



Testimony of
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Committee on Financial Services
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**“Diversity in the Financial Services Industry and Access to Capital
for Minority-Owned Businesses: Challenges and Opportunities”**

U.S. House Committee on Financial Services Chairman Michael Oxley, Ranking Member Barney Frank, Subcommittee Chairman Sue Kelly, Subcommittee Ranking Member Luis Gutierrez and members of the Committee, on behalf of the New America Alliance board of directors and members, I commend you for your leadership and the opportunity to appear before you to address the participation of American Latinos in the financial services industry and highlight issues regarding access to capital.

New America Alliance is a 501 (c) 6 organization of American Latino business leaders united to promote the economic advancement of the American Latino community to improve the quality of life in the United States. We are organized on the principle that American Latino business leaders have the responsibility to lead the process of building the forms of capital most crucial for Latino progress – economic capital, political capital, human capital and the practice of philanthropy. Alliance members believe that strategies to enhance these forms of capital must include many approaches, but one which American Latino business leaders are uniquely capable of leading is investment in our own community through coordinated philanthropy and public & private strategic collaboration.

New America Alliance programs are developed around our Economic Capital agenda which focuses on increasing access to capital markets and financing for Latino businesses, promoting the participation and influence of American Latinos on our nation's corporate and pension fund boards, expanding the participation and influence of American Latinos in federal and state financial institutions, and investing in the higher education of American Latinos in the fields of business and finance.

American Latino Population, Purchasing Power and Entrepreneurship

The United States is the fourth largest Spanish-speaking country in the world. American Latinos – individuals of Hispanic or Latin American descent residing in the U.S. – comprise the fastest growing segment of the U.S. population. Latinos currently exceed 44 million people, representing 15 percent of our nation's population. Latinos are expected to increase to 25 percent of the U.S. population by the year 2050. Current purchasing power of the Latino community is estimated at \$700 billion and it is projected to reach \$1 trillion by 2010, almost 11 percent of the U.S. total. This segment represents the nation's largest single pool of transnational bilingual citizens, an important part of the Spanish-speaking majority of the Western Hemisphere, portending significant trade and foreign policy implications. As the Latino population continues to increase exponentially, there is also rapid growth in its entrepreneurial activity. According to HispanTelligence, the research division of Hispanic Business Inc., it is estimated that there are currently over 2 million Latino businesses in the U.S., a number expected to increase to over 3 million companies by 2010, generating revenue of more than \$465 billion.

American Latino Leadership in Executive and Top Management Positions

While indicators reveal increased participation and integration of Latinos in all facets of U.S. entrepreneurial activity and the economy, the participation of Latinos in leadership and executive roles on corporate boards and in the finance industry continues to lag. As indicated in the Hispanic Association on Corporate Responsibility *2003-04 Corporate Governance Study*, there are only 166 Fortune 1000 companies that include Latinos on their boards. Furthermore, when measuring the number of director positions occupied by Latinos, out of 10,314 positions, Latinos occupy only 202 seats, or 1.97 percent.

Collectively, the seventy-three Fortune 1000 companies classified as commercial banks, securities firms, and savings institutions have 936 director seats and 793 executive positions.

American Latinos occupy 28 of those board seats, or 2.9 percent. Nineteen percent of these companies have at least one Latino on their board including Bank of America, Citigroup, Countrywide Credit Services, Fannie Mae, Freddie Mac, General Electric, Golden West Financial, KeyCorp, Marsh & McLennan, M & T Bank, Popular, Inc., Provident Financial, Union Planters, and Wells Fargo. It is important to note that two of these companies, Citigroup and Wells Fargo, are New America Alliance Corporate Partners; we commend them for their leadership and vision.

Of the total 793 executive positions in commercial banks, securities firms, and savings institutions, American Latinos occupy 20 positions, or 2.5 percent. The companies that have at least one Latino on their executive team include Countrywide Financial, Fannie Mae, M & T Bank, Marshall & Ilsley, National City Corporation, Popular, Inc., and Union Planters.

