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UNITED STATES GENERAL ACCOUNTING OFFICE

REPORT TO THE CONGRESS 093367

Limited Success Of Federally Financed Minority Businesses In Three Cities

B-149685

Small Business Administration
Office Of Minority Business Enterprise
Department Of Commerce

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D C 20548

B-149685

To the Speaker of the House of Representatives
and the President pro tempore of the Senate

This is our report on the limited success of federally financed minority businesses in three cities. The Small Business Administration and the Office of Minority Business Enterprise, Department of Commerce, are responsible for the activities discussed in this report.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget, the Administrator, Small Business Administration, the Secretary of Commerce, and the Director, Office of Minority Business Enterprise, Department of Commerce.

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

ACE	Active Corps of Executives
BRC	business resource center
EOL	economic opportunity loan
GAO	General Accounting Office
LBDO	local business development organization
MESBIC	minority enterprise small business investment company
OMBE	Office of Minority Business Enterprise
SBA	Small Business Administration
SCORE	Service Corps of Retired Executives

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

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D I G E S T

WHY THE REVIEW WAS MADE

The Small Business Administration (SBA) and the Office of Minority Business Enterprise (OMBE), Department of Commerce, have been involved in the Federal Government's emphasis on assisting minority businessmen.

Neither SBA nor OMBE had ever examined the factors which contributed to the success or failure of minority businesses assisted by SBA loan programs. (See p. 68.)

GAO wanted to determine the degree of success or failure of such businesses Accordingly, an examination was made of the minority businesses that received loans from SBA offices in Washington, D.C., Chicago, and Los Angeles. (See pp. 26 and 76.)

Background

Minorities make up about 17 percent of the Nation's population, but own only about 4 percent of the Nation's businesses. (See p. 5.)

Recognizing the need to increase the number of minority businesses, the Federal Government has expanded existing programs and has initiated new programs SBA and OMBE have been primarily involved in this effort.

SBA loans to minorities have increased from $104.6 million in fiscal year 1969 to $334.0 million in fiscal year 1973. SBA emphasized providing management assistance to minority businessmen beginning in fiscal year 1969. (See p. 16)

OMBE received a supplemental appropriation of $40 million in fiscal year 1972 and a total appropriation of $63.9 million in fiscal year 1973 to expand its technical and management assistance to minority businessmen. (See p 7.)

The scope of the review is shown on page 76.

FINDINGS AND CONCLUSIONS

Minority businesses have had limited success

Of the 845 minority-owned businesses receiving SBA loans disbursed by the Chicago, Los Angeles, and Washington district offices during fiscal years 1969 and 1970, GAO classified about 27 percent as failures, about 25 percent as probable failures, about 31 percent as probable successes, and about 17 percent as undeterminable. These results were based on GAO's analysis of 443 businesses randomly selected from the 845. Businesses were classified on the basis of

Tear Sheet Upon removal the report cover date should be noted hereon loan repayment status and business-operating results.

GAO was unable--for purposes of comparison--to locate published statistics on failure rates for minority businesses or for small businesses in general. (See p. 18.)

A lack of managerial capability of the owner was the sole reason for the failure of about 30 percent of the businesses classified as failures or probable failures and a contributing reason for the failure or probable failure of an additional 39 percent. (See p 57.)

The high percentage of failures must necessarily have an adverse effect on the creditability of the Federal minority enterprise effort.

More attention should be given to reducing this high rate because negative effects of business failures offset in some degree the benefits of business successes. (See p 23)

The rate of growth in the number of SBA loans made each year to minorities has been slowing (See p. 22.)

Because of this slowing growth rate, the high rate of failures and probable failures, and the fact that any attempt to reduce this high rate should increase the number of disapproved loan applications, GAO questions whether Federal efforts will result in significant increases in the number of successful minority-owned businesses in the Nation. (See p 24)

Factors influencing success and failure

GAO analyzed a sample of 443 minority businesses to identify relationships existing between certain characteristics of owners, businesses, or type of financing and success or failure of the businesses. GAO found that

--Borrowers using loan funds to purchase existing businesses were more successful than borrowers using funds to expand their existing businesses or to start new businesses.

--Unfavorable business locations usually resulted in failure

--Businesses with bank loans were more successful than businesses with direct SBA loans (See p. 26.)

Management assistance has had little impact on businesses' success

Management assistance was not provided to about 50 percent of the businesses in GAO's sample which had identified needs for management assistance. (See p. 39.) When management assistance was provided to solve business problems, it generally did not improve the business status or reverse a trend toward failure Of the businesses that received assistance, 25 percent were classified as failures, 37 percent as probable failures, and 22 percent as probable successes (See p. 49.)

Ineffectiveness of management assistance provided appears to be due primarily to the fact that timely assistance is not provided because of inadequate loan-servicing activities

Also certain business problems, such as vandalism or owner illness, do not appear to be susceptible to solution through management assistance (See p 51.)

During fiscal year 1972 OMBE initiated an expanded program of technical and management assistance for minority businessmen Under the program OMBE funds local business development organizations which provide the assistance. (See p. 61.)

GAO questions whether the additional resources from this expanded program will have a significant impact in resolving the business problems of minority businesses. According to OMBE, much of the resources of local business development organizations will be used in preloan activity rather than in providing management assistance to solve business problems. Also, OMBE initiated the expanded program without adequately evaluating the past effectiveness of similar organizations (See p 65)

Beginning in June 1972, however, OMBE implemented a planning, evaluation, and information system to provide data necessary to evaluate the local business development organizations.

Evaluations by the agencies

SBA measures the success of its program primarily by the number and amount of loans made to minority businessmen rather than the number of successful minority businesses established SBA has never established goals in terms of the number of successful businesses to be established or an acceptable failure rate for minority businesses it financed.

SBA apparently has emphasized increasing the quantity of minority loans rather than improving the rate of success of businesses financially assisted by SBA. (See p 68)

Recently SBA made a study of owner and business characteristics related to the success or failure of minority businesses assisted by it, its final report had not been issued as of September 12, 1973 (See p 73)

Although OMBE has implemented a system to measure the success of its program, OMBE has not established long-range goals for the Federal minority enterprise effort in terms of the number of successful minority businesses to be established. (See p 69)

RECOMMENDATIONS

GAO recommends that

--SBA develop loan approval criteria based on an assessment of owner and business characteristics relating to business success and failure

This is to provide greater assurance that loans are made to minority businessmen with reasonable prospects for success and thus reduce the rate of failure and probable failure (See p 37.)

--SBA improve the effectiveness of management assistance provided to minority businessmen This relates to earlier resolution of managerial deficiencies, improvements in SBA and bank loan servicing, an evaluation of the effectiveness of assistance provided by paid contractors, and improvements in the methods of employing retired and active businessmen who volunteer their services (See p 59)

--OMBE use its new planning, evaluation, and information system to evaluate the effectiveness of local business development organizations in terms of numbers of successful businesses established.

--OMBE coordinate its management assistance activities with those of SBA to provide maximum benefit to minority businessmen. (See p. 66.)

--OMBE establish long-range goals in terms of numbers of successful minority businesses to be established by the Federal minority enterprise effort. (See p. 74.)

--SBA establish goals, in conjunction with OMBE, in terms of the number of successful minority-owned businesses to be established through SBA's programs and establish an acceptable failure rate for minority loans

--SBA develop an information system which would enable measurement of accomplishments in terms of successful minority businesses established (See p. 74.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

In general, the Administrator and Director expressed agreement with the facts contained in this report and with GAO recommendations See pages 24, 38, 59, and 74 for their specific comments concerning each recommendation.

MATTERS FOR CONSIDERATION BY THE CONGRESS

GAO is reporting to the Congress the results of its review of Federal assistance to minority business enterprise because of expressed interest in this national issue by a number of committees and by Members of Congress.

CHAPTER 1

INTRODUCTION

In recent years the Federal Government has emphasized assisting minorities to become business entrepreneurs, because of its concern about the proportionately small number of businesses owned by minorities in the United States and the problems which have to be overcome to correct this imbalance.

Blacks, Americans of Puerto Rican and Mexican descent, Indians, and other minority groups make up about 17 percent of the population of the United States, yet minority-owned businesses in 1969 (about 322,000) represented only 4 percent of the Nation's businesses.[1] Further, the minority-owned businesses are generally small--accounting for less than 1 percent of total business receipts in the United States.

Such factors as the lack of a business tradition, inadequate financial and management resources, language barriers, and racial discrimination are generally recognized as limiting the opportunities for minority ownership of businesses. The Secretary of Commerce in his "Report to the President on Minority Business Enterprise" dated June 30, 1970, pointed out that

> "Most minority-owned businesses function in rundown neighborhoods which are unattractive to potential customers. Vandalism, pilferage, robbery, and other crimes are daily hazards which add to costs of doing business. The surrounding community is normally a poor source of consumer dollars and of skilled personnel. Credit and collection costs are high. Suppliers, unions, and lenders may face the enterprise with subtle discriminatory policies. Insurance may be unobtainable In this setting, mere survival is a grueling and all-consuming task for most minority businessmen."

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[1]"Minority-Owned Businesses 1969," U.S. Department of Commerce, Bureau of the Census, August 1971.

OFFICE OF MINORITY BUSINESS ENTERPRISE

The Office of Minority Business Enterprise (OMBE), established within the Department of Commerce under Executive Order 11458 dated March 5, 1969, is the focal point of the Federal Government's efforts to assist in establishing and expanding minority enterprise. OMBE is responsible for coordinating the plans, programs, and operations of the Federal Government that affect minority businesses, stimulating State and local governments and private institutions to undertake activities to facilitate the growth of minority businesses, and developing and disseminating information helpful to those who would assist or engage in minority business development.

To coordinate and stimulate minority enterprise at the local level, OMBE, as of June 30, 1972, had fostered the establishment of Minority Business Opportunity Committees in 29 cities. These committees are composed of top-level Federal personnel who have responsibilities relating to the minority enterprise effort and persons from State and local governments, minority communities, and the private sector

OMBE also entered into working arrangements with local business development organizations in a number of cities. These organizations provide technical and management assistance to minority businessmen. Until fiscal year 1972 these organizations were called OMBE affiliates and were funded, in whole or in part, by such Federal agencies as the Economic Development Administration and the Small Business Administration (SBA) Activities of OMBE affiliates included identifying potential minority businessmen and aiding and advising the minority businessmen in developing their business plans and preparing their loan applications

Through the first half of fiscal year 1972, OMBE's role was primarily that of coordinating the activities of the various Federal agencies and stimulating activity in the private sector. OMBE had not directly conducted programs of financial and management assistance for minority enterprise.

In line with this role, OMBE spent about $2 million for salaries and administrative expenses in fiscal year 1971 and initially estimated that it would spend $3.5 million for salaries and administrative expenses in fiscal year 1972

However, during fiscal year 1972, OMBE initiated an expanded program of technical and management assistance for minority businessmen. The program is essentially an enlarged version of the "OMBE affiliate" concept, except that OMBE now furnishes funds to the local business development organizations which are no longer referred to as OMBE affiliates. For this program OMBE received a supplemental appropriation of $40 million for the remainder of fiscal year 1972 and an appropriation of $63.9 million for fiscal year 1973.

As of June 30, 1972, OMBE had placed 19 field representatives in major cities to coordinate and monitor the activities of Minority Business Opportunity Committees, local business development organizations, and other local organizations.

OMBE has cited the following as some of the more important results of its efforts to coordinate Federal Government programs and stimulate private sector activity.

1. Federal grants, loans, and guarantees to minority businesses totaled $472.6 million in fiscal year 1972 compared with $434 million in fiscal year 1971.

2. Direct Federal procurements from minority businesses totaled $242.3 million in fiscal year 1972, an increase of $164.5 million over fiscal year 1971.

3. As of June 30, 1972, 51 minority enterprise small business investment companies (MESBICs) had been establish. Through April 1972 MESBICs had made 442 financings (loans or stock purchases) to minority businesses using $7.6 million of MESBIC capital which generated $35.9 million in capital from other private sources.

4. Additional Federal and private funds of over $200 million were deposited in minority banks through June 30, 1972.

5. The number of minority-owned franchised businesses increased from 1,184 to 1,470 during fiscal year 1972.

6. In fiscal year 1972 local business development organizations aided 1,540 minority businesses obtain funding totaling about $83 million

SMALL BUSINESS ADMINISTRATION

Because SBA is the principal source of Federal financial and management assistance to minority businessmen, we primarily emphasized evaluating SBA's minority enterprise activities. The Small Business Act of 1953 established SBA as an independent agency under the general direction and supervision of the President. The Administrator of SBA is appointed by the President, with the advice and consent of the Senate. SBA was established primarily to aid small businesses, which are defined in the act as those which are independently owned and operated and which are not dominant in their field of operation.

In addition to its headquarters office in Washington, D.C., SBA has 10 regional offices, 53 district offices, and 14 branch offices throughout the United States.

Operation Business Mainstream

SBA has given the name Operation Business Mainstream to its effort to increase the number of minority-owned businesses in the Nation. Operation Business Mainstream consists of elements of almost all SBA programs, including the section 7(a) business loan program, the economic opportunity loan (EOL) program, the section 8(a) procurement program, the management assistance program authorized by section 406 of the Economic Opportunity Act of 1964, and the MESBIC program.

The Office of the Assistant Administrator for Minority Enterprise coordinates SBA activities relating to minority enterprise. His office includes

--The Office of Program Planning and Control which is responsible for developing plans, operating procedures, and criteria applicable to SBA's minority enterprise efforts and for monitoring the performance of field offices.

--The Office of Government and Industry Relations which promotes the involvement of industry, trade associations, local governments, and community action groups in the area of minority enterprise.

--The Office of Program Assistance whose personnel act in an advocacy role to resolve problems and difficulties encountered by applicants in obtaining SBA assistance.

As of February 28, 1972, 103 SBA employees designated as minority enterprise representatives were operating in 43 cities under the direction of SBA regional directors. These employees are responsible for coordinating SBA's minority enterprise related activities in the geographical area for which they have responsibility, working with community organizations to obtain their aid in identifying potential minority businessmen, assisting applicants prepare loan applications, processing loan applications, and monitoring the progress of SBA borrowers.

Section 7(a) business loan program

Section 7(a) of the Small Business Act authorizes SBA to make, participate in, or guarantee loans to small businessmen purchasing new businesses, expanding existing businesses, or purchasing equipment. The loans are designated as direct, immediate participation, or guaranty loans. SBA makes direct loans to the borrower. Either SBA or a private lending institution makes immediate participation loans to the borrower, and either the lending institution or SBA purchases an agreed percentage of each loan amount. A bank makes a guaranteed loan under an agreement with SBA whereby SBA purchases the guaranteed portion--up to 90 percent--of the outstanding loan balance from the bank in the event the borrower is in default of repayment for 90 days.

