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2023 Report on Startup Firms Owned by People of Color:

Findings from the 2022 Small Business Credit Survey

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INTRODUCTION

Since the beginning of the COVID-19 pandemic in early 2020, researchers have noted a possible surge in entrepreneurship across the United States, particularly among people of color. This report focuses on the many firms owned by people of color that started during the pandemic.¹ Comparing startups of color to their white-owned counterparts, this publication explores differences in financial characteristics and explores how each set of startups funds their businesses. The 2022 Small Business Credit Survey (SBCS) data show startups of color—particularly employer firms—are far less likely than white-owned startups to fund their businesses through financial institutions or lenders despite applying just as often. Overall, approval rates on applications for credit are lower for startups of color, an important finding given startups of color are more likely than white-owned firms to say they want to grow their business in the next year and may need the financing to do so.

The views expressed here are those of the authors and not necessarily those of the Federal Reserve Bank of Cleveland, the Federal Reserve Bank of Dallas, or the Federal Reserve System.

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BACKGROUND

After decades of little change, the rate of new business applications in the United States increased during the pandemic. The number of business applications more than doubled from April to July 2020 and has remained elevated through the beginning of 2023.² This increase matters for several reasons. For one, new small firms are historically responsible for the majority of jobs created.³ Additionally, high startup rates create more opportunities for competition and innovation. Lastly, startup small businesses are more likely to hire immigrants, new workers, and those with less education—providing jobs for workers who traditionally have a more difficult time finding employment than other job seekers.⁴

At the same time, firms owned by people of color represent a growing share of small businesses. Since the onset of the COVID-19 pandemic in March 2020, researchers have noted a rise in business ownership among people of color. Specifically, economist Robert Fairlie noted that, through September 2022, “the numbers of Black, Latinx, Asian, and Native American active business owners are substantially higher than prepandemic levels.”⁵ Data from the Current Population Survey (CPS), conducted by the US Census Bureau and US Bureau of Labor Statistics, point to the heightened frequency of self-employment among people of color. From January 2020 to April 2023, the number of incorporated, self-employed people of color increased 13%, from approximately 1.7 million workers to 2 million. Inversely,

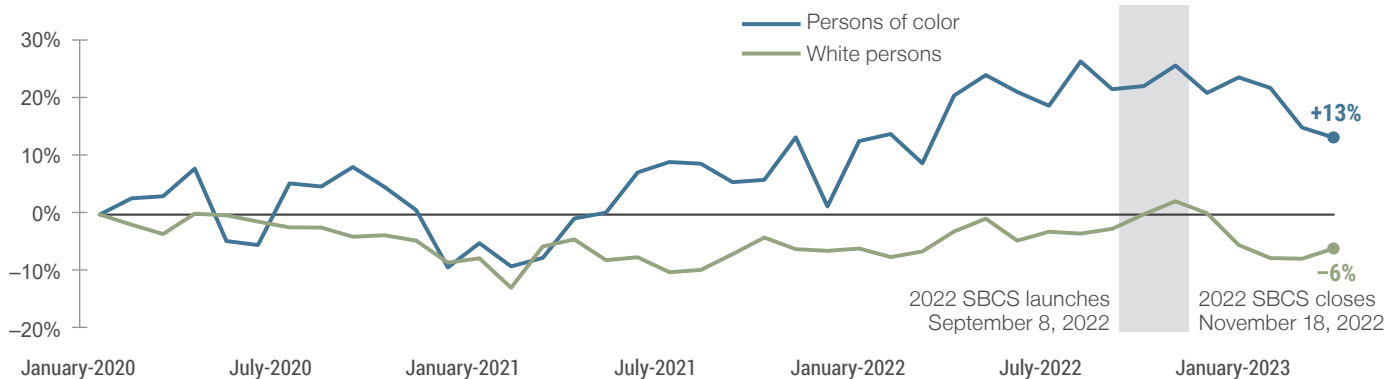
the number of incorporated, self-employed white workers declined 6% over the same timeframe, falling from 5 million to 4.7 million self-employed workers.⁶ Still, there are more than two times as many self-employed white workers as there are self-employed workers of color, though the differences in trends since 2020 are certainly worth examining.

With the growth of entrepreneurship among people of color following the onset of the pandemic, studying the financial condition, challenges, and opportunities for these new firms is valuable given their potentially larger impact on the economy. This publication highlights findings from the Federal Reserve’s SBCS for firms that launched in 2020 up to the time of the survey in late 2022 (hereafter “startups”). In particular, the focus of this analysis is on firms owned by people of color that launched during this time (hereafter “startups of color”), in order to surface opportunities and potential barriers these businesses disproportionately face that could hold them back from growth. The survey was fielded from September 8, 2022, to November 18, 2022, which, as shown in Figure 1, was a period of time in which rates of self-employment were among their highest for both people of color and white workers since 2020.