Also, as measured by the Securities Industry Association's *2003 Report on Diversity Strategy, Development and Demographics*, the U.S. securities industry Latino workforce constitutes 4.7 percent. This, added to 7.3 percent of Asians/Pacific Islanders, 5.5 percent of African Americans, and 0.8 percent of other minorities, totals 18.3 percent of the workforce identified as minority. Taking into account that the Latino population constitutes about 15 percent of the U.S. population and that minorities collectively add up to approximately 30 percent and are expected to comprise 50 percent of the population by 2050, we encourage further efforts by the financial services industry to employ a workforce that is more representative of our nation's population.

American Latino Financial Services Firms in Institutional Investment

New America Alliance recognizes that the lack of participation by American Latinos in senior positions in the financial services industry presents a concern because the finance industry functions as the primary capital distributor in society. In the institutional investment arena, Latino majority-owned institutions continue to struggle to find adequate access to public and private pension funds, and minority procurement programs at major corporations have not typically included financial services. Furthermore, many public pension funds have not established or enforced emerging and minority managers programs.

In October 2003 as part of an ongoing research effort, New America Alliance published the White Paper *American Latinos in Financial Services* identifying trends and issues affecting American Latinos in financial services. By studying the current realities and anticipating future

conditions, this report seeks to provide the strategic planning and the tactical decision-making elements to:

- increase the participation of American Latino financial services firms in the management of investments at public pension funds, corporate America and the institutional investor community
- increase access for all Latino financial services providers and
- promote the development of future American Latino financial executives.

Key findings of the White Paper which specifically examines Latino companies in the investment management consulting, asset management, private equity, and brokerage segments, are as follows:

- There is only one Latino-owned investment management consulting firm.
- In the asset management field, less than one half of one percent, \$28.8 billion of the \$7.2 trillion in U.S. institutional tax-exempt assets, is managed by American Latinos.
- Latino-owned private equity firms have aggregate capital available for investment of less than \$500 million, translating to control of less than 0.2 percent of the funds available for investments across private equity overall.
- In the \$1.1 trillion public pension fund arena in the Top 6 American Latino states (CA, FL, IL, NY, NM, and TX), total brokerage fees are roughly \$1.5 billion for the management of assets. Participation of Latino-owned firms is approximately .005 percent or \$7.5 million.

Some of the common challenges and barriers that limit the size and competitive advantage of American Latino financial services firms as identified in the New America Alliance White Paper are:

- 1) Limited access to decision makers in institutional investment such as pension trustees, executive directors and consultants, places a barrier for contracting consideration;
- 2) There is a misperception that Latinos do not have the ability to invest and manage funds wisely, generate attractive returns and be value-added investors;
- 3) These companies lack capital for expansion as they face the financing barriers that other Latino companies face;
- 4) Small company size, in terms of assets under management, limits the company's ability to secure contracts. As an example, for an asset manager to be considered a viable player in the \$7.2 trillion institutional (tax-exempt) fund arena, the company must have a minimum base of

assets under management of \$250 million to \$300 million to be considered a viable player.

However, such an asset base may not satisfy the biggest pension plans;

5) There is a small number of new American Latinos entering the industry. For example, there is a thin pipeline in place to produce the new generation of Latino private equity fund managers. Eighty-two percent of the fund managers across the industry are privately owned, relatively small partnerships which are generally tightly controlled by the founding partners/team and may not have interest in promoting Latinos. This, in itself, limits the ability of Latinos to obtain the necessary experience in the industry.

The four financial service sectors studied shared a common conclusion – the importance of conducting public hearings at the local, state and congressional levels. We believe that public hearings, such as this hearing, can enhance information sharing, promote familiarity with the roles and functions of key players in the financial services sector and increase the accountability of elected and appointed officials responsible for overseeing public funds.

The reach of legislators goes beyond the public funds since many corporations seek favorable legislation and/or business within the states they reside. This presents an opportunity for legislators to encourage corporations to apply the same best practices of diversity they currently use regarding procurement in the financial services sector.

Furthermore, in increasing the leadership of Latinos in financial services and Latino ownership of financial services firms, training and education are paramount. It is imperative to promote the education and integration of Latinos into the financial services industry through education and mentorship networks. Latinos must be promoted in all ranks.

American Latino Businesses and Access to Capital

American Latino entrepreneurs continue to face challenges in securing the necessary capital to start and expand their businesses. According to Hispanic Business Inc. HispanTelligence research on the Hispanic Business 500 (HB500), lack of access to capital affects the growth of Latino businesses, particularly those with revenues under \$300 million. Of the 115 HB500 companies in the revenue bracket of \$5 to \$300 million, 70 percent finance their businesses with commercial loans or their own savings. More than 50 percent of HB500 companies with revenue of \$300 million or above finance their businesses with commercial loans and only 13 percent used private placement or venture capital.