Section 7(a) loans may not be made for a period exceeding 10 years except that loans made for constructing facilities may have a maturity of 15 years plus additional time required to complete such construction. The act provides that no more than $350,000 can be loaned to one borrower under the section 7(a) business loan program, but SBA has established a ceiling of $100,000 for direct loans and $150,000 for SBA's share of immediate participation loans. Interest rates on direct loans and on SBA's share of immediate participation loans can be no more than 5 5 percent

Loans provided to minorities under the section 7(a) business loan program are shown below.

Fiscal year	Number of loans	Amount
		(millions)
1969	1,460	$ 58.3
1970	1,629	84.4
1971	2,123	121.5
1972	3,049	165.4
1973	3,285	200.9

Economic opportunity loan program

Title IV of the Economic Opportunity Act of 1964 established a business loan program for persons in poverty and high unemployment areas. Title IV as originally enacted placed jurisdiction of the program under the Director of the Office of Economic Opportunity, the Director delegated the authority to make loans to the Administrator, SBA. Section 401 of the Economic Opportunity Amendments of 1966 transferred the responsibility for the EOL program to the Administrator, SBA, in November 1966.

Loans under this program were limited to $25,000 until June 1972 (when changed to $50,000) and are repayable in not more than 15 years. As with section 7(a) loans, EOLs may be either direct, immediate participation, or guaranteed. EOLs can be guaranteed up to 100 percent. The act provides that the loans bear interest at a rate not less than a rate determined by the Secretary of the Treasury, taking into consideration the average market yield on outstanding Treasury obligations of comparable maturity plus such additional charge, if any, toward covering other costs of the program as SBA may determine to be consistent with the program's purposes

In recent years the interest rate on direct loans and on SBA's share of immediate participation loans has ranged from 4.875 percent to 7.75 percent The Economic Opportunity Act of 1964 does not provide an upper limit on the interest rates banks may charge on guaranteed loans or on their share of immediate participation loans, however, each quarter SBA establishes an interest rate ceiling that is about 3 percent above the "prime" rate for guaranteed loans and about 2 percent above the "prime" rate for immediate participation loans

The act provides that in making EOLs the SBA Administrator should emphasize preserving or establishing small businesses owned by low-income persons or located in areas with high proportions of unemployed or low-income persons SBA directives provide that an individual, to be eligible to receive an EOL, must be either a low-income person or a person who, due to social or economic disadvantage, has been denied financing through normal-lending channels on reasonable terms. SBA includes minorities under the social and economic disadvantage category

Loans provided to minorities under the EOL program are shown below.

Fiscal year	Number of loans	Amount (millions)
1969	3,118	$ 38.2
1970	4,505	60.6
1971	5,451	75.7
1972	5,791	74.0
1973	5,557	110.0

Other SBA loan programs

Minority businessmen also may obtain loans under SBA's local development company and displaced business loan programs. SBA provides loans to local development companies to further the economic development of a community. Such loans can be used to acquire land, construct, convert, or expand buildings, and purchase machinery and equipment for identifiable small businesses. SBA also makes loans to enable small businesses which have been physically displaced by Federal construction projects to relocate. Loan provided to minorities under these two loan programs are shown below.

Local Development Company Loans

Fiscal year	Number of loans	Amount (millions)
1969	56	$ 6 8
1970	105	12.5
1971	171	14.9
1972	140	16.4
1973	203	20.5

Displaced Business Loans

Fiscal year	Number of loans	Amount (millions)
1969	20	$1.3
1970	23	2.9
1971	31	1.7
1972	36	2.4
1973	29	2.5

Section 8(a) procurement program

Under section 8(a) of the Small Business Act, SBA channels Government purchases to minority businesses by contracting to provide supplies or services to a Federal agency and then subcontracting the performance of the contract to a minority business. In many instances SBA allows minority businesses to receive amounts above the competitive market price. This differential--paid by SBA--covers such things as added startup, labor, or material costs incurred by the minority business. A basic aim of the program is to develop businesses that will become self-sustaining in a normal competitive environment.

Section 8(a) contracts awarded to minorities are shown below.

Fiscal year	Number	Amount
1968	8	$ 10,493,524
1969	28	8,857,771
1970	199	22,520,209
1971	811	65,391,498
1972	1,706	151,598,150

The Federal departments or agencies making most of the procurements under this program during fiscal year 1972 were the Department of Defense and the General Services Administration with procurements totaling $73.7 million and $34.2 million, respectively

Minority enterprise small business investment companies

Under the Small Business Investment Act of 1958, SBA licenses, regulates, and provides supplemental financing to privately owned and publicly owned small business investment companies. Small business investment companies provide small business with long-term investment capital and management assistance.

In 1969 SBA initiated a program to establish MESBICs, which would specialize in providing long-term investment capital and management assistance to minority businessmen.

According to SBA, as of December 31, 1972, 53 MESBICs had been established with total private funds of about $18.4 million and, as of March 31, 1972, MESBICs had provided 331 financings totaling $4.6 million to minority businesses.

Management assistance

SBA considers the provision of management assistance to be an important element in developing successful minority-owned businesses. Management assistance as used in this report is not a specific, structured program but is all the management and technical assistance needed or available to minority-owned businesses regardless of which organizational segment of SBA or other source provides it. In addition to the assistance that may be provided by SBA employees, management assistance is provided to minority businessmen by the Service Corps of Retired Executives (SCORE), the Active Corps of Executives (ACE), and contractors funded by SBA under section 406 of the Economic Opportunity Act. Before fiscal year 1973, grantees, also funded under section 406, provided management assistance to minority businessmen. (The grantees and contractors funded under section 406 are hereinafter referred to as section 406 grantees and contractors.)

SCORE is composed of retired business executives who have volunteered their services to help small businessmen solve their problems. SCORE was established specifically to help the small businessman (minority and nonminority) who normally cannot afford a professional consultant. SCORE volunteers provide their services free of charge. ACE was formed in 1969 for essentially the same purpose as SCORE, the difference being that ACE personnel are active in a business career. As of May 30, 1972, about 4,100 volunteers were SCORE members and 2,500 volunteers were ACE members.

An SBA report shows that during fiscal year 1972 SCORE and ACE volunteers held 6,915 interviews with small businessmen, counseled small businessmen on 19,545 occasions, made 2,613 management ability evaluations, and prepared 493 management assistance plans for small businessmen. SBA reports do not indicate how many of these cases involved minority businessmen.

Section 406 of the Economic Opportunity Act authorizes the SBA Administrator to award grants or contracts to public or private organizations to pay the costs of providing technical and management assistance to businessmen or potential businessmen who are eligible under the act. (See p. 11.) Section 406 contractors provide various types of management assistance, including accounting, merchandising and advertising, and planning and organization The contractors generally provide their services within one SBA region, but they can serve businesses in any section of the Nation if called upon by SBA. A total of 16 and 12 contractors were active in the Nation in fiscal years 1971 and 1972, respectively, the contract amounts totaled $1.8 million in fiscal year 1971 and $1.3 million in fiscal year 1972.

Before fiscal year 1973, section 406 grantees assisted minorities in obtaining financing to start or expand their businesses and provided management and technical assistance to minority businessmen. Unlike section 406 contractors who provide assistance to minority businessmen only after assignment by SBA, section 406 grantees provided assistance without being contacted by SBA. Section 406 grantees did not need to be directed to businessmen who needed assistance because the grantees usually kept in touch with the businessmen whom they had helped obtain financing and thus were often aware of their problems. Twenty-one organizations received grants totaling $2.8 million in fiscal year 1971, 26 organizations received grants totaling $1.4 million in fiscal year 1972. Because OMBE, under its expanded technical and management assistance program, now provides grants to local business development organizations, SBA dropped its section 406 grantee program after fiscal year 1972 and is now using its section 406 funds for its contractor program.

HISTORY OF SBA MINORITY ENTERPRISE EFFORTS

SBA's efforts to promote minority enterprise began in 1964 with a program known as "6x6." According to SBA officials the program operated only in Philadelphia, Washington, D.C., and New York City. The objective was to help very small retail and service enterprises owned by the disadvantaged who had no opportunity to borrow through normal channels. Loans up to $6,000 were made for a 6-year period. Less importance was placed on collateral than in other SBA programs and the borrower was not required (as with regular SBA business loans) to have a letter showing that a bank had denied his request for a loan. The program was funded under SBA's section 7(a) business loan program.

After title IV of the Economic Opportunity Act of 1964 provided new authority to make loans, SBA was able to expand its minority enterprise loan program Loans up to $25,000 could be made for a 15-year period

In 1968 SBA's minority enterprise effort was named "Project OWN." No statutory changes were made, but several changes were made to SBA's lending criteria to facilitate the making of loans to minorities. The changes included (1) relaxing restrictions on using loans to purchase existing businesses, (2) reducing equity investment requirement, (3) relaxing debt to net worth requirement, (4) eliminating collateral requirement under certain circumstances, (5) using flexible repayment provisions, and (6) removing restriction on loans for liquor stores. During the time of Project OWN, SBA placed increased emphasis on guaranteed bank loans for minorities and nonminorities.

Fiscal year 1968 marked the beginning of the section 8(a) procurement program.

In 1969 SBA changed the name of its minority enterprise effort from Project OWN to Operation Business Mainstream Many of the activities remained the same, but some changes were made SBA established the position of Assistant Administrator for Minority Enterprise to coordinate all SBA activities relating to minority enterprise. In additon, SBA emphasized providing management and technical assistance to minority businessmen. The MESBIC program was also initiated in 1969

When its minority enterprise effort was known as Project OWN, SBA's goal was to achieve a loan approval rate of 10,000 a year by June 30, 1969, and 20,000 a year by June 30, 1970. SBA loans to minorities are shown below.

Fiscal year	Number of loans	Amount
		(millions)
1969	4,654	$104.6
1970	6,262	160.4
1971	7,776	213.8
1972	9,016	258.2
1973	9,074	334.0

CHAPTER 2

FEDERAL EFFORTS TO ASSIST MINORITY BUSINESSES

Businesses financed through Operation Business Mainstream have had limited success. Our study of 845 minority businesses in 3 selected SBA districts showed that 52 7 percent of businesses were failures or probable failures. The negative effects of these failures or probable failures offset in some degree the benefits of successes. Greater attention should be given to reducing the high rate of failures and probable failures.

SBA and bank officials' analyses of why businesses had failed or were failing revealed that the most common reason was the owner's lack of managerial capability as evidenced by certain conditions of the business, such as inadequate sales, heavy operating expenses, and difficulties with inventories or receivables.

Because the rate of growth for SBA's minority loans has been slowing, because of the high failure rate of SBA's loans, and because the number of loan applications disapproved should increase if attempts are made to reduce the high failure-probable failure rate, we question whether Federal efforts will result in significant increases in the number of successful minority-owned businesses in the Nation.

DEGREE TO WHICH BUSINESSES FINANCED THROUGH OPERATION BUSINESS MAINSTREAM HAVE BEEN SUCCESSFUL

Of the 845 minority-owned businesses receiving SBA loans disbursed by the Chicago, Los Angeles, and Washington, D.C., district offices during fiscal years 1969 and 1970, we classified

--232, or 27.5 percent, as failures,

--213, or 25 2 percent, having serious problems as probable failures,

--260, or 30 7 percent, as probable successes, and

--140, or 16.6 percent, as undeterminable.

We were unable--for purposes of comparison with the failure rate developed by our analysis--to locate published statistics which show failure rates for minority businesses or for small businesses in general.

SBA's Assistant Administrator for Minority Enterprise said the failure-probable failure rate disclosed by our analysis was higher than he considered desirable. SBA's district office officials at Los Angeles said the high failure-probable failure rate we found was unacceptable

The Congress expressed concern about the increasing failure rates of businesses assisted under the economic opportunity loan (EOL) program. The House Select Committee on Small Business, in its report "Organization and Operation of the Small Business Administration," dated April 19, 1972, recommended that SBA review its criteria for evaluating applicants for EOLs to reduce the loss rate on such loans.

Criteria for classifying businesses

The 443 minority-owned businesses which we analyzed had loans of about $18.4 million Of these businesses, 171 had direct loans, 264 had SBA-guaranteed bank loans, and 8 had both direct and SBA-guaranteed bank loans. We classified each of the 443 businesses as either a probable success, a failure, a probable failure, or undeterminable from the following criteria.

Probable success

1 Current in loan payments and operating at a profit as supported by the most recent financial statements which covered operations for some period after July 1, 1970.

2. Current in loan payments and having a good payment record, no indications of problems, and a positive statement from either SBA or bank officials.

Failure

1 Liquidated or in liquidation and not operating

2. In liquidation and operating at a deficit with no evidence of being able to reverse the trend as

supported by either the most recent bank correspondence or the financial statements which covered operations for some period after July 1, 1970

3. Original borrower sold or otherwise disposed of his business because of inability to operate successfully (even though he may be making loan payments).

Probable failure

1. Delinquent in loan payments (over 60 days past due).

2. Current in loan payments <u>and</u> operating with a deficit with no evidence of being able to reverse the trend as supported by either the most recent bank correspondence or the financial statements which covered operations for some period after July 1, 1970.

3 In liquidation and operating without evidence of a recent payment history.

Undeterminable

1. Current in loan payments, but no financial statements available at SBA (covering operations for some period after July 1, 1970) or no other evidence of successful operation.

2 Loan payments presently deferred.

3 In liquidation and operating with evidence of a recent payment history or at a profit as supported by either the most recent bank correspondence or the financial statements which covered operations for some period after July 1, 1970.

4 Any other situation which does not fit the above criteria, and whose probable status cannot otherwise be determined.

Before we classified the sample of minority businesses, both SBA central office and district office officials agreed that these criteria were a reasonable basis for our classification

Results of classification

The results of our classifications of the 443 businesses in our sample and the projection of these results to the total number of minority businesses at the 3 SBA offices are shown below.

Business status	Number of businesses (note a) Sample	Projection	Percent
Probable success	137	260	30.7
Failure	116	232	27.5
Probable failure	111	213	25.2
Undeterminable	79	140	16.6
Total	443	845	100.0

[a]See app. I for the classifications of businesses by office and for the sampling error in the projections.

