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STRENGTHENING ACCESS TO CAPITAL FOR MINORITY-OWNED SMALL BUSINESSES

FIELD HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

SEPTEMBER 14, 2018

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STRENGTHENING ACCESS TO CAPITAL FOR MINORITY-OWNED SMALL BUSINESSES

FRIDAY, SEPTEMBER 14, 2018

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Baltimore, MD.

The Committee met, pursuant to notice, at 10:04 a.m., at Morgan State University Earl G. Graves School of Business and Management, Martin D. Jenkins Hall, Behavioral Science Center, Room 514, 1600 Havenwood Road, Baltimore, Maryland, Hon. Ben Cardin presiding.

Present: Senator Cardin.

OPENING STATEMENT OF HON. BENJAMIN L. CARDIN, RANKING MEMBER, A U.S. SENATOR FROM MARYLAND

Senator CARDIN. Good morning, everyone. Let me thank you all for being here.

Let me call to order the meeting of the Senate Small Business and Entrepreneurship Committee in this field hearing at Morgan State University, here in Baltimore. This is part of our oversight function of the Small Business and Entrepreneurship Committee, and today we will be talking about the source of capital for minority businesses. And I thank all the witnesses that are here.

I want to start by first acknowledging and thanking the leadership of our Chairman, Senator Risch, who authorized this field hearing. I serve as the lead Democrat on the Small Business Committee. Senator Risch is the Chairman. The two of us have worked very closely together through this Congress, and we are very proud that we have been able to produce several significant bills that have become law, and we have worked together on oversight of the SBA and small business. I particularly thank Senator Risch for his cooperation and for allowing this Committee field hearing to take place.

I want to acknowledge the staff that is here. From Senator Risch's office, we have Meredith West, Renee Bender, and J.R. Walker; and our Chief Clerk of the Committee, Kathryn Eden.

I also want to acknowledge from the Democratic staff, we have Sean Moore, Kevin Wheeler, Beth Bell, Olivia Nutter, Ellen Harrington, and Sean Bartlett.

On my staff, I want to thank Jerome Stevens. Whenever we are at Morgan, Jerome is going to be here with me. He is an incredible asset to our field operations as my outreach director, and I thank

you. And Carleton Atkinson, who is my Maryland director, is also with us today.

So we have a full staff that is with us. Steve Umberger is here, who is the SBA director in the Baltimore office. He is also my neighbor. We are both in the Bank of America building together, and I thank Steve. He does a great job in reaching out, getting as much input as we can and providing services to businesses. He was on the ground immediately every time we have had a significant crisis in our business community, Ellicott City being one that stands out, the great work that the SBA office here did in helping those businesses in Ellicott City.

Dr. Wilson will be with us shortly, and when he is here, I am going to ask the witnesses if we will interrupt for a moment so I can give him an opportunity. Dr. Wilson is the president at Morgan State University. Morgan State University is very proud of the work that they have done in leadership, innovation, and producing great leaders in minority-owned businesses in our community. There are several examples that we will be talking about today that owe their roots to their education at Morgan State University. So we are very, very pleased about that.

Again, I thank all the panelists. I thank the people that are here.

Let me just start, if I might. A friend of mine gave me this book to read, "They Call Me Little Willie." Now, for those of you who know Baltimore, we are talking about Willie Adams. He was a legend in our community, a person who was known as one of the great leaders in the black community in Baltimore.

I mention Little Willie because it is very relevant to the topic we are talking about today, access to capital by minority businesses, and Little Willie, Willie Adams, came to Baltimore from the South. He had virtually no education, but he was an entrepreneur. He had a brilliant mind for business, and just about every legal avenue for business was not available to him, coming to Baltimore in the 1940s.

So he decided the only way he could make some money was to run numbers. He was good at it. I mean really good at it. He understood numbers, and he was able within a relatively short period of time to establish the largest numbers business in Baltimore and basically was able to get capital. And he used that capital to help black entrepreneurship in Baltimore.

There are many, many examples, but probably the most prominent would be Henry Parks and Ray Haysbert with Parks Sausage, which was financed by Willie Adams to get started.

The other, which is known very well, is ANR with Theo Rodgers, and the rest is sort of history.

