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Partnership for Lending in Underserved Markets

Phase I Summary: Developing Action-Oriented
Solutions to the Financing Challenges Facing
Minority-Owned Small Businesses

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ACCESS TO
CAPITAL

EXECUTIVE SUMMARY

BACKGROUND

Minority-owned small businesses play an important role in the nation's economic health by driving job creation, raising wages, and elevating better standards of living in communities throughout the United States. Business ownership is also a critical pathway for Blacks and Hispanics to close the racial wealth gap—an increase in entrepreneurship among people of color can create income for both entrepreneurs and the people of color who work at the businesses.

Over the past two decades, the racial and ethnic composition of the United States has changed, and so too has the racial and ethnic composition of U.S. businesses. Parity is achieved when the percent of minority-owned businesses approximates the percent of the minority population. In the 10 years between 2002 and 2012, the share of minority-owned small businesses increased—and the rate of increase far outpaced changes in population. However, given the relatively small base, minority-owned businesses still remain dramatically underrepresented.

In 2012, Blacks made up 13.1 percent of the population, yet only owned 2.1 percent of classifiable small employer firms and only made up 1.1 percent of sales (average receipts of \$866,866), 1.9 percent of employees, and 1.4 percent of payroll (average wages of \$28,594). Hispanics made up 16.9 percent of the population, yet only owned 5.6 percent of classifiable small employer firms and only made up 3.4 percent of sales (average receipts of \$1,021,506), 4.5 percent of employees, and 3.6 percent of payroll (average wages of \$30,110). These employee and payroll figures speak to a disadvantaged community and lasting economic effects—the number of employed workers and how well those workers are paid.

The Partnership for Lending in Underserved Markets (PLUM) initiative—a two-year pilot program focuses on developing actionable solutions to address long-standing structural problems that inhibit minority-owned small businesses from accessing capital and growing their operations

MISSION: IMPACT

Starting a new firm or growing an established business requires capital, but Black and Hispanic businesses are reported to have higher barriers to capital access. The challenges are well documented and many solutions have been proposed, but to achieve change, we need to move ideas into action. The federal government actually has a lot of programs that can help. Between the Small Business Administration's (SBA's) Community Advantage Loan Program, Treasury's Community Development Financial Institutions (CDFI) Fund), Commerce's Minority Business Development Agency (MBDA), and the Department of Agriculture's Office of Small and Disadvantaged Business Utilization(OSDBU), there is potential to mobilize resources that drive job creation and economic growth, especially in minority communities throughout the country. We need to leverage these resources, as well as develop and execute new solutions.

Building from a series of meetings with local stakeholders in June 2016 convened by the Milken Institute and the SBA's Los Angeles regional office, the Milken Institute and the SBA convened a national roundtable at the White House to review the stubborn barriers to capital access that impede Black and Hispanic Americans from starting and growing their businesses. The aim of this roundtable was to discuss opportunities and develop a plan to overcome inhibiting hurdles. Representatives from financial institutions, regulatory agencies, community groups, research institutes, and others considered how to increase not only the number and value

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of loans to minority-owned businesses, but also the number of successful (growing) minority-owned small businesses in Black and Hispanic communities employing Black and Hispanic workers.

That is why the Milken Institute and the SBA formed the Partnership for Lending in Underserved Markets (PLUM) initiative—a two-year pilot program to develop actionable solutions to address long-standing structural problems that inhibit minority-owned small businesses from accessing capital and growing their operations. The focus of this initiative is on classifiable small employer firms vs. non-employer firms (sole proprietors) that may generate income for an individual, but are less likely to make an economic impact in their communities as they do not create jobs and therefore do not achieve the multiplier effect of associated additional economic activity. Also, a deliberate commitment was made to acknowledge and pay attention to the different financing (and technical assistance) needs of start-ups vs. established firms.

Baltimore, Maryland and Los Angeles, California were selected as the pilot cities. The Baltimore protests in the wake of the 2015 death of Freddie Gray while in police custody brought attention on a national level to the consequences of long-standing racial tension and community divestment. Los Angeles is a microcosm of racial and ethnic diversity with an instructive mix of overlapping jurisdictions and governance structures. Both cities have local-level actors with the will and infrastructure to activate good ideas.

The initiative is divided into three phases:

Phase I—Problem Definition: Identify and analyze root causes affecting lending to minority-owned small businesses. Create working groups in Baltimore and Los Angeles to identify specific challenges related to the loan underwriting process, public policy, and economic development. Initiate research on these topics at the national level.

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Phase II—Solution: Identify solutions and opportunities for action. Action groups develop strategic plans with defined objectives, tactics, champions, and an execution timeline. Nationally, the Milken Institute develops policy briefs and convenes Financial Innovations Labs® and other targeted research and activities to identify actionable recommendations to address national policy priorities and the loan underwriting process.¹

¹ For more information about the Institute's Financial Innovations Labs, see here: www.milkeninstitute.org/events/labs/.

Phase III—Implementation: Begin to execute the strategic plans and other recommendations developed during Phase II. For pilot cities, learn what works and establish best practices, as well as learn what does not work and where to tweak program and approach. Release final reports summarizing the two-year effort and publish outcomes of Financial Innovation Labs and other national activities.

PHASE I: PROBLEM DEFINITION

PLUM-Baltimore launched in September 2016 and PLUM-Los Angeles launched in October 2016. In both cities, the Milken Institute and SBA first convened steering committees composed of local stakeholders to oversee and guide pilot efforts. Launch events were held with a broader task force of government officials, data providers, economic development representatives, business resource specialists, traditional and alternative lenders, and small businesses. It was vital to hear from practitioners and community groups on how they defined the universe of local challenges in order to later prioritize issues to address.

Working groups were created to identify specific issues related to lending, public policy, and economic development. Through the fall and winter months, working group members shared their knowledge, expertise, and experience to describe the minority small-business and lending environments in Baltimore and Los Angeles. They provided anecdotal stories, presented qualitative and quantitative survey data, shared local studies, and engaged with additional stakeholders. Additionally, the Milken Institute explored

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the issues at the national level, including conducting preliminary small business data analysis.

PHASE II: SOLUTION PRIORITIZATION

In January and February 2017, the Milken Institute and the SBA reconvened the Baltimore and Los Angeles task forces to summarize the discussions thus far, share what had been learned, and ask the groups to choose a path forward. Based on the issues identified above, the Milken Institute prepared a survey and asked task force participants to prioritize the challenges that PLUM would take on in Phases II and III. While participants found it challenging to rank activities, the exercise provided the SBA and the Milken Institute insight into participants' priorities at the national and local levels. Based on the combined survey results, additional discussions with PLUM participants and stakeholders, and consideration of what other partners and groups were doing, the Milken Institute selected the following priority areas for PLUM to engage:

- **Local Research:** Gather data-driven insights on minority-owned small businesses, the lending environments, and the industry sectors and geographic clusters to provide the evidence base to enhance access to capital for new and growing Black- and Hispanic-owned small businesses.
- **Local Policy:** Engage with local and county officials to establish champions to drive the PLUM effort forward.
- **Technical Assistance (TA) Best Practices:** Support efforts to identify best practices and standardize TA efforts focused on individual TA providers, lenders, and new and established small businesses.
- **National Policy:** Provide thought leadership and support to policymakers, federal officials, and regulators.
- **Underwriting:** Convene industry stakeholders, policymakers, and regulatory officials to test- drive alternative underwriting models to enhance investment in creditworthy, minority-owned small businesses, and improve standardization in this space.
- **Investor Capacity:** Create a participation fund to enhance the capacity of local investors to provide capital to minority-owned small businesses in a responsible manner.

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Subsequently, the Phase I working groups were dissolved and new action groups were constituted to cover each of the priority areas and identify solutions and opportunities for action. The cities of Baltimore and Los Angeles are now tailoring their efforts for maximum local impact. At the national level, the Milken Institute is developing policy briefs and convening Financial Innovations Labs and other targeted research and activities to identify actionable recommendations to address public policy and the loan underwriting process.

Phase II extends through the end of 2017.

BACKGROUND

Minority-owned small businesses play an important role in the nation's overall economic health, driving job creation, raising wages, and bettering standards of living in communities throughout the United States. Business ownership is also a critical pathway for Blacks and Hispanics to close the racial wealth gap.² Per the Ewing Marion Kaufmann Foundation, an increase in entrepreneurship among people of color can create income for both the entrepreneur and the people of color who work at the firm. For example, if half of the employees working at businesses owned by people of color are also people of color, a 10 percent increase in the number of employees and firms owned by people of color could lead to approximately one million new jobs, as well as wealth creation, for people of color. Over the past 30 years, the average wealth of White families has grown by 84 percent—1.2 times the rate of growth for the Hispanic population and three times the rate of growth for the Black population. If the past 30 years were to repeat, the next three decades would see the average wealth of White households increase by over \$18,000 per year, while Hispanic and Black households would see their respective wealth increase by about \$2,250 and \$750 per year.³

² The Milken Institute and SBA recognize the difference between "Hispanic" and "Latino" designations and the ongoing debate regarding which is most appropriate. However, because this is a data-driven report and the U.S. Census Bureau uses the "Hispanic" classification, for consistency we have chosen to use "Hispanic" throughout this report. Likewise, we will defer to "Black" versus "African-American," again consistent with the Census Bureau classification.

³ CFED, Racial Wealth Divide Initiative, Institute for Policy Studies, 2016.

