



Final Report

Financial Characteristics of Inner City Companies

Supported by Next Street Financial LLC

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Initiative for a Competitive Inner City (ICIC)

1. Introduction and Overview

Inner cities are emerging markets characterized by population density, a high proportion of minorities, and mixed-incomes. Next Street Financial LLC engaged the Initiative for a Competitive Inner City (ICIC) to study the finances of inner city companies using a well-respected Ewing Marion Kauffman Foundation database containing longitudinal data about these companies. The study was also to take into account the context of the inner city economy in the 100 largest cities and inner-city Boston.

The work was divided into three parts:

1. Provide Next Street Financial with access to summarized information from ICIC/Inc. Magazine *Inner City 100* winners in Boston
2. Summarize economic cluster data from State of the Inner City Economies (SICE) about inner city Boston.
3. Provide for the first time a set of basic financial performance data from a sample of 35,000+ inner city companies, for inner city Boston, the 100 inner cities, and the U.S. as a whole.

This report provides the results from parts two and three. The findings are based on ICIC's inner city boundaries and on an overall sample of over 200,000 U.S. companies in the Kauffman sample. Fintel, LLC provided data and key analytical inputs in their role as administrator of the Kauffman database. The report details information for three geographic samples: inner city Boston, inner cities of the 100 largest U.S. cities, and the U.S. as a whole.

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2. Key findings

- Inner city companies are typically **smaller** by revenues than U.S. companies as a whole.
- A **significant proportion of inner city companies have revenues of \$20 million or more**. 9 percent of inner city companies have over \$20 million in revenues compared to 15 percent for the U.S. as a whole.
- Inner city companies are **more profitable** in the \$5M to \$100M sales range than U.S. companies as a whole. In the \$1M-\$5M sales range, they are **equally profitable**.
- Inner city companies have similar **liquidity** ratios than U.S. companies as a whole.
- Inner city companies are **less leveraged** and the median company holds significantly **lower amounts of debt** than U.S. companies.
- Compared to companies in inner cities of the largest 100 cities and U.S. companies as a whole, companies in inner city Boston are **more profitable** and hold **lower debt** across all size categories

3. Inner cities of the 100 largest cities

A. Economy

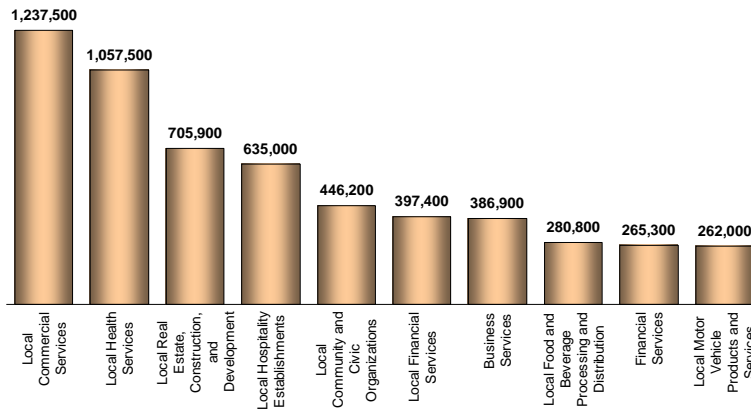
According to ICIC research, inner cities in the 100 largest U.S. cities¹:

- Contain **8.3 million** jobs (2003) and **21 million** residents (2005);
- Represent **8%** of U.S. private employment (2003); and
- Pay an average wage of **\$39,300** (in 2003, compared to \$41,400 in their corresponding metro areas).

Source: *State of the Inner City Economies, 2006*.

Overall, inner city job growth lags that of the corresponding metropolitan area. This results masks a large variation in performance in job growth across inner cities. For instance, ten inner cities grew even faster than their metropolitan areas from 1995 to 2003. Below are the largest clusters, by employment, for the 100 inner cities:

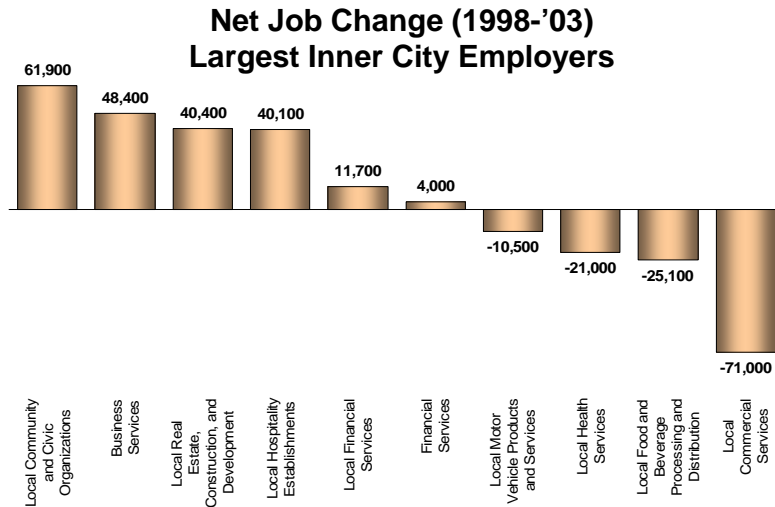
Largest Inner City Employers, 2003



Source: *State of the Inner City Economies, ISC Harvard, 2006*

Commercial services and health services are the largest employers, followed by real estate, construction and development. The chart below shows the net job gains and losses for these ten clusters:

¹ Inner cities are emerging markets characterized by population density, a high proportion of minorities, and mixed-incomes. Specifically, those census tracts of the 100 largest central cities with 20% or more of their residents below the poverty line, or meeting other related criteria of unemployment, poverty, and lower median income. www.icic.org contains the full methodology.



Source: State of the Inner City Economies, ISC Harvard, 2006

Local community and civic organizations; business services, and real estate, construction, and development are the top three job gainers in the 100 inner cities.

Taken together, ICIC found that the economy of the 100 inner cities holds a similar mix of clusters (by share of jobs) as that of their corresponding metropolitan areas but has generally slower performance (by job growth) across those same clusters from 1998-2003.

B. Companies

Companies from the 100 inner cities, on balance, are somewhat smaller by revenue than companies in the overall U.S. sample. More specifically, the table below shows the proportion of companies by size in the two samples². From this, we observe that the companies from the 100 inner cities ('inner city companies') have a much higher proportion of companies below \$1 million in revenues than the U.S. sample. Put simply, the median inner city firm is smaller³. Notwithstanding, there are still a sizable proportion of inner city companies with more than \$20 million in revenues. Adding together the largest two revenue categories, 9 percent of the inner city companies have over \$20 million in revenues as compared to 15 percent of the U.S..

