

THE WEALTH GAP AND THE RACIAL DISPARITIES IN THE STARTUP ECOSYSTEM

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Although much attention has been given to structural inequality as it manifests in the criminal justice context, little has been said about economic inequality as it relates to the startup ecosystem. This Article details how the historic creation of the wealth gap affects entrepreneurship, highlighting how the wealth gap adversely impacts entrepreneurs of color. Entrepreneurship is a compelling solution to wealth inequality, but wealth inequality can be an impediment to success in entrepreneurship. This Article explains how the United States' history of bolstering wealth creation for some, while inhibiting wealth creation for people of color, matters for understanding the startup ecosystem today. This Article describes how access to traditional and innovative sources of capital raising perpetuates the racial wealth gap, and this Article makes concrete proposals for addressing these shortcomings.

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INTRODUCTION

In the United States, racial disparity has manifested a dramatic wealth gap along racial lines.¹ For example, for every dollar that a White household had in 2011, the median Black American household had roughly seven cents.² This wealth gap exists across the demographics of age, marital status, education, and income.³ By 2013, the average wealth of White families was over \$500,000 higher than the average wealth of Black American families (\$95,000) and of Latino families (\$112,000).⁴ In 2016, White families on average had seven times the wealth of Black American families and five times the wealth of Latino families.⁵ For Black Americans specifically, economists estimate that it would take 228 years to acquire the amount of wealth that the average White American possesses today.⁶ Wealth, often referred to as net worth, means the resources that individuals or families have at their disposal for emergencies, for investment

When people can start their own businesses, it helps individuals and families succeed. It can make whole communities more prosperous and more secure. It offers a positive path for young people seeking the chance to make something of themselves, and can empower people who have previously been locked out of the existing social order—women and minorities, others who aren't part of the "old boys" network—give them a chance to contribute and to lead.

....

And entrepreneurship is what gives people like you a chance to fulfill your own dreams and create something bigger than yourselves.²²

Entrepreneurship theory promotes entrepreneurship as a wealth-

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the intergenerational wealth necessary to scale business ventures. This Article explains how traditional and innovative sources of capital raising perpetuate the

Yet, even as we see the value and contribution of entrepreneurs to the economy,³⁰

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color in this Part I, the next Part will discuss how the differences are due in large part to structural barriers—those policies and practices that perpetuate inequality based on race—that continue to reproduce racial disparity that has manifested in the dramatic racial income and wealth gap.⁵³

II. THE ORIGINS OF THE RACIAL WEALTH GAP

The legacy of President Franklin Delano Roosevelt, which includes the passage of landmark social welfare legislation, referred to as the New Deal, is widely held to be a “social revolution” that “raised the entire nation to a plateau of social well-being never before experienced in U.S. history.”⁵⁴ While some, mostly White citizens, in the nation experienced a “plateau of social well-being never before experienced in history,” others, mostly people of color and immigrants, were experiencing devastating effects of discriminatory policies and practices that would have profound repercussions for generations.⁵⁵ This Part describes federal policies that created the wealth gap and the sources of wealth, which widen the gap.

A. *The Effect of Race-Neutral Federal Policies*

The United States has a long and entrenched h

categories of work where Black people and other people of color were overrepresented.⁵⁸ As described in more detail below, immigrants, Black Americans, and other people of color were excluded from economic opportunities tied to the social welfare legislation of the New Deal and did not benefit from such programs until decades after the legislation was enacted.⁵⁹

The Social Security Act of 1935 (“Social Security”) enacted during the Great Depression provided unemployment insurance and old age insurance to certain workers.⁶⁰ Under Social Security, covered workers paid into the scheme and were guaranteed money for retirement, disability, or the death of the family’s breadwinner.⁶¹ The insurance program applied to about half the jobs in the economy at the time it was enacted. Among those left out were farm and domestic workers, positions that were filled predominantly by people of color and immigrants.⁶² In general, “[sixty-five] percent of African Americans fell outside the reach of the new program” and the numbers went up to between seventy and eighty percent in different parts of the South.⁶³ Historian Ira Katznelson argues that since a disproportionate number of Black Americans were in these two occupational groups, the disproportionate impact is evidence of a racial bias as the motive for exclusion.⁶⁴ The effective exclusion of Black Americans and other groups—domestic and farm workers—from receiving Social Security benefits lasted until the 1950s.⁶⁵ By that time, a significant majority of the Black population was, economically speaking, behind their White counterparts.

