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SMALL BUSINESS AND ECONOMIC
DEVELOPMENT IN THE NEGRO COMMUNITY

Statement of

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before the

Select Committee on Small Business

House of Representatives

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By
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I greatly appreciate the opportunity to share with the Select Committee on Small Business my views on the "role of small business in minority economic development." In responding to the invitation to testify, it occurred to me that I might be able to make a modest contribution to these hearings through an appraisal of the prospects for minority groups in business, based on an economic analysis of the market in which Negro businessmen are attempting to operate profit-making enterprises in the United States today. Thus, my efforts consist of an objective examination in which I set aside questions relating to noneconomic goals (such as enhancing pride of ownership) which other observers may find it worthwhile to pursue.

On the basis of my analysis of the economic evidence, I have concluded that we should be extremely cautious in encouraging Negroes to seek careers as self-employed, small businessmen. This is especially true if the expectation of success is based on the assumption that such a business can be conducted in a separate, all-black environment, protected from the competition of firms doing business in a nationwide market. In general, if one wishes to restrict his efforts to small-scale neighborhood retailing and the provision of relatively simple personal services, it is quite possible that he can earn a living -- although it is likely to be

a modest one. However, if the desire is to engage in manufacturing, construction, transportation or wholesale trade, the prospects of success appear to be extremely dim -- if the firm's output is to be sold mainly in the limited market provided by the Negro community. Between these extremes, the outlook for successful operation becomes less-and-less promising as the scale and technical sophistication of the enterprise increase.

Economic Impact of Segregation and Desegregation

Before proceeding further with this assessment of the prospects for Negroes in small business, we should pause briefly to review the consequences of economic separatism which resulted as an historical legacy of racial discrimination and segregation and the later consequences when some of these barriers were removed. In general, the effects were similar to those produced in international trade when a high tariff wall is erected between two countries. Separate markets prevail in the two areas for items subject to tariff control. For the Negro community in the United States, the greatest barrier imposed by segregation was not in the market for goods -- to which they generally had relatively open access -- but in the market for personal services, such as barber and beauty shops and funeral services. Consequently, a protected market evolved for the provision of these services within the Negro community.

Moreover, as one would expect, this wall of protection provided incentives for Negro professionals and entrepreneurs who began to specialize in activities servicing the Negro community. Negro professionals were

highly concentrated in fields such as medicine, education, and religion -- all hampered by segregation -- but all of which also provided a protected market. In occupations which were dependent upon unprotected national markets, Negroes were conspicuously absent. For example, in 1960 (the last year for which we have detailed information) engineers, scientists, and technicians comprised only 3.8 per cent of all Negroes classified as professional, technical, and managerial; the corresponding figure for whites was 10.5 per cent. The fraction of Negro professionals who were architects was less than one-fifth the fraction for whites. Clearly Negro professionals were concentrating on servicing the Negro community.

In business the same pattern prevailed. Negroes were concentrated in enterprises servicing the protected Negro market. Life insurance provides probably the best example. For years, the major life insurance companies either did not sell policies to Negroes or did so on the basis of different actuarial tables which greatly increased the cost of protection to Negroes. The result was the creation of an environment where Negro life insurance companies were able to grow and prosper. In enterprises that sold to a more general public, such as hardware and department stores, Negroes have not made much headway.

The recent progress toward desegregation in the United States (symbolized by the opening of public accommodations) has eroded the position of many Negro businessmen who were dependent upon segregation to protect their markets. For instance, in many large cities in the East and Midwest, most of the hotels and restaurants which previously catered

to Negroes have encountered hard times, and a few have actually closed their doors.

The trend towards desegregation in American life has influenced the Negro businessman in another important manner. Not only have many of his traditional customers deserted him to shop in the more diverse stores serving national markets but he has also encountered an increasing competition for his traditional supply of labor. Large national corporations for some time have been actively recruiting Negro personnel. Initially the aim was to help market their products in Negro areas, but more recently they have also been seeking manpower for their overall operations. Negro businessmen operating from much smaller economic bases are unable to offer competitive salaries or commensurate opportunities and are thus having a great deal of difficulty retaining qualified employees.