Indications of business difficulties were evident for some of the 79 businesses in our sample classified as undeterminable. For example, of the 79 businesses, 10 had deferred loan payments and 8 were current in loan payments but showed losses on their most recent profit and loss statements which covered operations for some period after July 1, 1970. However, there was evidence that the eight businesses might be able to reverse the loss trend and therefore were not classified as probable failures. Of the 79 businesses, 39 were current in loan payments but were classified as undeterminable because no financial statements were available.

The businesses classified as probable successes include businesses having varying degrees of success. For example, of 42 businesses classified as probable successes for which full year profit and loss statements were available, 15 had net profits of less than $5,000, 13 had net profits between $5,000 and $10,000, 8 had net profits between $10,000 and $20,000, and 6 had net profits of over $20,000.

REASONS FOR FAILURE

We reviewed SBA and bank records and correspondence to find evaluative statements or comments by SBA and bank officials as to the reasons for the failure or probable failure of the 227 businesses so classified in our sample We identified reasons for 203 of the 227 businesses and classified them into categories similar to those used in the Dun and Bradstreet annual reports on comprehensive studies of business failures The number of times each reason was identified with a business classified as either a probable failure or failure is shown below. Some of the businesses had more than one reason for failure or probable failure

Reasons	Number of businesses affected
Lack of managerial capability (heavy operating expenses, difficulties with inventories or receivables, and inadequate sales)	155
Neglect (bad habits and health and personal problems)	53
Disaster (acts of God, thefts, and labor problems)	37
Fraud by borrower (irregular disposal of assets and false financial statements)	25
Miscellaneous (reasons not covered by above categories, such as downturn in the general economy)	54
Unknown	24

We also attempted to identify the reasons for business success, but usually SBA's records did not provide such information because SBA personnel normally directed their attention to those businesses in difficulty

RATE OF GROWTH IN THE NUMBER OF MINORITY LOANS SLOWING

The chart below shows that increases from year to year in the number of loans to minorities have become more difficult to achieve after the initial years of SBA's minority enterprise effort The rate of growth in the number of SBA loans has been slowing

Fiscal year	Number of loans	Increase in number of loans over previous year	Percentage increase
1968	2,335		
1969	4,654	2,319	99
1970	6,262	1,608	35
1971	7,776	1,514	24
1972	9,016	1,240	16
1973	9,074	58	1

Also the percent of minority loans in relation to total SBA loans has been declining annually Minorities received 41 percent of all SBA loans in fiscal year 1970, 36.2 percent in fiscal year 1971, and 32 2 percent in fiscal year 1972 These figures are exclusive of disaster loans

On March 31, 1972, the SBA Administrator wrote to his regional directors and expressed his concern at SBA's failure to maintain its level of minority enterprise loan activity. The Administrator pointed out that, although the number of total business loans had increased markedly, the same increase had not been reflected in minority loans. The Administrator called for greater efforts to increase minority loans

CONCLUSION

SBA and OMBE cited increases in the number of loans to minorities as a measure of success of the Federal effort to assist minority businesses Such a measure gives no recognition to the fact that the Federal effort has a potential risk as well as a reward The risk is that minorities, encouraged to go into business, may fail and be left deeply in debt and much worse off than before they received help A high percentage of failures must necessarily have an adverse effect on the creditability of the Federal minority enterprise effort among the minority community, the public, and the Congress

The negative effects of business failures offset in some degree the benefits of business successes Inasmuch as our analysis shows that the failure-probable failure rate of 52 7 percent exceeds the success rate, it would seem a good time to give more attention to reducing the high failure-probable failure rate. We make a recommendation in chapter 3 regarding the reduction of the failure-probable failure rate

We believe that SBA may find it difficult to significantly increase the number of loans to minorities because

1. The rate of growth for SBA's minority loans has been slowing

2. The current high rate of failures and probable failures could discourage many minorities from requesting loans.

3. Attempts to reduce the rate of failures and probable failures by improving the criteria for approving loans (see ch 3) should increase the number of loan applications which are disapproved

For these reasons we question whether Federal efforts will result in significant increases in the number of successful minority-owned businesses in the Nation

AGENCY COMMENTS AND OUR EVALUATION

Both the SBA Administrator and the OMBE Director expressed concern about the failure rate on minority loans and noted that providing needed management assistance was the way to lower the failure rate

The SBA Administrator (see app. II) stated that the EOL program, under which most of SBA's minority loans are made, was established by the Congress as a more liberal loan program than other SBA loan programs and therefore the Congress must have understood that the EOL program would carry higher risks and would result in a higher failure rate than other programs

We do not disagree with the Administrator that the Congress, in granting authority for the EOL program, probably expected the loss rate to be higher than that for other SBA programs. The Congress, however, has expressed concern over the high loss rate of the EOL program. The House Select Committee on Small Business, in its report "Organization and Operation of the Small Business Administration," dated April 19, 1972, stated that

"* * * the laws governing such [economic opportunity] loans require reasonable assurance of repayment. With a 30-percent loan loss projection ratio, * * * a delinquency ratio of 10.4 percent, and a loans in liquidation ratio of 11.9 percent * * * there appears to be some question whether this program is being administered by the Administrator in accordance with the intent of Congress."

The SBA Administrator noted that the discussion of failure rates was not complete without comparisons with failure rates of small businesses in general and failure rates of nonminority businesses assisted by SBA. He also noted that our report did not consider the particular problems of a minority small businessman. We agree that a comparison of the results of our analysis of the failure rate for minority businesses receiving SBA loans with either the failure rate for small businesses in general or the failure rate for nonminority businesses with SBA loans would have been meaningful, if such failure rates had been available.

The Administrator may wish to consider developing information on failure rates for nonminority businesses with SBA loans and information on particular problems of minority businessmen to facilitate any future analyses of SBA's loan programs.

CHAPTER 3

FACTORS INFLUENCING SUCCESS AND FAILURE OF MINORITY BUSINESSES

We analyzed the 443 businesses in our sample to identify relationships that might exist between certain characteristics of the owners, businesses, or type of financing and the success or failure of the businesses

We found that

--Borrowers using loan funds to purchase existing businesses were more successful than borrowers using funds to expand their existing businesses or to start new businesses

--Unfavorable business locations usually resulted in failure

--Businesses with bank loans were more successful than businesses with direct SBA loans.

Relationships between business success or failure and other characteristics, such as the owner's past experience and equity in the business, were less significant. However, a more detailed analysis at SBA's Los Angeles district office showed that the number of years of managerial experience of the owner had a significant relationship to business success

Our analysis also showed that management assistance was provided to only about one-half of the businesses included in our sample that needed such assistance Furthermore, the assistance that was provided to businesses had little effect on improving the status of the businesses

Of the businesses which received additional loans, 18 percent were classified as probable successes, whereas 56 percent were classified as failures or probable failures Thus, providing an additional loan to a business appears to be of limited value in improving the chance of business success

Few of the businesses in our sample received 8(a) procurement assistance

BUSINESSES WITH BANK LOANS MORE SUCCESSFUL THAN THOSE WITH SBA DIRECT LOANS

The percentage of businesses with SBA-guaranteed bank loans which were classified as probable successes was more than twice that of businesses with SBA direct loans. (See chart on following page)

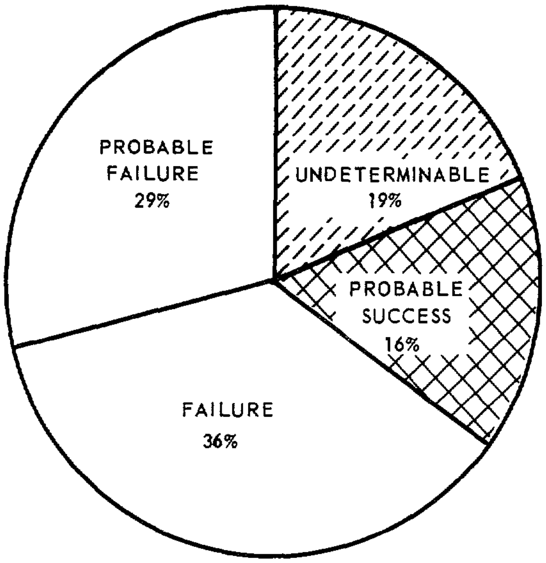
We spoke with bank and SBA officials about why businesses with bank loans have a higher probable success rate than businesses with SBA direct loans. According to a bank official in Los Angeles, bank branch managers have a better knowledge of the community than do SBA loan specialists, which is helpful in deciding on the chance for success of a particular type of business

According to an SBA official in Los Angeles (1) the loan officers have had to make many high-risk loans, because SBA has attempted to meet quotas for loans to minorities, (2) banks have sufficient personnel to check, in most cases, the borrower's background and experience by contacting personal and business references, whereas SBA only does so on a limited basis, and (3) banks have enough staff to check the borrower's credit, whereas SBA relies on credit company reports which in many cases are not adequate.

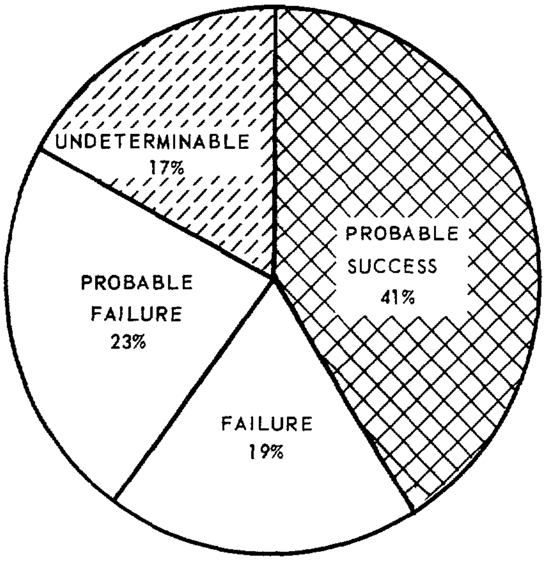
SBA officials in Chicago attributed the higher probable success rate of businesses with bank loans to the closer proximity and greater rapport between the banks and their borrowers They also said that banks could respond much quicker to the additional financial needs of a borrower

That businesses with bank loans have a higher probable success rate than businesses with direct loans is not unexpected The Small Business Act, as amended, prohibits the making of a direct loan if the financial assistance applied for is otherwise available on reasonable terms SBA regulations state that the unavailability of financial assistance must be demonstrated by proof of refusal of the loan application by either the applicant's bank of account or, in cities where the population exceeds 200,000, by not less than two banks Because SBA does not make a direct loan

DIRECT LOANS
(171 businesses)



BANK LOANS
(264 businesses)



Note Eight businesses having both bank and direct loans were not included in this sample unless a bank has refused to make the loan, the risk associated with direct loans is higher than that associated with bank loans

We also compared the size of a loan with business success or failure. As shown in the following table, almost as many businesses with loans of more than $25,000 were classified as probable successes as were classified as failures and probable failures combined For businesses with loans of $25,000 or less, combined failures and probable failures outnumbered probable successes by more than 2 to 1. These results are probably due, in a large part, to the fact that most of the loans of $25,000 or less are SBA direct loans, whereas most of the loans over $25,000 are bank loans.

	Size of loan			
	$25,000 or under		Over $25,000	
	Number of businesses	Percent	Number of businesses	Percent
Probable success	70	25	67	41
Failure	86	31	30	18
Probable failure	67	24	44	27
Undeterminable	55	20	24	14
Total	278	100	165	100

BORROWERS PURCHASING EXISTING BUSINESSES MORE SUCCESSFUL THAN THOSE EXPANDING EXISTING BUSINESSES OR STARTING NEW BUSINESSES

We classified the businesses included in our sample as new, expand existing, or purchase of existing. A business was classified as purchase of existing if the borrower used the loan proceeds to buy a previous owner's business and carried on the business at the same location, as new if the borrower used the loan proceeds to start a new business, and as expand existing if the borrower was already operating a business and the loan proceeds were used to expand the business.

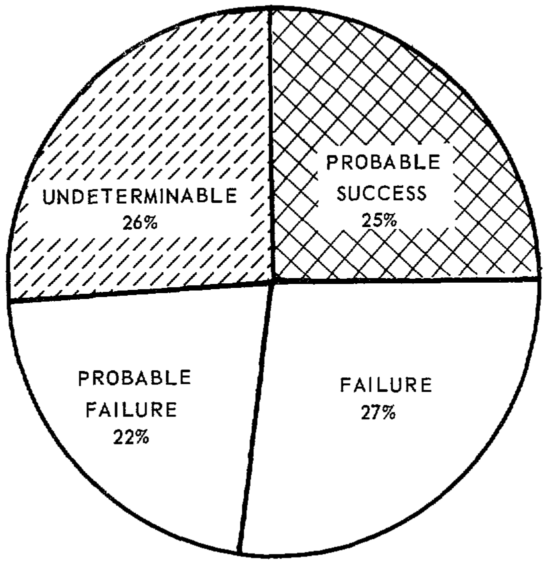
As shown in the chart on the following page, borrowers who used the loan proceeds to purchase existing businesses were more successful than borrowers who used the loan proceeds to start new businesses or expand existing businesses.

SBA officials told us of two possible reasons why businesses classified as purchase of existing had the highest probable success rate First, because a business must have shown profitability before SBA will make a loan for its purchase, a viable market has already been established Second, the potential business purchaser often has had managerial experience in the same business he intends to buy or in a similar business Although SBA would consider these factors--viable market and managerial experience--in making a loan to a borrower expanding his existing business, it apparently does not consider them as critical as in the case of a borrower purchasing an existing business.

