THE NEW AGENDA FOR MINORITY BUSINESS DEVELOPMENT

Prepared by
The Boston Consulting Group

June 2005

THE BOSTON CONSULTING GROUP

TABLE OF CONTENTS

EXECUTIVE SUMMARY

Marked and measurable progress has been made in minority business development since the authors first examined the topic in depth for the U.S. Department of Commerce more than 25 years ago in the reports *The New Strategy for Minority Businesses* (1978) and *Minority Business Enterprise Development in the 1980s* (1980).[1] The evolution from nascent to noteworthy however was just the first step in minority business development. Taking the next step, moving from presence to prominence, poses new challenges and therefore demands a "New Agenda," with a focus on growing larger and self-sustaining minority businesses.

The Gains

Once hobbled by a lack of capital, lack of access to government and private-sector market opportunities, and a lack of managerial talent, minority businesses face a vastly different reality today. Since the 1980s, with support from expanded government and corporate supplier diversity programs as well as other initiatives, minority firms as a whole have seen their revenue rise by about 10 percent annually, have created 23 percent more jobs, and have enjoyed an overall growth rate three times higher than that of traditional businesses.

The Gap

Even though the number of minority businesses has reached unparalleled heights, their proportion does not yet fully reflect the growing size and importance of minority communities in the United States—soon to account for 40 percent of the population. Fueling the disparity is the fact that minority businesses are disproportionately represented in low-growth and no-growth sectors. They also tend to rely on personal debt and family financing over business loans, equity, and other tools that are otherwise commonly accepted in the capital markets. As a result, minority businesses often lack the size, scale, and capabilities of their majority counterparts.

A shift in mind set is required for:

- ***Corporations*—**elevating minority business development to a higher level in terms of strategic importance and fostering increased collaboration between minority entrepreneurs, consumers and employees
- ***Government*—**recognizing the critical importance of minority business in economic development and fostering the growth of not just small businesses, but those companies of size and scale that are positioned in growth industries
- ***Minority Entrepreneurs*—**growing businesses of size is the major imperative, requiring the entrepreneur to use all aspects of corporate supplier diversity progress and assume broader leadership roles—in their communities and on major corporate boards.

[1] These reports were prepared by the authors when they were employed by James H. Lowry & Associates.

Specifically, to achieve greater size and scale and expand their capabilities, minority businesses "community" must proactively close the gap by:

- Viewing minority business development as a key to U.S. economic development
- Diversifying or expanding minority businesses to seize opportunities in growth industries
- Building capacity and capabilities of minority businesses to provide more value-added products and services
- Growing these businesses beyond the "sole proprietorship" model of business ownership
- Expanding the use of mergers, acquisitions, and strategic partnerships
- Fully accessing and deploying the capabilities of the financial markets for minority business development
- Aggressively responding to major trends in global supply chain management.

The good news is that minority entrepreneurs can indeed close the gap with their competitors in the broader business community if they operate innovatively; radically change the way they think about their business, their customers, and their competition—and move aggressively. The bad news is that those businesses that won't or don't make transformative changes to close the gap will ultimately fail. The growth rate for these firms will begin to slow, and a limited number of jobs will be created within our society.

The Challenge

Closing the gap for minority businesses requires that all the major players in the field—large corporations, government officials, major universities, foundations and of course minority entrepreneurs themselves—shift their mindset and their focus to embrace a New Agenda. Past and current efforts—while successful in making broad gains—will prove inadequate in resolving the remaining disparity and in achieving future progress. Efforts must be consolidated and resources allocated with precision to home in on the most promising and powerful opportunity: building minority businesses of size.

The overarching conclusion is that only large minority-owned businesses can create the kind of explosive and transformative growth that is needed to invigorate minority communities, inner-city markets, minority entrepreneurs and business leaders, and both the local and national economies.

The Benefits—and the New Opportunities

The New Agenda will be challenging to pursue, but, if successful, its benefits will accrue not only to the entrepreneurs who succeed but also to corporations and society as a whole. Minority communities will enjoy both stronger economies as well as a new breed of leadership—one capable of effecting change in the community and society at large.

Private-sector corporations will benefit from more dependable suppliers that are capable of taking on major opportunities and eventually fostering minority business programs of their own. Bolstered, all these businesses will contribute to the economic development agenda of government—revitalizing inner-city communities, expanding the tax base, and creating new jobs.

ACKNOWLEDGEMENTS

In 2004, the Ewing Marion Kauffman Foundation commissioned James H. Lowry and Richard Holland of The Boston Consulting Group to:

- Research the current issues confronting minority-owned businesses in the United States today

- Determine the major trends that support or impede the development of these businesses

- Provide a series of recommended actions and/or initiatives that will help improve the overall environment for minority-owned firms.

The authors were aided in their research by members of the Billion Dollar Roundtable (BDR).[2] The BDR was created in 2001 to recognize the accomplishments of corporations that have spent more than $1 billion annually with minority- and women-owned businesses. The organization promotes the development of these entities by:

- Exploring opportunities for fostering greater corporate purchasing from diverse suppliers

- Sharing best practices

- Addressing common business issues and challenges

- Providing critical insights on approaches for sustaining current levels of diversity spending.

Moreover, the BDR has led the business community in identifying and developing the most promising of the minority-owned businesses.

The authors collaborated closely with the BDR, the leaders of the Kauffman Foundation, colleagues at The Boston Consulting Group, leaders of the National Minority Supplier Development Council, the alumni of the J.L. Kellogg Graduate School of Management's Advanced Management Education Program (AMEP), members of The Executive Leadership Council (ELC), government officials, and many other scholars, procurement professionals, and practitioners in minority business development.

The authors would like to thank all the contributors, as well as the BCG support team. Without their efforts, this report would not have been possible.

---

[2] As of April 2005, the BDR members were: Altria, AT&T, DaimlerChrysler, Ford Motor Company, General Motors, IBM, Johnson Controls, Lockheed Martin, Lucent Technologies, SBC, Verizon, and Wal-Mart.

THE CURRENT STATE OF MINORITY BUSINESS DEVELOPMENT

Over the past two decades, minority business development has received a great deal of attention in the United States. Today, far from fading, the spotlight remains fixed on the subject, highlighting both spectacular gains in the area as well as troubling shortcomings.

On the positive side, growth within the minority-owned business community has been dramatic. The number of minority businesses—as well as average revenue and employees per business—has grown at rates that significantly outpace those achieved by businesses overall. On the negative side, however, few minority entrepreneurs have yet to expand beyond small and often family-run operations. Furthermore, despite the progress that has been made, the total number of minority-owned businesses still leaves minorities underrepresented in this realm.

For the purposes of this report, a minority-owned business is defined as a business that is at least 51 percent owned and controlled by one or more members of the following minority groups:

- African Americans
- Hispanic Americans (Mexican, Cuban, South American, Puerto Rican, or other Hispanic or Latino Americans)
- Asian and Pacific Islander Americans (Asian Indian, Chinese, Filipino, Japanese, Korean, Vietnamese, or other Asian Americans)
- Native Americans and Alaskan Native Americans.

Under this definition, minorities currently represent approximately 28 percent of the U.S. population[3]—yet minority-owned businesses account for only 15 percent of all U.S. businesses.[4]

As the research highlighted in this section reveals, this disparity has narrowed in recent years, and progress clearly has been made. Yet a disparity nonetheless remains, and the incremental improvements that have been achieved through conventional approaches to date will be inadequate to fill the gap in the future. A quantum leap is needed in minority business development, given the higher stakes facing minorities, business, and the American economy overall.

A "New Agenda" for minority business development therefore is needed to focus on a series of solutions that combine an optimal mix of resources from government, corporations, universities, foundations, and minority-owned businesses.[5]

---

[3] Based on U.S. Census Bureau figures in *Census 2000.* (Washington, D.C.: U.S. Government Printing Office, 2002).
[4] U.S. Census Bureau, "1997 Survey of Minority-Owned Business Enterprises," *1997 Economic Census*. (Washington, D.C.: U.S. Government Printing Office, 2001).

Minority Business Development Has Evolved Over a 40-Year Period

Since minority business development first emerged as a national priority in the late 1960s, the challenge of developing strong and robust minority-owned businesses has undergone a gradual but continuous process of reinvention.

- ***The 1960s.*** Early policy makers were active in designing a wide range of programs that sought to assist ethnic minorities in building competitive capabilities by providing **access to previously inaccessible opportunities—** specifically in education, housing, employment, and, most importantly, business.

- ***The 1970s.*** As political agendas shifted:

  – The **federal government** and many large urban centers began to launch programs for small minority-owned firms, providing access to purchasing opportunities with governmental agencies as well as limited financing.

  – At roughly the same time, **major corporations** began to recognize that urban communities were critical to their continued economic growth and development. Therefore, these private players created similar programs to provide procurement opportunities to minority-owned suppliers located near their headquarters or major facilities.

  – In addition, **federally mandated requirements for prime contractors** increased the pressure on their major corporate suppliers to find ways to incorporate minority-owned businesses in the execution of awarded contracts. *Exhibit 1* lays out a timeline for the major pieces of legislation and other organizational enactments that served as the foundation for minority business development in the United States.

- ***The 1980s.*** Increases in set-aside programs caused large government contractors and those companies conducting business with state and local governments to be more aggressive in developing subcontract opportunities for minority-owned suppliers. Assistance programs through the U.S. Small Business Administration (SBA) and the U.S. Department of Commerce's Minority Business Development Agency (MBDA) began to recognize the critical importance of improving the capabilities of these suppliers. Corporations began to deepen their commitment to minority business development programs, as well as creating opportunities for women-owned businesses, and programs begin to increase dramatically both in number and quality.

---

[5] It should be noted that the progress made by women-owned businesses has been similarly significant and warrants further study. This report, however, has focused specifically on the growth and development of ethnic minority businesses.

Exhibit 1

MINORITY BUSINESS DEVELOPMENT HAS BEEN ESTABLISHED THROUGH MAJOR FEDERAL GOVERNMENT LEGISLATION AND PROGRAMS 1960-1979

1965

President Johnson issues Executive Order 11246, which enforces affirmative action for the first time by requiring that government contractors “take affirmative action” toward all prospective minority employees. An amendment made in October extends affirmative action to include gender as well.

1966

1967

The Economic Opportunity Act of 1964, Title IV was amended and the government pledges to assist in the establishment, preservation, and strengthening of small business concerns "located in urban areas of high concentration of unemployed or low-income individuals" or "owned by low-income individuals."

1968

The Small Business Administration’s Section 8(a) program was established to enhance federal purchases from socially or economically disadvantaged owners of small businesses

1969

With the passage of Executive Order 11458, the U.S. Office of Minority Business Enterprise within the Department of Commerce is created to provide minority business owners with more federal resources.

Also, President Richard Nixon initiates the "Philadelphia Order," the strongest plan of its time, which is designed to guarantee fair hiring practices on construction jobs.

1970

President Nixon signs Executive Order 11518, which instructs the SBA to represent the small business community, with an emphasis on minority-owned and controlled business, before all federal agencies.

1971

Executive Order 11458 and Executive Order 11625 are expanded to give the Secretary of Commerce the authority to: (1) implement federal policy supporting minority business enterprises; (2) provide technical and management assistance to disadvantaged businesses; and (3) coordinate activities between all federal departments to minority business development.

1977

Congressman Parren J. Mitchell authors an amendment to President Jimmy Carter's $4 billion public works bill, an alteration that requires state, county and municipal governments that are seeking federal grants on public works projects to set-aside 10 percent of contracts for minority-owned firms.

The passage of Public Law 95-89 increases loan authorizations and surety bond guarantee authority to minority businesses; and Congress enacts the Community Reinvestment Act (12 U.S.C. 2901), which is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations.

1978

Congressman Mitchell introduces legislation leading to Public Law 95-507 which mandates that bidders for federal contracts in excess of $500,000 for goods and services and $1,000,000 for construction submit prior to contract award, a plan which includes percentage goals for the utilization of minority businesses. This law also contained several amendments to the Small Business and Small Business Investment Act of 1958.

1979

Executive Order 12138, signed by President Carter, requires federal agencies to take affirmative action in support of businesses owned by women.

Exhibit 1

MINORITY BUSINESS DEVELOPMENT HAS BEEN ESTABLISHED THROUGH MAJOR FEDERAL GOVERNMENT LEGISLATION AND PROGRAMS 1980-1999

1982

Section 105(f) of the Surface Transportation Assistance Act is the ten percent set-aside amendment sponsored by Chairman Parren Mitchell of the House Small Business Committee. This set-aside provision mandates that not less than ten percent of all funds appropriated over the four-year period (1982-1986) shall be expended with small businesses that are owned and controlled by socially and economically disadvantaged individuals

1983

President Ronald Reagan signs Executive Order 12432, which requires all federal agencies to develop specific goal-oriented plans for expanding procurement opportunities to minority businesses.

1984

1985

Congressman Mitchell introduces H.R. 1961, which establishes criminal penalties for front companies that have taken advantage of minority programs, such as by receiving an 8(a) contract, a small business set-aside, a subcontract awarded under the Section 8(d) subcontracting plan, or a contract awarded under the 10 percent set-aside of the Surface Transportation Assistance Act of 1982.

1986

Public Law 99-661 is a precedent-setting bill requiring affirmative efforts by all government contractors towards a three-year goal of 5% minority (disadvantaged) business participation in Department of Defense procurement. It provides that:

- "To the extent practicable", each contractor demonstrate full compliance with the intent of the legislation.
- Contractors may pay no more than fair market price (FMP), which may exceed 10% of the market price.
- Contractors may be criminally prosecuted for acts of misrepresentation.
- Contractors must report utilization for all separate groups that make up the protected class of minorities.

1987

1988

1989

California General Order 156 reaches farther than any state or local MBE initiative ever conceived. The General Order calls for the setting of goals, establishment of viable program initiatives, verification of racial or gender ownership status of suppliers and the adoption of a formal complaint procedure. This results in the California Public Utility Commission having the potential for withholding action on utility rate cases brought before it, where the affected utilities have not complied with the General Order.

1990

Metro Broadcasting, Inc. v. FCC. The Supreme Court upholds a race-based preference in granting broadcast licenses. According to the majority, while racial preferences created by state law must meet the test of strict scrutiny, benign race-based preferences that are enacted by Congress need not satisfy strict scrutiny, but must simply be substantially related to the achievement of important governmental objectives.

1990–1999

During this decade, several Circuit Court cases are filed regarding set-aside programs and public contracting, many of which were found invalid or insufficient to establish that under-representation of minority business enterprises in public contracts was the result of discrimination; or, in some cases, found that, without having exhausted racially neutral means, the use of target goals amounted to quotas, presenting a constitutional threat.

1995

After hearing *Adarand Constructors, Inc. v. Peña*, the Supreme Court once again calls for "strict scrutiny" in determining whether discrimination existed before implementing a federal affirmative action program, requiring that affirmative action programs have a "compelling governmental interest," and be "narrowly tailored" to fit the particular situation. In the 5-2 decision, the majority of judges asserts that "the unhappy persistence of both the practice and the lingering effects of racial discrimination against minority groups in this country" justified the use of race-based remedial measures in certain circumstances.

1999

President Clinton signs Public Law 106-50, the Veterans Entrepreneurship and Small Business Development Act, which, among other requirements, establishes additional procurement assistance for veterans, including a 3 percent government-contracting goal for service-disabled veteran-owned small businesses. It requires the head of each federal agency to take the necessary steps to establish the 3 percent goal in that agency's prime contract and subcontract awards.

- ***The 1990s.*** During this decade, a variety of challenges to the set-aside requirements of **government programs** begin to emerge. **Corporate programs** assumed the leadership role in minority business development, providing opportunities for the growth and development of small, medium-sized, and large minority-owned businesses. With this change, however, came strong pressure for minority-owned businesses to provide higher levels of quality, deliver excellent service, and offer competitive prices.

- ***The 2000s.*** Just four years into the 21st century, the challenges facing minority-owned businesses have increased dramatically. Government pressures to dismantle set-aside programs have escalated, and corporations are beset by major global competition and the tightening of global supply chains. In addition, the tragic events of September 11, 2001, have changed all lives and businesses in the United States. Therefore, minority businesses face the new millennium threatened by forces that would confound even the largest and most prolific businesses. These challenges seem monumental—but where there is significant threat there is also significant opportunity.

Minority Business Development Matters to American Business

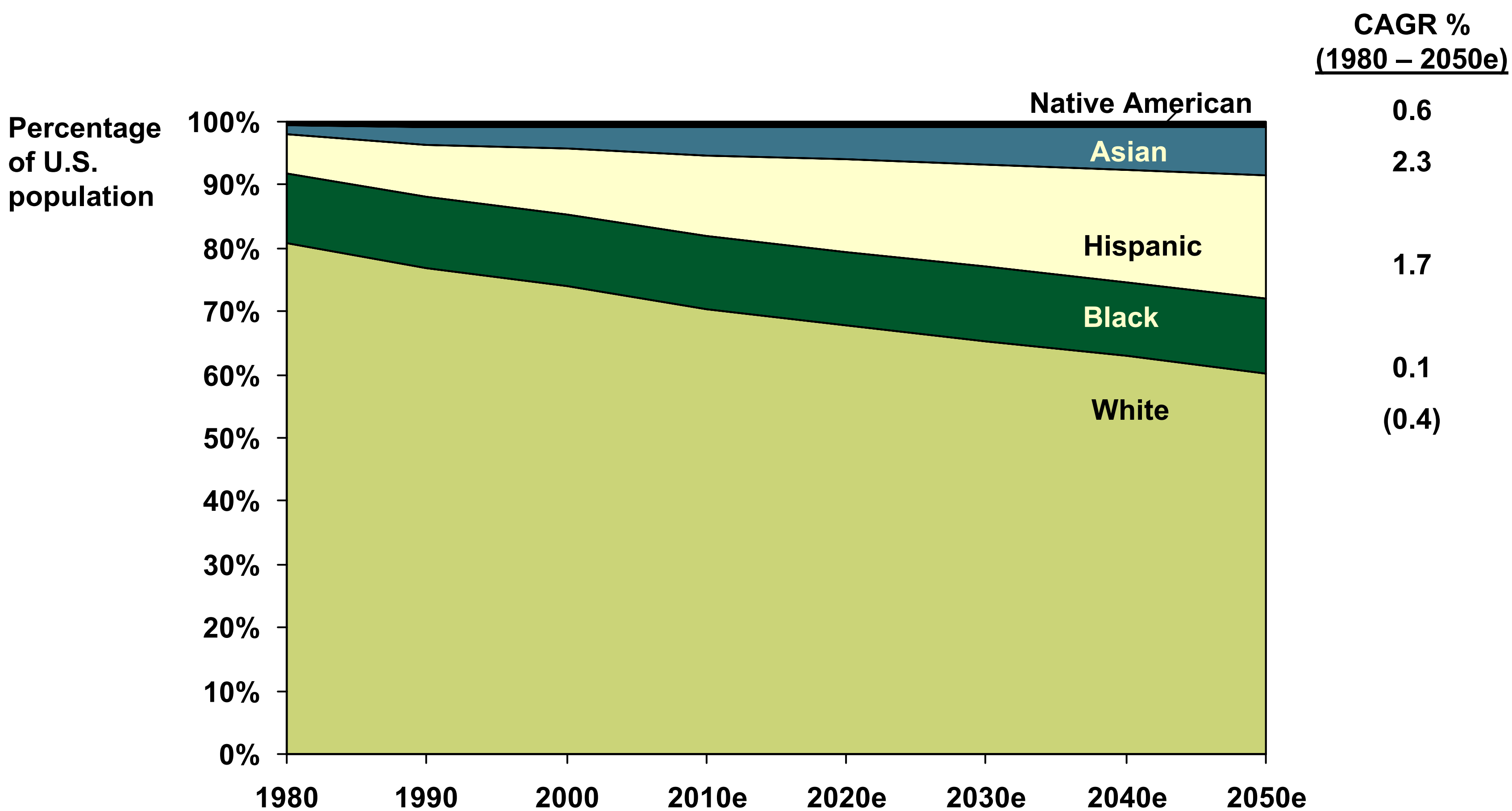
Throughout its evolution, minority business development has grown significantly in importance. Yet the primary rationale for continuing to grow and develop minority-owned firms has remained the same, grounded in three fundamental tenets.