"While the past three decades have seen the average wealth of Latino and Black households increase from \$58,000 and \$67,000 in 1983 to \$98,000 and \$85,000 in 2013, respectively, the trends at the median show Latino and Black wealth moving in the wrong direction. In fact, when consumer durable goods are excluded, median wealth for Black and Latino families has gone down over the past thirty years from \$6,800 and \$4,000 in 1983 to \$1,700 and \$2,000 in 2013, respectively. If current trends continue, Black and Latino families at the median will never reach the level of wealth of White families today."³

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TRENDS: MINORITY-OWNED BUSINESSES IN CONTEXT

Between 2002 and 2012, the population of the United States grew about nine percent, from 288 million to 314 million [see Table 1].⁴ In 2002, minorities made up 31.8 percent of the total population (12.8 percent Black, 4.1 percent Asian, and 13.4 percent Hispanic). By 2012, these shares had increased by 37 percent, 13.1 percent, 5.1 percent, and 16.9 percent. The largest increases occurred among the Hispanic and Asian populations. The Hispanic population increased by 37.3 percent and the share of Hispanics to the total population increased by 25.8 percent. The non-minority population grew just 0.8 percent and its share of the total population fell by 7.6 percent.

⁴ 2002 and 2007 population data: U.S. Census Bureau, Intercensal Estimates of the Resident Population by Sex, Race, and Hispanic Origin for the United States: April 1, 2000 to July 1, 2010; 2012 population data: U.S. Census Bureau, Annual Estimates of the Resident Population by Sex, Race, and Hispanic Origin for the United States, States, and Counties: April 1, 2010 to July 1, 2012.

⁵ U.S. Census Bureau, 2002, 2007, and 2012 Surveys of Business Owners.

Table 1. U.S. Population, 2002-2012

	2002		2007		2012		2002-2012	
	Population	Share of Total	Population	Share of Total	Population	Share of Total	Δ Population	Δ Share of Total
Total	287,625,193		301,231,207		313,914,040		9.1%	
Black	36,684,650	12.8%	38,935,533	12.9%	41,204,793	13.1%	12.3%	2.9%
Asian	11,649,265	4.1%	13,934,641	4.6%	16,145,821	5.1%	38.6%	27.0%
Hispanic	38,617,620	13.4%	46,196,853	15.3%	53,027,708	16.9%	37.3%	25.8%
Minority	91,484,653	31.8%	104,219,813	34.6%	116,208,385	37.0%	27.0%	16.4%
Non-Minority	196,140,540	68.2%	197,011,394	65.4%	197,705,655	63.0%	0.8%	-7.6%

Sources: 2002 and 2007 population data from U.S. Census Bureau Intercensal Estimates of the Resident Population by Sex, Race, and Hispanic Origin for the United States: April 1, 2000 to July 1, 2010; 2012 population data from U.S. Census Bureau Annual Estimates of the Resident Population by Sex, Race, and Hispanic Origin for the United States, States, and Counties: April 1, 2010 to July 1, 2012

As the racial and ethnic composition of the country changed, so too did the racial and ethnic composition of U.S. businesses.⁵ In fact, in the 10 years between 2002 and 2012, not only did the number and share of minority small businesses increase, the rate of increase far outpaced changes in population.

For example, while the Black population increased 12.3 percent between 2002 and 2012, the number of Black-owned small businesses increased 115.8 percent [see Table 2]. Blacks went from making up 12.8 percent of the population in 2002 to 13.1 percent

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of the population in 2012—a 2.9 percent increase. Yet Black-owned businesses went from making up 5.2 percent of small businesses in 2002 to 9.4 percent of small businesses in 2012—a 79.5 percent increase. The gains were greater for non-employer businesses, yet even among classifiable employer small businesses, gains outpaced population growth.

Table 2. Changes in Black Population and Business Ownership 2002-2012

	2002		2007		2012		2002-2012	
	Count	Share	Count	Share	Count	Share	Δ Count	Δ Share
Population	36,684,650	12.8%	38,935,533	12.9%	41,204,793	13.1%	12.3%	2.9%
All Small Businesses	1,197,480	5.2%	1,921,760	7.1%	2,584,300	9.4%	115.8%	79.5%
Non-Employer Small Businesses	1,103,049	6.3%	1,815,298	8.5%	2,475,266	11.1%	124.4%	76.4%
Classifiable Employer Small Businesses	94,431	1.7%	106,462	1.9%	109,034	2.0%	15.5%	17.6%

Like Black small-business owners, Hispanics more than doubled their numbers between 2002 and 2012 (from 1.6 million firms to 3.3 million) [see Table 3]. Their relative gains were slightly less than Black owners overall, but Hispanics had much stronger growth among employer firms—a potential indicator of job creation.

Table 3. Changes in Hispanic Population and Business Ownership 2002-2012

	2002		2007		2012		2002-2012	
	Count	Share	Count	Share	Count	Share	Δ Count	Δ Share
Population	38,617,620	13.4%	46,196,853	15.3%	53,027,708	16.9%	37.3%	25.8%
All Small Businesses	1,573,282	6.9%	2,260,089	8.3%	3,305,625	12.0%	110.1%	74.7%
Non-Employer Small Businesses	1,373,922	7.9%	2,011,417	9.4%	3,018,371	13.6%	119.7%	72.7%
Classifiable Employer Small Businesses	199,360	3.6%	248,672	4.3%	287,254	5.3%	44.1%	46.8%

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STATUS QUO: PERSISTENT UNDERREPRESENTATION

While population and business trends indicate minority-owned businesses are gaining ground, analysis of the 2012 data point to clear disparities in minority small-business ownership. Minority small-business owners remain underrepresented compared to their proportion of the population, and both Black- and Hispanic-owned businesses fare below even the minority averages. In 2012, 37 percent of the U.S. population identified as minority [see Table 4], yet only 17.7 percent of the 5,129,266 classifiable small employer firms were minority owned [see Table 5].^{6,7} And while minority-owned firms generated \$1 trillion in sales (average receipts of \$1.1 million), employed 6.3 million people, and accounted for \$192 billion in payroll (average annual wages of \$30,544), the underrepresentation compared to their share of the population was even worse across these categories: sales (11.8 percent), employment (14.1 percent), and payroll (11.4 percent).

⁶ 2012 population data came from the U.S. Census Bureau, Annual Estimates of the Resident Population by Sex, Race, and Hispanic Origin for the United States, States, and Counties: April 1, 2010 to July 1, 2012.

⁷ In 2012, there were 27.6 million small businesses (defined as less than 500 employees) in the United States. About 22.2 million (80.4 percent) were non-employer firms, most of which were self-employed individuals operating very small, unincorporated businesses. Non-employer firms accounted for 8 percent of small business sales (3 percent of total sales) and no added employment. Overall, non-employer businesses may generate income for an individual, but they are less likely to make an economic impact in the individual’s community, as they do not create jobs and therefore do not achieve the multiplier effect of associated additional economic activity. The remaining 5.4 million small businesses were employer firms accounting for \$11.4 trillion in sales, over 54 million jobs, and \$2.2 trillion in annual payroll. Finally, of the 5.4 million employer firms, about 277,000 (5 percent) were public held, leaving 5.1 million small firms (95 percent) classifiable by gender, race, ethnicity, and veteran status.

Table 4. U.S. Population, 2012

2012	
Total	313,914,040
Black	41,204,793 13.13%
Asian	16,145,821 5.14%
Hispanic	53,027,708 16.89%
Minority	116,208,385 37.02%
Non-Minority	197,705,655 62.89%

Source: U.S. Census Bureau, Annual Estimates of the Resident Population by Sex, Race, and Hispanic Origin for the United States, States, and Counties: April 1, 2010 to July 1, 2012

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Table 5. U.S. Population, 2012

	Number of Firms	Percent of Total	\$ Sales (\$000s)	Percent of Total	Number of Employees	Percent of Total	\$ Payroll (\$000s)	Percent of Total
Total	5,129,266		8,616,304,593		44,697,223		1,686,452,229	
Black	109,034	2.13%	94,517,860	1.10%	839,673	1.88%	24,009,337	1.42%
Asian	480,784	9.37%	577,862,896	6.71%	3,222,635	7.21%	99,254,497	5.89%
Hispanic	287,254	5.6%	293,431,631	3.41%	1,988,218	4.45%	59,864,338	3.55%
Minority	908,183	17.71%	1,014,425,144	11.77%	6,303,197	14.10%	192,522,074	11.42%
Non-Minority	4,150,400	80.92%	7,516,131,229	87.23%	37,805,181	84.58%	1,474,033,739	87.40%

Source: U.S. Census Bureau, 2012 Survey of Business Owners

In 2012, Blacks made up 13.1 percent of the population, yet only owned 2.1 percent of classifiable small employer firms and only made up 1.1 percent of sales (average receipts of \$866,866), 1.9 percent of employees, and 1.4 percent of payroll (average wages of \$28,594). Hispanics made up 16.9 percent of the population, yet only owned 5.6 percent of classifiable small employer firms and only made up 3.4 percent of sales (average receipts of \$1,021,506), 4.5 percent of employees, and 3.6 percent of payroll (average wages of \$30,110). These employee and payroll figures speak to a disadvantaged community and lasting economic effects—the number of employed workers and how well those workers are paid.

MISSION: IMPACT

Starting a new firm and growing a business requires capital. From start-up funds to expansion capital, sales require investment in the business enterprise, and Black and Hispanic businesses are reported to have lower levels of available working capital and profits to reinvest in their growth. There is extensive research on these barriers to capital access from university scholars, government organizations, think tanks, community groups, and advocates (see Appendix A for a literature review). The challenges are well documented and many solutions are proposed. Yet to achieve change, we need to move these ideas into action.

Starting in early 2016, the Milken Institute and the SBA Los Angeles regional office held a series of meetings at the Los Angeles office of the Federal Reserve Bank of San Francisco with stakeholders from the business, lending, and regulatory communities. These meetings helped create consensus on the need for more capital going to minority-owned small businesses and to define the gaps in capital access—the group also realized that this was an issue that demanded national attention. Therefore, in June of 2016, the White House officially convened a meeting co-hosted by the SBA and the Milken Institute to review these inhibitors to capital access for Black and Hispanic Americans to start and grow their businesses in order to discuss opportunities and develop a plan to overcome these hurdles. Representatives from financial institutions, regulatory agencies, community groups, research institutes, and others considered how to increase not only the number and value of loans to minority-owned businesses, but also the number of successful (growing) small businesses in Black and Hispanic communities.