For the purposes of this report, businesses at least half-owned by individuals who identify as non-Hispanic white are categorized as white-owned, and all other businesses are classified as firms owned by people of color. Figure 2 shows the detailed racial and ethnic composition among both employer and nonemployer startups of color.

FIGURE 1. PERCENT CHANGE IN NUMBER OF INCORPORATED, SELF-EMPLOYED PERSONS SINCE JANUARY 2020

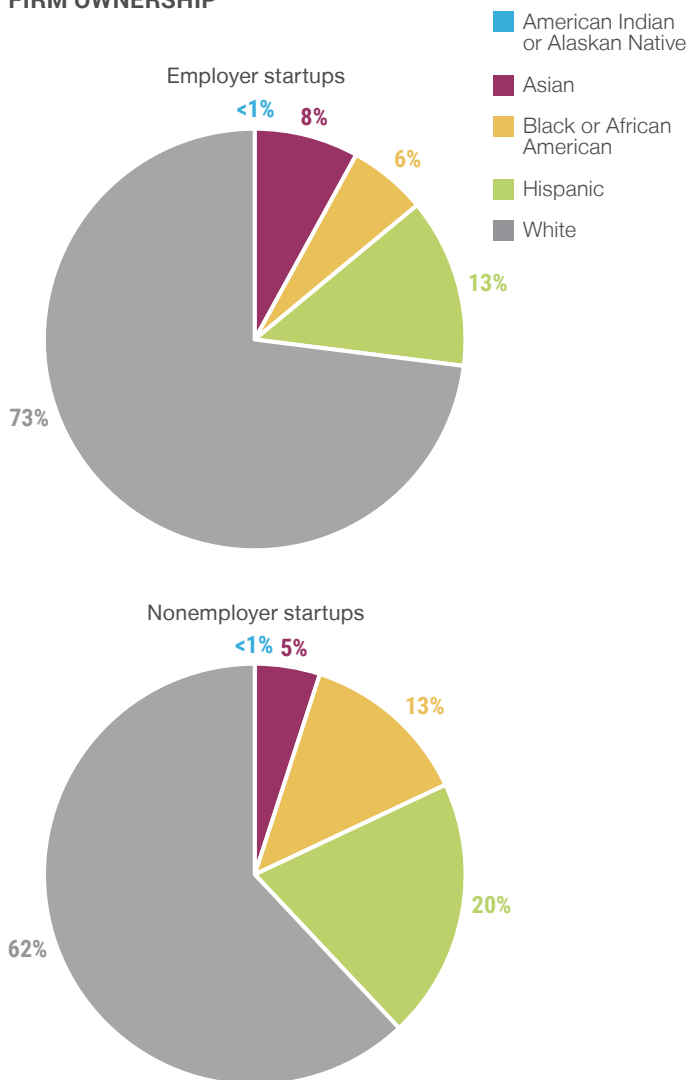
(January 2020 = 0)



Notes: In Figure 1, a person of color is a nonwhite, non-Hispanic respondent. A mixed-race respondent is classified as a person of color. Includes workers with more than one job. Sources: Authors’ calculations, US Census Bureau, 2020–2023 Current Population Survey.

- 1 For SBCS data by race and ethnicity of firm ownership, see 2023 Firms in Focus: Chartbook on Firms by Race and Ethnicity of Ownership at <https://doi.org/10.55350/sbcs-20230509>.
- 2 US Census Bureau, *Business Applications: Total for All NAICS in the United States [BABATOTALSAUS]*, retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/BABATOTALSAUS>, May 4, 2023. See also <https://www.bls.gov/news.release/cewbd.t08.htm>.
- 3 Through the Business Employment Dynamics dataset, the US Bureau of Labor Statistics shows job gains and losses by revenue size. In the latest release for 2022:Q3, firms with 1–49 employees added approximately 3.3 million jobs, compared to approximately 2.6 million jobs that were created by firms with 250 or more employees. See more at <https://www.bls.gov/bdm/>.
- 4 [The Case for Economic Dynamism and Why It Matters for the American Worker](#)
- 5 [“COVID-19, Small Business Owners, and Racial Inequality”](#)
- 6 When analyzing both unincorporated and incorporated self-employed workers in the CPS, the data show an increase in self-employment among people of color and a decline among white people. The analysis of the CPS in this publication narrowly focuses on incorporated self-employment to reflect the SBCS sample, in which most respondents identify that their business is legally incorporated. For example, when the question was asked of nonemployers in 2022, 74% said that their business was incorporated.