The New Deal also brought changes to labor law and standards. Under the New Deal, legislation was passed that created modern unions and established a national minimum wage. The National Labor Relations Act (“NLRA”) was

58. Cable & Mix, *supra* note 57, at 195.

59. IRA KATZNELSON, WHEN AFFIRMATIVE ACTION WAS WHITE: AN UNTOLD HISTORY OF RACIAL HEN HEN

passed in 1935.⁶⁶ The NLRA authorized workers to organize and to engage in collective bargaining.⁶⁷ In 1938, Congress passed the Fair Labor Standards Act (“FLSA”).⁶⁸ The FLSA set a national minimum wage and minimum standards for working conditions, including maximum work hours per week and prohibiting child labor.⁶⁹ According to some historians, the Southern Democrats in Congress supported the legislation as long as the laws did not threaten the existing racial hierarchy commonly known as Jim Crow.⁷⁰ As a result, to preserve the *status quo*, farmworkers and maids were carved out of the law’s protections.⁷¹ The carve out for farmworkers and maids from the new labor standards had the effect of excluding the majority of the Black population of workers in the South from benefiting from the law’s protections. In the same

FHA's first thirty-years of existence, just two percent of FHA loans went to families of color.⁷⁸ Black Americans generally did not benefit from federal housing programs until 1968 when the Fair Housing Act became law.⁷⁹ The Fair Housing Act prevented future discrimination but did nothing to remedy the past wrongs. By the time the Fair Housing Act was put into place, people of color had missed out on decades of growth and opportunity in the housing market.

In 1944, the Servicemen's Readjustment Act, better known as the G.I. Bill, was enacted to help World War II veterans adjust to civilian life.⁸⁰ The G.I. Bill is credited with providing low

universities.⁸⁷ Further, many Black veterans avoided applying for government guaranteed mortgages because they felt that the Veteran's Administration would reject them because of their race.⁸⁸ The veterans who benefited from the G.I. Bill went on to use the bill to acquire farms, start businesses, and buy homes guaranteed by the Veteran's Administration. The descendants of the excluded veterans did not inherit any wealth that would have accumulated as a result of the G.I. Bill, unlike the descendants of White veterans who did.

Some historians attribute the exclusion of Black Americans from these successful large-scale national programs that launched a strong White middle-class to racist and segregationist elements, such as the Southern wing of the Democratic Party in the United States Congress, who legislated and regulated these policies.⁸⁹ The Southern Democrats, who ascribed to Jim Crow, were a powerful element in Congress. According to Katznelson, they wanted to maintain the racist and segregation social norms of their constituents.⁹⁰ They achieved this by systematically excluding categories of work in which Black people were overrepresented, placing administration of the programs in the hands of local officials, and preventing Congress from including anti-discriminatory language in the legislation promoting the programs. Social Security, the National Housing Act, and the G.I. Bill were race-neutral federal programs that, in the early part of the twentieth century, effectively helped to create a White American middle class while hampering wealth creation in Black communities, thus maintaining a Black lower class.⁹¹ These public policies provided White Americans with a strong social safety net that advanced their economic status, insured them in old age, and allowed them to get good jobs, send their children to college, build wealth through the equity in their homes,

87. The statistics on disparate treatment are staggering. By October 1946, 6500 former soldiers had been placed in non-farm jobs by the employment service in Mississippi: White veterans filled eighty-six percent of the skilled and semiskilled jobs and Black veterans filled ninety-two percent of the unskilled jobs. KATZNELSON, *supra* note 51, at 105 (2004). See also Katznelson, *supra* note 10, at 105 (2004).

