Fast Facts on Emerging Domestic Markets

Definition of Emerging Domestic Market

- Emerging domestic markets refer to people, places, or business enterprises with growth potential that face capital constraints due to systemic undervaluation as a result of imperfect market information. These markets include ethnic- and women-owned firms, urban and rural communities, companies that serve low-to-moderate-income populations, and other small- and medium-sized businesses.[1]

Market Drivers

- In the last 10 years, there has been a renewed interest by institutional investors in identifying businesses and real estate opportunities in emerging domestic markets. This growth in investor interest is driven, in part, by the recognition that changing demographics in the United States has resulted in a significant increase in minority purchasing power and business development by minority owned firms.[2]

- Over the next 40 years, 85% of the U.S. population growth will come from non-white ethnic groups.[3]

- The current size of the United States Hispanic and African-American consumer market is larger than the GDP of all but nine countries in the world.[4]

- The Internal Revenue Service predicts that Latinos will soon own 1-in-10 businesses. Overall growth rates in the number of minority-owned businesses are 3-to-4 times higher than for white-owned businesses.[5]

- Minority firms' sales are growing 34% per year—more than twice the rate of all other firms.[6]

- Small businesses provide approximately 75% of net new jobs in the nation.[7] In California, small businesses comprise over 98% of all businesses and businesses with less than five employees make up over 88% of all businesses in the state.[8]

- Woman-owned firms, particularly among ethnic women, increased at a rate 5 times greater than all firms. The rate of African-American women owned firms increased by 12% annually, as compared to 2% for all firms and just under 4% for all woman-owned firms.[9]

Capital Market Limitations

- Despite their growth, EDMs' ability to grow is constrained by their access to capital. Even after accounting for a variety of factors (education, experience, industry, and location) EDM firms receive less capital and on less advantageous terms.[10] Latinos and African Americans are turned down for business loans at 3 times the rate of whites with equivalent credit characteristics.[11]

- Minority-owned firms tend to start their businesses with lower levels of personal wealth and face barriers when tapping traditional financing sources, contributing to lower rates of overall success and growth.[12]

- In 2006, $130 billion was raised by private equity venture funds; approximately $25.5 billion was invested in 3,416 deals.[13] The composition of EDM venture portfolios differ from mainstream portfolios. EDM venture portfolios are typically comprised of retailers, financial and business service entities, makers and distributors of consumer products, and computer software companies. These types of companies comprise only 10% of mainstream venture capital investments.[14]

- Although women own approximately 40 percent of all businesses in the US, they receive less than five percent of all venture capital.[15]

- Minority owners comprise 8% of all owner firms, with Hispanics owning close to 4%. However, minority-owned firms receive less than 2% of venture capital.[16]

- Rural entrepreneurs account for 10% of all businesses but receive less than 2% of all venture capital.[17]

<u>The EDM Marketplace Today</u>

- Most providers of equity capital do not target mid-sized, traditional enterprises. Exceptions include minority-focused venture funds, Community Development Venture Capital funds, triple-bottom line funds, and increasingly, environmental funds. However, these models face constraints due to a lack of scale capital in the market at the particular risk/return/social impact offering.[18]

- A public pension fund's decision to invest in EDMs is driven first and foremost by its fiduciary duty and overarching mission to serve its members. Targeted investments in EDMs can play a part in the fund's overall strategy to identify investment opportunities where traditional sources of capital may have been overlooked, and to target investments in geographic areas that also benefit the economic climate where their beneficiaries live and work.[19]

- It is estimated that there is approximately $11 billion of public-sector pension fund commitments across all asset categories targeted at EDM and economic development related investments[20]

- Despite the clearly identified opportunities, EDM businesses are projected to remain underserved by mainstream institutional investors due to a lack of relationships, the poor fit between EDM business types and mainstream venture capital preferences, and discrimination.[21]

- Although the Initiative for a Competitive Inner City has demonstrated through its "Inner City 100" program that appropriate risk adjusted returns can be achieved, strong mechanisms do not exist to connect the larger universe of inner-city companies to potential investors.[22]

- Research continually concludes that the current system for capturing and sharing market data about lower income populations is too immature to be reliable.[23]

- Reaching underserved markets is a specialized process that requires an in-depth understanding of the market and having the ability to break through barriers like high information and transaction costs. [24]

- The undercapitalization and lack of scale within the EDM market starves both individual businesses and their surrounding neighborhoods. Without scale, private investment may be insufficient to transform neighborhoods and companies and thus achieve the targeted returns. [25]

[1]Glenn Yago, Arron Pankratz, "The Minority Business Challenge" Milken Institute and the United States Department of Commerce (2000)

[2] Toni Symonds, Leslie Spahnn. California's Economic Development Programs: Meeting the Challenges of Today's Economy, Assembly Committee on Jobs, Economic Development, and the Economy, March 2007.