1. **Minority business development fosters economic development—particularly in the inner city, where minority populations are predominant.** Typically, minority businesses employ minorities; hence the growth and development of these businesses is linked inextricably to the economic growth and development of minority communities. Strong minority-owned businesses operating in growth industries therefore could serve as a powerful new infrastructure for inner-city economies, which themselves contribute critically to the overall economic growth of the United States.

2. **Minority groups have long been growing as a percentage of Americans—and are on the verge of becoming the majority of the population.** Major ethnic minority groups—African Americans, Asian Americans, Hispanics, and Native Americans—will account for 40 percent of the U.S. population by 2050, according to projections by the U.S. Census Bureau. This shifting demographic warns the business sector that both its future employee base as well as its future customer base will increasingly be drawn from ethnic minority groups (see *Exhibit 2*). The implication, therefore, is that continued economic progress hinges on the ability to effectively integrate minority consumers into the mainstream of American business—both as employees as well as entrepreneurial partners.

Exhibit 2

GROWING ~5% ANNUALLY, MINORITIES WILL ACCOUNT FOR 40% OF POPULATION BY 2050



Source: U.S. Census Bureau, *National Estimates, Annual Population Estimates by Sex, Race, and Hispanic Origin, Selected Years From 1990 to 2000*

3. **As minority businesses expand, their founders and CEOs will emerge as an insightful and powerful cadre of new business and civic leaders.** Today, minority business leaders don't always get to contribute to and shape policy, public dialogue, and private development—leaving our nation's assets underutilized. Minority business leaders hold the key to enhanced economic success because they serve as a bridge between the corporate world and minority groups. As their experience and power expand, they will be poised to aid corporations in tapping the value of both a minority workforce and minority suppliers. Moreover, they will also inject a fresh perspective and new approaches into the overall business sector. At the same time, they can link fellow minorities and minority entrepreneurs to much-needed corporate resources: capital, markets, jobs, and know-how.

Significant Progress Has Been Achieved in Minority Business Development

The minority business community has made significant strides and achieved impressive growth.

- Between 1982 and 1997, the number of minority-owned firms grew at 8.5 percent annually—**a rate three times that of U.S. businesses overall**.[6] Over this same period, the number of minority-owned firms more than tripled from 825,000 in 1982—and approximately 7 percent of all businesses—to almost 3 million and 15 percent of all businesses in 1997. (See *Exhibit 3*).

- Revenue from minority-owned firms also rose dramatically by 22.5 percent from 1987 to 1997—**an increase equivalent to an annual growth rate of 10 percent.**

- **Employment opportunities within minority-owned firms have increased by 23 percent** over the same period of time.

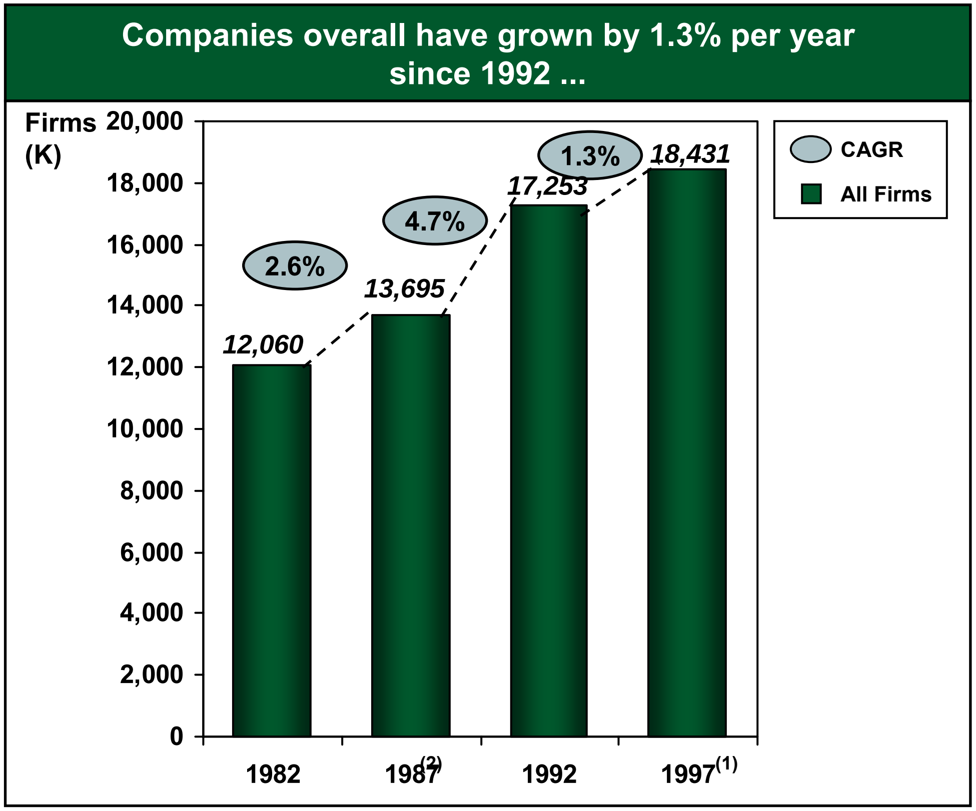
Equally impressive, business opportunities for minority-owned firms have realized significant growth. Since 1990, federal government contracting opportunities have grown annually by 8.6 percent, resulting in more than $15.3 billion in expenditures by 2002, as shown in *Exhibit 4***.**

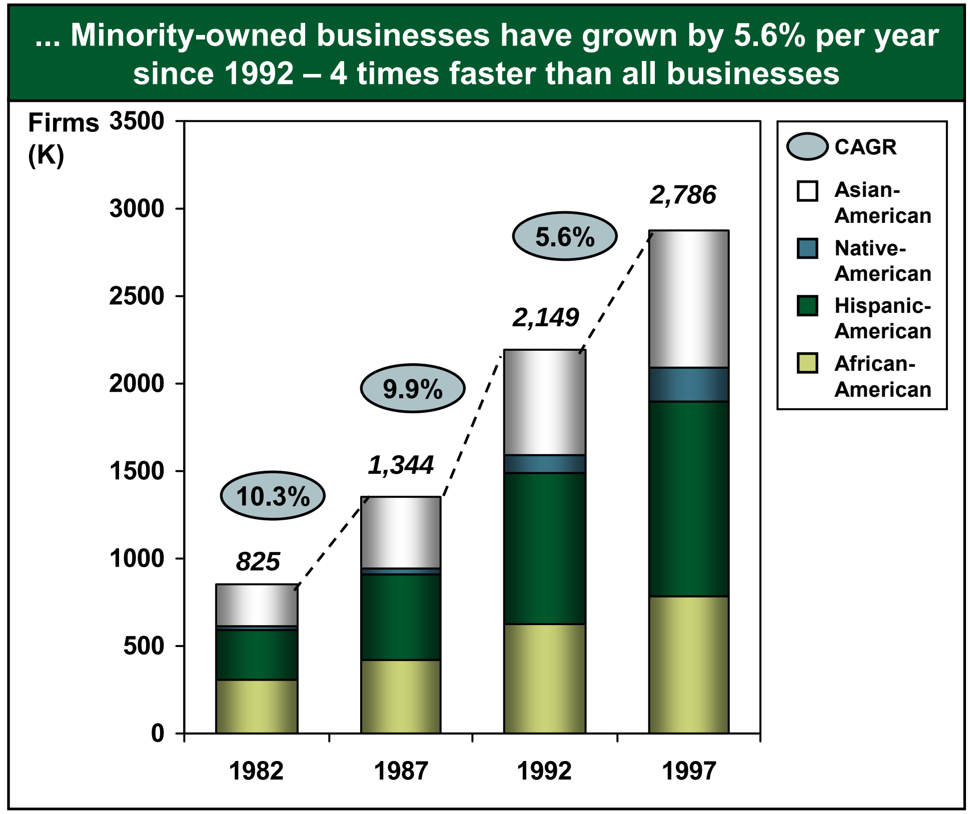
Taking the lead from government programs, the private sector has also been increasingly active in providing these opportunities for minority-owned firms, evidenced by the data reported by the National Minority Supplier Development Council (NMSDC). According

[6] The official data on the number of minority-owned businesses were pulled from the *1997 Economic Census*; the data from the "2002 Survey of Minority-Owned Business Enterprises" for the *2002 Economic Census* were not publicly available when this research was conducted. A three-year lag exists between when the census is conducted and when data on the minority business community become available. U.S. Census Bureau, "1997 Survey of Minority-Owned Business Enterprises," *1997 Economic Census*. (Washington, D.C.: U.S. Government Printing Office, 2001).

Exhibit 3

MINORITY-OWNED BUSINESSES ARE GROWING 3-4 TIMES FASTER THAN THE TOTAL U.S. BUSINESS POPULATION



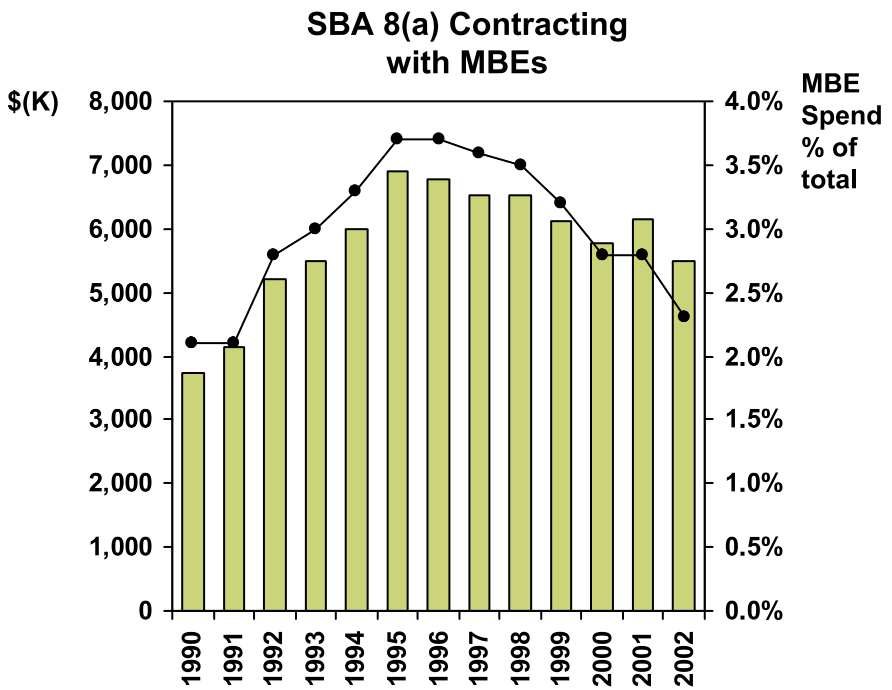


(1) Estimated value based on U.S. Census data for 1997
(2) Figures adjusted for change of analytical methodology, U.S. Census, 1992
Source: U.S. Census (1997); BCG forecast; BCG analysis

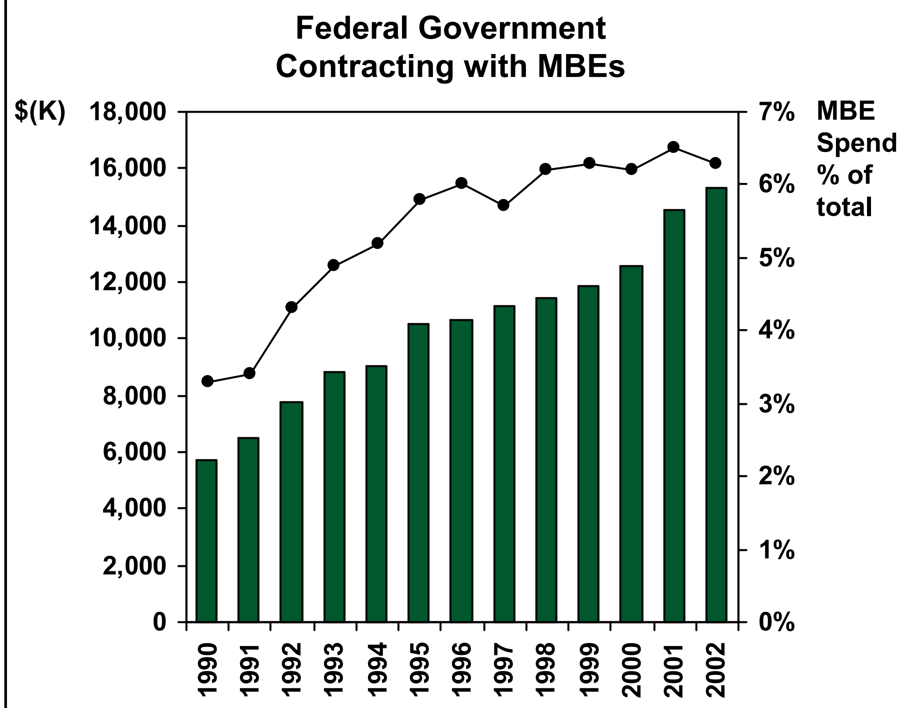
Exhibit 4

GOVERNMENT PROCUREMENT OPPORTUNITIES HAVE GROWN DRAMATICALLY OVER TIME, LEVELING OFF RECENTLY

SBA 8(a) program expenditures are beginning to decrease



Federal government contracting expenditures are beginning to plateau



Source: The Small Business Economy 2003; Procurement from Minority- and Women-owned Businesses pages 94-102; SBA (2003); BCG analysis to that data, purchasing from minority-owned businesses by the private sector has grown at an annual rate of 13 percent since 1990, resulting in more than $65 billion in expenditures in 2002, as shown in *Exhibit 5*.

With this increased support, minority businesses have been able to make sizeable contributions to the U.S. economy. As one would expect, larger minority-owned companies have made the most dramatic contribution, generating the greatest impact on business and job growth.

- Minority-owned firms with more than $500,000 in annual revenue—171,000 businesses—accounted for 76 percent of the revenue generated by minority-owned firms. They also accounted for 70 percent of all employment by minority-owned firms, a share that equates to more than 3.1 million workers. Since 1992, the number of these larger firms—and the number of jobs they provide—has tripled. (See *Exhibit 6*.)

- From an industry perspective, more than 80 percent of these larger firms operate in four sectors: services (27 percent), retail (27 percent), wholesale trade (19 percent), and construction (9 percent)

- The number of minority-owned firms employing more than 100 people increased from 1,690 in 1992 to 4,432 in 1997, when they accounted for $105 billion in revenue.

Yet a Major Gap Continues to Exist…

Clearly, the aggressive development of corporate and government programs over the past 20 years is beginning to yield results. But even though larger and highly successful minority-owned firms are emerging, these firms are struggling to reach parity with majority-owned companies—and they face a long road ahead.

A significant gap remains between minority-owned businesses and the overall business community in the United States. As noted in *Exhibit 7*, minority-owned firms account for only:

- 2.7 percent of total U.S. gross revenue from all firms

- 4.3 percent of all U.S. employment

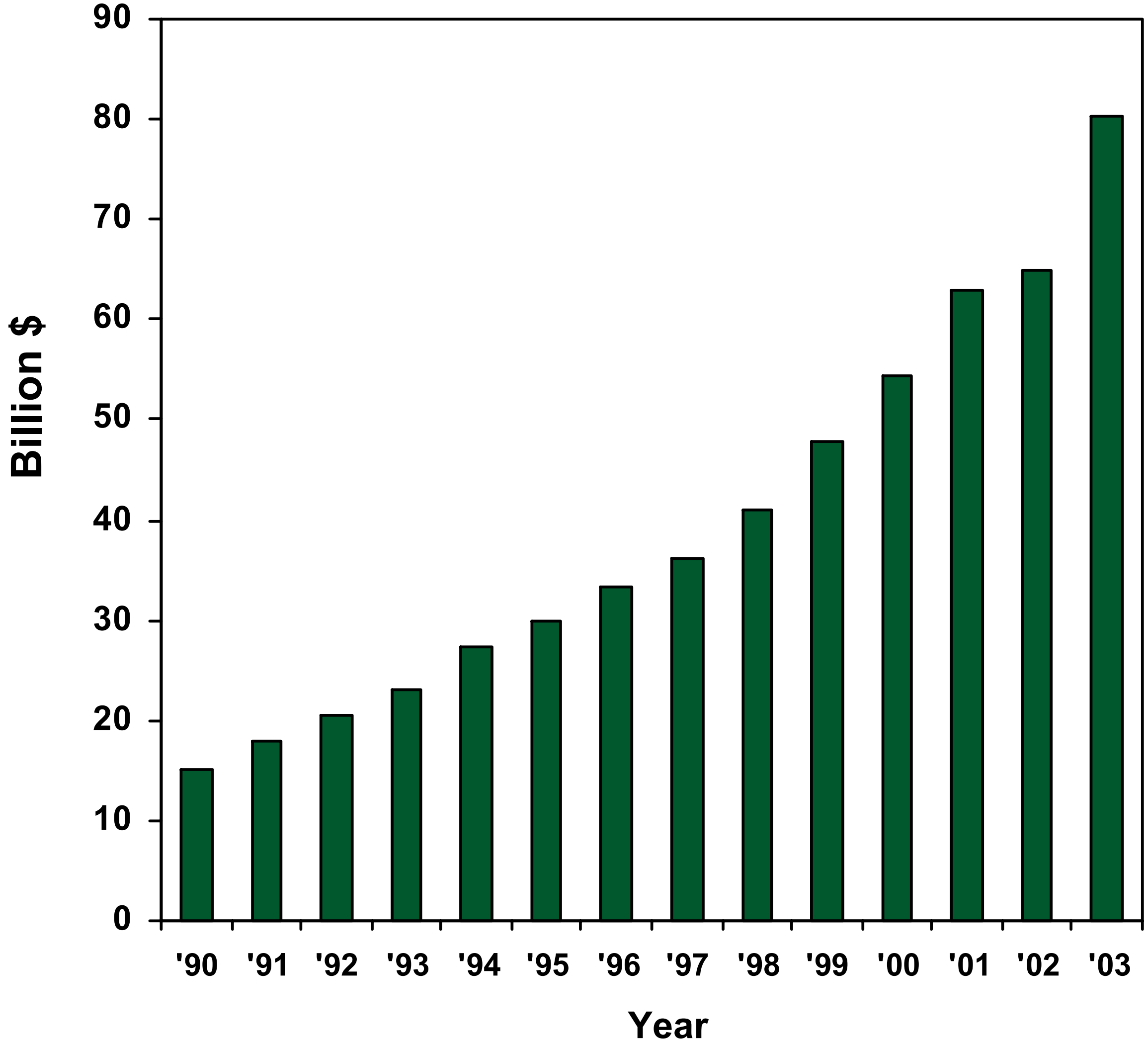
- 9 percent of U.S. firms with $500,000 or more in revenue

- 5 percent of U.S. firms with more than 100 employees.