these advantages.”¹¹⁵ White Americans are more likely to receive an inheritance than Black Americans.¹¹⁶

Despite the collapse of the housing market during the Great Recession, homeownership is still the greatest source of wealth in the United States.¹¹⁷ Black homeownership lags behind White homeownership.¹¹⁸ Only forty-one percent of Black Americans own their homes, compared with seventy-one percent of White Americans.¹¹⁹ Black Americans not only build less wealth through a low rate of homeownership,¹²⁰ but home values in segregated communities of color are lower than in those of White communities,¹²¹ resulting in Black homeowners earning a smaller return on their investment. Further, because they are less likely to inherit money or receive financial assistance from their families, it takes Black people longer to buy homes, and they also have smaller down payments than their White counterparts.

Personal wealth, manifested by homeownership, plays an important role in entrepreneurship, often negatively affecting an entrepreneur’s ability to access capital. If a business owner is already wealthy or owns a home, it is more likely that the business owner will receive a bank loan.¹²² Studies show that owning a

115. AUSTIN, *supra* note 51, at 18.

116. THOMAS SHAPIRO, TATJANA MESCHEDÉ & SAM OSORO, INST. ON ASSETS & SOC. POLICY, THE ROOTS OF THE WIDENING RACIAL WEALTH GAP: EXPLAINING THE BLACK-WHITE ECONOMIC DIVIDE 5 (2013), <https://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf> [<https://perma.cc/5UJY-85F5>].

117. Doug Ryan, *Homeownership Is Still Very Much an Asset-Building Strategy*, SHELTERFORCE (Aug. 12, 2014), https://shelterforce.org/2014/08/12/homeownership_is_still_very_much_an_asset-building_strategy/ [<https://perma.cc/CL8S-6YBE>].

118. SHAPIRO ET AL., *supra* note 116, at 3.

119. Rodney Brooks, *Declining Black Homeownership Has Big Retirement Implications*, FORBES (May 10, 2017, 12:21 PM), <https://www.forbes.com/sites/nextavenue/2017/05/10/declining-black-homeownership-has-big-retirement-implications/#45d87371e90c> (last visited Feb. 9, 2018).

120. SHAPIRO ET AL., *supra* note 116, at 3–4.

121. See ASS’N FOR ENTER. OPPORTUNITY, THE TAPESTRY OF BLACK BUSINESS OWNERSHIP IN AMERICA: UNTAPPED OPPORTUNITIES FOR SUCCESS 24 (2016), https://aeoworks.org/images/uploads/fact_sheets/AEO_Black_Owned_Business_Report_02_16_17_FOR_WEB.pdf [<https://perma.cc/SEZ9-L43E>]; Emily Badger, ‘This Can’t Happen by Accident,’ WASH. POST (May 2, 2016), <https://www.washingtonpost.com/graphics/business/wonk/housing/atlanta/> (last visited Feb. 9, 2018).

122. Ken Cavalluzzo & John Wolken, *Small Business Loan Turndowns, Personal Wealth and Discrimination*, 78 J. BUS. 2153, 2170–71 (2005); ALICIA ROBB, SBA OFFICE OF ADVOCACY, ACCESS TO CAPITAL AMONG YOUNG FIRMS, MINORITY-OWNED FIRMS, WOMEN-OWNED FIRMS, AND HIGH TECH FIRMS 4 (2013), [https://www.sba.gov/sites/default/files/files/rs403tot\(2\).pdf](https://www.sba.gov/sites/default/files/files/rs403tot(2).pdf) [<https://perma.cc/4823-6WGY>]. Banks are rarely a source of credit for Black businesses. ASS’N FOR ENTER. OPPORTUNITY, *supra* note 121, at 24–25. If Black business owners are approved for credit, it is for lower amounts than their White peers. *Id.* Approval rates are also lower for businesses owned by people of color than for White businesses, even with respect to credit products designed specifically to serve small business. *Id.*

home decreases the probability of loan denials among existing business owners.¹²³ With homeownership directly linked to building wealth, it is an example of a resource that is unavailable to entrepreneurs of color. The low rate of homeownership among entrepreneurs of color is important because entrepreneurial ventures often are financed with business loans that are tied to equity in the founder's home.¹²⁴ Low rates of homeownership translate into an inability for entrepreneurs of color to access capital through traditional mechanisms.