FIGURE 2. RACIAL AND ETHNIC COMPOSITION OF STARTUP FIRM OWNERSHIP



Notes: Data used to weight race and ethnicity of employer firm ownership are derived from the US Census Bureau's 2020 Annual Business Survey. Nonemployer race and ethnicity data are derived from the US Census Bureau's 2018 Nonemployer Statistics by Demographics. For more details on SBCS weighting, see the Methodology section of the [2023 Report on Employer Firms](#). Source: 2022 Small Business Credit Survey.

Employer firms are businesses with 1–499 employees other than the owner or owners, and nonemployer firms are those with no employees other than the owner or owners of the firm. This report includes findings from the 2022 SBCS for 353 employer-firm startups of color and 707 nonemployer-firm startups of color and includes comparisons to white-owned startups, of which there are 250 employers and 535 nonemployers in this analysis. Race and ethnicity categories for startups are aggregated because of sample size considerations, though other SBCS publications detail the experiences and challenges unique to Asian-, Black-, Hispanic-, and American Indian- or Alaskan Native-owned firms.

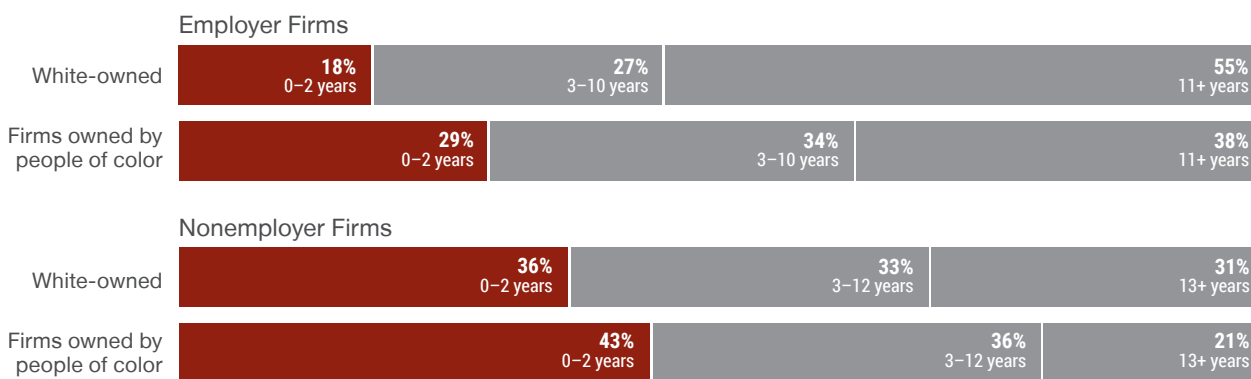
Additionally, this report defines startups as firms that started in 2020 and up to the time of the 2022 survey. After weighting the survey dataset using US Census Bureau data, many small businesses in the sample started in 2020 or later and meet the aforementioned definition of a startup; 20% of employer firms and 38% of nonemployer businesses, respectively. As shown in Figure 3, firms owned by people of color are generally more likely to be startups than white-owned businesses, though a significant portion of both white-owned firms and firms owned by people of color are startups.

Both Figures 2 and 3 are derived from the weighted 2022 SBCS dataset. These distributions closely approximate the distributions of firms by both the race and ethnicity of firm ownership as well as the age of the firm. For instance, while Figure 2 shows that 73% of startup employer firms are white-owned, the US Census Bureau's 2020 Annual Business Survey data show that 75% of startups are white-owned. These figures rely on SBCS data for illustrative purposes: Nonemployer firms are more often owned by people of color than white-owned firms, and are also more often categorized as startup businesses.

FINANCIAL CHARACTERISTICS OF PANDEMIC-ERA STARTUPS

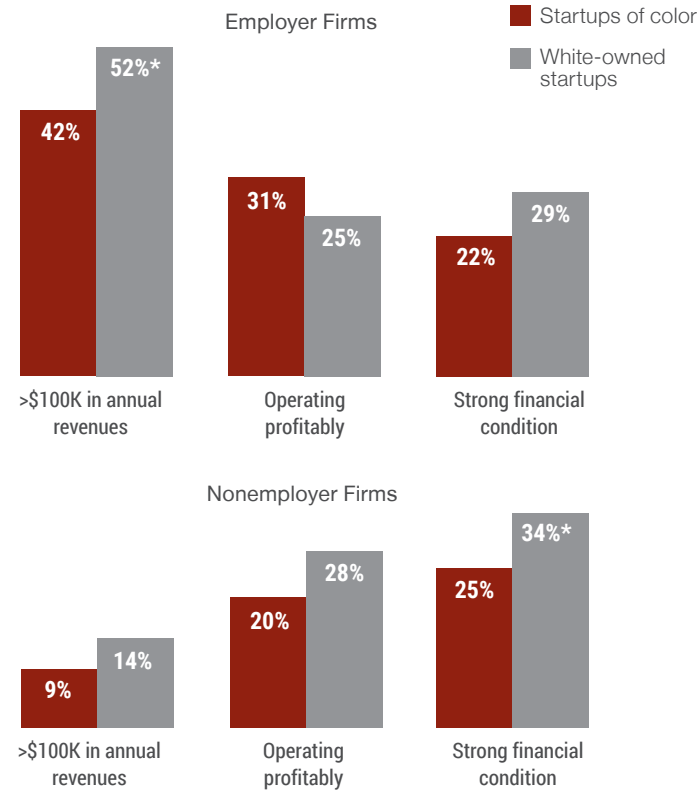
Understanding the characteristics of pandemic-era startups is important to gauging their potential growth trajectory, financing opportunities, and potential challenges.