Obviously, minority-owned firms overall are significantly smaller in size, but there's more to the story. Net worth for example is another factor that plays a critical role, particularly since ethnic minority-owned businesses traditionally rely on equity financing

Exhibit 5

MBE EXPENDITURES AT MAJOR CORPORATIONS HAVE GROWN 13.6% ANNUALLY SINCE 1990

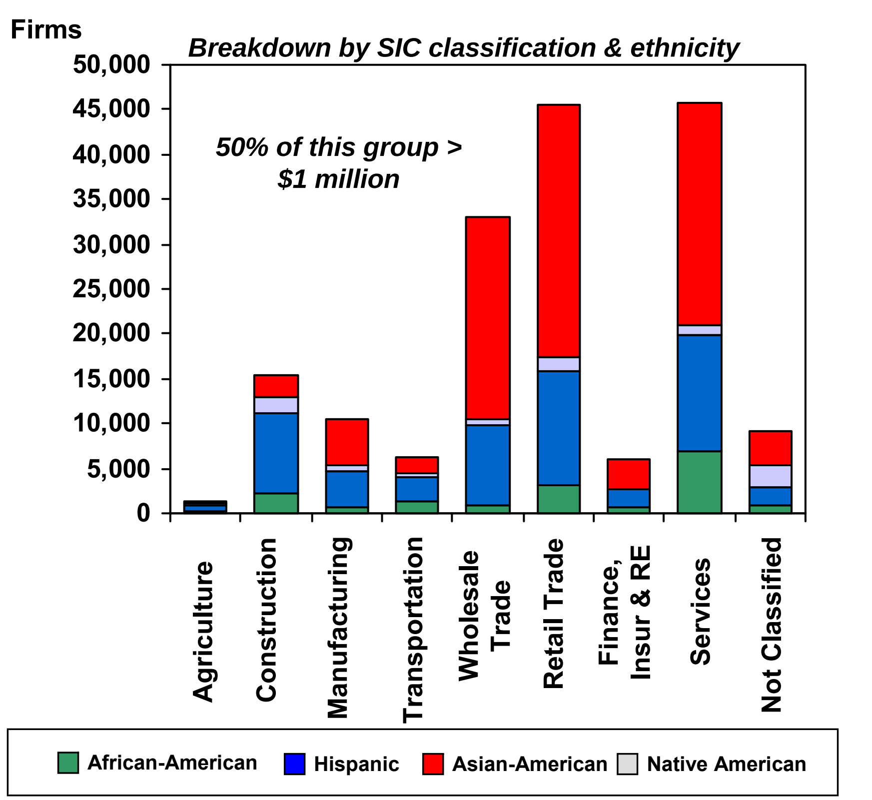


Source: National Minority Supplier Development Council website; www.nmsdcus.org

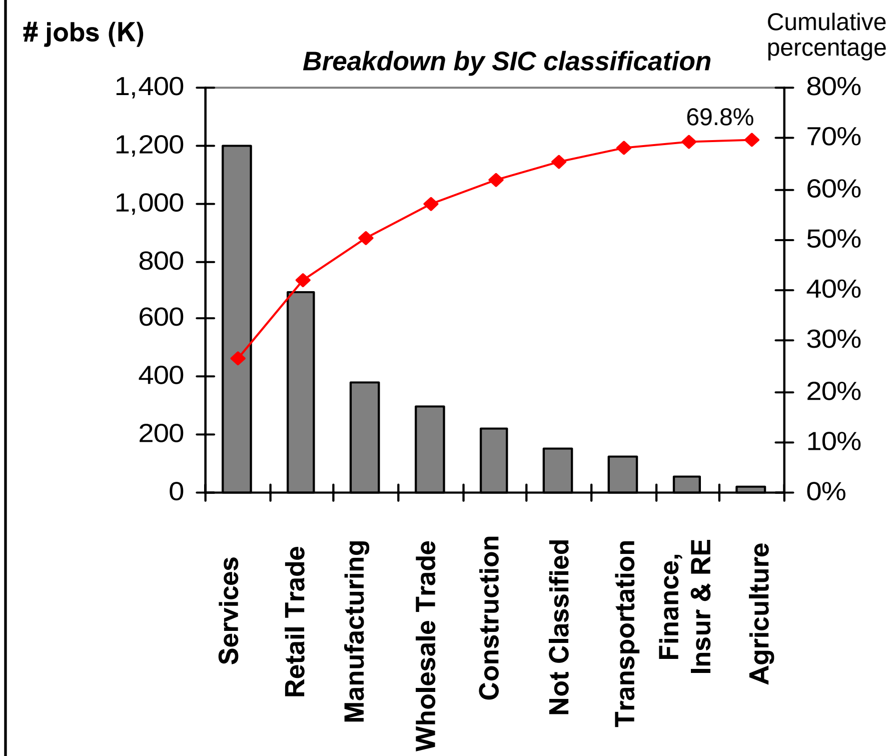
Exhibit 6

171 THOUSAND MINORITY FIRMS HAD ANNUAL REVENUES OF >$500M – THESE FIRMS REPRESENTED 70% OF ALL JOBS

76% of the revenue of all firms exists in those with more than $500K in revenue



3.1 million jobs (or ~ 70%) exist in nine major industry groups

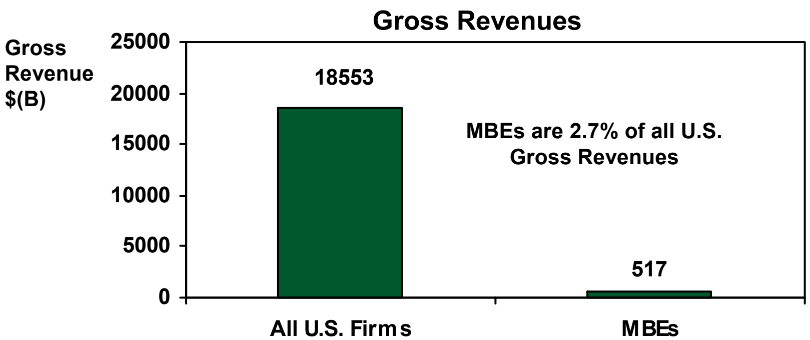


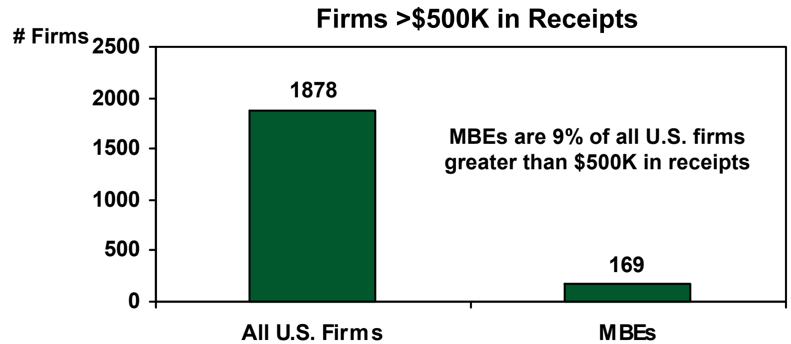
(1) Since sample is from certified businesses, the absence of firms in the area of retail, social services and personal services is expected, and not of concern

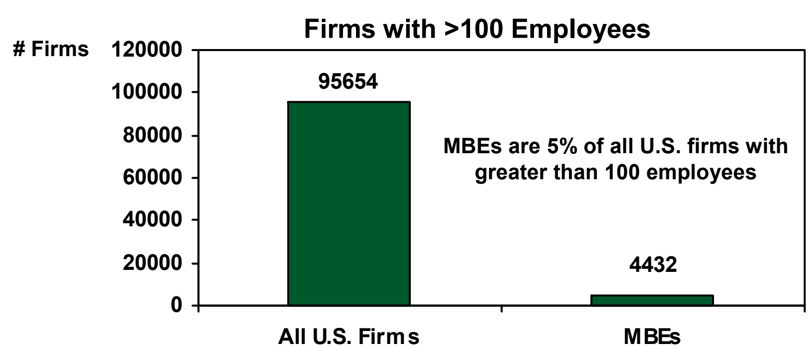
Source: 1997 Economic Census; Sample set of certified businesses; BCG analysis

Exhibit 7

COMPARISONS WITH MBE FIRMS AND TOTAL U.S. BUSINESS COMMUNITY







Source: 1997 Economic Census; Sample set of certified businesses; BCG analysis

from the savings of the owner or his/her friends and family.[7] A recent study by the Pew Hispanic Center[8] found that during the most recent recession (1999–2002), the net worth of African-American and Hispanic-American households decreased dramatically, by 27 percent for each group, while white American households experienced an increase in net worth of 2 percent. Overall, the net worth of white households, the study found, was eight times greater than that of Hispanic-American households and more than 11 times greater than that of African-American households.

In addition, the growth rates and sizes of minority-owned businesses vary greatly among the different ethnic groups within the universe of minority-owned businesses. And the research clearly reveals that African-American businesses are not growing as quickly as businesses owned by other ethnic groups.

The list below highlights a few brief statistics on the major ethnic segments of the minority business population; the business data are drawn from the 1997 Economic Census, and the population data from the 2000 Census. No doubt, clear and compelling reasons may drive the differences; it was however beyond the scope of this study to examine the differences in detail.

- **African Americans** account for 12.3 percent of the U.S. population and 40 percent of the total minority population. Yet African Americans own only 823,000 businesses, representing just *4 percent of all U.S. businesses* and 26 percent of all minority firms. Businesses owned by African Americans generated revenue of $71.2 billion and employed 718,000 with an associated payroll of $14.3 billion in 1997. Between 1982 and 1997, the number of African-American businesses grew annually by 6.4 percent.

- **Hispanics** represent 12.5 percent of the U.S. population and 40.6 percent of the total minority population. Hispanics own 1.2 million businesses, representing *just under 6 percent of all U.S. businesses* and 39 percent of all minority firms. Businesses owned by Hispanics generated revenue of $186.3 billion and employed 1.4 million, with an associated payroll of $29.8 billion in 1997. Between 1982 and 1997, the number of Hispanic businesses grew by 9.6 percent annually. Within the Hispanic business community, four ethnic groups own 80 percent of the businesses:
  - Mexican 39.3 percent
  - Latin American 23.9 percent
  - Cuban 10.9 percent
  - Puerto Rican 5.8 percent

[7] Glenn Yago, Betsy Zeidman, and Bill Schmidt, *Creating Capital, Jobs and Wealth in Emerging Domestic Markets: Financial Technology Transfer to Low-Income Communities* (Santa Monica: Milken Institute, 2003).
[8] Rakesh Kochhar, *The Wealth of Hispanic Households: 1996-2002* (Washington, D.C.: Pew Hispanic Center, 2004).

- **Asian and Pacific Islanders** account for 3.6 percent of the U.S. population and 12.3 percent of the total minority population. Asian and Pacific Islanders own 912,000 businesses, representing 4.4 percent of all U.S. businesses and 30 percent of all minority firms. Businesses owned by Asian and Pacific Islanders generated revenue of $306.9 billion and employed 2.2 million, with an associated payroll of $46 billion in 1997. Between 1982 and 1997, the number of Asian-American businesses grew by 8.2 percent annually. Within the Asian business community, six minority groups own 90 percent of the businesses:
  - Chinese 27.7 percent
  - Asian Indian 18.3 percent
  - Korean 14.9 percent
  - Vietnamese 10.7 percent
  - Japanese 9.4 percent
  - Filipino 9.3 percent

- **Native Americans** account for 0.9 percent of the U.S. population and 3 percent of the total minority population. Native Americans own 197,300 businesses, representing 0.9 percent of all U.S. businesses and 6.3 percent of all minority firms. Business owned by Native Americans generated $34.3 billion in revenue and employed 299,000, with an associated payroll of $6.6 billion. Current census information indicates that between 1982 and 1997, Native American businesses have increased by 17.3 percent annually, but this high growth rate may be inflated. Earlier statistics may not have captured the full extent of the Native American business community.[9]

…And Legal, Legislative, and Regulatory Changes Threaten Government Purchasing

Historically, government purchasing programs have set the trends in minority business development. Recently, however, these initiatives have been squeezed by budget deficits and cuts. More importantly, they have been the subject of legal cases examining racial preferences in procurement and contracting. They have also served as a touchstone for a continuing debate on America's so-called color-blind society.

Court decisions, such as *Adarand Constructors v. Pena* and *City of Richmond v. J.A. Croson Co.*, have mandated that federal and state programs aimed exclusively at minority-owned business must now past the test of "narrow tailoring." Under such a test, procurement programs are required to be race-neutral except when remedying specific instances of past discrimination toward a particular group. Moreover, quotas or "set-asides" are prohibited, and replaced with more ubiquitous goals and objectives. Consequently, certain state and federal agency guidelines have been modified.

---

[9] Dramatic increases in the number of Native American Businesses largely resulted from a change in methodology after the *1992 Economic Census*.

The direct impact of this change on state and local government programs is difficult to assess, but a trend is noticeable: Mandated compliance with formal goals and objectives has weakened for all supplier diversity efforts in the governmental procurement process.

- **In general, almost all state programs have abandoned their "set-aside" language in favor of defining goals and objectives.** Some states, such as California, do not report, track, or in any way establish targets for disadvantaged or women-owned businesses. (See *Exhibit 8* for a synopsis of selected state government programs).

- **Major cities are also changing their program requirements and are undertaking disparity studies** that will justify establishing goals and objectives for purchasing programs targeting disadvantaged businesses and other business development programs. The City of Chicago's minority-business development program,[10] which required that 25 percent of all contracting opportunities be awarded to minority businesses, endured 20 years of scrutiny before a 2004 decision required that the program be fundamentally redesigned. While some local governments view the legal developments as a setback, others believe that programs with strong commitments can continue to create and develop more minority businesses.

An excellent example highlighting the changes in the federal procurement process is the SBA's 8(a) program. Since its inception in 1968, the 8(a) program has focused on small minority-owned businesses, using government procurement opportunities to assist these businesses in becoming more prolific enterprises. As a result of the confluence of forces, however, SBA 8(a) contract awards have experienced a decrease of 20 percent, falling from a high of $7 billion in 1995 to $5.6 billion in 2002 (see *Exhibit 4*).

Moreover, in 1995, the SBA suspended the "rule of two," previously used to determine when a requirement would be "set aside" for competition by minority-owned businesses. Under the rule, whenever at least two small, disadvantaged businesses[11] wished to bid on a contract, the contract could be set-aside for exclusive participation by disadvantaged firms. Once a powerful means for affording opportunities to minority-owned businesses, the rule of two remains suspended to this day.

A Potentially Promising Future

Today, according to BCG estimates, 20 to 25 minority-owned businesses generate revenue that exceeds $500 million—a noteworthy accomplishment. (As a basis for

[10] The City of Chicago's program, one of the first of its kind, was proposed by James H. Lowry & Associates in 1985 for then-mayor Harold Washington.

[11] Disadvantaged businesses are those that have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. In addition, the social disadvantage in question must stem from circumstances beyond the control of the minority groups. Economically disadvantaged entrepreneurs must have a net worth of less than $750,000—excluding their personal residence.

Exhibit 8

SELECTED STATE PROGRAMS FOR DISADVANTAGED BUSINESS

State	Current minority business activity
New York	New York State's division of Minority & Women's Business is charged with assisting state agencies in awarding a "fair share" of contracts to M/WBEs. State agencies reported expenditures in 2001 of $558 million, with MBEs receiving $305 million, and WBEs receiving $252 million. A State Controller review of the program in 2002 revealed that under the "fair share" approach only 24% of all state agencies met or exceeded their objectives for MBEs—and 41% for WBEs.
Florida	All state agencies must submit plans annually that outline strategies to increase their spending with companies certified as MBEs in construction, commodities, contractual and architectural and engineering services. In Fiscal Year 2003, state agencies spent $748 million with certified MBEs. Recently, construction contracting requirements were modified after a legal challenge from the Florida Associated General Contractors Council. The new language reads specifically that "state construction contracts will not be awarded upon the basis of race, ethnicity, or gender."
New Jersey	New Jersey statutes require that a 25% minimum of the total number of state contracts and purchase orders be allocated to small, minority-owned and female-owned businesses. The law stipulates that for state contracts 15%, 7% and 3% should go to small business, minority-owned businesses and female-owned businesses respectively.
Maryland	The state's mission is to achieve a minimum goal of 25% of the designated unit's total dollar value of procurement contracts made directly or indirectly to certified MBEs. Of that 25% goal, a minimum of 7% is to be awarded to certified African-American-owned MBEs and a minimum of 10% is to be awarded to certified women-owned MBEs.
Illinois	In Fiscal Year 2003, $401 million in state agency and university contracts were awarded to qualified vendors that were women, minorities, or persons with disabilities. The minimum participation goals were established, based on a 1997 disparity study, of 12%, 5% and 2% for women, minorities, and persons with disabilities.
Ohio	The state program for Encouraging Diversity, Growth and Equity (EDGE) was established in 2002 to provide goals and objectives for individual state agencies. Current targets account for ~$190 million in spending with woman-owned, minority-owned and businesses owned by persons with a disability.
Texas	Texas has established goals for Historically Underutilized Businesses (HUBs) by area of procurement such as heavy construction (10.1%), building construction (19.2%), special trade (28.6%), professional services (21.5%), other services (21.5%) and commodities (14.9%). In 2004, expenditures were $1.5 billion, or 14.5% of statewide expenditures.
California	Proposition 209 (a California voter's initiative) eliminated goals on State of California contracts for minority-owned businesses and women-owned businesses.