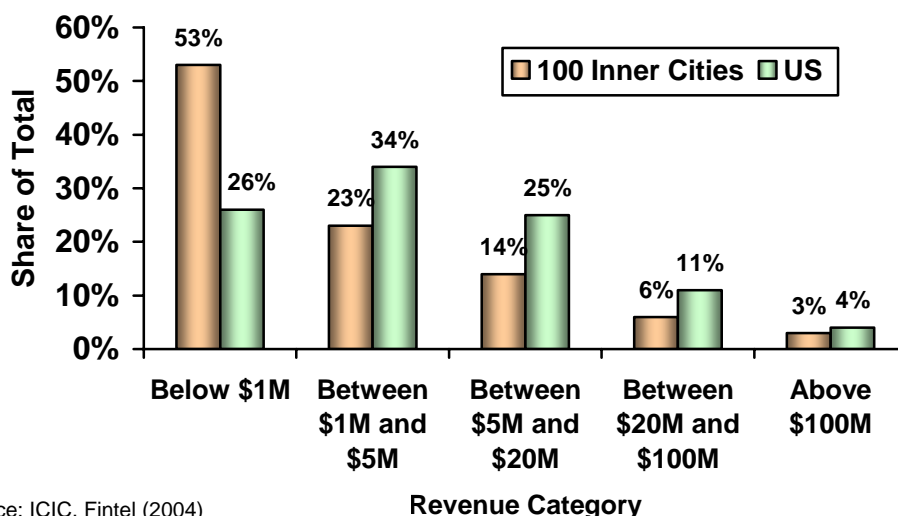
² These samples are *not* exclusive categories – the 100 inner cities data contains inner city Boston companies. The U.S. sample contains all 100 inner cities, including inner city Boston. This grouping is consistent throughout the financial summaries of this report.

³ SOICE analysis finds that the average inner city establishment, by employee size, for the 100 inner cities is similar to that of their corresponding MSAs. Though establishments are analytically different

2004 Revenues	Number of companies		% of total	
	100 Inner Cities	US	100 Inner Cities	US
Below \$1M	19,805	53,550	53%	26%
\$1M-\$5M	8,670	71,617	23%	34%
\$5M-\$20M	5,222	51,646	14%	25%
\$20M-\$100M	2,249	23,296	6%	11%
Above \$100M	1,162	7,860	3%	4%
TOTAL	37,108	207,969	100%	100%

Source: ICIC and Fintel, 2004

Distribution of Companies by Revenue Size



Source: ICIC, Fintel (2004)

Given the inclusion of non-employer firms, sole proprietorships, and ‘mom and pops’ within the sub-\$1M category, ICIC decided not to analyze these firms in further detail. Reaching conclusions about these very small firms might be difficult given that many may not be companies in the conventional sense.

Nevertheless, one should consider the relative weight of these smaller firms as a share of the overall inner city economy. Over half of all inner city companies are below \$1M in revenues, with several possible explanations. It may reflect greater entrepreneurial activity among minorities and immigrants that live in inner cities⁴. It might show

⁴ Several studies have shown the greater propensity of immigrants to be self-employed and/or start their own businesses. For example, the Kauffman Index is the first study to measure business start-up activity for the entire U.S. adult population at the individual owner level. The data are derived from the monthly Current Population Survey (CPS), a national population survey conducted by the U.S. Bureau of the Census and the Bureau of Labor Statistics. Two especially surprising findings from the study are that the Latino rate of entrepreneurship increased from 0.38 percent in 1996 to 0.48 percent in 2004, which was higher than the white, non-Latino rate of 0.39 percent, and that immigrants have substantially higher rates

evidence of sluggish inner-city participation in the economy, or lower firm-level productivity. It could also reflect an inability to grow and/or a lack of access to capital to do so. For instance, one could understand the entrepreneurial activity in response to a lack of available employment opportunities at large and growing firms, or a lower incidence of these firms themselves.

Turning now to the larger size categories, common perception takes the smaller size of inner city companies to extremes, believing that the inner city economy almost exclusively contains small-scale mom and pop firms. This myth was discredited first by ICIC's inner city 100 program of fast-growing firms and now more formally by this study. As described above, 9 percent of firms are above \$20 million in revenues. Presumably some of these fall just inside within inner city boundaries and so might not be commonly thought of as 'inner-city'. For this reason, we chose to refrain from analyzing those firms above \$100 million until we have a better sense of whether we are capturing these truly large firms properly. However, boundary effects cannot be the sole reason for so many large companies, and especially the six percent of the total of companies in the \$20 million to \$100 million category. For the first time, we now have a sense of the presence of large firms in the inner city economy.

C. Financial analysis

The financial analysis looks across three categories:

- i. *Micro* companies (between \$1 million and \$5 million)
- ii. *Small* companies (between \$5 million and \$20 million)
- iii. *Mid-sized* companies (between \$20 million and \$100 million)

These are not standard definitions but rather what we believe are useful and revealing break-points, following a discussion with knowledgeable persons from the finance industry. By way of comparison, the U.S. Small Business Administration (SBA) Office of Size Standards defines thresholds for small businesses⁵ by either employee size or revenues for each industry code⁶. These cutoffs vary. Looking at a sample of SBA employee cutoffs across various codes, these codes typically define a small business as having fewer than 500 employees. In cases where SBA used a financial threshold instead, they ranged from \$6.5 million to \$23.5 million in annual revenues.

Inner city companies are compared to the U.S. sample, inclusive of inner city firms⁷. At first blush, this is a broad and accurate comparison. By definition these represent the U.S. economy and are the population from which the inner city sample is drawn. But

of entrepreneurship than native-born individuals. The average rate of entrepreneurship for immigrants was 0.46 percent compared with 0.35 percent for the native-born.