As it pertains to venture capital investment, the Kauffman Foundation's report *Minorities and Venture Capital* states that while with sufficient venture capital support, minority businesses can thrive and grow, the reverse is also true. Heightened access to venture capital will depend in part on a greater understanding of how this capital works. This report found that minority enterprise venture capital investment is very profitable. Internal rate of return was calculated by combining the cash inflows and outflows of each fund. This resulted in an internal rate of return median of 19.5 percent and a mean of 23.9 percent versus 20 percent return indicated by the comparable benchmark of the overall market. The study also revealed key sources of funding for minority investment funds including public pension funds, commercial banks and insurance companies, and intermediary fund of funds, among other sources. Of these, public pension funding was the most significant source.

While private and venture investment in minority companies is a highly profitable proposition, a study by The Milken Institute, *Mainstream Minority Businesses: Financing Domestic Emerging Markets*, indicates that less than 4 percent of Small Business Investment Company private equity funds were invested in minority deals. Furthermore, the study reveals that private equity firms focusing on minority investments have less than 3 percent of all venture capital funds under management.

In reference to Latino-managed private equity funds, the New America Alliance White Paper identifies five Latino-owned equity firms of which three are actively investing. We estimate that Latino-owned private equity firms have aggregate available capital for investment of less than \$500 million, thereby controlling less than 0.5% of the funds available for investment in the buyout industry and less than 0.2% of the funds available for investment across private equity overall. We were unable to identify any Latino-owned private equity firms managing a fund larger than \$250 million. Based on this information, as a group, Latino-owned firms are grossly underrepresented in the private equity sector and appear to be significantly underfunded. The biggest challenge for Latinos in private equity remains raising capital. Additionally, Latinos are often perceived as not being capable of investing funds wisely generating attractive returns, even when actual performance indicates profitability. Another common barrier not only to the proliferation of Latino-managed funds, but to private equity allocations to Latino and minority business, relates to the lack of relationships within the private equity sector which is relationship driven and difficult to penetrate. This is highly significant given that private equity and venture

capital are critical components of growth for the larger and more successful small cap companies.

Availability of Data on American Latino Leadership in the Finance Industry and Public Policy Implications

Reliable data regarding Latino participation in the financial services industry is scarce. Although New America Alliance undertook the research for the White Paper as have other organizations cited in this testimony, companies are not compelled to respond to inquiries regarding Latino employment, management and funding matters. It is not unusual to find a stated minority participation of 18 percent with a Latino percentage hovering at less than 5 percent for the total workforce. While the minority umbrella is as inclusive as it should be, it tends to present a more favorable picture overall than is actually the case for the Latino segment specifically, which is significantly smaller when considering the management ranks. Hispanic Business Inc. conducts continued research, particularly on the Hispanic Business 500, through its research division HispanTelligence; this is one of the few existing sources of Hispanic-focused business research.

Recommendations to Improve American Latino Participation in Executive Level Positions in the Finance Industry

Having inclusive and diverse leadership teams based on economic opportunity and market representation makes good business sense. Broadening the composition of a corporate board with the inclusion of American Latinos and other minorities of diverse backgrounds not only makes good business sense, it demonstrates the overall strategic direction of the corporation and provides a desired edge and competitive advantage. Furthermore, the Sarbanes-Oxley reforms requiring a majority of independent directors provide an historic opportunity to incorporate diversity on corporate boards. Given the requirement for corporate boards to appoint new independent directors, corporations have an unprecedented opportunity to increase the diversity on their boards, including a greater presence of American Latinos.

Because the corporate board appointment process is highly subjective, and because decision-making is in the hands of the CEO, members of the board, and sometimes other members of the executive team, efforts to influence the selection process at this level are imperative. Corporate leaders can be proactive by developing an infrastructure to guide board appointment and hiring initiatives to create a diverse and complementing team. This can be accomplished in a number of ways including careful selection of the nominations committee and human

resources executives. We believe that American Latinos serving on corporate boards also have a role in promoting the board appointment and hiring of more Latinos; given that they are inside the network, they can play an invaluable role in advancing diversity. Furthermore, executive search firms play a pivotal role in this process and are in a position to influence the selection process.