FIGURE 3. AGE OF FIRM BY RACE AND ETHNICITY OF FIRM OWNERSHIP



Notes: Data used to weight race and ethnicity of employer firm ownership are derived from the US Census Bureau's 2020 Annual Business Survey. Nonemployer race and ethnicity data are derived from the US Census Bureau's 2012 Survey of Business Owners. Age of firm is calculated as the year of the survey (2022) minus the year the respondent reported that their business started. Percentages may not sum to 100 due to rounding. Source: 2022 Small Business Credit Survey.

FIGURE 4. FINANCIAL CHARACTERISTICS OF EMPLOYER-FIRM AND NONEMPLOYER-FIRM STARTUPS



*Statistically significantly different from startups of color at the 5% significance level
 Note: "Strong financial condition" includes firms that self-reported they were in "Good," "Very good," or "Excellent" (as opposed to "Poor" or "Fair") financial condition at the time of the survey.
 Source: 2022 Small Business Credit Survey.

SBCS data show that, on average, startups of color are smaller and in somewhat worse financial condition than white-owned startups (Figure 4).

Starting with employer firms, startups of color are 10 percentage points less likely than their white-owned counterparts to have annual revenues of more than \$100,000 (42% and 52%, respectively). Additionally, startups of color were often in weaker financial condition at the time of the survey. Contrary to the metrics that favor white-owned startups, startups of color were slightly more likely than white-owned startups to report operating at a profit (31% versus 25%, respectively).⁷ Among nonemployers, startups of color lagged white-owned firms across the three metrics shown. Compared to white-owned nonemployer startups, nonemployer startups of color had smaller annual revenues, were less profitable, and reported they were in weaker financial condition.

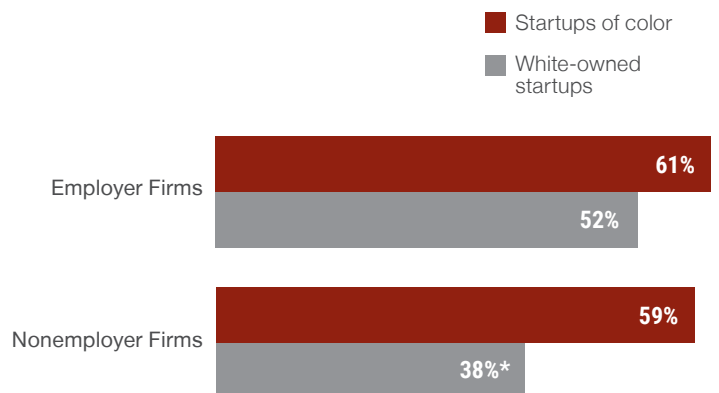
It is worth noting that while startups of color are often in worse financial condition than white-owned startups, startups in general—regardless of the race or ethnicity of the owners—often report being in precarious financial condition.

They are much less likely to be profitable than established firms (27% of startups were operating profitably at the end of 2021 compared to 49% of older firms) and more often identify their financial condition as “poor” or “fair” (73% of startups said they were in “poor” or “fair” financial condition compared to 53% of older firms). The comparatively poor financial condition of startups may be driven by poor performance in some cases, though in other cases, startups may simply be in the process of establishing themselves financially. That said, many startups—particularly those owned by people of color—planned to grow their business by adding employees, as illustrated in Figure 5.

Figure 5 shows the share of startups that expected to add employees in the 12 months following the survey. Among employer firms, startups of color were 9 percentage points more likely than white-owned startups to say they expected to add more employees in the next year. Similarly, nonemployers of color were more likely than their white-owned counterparts—specifically, 21 percentage points more likely—to say they expected to add employees.

Collectively, the data shown in Figures 4 and 5 have important implications. Overall, regardless of race or ethnicity of firm ownership, most startups are unprofitable and in weak financial condition. An important difference between startups of color and white-owned startups, however, is around expectations of adding employees. Compared to white-owned startups, startups of color are more likely to anticipate adding employees and growing their business in the coming year. Despite the challenges faced by all startups, startups of color are more likely to pursue growth and may need external financing to do so. The next section of this report explores the types of funding startups turn to and the difference in where startups of color and white-owned startups obtained capital.

