RESEARCH REPORT | EXECUTIVE SUMMARY

LATINO-OWNED BUSINESSES: SHINING A LIGHT ON NATIONAL TRENDS

Latino-owned businesses are growing in number and importance to the American economy. Contributing more than $700 billion in sales to the economy annually,[1] they are also an important source of employment as sole proprietors and as firms with employees on payroll. The 2012 U.S. Census Survey of Business Owners estimated that Latino firms have 2.3 million employees on payroll, a number that by several counts has grown since the survey's release. One in four new businesses, traditionally key sources of new jobs,[2] is now Latino-owned. Quite simply, small business growth is tied to the fortunes of Latino-owned businesses.

Yet, research also shows that Latino firms face significant growth barriers. Estimates from the Stanford Latino Entrepreneurship Initiative (SLEI) highlight that only three percent of Latino businesses grow to $1,000,000 or more in annual revenues, compared to six percent of white-owned businesses.[3] In short, despite impressive numbers of startups, Latino firms tend to stay small.[4]

This report builds on earlier work from SLEI and the Aspen Institute[5] to probe firm-level and environmental-level growth factors that influence Latino business performance. By comparing Latino-owned firms to non-Latino white-owned firms, unscaled Latino firms to scaled firms, and metro areas of relatively strong Latino entrepreneurship to those with smaller shares of Latino businesses, we are able to discern the most acute challenges and begin to highlight remedies to these challenges. This report's goal is to focus attention on potential investments at the firm- and community-level that will advance Latino business growth. It draws on analysis of U.S. Census Bureau data, surveys from SLEI and the Federal Reserve Banks, and interviews with unscaled and scaled Latino-owned firms as part of a research collaboration between Stanford Graduate School of Business, the Federal Reserve Bank of New York, and Interise.

KEY FINDINGS

1. Latino business owners tend to rely on informal financing and are frequently averse to taking on debt.

- Latino business owners tend to depend on personal savings and seed funding from friends and family to start their businesses.
- Latino entrepreneurs state they are averse to amassing debt to support the business, and that such financing is often not available at acceptable terms.
- Reliance on personal funds and loans from family/friends can cause a deterioration of personal credit and inhibit scaling.

2. Latino business owners bear greater personal financial risk, related to lower credit scores and limited credit histories.

- Latino business owners are more likely than non-Latino white business owners to use credit cards, factoring, and merchant cash advances—products that require less collateral and are associated with higher average interest rates.
- Latino-owned firms are also much more likely to use personal guarantees than business assets to secure financing (47 percent compared to 34 percent).
- Latino-owned businesses report being medium or high credit risk at higher rates than non-Latino white-owned firms: 49 percent compared to 29 percent. These patterns are consistent with the fact that a higher proportion of Latino-owned businesses are startups, but also suggest a limited ability to secure affordable growth capital.

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3. Latino business owners face significant financial challenges compared to white business owners.

- Despite reporting comparable patterns of revenue growth, employment growth, and profitability as non-Latino white-owned businesses, Latino-owned businesses report acute operating expense and credit availability issues.

- These challenges are equally common among unscaled and scaled Latino-owned businesses, with 44 percent of scaled firms stating that they have difficulties paying operating expenses and 35 percent reporting credit availability issues. In fact, scaled Latino-owned businesses are more likely to report credit availability issues than unscaled non-Latino white-owned businesses.

- Latino-owned businesses applied for financing in 2017 at slightly higher rates than non- Latino white-owned businesses—47 percent compared to 40 percent—but were much more likely to experience funding shortfalls: 28 percent received full funding, compared to 49 percent of non-Latino white-owned businesses. What's more, the funding gaps are especially acute for the large share—97 percent—of Latino-owned businesses with $1,000,000 or less in annual revenues: 40 percent of loan and line of credit applicants received none of the financing applied for, compared to only 23 percent of non-Latino, white-owned businesses.

4. Operational challenges differ for scaled and unscaled Latino-owned businesses.

- Scaled firms are facing talent shortages, citing smaller pools of skilled workers. These firms are considering ways to develop talent and create unique value propositions in order to set themselves apart.

- Unscaled firms cite difficulty accessing credit to help manage cash flow and to fund startup costs related to expansion and procurement.

5. Metro areas with the highest concentrations of Latinos do not necessarily have the densest shares of Latino entrepreneurs.

- The external funding network (including availability of alternative lenders, e.g. CDFIs), local economic development that favors certain industries (e.g. construction), property values, state minimum wage laws, and local and state tax rates all play critical roles in incentivizing Latino entrepreneurs.

- Among areas with the densest Latino populations, only Miami and Chicago have commensurate entrepreneurship rates.

6. Latino-owned businesses have more success with relationship banking.

- The most common forms of capital that Latino-owned small businesses need are lines of credit, loans, and cash advances, like many small businesses.

- Latino business owners have more success working with small, local banks than large or national banks. Latino business owners in areas like Chicago and Houston use local banks at ten times the rate and six times the rate of national banks, respectively.

- At small banks, there is opportunity for developing personal relationships with bankers, having more access, and getting advice.

7. Latino firms have opportunities to diversify and expand their revenue sources, including B2B and government sales.

- A majority of Latino firms (64 percent) sell to individuals.

- Forty-two percent of Latino-owned businesses sell to other businesses, compared to 47 percent of non-Latino white-owned businesses.

- Despite incentives in state, local, and federal government procurement, only 16 percent of Latino firms sell to state/local government and only 11 percent sell to the federal government. These percentages are identical to those of non-Latino white-owned businesses.

8. **Density of existing business networks makes certain areas more conducive to Latino business growth, as do mentorship and capacity building programs.**
   - Latino business owners in the San Diego area participate in trade associations at nearly twice the rate of trade association participation among Latinos nationally (23 percent compared to 12 percent). There is also high trade association participation in Miami at 19 percent.
   - Latino business owners in the Phoenix area participate in Hispanic chambers of commerce at nearly three times the rate of the national participation among Latinos (28 percent compared to ten percent).
   - Experienced mentors help Latino business owners overcome business and environmental hurdles and can serve as models for success. Multiple business owners cited engaging mentors and participating in business organizations and executive education programs as ways to obtain information on new opportunities and further business support.

REPORT AUTHORS

- Claire Kramer Mills, Ph.D., AVP, Federal Reserve Bank of New York
- Jessica Battisto, Senior Analyst, Federal Reserve Bank of New York
- Scott Lieberman, Senior Analyst, Federal Reserve Bank of New York
- Marlene Orozco, Lead Research Analyst, Stanford Latino Entrepreneurship Initiative
- Iliana Perez, Research Analyst, Stanford Latino Entrepreneurship Initiative
- Nancy Lee, Senior Manager Research and Evaluation, Interise

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- Federal Reserve Bank: www.newyorkfed.org/aboutthefed/whatwedo.html
- Interise: www.interise.org
- Stanford Latino Entrepreneurship Initiative: www.gsb.stanford.edu/slei

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