We formed the Partnership for Lending in Underserved Markets (PLUM) initiative—a two-year pilot program to develop actionable solutions to address long-standing structural problems that inhibit

White House Convening Participants

Aspen Institute
Association for Enterprise Opportunity (AEO)
BBIF Florida
Board of Governors of the Federal Reserve System
Business Resource Group
City First Bank
City National Bank
City of Baltimore Small Business Resource Center
Consumer Financial Protection Bureau
Ewing Marion Kauffman Foundation
Harbor Bank of Maryland
Hope Credit Union
Industrial Bank
JP Morgan Chase & Co
Latino Economic Development Center
LEAF College Savings
Les Cayes Partners
Local Initiatives Support Corporation (LISC)
Los Angeles Development Corporation
M&T Bank
Maryland Capital Enterprise
Milken Institute
National Community Investment Fund
National Urban League
Office of Los Angeles Mayor
Onwest Bank
Pacific Coast Regional Corporation
People Fund
The Support Center
U.S. Small Business Administration
U.S. Black Chambers, Inc.
Valley Economic Development Center
W.K. Kellogg Foundation

minority-owned small businesses from accessing capital and growing their operations. The Milken Institute agreed to provide direction and research support and engage stakeholders, while the SBA committed to lending its expertise and available data. Key stakeholders joined task forces and related working groups in each city to provide local market context.

We chose to focus on classifiable small employer firms versus non-employer firms (sole proprietors), which may generate income for an individual, but are less likely to make an economic impact in communities, as they do not create jobs and therefore do not achieve the multiplier effects of associated additional economic activity. Yet, the age and growth stage of small businesses—i.e., the entrepreneurs vs. growing businesses—was another classification we deliberately wanted to address.

START-UPS

Start-ups are new and young firms (zero to two years old) and account for nearly all net new job creation.^{8,9} Of the 5.1 million employer small businesses in the 2012 U.S. Census Bureau's Survey of Business Owners, 59 percent reported and knew the age of their business.¹⁰ Almost 16 percent (299,414) of these businesses were start-ups (between zero and two years old). Over three-quarters of these firms (78 percent) employed between zero and four employees.¹¹ Companies less than one year old have created an average of 1.5 million jobs per year over the past three decades.¹²

While start-ups are important sources of job creation, they are also inherently volatile, with a high exit rate.¹³ Many young firms exhibit an "up or out" dynamic in which innovative and successful firms grow rapidly and become a wellspring of job and economic growth or quickly fail and exit the market, allowing capital to be put to more productive uses.¹⁴ While these businesses have high churn rates

⁸ Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond, and St. Louis, "2015 Small Business Credit Survey Report on Employer Firms," March 2016.

⁹ Ewing Marion Kaufmann Foundation, "The Importance of Young firms for Economic Growth" by Jason Wiens and Chris Jackson, 2015.

¹⁰ Of 5,129,264 classifiable employer businesses with less than 500 employees, 3,517,104 answered the question, "In what year was this business originally established or self-employment activity begun?" However, 481,219 firms indicated they did not know the year. Therefore, we performed calculations with a base of 3,124,161 firms. E.g., $481,219/3,517,104 = 13.6\%$.

¹¹ Employment is based on the number of employees during the pay period including March 12. "Employer firms with zero employees" consists of firms with no March 12 pay period employees, but who had payroll during other pay periods during 2012.

¹² Ewing Marion Kaufmann Foundation, "The Importance of Young firms for Economic Growth" by Jason Wiens and Chris Jackson, 2015 and John Haltiwanger, Ron S. Jarmin, and Javier Miranda, "Who Creates Jobs? Small versus Large versus Young," *The Review of Economics and Statistics*, Vol XCV, Number 2, May 2013.

¹³ John Haltiwanger, Ron S. Jarmin, and Javier Miranda, "Who Creates Jobs? Small versus Large versus Young," *The Review of Economics and Statistics*, Vol XCV, Number 2, May 2013.

¹⁴ Jason Wiens and Chris Jackson, "The Importance of Young firms for Economic Growth," Ewing Marion Kaufmann Foundation, 2015.

(opening and closing frequently), they contribute less to net job creation than high-growth businesses. They are, however, critical to America's middle class. These "Main Street" or "mom-and-pop" small businesses are the dry cleaners, mechanics, and medical clinics that form the fabric of our communities. Many of these businesses exist largely to support a family and are not principally focused on expansion.¹⁵

HIGH-GROWTH START-UPS

As for "high-growth start-ups," there is no singular definition for these businesses that grow bigger and faster than the rest. However, those that exist tend to focus on either firm attributes, such as "secured venture capital funding" or "participated in an accelerator program" or on business performance metrics such as revenue growth, employment, or exits (e.g., the firm was acquired or went public).¹⁶ Though few in number, high-growth businesses have a big impact on the economy. The Kaufmann Foundation summarized key research on high-growth businesses and found that these firms account for up to 50 percent of new jobs created. A recent Harvard study cited research indicating high-growth start-ups are responsible for 20 percent of gross job creation.¹⁷ Regardless of the difference in percentages, these firms differentiate themselves from other companies by expanding not just in size, but also in number of new locations—creating new opportunities in diverse geographic areas and encouraging subsequent employment growth in their related industries.¹⁸ They are important engines of dynamism in local economies—adding jobs and spurring innovation.¹⁹

GROWING BUSINESSES

Again, there is no single definition for this group. The Federal Reserve defines growing businesses as those that have increased revenue or maintain employment in the next 12 months.²⁰

¹⁵ Mills, Karen Gordon, and Brayden McCarthy, "The State of Small Business Lending: Innovation and Technology and the Implications for Regulation," Working Paper 17-042, Harvard Business School, 2016.

¹⁶ "Entrepreneurship Policy Digest: The Economic Impact of High-Growth Start-Ups," Ewing Marion Kaufmann Foundation, June 7, 2016.

¹⁷ Ewing Marion Kaufmann Foundation, "The Importance of Young firms for Economic Growth" by Jason Wiens and Chris Jackson, 2015 and Mills, Karen Gordon, and Brayden McCarthy, "The State of Small Business Lending: Innovation and Technology and the Implications for Regulation," Working Paper 17-042, Harvard Business School, 2016.

¹⁸ "Entrepreneurship Policy Digest: The Economic Impact of High-Growth Start-Ups," Ewing Marion Kaufmann Foundation, June 7, 2016.

¹⁹ Ewing Marion Kaufmann Foundation, "The Importance of Young firms for Economic Growth" by Jason Wiens and Chris Jackson, 2015.

²⁰ To assess employer intentions, respondents were asked, "Expected Employee Change, Next 12 Months," with the options of selecting "Will decrease," "No change," or "Will increase."

We can supplement this definition and distinguish growing businesses from high-growth start-ups by adding a criterion that growing businesses are at least five years old.

According to the Bureau of Labor Statistics, about half of all new establishments survive five years or more and about one-third survive 10 years or more. The probability of survival increases with a firm's age and survival rates have changed little over time.²¹

While start-ups are the economy's primary job creator, in the last two decades about 60 percent of the private sector's net new jobs have been created by existing establishments (vs. about 40 percent from the churn of start-ups minus closures).²² In addition to job creation, established firms help to stabilize communities.

In 2012, slightly more than half of all employer small businesses were established between 1990 and 2007. These firms (five to 22 years old) employed 13.7 million, about 45 percent of the reported working employer small-business population.²³

With these size and age parameters in mind, the Milken Institute and SBA selected Baltimore, Maryland and Los Angeles as the pilot cities for the launch of the PLUM program. The Baltimore protests in the wake of the 2015 death of Freddie Gray in police custody brought national attention to the consequences of longstanding racial tension and community divestment. Los Angeles is a microcosm of racial and ethnic diversity with an instructive mix of overlapping jurisdictions and governance structures. Both cities have local-level actors with the will and infrastructure to activate transformational ideas.

We divided the program into three phases:

- **Phase I—Problem Definition:** Identify and analyze root causes affecting lending to minority-owned small businesses. Create working groups in Baltimore and Los Angeles to identify specific

²¹ "Survival rates of establishments, by year started and number of years since starting, 1994–2015, in percent," Business Employment Dynamics, Bureau of Labor Statistics available at www.bls.gov/bdm/entrepreneurship/bdm_chart3.htm.

²² Bureau of Labor Statistics, Business Employment Dynamics from "Frequently Asked Questions about Small Businesses," Office of Advocacy, U.S. Small Business Administration, September 2012.

²³ Of the 54,423,326 paid employees for the pay period including March 12, 2012, 34,963,609 were included by firms who reported and knew the age of their businesses. Of this sub-set, 13,701,014 worked for firms that were established between 1990 and 2007.

challenges related to the loan underwriting process, public policy, and economic development. Initiate research on these topics at the national level.

²⁴ For more information about the Institute's Financial Innovation Labs, see here: www.milkeninstitute.org/events/labs/.

- **Phase II—Solution Prioritization:** Identify solutions and opportunities for action. Action groups develop strategic plans with defined objectives, tactics, champions, and an execution timeline. Nationally, the Milken Institute develops policy briefs and convenes Financial Innovations Labs and other targeted research and activities to identify actionable recommendations to address national policy priorities and the loan underwriting process.²⁴
- **Phase III—Implementation:** Begin to execute the strategic plans and other recommendations developed during Phase II. For pilot cities, learn what works and establish best practices, as well as learn what does not work and where to tweak program and approach. Release final reports summarizing the two-year effort and publish outcomes of Financial Innovation Labs and other national activities.

