

# Austin Hispanic Quality of Life Initiative

## Economic Development Section

**“.....the most promising and powerful opportunity: building minority businesses of size.”**

*- Boston Consulting Group. The New Agenda for Minority Business Development. 2005.*

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## Hispanic Quality of Life Initiative, Economic Development Section

**“.....the most promising and powerful opportunity: building minority businesses of size.”**

- Boston Consulting Group. *The New Agenda for Minority Business Development*. 2005.

### Background – Hispanic Economic Competitiveness

While Hispanics continue to make up a larger percentage of the United States, Texas, and Austin’s populations, the Hispanic community is increasingly marginalized in terms of economic competitiveness and economic equality.

The community wishes to put forth an Economic Development proposal for the City of Austin that addresses the Hispanic community’s desire for:

- Dignity & Respect
- Wealth Creation
- Community Asset Building
- Shared Prosperity

### Big Problems Require Big Solutions

The proposal set forth may appear to some policy makers as too ambitious; nevertheless, it is the opinion of the Hispanic community ***that the size of the solution should reflect the magnitude of the problem.*** In order to positively impact Hispanic Quality of Life, programs of large magnitude must be enacted.

## Challenges, Opportunities, and Root Causes

### US Hispanic Business Performance

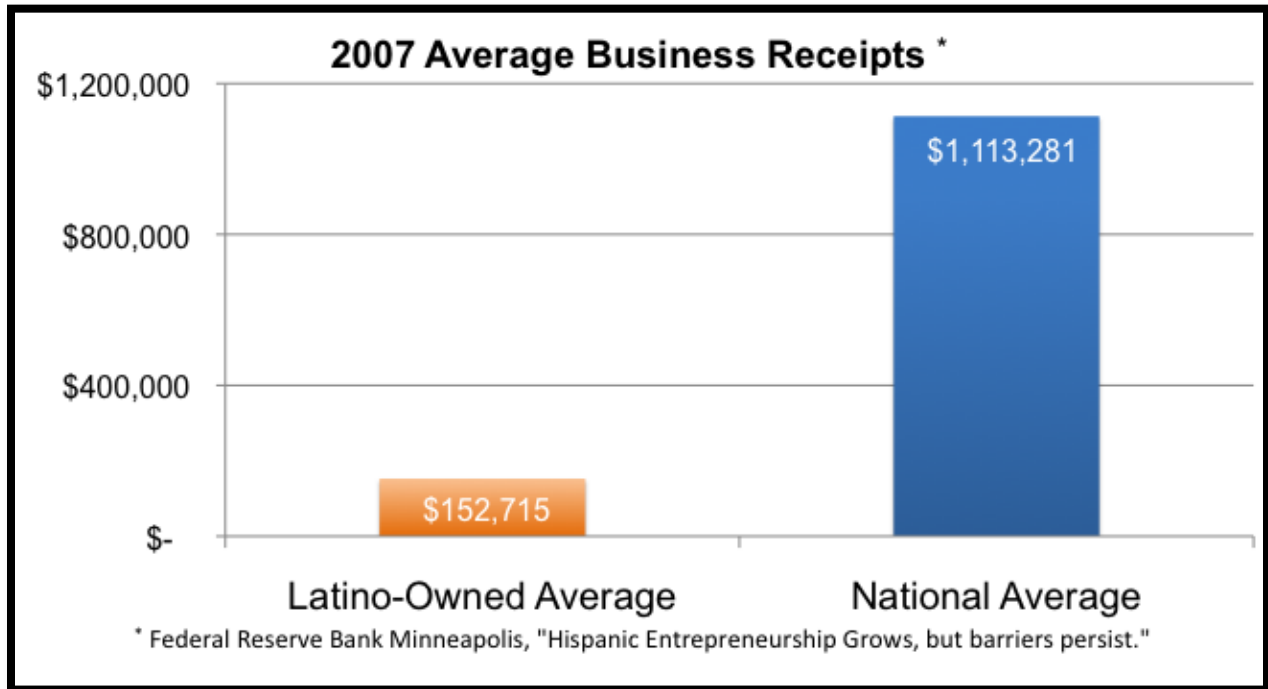
Hispanics lag severely behind other groups in both firm creation and firm size. Over the last several decades, the various small business development programs promoted by federal, state, and local efforts have resulted in a noticeable growth of Hispanic firm creation; however, the Austin Hispanic community agrees with Steven Wray, Executive Director of the Economy League of Greater Philadelphia, when he stated:

