SECTION V

STRONGER FAMILY BALANCE SHEETS: ASSETS

Building Wealth Inclusively Through Business Ownership

BY JOYCE KLEIN

Although business ownership may not be the primary way that most individuals and families build wealth in the United States, in any capitalist economy it's a route that cannot be ignored. Especially when the rules of that economy have been set such that in the past two decades, much of the growth in income inequality has been driven by a combination of returns to capital and, at the highest levels, pass-through business income.[1]

Although business ownership is clearly driving income generation and wealth accumulation among the top 10% and 1%, it can and should have a role in raising wealth levels for those in the bottom quintile of the wealth distribution. While it may be harder to draw the connection between the ownership of mom-and-pop enterprises or self-employment and wealth accumulation, there is evidence that households in which the head of household is self-employed have substantially higher wealth levels than those in which the head works for someone else.[2] Research has found this outcome is particularly strong for minority and women business owners and that the median net worth for Black business owners is 12 times higher

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1 Thomas Piketty, Emmanuel Saez and Gabriel Zucman, 2018. "Distributional National Accounts: Methods and Estimates for the United States." *Quarterly Journal of Economics*, 133, 553-609, https://gabriel-zucman.eu/files/PSZ2018QJE.pdf; Matthew Smith et al., 2019. "Capitalists in the Twenty-First Century." *Quarterly Journal of Economics*, 134, 1675-1745, https://academic.oup.com/qje/article/134/4/1675/5542244?login=true.

2 Brian K. Bucks, Arthur B. Kennickell and Kevin B. Moore, with assistance from Gerhard Fries and A. Michael Neal, 2016. "Recent Change in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances." Federal Reserve Bulletin, A1-A38, https://www.federalreserve.gov/pubs/bulletin/2006/financesurvey.pdf.

than Black nonbusiness owners.[3]

But while Black and Hispanic families are about as likely as white families to own wealth in the form of equity in a closely held business, the level of wealth they hold is lower. The images below show time-series data from the Survey of Consumer Finances on the share of families with wealth from a closely held firm and the median value of business equity (from analysis by the Institute for Economic Equity at the Federal Reserve Bank of St. Louis).[4] Data on both measures are quite volatile over time, but the general trend is that Black families have about half the level of business equity as white families, with Hispanic families having wealth levels somewhere in between the two.

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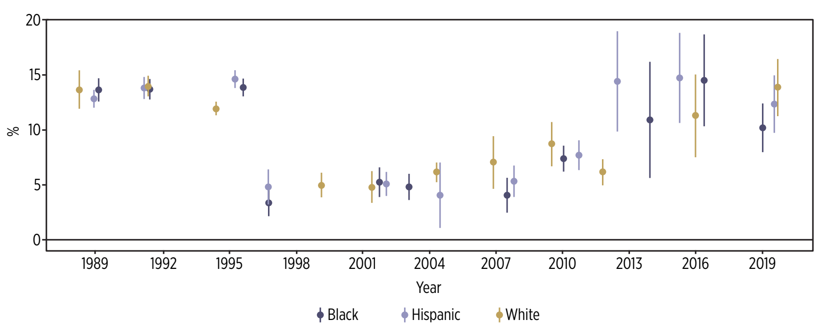
Share of Families That Own Equity in Closely Held Businesses

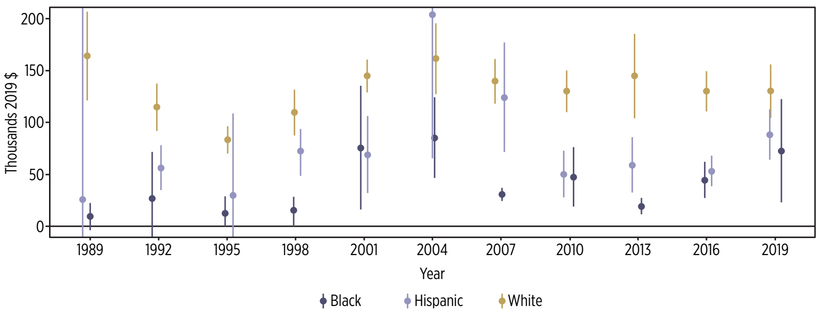


Source: Federal Reserve Board's Survey of Consumer Finances, calculations by Institute for Economic Equity.
Note: Replicate weight adjusted 90% CIs.

[3] Analysis of 2008 SIPP microdata conducted by Robert Fairlie for the Association for Enterprise Opportunity, as cited in The Tapestry of Black Business Ownership in America, 2017, Washington, DC: Association for Enterprise Opportunity, p. 8, http://www.aeoworks.org/wp-content/uploads/2019/03/AEO_Black_Owned_Business_Report_02_16_17_FOR_WEB.pdf.

[4] The Survey of Consumer Finances aggregates all other racial and ethnic identities into an "other" category. As a result, it is not possible to include analysis of these data points for Asian, Native/Indigenous or any other racial and ethnic identities.

