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# A One Percent Solution

## Targeted Capital Investment in New York M/WBES

## Introduction

In 2012, the United States Survey of Business Owners identified more than 1.1 million minority- and women-owned firms in New York State, totaling more than \$185 billion of annual sales and receipts. This number almost certainly is a low estimate - between 2012 and 2016 there has been a significant growth of new business in the W/MBE sphere. However, an increasing body of evidence shows that these businesses are fundamentally underfunded.

A 2013 Small Business Administration study of the capital profiles of growing companies shows the deep gaps in capital access across demographic groups. In the study, black and hispanic firms attract half as much outside equity investment as those owned by white men. Woman-owned companies attract only a quarter as much outside equity investment as their male-owned counterparts, and those firms are almost twice as reliant on debt backed by the personal assets of the business owner than the average firm. Across the board, women and minority-owned businesses are far more reliant on the personal resources of the business owner than non-minority male-owned companies.

In the face of this data, the challenge becomes clear. Targeted investment in minority- and women-owned businesses must be structured to meet the current capital and credit needs of M/WBEs, while in the long term reducing M/WBE entrepreneurs' exposure to personal debt and establishing equity networks to support M/WBEs.

# Capital Demands of the M/WBE Marketplace

The New York M/WBE Marketplace		
M/WBE Category	Number of Firms in New York State	Annual Sales, Receipts, or value of Shipments
Minority-owned Businesses*	709,021	\$99,557,288,000
Minority-owned/Male-owned	356,570	\$73,394,732,000
Minority-owned/Woman-owned	330,048	\$19,050,699,000
Nonminority-owned/Woman-owned	394,553	\$85,763,335,000
<b>Total M/WBE</b>	<b>1,103,574</b>	<b>\$185,320,623,000</b>

2012 Census Survey of Business Owners. 15 Dec. 2015. Raw data. N.p.

*\*Due to incomplete survey answers and the number of firms that have shared male/female ownership, numbers for minority-owned/male-owned and minority-owned/woman-owned firms do not represent 100% of minority-owned businesses.*

## Project-Oriented Capital

There is a demonstrated need, both quantifiably and anecdotally, for project-based capital investment in M/WBEs through factoring, trade credit, or other types of financial partnership. A small to mid-scale factoring product would allow many M/WBEs to significantly expand the scope and scale of their operations without taking on long-term debt or surrendering control of their company. Additionally, contract-based financial partnerships with large, established funders provide some insulation and negotiating leverage for M/WBEs and their employees when dealing with late or extended payment cycles. At the same time, contract-based products like factoring provide an incredibly safe investment if well-chosen and well-administered.

### Minority and Women-owned Business Investment Companies

The New York State Common Retirement Fund and the five funds of the New York City Employee Retirement System should create and fund Minority and Women-owned Business Investment Corporations (MWBICs); investment vehicles modeled off of the United States Small Business Administration’s (SBA) Small Business Investment Corporations (SBICs). While the current Federal SBIC program relies on private investment capital backed by public leverage, New York could directly establish and fund SBICs targeted at M/WBE investment (MWBICs). The ongoing success of SBA registered SBICs demonstrates the potential returns of such investments, while the existence of the state-wide M/WBE certification program simplifies the bureaucratic regulation of SBIC investment policies significantly. Existing commitments to expanding the pool of M/WBE certified companies offers a diverse array of potential businesses with which State-financed SBICs can invest. Additionally, targeted capital investment in M/WBEs will encourage the growth of this class of business, further diversifying the pool of potential investments. Targeted investment will help bridge the gap between M/WBEs and non-minority businesses, by reducing disparities in access to equity capital networks. Given the latent potential of currently under-capitalized M/WBEs, targeted MWBIC investment could produce returns significantly above market averages.

Capital Profiles of M/WBEs				
Capital Investments	White	Black/Hispanic	Female	Male
Owner Equity	9.1%	13.1%	12.7%	9.1%
Insider Equity	2.1%	0.5%	0.2%	2.3%
Outsider Equity	11.3%	7.1%	3.0%	12.8%
Owner Debt	4.5%	6.6%	8.0%	4.0%
Insider Debt	8.8%	9.1%	13.6%	8.3%
Outsider Debt	64.1%	63.6%	62.5%	63.5%
* "Insider" in this context refers to funds obtained outside of formal structures - social networks, professional networks; any non-institutional source.				
Robb, Alice. <i>Access to Capital among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms</i> . Rep. United States Small Business Administration Office of Advocacy, Apr. 2013. Web.				