*...the average Hispanic business is seven times smaller...*

*“While the past 40 years have helped create more minority business owners, the **next generation of policies and programs must focus on growing more minority-owned businesses to scale, helping move them toward the next level of size, profitability, and influence.**”<sup>1</sup>*

<sup>1</sup> “Everyone’s Business: Building Minority Businesses to Scale,” Steven Wray (2008, p. 1)

To support this statement, one only needs to look at the data. The chart below is created from figures provided by the Minneapolis Federal Reserve Bank in a study titled: "Hispanic Entrepreneurship Grows, but barriers persist."



It is clear from the enormous gap in the size of Hispanic vs Non-Hispanic businesses, the magnitude of the problem is nothing short of severe given that the average Hispanic business is seven times smaller than Non-Hispanic businesses.

### Texas Hispanic Business Performance

Considering the poor performance of Hispanic businesses at a national level, the question then becomes: How do Texas Hispanic Businesses fair versus the national average?

A recent study by the IC<sup>2</sup> Institute at the University of Texas demonstrates a surprising statistic. The study is titled a "Survey of Texas Hispanic Owned Businesses with Paid Employees," and it reports that the average Hispanic business in Texas has gross annual receipts of \$138,287.<sup>2</sup> That number means that Texas Hispanic businesses are 10% smaller than Hispanic Business across the United States.

*....Texas's legacies of discrimination and institutionalized exclusionary practices have had effects on Hispanic business and economic power that are still visible today and into the future.*

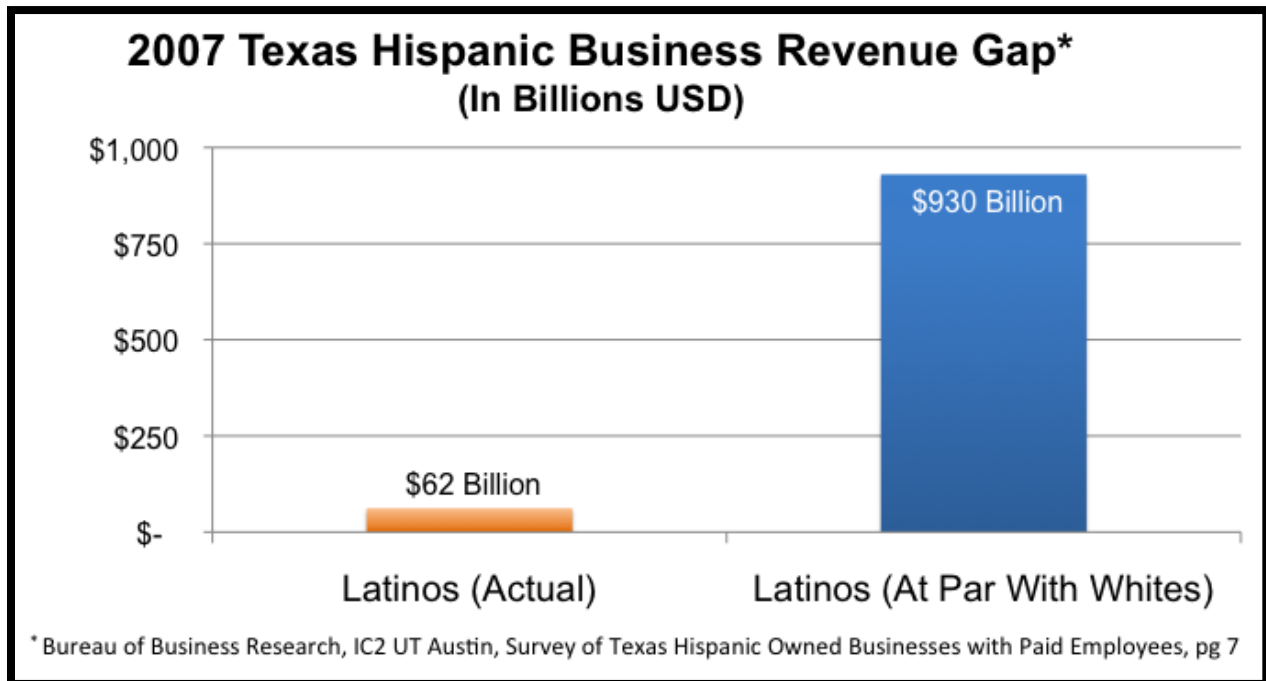
Considering that Hispanics make up nearly 40% of Texans, it would be safe to assume that Hispanics' presence in institutions of power would result in a more favorable position for Hispanic businesses in Texas; nevertheless, *the data*