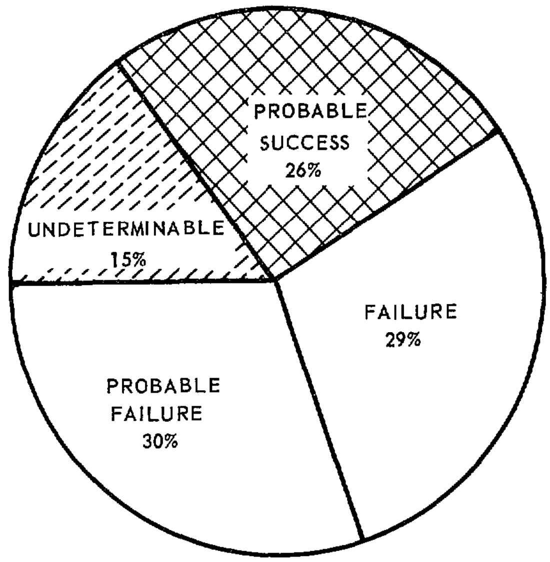
BUSINESSES WITH UNFAVORABLE LOCATIONS USUALLY FAIL

On the basis of SBA's analysis of such factors as market potential, competition in the area, visibility of the business, and extent of crime in the area, we classified the locations for 392 of the 443 businesses in our sample as either favorable, unfavorable, or unimportant Because of a lack of information in the files, we were unable to classify the locations of the other 51 businesses We generally classified a location as unimportant for manufacturing and construction businesses and for such businesses as consulting or trash

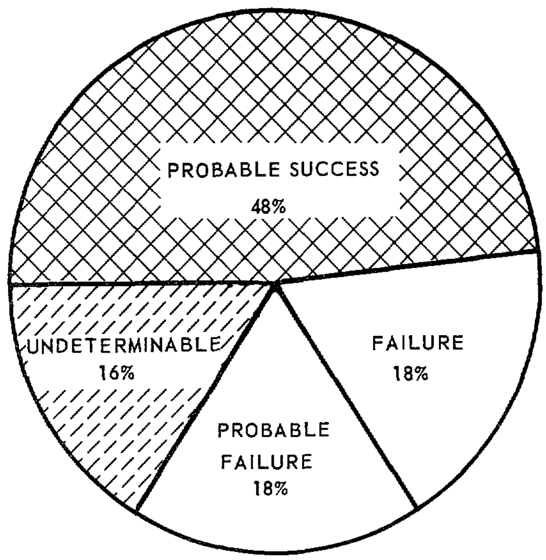
NEW
(113 businesses)



EXPAND EXISTING
(228 businesses)



PURCHASE OF EXISTING
(102 businesses)



removal firms that provide their services where the customers are located

As shown in the following table, 50 percent of the businesses with favorable locations were classified as failures or probable failures, whereas 33 percent were classified as probable successes Because most of the minority-owned businesses are in low-income and high crime areas, these locations may be only relatively favorable Only 14 percent of the unfavorably located businesses were classified as probable successes, whereas 64 percent were classified as failures and probable failures Thus, although a favorable location did not guarantee business success, unfavorably located businesses usually were failures or probable failures.

	Location							
	Favorable		Unfavorable		Unimportant		Inadequate information	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Probable success	83	33	8	14	30	35	16	31
Failure	61	25	20	34	22	26	13	25
Probable failure	61	25	18	30	21	25	11	22
Undeterminable	43	17	13	22	12	14	11	22
Total	248	100	59	100	85	100	51	100

RELATIONSHIPS OF OTHER CHARACTERISTICS LESS SIGNIFICANT

The relationships of other characteristics (prior experience of owner, amount of owner's equity, industry line, and working capital) to success and failure were less significant and contributed little to explaining why a business was a success or a failure.

Prior experience

We classified the prior work experience of the owners of the businesses into one of four categories--managerial experience in a similar business, managerial experience in another type of business, other experience in a similar business, and all other experience

As the following table shows, businesses whose owners had previous managerial experience were classified as probable successes at somewhat higher percentages than businesses whose owners had other than managerial experience

	Type of experience							
	Managerial in a similar business		Managerial in another type of business		Other experience in a similar business		All other experience	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Probable success	83	35	10	33	28	27	16	23
Failure	54	23	9	30	35	34	18	25
Probable failure	67	28	7	23	19	19	18	25
Undeterminable	34	14	4	14	21	20	19	27
Total	238	100	30	100	103	100	71	100

Our analysis of the relationship of managerial experience to business success at the Los Angeles office indicated that the number of years of managerial experience of the owner may be a significant factor in determining whether a business will succeed or fail As shown below, the success rate of businesses whose owners had more than 5 years of managerial experience in similar businesses was more than double the success rate of businesses whose owners had 5 years or less of managerial experience in similar businesses.

	Managerial experience in similar business					
	5 years or less		Over 5 years		Specific time undeterminable	
	Number of businesses	Percent	Number of businesses	Percent	Number of businesses	Percent
Probable success	8	16	18	40	4	27
Failure	25	49	7	16	6	40
Probable failure	12	23	14	31	1	6
Undeterminable	6	12	6	13	4	27
Total	51	100	45	100	15	100

Equity

No significant relationship was evident between the amount of an owner's equity expressed as a percentage of total business assets and the success or failure of a business. However, some relationship was evident as the dollar amount of equity increased Only 26 percent of the businesses with owner equity of $11,000 or less were classified as probable successes, whereas 41 percent of the businesses with owner equity of over $11,000 were classified as probable successes

Industry

Of the 443 businesses in our sample, 207 were retail businesses and 164 were service businesses As shown below, the probable success rate for these two types of businesses was about the same--32 percent for retail and 30 percent for service

Only 12 businesses in our sample were construction companies, and they had a probable success rate of 58 percent Manufacturing firms, with a probable success rate of only 19 percent, were the least successful

	Retail		Service		Manufacturing		Wholesale		Construction	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Probable success	67	32	49	30	8	19	6	32	7	58
Failure	53	26	45	27	11	27	4	21	3	25
Probable failure	50	24	37	23	16	39	6	32	2	17
Undeterminable	37	18	33	20	6	15	3	15	—	—
Total	207	100	164	100	41	100	19	100	12	100

Inadequate working capital

Our analysis did not identify any relationship between inadequate working capital and business success or failure To determine whether borrowers may have had inadequate working capital, we sent questionnaires to 1,252 borrowers who received loans from the Chicago, Los Angeles, and Washington offices from April 1, 1968, through December 31, 1970, asking them if they had received as large a loan as they had requested Of the 703 borrowers who responded, 135, or 19 percent, stated that the amount of the loan they received was less than the amount they requested At Chicago and Washington, 29 of the 59 borrowers who stated they received less than they requested owned businesses included in our sample (no information was developed on this matter at Los Angeles) Of these businesses, 9 (31 percent) were classified as probable successes and 15 (52 percent) were classified as failures or probable failures. These rates are approximately the same as the overall rates for our sample.

Possible reasons for insignificant relationships

Two possible reasons for the insignificant relationships between some of the characteristics analyzed and business success and failure are

1 The information on a characteristic may not be specific enough. As shown by our analysis of managerial experience, more specific information about a particular characteristic may facilitate a more meaningful analysis As a further example, rather than characterizing a business as a retail business, the important characteristic might be that the business was a grocery store.

2. Certain characteristics may have no relationship.

All possible characteristics were not considered. Other characteristics identified in the loan file, such as age and educational experience of the borrower, may be significantly related to success or failure. To have developed information on all possible characteristics and to have developed more specific information on those characteristics we did analyze would have required a prohibitive amount of effort In addition, the loan files were occasionally incomplete or the information was insufficient to make additional analyses.

APPLICATION OF SBA RESOURCES HAD LITTLE EFFECT ON IMPROVING CHANCES OF SUCCESS FOR MINORITY BUSINESSES

A number of resources which can aid borrowers in developing or maintaining successful businesses are available under Operation Business Mainstream These resources include management assistance provided by SCORE, ACE, section 406 contractors, and SBA personnel, the section 8(a) procurement program, and, where required, additional financial assistance. Also, before July 1972, management assistance was available from section 406 grantees. The extent to which such resources were used for the businesses included in our sample and the relationship of such activities to business success are discussed below

Management assistance

Approximately 50 percent of the businesses that needed management assistance did not receive assistance. When management assistance was provided, it had little effect on improving business status or reversing a trend toward failure Management assistance activities are discussed in chapter 4

Procurement assistance

Under the section 8(a) procurement program, SBA enters into procurement contracts with other Federal agencies and then subcontracts the performance of the contracts to minority businesses. Only 15 of the 443 businesses received section 8(a) procurement assistance under 49 subcontracts having a total value of about $7.6 million We classified four as probable successes, two as failures, five as probable failures, and four as undeterminable

Of the 443 businesses, 207 (47 percent) were retail businesses None of these retail businesses received section 8(a) procurement assistance SBA reports show that most section 8(a) subcontracts were awarded to construction, manufacturing, and service businesses. Thus a large number of minority retail businesses apparently are not being helped by the section 8(a) procurement program

Additional financial assistance

Additional loans are available to all borrowers under SBA programs, subject to the following condition set forth in SBA's National Directive 510-1A

> "An additional loan or a refunding loan shall not be made for the primary purpose of protecting an existing SBA loan. Additional loans and refunding loans are subject to the same credit standards as an original loan The loan report on an additional or refunding loan shall include an explanation of why the first loan did not accomplish its intended purpose, whether an additional or refunding loan can accomplish it, and a penetrating examination of the borrower's financial condition and repayment ability "

Of the 443 businesses, 74 had received two or more loans as of October 1971. Of the 74 businesses, 13 were classified as probable successes, 42 as failures or probable failures, and 19 as undeterminable. Because businesses classified as failures or probable failures outnumber those classified as probable successes by 3 to 1, providing an additional loan to a minority business appears to be of limited value in improving the chances of business success

CONCLUSION

Our review has demonstrated that significant relationships exist between certain characteristics of the businessman and his business and business success and failure The development of loan approval criteria based on an assessment of owner and business characteristics relating to business success and failure could possibly reduce the failure rate. The development of such criteria should be based on an evaluation of businesses receiving SBA loans to identify those characteristics most often related to success and failure

RECOMMENDATION TO THE ADMINISTRATOR, SBA

To provide greater assurance that loans are made for minority businesses with reasonable prospects for success and thus reduce the current high rate of failure and probable failure, we recommend that SBA develop loan approval criteria based on an assessment of owner and business characteristics relating to business success and failure Such criteria could be developed using the results of our review and analyses made by SBA or other organizations involved in the minority enterprise effort.

AGENCY COMMENTS

The SBA Administrator agreed that more work ought to be done to improve loan approval criteria. He noted that SBA's Office of Planning, Research, and Analysis had made a relevant study and the results will be issued shortly. (See p. 73.) The Administrator agreed to continue efforts to identify the characteristics of businesses and businessmen that are related to business success or failure.

CHAPTER 4

SBA MANAGEMENT ASSISTANCE HAD LITTLE

IMPACT ON SUCCESS OF MINORITY BUSINESSES

SBA management assistance activities have had little impact on the success of minority businesses. Management assistance in solving business problems was not provided to about 50 percent of the businesses in our sample that had an identified need for such assistance. Even when assistance was provided, it had little effect on improving business status or reversing a trend toward failure.

The ineffectiveness of management assistance provided appears to have been caused by the failure to provide timely assistance and by the possible inferior quality of some of the assistance Also, because such business problems as vandalism, owner fraud, or owner illness may not be susceptible to solution through management assistance, many businesses may fail even if management assistance is provided more often and/or more effectively.

IMPORTANCE OF MANAGEMENT ASSISTANCE

SBA officials and others have emphasized the importance of management assistance in establishing and expanding successful minority businesses as illustrated by the following statements.

SBA

"SBA's management assistance programs are keyed to furthering the establishment, growth, and success of small businesses. The need for this assistance can be pointed up by failures that occur in the small business community every year

"It is estimated that 9 out of every 10 business failures are due to managerial deficiencies. These discontinuances represent a tremendous economic loss for the small business economy Many of these business failures probably could have been avoided if the small business owner had received the necessary management assistance at the appropriate time.

"Therefore, one of the major objectives of the SBA is to remedy this situation * * * we work to strengthen the management capabilities of small businessmen "

<u>President's Advisory Council on Minority Business Enterprise</u>

"The need for extensive management and technical assistance is not unique to minority business * * * However, the health of minority businesses tends to be more precarious due to the extensive managerial and technical deficits characteristic of minority entrepreneurs In general, these deficits stem from a lack of formal business training. Other causative factors include the absence of an enduring entrepreneurial tradition, failure to find meaningful managerial employment, the typical undercapitalization of minority businesses, which leaves less room for error and little or no money for necessary assistance, as well as the unavailability of self-help aids for the minority businessman who seeks to develop his business skills." ("Minority Enterprise and Expanded Ownership Blueprint for the 70's," June 1971, p. 52)

<u>OMBE</u>

"The plight of the minority entrepreneur is especially desperate because he may not even know where to turn for technical assistance or may not feel he can afford it It is important that he be directed to sources of assistance not only while he is setting up his business, but also on a continuing basis so that help will be available to cope with the problems as they arise "

Both the SBA Administrator and the Assistant Administrator for Minority Enterprise have stated that an increase in management assistance is necessary to reduce the high failure rates for minority businesses.

SBA MANAGEMENT ASSISTANCE
AVAILABLE TO MINORITIES

Various types of management assistance are available to minority businessmen through various SBA programs. Businessmen and potential businessmen can learn management techniques by attending SBA-sponsored general management instruction courses and workshops. A potential borrower can receive assistance in putting together his loan application package from minority enterprise representatives or loan officers.

During loan processing the potential borrower's management ability may be evaluated by a SCORE volunteer or an SBA management assistance officer. An evaluation of management ability is required for each applicant for a direct EOL and may be made for any minority loan applicant. The purpose of the evaluation is to identify existing or potential deficiencies in such functions as recordkeeping or advertising, which indicate a need for management assistance. The loan officer processing the business loan application may also identify deficiencies which indicate a need for management assistance

After a loan is made, SBA employees are required to service the loan so that they may be informed regarding the borrower's operations and financial status. Business problems may be identified during visits to the borrower or through a review of financial statements submitted by the borrower.

SBA also calls on SCORE volunteers and section 406 contractors to identify business problems. A section 406 contractor often spends a few days making a management evaluation in which he studies the history, problems, and prospects of a business and then recommends the amount of assistance needed to resolve the problem identified (for example 3 days of management assistance in merchandising and advertising). SCORE volunteers follow a similar procedure but generally spend less time on an evaluation than the section 406 contractors

The primary SBA sources of management assistance to solve identified problems of minority borrowers are section 406 contractors. Borrowers may also obtain assistance from SCORE and ACE volunteers, community organizations, banks, and other private sector sources Before July 1972, assistance was also available from section 406 grantees

MANAGEMENT ASSISTANCE PROVIDED TO ONLY 50 PERCENT OF MINORITY BORROWERS WITH IDENTIFIED NEEDS

Of the 443 businesses in our sample, SBA personnel, section 406 contractors and grantees, and SCORE volunteers had identified 224 that needed management assistance. SBA records showed that management assistance had been provided to only 111 of these 224 businesses.

We identified the following reasons for the limited amount of management assistance provided to solve the identified problems of minority borrowers (1) the amount of section 406 management assistance available to borrowers is minimal, (2) SBA frequently calls on 406 contractors to identify problems, thus leaving the contractors with less time to assist in solving the problems identified, (3) SBA infrequently calls on volunteer personnel to assist in solving identified problems, and (4) borrowers are often reluctant to accept management assistance.

