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THE PARTNERSHIP FOR LENDING IN UNDERSERVED MARKETS

Increasing Minority Entrepreneurs' Access to Capital

BY CAROLYN SCHULMAN

MILKEN INSTITUTE

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ABOUT US

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INTRODUCTION

The contribution and importance of small businesses to the nation's economy is well-researched and understood; for minority-owned small businesses the impact and significance is even greater. Not only do minority-owned small businesses help drive job creation, raise wages, and elevate better standards of living, they also offer a critical pathway for Black and Hispanic populations 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. Yet, starting a new firm or growing an established business requires capital, and Black and Hispanic businesses have higher barriers to accessing capital.

In 2016, the Milken Institute and the U.S. Small Business Administration (SBA) formed the **Partnership for Lending in Underserved Markets (PLUM)** to develop actionable solutions to long-standing barriers that constrain minority entrepreneurs from accessing capital to start and grow businesses. The Institute committed to forming local programs in Baltimore and Los Angeles and to undertaking national research and policy efforts. The SBA provided seed funding and on-the-ground support.

The Institute has been documenting preliminary findings and outcomes, as well as publishing public comment letters and other research.[1] In the following pages, we summarize research, activities, and outcomes in hopes that local and national leaders can build on the PLUM foundation and continue to advance solutions to increase minority access to capital.

1. The PLUM library of publications is available at http://www.milkeninstitute.org/plum.

PART I: LANDSCAPE OVERVIEW

It is important to assess the current state of minority-owned small businesses and minority entrepreneurs' success in securing financing, as well as what forces may be driving their capital outcomes. This understanding creates a foundation to unpack the issues and pain points and begin to identify and advance solutions.

Economic Indicators

Abundant, successful, and growing minority-owned small businesses are a critical component to minority economic development. The stronger minority-owned businesses perform, the more likely they are to employ additional workers and pay them decent wages. These are straightforward economic indicators that speak to the health and potential of minority communities.

In the following pages we analyze data from the U.S. Census Bureau, Federal Reserve Bank of New York, and the U.S. Small Business Administration. With the PLUM program, the focus was employer firms vs. non-employer firms (sole proprietors), which generate income for individual owners but do not generate the multiplier economic effects that come with job creation. Therefore, we filtered census data by private (not publicly-held) employer firms with less than 500 employees. The Federal Reserve data only looked at private employer firms with less than 500 employees. The SBA's small business size standards (the largest that a business can be and still qualify as a small business for federal government programs) vary by industry. Therefore, to avoid drawing erroneous conclusions, readers should note that the definition of a small business is not consistent across data sets.

Also, the Milken Institute recognizes there is a difference between "Hispanic" and "Latino" designations. However, the U.S. Census Bureau is now using "Hispanic" and "Latino" interchangeably (as they do "Black" and "African American"). Because this is a data-driven report, we have followed suit throughout the report.

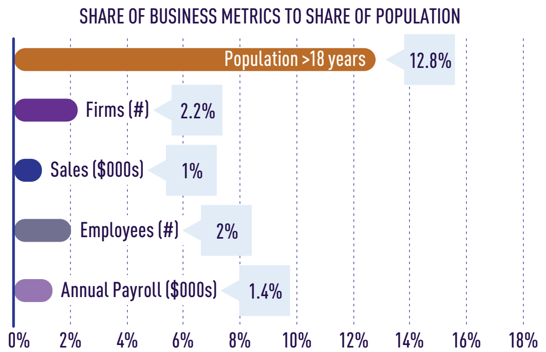
AFRICAN AMERICAN SMALL BUSINESSES

African Americans would have small business parity if their share of small businesses (and sales, employee count, and annual payroll) relative to all U.S. small businesses (and total sales, total employees, and total annual payroll) approximated their share of the total population ages 18 years and older.

In 2016, African Americans ages 18 years and older made up 12.8 percent of the population. Parity would be about 13 percent of all U.S. businesses being owned by African Americans and Black-owned firms accounting for approximately 13 percent of total sales, total employees, and total payroll. As seen in Figure 1, the metrics are nowhere close to parity. Black-owned small businesses are significantly underrepresented.[2]

FIGURE 1

BLACK-OWNED SMALL BUSINESS DISPARITIES, 2016



Source: U.S. Census Bureau.

Black-owned small businesses are gaining ground in their share of employees and payroll, but their number of firms are not keeping pace with population changes, and they are losing share of sales. Between 2007 and 2016, the Black population ages 18 years and older grew 22.3 percent (see Figure 2, "% Δ Count"), and the share of the Black population ages 18 years and older to the total population 18 years and older increased 10.3 percent (see Figure 2, "% Δ Share").[3] The number of Black-owned small businesses did not increase nearly as much as the population (1.1 percent vs. 22.3 percent), and the change in the share of Black-owned small businesses to all small businesses did not exceed the share of the population increase (9.3 percent vs. 10.3 percent).[4] Increases in the share of employees (20.4 percent) and payroll (26 percent) did exceed population growth, but the share of sales dropped 9.6 percent. Despite employing a greater share of workers and paying a greater share of total payroll, it is a troubling indicator of future success that African American-owned small business did not capture a greater share of total firms and lost share of sales.

Looking at the population that is 18 years and older more accurately captures entrepreneurs when they are forming businesses vs. looking at the total population. However, doing so may understate disparities, particularly among Latinos, whose population skews younger than other populations.

Also, as the Black and Latino populations age into their business-owning years, measures of business parity could worsen if minorities continue to grow their share of the total population and capital access barriers remain.

2. "2016 Population Data," American FactFinder, Population Division, U.S. Census Bureau, https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk; "2016 Annual Survey of Entrepreneurs," American FactFinder, U.S. Census Bureau, https://factfinder.census.gov/faces/nav/jsf/pages/index.xhtml.

3. "National Intercensal Tables: 2000-2010, 2007 Population Data," U.S. Census Bureau, https://www.census.gov/data/tables/time-series/demo/popest/intercensal-2000-2010-national.html; "2016 Population Data."

4. "2007 Survey of Business Owners," American FactFinder, U.S. Census Bureau, https://factfinder.census.gov/faces/nav/jsf/pages/index.xhtml; "2016 Annual Survey of Entrepreneurs."

BLACK-OWNED SMALL BUSINESSES ARE GAINING GROUND IN THEIR SHARE OF EMPLOYEES AND PAYROLL, BUT THEIR NUMBER OF FIRMS ARE NOT KEEPING PACE WITH POPULATION CHANGES, AND THEY ARE LOSING SHARE OF SALES.

HISPANIC SMALL BUSINESSES

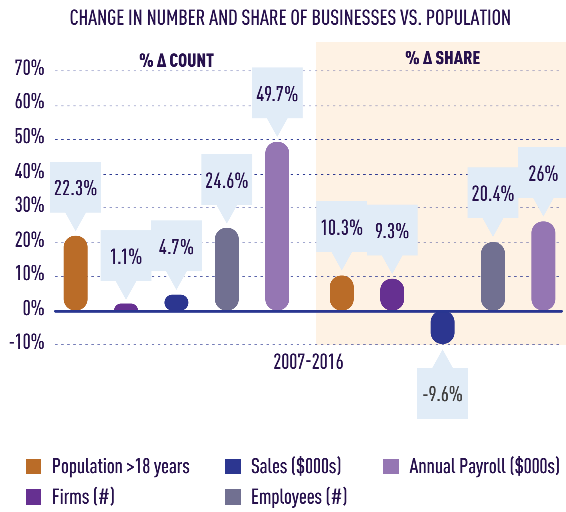
In 2016, Latinos ages 18 years and older accounted for 15.7 percent of the U.S. population. Like with African American-owned small businesses, Latino-owned small businesses were underrepresented across all metrics (see Figure 3).[5]

However, Latinos are faring better than African Americans; between 2007 and 2016, Hispanic-owned small businesses increased their share of total firms and employees, and paid a greater share of total payroll (see Figure 4).[6] While not enough to exceed the increase in the share of population growth, Hispanic-owned small businesses also increased their share of total sales.

5. "2016 Population Data;" "2016 Annual Survey of Entrepreneurs."
6. "National Intercensal Tables: 2000-2010, 2007 Population Data;" "2016 Population Data;" "2007 Survey of Business Owners;" "2016 Annual Survey of Entrepreneurs."

FIGURE 2

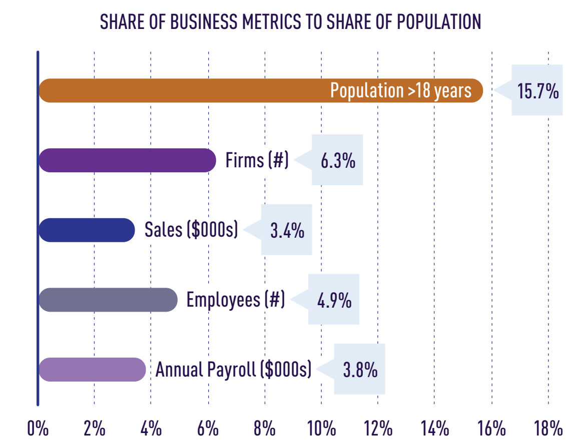
BLACK-OWNED SMALL BUSINESS PERFORMANCE OVER TIME



Source: U.S. Census Bureau.

