FOSTERING MINORITY ENTERPRISE

An Address By

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I have been looking forward with particular pleasure to coming here tonight because I believe that securing broad participation of minority groups in business enterprise is such an important and challenging task.

The Chicago Economic Development Corporation has a record of accomplishment in making opportunity available to all. But as you know better than anyone, the task is large. Only a modest beginning has been made. We need more success stories like Quinco and San Juan Sales. We need more organizations like CNA and Ford Motor Stamping. We need more men like George Gregg, Dempsey Travis, Jesse Jackson, Bertal Daigre and Gordon Sherman.

Others are accepting the challenge, too. Not the least of these are the Federal Government and the banking industry.

The Federal Government is attempting to present a balanced strategy. It consists of three different components:

The first of these is an effort to re-direct the Federal Government's participation in the marketplace. Changes in the Federal procurement program are expected to divert $100 million in purchases to minority-owned businesses this year--more than double last year's record. This is a logical extension of a long-standing Federal policy of encouraging market development for small business enterprises.

A newer development in this area is the practice of depositing Government funds in minority-owned banks. Not only will this expand the lending potential of banks in minority neighborhoods, but it will help to reduce the operating costs of these banks, which typically have an above average proportion of their deposits in expensive-to-service small personal accounts.

The second component of the Federal Government's strategy is to press for a more active role by businessmen and by the companies themselves. Under the leadership of the Office of Minority Business Enterprise, for example, the nation's major oil companies are seeking to create thousands of new minority-owned service station dealerships.

The Office of Minority Business Enterprise has been criticized because it lacks funding authority. We must bear in mind, however, that it is only one part of the Federal strategy and it has so far provided a useful function.

The ultimate success of this component of the strategy depends heavily on the private sector. The going will not be easy. The Wall Street Journal carried a story last Tuesday about the difficulties encountered by the automobile manufacturers in expanding the number of minority-owned dealerships. The difficulties were typical of businesses located in less prosperous neighborhoods.

However, it is gratifying to learn from this article that "many auto men now favor placing black dealers on the fringe of the ghetto--or in the suburbs--instead of locating them in troubled inner city areas."

Direct program action is the third component of the Federal Government's strategy. It requires enlarging existing program elements and adding new ones to fill important gaps. For example, there are clearly major roles for the Small Business Administration, the Economic Development Administration and the Department of Housing and Urban Development, and these agencies are committed to fulfilling them.

A hopeful program is a cooperative effort between the Federal Government and the private sector to provide equity capital to minority businesses through Minority Enterprise Small Business Investment Companies--MESBIC's for short.

This program is not novel--it is another version of the older Small Business Investment Corporation program --but it is important. The lack of sufficient equity capital can mean the premature end of an otherwise promising business venture, or it may mean that the business will never even get started.

You have recognized this problem by forming one venture capital organization to operate in Model Cities areas. You have also become the organizing focus for a Chicago MESBIC.

While I was in Washington, I worked closely with Secretary of Commerce Stans and I can assure you of his personal conviction of the importance of the entire minority enterprise focus.

Before I went to Washington, I was already convinced of the crying need for active commercial bank encouragement to minority enterprise. The banking industry needs efforts like yours if it is to realize its full potential for financing minority-owned businesses.

The banking industry has just in the past two years begun to indicate its willingness and enthusiasm to participate fully in the expansion of business opportunities for minorities. The American Bankers Association, acting on the recommendation of its Committee on Urban Affairs, has endorsed a five-year goal of $1 billion in lending to minority-owned business--approximately double the estimated rate of lending over the last five years. As you all know, Don Graham, Chairman of the Continental Bank, was the first chairman of that committee.

To encourage banks to help meet this 5-year goal, the Association is conducting seminars in 50 cities across the country. Bankers who have been particularly successful in the area of minority lending are training others through these seminars. At the seminar held here in Chicago, more than 40 banks were represented, many by senior officers.

Meeting the $1 billion goal will require a major effort, but the nation's banks are equal to it. A year ago, half of the nation's major banks reported having adopted an official policy--established through formal board or management action--favoring inner-city economic development or expanded minority business lending.

Many more than half of the major banks reported having initiated special procedures to lend to minority-owned businesses which would not qualify for a loan under conventional lending standards.

If we can generalize from the lending experience of the major banks which have knowledge of their borrowers' race, about one-fifth of all commercial loans made to minority businesses in fiscal 1969 were made using special lending standards and without involving the Small Business Administration.

Although 40 percent of all commercial loans were made using conventional standards, also without SBA involvement, delinquency and charge-off rates have been high on minority loan portfolios.

These risks were anticipated by the ABA when the $1 billion lending goal was adopted. When ABA president Nat Rogers explained the goal to the Board of Governors of the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, he requested that each one issue a statement to its examining personnel establishing criteria for evaluating the soundness of minority loans in bank portfolios.