<sup>2</sup> Bureau of Business Research, IC2 UT Austin, Survey of Texas Hispanic Owned Businesses with Paid Employees, pg 7

suggests that Texas's legacies of discrimination and institutionalized exclusionary practices have had effects on Hispanic business and economic power that are still visible today and into the future.

### Texas Hispanic Revenue Gap – A Missed Opportunity

What are the implications to Texas and to Hispanics from such disparities? According to Dr. Elsie Echeverri-Carroll and Dr. Bruce Kellison, researchers at IC<sup>2</sup> Institute and authors of the study referenced above, the implications to Texas's economy are enormous. The chart below contains the total revenue of Hispanic businesses in Texas, and an estimate of the size these businesses if they were at par with White businesses in Texas.



According to the data from the chart above, Hispanics businesses in Texas have a revenue gap of \$868 Billion. Besides the negative economic impact to Texas, there is a social impact to the state, and very direct negative effect on the Hispanic community in Texas.

It is the belief of the Austin Hispanic Community that had Texas cultivated its Hispanic businesses, the Hispanic community in Texas would have the dignity, respect, political AND economic power possessed by their White counterparts.

*...Hispanic businesses in Texas have a revenue gap of \$868 billion.*

Many of the problems plaguing Hispanics in Texas, including poor educational attainment, high teenage pregnancy rates, high incarceration rates, high diabetes rates, and other social ills are best addressed by Hispanic-controlled institutions given their familiarity with the culture. However, since Hispanics have extremely low level of building assets and wealth, the community is not in a position to “help itself.” It is simply lacking the resources and wealth necessary to address the challenges facing Hispanics.

## Why Hispanic Businesses Lag Behind

There are many reasons why Hispanic businesses lag behind. Previous studies conducted by researchers across the nation have found that Hispanics' have:

- lower levels of assets and education
- lower percentage of parents with business experience
- smaller networks than Whites

According to Echeverri-Carroll and Kellison, the elements above are important factors in explaining Hispanic/White differences in business performance.<sup>3</sup> The Hispanic community of Austin agrees with Carroll and Kellison's conclusions; nevertheless, the community wishes to express that in a state where Hispanics make up nearly 40% of the population, the "lower levels of assets," "lower percentage of parents with business experience," and "smaller networks" than Whites are all a direct consequence of the state's history of institutionalized exclusion. Laws and practices that sought to disenfranchise Hispanics were designed, created, and implemented to have the effects on the Hispanic community that Texas is experiencing today.

*Laws and practices that sought to disenfranchise Hispanics were designed, created, and implemented to have the effects on the Hispanic community that Texas is experiencing today...*

## Why Hispanics must play a role in High Growth and Venture Capital Backed Businesses

Technological innovation is linked to three-quarters of the Nation's post-WW II growth rate, and innovation produces high-paying jobs. The average compensation per employee in innovation intensive sectors increased 50% between 1990 and 2007, nearly two and one-half times the national average.<sup>4</sup> Moreover, in 2003, companies that were backed by venture capitalists employed 10 million people, or 9.4 percent of the private sector labor force in the United States<sup>5</sup>

Not surprisingly, there is a lack of diversity in high-growth or wealth-creating entrepreneurship, and this homogeneity limits the potential of innovation and the state's economic growth. With minorities averaging only 5% of the workforce that effects innovation, we are missing a wealth of talent and ideas that could further advance our society. Research suggests that the current generation of minorities make up only 4% of entrepreneurs who are funded by angel capital each year, and over the last 40 years