FIGURE 3

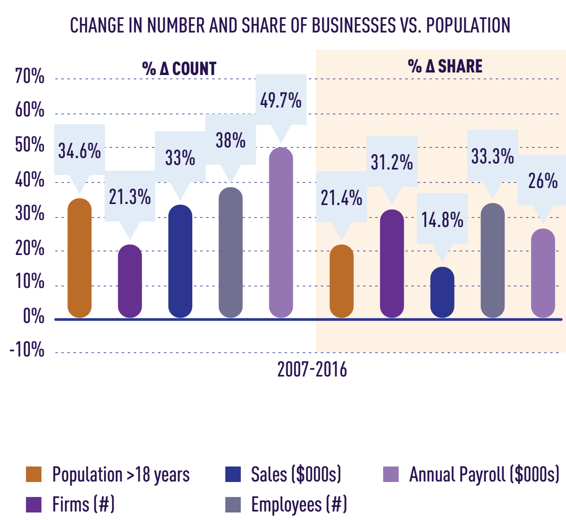
HISPANIC-OWNED SMALL BUSINESS DISPARITIES, 2016



Source: U.S. Census Bureau.

FIGURE 4

HISPANIC-OWNED SMALL BUSINESS PERFORMANCE OVER TIME



Source: U.S. Census Bureau.

Access to Capital

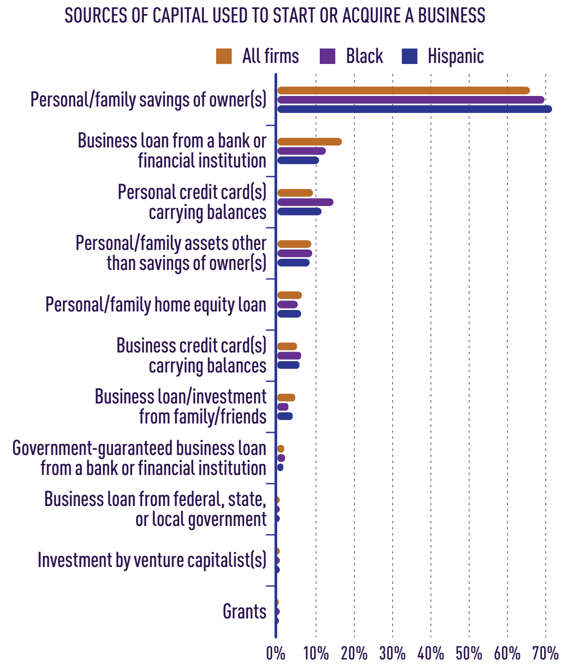
To advance minority economic development, more minorities need to be able to start and grow businesses in their communities. However, this requires access to capital, and Black and Hispanic business owners have higher barriers to accessing safe and affordable capital.

STARTUP FINANCING

In 2016, general trends across race and ethnicity were similar in terms of sources of capital used to start or acquire a business, but, according to the "2016 Annual Survey of Entrepreneurs," African American and Latino business owners were more likely to report using personal and family savings, credit cards, and other sources of capital to start their businesses compared to all business owners, who reported higher use of business loans (see Figure 5).[7]

FIGURE 5

STARTUP FINANCING, 2016



Source: U.S. Census Bureau.

DATA DEFICIT

It is very important to note that the public does not have anywhere near sufficient access to small business financing data, including lending data. There are no reporting requirements for small business lending similar to those for mortgage lending under the Home Mortgage Disclosure Act (HMDA), and the Community Reinvestment Act (CRA) does not require small and mid-sized banks, credit unions, or community development financial institutions to report their small business lending activity.

Section 1071 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended the Equal Credit Opportunity Act to address this issue by requiring financial institutions to compile, maintain, and report information concerning credit applications made by women-owned, minority-owned, and small businesses. However, the rule has yet to be implemented, and in 2017 the U.S. Department of the Treasury recommended repealing the application of Section 1071. Also in 2017, the Consumer Financial Protection Bureau did put out a request for comment regarding the small business lending market to "inform the Bureau's work on the business lending data collection rulemaking to implement section 1071." In October of 2018 they put small business lending data collection on their list of "long-term actions."* Without complete data, it is difficult to identify lending and other financing deficits to minority groups.

*U.S. Consumer Financial Protection Bureau, "Request for Information Regarding the Small Business Lending Market" available online at https://www.consumerfinance.gov/policy-compliance/notice-opportunities-comment/archive-closed/request-information-regarding-small-business-lending-market/; U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities, Banks and Credit Unions, Report to President Donald J. Trump" available online at https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf.

7. "2016 Annual Survey of Entrepreneurs."

AFRICAN AMERICANS AND LATINOS PAY MORE TO BORROW CAPITAL TO START AND EXPAND BUSINESSES COMPARED TO THE POPULATION AT LARGE.

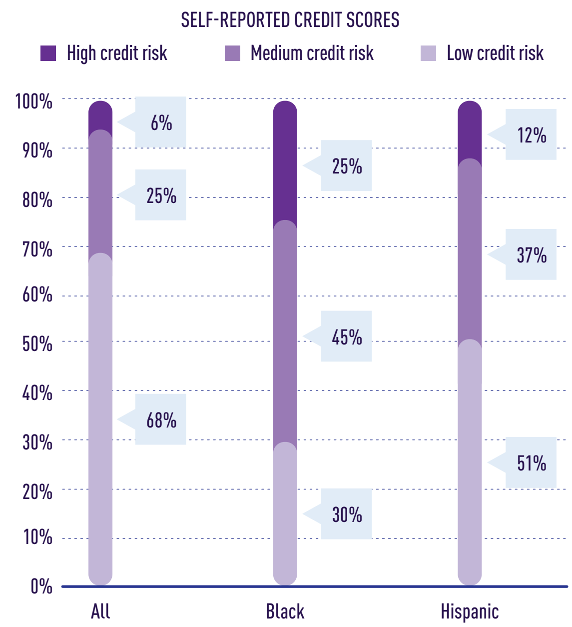
Online and alternative lenders may be able to provider lower-cost small business loans—average APRs from these lenders range from 7 percent to over 100 percent. When compared to banks, online and alternative lenders often have higher interest rates because they have fewer eligibility requirements and faster underwriting processes, potentially returning a credit decision within a few hours. Due to the reduced eligibility criteria, online lenders appeal to businesses and borrowers that are less bankable, such as startups, low revenue businesses, or applicants with lower credit scores. There are many safe alternative and online lenders, however, the risk of predatory lending can be much higher.

The average interest rate (AIR) on a conventional business loan is around 3 to 5 percent.[8] Unlike the annual percentage rate (APR), the effective annual interest rate (AIR) does not include any closing, origination or other fees, which will increase the cost of the loan. Still, the APR is 14 percent on a business credit card and 16.5 percent for all credit cards.[9] Consequently, African Americans and Latinos end up paying more to borrow capital compared to the population at large.

The most oft-cited reasons banks decline Black and Hispanic borrowers' loan applications in the first place are lower credit scores, lower net worth, and lack of assets.[10] Of the more than 8,000 firms surveyed for the "2017 Small Business Credit Survey," the majority of all firms (68 percent) reported a low-risk credit score vs. the majority of Black and Hispanic firms who reported medium- or high-risk scores (see Figure 6).[11] African American business owners reported the most medium- (45 percent) and high-risk (25 percent) credit scores of all.

FIGURE 6

CREDIT RISK, 2017



Low risk: business score of 80-100 or personal score of 720+
Medium risk: business score of 50-79 or personal score of 620-719
High risk: business score of 1-49 or personal score less than 620

Source: Federal Reserve Bank of New York.

8. "Survey of Terms of Business Lending - E.2," FRB: E.2 Release—Survey of Terms of Business Lending—Current Release, https://www.federalreserve.gov/releases/e2/current/default.htm.
9. Kelly Dilworth, "Rate Survey: Average Card APR Breaks New Record, Climbing to 17.08 Percent," CreditCards.com, October 24, 2018, https://www.creditcards.com/credit-card-news/rate-report.php.
10. Robert W. Farlie and Alicia M. Cobb, "Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs," Minority Business Development Agency, U.S. Department of Commerce (2010), https://www.mbda.gov/sites/mbda.gov/files/migrated/files-attachments/DisparitiesinCapitalAccessReport.pdf.
11. "2017 Small Business Credit Survey," Federal Reserve Bank of New York, https://www.newyorkfed.org/smallbusiness/small-business-credit-survey-2017.

NEW FUNDING RELATIONSHIPS FOR GROWING BUSINESSES

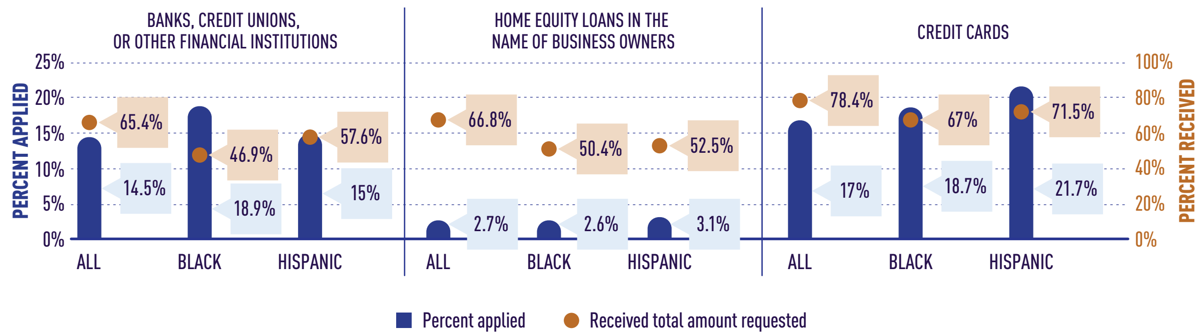
The same capital access trends that appeared for startups appear for young and established firms seeking to form new funding relationships. Based on self-reported activities and outcomes in the "2016 Annual Survey of Entrepreneurs," among young firms (those that have been in business for less than two years) and established firms (those that have been in business for more than two years), Black- and Hispanic-owned businesses were more likely to apply for credit cards and less likely to receive small business or home equity loans compared to all businesses (see Figure 7 and Figure 8).[12]

Results of the "2017 Small Business Credit Survey" reinforce findings from the "2016 Annual Survey of Entrepreneurs"—banks and other financial institutions were less likely to approve loans and lines of credit, especially for the full amount requested, for young and established minority firms compared to all firms (see Figure 9).[13] Approval rates vary between the two surveys, as both are based on a sample of business owners self-reporting their activities and outcomes. The trends, however, are consistent. Moreover, the primary explanation for credit denials were poor or limited credit and insufficient collateral (see Figure 10).[14]

Reading the graphs: While more young Black-owned firms applied for a loan from a bank (18.9 percent) than the average across all young firms (14.5 percent), a smaller share received the full amount requested (46.9 percent vs. 65.4 percent).