Source: BCG research and analysis

comparison, achieving a Fortune 1000 business listing would require about $1.2 billion in revenue.[12]) Most of these larger firms, having worked diligently to improve their capabilities and skills, offer valuable service to some of the largest companies in the United States. In turn, the leadership of the major corporations, coupled with the trends toward more global business environments, positions these large minority-owned businesses for dramatic, ongoing growth.

But much more must be accomplished to create the types of initiatives and opportunities that will be mutually beneficial to both larger minority-owned firms and major corporations. This research indicates that creating large minority-owned businesses—that is, those with at least $100 million in revenue—is the key to:

- Driving significant economic development for the community
- Creating meaningful, lasting, and higher-paying jobs
- Providing a cost-competitive and highly capable supply base for major corporations and government
- Providing procurement opportunities for smaller minority-owned businesses
- Developing opportunities for younger entrepreneurs to identify growth prospects and develop businesses of size
- Creating wealth for minorities
- Fostering a new cadre of leaders to further support the historic community/civic leadership.

The balance of this report concentrates on the factors that we believe are perpetuating the "gap" between minority-owned businesses and businesses overall—as well as specific recommendations for closing that gap and examples of firms that have adapted a new mindset that is oriented toward growth.

[12] In 2005, the lowest revenue for a business ranked on the Fortune 1000 listing was $1.188 billion.

CLOSING THE GAP

Over the years, private- and public-sector programs have helped enhance the ability of minority entrepreneurs to compete more successfully for business opportunities. But a disparity remains for a variety of reasons.

1. The **discriminatory conditions** that previously existed were deep and pervasive and have not been fully reversed.

2. Even more damaging than blatant discrimination has been the negative effect of **abuse and fraud** in the programs established to help minority businesses grow and develop. So-called front companies continually raise concerns about the objectives and impact of supplier diversity programs and initiatives. (See *Sidebar 1, Program Abuses and 'Front Companies' Impede Supplier Diversity Efforts*)

3. Some minority business have been unable—or unwilling—to adjust to a **changing global economy**.

Therefore, the gap that exists has not in any way been caused by a lack of effort on the part of minority entrepreneurs. Rather, many of the conditions that confront minority businesses are environmental and have developed over time as part of the progress that has been—and is still currently being—made. Addressing and exploiting these conditions in order to achieve the next level of performance will require a shift in the mindsets held by the corporate community, government, universities, foundations, and most importantly minority entrepreneurs.

These shifts in mindset must occur to build larger minority businesses that are well capitalized, are targeted on growth opportunities/industries, leverage the benefits of strategic alliances to expand their capacity and capability, and therefore have the greatest possible impact on the U.S. economy.

Before exploring the requisite shits in mindset in greater depth in this section, the authors of this report wish to emphasize that small businesses with few employees will undoubtedly remain critical players in expanding the U.S. economy. Programs designed to support small businesses should be expanded, but they should be neither the only area nor the bulk of focus for economic development. Rather, the next wave of improvement should be bifurcated:

- In recognition of the need to continue improving the numbers of minority entrepreneurs that enter the free enterprise system, one track should **support the continuing growth of minority business in general**.

- With the ultimate objective of growing businesses of significant size and scale for maximum impact, the second track should focus on **ensuring that larger**

minority businesses establish themselves in industries with strong potential for growth.

SIDEBAR 1

Program Abuses and 'Front Companies' Impede Supplier Diversity Efforts

One of the most controversial topics in minority business development is the best approach for ensuring that only bona fide suppliers are certified to participate in supplier diversity programs. Early on, the process for certifying minority-owned businesses was established to verify the subtleties of ownership and actively involved management. Typically, corporations accept certifications from federal, state, or local government agencies as well as certifying organizations such as the National Minority Supplier Development Council (NMSDC).

But otherwise ineligible suppliers sometimes manage to slip undetected through the certification process. Known as "fronts," these majority-owned firms masquerade as minority-owned enterprises. Fronts, around since minority business programs were created in the late 1960s, represent one of the most serious complaints voiced by both detractors and supporters of minority procurement programs.

When major public-sector programs provided for set-aside contracts for members of economically disadvantaged groups—such as women and ethnic minorities—the lure of the large contracts was powerful, attracting interest from majority-owned businesses as well. Every city and state has since encountered front companies that were created through convoluted ownership and operational structures to meet the criteria of minority business programs—but that serve only to line the pockets of larger, more established companies.

Fronts must be denounced and eradicated from the minority business lexicon. Quite simply, the programs designed to create opportunities for individuals and companies that have been systematically excluded from participation in the free enterprise system will not succeed if the intended benefits are not realized by the targeted groups.

Although the number of fronts is small compared with the number of authentic minority-owned businesses, each and every abuse by a front diminishes overall satisfaction with the programs designed to help minority-owned companies grow and develop. For instance, falsifying payrolls, evidence of kickbacks, absentee management, and pass-through invoicing are examples of the type of deceit that characterizes front companies. As more and more joint venture and alliance arrangements are created between minority-owned and majority-owned companies, it is imperative that certifying agencies clearly understand requirements for bona fide status and thoroughly investigate the structures of the businesses.

Eliminating front companies will prove difficult, particularly since many of these companies have been accepted as minority organizations for some time. Adequate resources must be devoted to ensuring that certified businesses satisfy all criteria. Scaling back on such resources as a cost-cutting measure essentially mortgages the future of all supplier diversity programs.

One viable option is pooling the myriad certification agencies that exist to create a vastly more efficient and effective certification organization that delivers multiple benefits to both public- and private-sector organizations. Today, many government agencies have their own certification arms as do organizations such as the NMSDC and the Women's Business Enterprise National Council (WBENC), just to name a few.

Shifts in the Mindset of Major Corporations

Initially, government served as a catalyst for change in minority business enterprise development. But the true drivers of progress have been CEOs and chief procurement officers in major corporations. These corporate leaders have followed the trends as articulated by diversity advocates and reinforced by growing numbers of minority workers in their companies, proactively embracing millions of minority consumers as employees, business owners, and partners.

The most progressive corporate leaders have always had longer-term goals and objectives for the development of minority businesses. They envisioned a free enterprise system in the United States in which minority and non-minority firms would collaborate, jointly investing and marketing to produce the very best basket of U.S. goods and services and thus compete successfully on a global level. They also envisioned such strategic partnerships delivering tangible and significant by-products:

- Accelerating job growth
- Rebuilding inner cities
- Enhancing local, state and federal tax bases
- Building a larger and more viable customer base
- Creating a new model of leadership for youth.

But what these leaders did not envision was that the road to change would be so difficult to traverse. Initially, several realities as well as misconceptions limited the growth of minority businesses, the most important being:

- The minority business community was in an immature state.
- The minority civil rights leadership, although highly motivated, never firmly established business development as a high priority.
- There were few minority businesses of size—and those that existed focused on the minority consumer market.
- Widespread discrimination against minorities existed in business as well as in other segments of our society.
- Few minorities had experience marketing to and servicing major corporations—and the majority of the experienced companies were professional service firms.

- In some instances, less-capable minority entrepreneurs were positioned for corporate contracts.

- Majority venture companies were reluctant to invest in minority businesses for myriad reasons, the most critical being the perceived absence of viable exit strategies.

In the face of these and other realities, however, Corporate America forged ahead and assisted in elevating minority business development to the next level, providing greater opportunities and greater access to capital. As previously stated—and illustrated in *Exhibit 5*—corporate expenditures with minority-owned firms have grown dramatically over the years. On the financing front, a variety of loan and working capital funds have been established. Most noteworthy is the NMSDC's Business Consortium Fund (BCF), which was established to provide contract financing to certified minority vendors through a network of participating banks and NMSDC affiliates.[13] Moreover, major corporations such as Sears, Equitable, and Amoco (prior to its merger with British Petroleum) worked with the SBA to launch the Minority Enterprise Small Business Investment Company (MESBIC). These initial institutions served as training grounds for the current leaders of the minority venture capital industry.

With the dawning of the new millennium, major corporations have begun to seek to further boost the number of larger minority businesses and Tier 1 suppliers. They stand to succeed if they can cast away old misconceptions about minority businesses, recognize the new realities of the sector, and draw on major progress made within the minority business community, most significantly:

- New minority and non-minority elected officials who are highly supportive of growth among larger minority businesses

- A critical mass of minorities in line-management positions within large corporations that are willing and able to manage and grow businesses of size

- The growing number of well-educated and trained minorities who are able to participate in the deal flow through the financial community.

- A myriad of minority entrepreneurs who can grow and diversify their businesses if afforded the right opportunities and resources

- A small but effective cadre of minority entrepreneurs who are willing and able to conduct large deals with other minorities, non-minorities, and off-shore partners.

[13] The BCF is the non-profit financial services program of the National Minority Supplier Development Council (NMSDC). The BCF provides access to capital exclusively to NMSDC certified ethnic minority-owned businesses which have supplier/vendor relationships with NMSDC national and regional corporate members and are experiencing difficulty obtaining financing though conventional channels on reasonable terms. For more on the BCF, see www.nmsdcus.org.

Shifts in the Government Mindset

Without question, minority business development has been on the agenda of federal, state, and local governments for many years. As described in the previous section of this report, legislative programs, government mandates, and strong advocacy initiatives have characterized government involvement focused on improving economic conditions for minority entrepreneurs and their businesses. In fact, various presidential administrations have fostered the growth of minority business enterprises, with the administrations of Presidents Richard Nixon and Jimmy Carter playing the most prominent roles. President Nixon instituted most of the programs established to further minority business development, and President Carter's administration, in conjunction with Congressman Parren Mitchell[14] and others, was responsible for the majority of innovative legislation.

A historical perspective reveals that the federal government's contribution was significant in:

- Establishing goals for all federal agencies to participate in minority purchasing programs
- Setting the stage for the development of state and local purchasing programs for minority- and women-owned businesses
- Ensuring that companies doing business with the federal government set goals for the development of economic and socially disadvantaged business
- Establishing financing programs within the SBA
- Designing mentor/protégé programs at several government agencies such as the U.S. Department of Defense
- Conducting focused and invaluable research in the field of minority business enterprise development.

As a testament to their power, many of these programs and laws remain in effect today. And they can continue to offer valuable support well into the future as long as they are modified to reflect changes in the economic environment and the critical need for growth-oriented companies.

In the future, however, the continued rollback of set-aside programs and the limited governmental resources assigned to minority business initiatives will continue to plague programs already stretched thin. For this reason, a shift in government thinking is

[14] Recently, Congressman Parren Mitchell was inducted into the Minority Business Hall of Fame and Museum, created by *Minority Business News* magazine and the National Minority Business Council. Minority Business Hall of Fame and Museum, http://www.mbhf.org/main.htm.

needed. New programs should focus on the development of both small businesses as well as larger ones positioned in growth industries and global markets.

In short, minority business development must not be relegated to only "small business" status. Yet this is often the result of current requirements which mandate that companies doing business with the federal government subcontract with "socially and economically disadvantaged businesses." The current criteria defining eligible businesses are so narrow[15] that most minority businesses are excluded from major opportunities offered by larger agencies such as the U.S. Department of Defense.

Consider for example that today most socially and economically disadvantaged minority firms cannot effectively compete with their majority-owned counterparts because they are too small and undercapitalized to:

- Establish major international partnerships
- Invest sizeable sums of money in research and development
- Attract venture capital investors
- Recruit senior management talent.

Moreover, in fostering growth in the more challenged of U.S. communities, the government should embrace strategies proven to work in the developing world. Recently, in his article, "Don't Just Throw Money at the World's Poor,"[16] Jeffrey E. Garten, Dean of the Yale School of Management, challenged world leaders to take different approaches to reducing the number of people living in extreme poverty by 2015. He contended that investments in developing-world nations that lack strong political, social, and economic infrastructure will fail. He also noted that the key to success in the developing world will be viable businesses with growth potential, led by strong entrepreneurs seeking to better themselves and their communities—with or without government support.

Certainly, the same statements hold true for investments in low-income communities in the United States. The ongoing decay of many U.S. cities clearly demonstrates that small businesses and community development corporations (CDCs) alone cannot reverse a declining economy. What is needed is an infrastructure of medium-sized and larger companies and institutions that create jobs, technological advances, and world-class products and services. Fueling this need are two factors: First, given that minority-owned companies hire minorities, it follows that large minority companies hire more minorities. Second and equally important, prominent minority business leaders represent

---

[15] Regulations limit this status only to those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. In addition, the social disadvantage in question must stem from circumstances beyond the control of the minority groups.

[16] Jeffrey E. Garten, "Don't Just Throw Money at the World's Poor," *BusinessWeek*, March 7, 2005.

models of change and advancement to be emulated by the young people in their communities.

Broadening the focus for development to include these larger businesses uses government resources to generate the maximum benefits in overall economic development and wealth-creation in minority communities.

Shifts in the Mindset of Minority Businesses

Today's global economy moves at dizzying speed, and keeping pace poses a critical challenge for minority-owned firms. Consistent with the outlook for corporate and government support programs, minority entrepreneurs must ready themselves to face the challenges of growing larger businesses, effectively utilizing all aspects of corporate supplier diversity programs, and assuming broader leadership roles.

Small businesses are built by passionate entrepreneurs, who often run them successfully as an extension of their personal selves. They forge customer relationships through one-on-one relationships and back commitments with their word and often their private finances. But this same approach is insufficient to foster the growth of large businesses or to deliver the extensive intellectual know-how, deep financial resources, or vast manpower required to expand into challenging but promising new business lines or industries. Minority businesses must begin to aggressively develop a mindset for growth.

Corporations are aggressively expanding their role in creating opportunities for minority businesses to grow and develop. Many minority suppliers understand that they must get involved earlier in the procurement process and position themselves for larger and longer-term contract opportunities. Furthermore, minority entrepreneurs must continue seeking ways to be innovative and to provide the added value that most major corporations demand. Among the ways to achieve this goal are expanding their capabilities and partnering with other, more prolific businesses.

Direct contracting with major corporations, however, might not be an opportunity suited to all minority businesses. Rather, the expansion of Tier 2 contracting programs provides access for a broader range of minority business. Corporations are beginning to ensure the authenticity of these subcontracting programs, resulting in additional opportunities for growth. Encouraging—or often mandating—Tier 2 procurement opportunities has created a new area of opportunity for minority businesses to serve as suppliers to the primary corporate suppliers. In fact, many of the larger minority businesses have recognized the corporate focus on economic development and have created supplier diversity programs of their own. Certainly, diligence and persistence are required to determine how best to get involved with lower-tier procurement, but these contracting opportunities are real and should not be overlooked.

Although many minority entrepreneurs have significantly lower financial net worth than their counterparts in the majority, they enjoy greater relative prominence and financial success in the minority community than do their peers in the broader community. As a result these business men and women are sought out more frequently for community leadership roles. Often, minority business leaders donate significant resources, time, and money while serving on major nonprofit boards and representing their communities. Research reveals, however, that these minority leaders are rarely asked to serve on corporate boards—where connections and resources might better assist them in growing their businesses. The future holds significant opportunities for corporations, government, and others to partner with minority entrepreneurs in creating greater opportunities for leadership positions on political, civic, and corporate boards–thereby creating greater opportunities for business growth.

Developing the Capabilities Minority Businesses Will Find Critical to Close the Gap

By distilling their observations, analysis, and research, the authors of this report have identified the seven most critical areas of improvement that corporations, government, and minority entrepreneurs must focus on to develop a strong and vibrant minority business community. Each of these areas sets radically new expectations for all the players in minority business development. All seven are bound together by a consistent theme of fostering the development of businesses with significant size and scale. Specifically, the minority business development "community" must:

- View minority business development as a key to U.S. economic development
- Diversify or expand minority businesses to seize opportunities in growth industries
- Build the capacity and capability of minority businesses to provide more value-added products and services
- Grow these businesses beyond the "sole proprietorship" model of business ownership
- Expand the use of mergers, acquisitions, and strategic partnerships
- Fully access and deploy the capabilities of the financial markets for minority business development
- Aggressively respond to major trends in global supply chain management.

View Minority Business Development as a Key to U.S. Economic Development

As they evolve, major corporations are coming to exemplify the strategic business case for minority business development that leverages supplier diversity achievements to create lasting impact in the marketplace. Overwhelming demographic realities are driving more and more companies in this strategic direction.

As previously stated in this report, minority groups will grow to become more than 40% of the U.S. population (see *Exhibit 2*). Fueling this demographic trend is another: Over the next 50 years, 90% of the growth in the U.S. population will occur in groups traditionally recognized as minorities (African Americans, Hispanics, Asians & Pacific Islanders and Native Americans). In 11 of the largest 15 cities in the United States, minority populations already exceed more than 50% of the total population. And in the second-most populated state in the country— California—the minority population already represents 50% of the entire state population. These trends create implications for both the supply side (jobs and labor) and the demand side (purchasing power) of the U.S. economy.

<u>Supply-Side Impact—</u>During the decade between 2002 and 2012, the U.S. Bureau of Labor Statistics (BLS) estimates that 70% of the approximately 17 million people who will enter the U.S. labor force will be ethnic minorities, equating to more than one-third of a total labor force estimated to be 162 million. This trend is expected to continue until 2020, when the minority workforce will begin to grow even faster. As previously noted, the minority business segment is also growing at four times the rate of growth for all businesses in the United States. The growth and development of viable minority businesses will therefore be a driving force in providing both employment and the workforce of the future, which will itself be dominated by ethnic minorities.

<u>Demand-Side Impact—</u>Similarly, minority consumers will drive demand over the next 20 years. The purchasing power of ethnic minority groups is growing by 7.2% annually. As shown in *Exhibit 9*, ethnic group purchasing power is forecast to be $3.6 trillion by 2014, double today's base of $1.7 trillion. The density of minority populations in urban areas has resulted in the phenomenon of the "emerging domestic market," a fact that many companies are beginning to take into account in their new product development and marketing strategies.

The combination of supply and demand patterns yields a highly compelling business case for continuing the focus on developing minority-owned business. Consequently, companies will begin to focus on larger businesses that have stronger capabilities and are capable of dramatic growth. These larger businesses will begin to generate meaningful results in economic development.