Now, many think he did a much better job on the use of lottery revenues in the states, doing today, but we will not go through that.

[Laughter.]

But it was the only avenue available to black entrepreneurs.

Now, we have come a long way since those days. We now have financing options available to minority businesses and women-owned businesses, but quite frankly, we still have a long way to go.

Many of you will recall this is my second term as Ranking Member of the Small Business and Entrepreneurship Committee. For a

brief period in 2015, I was the Ranking Democrat, and we held a field hearing at Bowie State University in 2015, talking about the barriers affecting minority-owned businesses.

As a result of that hearing, we did talk about the importance of the Fee Waiver Program under the 7(a) and how that helped minority businesses. We also talked about the SBA Microloan Program and its success rate in getting funds to small businesses, and we looked at the challenge at that time of the baby boomers selling their businesses and whether black entrepreneurs were going to be able to deal with that. And we looked at employee-owned businesses and other opportunities that we thought would be relevant in order to advance those issues.

Well, now I am Ranking Member of the Small Business Committee again, and I felt it was important to build on what we started in 2015, recognizing that America's strength is in our values. It is in our values. Our values are that every American, every person has the opportunities of this great Nation, and the fact that black owners do not have the same ability for capital is against the values of this Nation. We need to do something about it. That is who we are as a country. So that is one reason we need to look at access to capital.

Secondly, we know about the wealth disparity in this country. We know about the tremendous wealth disparity between the minority community, between women, and we need to bridge that gap.

Yesterday, I was at the Congressional Black Caucus when we looked at the issues of venture capital with start-up companies, and we looked at the disparities there. I commented then there is a reason why venture capitalists are not investing as much in black businesses. One reason is that you look at the senior leadership in venture capital, and only 2 percent are African American. So there are obstacles that are out there that we need to do something about.

And, yes, it is important because that is what is right about this country is to give opportunity to all, but it is also holding down the growth potential of this country when we hold down entrepreneurship in minority communities.

The fastest growing firms in the United States are owned by minority entrepreneurs. The great State of Maryland is no exception. In fact, Maryland is home to the highest average number of minority-owned businesses in the country and ranks second for minority-owned women businesses.

In 2012, minority businesses accounted for 38 percent of all Maryland small firms compared to 29 percent nationally. Despite this growth, gaps in key areas remain in Maryland's minority-owned and non-minority-owned businesses.

In 2012, minority-owned businesses created .8 jobs to the economy, compared to the non-minority community, 2.3 jobs. It shows that this gap, what is affecting our overall economy. If we could do better with access to capital to all businesses, we will grow our economy and create more jobs.

Non-minority-owned firms also reported gross receipts four times that of minority-owned businesses. This disparity, if we can bridge this gap, we can grow our economy. The gap results in part from

the significant obstacles that minority business owners face in accessing capital, including capital through contracting opportunities.

Here is what we know. Minority-owned businesses are two to three times more likely to be denied credit, more likely to avoid applying for loans because they believe they will be turned down from those lines, and are more likely to get smaller loans and pay higher interest rates and use non-conventional loan sources that are not as regulated.

Adding to these barriers, we know that banking consolidation has harmed small businesses lending in Baltimore. There has been a consolidation in banking. We all know that. We know how we have seen the conglomerates, these international firms. They are not as attuned to dealing with small businesses, minority businesses, women-owned businesses.

According to a recent report from Johns Hopkins—and we will have testimony on this from Mary Miller—bank deposits in Baltimore nearly doubled between 2007 and 2016, yet the number of small loans actually were less. So there has been a disconnect between the banking community and providing access to capital to small businesses. Access to capital matters because it correlates to hiring. Closing the wealth gap between minorities and non-minorities are fueling the general economy.

Based on the data from the National Small Business Association, there is a clear correlation between a small business' ability to get financing and its ability to hire. If minorities are not getting access to capital, the economy is losing job opportunity. All of us need to be interested in this issue for many reasons.

As Stanley Tucker testified in 2015 on this topic, "There is a direct correlation between the growth of these businesses, minority- and women-owned, and who they are. Minorities hire minorities; women hire women."

Entrepreneurship is one way to chip away at the wealth gap experienced in the minority communities, particularly in the black community.