FIGURE 7

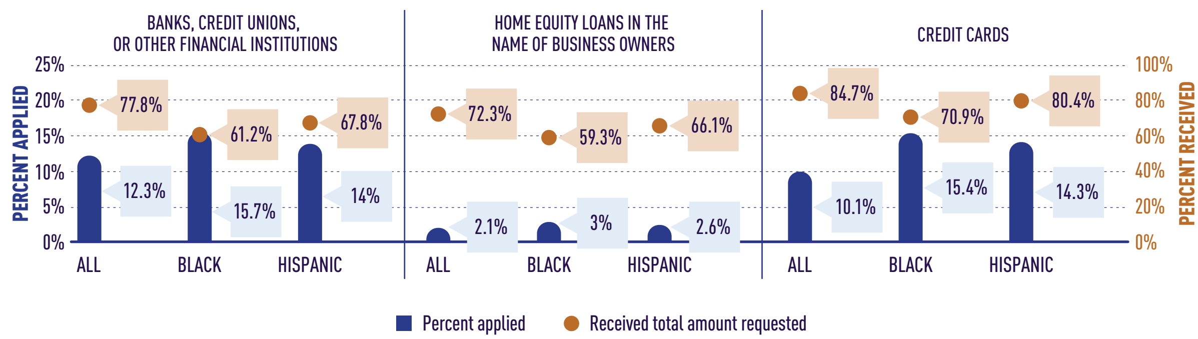
NEW FUNDING RELATIONSHIPS, DEBT, YOUNG FIRMS, 2016



Source: U.S. Census Bureau.

FIGURE 8

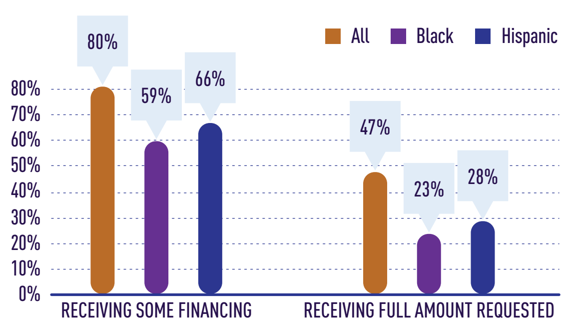
NEW FUNDING RELATIONSHIPS, DEBT, ESTABLISHED FIRMS, 2016



Source: U.S. Census Bureau.

FIGURE 9

LOAN AND LINE OF CREDIT APPROVAL RATES, 2017



Note: Inclusive in the small business credit survey's definition of loans or lines of credit are SBA loans or lines of credit, business loans, lines of credit, home equity lines of credit, personal loans, mortgages, and auto or equipment loans.

Source: Federal Reserve Bank of New York.

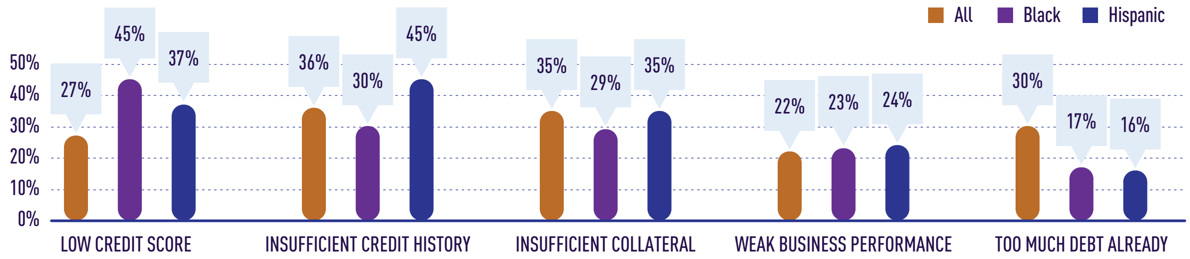
12. "2016 Annual Survey of Entrepreneurs."

13. "2017 Small Business Credit Survey."

14. "2017 Small Business Credit Survey."

FIGURE 10

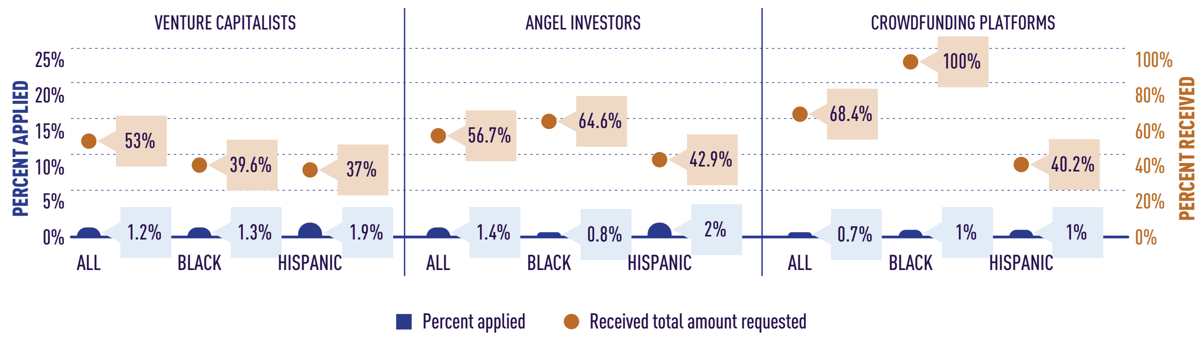
REASON FOR CREDIT DENIAL



Source: Federal Reserve Bank of New York.

FIGURE 11

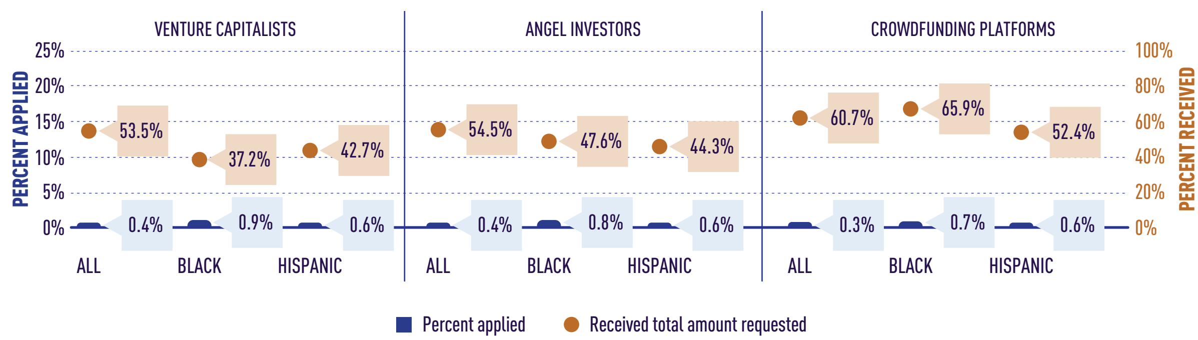
NEW FUNDING RELATIONSHIPS, EQUITY AND ALTERNATIVE CAPITAL, YOUNG FIRMS, 2016



Source: U.S. Census Bureau.

FIGURE 12

NEW FUNDING RELATIONSHIPS, EQUITY AND ALTERNATIVE CAPITAL, ESTABLISHED FIRMS, 2016



Source: U.S. Census Bureau.

While application rates were much lower for new funding relationships with equity and alternative capital providers compared to debt providers, across the board, young Black-owned firms did have more success than all firms, including Hispanic-owned firms, in securing new funding relationships with angel investors and through crowdfunding platforms (see Figure 11). Hispanic-owned firms were consistently the least likely to secure new funding relationships with equity and alternative providers, despite applying the most (on par with African American-owned firms for crowdfunding applications).

Again, regardless of race or ethnicity, application rates for equity and alternative capital providers were even lower among older firms (see Figure 12). However, established Hispanic-owned firms were more successful than young Latino firms in securing new relationships, and established Black-owned firms outperformed all firms, including Latino-owned firms, in securing new funding from crowdfunding platforms.

Given minorities' reported relative success securing equity capital, a deeper understanding of what drove these results could lead to more accessible avenues to capital for this population of small business owners.

SBA LENDING

In the U.S. Census Bureau's "2016 Annual Survey of Entrepreneurs," less than 2 percent of business owners reported using government-guaranteed business loans from a bank or other financial institution, including SBA-guaranteed loans, to start or acquire a business.[15]

15. "2016 Small Business Credit Survey," Federal Reserve Bank of New York, April 2017, https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf.

7(a) loans are the SBA's basic and most popular lending product. A 7(a) loan does not come directly from the SBA. Instead, an authorized SBA lender makes the loan and the SBA guarantees a portion of it, mitigating much of the risk for the lender. With the SBA guaranteeing a large portion of the loan, the lender can lower its lending standards, allowing small business owners with less established credit histories or less cash flow to qualify. If purchasing a business or getting working capital is the goal, the SBA 7(a) loan is likely the better tool.