PHASE I: PROBLEM DEFINITION

PLUM-Baltimore launched in September 2016 and PLUM-Los Angeles launched in October 2016. In both cities, the Milken Institute and SBA first convened steering committees of local stakeholders to oversee and guide pilot efforts. We then held kick-off events with a broader task force of government officials, data providers, economic development representatives, business resource specialists, traditional and alternative lenders, and small businesses. It was important to hear from practitioners and community groups about how they defined local challenges. In addition, we needed to survey the universe of challenges in order to later prioritize issues to address.

Baltimore Steering Committee Co-Chairs

Aron Betru, Managing Director, Center for Financial Markets, Milken Institute
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Eric Weaver, Chief Executive Officer, Opportunity Fund

Note: All Baltimore members as of September 2016; all Los Angeles members as of October 2016

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To ensure that we captured all the structural issues affecting minority-owned businesses' access to capital, we created working groups to identify specific issues related to lending (e.g., at what point(s) is the underwriting process breaking down? What are the issues securing other financing, such as crowd funding investments?), public policy (e.g., which government interventions are helpful and which ones are impediments?), and economic development (e.g., what is preventing more minority entrepreneurs from starting new businesses? What are the unique challenges affecting growing businesses?).

Baltimore, MD	Los Angeles, CA
Lender Working Group Policy and Regulatory Working Group Economic Development Working Group	Lender Working Group Policy and Regulatory Working Group Entrepreneurial Ecosystem-Emerging Businesses Working Group Economic Development for Established Businesses Working Group

KEY FINDINGS

In the fall and winter of 2016-17, working group members shared their knowledge, expertise, and experiences to describe the minority-owned-small-business and lending environments in Baltimore and Los Angeles. They provided anecdotal stories and quantitative survey data, shared local studies, and engaged with additional stakeholders. Additionally, the Milken Institute explored the issues at the national level, including conducting some preliminary small-business data analysis. The key issues raised during Phase I are summarized below.

Lending and Other Financing

Underwriting

After the great recession, many minority homeowners saw their home values and credit scores wiped out due to the worst financial crises since the Great Depression. As a common source of collateral used in the traditional underwriting process, the decline in home

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equity values (among other issues) made it far more difficult for minority small-business owners in particular to secure capital. Alternatives were needed.

Technological advancement and the proliferation of data over the years has opened up new avenues for small businesses to unlock capital. New, alternative underwriting models can incorporate far greater criteria to more accurately assess the overall creditworthiness of a small business when compared to traditional underwriting processes. Both traditional and non-bank lenders commented on the difficulties and potential of incorporating alternative data into their underlying credit methodologies.

For instance, traditional lenders commented on the difficulty of adopting alternative underwriting methods citing the uncertainty of their effectiveness, especially given the implementation hurdles (e.g., time it takes to fully understand the algorithms used in assessing credit risk, testing those algorithms, and documenting the process for regulators without knowing how regulators will react).

Non-bank lenders were quick to point out that innovative platforms still use the “Five C’s” of credit analysis (character, capacity, capital, collateral, and conditions) just like traditional lenders. Although they use the traditional means, they also pool that data with other data pulled from services such as Quickbooks, payroll processors, and other data metrics such as shipping analytics to provide for a broader credit analysis of the business, and to develop mechanisms that indicate the types of financing products companies really need.

Non-bank providers also commented on the need for the Internal Revenue Service (IRS) to build an application programming interface (API) for its Income Verification Excess Service to provide lenders with additional data points to more accurately assess a business borrower.

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Meanwhile, microlenders pointed out the lack of empirical analysis on their own models and algorithms in use domestically, compared to the vast quantities of research conducted on microlenders operating overseas, particularly in developing economies. The lack of academic inquiry into domestic microlenders makes it difficult to develop a critical mass of understanding in how crucial these platforms are for small businesses.

Standardization and Best Practices

One of the key issues that surfaced during PLUM meetings was the lack of standardization and best practices in the small-business lending space. According to former Treasury Secretary Jack Lew, 8,000 small and microbusinesses are denied credit each day—roughly two million in a given year.²⁵ Of those declined, roughly one-third are considered creditworthy using currently available underwriting methodologies, proving, once again, the significant product mismatch that occurs between lenders and minority-owned small businesses.²⁶ In conversations with PLUM participants and external stakeholders, discussions focused on the development of a loan participation fund, which would provide lenders with balance sheet relief in originating small-business loans and also act as an incentive for lenders to provide standardization across a range of small business products in a responsible and more transparent manner.

While supportive, a few participants noted that the financing structure of a small business is more important than the standardization of products, as capital needs of a small business may need a bespoke form of financing unique to that small business' need.

Patient Capital

There was particular concern from participants on the lack of long-term capital to minority-owned small-business firms. In Baltimore,

²⁵ Prepared remarks in June 2013 by then Secretary of the Treasury Jack Lew on growing America's small businesses: "Every day, thousands of small businesses and entrepreneurs struggle to get a loan. In fact, in 2011 alone, roughly 8,000 small and microbusinesses sought credit each day and were denied. That is more than 2 million businesses a year."

²⁶ Micro Capital Task Force Congressional Briefing One-Pager, Association for Enterprise Opportunity.

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for instance, discussions centered on how to best promote equity capital investment.²⁷ Similarly to the concerns expressed earlier about investor perceptions of the city, participants were clearly concerned about the lack of equity available to the city's entrepreneurs. Participants viewed the identification of a local champion capable of bringing investors and small businesses to the table as a top priority for the PLUM initiative in Baltimore. This is not just a Baltimore-specific issue, but a national issue as well, as the average amount of new equity investments in minority firms across the U.S. in 2010 was roughly \$3,400, or 43 percent the level of non-minority-owned firms.²⁸

In Los Angeles, participants spoke to the need to promote state legislative efforts in implementing intrastate crowdfunding in California. While Maryland is one of the 35 or so states to have implemented intrastate crowdfunding, California has yet to pass legislation in this space. One participant noted the importance of local investing and the opportunities it provides to drive wealth creation and capital to underserved communities in particular. Similarly, intrastate crowdfunding offers the ability for small businesses to apply for hybrid financing with a certain portion raised during the crowdfunding effort acting as collateral for financing from a traditional financial institution.

However, one participant in Baltimore was concerned about drawing funds from non-accredited investors without the education and support that accredited investors often have. Nevertheless, one participant from the PLUM-Los Angeles Task Force observed that the use of a special purpose vehicle in intrastate crowdfunding would reduce the complexity of a large number of investors investing in a small business.

Financing Education

The lack of understanding and education regarding financing alternatives that go beyond traditional bank loans hinders minority-

²⁷ In 2013, the Kauffman Foundation State of Entrepreneurship Address, found that small businesses overwhelmingly rely heavily on personal loans to the founder, personal credit cards, business bank loans, business credit cards, and personal lines of credit, some of which required collateral that largely came from and were backed by home equity lines of credit.

²⁸ Alicia Robb and Robert Fairlie, *Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs*, U.S. Department of Commerce, January 2010.

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owned small businesses from accessing the right kind of financing products more tailored to the capital demands of a small business.

A PLUM-Los Angeles partner, the Business Resource Group (BRG), in collaboration with the California Black Legislative Caucus, hosted three Black roundtable events in and around LA County between September–December 2016. Businesses were asked to share their experiences, challenges, and needs as they related to accessing capital, revenue and contracts, and building wealth. Approximately 169 businesses and 22 community organizations participated.

Many businesses expressed a need to better understand the differences between consumer and business banking. They said that existing programs teach about credit scores or the documents lenders want in a loan package, but they do not help businesses understand the factors considered for approving a loan. Some questions asked by participants included:

- Do lenders really look at the whole story?
- Are mitigating factors considered?
- How are past credit issues and current operations considered with automated loan underwriting taking over?
- Before putting in the effort, what is the actual likelihood of obtaining a loan?

Roundtable participants also shared that they really are not aware of nor do they understand alternative capital options, specifically:

- Bitcoin for small businesses
- PayPal loans
- Gap financing
- Angel investors and other venture capital financing
- Alternative collateral and guarantee programs
- Seed capital for inventors and innovators
- Crowdfunding

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Also, 90 percent of Black roundtable participants were unaware of available financial subsidies for innovation, energy efficiency, and disability access, as well as other financial incentive programs such as state tax credits.

Bank Referral Approaches

Both Los Angeles and Baltimore participants touched on the deficits of current lender referral programs when prospective borrowers are declined from traditional lenders. A primary concern is whether small-business owners are being steered to products and services that meet them where they are in the financing process.

At the BRG roundtables in Los Angeles, although 90 percent of businesses who were declined loans were told by banks why there were denied, most (70 percent) did not receive any guidance or information on steps that they could take to improve their ability to obtain bank financing. Working groups and roundtable participants questioned whether traditional institutions are simply steering small businesses to their affiliates or sending them to community banks, CDFIs, alternative finance platforms, and other capital providers that may not be the most appropriate, comfortable, or safest match.

One example is that there is a critical disconnect between CDFIs and small businesses located in underserved communities. Of the 2.2 million small businesses located in low-income communities, only between 2 and 5 percent are receiving financing from CDFIs.²⁹ CDFIs operate in a fragmented industry community with more than 1,000 individual entities and many have not adapted to changes in the landscape of financial technology.³⁰ Further, working group members consistently reported that CDFIs are undercapitalized and not enough of them are located in minority geographies.

Fear and mistrust of financial institutions and community lenders is another example. At the BRG roundtables in Los Angeles, many Black business owners reported that the nonprofit lenders to whom

²⁹ Association for Enterprise Opportunity, “Project CUE: Connecting Underserved Entrepreneurs.”

³⁰ “Community Development Financial Institutions: On the Front Lines” Speech by Dennis Lockhart, former President and Chief Executive Officer Federal Reserve Bank of Atlanta at the Opportunity Finance Network Conference in Atlanta, GA, October 25, 2016.

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they were referred did not understand their cultures, and specifically that there are not enough Black lenders in their communities. Some Black business owners said that they view many nonprofit lenders as outsiders, and that they prefer to do business with banks and nonprofits that they know and trust.

