SMALL BUSINESS AND THE RACIAL WEALTH GAP
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ABSTRACT
The racial wealth gap in the US is wide and growing. This issue paper combines research about the racial wealth gap and about small business ownership to explore the relationship between the two. The paper starts by defining wealth, and establishing its connection to home ownership in the US. Wealth is a crucial source of capital for small business owners, and the racial wealth gap has influenced the development of minority-owned businesses. Moreover, the Great Recession impacted various racial and ethnic groups differently, affecting levels of home ownership, wealth, and access to capital. The Great Recession added to the effects of historical policies that were racially discriminatory, and while current lending and tax policies are more inclusive, they are less focused on asset development. The paper asserts that the wealth gap is primarily due to these policies and not due to individual choices. Finally, Interise recommends small business growth as a sustainable solution to the wealth gap, through minority-owned businesses creating jobs and wealth locally. Suggested solutions include increasing the quantity and type of financial products available for small businesses; expanding capacity-building programs for small businesses; and increasing procurement diversity. The paper sets up future Interise research that will focus on how building capacity among small businesses may build wealth in minority communities.

INTERISE ISSUE PAPERS
Interise issue papers highlight salient topics from current events, emerging small business trends, and public policy research for the purposes of creating a healthy ecosystem for inclusive and equitable economic development. Interise focuses on established small businesses that are employers, especially those located in low- and moderate-income communities and/or owned by underrepresented groups. These papers give context to an issue and lay the foundation for deeper research and analysis. Further research will use Interise’s proprietary database of longitudinal firm-level data, collected annually from a network of over 6,000 small businesses and with a response rate of over 50%, to more fully analyze the trends among Interise alumni and small businesses nationwide. The next research publication will analyze Interise’s first ten years of impact. Interise invites our network and the fields of economic development and public policy to join us in studying the role of small businesses in creating economies that work for all.

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Small Business and the Racial Wealth Gap

“The extent of and continuing increase in inequality in the United States greatly concern me…. I think it is appropriate to ask whether this trend is compatible with values rooted in our nation’s history, among them the high value Americans have traditionally placed on equality of opportunity.... For many people, the opportunity to build a business has long been an important part of the American dream. In addition to housing and financial assets, the SCF [Survey of Consumer Finances] shows that ownership of private businesses is a significant source of wealth and can be a vital source of opportunity for many households to improve their economic circumstances and position in the wealth distribution.”

Janet L. Yellen, Chair of the Board of Governors of the Federal Reserve System

White Americans have levels of wealth that are ten times higher than those of Hispanic and African-Americans.\(^1\) Over 25 percent of African-American households have no or negative net worth.\(^2\) The racial wealth gap is wider in metropolitan areas;\(^3\) in Boston, the median wealth of white households is $247,500 and almost zero for Dominicans and African-Americans.\(^4\) This gap has profound implications on minority households’ ability to weather financial challenges and build for their future.\(^5\) And unless something is done to resolve the divide, it will keep growing: before 2046, the wealth of median African-American and Hispanic/Latino households will be less than 0.8 percent of that of median white households.\(^6\)

Small business is affected by this gap, because lower levels of wealth mean that minority entrepreneurs tend to have much lower access to capital than white entrepreneurs for start-up and expansion. However, business ownership can also be a path towards closing the gap. For example, African-American business owners have levels of wealth that are 12 times that of African-American non-business owners.\(^7\) In addition, when comparing the median wealth of white and African-American business owners, the gap decreases to a factor of three.\(^8\) This paper will explore the racial wealth gap, how it has affected small businesses, and the potential of small business to reduce the divide.

WHAT IS WEALTH?

What exactly is wealth? Wealth is comprised of a person’s or household’s individual assets, like a house or a bank account, minus any debt, like student loans or mortgage debt. The
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The racial wealth gap refers to differences in wealth between different racial groups. Wealth can provide a safety net in periods of crisis, like unemployment or medical emergencies. It can also allow people to take risks like starting or growing a business. With lower levels of wealth, people have less access to education, opportunities, homeownership, and economic security. They also have less to pass on to the next generation, which leads to constraints on intergenerational mobility.