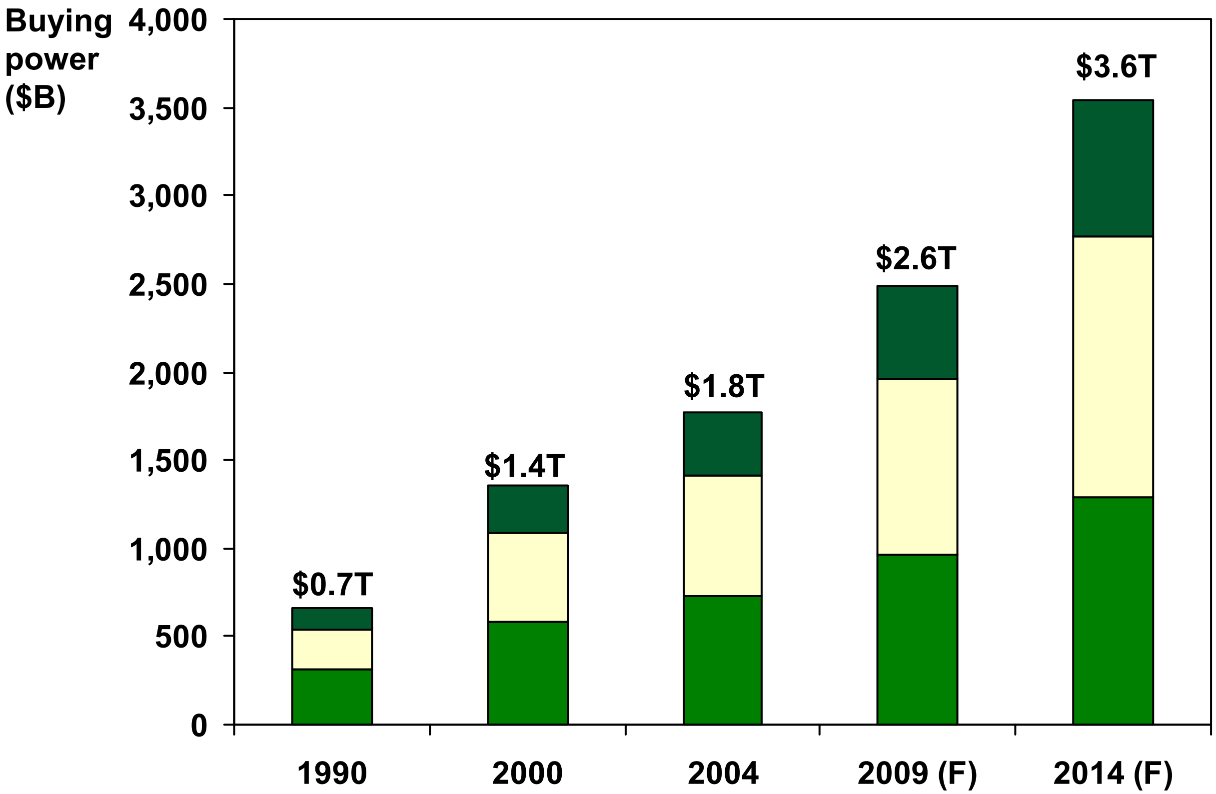
Government programs can further support this focus, if federal, state, and local programs come to view minority businesses as critical for economic development, rather than seeing them as "preferential" initiatives. Even though small minority-owned businesses continue to have a role to play, truly accelerated growth will come to minority communities only if the government makes strides in fostering the development of minority businesses of size. To foster growth in both types of businesses, the government should consider a bifurcated approach, designing programs that assist both small and disadvantaged minority businesses as well as larger and more growth-oriented companies.

Such an approach would reflect the reality that the root causes of many of the social, educational, and economic burdens plaguing residents of low-income communities

Exhibit 9

ETHNIC GROUPS BUYING POWER OF ~$1.8T (21% OF U.S. TOTAL)

Projected to Be ~$3.6T in 2014, Representing a 7.2% CAGR From 1990



	Projected CAGR (%) (1990-2009)	Est. % of U.S. buying power
Total U.S. buying power	5.1	
Asian	8.2	4.8
Hispanic	8.2	8.9
African American	6.0	8.7
	7.2	

Source: *The Multicultural Economy 1990 - 2009: America's Minority Buying Power*; Selig Center for Economic Growth, University of Georgia, May 2004; BCG analysis cannot be eradicated through government largess and are far too weighty to be shifted to the backs of mom-and-pop businesses. It would also reflect the historical reality that building wealth has made this country great—as well as the future reality that building wealth among minority businesses can make it even greater.

As an example, note that the Black Enterprise 100 and Hispanic Business 100—which warrant consideration as large businesses—had average revenue in 2004 of $164 million. On average, these businesses employed 682 people. Creating 100 additional minority businesses of this size, therefore, would also create an average of 68,000 new jobs—many of which would be filled by minority workers.

Through development initiatives backed by all parties, minority businesses can begin to create in their communities the value—and ultimately the wealth—that will yield the lasting results that both corporations and government have found so elusive.

Diversify or Expand Minority Businesses to Seize Opportunities in Growth Industries

Minority-owned businesses already participate in a wide variety of industries, as illustrated in *Exhibit 10*. The current mix of businesses however is concentrated disproportionately in traditional low-growth and low-opportunity sectors. Therefore, minority firms must find ways to take aggressive and entrepreneurial actions that will propel them into high-growth sectors.

Specifically, 25 percent of all minority-owned businesses—compared to 18 percent of majority-owned businesses—participate in six categories of traditionally low-growth segments:

- Personal services
- Food stores
- Trade contractors[17]
- Apparel and other textile products
- Eating and drinking establishments
- Local and inter-urban passenger transportation.

Minority-owned firms, as *Exhibit 11* illustrates, are overrepresented in all the categories except one: trade contractors. (But a significant number of the minority-owned businesses in this sector are smaller and focused on trade support, requiring lower levels of skill.). The disparity is greatest in personal services—that is, services for individual

[17] Although minorities are not overrepresented in the category of trade contractors, a significant number of the minority-owned businesses in this sector are smaller and focused on trade support, requiring lower levels of skill.

Exhibit 10

MINORITY-OWNED BUSINESSES HAVE GROWN ACROSS SEVERAL INDUSTRY CATEGORIES...

	20-Year MBE Growth Statistics		
Major industry category	1997	1977	CAGR
Construction industries and subdividers and developers	255,251	52,478	8.23%
Manufacturing	63,640	12,527	8.47%
Transportation, communications and utilities	109,564	36,527	5.64%
Wholesale trade	92,727	9,382	12.13%
Retail trade	439,450	147,189	5.62%
Finance, insurance and real estate industries	164,043	28,396	9.16%
Service industries (excluding membership organizations and private households)	1,339,486	234,321	9.11%
Other industries	491,443	40,576	13.30%

Source: 1977 Economic Census data, 1997 Economic Census; BCG analysis

Exhibit 11

...BUT ONE-FOURTH OF MINORITY-OWNED FIRMS OPERATE IN PRIMARILY SERVICE AND/OR LOW-GROWTH SECTORS

Industry & # of firms (K)	Δ vs. majority	% of Total	Description	Comments
Personal Services – 299.1	3.97 %	9.8	Establishments primarily engaged in providing services generally to individuals, such as barber and beauty shops, dry cleaning plants, laundries, and photographic studios.	23% of all services firms vs. 14% for non-minority firms
Food Stores – 59.9	1.16 %	2.0	Retail stores primarily engaged in selling food for home preparation and consumption.	14% of all retail services firms vs. 6% for all non-minority firms
Trade contractors – 215.6	- 1.45 %	7.1	Special trade contractors who undertake activities of a type that are specialized either to building construction, including work on mobile homes, or to both building and non-building projects	84% of all construction firms vs. 74% for all non-minority firms Construction growth forecast at 1.5% annually
Apparel & other textile products – 13.8	0.22 %	0.5	Needle trades—includes establishments producing clothing and fabricating products by cutting and sewing purchased woven or knit textile fabrics and related materials, such as leather, rubberized fabrics, plastics, and furs	21% of all manufacturing firms vs. 7% for non-minority firms Growth is flat to slightly negative—pressure from overseas suppliers
Eating & drinking establishments – 117.4	1.70 %	3.7	Retail establishments engaged in selling prepared food and drinks for consumption on the premises. Also included are caterers, lunch counters and refreshment stands	26% of all retail firms vs. 17% for non-minority firms
Local and interurban passenger transportation – 52.1	1.46 %	1.7	Establishments primarily engaged in furnishing local and suburban passenger transportation—also included are establishments primarily engaged in furnishing highway passenger transportation and highway passenger terminal or maintenance facilities	28% of transportation and communications firms vs. 54% for non-minority firms

Source: 1977 Economic Census data, 1997 Economic Census; BCG analysis consumers—with minority-owned firms being overrepresented by approximately 4 percent. Most importantly, these six low-growth categories account for 30 percent of all employment opportunities created by minority-owned firms.

Concentrating about one-quarter of firms and about one-third of employment in low-growth industries hardly serves as a sound strategy for the future success of minority-owned business. Moreover, these industries are largely devoid of public- and private-sector contract opportunities.

As *Exhibit 12* illustrates, growth in the number of minority-owned businesses has been significant in part given the low historical starting point. Today, as opportunities continue to emerge, minority-owned firms must be more strategic in selecting their targeted industries—or risk losing out on the most promising opportunities for future growth. Strategic alternatives can be formulated for starting or growing a business in a sector, based on growth and minority business participation in that sector (see *Exhibit 13*). For example:

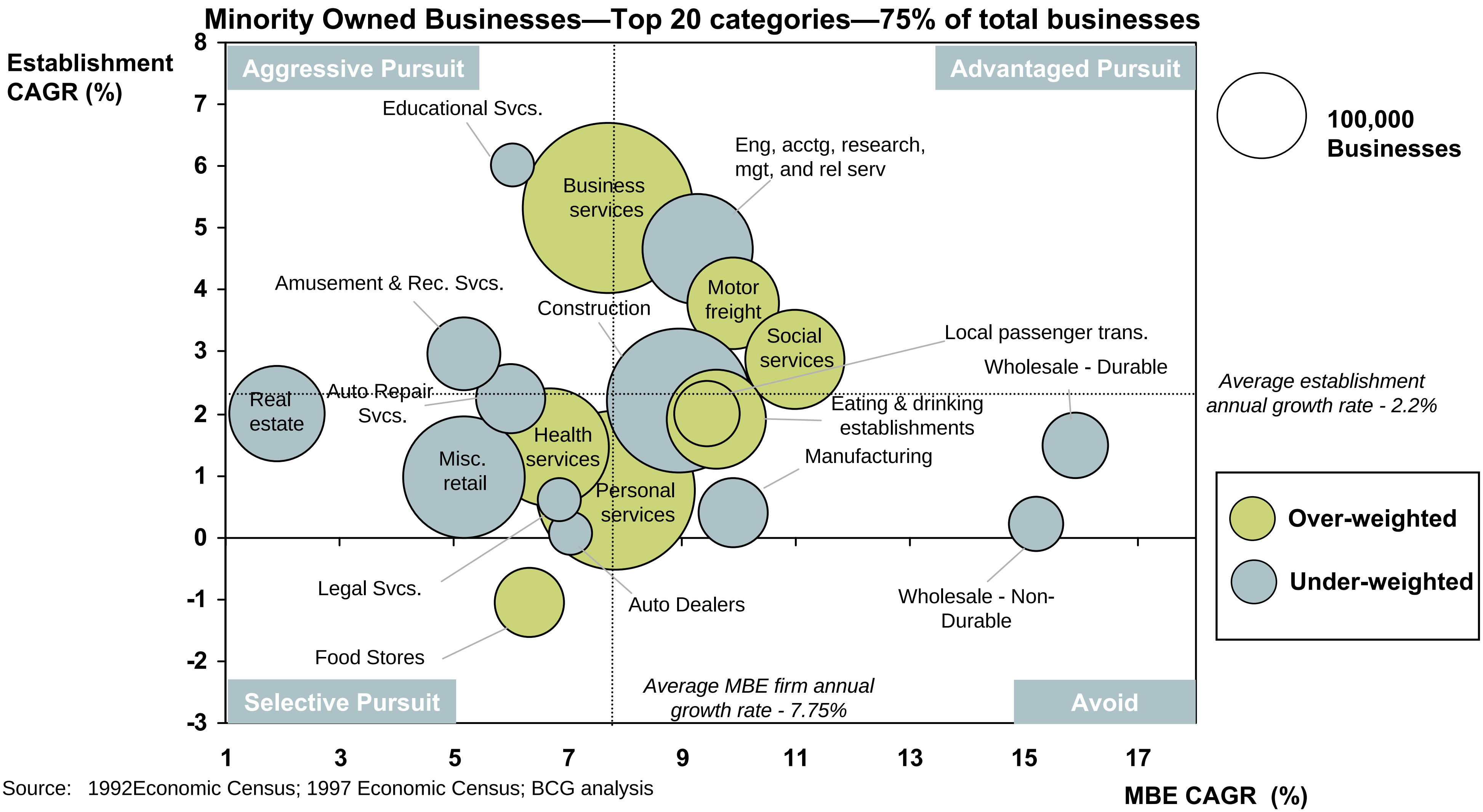
- **An industry with high sector growth and low growth among minority-owned businesses warrants aggressive pursuit of opportunities.** Offerings in the business services area, for instance, have experienced dramatic growth, driven by information technology (IT) products and services as well as support services for personnel. But with many of their peers already competing in the field, minority-owned businesses positioning themselves in this sector should be careful to differentiate their services and to ensure that customers recognize their value. In portions of the sector where minority businesses might be underrepresented, a strong partner could help a minority firm enhance capabilities and capture advantage quickly.

- **Conversely, industries in which minority business growth has been significant but business growth overall is low should be avoided.** Minority entrepreneurs should only pursue these opportunities if they enjoy a true cost or service advantage or if specific circumstances provide unique opportunities for minority businesses. The classic example might be minority-owned office supply companies. With the advent of mega-stores such as Staples, Office Depot, and others, as well as delivery specialists such as Corporate Express, a minority-owned firm that provides only office supplies must offer a value proposition of extremely low cost and high service—a significant challenge. Those considering startups or acquisitions in this very saturated market must ensure therefore that they have a fresh perspective—or face a major fight for survival.

Confining investment to traditional segments has made it difficult for minority firms, as a whole, to position themselves for higher-growth opportunities. Larger minority-owned firms are however emerging to target niches where few if any minority-owned companies are involved—or to compete in industries where significant growth opportunities exist.

Exhibit 12

MINORITY BUSINESSES ARE GROWING IN A VARIETY OF INDUSTRIES, BUT TARGETED STRATEGIES ARE NEEDED



Source: 1992Economic Census; 1997 Economic Census; BCG analysis

Exhibit 13

TARGETED STRATEGIES FOR SUCCESS

Sector Growth	MBE Growth: Low	MBE Growth: High
High	**Aggressive Pursuit** • Over-indexed—differentiate products and services (e.g., business services) • Under-indexed—partner for maximum growth (e.g., educational services)	**Advantaged Pursuit** • Over-indexed—differentiate or become industry leader (e.g., motor freight) • Under-indexed— focus on growth areas for quick results (e.g., engineering, accounting and research services)
Low	**Selective Pursuit** • Over-indexed—tightly fine-tune product and service offerings, and partner for scale (e.g., health services) • Under-indexed—target specific niches and develop specialty or avoid (e.g., food stores)	**Avoid** • Over-indexed—avoid unless true cost or service "leader" (e.g., eating and drinking establishments) • Under-indexed—focus carefully on unique services or avoid (e.g., wholesale durable)

Industries such as IT, financial services, security, and legal services represent "non-traditional" areas in which the overall development of minority firms has been slow. In addition, more traditional industries for minority business—such as construction, advertising, and communications—have also seen larger businesses leverage opportunities for major growth. In 2004, the Black Enterprise 100 and Hispanic Business 100 listed 17 companies with combined revenue in excess of $1.6 billion. In addition, the growth over the years in the number of large construction businesses is impressive, and with the U.S. construction industry approaching a $1 trillion market, the opportunities are plentiful. *Exhibit 14* highlights a sample of key growth industries, trends, and examples in which minority entrepreneurs have made their mark. *Exhibit 15* illustrates how many of these sectors are among the higher-growth sectors in the economy.

Exploiting emerging growth industries requires entrepreneurs to take aggressive action. To get in on the ground floor of exciting new developments, minority entrepreneurs will need to use every resource available though government and private-sector programs. For example, one outgrowth of the technology explosion in the late 1990s was the creation of support mechanisms at many colleges and universities that enable technology transfer.[18] Major universities recognize the technology opportunity and have been developing technology transfer offices that not only help entrepreneurs in developing real-world applications, but also serve to generate revenue from joint ownership of patents and applications.

In addition, SBA's Innovation Research (SBIR) and Technology Transfer (STTR) Programs reserve a specific percentage of federal R&D funding for awards to small business and nonprofit research institution partners. In 2002, the annual grants totaled $1.3 billion. It is estimated that approximately 9 percent of the grants and 10 percent of the funds went to minority entrepreneurs,[19] making the programs a significant opportunity largely underutilized by minority entrepreneurs. Moreover, joint initiatives between minority entrepreneurs and institutions such as the Historically Black Colleges and Universities (HBCUs) could create market impact that is mutually beneficial to both parties.

Several individuals exemplify the newly required mindset of expansion and entrepreneurial spirit.

- **Dr. William Pickard, a prominent entrepreneur in Detroit in the 1980s, determined that custom injection molding was a major and fast-growing area.** Pickard's entrepreneurial drive, combined with opportunities at Ford Motor Company, positioned him in this new field and resulted in the creation of Regal Plastics. Today the Global Automotive Alliance, a $200 million company, consists of five entities involved in injection molding, automotive fuel system manufacturing, logistics, and interior trim and seat cover assembly. Global

[18] Technology transfer is the process of developing practical applications for the results of scientific research.
[19] Based on 1998 data from the SBA, minorities received 8.5 percent of grants and 9.7 percent of the funds for the combined SBIR and STTR programs.