[3] U.S. Department of Commerce Minority Business Development Agency. September 1999. "Minority Population Growth: 1995 to 2050." and Glenn Yago, Betsy Zeidman, Alethea Abuyman. Milken Institute, "A History of Emerging Domestic Markets"

[4] Jeffrey M. Humphreys. "The multicultural economy, 2006" Georgia Business and Economic Conditions, 66:6 (2006) and Glenn Yago, Betsy Zeidman, Alethea Abuyman. Milken Institute, "A History of Emerging Domestic Markets"

[5] Boyd (2006) from Janneke Ratcliffe, Center for Community Capitalism, University of North Carolina at Chapel Hill, "Who Counting? Measuring Social Outcomes from Targeted Private Equity."

[6] Glenn Yago, Arron Pankratz, "The Minority Business Challenge" Milken Institute and the United States Department of Commerce (2000)

[7] United States Small Business Administration, www.census.gov/epcd/www/smallbus.html from Janneke Ratcliffe, Center for Community Capitalism, University of North Carolina at Chapel Hill, "Who Counting? Measuring Social Outcomes from Targeted Private Equity."

[8] California Association for Microenterprise Opportunity, 2006 Fact Sheet

[9] U.S. Census Bureau. 2002 "Survey of Business Owners" and Glenn Yago, Betsy Zeidman, Alethea Abuyman. Milken Institute, "A History of Emerging Domestic Markets"

[10] Glenn Yago, Betsy Zeidman, Alethea Abuyman. Milken Institute, "A History of Emerging Domestic Markets"

[11] Glenn Yago, Arron Pankratz, "The Minority Business Challenge" Milken Institute and the United States Department of Commerce (2000)

[12] Robb and Fairlie, 2006, from Janneke Ratcliffe, Center for Community Capitalism, University of North Carolina at Chapel Hill, "Who Counting? Measuring Social Outcomes from Targeted Private Equity."

[13] PricewaterhouseCoopers and the National Venture Capital Alliance 2007 from Janneke Ratcliffe, Center for Community Capitalism, University of North Carolina at Chapel Hill, "Who Counting? Measuring Social Outcomes from Targeted Private Equity."

[14] Janneke Ratcliffe, Center for Community Capitalism, University of North Carolina at Chapel Hill, "Who Counting? Measuring Social Outcomes from Targeted Private Equity."

[15] Brush, Candida, et al, “Gatekeepers of Venture Growth: A Diana Project Report on the Role and Participation of Women in the Venture Capital Industry,” Kaufman Foundation, 2004 and Glenn Yago, Betsy Zeidman, Alethea Abuyman. Milken Institute, "A History of Emerging Domestic Markets"

[16] Glenn Yago, Arron Pankratz, "The Minority Business Challenge" Milken Institute and the United States Department of Commerce (2000)

[17] Schmitt, 2003 from Janneke Ratcliffe, Center for Community Capitalism, University of North Carolina at Chapel Hill, "Who Counting? Measuring Social Outcomes from Targeted Private Equity."

[18] Prabal Chakrabartim Federal Reserve Bank, San Francisco, "Panning for Gold in Inner City Markets"

[19] Lisa Hagerman, Gordon Clark, Tessa Hebb, University of Oxford and Harvard Law School, "Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization" 2007

[20] Lisa Hagerman, Gordon Clark, Tessa Hebb, University of Oxford and Harvard Law School, "Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization" 2007

[21] Janneke Ratcliffe, Center for Community Capitalism, University of North Carolina at Chapel Hill, "Who Counting? Measuring Social Outcomes from Targeted Private Equity."

[22] Prabal Chakrabartim Federal Reserve Bank, San Francisco, "Panning for Gold in Inner City Markets"

[23] Glenn Yago, Betsy Zeidman, Alethea Abuyman. Milken Institute, "A History of Emerging Domestic Markets"

[24] Lisa Hagerman, Gordon Clark, Tessa Hebb, University of Oxford and Harvard Law School, "Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization" 2007

[25] Lisa Hagerman, Gordon Clark, Tessa Hebb, University of Oxford and Harvard Law School, "Investment Intermediaries in Economic Development: Linking Public Pension Funds to Urban Revitalization" 2007