504 loans can only be used for commercial real estate or long-term machinery purchases. 504 loans come with lower interest rates and down payments than 7(a) loans, making them a much better choice if a business owner plans on buying property or investing in equipment. While 7(a) loans can also be used for real estate, they are better suited for other uses such as working capital, debt refinancing or supplies and inventory because they offer more flexibility in their terms.

VISIT

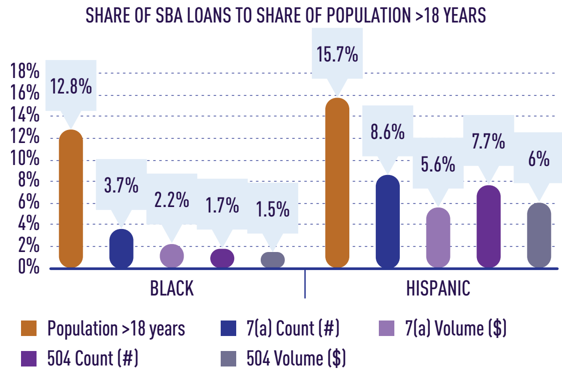
https://cdcloans.com/lender/504-7a-loan-comparison/ for more information.

There was little variance across race and ethnicity (see Figure 5). Still, given insufficient small business lending data, comparing the share of SBA loans for which data is available among Black and Hispanic business owners to the share of the population provides a lens into lending parity and is indicative of disparities in capital access.

Accounting for 12.8 percent of the 18 years and older population, African Americans would have had SBA lending parity if they received roughly 13 percent of SBA loans, by both count (number of loans) and volume (dollar value of loans). Hispanic parity would have been about 16 percent. As seen in Figure 13, across lending products, African Americans and Latinos were underrepresented.[16]

FIGURE 13

SBA LENDING, 2016

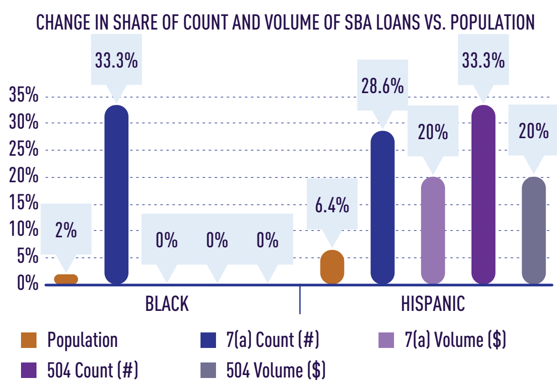


Source: SBA.

On a positive note, Latinos are capturing more of the SBA lending market. Between 2012 and 2016, their share of SBA lending products (in terms of count and volume) increased at a higher rate than the increase in their share of the population (see Figure 14).[17] Less encouraging, African Americans only gained ground in their share of the number of 7(a) loans received—albeit a large increase (33.3 percent). However, their share of the lending volume of 7(a) and 504 loans and count of 504 loans all remained flat at about 2 percent, which translated into zero change in share.

FIGURE 14

SBA LENDING, 2012-2016



Source: SBA.

16. "2016 Population Data;" SBA lending data made available to the Milken Institute after a Freedom of Information Act (FOIA) request to the SBA dated September 28, 2018.

17. "2017 Population Data," American Fact Finder, Population Division, U.S. Census Bureau, https://factfinder.census.gov/faces/nav/jsf/pages/index.xhtml; SBA lending data released to the Milken Institute after an FOIA request to the SBA dated September 28, 2018.

A LEGACY OF POVERTY, INEQUALITY, AND BIAS CONTRIBUTE TO THE BARRIERS AFRICAN AMERICANS AND LATINOS FACE WHEN SEEKING STARTUP AND EXPANSION SMALL BUSINESS CAPITAL.

Cultural Barriers

Why do African Americans and Latinos have higher barriers to accessing capital compared to the general population and other racial and ethnic groups? A legacy of poverty, inequality, and bias plays a large role. Entrepreneurs who are well-educated, professionally experienced, and (perhaps most importantly) have access to social and capital networks are best positioned to succeed. Many African Americans and Latinos are at a disadvantage before even getting started.

GENERATIONAL POVERTY

As of 2017, the median wealth of white households was 10-times larger than Black households and eight-times larger than Hispanic households.[18] Intergenerational wealth transfers enable opportunities such as financing a college education, making a down payment on a first home, and providing capital to start and grow a business.[19] Nearly a quarter of all entrepreneurs worked in a family business before acquiring that business or starting one of their own.[20] Multiple studies have shown that inequalities in the personal wealth of disadvantaged communities translate into disparities in their relative business creation and ownership rates.[21]

The Great Recession of 2007-09 triggered a sharp, prolonged decline in the wealth of all Americans, but it had a particularly negative impact on Black and Hispanic groups, wiping out decades of slow and steady gains. Black and Hispanic populations had a higher proportion of their wealth tied up in their homes compared to whites and Asians, which exacerbated their losses when the housing market collapsed.[22] While whites had—and continue to have—higher homeownership rates compared to African Americans and Latinos, between 2006 and 2012, homeownership rates among Black and Hispanic homeowners fell by 8.4 and 7.2 percent, respectively, compared to 3 percent for white homeowners.[23] Lower homeownership rates translate to lower eligibility for secured small business loans as real estate assets and home equity are the most common type of collateral used by borrowers.[24]

18. Rakesh Kochhar and Anthony Cilluffo, “How U.S. Wealth Inequality Has Changed since Great Recession,” Pew Research Center, November 1, 2017, http://www.pewresearch.org/fact-tank/2017/11/01/how-wealth-inequality-has-changed-in-the-u-s-since-the-great-recession-by-race-ethnicity-and-income/.

19. Lisa J. Dettling et al., “Recent Trends in Wealth-Holding by Race and Ethnicity: Evidence from the Survey of Consumer Finances,” FEDS Notes 2017, no. 2083 (2017), https://www.federalreserve.gov/econres/notes/feds-notes/recent-trends-in-wealth-holding-by-race-and-ethnicity-evidence-from-the-survey-of-consumer-finances-20170927.htm; Robert W. Fairlie and Alicia M. Robb, “Why Are Black-Owned Businesses Less Successful than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital,” *Journal of Labor Economics 25*, no. 2 (2007).

20. Robert W. Fairlie and Alicia Robb, “Families, Human Capital, and Small Business: Evidence from the Characteristics of Business Owners Survey,” *ILR Review 60*, no. 2 (2007), http://ftp.iza.org/dp1296.pdf.

21. David S. Evans and Boyan Jovanovic, “An Estimated Model of Entrepreneurial Choice under Liquidity Constraints,” *Journal of Political Economy 97*, no. 4 (1989); Robert W. Farlie, “Entrepreneurship among Disadvantaged Groups: An Analysis of the Dynamics of Self-Employment by Gender, Race and Education,” *Handbook of Entrepreneurship*, July 2005, https://people.ucsc.edu/~rfairlie/papers/published/springer%20 2006%20-%20handbook%20article.pdf; Simon C. Parker, The Life Cycle of Entrepreneurial Ventures (New York: Springer, 2011); Robert W. Fairlie and Alicia M. Robb, “Why Are Black-Owned Businesses Less Successful than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital;” Robert W. Fairlie and Christopher M. Woodruff, “Mexican-American Entrepreneurship,” *SSRN Electronic Journal*, (2006).

22. Anna Brown and Richard Fry, “In a Recovering Market, Homeownership Rates Are Down Sharply for Blacks, Young Adults,” Pew Research Center, December 18, 2017, http://www.pewsocialtrends.org/2016/12/15/in-a-recovering-market-homeownership-rates-are-down-sharply-for-blacks-young-adults/.

23. “Housing Vacancies and Homeownership Annual Statistics 2017,” U.S. Census Bureau, https://www.census.gov/housing/hvs/data/ann17ind.html.

24. Fairlie and Robb, “Why Are Black-Owned Businesses Less Successful than White-Owned Businesses? The Role of Families, Inheritances, and Business Human Capital.”

EDUCATIONAL ATTAINMENT

Educational opportunities for minority children remain unequal due to a lack of key educational resources, including skilled teachers and quality curriculum.[25] Even though high school graduation and college graduation rates have increased, Black and Hispanic youth remain less likely to complete their high school and bachelor's degrees compared to their white and Asian counterparts.[26]

Also, youth may come from families and communities with low levels of educational attainment, which influences their experience and desire to excel in school.[27] A study based on interviews and focus groups with students who grew up in generational poverty found that communication about education in the home was limited. Ninety-six percent reported their educational goals were to do "just a little better" than their parents (who often had not graduated high school). The majority could "not envision completing school."[28]

Multiple studies have found the education level of a business owner is strongly associated with entrepreneurship and entrepreneurial success.[29] Businesses with highly educated owners have higher sales, profits, and survival rates, and hire more employees than businesses with less educated owners. Completing high school and college reinforces critical thinking and problem-solving skills and provides students with credentials to build their reputation and access to peer and professional networks, including mentoring opportunities.[30]

BUSINESSES WITH HIGHLY EDUCATED OWNERS HAVE HIGHER SALES, PROFITS, AND SURVIVAL RATES, AND HIRE MORE EMPLOYEES THAN BUSINESSES WITH LESS EDUCATED OWNERS.

PROFESSIONAL TRAINING AND MANAGEMENT DEFICITS

Despite historically low unemployment rates nationwide, Black and Hispanic populations continue to experience higher unemployment (5.9 and 4.9 percent) compared to whites (3.5 percent).[31] And, while employment for minorities has improved, African Americans and Latinos continue to have lower earnings compared to whites. The median weekly earnings of full-time wage and salary workers in 2016 was $678 for African Americans, $624 for Latinos, and $862 for whites.