³¹ Gwendy Donaker Brown, Caitlin McShane and Eric Weaver, *Unaffordable and Unsustainable: The New Business Lending*, Opportunity Fund, May 2016.

Predatory Lending

Given the struggles business owners face in determining which financing providers are well suited to the type of business (and market) and can provide financing in a responsible manner, a few participants (particularly those focused on business development) were interested in the idea of developing a Better Business Bureau list of approved lenders at the local level. This would provide small businesses with a trusted source that they could turn to when searching for responsible lenders operating in the city/area, with minimum levels of disclosure thresholds determined by a third party, the office of the mayor, or some other standards currently in place (such as SMART Box Initiative or Small Business Borrowers Bill of Rights).

Participants in both cities noted that minority-owned small businesses are susceptible to predatory lenders who are able to effectively market themselves through cold calling or online mediums, which potentially places owners at substantial financial risk. At the BRG roundtables, some business owners shared that when their loans were declined by banks, they were referred to a nonprofit lender charging exorbitantly high interest rates. One Opportunity Fund report found that “the average alternative loan they analyzed carried an annual percentage rate (APR) of 94 percent, with one loan reaching a shocking 358 percent.”³¹

Because small-business owners and regulators often do not fully understand the differences between various financial products offered to them, there is a high likelihood that borrowers select a product that is ill suited and potentially costlier than products more

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suited and available from responsible financing providers (e.g., merchant advances and payday-like loans vs. a CDFI).

In an effort to provide for a more responsible (and responsive) financing system for minority-owned small businesses, participants also highlighted their concerns regarding brokers operating in the small business lending space. In the alternative financing space in particular, there is the question of whether brokers have small businesses' best interests at heart, as there is no real regulation or fiduciary responsibility that brokers must adhere to. As noted by participants in Baltimore and Los Angeles, brokers' main concern is their commission, and small businesses are often steered towards financing providers based on commission, not on product suitability, resulting in higher costs for the small-business owner.

³² According to a statement from Rep. Nydia Velasquez (D-N.Y.) during a House Small Business Committee hearing on April 5, 2017. Link to hearing: www.smallbusiness.house.gov/calendar/eventsingle.aspx?EventID=399829.

7(a) Loan Adjustments

The SBA's flagship 7(a) Loan Program has facilitated more than \$26 billion in financing to small businesses nationwide and operates at zero taxpayer subsidy with default rates of less than 1 percent.³² Despite the program's benefit to small-business finance and growth, the program is not effectively targeting minority-owned small businesses. For instance, Blacks and Hispanics currently make up less than 10 percent of overall SBA 7(a)-guaranteed lending to U.S. small businesses.

Separate from the distribution of 7(a)-guaranteed loans, the way in which the program assesses non-performing loans is a significant problem, leaving lenders with no flexibility in being able to help small businesses adjust their finances, resulting in increased defaults in times of stress and heightening the credit risk of the business owner.

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Policy and Regulation

Data Reporting and Analysis

Access to reliable and timely small-business and lending data is key to crafting effective policy recommendations to increase lending to Black and Hispanic small-business owners. Without complete data, it is difficult to identify lending deficits and opportunities for investment in specific neighborhoods or to target demographics. The groups raised several challenges with existing data collection and analysis.

- It's not "apples to apples." Various definitions of what is a small business and a small-business loan make analysis difficult. Typically, small businesses are defined in terms of a size standard, which is often stated in the number of employees or average annual receipts. The U.S. Census Bureau, Federal Reserve, and SBA all define small businesses as any business with less than 500 employees. Certain government programs (such as SBA loan programs and contracting opportunities) are reserved for small-business concerns, and in order to qualify businesses must satisfy SBA's definition of small-business concerns along with the size standards for small business, which often vary by industry.³³ Then, there are small-business advocacy groups. The typical member of the National Federation of Independent Business (NFIB) employs 10 people and reports gross sales of about \$500,000 a year.³⁴ The Small Business and Entrepreneurship Council loosely groups businesses into three tiers by number of employees: fewer than 100 is considered small, a mid-sized business is 100 to 500, and a company with more than 500 is large.³⁵ At the June 2016 Milken Institute–SBA White House roundtable, the SBA shared there are more than 40 definitions at the federal level on what constitutes a small business.³⁶

- Not all lenders are required to report small-business lending

³³ See www.sba.gov/contracting/getting-started-contractor/make-sure-you-meet-sba-size-standards/table-small-business-size-standards.

³⁴ See www.nfib.com/about-nfib/what-is-nfib/who-nfib-represents/.

³⁵ See www.sbecouncil.org.

³⁶ Remark made during the Milken Institute–U.S. Small Business Administration roundtable held at the White House in June 2016.

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data. Under the Community Reinvestment Act, banks and thrifts report small business and farm data, and community development data if they have total assets greater than \$1 billion dollars. The regulations miss the lending activities of the small and mid-size banks whose commercial loans portfolios tend to consist mostly of small-business loans. In addition, smaller banks may be the most predisposed towards lending to the smaller, locally owned businesses.

- Participants, particularly in Baltimore, were cautious in their assessment of the Consumer Financial Protection Bureau's (CFPB) approach to the collection of small-business data. While efforts are ongoing at the CFPB to build out their small-business office, participants questioned how the Bureau intends to collect small business lending data under Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Certain lenders were concerned that this would add extra compliance burden, especially given the lack of clarity on what constitutes a small business (mentioned above), which would increase costs and prevent them from focusing on lending and the success of a small business. Other lenders noted that the CFPB is already entering commercial banks and examining fair lending applications, approvals, and denials, and performing tests based on the name and/or zip code provided, therefore efforts are redundant. Others noted that banks are already obligated to collect information pertaining to consumer lending and that the infrastructure in place could be amenable to how the CFPB intends to collect small-business data.

- There is no consistent reporting for CDFIs (who are often recipients of investments from large banks). Again, we are missing a piece of the market.

- Extensive reporting requirements can create administrative burdens on lenders, which ultimately may translate to higher

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costs for customers.

³⁷ See www.cdfifund.gov/programs-training/Programs/new-markets-tax-credit/Pages/default.aspx.

In Los Angeles in 2012, the Los Angeles City Council adopted a “responsible banking ordinance” that requires banks doing business with the city to disclose detailed data on loans (including small-business lending) and foreclosure activity by community. Banks that decline to provide the information are deemed unqualified to bid for a piece of the city’s billions of dollars in deposits and pension funds. However, much of the information is already reported under federal law. At the time, proponents said that the federal data could be hard to find in voluminous federal banking reports and that the new law would bring the information together on a city website that the public could search by census tract. Yet to date this information is not readily available (e.g., it is not available on www.data.lacity.org).

Some participants in both cities questioned the overall extent to which PLUM should be engaged on this issue given the forces in and around Washington, D.C., in support of or opposition to the CFPB’s efforts, and what sort(s) of accomplishments could be derived from PLUM applying resources into this space.

Overall, many agreed that there is a need for accurate data to inform effective policy to help increase access to capital. However, the lack of clarity in how reporting standards would be implemented had some stakeholders concerned (e.g., bankers do not know how new or revised regulations would affect their bottom line).

Tax-Based Incentives

The New Markets Tax Credit Program (NMTC) provides tax credits to spur private investment in underserved communities.³⁷ Since inception, the program has funded more than 5,400 businesses leading to the creation or retention of 275,000 jobs, with nearly three-quarters of NMTC investments made in highly distressed areas. The program also generates \$8 dollars of private investment for every \$1 dollar invested by the federal government.

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However, during PLUM meetings, lenders discussed the difficulties associated with obtaining NMTC funding due to the required paperwork, while non-bank financing providers highlighted the difficulty of participating in the program as the evaluation of firms interested in NMTC funding is largely viewed through a traditional financial lender lens. Apart from the difficulties of participating, it was also noted that NMTC has long favored real estate investment over investment in small businesses, particularly those most underserved.

State Guarantee Programs

Both Los Angeles and Baltimore task force participants cited the need for greater awareness among small businesses and lenders of the variety of state guarantee programs available to them. Both groups also encouraged the use of PLUM as a resource for educating lenders on the benefits of leveraging the guarantee to make inroads into Hispanic and Black communities that they would not have made otherwise. In Los Angeles, participants noted the lack of a secondary market as detrimental to the use of state guarantees.

SBICs

The SBA's Small Business Investment Company program provides long-term equity and/or debt to qualifying small businesses. SBICs are privately owned, managed, licensed and regulated by the SBA, which provides a guarantee on top of qualifying investments to small businesses.

Participants discussed how the process to set up an SBIC and distribute funds is very convoluted. In addition, the program is geographically concentrated with only a few states receiving more than half of SBIC investment (California, New York, Texas, Massachusetts, Illinois, and Florida), and less than a quarter of SBIC investments were made to low- and middle-income areas in 2014. In addition, SBICs can voluntarily report data regarding the percentage of investments made to minority, women, and veterans' small

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businesses, and concerns remain as to the viability of the data and the lack of standardization in the reports.

Economic Development

Technical Assistance

Small-business technical assistance (TA) refers to the support provided to small businesses beyond financing, for example: capital opportunities, business planning and operations, employee recruitment, and specialty training (e.g., e-commerce). Technical assistance is a big topic in of itself and the economic development (ED) working groups in Baltimore and Los Angeles identified several challenges and areas for improvement:

- Location, coordination, and quality of services: The geographic separation between TA providers and lenders came up consistently throughout the ED groups as a key TA challenge. Co-locating service providers and lenders would facilitate a smoother and more comprehensive lender referral process (see page X for prior commentary on the lender referral process). Similarly, locating TA services in geographically convenient locations in the first place also made a lot of sense to group participants. For example, Black business owners who participated in the BRG roundtables and who were located in the South Bay and Westside cities shared that they do not want to drive into downtown or south Los Angeles to access business assistance services.