The Small Business Administration has programs that exist to increase access to capital. They do a lot of good, and I support them, but some of these programs struggle to adequately serve minorities and have been struggling for some time.

In the 7(a) loan program—this is our premier program under the SBA, the one that gets the most attention—black business owners received only 4 percent of approvals and 2 percent of the dollars in FY 2017, despite owning 9 percent of the country's small businesses. That is unacceptable. Hispanic or Latino borrowers received only 8 percent of the 7(a) approvals and 6 percent of dollars, despite owning 12 percent of small businesses. We must do better.

In Baltimore, the lending environment is even more disparate, with black businesses receiving only 19 percent of approvals and 12 percent of dollars, despite owning 47 percent of businesses.

The SBA 504 program, which finances buildings and equipment, the longer-term financing critical for economic expansion of a business, a growth, that are poised to create or save jobs, also does a lot of essential financing in this country, but it consistently fails to reach black and Hispanic or Latino borrowers at the level equal to their business ownership.

Now, not all is bad. The SBA's Microloan Program and the 7(a) Community Advantage Pilot Program have shown promising results in reaching underserved communities, and I hope we will have a chance to talk about that. And I look forward to hearing more from our witnesses as to how these programs have been effective and what we can do to make the 7(1) and 504 programs more effective and reaching all audiences.

Lack of access to credit for minorities is not a new problem, and the trends show that this situation is not improving as quickly as it needs to do. We can and must do better.

Today, we will hear from witnesses who can talk about the programs I just mentioned. If the SBA programs are not working to adequately reach all Americans, I want to have a constructive exchange about how to make them better. I also want to hear about non-SBA products and services that are helping minority-owned small businesses in Maryland.

So, to our witnesses—and I really do thank you all for being here. This is an incredibly important topic, and I really do look forward to your testimonies and our exchange.

As is the Committee's practice, without objection, your full statements will be made part of our record. We would ask that you try to summarize, 5 minutes. We do not have a timer on. I think they forgot to bring the timer, but anyway——

Ms. WHEELER. Kathryn has——

Senator CARDIN. Oh, we do have a timer. I see. I am sorry. We have the old-fashioned timer, not quite as fancy as we have in our Committee room in D.C.

[Laughter.]

But we ask that you try to keep it within that range.

First, we will hear from Bill Manger, associate administrator of the SBA Office of Capital Access. Mr. Manger oversees the SBA loan program policy and oversight, managing a $120 billion portfolio of direct and guaranteed loans, nine operation centers, and 560 employees.

After Mr. Manger, we will hear from Dawn Medley, vice president of Business Finance Programs for FSC First, a nonprofit organization whose mission is to provide local, small, and minority-owned businesses in Prince George's County and the State of Maryland access to creative and innovative finance solutions through direct and indirect loans.

Following Ms. Medley's remarks, we will hear from John Lewis, who is executive vice president and chief administrative officer of The Harbor Bank of Maryland, the only Maryland-chartered, African American-owned and -managed commercial bank. We did not have Harbor Bank during Willie Adams' day, so that did not exist. The Harbor Bank is an important fixture in Baltimore, especially for the black business community, providing underserved entrepreneurs with SBA loans and business assistance, checking and savings accounts, and critical financial guidance. Mr. Lewis has over 20 years of experience in the financial services. So we welcome you here.

And lastly on this panel—we have two panels—we will hear from Marla Bilonick, the executive director of the Latino Economic Development Center, on the importance of SBA Microloan Programs

for business owners and particularly Latino business owners in the Baltimore area and D.C. She has led the LEDC's regional efforts to drive the economic independence and social advancement of working-class Latinos and minorities. LEDC is the second largest SBA micro lender in Maryland—and found out this week that they have been approved to participate in the SBA's 7(a) Community Advantage Pilot Program. That is critically important and one of the subjects we are going to talk about today because of the moratorium that has been put in place.

Congratulations for getting in under the wire. We would like to hear how you were able to achieve that.

I will hold the introductions of the second panel after we complete the first panel, and we will start with Mr. Manger.

