# 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. Settlement from refugee camps continued well into the 1980s.*

*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 business owners. Moreover, Hmong and white business owners have similar views on the barriers to their access to credit. Focus group discussions with local community leaders and commercial banks indicate that special 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

The Community Reinvestment Act of 1977 gave the Federal Reserve System a congressional mandate to ensure that commercial banks meet the credit needs of their communities. This mandate includes ensuring fair and equal access to capital and credit for immigrant or refugee small business owners. 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 to their attempts to obtain credit?
- Are there special characteristics of the Hmong community or the banking environment of the MSP area that have affected small business owners' access to credit?

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 region of Asia, providing them with limited experience in an advanced capitalist system. This fact, coupled with their relatively recent migration to the United States as political refugees, suggests that the Hmong are likely to experience suboptimal access to credit from commercial banks and other formal financial institutions.[1] Second, the Hmong community located in the MSP area constitutes the largest Hmong population center in the United States and has recently begun developing a distinct, recognized, and viable small business sector. These attributes make the MSP Hmong community a particularly

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

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] 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 are no substantial differences at start-up in the likelihood of seeking/obtaining a bank loan or in the amount of formal loans used by Hmong business owners relative to white business owners (the comparison or control group). Moreover, we find that both groups of entrepreneurs reported similar barriers to their attempts to obtain financing and little evidence indicating the Hmong owners systematically felt they were receiving less access to credit than the control group. We also analyze credit utilization and access during the later phase of the business (two years prior to the survey date). Although an initial review of the data indicates that credit utilization is lower for Hmong owners during this later phase, we find evidence that a lack of demand may be responsible for the lower utilization rates. Finally, focus group responses suggest that certain banking practices might explain the relative success in the credit market experienced 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 experience. Section IV discusses the survey instrument and provides descriptive statistics on the two populations surveyed. 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

[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).

community representatives and bankers to verify the accuracy of the survey and our conclusions. Section VIII contains a summary of our results and suggestions for future research.

## II. Small Businesses and Liquidity Constraints

### *Why small businesses may have difficulty accessing formal financial markets*

Modern theories of financial intermediation maintain that in advanced economies, with high per capita income and high levels of wealth, financial intermediaries (banks, venture capital firms, risk management firms, and so on) emerge specializing in producing information. By such specialization, they help to resolve information asymmetries and reduce transaction costs of monitoring. [See for example, Diamond (1984) and Boyd and Prescott (1986).] But specialization has not eliminated all asymmetries. Indeed, research suggests that information asymmetries are quite pronounced in the case of new and small firms; hence, they are less likely to have publicly traded financial information (Petersen and Rajan, 1994). Aghion and Bolton (1992) and Lehnert et al. (1999) show that at low levels of income and wealth, individuals face higher interest rates or are cut out of the financial market altogether. These studies suggest that what is true for individuals may also be true for firms and that the cost of capital may be prohibitive, particularly for small new ventures with lower revenues. And, to the extent that these firms are clustered within certain locations, this would translate into lower lending activities in these communities.

While a number of factors could lower the cost of acquiring financial capital, smaller firms are not always in a position to take advantage of them. For example, at least a partial solution to the asymmetric information problem is collateral. Firms' pledging collateral should mitigate adverse selection 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 (Van Auken and Neeley, 1996; Scholtens, 1999).

The ownership structure of small firms, whereby the entrepreneur is also the owner, is cited as another partial solution to the asymmetric information problem (Scholtens, 1999). This is because firms owned and operated by the 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 businesses, and the greater vested interest in the business signals higher creditworthiness (Bopaiah, 1998). In practice, however, because owners of new, small firms typically have little personal equity and have difficulties generating revenue and cash flow, they experience more difficulty signaling creditworthiness and are therefore more liquidity constrained.

One other potential solution to the asymmetric information problem is noted in the literature, but it will not be effective for new firms. Since information production is costly, a long-term relationship between a firm and a financial institution has the potential to lower information costs and 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 (Fama, 1985; Petersen and Rajan, 1994; Berger and Udell, 1995; Cole, 1998; Scholtens, 1999; Uzzi, 1999). 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 and opens the possibility for greater compliance of contract.

