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MESBIC'S: THE BLEND OF PRIVATE INITIATIVE AND GOVERNMENTAL ENCOURAGEMENT

Walter L. Sorg*

In assisting individuals to emerge from previous economic dependency to current independency, the role of the Federal programs should not be one of doing, but rather one of encouraging others to do for themselves. The greatest involvement and initiative must come from the private sector.

A catalyst for this interaction between the Federal government and the private sector was created in March, 1969 when President Nixon signed Executive Order 11458 which established the Office of Minority Business Enterprise (OMBE). The goal of OMBE is to stimulate and aid in the development of a free enterprise system in which minorities can achieve economic status through the business mechanism.

Central to the concept of the minority business effort is the belief that the economic self-interests

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of each American will be best served only if all Americans have access to economic opportunity.

There are a number of reasons which validate this belief. Secretary of Commerce, Maurice H. Stans, cited three in his report to the President dated June 30, 1970:¹

"First, the United States cannot afford to continue wasting the potential contribution to economic progress which rests within those who have in effect been excluded from 'the system'.² Productive capitalism thrives on broad competition. Increasing our base of entrepreneurs will not exhaust a limited marketplace. On the contrary, it can increase both the size and quality of the enterprise economy. In that process, all can benefit.

"Second, the exclusion of so many from the upper level of the productive society can endanger its future. Those who do not participate are not likely to understand how well it works and how it can be advanced for the common good. They are then less likely to support it against the attacks of its critics, and more likely to become its critics. Those who know that they can participate in the adventure of American free enterprise if they wish, will be less disposed to join with those who would destroy it.

"Third, and above all, the doors of ownership opportunity must be opened fully because it is the right thing to do. American competitive enterprise cannot achieve its full dignity so long as any American is denied his full opportunity to share in basic American freedoms...the right to venture, the right to compete, the right to own."

OMBE recognizes that minority entrepreneurs will move into the system as they perceive realistic opportunities and as American business and the American majority make it possible for them to do so. Thus OMBE, as the focal point for the national minority business effort, concerns itself with creating incentives for interaction between the majority and minority sectors.

The minority business program is neither a welfare project nor is it a small business program. It is a business opportunity program, and carries with it all of the challenge and risk associated with business ownership. Though it is recognized that most businesses start small and grow, there is nothing in the program that precludes large-scale business ventures. Because business must necessarily be located where market opportunities are more abundant, there is no attempt to limit the program to the ghettos and barrios. While there are undoubtedly significant business opportunities in the inner-city, suburbia should also be considered a fertile marketplace for minority business development.

The minority business program will have achieved success only when all our citizens have access to those

resources which can insure each person of an equal right to try, an equal right to succeed and an equal right to fail. OMBE concentrates on stimulating the generation and availability of increased opportunities, capital and business know-how. In effecting a partnership between the Federal Government and the private sector that is complementary rather than competitive, the Administration seeks Federal support to provide management and technical assistance from private sources. Tax incentives and loan guarantees are deemed essential to stimulate the flow of private capital for investment in business opportunities.

An almost classic example of the public-private partnership, which is entirely consistent with the writer's concept of our common conservatism, is the Minority Enterprise Small Business Investment Company (MESBIC) Program. Both the Federal Government and those who sponsor MESBICs perform essential and complementary functions. Both, acting in concert, are satisfying critical minority business needs.

The Small Business Investment Act of 1958 provides for the establishment of Small Business Investment Companies (SBICs) to make equity and long-term debt

investments in small business concerns.³ Although this Act was intended to assist all small businesses, relatively few investments were made in minority businesses in the ensuing years.⁴ Based upon the experience of a special purpose SBIC,⁵ in the spring of 1969, Secretary Stans concluded that the concept offered a great potential for a more representative participation of minority entrepreneurs in the nation's economy. In recognition of the greater need by minority businessmen for investment capital as opposed to venture capital (the orientation of SBICs, generally), the special-purposes SBIC (MESBIC) was born.

MESBICs are special SBICs which make capital available directly to minority-controlled business establishments. They are private investment companies that specialize in providing long-term investment capital and management assistance to minority businesses. They are conduits to move investment capital and expertise from those who have these resources to those who need capital to initially finance or expand their businesses. They are for-profit corporations, that are privately operated.

A MESBIC is formed when private investors invest a minimum of \$150,000 in capital, incorporate as an investment company, and obtain a license to operate from the Small Business Administration (SBA). When it is in operation, the MESBIC becomes eligible to borrow \$2.00 from SBA for every \$1.00 of private capital, through the issuance of debentures. An effective capital base equal to three times the sponsor's capital is therefore provided for investment under the direct control of the strong sponsor(s).