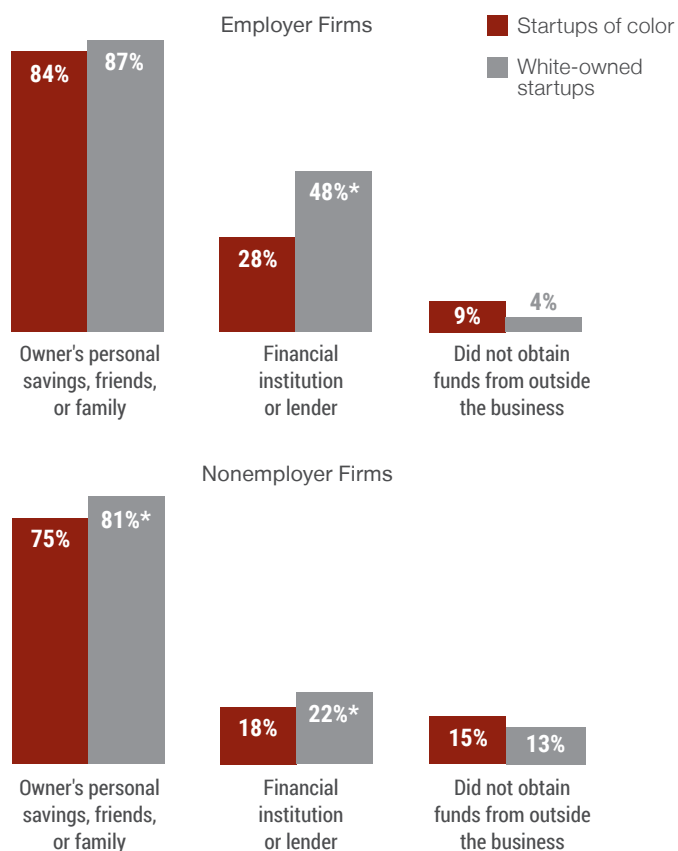
FIGURE 5. SHARE OF FIRMS THAT EXPECT TO ADD EMPLOYEES IN THE NEXT 12 MONTHS



*Statistically significantly different from startups of color at the 5% significance level
 Note: The difference between employer-firm startups of color and white-owned startups is statistically significant at the 10% significance level.
 Source: 2022 Small Business Credit Survey.

⁷ SBCS data collected in 2019 also show that startups of color were slightly more profitable than white-owned startups.

FIGURE 6. SOURCES USED TO FUND BUSINESS SINCE OPENING



*Statistically significantly different from startups of color at the 5% significance level
 Notes: Respondents could select multiple options. Select response options shown.
 *Financial institution or lender” includes all bank or nonbank financial intermediaries, such as banks, finance companies, online lenders, and credit unions.
 Source: 2022 Small Business Credit Survey.

STARTUP ACCESS TO CAPITAL

Access to external capital can be a pivotal component of a small business’s ability to both survive and grow. Capital allows young businesses to manage cash flow and establish a financial safety net, while bolstering the firm’s ability to invest in assets and employees that help the business scale up.⁸ Figure 6 shows the ways in which firms funded their business since opening.

As Figure 6 indicates, the most common sources of business funding for startups are personal: either the owner’s personal savings or money from friends and family. Looking at race and ethnicity of firm ownership reveals little difference in the share of firms that relied on these personal sources of funding. The reliance on personal sources of funding rather than funding from financial institutions or lenders is unsurprising, especially as the SBCS has shown that younger firms are generally more likely than older businesses to be discouraged borrowers—that is, they did not apply because they did not think they would be approved. Lenders may have revenue thresholds, collateral requirements, or expect several years of financial statements that startup firms are often unable to provide.

Despite the barriers for startups in accessing funding from financial institutions, 48% of white-owned employer startups reported doing so since opening, in contrast to 28% of employer startups of color. The difference is narrower among nonemployer startups, though nonemployer startups of color were still four percentage points less likely than their white-owned counterparts to report access funding through a lender. This difference in the use of financial institutions between startups of color and white-owned startups exists despite SBCS data suggesting that a large majority of startups—regardless of race and ethnicity—have a relationship with a financial services provider. More than 90 percent of employers and at least 85 percent of nonemployers use financial service providers—both firms of color and white-owned firms. Still, even among those firms with a financial services provider, startups owned by people of color were less likely than white-owned startups to report funding their businesses through a financial institution or lender.

SBCS data include application-level details about the recent credit-seeking experiences of firms that can help explain why startups owned by people of color—especially employer firms—are much less likely to secure funding through financial institutions or lenders. The next section explores those findings.