Moreover, across the corporate pipeline, the proportion of women and people of color decreases with seniority compared to white men, who progressively account for a larger share of senior roles.[32] Per McKinsey & Company's report, "Women in the Workplace 2016," women of color

25. "Public Education Funding Inequity in an Era of Increasing Concentration of Poverty and Resegregation," United States Commission on Civil Rights, January 2018, https://www.usccr.gov/pubs/2018/2018-01-10-Education-Inequity.pdf.
26. "Fast Facts," National Center for Education Statistics, https://nces.ed.gov/fastfacts/display.asp?id=16; "On Views of Race and Inequality, Blacks and Whites Are Worlds Apart," Pew Research Center, June 27, 2016, http://www.pewsocialtrends.org/2016/06/27/1-demographic-trends-and-economic-well-being/.
27. Donna Beegle, "Overcoming the Silence of Poverty," Talking Points, vol. 15 (2003), https://secure.ncte.org/library/nctefiles/store/samplefiles/journals/tp/tp0151overcoming.pdf.
28. Beegle, "Overcoming the Silence of Poverty."
29. Michael S. Barr, "Minority and Women Entrepreneurs: Building Capital, Networks, and Skills," Brookings, March 2015, https://www.brookings.edu/wp-content/uploads/2016/07/minority_women_entrepreneurs_building_skills_barr.pdf; Fairlie and Robb, "Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs."
30. Christopher R. Huber and Nathan R. Kuncel, "Does College Teach Critical Thinking? A Meta-Analysis," *Review of Educational Research 86*, no. 2 (2016): 431-68; "The State of American Jobs," Pew Research Center, October 2016, http://www.pewsocialtrends.org/2016/10/06/5-the-value-of-a-college-education/.
31. "Labor Force Statistics including National Unemployment Rate," Current Population Survey, Bureau of Labor Statistics, accessed October 23, 2018, https://factfinder.census.gov/faces/nav/jsf/pages/index.xhtml.
32. "Women in the Workplace 2016," McKinsey & Company, https://c.ymcdn.com/sites/www.napaba.org/resource/resmgr/2016_napaba_con/CLE_Materials/CLE_503.pdf.

(defined as Black, Hispanic, Asian, American Indian, or Alaskan Native, Native Hawaiian, or Pacific Islander, and mixed-raced) are the most underrepresented group of all. Despite accounting for 20 percent of the U.S. population, they hold 17 percent of entry-level positions and only 3 percent at the C-Suite level. Without the same experience-based financial and organizational management skills as white entrepreneurs, many Black and Hispanic entrepreneurs enter small business ownership at a disadvantage.

> Diversity at senior levels also speaks to job creation and wealth accumulation because women and minorities in senior roles generally build more diverse organizations. Increasing the number of Black and Latino small business owners, likewise, increases minority employment opportunities.

COUNTRY OF ORIGIN AND IMMIGRATION STATUS

For Latinos, especially recent immigrants, limited awareness of U.S. laws and regulations, immigration status, and language issues can all act as barriers to obtaining capital. Many new immigrants are unfamiliar with U.S. incorporation laws and regulations, making the process of starting their own entrepreneurial ventures within the formal economy difficult. The challenge is compounded when technical assistance (TA) providers provide marketing materials and TA services in English only. Undocumented workers in particular face limited financing options, though some financial organizations will accept an individual taxpayer identification number, a tax-processing number issued by the Internal Revenue Service to individuals who do not have and are not eligible to obtain a social security number.

DISCRIMINATION

Despite government interventions to prevent discrimination against minorities and low- and moderate-income borrowers, Black- and Hispanic-owned firms continue to experience higher loan denial probabilities and pay higher interest rates than white-owned businesses—even after controlling for differences in creditworthiness.[33]

Research also indicates loan officers treat minority consumers differently when researching financing options in the information provided to them, the information required from them to apply for a loan, and the encouragement and assistance demonstrated to them (see Table 1).[34]

TABLE 1

HOW LOAN OFFICERS TREAT MINORITY APPLICANTS

		FREQUENCY	
		WHITE (%)	MINORITY (%)
Provide less information	Loan fees	**59.1**	25.9
	Loan terms	**52.5**	27.5
	Interest rates	**82.4**	61.5
Request more information	Financial statements	50.0	**82.8**
	Tax returns	52.4	**86.2**
	Bank account information	0.0	**25.0**
	Personal savings and investments	21.7	**60.5**
	Credit card debt	13.0	**42.5**
	Auto loan debt	8.7	**32.5**
Provide less assistance	Help completing a loan application	**59.1**	18.2
	Offered a business credit card	**81.8**	42.9
	Offered help with future banking needs	**68.2**	42.9

Source: Sterling Bone, Christensen, Glenn, Williams, Jerome, "Rejected, Shackled, and Alone: The Impact of Systemic Restricted Choice on Minority Consumers' Construction of Self," Journal of Consumer Research, Volume 41, Issue 2, August 1, 2014, Pages 451-474.

33. Robert Farlie, Alicia Robb, and David T. Robinson, "Black and White: Access to Capital among Minority-Owned Startups," Stanford Institute for Economic Policy Research, December 2016, https://siepr.stanford.edu/sites/default/files/publications/17-003.pdf.

34. Sterling Bone, Christensen, Glenn, Williams, Jerome, "Rejected, Shackled, and Alone: The Impact of Systemic Restricted Choice on Minority Consumers' Construction of Self," Journal of Consumer Research, Volume 41, Issue 2, August 1, 2014, Pages 451-474.

The disparities extend to equity financing. For example, per an oft-cited 2010 analysis by CB Insights, among venture capitalists, all-Black founding teams raised the smallest rounds of national internet seed and series A funding ($1.3 million), compared to teams that were multiracial ($2.2 million), all-white ($2.3 million), and all-Asian-Pacific ($4 million).[35]

In 2016, minority angels accounted for 4.9 percent of the angel population and minority-owned firms represented 15.3 percent of the entrepreneurs that presented their business concept to angels. The yield rate for these minority-owned firms was 12.3 percent—lower than the 19.7 percent of overall investment opportunities brought to the attention of investors resulting in an investment.[36]

Finally, a 2018 report from digitalundivided's "ProjectDiane," a biennial demographic study that looks at the state of play for Black women business founders in the U.S., found that between 2009 and 2017, Black women-led startups raised $289 million in venture and angel funding (the majority of which was raised in 2017 alone). The nine-year total represents 0.0006 percent of the $424.7 billion in total tech venture funding raised.[37]

TRUST GAP

The culmination of cultural barriers has created a trust gap—minorities are weary of banks, other financial institutions, and potential mentors and consultants.[38] The experience and expectation of bias discourages small business owners from seeking financing in the first place. For minority women, the added pressure as an entrepreneur of color, who is also female, to prove herself and the value of her work and ideas heightens the trust gap.[39]

BETWEEN 2009-2017, BLACK WOMEN-LED STARTUPS RAISED $289 MILLION IN VENTURE CAPITAL AND ANGEL FUNDING—0.0006% OF THE TOTAL TECH VENTURE FUNDING RAISED.

—DIGITALUNDIVIDED, "PROJECTDIANE"

35. Jonathan Sherry, "Data Driving Important Discussions," PowerPoint presentation at Galvanize SF, June 3, 2015, https://www.slideshare.net/slideshow/embed_code/key/gL299OELEtADdQ.
36. Jeffrey Sohl, "A Cautious Restructuring of the Angel Market in 2016 with a Robust Appetite for Seed and Start-Up Investing," Center for Venture Research, May 31, 2017, https://paulcollege.unh.edu/sites/default/files/resource/files/2016-analysis-report-final.pdf.
37. "The State of Black Women Founders ProjectDiane2018," digitalundivided, http://www.projectdiane.digitalundivided.com/.
38. "The Tapestry of Black Business Ownership in America: Untapped Opportunities for Success," Association for Enterprise Opportunity, February 2017, https://aeoworks.org/images/uploads/fact_sheets/AEO_Black_Owned_Business_Report_02_16_17_FOR_WEB.pdf.
39. Emily Fetsch, "Including People of Color in the Promise of Entrepreneurship," Ewing Marion Kauffman Foundation, December 5, 2016, https://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/including-people-of-color-in-the-promise-of-entrepreneurship.

PART II: THE PARTNERSHIP FOR LENDING IN UNDERSERVED MARKETS

Building on a series of meetings with local stakeholders organized by the Milken Institute and the SBA's Los Angeles regional office, in June 2016, the Milken Institute and the SBA convened a national roundtable at the White House to review barriers to capital access African Americans and Latinos face when starting and growing businesses. Leaders from financial institutions, regulatory agencies, community groups, research institutes, and others considered ways to increase not only the number and value of loans to minority-owned businesses, but also the number of successful minority-owned small businesses in Black and Latino communities employing Black and Latino workers.

The **Partnership for Lending in Underserved Markets** initiative was an outgrowth of the roundtable. Spearheaded by the Milken Institute, with seed funding and on-the-ground support provided by the SBA, PLUM sought to develop, over a two-year period, actionable solutions to address long-standing barriers that constrain minority entrepreneurs and small business owners from accessing capital to start and grow businesses.

We selected Baltimore and Los Angeles as pilot cities to better understand how local dynamics affect capital access in a given market and to test solutions. The Baltimore protests in the wake of the 2015 death of Freddie Gray while in police custody brought national attention 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 had local-level actors with the will and infrastructure to activate good ideas.

At the national level, the Milken Institute committed to initiating research, exploring improvements to federal policies and institutions that affect minority small business capital access, and identifying broader opportunities to overcome structural limitations on minority small business lending, improve the evidence-base for action, expand small business market opportunities, and coordinate urban development.