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<sup>3</sup> Bureau of Business Research, IC2 UT Austin, Survey of Texas Hispanic Owned Businesses with Paid Employees, pg 8

<sup>4</sup> According to the recent report from the Department of Commerce titled, *Patent Reform: Unleashing Innovation, Promoting Economic Growth, and Producing High-Paying Jobs* ; [http://www.commerce.gov/sites/default/files/documents/migrated/Patent\\_Reform-paper.pdf](http://www.commerce.gov/sites/default/files/documents/migrated/Patent_Reform-paper.pdf)

<sup>5</sup> Venture Impact—The Economic Importance of Venture Capital Backed Companies to the U.S. Economy, 4<sup>th</sup> Edition updated 2006

less than 5% of those funded by professionally managed venture capital firms were minorities. Additionally, minorities make up only 3% of the investment professionals within the venture capital industry.<sup>6</sup>

*...Hispanic programs must be created to help facilitate the inclusion of Hispanic in the venture capital industry and venture capital backed entrepreneurship....*

When one considers the huge gap, the Austin Hispanic community strongly recommends that Hispanic programs must be created to help facilitate the inclusion of Hispanics in the Venture Capital industry and Venture Capital backed entrepreneurship and technology commercialization entrepreneurship.

## Proposed Solutions

The various Economic Development programs outlined below are designed to address gaps in Hispanic Wealth-Creation and Community Asset Building.

### CDC Program: Fund a local CDC to address the problem of Hispanic scalable enterprises

The Community Development Corporation funded will:

- **Execute an Applied Entrepreneurship Program for High Growth and Technology Commercialization**
- **Manage three Renewable Capital Funds:**
  - o **Venture Capital Fund for Hispanic High Growth & Technology Entrepreneurs**
  - o **Low-Interest Debt Fund for Hispanic Non-Profits focused on Building Organizational Capacity and Assets**
  - o **Low-Interest Debt Fund for Hispanic Small Businesses and Worker Owned Cooperatives**

#### *Applied Entrepreneurship Program for Scalable Enterprises*

An applied entrepreneurship program focused on assisting Hispanic business owners who wish to scale, or Hispanic Technology Entrepreneurs who wish to launch a scalable enterprise should be modeled after RampCorp, a similar program that addresses the problem of women's participation in scalable enterprises. For more information on RampCorp, please go to:

<http://www.txstate.edu/rampcorp/>

#### *Venture Capital Renewable Fund*

This report has addressed the historical exclusion of Hispanic entrepreneurs from accessing venture capital, and has explained the importance of Hispanic entrepreneurs participating in this asset class.

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<sup>6</sup> <http://springworks.org/the-carver-society/> For inquiries, please contact: info@springworks.org



Moreover, the availability of venture capital is also a problem in the state of Texas, and more specifically, early stage venture capital is lacking in Texas and nationally. According to the Alamo Multi-Tech Venture Capital Fund of Funds Market Assessment Report, there is a large unmet need for Venture Capital, particularly in seed and early stage capital, throughout Texas.<sup>7</sup> This finding is further backed by the U.S. Small Business Administration, which reports:

*“Early-stage companies face difficult challenges accessing capital, particularly those without the necessary assets or cash flow for traditional bank funding. For high-growth companies, the gap is particularly acute in the so-called ‘Valley of Death’ for financing rounds between \$1-\$4 million. Over the past 4 years only 6% of all venture capital has been deployed in that stage, with 70% of the financings going to only three states – California, Massachusetts and New York.”<sup>8</sup>*

It is for these reasons that the Austin Hispanic Community believes a Venture Capital fund should be created to target emerging Hispanic high growth and technology entrepreneurs. This fund will not only serve existing Hispanic entrepreneurs, it will also serve as source of much badly needed early stage and growth capital for participants in the “Applied Entrepreneurship for High Growth and Technology Hispanic Entrepreneurs” program proposed above.

The fund should be designed in such a way that it is renewable, covering all fund management fees, obtaining back its principle, and should generate a market-rate profit. More importantly, the profits should be shared with the community as a whole (See CDC’s Shared Prosperity Model Section for more information).