Elected and appointed officials can also play an important advocacy role in promoting corporate diversity through public statements and hearings such as this one, that foster enhanced representation and identify inclusion on the board and executive team as required criteria for excellence in governance and business. Elected and appointed officials' support of initiatives by non-profit organizations such as New America Alliance, Hispanic Association on Corporate Responsibility, The Executive Leadership Council, Catalyst, and others that promote governance excellence and diversity would also be extremely productive in advancing the inclusion of minorities on corporate boards.

Recommendations to Enhance Access to Capital

As stated by Hispanic Business HispanTelligence, closing the capital gap requires the transfer of financial technologies and market-based public policy innovations from mainstream applications to emerging domestic markets, carving channels of capital from investors to entrepreneurs. The goal is to overcome the recurring obstacles for financing of Latino and minority businesses such as the perception of being a higher risk investment, the need for smaller loans, the lack of information on market potential, and the lack of professional and social networks that link entrepreneurs to lenders, among others. This would require systematic innovations such as changes in business structures, new types of financial intermediaries, and new legal and regulatory frameworks. Product innovations that provide credit enhancements blended fund structures, angel pools and networks, and equity equivalent investments. Process innovations would also be important such as collection of data, credit scoring, mentorship and advisory services.

In a recent report issued by the U.S. Minority Business Development Agency, produced in collaboration with financing experts and community leaders, recommendations for improving flow of capital to minority enterprises include development of current and existing governmental data to support investment decision-making and identify opportunities in the MBE community; improvement of capital availability and accessibility; expanding availability of management and

technical assistance; and integration of the investment community, minority entrepreneurs and the Federal Government.

We encourage the Financial Services Committee to work with other Committees of jurisdiction to examine the factors that influence selection of fund managers by retirement plan trustees to ensure American Latino-owned firms are not prevented from full participation.

A specific recommendation would involve the expansion of current Community Reinvestment Act (CRA) regulation to include insurance companies as well as public and private sector pension funds. The CRA was enacted in 1977 by Congress with the purpose of encouraging financial institutions to make credit available to the communities in which they operate. It was hoped that economically depressed areas would benefit if the money deposited in those communities stayed in those communities, benefited the people in those communities, and helped jump start economic growth. From 1997 through 2001, National Community Reinvestment Coalition calculates that banks have pledged over \$1.512 trillion in loans, investments, and services to minority and low- and moderate-income communities in CRA agreements and voluntary commitments. The vast majority of the funds were for housing, small business financing and community development activities. This sum far exceeds the capital allocated by public and private pension funds or insurance companies to the lower income communities throughout the nation. While the CRA act could be improved, it has served as a significant economic locomotive to disadvantaged areas of our country and for the most part has proven to be a profitable activity for banks. We believe similar programs sponsored by insurance companies and pension funds would be equally profitable and provide additional billions of dollars in capital to our domestic emerging markets.

Conclusion

This hearing, in and of itself, and the interest this Committee has taken in the matter, will serve to convey your commitment to corporate responsibility and governance leading to equitable consideration and proactive initiatives which will result in economic progress for the country as a whole. We encourage the Financial Services Committee to continue this effort and to examine diversity practices and the participation of American Latinos in the financial services industry in further detail.

The relationship between business success and access to capital applies to all entrepreneurial ventures whether in the minority space or in the mainstream. While initiatives to improve access to capital must continue to be at the forefront of private, public, and community efforts, it is equally important to integrate American Latinos and diverse minority representation in top leadership and decision-making positions so that the process of developing and implementing solutions can consider and address diverse perspectives and experiences.

We, at New America Alliance, are committed to increasing access to capital markets and financing for Latino businesses, promoting the participation and influence of American Latinos on our nation's corporate and pension fund boards, expanding the participation and influence of American Latinos in federal and state financial institutions, and investing in the higher education of American Latinos in the fields of business and finance. Our effort to promote the economic advancement of the American Latino community is intended to benefit our community and our nation. We stand ready to collaborate with the U.S. House Committee on Financial Services, other legislative and government leaders, corporate America, and the minority community leaders in advancing our common goal of prosperity for all.

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