Income, which refers to the cash flowing to a person, usually from their wages, impacts that person’s wealth but does not show the whole picture. Many people are aware of income inequality, but as the wealth gap grows over time, it has more profound effects on people’s ability to weather financial challenges or take risks. Lower levels of income limit people’s lifetime wages and increase the wealth gap over time, thereby inhibiting the ability of entrepreneurs in particular to start or grow a business. Figure 1 shows the difference between income inequality and the racial wealth gap. While median income for whites is nearly twice that of income for African-Americans and Hispanics/Latinos, median wealth is over ten times higher.

Lower income also reduces a person’s chances of owning a house, and homeownership is the most common way that people build assets. Housing equity comprises about two-thirds of the median household’s wealth. Since housing has traditionally been how people build wealth, racial differences in homeownership play a key role in the racial wealth gap. Sixty-eight percent of whites own homes, compared to only 43 percent of Hispanics/Latinos and 42 percent of African-Americans. Despite being less likely to own homes, African-Americans and Hispanics/Latinos are 86 percent and 36 percent more likely to be underwater in their mortgages, respectively, than whites are. In addition, homes in African-American neighborhoods do not appreciate as much as those in white neighborhoods. Houses are often the source of equity for a business, so the racial disparity in homeownership impacts small business owners. Race and place intersect, and both are factors that compound the wealth gap.

Figure 1. Comparison of Median Income and Wealth among Whites, African-Americans, and Hispanic/Latino Households.
WEALTH AS A SOURCE OF CAPITAL FOR SMALL BUSINESS OWNERS

The pervasiveness of the wealth gap affects minority small business owners in particular. Most business owners turn to their own wealth or that of their friends and family when starting and operating a business. Minorities who have lower levels of wealth on average therefore have less of their own capital to invest in their businesses. They also are less likely to be able to rely on housing equity from themselves or their networks.

Aggravating the problem, minorities have less access to other types of capital. When it comes to loans, “minority-owned businesses are more likely to be declined a loan, receive smaller loan amounts, and often pay higher interest rates than white-owned businesses.” This leads to a “trust gap,” where many minority business owners do not ask for capital from financial institutions and banks because they think they will be turned down. Compared to white business owners, African-American business owners are almost three times as likely to report lower profits because of a lack of access to capital. Figure 2 demonstrates the extent of the trust gap.

![Figure 2. Trust Gap: The Extent of White, Minority, and Hispanic/Latino Entrepreneurs Avoiding Small Business Financing Because They Thought the Loan Would Not Be Approved.](source)

Source: Morelix et al, Zero Barriers, 16.

This credit gap, created by the trust gap and lending biases, means that the bulk of minority business owners have less access to bank financing and rely more on their own investments, although due to the wealth gap, particularly among African-American and Hispanic/Latino business owners, they tend to have less of their own capital to invest.

“The credit gap means that the bulk of minority business owners have to rely more on their own investments, although due to the wealth gap, they tend to have less of their own capital to invest.”
THE WEALTH GAP HAS INFLUENCED THE DEVELOPMENT OF MINORITY-OWNED BUSINESSES

Given that wealth and access to capital are crucial for small business owners, the wealth gap has influenced the development of minority-owned businesses. While the number of minority-owned businesses is growing, there are 1.1 million “missing businesses” in the US due to historical discrimination against certain minority groups and present-day discrimination in accessing loans and credit. These “missing businesses” could contribute 9 million more jobs and $300 billion in national income. African-Americans are more likely to start businesses than the average individual, but African-American- and Hispanic-owned businesses are more likely to fail, since less managerial and prior family business experience and lower access to capital make these owners more likely to enter industries with lower barriers to entry and thus higher failure rates.

Not only do minority-owned businesses start and stay smaller, as shown in Figure 3, the revenue divide grows with the age of the business. This may be explained by the restricted access to credit and the fact that historically, minority-owned businesses have been limited to their own communities for customers. The smaller size of Hispanic/Latino- and African-American-owned businesses, and the lower rates of business ownership, means that there is less business wealth overall among people of color.

