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Economic Impact Report

The Effects of HMSDC Certified Minority Business Enterprises on the Houston Metropolitan Economy

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EXECUTIVE SUMMARY

One of the reasons most often given for major buying entities (corporations, hospitals, universities, state and local government, etc.) to have a supplier diversity initiative and engage in minority business development is that by promoting greater vendor participation, they are helping to support the economic base of the communities in which they do business. This sounds good, but is it accurate?

Early in 2015 the Houston Minority Supplier Development Council (HMSDC) retained The Institute for Thought Diversity to assist the Council in conducting a study to assess the economic impact that HMSDC certified Minority Business Enterprises (MBEs) have on Houston, the most populous city in the state of Texas, and the fourth most populous in the United States. This impact includes the increased business activity created by the 677* MBEs of HMSDC, the jobs that are maintained/created as a result of this activity throughout the various sectors of state's economy, and the incremental business taxes that are generated at the local, state and national levels.

The results of the study are that today, HMSDC MBEs have a **total economic impact of \$22.8 billion** which is composed of over **\$17.1 billion dollars in output** that results in the creation and/or preservation of more than **67 thousand jobs** held by persons who find themselves either directly or indirectly employed by HMSDC certified MBEs. These are jobs that not only support individuals, but also contribute to the economic well-being of their families, their communities, the territories covered by the HMSDC and far beyond through more than **\$4.2 billion in salaries and benefits**. This is particularly striking in a time when unemployment is at an all-time high within many minority communities. These same minority suppliers are also generating over **\$1.4 billion** in tax revenue (local, state, and federal).

In many circles, with the rapidly changing demographics of the United States, the minority business sector is arguably the fastest growing segment of small business. Therefore, it stands to reason that ensuring the success of minority business will have significant, positive effects on both the United States economy in general and the Houston, Texas economy in particular. Simply put, the fledgling economies of the territories under the jurisdiction of the HMSDC cannot reach their full and true potential unless the minority business community is growing and reaching its full and true potential. HMSDC has a long-standing history as the primary driver of and catalyst for that growth.

** The number of HMSDC certified MBEs as of June 2015*

INTRODUCTION AND PURPOSE

Minority-owned businesses have recently been growing in terms of the number of firms, gross receipts, and paid employment at a faster pace than non-minority firms nationwide. If not for the employment growth created by minority firms, American firms (excluding publicly-held firms) would have experienced a greater job loss during the Great Recession, which according to the National Bureau of Economic Research (NBER) was officially from December 2007 to June 2009. Despite the fact that the recession officially ended in 2009, many areas of the United States continued to struggle with high unemployment, foreclosures, stagnant or declining consumer consumption and, in fact, are just now approaching pre-recession numbers (Lansing, 2011).

While the overall impact of the recession was definitely felt within the minority business community; according to Minority Business Development Agency (MBDA), Minority Business Enterprises (MBEs) continue to be the engine of employment in emerging and minority communities (Fairlie & Robb, 2010).

The purpose of this study is to present empirical evidence demonstrating the positive impact that the Houston Minority Supplier Development Council's certified minority business community has on the local economy. This will be accomplished by examining the economic impact of the HMSDC MBE community through the lens of job creation, income generation and tax revenue.

METHODOLOGY OF THE STUDY

The full economic impact of the 677 MBEs certified by the Houston Minority Supplier Development Council (HMSDC) on the US economy, was estimated using classic input-output model methodology in combination with regional specific Social Accounting Matrices and Multiplier Models. In this input-output model, the business sectors of the economy being examined are organized according to who makes what outputs and who uses what inputs (imagine a matrix).

The benefit of using input-output methodology is that it helps evaluate the effects of HMSDC MBEs on each other and all other industries within the territory covered by the HMSDC. This interrelatedness of all businesses within the HMSDC footprint is rooted in the supposition that all businesses use the outputs of each other as inputs. An input-output model makes it possible to examine economic relationships between businesses as well as between business and consumers. It will measure changes in any one or several economic variables on the areas impacted by the HMSDC.