Minimal section 406 management assistance available to borrowers

The section 406 management assistance available to minority borrowers has been minimal. The number of section 406 contractors and grantees available to provide assistance during fiscal years 1969 through 1972 in each of the three SBA offices included in our review and the dollar amounts of the contracts and grants are shown below.

	Fiscal year							
	1969		1970		1971		1972	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount
		(000 omitted)		(000 omitted)		(000 omitted)		(000 omitted)
406 contractors								
Washington	-	-		$ -	3	$ 375	2	$212
Chicago		-	-		2	250	1	185
Los Angeles		-	-	-	3	325	2	283
National (note a)			1	250	-	-	-	—
Total			1	$ 250	8	$ 950	5	$680
406 grantees								
Washington	3	$143	2	$ 82	2	$ 181	4	$119
Chicago	1	79	-	-	-	-		-
Los Angeles	1	95	2	84	1	129	2	66
National (note a)	1	19	3	897	1	900	2	189
Total	6	$336	7	$1,063	4	$1,210	8	$374

[a]These grantees and contractors provided services to one or more of the three offices and to other SBA offices across the country

The section 406 contractors shown above not only provided assistance to minority businessmen in the areas served by the three offices we reviewed but also assisted minority businessmen in the remainder of each of the three SBA regions in which the offices are located. For example, Washington is in SBA region 3 which also includes Delaware, Maryland, Virginia, West Virginia, and Pennsylvania. (Chicago is in SBA region 5, and Los Angeles is in SBA region 9.)

On the basis of an average cost of $186 per man-day (calculated from the costs of section 406 contract services in the three cities), the $212,000 available in SBA region 3 for fiscal year 1972 should have provided about 1,120 man-days of contractor services, the $185,000 available in region 5 should have provided about 1,080 man-days, and the $283,000 available in region 9 should have provided about 1,320 man-days. As of April 30, 1972, about 1,478 minority loans were outstanding in region 3, 2,469 in region 5, and 2,525 in region 9. If one-half of the borrowers of these loans had identified needs for assistance (as was the case in our sample), section 406 contractors could have provided only an average of slightly more than one man-day of assistance for each borrower with identified needs.

Section 406 grantees spent much of their time doing such things as identifying opportunities for minority businessmen and aiding them in preparing loan applications rather than providing management assistance to meet identified needs.

Our review of the activities of these section 406 grantees operating in Los Angeles showed that two were emphasizing assistance in helping minorities obtain loans, rather than assistance, after the loans had been received. Our review of the activities of two section 406 grantees in Chicago showed that one had limited its activities to helping minorities obtain loans.

In addition to providing various types of assistance to minority businessmen with SBA loans, section 406 grantees and contractors provided assistance to minority businessmen who did not have SBA loans. This placed further demands on the minimal resources available.

Section 406 contractors often called on to identify problems rather than solve them

SBA's Washington office frequently called on these contractors to identify problems of minority businesses, leaving the contractors with less time to assist in solving the problems identified. During fiscal years 1970 and 1971, these contractors provided services to 32 borrowers on 48 occasions. Of the services provided on these occasions, 28 were management evaluations to identify problems and only 20 were directed toward furnishing needed assistance. In Los Angeles and Chicago, however, these contractors were called on primarily to furnish assistance in solving identified business problems. Problems were identified mainly by SBA and volunteer personnel.

Volunteer personnel infrequently called on to assist in solving identified problems

At each of the three offices included in our review, SBA had infrequently called on SCORE volunteers for assistance, and the services that such personnel provided generally did not involve solving identified problems of SBA minority borrowers. Also we found evidence of only two borrowers in our sample who had received management assistance from ACE volunteers. SBA officials informed us that ACE volunteers had served as lecturers and instructors at SBA-sponsored seminars and training courses and that they were reluctant to call on these volunteers to help resolve identified business problems because of possible conflicts of interest. For example, if a borrower needed accounting assistance, an ACE volunteer accountant might recommend continued assistance from himself on a fee-for-service basis.

As of December 1971, 72 SCORE volunteers served the Chicago district and 118 SCORE volunteers served the Los Angeles district. As of March 1972, 40 SCORE volunteers served the Washington district.

SBA officials at each of the three district offices brought to our attention the infrequency with which SBA calls upon SCORE volunteers. A Washington district office official informed us in November 1971 that only 6 to 8 of the 40 volunteers were actually providing assistance. A Chicago office official and a SCORE volunteer pointed out that the SCORE caseload was not very substantial and that volunteers frequently complained about the lack of work. A Los Angeles office official told us we would find few instances of SCORE assistance for minority businessmen.

We found evidence of only 40 postloan contacts by SCORE volunteers with the minority borrowers in our sample. Of these contacts, 22 were management evaluations and 18 involved assistance to the borrower in solving problems. According to SBA district office officials, SCORE volunteers usually do not assist borrowers in solving business problems and most contacts with borrowers are generally limited to 1 hour of counseling. According to a Washington district office official, although SCORE volunteers identify problems and counsel and advise borrowers, such assistance usually is not sufficient, by itself, to bring about business success.

He stated that such success would usually depend on additiona assistance from section 406 contractors or from consultants paid by the borrower. A Los Angeles district office official told us SCORE volunteers did not usually get into the details involved in solving problems.

Officials at each of the three SBA offices and represent tives of several section 406 grantees discussed the characteristics of volunteers which limited their usefulness in providing assistance to minority borrowers. They stated that most of the SCORE volunteers were retired nonminorities, many of whom held positions in large companies, rather than small businesses.

The SBA officials said that SCORE volunteers had been reluctant to go to the ghetto to visit a borrower at his place of business. Instead, much of the counseling was done at the SBA district office. They also stated that SCORE volunteers had not been able to communicate effectively with minorities and thus minority businessmen had not been receptive to SCORE assistance.

These problems relative to volunteer assistance were discussed in the report to the President by the Advisory Council on Minority Business Enterprise, dated June 1971. Referring to the need for management assistance, the report stated

> "While it is generally accepted that assistance to minority businesses is essential, it is often maintained that efforts in the past, as a whole, have not been successful. Either aid has not been available in the quantity or variety to help business in a fully systematic way, or a specialist in one area finds himself deployed in an entirely different field. As a rule, general business knowledge is most common among volunteer consultants and it may not be adequate to handle specialized problems that may arise.
>
> "Another weakness in current assistance efforts may be due to a lack of effective communication between businessmen who look for help and the individuals who volunteer to give aid A close continuing relationship between client and

counselor is crucial to the success of their efforts, but such a relationship has been difficult to maintain in traditional volunteer programs. The frequent crises of day-to-day operations afflicting the minority businessmen make quick access to assistance critical, and yet the volunteer nature of most assistance programs has made quick access difficult and sometimes impossible."

According to the Assistant Administrator for Minority Enterprise, a volunteer program is useful but generally is not adequate to meet the management assistance needs of minority borrowers.

Borrowers are reluctant to accept management assistance

Officials at each of the three SBA offices included in our review informed us that the reluctance of minority borrowers to accept assistance was one of the major problems in developing adequate management assistance programs. One factor causing this problem may be the aforementioned difficulty in establishing rapport between SCORE volunteers and minority borrowers.

SBA officials in Los Angeles told us that few borrowers were interested in management assistance. They said that a recent district office survey of borrowers revealed that less than 3 percent would accept management assistance, if offered. A SCORE volunteer in Chicago said the reluctance of borrowers to request assistance had been a major problem.

To take advantage of SBA management assistance programs, a borrower must sign release forms which give the volunteer or contractor access to the borrower's loan file and which remove volunteer or contractor liability for bad advice. Peat, Marwick, Mitchell & Co., in a report dated April 26, 1971, on the results of its management study of SBA, noted that many SBA clients refused to sign the form necessary to secure SCORE volunteer assistance.

According to a Washington district office official

--most borrowers have to be pressured into accepting management assistance,

--most requests for assistance come from nonborrowers,

--potential borrowers sometimes agree to accept management assistance, because they think the appearance of being willing to accept assistance will help them get a loan,

--borrowers often fail to appear for assistance appointments after the loan is made, and

--borrowers who are delinquent in loan payments and who need management assistance often fail to appear for appointments to avoid contact with SBA.

MANAGEMENT ASSISTANCE INEFFECTIVE

Management assistance provided to minority businesses to help solve their identified business problems had little effect on improving business status or reversing a trend toward business failure. We determined the status of the 111 businesses included in our sample which received management assistance and found that only 24 were classified as probable successes, whereas 69 were classified as failures and probable failures. The results of our classification follow.

Status	Businesses which received management assistance: Number of businesses	Percent
Probable success	24	22
Failure	28	25
Probable failure	41	37
Undeterminable	18	16
Total	111	100

Information on the nature and/or extent of the assistance provided by SCORE volunteers, section 406 grantees, and other nonsection 406 contractor sources was limited in many cases. We analyzed the effectiveness of the management assistance provided by section 406 contractors to 44 businesses in our sample because reports submitted to SBA by these contractors included more detailed information on the nature and extent of the assistance provided

As shown below, of the 44 businesses, only 6 (14 percent) were classified as probable successes, a lower probable success rate than the 22 percent applicable to all businesses which received management assistance.

Status	Businesses which received section 406 contractor assistance	
	Number of businesses	Percent
Probable success	6	14
Failure	9	20
Probable failure	19	43
Undeterminable	10	23
Total	44	100

We also compared the loan repayment status of businesses before and after contractor assistance was provided to determine whether the status had improved after receiving assistance. The loan status at the time the assistance was provided was considered to be the "before" status, the status at the time of our review was considered to be the "after" status. The time lapse between the time assistance was provided and the start of our review for the 44 businesses that received assistance is shown below.

Time lapse (nearest month)	Number of businesses
0 to 2 months	2
3 to 6 months	21
7 to 12 months	16
over 13 months	5

The results of our analysis of changes in loan repayment status after section 406 contractor assistance are shown below

Change in loan status	Number of businesses	Percent
Improvement		
Deferred to current	3	
Delinquent to current	1	
Total	4	9
No Change		
Current	15	
Deferred	1	
Delinquent	8	
Total	24	55
Deterioration		
Current to delinquent	4	
Current to liquidation	3	
Deferred to delinquent	2	
Deferred to liquidation	1	
Delinquent to liquidation	6	
Total	16	36
Total	44	100

Of the four businesses which improved in loan repayment status, none were classified as probable successes, two were classified as undeterminable, and two as probable failures. Of the 24 businesses which showed no change in loan repayment status, 15 were businesses with a "current" status at the time of assistance. Of these 15 businesses, 6 were classified as probable successes, 6 as undeterminable, and 3 as probable failures.

The ineffectiveness of management assistance provided appears due to the fact that timely assistance is not provided because of inadequate loan-servicing activities Also certain business problems may not always be susceptible to solution through management assistance

Timely assistance not provided

Assistance is often provided to a business too late to have an effect on improving the status of the business or reversing a trend toward business failure. In many instances the management assistance provided was not timely because inadequate loan servicing prevented the problems from being identified at an early date

Officials of both of the section 406 contractors with whom we talked in Los Angeles said many of the businesses they assisted were too deep in financial trouble to benefit from assistance This problem was noted by Arthur Young & Company in its study report entitled "An Independent Evaluation of Programs Funded with Fiscal Year 1969 Funds under Section 406 of the Economic Opportunity Act" dated November 12, 1970 The report stated

> "* * * that much of the contract work orders were placed in an effort to 'bail out' a client, frequently an individual or organization already in default on SBA loans This is normally a lost cause and a contractor who attempts to provide technical or management assistance under such circumstances cannot hope to be very successful "

In addition, SBA officials at both Washington and Chicago have stated that SCORE volunteers provide assistance to businesses which are in such poor condition that they cannot benefit from the assistance

SBA cannot provide management assistance until the problems of a business are identified SBA loan-servicing personnel have primary responsibility for early identification of potential and actual business problems of minority businessmen. Banks also assume partial responsibility for servicing many of the loans they make.

One of the primary ways to identify a borrower's problems is to visit his business Our analysis of loan-servicing activities applicable to the 443 businesses through October 1971 showed that SBA personnel made infrequent loan-servicing visits and that initial visits were often not made within the required period SBA procedures, in effect between the dates the loans were made and the date our review was made, required that initial loan-servicing visits be made to borrowers with direct section 7(a) business loans at the earliest feasible date within 6 months of loan disbursement and to borrowers with direct EOLs within 60 days of disbursement Businesses with SBA-guaranteed loans--section 7(a) loans or EOLs--serviced by banks are to be visited by SBA at least once during the first year We made our analysis in October 1971--15 months after the latest date (June 30, 1970) that a loan in our sample was disbursed.

Of 152 businesses with direct EOLs, 108 were not visited within 60 days after loan disbursement Of the 108 businesses, 15 were never visited and 14 were not visited until more than 1 year after loan disbursement. Of 69 businesses with SBA-guaranteed EOLs, 20 were never visited. Of the remaining 49 businesses, 11 were not visited until more than 1 year after loan disbursement.

Of 19 businesses with direct section 7(a) loans, only 7 were visited by SBA within 6 months of loan disbursement, 5 were not visited until more than 1 year after loan disbursement, and 6 were never visited Of 195 businesses with SBA-guaranteed section 7(a) bank loans, 34 were not visited until more than 1 year after loan disbursement and 76 were never visited. We did not analyze the loan-servicing activities for the eight businesses with both direct and guaranteed loans.

An additional delay in providing assistance was noted at the Washington district office where the time lapse between the date a borrower's need for management assistance was identified and the date that section 406 contractor assistance was provided was 4 or more months in 11 of 17 instances We could not determine when assistance was provided in three other instances. During the many months between the date that a borrower's need for assistance is identified and the date that assistance is provided, the position of his business could deteriorate

Our review of bank records and discussions with bank officials showed that many banks did not make servicing visits to minority businessmen with SBA-guaranteed loans.

