Credit Availability in the Minneapolis-St. Paul Hmong Community

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Abstract

Congress mandated that the Federal Reserve System ensure that commercial banks meet the credit needs of their communities by passing the Community Reinvestment Act of 1977. Capital and credit market access is particularly important for immigrant or refugee small business owners because self-employment has been an important channel for building wealth and increasing the economic status of ethnic communities. To develop a better understanding of immigrant/refugee small business financing, the Federal Reserve Banks of Chicago and Minneapolis surveyed Hmong and white small business owners in Minneapolis and St. Paul. The Hmong are immigrants from Laos and other Southeast Asian countries who settled in the United States as political refugees following the Vietnam War in the late 1970s.

Despite their roots in an extremely underdeveloped part of Asia and relatively recent migration to the United States, the Hmong small business owners appear to have well-developed access to credit; that is, their utilization of credit from formal financial institutions is largely comparable to that of white-owned businesses. Moreover, Hmong and white business owners have similar views on the barriers or obstacles posed by their access to credit. Focus group discussions with local community leaders and commercial banks indicate that unique lending strategies (for example, employing Hmong loan officers and being active in Hmong community affairs) may be partially responsible for the well-developed credit access of the Hmong entrepreneurs.

I. Introduction and Overview

Since the passage of the Community Reinvestment Act of 1977, the Federal Reserve System has been given a Congressional mandate to ensure that commercial banks meet the credit needs of their communities. Of particular importance is the ability of small business owners to obtain adequate access to capital and credit markets since self-employment has been an important channel for building wealth and fostering community economic development. To develop a better understanding of immigrant/refugee small business financing, the Federal Reserve Banks of Chicago and Minneapolis surveyed Hmong and white small business owners in the central cities of Minneapolis and St. Paul (MSP). The survey was designed to measure the ability of these groups to access credit from both formal and informal sources. Specifically, we put forward the following research questions:

- How available is start-up and operational financing for Hmong small businesses in the MSP area?
- What sources of credit are actually used?
- Do Hmong entrepreneurs report substantial barriers in their attempts to obtain credit?
- Are there unique characteristics about the Hmong community or the banking environment of the MSP area that has impacted the access to credit of small business owners?

We studied the experiences of Hmong entrepreneurs in the MSP area for several reasons. First, the Hmong population's roots are in an extremely underdeveloped portion of Asia, providing them with limited experience to a capitalist system. This fact, coupled with their relatively recent migration to the United States as political refugees, suggests that the Hmong are likely to suffer from sub-optimal access to credit from commercial banks and other formal financial institutions.[1] Second, the Hmong community located in

[1] Evidence exists that immigrant groups in general lack capital and sufficient credit history to borrow from banks and financial institutions (Bates, 1996).

the MSP area constitutes the largest Hmong population center in the nation, and has recently begun developing a distinct, recognized, and viable small business sector. These attributes make the MSP community a particularly interesting one to review for evidence indicating potential difficulty in accessing formal credit. Third, the presence of immigrant/refugee small business sectors is an integral and growing aspect of the vitality of urban neighborhoods throughout the United States.[2] The clustering of immigrant groups and their businesses within specific areas translates into greater economic activities in these neighborhoods. Moreover, self-employment has traditionally been an important channel for raising the economic status of immigrant communities. Diminished access to formal credit may reduce the optimal size of immigrant-owned businesses, increase their probability of failure, and delay or deter entry into self-employment by immigrant entrepreneurs.

We find that Hmong small business owners in the MSP area have well-developed access to credit. By well-developed access to credit we mean that there is no substantial differences in the amount of formal loans used by Hmong owners relative to the control group. And that is what we find for start-up loans. With respect to operational financing, we find that Hmong owners were less likely to apply for formal credit but had loan approval rates consistent with the control group. Moreover, key differences between the two groups may partially explain the lower Hmong propensity to apply for credit. We also found that both groups of entrepreneurs reported similar barriers in their attempts to obtain financing and little evidence that indicated the Hmong owners systematically felt they were receiving less access to credit than the control group. Finally, focus group responses suggested that unique banking practices possibly explain the well-developed credit access exhibited by the Hmong community.

The remainder of the paper is organized as follows. The next section provides a summary of the theoretical background involved in understanding small business financing issues. Section III describes the Hmong population. Section IV discusses the survey instrument and provides descriptive statistics on the two populations surveyed.

[2] Self-employed immigrants represent 12.4 percent of all self-employed workers in the United States. The number of foreign-born self-employed workers climbed by 46 percent between 1990 and 2000, compared to a 7 percent increase in total self-employed workers (Unpublished foreign-born tables, Current Population Survey (CPS), Bureau of Labor Statistics, 2001 annual averages).

Section V presents results from the survey concerning the ability of Hmong entrepreneurs to access credit from formal financial institutions and Section VI reports evidence of problematic credit access. Section VII provides a summary of meetings held with local community representatives and bankers to verify the accuracy of the survey and our conclusions. Section VIII contains an overview of our results and suggestions for future research.

II. Small Businesses and Liquidity Constraints

Why small businesses in some communities may have difficulty accessing formal financial markets

Modern theories of financial intermediation maintain that in a developed financial system, with high per capita income and high levels of wealth, financial intermediaries (i.e., banks, venture capital firms, risk management firms, etc.) emerge, specializing in producing information that resolve information asymmetries and reduce transaction costs of monitoring (Allen and Santomero, 1998). Nevertheless, research suggests that information asymmetries are more pronounced in the case of new and small firms. This is due to the fact that, among other factors, they are less likely to have publicly traded financial information (Peterson and Rajan, 1994). Aghion and Bolton (1992), and Lehnert, Ligon and Townsend (1994) showed that at low levels of wealth, moral hazard is more acute and poor individuals face higher interest rates or are cut out of the financial market altogether. These studies suggest that the cost of capital may be prohibitive particularly for small new ventures with lower revenues. To the extent that these firms are clustered within certain income geographies, this would translate into lower lending activities in these communities.