In instances where a long-term relationship with a financial institution is lacking, small businesses may deal with the asymmetric information problem by using informal relationships, that is, by using complementary or alternative sources of capital available in the informal sector. For example, Bond and Townsend’s (1996) study of a group of Hispanic immigrant business owners in a Chicago enclave raises the possibility that that group may seek financing in the informal sector instead of from banks because of preference or cultural factors. A vast body of theoretical and empirical research has begun to acknowledge the importance of nontraditional sources of financing (for example, “bootstrap” financing and/or micro lending) for small business financing, especially during the formation stage of the business (Van Auken and Neeley, 1996; Anthony, 1999). The main characteristics of informal financing are that monitoring is more intensive, search costs and information costs are relatively low, and enforcement mechanisms may be more effective.[3] Informal financing is also relevant when the lending relationship is non-economic and is based rather on familial, social, and cultural considerations. The preference for relying on family members, for example, reflects a pragmatic assessment by the immigrant of the potential for this type of financing to circumvent increased transaction costs associated with the formal sector lending process (Sanders and Nee, 1996).

### *Particular challenges facing immigrant/refugee-owned small businesses in accessing credit*

Immigrant/refugee small business owners may encounter additional difficulties, beyond those faced by other small business owners, as they attempt to access formal financial markets. To our knowledge, no previous study has directly tested for discrimination on the basis of immigrant or refugee status of business owners. However, research suggests that immigrant groups may experience particular constraints accessing formal credit because they may not have a record of previous business ventures or because they lack sufficient capital to borrow (Bates, 1996).

Research also suggests that some immigrant groups may have less access to credit because of lower human capital. Human capital such as English language proficiency allows immigrants to organize and operate their businesses, communicate with customers and suppliers who may be from a different ethnic group, and adhere to legally mandated practices. The longer an immigrant group has been in the new country, the more human capital they acquire and the more likely they are to become financially assimilated into the new society. For the Hmong specifically, Paulson et al. (2002) find that it takes them close to 15 years to become financially assimilated (in the sense that utilization of financial services is at the same rate as non-Hmong populations in their area).

In summary, theory suggests that financial intermediaries arise, in part, to address problems of information asymmetry, which are particularly important in explaining small firms' limited access to bank credit. However, even with these specialized intermediaries,

[3] Several works on informal finance are in the context of developing countries (Khandker et al., 1995; Fafchamps, 1999). For example, Khandker et al. (1995) note that informal (or quasi-informal) financial sectors in developing countries often use group pressure to collect obligations; they may also accept flexible and unconventional types of collateral, including labor.

we may find that some firms—especially immigrant/refugee-owned small firms—get less than optimal financing.

## III. The Hmong Experience

The Hmong are immigrants from Laos and other Southeast Asian countries who settled in the United States as political refugees after the Vietnam War.[4] The 2000 decennial census data put the total U.S. Hmong population at roughly 169,000, making it one of the fastest growing Asian groups in the United States. Minnesota and Wisconsin have the largest concentrations of Hmong-Americans in the United States as a result of both direct settlement from Southeast Asia and resettlement. The latest enumeration shows 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 agriculture-based businesses to capitalize on these traditional skills. As they increasingly congregated in urban areas, they naturally shifted their business focus.

The largest concentrations of Hmong households and businesses are located in the Payne-Phalen and Thomas-Dale neighborhoods in St. Paul and along the Penn Avenue North corridor in Minneapolis. These neighborhoods are in the core cities and are characterized by well-established commercial strips composed 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.

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[4] Hmong refugees also settled in France and Australia. Settlement began in the mid-1970s and continued into the 1980s from refugee camps in Southeast Asia.

## IV. Survey Overview and Descriptive Statistics

The Hmong Small Business Survey (HSBS) is 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.[5] 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.[6] 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, compared to the two hours used to administer the full version in Chicago.