STATEMENT OF BILL MANGER, ASSOCIATE ADMINISTRATOR, OFFICE OF CAPITAL ACCESS, U.S. SMALL BUSINESS ADMINISTRATION, WASHINGTON, DC

Mr. MANGER. Okay. Thank you to the members of the Senate Committee on Small Business for having me testify today. I would also like to thank Ranking Member Cardin for the opportunity to answer questions in his home State about SBA's loan programs and how they assist minorities with access to capital. Additionally, I would like to thank our hosts at Morgan State University for providing this beautiful venue.

As associate administrator for the SBA Office of Capital Access, it is my job to administer programs that make capital available to small business entrepreneurs who would otherwise be unable to access capital to start or expand a business through conventional means. Many of SBA's lending partners are community-based and have a particular focus on providing loans to veterans, women-owned businesses, minority-owned businesses, and businesses located in rural communities.

SBA has several programs that help minority entrepreneurs obtain access to capital, but the most common and widely known is the 7(a) loan program. This loan program offers guarantees on loans to small businesses of up to $5 million on reasonable terms and conditions that can be used for almost anything, including acquiring land, purchasing or constructing a building, purchasing equipment, or working capital. On loans up to $150,000, the guarantee is 85 percent of the value of the loan. For loans over $150,000, the guarantee is 75 percent.

For small businesses that need longer-term loans for fixed-asset acquisition, such as property, a building, or heavy equipment, SBA offers the 504 Loan Program. These loans are made available through Certified Development Companies, CDCs, which are SBA's community-based partners. The 504 loans are typically structured with a lender providing 50 percent of the cost of the project. The CDC is providing the next 40 percent—that is the 504 loan—and the borrower contributing the remaining 10 percent of the project cost.

The advantage of this program is that it provides terms of 10 years, 20 years, and, just introduced in April, 25 years, all at fixed interest rates. The addition of the 25-year term for the 504 pro-

gram offers borrowers an extra 60 months of financing, freeing up cash flow for the small business.

An example of a recent 504 loan being made to a local business owner right here in the Baltimore area is the $3.5 million loan that went to Laundry City West in June. The owner currently has plans to increase the number of his employees over the next 2 years.

Under Administrator McMahon's leadership, there has been growth in our smaller, including a record volume of dollars lent in our Microloan and Community Advantage Programs. Both the Microloan and Community Advantage Programs are designed to provide access to capital to traditionally underserved communities through mission-oriented lenders.

The SBA's Microloan Program offers small business loans of up to $50,000 from not-for-profit lending intermediaries. SBA makes funding available directly to the intermediaries which in turn lend to small businesses. The average size of a microloan in the program is just under $14,000.

The program has been very successful in filling a need for small loans. For example, in Fiscal Year 2017, the Microloan Program provided loans with reasonable interest rates to almost 5,000 small businesses. Year-over-year, we have seen a 5.6 percent increase in these loans, which created and/or retained an estimated 17,648 American jobs year to date. I would like to note here that over 8 percent of our microloan small business borrowers return to the SBA when seeking larger amounts of capital from one of our other loan guarantee programs.

In our Community Advantage Program, mission-oriented lenders can make SBA-guaranteed 7(a) loans of up to $250,000 for those small businesses that have capital requirements above the microloan limit of $50,000.

Currently, my office has implemented new collaborative efforts with our Office of Field Operations to increase the number of loans in both inner cities and rural areas. We have a goal to increase the number of loans by 5 percent in HUBZones and rural areas, and beginning October 1st, we are offering fee relief for 7(a) loans of up to $150,000 made in these specific areas.

We view this initiative and others such as the launch of our Lender Match tool last year as valuable ways to provide access to capital for minority entrepreneurs looking to attain the American dream. Lender Match is a technology platform that allows entrepreneurs to complete a quick online form, without registration or cost, in order to be connected with an approved SBA lender within 48 hours. Lender Match is an extremely useful tool to protect small businesses from non-regulated predatory lenders.

Another electronic platform we have developed for our lending partners who do not make a large number of SBA loans is SBAOne, which provides a step-by-step process for submitting a loan with an SBA guarantee.

Additionally, my office is working in collaboration with our Office of Field Operations to train our Lender Relations Specialists on how to better support our lending partners, encourage more lenders to use our programs, and provide first-class customer service.

As you can see, there is a lot of work being done at the SBA to help aspiring entrepreneurs everywhere. I am very proud of the

work we are doing at SBA and the strides we have made to make our programs as effective and efficient as possible.

