and in the services industry. Differences between other minority-owned firms and white-owned firms tend to be less pronounced, although differences are found.

Clearly, there are many factors considered in credit decisions. Smaller businesses with limited equity capital, fewer assets to pledge as collateral, uncertain earnings streams, and high failure rates can reasonably be expected, on the whole, to experience greater difficulties in obtaining credit than larger firms. The personal creditworthiness of the business owner in sole proprietorships or small partnerships, as well as in small corporations, is also an important consideration. Creditor evaluations of risk, based on these and other legitimate economic factors, properly play a central role in credit decisions.

According to the research, minority and women-owned firms differ from white and male-owned firms, not only on some important financial and nonfinancial dimensions, but also in some of their credit market experiences. The three papers, however, reached mixed conclusions regarding the nature and size of differences in credit market experiences. All three papers concluded that black-owned firms were more likely to be turned down for credit. Even in this regard results vary. For example, in urban markets, which accounted for the vast majority of firms in the study, differences in turndown rates are less pronounced than in rural areas. And when small retail establishments are considered separately, denial rates for black-owned and white-owned firms are similar. Clearly, additional research will be required to more fully understand these complexities.

Determining whether and to what extent discrimination may play a role in explaining differences in the credit market experiences of small businesses owned by individuals from different demographic groups is difficult. Our small business survey is extremely useful because it allows for the documentation of differences in credit market experiences and provides clues regarding the reasons for these differences. However, these data can not identify all of the unique factors involved in the credit-granting decision.

Discrimination, if it does exist in any creditor's decision, is disturbing. The moral and legal objections to discrimination are obvious. In addition, constraints on access to credit due to discrimination carry real costs and serious economic consequences. Such constraints inhibit economic opportunities by limiting the ability of victims to purchase homes, expand businesses, and accumulate wealth. At its heart, discrimination in granting credit artificially restricts the flow of capital. It means that viable economic activity goes unfunded and markets that should work do not.

I can assure you that the Federal Reserve will remain vigilant to any indications that illegal discrimination is part of credit decisions. We, of course, continue to examine banks to measure and ensure their compliance with the Equal Credit Opportunity Act. And we will continue to sponsor research that bears on issues of credit availability and constraints, including those involving potential illegal discrimination.

**Information and Educational Programs**

In addition to our collection and analysis of data on small businesses, the Federal Reserve has also supported and supplemented its other functions with a proactive program to help banks meet key community credit needs. Through our Community Affairs programs at each of the twelve Federal Reserve Banks, we conduct ongoing outreach, educational, and hands-on technical assistance activities designed to help banks, their customers, and communities understand and address community credit needs, including those of small businesses. This is no small commitment. Combined, the Federal Reserve Board and the twelve Reserve Banks devote over 100 full-time staff persons to help institutions understand and participate in the community development process.

To give you an idea of the scope of our activities, over the last three years, Federal Reserve Community Affairs staff have conducted over 4,600 outreach meetings throughout the country to discuss credit-related issues with a wide range of groups interested in community development and investment, including small businesses. During that same period, the twelve Federal Reserve Banks sponsored over 700 educational conferences, seminars, and workshops attended by over 35,000 people, including bankers, representatives of small businesses and community-based organizations, as well as public officials, focusing on credit and investment issues. Although some of this activity involves issues related to affordable housing and community development, over the past few years, our Community Affairs activities have increasingly focused on small business and economic development.

Here are just a few examples that took place during this past year. The Federal Reserve Bank of Boston sponsored a major conference, entitled, "Making it in the Mainstream," which reviewed partnerships between minority enterprises and major corporations as a strategy for inner-city business development and job creation. To help bankers understand the financial techniques available to assist very small and start-up businesses, several educational programs were offered. The Federal Reserve Bank of Minneapolis sponsored a conference on small business incubation, while the Atlanta Reserve Bank conducted a workshop on issues affecting microenterprise lending. The Boston Reserve Bank developed a *Microenterprise Training Curriculum*, designed to provide lending and technical assistance training to organizations that offer services to micro-entrepreneurs. And the Federal Reserve Bank of Richmond conducted a series of six conferences, in conjunction with the National Association of Women Business Owners, on the subject of "Access to Capital: Start to Finish," which focused on financing needs and resources for women-owned businesses.

As an adjunct to their educational programs, the Reserve Banks provide direct technical assistance to bankers, business and community development organizations to help them identify and address capital and credit issues. Many of our Reserve Banks have helped bankers create multi-bank community development corporations (CDCs) and other consortium lending intermediaries, which focus on equity and debt financing for small and disadvantaged businesses. They also help banks deal with regulatory requirements that often must be addressed before investing in CDCs, Small Business Investment Companies, or multi-bank loan consortia. The Federal Reserve Bank of Atlanta, for example, worked with the Florida Black Business Investment Board and assisted banks interested in investing in regional Black Business Investment Corporations, which provide equity and loans to black-owned businesses in that state.

Throughout the country, the Federal Reserve, through its Community Affairs program, regularly works with a wide variety of small business development groups, such as the SBA, small and minority business development centers, community development corporations, and small business associations to identify small business credit issues and convene meetings with bankers to help craft solutions.

**Access to Capital Initiative**

One promising approach is taking place in Cleveland. The Federal Reserve Bank of Cleveland has joined forces with the Small Business Administration and the Greater Cleveland Growth Association's Council of Smaller Enterprises (COSE) to fund and coordinate a community-wide effort to improve capital access for the Northeast Ohio small businesses. The Initiative was created to help narrow the gap between the need for and the availability of start-up and expansion capital for new and growing businesses.

Research had indicated that over a five-year period an average of 5,800 businesses failed each year in the eight-county region of Northeast Ohio, often for lack of sufficient capital at start-up and during key growth phases.

To address capital availability issues, the Initiative's strategy was to engage broad participation from capital providers, business owners, small business support organizations, and legal and accounting professionals both to help identify and shape issues, and to develop solutions. A representative planning committee was formed to help guide the process. Its roles were to identify issues, select people to serve on work teams, review work team recommendations, and champion the new capital access system strategy that was to emerge. A meeting of over 175 bankers, representatives of small business finance intermediaries, venture capitalists, accountants, attorneys, public officials, and small business owners developed a series of recommendations and action plans. The process in Cleveland is continuing and the Federal Reserve continues to play a key role in helping convene meetings and move the process forward.

In a related effort this past year, the Federal Reserve Bank of Chicago began the initial phases of its "Small Business Credit Access Initiative" which will identify and address barriers to equity and debt capital for small enterprises in the Chicago metropolitan area, especially those businesses located in predominately minority and low-income communities.

**Conclusion**

Let me conclude by reemphasizing that the Federal Reserve employs many tools that help us understand credit markets, and address credit and capital availability issues confronting small businesses. Through effective monetary policy, our goal is to help maintain price stability and sustain conditions for growth that provide continuing opportunities for small businesses to flourish. Through our bank supervision functions, we continue to monitor the activities of financial institutions and their compliance with laws requiring them to offer credit on a fair and impartial basis. And we will continue to sponsor research on small business credit markets, and address issues that help foster credit availability for small and disadvantaged firms.

Thank you.

Return to top

1999 Speeches

---