An extensive effort was undertaken to compile a list of all known Hmong businesses in the greater MSP area, most of which were located along two primary commercial strips in St. Paul.[7] The resulting list was screened to eliminate duplicates and to verify Hmong ownership of an extant business in the core cities of Minneapolis and St. Paul, a process that identified 170 Hmong businesses. Of these 170 owners, 121 (71 percent) completed the survey, 36 refused, and 13 could not complete the survey 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 arises from

[5] 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; Huck et al., 1999).
[6] The Wilder Research Center of St. Paul, 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.
[7] Information sources included the *Hmong-American Residence and Business Directory*, a local Hmong Chamber of Commerce, community development groups, and economic development agencies.

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 agency. The list was subsequently randomized and purged of any Hmong businesses or known government and nonprofit organizations. From the randomized list, 342 businesses were contacted and 220 were found to be for-profit enterprises still in existence. Of these 220 owners, 131 completed the survey (60 percent), 41 refused, and 48 could not complete the survey within the study period. (Control businesses were surveyed from June 2001 through 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 identified themselves as being white or Caucasian.[8] White-owned firms provide the appropriate benchmark since, other things equal, this group should have the greatest access to credit of any racial or ethnic group.

***Business and owner characteristics***

Since the control group was constructed on the basis of co-location with Hmong businesses, as expected, we found that the two groups share several similar characteristics. However, where the two groups differ, the Hmong would likely be disadvantaged in their ability to access credit. In particular, the Hmong and their businesses were much younger than the control group and, hence, higher-risk borrowers.

The majority of Hmong and control businesses were retail and service firms. (See Table 1 for business characteristics.) Virtually all of the businesses were classified as nonfranchise 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 had high levels of human capital. (See Table 2.) Between 40 and 50 percent of each group had at least a college degree, and a slightly smaller percentage reported owning at least one business

[8] Throughout the rest 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.

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 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 existed, we expect that the differences would bias the survey results against a finding of access to credit for the Hmong comparable to that of the white owners. For example, the median Hmong owner was roughly 10 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 10 fewer years relative to those of the control group. Moreover, nearly 70 percent of the Hmong businesses were started from scratch by the current owner, compared to only half of those 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—one-third the size of the median control business. Correspondingly, nearly 60 percent of the Hmong businesses reported having no 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 sizable share of firms in two categories that again would bias the results against a finding of comparable credit access. Of the white-owned firms, 14 percent were classified as construction and industrial businesses, while 20 percent of the Hmong establishments were part of the financial sector (insurance agencies or financial service providers). Industrial firms that extensively use heavy machinery and maintain large inventories of raw materials require larger amounts of start-up capital and more frequently request bank financing. Less capital-intensive financial enterprises, such as 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 (Van Auken and Neeley, 1996; Scholtens, 1999).

Survivor bias should also influence comparisons between the Hmong and control groups. Since the white-owned firms were generally older, they should contain fewer marginal firms on a percentage basis than those 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

Our primary interest is determining whether the Hmong small business owners have access to credit comparable to white business owners. 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.[9] In addition, 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 since the two groups may experience different denial rates on their applications.[10] Another consideration is that because our sample includes only firms that by definition have survived, it is difficult to get an accurate reading on whether potential applicants or latent entrepreneurs were discouraged from applying for loans. This would bias our results toward finding a more positive experience than might be the reality.

### *Start-up funding*

Overall, the Hmong businesses appeared quite similar to the control group businesses in terms of total start-up funds. As expected, the total amount of capital used to start a firm

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

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

from scratch was much lower than the amount used to acquire an existing establishment. Once we control for this attribute, we find roughly equivalent utilization of start-up funds between the two groups. (All amounts are converted into 2001 dollars.) Hmong owners who acquired an existing business reported marginally lower start-up capital amounts than the white owners ($112,000 versus $123,000), but modestly higher amounts for firms started from scratch ($23,000 versus $19,000).

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

We find that a sizable number of owners were able to obtain funds from formal external sources (Table 3). At least 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. Twenty-five 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 (a primarily Hispanic enclave in Chicago) found that only 11 percent of Hispanic owners reported use of a bank loan to finance the start of the business.[11] 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

[11] We note that this comparison may be influenced by differences in the characteristics of the firms in each survey.

owner. Moreover, denial rates for start-up loans were roughly comparable: 43 percent for the Hmong and 34 percent for the control.