Exhibit 14

EXAMPLES OF MAJOR INDUSTRIES AND NEW AGENDA MINORITY-OWNED BUSINESSES (I)

Industry	Challenges	New Agenda minority-owned businesses
Construction	• Solid industry growth rate—job prospects expected to increase by ~15% over the next 10 years; even faster growth for experienced workers • Surety support programs are needed to secure bonding • Few MBEs with general contractor capabilities for large projects • Widespread abuses in subcontracting for major government programs and backlash against set asides have reduced program effectiveness • Minorities in trade unions—historically low numbers	HJ Russell Industries has been a pioneer in providing general construction and project management services for 20 years. The company took advantage of construction opportunities created for MBEs at the Atlanta airport, building a $300 million business that has participated in both public-sector and private-sector projects such as the Georgia Dome
Financial services	• Rapid industry growth—anticipated job growth of ~ 16% over the next ten years • Critical success factor—capital reserves • 100+ minority-owned banks total only $42 billion in assets • Minority companies typically undercapitalized • Brokerage firms making significant improvement, but adequate capital and management talent remain significant challenges • Aging baby-boomer market will be investing more—in particular, affluent minority consumers are becoming more savvy about financial services	Banks such as Bank of Boston and International Bancshares Corporation have the vision to merge minority banks to acquire scale and national capabilities Broker-dealer firms such as Williams Capital, Blaylock and Partners and Utendahl Capital are positioning themselves to assume lead management roles on underwriting deals through partnerships with larger firms Asset management companies such as Ariel Capital Management have blended pension fund interest in minority firms with direct consumer products to create an industry powerhouse
Information technology	• Rapid industry growth—cooled by technology "bust" in recent years • Contract bundling and outsourcing ranks many firms as a Tier 2 subcontracting status • Numerous opportunities exist for distributors if contracting companies are innovative	Aquent, Inc., grew from a temporary services company into a more than $300 million IT consulting and staffing services firm. An early developer of outsourced IT solutions, Aquent has consistently provided innovative customer service solutions Worldwide Technology Services was created to analyze freight invoices, used the emergence of internet technology to create a more than $1 billion firm that provides supply-chain management solutions. Technological savvy was successfully used to position this firm for dramatic and continued growth

Source: BCG research and analysis

Exhibit 14

EXAMPLES OF MAJOR INDUSTRIES AND NEW AGENDA MINORITY-OWNED BUSINESSES (II)

Industry	Challenges	New Agenda minority-owned businesses
Advertising services	• Growth rate strong—employment projected to grow by ~ 20% over the next 10 years • Proliferation of the number and types of media outlets creating a variety of new opportunities • More and more specialization will be the norm as firms carve out their niches	GlobalHue, the largest African-American advertising agency acquired Innovasia—a full service Asian-American advertising agency to gain additional client relationships and add another focused capability to its portfolio of services
Communications	• Rapidly growing industry for distribution of entertainment products and programs • Historically larger minority-owned business were in print media • Industry attitude favorable toward minority acquisitions • Directly linked to tapping minority/ethnic market segments	Radio One and the Spanish Broadcasting System jointly own 90 radio stations across the country and in Puerto Rico. Both companies have used public offering and joint ventures with major corporations to acquire financial strength and distribution capabilities—positing them for continued growth Entrepreneurs such as Robert Johnson of BET Entertainment and Ed Lewis of Essence Communications Partners have sold their companies to major corporate players in the media and communications industries.
Business services—security	• Rapid industry growth—fueled by the response to the attacks of September 11, 2001 • Rapid expansions—industry needs and growth outpacing capabilities • First-mover premium in many aspects of providing security service	Carter Brothers LLC is positioning its firm for national growth through a unique partnership with Tyco-ADT to: 1) Provide installation capabilities for major corporate security system clients; and 2) Serve as a partner for major sales initiatives. The strategy is designed to quickly capitalize on the growing security market
Business services—legal services	• Industry experiencing moderate growth • Specialization becoming more and more important • Larger firms organizing for global positioning—but regional/local presence needed (for counsel relationships)	Adorno & Yoss, the nation's largest certified MBE law firm has been on mission to expand its footprint by merging with law firms in major locations. Recently, it merged with North Texas-based White and Wiggins (the largest African-American firm in the area) to add to its mergers with Alvarado & Smith in Los Angeles, Sanchez and Daniels in Chicago, and Link International (a firm with significant presence in Mexico)

Source: BCG research and analysis

Exhibit 15

GROWTH RATES FOR MANUFACTURING AND NON-MANUFACTURING (PRODUCTS AND SERVICES) SECTORS

Approximate growth rates for selected manufacturing subsectors (1)	
• Information technology	12%
• Health-drug-medical & dental equipment	5%
• Instruments	3%
• Chemicals & plastics	2%
• Consumer durables	2%
• Construction materials	2%
• Food & kindred products	2%
• Industrial supplies	2%
• Motor vehicles & parts	2%
• Printing & publishing	2%

Approximate growth rates for selected non-manufacturing & services subsectors (2)	
• Computer & data processing services (2)	19%
• Securities & trading companies	15%
• Management consulting & public relations	13%
• Accounting, auditing & bookkeeping	9%
• Telecommunications	8%
• Advertising services	6%
• Legal services	5%
• Retailing	5%
• Commercial banking	5%
• Wholesale distribution	3%

(1) Growth rates based on constant 1992$ and 1999-2000 annual growth projections
(2) Growth rates rounded to nearest percent; calculated based on total shipments or revenues
(3) Data processing services include professional computer services, data processing and network services, and information retrieval services
Source: U.S. Department of Commerce, U.S. Bureau of the Census, and U.S. Industry & Trade Outlook, BCG Analysis

Automotive Alliance was the first minority-owned group of Tier 1 and Tier 2 suppliers to provide plastic parts for the industry.

- **Earl Graves, founder and publisher of *Black Enterprise* magazine** used a $175,000 small business loan to build a magazine designed to teach the African-American entrepreneur how to tap into the billions of dollars generated by their community. With more than $55 million in revenue, *Black Enterprise* has expanded to include radio stations (since sold), networking conferences, and television programs.

- **Jonathan Pinson, founder and managing partner of temporary service firm Pindrum Staffing uncovered and exploited an opportunity in food supply.** Based on his assessment of the growth areas in which no minorities participated—and with an opportunity provided through Denny's—Pinson decided to become a wholesale distributor of french-fried potatoes. In 2001, Pinson bought 6,000 acres of potato fields and later converted Cascades Food Group into a minority-owned company. Today, Cascades' revenue exceeds $35 million, with the company providing french fries to companies such as Denny's, MGM, and TGI Friday's.

- **Joanna Lau, building on her corporate career at General Electric and the former Digital Equipment Corporation, acquired a struggling defense contractor in 1990.** Through contracts with companies such as Raytheon and Lockheed Martin, Lau Technologies has grown to include defense systems and digital imaging technology, emerging as a leader in facial recognition technology.

- **Robin and Frank Brooks purchased the Golden West Foods operation from McCormick Foods in 1995, creating The Brooks Food Group.** Given numerous corporate opportunities, expansion came two years later with an acquisition of additional capacity from Wampler Foods. As one of America's few minority-owned food service companies, Brooks Foods has grown to more than $80 million in revenue, employing 400 people.

- **The "hip-hop" entertainment entrepreneurs characterize the new mindset of aggressive growth and expansion better than almost any other group.** No matter how one feels about their music, its content, or the negative press they sometimes generate, no one can deny that these entrepreneurs are creating multiple businesses in different industries and positioning themselves as the business leaders of tomorrow. (See *Sidebar 2, Hip-Hop Entrepreneurs are a New Breed*.)

As illustrated previously, the private sector has remained extremely committed and aggressive in positioning minority business development. The movement has been led by the automobile industry and closely followed by telecommunications, consumer goods, and banking. Other industries have articulated a strong desire to increase procurement from minority-owned firms, but the complexity of their buying requirements has held the overall percentage of purchases from minority- and women-owned businesses far below the stated national target of 7-10 percent. Three of these industries—pharmaceuticals, health services, and business services—represent the nation’s fastest-growing and larger industries.

If minority businesses could identify viable opportunities in these and other industries in which minority procurement falls below the national average, it is very likely that their products and services would not only be accepted but integrated into the respective supply chains. Consider the opportunity that awaits a minority entrepreneur that offers a proprietary product or service to the $400 billion pharmaceutical industry. The growth potential for such a product or service would itself represent a real home run, and it could be expanded further still to emerging global markets.

SIDEBAR 2

Hip-Hop Entrepreneurs Are a New Breed

As the culture of hip-hop grows increasingly mainstream, opportunities abound—well beyond the recording realm. "Hip-hop entrepreneurs," an entirely new breed, are rewriting the book on the industry and on business building overall, as they expand their footprint on American culture. These entrepreneurs exemplify an approach to developing minority-owned business that represents intelligent approaches to diversification, is supported by strategic alliances, and focuses on growth industries.

Hip-hop entrepreneurs demonstrate an ability to diversify within their industry—Rap artists such as Shawn Carter (Jay-Z) and Jermaine Dupri have made the move from recording artists to CEOs of major record labels at Universal Music Group and Virgin Records, respectively. In addition, hip-hop artists such as Queen Latifah have expanded into acting and into leading companies in artist management and entertainment.

Hip-hop entrepreneurs diversify their business interests across a variety of industries—Drawing on the broad recognition they've gained through the hip-hop culture, entrepreneurs have expanded into a number of different markets and industries. The godfather of hip-hop entrepreneurs, Russell Simmons, founded the Def Jam label 20 years ago and has now expanded into multimedia communications through Rush Communications, into Broadway entertainment through Def Poetry Jam, and clothing through the Phat Farm clothing line (recently sold to Kellwood Company). Likewise, hip-hop mogul Damon Dash, who launched Roc-A-Fella Records, now boasts ROC, a holding company that also includes Rocawear and other apparel brands such as State Property, Team ROC, Rocawear by Kayne West, RaynKenny, and C.RNSN. ROC is aggressively expanding distribution in the UK, France, and Germany, positioning the company for a global presence.

Hip-hop entrepreneurs forge strong partnerships—Damon Dash's ROC group represents a partnership with Jay-Z and other entertainment-industry executives. Similarly, Jay-Z participates in a group that recently purchased the New Jersey Nets basketball franchise. Sean "Puffy" Combs has firmly established himself as an apparel designer and executive with Sean Jean clothing. In 2003, Combs signed a deal with L.A. billionaire Ron Burkle, managing partner of private equity firm The Yucaipa Cos., for an estimated $100 million investment to fuel retail expansion of Sean Jean. More recently, Sean Jean entered into a joint venture with designer prodigy Zac Posen's Outspoke LLC. The companies will operate as equal partners but will leverage Sean Jean's capital and infrastructure to grow the business and expand into other categories.

Hip-hop entrepreneurs draw on the culture to target the youth market—Hip-hop artists have lent their names and reputations to endorse products such as footwear, fragrance licensing, restaurants, and apparel. Jennifer Lopez, world-renowned actress and singer, has used her fame to create a multi-million-dollar business enterprise consisting of restaurants, fashions, and fragrances. While such moves represent a normal progression for many celebrities, the hip-hop generation <u>owns</u> their brands. Moreover, companies such as McDonald's, DaimlerChrysler, and Hewlett-Packard are attempting to use the hip-hop culture and experiential marketing to gain access to the almost $200 billion youth market.[20] Although often controversial in their messages, hip-hop artists and entrepreneurs can undoubtedly sell product. Reportedly, the mention of Courvoisier in Busta Rhymes' hip-hop chart-topper "Pass the Courvoisier" increased sales for the cognac brand by 4.7 percent.[21]

Forging partnerships and diversifying into new and promising industries—characteristics of the new breed of hip-hop entrepreneur—are powerful lessons that traditional minority-owned businesses can leverage to increase their own potential for success.

---

[20] Teenage spending was estimated to be $175 billion in 2003. "Bridging Hip-Hop Consumers and Suits," *New York Times*, September 22, 2004.

[21] Beverage Network, http://wwww.bevnet.com.

Build the Capacity and Capability of Minority Businesses to Provide More Value-Added Products and Services

In the manufacturing sector, majority-owned firms generate 1.5 times more revenue per employee than minority-owned firms do. And, as *Exhibit 16* illustrates, this case isn't an anomaly. In other industries, revenue at majority-owned firms can run as much as 16 times higher than at minority counterparts. The significantly enhanced productivity that the majority-owned manufacturers enjoy largely results from their more effective use of technology, such as computer-aided design (CAD) and other automation.

It is not that larger minority-owned businesses don't understand the importance of computer technology. In fact, a recent U.S. Department of Commerce report found that more than 90 percent of minority-owned firms with more than $500,000 in revenue used computers in their business and were about as likely as majority-owned businesses to offer a company Web site.[22] Rather, a problem arises because minority-owned businesses don't yet fully utilize technology to create productivity gains, enhance their capabilities, and ultimately generate more revenue. For example:

- A study of small businesses—the majority of which were owned by minorities—located in Southern California found that the larger the employee base of a business, the greater the likelihood that the company utilizes the Internet.

- Analysis conducted by the Urban Institute[23] indicated that the "computer intensity" in small firms increases in correlation with the owner's familiarity and personal involvement with technology—as well as the number of workers at the firm.

- Moreover, a majority of small businesses indicated that affordability was not the major issue in utilizing technology effectively. Indeed, the study found that many firms admit they are not effectively utilizing the technology they already own.

- IT solutions have in fact been utilized for administrative and accounting functions at some minority businesses, creating modest gains in productivity.

- The primary barrier limiting computer usage at minority-owned firms was a lack of the skills necessary to utilize the technology efficiently.

The Urban Institute's analysis indicates that if larger firms owned by women and minorities invested not just in purchasing technology but in fully exploiting its advantages and translating them into productivity gains, the firms as a whole could

---

[22] U.S. Department of Commerce, MBDA, *Minority Businesses' Use of Internet Technology: A Preliminary Case Study of Large Firms*, July 2001. Prepared by The Tomas Rivera Policy Institute, Washington, DC.

[23] Robert I. Lerman, Caroline Ratcliffe, Harold Salzman, Douglas Wisocker, and Jennifer Gaudet, *Can Expanding the Use of Computers Improve the Performance of Small Minority and Women-Owned Enterprises,* (The Urban Institute, March 2004).

Exhibit 16

MINORITY-OWNED FIRMS LAG IN PRODUCTIVITY WHEN COMPARED TO MAJORITY-OWNED FIRMS

	Revenue/Employee		
Major industry category	**Majority-owned**	**Minority-owned**	**Disparity**
Agriculture & mining	165,381	63,058	162.3%
Construction industries and sub-dividers and developers	147,393	115,274	27.9%
Manufacturing	211,175	135,742	55.6%
Transportation, communications and utilities	195,738	85,178	129.8%
Wholesale trade	616,153	458,030	34.5%
Retail trade	115,738	95,027	21.8%
Finance, insurance and real estate industries	325,689	155,885	108.9%
Service industries (excluding membership orgizations and private households)	69,574	62,445	11.4%
Other industries	105,146	93,124	12.9%
Total	172,997	114,510	51.1%

Source: 1997 Economic Census data for firms with employees, BCG analysis realize as much as $100 billion to $200 billion in additional revenue—without expanding the workforce.

Grow Beyond the "Sole Proprietorship" Model of Business Ownership

With the vast majority of minority-owned businesses operating as sole proprietorships, most companies that want to make the leap to high-growth sectors or new opportunities will need to rethink and reorganize the enterprise. Indeed a disproportionate amount of minority businesses are sole proprietorships—82 percent compared to the 71 percent of majority-owned firms in the same category. And upon closer examination, the disparity is even more pronounced among African-American, Hispanic, and Native American firms. As shown in *Exhibit 17*, only Asian-American businesses are at parity with majority firms in the percentage of sole proprietorships—they even exceed the overall business community in the use of subchapter S and C-type corporate structures.

Beyond the Asian-American business community, however, other minority firms have not positioned themselves to utilize the benefits inherent in corporate organizational structures—an unfortunate trait typical of first-generation entrepreneurs. Among first-generation entrepreneurs, many create wealth and enjoy a standard of living that exceeds that of their family members, most of their fellow minority colleagues, friends, classmates, and former corporate associates. Too often, unlike more aggressive and often younger entrepreneurs in the larger business realm, minority business leaders don't aspire to generate large sums of wealth, accepting the psychological and financial limits of operating a small, "lifestyle" business.

To succeed, minority-owned companies must shift from a "100-percent CEO" model to hire strong managers who will bring alternate approaches and ideas to enhance business solutions. Another approach that many smaller businesses can take is forming strategic partnerships with minority or corporate partners. Such partnerships, the backbone of global expansion over the past 20 years, are discussed in greater depth below.

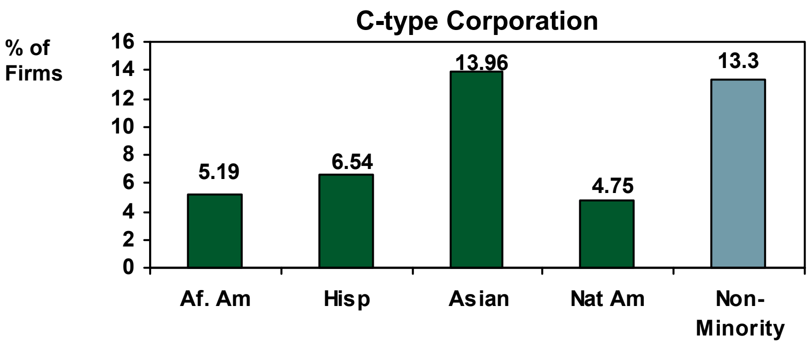
Expand the Use of Mergers, Acquisitions, and Strategic Partnerships

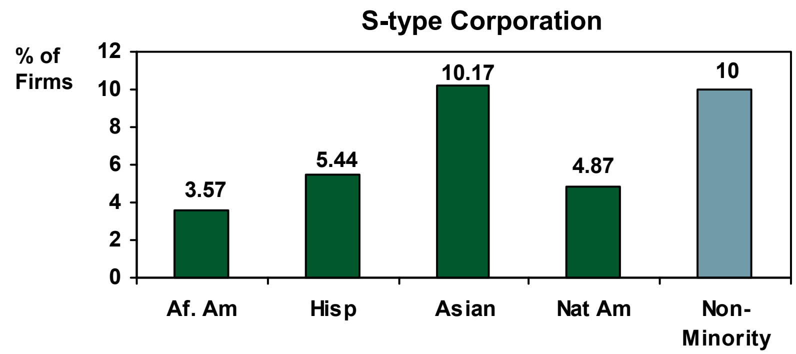
Precisely because minority entrepreneurs typically haven't pursued growth aggressively or have preferred to "go it alone" as business founders/leaders, the vast majority of minority businesses have not yet entered into alliances or embraced other options such as mergers or acquisitions to reposition their businesses for greater opportunity.