While there are a number of factors that could potentially lower the cost of acquiring financial capital, smaller firms are not always in a position to take advantage of them. For example, a firm's pledging collateral should mitigate adverse selection and moral hazard and decrease the up-front cost of financing. However, small firms, especially those in the service industry (where small firms tend to be more predominant), are less capital intensive and often have more intangible assets. Consequently, they are less likely to have collateral (Scholtens, 1999; Van Auken and Neeley, 1998).

The ownership structure of small firms, whereby the entrepreneur is also the owner, is cited as another situation that could induce the availability of external financing (Scholtens, 1999). This is because firms owned and operated by the owner/entrepreneur do not suffer from principal-agent problems (inconsistencies of objectives between managers and owners). Owners are more likely and willing to use their personal resources as equity capital to start their business; and the greater vested interest in the business signals lower potential moral hazard problems (Bopaiah, 1998). In practice, however, because smaller firms have difficulties generating revenue and have less cash flow, they experience more difficulty signaling creditworthiness and are therefore more liquidity constrained.

Finally, the literature suggests that minority-owned small businesses may have less access to financing due to discrimination --owners are denied loans even though others with the same qualifications are granted loans. Such credit rationing can take place along whole community lines, particularly in low-income communities with more marginalized businesses (e.g., see Bates, 1988, 1991).

The role of relationship and informal financial markets in channeling credit to small businesses

Since information production is not costless, a relationship between the firm and a financial intermediary has the potential to lower transaction costs and to decrease the cost of obtaining capital by the firm. An increasingly large body of research looks into the advantages of a relationship between small firms and providers of capital in facilitating access to funds (Uzzi, 1999; Scholtens, 1999; Cole, 1998; Berger and Udell, 1995; Petersen and Rajan, 1994; Fama, 1985). In general, a long-term relationship with a formal financial intermediary is expected to lower the costs of financing because it decreases the costs of monitoring, opens the possibility for greater compliance of contract, and gives the financier greater control of moral hazard. [3]

[3] It has been noted however that, to the extent that new financial institutions do not have the benefit of a relationship with the firm (in the sense that information is not transferable), the existing financial institution with which the firm has a relationship would have an information monopoly. As such, the benefit of the

Previous research has proposed several hypotheses on the nature of the relationship that matters for financing. For example, Fama (1980) maintains that the potency of the relationship between a firm and a lender lies in the duration of the relationship, and the longer a borrower has serviced its loan, the more likely the business is viable, and the owner trustworthy. Given a time-tested relationship, new loans are expected to cost less and the lender to be more willing to provide financing. This suggests that the lending opportunities of a small business should change over its life cycle. After the startup phase of the business, and after the relationship has been cemented, more financing opportunities on more favorable terms should be expected.

Similarly, a previously maintained non-borrowing relationship with a financial institution, such as having deposits in a bank, can help build relationships overtime. Petersen and Rajan (1994) argue that such a relationship allows the lender (i.e., the bank) to monitor the cash flow (e.g., on a checking account) and to obtain information about sales in the business. This relationship improves the lender's monitoring control, reduces its transaction costs in providing the loan, and increases the availability of loans for the firm.

In many instances where a relationship with a financial institution is lacking or does not warrant sufficient financing, small businesses may use complementary or alternative sources of capital available in the informal sector.[4] A vast body of theoretical and empirical research has begun to acknowledge the importance of non-traditional sources of financing (e.g. "bootstrap financing" and/or micro lending) for small business financing, especially during the formation stage of the business (e.g., Van Auken and Neeley, 1998; Anthony, 1999). The main characteristics of informal finance are that monitoring is more intensive, search costs and information costs are relatively low, and enforcement mechanisms may be more effective.[5] Informal financing is also relevant

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relationship, in terms of savings in the pricing of capital to the firm is increased by less than the true decline in cost of having information. Therefore it is unclear, beyond increasing access, whether the actual interest rate or costs of capital would be lower from a maintained relationship with one particular financial institution (Rajan, 1992).

[4] Bond and Townsend (1996) raise the possibility that certain groups may seek financing in the informal sector instead of banks due to preference or cultural factors.

[5] Several works on informal finance are in the context of developing countries (e.g., Fafchamps, 1999; Khandker, 1995). For example, Khandker et al. (1995) note that informal (or quasi-informal) financial

when the lending relationship is non-economic and is based on familial, social and cultural considerations. An important shortcoming of the informal financial sector is that given its relatively small size, funds are relatively scanty and a business' ability to rely solely on these non-traditional or informal sources of financing is likely to be limited.

In the context of immigrant business research, it has been suggested that the informal financial sector can play an even more important role, where businesses tend to be formed within an *ethnic economy* or *ethnic enclave* (Bonacich and Model, 1980; Light, 1972; Aldrich and Waldinger, 1990). Accordingly, some immigrants are "pushed" into self-employment in response to disadvantages faced in the labor market (i.e., lack of English language proficiency and discrimination or *blocked mobility*) and, as such, they rely more heavily on ethnic networks. Ethnic social structures consist of the networks of kinship and friendship or formal ethnic organizations around which ethnic communities are arranged. Ethnic networks can play a role in mobilizing monetary and information resources for ethnic small businesses. *Ethnic economies* and/or *ethnic enclaves* potentially can provide an opportunity structure for greater business networks, and offer a *protected market* for ethnic goods production.[6]

III. The Hmong Experience

The Hmong are immigrants from Laos and other Southeast Asian countries who settled in the United States as political refugees during the late 1970s after the Vietnam War.[7] The 2000 decennial Census data puts the total Hmong population at roughly 169,000, making it one of the fastest growing Asian groups in the nation over the preceding decade. The

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sector in developing countries often use group pressure to collect obligations; they may accept also flexible and unconventional types of collateral, including labor.