For each dollar invested by a MESBIC, up to \$4.00 of working capital can be provided through bank loans, which are 90% guaranteed by the SBA. As this process is repeated, a total capital flow of \$4,250,000 is possible with each \$150,000/ of private MESBIC capital. Thus, as much as \$15.00 is leveraged for each \$1.00 of private investment in the MESBIC. Technical and management assistance can also be "leveraged" by a MESBIC. In addition to assistance directly available from the sponsor, the sponsor in turn will often stimulate the interest of independent attorneys, accountants and others within their business milieu to voluntarily provide specialized assistance to portfolio clients of the

MESBIC. As of March 31, 1972 there were 49 MESBICs with private paid-in capital of \$15,000,000. With SBA and bank leveraging, the potential capital flow to minority businesses exceeds \$200,000,000.

Although many MESBICs are newly-licensed and have therefore made but few investments, it is worth noting that 422 businesses have been financed by MESBICs; \$43.7 million has been invested (MESBIC and external capital). These businesses employ over 4,400 people, have an estimated annual payroll of \$20 million, and estimated annual sales of over \$82 million.

We are told by cynics that corporations take a narrow view of their self-interest and will therefore not voluntarily take initiatives in areas of social action. Any plan built upon this premise is suggested to be a hoax. However, 124 corporations have invested in the 49 MESBICs. Of these, over 100 corporations have invested \$25,000 or more and 21 corporations have invested \$150,000 or more. The corporate world has, in point of fact, made a meaningful beginning in this critical area of need.

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Because it is the principal tool by which men implement their awareness of their duties to their fellow

men, Government should act in the self-interest of its citizens by ensuring to the individual maximum freedom of self-determination. As a social arbiter, it creates conditions in which individuals perceive that it is contrary to their self-interest to undertake certain activities which are harmful to others. Government should restrain from doing more and more things for each citizen and concentrate upon creating conditions in which citizens can do more and more with each other. The value of the MESBIC program rests not, therefore, only on its tangible benefits, but on its demonstration that the role of government in stimulating progress by encouraging incentive, is the most effective way to improve the lot of the American people.

FOOTNOTES

1. No longer in print. A copy may be examined in the OMBE Information Center, U. S. Department of Commerce, Washington, D. C.
2. In a press release dated September 25, 1962, the Council of Economic Advisors estimated the economic cost of those discriminatory practices which prevented minorities from developing their full potential productivity to be approximately \$17.3 billion, roughly 3.2% of the GNP which totaled \$554.9 billion at that time. Based upon our current GNP, this cost approximates \$35 billion.
3. Small businesses are generally defined as those whose assets do not exceed \$7.5 million, whose net worth does not exceed \$2-1/2 million and whose average net income the preceding two years does not exceed \$250,000 after Federal income taxes.
4. It should be noted that SBICs are generally venture capital-oriented. The minority enterprise program principally seeks investment capital flow.
5. Arcata National Corporation formed a subsidiary in May 1968 (Arcata Investment Company), solely to provide financial and management assistance to minority businessmen. It was initially capitalized at \$150,000. Upon learning of this activity, the Small Business Administration suggested that Arcata National consider chartering this subsidiary as an SBIC. The idea was favorably received. Arcata Investment Company was licensed by SBA in August 1968.
6. Other examples of private sector initiative include:
 - (1) Minority bank deposits have risen by \$242 million, approximately 61%, between September 30, 1970 and December 31, 1971. Some 600 corporations have made deposits in support of this program.

- (2) The American Bankers Association has established a goal of \$1 billion of new minority business loans by 1975. A recent ABA survey indicates that the banking industry will meet this goal. Over 6,000 commercial banks are presently making minority business loans.
- (3) The commercial banking industry has established an investment company "minbanc" to supply equity capital to minority-owned banks. "Minbanc" will be capitalized at \$10 million. Thirteen (13) banks throughout the country will participate in the private offering.
- (4) On November 9, 1971, 14 institutional investors announced plans to create Urban National Corporation with initial capitalization of \$5 million.
- (5) One hundred twenty-six life insurance companies have invested \$1.8 billion in housing or job-creating facilities for the benefit of low or moderate income families. \$87.8 million has been invested in minority businesses.
- (6) The franchise industry has increased the number of minority-owned franchises from 405 in 1969 to 1,184 in 1971, an increase of over 192%. Similarly, the petroleum industry has increased its number of minority-owned service stations from 10,720 in 1969 to an estimated 13,010 in 1970, an increase of 21%.
- (7) The automobile industry has increased auto dealerships from 14 in 1969 to 85 in 1971, a sixfold increase.
- (8) The Menswear Retail Association has assisted in establishing 61 new retail stores throughout the country. The stores in operation have retail sales that exceed \$87 million.
- (9) Voluntary management and technical assistance is being furnished to minority businessmen by

many organizations. A sampling of these organizations resulted in the following fiscal '71 statistics:

- . Menswear Retail Association - 8,340 man-hours
- . National Association of Accountants - 591 cases equivalent to 12,000 man-hours
- . The American Institute of Certified Public Accountants - 691 cases, equivalent to 7,627 man-hours