B. The Impact on Entrepreneurs of Color

The wealth building policies that favored White households over households of color continue to play a role in not only the current economic system but in

its report, *The Color of Entrepreneurship*, the Center for Global Policy Solutions illustrated some of the historic factors that influence the current racial disadvantage in entrepreneurship, writing that:

African Americans have been disadvantaged because of slavery, Jim Crow, segregation, redlining, and their exclusion from the G.I. bill and homeownership incentives that enriched Whites after World War II. . . . These and other policies and practices greatly reduced the opportunities for people of color to build wealth.¹²⁸

The separate but equal doctrine entrenched during the Jim Crow era severely limited Black economic power and hindered business ownership as it restricted the location of Black-owned business t

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accessing financial capital to build and grow their business ventures as compared

A. *The Wealth Gap and Traditional Sources of Capital*

Beyond the challenges minority entrepreneurs face due to lack of individual wealth and low homeownership rates, they also face challenges with respect to accessing external sources of capital to start and grow their venture.¹⁴⁵ All entrepreneurs need access to capital to start or build their business ventures. Yet, as a practical matter, startup funding¹⁴⁶ almost exclusively goes to White men.¹⁴⁷ As of 2006, for example, only thirteen Black female founders have received over \$1,000,000 in outside funding,¹⁴⁸ while there are over 1.5 million businesses run by Black women.¹⁴⁹ The average initial capitalization of Black entrepreneurs is fifty-seven percent of White-led new businesses.¹⁵⁰ Economists Robert Fairlie and Alicia Robb found that the difference in the startup capitalization of new startups led by Black and White founders had a large effect on performance and that such low capitalization is a reason why Black-owned businesses are less successful.¹⁵¹ There are many reasons for this difficulty to obtain traditional sources of financing including lack of substantial collateral and business subject matter expertise, whether actual or perceived.¹⁵² Moreover, it has been shown that investors expect for a founder to invest a significant portion of his or her own capital into the business before the investor is willing to invest.¹⁵³ Because wealth is concentrated among primarily White individuals and funding streams to entrepreneurs mirror where the wealth already exists, the result is White male entrepreneurs receiving the majority of startup financing.¹⁵⁴

The success of a venture is directly tied to the founder's ability to finance the venture.¹⁵⁵ Therefore, acquiring external sources of capital is paramount to

145. See Dana Thompson, *L3Cs: An Innovative Choice for Urban Entrepreneurs and Urban Revitalization*, 2 AM. U. BUS. L. REV. 115, 124–26 (2012) (describing the challenges faced by urban entrepreneurs).

146. Startup funding refers to the funding required to start a new business, whether it be required for salary, marketing expenses, licenses, inventory, technology or product development, or other expenses.

147. KATHRYN FINNEY, *THE REAL UNICORNS OF TECH: BLACK WOMEN FOUNDERS*, DIGITAL UNDIVIDED 3, 8 (2016); see Bryce Covert, *Startup Funding Is Given Almost Entirely to Men*, THINAI.6(N)-3(Tw 10.56.52 4(es)1.7cq 1T) Tj -0.015 E9[9215 E9[9215 E9[96(N)-34.52 138.96 282G8.96 28293.16S.4(r)IHOOLO OFYN '

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Although the JOBS Act was intended to provide greater access to capital for entrepreneurs¹⁸⁴ and increased economic opportunity for ordinary investors, the legislation and current capital raising schemes available to entrepreneurs may not be enough to meaningfully narrow the racial wealth divide in part because the legislation and existing capital raising schemes take a narrow view of entrepreneurship, targeting mainly high-growth businesses.¹⁸⁵ Given the