Small businesses that have paid employees can have much more economic impact on their communities than those that do not, and are more able to scale. However, the vast majority of businesses do not have employees, especially those owned by women and/or African-Americans and Hispanics/Latinos. Employer firms account for three percent of all firms owned by African-American women, five percent of those owned by Hispanic women, six percent of those owned by African-American men, and 11 percent of those owned by Hispanic men. However, 24 percent of all firms owned by white men have employees. Minority-owned businesses have smaller revenues and average payroll, which inhibit their...
opportunity to support economic development through job and wealth creation in their local communities.

The wealth gap and contributing factors like income inequality and the trust gap are compounding barriers to entry into business ownership for minority business owners. Minorities earn less money overall and they likely have much less wealth, including assets like houses. Their networks are also less likely to have housing equity or assets that the business owners can borrow. Minority business owners cannot rely on lending institutions, and even if they open businesses, their businesses start and stay smaller.

THE GREAT RECESSION’S EFFECT ON WEALTH AND ACCESS TO CAPITAL

The Great Recession, in particular, affected housing wealth in communities of color and therefore the main source of equity for minority business owners. Leading up to the Great Recession, lenders targeted minorities for predatory mortgages. High-income African-Americans were nearly twice as likely to receive subprime loans as low-income whites were. African-American and Hispanic/Latino borrowers were almost 50 percent more likely than white borrowers to face foreclosure. The Center for Responsible Lending found in 2006 – before the Great Recession – that “for many types of loans, borrowers of color in our database were more than 30 percent more likely to receive a higher-rate loan than white borrowers, even after accounting for differences in risk.” The Center made a prescient observation about the importance of mortgage costs: “Whether or not families receive fairly priced home loans is a major factor in their fundamental financial security. Higher loan costs will both dissuade some potential borrowers from investing in homeownership and increase the risk of foreclosure for those who do.” And since it reduced overall capital, the housing crisis and accompanying loss in financial security reduced access to capital for would-be or existing entrepreneurs.

The Great Recession had a disproportionate impact on communities of color, and African-American and Hispanic/Latino families in particular were negatively impacted by their wealth’s concentration in home equity. Figure 4 demonstrates the disparate impact of the recession on different minority groups. In proportion to their total wealth, Hispanic/Latino homeowners lost over four times as much as white homeowners and African-American homeowners lost over three times more than their white counterparts.

Asian-American homes tended to be concentrated in urban areas with rising home values, which accounted for their high median net worth ($176,225 in 2005, as opposed to over $142,000 for white households, $19,228 for Latino households, and $12,840 for African-American households). This also helps to explain why Asians as a group lost the most wealth in terms of dollars rather than percentage change. Tippett et al. Beyond Broke, 14.

Figure 4. Percentage of Wealth Lost Following the Great Recession, 2005 to 2009.

Source: Tippett et al, Beyond Broke, 14.
In addition, since minorities have less asset diversity than whites, they were hurt more by the housing crisis. For example, home equity is 92 percent of African-Americans’ net worth and only 58 percent of whites’ net worth, so their risk was more concentrated in housing. Asset type matters because “business and financial assets provide greater diversification and higher average returns over time than tangible assets such as homes." Lower rates of business equity in particular mean that businesses have less capital to grow with. Therefore, affected business owners would have less of their own capital for start-up or growth, and business owners in these communities would have less access to capital as well. Figure 5 shows Asians have the highest level of business equity, followed by whites, African-Americans, and Hispanic/Latinos.

CURRENT POLICIES ARE MORE INCLUSIVE BUT HAVE SHIFTED AWAY FROM ASSET DEVELOPMENT

In addition to the disparate effects of the Great Recession, the US has a history of developing assets for largely white middle and upper classes. Current anti-poverty policies do include people of color, but they have largely shifted away from asset development and towards subsistence. Those that do focus on asset development do not tend to benefit low-income families. For example, in 2013, of $340 billion in federal spending on asset development, $251.4 billion went to households in the top 20%. The top 1% received more in spending than the bottom 80% combined. In 2015, $90 billion of that total amount went to the mortgage interest and property tax deductions, which actually perpetuate inequality. Figure 6 shows the striking difference in accrued benefits to low, middle, and upper income households.