The adverse effects of these changes on Negro businessmen concentrating in those activities formerly protected by segregation is quite striking. This can be seen most clearly in the income trends among nonwhite men during the 1960's. For example, between 1959 and 1967, mean income of all self-employed nonwhite males rose by roughly 114 per cent to about \$7,200; among all self-employed white men, the rise was only 44 per cent to approximately \$8,500. In sharp contrast, income gains for self-employed retail merchants were much smaller for both groups (39 per cent to about \$7,400 for whites and 28 per cent to about \$4,500 for nonwhites).

Expressed differently, in 1959, average incomes of both white and nonwhite retail merchants were well above the average incomes of all

employed men (13 per cent above all whites for white retailers and 28 per cent above all nonwhites for nonwhite retailers). By 1967, however, the averages for self-employed retail merchants showed smaller rises and were below the averages for all employed men -- 9 per cent below all whites for white retailers and 12 per cent below all nonwhites for nonwhite retailers.

Economic Environment of Negro Business

The legacy of racial segregation is important because it has shaped the economic environment in which Negro businessmen are currently operating -- and in which they are likely to operate for some time. The main economic characteristics of the Negro community are widely known and need not be reviewed in detail here. For example, in 1967, Negroes had a median family income of \$4939 which was only 59 per cent of that of white families. These income figures are important because they clearly point up the differences in purchasing power in the two communities -- a matter of fundamental importance to businessmen. However, when we examine the financial assets and liabilities of Negroes compared with other families, the differences in market potential are thrown into even sharper focus.

These differences are clearly marked in Tables 1 and 2 (attached), which summarize data on assets and liabilities from the Survey of Consumer Finances conducted by the Survey Research Center at the University of Michigan. The ownership of financial assets is presented in Table 1. As mentioned earlier, Negro life insurance companies emerged as a response to the failure of white life insurance companies to serve the Negro market.

The result of this segregated market is that Negroes at all levels of income appear to have a slightly higher probability of holding life insurance than whites. The picture on other financial assets is quite different. Negroes at virtually all levels of income are less likely to have savings accounts or stocks. The lone exception appears in the over \$10,000 income class where Negroes rely heavily on savings accounts but invest far less frequently in stocks. In fact, although not shown in Table 1, the Michigan Survey reported that in 1966 Negro families obtained only 2 per cent (versus 6 per cent for non-Negro families) of their total money income from dividends, rent, interest and trust funds.

The most important data in Table 1 are for the income categories between \$5,000 and \$10,000. These two categories contain roughly 40 per cent of all Negro families, and it is this range of income which provides the broadest foundations of the Negro market. The asset data for families within this critical income range show that Negroes have considerably less financial accumulation than white families. This finding implies that these Negro families would not be as good potential consumers as the income figures might suggest.

The other side of the financial picture is liabilities. (See Table 2, attached) One is immediately struck by the fact that Negroes at all levels of income are much more heavily burdened with installment debt. The repayment of this debt represents a sizable claim on disposable income and thus makes a Negro family a poorer potential consumer for additional goods and services than a family of similar income who is less encumbered

by installment debt payments. The case of mortgage debt is a bit more difficult to analyze. The probability of home ownership rises substantially with income and is higher at all levels of income for whites than for Negroes. A single (not fully explained) exception to this general trend is the high tendency for Negro families in the lowest income category to own homes. In part this may reflect older retired families and in part it may represent impoverished rural southern Negroes whose home ownership may be quite modest. In general, it is safe to conclude that Negroes of similar income are not accumulating an equity position in housing at the same rate as white families.

The tendency to owe mortgage debt, however, appears roughly equal for Negroes and whites of similar income. Since Negroes have a lesser tendency to own a home at a given level of income, this similarity in the fraction of the total population owing mortgage debt suggests clearly that if a Negro does own a home, the chances are greater that he has a mortgage on it than for a white homeowner with the same income.

These data on the financial assets and liabilities shed new light on the economic achievements of Negro families. These data show that Negro families of comparable income have greater liabilities and fewer financial assets to meet these liabilities than whites. This finding suggests that the usually observed data on white-Negro income differentials actually understate differences in purchasing power, because the income figures do not indicate the relatively poorer net financial position of Negro families. The figures on assets and liabilities

accentuate the problems of weak markets facing businessmen who limit themselves to the Negro community.