CREDIT-SEEKING EXPERIENCES OF STARTUPS

Access to capital is critical as startups sustain their operations and pursue opportunities to grow. Most startups lean on personal sources of funding to do so, but Figure 6 shows that many firms—particularly, employer firms—turn to financial institutions or lenders for funding. As the following section shows, startups of color and white-owned firms are about as likely to seek financing from lenders, but startups of color are much less likely to actually receive funding for which they applied.

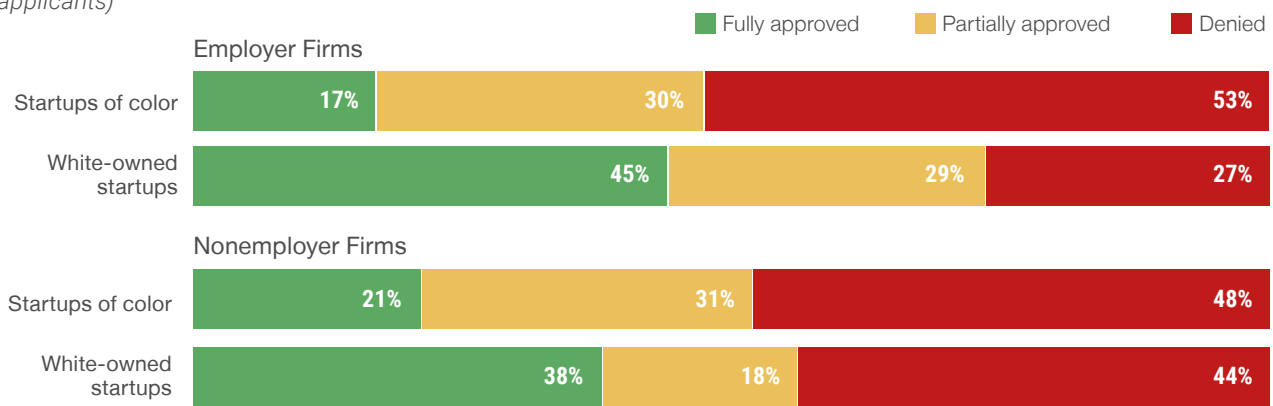
Applications and outcomes

Just under half of employer-firm startups applied for financing in 2022—specifically, 47% of startups of color and 46% of white-owned startups applied for a loan, line of credit, or merchant cash advance. Nonemployer startups were generally less likely to apply than employers, though nonemployer startups of color were slightly more likely than white-owned nonemployer startups to do so (34% and 26%, respectively). While startups of color were as likely or more likely to apply for financing, they were less likely to receive all that they sought. As shown in Figure 7, employer-firm startups of color were less than half as likely as their white-owned counterparts to be fully approved on applications and around twice as likely to be denied. Nonemployer-firm startups of color were only slightly more likely than white-owned nonemployer startups to be denied, but the gap in the share of firms fully approved persists.

8 Greater Access to Capital Is Needed to Unleash the Local Economic Development Potential of Minority-Owned Businesses

FIGURE 7. OUTCOMES ON LOAN, LINE OF CREDIT, AND MERCHANT CASH ADVANCE APPLICATIONS

(% of applicants)



Source: 2022 Small Business Credit Survey.

Creditworthiness

Considering differences in applicants' financial characteristics and where they applied provides some insight on differences in outcomes. However, none of these factors sufficiently explains the gap between approvals for white-owned startups and startups of color. For example, consider only employer-firm startup applicants that were operating profitably. Among those owned by people of color, 38% said they were at least partially approved. The same was true of 84% of white-owned employers that reported

operating profitably, a difference which—even with narrow sample sizes—is statistically significant. Though not explored in this publication, other research shows that even when controlling for a multitude of factors a lender might consider in an approval process, race and ethnicity of firm ownership remains an important predictor of approval.⁹

Credit scores may also play an important role in whether startups are approved for financing.¹⁰ As shown in Figure 8, employer-firm startups of color were about as likely as white-owned startup employers to be classified as low credit risk based on their self-reported credit scores.¹¹ The similarities hold when narrowing the sample to only applicants. Among employer-firm applicants, 41% of startups of color were low credit risk, compared to 45% of white-owned startups. Turning to nonemployers, startups of color were more likely than their white-owned counterparts to be medium- or high-risk applicants. Still, even those nonemployer startups of color that were low-risk applicants were less likely to be fully approved for financing than nonemployer white-owned startups (41% of low-risk nonemployer startups of color were fully approved, compared to 61% of nonemployer white-owned startups, a statistically significant difference at the 10% level).