[6] There is a rich literature on the role of ethnic economies and ethnic enclaves in facilitating the formation of small businesses among immigrant entrepreneurs. Bonacich and Model (1980) first introduced the term "ethnic economy". It is characterized by a situation where an immigrant or ethnic minority group maintains an economic sector, produces distinct (often ethnic) goods in which they have market power, where the members of the group have ownership stake and hire co-ethnic employees. An ethnic enclave (a term coined by Wilson and Portes, 1980) is a type of ethnic economy, except that it is defined by a geographic clustering of these activities. The actual benefits and limits of ethnic economies in facilitating the development and success of ethnic businesses are hotly debated (Sanders and Nee, 1987).

[7] Hmong refugees also settled in France and Australia.

Hmong initially settled in rural areas, such as Fresno and Sacramento, California. Now, the largest concentrations live in Minnesota and Wisconsin, reportedly due to low unemployment in these states and support from social services. When a family member moves to an area and secures a job and a home, the rest of the typically large extended family has tended to relocate as well.

Because of in-migration, Minnesota's Hmong population has soared over the past decade. The latest enumeration showed 41,800 Hmong in Minnesota, roughly one-fourth of the nation's total and almost 2.5 times the 1990 total of 16,833. St. Paul, with a Hmong population of 24,389, remains the home of more than half of all Hmong in Minnesota. Minneapolis has the next largest population, with 9,595 Hmong residents, followed by two northern suburbs of Minneapolis, Brooklyn Center with 1,346 and Brooklyn Park with 1,226. Indeed, the MSP area boasts the largest Hmong community in the world outside of Thailand.

The Hmong have little tradition in formal business ownership. Their historical economic experience consisted primarily of subsistence farming. Once in the United States, many of the Hmong began agricultural-based businesses to capitalize on these traditional skills. As they moved out of rural areas, they naturally have shifted their business focus.

The largest concentrations of Hmong households and businesses are located in the Payne-Phalen neighborhood and along the Penn Avenue North corridor in St. Paul, and the Thomas-Dale neighborhood of Minneapolis. These neighborhoods are in the core cities and are characterized by well-established commercial strips comprised of aging commercial, industrial and mixed-use buildings surrounded by older housing stock. The types of businesses located in these neighborhoods range from small service-oriented businesses, restaurants and retail to large industrial and manufacturing operations.

IV. Survey Overview and Descriptive Statistics

The Hmong Small Business Survey (HSBS) was based on a more elaborate survey developed by the University of Chicago and the Federal Reserve Bank of Chicago for their data collection in Hispanic and Black neighborhoods.[8] We edited the original survey tool to focus on questions pertaining to small business development and to account for Hmong cultural differences. The survey was then translated to Hmong and reviewed by a Hmong Advisory Group (consisting of local Hmong business and community leaders), as well as the Hmong interpreters who conducted the survey.[9] Language barriers proved challenging; for example, there are no Hmong words for "access" and "credit," which form the very basis of the survey. Likewise, for those words and many others, a large number of Hmong words were needed to describe a single English-language term. Even in its abbreviated form, the survey took from three to four hours to complete, which compares to the two hours used to administer the full version in Chicago.

An extensive effort was undertaken to compile a listing of all known Hmong businesses in the greater MSP area, most of which were located along two primary commercial strips in St. Paul.[10] The resulting list was unduplicated and screened to verify Hmong ownership of an extant business in the core cities of St. Paul and Minneapolis, a process that identified 170 Hmong businesses. Of these 170, 121 (71 percent) completed surveys, 36 refused, and 13 could not be completed within the study period (owners were surveyed from November 2000 through April 2001).

We also surveyed a control group of non-Hmong business owners drawn from the same zip codes as the Hmong establishments. Constructing the control on the basis of this geographic restriction ensures that the two samples have physical access to the same financial institutions, thus minimizing the methodological concern that would arise from making inferences about the two populations in different regions where the supply of financial services could differ systematically. Specifically, we obtained a list of businesses whose zip codes matched those in the Hmong sample from a direct marketing

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[8] These surveys were conducted during the mid-1990s under the direction of Richard Taub, Marta Tienda, and Robert Townsend through the Center for the Study of Urban Inequality, University of Chicago, and were cosponsored by the Federal Reserve Bank of Chicago (Bond and Townsend, 1996, and Huck et al, 1999).

[9] The Wilder Research Center of St. Paul, Minn., a division of the Amherst H. Wilder Foundation, was retained to manage the implementation of the Hmong and control group surveys, including translation, sample selection and survey interviews.

[10] Information sources included the Hmong-American Residence and Business Directory, a local Hmong Chamber of Commerce, community development groups, and economic development agencies.

agency. The list was subsequently randomized and purged of any Hmong businesses or known government and nonprofit organizations. 342 businesses from the randomized list were contacted and 220 were found to be for-profit enterprises still in existence. Of these 220, 131 completed the survey (60 percent), 41 refused, and 48 could not be completed within the study period (control businesses were surveyed from June 2001 to August 2001). Given our interest in studying the ability of Hmong small business owners to access credit from formal financial institutions, we chose to analyze only the responses of 93 owners who self-identified themselves as being White or Caucasian.[11] White-owned firms provide the appropriate benchmark group since these owners should have the greatest access to credit of any racial group.

Business and owner characteristics

We draw two main conclusions after comparing general descriptive statistics on business and owner characteristics for the Hmong and control groups. First, although the control group was constructed solely on the basis of physical location, the aggregate properties of this group appear quite similar to those of the Hmong owners along several other dimensions. Second, the differences that do exist between the descriptive statistics of the two groups imply that the Hmong owners may have relatively less credit access than the control group.