⁵ See <http://www.sba.gov/size/sizetable2002.html>

⁶ According to NAICS – North American Industry Classification System

⁷ About 18% of the companies in the U.S. sample are inner city companies. However, across the three categories of analysis - \$1 million to \$100 million – only about 11% of the U.S. companies in the sample are inner city companies. Using inclusive categories serves to drive the comparison figures somewhat closer together than they would be as exclusive categories. Either method should work to demonstrate significant differences between samples since median values are used. From a statistical perspective, the use of inclusive categories would present some multicollinearity due to the overlap of samples. With only about one-tenth of the sample overlapping, the effect should be modest. Tightening the probability threshold when employing a t-test of significant differences could help resolve this.

one issue to consider is that the sample of inner city companies might differ from U.S. companies in terms of their industry mix. An alternative method would be to adjust the U.S. sample to reflect the inner city mix. We chose the unadjusted method on the virtue of simplicity and the ability to compare findings to outside sources. Hopefully, in future research, we will be able to consider whether comparing to an adjusted U.S. sample works better.

i) 'Micro' Companies (from \$1 million to \$5 million in revenues.)

Profitability

In the \$1 million to \$5 million category, inner city companies are equally **profitable**, with the median operating income as a percentage of sales of **2.0%**, compared to **2.0%** for those in the US. The median value of after-tax profit is \$44,213 for inner city companies as compared to \$40,236 for U.S. companies.

	<i>100 ICs</i>	<i>US</i>
Median return on sales⁸	2.0%	2.0%
Median after-tax profit⁹	\$44,213	\$40,236

The **return on assets** for inner city companies is superior from companies in the US as a whole, **5.0%** compared to **4.0%**, respectively. Asset bases are dramatically different for different types of businesses. For example, service companies whose main assets are their people (something not quantified as an asset on the balance sheet), have a much lower asset base than a manufacturing company whose asset base includes a lot of heavy machinery. It may be the difference in types of industries that locate in the inner city affect the superior return on assets.

	<i>100 ICs</i>	<i>US</i>
Median Return on Assets¹⁰	5.0%	4.0%

While **sales per employee** may be a revealing measure of firm productivity, there may be an issue of data accuracy within this data set with respect to employee counts. Checks on the data seem to show that employee counts may be incomplete for a large portion of US companies. Hence, the data presented here not accurately represent the productivity of the companies in this sample. Overall, the median sales per employee

⁸ This figure is taken from the ratio tables. It represents the median value of return on sales for all firms in the respective sample. All median dollar value figures are taken from the balance sheet table. Importantly, the two tables can appear contradictory, mainly because the median of ratios is not the same as the ratios of respective medians. For instance, the median current ratio is different from the ratio of each of the components of the current ratio (current assets over current liabilities) shown as medians on the balance sheet table. There is no optimum way to handle this, we chose to adopt a consistent procedure of using the ratio table where ratios are concerned, and the balance sheet table where dollar values are presented. Using the balance sheet table, return on net sales would be 2.8% for the IC and 2.8% for the U.S.

⁹ Balance sheet table

¹⁰ Ratios table

figure is lower for inner city companies than those in the US as a whole, **\$121,485** versus **\$136,521**, respectively. (Profit per employee is more similar, \$2,339 for inner city companies versus \$2,207 for the U.S. companies).

Liquidity and Capital Structure

Overall, inner city companies are just as liquid as their counterparts in the rest of the US. Inner city companies have a median **current ratio** (current assets / current liabilities) of **2.1** (compared to 2.0 for U.S. companies) and a **quick ratio** (current assets – inventory / current liabilities) of **1.2** (compared to 1.1 for U.S. companies). Both these ratios show that companies in both geographies would be able to pay off their debts if no additional revenue was gained.

	<i>100 ICs</i>	<i>US</i>
Median current/quick ratios¹¹	2.1 / 1.2	2.0 / 1.1

In terms of capital structure, looking at the balance sheet tables, inner city companies in the \$1 million to \$5 million range are similar to companies in the US as a whole. Their **debt to equity** ratio is somewhat less – **67%** for inner city companies versus **69%** for US companies¹². This suggests that inner city companies are somewhat less leveraged than their U.S. counterparts.

The median value of long-term debt is low because the typical (median) small business carries very little bank debt¹³. Unsurprisingly, the level of bank debt held is directly proportional to the size of the firm. According to the SBA-funded study *Financing Patterns of Small Firms: Findings from the 1998 Survey of Small Business Finance*, 55% of all small firms carry bank debt, while 71% of all firms carry loans from non-traditional sources such as owner loans or credit cards. Because the \$1 million to \$5 million category exclusively contains these small firms, the median (by definition the 50th percentile) company can be expected to hold little debt.

	<i>100 ICs</i>	<i>US</i>
Median debt-to-equity	67%	69%
Median value of long-term debt	\$12,456	\$31,974

ii) 'Small' Companies (from \$5 million to \$20 million in revenues.)

Profitability

¹¹ Ratios table

¹² In the balance sheet table, the **debt to assets** ratio for inner city companies is **54.3%** compared to **55.9%** for the US. Their **debt to equity** ratio is somewhat less – **63%** for inner city companies versus **73%** for US companies. The median long-term-debt to assets ratio is 1.4% for IC companies vs. 3.6% for U.S.

¹³ The full SBA report is available at http://www.sba.gov/advo/stats/ssbf_98.pdf

In the \$5 million to \$20 million category, inner city companies are more **profitable**, just like in the micro category, with the median operating income as a percentage of sales of **1.7%**, compared to **1.0%** for those in the US. The median value of after-tax profit also compares favorably, \$153,649 as compared to \$132,304.

	100 ICs	US
Median operating income/sales¹⁴	1.7%	1.0%
Median after tax profit¹⁵	\$153,649	\$132,304

The median **return on assets** for inner city companies ranging from \$5 million to \$20 million is again superior compared to companies in the US as a whole, **4.1%** compared to **4.0%**, respectively.

	100 ICs	US
Median return on assets¹⁶	4.1%	4.0%

Overall, the median sales per employee figure is lower for inner city companies than those in the US as a whole, **\$164,062** versus **\$191,717**, respectively. (Profit per employee is more similar, \$2,784 for inner city companies versus \$2,866 for the U.S. companies).

Liquidity and Capital Structure

Overall, inner city companies in the \$5 million to \$20 million range are just as liquid as their counterparts in the rest of the US. Inner city companies have a median **current ratio** (current assets / current liabilities) of **1.7** (compared to 1.7 for U.S. companies) and a **quick ratio** (current assets – inventory / current liabilities) of **1.0** (compared to 1.1 for U.S. companies). These figures suggest inner city companies can cover their debts if no additional revenue was gained.

	100 ICs	US
Median current/quick ratios¹⁷	1.7 / 1.0	1.7 / 1.1

In terms of capital structure, looking at the balance sheet tables, inner city companies in the \$5 million to \$20 million range are similar to companies in the US as a whole. Their **debt to equity** ratio is comparable, **99%** for inner city companies versus **98%** for US companies¹⁸. The median value of long-term debt is considerably lower for inner city companies, \$95,544 as compared to \$147,000 for U.S. companies.