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

Onewest Bank

Pacific Coast Regional Corporation

People Fund

Small Business Administration

U.S. Black Chambers, Inc.

Valley Economic Development Center

W.K. Kellogg Foundation

Strategies to Overcome Minority Capital Access Barriers

PLUM launched in September 2016, and the first 4-6 months of the initiative centered around convening government officials, data providers, economic development workers, traditional and alternative capital providers, and others to share their knowledge, expertise, and experiences to describe the minority-owned small business and lending environments in Baltimore, Los Angeles, and nationally. Stakeholders provided anecdotal stories and quantitative survey data, shared research, and engaged additional interested parties.

> "The process of pulling the number of organizations together to get the work done was one of the most impressive things to come out of the initiative in a town where there is not a lot of collaboration happening within organizations. This is a real tribute to the Milken Institute and the SBA and in getting us all to the table in a way that allowed work to flow in a positive manner. The approach was serious and focused on building on past initiatives, with our eyes on using those learnings and building new processes that would last the next 15 years and allow for stronger results."
>
> **—QUENTIN STRODE**
> **Co-Founder, OmniWorks**

From these meetings, together we identified seven strategies to overcome minority barriers to capital access:

» Improve the evidence-base for action

» Address the structural limitations of minority small business lending

» Increase equity and patient capital in underserved markets

» Improve transparency and efficacy of small business lender engagement

» Expand small business market opportunities

» Customize technical assistance

» Coordinate economic development

STRATEGIES TO OVERCOME MINORITY CAPITAL ACCESS BARRIERS

IMPROVE THE EVIDENCE-BASE FOR ACTION

- Lack of sufficient measurement and evaluation of minority small business and capital environments results in a limited understanding of the scope and magnitude of the barriers minorities face.
- Limited visibility constrains opportunities to target and mobilize public and private resources.

ADDRESS THE STRUCTURAL LIMITATIONS OF MINORITY SMALL BUSINESS LENDING

- Traditional credit scoring models prioritize common minority deficits including limited or poor credit history and lack of collateral.
- Lender products are homogenous and not responsive to borrower profiles.
- The Community Reinvestment Act favors compliance with compulsory obligations before rewarding innovative and flexible lending practices.
- Lenders (CDFIs, MDIs) in underserved markets are undercapitalized.

INCREASE EQUITY AND PATIENT CAPITAL IN UNDERSERVED MARKETS

- Investors perceive underserved markets as high-risk.
- There is a lack of coordination in sourcing and funding equity investments in underserved markets.
- State laws prevent some cities from participating in online fundraising from multi-investor facilities.

IMPROVE TRANSPARENCY AND EFFICACY OF SMALL BUSINESS LENDER ENGAGEMENT

- Lenders have a limited knowledge and understanding of existing policies and programs that promote lending to underserved markets.
- The process to refer businesses that do not qualify for traditional loans to other sources of capital lacks standardization and best practices.
- Predatory lenders target small businesses with limited financing options.
- Brokers do not have a fiduciary responsibility to their small business clients and instead are motivated to maximize profits.

EXPAND SMALL BUSINESS MARKET OPPORTUNITIES

- Supply chain and procurement opportunities favor larger, more established businesses.
- It is difficult for small businesses to navigate multiple and overlapping jurisdictions with varying regulatory and program qualification requirements.

CUSTOMIZE TECHNICAL ASSISTANCE

- Businesses are not bankable without sound operations and attention to business fundamentals.
- Financial illiteracy limits capital opportunities.
- Technical assistance programs are not tailored for minority entrepreneurs and small business owners.

COORDINATE ECONOMIC DEVELOPMENT

- Narrow or singular financing and development strategies do realize the multiplier benefits and increased impact of coordinated efforts.

Pilot Cities

Of the seven strategies, the Institute concluded some would be more appropriately addressed at the national level (see page 23 regarding national activities and outcomes); the rest were tackled locally through working groups in each city.

MARKET RESEARCH

Data about minority-owned small businesses—location, performance, financing, industry, etc.—are either not adequately captured, not available for the public to access, or not compatible across geographies and other demographics to allow for meaningful analysis. For example, the U.S. Census Bureau collects business data at the metropolitan statistical area and county level, including industry, number of employees, average sales, and average wages. Municipal-level data, however, are scarce or difficult to acquire.

DATA DEFICIT

Per the U.S. Department of Justice, the FOIA provides the public the right to request access to records from any federal agency. Federal agencies are required to disclose any information requested under the FOIA unless it falls under one of nine exemptions which protect interests such as personal privacy, national security, and law enforcement.

Visit www.foia.gov/about.html for more information.

Improving the evidence-base for action is the first strategy the PLUM taskforce identified to overcome minority capital access barriers. Lack of sufficient measurement and evaluation of minority small business and capital environments results in a limited understanding of the scope and magnitude of the barriers minorities face, which constrains opportunities to target and mobilize public and private resources. Any obstacle to access, or extra step required, impedes efforts to build the evidence-base. Access to data under FOIA is an option, but it is an extra step. And, worth noting, some federal data, such as SBA lending data disaggregated by lending product and geography was available for download on SBA's website prior to 2017 without having to file a FOIA request; now, one is required.

In Los Angeles, the City's DBE/MBE/WBE directory lists the company name, address, phone number, and NAICS (industry) code for city-certified Disadvantaged Business Enterprises, Minority Business Enterprises, and Women Business Enterprises. It does not categorize businesses by the race, ethnicity, or gender of the business owner, nor are there sales, employee, or wage data. The data are not in a downloadable format, and ultimately are not representative of minority-owned small businesses at large because certification primarily helps businesses compete for contracting and procurement opportunities. Businesses outside this scope likely do not register. Also, in Los Angeles, the higher percentage of non-employer Black and Hispanic firms (and businesses operating outside the formal economy) increases the risk that the total will be undercounted.

There are databases to purchase, such as Dun & Bradstreet, Hoovers, and Resource USA, but they are costly and verifying methodology and accuracy is difficult.

In Los Angeles, the PLUM market research and industry clusters working group submitted Freedom of Information Act data requests to national agencies, conducted their own surveys of Black and Hispanic businesses, and reviewed all city- and county-level data they could identify to piece together the LA landscape. The group succeeded in identifying some synergies.

Per the Los Angeles County Economic Development Corporation, Latinos in the county are more likely to be employed in manufacturing and construction firms than the average LA County worker,[40] and construction and selected manufacturing are growth industries in the county.[41] Major development projects—including overhauling Los Angeles International Airport, building the LA Rams' new NFL stadium in Inglewood, and preparing the city for the 2028 Olympics—point to procurement and logistics opportunities for Latino owners of construction firms. However, Los Angeles County includes 88 cities and 11 unincorporated areas which do not align neatly with ethnic communities. The airport is in the City of Los Angeles, Inglewood is its own city, and the Olympics will tap infrastructure and transportation agencies and firms from across the county. Without more specific data around where Latinos live, work, and own businesses, it is difficult not only to tailor policy and programming, such as where and to whom to market and recruit for

40. Lawren Markle, "Economic Profile of the Latino Community in L.A. County," Los Angeles County Economic Development Corporation, February 22, 2017, https://laedc.org/2017/02/21/economic-profile-latino-community-l-county.

41. Lawren Markle, "People, Industries, Jobs Report - 2017 Edition," Los Angeles County Economic Development Corporation, June 30, 2017, https://laedc.org/2017/06/30/pij-2017/.

projects, but also to coordinate agencies and resources to help firms identify and navigate opportunities.

In terms of mapping the capital landscape, questions to consider included:

- What lenders, investors, and technical assistance providers are in the market, including local, statewide, national, or online providers?
- Are there adequate providers in place to serve Black and Hispanic entrepreneurs and business owners?
- Are they located near and accessible to businesses who need them?

To examine credit product offerings and gauge their capacity to meet minority needs, we need to understand who is in the market. Again, sufficient and accessible data is limited.

It is possible, through a manual and time-consuming process, to piece together a fairly comprehensive capital landscape by leveraging resources and information from think tanks, universities, and city and county agencies. Supplementing the information with community insights and local knowledge and expertise helps to identify gaps and opportunities for minority business owners.

A PLUM Baltimore partner, the 21st Century Cities Initiative at Johns Hopkins University, did undertake such a manual process. They researched 40 public and private funding sources and programs from 2000 to 2016 and interviewed more than 50 stakeholders in government, banks, investment firms, community development financial institutions, incubators, nonprofits, and small businesses. Their final report, “Financing Baltimore’s Growth: Measuring Small Companies’ Access to Capital,” cites 13 sources across the public and private sectors covering capital products ranging from guaranteed loans, bank loans, non-bank (CDFI) loans, equity investments, research grants, and others.[42] It took researchers six months to map the ecosystem and determine that “given Baltimore’s competitive advantages—our strong industries, great universities, and geography—the local financing system for startups and small businesses should be much stronger.”[43]

Maximum opportunity for economic growth lies in the overlap among industries in which African American and Latino presence is strong (i.e., own businesses and are employed), in the industries that are growing regionally, and the communities in which African Americans and Latinos live and work. Improving the evidence-base for action is critical to demonstrate the magnitude of the problems and justify funding for corrective programs and initiatives.