The Structure of Negro Businesses and the Outlook for Economic Development

Having highlighted some of the limitations inherent in the Negro market, it might be helpful to see what types of enterprises have developed in this environment. For this purpose, only fragmentary information is available. One source relates to Negro owned and operated businesses in Washington, D. C., in 1967. (See Table 3 attached.) These data show a heavy preponderance in the service area. The distribution of businesses within each category is also revealing:

- Of the 1,249 businesses classified as services, 555 (or 44 per cent) were barber shops, beauty salons or beauty schools, while 146 (or 12 per cent) were drycleaning establishments.
- Of the 473 retail businesses, 240 (or 51 per cent) were carryout shops, delicatessens, grocery stores, or restaurants. There were only 2 used car lots in this category and no new car dealers.
- Of the 84 businesses in finance, insurance, and real estate, there were 2 banks, 1 finance company, 7 insurance companies, 1 title company, and 73 (or 87 per cent) were in real estate.
- Of the 35 manufacturing companies, 28 (or 80 per cent) were newspaper publishers, printers, or sign shops.

Thus, businesses in the Washington area are highly concentrated in areas such as barber shops, beauty salons, and drycleaning establishments where Negroes are servicing Negroes.

However, a second -- and more important -- conclusion emerging from these data is that these are not the types of enterprises which can serve as the mainsprings of economic development in the long-run.

This conclusion is also strongly supported by the results of a seven-city survey of Negro businesses conducted by the National Business League in early 1969. (See Table 4 attached.)* Of the 564 businesses reported in the Survey, 329 (or 58 per cent) were concentrated in six out of sixty-seven industry categories. These six categories correspond closely to the local market oriented service operations in Washington, D.C., described above.

A careful look at the employment patterns within the specific categories of Negro business is useful. Of the 329 businesses in the six-industry group, 268 (or 82 per cent) had four or less employees, while the corresponding figure for the entire sample was nearly as high -- 80 per cent. Thus, these six categories are a good representation of employment patterns for the entire sample. The obvious conclusion from these figures are that Negro businesses are very small, indeed.

The small size of the average Negro business is, in part, due to a concentration in the types of enterprises which are traditionally quite small. Barber and beauty shops are small operations, and it is no surprise that 92 (or 90 per cent) of the barber and beauty shops had four or fewer employees. What is more distressing is the tendency for Negro businesses to be small in operations which are not traditionally small. The category labeled grocery stores and supermarkets is a good example. Of the 82 businesses in this category, 70 (or 85 per cent) had four or

*I am grateful to Mr. Berkeley Burrell, President of the National Business League, for permission to use data from the unpublished findings of this Survey.

fewer employees, and only 1 had over twenty-one employees. Clearly the category labeled grocery stores and supermarkets refers to very small grocery stores serving limited markets.

Employment figures present only one dimension of Negro businesses, and more information is possible through data on income and profits. (See Table 5 attached.) The income and profit figures reflect the same general trends as the employment data. Of the 329 firms in the six-industry groups, 279 (or 85 per cent) expected gross income in 1967 of \$20,000 or less, while 455 (or 81 per cent of the total sample) expected to be in this range. For estimated net profits, the picture was equally poor -- with 290 (or 88 per cent of the businesses in the six categories) and 474 (or 81 per cent of all businesses) -- expecting a net profit of \$5,000 or less. Of the 54 restaurants in the sample, 49 (or 91 per cent) estimated net profits of \$5,000 or less and the remaining 5 anticipated profits of between \$5,000 and \$10,000.

Concluding Comments

From this analysis, we can conclude that the prospects for economic development through Negro owned businesses dependent upon the type of infrastructure discussed above are not very encouraging. The asset and liability data presented above reinforce the already familiar income statistics, and together they show clearly that the Negro market is by no means a strong one. Consequently, entrepreneurs who limit themselves to these markets will be denied the economies of scale which are a pre-condition of long-run economic development. The small firms spawned by

these markets offer a limited potential for an expansion in the total number of job opportunities. The high concentration of these firms in service areas does not provide a margin of profit large enough for the accumulation of new capital, and it inhibits the development of the types of skills needed to compete successfully for executive positions in large corporations operating in a modern high technology economy.