ED working group members also discussed the need for extended and flexible hours to meet the needs of business owners. The Los Angeles Emerging Businesses Working Group identified a lack of coordination between investment in business and the anticipated size and scale of the eventual operation. They discussed how regional incubators could partner with local governments and educational entities to provide a standard

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framework for technical assistance and mentorship that could be utilized to educate and prepare entrepreneurs to not only apply for credit successfully, but also apply for the right kind of credit needed to start growing their businesses.

This general notion of enhancing or standardizing the quality of technical assistance providers in the market place was also raised. A “Better Business Bureau” of approved TA providers could ensure that the providers are prepared and capable of meeting the needs of the target businesses in their markets.

- Data standardization: As was discussed in the policy groups, the ED groups said that the lack of standardization of data-sharing tools and practices among public and private sector TA providers serves to create numerous additional obstacles both to lenders and to small businesses by increasing the costs and complexity of risk assessment for both primary and secondary lenders. Developing standards for anonymous data sharing that includes geographic components for applicants and borrowers, as well as standardizing standards of measurement between different federal and state agencies, should significantly reduce costs in risk assessment as well as expedite the approval process, particularly for newer borrowers.

- Education and mentorship: As was mentioned in the lender working groups, the economic development groups in both cities felt TA should include not just basic financial literacy education, but financing education too, as well as offer basic management training. The Los Angeles Established Businesses Working Group observed that growing businesses lack strategic advising and resources. These firms are often held back by either misunderstanding of risk, limited market knowledge, or mismatch of appropriate capital opportunities. Accelerators, for example, might provide access to relationships with other business owners and lenders that enable businesses to scale. In Baltimore, the group emphasized that locating accelerators

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(and incubators for start-ups) in geographic areas of need could increase access to these critical opportunities.

- Industry clusters: The ED groups in both cities all commented on the lack of strategic targeting of industry clusters for growth industries and tailoring the TA for those industries and clusters' specific needs. The Baltimore group felt that clustering TA providers into coordinated activities would be helpful. Regional creation of accelerators based on growth sectors (bioscience, entertainment, renewable energy, transportation, construction/facility services, utilities, IT/professional services, and healthcare/social services) that includes targeted TA based on the individual cluster would facilitate a heightened ability to obtain capital and scale.

- Marketing and outreach: All of the ED groups acknowledged that there are some great resources available to entrepreneurs and to those looking to grow their businesses, but that marketing and outreach efforts fall short. There is a lot of opportunity to streamline and connect potential and existing small-business owners with in-person and online support.

Procurement and Supplier Diversity Programs

There are hundreds of programs to encourage government or private sector contracting with minority-owned businesses, yet most of these programs are voluntary, and those with statutory mandates lack enforcement. Working groups mentioned companies using a "bait and switch" approach whereby companies say they will use a minority-owned firm and then replace the firm after a contract is secured.

BRG roundtables participants reported the following barriers and challenges that adversely impact their ability to leverage contract opportunities:

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- Insufficient expertise or time to plan, market, and implement a new a sales strategy (including support) to develop and submit sales proposals and bids
- Limited legal resources to structure joint ventures and partner on contracts
- Lack of marketing staff to find new contract opportunities
- Lack of relationships or access to contacts to win new business
- Many are not registered as a disadvantaged or minority businesses

³⁸ “Enterprise Zone Program,” California Department of Housing and Community Development, available at www.hcd.ca.gov/grants-funding/archive/enterprise-zone.shtml.

The groups brainstormed how to strengthen procurement and supplier diversity programs via both “carrot” and “stick.” The Los Angeles Policy Working Group also spoke about procurement and specifically mentioned programs with the Los Angeles Unified School District (LAUSD), LA Metro, the California Public Utilities Commission (CPUC), the Los Angeles Department of Water and Power (DWP), and others.

One participant noted that large companies that take diversity seriously develop their own in-house mentoring and training programs to create their own pipeline of suppliers.

Overlapping Jurisdictions

In Los Angeles, a multitude of jurisdictions (cities, county) creates regulatory confusion and complexity. Municipal self-interest and limits on municipal financing to restricted geographies means centers of minority-owned business activity may not align within existing programs.

Enterprise Zones, which were abandoned in 2014, may be a helpful construct in which to think about small-business development.³⁸

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The Enterprise Zone Program, under the California Department of Housing and Community Development, had been responsible for the designation and administrative oversight of the 42 Enterprise Zones authorized by the state legislature. Targeting economically distressed areas throughout California, the program provided special incentives designed to encourage business investment and promote the creation of new jobs. The purpose of the program was to stimulate economic development by providing tax incentives to businesses enabling private sector market forces to revive the local economy. Each Enterprise Zone was administered by its local jurisdiction working with local agencies and business groups to promote economic growth through business expansion, attraction, and retention, while providing an environment to nurture business creation as well.

³⁸ “Enterprise Zone Program,” California Department of Housing and Community Development, available at www.hcd.ca.gov/grants-funding/archive/enterprise-zone.shtml.

The group considered the idea of revisiting regional “hot spots” or development zones where there are high concentrations of Black and Hispanic small-business owners who would benefit from pilot activities during future phases of the PLUM initiative. Several participants said policies should be crafted to prevent unintended gentrification in the development zones.

Financial Literacy for Youth

There was some discussion among participants in Baltimore and Los Angeles on the importance of educating younger generations on how to run a business and to develop an understanding of basic finance. This could include how to develop and successfully market a product and understand balance sheet and cash flow analysis. Participants highlighted the need to track younger students as they go through the programs and look to become entrepreneurs to fully assess how successful current efforts are at promoting financial literacy.

Community Perception

Participants, particularly in Baltimore, discussed the difficulties the

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the city, thereby making it difficult for small businesses operating in the area to attract investment interest and open up new avenues of raising capital for small businesses.

Prioritization of Issues

In January and February, the Milken Institute and the SBA reconvened the Baltimore and Los Angeles task forces, respectively, to summarize the discussions thus far, share what had been learned, and ask the groups to choose a path forward. Based on the issues identified above, the Milken Institute prepared a survey of seven solution-oriented strategies with 23 associated activities on which PLUM might engage (see Appendix B). Task force participants assigned a rating next to each activity on a scale of one to five (One: No need to focus on; Five: Must-do). While challenging to rank activities, the exercise provided the SBA and Milken Institute insight into participants' priorities at the national and local levels (see Appendix C for complete survey results).

In Baltimore, more than 60 task force members came together and helped identify the following as Baltimore's priority areas for engagement, all of which are solutions to the issues that are negatively impacting minority small businesses and their ability to access capital identified during Phase I:

1. Financial literacy for youth
2. Technical assistance best practices
3. Baseline data
4. Marketing PLUM
5. Improved underwriting

The top five priority areas for engagement in Los Angeles, as ranked by 40 task force members, were:

1. Marketing PLUM

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2. CRA rightsizing
3. Improved credit scoring/underwriting
4. Co-location of TA providers and small-business lenders
5. Customized TA approaches

Between both cities, the lender groups also ranked highly incentivizing standardization and best practices by lenders with a secondary market fund as the “carrot” and also exploring improved credit scoring and underwriting models. The policy groups favored rethinking tax-based incentives, state guarantee programs, and supplier diversity programs, and the economic development groups strongly supported improving the lender referral process and establishing technical assistance best practices. All groups in both cities would like to have a better understanding of the baseline minority small-business lending environment (i.e., access to data).

PHASE II: SOLUTIONS

Based on the combined survey results, additional discussions with PLUM participants and stakeholders, and consideration of what other partners and group are doing, as well the capacity of the PLUM constituency, the Milken Institute selected the following areas for PLUM to engage:

- **Local Research:** Gather data-driven insights on minority-owned small businesses, the lending environments, and the industry sectors and geographic clusters to provide the evidence base to enhance access to capital for new and growing Black- and Hispanic-owned small businesses.
- **Local Policy:** Engage with local and county officials to establish champions to drive the PLUM effort forward.
- **Technical Assistance Best Practices:** Support efforts to identify best practices and standardize TA efforts focused on individual TA providers, lenders, and new and established small businesses.
- **National Policy:** Provide thought leadership and support to policymakers, federal officials, and regulators.
- **Underwriting:** Convene industry stakeholders, policymakers, and regulatory officials to test- drive alternative underwriting models to enhance investment in creditworthy minority-owned small businesses and improve standardization in this space.
- **Investor Capacity:** Create a participation fund to enhance the capacity of local investors to provide capital to minority-owned small businesses in a responsible manner.

In late February and March, the Institute shared the path forward

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with the respective steering committees. We dissolved the working groups and formed action groups covering each area to identify solutions and opportunities for action. Like the working groups, Baltimore and Los Angeles are tailoring their efforts for maximum local impact. At the national level, the Milken Institute is developing policy briefs and convening Financial Innovations Labs and other targeted research and activities to identify actionable recommendations to address public policy and the loan underwriting process.

Phase II will run through 2017.