Strictly speaking, each industry that produces goods and services has an influence on, and in turn is influenced by, the production of goods and services of other industries. These interrelationships are captured through a multiplier effect as the demand and supply from various industries trickle over from business to business. This allows for the quantification of the cumulative total economic impact, which includes output, compensation, employment, local, state and federal tax revenue (Varshney & Tootelian, 2009).

THE MULTIPLIER EFFECT

Having a workable understanding of the multiplier effect is crucial to gaining a better grasp of the methodology of this study and as a result, having a better understanding of the results being reported. The multiplier effect in this study is based on the sales, employment and industry data extracted from the HMSDC certified MBEs and reflects the increased economic activity that comes from sales being generated, and expenses being incurred, by the HMSDC certified businesses.

When an HMSDC MBE generates sales, it must use a portion of that money to purchase other goods and other services as well as hire people to meet the demand for its products and services. Purchases made by the HMSDC MBE are representative of sales to other firms who must then also purchase goods and services and hire people to meet their new demand derived from the MBE community. The additional hiring to meet this increased demand means that more people have income which they will use to purchase goods and services for their households and families. All of this brings added sales to businesses in the community. The net effect is that HMSDC MBE sales dollars are being recycled in the community through this process of sales, once again requiring additional purchases and increased employment, which result in sales for other businesses who must use that money to make their own purchases and hire additional people.

SCOPE OF THE STUDY

To qualify for and be included in the study, MBEs had to be certified and in good standing with HMSDC. The certification process usually takes anywhere from thirty to ninety days depending on the complexity of the certification application submitted by the minority business in question. Regional Minority Supplier Development Councils (RMSDC) like HMSDC, which are affiliate councils of the National Minority Supplier Development Council (NMSDC), are responsible for conducting a thorough review of the certification application in accordance with the standards and practices established by the NMSDC. Certification lasts for one year from the date of approval and as such, each application is subject to review for any material changes to the ownership and control of the company on an annual basis.

One of the primary advantages in having an independent third party in charge of the certification process is that the burden of proof that the MBEs are bona fide minority owned enterprises rests on the shoulders of the RMSDCs. Currently there are 24 regional councils authorized by the NMSDC to grant MBE certification status to companies who meet the nationally standardized criteria for MBE certification. Corporations and other major buying entities using HMSDC certified MBEs can rest assured that the company's ownership, management and operations are under the jurisdiction of one of the five minority groups designated as eligible for certification.

ECONOMIC IMPACTS

This research mainly focuses on the economic impact of HMSDC certified minority business enterprises on the Houston and Texas economies (and ultimately the US economy) and comprises several components. Specifically, the report analyzes three types of economic impacts:

- **Output Effect:**
This is the most extensive measure of economic impact. It is a measure of sales or revenues generated by HMSDC certified MBEs.
- **Income Effect**
A measure of total income generated within the HMSDC footprint by certified MBEs.
- **Employment Effect**
A measure of the number of jobs created as a result of the business activities of certified MBEs.

Direct

The direct effect represents the impact created directly by the business activities of the 677 HMSDC certified MBEs. For example, if an HMSDC certified MBE opens a new production facility in a new territory and records \$5 million in sales, the direct impact of the facility is an additional sale of \$5 million. The total gross output of the territory in question (all other things being equal) is greater by \$5 million. In addition this new production facility will likely have hired employees to produce the goods needed for \$5 million in sales. These new jobs are a direct result of the facility's business activity.

Indirect

The indirect impact represents business to business transactions. These transactions (also known as second round impacts) occur when the suppliers of HMSDC MBEs purchase goods and services from other suppliers. In the above example, if the new production facility generating \$5 million in sales buys the supplies and/or services needed for production, its supplier must in turn hire the appropriate number of people and goods and services needed to meet the demands of the HMSDC certified MBE. These business activities by the supplier are indirect in nature. It is important to note that these second round impacts would not occur if it were not for the business activities of the HMSDC certified MBEs.

Induced

The induced effect occurs as a result of the spending patterns of the families of the employees of both HMSDC MBEs and the employees of the indirectly affected businesses supporting HMSDC MBEs. Examples of purchases comprising the induced impact include, but are not limited to, retail purchases, housing, banking, medical services and insurance.