We obtained information from 27 banks in Chicago on their loan-servicing activities. Officials at three of the banks told us that no servicing visits had been made to borrowers' places of business and that servicing had been done either by telephone or during a borrower's visit to the bank At 15 banks we were told that the frequency of visits to borrowers depended upon their needs for assistance, nine other banks required a certain minimum number of visits to each borrower

The records at 11 banks for 102 businesses showed that bank personnel had not made servicing visits to 58 of the businesses. Bank officials informed us that 46 of the 58 businesses had been visited one or more times but that information on the visits had not been recorded

The records of Washington banks for 52 businesses showed that 42 had not been visited by bank personnel Bank officials informed us that most of the contact they had with the borrowers occurred at the bank rather than at the borrowers' places of business They stated also that the costs of administering minority loans exceeded the related interest income and that public relations was the major consideration in making loans to minorities

The records of Los Angeles banks we visited showed that few or no visits had been made Officials at some of these banks said they did not make servicing visits, and officials at other banks told us they did not keep records of visits that had been made

In regard to bank servicing, Peat, Marwick, Mitchell & Co stated

> "The quality of loan servicing by banks under the guarantee program has been extremely variable * * * Many banks ignore this function even though it is a required part of the guarantee contract Moreover, during periods of 'tight money' there is even less inducement to carry out the servicing function since it is not associated with further bank business development activity "

In April 1969 we reported certain weaknesses in loan servicing and management assistance to the Congress [1] In that report, we concluded that SBA should pursue a more active loan-servicing program to identify borrowers requiring management assistance In notifying us of corrective action taken to resolve the problem noted in that report, the SBA Administrator stated on November 5, 1968, that loan-servicing visits within 60 days of loan disbursements had been established as a requirement for direct EOLs. Our current review showed that the loan-servicing problem had not been resolved

SBA officials at each of the three district offices informed us that the offices did not have sufficient personnel to meet the requirements for loan-servicing visits. The SBA Administrator, in testimony before the Subcommittee on Small Business of the House Committee on Banking and Currency on April 19, 1971, acknowledged that some minority business failures could be related to the fact that SBA did not have the personnel or money to give the full supportive services needed during the first 90 days after a loan was made He stated that

> "When you stop and consider the increase that we have had in our loan portfolio, the total number has gone up at an astonishing rate. An increase in our personnel to provide supportive services * * * has not occurred and the result is a lack of supportive services to borrowers. During the critical period, which is the first 90 days after a loan is made, * * * we have not been able to provide service to the degree we would like "

The President's Advisory Council on Minority Business Enterprise also noted the problem of providing adequate loan servicing in its report of June 1971 In commenting on assistance needs of minority businesses in general, the Council pointed out that an effective system for monitoring potential problems of minority businesses and for encouraging the formulation of preventive safeguards had not been developed.

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[1] "Survey of Economic Opportunity Loan Program Shows Need for Improved Administration and Increased Effectiveness" (B-130515, Apr 23, 1969)

From June through December 1971, SBA increased from 461 to 565 the total number of professional loan-servicing personnel in its field offices In testimony before the House Select Committee on Small Business on September 21, 1971, the SBA Administrator said the increase in personnel would provide early recognition of business problems and would enable remedial measures to be taken before a borrower is in serious trouble

Before the Subcommittee on Minority Small Business Enterprise of the House Select Committee on Small Business on April 26, 1972, the SBA Administrator testified that the emphasis on loan administration activities had some effect in decreasing the "trouble rate" of EOLs but that SBA was still weak in this area because of a shortage of personnel.

In May 1972 SBA revised its directives to require that initial loan-servicing visits to direct EOL borrowers be made not more than 6 months from the initial disbursement unless for some reason the visit is waived The revised procedures state that, if payments are current and financial statements indicate a satisfactory condition, subsequent visits need not be made except as some specific circumstances might warrant

An SBA official informed us that the requirement that initial loan-servicing visits to borrowers with direct EOLs be made within 60 days of loan disbursement had been changed because the district office staffs were having great difficulty in complying with this requirement He stated that the increase in the number of loans had offset the increase in the number of loan-servicing personnel

In a May 1973 SBA circular sent to the field offices, it was noted that loan-servicing officers had misinterpreted the new requirement. The circular stated

> "It appears that field visits in direct loan situations have become rare exceptions and in the Guaranty Program, are nonexistent. It is very clear that many more are required than are being made at present "

Business problems may not be susceptible to management assistance

Management assistance may not be effective when such business problems as vandalism, owner fraud, or illness of the owner are causes of business failure. Businesses having such problems may have failed even if the owner was a capable manager or if frequent effective management assistance had been provided.

As discussed earlier in this report (see p 22), we recorded the reasons identified by SBA or banks for the failure or probable failure of businesses in our sample and classified them into five categories· neglect, fraud, lack of managerial capability, disaster, and other. We also analyzed the reasons for business failure and probable failure to distinguish between situations involving a lack of managerial capability and situations where other reasons were involved in addition to the lack of managerial capability or where managerial capability was not a factor. The results of our analysis are summarized below.

Reasons relating to failure or probable failure	Businesses	
	Number	Percent
Lack of managerial capability only	67	29.5
Lack of managerial capability and other factors	88	38.8
Other factors only	48	21.1
Unknown factors	24	10.6
Total	227	100 0

Of the 203 businesses in our sample for which reasons could be identified, 136 either had one or more problems in addition to a lack of managerial capability or the problems identified did not include a lack of managerial capability Therefore, even if management assistance could solve those business problems related to managerial capability, these 136 businesses would have had other problems which management assistance could not solve

CONCLUSIONS

SBA's management assistance activities have had little effect in preventing a high failure rate for minority businesses Management assistance has been ineffective partly because many businesses have not received needed assistance The following factors have contributed to this problem the minimal section 406 management assistance available to borrowers, the use of section 406 contractors to identify problems rather than to assist in solving them, the infrequent use of volunteer personnel to assist in solving identified problems, and the reluctance of many minority borrowers to accept assistance.

The expanded program of management assistance OMBE initiated in the latter part of fiscal year 1972 (see ch 5) may supplement the management assistance resources available to SBA and its minority borrowers.

Management assistance, even when provided, was ineffective Our review disclosed a 69-percent failure/probable failure rate after businesses had received management assistance The ineffectiveness of the assistance that was provided appears to have been due to the failure to provide timely assistance This failure stems mainly from SBA's and the banks' inadequate loan servicing SBA's extension of the period during which initial visits to direct EOL borrowers must be made from 60 days to 6 months is unlikely to contribute to more effective loan servicing for minority borrowers

Because some business problems may not be solved by management assistance, some businesses may fail even if SBA strengthens its management assistance activities so that assistance is provided more often and/or more effectively However, if SBA improves its loan selection process by developing loan approval criteria based on an assessment of the characteristics of businessmen and their businesses that are related to business success and failure (see recommendation in ch 3), the frequency that these problems occur may be reduced For example, if more of the businesses with loans have favorable locations, then vandalism and theft may contribute to fewer business failures

RECOMMENDATIONS TO THE ADMINISTRATOR, SBA

To improve the effectiveness of management assistance provided to minority businessmen, we recommend that SBA

--Place greater emphasis on identifying managerial deficiencies before loan approval and on making the acceptance of needed management assistance a condition of the loan.

--Require that managerial deficiencies be resolved before loan disbursement when short-term training can resolve the problem.

--Use loan servicing, whenever possible, to identify problems so that section 406 contractors may devote their time to solving problems.

--Require loan-servicing visits to all minority borrowers within the critical first 90 days after loan disbursement.

--Establish procedures to insure that the required initial loan-servicing visits are made and that subsequent visits are made as needed.

--Monitor and evaluate the adequacy of each participating bank's servicing of SBA-guaranteed loans to minorities and, when a bank's servicing is inadequate, assume the responsibility for servicing.

--Identify methods to engage volunteers more frequently in solving, rather than identifying, problems

--Monitor and evaluate the effectiveness of the assistance provided by each section 406 contractor to remove ineffective contractors from the program

AGENCY COMMENTS

The SBA Administrator did not specifically agree or disagree with our recommendations regarding management assistance However, he noted that, within the constraints of its resources, SBA would make every effort to improve the efficiency and effectiveness of its management assistance services

The Administrator made the following comments on our recommendations

--SBA is using all of its section 406 funds for contracts to provide specific assistance on the spot, as needed, after the problems have been identified by SBA employees or volunteers

--SBA is in the process of restructuring its evaluation of and its involvement in the loan-servicing techniques of participating banks

Finally, the Administrator noted that innovative thought was needed for management assistance and that SBA was considering improvements within its fiscal constraints He said that a pilot program had been initiated in which university students would counsel small businessmen and would receive academic credit for their work.

CHAPTER 5

OMBE's EXPANDED PROGRAM OF TECHNICAL AND MANAGEMENT ASSISTANCE

During fiscal year 1972 OMBE initiated an expanded program of technical and management assistance for minority enterprise. The program is essentially an enlarged version of the OMBE affiliate concept and involved a supplemental appropriation of $40 million in fiscal year 1972 and a total appropriation of $63.9 million in fiscal year 1973. OMBE initiated the program without adequately evaluating the effectiveness of past activities of OMBE affiliates in helping minority businessmen to become successful. Such an evaluation was particularly important because management assistance is the primary activity under OMBE's expanded program, and our review of SBA management assistance disclosed that such assistance had generally been ineffective.

Beginning in June 1972, however, OMBE implemented a planning, evaluation, and information system (Performance Management System) to provide data necessary to evaluate the performance of organizations funded under its expanded program. On the basis of our review of the types of information to be generated by the new system, we believe that the information, if properly used, should improve OMBE's ability to evaluate the activities of these organizations.

During the first 2-1/2 years of its existence, OMBE's role was primarily that of coordinating the minority enterprise activities of the various Federal agencies and stimulating activity in the private sector. In this capacity OMBE worked with various business associations and organizations and with various Federal agencies to coordinate the financial, management, and procurement assistance programs and resources available to minority businessmen. OMBE entered into working arrangements with 34 local business development organizations (called OMBE affiliates) through which assistance was provided to minority businessmen. These organizations were funded and directed by other Federal agencies, such as the Economic Development Administration and SBA. Because OMBE's role was chiefly one of persuasion and coordination, its staff was small and annual expenditures were only about $2 million.

OMBE received a $40 million supplemental appropriation for fiscal year 1972. The largest part of the $40 million was used to fund local organizations which provide business loan packaging and management and technical assistance to minority businessmen.

The two most important types of local organizations OMBE funded and directed are local business development organizations (now referred to as LBDOs rather than OMBE affiliates) and business resource centers (BRCs) During fiscal year 1972, OMBE used $23 8 million to fund 83 LBDOs and $1 million to fund 7 BRCs

LBDOs, staffed to a large extent by minorities, serve as a primary source of assistance to minority businessmen LBDOs identify potential minority businessmen, aid them in formulating business ideas, help them to develop their business plans and prepare their loan applications, and counsel them on a continuing basis. Thus, the primary functions of the LBDOs, like those of the affiliates, are designed to assist the minority businessmen in starting businesses

According to an OMBE official, the average LBDO has five or six professional employees and funding of $170,000 compared with the average affiliate which had three professional employees and funding of $130,000.

A BRC is a vehicle for private sector participation in the minority enterprise program and serves as a ready source of assistance when a client's needs are beyond an LBDO's capability A BRC (1) helps minority businessmen obtain financing, (2) provides full-time management consultants and technical experts, and (3) develops a skills bank of experienced volunteers.

In its presentations to congressional committees, OMBE stated that establishing BRCs, increasing the number of LBDOs, and increasing the professional staffing at most LBDOs should significantly increase the available resources for providing management assistance.

During hearings OMBE also informed the Congress that the LBDO concept was developed on the basis of experience acquired through the activities of OMBE affiliates OMBE stated that the affiliates had been successful and had proven to be effective sources of assistance for minority businessmen

OMBE said that the small size of an affiliate's professional staff had prevented adequate specialization and had resulted in less-than-satisfactory service to those clients who needed more than general technical assistance. In its fiscal year 1971 annual report, OMBE stated that the design for the LBDO concept was based on 2 years of "relentless testing and experimentation."

We asked OMBE to provide us with the evaluations, studies, and analyses which were used in arriving at its conclusions on the effectiveness of OMBE affiliates. OMBE presented us with material showing that it had obtained data on the nature and amount of activity engaged in by the affiliates. The data included the number of people counseled, number of loan applications prepared, number of loans made, number of cases for which management and technical assistance was provided, and the annual workload per affiliate staff member.

An OMBE official also told us that OMBE personnel had visited an affiliate in the Washington, D.C., area to discuss its operations and had telephone discussions with several affiliates concerning the degree of success being attained by assisted businesses. No documentation was available on these contacts. OMBE was unable to provide us with more information concerning its evaluation of the effectiveness of OMBE affiliates. OMBE officials said that through fiscal year 1972 OMBE did not have procedures for evaluating the success of its activities in terms of the number of businessmen helped to become successful.

OMBE affiliates varied in methods of operation, the number of professional personnel, the types of personnel, the proportion of staff time spent on preloan and postloan activity, and the types of management assistance given. Such wide variations presented an excellent opportunity for OMBE, on its own or through SBA and the Economic Development Administration, to have identified those staff levels, allocations of resources, and methods of operations, which produced the best results in terms of the number of businesses helped to become successful

After completion of our review, OMBE established a planning, evaluation, and information system to accumulate certain information on the workload of each LBDO, including the number of (1) loans packaged and approved, (2) new business starts, and (3) businesses assisted. According to OMBE officials, an LBDO's performance will be evaluated by comparing actual performance data with estimates submitted by the LBDO at the time it requests funding

In addition, the new system will maintain certain information--size, industry, and number of employees--on the businesses assisted and will provide for the monitoring of certain changes--failure or growth--in the businesses. A profile with such information as age, education level, equity, and years of experience will be compiled for each businessman.

CONCLUSIONS

The additional resources now available to OMBE should increase the management assistance being provided to minority businessmen. We have some question, however, as to whether these additional resources will aid significantly in resolving their problems.

OMBE affiliates generally emphasized activities designed to place a minority in business, such as helping the businessman to formulate his business plans and prepare his loan application. Should this emphasis continue, and OMBE has stated that it will, many of the additional personnel in the LBDOs will be engaged in preloan activity. This practice coupled with the resultant increase in the number of minorities going into business because of the increased preloan activity may result in the diffusion of management assistance resources. If so, management assistance may remain inadequate because the management assistance will not be directed toward solving business problems which arise after the businessman has received his loan and has begun operating.

In addition, we believe that OMBE's failure to adequately evaluate the activities of OMBE affiliates before initiating its expanded program of technical and management assistance further compounds the uncertainty as to whether the additional resources resulting from this expanded program will aid significantly in resolving the business problems of minority businessmen. The affiliates operated with a variety of methods and procedures, and OMBE had an opportunity to identify those most conducive to establishing successful minority businesses. OMBE could have used such knowledge to provide guidance to LBDOs when they began operations under the expanded program.

On the basis of our review of the types of information to be generated by OMBE's new Performance Management System, we believe that the new system, if the information is properly used, could be valuable in measuring the performance of LBDOs and thereby identify those methods of operation which will provide minority businessmen with assistance needed to improve their chances of success Information reported to OMBE by these organizations to date concerns minority businesses assisted during fiscal year 1973 Insufficient time has elapsed for OMBE to evaluate the effects of such assistance in terms of the success or failure of the businesses.