¹⁴ Taken from ratios table. The balance sheet comparable is 2.7% for IC and 2.8% for U.S.

¹⁵ Balance sheet table

¹⁶ Ratios table

¹⁷ *ibid.*

¹⁸ From the balance sheet table, the **debt to assets** ratio for inner city companies is **58.7%** compared to **59.7%** for the US. Their **debt to equity** ratio is somewhat less, **89%** for inner city companies versus **94%** for US companies. The median percentage of long-term debt is 2.6% of assets for inner city companies yet 4.2% for U.S. companies.

	100 ICs	US
Median debt-to-equity¹⁹	99%	98%
Median value of long-term debt²⁰	\$95,544	\$147,000

iii) 'Mid-sized' Companies (from \$20 million to \$100 million in revenues.)

Profitability

In the mid-sized \$20 million to \$100 million category, inner city companies are once again more **profitable** with the median operating income as a percentage of sales of **1.8%**, compared to **1.0%** for those in the US. After-tax profit also compares very favorably, a median of \$602,448 for inner city companies as compared to \$482,355 for U.S. companies.

	100 ICs	US
Median return on sales²¹	1.8%	1.0%
Median after tax profit²²	\$602,448	\$482,355

The median **return on assets** for inner city companies ranging from \$20 million to \$100 million is again superior compared to companies in the US as a whole, **3.6%** compared to **3.0%**, respectively. Returns on assets are lower for these larger firms overall – this is to be expected based upon the larger asset base.

	100 ICs	US
Median return on assets²³	3.6%	3.0%

Overall, the median sales per employee figure is lower for inner city companies than those in the US as a whole, **\$230,815** versus **\$245,553**, respectively. (Profit per employee is superior for inner city companies, \$3,996 for inner city companies versus \$3,496 for the U.S. companies). Here, the larger companies demonstrate greater productivity overall as compared to the micro and small categories.

Liquidity and Capital Structure

Overall, inner city companies in the \$20 million to \$100 million range are just as liquid as their counterparts in the rest of the US. Inner city companies have an identical median **current ratio** (current assets / current liabilities) of **1.5** (compared to 1.5 for

¹⁹ Ratios table

²⁰ Balance sheet table

²¹ Ratios table

²² Balance sheet table

²³ Ratios table

U.S. companies) and a comparable **quick ratio** (current assets – inventory / current liabilities) of **1.0** (compared to 0.9 for U.S. companies). These figures still suggest inner city companies can cover their debts if no additional revenue was gained.

	<i>100 ICs</i>	<i>US</i>
Median current/quick ratios²⁴	1.5 / 1.0	1.5 / 0.9

In terms of capital structure, looking at the balance sheet, inner city companies in the \$5 million to \$20 million range are similar to companies in the US as a whole.

The inner city company **debt-to-equity** ratio of mid-sized inner city companies is less than that of the U.S., **104%** versus **112%**²⁵. The median value of the debt of inner city companies is much lower than that of the U.S., about three-quarters of \$1 million as compared to just over \$1 million.

	<i>100 ICs</i>	<i>US</i>
Median debt-to-equity	104%	112%
Median value of long-term debt	\$746,051	\$1,075,000

4. Inner city Boston

A. Economy

Inner city Boston:

- Contains **177,000 jobs** (ranked 9th highest out of the inner cities with more than 50,000 residents²⁶) and **289,000 residents** (of 100, ranked 16th).
- Represents 8% of total private employment in the metropolitan area
- Pays an average wage of \$52,300 (ranked 4th highest).

²⁴ *ibid.*

²⁵ From the balance sheet table, the **debt to assets** ratio for inner city companies is **58.6%** compared to **63.3%** for the US. The **debt to equity** ratio of mid-sized inner city companies is somewhat less, **91%** for inner city companies versus **105%** for US companies. US companies have higher ratios for mid-sized companies than for small companies, a trend that does not hold true for inner city companies in this mid-sized category. The median percentage of long-term debt is 4.4% of assets for inner city companies yet 6.6% for U.S. companies. Put differently, according to the balance sheet tables, the inner city *mid-sized* company carries a similar amount of long-term debt as a proportion of assets as the *small* U.S. company, a surprising finding.

²⁶ To avoid skewed data resulting from the mapping business data at the ZIP code level to inner cities defined by census tracts, ICIC ranked only those cities with greater than 50,000 residents for wages and job performance, for a total of 82 inner cities. Demographic data is ranked for all inner cities as the boundaries match precisely by definition.

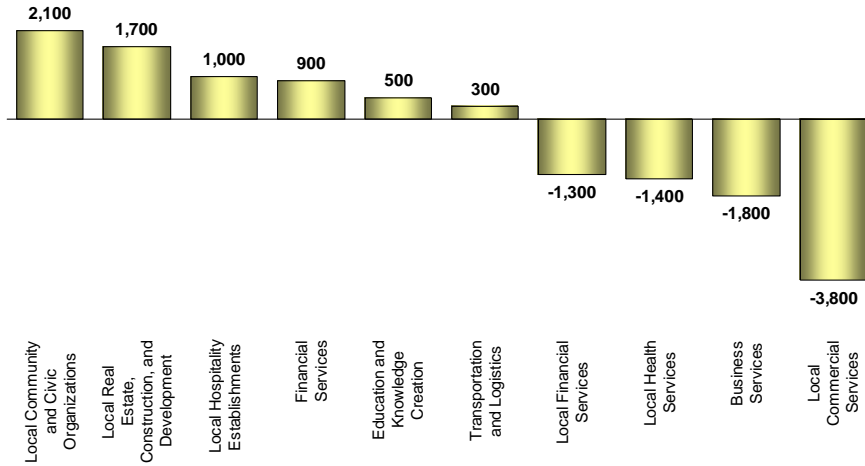
Inner city Boston performs well on job growth relative to most other inner cities. Job growth for Boston falls within the top quartile of inner cities (ranked #21). This may be the result of the relatively high college attainment rates (25% of inner city residents hold a degree from a four-year college), which is 4th highest among the 100 inner cities. Moreover, inner city Boston is able to attract immigrants, nearly one-third (31%) of inner city residents are immigrants, the 9th highest. Whether this is a cause or consequence of job growth may be a matter for debate, but regardless the presence of immigrants in inner city Boston creates a virtuous circle. According to State of the Inner City Economies research (SICE), both immigration and college attainment are drivers of job gains.