New York Small Business Financing (2015)*	
Business Financing Instrument	Application Rate by Financial Product (percent of total applicants)
Loan/Line of Credit	85%
Credit Card	39%
Equity Investment	7%
Project-oriented Capital (factoring, trade credit, etc.)	16%
Leasing	10%
Other	6%
<p>* Although most minority and women-owned businesses are small, statistics limited to “small businesses” are an imperfect proxy for M/WBEs. Recommendations in this document are based on interviews with minority and women business organizations, data about statistical disparities, and general investment demand.</p> <p><i>2015 Small Business Credit Survey. Rep. The Federal Reserve Bank, Mar. 2016. Web. 6 Mar. 2016.</i></p>	

### Fixed Income Investments

Far and away the investment product most sought by M/WBEs is credit, or credit-based investment. Although generally speaking fair-rate credit programs should be administered through depository banks to establish long-term relationships, there is an opportunity for significant fixed-income investment in mobilization capital and significant real asset . New York City and New York State have both demonstrated the capacity and capability to successfully manage real asset investment. It would be relatively simple for New York City and State to expand current affordable real estate investment programs to target capital improvements to M/WBEs as well. This is consistent not only with the current (and profitable) investment policies of the NYCERS ETI portfolio, but with the stated goals of the ETI portfolio to address credit disparity and reduce predatory lending. Additionally, investment in capital improvements for M/WBEs fits in with the New York State Common Retirement Fund’s stated Fiscal Year 2016 asset reallocation policies, which call for an increase in real estate investment from

6.6% of the CRF portfolio to 8%. Given the current and historic strength of the New York real estate market, it's hard to argue that such expansion can't be safely made through investments in New York markets. Investment in other types of real asset, while slightly more complicated, provide the same sort of security. Capital investment of any type in M/WBEs would address aspects of the credit disparity while providing relatively safe returns to investors.

### **Angel Investing and Traditional Private Equity**

Currently, equity investment represents a relatively small share of the financial products sought by M/WBEs. However, there is a demonstrated disparity in access to private networked capital, as well as access to formal external investment. M/WBE firms at all stages of growth could benefit significantly from access to non-discriminatory venture capital. Still, there are two obvious targets for private equity investing. Private equity investment programs should be targeted at currently underfunded M/WBE high-growth startups, and large M/WBE firms with the long-term potential to transition into the public sector.

## The One Percent Solution

Controller Stringer and Comptroller DiNapoli have made laudable commitments to internal diversity through their Emerging Manager Program and to corporate diversity through their shareholder initiatives to diversify corporate boards. The next step in expanding that commitment to equality is real, “dollars-on-the-street” investment in minority- and women-owned businesses.

We are proposing a capital commitment of 1% of the assets of the New York City Employee Retirement Systems and 1% of the assets of the New York State Common Retirement Fund towards “dollars-on-the-street” investment in minority and women-owned businesses.

A one percent commitment from New York City and New York State would create \$3.4 billion dollars of targeted capital investment in minority and women-owned businesses, while creating and stimulating an American emerging market. Through careful commitments to fair capital investment, Comptroller Stringer and Comptroller DiNapoli could launch New York City and New York State towards a new era of growth.

Proposed Fair Capital Commitment				
Investment Type	Percentage Allocated (of 1% M/ WBE Commitment)	State Pension Fund Commitment	City Pension Fund Commitment	TOTAL
Project-based Capital	40%	\$720,000,000	\$640,000,000	<b>\$1,360,000,000</b>
Fixed-Income Capital	20%	\$360,000,000	\$320,000,000	<b>\$680,000,000</b>
MWBIC	30%	\$540,000,000	\$480,000,000	<b>\$1,020,000,000</b>
Angel Investing and Traditional Private Equity	10%	\$180,000,000	\$160,000,000	<b>\$340,000,000</b>
<b>Total</b>	<b>100%</b>	<b>\$1,800,000,000</b>	<b>\$1,600,000,000</b>	<b>\$3,400,000,000</b>