As mentioned at the outset, my purpose in testifying today is not to demean small businesses which I feel do offer modest opportunities for some potential Negro entrepreneurs. Rather, my purpose has been to point out some of the serious economic pitfalls of a strategy based upon separatism and segregation. Economic separatism has been tried in the past, and it has failed to provide genuine opportunity for Negro businessmen -- and it certainly has failed to provide economic well-being for our Negro population. I am personally convinced that the most promising path of economic opportunity for Negroes lies in full participation in an integrated national economy. This holds for Negroes who want to be businessmen as well as for everyone else. The sooner we recognize this important lesson from the past, the quicker we can start to attack the real obstacles to the Negro's economic progress in the United States.

Table 1

FRACTION OF POPULATION HOLDING DIFFERENT
FINANCIAL ASSETS, BY INCOME CLASS AND RACE, 1967

Income Class	Life Insurance		Savings Accounts		Stocks	
	Negro	Non-Negro	Negro	Non-Negro	Negro	Non-Negro
Under \$3,000	54	49	13	44	0	11
\$3,000-5,000	75	68	41	56	1	15
\$5,000-7,500	85	80	52	62	5	21
\$7,500-10,000	95	92	58	69	5	26
Over \$10,000	100	96	89	79	30	45
Total	73	80	38	64	4	26

Source: Survey Research Center, University of Michigan

Table 2

FRACTION OF POPULATION WITH DIFFERENT FINANCIAL LIABILITIES,
BY INCOME CLASS AND RACE, 1967

Income Class	Installment Debt		Mortgage Debt			
	Negro	Non-Negro	Negro		Non-Negro	
			Owners	Debt	Owners	Debt
Under \$3,000	49	19	40	10	52	8
\$3,000-5,000	59	39	29	8	54	18
\$5,000-7,500	84	52	37	25	54	27
\$7,500-10,000	71	60	50	39	68	46
Over \$10,000	93	53	70	66	79	55
Total	64	46	40	20	63	37

Source: Survey Research Center, University of Michigan

Table 3

Distribution of Negro Owned and Operated Business in
Washington, D. C., 1967

<u>Type of Business</u>	<u>Number</u>	<u>Per Cent</u>
Services	1,249	60.5
Retail	473	22.9
Contract Construction	119	5.8
Transportation	82	4.0
Finance, Insurance, and Real Estate	84	4.1
Manufacturing	35	1.7
Wholesale	<u>20</u>	<u>1.0</u>
Total	2,062	100.0

Source: A Directory of Negro-Owned and Operated Businesses in Washington, D.C., compiled by Small Business Guidance and Development Center, Howard University, 1967

Table 4

DISTRIBUTION OF NEGRO OWNED ENTERPRISES BY NUMBER OF EMPLOYEES,

National Business League Survey, 1969.

Number of Employees

Category of Business	1-4	5-10	11-20	21-30	Over 30	Total
Restaurants	44	9	1	0	0	54
Snack & Carryouts	9	4	0	0	0	13
Grocery and Supermarkets	70		4	0		82
Service Station and Auto Repairs	29	10		0	0	40
Laundry and Drycleaning	24	8	3	2		38
Beauty and Barber Shops	92	8	2	0	0	102
Total in Six Categories	268	46	11	2	2	329
Total, All Businesses	452	83	21	3	5	564

Table 5

DISTRIBUTION OF NEGRO OWNED ENTERPRISES, BY SIZE OF ESTIMATED INCOME AND PROFIT, 1967

National Business League Survey

Category of Business	Estimated Gross Income					Estimated Net Profit				
	Under 20	20-50	50-95	Over 95	Total	Under 5	5-10	10-20	20-30	Over 30
Restaurants	48	4	1	1	54	49	5	0	0	0
Snack and Carryout	11	1	1	0	13	13	0	0	0	0
Grocery and Supermarkets	62	10	2	8	82	75	4	2	1	0
Service Station and Auto Repairs	31	4	3	2	40	31	5	4	0	0
Laundry and Drycleaning	30	5	2	1	38	27	8	3	0	0
Beauty and Barber Shops	97	3	0	2	102	95	6	1	0	0
Total in Six Categories	279	27	9	14	329	290	28	10	1	0
Total, All Businesses	455	59	24	26	564	474	58	25	3	4