Thank you very much for inviting me to testify here today, and I look forward to answering your questions.

[The prepared statement of Mr. Manger follows:]

Statement of William Manger
Associate Administrator
Office of Capital Access
U.S. Small Business Administration

before the
U. S. Senate Committee on Small Business and Entrepreneurship
at Morgan State University, Earl G. Graves School of Business and Management
Hearing on "Strengthening Access to Capital for Minority-Owned Small Businesses"
September 14, 2018

Thank you to members of the Senate Committee on Small Business for having me testify today. I would also like to thank Ranking Member Cardin for the opportunity to answer questions in his home state about SBA's loan programs and how they assist minorities with access to capital. Additionally, I would like to thank our hosts at Morgan State University for providing the venue.

As Associate Administrator for the SBA Office of Capital Access, it is my job to administer programs that make capital available to small business entrepreneurs who would otherwise be unable to access capital to start or expand a business through conventional means. SBA's loan programs have been helping small businesses get on their feet and grow for decades. Many of SBA's lending partners are community based and have a particular focus on providing loans to veterans, women-owned businesses, minority-owned businesses and businesses located in rural communities.

SBA has several programs that help minority entrepreneurs obtain access to capital, but the most common and widely known is the 7(a) loan program. The 7(a) loan program is a powerful tool for helping create and retain jobs for American workers. This loan program offers guarantees on loans to small businesses of up to $5 million on reasonable terms and conditions that can be used for almost anything including: acquiring land, purchasing or constructing a building, purchasing equipment, or working capital. On loans up to $150,000, the guarantee is 85% of the value of the loan. For loans over $150,000, the guarantee is 75%.

The SBA has established credit criteria and terms and conditions for loans made by its partnering lenders, including national banks, community banks, credit unions and other financial institutions. The SBA reduces risk for lenders and makes it easier for small businesses to get loans.

For small businesses that need longer-term loans for fixed asset acquisition, such as: property, a building, or heavy equipment, SBA offers the 504 Loan program. These loans are made available through Certified Development Companies (CDCs), which are SBA's community-based partners. The 504 Loan program is a powerful economic development loan program that offers small businesses another avenue for business financing, while promoting business growth, and job creation. 504 Loans are typically structured with a lender providing 50% of the cost of the project, the CDC providing the next 40% (that's the 504 loan), and the

borrower contributing the remaining 10% of the project cost. The advantage of this program is that it provides terms of 10 years, 20 years, and, just introduced in April, 25 years, all at fixed interest rates. This is especially important in a rising interest rate environment. The addition of the 25 Year term for the 504 Program offers borrowers an extra 60 months of financing, freeing up cash flow for the small business. An example of a recent 504 loan being made to a local business owner right here in the Baltimore area is the three and a half million dollar loan that went to Laundry City West in June. The owner currently has plans to increase the number of his employees over the next two years.

SBA Administrator McMahon and I understand how important access to capital is for a budding entrepreneur and how difficult obtaining small dollar loans can be. That is why we continue to stress to our lending partners that we want to see more small-dollar loans being made – and I'm pleased to report that we have seen that in the numbers. Under Administrator McMahon's leadership, there has been growth in our smaller loans, including record volume of dollars lent in our Microloan and Community Advantage Programs. Both the Microloan and Community Advantage programs are designed to provide access to capital to traditionally underserved communities through mission-oriented lenders.

The SBA's Microloan Program offers small businesses loans of up to $50,000 from not-for-profit lending intermediaries. SBA makes capital available directly to the intermediaries which, in turn, lend to small businesses. The average size of a microloan in the program is just under $14,000.

The program has been very successful in filling a need for small loans. For example, in Fiscal Year 2017, the Microloan Program provided loans with reasonable interest rates to almost 5,000 small businesses. Year-over-year, we have seen a 5.6% increase in these loans, which created and/or retained an estimated 17,648 American jobs year to date. Realizing the success of the program, Congress recently passed a law that increases the maximum ceiling for the SBA loan to microlending intermediaries from $5 million dollars to $6 million dollars. I would like to note here that over 8% of our microloan small business borrowers return to SBA when seeking larger amounts of capital from one of our other loan guarantee programs.