In addition, tax breaks for college savings or homes disproportionately benefit white high-income people. Policies like these that do not address the wealth gap can instead exacerbate inequalities. A 2009 report from the Insight Center for Community Economic Development went so far as to describe current tax policies as “redistributive – from the poor to the wealthy.” In order to fully enable minority small business owners to reach their potential, and to build a more inclusive and equitable economy, policies will need to focus at least in part on the long-term and building wealth for people of color in general – the equivalent of a “21st century Homestead Act.”
WEALTH GAP IS NOT DUE TO INDIVIDUAL CHOICES

The “pull yourself up by your bootstraps” vision of the American Dream attributes the wealth gap to individual choices, and claims that the gap can be solved with education, marriage and family structure, full-time employment, and spending habits, to name a few. In fact, none of these can explain the gap, and none can close it, as demonstrated by the following graphs.

Figure 7 shows a white household with less than a high school degree has 1.7 times as much wealth as an African-American household with at least some college. A white single-parent household has 2.2 times as much wealth as an African-American two-parent household, and a white two-parent household has levels of wealth 10 times higher than that of African-Americans and 8.6 times higher than that of Hispanic/Latinos.

In fact, a typical white family with an unemployed head of household has more wealth than a typical African-American family with a head of household with full-time work. In addition, regarding spending habits, “the average white household spends 1.3 times more than the average African-American household of the same income group.” The Federal Reserve Bank of Boston found that “inheritances, bequests, and intrafamily transfers account for more of the racial wealth gap than any other demographic and socioeconomic indicators, including education, income, and household structure.” Given the history of asset development for whites, the report continued, “explanations that attribute the lack of assets among minority groups to a relative deficiency in current savings behaviors are at the very least an oversimplification [of] the problem.”
Figure 7. Comparisons of Median Wealth among White, African-American, and Hispanic/Latino Households

STUDENT DEBT

Education in particular comes at a higher cost for low-wealth families, and does not result in similar long-term benefits. Student loan debt has increased by 84 percent since 2008, and minority families are more likely to be affected by student debt: more than four out of five African-American students graduate with student loan debt, while the same is true for less than three out of five white students. Moreover, college degrees do not have equal payoffs: a college degree is associated with $55,900 in wealth for white households, but only $4,800 and $4,200 for African-American and Hispanic/Latino households, respectively. A 2017 report by Demos and the Institute on Assets and Social Policy at Brandeis described this as a “wealth feedback loop”: wealth determines who can get a degree, how much student debt they will have, and therefore whose children will be able to afford a degree too.

SMALL BUSINESS AS A SUSTAINABLE SOLUTION

But there may be good news: building capacity among minority-owned businesses and businesses located in low- to moderate-income communities has the potential to help with the wealth gap. Compared to African-American non-business owners, African-American business owners have 12 times more wealth and also have higher levels of wealth mobility. In addition, small businesses are important job creators for other members of their communities. Employers of color are more likely than whites to hire people of color. Interise will conduct further research into business ownership’s impact on the wealth gap.

Some solutions and resources for small businesses do already exist. Community development financial institutions (CDFIs) provide access to capital and technical assistance to underserved communities, including low-income and minority business owners. The Federal Reserve Bank of New York found that applicants for loans and lines of credit had a 77 percent approval rate for CDFIs, which was the highest approval rate for businesses with less than $1 million in revenue.

The Minority Supplier Diversity Council allows certified Minority Business Executives access to executive education, training, technical assistance, and networking and business opportunities with each other and with prospective buyers. The Department of Commerce runs the Minority Business Development Agency (MBDA), which conducts research to promote minority-owned businesses in public policy and advocate for their growth. MBDA also connects minority business owners with technical assistance, access to capital, and contracting opportunities.

The Small Business Administration’s (SBA) 8(a) Business Development Program provides business assistance to small businesses that are majority-owned by both socially and economically disadvantaged individuals, including access to sole-source contracts and a Mentor-Protégé Program to learn from more experienced businesses. The SBA also works with local Small Business Development Centers, which provide new and existing businesses with business consulting and training services.
Supplier diversity programs at the national, state, and local levels aim to award more contracts to small businesses, including sub-goals for minority-owned, women-owned, and economically disadvantaged businesses. New York State, for example, has a goal of 30 percent of state contracts going to minority- and woman-owned businesses. New York City has established a revolving loan fund for minority- and woman-owned businesses contracting with the City, which is administered by the Department of Small Business Services. New York City has a bond collateral assistance fund for minority- and woman-owned businesses and local small businesses to assist in obtaining surety bonding for construction projects with City agencies and the New York City Economic Development Corporation.