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IV. SOME RECOMMENDATIONS TO NARROW THE RACIAL WEALTH GAP

There is no legal framework for challenging the structural barriers that have created the systemic racial wealth gap and the barriers to success for entrepreneurs of color. In fact, such ideas are political landmines. Yet, law and policymakers need to have such a lens to effectuate policies that address systemic problems and reduce the existent disparities resulting from previous *race-neutral* policies and laws. The underlying issues that contributed to the racial wealth gap will not be addressed by legislation unless the legislation addresses structural inequalities that led to the wealth and resource disparities in the first place. Such a system would also need to address the structural barriers that lead to the disparities in entrepreneurship.²⁰²

Changing the status quo to create circumstances for entrepreneurs of color to grow their business and build and create wealth within their communities will allow everyone to benefit from greater economic output that is not concentrated among the majority population. Otherwise, without significant, targeted interventions in the American economy, entrepreneurs of color, and in turn, people of color, will never be able to close the racial wealth gap.

Given the long history of disparity that has led to the wealth gap and its effects on entrepreneurs of color, the removal and redress of structural barriers and effects of discrimination are challenging prospects. Part IV offers recommendations that could narrow the racial wealth gap for communities of

racial wealth gap.²⁰⁵ There needs to be a holistic approach that incorporates marginalized communities into the entrepreneurial ecosystem. The solution to the gap must be multifaceted and contain multiple solutions. In 1943, a developmental psychologist, Abraham Maslow introduced a hierarchy of human needs, in his paper, *A Theory of Human Motivation*.²⁰⁶ Maslow's theory is that human beings cannot have self-actualization if they do not have all the other elements in place first.²⁰⁷ The parallel to his work with respect to entrepreneurship is that you cannot have a fair and equitable startup ecosystem without addressing some of the systemic inequities that surface within the system.

1. Increasing Access to Financial Capital

Typically, the success of a venture, whether it is a low-growth or high-growth venture, is directly tied to the founder's ability to finance the venture. As described above in Part III, research shows that capital is the number one predictor of

be uniquely positioned to meet the financial services needs of those without access to banks. In a white paper, the Postmaster General describes the problem of the average underserved household spending \$2412 each year or a total of \$89 billion on interest and fees for alternative financial services.²¹¹ The Postal Servic

of companies that go through an accelerator are three times that of companies that do not participate in one.²¹⁸ Research also shows that companies that complete an accelerator program grow faster than companies that do not complete an accelerator program.²¹⁹ There are often university-based, private, and nonprofit incubators that offer assistance to small businesses and startup founders to address the unique challenges that entrepreneurs face, such as access to capital, technical assistance, and networking. Often these programs offer access to mentors, provide some type of programming, and make referrals to financing and funding. Women and people of color are noticeably absent from these programs, however; they do not participate in incubators and accelerators at the same rates as their White male counterparts.

sufficient. One example of a company targeting multicultural and women founders is Morgan Stanley.²²² Morgan Stanley launched the Multicultural Innovation Lab (“Lab”), an accelerator program for technology and technology-enabled startups.²²³ The Lab was intentionally designed to increase outcomes for multicultural and women founders.²²⁴ The program focuses on companies with a founder, co-founder, or chief technology officer who is a woman or a person of color. In addition, the Lab seeks companies that “have the potential to develop innovations that could disrupt sectors.”²²⁵ The Lab will also invest in the companies supported by the Lab.²²⁶

As described above, entrepreneurs of color lack social networks and capital to attract venture capital investors.²²⁷ Supporting the expansion of venture capital dollars to entrepreneurs of color is a way to overcome structural barriers to economic success. One recommendation that has been suggested by the Center for Global Policy Solutions is the creation of tax incentives for venture capitalists to invest in certain neighborhood businesses, similar to an Empowerment Zone, in the form of a tax credit to promote venture capital investments in businesses owned by entrepreneurs of color.²²⁸ The Venture Capital Access Program is an example of a program that provides women and entrepreneurs of color access to angel investors and venture

model that uses objective criteria to determine an individual's risk profile.²³⁰ Critics and experts question whether FICO is an appropriate credit model and have provided some alternatives.²³¹ The alternative credit model would use a different risk profile than the FICO credit score system, such as looking at payment of rent, utilities, childcare, and medical care to establish credit histories.²³² The alternative system would allow consumers to demonstrate credit-worthy behavior beyond the *objective* criteria of financial institutions with discriminatory history. This would expand access to credit and would be a strategy toward closing the racial wealth gap.