In our Community Advantage program, mission-oriented lenders can make SBA-guaranteed 7(a) loans of up to $250,000 for those small businesses that have capital requirements above the Microloan limit of $50,000.

Currently, my office has implemented new collaborative efforts with our Office of Field Operations to increase the number of loans in both inner cities and rural areas. We have a goal to increase the number of loans by 5% in HUBZones and rural areas, and beginning October 1st, we are offering fee relief for 7(a) loans of up to $150,000 made in these areas. We view this initiative and others such as the launch of our Lender Match tool last year as valuable ways to provide access to capital for minority entrepreneurs looking to attain the American dream. Lender Match is a technology platform that allows entrepreneurs to complete a quick online form, without registration or cost, in order to be connected with an approved SBA lender within 48 hours. To date, Lender Match has generated over 3.5 million leads on behalf of small businesses to our lenders; and over 146,000 unique borrowers have been contacted by lenders

with financing options. Lender Match is an extremely useful tool to protect small businesses from non-regulated predatory lenders. Another electronic platform we have developed for our lending partners who do not make a large number of SBA loans is SBAOne, which provides a step by step process for submitting a loan with an SBA guarantee.

Additionally, my office is working in collaboration with our Office of Field Operations to train our Lender Relations Specialists on how to better support our lending partners, encourage more lenders to use our programs and provide first-class customer services. It is important to Administrator McMahon and me that the SBA provides our lenders with a unified and consistent experience across the country.

As you can see, there is a lot of work being done at the SBA to help aspiring entrepreneurs everywhere. Our agency stands committed to help advance opportunities for the millions of American small businesses that contribute so much to our economy. These businesses bring economic development that makes an immeasurable difference in their communities. They hire American workers, and transform the landscape by invigorating entire neighborhoods or even entire industries. I am very proud of the work we are doing at SBA and the strides we have made to make our programs run as effectively and efficiently as possible.

Thank you for inviting me to testify here today and I look forward to answering your questions.

Senator CARDIN. Thank you very much.

I do also want to acknowledge that Ryan Dorsey is with us, the Councilman from this District. We thank you very much for being here.

And we also have a representative representing my colleague in the Senate, Chris Van Hollen, my partner, who does an incredible job on these issues, small business issues, so thank you very much.

I also want to acknowledge my colleagues in the House that represent this area—Elijah Cummings, John Sarbanes, and Dutch Ruppersberger—all strong proponents of small business.

And, lastly, I think I should mention Parren Mitchell, who chaired the House Committee on Small Business and provided great leadership for the small business community through his leadership in the House of Representatives.

Ms. Medley.

STATEMENT OF DAWN R. MEDLEY, VICE PRESIDENT OF BUSINESS FINANCE PROGRAMS, FSC FIRST, LARGO, MD

Ms. MEDLEY. Thank you again, Senator Cardin and members of the Committee on Small Business. My name is Dawn Medley, as stated before, and as the vice president of Prince George's Financial Service Corporation, also known as FSC First, I provide oversight of our loan administration team, which consists of five bankers, including myself, from various institutions like SunTrust, PNC, NCB, CitiFirst, BB&T, and SBA's OCRM and various Federal, State, and County State agencies.

And I also administer eight loan products, including the SBA Community Advantage Program. We market it as a Small Business Growth Fund and SBA 504.

Again, it is my pleasure to serve on this panel today because it is always a great day to speak about what is working to assist small business with access to capital and what can be done to further improve that effort.

FSC First has a 40-year successful track record in the industry. We were established in 1978 as a 501(c)(3) nonprofit organization and in 2000 was designated as a CDFI by the U.S. Treasury.

In 1982, 36 years ago—I was not there then.

[Laughter.]

Through the U.S. Small Business Administration, FSC was designated as a Certified Development Company, or CDC. We have been an SBA Community Advantage Lender now for 5 years, receiving our approval in 2013, and received Delegated Authority in March of 2017.

We also serve as a fund manager and lender service provider for a Microenterprise Fund; the Maryland Video Lottery Terminal, or VLT Program; the County's $50 million Economic Development Incentive Fund; the City of Bowie Revolving Loan Fund; and two Green Energy Programs, C–PACE and Green Energy Loan Guaranty Program.