Products and lenders

At the application level, startups of color often apply for similar credit products as white-owned startups, but there are important differences in the lenders at which they apply for those products. As shown in Figure 9, startups owned by people of color were as likely as white-owned startups to apply at a large bank or online lender for credit, but they were far less likely—in fact, about one-third as likely as white-

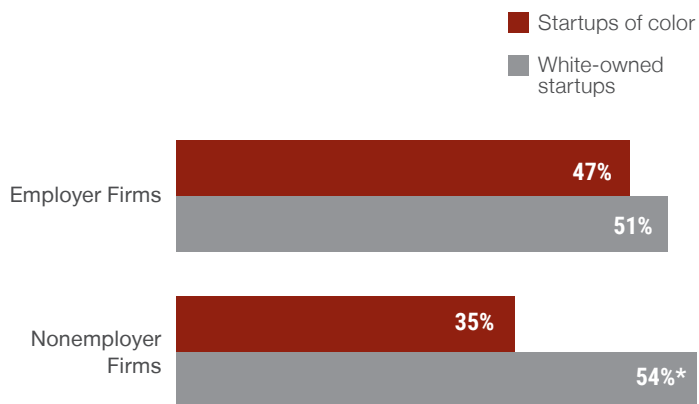
Due to startup sample size constraints, this publication does not show more specific race and ethnicity categories of firm ownership. Beyond startups, however, the broader SBCS sample shows that firms owned by people of color universally lag white-owned firms with respect to loan, line of credit, and merchant cash advance approvals, and the degrees to which they differ vary. For example, when considering all applicant employer firms in the 2022 survey, 58% of white-owned firms were fully approved for the credit they sought. Comparatively, the same was true of 38% of Hispanic-owned firms and 33% of Asian-owned firms. Among Black-owned employer firms, just 20% said they were fully approved for the credit they sought. The gaps in approvals are not specific to the startup firms upon which this publication focuses; rather, the SBCS shows differences in likelihood of being approved across firms by race and ethnicity, regardless of firm age.

9 There are also gaps in approvals when controlling for revenue size and credit risk, though the differences are not statistically significant. Fifty-two percent of employer-firm startups of color were approved on applications for loans, lines of credit, and merchant cash advances, compared to 77% of white-owned startups. Similarly, low-credit-risk startups of color were approved 56% of the time compared to 77% of white-owned low-credit-risk startups. For other analysis, see ["Credit Availability for Minority Business Owners in an Evolving Credit Environment: Before and During the COVID-19 Pandemic."](#)

10 While this report includes findings on financing approval rates by credit risk of firm, we acknowledge that questions remain around the use of credit scores in decisions to approve financing given the structural limitations that disadvantage people of color and the firms they own.

11 The SBCS defines a "low-credit-risk firm" as a firm with either a business credit score of 80–100 or a personal credit score of 720 or greater. If the respondent indicates they rely on both their business and personal credit score, the lower of the two is considered.

FIGURE 8. SHARE OF EMPLOYER- AND NONEMPLOYER-FIRM STARTUPS THAT ARE LOW CREDIT RISK



*Statistically significantly different from startups of color at the 5% significance level
 Note: See footnote 11 for details on SBCS definitions of credit risk.
 Source: 2022 Small Business Credit Survey.

owned startups—to apply at small banks (defined as those with fewer than \$10 billion in deposits).¹² Importantly, among the full SBCS sample, small-bank applicants were more likely than those at large banks and online lenders to be approved since the onset of the pandemic. Geography plays an important role in choice of lenders, but even when controlling for urbanicity, startup firms owned by people of color were less likely than white-owned firms to use small banks.¹³

Other factors

As mentioned in the prior section, documentation such as credit reports and financial statements are required by most lenders. While documentation is crucial to a business’s likelihood of being approved, it can also be a barrier for some firms in accessing financing, particularly among firms owned by people of color. Startups of color were more likely than white-owned firms to say they were denied because they did not have the necessary documentation required by the lender. Access to paid professionals in a business owner’s network (for example, an accountant) can be a helpful resource when preparing to apply for financing and gathering documentation—in fact, 2021 SBCS data show that businesses that relied on a paid resource such as an accountant were more likely to be fully approved for financing than those that did not. However, SBCS data suggest paid professionals were less common among firms owned by people of color than they were among white-owned firms, as just 45% of firms owned by people of color reported having a paid professional in their network as opposed to 64% of white-owned businesses.

It is important to note that the data used in this analysis does not offer a complete picture of a small business’ creditworthiness. Credit scores and revenue are crucial inputs into a lender’s decision but are not the only factors. Other factors that are potentially relevant to the decision to lend, including a firm’s collateral, cash flows, and documentation, may account for some of the gaps in access to financing.