These services could be expanded to strengthen support for business owners. FIELD at the Aspen Institute proposed a range of policies related to small businesses that would start to even the playing field:

- Improve and expand programs for minority business owners to access contracting and procurement opportunities, especially with large anchor institutions,
- Assist small businesses with capital and cash flow issues, and
- Increase funding for business development programs for minority-owned businesses who are ready to grow to the next level.

U.S. POLICIES THAT CONTRIBUTED TO RACIAL WEALTH GAP

The housing crisis and the Great Recession had a disproportionate impact on communities of color and exacerbated the effects of policies enacted throughout US history that created and developed the racial wealth gap. Slavery itself kept most African-Americans from accruing wealth for the almost 250 years that slavery existed in the US. After slavery ended, the Homestead Act of 1862 gave land for free to overwhelmingly white settlers and thus helped them to build assets. During the Great Depression, FDR’s New Deal built an American middle class but largely excluded African-Americans; legislation for the minimum wage, Social Security, unemployment insurance, and workers’ compensation excluded agriculture and domestic work, thereby excluding most African-Americans. Post-World War II, the GI Bill of Rights helped to further develop the white middle class, including paying for tuition and low-interest mortgages. But the GI Bill largely excluded African-Americans: of 67,000 mortgages insured by the GI Bill in New York and part of New Jersey, fewer than 100 went to minorities, and as for accessing secondary education, there simply was not enough room for African-American veterans at historically black colleges and universities. African-Americans have also been subject to redlining and other discriminatory lending practices. These policies had a real effect on African-Americans’ ability to build assets: in 1910, African-Americans owned 16-19 million acres of land in the US; as recently as 1999, they owned only 7.8 million acres.

Impact assessment data from Interise’s StreetWise ‘MBA™ has demonstrated that growing established small businesses can increase jobs and revenue for the businesses and their communities through increased access to capital and contracts. Sixty percent of Interise alumni respondents created new jobs in 2015, with an average salary of $52,466 and an
Average of 5.8 new jobs among businesses that added jobs. Minority-owned companies that created jobs did so at an average rate of 7.2 jobs per business. White business owners reported a lower average salary ($50,554) than business owners who were a racial minority ($56,136). These jobs, with good salaries, create local employment and wealth.

In Interise’s first ten years of impact data, from 2004 to 2014, alumni who increased revenues between starting the program and their final annual assessment three years later did so by an average rate of 75 percent. Of that group, racial minorities increased revenues by an average rate of 84 percent. Growing revenues at small businesses can help money stay in the community.

In 2015, 32 percent of white business owners reported access to new financing, as compared to 29 percent of both business owners who were a racial minority and who identified as Hispanic/Latino/Spanish. However, racial minorities reported a much higher average size of new financing: $388,376 as compared to $228,196 for whites and $233,461 for Hispanics. One reason for this may be that Interise’s StreetWise “MBA™ curriculum provides access to knowledge, know-how, and markets from which racial minorities tend to be excluded. Demonstrating better financial analysis and business strategy likely makes these businesses more attractive to conventional lending institutions.

In 2015, 23 percent of white-owned businesses secured contracts, with an average size of $275,127, while 40 percent of both businesses owned by racial minorities and businesses owned by Hispanics secured contracts, with an average size of $143,829 and $156,135, respectively. By building their capacity and increasing their contract readiness, minority-owned firms are better positioned to take advantage of supplier diversity programs and contracting opportunities.

Small business can be a sustainable way to approach the racial wealth gap. Building capacity among minority-owned businesses can grow wealth for the business owners, which they can invest back into their businesses and also use to support the businesses of their family and friends, creating a feedback loop that strengthens local economies.