The official reply of the Board of Governors of the Federal Reserve System was dated August 27. I quote from it in part:

"We believe the proposed program of the banking industry is worthwhile and are pleased to see that the Association's undertaking has the needed support of the commercial banks. The problems of the nation's cities and its disadvantaged minorities are areas in which commercial banks can make a most important contribution to progress.

"In the Board's judgment the more loans to disadvantaged minorities the better, provided they are sound. . . . However, in examining banks a disadvantaged person or firm must be evaluated just as any other loan--that is, on the basis of the ability of the borrower to make timely repayment and his record of performance."

I submit that there is a crucial distinction to be made between evaluating a loan before it is made, and after it is made.

Those who have urged banks to become more responsive to the needs of minorities have suggested that, in some sense, bankers are not well qualified to judge the prospects of a minority-owned business. They reason that cultural differences may prevent proper communication between the banker and the loan applicant.

This kind of urging has prompted a re-thinking of the accepted reasons for certain lending practices, and at the same time it has encouraged experimentation with alternatives. These are healthy responses that the Board's reply is designed to encourage. Banks that have become leaders in the industry are always re-evaluating their policies and innovating.

It is not inconsistent for the Federal Reserve System to encourage banks to experiment in making more minority loans, and still insist that the same standards of soundness be applied to all loans already on the books. Once a loan is made, the performance of the borrower in making repayment is paramount.

The ultimate reason for expanding business opportunities among minorities is to breed successful business ventures. The Federal Reserve Board, in responding to the ABA request, added that it presumed banks would reduce the risk associated with any minority loan by providing adequate counseling to the customer.

Counseling is absolutely essential. For equal opportunity to be meaningful, ways must be developed to transfer the lessons of successful business experience to each potential enterpreneur, regardless of his social background or level of formal education.

Many banks offer some kind of special counseling service to their minority customers. The Federal Reserve Bank of Chicago recently conducted a survey of non-credit services offered at Seventh District banks. It revealed that 32 banks in the Chicago area offer special counseling to minority loan applicants, and 11 offer special management counsulting to their minority customers.

Counseling should do more than simply reduce the riskiness of a loan. It should place the minority entrepreneur in a competitive position. The rate of business failure is high, even among non minorities. Secretary Stans has noted that 50 percent of white entrepreneurs close their doors within two years of starting operation. Many of these do not default on their bank loans; they are able to cover their costs, but they find working for somebody else more remunerative.

It is clear that there are high risks and low average payoff potential in self-employment generally. But this need not discourage efforts to foster minority ownership.

In an address on black capitalism delivered before the American Economic Association last December Governor Brimmer of the Federal Reserve Board noted that non-whites were under-represented in the group of self-employed individuals. Non-white persons account for just over ten percent of total employment, but represent less than five percent of self-employed individuals. Expanding minority ownership is essential if we are to erase the legacy of economic and social discrimination.

Nor, is it enough to transfer white-owned businesses located in black neighborhoods to blacks. Indeed, if this is all we do to expand minority enterprise, we are in danger of fostering racial separatism.

Besides this, successful business ventures are generally large. Your group recognized this when it established BIG--Business and Inner-City Growth--program. I wish you well. Helping to form 50 companies with forecasted sales in excess of $100 thousand each in the next year or so is indeed a real challenge.

Awards dinners such as these serve to remind us that when we commit ourselves to minority enterprise, we are committing ourselves to creating success stories, not marginal businesses.

The economic climate, too, should be more conducive to creating these success stories in the future than it is today. There is no question that our economy and our financial system have experienced unusual strains and stresses this year. Over the past five years we have been plagued with dangerous inflationary pressures.

Policies designed to dampen these pressures, plus a decline in resources devoted to national defense and the space program, have forced difficult adjustments on business. Marginal firms have probably been more hard-pressed than others--but the alternative of letting inflation run rampant could have been disastrous.

The Government's budget policy and the Federal Reserve's credit policy have together been paving the way for resumption of sustainable economic growth with stable prices. They have been creating the only type of climate in which enterprises can truly be successful. This is obviously the type of climate necessary for the sustained expansion of opportunities for minority business ventures.

A strong economy in conjunction with the program efforts of the Federal Government and the banking industry will help create these success stories. I foresee no novel programs. But I do see a new spirit and much hard work.

The Federal Government is acting mainly through variations on existing programs, and encouraging voluntary action by existing businesses. These programs appear to have the capacity to supply all of the Federal incentives needed for the task ahead of us.

The banking industry continues to do what it does best--loaning funds--but it is doing it in new and unusual ways. As more seed capital becomes available, I am sure that the banking industry will be providing adequate funds for minority enterprises.

A potentially more serious problem than lack of funds, or organizational assistance, is the need for new ideas for business ventures arising within the minority community itself. But when we open the doors of opportunity, we bring hope and desire, which like flint and steel ignite the sparks that become the ideas behind successful business ventures.