The majority of Hmong and control businesses are retail and service firms (see Table 1 for business characteristics). Virtually all of the businesses were classified as non-franchise establishments, and a substantial percentage of firms in each group were organized as partnerships when started. Roughly half of the businesses in each group were dependent on local neighborhood income for profitability. With respect to owner characteristics, we find that both the Hmong and control owners have high levels of human capital (see Table 2). Roughly 40 percent of each group has at least a college degree, and a slightly smaller percentage reported owning at least one business prior to the current establishment. These results suggest that the formal credit usage by these owners may be higher than for other communities, since entrepreneurs with high levels of

[11] Throughout the remainder of the paper we use the terms "white" and "control" synonymously to refer to this group of 93 owners. We also note that all 93 owners either started the business from scratch or bought an existing business. None of the owners in either group inherited or were given their businesses.

human capital may be more efficient in obtaining information about financial markets and attracting funding (Cressy, 1996). In addition, almost all of the Hmong owners reported being at least moderately proficient in English. Indeed, over 33 percent of the Hmong owners elected to complete the English version of the survey. Finally, Hmong and white owners were both predominantly male.

Where noticeable differences between the Hmong and control owners exist, we expect the differences would bias the survey results against a finding of access to credit for the Hmong that was comparable to that of the white owners. For example, the median Hmong owner was roughly ten years younger than the control counterpart. Reflecting the asymmetrical distribution of owner ages, the Hmong businesses were also in the possession of the current owner for roughly ten fewer years relative to the control. Moreover, nearly 70 percent of the Hmong businesses were started from scratch by the current owner, compared to only half of the control group. To the extent that age is a proxy for human capital or creditworthiness, the substantially younger ages of the Hmong owners could indicate greater potential risk to lenders, resulting in diminished access to credit. Similarly, commercial lenders have less incentive to lend to relatively new firms whose performance they cannot adequately document for a sufficient period of time because such loans have high relative costs. Banks may also be unwilling to lend funds to businesses that are below a minimum size. The median reported asset value of the Hmong firms was only $80,000--only one-third the size of the median control business. Correspondingly, nearly 60 percent of the Hmong businesses did not report having any full-time employees, compared to less than 35 percent of the control businesses.

Although the retail and service sectors accounted for approximately 80 percent of the surveyed businesses, the Hmong and control groups each had a sizeable share of firms in two separate categories that again would bias the results against a finding of comparable credit access. 14 percent of the white-owned firms were classified as construction and industrial businesses, while 20 percent of the Hmong establishments were part of the financial sector (e.g., insurance agencies, financial service providers, etc.). Industrial firms that extensively use heavy machinery and maintain large inventories of raw materials require larger amounts of startup capital and more frequently request bank financing. Less capital intensive financial enterprises like independent insurance agents, conversely, have greater amounts of intangible assets, suggesting reduced levels of start-up financing and lower credit needs and utilization relative to industrial firms (Scholtens, 1999; Van Auken and Neeley, 1998).

Survivor bias should also influence comparisons between the Hmong and control group. Since the white-owned firms are generally older, they should contain fewer marginal firms on a percentage basis as are found in the Hmong sample. Simply put, the Hmong businesses may not have been in existence for a sufficient period of time for those of questionable viability to be eliminated.

V. Measuring the Comparability of Credit Access

As discussed earlier, our primary interest is determining whether the Hmong small business owners have comparable access to white business owners. Specifically, were Hmong business owners able to utilize credit from formal financial institutions at the same level as their white counterparts? Answering such a question is complicated by several factors, most notably the small sizes of the samples and the lack of detailed information on the personal wealth and credit histories of the business owners.[12] However, to the extent that the Hmong owners systematically received equivalent credit to the control group, or encountered similar barriers and obstacles in their attempts to obtain credit, one could reasonably conclude that access to credit was comparable between the two groups. We find that the Hmong owners utilized formal bank financing to the same extent as the control group when the business was started and to the same extent, but at slightly lower rates, thereafter. With respect to credit access as a self-identified problem, we did not find substantial differences between the Hmong and white owners.

During the Start-up Phase

We begin our analysis of credit utilization by focusing on start-up funding. Overall, the Hmong businesses appeared quite similar to the control group in terms of total start-up funds, the sources of start-up financing and the relative shares provided by each source.

One difference between the two groups involved the use of informal funding sources. While both the white and Hmong owners made extensive us of informal funds, Hmong owners utilized personal savings at higher rates and levels than their white counterparts.

The total amount of capital needed to start a firm from scratch is typically much lower than the amount needed to acquire a pre-existing establishment. Once we control for this attribute we find roughly equivalent utilization of start-up funds between the two groups (all amounts were converted into 2001 dollars). Hmong owners who acquired pre-existing businesses reported marginally lower start-up capital amounts than the white owners ($112,000 as opposed to $123,000), but modestly higher amounts for firms started from scratch ($23,000 versus $19,000).

Of course, the fact that the Hmong owners used roughly the same amount of funds as white owners to commence their businesses does not necessarily imply that the Hmong had the same access to credit from formal financial institutions. To more fully address the question of access to credit, we next explored the various sources of start-up capital that were employed, based on the following three broad categories:

- internal sources (i.e., funds provided by the owner including credit card and home equity loans);
- formal external sources (i.e., loans from formal lenders and government programs); and
- informal external sources (i.e., loans, gifts, and investments from relatives and other personal contacts).

We find that a sizeable number of owners were able to obtain external funding from a formal source (see Table 3). Over 30 percent of both groups made use of such financing, with small business loans from banks accounting for most of the responses in each group. 25 percent of the Hmong owners reported receiving a loan from a bank or other formal lender, compared to 30 percent of the control. To put the utilization of bank financing in context, a survey of small business owners in Little Village (the primarily

[12] The ability of small businesses to obtain bank financing is heavily influenced by he financial characteristics of the owner (Mester, 1997).