Our business loan programs have assisted businesses that have created over 7,600 jobs in just the last 20 years. We operate very much like a community bank in that we fully underwrite all our loans and we retain the loans and service them from origination to maturity; however, we also focus on business sustainability. There

is no need in providing capital with terms so burdensome that they are impediments to healthy cash flow and liquidity at the outset of the business.

Our experience as a Community Advantage lender is that this program has been an invaluable asset to our ability to provide capital to small minority-owned business in Prince George's County Maryland. We could do more if we were not limited by having to provide loan loss reserves because our $4 million loan pool is limited to serving county-based businesses due to the funding source for those loan loss reserves.

Just this past fiscal year, we had to turn away or attempt to source another program, $3.4 million in applications from small minority businesses throughout Central and Southern Maryland across seven counties. We became a CA lender to better service this unmet need for capital but are still restricted from helping due to this requirement.

Still, without this guaranty provided by Community Advantage, we would not be able to utilize our loan pool at the rate we do now because our bank pool of participating lenders requires that we have a guaranty in order to lend. Nevertheless, we manage to do a very good job providing loans in our underserved communities utilizing CA where we can.

FSC's portfolio of CA loans is diverse, consisting of 100 percent of loans being made to minorities and 55 percent to women-owned businesses. Sixty-six percent of the loans are to black or African-owned businesses; 22 percent are to Asian-owned business, and 11 percent are to American Indian- or Alaskan Native-owned businesses.

Our industry mix is just as diverse, consisting of restaurants, food service and caterers, media and broadcasting, professional staffing, and construction.

Seventy-seven percent of our loans have been made in underserved markets, as defined by the SBA, creating 122 jobs and retaining 94 jobs.

The CA portfolio is quite healthy as well. FSC has experienced zero losses—no defaults, no charge-offs, no workouts, no liquidations. There is one caveat. One borrower filed for personal bankruptcy, which of course is a technical default of the loan documents, but continued to pay as agreed and paid the loan off early and in full.

Our borrowers realize that but for the Community Advantage loan guaranty, their business ownership and expansion dreams would not be possible, and so they have been diligent in being good stewards of the financing that has been made available to them.

Many of our businesses are startup or emerging businesses who have been turned away by banks. We manage risks starting with the application package, requiring a business plan, not a business paragraph, which includes a viable marketing strategy and financial assumptions based on current industry data and site location demographics.

A good business in a bad location can be just as detrimental as unrealistic revenue projections. We use common sense and best practice underwriting to give the business the best chance to be able to repay the loan, and we stay close to our borrowers through

site visits, financial statement and tax return analysis, and regular personal engagement, so we can try to detect any tremors in the business early enough to help.

We utilize this approach to be an instrument in eliminating barriers to capital and to graduate businesses to being bankable.

One of our borrowers, a media and broadcast company, has been able to expand nationally after receiving a $100,000 CA loan. Even though they had a collateral shortfall, she has paid her loan off 3 years early and is now bankable.

Prior to Community Advantage, the SBA 504 program was our organization's flagship program. It is our desire for it to be so again. We have obtained SBA authorizations for 90 loans in our 40-year history, most of them not in the recent past due to competition with banks utilizing the 7(a) program over the 504 program, increased regulations, increased compliance and reporting requirements, loan submission software limitations, and surprise new policies not clearly communicated or included in the SOP.

Even though SBA has been responsive to our inquiries and addresses our questions rapidly, the latter makes utilizing the program more difficult and is a barrier to making more loans and creating more jobs.

Of those 90 loans, only 29 were to minority-owned businesses and 12 were to women-owned businesses.

We would like the opportunity to increase 504 lending again as our pipeline and our target market areas are revealing many new possibilities.

FSC First specializes in blending our diverse loan products to create capital solutions for businesses that then create jobs and increase economic growth.

I thank you for the opportunity and for inviting me to testify today.

[The prepared statement of Ms. Medley follows:]

Dawn Medley, Vice President, Business Finance Programs
Prince George's Financial Services Corporation (FSC First)

Good Morning Senator Cardin and Members of the Committee on Small Business and Entrepreneurship. My name is Dawn Medley. I am the Vice President of Business Finance Programs with Prince George's Financial Services Corporation aka FSC First. As such I provide oversight of our Loan Administration team and all 8 loan products including SBA Community Advantage (aka as Small Business Growth Fund) and SBA 504. It is my pleasure to serve on this panel today. It's always a great day to speak about what's working to assist small businesses with access to capital and what can be done to further improve that effort.