Below we see the top ten clusters for inner city jobs and their respective net job growth rates – commercial services, health services, and financial services are the top three.



Community organization, real estate and construction, and local hospitality were the top three job gainers. Worryingly, both commercial services and health services are losing jobs on a net basis, with some likely possible explanations. In commercial services, the sector as a whole is down from the late 1990s peak. In health services, automation or off-shoring may cause job loss. Here, however, some job losses may show up as gains in other clusters with inner city jobs due to outsource contracting.

Largest Boston Inner City Employers, Job Changes 1998-2003



B. Companies

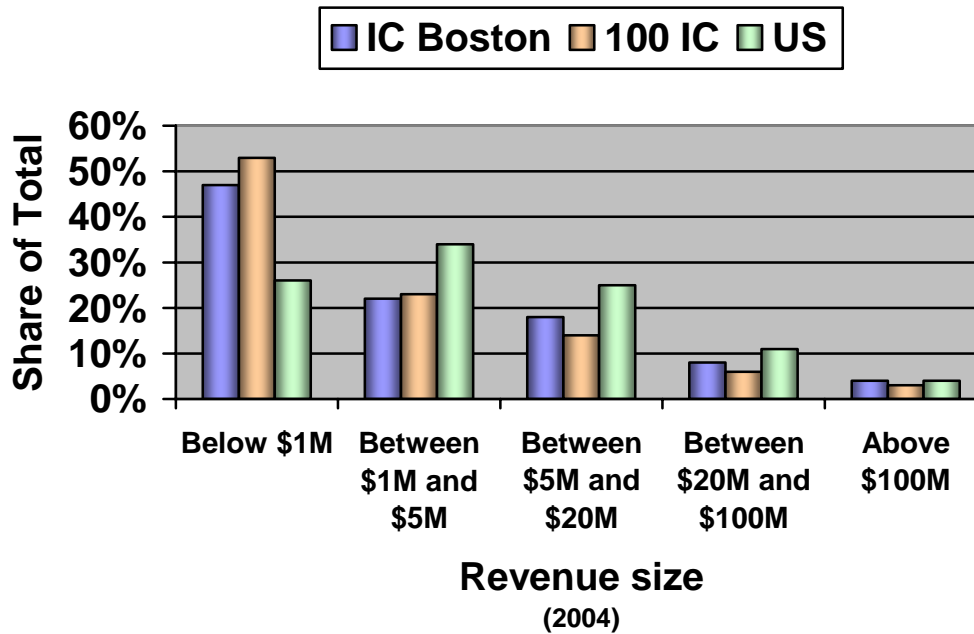
Note - Many of the previous findings in section three about how companies in the sample from 100 inner cities differ from the U.S. overall also hold for companies in the inner city Boston sample. To avoid redundant discussion, this section will compare inner city Boston to the 100 inner cities. For a sense of how inner city Boston companies differ from the U.S. overall, section three should be read closely.

Companies in inner city Boston, like inner cities nationally, are predominantly smaller companies by revenue size. However, this is less pronounced in inner city Boston, particularly in the proportion of companies between both \$5 million and \$20 million and \$20 million and \$100 million. The table and chart below show that inner city Boston holds a higher proportion of firms with more than \$5 million, \$20 million, and \$100 million in revenues than the 100 inner cities as a whole.

Sample Breakdown by Revenue Size

2004 Revenues	Number of companies			% of total		
	IC Boston	100 IC	US	IC Boston	100 IC	US
Below \$1M	272	19,805	53,550	47%	53%	26%
\$1M-\$5M	128	8,670	71,617	22%	23%	34%
\$5M-\$20M	107	5,222	51,646	18%	14%	25%
\$20M-\$100M	47	2,249	23,296	8%	6%	11%
Above \$100M	25	1,162	7,860	4%	3%	4%
TOTAL	579	37,108	207,969	100%	100%	100%

Source: ICIC and Fintel analysis



C) Financial Analysis

i) 'Micro' Companies in Inner City Boston (from \$1 million to \$5 million in revenues.)

Profitability

In the \$1 million to \$5 million category, inner city Boston companies are considerably more **profitable**, with the median operating income as a percentage of sales of **3.2%**, compared to **2.0%** for the 100 inner cities and 2.0% for the US. The median value of after-tax profit is \$69,087 for inner city Boston companies as compared to \$44,213 for inner city companies.

	IC Boston	100 ICs
Median return on sales²⁷	3.2%	2.0%
Median after-tax profit²⁸	\$69,087	\$40,236

The **return on assets (ROA)** for inner city companies compares closely to the 100 inner cities sample, **4.9%** compared to **5.0%**, respectively.

	IC Boston	100 ICs
Median ROA²⁹	4.9%	5.0%

Overall, the median sales per employee figure is similar for inner city Boston companies than those in the 100 inner cities, **\$123,950** versus **\$121,485**, respectively. (Profit per employee is higher, \$3,446 for inner city Boston companies versus \$2,207 for inner city companies from the 100 inner cities).

Liquidity and Capital Structure

Overall, inner city Boston companies are more liquid as their counterparts in the 100 inner cities. Inner city Boston companies have a median **current ratio** (current assets / current liabilities) of **2.8** (compared to 2.1 for 100 inner-city companies) and a **quick ratio** (current assets – inventory / current liabilities) of **1.6** (compared to 1.2 for 100 inner-city companies). These figures point to even more favorable debt coverage ability for inner city Boston companies.

	IC Boston	100 ICs
Median current/quick ratios³⁰	2.8 / 2.1	1.6 / 1.2

²⁷ From ratios table. Using the balance sheet table, return on net sales would be 7.9% for the IC Boston and 2.8% for the 100 ICs (and 2.8% for the U.S.)

²⁸ Balance sheet table

²⁹ Ratios table

³⁰ Ratios table

In terms of capital structure, looking at the balance sheet tables, inner city companies in the \$1 million to \$5 million range are less leveraged than companies in the 100 inner cities (and U.S.) as a whole. Their **debt to equity** ratio is much less – **39%** for inner city Boston companies versus **67.3%** for companies in the 100 inner cities³¹. This suggests that inner city Boston companies are much less leveraged than their 100 inner city (and U.S.) counterparts. The higher net worth of inner-city Boston micro companies appears to drive this difference.