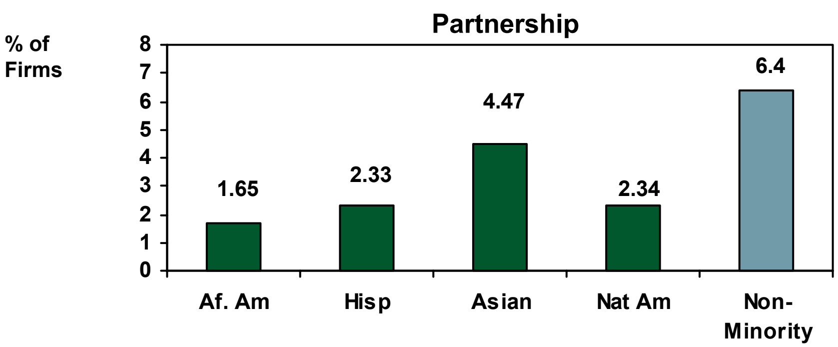
But in the larger business community, alliance strategies have been proven to help companies respond to the pressures of supply chain management and other business demands. As shared in *Exhibit 18*, BCG classifies collaborations as ranging from purchase strategies (mergers or acquisitions) to partner strategies (joint ventures and alliances). Alliances, being one step removed from standard supply arrangements, are important because they allow an entity to retain independence while enabling risk-sharing and providing longer-term arrangements. Although studies show that alliances do not enjoy any greater probability of success over other forms of collaboration, the flexibility

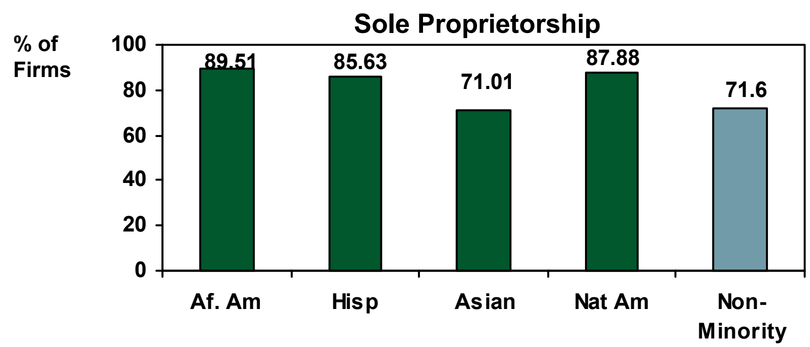
Exhibit 17

ASIAN-AMERICAN FIRMS LEAD MINORITY-, MAJORITY-OWNED FIRMS IN ADAPTING DIFFERENT FORMS OF ORGANIZATION





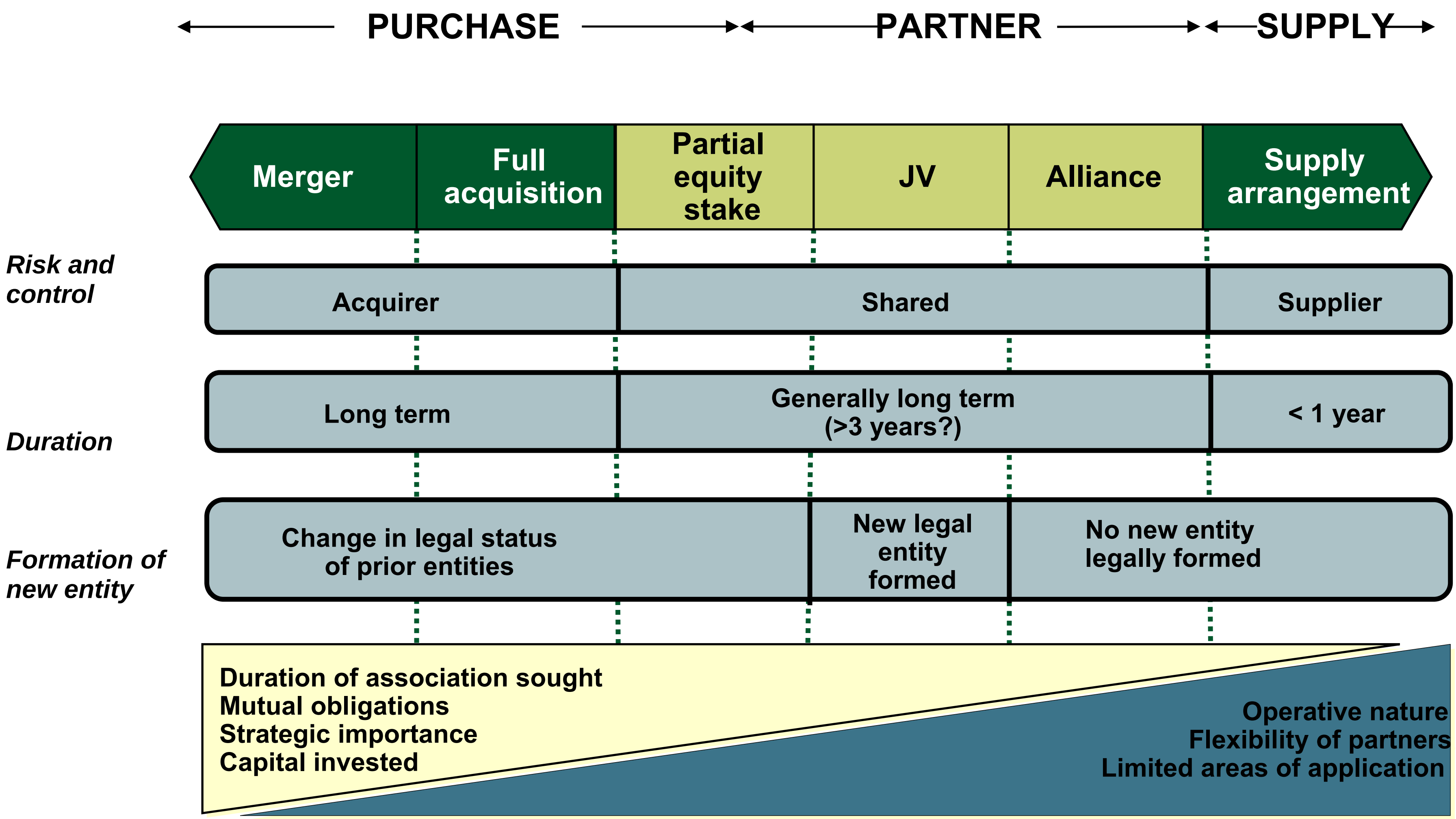




Source: 1997 Economic Census; Sample set of certified businesses; BCG analysis

Exhibit 18

BUSINESS COLLABORATIONS SPAN A RELATIONSHIP CONTINUUM



Source: BCG research and analysis

afforded by an alliance relationship offers the benefits of enhanced speed and more easily aligned objectives.

Some trend-setting corporations and larger minority-owned businesses have demonstrated convincingly that well-developed alliances and partnerships can and do work for minority-owned firms. *Exhibit 19* highlights recent examples that span the alliance continuum, from alliances to mergers and acquisitions. These minority firms illustrate how the power of strategic partnerships can be tapped to build and develop a business. Several of the deals in the exhibit are also described below.

- **Federal Mogul Corporation has entered into a strategic alliance with Paper Plas, Inc., a minority-owned paper packaging company.** The companies will provide replacement engine gasket kits for vehicle and equipment manufacturers that offer replacement automotive parts

- **Jorge and Carlos de Cespedes, owners of medical supply company Pharmed Group, and Bob Johnson, the former owner of the BET cable network, recently formed a landmark venture.** The de Cespedes brothers bought a percentage of Johnson's Charlotte Bobcats basketball franchise, while Johnson, in turn, invested in Pharmed and joined its board of directors. In this deal, one of America's wealthiest African Americans joins forces with two Cuban-American businessmen in anticipation that both parties will realize significant benefits. Pharmed is the largest independent, full-line distributor of medical, surgical, and pharmaceutical supplies in the United States, but until recently, it has largely been a Florida company. The connections and influence of board member Bob Johnson will be invaluable as the company expands geographically throughout the United States, fulfilling the owners' forecast of reaching $1 billion in revenue during the next two years. At the same time, the addition of two prominent Hispanic businessmen from Miami to the ownership of the Bobcats team helps to realize the franchise's vision of creating the model for business diversity within the sports and entertainment industry.

- **GCI Systems, a minority-owned technology solutions provider based in St. Paul, Minnesota, is partnering with Netpro Technologies, a software services provider based in India.** The joint venture combines the marketing and client relationship capabilities of GCI with Netpro's expertise in applications development to target the growing market for outsourced IT solutions and services.

- **Johnson Bryce was established in the mid-1990s as a joint venture between entrepreneur Robert Johnson and the Bryce Corporation.** This start-up venture was established as the first minority-owned supplier of flexible packaging material for PepsiCo's Frito-Lay. Over the years, the company has grown to $25 million in revenue, employing more than 100 people.

Exhibit 19

EXAMPLES OF UNIQUE STRATEGIC PARTNERSHIPS (I)

Partnership	Industry	Nature of Deal	Benefit	Potential
Time Warner/ Essence Communications	Communications	• Time Warner purchased 40% of Essence Communications, Inc. in 2001 • Time Warner recently completed a full buy-out of Essence Communications, Inc.	Having Time Warner's full financial support adds even greater strength to Essence's resources and additional credibility with advertisers as a major part of the largest magazine group in the world	Distribution muscle, ad agency relationships and magazine operations all will be enhanced through the new ownership structure
Bob Johnson & Carlos & Jorge de Cespedes	Pharmaceuticals	• Unique strategic relationship • de Cespedes brothers join ownership team of NBA franchise • Bob Johnson takes a stake in Pharmed and joins board of directors	Pharmed receives the benefits of Bob Johnson's contacts and knowledge The Charlotte franchise realizes model of ownership diversity	Pharmed's vision of reaching $1 billion in sales will be accelerated Very diverse ownership structures in the entertainment industry are pioneered and successes are demonstrated
Plastech Engineered Products/LDM Technologies	Automotive	• Plastech (MBE) acquired LDM Technologies—a major competitor • Combined company created the largest minority auto supplier in the U.S. (2003)	Creates a "one-stop" approach for customers and major partners Combination will create cost efficiencies because of overcapacity in plastics supply industry	Combined company will have sales in excess of $1 billion and will significantly enhance customer service Plastech has a long-term contract with Johnson Controls—benefits from the acquisition will accrue to both companies
Federal Mogul Corporation/ Paper Plas	Automotive	• Strategic alliance between Paper Plas (MBE) and Federal Mogul • Provide replacement engine gasket kits for vehicle and equipment manufacturers	Combining resources allows both companies to partner and be recognized as the industry's preferred supplier for gasket kits	Federal Mogul can leverage the minority relationship to satisfy Tier 2 requirements from its customers, resulting in increased contract opportunities for both companies

Source: BCG research and analysis

Exhibit 19

EXAMPLES OF UNIQUE STRATEGIC PARTNERSHIPS (II)

Partnership	Industry	Nature of Deal	Benefit	Potential
Bridgewater Interiors	Automotive	• Joint venture between Johnson Controls and Epsilon LLC (MBE) • Manufacturing of seating systems	Created MBE of sufficient scale to be significant competitor	Strong potential for growth as more manufacturers use the venture—continued pressure on margins will continue in automotive industry
Tyco/ADT & Carter Brothers LLC	Security	• Strategic alliance between Tyco/ADT & Carter Brothers LLC (MBE) • Design and installation of security systems	Creates MBE with national scale and scope—ears for working capital	Near-term creation of a national security supplier with potential for global expansion
WIBS Group	Defense contractor	• Strategic alliance between four MBEs (Walker Int'l Transportation; Inner Circle Logistics; Banneker Industries and SpringBoard Technologies) • Provide integrated supply chain management solutions	Combines four sets of capabilities into one strong alliance partnership vs. developing or acquiring capabilities by individual companies	Near-term opportunities with Raytheon to assume significant supply-chain management responsibilities Once created, the supply-chain operating model can be replicated across industries
GCI/Netpro	Information technology	• Joint venture between minority owned GCI and Netpro Technologies—a software services provider based in India • Formed to market software services around the Microsoft .Net Technologies	Combines the extensive marketing and client-management skills of GCI with software development expertise of Netrpo Leverages global sourcing strategies with India-based firm to create a strong cost competitive position	Creates ability to provide low-cost applications development and maintenance, product development, Customer Relationship Management (CRM) and eBusiness solutions to a growing market segment

Source: BCG research and analysis

Exhibit 19

EXAMPLES OF UNIQUE STRATEGIC PARTNERSHIPS (III)

Partnership	Industry	Nature of Deal	Benefit	Potential
Kellwood/Phat Farm	Apparel	• Kellwood acquired Phat Farm (MBE) • Kellwood acquires Phat Farm, Phat and Baby Phat brands	Kellwood gained licensing of apparel for men, women and children, and athletic shoes and accessories Russell Simmons and Kimora Simmons will continue involvement with the development of the brands	Kellwood gains strong brands that will provide access to the $10 billion emerging urban lifestyle market—marketing expertise will drive higher revenues for new product introductions
EnPointe Technology	Information technology	• Involved institutional investors in ownership of company (minority-controlled under NMSDC growth initiative) • Raised equity capital in public markets	Provided company with the ability to raise equity capital and still have status as a minority-controlled company	Capital influx will permit the resources needed to grow profitably—2004 net income of $1.4 million vs. a negative $3.4 million net income in 2002
Johnson-Bryce	Consumer goods	• Joint venture between Bob Johnson and Bryce Corporation • Create MBE to provide flexible packaging material to Frito-Lay	Creation of a one-of-a-kind MBE in flexible packaging industry Bryce Corporation secures an additional percentage (their equity) of business from Frito-Lay	Establish an MBE in the very lucrative flexible packaging industry with potential to provide products to a variety of consumer goods companies
ARD Logistics	Automotive	• Merger between several minority businesses to create venture to support JCI • Venture assembles seat covers for JCI and consolidates inbound shipments from suppliers	Establishes MBE to provide just-in-time and sequence deliveries to automotive manufacturers	MBE, created to provide logistical solutions to JCI, seized the opportunity to add additional services to directly service other automotive customers such as supply of batteries, interior trim and off-shore supply coordination

Source: BCG research and analysis

- **Global Automotive Alliance LLC, the brainchild of entrepreneur William Pickard, is a holding company consisting of six corporations, most of which are joint ventures between minority-owned entities and majority corporations.** Since 1997, the Vitec joint venture (of Pickard, Lawrence Crawford, and Michigan-based Walbro Corporation) has been making plastic fuel tanks for manufacturers such as General Motors, DaimlerChrysler, and Harley-Davidson. Other subsidiaries such as ARD Logistics, Group Antolin-Wayne, and Camrose Technologies all represent joint ventures.

- **TAG Holdings, LLC, started by Joe Anderson, has a growth strategy that does not concentrate on one industry, one customer, or one geographic region.** TAG operates manufacturing facilities in Korea and China as well as in the United States. TAG sells products to the most highly industrialized areas of the world including Europe, Asia, and North America, and it competes in diverse industries such as automotive, recreational vehicle, consumer products, commercial construction, material handling, robotics, and industrial automation. TAG's offerings include highly engineered components, electronic chips and sensors, precision ceramic components and systems, modular assemblies as well as logistics, and services in supply chain management. Consequently, TAG has developed a broad range of competencies that can be built upon and shared between companies and industries.

Fully Access and Deploy the Capabilities of the Financial Markets for Minority Business Development

Minority firms have long shrunk from pursuing private financing, and equity financing has largely seemed—and been—a near impossibility for them. Most avoided the markets either because refusal seemed a forgone conclusion or because they were unaware that options existed beyond the personal and government financing with which they were familiar.

But the time has come for minority firms to fully access and deploy the capabilities of the financial markets, going not hat in hand in search of altruistic loans but understanding that they present attractive value propositions and lucrative investment opportunities. These companies must recognize that the unique market niche they serve as well as the unique cost and contracting advantages they often enjoy make them highly attractive to banks and venture capitalists.

To secure more and larger loans from government and private lenders—and to attract the attention of venture capital firms in search of a promising opportunity—minority entrepreneurs must radically alter the financial mindset that they and their firms hold. They must replace "lone wolf" founders/CEOs with experienced management teams, formulate and articulate high-quality deal opportunities, and demonstrate a willingness and capability to partner with others to acquire needed capabilities.

Getting past 'no' in debt financing

When the earlier reports in this series were researched and written, the lack of adequate capital was identified as the No. 1 problem constraining the growth of minority-owned businesses. Indeed, minority businesses have historically been undercapitalized, having been built largely on personal financing and small amounts of hard-to-come-by debt.

Initially, the difficulty in securing financing was certainly not self-imposed. According to a study by Blanchflower, Levine, and Zimmerman,[24] ethnic minorities seeking financing were denied loans twice as often as were white-owned firms. African-American and Hispanic companies experienced the greatest disparity in financing, with respective denial rates 2.6 and 2.2 times higher than those of whites. Moreover, even when minorities succeeded in securing loans, the interest rates charged them ranged from 0.9 percent to 1.7 percent higher than rates charged to white-owned firms. Small wonder many ethnic entrepreneurs—even those with larger businesses—opted not to seek out debt financing, no matter how desirable or badly needed.

Instead, the minorities who sought financing often relied on government loans. As a result, the SBA's 7(a) loan guaranty program has seen a steady increase in minority participation, with approximately 20 percent of the proceeds on average awarded to ethnic minority groups (see *Exhibit 20*)[25]. Recent enhancements to these loan programs may well result in larger loan packages, but this mode of financing remains steadfastly concentrated on <u>small</u> businesses.

Ironically, government programs have traditionally focused on financing those firms least likely to succeed, granting awards to the companies saddled with the most significant economic disadvantage and typically headed by entrepreneurs who were less experienced or educated. Subsidizing the riskiest investments is obviously not, however, the best strategy for achieving the desired result of economic development and increasing the number of jobs.

Therefore, the largest and most innovative minority firms now stand to gain much by aggressively pursuing debt financing, as private programs seek companies with the greatest potential and public programs seek programs most likely to advance job creation and boost the economy. Financiers across the board are recognizing the newest prescription for success and funding it richly: focusing well-educated entrepreneurs around sound business opportunities that utilize capital to create many jobs and much wealth and deliver superior products to growing markets.