RECOMMENDATIONS TO THE SECRETARY OF COMMERCE

To adequately measure the success of LBDOs and to identify those methods of operation most closely related to the establishment of successful businesses, we recommend that OMBE use its new information system to evaluate the effectiveness of LBDOs in terms of numbers of successful businesses established. In addition, we recommend that OMBE coordinate its management assistance activities with those of SBA to provide maximum benefit to minority businessmen and consider our comments and recommendations in chapter 4 in the administration of its expanded assistance program

AGENCY COMMENTS AND OUR EVALUATION

The OMBE Director stated that OMBE's new Performance Management System was designed to correct the conditions noted in this chapter and that most, if not all, of the problems cited had been addressed by this system

We reviewed the types of information to be generated by OMBE's new system and believe the system should provide OMBE with information which could be used to make changes in LBDO operations and activities.

The Director stated that OMBE did study the question of optimum LBDO size and method of operation and had developed guidelines and standard activities for LBDOs. He said, however, that the thrust of OMBE's technical and management assistance program was local and that OMBE had encouraged each LBDO to formulate its own activities according to local needs

We asked an OMBE official to supply us with the studies made of optimum LBDO size and methods of operation, and he told us that no studies had been made. He said that, in drafting the guidelines, OMBE had relied on the knowledge of its own officials who had had experience with OMBE affiliate operations and on the knowledge of SBA officials who had had similar experience.

We do not disagree with the Director that LBDOs may need to establish programs with differences necessary to meet local needs, however, OMBE did not develop information necessary to identify basic methods for the most effective LBDO operations. As a result, many LBDOs may provide less effective assistance than it could otherwise have been in improving the chances of minority businesses to succeed.

The SBA Administrator indicated that SBA and OMBE were coordinating their efforts to insure that the management assistance resources of OMBE-funded private organizations will be used effectively.

CHAPTER 6

AGENCIES' EVALUATION OF

FEDERAL MINORITY ENTERPRISE EFFORT

OMBE has recently implemented a Performance Management System which should give OMBE the ability to measure the success of LBDOs in terms of successful businesses established. Although iterim goals or objectives have been established for various activities in OMBE's program, we believe that OMBE should develop long-range goals as to how many successful minority-owned businesses should be established to enable it to measure the progress of the total Federal effort.

SBA has measured the success of Operation Business Mainstream primarily by the annual increase in the number and dollar amount of loans made rather than by the number of successful minority businesses established. SBA has never established an acceptable failure rate for minority businesses it financed. SBA apparently has emphasized increasing the number of minority loans rather than improving the rate of success of businesses financially assisted by SBA.

Until late 1971, SBA had not made any studies or evaluations of Operation Business Mainstream to determine (1) how successful it had been in establishing successful businesses or (2) the factors relating to business success and failure. In 1971, at the request of the Office of Management and Budget, SBA initiated an evaluation of Operation Business Mainstream.

LACK OF GOALS TO MONITOR PROGRESS OF THE FEDERAL EFFORT

Before OMBE implemented its Performance Management System, it relied on increases in the amount of loans, grants, section 8(a) contracts, and management assistance provided to minorities to measure the effectiveness of the Federal minority enterprise effort.

Under its new system, OMBE receives information on each minority business assisted by an LBDO. According to OMBE, each LBDO-assisted minority business will be evaluated semiannually by an LBDO and the progress or lack of progress of each business will be reported to OMBE. Therefore OMBE should be able to evaluate an LBDO's success in establishing successful minority businesses.

As a part of its new system, OMBE has established interim goals or objectives for each type of LBDO activity for fiscal years 1973 and 1974. For example, OMBE's fiscal year 1973 goal for new minority businesses established by all LBDOs in fiscal year 1973 was 1,000. The interim goals OMBE established relate only to LBDO and other OMBE activities, OMBE has not established long-range goals in terms of the number of successful minority businesses to be established as a result of the total Federal minority enterprise effort.

EVALUATIONS OF OPERATION BUSINESS MAINSTREAM NOT RELATED TO SUCCESS AND FAILURE

Goals have not been established for Operation Business Mainstream in terms of the number of successful minority businesses to be established. The few goals that have been established have been stated primarily in terms of the number and dollar amount of loans to be made, accomplishments are measured in terms of the number and dollar amount of loans made.

SBA presentations to the Congress on the results of Operation Business Mainstream included information on the number and dollar amount of loans made, the number of delinquent loans, the number of loans in liquidation, and the actual and estimated losses. We found no evidence that SBA had presented information to the Congress on the number of successful minority enterprises or that SBA had established any goals in terms of success or failure rates of businesses with SBA loans.

Peat, Marwick, Mitchell & Co. in its April 1971 study report commented on SBA's failure to establish goals. The report stated that the objectives of Operation Business Mainstream were not stated in terms of specific results to be achieved. Regarding SBA's inadequacies in establishing objectives, the report made the following statement.

> "In the absence of well-defined statements on its mission and objectives, SBA has not been able to develop program plans which relate resource

requirements to areas of priority and high return The effect has been to present resource requirements in terms of projections of 7(a) loans and total fund requirements based on average figures for loans, and not in terms of specific objectives SBA hopes to achieve through its loan programs, i e , improving the success rate of 7(a) loans by X percent through an integrated program of assistance which requires specified resources."

Peat, Marwick, Mitchell & Co also stated that SBA in adopting a policy of making more loans to minority individuals had not formulated an acceptable loss rate for such loans to take into account the higher probability of nonrepayment The report pointed out that SBA relied exclusively on the number of loans being made to measure the success of its programs without attempting to develop additional measures.

An increase in the number and dollar amount of loans cannot be an adequate measure of the success of the minority enterprise effort because only an indirect relationship exists between the number of loans made and the number of successful minority-owned businesses. On April 26, 1972, the OMBE Director in a statement before the Minority Small Business Subcommittee of the House Select Committee on Small Business stressed the importance of measuring the success of minority enterprise programs in terms of successful businesses, rather than by the amount of Federal activity--which he referred to as input. He stated

"These inputs are important, they are the basic building blocks of our entire effort. They are worth nothing, however, unless they produce results which materially increase minority business ownership "

"* * * the ultimate pay-off, the only true measure of success, will be found on that bottom line of the [profit and loss] statement "

In recent years SBA, either in-house or through contracts with management consultant firms, has studied and evaluated its activities. These studies have ranged in scope from covering all SBA's activities to covering only the section 406 management assistance program. However, none of these studies related their findings to the success or failure of minority businesses. A brief discussion of each of the studies follows.

Evaluations by consultants

The first study by a consultant was made by Sam Harris Associates, Ltd., and was completed in May 1969 with the issuance of a report entitled "Compensatory Capitalism A Description and Evaluation of Project OWN." This report's major conclusion was that "given the resources available to it, the SBA did an exceptional job relative to its past performances in programs of Compensatory Capitalism." This conclusion was based on the increase in the number and dollar amount of minority loans during Project OWN. During the study the consultant developed information on such characteristics as education and work experience for 57 loan applicants. However, no attempt was made to relate these characteristics to an applicant's business success or failure.

A study made in 1970 by Arthur Young & Company measured the impact of the section 406 management assistance program in terms of the number of businesses assisted and the number of employees who would be out of work if their businesses had not received assistance. (See p. 52.) The study report concluded that

> "* * * the lack of definitive records prohibits the making of valid estimates of changes in business income, the average profitability of the assisted business, or of the number of employees resulting from 406 assistance."

The report also contained several findings and recommendations concerning the administration and management of the section 406 management assistance program.

The most recent consultant evaluation was a comprehensive management study of SBA operations by Peat, Marwick, Mitchell & Co The study identified a number of deficiencies in the minority enterprise effort, including management assistance activities The study report, dated April 26, 1971, pointed out that SBA was measuring the success of its efforts by the increases in the number of loans, rather than the number of successful businesses established.

In-house evaluations

SBA in-house studies relating to its minority enterprise programs have been limited and have been concerned primarily with management assistance activities

SBA reported to the Congress the results of a 1969 pilot study, "Measuring the Benefits of Management Assistance," which showed that a net increase of about $10 in small business profits resulted from each dollar SBA spent for management assistance. An SBA official informed us in May 1972 that the information was obtained from questionnaires to individual businessmen who had received counseling or training. The businessmen were asked to report any increase in profits as a result of assistance received. We question the validity of the reported results because of the difficulty of relating assistance received to an increase in profits. The official stated that the questionnaire was sent to both minority and nonminority businessmen He said that probably not many minority businessmen were included because the study was completed during fiscal year 1969 and thus covered businesses that had been established largely before SBA emphasized minority enterprise.

In September 1970 SBA's Office of Organization and Management completed a study of the effectiveness of SBA's administration of the section 406 management assistance program The study report recommended certain administrative changes to increase the efficiency of SBA's administration of the program and to provide increased services to minority businessmen.

Other SBA actions to evaluate the effectiveness of assistance programs have been limited. No formal evaluation of the management assistance provided by each section 406 contractor or grantee had been made as of April 1972. To develop information on the adequacy of assistance provided by SCORE volunteers, SBA asks the recipient of the assistance to comment on the adequacy of the assistance received. An SBA official in Chicago told us that due to a lack of clerical help the forms were not being sent out, and an SBA official in Washington told us that most forms were not returned by the businessmen

SBA, at the request of the Office of Management and Budget, made a study of Operation Business Mainstream which included an in-depth review of 600 SBA-financed minority businesses at 45 field offices. The study was to determine the extent to which firms remain in business or fail over a period of time after receiving loans, how their income and sales have increased or decreased, the influence of management assistance, and the various business and owner characteristics which affected their survival and progress. As of September 12, 1973, a final report on this study had not been issued. The results of this study should provide a basis for taking action to reduce the failure rate of minority businesses with SBA loans.

CONCLUSIONS

OMBE should establish long-range goals in terms of the number of successful minority businesses to be established to enable it to adequately monitor the progress of the total Federal effort. Also SBA should establish goals in terms of successful minority businesses to be established by Operation Business Mainstream. These goals would be a part of the overall goals for the Federal effort.

SBA measures the success of Operation Business Mainstream primarily by the increases in the number and dollar amount of loans made to minorities. In our opinion, increases in program activities, by themselves, are not adequate measures of program effectiveness. A more meaningful measure of effectiveness would be the number of successful businesses established. With its new Performance Management System, OMBE should be able to measure the success of LBDOs in terms of successful businesses established. We believe that SBA should also establish a system to adequately monitor the success of its efforts in terms of successful minority businesses established. SBA has never established an acceptable failure rate for minority businesses financed with SBA loans. Because of the adverse effect that high failure rates may have on the creditability of the Federal effort among the minority community, the public, and the Congress, SBA should establish an acceptable percentage standard for failures.

RECOMMENDATION TO THE SECRETARY OF COMMERCE

We recommend that OMBE establish long-range goals in terms of the number of successful minority businesses to be established by the Federal minority enterprise effort.

RECOMMENDATIONS TO THE ADMINISTRATOR, SBA

We recommend that SBA

--Establish goals, in conjunction with OMBE, in terms of the number of successful minority-owned businesses to be established under Operation Business Mainstream.

--Develop a management information system which would enable measurement of SBA's accomplishments in terms of successful minority businesses established.

--Establish an acceptable failure rate for Operation Business Mainstream.

AGENCY COMMENTS AND OUR EVALUATION

The SBA Administrator agreed that different goals and measurement systems were needed. According to the Administrator, SBA has been working with the Office of Management and Budget and OMBE to develop a basic data gathering and reporting system which will enable SBA to set more meaningful and realistic goals.

The SBA Administrator questioned whether any specific figure expressing an acceptable failure rate would be anything but controversial. He indicated that SBA would continue to attempt to reduce the actual failure rate but that SBA would also continue to provide minorities with the opportunity to enter the mainstream of American business.

We agree that an acceptable failure rate is controversial and that attempts to reduce the actual failure rate should continue. But, we believe, SBA should establish an acceptable failure rate. By establishing such a rate, SBA would be stating to the Congress that this rate is the maximum failure rate SBA would accept for minority businesses on the basis of loan eligibility criteria and the level of resources allocated to assisting minority borrowers. If the actual failure rate exceeded the acceptable failure rate, SBA would need to reevaluate its minority enterprise programs to determine what adjustments should be made to its loan eligibility criteria and/or to the level of resources allocated to assisting minority borrowers.

CHAPTER 7

SCOPE OF REVIEW

We conducted our review at SBA and OMBE headquarters in Washington, D C., and at SBA district offices in Chicago, Los Angeles, and Washington, D.C

To evaluate the degree of success attained by minorities receiving SBA loans, we selected for examination a statistically random sample of 443 minority businesses from the loan portfolios of the Chicago, Los Angeles, and Washington offices

Our selection was made from businesses for which EOLs and section 7(a) business loans were disbursed during fiscal years 1969 and 1970. The number of minority businesses for which loans were disbursed during the 2 fiscal years and the number of businesses selected for review at each of the three SBA offices are shown below

SBA office	Fiscal year 1969		Fiscal year 1970		Total fiscal years 1969 and 1970	
	Total	Selected	Total	Selected	Total	Selected
Chicago	125	54	199	96	324	150
Los Angeles	145	61	233	89	378	150
Washington	69	69	74	74	143	143

Few minority-owned businesses received SBA loans before fiscal year 1969, therefore, we did not select such loans for review Businesses with loans disbursed after fiscal year 1970 were not selected because sufficient time had not elapsed since the loans were made to adequately evaluate the probability of success or failure of the businesses

We examined SBA and bank loan files and other documentation relating to the businesses selected for review. Discussions were held with officials at SBA headquarters and the three district offices and with section 406 grantee and contractor personnel, bank officials, and selected minority borrowers In addition, we reviewed SBA regulations, policies, and procedures pertaining to Operation Business Mainstream

We also held discussions with OMBE officials and reviewed pertinent OMBE documents, particularly those pertaining to the planning for its expanded technical and management assistance program.

The number and amount of minority loans approved at each district office under SBA's EOL and section 7(a) business loan programs during fiscal years 1969 and 1970 are shown below.[1]

SBA office	Fiscal year 1969		Fiscal year 1970		Total fiscal years 1969 and 1970	
	Number	Amount	Number	Amount	Number	Amount
		(000 omitted)		(000 omitted)		(000 omitted)
Chicago	172	$6,540	263	$11,353	435	$17,893
Los Angeles	178	4,971	310	9,461	488	14,432
Washington	77	2,229	92	2,294	169	4,523

The number and dollar amount of minority loans approved by the three offices during fiscal year 1970 was 665 and $23.1 million, respectively. Under the EOL and section 7(a) business loan programs, SBA during fiscal year 1970 approved 6,134 minority loans valued at $145 million. The three district offices accounted for 10.8 percent of this number and 15.9 percent of this dollar amount.