	<i>IC Boston</i>	<i>100 ICs</i>
Median debt-to-equity	39%	67.3%
Median value of long-term debt	\$4,256	\$12,456

ii) 'Small' Companies in Inner City Boston (from \$5 million to \$20 million in revenues.)

Profitability

In the \$5 million to \$20 million category, 'small' inner city companies in Boston are somewhat less profitable than those in the 100 inner cities and in the U.S. sample, with the median operating income as a percentage of sales of **2.1%**, compared to **1.7%** for those in the 100 inner cities (and 1.0% in the U.S.). The median after-tax profit is higher for inner city Boston as compared to the 100 inner cities, nearly \$190,000 as compared to slightly over \$150,000 for the 100 inner cities.

	<i>IC Boston</i>	<i>100 ICs</i>
Median Return on Sales ³²	2.1%	1.7%
Median after-tax profit ³³	\$186,656	\$153,649

The **return on assets (ROA)** for inner city Boston companies compares closely to the 100 inner cities sample, **4.0%** compared to **4.1%**, respectively.

	<i>IC Boston</i>	<i>100 ICs</i>
Median ROA ³⁴	4.0%	4.1%

³¹ Here in the balance sheet there is close concordance with the ratios table – as the debt-equity ratio is report at 39% for IC Boston and 67.3% for 100 inner cities. In the aggregate, the **debt to assets** ratio for inner city Boston companies is **42.9%** compared to **54.3%** for the 100 inner cities. Their **debt to equity** ratio is much less – **35%** for inner city Boston companies versus **63%** for companies in the 100 inner cities³¹. Moreover, the median percentage of long-term debt is 0.3% of assets for inner city companies, even less than the low 1.4% for inner city companies from the 100 inner cities.

³² Taken from ratios table. In the balance sheet, the median operating income as a percentage of sales is **2.3%**, compared to **2.7%** for those in the 100 inner cities (and 2.7% in the U.S.).

³³ Balance sheet table

³⁴ Ratios table

Overall, the median sales per employee figure is lower for inner city Boston companies than those in the 100 inner cities, **\$150,790** versus **\$164,062**, respectively. (Profit per employee is higher, \$3,269 for inner city Boston companies versus \$2,784 for inner city companies from the 100 inner cities).

Liquidity and Capital Structure

Overall, inner city Boston companies are just as liquid as their counterparts in the rest of the US. Inner city companies have a median **current ratio** (current assets / current liabilities) of **1.7** (compared to 1.7 for 100 inner-city companies) and a **quick ratio** (current assets – inventory / current liabilities) of **1.1** (compared to 1.0 for 100 inner-city companies).

	<i>IC Boston</i>	<i>100 ICs</i>
Median current/quick ratios³⁵	1.7 / 1.1	1.7 / 1.0

In terms of capital structure, looking at the balance sheet tables, inner city companies in the \$5 million to \$20 million range are less leveraged than companies in the 100 inner cities (and US) as a whole. Their **debt to equity** ratio is much less – **78%** for inner city Boston companies versus **99%** for 100 inner city companies³⁶. This suggests that inner city Boston companies are much less leveraged than their 100 inner city (and U.S.) counterparts. Again, the higher net worth of inner-city Boston small companies appears to drive this difference.

	<i>IC Boston</i>	<i>100 ICs</i>
Median debt-to-equity³⁷	78%	99%
Median value of long-term debt³⁸	\$35,627	\$95,544

iii) ‘Mid-sized’ Companies in Inner City **Boston** (from \$20 million to \$100 million in revenues.)

Profitability

³⁵ Ratios table

³⁶ Here the debt-to-equity ratios shown from the ratios table are also far apart- 78% for IC Boston compared to 99% for the 100 ICs. Looking at the balance sheet tables, inner city companies in the \$5 million to \$20 million range are less leveraged than companies in the 100 inner cities (and US) as a whole. In the aggregate, the **debt to assets** ratio for inner city Boston small companies is **52.9%** compared to **58.7%** for the 100 inner cities. Their **debt to equity** ratio is much less – **64%** for inner city Boston companies versus **89%** for 100 inner city companies. Moreover, the median percentage of long-term debt is 0.7% of assets for inner city companies, even less than the low 2.6% for inner city companies from the 100 inner cities. Recall the U.S. small company comparable for long-term debt is 4.2% of assets.

³⁷ Ratios table

³⁸ Balance sheet table

In the \$20 million to \$100 million category, 'mid-sized' inner city companies in Boston are more profitable than those in the 100 inner cities and in the U.S. sample, with the median operating income as a percentage of sales of **6.5%**, compared to **1.8%** for those in the 100 inner cities (and 1.0% in the U.S.).

	<i>IC Boston</i>	<i>100 ICs</i>
Median Return on Sales³⁹	6.5%	1.8%
Median after-tax profit⁴⁰	\$928,585	\$602,448

The **return on assets (ROA)** for inner city Boston companies is superior to the 100 inner cities sample, **4.5%** compared to **3.6%**, respectively.

	<i>IC Boston</i>	<i>100 ICs</i>
Median ROA⁴¹	4.0%	4.1%

Overall, the median sales per employee figure is higher for inner city Boston companies than those in the 100 inner cities, **\$264,903** versus **\$230,815**, respectively. (Profit per employee is much higher, \$7,142 for inner city Boston companies versus \$3,996 for inner city companies from the 100 inner cities).

Liquidity and Capital Structure

Overall, inner city Boston companies are as liquid as their counterparts in the rest of the US. Inner city companies have a median **current ratio** (current assets / current liabilities) of **1.4** (compared to 1.5 for 100 inner-city companies) and a **quick ratio** (current assets – inventory / current liabilities) of **0.8** (compared to 1.0 for 100 inner-city companies).

	<i>IC Boston</i>	<i>100 ICs</i>
Median current/quick ratios⁴²	1.4 / 0.8	1.5 / 1.0

In terms of capital structure, looking at the balance sheet tables, inner city companies in the \$20 million to \$100 million range are less leveraged than 100 inner cities as a whole. Their **debt to equity** ratio is much less – **60%** for inner city Boston companies versus **104%** for 100 inner city companies. Again, the higher net worth of inner-city Boston small companies appears to drive this difference. Intriguingly, the median value of long-

³⁹ Taken from the ratios table. Looking at the balance sheet table, the median operating income as a percentage of sales of **4.0%**, compared to **2.6%** for those in the 100 inner cities (and 2.5% in the U.S.). After-tax profit compares favorably, a median of 2.5% of sales for inner city companies as compared to 1.7% for the 100 inner cities sample and 1.4% in the U.S.