CONCLUSION AND POLICY CONSIDERATIONS

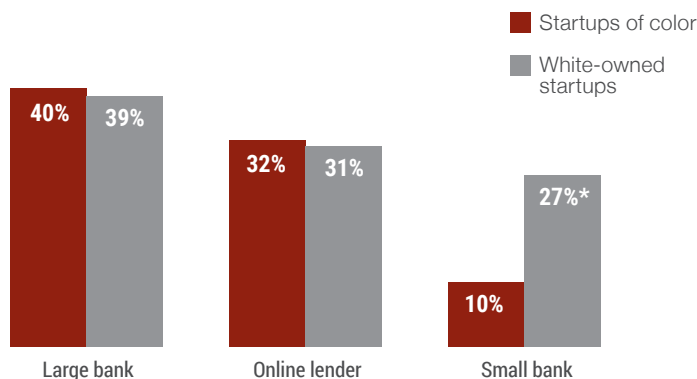
Regardless of the cause, difficulties that firms of color face in access to financing is an obstacle on their path to sustain themselves and grow. Given that people of color are an increasingly large share of the self-employed, and that startups of color are more likely than their white-owned counterparts to indicate a desire to grow, a focus on closing these gaps will only become more important. Further research on the root cause of these disparities should be prioritized to understand what interventions might be feasible and effective.

These long-standing gaps in access to financing for startups will likely require a multi-pronged approach from several areas within the small business ecosystem. Results of this analysis suggest the following as areas for future research and policy consideration.

Education and technical assistance for small startups:

As mentioned above, firms owned by people of color may be less likely to have business documents and account statements required by many lenders. In some cases, the business owner may not have the knowledge or the resources to understand regulations and assemble required

FIGURE 9. CREDIT SOURCES APPLIED TO (% of startup employer-firm applicants)



*Statistically significantly different from startups of color at the 5% significance level
 Notes: Respondents could select multiple options. See footnote 12 for details on SBCS lender definitions.
 Source: 2022 Small Business Credit Survey.

12 The SBCS defines a large bank as a bank with at least \$10B in total deposits; small banks are those with less than \$10B in total deposits. For applicable questions, respondents are shown a list of large banks operating in their state to assist them with proper classification of their institution. Online lenders (or “fintech lenders”) are nonbanks that operate online. Examples include OnDeck, CAN Capital, Paypal Working Capital, and Kabbage.

13 Communities of color—particularly Black communities—are often underbanked, and access to bank branches continues to decline. For more, see [An Analysis of Financial Institutions in Black-Majority Communities: Black Borrowers and Depositors Face Considerable Challenges in Accessing Banking Services](#).

documentation. Organizations that serve diverse businesses can play a valuable role in educating small business owners about the importance of business statements and proper documentation and the role that formal paperwork plays in access to capital. Notably, in roundtables conducted with stakeholders held by the Federal Reserve, financial intermediaries often pointed to the success of programs that tie funding to training or technical assistance.¹⁴

Capacity-building programs for mission-oriented lenders: Although they represent a small share of overall lending, mission-oriented financial institutions play a crucial role in the small business ecosystem, particularly for startups, very small firms, and firms owned by people of color. These community-based lenders, such as minority depository institutions (MDIs) and community development financial institutions (CDFIs), have received heightened attention due to their ability to reach diverse firms during the pandemic. For example, analysis from the Federal Reserve Bank of Dallas highlights the role these types of institutions played in connecting vulnerable businesses to pandemic-related financial assistance, specifically helping those businesses access loans through the US Small Business Administration’s Paycheck Protection Program.¹⁵ Several

federal funding programs, such as the CDFI Rapid Response Program and the Emergency Capital Investment Program, have been created to assist these lenders in serving small businesses that may be less likely to access credit at a more traditional bank. These programs are relatively recent, but the efficacy of improving lending to firms of color through MDIs and CDFIs should be studied when feasible.

Loan guarantee programs: Because entrepreneurs—particularly those of less wealth—often lack the necessary collateral that would signal creditworthiness to a traditional lender, alternatives such as loan guarantee programs may improve application success rates. The SBA guarantees eligible loans through its 7(a) program, reducing the risk for the lender and making an approval more likely. Other guarantee programs include what many states plan to offer through the State Small Business Credit Initiative (SSBCI). Originally established in 2010, the initiative was renewed in 2021 and allows states to receive fund allotments for certain programs, including loan guarantees. Other eligible state programs include collateral support and venture capital. States are also incentivized to explicitly support business owned by “socially and economically disadvantaged individuals” through additional funding.

**For more Small Business Credit Survey content, visit
FedSmallBusiness.org.**

¹⁴ [How PPP Loans Eluded Small Businesses of Color](#)

¹⁵ [Mission-Oriented Banks in Texas and Underserved Businesses: Lessons from the Paycheck Protection Program](#)