Hispanic enclave in Chicago) found that only 11 percent of Hispanic owners reporting use of a bank loan to finance the start of the business.[13] The average share of funding provided by bank loans, conditional on the owner obtaining such financing, was also relatively similar between the two groups. Bank loans accounted for 50 percent of start-up funds for the median Hmong owner, compared to 61 percent for the median white owner. Moreover, denial rates for start-up loans were roughly comparable, 43 percent for the Hmong and 34 percent for the control.

Hmong owners differed from the control group with respect to their utilization of personal savings. While the vast majority of both owners relied on internal sources to finance their establishments, white owners were not as likely to directly invest their savings into the business. Nearly 90 percent of the Hmong owners used personal savings during the period of business formation, compared to less than 70 percent of the control group. The average share of total start-up financing provided by internal sources also differed slightly between the two groups, accounting for nearly 60 percent of the typical Hmong owner's start-up funds versus roughly 50 percent for the average white owner.

A more formal statistical analysis of start-up funding is described in the appendix. After controlling for human capital, business type, and certain attitudinal factors (such as the owner's preference for risk, credit, etc.) we find no statistical difference between the Hmong and white owners in the amount of financing provided by formal sources or in the total amount of capital used at start-up.

After the Start-up Phase

Survey respondents were also questioned about their attempts to obtain loans during the two years prior to the survey outside of start-up capital requests (defined here as operational credit), regardless of the source. Fewer than 20 percent of the Hmong owners reported making such a request, compared to over 40 percent of the control. Bank loans were the dominant type of operational credit sought by each group (see Table 4 for a breakdown of the applications by lender identity), accounting for over 75 percent of the individual requests. Virtually all of the owners made at least one request to a bank as

[13] The Little Village survey also included informal businesses that were operated out of households' homes, which may have contributed to the low utilization of bank loans.

well, with 83 percent of the Hmong owners who applied to a bank having at least one of their requests granted and 91 percent of the white control group.[14]

In an attempt to explain the discrepancy between the Hmong and white owners' attempts to obtain operational credit, we investigated several potential hypotheses based on the differences in their characteristics that we discussed earlier. We noted, for example, that Hmong enterprises were considerably younger and smaller than those in the control group. To the extent that the probability of applying for operational credit is an increasing function of the age and/or size of the establishment, the low usage of such credit at Hmong businesses, relative to the control, may simply reflect the age and size of the white-owned businesses. However, the propensity to apply for credit of each group did not appear related to any of the business or owner characteristics on which we had data.

By itself, a finding of different propensities to apply for credit is not necessarily evidence of diminished access to credit. Hmong business owners who decided not to apply for credit during the two years prior to the survey might simply have had little or no need for additional financing. Determining whether such "lack of need" is responsible for the high percentage of Hmong owners, relative to the control, who reported that they did not attempt to get an operational loan is not directly possible since the survey did not include questions on the reasons for non-use. However, the "lack of need" hypothesis is supported by the relatively low utilization of suppliers' credit or trade credit. According to the survey, over 75 percent of the white owners reported that at least one of their suppliers provided merchandise or equipment on credit, with 68 percent of those having access to this type of credit making use of it at the time of the survey. More than half of the Hmong businesses had suppliers that offered trade credit, but- only 25 percent of this cohort owed a supplier when surveyed.

While these findings are far from conclusive, they potentially suggest that the Hmong owners had access to credit from banks that was comparable to white owners. Each group had relatively the same success rate when applying to banks for operational credit. Although the Hmong owners applied for bank loans at a much lower frequency,

[14] None of the Hmong owners reported trying to obtain a loan from an informal source, such as a relative or friend.

their relatively lower use of suppliers' credit could be indicative of simply having less need for credit during the period in question. Moreover, the survey recorded no evidence of Hmong owners seeking operational credit from relatives or other personal contacts, which again could be indicative of not having a need for credit.

VI. Evidence of Problematic Credit Access

Measuring the use of bank credit at different points in a business's lifetime is one potential way of addressing the question of equality of credit access. However, results indicating approximately equal usage of bank loans between two groups do not necessarily imply that the access of each group to bank credit is the same. For example, the two groups may experience different denial rates on their applications.[15] To alleviate this concern, we also searched for evidence of unequal access in a series of questions that were designed to allow owners to directly identify credit access as problem or barrier. If the Hmong owners were systematically receiving less access to credit than their white counterparts, it would likely appear more frequently in their responses to such questions than in the control group. However, we found the prevalence of such answers to be largely the same between the Hmong and white owners, indicating that problematic credit access may not be unique to Hmong small businesses.

Both groups reported similar reasons for not seeking a loan at start-up

We first explored whether the reasons for not seeking financial assistance at the start of the business differed between the Hmong and white owners. Survey respondents who didn't receive a loan, either from a formal or informal external source, were asked why they elected not to seek financial assistance (see Table 5). For both the white and Hmong owners the principal answer was "lack of need"--74 percent of the white owners and 58 percent of the Hmong who identified a specific reason cited this circumstance. A general aversion to indebtedness was also noted by roughly 23 percent of the Hmong owners who

[15] Alternatively, one group may contain a substantial number of individuals who are unlikely to apply for credit because they believe they be denied on the basis of ethnicity.

elected to forego seeking a loan or financial assistance, along with 19 percent of the control.

Intriguingly, nearly 23 percent of the Hmong respondents cited the expectation of a denial as the reason for not applying for some type of loan, compared to none of the white control group. Unfortunately, we did not question respondents about the basis for this expectation, so we are unable to determine if the Hmong owners who offered this response expected to be denied on the basis of their ethnicity or creditworthiness. However, we note that two-thirds of the Hmong owners who formally applied for a bank loan and were denied at start-up felt the denial was due solely to financial reasons (i.e., lack of collateral), while one-third felt race or ethnicity was at least partially responsible.