APPENDICES

APPENDIX A. LITERATURE REVIEW

Institutional

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APPENDIX B. PHASE I SURVEY

Strategy	Activity	Description
1. Improve evidence base for PLUM.	Find baseline of current levels of lending and existing opportunities.	Conduct research to create a baseline of current levels of lending and existing opportunities in target underserved markets.
	Support regulatory efforts to mandate small business data collection.	Work with partners to support Dodd-Frank 1071 (small business data collection).
	Market PLUM.	Identify champions across multiple jurisdictions levels who will join in developing a marketing strategy.
2. Improve market opportunities for small businesses.	Enhance supplier diversity programs.	Make mandatory what are currently voluntary supplier diversity programs of state procurement, ensure effective enforcement mechanisms are in place, and improve program efficiency (shorten program certification times and streamline bureaucracy).
	Develop a supplier mentor program.	Primes take on sub-primes mentee small businesses, who then gain experience to become primes on future projects. The sub-primes would need to be from target communities to ensure the spread of economic growth to those communities.
	Improve access to large market opportunities.	Structure minority-owned business requirements for development projects. For example, as part of a Community Benefits Agreement. Like affordable housing requirements (e.g., LAX).
3. Improve structural limitations of small-business lender financing in underserved markets.	Incentivize standardization and best practices by lenders with a secondary market fund as a carrot.	Support the creation of a secondary market fund that can provide capital (as an incentive) to lenders within a short-term period after originating specific loans that conform to best practices.
	Tax-based incentives.	Identify opportunities via New Market Tax Credit program.
	Enhance state guarantee programs.	Support efforts for state loan guarantee programs to leverage federal (SBA) guarantee structure with lower subsidies.
	Support place-based SBIC.	Identify champion to lead in the creation of a place-based SBIC that can help fund small-business lenders in target underserved markets.
	Improve credit underwriting.	Create a regulatory sandbox at appropriate level (state vs. federal) to advance new models of credit scoring/underwriting.
	Support CRA rightsizing.	Support national legislation to strengthen CRA rules in support of underserved markets.
	Improve 7(a) loan adjustments.	Identify improvements in the SBA Advantage 7(a) loan program to increase utilization. E.g., flexibility in National Priorities List (NPL) requirements.
4. Increase equity/patient capital in underserved markets.	Promote angel network of investors.	Support anchor champion/partner to screen and host quarterly pitch event of entrepreneurs.
	Promote intrastate equity crowdfunding.	Support state legislation that enables the growth of Internet-based intrastate equity crowdfunding.

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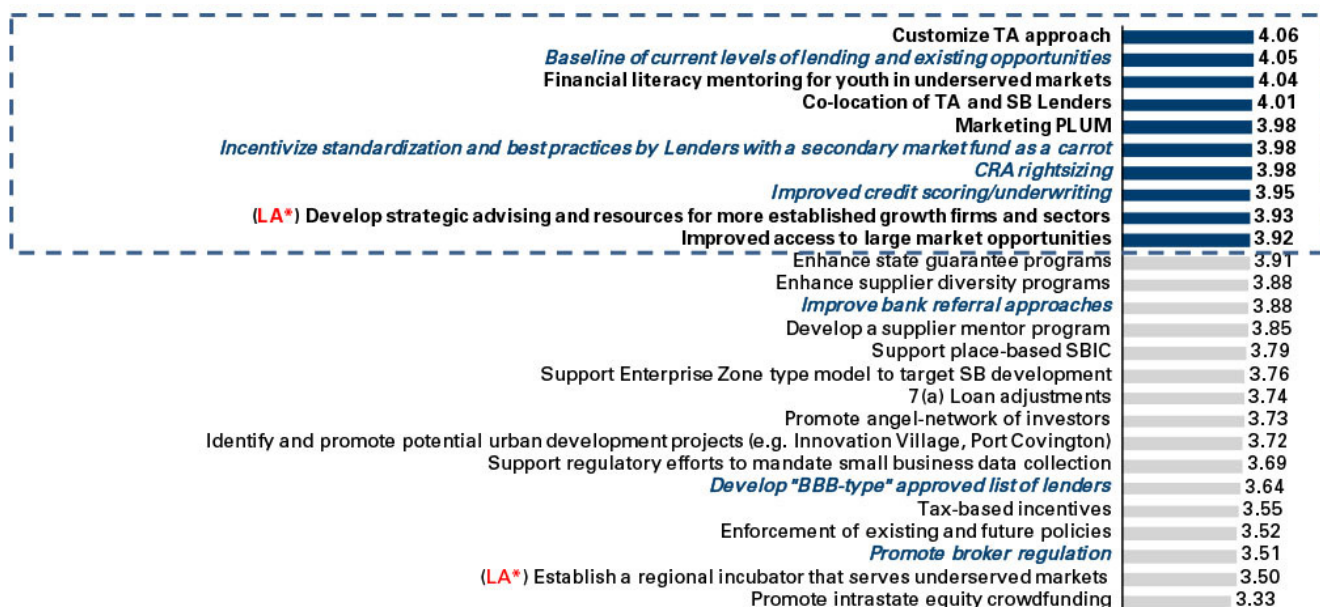
Strategy	Activity	Description
5. Improve technical assistance.	Support co-location of TA and small-business lenders.	In key zip codes, work with select small-business lenders to have embedded TA providers that can assist with both education or lenders and provide support for small businesses.
	Customize TA approach.	Improve efficiency of traditional TA, while supporting the creation of accelerator clusters in high-growth sectors (bioscience, entertainment, renewable energy, transportation, construction/facility services, utilities, IT/professional services, and healthcare/social services) and Incubators for other established sectors.
	Support financial literacy mentoring for youth in underserved markets.	Work with youth mentoring organizations to introduce small-business financial literacy training.
6. Improve transparency and efficacy of SB-lender engagement in underserved markets.	Improve bank referral approaches.	Support the scale up of the Treasury's Project Q to incentivize bank referrals of small-business declines to CDFIs (and other alternative finance providers).
	Develop "BBB-type" approved list of lenders.	Work with Small Business Bill of Rights/SMART Box to create a list of standards that lenders (e.g., disclosures and/or product types) must agree to and publish a list (managed by city leadership) of lenders that have provided certification.
	Enforce existing and future policies.	Make relevant existing policies and regulations "required" and not just "suggested."
	Promote broker regulation.	Support creation of (and regulation of) standards to govern small-business lender brokers' fiduciary responsibility.
7. Support small-business linked urban development.	Identify and promote potential urban development projects (e.g., Innovation Village, Port Covington).	Create a standard for what a small-business-linked urban development program needs to look like, identify potential examples, and promote them as a guidepost for the facilitation of future economic development and how it will be accomplished.

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APPENDIX C. PLUM SURVEY RESULTS

Methodology: In early 2017, the Milken Institute prepared a survey for participants on the Los Angeles and Baltimore PLUM task forces. Participants were asked to rank each of the activities (see Appendix B) from one to five, with one being least important and five representing most important. As can be seen in the below results, not everyone who participated in the Baltimore and/or Los Angeles PLUM launch were in attendance for the meetings held earlier this year. To ensure everyone’s voice was heard, the Milken Institute also reached out through an online survey to those who could not attend the in-person meetings. Respondents to the online survey were added to the sample size in the below charts. The purpose for the survey was to help the Institute map out the direction for Phase II and where the PLUM initiative should best apply its resources given limited capacities. The results of this survey led the Institute to develop several action groups focused on both local and national efforts in Baltimore and Los Angeles (see Phase II: Solutions).

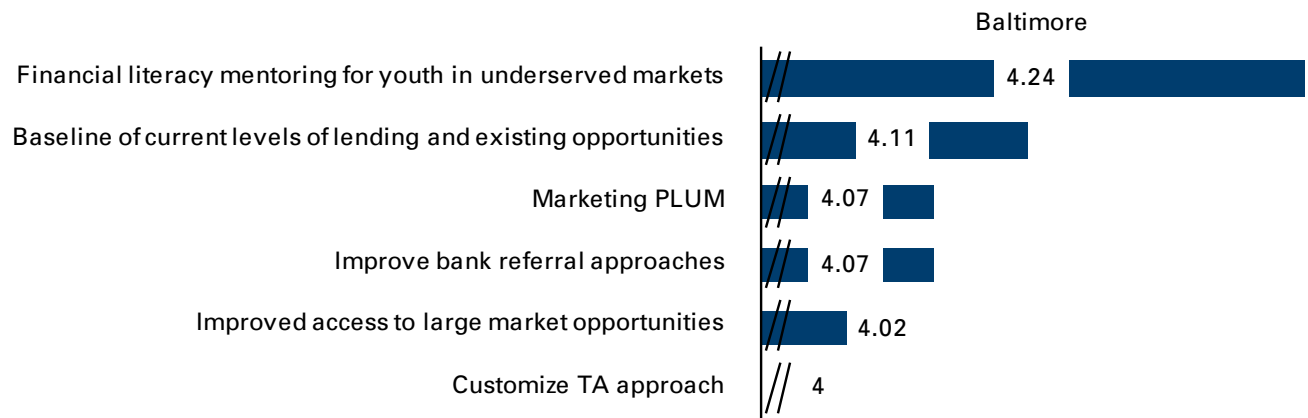
Los Angeles and Baltimore Survey Results: Combined



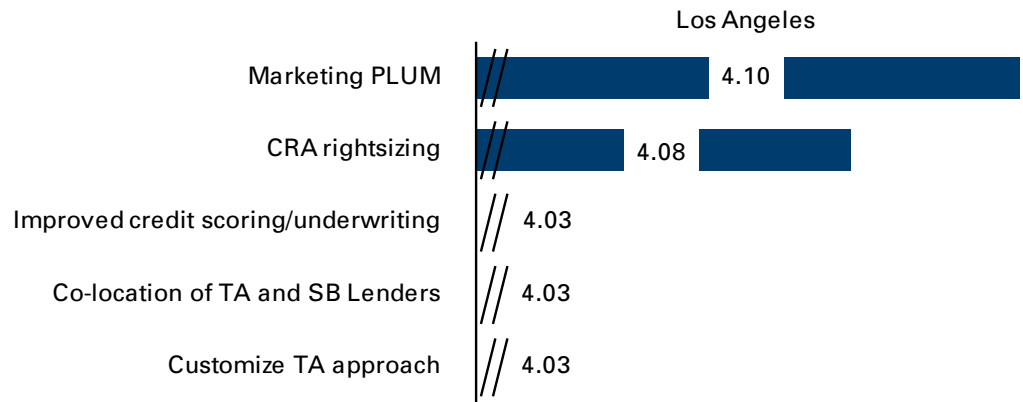
Note: Sample size: 86. *Only included in LA survey (sample size: 40)

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Los Angeles and Baltimore Survey Results: Top Activities Broken Out