While small businesses have historically been owned by white men, they are increasingly diversifying. According to the Minority Business Development Agency, the number of non-minority-owned firms declined by six percent from 2007 to 2012, but those owned by minorities increased by 38 percent. In that same time period, the National Women’s Business Council reports, the number of African-American women-owned businesses and Latina women-owned businesses grew by 67 percent and 87 percent, respectively. Hispanic, African-American, white, and Asian immigrants are all more likely to be self-employed than their respective peers born in the US, due to higher levels of education, resources, and willingness for risk-taking.
Building capacity among these businesses, including enabling more of them to become employer firms, could have positive effects on local economic development. Future Interise research will take a closer look at how building capacity among small businesses can help build wealth among minority communities. Especially given demographic trends, which show minorities becoming the majority of Americans, the racial wealth gap must be closed in order to accomplish an economy that works for all.85

DISCUSSION AND NEXT STEPS

The racial wealth gap cannot be explained by individual choices or single factors. It is complex and is compounded by societal factors, economic conditions, and public policies. This paper focuses on the experiences of small businesses and their ability to help close the gap. Due to the racial wealth gap, minority-owned businesses face less access to capital. Homeownership, a common form of equity used to fund business ventures, has been a constricted resource for minority business owners due to historic and recent lending practices. In addition, minority business owners’ networks face the same pressures they do: they are less likely to own homes, more likely to be underwater in their mortgages, and more likely to be subject to predatory lending. These factors, in addition to the trust gap and the lower rate of loan approvals by banks, contribute to lower access to capital overall. A step in the right direction would be for retail and commercial banks to reconsider the loans and financial products they make available to small businesses, and to create more and better resourced CDFIs.

Despite these financial challenges to entrepreneurship, small businesses have a real opportunity to benefit their communities through job and wealth creation. Building human capital through capacity building for minority business owners is another supportive route to strengthening local economies. Minority business owners tend to have smaller businesses and are less likely to have employees. Expanding capacity-building programs to create situations in which minority business owners have greater access to the networks needed to enable growth, and the knowledge and management skills needed to grow their businesses more strategically, can lead to job creation and wealth accumulation in their communities.

Procurement contracting, along with capacity and capital, needs to be more available to minority small business owners seeking to grow their businesses. Procurement diversity is advantageous to anchor institutions like hospitals, universities, and other large place-based employers, who are invested in their local communities, and the potential of this partnership should be made more obvious and accessible to anchor institutions and to small businesses. In addition, community banks and CDFIs can play a key role in expanding capital to business owners pursuing procurement opportunities. Integrating capital, capacity, and contracting can counteract some of the challenges that the racial wealth gap has posed for minority-owned small businesses, and thereby create jobs and wealth in communities of color.

CAPACITY BUILDING

Capacity building is not a one-time effort to improve short-term effectiveness, but a continuous improvement strategy toward the creation of a sustainable and effective organization. For businesses at the second stage of growth in the business life cycle, effective capacity building requires a dual focus on the evolution of the business and the business owner because of the interconnectedness of system and process changes and the owner’s management and leadership styles.

Interise makes a call to action among stakeholders in these three areas — capacity building, contracting, and capital contracting — to join the conversation and implement the actions needed to focus on minority businesses as part of a larger focus on economic development.
Notes


8 *The Tapestry of Black Business Ownership in America*, 8.


15 Tippett et al., *Beyond Broke*, 3.
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18 Klein, Bridging the Divide, 10.


22 Klein, Bridging the Divide, 10.

23 Austin, The Color of Entrepreneurship, 19.

24 Austin, The Color of Entrepreneurship, 3, 18. “Generally, employer firms owned by people of color are underrepresented relative to the proportion of people of color in the labor force. If the number of these people-of-color firms matched their distribution in the labor force relative to Whites by gender, people of color would own 1.1 million more businesses with employees. These firms would add about 9 million jobs and nearly $300 billion in workers’ income to the U.S. economy.” Austin, The Color of Entrepreneurship, 14.


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Interise’s mission is to spur economic development in lower income communities by providing a diverse group of small business owners with executive-level education, access to markets, and integration into new networks across the small business ecosystem.

Interise’s capacity-building program, the StreetWise ‘MBA™’, uses a peer-based learning model that provides small business owners with the business knowledge, the management know-how, and network relationships they need to achieve scale.

Interise focuses on established companies — businesses that have survived the start-up stage — located in low- to moderate-income communities, and/or minority-owned. As these companies grow, they contribute to local economic development and job creation where it is needed most.

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