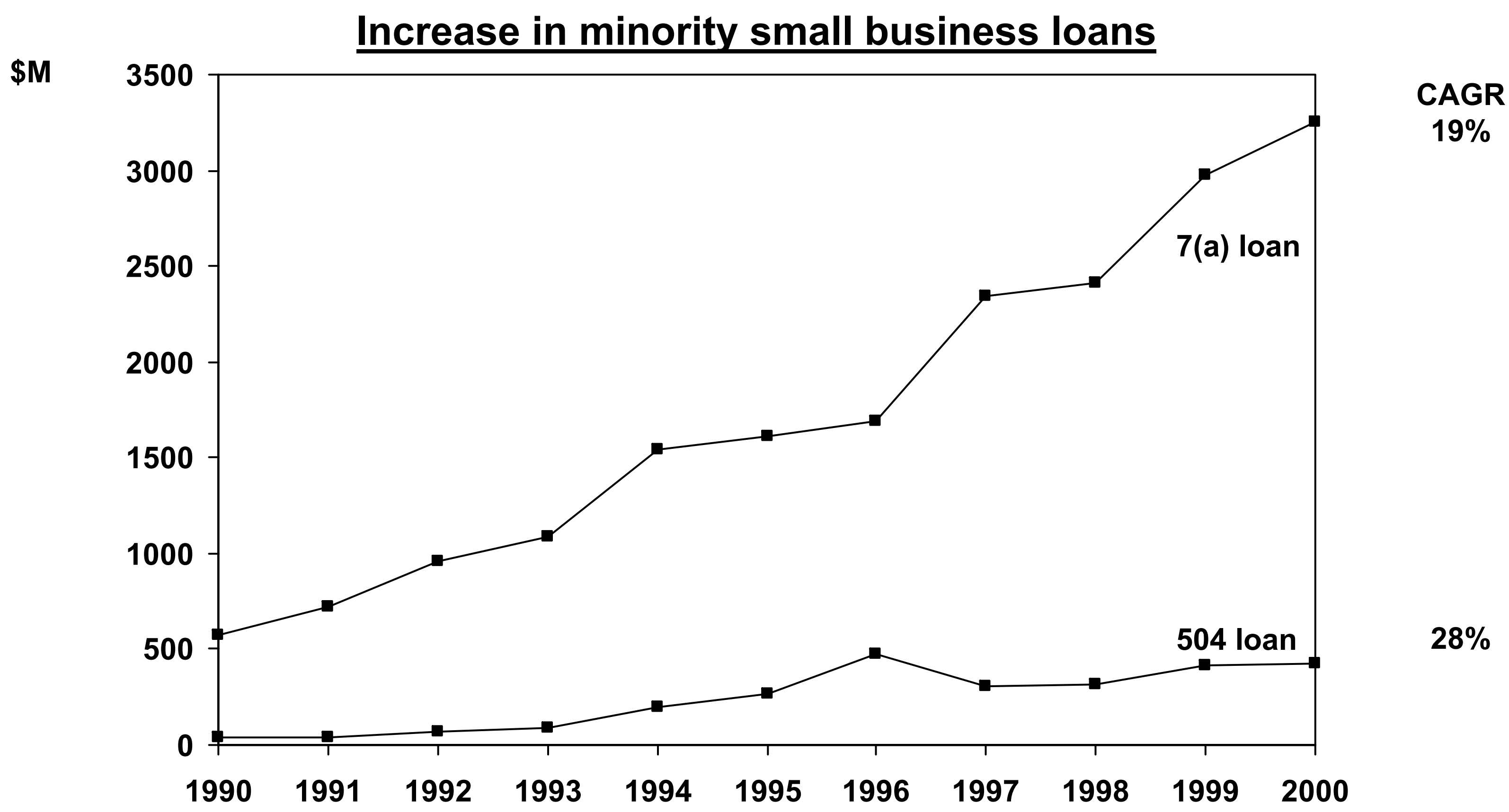
Embracing equity

[24] David G. Blanchflower, Phillip B. Levine, and David J. Zimmerman, *Discrimination in the Small Business Credit Market* (Hanover, New Hampshire: Dartmouth College, 2002).

[25] Although the SBA has not reported specific data on the minority-owned business segment since 2000, the number of loans to those firms continues to grow. As an example, the number of loans to all minority-owned firms increased by 38 percent from 15,836 in FY 2002 to 21,830 in FY 2003, (SBA news release October 10, 2003 – Release # 03-72).

Exhibit 20

MBEs TURN TO DEBT-BASED FINANCING TO EXPAND CAPABILITIES AND CAPACITY



Source: SBA Office of Advocacy, *Minorities in Business,2001*

Since less than 2 percent of all equity capital provided by institutional investors has gone to minority entrepreneurs, it is understandable that minorities firms have considered equity financing a nonstarter. But the financial engine is revving these days, with venture capitalists, large financial institutions, and other private equity sources beginning to realize that minority-owned businesses represent a major market.

Niche-focused funds specializing in the minority entrepreneur have been growing rapidly, driven by the greater opportunities provided by private-sector companies to minority firms as well as the growing demand from large corporate pension funds for investments in alternative asset classes. These funds are coming up against resistance, however, since historically, most minority entrepreneurs:

- Have been unwilling to cede a percentage of their business in exchange for equity
- Believe strongly that they can grow their business solely on increased revenue and cash flow
- Have been unable or unwilling to identify potential venture and angel investors
- Have been unwilling to grow their business and present a balance sheet/profit and loss statement that is attractive to venture capitalists
- Rarely conduct research on niche plays and trends in the venture capital industry.

Nonetheless, all ethnic minority sectors have not had equal difficulty in attracting capital.[26]

- **Asian-American firms** enjoy a large presence among technology-driven companies and have strong allegiances to many technology-focused venture funds.
- **Hispanic businesses** that make the connection to the emerging Latin and South American marketplace can attract the attention of a number of venture capital concerns. Those focused on the media (radio and television) and the marketing space that is poised to exploit the burgeoning Latino market in the United States are likewise very well positioned.
- **African-American firms** probably are positioned least favorably, but they have been successful in garnering financing for radio and television opportunities, as well as for telecommunications and technology, primarily due to the early identification of opportunities by venture capitalists such as Herb Wilkins and

[26] It is important to note that in the 1980s, SBA's Specialized Small Business Investment Company (SSBIC) program—known as the Minority Enterprise Small Business Investment Company (MESBIC) program—created venture capital organizations for minority businesses. Recent legislative changes have eliminated the MESBIC in favor of the SBIC, however, which must offer loans to small business.

Terry Jones.

- **Native American firms** are largely overlooked but can find venture funds for businesses that leverage tribal clout, such as farming enterprises and gaming (where appropriate).

The successes in this area all share two critical success factors: a focus on growth and an attachment to entrepreneurs who possess the managerial sophistication necessary to make the deals work. Examples of such entrepreneurs are highlighted below.

- Within the past two years, **Merrill Lynch** and **Goldman Sachs** both have created programs that fund and target venture capital toward minority entrepreneurs (see *Exhibit 21*).

- **The National Association of Investment Companies (NAIC)** is an association for leading private equity firms, small business investment companies, and other government-chartered companies that focus on providing private equity to minority-owned firms. With more than $5 billion in capital under management, these firms are well-positioned to provide equity capital for major minority business opportunities.

- Confronted by the demographic trends discussed earlier and the demise of the technology funding bubble, **many private equity sources that are not focused on minority firms** are beginning to consider specific, opportunistic ventures with ethnic entrepreneurs.

- Several **large, successful funds such as Fairview Capital Management** invest in other funds focused on funding ventures for minority entrepreneurs.

More importantly, the successes also promise to provide the level of returns that venture capitalists expect. A recent study by Bates and Bradford[27] found that venture capital funds focused on minority enterprises enjoyed a profitable business—even though the funds did not concentrate on high-technology ventures. The research tracked investments from 24 venture funds that target minority business exclusively, finding a 20 percent rate of return—in line with the 20.2 percent achieved by the Private Equity Performance Index during the same period of time.

Funding is largely driven by major pension funds, which are increasingly attracted to minority business deal opportunities. Major public-sector pension funds have historically worked to include more minority-owned businesses in both trading and asset management. As these funds continue to diversify their holdings into alternative asset classes such as venture capital and real estate, a strong commitment is similarly emerging

[27] Timothy Bates and William Bradford, *Minorities and Venture Capital—A New Wave in American Business* (Kansas City: Ewing Marion Kauffman Foundation, 2003).

Exhibit 21

GOLDMAN SACHS URBAN INVESTMENT GROUP SEEKING TO GROW MBES OF SIZE

Goldman Sachs Urban Investment Group (UIG) is committed to investing in minority ventures

UIG is a long-term capital partner for a wide range of minority and urban ventures, making corporate, real estate investments up to $25 million across an array of industries, project types, and financial structures

UIG seeks out excellent operating partners or development teams, strong prospects for growth and market positions that can withstand competitive pressures

Past investment activities include the development of a low-impact housing project – the Dorothy Day Apartments in Harlem

UIG is now working with C.H. James & Co. to create a competitive player in the food industry

Chuck James, CEO, was seeking a credible financial and strategic partner to facilitate acquisition of a ~$50 million food company. The goal of the initiative is to create a food supplier of size to do business with major customers such as McDonald's, Yum! Brands, Darden Restaurants and Wendy's

> **"'We want to do business with you, but... we need suppliers that can support us regionally, if not nationally, ideally internationally at the same price, quality and service levels that we're already used to.' This is the Fortune 500 companies talking."**
>
> **- Chuck James, CEO, C.H. James & Co.**

Source: Goldman Sachs; *Black Enterprise*, July 2003 to seek opportunities for investing with qualified minority managers at venture capital firms.

Many hot and still-emerging areas remain in which minority business could score significant funding and business gains. A recent *BusinessWeek* article for example noted that angel investors are flocking to biotech, investing $1.98 billion in 2004—a total investment up 10 percent from 2003 and up 52 percent from 2002.[28] Since September 11, 2001, venture funds have also pumped substantial sums of money into security technologies. Moreover, two veteran venture capital firms have launched a special venture fund to invest in small orphan tech firms with positive growth potential. The opportunities exist—minority firms simply must begin to think differently about how to capture them.

Aggressively Respond to Major Trends in Global Supply Chain Management

When minority business development in the private sector took off dramatically in the early 1990s, major changes were also beginning to alter the procurement function within major corporations. This was clearly the case in the $600+ billion auto industry, where the Big Three U.S.-based automobile manufacturers were facing formidable competition from Japanese competitors. In order to stay competitive and profitable, major corporations were forced to develop dramatically new approaches for managing their supply chains.

Today, similar pressures squeeze most industries, and supply chain management continues to evolve in response. In compiling this report, BCG has noted eight major trends that are changing the shape and nature of supply chains on a worldwide basis. These trends (see *Exhibit 22*) are:

- ***Global sourcing*****—**Low-cost-country sourcing is extending beyond traditional categories such as apparel and consumer electronics into many more industries, thereby creating ever-larger and more critical global suppliers.

- ***Critical information flows*****—**Real-time, transparent information is a key enabler of the new supply chain.

- ***Enhanced strategic sourcing*****—**Companies are realizing the value/importance of strategic sourcing and moving beyond commodities to value-added services.

- ***Supplier segmentation*****—**The supplier base is segmenting, with commodity products driven toward more efficient models (exchange, e-auctions) that keep suppliers at arm's length.

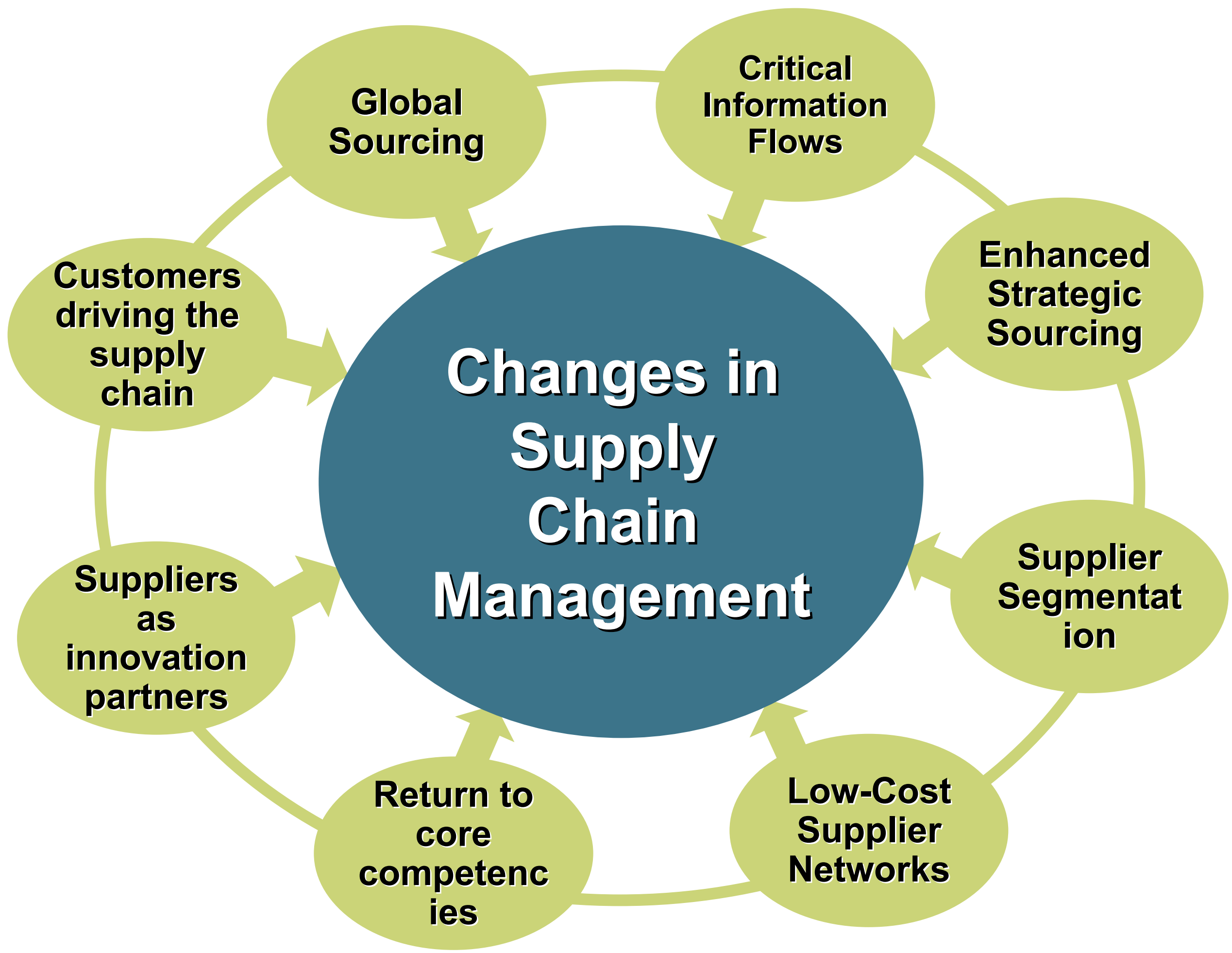
- ***Low-cost supplier networks*****—**Lower transaction costs are enabling suppliers to coordinate activities more efficiently.

---

[28] Arlene Weintraub, "Where VCs Fear to Tread: Angel Investors Are Filling a Critical Gap by Providing Early Backing for Biotechs," *BusinessWeek,* March 7, 2005.

Exhibit 22

GLOBAL TRENDS IN SUPPLY CHAIN MANAGEMENT WILL AFFECT MINORITY SUPPLIERS



Source: BCG research and analysis

- ***Return to core competencies***—Outsourcing continues to grow rapidly—business-process outsourcing and off-shoring in particular—driving the need for integrated supply chains.

- ***Suppliers as innovation partners***—To spread risk and reduce capital requirements, companies are pushing the responsibility for innovation to suppliers.

- ***Customers driving the supply chain***—Companies are more closely linking the front end of the supply chain to the back-end processes, thereby ensuring that replenishment is more directly driven by demand.

The challenges created by the various trends in supply chain management are highlighted in *Exhibit 23*. In general, minority-owned firms have not developed—either internally or through external alliances—the capabilities necessary to position themselves to exploit these latest trends. In combination therefore, new trends and the old corporate mindset about partnering present a formidable challenge for minority business owners.

- For example, most minority-owned firms lack global capabilities. As trends shift, developing alliances and relationships that provide access to global markets—in order to acquire lower-cost inputs or to access emerging consumer markets—will be imperative.

- Likewise, in order to position themselves as the most strategic sourcing option for major corporations, minority-owned firms must either integrate upstream or downstream in their value chain or partner with others to acquire the capabilities that are needed to create or sustain strategic relationships.

- Our initial research indicates that clear opportunities for joint ventures with foreign companies exist for minority-owned businesses that have ties to major corporations operating in foreign countries.

*   *   *

It's a good news/bad news scenario for minority-owned businesses: The good news is that minority players can indeed close the gap with their competitors in the broader business community if they operate innovatively; radically change the way they think about their business, their customers, and their competition—and move aggressively. The bad news is that those businesses that won't or don't make transformative changes to close the gap will ultimately fail. The growth rate for these firms will begin to slow, and a limited number of jobs will be created within our society.

With so much hanging in the balance, minority businesses must emerge as real players in the world economic order—and that means that a New Agenda must emerge for minority business development. The following section outlines these new imperatives, the respective roles and responsibilities, and the new mindset all key players must embrace.

Exhibit 23

SUPPLY CHAIN MANAGEMENT TRENDS AND IMPLICATIONS FOR MINORITY-OWNED BUSINESSES

Supply chain trend	Explanation	Positioning of minority-owned businesses
1 Global Sourcing: Moving Beyond Footwear	• Low-cost-country sourcing will extend beyond traditional categories (apparel, consumer electronics) to many more industries	• Most MBEs are not global • Cost of global operation can be prohibitive for smaller suppliers • Low-cost-country sourcing puts tremendous cost pressure on MBEs
2 Information Flows as Critical as Product Flows	• Key enabler of the new supply chain is real-time, transparent information	• MBEs have limited use of technology as a driver for revenue growth and productivity
3 Expanded Role of Sourcing Department	• Companies realizing value/importance of strategic sourcing and extending reach from commodities to value-added services	• MBEs must be prepared to spend more resources to manage sourcing team requests • Increased focus on competitive bidding exacerbates already tight cost focus
4 A Segmented Approach to the Supplier Relationship	• Commodity products increasingly driven toward arm's length • More efficient models (exchange, e-auctions) • Companies are forming key strategic partnerships for higher-value-added products and services	• MBEs traditionally caught in lower-value-added products/services • Forced to be "commodity" suppliers unless services and products are unique and sophisticated
5 The Power of Supplier Networks	• Lower transaction costs are reducing costs to coordinate activities between suppliers	• Many MBEs lack capabilities required for participation in virtual networks • Reluctance and discomfort with partnerships and alliances can be an inhibitor
6 Core Competency 101: Outsource Functions That Are Not Critical	• Process outsourcing continues to grow rapidly (especially business process outsourcing and off-shoring)	• MBEs are positioned to lose in outsourcing arrangements • Not enough firms looking at outsourcing as MBED opportunity vs. a threat
7 Suppliers Not Just Meeting—But Also Designing the Specs	• Companies pushing innovation responsibility to suppliers to spread risk and reduce capital requirements	• MBEs not vertically integrated—implying difficulty in both product design and fabrication • MBEs have low-value-added profile
8 Customers Driving the Supply Chain	• Companies linking the front end to the rest of supply chain to create more of a inventory pull system	• MBEs not as oriented to consumers • Limited capabilities to manage the entire supply chain

Source: BCG research and analysis