The CDC will hire experienced Venture Capital personnel to help it manage the fund, and ensure it meets its financial goals. Moreover, the CDC will use existing Impact Investing reporting frameworks established by B-Corporation and the Global Impact Investing Network to report back to the city the fund’s social goals.

#### ***Low Interest Debt Fund for Hispanic Non-Profits***

Similar to the capital challenges faced by Hispanic businesses, Hispanic controlled non-profits also face challenges for accessing capital needed to build capacity and build organizational assets. Philanthropic funders are increasingly “nudging” nonprofits to become self-sustaining, and the only way to do so is for a nonprofit to build organizational assets.

Furthermore, white persons control most philanthropic organizations (private and public foundations), a fact which is not surprising considering Hispanics’ lack of economic power. This reality creates challenges to scalability for nonprofit corporations managed or controlled by Hispanics.

Given these challenges, the Austin Hispanic Community also proposes that the city create a Low-Interest Debt Fund for Hispanic Non-Profits. The fund will be a renewable

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<sup>7</sup> ALAMO MULTI-TECH VENTURE CAPITAL FUND-OF-FUNDS MARKET ASSESSMENT REPORT, Brooke Private Equity Advisors; May 2009

<sup>8</sup> SBA’s Startup America Initiative, <http://www.sba.gov/startupamerica>



fund, and similar to the Venture Capital fund, the CDC will hire experienced Commercial Capital personnel to help it manage the fund, and ensure it meets its financial goals. Moreover, the CDC will use existing Impact Investing reporting frameworks established by B-Corporation and the Global Impact Investing Network to report back to the City the fund's social goals.

### *Low Interest Lending Fund for Hispanic Small Businesses and Worker Owned Cooperatives*

While community-lending groups like PeopleFund and Acción Texas meet many of the needs of small business owners not addressed by traditional banks, data from the U.S. Small Business Administration shows that minorities are still not accessing debt capital at equal rates than whites. Aaron Glantz of New America Media reported that,

*“Loans handed out to struggling small businesses as part of President Barack Obama’s stimulus package have largely shut out minority businesses — especially those owned by Blacks and Latinos — according to data provided by the federal government’s Small Business Administration (SBA) to New America Media (NAM).”<sup>9</sup>*

The data obtained by NAM from the SBA found that of the 4,497 ARC loans where the race of the borrower was reported, the breakdown was

91.0%	White-owned firms
3.0%	Hispanic-owned businesses
3.0%	Asian- or Pacific Islander-owned businesses
1.5%	black-owned firms <sup>10</sup>

Because of these challenges, the Austin Hispanic Community proposes that the city create a Low-Interest Debt Fund for Hispanic Small Businesses and Worker Owned Cooperatives.

The fund will be a renewable, and similar to the Venture Capital fund, the CDC will hire experienced Commercial Capital personnel to help it manage the fund, and ensure it meets its financial goals. Moreover, the CDC will use existing Impact Investing reporting frameworks established by B-Corporation and the Global Impact Investing Network to report back to the City the fund's social goals.

### *Program Considerations*

The community wishes to address that the funding of the CDC proposed programs should take into account the following considerations:

**Use of Endowments:** The sustainability of the low interest debt capital and venture capital funds are “intrinsic” to the business model. Nevertheless, a program for Applied Entrepreneurship can only be sustainable on a long-term basis. In that regard, a program of this nature requires that it be “endowed.” By creating an endowment, the core staff of the program will not have to rely on grant writing or fundraising, which becomes a distraction from executing the program goals.

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<sup>9</sup> “Minority Businesses Shut Out of Business Loans,” by Aaron Glantz, New America Media, reported by IM Diversity.

<sup>10</sup> “Minority Businesses Shut Out of Business Loans,” by Aaron Glantz, New America Media, reported by IM Diversity.

## **Shared Prosperity & Community Asset Building:**

*“What is the market? It is the law of the jungle, the law of nature. And what is civilization? It is the struggle against nature.”*

- French Prime Minister, Eduard Balladur, quoted from an interview in the *Financial Times*, 31 December

Many of these programs seek to enhance the “individual” wealth of entrepreneurs. However, in a capitalist society there will always be segments of the population who simply cannot take advantage of the opportunities in a free and open market society, due to personal, family, or natural situations.