ECONOMIC IMPACT SUMMARY

The economic impact analysis in this study was conducted for the total expenditures of 677 HMSDC certified MBEs. In order to qualify for and be included in the study, the MBEs had to be certified and in good standing with HMSDC. It should be noted that this analysis, based on annual revenues of HMSDC MBEs, measures the impact expected to occur each year in which such spending with the MBE community occurs.

The Output, Employment, Labor Income, and Indirect Business Taxes for the HMSDC MBEs is summarized and presented in the table below.

ECONOMIC IMPACT SUMMARY	TOTAL	PER DAY
Output	\$17,182,894,067	\$47,076,422
Employment	67,640	N/A
Labor Income	\$4,232,628,736	\$11,596,243

Output

The overall output, or the amount of overall business activity created by HMSDC MBEs, is over \$ 17.1 billion, which equates to over \$47 million per day. This includes the direct spending with the HMSDC MBE community ("Direct"), the amount of additional business activity created by that spending ("Indirect"), and the amount of additional business activity created by discretionary spending as a result of the incremental labor income ("Induced") (See AppendixII).

Employment

There are 67,640 jobs that are created and/or maintained within the Houston MSDC footprint as a result of the activities of the HMSDC MBE community. 22,016 of these jobs or 33% are people that are directly employed by HMSDC MBEs. The remaining 45,624 jobs would not be possible without the expenditures of either the MBE companies or their employees.

Labor Income

The 677 HMSDC certified MBEs disbursed over \$1.8 billion in salary, wages and benefits to the 22,016 employees as measured in direct labor income. This direct labor income served as a catalyst for the \$1.4 billion in indirect income paid to the non-MBE supplier community. It is necessary to remember that these businesses had to hire these additional employees to meet the business demands of 677 certified MBEs. The induced income is estimated to be a little less than \$950 million, bringing the total labor income effect to more than \$4.2 billion, which equates to approximately \$11.6 million per day.

TAX IMPACT

The tax results presented in this study represent estimates of the total tax revenues associated with the all of the business activities related to the HMSDC certified MBEs, with the assumption of the current tax laws and policies in place. More specifically the estimated taxes are generated from the direct, indirect, and induced spending activities linked with the continued business activities of the HMSDC certified MBE community.

It should also be noted that these direct and indirect tax estimates are the immediate taxes (e.g., sales taxes) generated by the retail sectors in the scenario. The total impact of the taxes is summarized and presented at the federal level and the state/local levels in the table below.

TAX IMPACT: Federal, State, Local

SUMMARY FOR TAX IMPACT	TOTAL	PER DAY
State/Local	\$484,049,251	\$1,326,162
Federal	\$955,509,928	\$2,617,835

State/Local

In Texas, approximately 48% of the state's revenue comes from state and local taxes, with another 32% coming from the federal government. It is important to understand that in 2015, 100% of the \$3.18 trillion in revenue for the federal government comes from three major tax related sources:

- **Income taxes paid by individuals:** \$1.48 trillion, 47% of all tax revenues.
- **Payroll taxes paid jointly by workers and employers:** \$1.07 trillion, 34% of all tax revenues.
- **Corporate income taxes paid by businesses:** \$341.7 billion, 11% of all tax revenues.

This means that 80% of Texas' revenue is tax related. Given these facts it stands to reason that an economic impact study must touch on the impact that HMSDC certified MBEs have upon the federal, state and local tax base (Texas Transparency, 2015).

Federal

Finally, more than \$950 million in additional federal tax revenue will be created from the business activities of the HMSDC MBEs, equating to more than \$2.6 million each day of the year. These are tax dollars generated from businesses benefiting from the heightened economic activity and the increased employment.

SUMMARY AND CONCLUSION

Relevance of Minority Business Enterprises

According to a Department of Commerce study, the minority population will contribute to as much as 70% of the total increase in purchasing power from 2000 to 2045. A joint report from the Milken Institute and the Minority Business Development Agency (MBDA) suggests that the number of minority business owners in the U.S. (currently estimated at 3.3 million) is growing at a rate of 17% annually--a staggering six times faster than the growth rate of allfirms.

Overall, MBE sales are growing at a rate of 34% per year, nearly twice as fast as the national average. The report concludes that MBEs are a driving force behind economic growth and will be a major segment of the U.S. economy in the 21st century as the transition to a more diverse demographic majority occurs (Tozzi, 2010).