While one might question the extent to which our control group is typical of white small business owners overall, we find that it is. The proportion of business owners making use of bank loans to fund their start-up is consistent with results from the U.S. Census Bureau's 1992 *Characteristics of Business Owners Survey*. This national survey indicates that close to 30 percent of white owners make use of bank loans to start their businesses, suggesting that the white small businesses in our sample tend to be capitalized in a manner that is consistent with average white small businesses in the nation.

We also find that the use of informal external sources of financing, such as loans and gifts from relatives and friends, was common to both Hmong and white business owners—46 percent for both groups. This finding supports the need for research to learn more about the use of informal markets to assess the true volume of credit available, particularly in ethnic communities where ethnic networks might be relevant.

Hmong owners differed from the control group with respect to their utilization of personal savings. While the vast majority of both types of 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. However, the relative amount of total start-up funds accounted for by personal savings was roughly 50 percent for both the median Hmong and the median 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 or credit), we find no statistical difference between the Hmong and white owners in the total amount of financing used and in the financing provided by formal external sources. An important corollary is whether Hmong business owners were more or less likely to use a formal lending institution relative to white business owners. Our empirical analysis results, controlling for industry type and owner's characteristics, found no evidence that Hmong business owners were any less inclined to seek bank financing to start their businesses.[12]

***After the start-up phase***

We use the term "operational credit" to refer to nonstart-up loans obtained in the two years prior to the survey. Survey respondents were questioned about their attempts to obtain operational credit, regardless of the source. Less than 20 percent of the Hmong owners reported making such a request, compared to over 40 percent of the control owners. Bank loans were the dominant type of operational credit sought by each group, accounting for over 75 percent of the individual requests. (See Table 4 for a breakdown of the applications by lender identity.) Virtually all of the owners made at least one request to a bank as well, with 83 percent of the Hmong owners and 91 percent of the control group who applied to a bank having at least one of their requests granted.[13]

In an attempt to explain the discrepancy between the Hmong and white owners' attempts to obtain operational credit, we investigated several 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 or size of the establishment, the low usage of such credit by 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 within each group did not appear to be 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 demand for additional financing. Determining whether such "lack of demand" is

[12] A probit analysis shows that the differences in the coefficients for Hmong and white owners was statistically insignificant for the likelihood of seeking and obtaining a bank loan. Results are available upon request from the authors in Chicago.
[13] None of the Hmong owners reported trying to obtain a loan from an informal source, such as a relative or friend.

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 nonuse. However, the "lack of demand" 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. Less than half of the Hmong businesses had suppliers that offered trade credit, and only 25 percent of this cohort owed a supplier when surveyed.

While these findings are far from conclusive, they suggest that the Hmong owners had access to credit from banks that was comparable to that of 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, their relatively lower use of suppliers' credit could be indicative of simply having less demand 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 demand for credit.

## VI. Evidence of Problematic Credit Access

Measuring the use of bank credit at different points in a business lifetime is one 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. As noted earlier, the two groups may experience different denial rates on their applications.[14] To alleviate this concern, we also searched for evidence of unequal access in a series of questions designed to allow owners to directly identify credit access as a 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

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

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. We offer a note of caution. The self-reported answers point to financial and liquidity constraints as obstacles to growth, particularly among the Hmong owners. More research, especially that which makes use of longitudinal data, will be necessary to confirm the specific difficulties encountered in this community in the course of its business life cycles.

***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 ask for a loan, from either 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 owners 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 elected to forgo 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 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 (for example, 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.) Twelve 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 owners. 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 ("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 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 given 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 ("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 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 one-third of the control group. Although we expected the response to this question to be highly correlated with the replies indicating whether access to credit was considered a barrier, we found a substantial difference between these answers in both groups. Forty-five 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.[15]

***Hmong owners appeared more likely to experience 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.[16] 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. 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 owners. (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 white owners who would not invest the funds in a new or existing business was roughly 50, and their responses may indicate that financing constraints, while potentially still important, are of secondary concern. Moreover, owners' attitudes to risk may also affect 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-owned and 27 white-owned businesses 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 percent to 50 percent of the

[15] 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 "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.