B. Improvements Beyond Entrepreneurship

1. Investing in Federal Policies

This Article has described how certain past federal policies affect outcomes for entrepreneurs of color, demonstrating that the racial wealth gap is perpetuated by historic and current federal policies that operate to reinforce and increase the wealth of the already wealthy. Half of the \$400 billion in annual federal asset-building subsidies, such as to promote homeownership, retirement

The Institute for Policy Studies and the Center for Expanding Economic Opportunity recommend an evidence-based, government-wide audit of federal policies to understand the role current federal policies play in perpetuating or closing the racial wealth divide.²³⁵ Researching the historic and current role of federal laws and regulations would certainly

consumption and income.”²³⁸ Wealth building policies, such as tax subsidies for homeownership, retirement, and life insurance benefit the wealthy.²³⁹ Since families of color are less likely to be able to use these subsidies, they benefit little or not at all. Reforming policies and promoting savings opportunities for all Americans will help improve wealth inequality. Economists Derrick Hamilton and William Darity Jr. write that “[g]iven the importance of intergenerational transfers of wealth and past and present barriers preventing Black wealth accumulation, private action and market forces alone cannot close . . . [the] racial wealth gap. [sic]—public sector intervention is necessary.”²⁴⁰ They present two important proposals that would develop the wealth of the poor. The first is the “American Dream Demonstration . . . which uses Individual Development Accounts . . . to create match incentives for the poor to save . . .” and second is “the Savings for Education, Entrepreneurship, and Down-payment . . . initiative which establishes Children’s Development Accounts [“(CDA”)]. . . .” that are commonly referred to as Baby Bonds, which would create endowed trusts for children at birth.²⁴¹ The eligibility for the program would need to be determined based on the child’s family wealth, not income. Families that fall below the median wealth guidelines would receive CDAs. According to economists:

[T]he budget for the program would be less than [ten percent] of the non-war spending budget for the Department of Defense. There are about [four] million babies born each year in the [United States]. If the average trust is set at \$20,000 per child and three-quarters of all newborns ([three] million) are made eligible for the program, the baby bond program would cost about \$60 billion per annum. Although this simple estimate does not incorporate costs resulting from increased fertility incentives, it also does not incorporate savings resulting from reduction in other federal transfer programs associated with better-resourced young adults.²⁴²

The United Kingdom implemented a program of baby bonds in 2005. The program supporting child trust funds closed in 2011 and has been replaced by a tax-free savings program, called Junior ISAs.²⁴³ In the baby bonds program, each

238. MCKERNAN ET AL., *supra* note 14, at 4.

239. “The federal government spends hundreds of billions of dollars each year to support long-term asset development. But these asset-building subsidies primarily benefit high-income families, while low-income families receive very little.” *Id.* at 5.

240. Darrick Hamilton & William Darity Jr., *Can ‘Baby Bond’ Eliminate the Racial Wealth Gap in Putative Post-Racial America?*, 37 REV. BLACK POL. ECON. 207, 214 (2010).

241. *Id.* at 215.

242. *Id.*; see ANNIE E. CASEY FOUND., INVESTING IN TOMORROW: HELPING FAMILIES BUILD SAVINGS AND ASSETS 3 (Jan. 2016), <http://www>

the reality of Black Americans who are being asked to start a business on an uneven playing field.

Confronting the racial wealth gap and the race-neutral public policies that continue to amplify the disparity can create a more equitable future. Rather than race-