> “Understanding the complexities of financing small and minority businesses in Baltimore is the first step to solving the wealth gap. It is also incumbent on government and private sector lenders to create new models of financing that will unlock the intellectual capital and creativity in these communities. The work and knowledge base that Milken brought to Baltimore is invaluable in our effort to develop an equitable landscape for growing our communities in Baltimore.”
>
> **—PAUL E. TAYLOR**
> **Director, Baltimore Mayor’s Office of Small, Minority and Women Business Development**

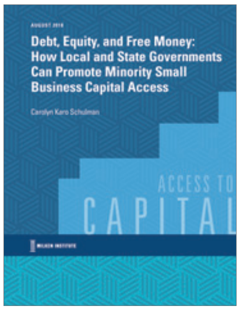
42. Mary Miller, Ben Seigel, and Mac McComas, “Financing Baltimore’s Growth: Measuring Small Companies’ Access to Capital,” Johns Hopkins University, http://21cc.jhu.edu/wp-content/uploads/2017/09/21cc-financing-baltimores-growth-sept-2017.pdf.

43. Johns Hopkins University, “Follow the Money: How Does Baltimore Support Small Business Growth?” news release, September 28, 2017, http://releases.jhu.edu/2017/09/28/follow-the-money-how-does-baltimore-support-small-business-growth/.

LOCAL POLICY

Many of the capital access barriers identified, including insufficient data, lack of coordination among jurisdictions and capital providers, and supply chain gaps, require structural change such as new local and state laws, policies, and programs to mandate and incentivize action.

In Los Angeles, the policy working group produced two briefs for local and state policymakers.



The first, published by the Milken Institute, "Debt, Equity, and Free Money: How Local and State Governments Can Promote Minority Small Business Capital Access," highlights innovative programs from California and across the country that are advancing minority small business and economic development. Some are creative approaches to financing and others more deliberately take on racial and ethnic disparities and seek to correct historical inequalities.

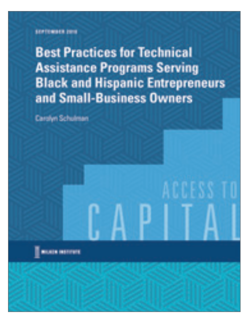
LA LISC, a PLUM LA partner, released "Supporting Economic Inclusion in Disadvantaged Communities: A Case for Inclusive Public Procurement Policies." The report, a direct outgrowth of the policy working group, delves into county and city contracting and identifies major challenges to increasing the participation of small, local, and diverse businesses in the public procurement process in Los Angeles. It offers practical recommendations to create a more inclusive procurement environment based on regional strategies and best practices agencies and municipalities have used to address similar challenges.

Identifying policy champions—individuals with the influence, access, and credibility to promote solutions to legislators and other policymakers—is paramount. Whether locally, statewide, or nationally, relationships and partnerships with policy champions can be the difference between good ideas and executed outcomes.

In 2016, the PLUM Baltimore policy working group prepared a series of recommendations for then-incoming Baltimore Mayor Catherine Pugh, including: 1) appoint and empower a small business ombudsperson to advocate, navigate, and troubleshoot for small businesses; 2) establish a one-stop shop in the city economic development department to coordinate and streamline business licensing and permitting requirements; 3) empower and resource the Baltimore Resource Center to execute its mandate of providing customized technical assistance to support small businesses in minority communities; and 4) leverage the City's HUD funding as equity injection for matching SBA loan guarantees for strategic community development investments. In 2017, Mayor Pugh included several recommendations in the "Mayor's Transition Report," and in 2018 the group met with her once more to share final lessons learned from the initiative.

TECHNICAL ASSISTANCE

Technical assistance refers to the education and guidance provided to entrepreneurs and small business owners to help them start and grow businesses. As it builds the capacity of organizations to operate effectively, TA positions entrepreneurs and small businesses to access capital. TA products and services provide entrepreneurs with strategies, tools, and a network to support their success and help navigate their challenges. However, as discussed previously, the legacy of poverty, inequality, and bias African Americans and Latinos face negatively affects their relationship with financial products and services, including a wariness to engage with banks, other financial institutions, and potential mentors and consultants. To effectively reach and support Black and Hispanic small business owners, TA needs to be culturally-competent. In other words, service providers need to recognize how race and ethnicity shape a population's relationship to financial products and services, and build TA programs that are responsive to these populations.



A product of the PLUM Los Angeles technical assistance working groups (one for startups and one for established businesses), the Institute published "Best Practices for Technical Assistance Programs Serving Black and Hispanic Entrepreneurs and Small-Business Owners." The report provides best practices in TA program design, service delivery, curriculum, and marketing and outreach. It also highlights programs and mission-driven organizations across the U.S. that already effectively serve minority and low-income entrepreneurs and business owners and integrate many of the best practices outlined in the report. The featured organizations provide real-world examples of best practices in action. The hope is that they inspire more providers to adopt their strategies and tactics.

Through the collaboration of high-caliber, knowledgeable, and vested partners brought together by the Milken Institute and SBA, we succeeded in mapping the technical assistance landscape in LA, identifying barriers to entry, growth, and scale, and creating a cooperative framework to educate and support minority entrepreneurs to conceptualize, capitalize, and create sustainable small businesses. I now have new partners who share my passion to serve the minority market and together we are creating an open online learning academy with curated TA curriculums.

—KEITH MCPHERSON
Founder and Head Nerd in Charge, A Cool Nerd

LENDER ENGAGEMENT

The current networks among debt and equity providers are disconnected, and shifting the discussion can result in an entirely different set of stakeholders. Often, capital and service providers have narrow relationship channels or limited awareness of the broader ecosystem of players. For example, banks and online lenders do not typically operate in the same space as crowdfunding organizations and angel investors, and lenders only know to refer declinations to a limited pool of organizations. Bridging the divide and bringing together those who do not traditionally interact will support new solutions and directly increase access to capital by growing the pool of options.

Technology offers one means of connection. There are a myriad of tools to support improved data collection, collaboration, and operations. However, there is much mistrust, apprehension, and doubt around the application of such tools. Some providers are hesitant to leverage online platforms because they rely on algorithms rather than human relationships to bridge the disconnect between providers and clients. There is no substitute for a personal relationship, but there are for- and non-profit organizations working to integrate high-tech and high-touch into their models. For example, the Community Reinvestment Fund and the Association for Enterprise Opportunity (AEO) are leveraging tech-driven solutions to encourage greater efficiencies in the loan origination process (SPARK) and connecting capital providers with businesses that have been declined by traditional lenders and are unaware of alternative options (Project Cue).[44] Any online matchmaking should be routing small businesses to the most cost-efficient products and services available to meet their needs. Predatory lending or routing to the highest cost products and services to gain a better commission are clearly activities to monitor and discourage. Yet, to realize the objective of increasing access to capital, we must embrace the opportunities technology and technology partners offer to save time and money while reaching more people, particularly the unbanked and underbanked.

44. For more information about SPARK, visit http://www.lendwithspark.com/; For Project Cue, visit https://aeoworks.org.

In Baltimore and Los Angeles, the lender referral working groups partnered with Star Mountain Capital, a national asset management firm focused on the U.S. lower- and middle-market, to convene SBIC fund managers, policymakers, and minority-owned small businesses, connect capital providers and small businesses, and educate the broader audience about capital solutions. These events broadened the network of providers and businesses, and targeted minority businesses and their specific capital needs.

Baltimore Mayor Catherine Pugh (center) at the Milken Institute and Star Mountain Capital SBIC event.

In Los Angeles, the lender referral working group created a half-day workshop to promote connections among capital providers and share new solutions for expanding minority small business access to capital. Debt and equity providers shared several case studies that demonstrated real, creative solutions to minority small business financing challenges, and attendees then workshopped other challenging financing scenarios. Ultimately, the goal was to create more opportunities for banks to refer Black and Latino entrepreneurs and small business owners to organizations that can give them suitable and safe financing for their stage of growth, industry, and personal circumstances.

When PLUM LA started many participants didn't have a working knowledge of crowdfunding and couldn't see how it was relevant to helping underserved entrepreneurs fund their businesses. By the final Lender Referral Networking Event in August of 2018, some of these same individuals were suggesting crowdfunding as a solution for entrepreneurs who had been turned down by lenders and were starting to see how crowdfunding could create a path to bankability. Prior to PLUM, I was having little success creating dialogue with lenders and technical assistance providers about the crowdfunding opportunity for underserved entrepreneurs, so this was a significant transformation and a direct result of two years of conversations facilitated by the Milken Institute and SBA among individuals who would not have been brought into meaningful conversation without the catalyst of PLUM. These relationships are already creating new collaborations, like the one between Crowdfund Better and OmniWorks, to incorporate crowdfunding as a core funding strategy for minority entrepreneurs participating in the OmniWorks incubator program.

—KATHLEEN MINOGUE
Founder & CEO, Crowdfund Better

EXECUTION AND IMPLEMENTATION

Perhaps the most significant lesson learned from the pilot cities to advancing any capital access solution is the necessity of committed, local partners who know the market and its players well. In addition to compensating for data deficits, local partners lend legitimacy to programs and initiatives, and create trust among stakeholders.

Anchor institutions provide local leadership and support buy-in from service providers and potential clients to new capital solutions. This local ownership matters because it empowers communities to create long-term, sustainable change. With providers engaged, it is more likely clients, borrowers, and small businesses will embrace new opportunities. Moreover, embedding a sustainable strategy requires a long lead time for both a diagnostic of the issues and potential solutions, and a runway for executing efforts with local ownership driving the way forward.

In Los Angeles, the SBA district office was a critical factor in legitimizing the LA PLUM pilot and creating trust among stakeholders. The office and its district director, Victor Parker, have strong relationships with CDFIs, banks, and other lenders. They have an intimate knowledge of the LA market and better insights than most about what is and is not working and why.

In Baltimore, the Harbor Bank of Maryland and its management team (Chairman, President, and CEO Joseph Haskins, Jr. and Executive Vice President and CAO John Lewis) attracted and marshalled participation from the community around the PLUM effort. The bank, which is a minority depository institution (MDI), is an anchor institution in the community with close connections to and knowledge of the local Black community.