[16] Holtz-Eakin et al. (1994) describe a model in which entrepreneurs face liquidity constraints.

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 percent to 11 percent of the Hmong owners cited such strategies.

## VII. 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 another 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 of leaders to educate, and flexibility in lending programs.

### *Cultural understanding*

The Hmong focus group said that the banking sector needed to have sufficient knowledge of 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.[17]

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.

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

***Education***

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 deny requests from potential borrowers because they lacked technical documents (business plans or cash-flow analyses), loan officers needed to explain what documentation was required and assist business owners 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 of a successful Hmong lending program, both in terms of being able to relate to applicants and in helping to educate them on issues such as saving, applying for a loan, and documenting business performance.

***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 or analysts, since these individuals could advocate for a loan using the bank's established underwriting more flexibly to include the borrower's 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 using only 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 their willingness to repay loans.

Finally, Hmong representatives felt that banks were successful in meeting the community's credit needs but that more could be done to improve overall access to 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. Summary 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 acquiring credit.

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

To provide a check on the survey results and to identify any special characteristics of the Hmong or the banking community that affected 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 certain characteristics 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 research 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 five 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 |
| **Aggregate Statistics** | | | | |
| Started from scratch by owner | 80 | 66 | 48 | 52 |
| Was a partnership at start-up | 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 in U.S. | 17 | | | |
| Gender is male | 111 | 92% | 78 | 84% |
| No high school degree (U.S.) | 8 | 7 | 7 | 8 |
| High school degree or some college | 54 | 45 | 48 | 52 |
| College degree or beyond | 58 | 48 | 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 |

* Because of nonresponses, some group totals may not sum to 121 or 93.

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 |
| —Gov't/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-up
(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-up
(Hmong = 121, White = 93)

| | Hmong | | White | |
|---|---|---|---|---|
| Reported a nonfinancial 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 toward 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
## Determinants of Start-up Funding Levels

In this Appendix, we describe a statistical analysis of the determinants of start-up funding.

Start-up Funds Regression Results (a)

| | Coefficient (b) | Standard Error |
|---|---|---|
| Intercept | 10.0728 *** | 0.734 |
| Hmong owner | 0.3291 | 0.2989 |
| Owner's age at start-up | 0.0182 | 0.0148 |
| Owner is married | –0.0299 | 0.3042 |
| Owner is female | 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 |
| Restaurant | 0.4187 | 0.4734 |
| Automobile services | 0.5278 | 0.4862 |
| Finance/insurance/real estate | –0.3682 | 0.3926 |
| Business services | –0.7520 ** | 0.3692 |
| Professional services | –1.0670 ** | 0.5056 |
| Personal services | –0.3965 | 0.3848 |
| Retail/clothing | 0.703 | 0.5641 |
| Convenience store | 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 | |

(a) This table reports OLS regression results for the logged level of total start-up funds. The omitted control variables are as follows:

- Ethnic/racial category: white
- Business category: grocery store and manufacturing
- Education category: high school degree or some college

Hence, the coefficient for the Hmong group measures differences in start-up funding relative to whites, the coefficients for the business categories measure differences relative to grocery stores, and the coefficients for education levels measure differences relative to a high school degree or some college.

(b) *** indicates significance at the 1% level, ** indicates significance at the 5% level, and * indicates significance at the 10% level.

The regression results show the following: Owners with experience in a previous or similar business begin with higher start-up capital, and owners who start their businesses from scratch have relatively lower start-up capital than owners who took on an existing business. Businesses that survive for a longer period of time begin with higher start-up capital. Other retail businesses, professional services, and business services have lower start-up capital. Attitudinal factors have a significant influence on the amount of capital that an owner is 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. However, an owner with access to formal credit begins with a significantly higher amount of start-up funding 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, but conditioned on the sources of funding—internal sources, formal external sources, or informal 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, the Hmong used a significantly larger amount of funding from internal sources, 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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