Both groups reported little existence of bank-related financial barriers at start-up

Business owners were also asked to describe any financial barriers they encountered during the start-up phase of their business (see Table 6). 12 percent of the Hmong owners reported a specific lack of credit (or capital), articulated a general problem borrowing money, or directly mentioned a bank, as did 16 percent of the white control. Another 18 percent of the Hmong owners indicated that they didn't have enough money, often accompanied by a specific need that wasn't being met (e.g., "not enough money for inventory", "not enough money to expand"), compared to only 6 percent of the control group. Determining whether the need for money was attributable to the poor performance of the business or instead was due to an inability to obtain financing from a bank was not possible.

Both groups reported that credit access is an obstacle to growth

With respect to the growth of the business, the Hmong and white owners were largely in agreement on what factors presented the biggest impediments to expansion (see Table 7). Access to credit was the third most frequently cited reason by each group, with roughly 25 percent of the Hmong and white owners considering credit access as a barrier to growth. An additional 12 percent of the Hmong owners again referenced the absence of sufficient money as a barrier (e.g., "not enough money to expand", "not enough money to buy equipment"). While it is possible that these responses were indicating an inability of the owner to obtain credit, they could also be signifying businesses that were unable to generate sufficient income to finance expansion or wealth constraints of the owners that were not related to their ability to obtain bank loans.

In a somewhat related question, owners were also asked directly if financing was an obstacle to expansion. Roughly three-fourths of the Hmong owners reported that financing was such an obstacle, compared to less than a third of the control group. Although we expected the response to this question to be highly correlated with the replies indicating whether or not access to credit was considered a barrier, we found a substantial amount of discordance between these answers in both groups. 45 percent of the Hmong owners who stated that financing was an obstacle to expansion did not report access to credit as a barrier to growth (or mention a derivation of "not enough money"), as did 15 percent of the control. Virtually all of the owners who previously indicated that credit access was a problem replied affirmatively to the question on financing.[16]

Hmong owners appeared more likely to suffer from financing constraints

Lastly, we searched for signs that owners were operating under financing constraints. According to economic theory, an increase in entrepreneurial wealth should have a marginal effect on the capital invested in a business if the entrepreneur is financially unconstrained.[17] This result occurs because the unconstrained establishment operates with the optimal level of capital. Business owners were asked how they would utilize a $20,000 windfall gift. Nearly 75 percent of the Hmong owners stated that they would invest the funds in a new or existing business, compared to only 20 percent of the white control (see Table 8). Part of the discrepancy between the reported proportions may be due to asymmetric age distributions of the two groups. The average age of the white owner who would not invest the funds in a new or existing business was roughly 50, and

[16] Two potential explanations for the inconsistency in the results are that the financing version of the question was posed too directly and respondents were "led" to answer yes, or that the word "financing" was interpreted quite broadly. For example, respondents may have answered yes because they were unable to obtain financing without having adequate collateral. Additional support for this view can be found in the responses to a question asking owners to identify the biggest problems faced by their businesses. While 45 percent of the Hmong owners reported that financing was an obstacle while credit access was not a barrier, only one owner from the cohort identified a current problem relating to credit availability.

their responses may indicate that financing constraints, while potentially still important, are of secondary concern. Moreover, the attitude of the owner to risk may also effect their decision to invest the funds in a business. A related question on risk tolerance revealed that close to 70 percent of the Hmong owners were somewhat or very willing to risk all of their possessions (including houses) in borrowing money to start another business, compared to 35 percent of the white owners.

The response of owners to bad times can also reveal financial constraints. Thirty-five Hmong and 27 white owned business that were in existence for at least three years and experienced a period of near failure were questioned about the strategies they used to survive the downturn in business. While both groups of owners were most likely to increase their own work hours or reduce input expenses in reaction to bad times, strategies involving credit use differed markedly. Roughly 40 to 50 percent of the white owners reported using a credit-related response--either borrowing more, obtaining suppliers' credit, increasing credit card balances, or failing to pay debts--while only 6 to 11 percent of the Hmong owners cited such strategies.

VI. The Response from Focus Groups

To augment the data collected from the survey, we conducted interviews with two focus groups, one consisting of representatives of several banks in the survey area for St. Paul and a second consisting of Hmong community leaders. Focus group participants were also asked to respond to a summary of our preliminary analyses, as a check on the accuracy of the survey and the conclusions we drew from it. On that note, the Hmong focus group generally agreed with the survey's findings concerning access to credit, namely that qualified Hmong business owners were likely to have adequate access to bank financing. Why? Independently, both focus groups described similar themes that were necessary to ensure proper access to credit: cultural understanding, willingness to educate, and flexibility in lending programs.

[17] Holtz-Eakin, Joulfaian, and Rosen (1994) describe a model in which entrepreneurs face liquidity constraints.

Cultural Understanding

On the first point, the Hmong focus group said that the banking sector needed to be sufficient knowledge about the Hmong society and its emphasis on relationships. For example, a Hmong grocery store owner located on a block with five similar businesses might appear to be a high-risk borrower, given the level of competition the store faced. Such a concern, however, might be mitigated by the fact that each store primarily served a specific Hmong clan.[18]

The bankers sounded a similar note. Establishing a personal relationship between the bank and the community was seen as paramount, the bankers maintained, given the high priority placed on relationships within the Hmong society. Examples included conducting outreach programs, participating in community organizations, and sponsoring neighborhood events and festivals.

Education

Secondly, a willingness to educate Hmong borrowers and potential borrowers was viewed as very important by the Hmong focus group. According to the Hmong, bankers needed to be willing to educate business owners on how to comply with loan policies. Rather than simply denying requests from potential borrowers because they lacked technical documents (e.g., business plans, cash-flow analyses, etc.), loan officers needed to explain what documentation was required and assist the business owner in producing it, or redirect them to an organization that could perform these tasks.

On this point, the bankers spoke with a clear view: The best way to educate the Hmong about the financial process was to first hire Hmong employees. Hiring Hmong personnel was a critical component to a successful Hmong lending program, both in terms of being able to relate to applicants and helping to educate them on issues such as saving, applying for a loan, and documenting business performance.