⁴⁰ Balance sheet table

⁴¹ Ratios table

⁴² Ratios table

term debt is just over \$150,000, far lower than the over three quarters of \$1 million for inner city companies and only a tenth that of the median value for the U.S. company in this size range.

	IC Boston	100 ICs
Median debt-to-equity⁴³	60%	104%
Median value of long-term debt⁴⁴	\$152,017	\$746,051

Clearly, the typical inner city Boston company in the mid-sized category holds much less debt than the U.S. comparable – by a factor of ten. Part of this may be to differences in the industry mix, but it might also speak to other issues.

5. Effects of Industry Mix

Broadly speaking, the economy of inner cities is a service economy. Over half of all inner city companies are defined as service companies.

This raises the question – does the industry mix of inner city influence the findings?

Looking across the samples, we find, on balance, that while **the industry mix may slightly influence some of the overall findings on some of the indicators, it cannot by itself explain the differences, especially in return on sales.** Inner city companies within the same industry code may well be quite different in terms of product or service, and this may explain differences, but the sectoral mix of the overall inner city economy isn't the issue.

As shown in the table below, the inner city sample has a higher proportion of companies in certain sectors – such as real estate, health care, social assistance, and religious, grantmaking, civic, professional, and similar organizations. This is even more pronounced in inner city Boston.

⁴³ Taken from ratios table. Looking at the balance sheet tables, inner city companies in the \$20 million to \$100 million range are less leveraged than 100 inner cities as a whole. In the aggregate, the *debt to assets* ratio for inner city Boston small companies is **46.7%** compared to **58.6%** for the 100 inner cities. Their *debt to equity* ratio is much less – **60%** for inner city Boston companies versus **91%** for 100 inner city companies⁴³. Again, the higher net worth of inner-city Boston small companies appears to drive this difference. Moreover, the median percentage of long-term debt is 0.7% of assets for inner city companies, much less than the 4.4% for inner city companies from the 100 inner cities. Recall the U.S. small company comparable for long-term debt is 6.6% of assets.

⁴⁴ Balance sheet table

Establishment Share of Economy by Industry (2004)

Industry	IC Boston Share	100 IC Share	US Share
Construction of Buildings	2.1%	2.7%	4.9%
Heavy and Civil Engineering Construction	2.6%	1.0%	2.0%
Specialty Trade Contractors	4.0%	6.1%	8.5%
Merchant Wholesalers, Durable Goods	4.0%	8.6%	10.3%
Merchant Wholesalers, Nondurable Goods	1.2%	4.2%	4.8%
Clothing and Clothing Accessories Stores	3.1%	3.2%	2.7%
Publishing Industries (except Internet)	1.2%	0.5%	0.5%
Credit Intermediation and Related Activities	1.4%	1.0%	0.9%
Securities, Commodity Contracts, and Other Financial Investments and Related Activities	4.3%	1.1%	0.5%
Funds, Trusts, and Other Financial Vehicles	1.2%	0.2%	0.1%
Real Estate	6.7%	3.1%	1.5%
Professional, Scientific, and Technical Services	11.1%	9.8%	9.1%
Administrative and Support Services	4.0%	3.0%	2.6%
Educational Services	3.6%	2.0%	3.0%
Ambulatory Health Care Services	4.1%	2.5%	1.5%
Nursing and Residential Care Facilities	2.1%	1.1%	1.3%
Social Assistance	8.6%	5.2%	2.2%
Performing Arts, Spectator Sports, and Related Industries	1.6%	0.9%	0.4%
Religious, Grantmaking, Civic, Professional, and Similar Organizations	11.2%	7.7%	3.0%
Administration of Housing Programs, Urban Planning, and Community Development	1.4%	0.4%	0.1%
Other	20.6%	35.6%	40.0%
TOTAL	100.0%	100.0%	100.0%

Source: ICIC and Fintel

For example, inner cities have high proportions of both ‘social assistance’, and ‘religious, grantmaking, civic, professional, and similar organizations’. In the U.S. as a whole, these two sectors have ratios for total liabilities to net worth of 35% and 31% respectively. So this would affect the overall medians for inner cities with respect to the U.S. because of the presence of a higher proportion of industries that carry little debt.

But even a cursory look at the figures show that **the real drivers are differences within the same industry. The levels are what matters, not the mix.** For instance, the weighted average of the medians of ratios for total liabilities to net worth is 56% for inner city Boston, 67% for 100 inner cities, and 106% for the U.S. This in itself reflects the differences we saw above across the different size categories. Recall, this difference is especially evident at the larger size categories.

Total Liabilities to Net Worth, by Industry.

Industry	IC Boston Median	100 IC Median	US Median
Construction of Buildings	213.0%	128.9%	160.0%
Heavy and Civil Engineering Construction	88.5%	117.2%	112.0%
Specialty Trade Contractors	124.1%	95.5%	110.0%
Merchant Wholesalers, Durable Goods	98.4%	99.1%	125.0%
Merchant Wholesalers, Nondurable Goods	153.1%	107.9%	136.0%
Clothing and Clothing Accessories Stores	67.6%	41.8%	59.0%
Publishing Industries (except Internet)	37%	41%	106%
Credit Intermediation and Related Activities	43%	93%	86%
Securities, Commodity Contracts, and Other Financial Investments and Related Activities	23%	25%	39%
Funds, Trusts, and Other Financial Vehicles	23%	26%	70%
Real Estate	50%	86%	122%
Professional, Scientific, and Technical Services	64%	62%	110%
Administrative and Support Services	66%	70%	124%
Educational Services	23%	37%	41%
Ambulatory Health Care Services	68%	53%	89%
Nursing and Residential Care Facilities	58%	44%	123%
Social Assistance	29%	25%	35%
Performing Arts, Spectator Sports, and Related Industries	30%	25%	59%
Religious, Grantmaking, Civic, Professional, and Similar Organizations	12%	17%	32%
Administration of Housing Programs, Urban Planning, and Community Development	36%	48%	31%
Other	NA	NA	NA
Weighted Average of Medians	56%	67%	106%

Source: ICIC and Fintel

The return on sales figures, shown below, demonstrate the same phenomenon even more dramatically. Here, social assistance and religious/grantmaking/civic/professional/ other both show low return on sales in the U.S. as a whole. So we would expect inner cities to also show lower returns on sales since they contain more companies in this sector. Yet, the weighted average of the medians of ratios for return on sales is 3.3% for inner city Boston, 2.5% for 100 inner cities, and 1.7% for the U.S. **This drives the differences in inner city performance we saw above across the different size categories.**