Capitalism rewards return on investment, and does not account for social justice. It is an economic system, not a comprehensive social system. As such, improving gross domestic product and improving Hispanic business performance alone will not necessarily result in community development.

As an example, one has to only consider the conditions of Travis County, the third richest county in Texas on a per capita basis, and recognize that despite the county’s wealth, it contains more children living in poverty than the state and national average. Texas as a whole is also an example of the decoupled reality between economic and social development. While the state is 2<sup>nd</sup> wealthiest in the USA in terms of Gross Domestic Product, the state suffers from having some of the lowest educational attainment, highest incarceration rates, highest teenage pregnancy rates, and 2<sup>nd</sup> highest income inequality after New York state. The clearest example of the consequences of the problem of extreme inequality or lack of shared prosperity is best captured by the chart below which demonstrates that health and social problems are worse in countries with high income inequality, with the United States ranking worse than countries such as Portugal or Greece.

## Health and Social Problems are Worse in More Unequal Countries

### Index of:

- Life expectancy
- Math & Literacy
- Infant mortality
- Homicides
- Imprisonment
- Teenage births
- Trust
- Obesity
- Mental illness – incl. drug & alcohol addiction
- Social mobility



Source: Wilkinson & Pickett, *The Spirit Level* (2009)

[www.equalitytrust.org.uk](http://www.equalitytrust.org.uk)

The Equality Trust

The conditions above have worsened in the last 50 years. In a 2002 article in the New York Times, the economist Paul Krugman comments on the impact of our nation's extreme inequality:

- *The U.S. has the highest levels of poverty of any advanced nation.*
- *The U.S. has some of the highest rates, if not the highest rate of illiteracy among advanced nations.*
- *Among developed nations, Americans work the longest hours and take less vacation time.*
- *CEO's in the U.S. get paid 2500% more today (adjusted for inflation) than 30 years ago.*
- *Since 1970, the average annual U.S. salary adjusted for inflation has risen 10% while the average annual salaries (adjusted for inflation) of the top 100 CEO's have gone from 1.3MM to 37.5 MM.*
- *the non-partisan Congressional Budget Office study found that between 1979-1997, the after-tax incomes of the top 1% of Americans rose 157%, while the after tax incomes for the middle class rose by only 10%.<sup>11</sup>*

<sup>11</sup> "For Richer: How the permissive of the boom destroyed American equality," Paul Krugman, New York Times, 2002.

In order to pursue a more just and fair society, the Austin Hispanic community believes that we must strive to integrate wealth creation with community development. In the section of this report titled CDC's Shared Prosperity Model, the Hispanic community proposes a profit sharing model that integrates individual wealth creation with community development.

**Culturally Sensitive & Community Control:** The CDC programs funded by the city must be culturally sensitive. In this regard, the Austin Hispanic community wishes to have adequate Hispanic representation. In addition to adequate representation, the Hispanic community wishes to have no less than 50% control of the CDC to ensure the programs are addressing the pain points in the community.

**Annual Program Costs and Total Project Cost**

The table below outlines the total cost of the project, and projected annual operating budget.

<b>Program</b>	<b>Endowment or Fund Size</b>	<b>Annual Operating Budget</b>
Venture Capital Fund for Hispanic High Growth & Technology Entrepreneurs	\$40 Million	\$800,000*
Low Interest Debt Fund for Non Profits	\$20 Million	\$400,000*
Low Interest Debt Fund for Small Business & Worker Cooperatives	\$20 Million	\$400,000*
Applied Entrepreneurship Program for High Growth & Technology Commercialization	\$20 Million	\$600,000**
<b>Total Project Cost</b>	\$100 Million	
<b>Annual Program Budget</b>		\$2.2 Million

\* Assumes 2.0% standard fund management fee for capital funds

\*\* Assumes 3.0% year generated from endowment returns

**CDC's Shared Prosperity Model: Individual & Community Wealth**

As explained in the Program Considerations section above, there is strong social need to integrate economic and community development.

Given the mission and structure of the low-interest debt funds, profits (after management costs) will be essentially zero, or at a very low margin. Any profits generated from the low-interest debt funds should be funneled back into the respective low-interest debt funds to grow their size over time. However, profits generated from enterprises that are graduates of the Applied Entrepreneurship program and the Venture Capital Fund are expected to be substantial.