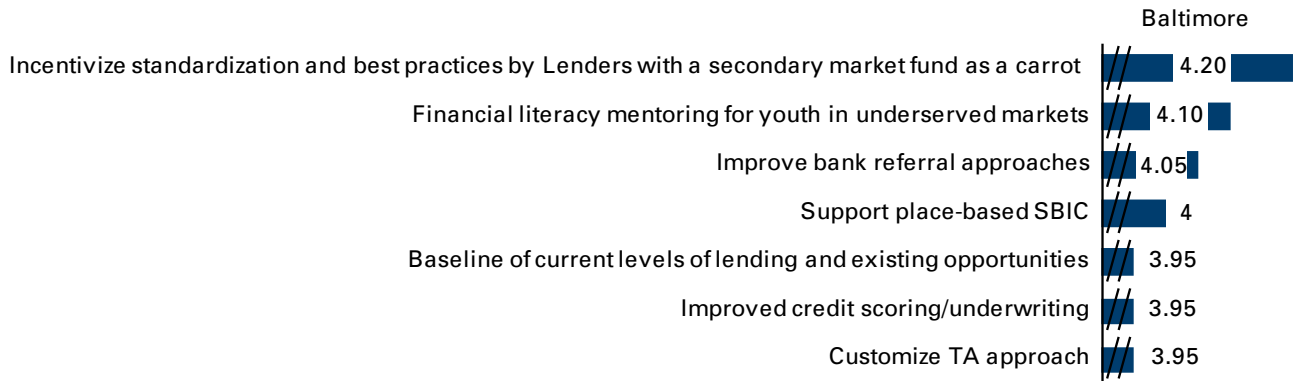
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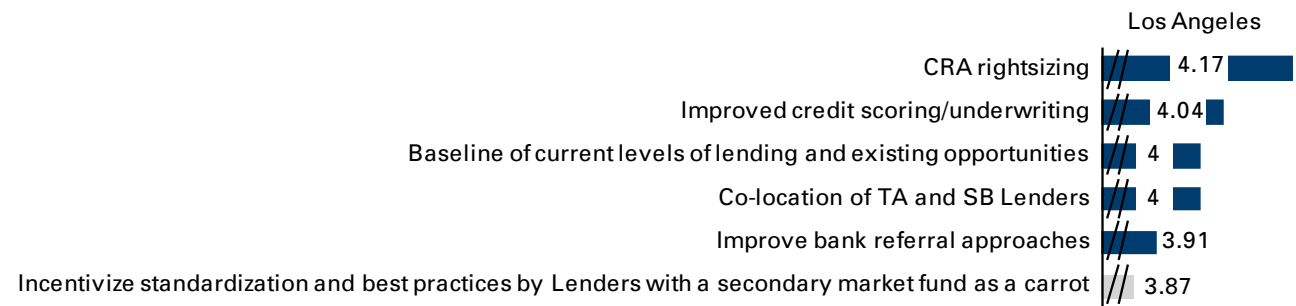
Note: Sample size: 40

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Los Angeles and Baltimore Survey Results: Lender Working Groups



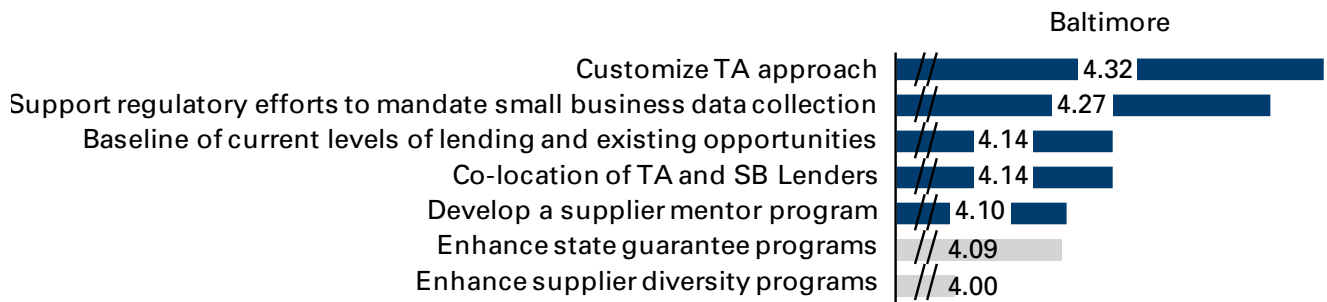
Note: Sample size: 20



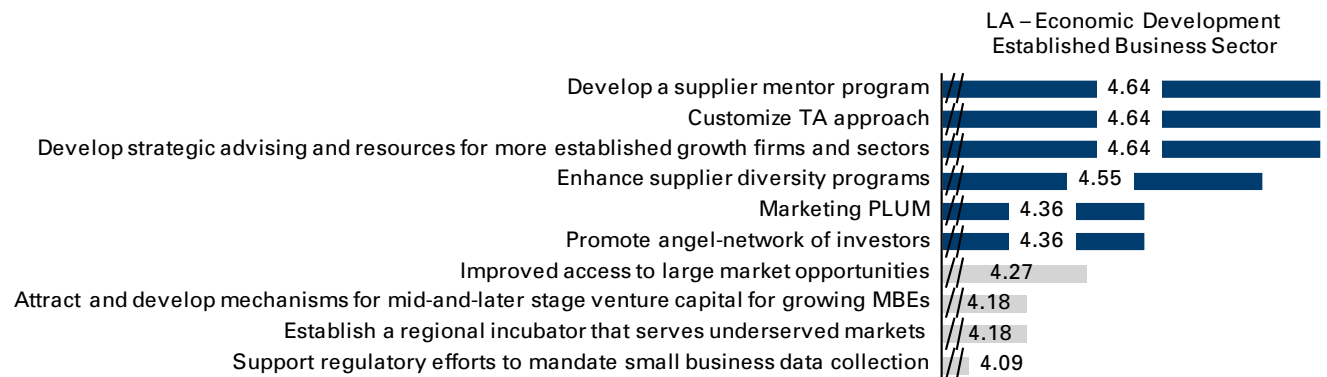
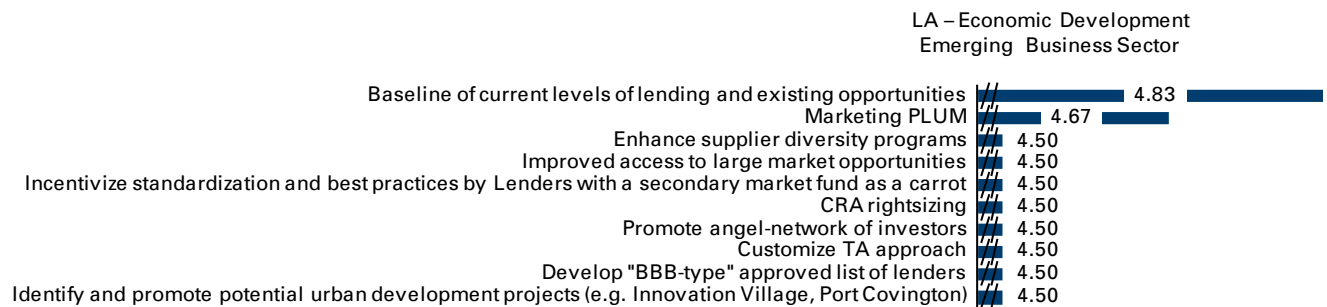
Note: Sample size: 23

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Los Angeles and Baltimore Survey Results: Economic Development Working Groups



Note: Sample size: 22



Note: The Los Angeles Economic Development Working Group was split into two groups: Emerging and established businesses. Sample size for emerging businesses: 6; Sample size for established businesses: 11

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Los Angeles and Baltimore Survey Results: Policy and Regulatory Working Groups



Note: Due to low turnout, this portion of the survey was not collected in Los Angeles. Additionally, because of the limited sample size in the policy and regulatory working group(s), this survey result may not be representative. Sample size in Baltimore: 4.

ABOUT US

ABOUT THE INITIATIVE

The Partnership for Lending in Underserved Markets (PLUM) is a two-year pilot program led by the Milken Institute and the U.S. Small Business Administration to develop actionable solutions to address long-standing structural problems in Baltimore, Maryland and Los Angeles, California that inhibit minority-owned small businesses from accessing capital and growing their operations. The pilot initiative will occur over three phases: Problem Definition—Define challenges and opportunities that minority-owned small businesses face in each metropolitan area; Solutions—Identify potential solutions to address the challenges through established action groups focused on local or national policies and the creation and development of strategic plans to guide execution; Implementation—Execute with local champions and other national recommendations and publish local lessons learned and best practices as well as the outcomes of other national activities.

ABOUT THE U.S. SMALL BUSINESS ADMINISTRATION

The U.S. Small Business Administration (SBA) was created in 1953 as an independent agency of the federal government to aid, counsel, assist, and protect the interests of small business concerns; to preserve free competitive enterprise; and to maintain and strengthen the overall economy of our nation. SBA recognizes that small businesses are critical to our economic recovery and strength, to building America's future, and to helping the United States compete in today's global marketplace. Although SBA has grown and evolved in the years since it was established in 1953, the bottom line mission remains the same. The SBA helps Americans start, build, and grow businesses. Through an extensive network of field offices and partnerships with public and private organizations, SBA delivers its services to people throughout the United States, Puerto Rico, the U.S. Virgin Islands, and Guam.

ABOUT THE MILKEN INSTITUTE

The Milken Institute is a nonprofit, nonpartisan think tank determined to increase global prosperity by advancing collaborative solutions that widen access to capital, create

ABOUT US

jobs, and improve health. **The Center for Financial Markets** promotes financial market understanding and works to expand access to capital, strengthen—and deepen—financial markets, and develop innovative financial solutions to the most pressing global challenges. The **California Center** produces rigorous, independent research—and maximizes the impact of our findings by convening influential stakeholders from the worlds of business, finance, policy, and philanthropy. Together with these stakeholders, the Center advances financing strategies and smart policy approaches that can build a more prosperous future for California.

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