However, there are challenges when casting the net widely. Competition for clients and resources can hinder collaboration, and some organizations and institutions worry new solutions will disrupt the status quo. Some local organizations can be hesitant to engage with national partners because they lack on-the-ground knowledge and might impose standards or requirements that do not work locally. A comprehensive minority capital access strategy should include existing players while making room for innovation. The value and necessity of engaging local stakeholders far outweighs possible tensions, but it is helpful to recognize these tensions with regard to outreach, expectations for participation, and buy in for new ideas.

U.S. Small Business Administration Los Angeles District Director, Victor Parker

Chairman, President, and CEO of the Harbor Bank of Maryland, Joseph Haskins, Jr.

National Efforts

While there is a clear role for local and state governments and other stakeholders in overcoming minority barriers to capital access, some policy areas and structural limitations are more appropriately addressed at the national level.

FEDERAL AND CONGRESSIONAL ENGAGEMENT

In Washington, D.C. and Los Angeles, the Institute participated in the Office of the Comptroller of the Currency's Small Business Lending Roundtable series focused on minority-owned small business financing.

The Institute also participated in a Congressional Black Caucus (CBC) Wealth Creation and Economic Development Task Force event covering the Community Reinvestment Act, small business data collection, and the role of FinTech in providing capital to underserved communities. The Institute continues to engage with members of the CBC and other lawmakers to inform the debate surrounding key legislation, including the Small Business 7(a) Lending Oversight Reform Act of 2018, regulatory requirements such as Section 1071 of the Dodd-Frank Act, and other public policies that affect minority entrepreneurship, economic development, and community revitalization.

COMMENT LETTERS

The Institute has submitted several comment letters to federal agencies. The first was submitted in response to an SBA request for comment regarding the reduction or elimination of unnecessary regulatory burdens and efforts to increase agency efficiency.[45] In our mission to improve the capital access pipeline to small businesses, we proposed action items such as expanding and making permanent the Alternative Size Standards to provide for greater certainty and to account for loan size when determining whether a small business qualifies for a program. This would include making the Community Advantage 7(a) Loan Program a permanent fixture and refining specific protocols, relaxing requirements for minimum SBIC capitalization thresholds to encourage smaller investments, and increasing the number of nonbank licenses with a specific low- and moderate-income focus.

We also submitted a series of recommendations and calls for clarification on the Consumer Financial Protection Bureau's (CFPB) efforts to bring transparency and information to the small business lending market through Section 1071 of the Dodd-Frank Act.[46] Efforts to address the data gap on small business lending could result in reduced product mismatch and more tailored technical assistance, enhanced responsiveness from local, state, and federal agencies, and reduced reliance on cookie-cutter underwriting processes.

Lastly, the Milken Institute responded to the CFPB's request for information regarding the use of alternative data and modeling techniques in the credit process.[47] Comments included a recognition that despite the inherent risks associated with the use of alternative data in the credit underwriting process, alternative data and modeling techniques are necessary considering the fact that a growing segment of the U.S. population is either underbanked or unbanked, and that relationship-banking is increasingly being replaced with automated credit scoring processes that fail to look beyond the FICO score or take into account the local economies within which small business operate.

RESEARCH AND INITIATIVES

In response to the 40th anniversary of the Community Reinvestment Act and our continued engagement with the CBC, the Institute initiated a series of meetings with stakeholders to determine what CRA policy should look like in the 21st century, given the proliferation of online, non-bank financing platforms and the continued consolidation of the traditional banking sector.

We have also engaged a third party to assess the role (and impact) of alternative data for small business credit underwriting purposes to produce potentially more accurate (and holistic) credit profiles. This work will inform the development of policy options for lawmakers and/or regulators to consider in efforts to redirect capital to credit-worthy small businesses.

The Institute is researching the potential impact of increasing minority depository institution equity capital and how it could translate to increased access to capital for minority-owned small businesses. Historically, MDIs have been a critical source of financial capital for low- to moderate-income

45. Kevin Klowden and Aron Betru. "Comment Letter to the SBA: Small Business Administration's Request for Information Aimed at Reducing Regulatory Burden," Regulations.gov, November 2017, https://www.regulations.gov/document?D=SBA-2017-0005-0254.

46. Jackson Mueller and Aron Betru, "Comment Letter to the CFPB for Information Regarding the Small Business Lending Market," Milken Institute, September 2017, http://www.milkeninstitute.org/publications/view/882.

47. Aron Betru and Jackson Mueller, "Comment Letter to the CFPB: Alternative Data and Modeling Techniques in the Credit Process," Milken Institute, March 2017, http://www.milkeninstitute.org/publications/view/861.

communities. However, today MDIs are significantly smaller in scale, limiting their ability to serve their communities. In order for MDIs to scale up their efforts, they require capital themselves—tier 1 equity capital in particular.

Finally, the 2017 Tax Cuts and Jobs Act established opportunity zones to encourage investment in low- to moderate-income communities through qualified opportunity funds, fueled by tax incentives. With more than half of the approximately 30 million residents in opportunity zones being minorities, this legislation offers potential to significantly increase jobs and accelerate wealth creation in areas that most need it by unlocking some of the nation's pool of unrealized capital gains, which are estimated to be more than $6 trillion. The Milken Institute is exploring the challenges and opportunities regarding the implementation of opportunity zones and opportunity funds.

Regionally, we are identifying local implementation barriers, including those created by regulation or tax policy, promoting regional and multi-sector collaboration to mitigate gentrification and displacement risks and maximize community development and job creation, and facilitating investment through qualified opportunity funds that leverage other economic development programs (LIHTCs, NMTC) and support local infrastructure and public works projects.

On the funding side, the Institute is exploring how investors can leverage different forms of capital (commercial and philanthropic) and gains (tax-advantaged and other) to optimize product features and returns, partnering with local institutions to execute high-potential investments in an efficient fashion, establishing impact metrics and measurement to protect against negative outcomes or criticism, and aligning with like-minded players—from other qualified opportunity funds, corporate project sponsors, and community development organizations—to create effective investment strategies.

MILKEN INSTITUTE EVENTS

At the 2016, 2017, and 2018 Milken Institute Global Conferences and Milken Institute California Summits, we held sessions where local stakeholders and government officials discussed ways to address the ongoing challenges in moving capital to underserved small business communities.

Milken Institute Center for Regional Economics Executive Director, Kevin Klowden, moderates a panel at the 2016 Milken Institute California Summit. SBA Administrator (2014 to 2017) Maria Contreras-Sweet joins the panel.

"Opening Up Capital Access for Underserved Small Businesses" moderated by Milken Institute Center for Financial Markets Managing Director, Aron Betru, at the 2017 Milken Institute Global Conference.

California State Assemblymember Autumn Burke (left) joins the panel for "Alternative Small Business Financing" at the 2017 Milken Institute California Summit. Milken Institute Center for Regional Economics Director, Carolyn Schulman, moderates.

CONCLUSION

Between the fall of 2016 and the fall of 2018, the Milken Institute, SBA, and hundreds of PLUM partners and participants rolled up our sleeves to understand and overcome minority small business capital access barriers.

The outputs around research, public policy, technical assistance, and lender engagement are meaningful and worthwhile contributions to this important issue. However, perhaps most enduring will be the relationships forged through the PLUM initiative. Already the connections made over the past two years are yielding new partnerships and expanded programming to better serve the capital-access needs of minority entrepreneurs and small business owners.

5 RESEARCH AND POLICY REPORTS

3 COMMENT LETTERS TO POLICYMAKERS

50+ WORKING GROUP MEETINGS

100s CONNECTIONS MADE

12 MATCHMAKING, NETWORKING, AND PANEL EVENTS

300+ ENGAGED PARTNERS AND PARTICIPANTS

> From our beginning in January 2017, our goal as an incubator was to grow through collaboration and partnering with other organizations. From the relationships established via the PLUM initiative we have made new partnerships and lasting relationships that are symbiotic in nature that foster that goal. For example, our recent Access to Capital 2.0 event was very successful partially based on the Milken Institute, SBA, and Los Angeles LDC partnering with us as presenters and co-promoters. In return, our Incubator has been able to help other organizations with their programming and referrals. A true win-win scenario. Thank you, PLUM.
>
> **—GARY POLK**
> **Executive Director, the Innovation Incubator at Cal State University Dominguez Hills**

Through our work on opportunity zones and minority depository institutions, the Milken Institute will continue our commitment to minority economic development. We also encourage local and national leaders to build on the PLUM foundation to advance solutions to increase access to capital for minority entrepreneurs and small business owners.

- Improve the evidence-base for action
- Address the structural limitations of minority small business lending
- Increase equity and patient capital in underserved markets
- Improve transparency and efficacy of small business lender engagement
- Expand small business market opportunities
- Customize technical assistance
- Coordinate economic development

Whether through policy or programming, taking on just one of these core strategies will go a long way towards growing the abundant and successful minority-owned small businesses needed to drive minority job creation, higher wages, and wealth accumulation.

ABOUT THE AUTHOR

Carolyn Schulman is a director at the Milken Institute Center for Regional Economics. An experienced strategist and manager, Schulman develops and oversees research and programming related to small business growth, capital access, and economic development. Previously, she held positions in public affairs and strategic communications at Finsbury and Ichor Strategies. Earlier, she served as director of policy for the Office of the New York City Comptroller, addressing economic development, pension reform, and education policies. Schulman started her career in community development at Citi, where she served on the Community Reinvestment Act team, working with Citi's retail, credit card, and investment banks to satisfy their regulatory obligations. She holds a B.A. from Brandeis University and a master's degree in public policy from The George Washington University.

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Joe Haskins, Jr., Chairman, President & CEO, The Harbor Bank of Maryland

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