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The barriers that hold back minority entrepreneurs

By Robert L. Johnson
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As an entrepreneur, I know firsthand the challenges minority entrepreneurs face. I also know the talent, dedication, determination and vision that minority entrepreneurs possess in their desire to become a part of and a contributor to the American Dream. But the simple fact of economic reality in America is that minority Americans are significantly and disproportionately underrepresented in access to capital to start and fund entrepreneurial enterprises due to years of racial and economic discrimination.

It's worth taking note of a recent study by the Economic Policy Institute, which found that the median net worth for African Americans was $11,800 compared with $118,000 for whites. When home equity was subtracted, African Americans had $300 in net assets while whites had $36,000. This gap is likely to widen as employment stagnates and as the mortgage crisis costs some black families their homes.

Without question, the lack of access to capital and capital formation are the principal factors holding back opportunities for minority businesses and as a consequence, wealth and job creation within the minority community. In my opinion, there are two crucial political and philosophical issues that first must be confronted and resolved before capital can be effectively directed to minority Americans in this society.

The first question is: Why do the federal and state governments and major U.S. corporations define minority ownership as owning or holding 51 percent equity?

The answer usually offered is that a 51 percent equity requirement prohibits so-called minority "front companies or shams" from gaining access to government preferences. But why do we assume minority companies are fronts? The answer is painfully obvious, and it is partially why we are all here today. We know that minorities as a whole lack access to capital and therefore are unlikely to raise sufficient equity capital to control a company without outside financial assistance. But whose fault is that?

Think about this for a moment: As a businessperson, your goal is to grow in scale and value. How do you accomplish this if your company cannot raise outside equity if it exceeds your 51 percent ownership requirement?

Why not the debt market, you might ask?

Lenders have only one goal, a repayment of debt with interest as quickly as possible. On the other hand, and I know this to be a fact, strategic equity partners seek to combine investment and operational synergies with the minority company to maximize long-term growth and value.

I suggest we let market relationships decide and base ownership not only on equity control, but other factors. Such factors could be: Is the minority the founder of the company? Is the minority the key revenue driver in the company based on his or her intellectual capital, i.e. Oprah Winfrey?

What about considering voting control in different classes of stock that give more votes to the minority, or board control where the minority has the right to appoint the board majority. Or simply drop the equity requirement from 51 percent to 10 percent to recognize what we all agree is the true problem: the disparity in capital access that minorities face when launching a business.

This leads me to my second point. Is there a compelling national interest for helping minority businesses and what are its limitations?

If the goal is to foster minority businesses as opposed to small businesses, how do we address the Supreme Court's compelling-national-interest test for race-based remedies to discrimination? The court in the past has ruled that any government-sponsored economic preference to minority businesses should be "narrowly tailored" so as not to cause reverse discrimination.

Justice Sandra Day O'Connor, writing for the majority in the *Adarand* case [*Adarand Constructors, Inc. v. Peña, June 12, 1995*], stated that there was no compelling national interest in favoring a minority contractor for a highway construction job over a majority company.

If this precedent dictates our approach to minority business development, it will forever, in my opinion, restrict minority access to government-sponsored business opportunities.

We agree that due to past discrimination, minorities can't compete on capital formation, on experience or scale without capital, and are unlikely to win most competitive bids without an advantage or preference.

I don't have a ready politically acceptable answer to these philosophical quandaries, but I am enough of a businessperson to know that the free marketplace, left to its own devices, will not solve this problem.

I don't believe the government can promote minority ownership by placing restrictions on their start-up potential by requiring an "unconditional 51 percent ownership." I don't believe the government can say it's critically important to have minority businesses succeed in the marketplace and on the other hand declare there is no compelling national interest to favor these businesses.

This commentary is adapted from Robert L. Johnson's testimony April 15 before the Senate Committee on Small Business and Entrepreneurship. Johnson, the founder of Black Entertainment Television, now chairs the RLJ Cos.

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