[18] The Hmong society is divided into 18 clans (or councils) that provides the basic form of social and political organization for the community.

Flexibility

Several Hmong participants also stressed the importance of flexibility and the willingness of banks to deviate from traditional loan analysis procedures where appropriate, such as using alternative sources to vouch for the creditworthiness of a potential borrower. Here again, a crucial factor under such arrangements was the employment of Hmong loan officers and/or loan analysts, since these individuals could advocate for a loan on the basis of the character of the borrower and their relationships within the Hmong community, consistent with safe banking practices.

Flexibility was also a major theme of the banking focus group. For example, the bank might consider measuring the income of the business owner's entire family, as opposed to only using the direct earnings of the owner, for calculating loan-to-income ratios. Lending to Hmong-owned businesses was viewed quite favorably by all of the banking focus group participants. Specific mention was made of the entrepreneurial disposition of the Hmong, their detailed knowledge of running successful businesses, their ability to leverage resources from multiple sources, and the willingness of Hmong borrowers to repay loans.

Finally, while Hmong representatives felt that banks were successful in meeting the community's credit needs, more could be done to improve overall access of credit. While few participants believed that Hmong individuals were subject to systematic discrimination from the banking sector, many business owners felt that bank loan requests would be rejected because of limited credit histories and the inability to produce required documentation—factors that could be mitigated by more education. Opinions were that family loan funds or lines of credit were the first place that most Hmong entrepreneurs would go for financial assistance. Participants also acknowledged that many in the Hmong community have a tendency to rely on personal savings to start their businesses. In their opinion, the frequent use of personal savings stems from a preference toward using one’s own and family savings. However, they did not rule out potential limited access to financial institutions. Again, they felt that banks could minimize this potential limited access through educational efforts.

VIII. Overview and Suggestions for Future Research

The goal of this study was to develop a better understanding of immigrant/refugee small business financing. To that end the Federal Reserve Banks of Chicago and Minneapolis surveyed Hmong and white small business owners in the central cities of Minneapolis and St. Paul. The survey was designed to measure the ability of these groups to access credit from both formal and informal sources, to identify these sources of credit, and to determine if there existed any substantial barriers to credit.

What we found was somewhat surprising. Despite the Hmong's cultural and economic disadvantage (their language, for example, did not even have words for bank, credit or loans), it appears that they have well-developed access to the credit market in the MSP area. The Hmong barriers to this market were the same as those faced by white-owned businesses did not have. And while the Hmong relied more heavily on personal savings, their use of banks and other types of formal financial institutions were roughly the same as white-owned businesses.

To provide a check on the survey results and to identify any unique characteristics of the Hmong or banking community that impacted this market, we convened focus groups of local Hmong community leaders and commercial bankers. The Hmong focus group generally agreed with the survey's findings. And both groups suggested that there were unique characteristics that led to this outcome. Clearly, in the view of the participants, a commitment by the lending institutions to cultural sensitivity and to a willingness to work with the borrower were keys to success.

How confident can we be in these results? While having a control group of white-owned businesses to compare to the Hmong is helpful, we recognize that our survey results are only suggestive-- not conclusive. However, if there were serious problems with credit availability in this market, we would expect that either the survey or the focus groups would have revealed them.

That we have found a credit market that appears to be working does not mean we can generalize to other markets. For example, one Hmong business leader suggested that the financial community in MSP is unique in its approach to Hmong businesses, suggesting that a comparable study of other Hmong communities would not be as positive. Our results also raise additional researchable questions. How do other ethnic groups fare in MSP? Is credit as available to the Hispanic or to the black community? How will the same Hmong community fare 5 years from now? These potential studies are, of course, time and place specific. However, we think that this is ultimately the type of research the Federal Reserve System needs to pursue in order to ensure that commercial banks are meeting the credit needs of their communities.

Table 1
Business Characteristics
(Hmong = 121, White = 93)

	Hmong		White	
	Number	Percent of Total	Number	Percent of Total
Retail	42	35%	38	41%
--Eating / dining	5	4%	7	8%
--Food stores	14	12%	10	11%
--Clothing and apparel	8	7%	1	1%
--Convenience stores	8	7%	2	2%
--Miscellaneous retail	7	6%	21	23%
Services	51	42%	37	40%
--Business	17	14%	11	12%
--Professional	5	4%	7	8%
--Personal	29	24%	19	20%
-----Auto services	6	5%	8	9%
-----Travel services	5	4%	1	1%
-----Miscellaneous personal	18	15%	10	11%
FIRE	24	20%	2	2%
-----Financial services	5	4%	1	1%
-----Insurance	14	12%	1	1%
-----Realtors	5	4%	0	0
Construction & Industrial	0	0	13	14%
Media	4	3%	0	0
Selected Statistics				
Started from scratch by owner	80	66%	48	52%
Was a partnership at startup	38	31%	39	42%
Business is a franchise	8	7%	3	3%
No full-time employees (any type)	69	57%	32	34%
Oriented toward ethnic group	21	17%	5	5%
Provide credit to customers	65	54%	38	41%
Profitability dependent on neighborhood income	65	54%	50	54%
Median business age / years since acquisition	3		11	
Median asset size	$80,000		$200,000	

Table 2
Owner Characteristics
(Hmong = 121, White = 93)

	Hmong		White	
	Number	Percent of Total	Number	Percent of Total
Median owner age	37		48	
Average Hmong age on arrival to US	17			
Gender is male	111	92%	78	84%
No high school degree (US)	8	7%	7	8%
High school degree or some college	54	45%	48	52%
College degree or beyond	48	40%	35	38%
Very proficient in English	28	23%		
Moderately proficient in English	91	75%		
Survey conducted in English	40	33%		
Previously owned a business	39	32%	34	37%