Economic Impact of HMSDC

One of the primary goals of the HMSDC is to promote minority business participation in the procurement process in order to create economic wealth in minority business communities throughout the nation. This is important because wealth creation is the end result of successful businesses. Wealth-creating businesses hire more people, invest more in their communities and actively participate in philanthropic activities; thus delivering more social value. According to the "Cultures of Giving" report by the W.K. Kellogg Foundation, minorities on average are more prone to giving than their non-minority counterparts and in some cases, giving up 25% more (Gravely, 2014).

The creation of healthy minority businesses that will in turn help their socio-economically challenged communities solve some of the existing problems is the core mission of HMSDC. However, without the empirical evidence provided by this study, it is impossible to determine if the HMSDC is indeed successfully fulfilling its mission.

The results are in, and the empirical evidence is indisputable. Over \$17.1 billion in annual revenue comes from the activities of the HMSDC certified MBE community. As a result, these same firms employ 67,640 people both directly and indirectly resulting in the dissemination of over \$4.2 billion in salaries and wages. Finally when combined with the more than \$1.4 billion in various tax revenues coming from the activities of the HMSDC MBE suppliers, the total economic impact rises to over \$22.8 billion.

There are many programs offered in both the public and private sectors, geared toward individuals who want to start a business. Undoubtedly these programs are important and meet a need. However, in terms of return on investment (ROI), this study provides indisputable empirical evidence of the significant impact of the HMSDC and its certified MBEs on national and local economies. Additionally, it distinguishes the Houston Minority Supplier Development Council as the premiere minority business development entity in Houston as compared to other noteworthy organizations with similar missions.

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APPENDIX I

CIRCULAR FLOW OF GOODS, SERVICES AND DOLLARS

To gain a better understanding of the different elements within the US economy, it is most convenient to start with a modified version of the circular flow diagram. The diagram is invaluable for several reasons, but primarily because it allows the reader to visualize (and thus better understand) the role that HMSDC MBEs play on job creation.

No matter where one begins within the Circular Flow Diagram, it is easy to follow the flow of dollars through the system and see exactly how it impacts the creation of jobs. Employees are compensated for their efforts in the form of wages and salaries. Wages and salaries constitute the core element of income for the majority of today's workforce. While a portion of the income the workers receive may be in the form of fringe benefits, the primary portion is usually in the form of money. Figure (1) is a diagram of the circular flow of goods and services in the free-market economy. It presents pictorially how HMSDC certified MBEs positively impact the US economy through job creation and income generation.

Figure 1 : Circular Flow of Goods and Services in a Free-Market Economy



HOUSEHOLDS

Households are the consumers of goods and services that come from the product market. The households in this context are particularly relevant for two reasons. First, they create the demand for goods and services provided by the product market. Second, households provide the labor for HMSDC MBEs or any company serving as a supplier. Households may also provide other resources including, but not limited to, entrepreneurial ability. As can be seen in this example, households can be made up of consumers, MBEs or anyone providing labor, property, money or any other factors of production necessary for businesses to deliver the goods and services that households consume (Piorkowsky, 2011).

FACTOR MARKET

The factor market is a conceptual term. Whereas households (i.e. consumers) do exist, the factor market is where households go to sell their labor, land, capital and entrepreneurial talent. In reality, it does not exist. In other words, there is no single place where businesses gather to meet potential employees, lease land or borrow money directly from households.

For example, if a business needs to borrow money for working capital, the business may choose to go to a bank. The bank will lend the money the household has already deposited into the bank as part of its savings. In return for lending the money to the business, the bank will charge the company interest. The bank in turn pays the household a portion of this interest collected from the borrowing entity, in exchange for depositing their money. This, in turn, enables the bank to have a supply of funds from which to draw. From this pool of funds, the lending institution can then loan these funds to the businesses. In this case, the households are lending the prospective business money indirectly through their relationship with the bank. In reality, however, the household did not meet the company at the factor market to make the exchange (McConnell, Brue & Flynn, 2009).