The performance of private equity funds, which includes venture capital, have been known to create returns on capital in a broad range with some funds performing as low as 12% - 14% IRR, while some other funds perform as high as 40%-50% IRR. The variances are due to the performance of fund managers and the economic conditions as a whole. Upper quartile performers in the venture capital industry typically return in the 20%-35% IRR range. Similarly, technology based companies and high-growth companies outperform their small business or lifestyle company peer; hence, that is why

these business models attract venture capital. Because of these large returns, the Austin Hispanic Community expects these two programs to share their profits as follows:

**Applied Entrepreneurship Program:** Entrepreneurs that become participants in the program will be expected to share a percentage, likely 10%, of the ownership in their companies with the program. The value of this ownership will not become meaningful or liquid for 7-15 years, until these early stage firms produce substantial revenue and profits, and are able to make revenue disbursements to owners or experience some other type of exit such as a company sale.

When the equity owned by the program becomes liquid, the program will then distribute these returns as follows:

Program Growth	30%
Hispanic Philanthropy Fund	35%
City of Austin – General Income	35%

With this plan, the Hispanic Community in Austin will benefit as a whole by donating capital into a fund for Hispanic Philanthropy, which will support Hispanic controlled nonprofits serving the Hispanic community. In addition, returning capital to the City will show a good faith effort by the program to pay Austin’s citizens the debt it incurs in funding this program.

**Venture Capital Program:** In a conventional venture capital fund, investments are made in 1-2 years, and then exited in a 5-10 year time frame. The typical Venture Capital fund generates a 1.5X - 3X multiple on capital. The principal is returned to investors, and the profits or “carry” is split between investors and fund managers, with 80% of profits returning to investors and 20% to the Fund Managers.

When the venture capital fund program exits its positions, the principal will be returned back to the fund, making it renewable, and the carry or profits will be distributed according to the table below:

**Assumptions:**

Fund Size:	\$ 40 Million
Fund Exit Size (2.2X estimate):	\$ 88 Million
Profit or “Carry”	\$ 48 Million

Entity	%	Projected Amount
Fund Manager Bonus	10%	\$ 4.8 million
Fund Size Growth	30%	\$14.4 million
Hispanic Philanthropy Fund	25%	\$12.0 million
City of Austin – General Income	35%	\$16.8 million
Total	100%	\$48.0 million

Similar to the earnings of the Applied Entrepreneurship Program, a meaning amount of the profits of the venture capital fund will be shared with the Hispanic Community as a

whole by donating capital for Hispanic Philanthropy, which will support Hispanic-controlled nonprofits serving the Hispanic community. In addition, returning capital earned by the program to the City will show a good faith effort by the program to pay Austin's citizens the debt it incurs in funding this program.

### **Hispanic Emerging Manager Program for City affiliated Pension Funds**

To facilitate the inclusion of Hispanics as Venture Managers, the City of Austin should begin a program for Hispanic Emerging Managers from all City affiliated pensions. The program would set aside capital from the pension to be awarded to Hispanic Private Equity managers, creating much needed access.

Given the sophisticated nature in managing such programs, a program of this nature can and should be managed by experienced Fund of Funds groups focused on the Emerging Manager space such as Credit Suisse or Bank of America, but it should have oversight by the CDC proposed above to ensure the program is meeting its stated objectives.

### **Increase Economic Development Zones**

The Hispanic Quality of Life community also recommends that the city create or increase Economic Development zones rather than "desired" development zones.

"Desired" development zones have historically only benefitted the individual investors, rather than the larger community in which the development occurred, providing no real community development.

These Economic Development zones should be created in accordance with 2010 Census data, identifying and prioritizing zones with high unemployment, low per capita income, and low educational attainment. Tax revenue projections should not be a factor in the selection of such zones.

## **CDC Structure**

### **Public / Private Partnership – Checks & Balances**

To ensure that this program becomes a private public partnership, the Austin Hispanic community proposes that the Board of the CDC be staffed as follows:

6 Total Board Members

#### Board Composition

3 City Council Appointed Members

3 CDC Staff Members