Table 3
Sources of Start-up Funds
(Hmong = 121, White = 93)

	Hmong		White	
	Number	Percent of Total	Number	Percent of Total
Internal	108	90%	70	75%
--Personal savings	104	87%	63	68%
--Credit cards	15	13%	5	5%
--Home equity loans	2	2%	8	9%
Informal External	55	46%	43	46%
--Relatives	37	31%	26	28%
--Friends/business associates	3	3%	6	6%
--Suppliers' credit	0	0%	9	10%
--Partners' contribution	18	15%	10	11%
Formal External	36	30%	34	36%
--Bank loans (other private loans)	30	25%	28	30%
--Mortgages (commercial)	2	2%	7	8%
--Govt/city programs	7	6%	2	2%
--Foundations	1	1%	3	3%
Other	4	3%	11	12%

Table 4
Requests for Operational Credit

	Hmong	White
Banks	22	37
Other financial institutions	2	7
Individuals	0	2
Community development / government programs	4	2
No name specified	0	4

Table 5
Reasons Given for Not Asking for Financial Assistance at Start
(Hmong = 53, White = 27)

	Hmong		White	
Owner didn't need it	31	58%	20	74%
Owner is averse to debt	12	23%	5	19%
Owner didn't know where to go	2	4%	0	0
Owner didn't think they would get it	12	23%	0	0
Other reasons	2	4%	3	11%

Table 6
Types of Financial Barriers Encountered at Start
(Hmong = 121, White = 93)

	Hmong		White	
Reported a non-financial barrier	13	11%	14	15%
Inadequate credit or capital	15	12%	15	16%
Not enough money	22	18%	5	5%
Excessive loan debt	5	4%	0	0
Lack of cash flow	4	3%	3	3%
No barriers reported	61	50%	55	59%

Table 7
Major Barriers to the Growth of the Business
(Hmong = 99, White = 80)

	Hmong		White	
Government regulation/zoning/taxes	29	29%	19	24%
Worker availability / benefits	28	28%	33	41%
Access to credit	26	26%	20	25%
Poor demand	17	17%	23	29%
Lack of money	12	12%	2	3%
Barrier specific to owner or business	6	6%	7	9%
Competition	5	5%	7	9%
Facility / location	4	4%	5	6%
Other	1	1%	1	1%

Table 8
Hypothetical Utilization of a Windfall Gift
(Hmong = 121, White = 93)

	Hmong		White	
Invest in a new or existing business	90	74%	18	19%
Purchase a new vehicle	1	1%	5	5%
Apply it towards a house	8	7%	3	3%
Save it in a bank	4	3%	12	13%
Take a vacation	1	1%	1	1%
Donate to charity	0	0	2	2%
Share with family / friends	1	1%	4	4%
Pay off debt	11	9%	29	31%
Invest in real estate, stock market, etc.	5	4%	18	19%

Appendix

Total Start-up Fund Regression Results

	Coefficient	Standard Error
Intercept	10.0728 ***	0.7340
Hmong owner	0.3291	0.2989
Owner's age at start up	0.0182	0.0148
Owner is married	-0.0299	0.3042
Female owner	0.1117	0.3826
Owner previously owned a business	0.7263 ***	0.2297
College degree or beyond	0.2637	0.2322
Less than high school degree	-0.6643	0.4412
Business Category: Other retail	-0.7060 *	0.3725
Business Category: Restaurant	0.4187	0.4734
Business Category: Automobile services	0.5278	0.4862
Business Category: Finance, Insurance, Real Estate	-0.3682	0.3926
Business Category: Business services	-0.7520 **	0.3692
Business Category: Professional services	-1.0670 **	0.5056
Business Category: Personal services	-0.3965	0.3848
Business Category: Retail, clothing	0.7030	0.5641
Business Category: Convenience stores	0.0599	0.5373
Years since start-up	0.0406 ***	0.0148
Business was started by owner	-1.0286 ***	0.2403
Risk Disposition	0.2265 *	0.1169
Preference for saving	-1.1182 ***	0.2522
Preference for credit	0.5639 **	0.2797
R-Square	0.4349	
Adjusted R-Square	0.3708	
Observations	208	

***= significant at 1% level. **= significant at the 5% level. *=significant at the 10% level

Note: This table reports OLS regression results for the logged level of total start-up fund. The omitted ethnic/racial category is white, the business category is grocery store, the omitted education category is high school degree or some college, the omitted business type is business was bought/acquired by owner. Hence the coefficients for the Hmong group measures differences in start-up funding relative to whites, the coefficient for the business categories measures differences relative to grocery stores, the coefficient for education levels measure difference relative to a high school degree or some college, the coefficient for business type: started by owner measures differences related to business type: was bought/acquired by owner.

These regression results show the following: Owners with experience in a previous/similar business begin with higher start-up capital, while, owners that start their business from scratch have relatively lower start-up capital than owners who took on an existing business. Businesses that survived for a longer period of time began with higher start-up capital. Other retail businesses, professional services, and business services had lower start-up capital. Attitudinal factors have a significant influence on the amount of capital that an owner was able or willing to put up to start a business. The less risk averse an owner is the more start-up capital is used in the business. Owners who show a greater preference toward savings start with relatively less capital than those who do not reveal a similar preference. On the other hand, an owner with access to formal credit begin with a significantly higher amount of start-up fund, than one who does not use or have access to formal credit. The results show no statistical difference in the total level of capital used by the Hmong compared to the White business owners.

We re-estimated the start-up fund results in a comparable way as above, but conditioned on the source of fund –whether internal sources, informal external sources, or formal external sources, respectively (the results are not reported in a table). Again, we found no statistical difference in the amount of formal external sources between the Hmong and White owners. However, Hmong used significantly a larger amount of funding from internal sources of funding, as well as from informal external sources relative to whites. These results are consistent with the descriptive analyses in the text.

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