Return on Sales, by Industry (2004)

Industry	IC Boston Median	100 IC Median	US Median
Construction of Buildings	1.2%	1.9%	2.0%
Heavy and Civil Engineering Construction	4.2%	2.6%	2.0%
Specialty Trade Contractors	4.3%	2.0%	2.0%
Merchant Wholesalers, Durable Goods	1.0%	1.4%	1.0%
Merchant Wholesalers, Nondurable Goods	0.5%	1.3%	1.0%
Clothing and Clothing Accessories Stores	3.3%	3.7%	2.0%
Publishing Industries (except Internet)	2.7%	1.4%	2.0%
Credit Intermediation and Related Activities	5.1%	8.6%	7.0%
Securities, Commodity Contracts, and Other Financial Investments and Related Activities	3.7%	3.6%	2.0%
Funds, Trusts, and Other Financial Vehicles	11.3%	17.3%	4.0%
Real Estate	4.2%	3.5%	5.0%
Professional, Scientific, and Technical Services	2.1%	3.0%	2.0%
Administrative and Support Services	0.7%	2.3%	2.0%
Educational Services	0.0%	3.2%	1.0%
Ambulatory Health Care Services	3.0%	2.1%	2.0%
Nursing and Residential Care Facilities	0.7%	1.8%	1.0%
Social Assistance	2.4%	1.9%	1.0%
Performing Arts, Spectator Sports, and Related Industries	2.3%	2.2%	1.0%
Religious, Grantmaking, Civic, Professional, and Similar Organizations	6.9%	2.6%	1.0%
Administration of Housing Programs, Urban Planning, and Community Development	3.1%	2.1%	6.0%
Other	NA	NA	NA
Weighted Average of Medians	3.3%	2.5%	1.7%

Source: ICIC and Fintel

6. Discussion of Findings and Implications for Further Research

- Inner cities contain many more smaller companies. Other studies have found higher rates of entrepreneurship among minorities in inner cities. There are several possible issues here worthy of exploration:
 - there may be more small companies in part because many firm owners do not have the financial, legal, or business know-how to grow. Or they lack the desire to grow because of the day-to-day impact on their lives.
 - there may be many smaller companies because residents lack enough attractive opportunities at larger firms located in the rest of the city and metropolitan area. Those interesting in moving ahead in business must start their own firms. And these firms stay small for a variety of reasons.
 - there may be some specific knowledge about inner city markets that inner city entrepreneurs can take advantage of, especially because of the lack of enough larger competitive players who see opportunity
 - there may be some historical momentum arising from the flight of large firms to suburbs.
 - start-ups from immigrants might be a strong contributing factor. These immigrants may lack specific U.S. legal or financial know-how to make their firms larger, among other possible factors.

- Within a particular industry sector, inner city companies may have found a niche that makes them more profitable. This could come from:
 - proximity to downtown businesses for commercial service companies,
 - lack of competition from larger players who do not see inner cities as profitable,
 - some types of business may benefit from access to lower wage labor force, perhaps because of high immigrant population or lower education
 - Service industries have an advantage in cities. Service industries tend to locate in cities because face-to-face contact is more important, in contrast to manufacturing. So the performance difference may be driven by higher productivity in service industries, and reflect an urban advantage.
 - resident density,
 - the specific type of business within a sector may differ – for example a health service firm in the suburbs is different than one in the inner city.
 - other aspects of the competitive environment in inner cities.

- Inner city companies may be debt capital constrained, holding back possible growth. We need to explore why. It could be:
 - lack of access to capital arising from lack of networks or other factors
 - aversion to debt
 - lack of knowledge about accessing debt
 - lack of credit history needed to qualify for financing
 - or... companies already have the optimal amount of debt due to local risk factors.

- Inner City Boston companies may especially reflect these issues, and so offer up a unique opportunity to answer them.

Possible further research

1. Examine the Inner City 100 database for further clues to the financing of inner city companies- especially from the company surveys and financial information.
2. Unpack the obstacles inner city companies face with respect to growth. Is it mostly a question of being too small to access enough financing to grow to scale or becoming more efficient? Is it a lack of sophistication issue – both in terms of financing and general business strategy?
3. What does the debt to equity ratio tell us about potential opportunities for inner city company investment? Inner City companies appear to be less leveraged as a percentage of their total assets. Why? In the case of inner city Boston, this is especially – what does this tell us?
4. Run similar data for other inner cities in order to benchmark inner city Boston. Possibilities could include Los Angeles, Chicago, Miami, and New York. Also examine whether inner city companies perform differently from companies located in their central city and MSA.

Appendix: List of Attachments Provided to Next Street Financial, LLC

Addendum:

- Inner city Boston summary economic profile (2005)
- Inner city Boston largest and fastest growing clusters (1998-2003)

Electronic files:

- Median Financial characteristics (2004) of inner city companies (IC Boston vs 100 ICs vs US)
 - Sales and Employment Growth
 - **(Balance Sheet Table)** Common Size Statements by Revenue Size
 - **(Ratio Table)** Median Financial Ratios by Revenue Size
- List of Inner City 100 Companies (1999-2005) from Boston
 - Applicants
 - Companies with revenue data
 - Winners
- Cluster Employment (1998-2003) for Six (6) Inner Cities
 - Manhattan-Bronx
 - Brooklyn-Queens
 - Los Angeles
 - Miami
 - Chicago
 - Boston
- Subcluster employment data (1998-2003) for inner city Boston

Methodological note

Because companies do not identify themselves as being 'inner-city', ICIC undertook a major task in unique fashion in identifying inner city companies in the two hundred thousand-plus company Kauffman database. Using mapping software, ICIC was able to identify the postal addresses of all inner city locations in the 100 inner cities. To give you a sense for the numerical complexity of this process, the number of business addresses in these inner cities alone is over eight hundred thousand.

After compiling the list of addresses (using USPS ZIP+4's) that correspond to ICIC's inner city boundaries, we then sent the list of qualifying inner city addresses to Fintel who were then able to extract the summary information for all companies located at these addresses in the Kauffman database. Similarly, we marked those addresses in inner city Boston to extract data for the companies in inner city Boston. From this, ICIC could receive data for the 37,000+ inner city companies, with a special cut for inner city Boston.