During fiscal year 1970, about 51 percent (3,132 loans) of the loans made to minority borrowers under the EOL and section 7(a) business loan programs were bank loans (participation or guaranty). The percentages of bank loans approved during fiscal year 1970 for minority borrowers by the Chicago, Los Angeles, and Washington offices were 93 2, 45.2, and 22.8, respectively. Thus, our selection included one office where the mix between direct loans and bank loans approximated the nationwide average for SBA, another office with predominantly bank loans, and a third with primarily direct loans.

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[1]The number of loans shown differs from the number shown on page 18. One reason for the difference is that this table includes loans by date of approval rather than by date of disbursement. A second reason for the difference is that a number of approved loans were withdrawn or canceled before loan funds were disbursed.

GAO'S CLASSIFICATION OF BUSINESSES

BY SBA DISTRICT OFFICE

Business status	Number in sample	Projections to universe: Estimated percent	Percent error (note a)	Estimated number	Number error (note a)
Chicago businesses (324 in universe)					
Probable success	59	38 7	± 5.5	126	± 18
Failure	26	18.9	± 4.3	61	± 14
Probable failure	44	28.7	± 5.2	93	± 17
Failure-probable failure (note b)	70	47.6	± 5.6	154	± 18
Undeterminable	21	13.7	± 3.9	44	± 13
Los Angeles businesses (378 in universe).					
Probable success	37	24.6	± 5.1	93	± 19
Failure	53	35.5	± 5.8	134	± 22
Probable failure	35	23.3	± 5.3	88	± 20
Failure-probable failure (note b)	88	58.8	± 5.9	222	± 22
Undeterminable	25	16.6	± 4.6	63	± 17
Washington businesses (143 in universe).					
Probable success	41	28.7	(c)	41	(c)
Failure	37	25.9	-	37	-
Probable failure	32	22.4	-	32	-
Failure-probable failure (note b)	69	48.3	-	69	-
Undeterminable	33	23.1	-	33	-
Total businesses (845 in universe).					
Probable success	137	30.7	± 3.1	260	± 26
Failure	116	27.5	± 3.1	232	± 26
Probable failure	111	25 2	± 3.1	213	± 26
Failure-probable failure (note b)	227	52 7	± 3.4	445	± 29
Undeterminable	79	16.6	± 2.6	140	± 22

[a] Percent or number error at 95-percent-confidence level.

[b] Combined total.

[c] All loans in universe reviewed, therefore, no percentage error.

U S GOVERNMENT
SMALL BUSINESS ADMINISTRATION
WASHINGTON, D C 20416

OFFICE OF THE ADMINISTRATOR

APR 4 1973

Mr. Donald C Pullen
Assistant Director
General Government Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Pullen

Thank you for the opportunity to comment on the draft report, "Evaluation of the Success of Federally Financed Minority Businesses " Because our staffs have already met and discussed technical details concerning specific sections of the report, including some questions we have concerning study sample and methodology, I will confine my comments to its overall aspects.

At the outset, let me say that the report which represents a good deal of work by your staff is well done and contains many incisive conclusions and recommendations. However, perhaps the title should be changed to a more descriptive one The report is a good summary of the ME effort, a detailed description of the Small Business Administration and Office of Minority Business Enterprise programs and statistics and field study of 443 minority businesses that received SBA loans together with recommendations based on this study It is not, however, an "evaluation of the success" of minority enterprises, and in fact does not purport to be, anywhere other than in the title.

The recommendations in the report fall into four basic categories, viz (1) development of new loan criteria, (2) providing more and more effective management and technical assistance, (3) establishing different goals and measurement systems and (4) failure rates We are pleased that your report singled out these four areas that we, too, believe to be the most important to ensure continuing success for the minority enterprise effort We have been, and will continue to emphasize these matters in our forward planning and implementation.

The question of developing new loan approval criteria in minority enterprise is one with which we have been concerned for some time. As you know, little research has been done in this area While there are almost as many theories as there are self-professed experts in this field, the empirical support is sadly lacking. Our Office of Planning, Research and Analysis has conducted a relevant study which should be ready shortly. In addition, we have contracted with the McBer Company to do pilot work in motivational training in eight different cities. Their final report should be ready in the next few months. Others, as well, have done some work on this subject. However, many questions remain unanswered. There is always a danger in attempting to find formulas for success. Entrepreneurship, unfortunately, cannot be standardized and the human judgment factor cannot be overlooked. We agree that more work ought to be done along these lines and we will continue our efforts to identify the characteristics of the business and the businessman that are related to business success or failure.

We completely agree with the emphasis that the draft report gives to appropriate management and technical assistance. Without the requisite management and technical expertise no business, no matter how well financed, will succeed. We are constantly attempting to simplify and streamline our Management and Technical Assistance. For example, within the last two years we have redirected our management assistance effort to focus attention on and give priority to our borrowers. Various components of our Management and Technical Assistance programs were placed under the Loan Administration Division to provide for more efficient utilization. We are concentrating all our 406 program funds in call contracts to provide specific assistance on the spot, as needed, after the problems have been identified by SBA employees or volunteers. We have also initiated a pilot program involving university students counseling small businessmen at the place of business. The students, who are supported by the college staff and other volunteer sources are receiving academic credit for their work. This program, known as the Small Business Institute, will continue during the current academic year at which time it will be evaluated and its effectiveness determined.

Also of major importance in this area is the funding of private organizations done by OMBE. Many of these groups are to provide management and technical assistance to SBA minority borrowers. At the local level, for delivery purposes, and at the national level for planning purposes we and OMBE are coordinating our efforts to ensure that this resource will be used in the most effective manner. Again, this is a relatively unseasoned effort and definitive results are not yet available.

In connection with bank loans, as you realize the basic servicing is done by the bank. Here too, however, we are concerned with the quantity and quality of servicing actually being performed. We are now in the process of restructuring our evaluation of and our involvement in the loan servicing techniques of the participating bank community We plan to complete the first phase of this work early in Fiscal Year 1974.

Providing proper management and technical assistance on a timely basis is one of our major concerns. Within the constraints of our limited personnel and budget resources we are making every effort to improve the efficiency and effectiveness of our service in this area. We certainly share the concern evidenced in this report on this subject and will continue to expend every effort to alleviate these problems, both through our action and through encouraging appropriate action by the private sector. Innovative thought is needed in this area and even now we are considering additional ideas to improve our management and technical assistance within our fiscal constraints.

The report also recommends that we develop different goals and measurement systems. We agree with this conclusion and have been working together with OMB and OMBE for the past six months along these lines. The start up time of encouraging rapid growth in loans and contracts has about ended. It is now time to consider what our programs have accomplished in terms of business starts, buyouts and expansion. The business activity of 1968, 1969 and 1970 is now approaching the point of maturity where appropriate analysis of our successes and shortcomings can and should be begun. The basic data gathering and reporting system known as the Performance Management System (PMS) has been worked out with OMB and OMBE and will be implemented gradually over the coming months as our current computer revision and conversion permits. We believe that the PMS will prove to be a realistic performance measurement tool and will enable us to set more meaningful and realistic goals.

And finally, as I am sure you realize, the question of failure rates has continually been in the forefront of our concern. Basically, we consider any failure rate, other than a minimal one, to be too high. We are constantly striving to provide the needed assistance to minority small businesses to lower the failure rate. In this connection, it should be remembered that the largest failure rates by far are those in the Economic Opportunity Loan Program (EOL). This program, which handles the bulk of our minority loans, was authorized by Title IV of the Economic

Opportunity Act of 1964. That Act and the legislative history clearly indicate that Congress intended to establish a more liberal loan program then those already in operation under the Small Business Act. Without doubt Congress understood that a more liberal program would, of necessity, carry higher risks and result in higher failure rates than those found in more conservative programs. Notwithstanding the higher loss rates, however, it should also be noted that the EOL program is one of the few programs authorized by the Economic Opportunity Act that provided for any direct return of funds to the government.

We question whether any specific figure expressing acceptable failure rates would be anything but controversial. It should also be borne in mind that discussions of failure rates in the area of minority enterprise are not complete unless comparisons are made with failure rates of small businesses in general, failure rates of non-minority businesses assisted by SBA and the particular problems present in the case of a minority small businessman, an area which the report does not consider. We will continue our attempts to reduce the failure rate, but we will also continue our efforts to provide minorities with the opportunity to enter the mainstream of American business. The risks of failure alone will not cause us to restrict the Administration's efforts to redress the disproportion that exists in minority business ownership and development.

I trust that this general discussion demonstrates our recognition of the problems set forth in the report and our positive approach to the recommendations made. We are aware of the difficulties inherent in this vital effort and will do our best to help resolve them.

Sincerely,

Thomas S. Kleppe

Thomas S. Kleppe
Administrator

THE ASSISTANT SECRETARY OF COMMERCE
Washington D C 20230

February 15, 1973

Mr. Donald C. Pullen
Assistant Director
General Government Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Pullen

This is in reply to your letter of December 11, 1972, requesting comments on a draft report entitled "Evaluation of the Success of Federally-Financed Minority Business."

We have reviewed the comments of the Office of Minority Business Enterprise and believe that they are appropriately responsive to the matter discussed in the report.

Sincerely yours,

Guy W. Chamberlin, Jr.
Acting Assistant Secretary
for Administration

Attachments

U S DEPARTMENT OF COMMERCE
Office of the Secretary
Washington D C 20230

15 FEB 1973

Mr. Donald C Pullen
Assistant Director
General Government Division
U. S. General Accounting Office
Washington, D C 20584

Dear Mr Pullen

In response to your letter of December 11, 1972, we have reviewed your proposed report to the Congress pertaining to the success of Federally-financed minority businesses.

With regard to the recommendations and conclusions relating to OMBE, we find the report reflects conditions which have been altered considerably since your study was completed The findings of GAO regarding OMBE were similar to those of internal OMBE evaluations conducted in early 1972, which led to the design and implementation of a new planning, evaluation and information system in July 1972

The OMBE system is based on the Performance Management System of the Office of Management and Budget and was developed jointly by OMBE, Department of Commerce, and OMB staff The system involves definition of program goals and objectives, establishment of targets, and measurement of the results The OMBE information system was designed to provide the data needed for PMS, primarily through the tracking of individual minority businesses from their initial concept to their final development.

It is important to note that the goals and objectives of OMBE agree with the subject report. Both express the need to establish new businesses, avoid failures, assist the growth of existing businesses, and open new markets for minority business products.

OMBE is interested in your analysis of SBA programs We are currently assisting in the implementation of a PMS within SBA which will hopefully relate to the problems and solutions outlined in the subject report. As the coordinator of all Federal efforts relating to minority businesses, OMBE would be very interested in an overall analysis of the program We feel, however, that your present report requires some correction and updating. The major problem areas which we located were

2

[18]
pp 17-18 Your question as to whether Federal efforts will result in significant progress in this area is answered by the fact that you recognize the dimensions of the problem If the problem is so great, it must certainly be addressed on the Federal level The contention would be an argument for increased Federal effort rather than less

[23]
pp 25 OMBE is very much aware of and concerned with the possible negative effect of high failure rates which you mentioned It is because of this that the program has emphasized the provision of adequate management services and technical assistance as the best way, we feel, to reduce failure rates Several systems are operating in this area--BDOs, BRCs, Contracted Support Services and Call Contractors, etc

[63-64]
pp 75-76 OMBE did study the question of optimum BDO size, method of operation, etc , and has developed guidelines and standard activities which all BDOs should engage in However, the thrust of the program is local and each BDO has been encouraged by OMBE to formulate their own program according to the needs of their locality

Chapters 5 & 6 These chapters need to be substantially rewritten to include current PMS data The majority, if not all, of the problems cited have been addressed by this system

To assist in revision, we are enclosing the most recent Performance Management Report (PMR) outlining OMBE goals, objectives, and activity to date In addition, the report form used by business development organizations funded by OMBE has been provided, and a copy of the BDO Handbook We will be happy to supply any additional information which you feel would be beneficial

Sincerely,

John L Jenkins
John L Jenkins
Director
Office of Minority Business Enterprise

3 enclosures

GAO note Number in brackets refer to page numbers in this report.

PRINCIPAL OFFICIALS
RESPONSIBLE FOR THE ACTIVITIES
DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
Small Business Administration		
ADMINISTRATOR		
Thomas S. Kleppe	Jan 1971	Present
Hilary Sandoval, Jr	Mar 1969	Jan. 1971
Howard J. Samuels	Aug. 1968	Feb. 1969
Robert C Moot	Aug. 1967	July 1968
ASSOCIATE ADMINISTRATOR FOR PROCUREMENT AND MANAGEMENT ASSISTANCE·		
Marshall J Parker	May 1970	Present
Clyde Bothmer (acting)	Mar. 1970	May 1970
William Murfin	Mar. 1969	Feb. 1970
Irving Maness	Feb. 1961	Mar. 1969
ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT (note a)		
David A Wollard	Feb. 1973	Present
Anthony S. Stasio (acting)	Jan. 1973	Feb. 1973
Jack Eachon, Jr	Dec 1969	Jan. 1973
Howard Rogerson (acting)	Aug. 1969	Dec. 1969
Logan B. Hendricks	Aug 1964	July 1969
ASSISTANT ADMINISTRATOR FOR MINORITY ENTERPRISE (note b)·		
Arthur McZier	Oct. 1969	Present
Arthur McZier (acting)	Aug. 1969	Sept. 1969
Philip Pruitt	Mar 1969	July 1969

	Tenure of office	
	From	To
Department of Commerce		
SECRETARY		
Frederick B. Dent	Feb. 1973	Present
Peter G. Peterson	Feb 1972	Feb 1973
Maurice H. Stans	Jan 1969	Feb 1972
DIRECTOR, OFFICE OF MINORITY BUSINESS ENTERPRISE		
Alex M. Armendaris	Apr 1973	Present
Walter L Sorg (acting)	Mar. 1973	Apr 1973
John L. Jenkins	Aug. 1971	Mar 1973
Abraham S. Venerable	Apr. 1970	Aug 1971
Thomas S. Roeser	Apr. 1969	Apr. 1970

[a] Before February 1973, this position was Associate Administrator for Financial Assistance.

[b] Position created in March 1969

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