BUSINESSES

This section is where the proverbial rubber meets the road, and is arguably the most important to understand conceptually. In most instances, the HMSDC certified MBE is a supplier to a corporate customer. HMSDC certified minority businesses overall are less likely to sell directly to the public (households in this scenario) although some do. As a result, most of the MBEs can be found in this category (businesses).

The role of businesses in this component of the circular flow diagram is either to produce the goods and services that will be sold by others in the product market, or to help support the infrastructure needed to maintain the product market (McConnell, Brue & Flynn, 2009).

PRODUCT MARKET AND THE CIRCULAR FLOW OF THE DOLLAR

Although not as common, it is not unheard of for HMSDC MBEs to provide goods and services directly to the public. There are a myriad staffing firms, caterers, insurance brokers, and other businesses that may also be suited to compete in the product market in this scenario. The product market is where consumers go to spend their hard earned dollars, some of which they earned as employees of HMSDC MBEs.

A percentage of the dollars collected by merchants selling their wares in the product market are used to pay expenses, including employees and suppliers. These suppliers could very well be HMSDC certified Minority Business Enterprises. These MBE

suppliers use a portion of the dollars that they collect from merchants in the product market to pay wages to their employees--many of whom come from households within the US community. Employees receiving wages and salaries return to the product market to spend a percentage of dollars received as HMSDC MBE employees, and thus the cycle begins again (Pordeli & Wynkoop, 2009).

APPENDIX II

ECONOMIC IMPACT SUMMARY

The results generated from the econometric model can be seen in table format, followed by detailed explanations of the results contained therein. In order to present the most comprehensive examination of the economic impact the HMSDC MBE community has on the United States' economy, it is necessary to review the three levels of impact (direct, indirect and induced). These three levels of economic impact combine to provide the most accurate depiction of the overall total economic impact.

Direct, Indirect and Induced Impacts

The direct economic impact is derived from the revenue generated by HMSDC certified MBEs. The indirect impact comes from the purchase of goods and services made by businesses from suppliers within their supply chain. These are purchases made by the suppliers of their suppliers. The induced impact represents the dollars put back into the economy as a direct result of the consumption patterns of the employees of these inextricably interconnected businesses (MBEs, suppliers and suppliers' suppliers).

Table 1: Economic Impact Summary

Impact Type	Employment	Labor Income	Output	Value Added
Direct Effect	22,016	\$1,855,021,361	\$10,186,039,144	\$2,749,992,197
Indirect Effect	25,207	\$1,429,362,568	\$ 4,140,262,857	\$2,265,439,205
Induced Effect	20,417	\$ 948,244,806	\$ 2,856,592,066	\$1,614,332,530
Total Effect	67,640	\$4,232,628,736	\$17,182,894,067	\$6,629,763,932

Employment and Labor Income Effect

The 677 HMSDC certified MBEs disbursed \$1.8 billion in salary, wages and benefits to the 22,016 employees measured in direct labor income. These business activities and increased need resulting from those receiving the direct labor income produced \$1.4 billion in indirect income for the 25,207 employees of other businesses. It is important to remember that these businesses had to hire these additional employees to meet the business demands of 677 certified MBEs. The induced income being paid to 20,417 workers is estimated to be a little more than \$948 million, bringing the total labor income effect to more than \$4.2 billion and jobs total to 67,640.

Output Effect

The results of the data gathered from the 677 HMSDC certified MBEs indicate that certified MBEs were directly responsible for more than \$10.1 billion in sales of products and services offered to customers. The indirect output of \$4.1 billion is representative of the increased procurement required from the suppliers of HMSDC MBEs. \$2.8 billion in induced output is the total dollar amount of goods and services purchased by the employees and families of certified MBEs from other merchants within the United States. The total of the direct, indirect and induced effects combined make the total output effect more than \$17.1 billion.

Value Added Effect

The value added effect is the difference between the total output of the 677 HMSDC certified MBEs and the cost of their intermediate inputs. Included in the total value added effect are income coming from self-employed businesses; dividends, rent, interest, profit payments and royalties; and ultimately each individual's sales taxes flowing to and through the businesses. The sums of the direct, indirect and induced effects combine to make the total value add effect over \$6.6 billion (Jensen, Lambert, Menard, English & Xu, 2011).