Median Value of Business Equity (Conditional on Ownership)



Source: Federal Reserve Board's Survey of Consumer Finances, calculations by Institute for Economic Equity.
Note: Replicate weight adjusted 90% CIs.

Unfortunately, many of the same forces that have contributed to income and wealth inequality—and perhaps as or more important, the very low wealth levels among most Black and Hispanic households—have hampered the growth of their firms. Most firms are started largely with the owner's own money—it is the source they use to provide equity or patient financing. Next, most owners leverage their assets (homes or retirement savings) or their credit histories to borrow—from their IRAs via a home equity line of credit or a personal credit card. Absent any of these assets, it is hard to borrow funds from traditional sources. Business owners with weaker credit histories have been able to borrow from nonbank alternative lenders, but in many cases the products they offer lack transparency and carry high costs, which in the end often strip wealth or limit the owner's ability to build the business.

Occupational segregation and lack of access to capital have also meant that Black and Hispanic entrepreneurs are concentrated in industries with low barriers to entry but also have lower revenues and low margins. It's harder to build wealth from these types of firms—especially when debt, or in some cases only high-cost debt, is the only source of financing that a business owner can access. This is because it's hard to make great leaps when repayments begin soon after borrowing and loans are sized relative to existing cash flows.

So what do we do to realize the potential for business ownership to be a route to wealth building, particularly for people of color?

It's worth starting by acknowledging that many of the other policies identified by other essay contributors to build wealth and protect against financial predation—by increasing savings, expanding homeownership, addressing student debt, eliminating unfair and unequal fines and fees, and so forth—will over time enable more individuals to invest equity in their own firms. Increasing access to capital share and employee ownership will allow workers as well as business owners to benefit from the wealth generated by larger firms. Strengthening policies that expand and improve the benefits of labor market participation will also help—by enabling those who are forced into self-employment out of necessity to achieve better economic outcomes and also removing some of the most marginal firms from the competition pool.

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But as we also put those policies into place, there are things we can do now to support business ownership that will disproportionately benefit people of color:

- Expand access to debt that is appropriately sized and affordably priced. Three policies are important here:
  - Increase the level of grant support for community development financial institutions (CDFIs) so that they can build the organizational capacity and capital bases needed to scale the level of their lending (note: the CARES Act included $12 billion in funding for CDFIs and minority depository institutions, which is an important start in strengthening these institutions).
  - Provide subsidies and incentives to CDFIs that make microloans (less than $50,000) so that they can scale their ability to make smaller dollar loans at affordable rates. The American Rescue Plan reauthorized and provided $10 billion in funding for the State Small Business Credit Initiative, which will fund state, territory and tribal government small business credit support and investment programs. To ensure these reach business owners of color, it will be important that state programs support smaller-dollar small business lending.

- Pass legislation that requires small business lenders to clearly disclose the price and terms of small business credit (including through the disclosure of annual percentage rates).[5]

- Continue to expand efforts to help small firms connect to markets and revenue-generating opportunities (through public and private procurement and other means as well). Importantly, also recognize that appropriate financing and support in scaling up operations may also be important—getting awarded a contract without appropriate financing can doom or weaken a business in the long term.
- Support capital markets and product innovation that increases the availability of equity and more patient capital. Among more bank-like institutions and CDFIs, this might involve appropriately structured and priced revenue-based financing or residual-value leasing; it can also include creating crowdfunding and equity models that are suited to businesses that have strong growth potential but do not meet the criteria sought by venture financing.
- Examine and revise laws and regulations that unnecessarily push business owners toward informality. At the local level, these often include licensing rules. At the state level, they can include limits on the types of jobs held by individuals who have been incarcerated, while at the federal level they include immigration laws. In the long term, businesses that remain informal simply cannot grow to the levels of those that can access financing and markets more formally.

Supporting the ability of business owners of color to build their firms will not only be important in addressing racial wealth inequality—it will also be important for the strength of the U.S. economy, as other essay contributors have demonstrated. As the percentage of new entrepreneurs who are people of color increases,[6] we will lose the benefits that small and growing businesses

[5] These disclosures are embodied in the recently passed New York State Small Business Truth in Lending Act as well as the truth in lending disclosure provisions included in the Small Business Lending Disclosure Act (H.R. 7921) introduced in the 116th Congress and poised to be reintroduced in the 117th.

[6] In 2018, the share of new entrepreneurs who are from minority groups was 45.6%, close to twice that in 1996 (22.9%). Robert Fairlie et al., 2019. "2018 National Report on Early-Stage Entrepreneurship," Ewing Marion Kauffman Foundation, p. 4, https://indicators.kauffman.org/wp-content/uploads/sites/2/2019/09/National_Report_Sept_2019.pdf.

play in driving innovation, product diversity and experiences if we cannot figure out how to ensure that Black, Brown and other non-white-owned firms can thrive and grow. And the bigger and more profitable the firms owned by business owners of color, the more likely they will contribute to building the wealth of their owners.

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