FSC First has a 40 year successful track record in the industry. FSC was established in 1978 as a 501 c (3) non-profit organization and in 2000 was designated as a Certified Development Financial Institution (or CDFI) by the U.S. Treasury. In 1982, 36 years ago, through the U.S. Small Business Administration, FSC First was designated as a Certified Development Company (or CDC). We have been an SBA Community Advantage Lender for 5 years receiving our approval in March of 2013 and then received Delegated Authority in March of 2017. We are also serve as fund manager and lender service provider for a Microenterprise Fund, the County's $50 Million Economic Development Incentive Fund, the Maryland Video Lottery Terminal (VLT) Small Business FLEX Fund, the City of Bowie Revolving Loan Fund and 2 Green Energy Programs (C-PACE and Green Energy Loan Guaranty Program). Our business loan programs have assisted businesses that created over 7,600 jobs in the last 20 years. We operate very like a community bank in that we fully underwrite all our loans and we retain the loans and service them from origination to maturity; however, we also focus on business sustainability. There is no need in providing capital with terms so burdensome that they are impediments to healthy cash flow and liquidity at the outset of the business.

Our experience as a Community Advantage lender is that this program has been an invaluable asset to our ability to provide capital to small and minority owned business in Prince George's County Maryland. We could do more if we were not limited by having to provide loan loss reserves because our $4 Million loan pool is limited to serving Prince George's County based businesses due to the funding source for those loan loss reserves. Just this past fiscal year, we had to turn away or attempt to source another program for $3.4 Million in applications from small and minority businesses throughout Central and Southern Maryland across 7 Counties. We became a Community Advantage lender to better service this un-met need for capital but are still restricted from helping due to this requirement. Still without this guaranty provided by Community Advantage, we would not be able to utilize our loan pool at the rate we do now because our bank pool of participating lenders requires that we have a guaranty in order to lend. Nevertheless, we manage to do a very good job providing loans in our underserved communities utilizing CA where we can.

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Dawn Medley, Vice President, Business Finance Programs
Prince George's Financial Services Corporation (FSC First)

FSC First's portfolio of Community Advantage loans is diverse consisting of 100% of our loans being made to minorities and 55% to women-owned businesses. 66% of the loans are to Black or African owned businesses; 22% are to Asian-owned business and 11% are to American Indian or Alaskan Native owned businesses. Our industry mix is just as diverse consisting of restaurants, food service & caterers, media & broadcasting, professional staffing and construction. 77% of our loans have been made in underserved markets as defined by the SBA creating 122 jobs and retaining 94 jobs.

The Community Advantage portfolio is quite healthy. FSC has experienced zero losses. No defaults, no charge offs, no workouts, no liquidations. There is one caveat. One borrower filed for personal bankruptcy which of course is a technical default of the loan documents but continued to pay as agreed and paid the loan off early. Our borrowers realize that but-for the Community Advantage loan guaranty, their business ownership and expansion dreams would not be possible and so they have been diligent in being good stewards of the financing that has been made available to them.

Many of our businesses are start-up or immerging businesses who have been turned away by banks. We manage risks starting with the application package requiring a business plan, not a business paragraph, which includes a viable marketing strategy and financial assumptions based on current industry data and site location demographics. A good business in a bad location can be just as detrimental as unrealistic revenue projections. We use common sense and best practice underwriting to give the business the best chance to be able to repay the loan. We stay close to our borrowers through site visits, financial statement and tax return analysis and regular personal engagement, so we can try to detect any tremors in the business early enough to help. We utilize this approach to be an instrument in eliminating barriers to capital and to graduate businesses to being bank-able. One of our borrowers, a media & broadcast company, has been able to expand nationally after receiving a $100,000 CA loan that had a severe collateral shortfall has paid her loan off 3 years early and is now bank-able.

Prior to Community Advantage, the SBA 504 program was our organizations flagship program. It is our desire for it to be so again. We have obtained SBA Authorizations for 90 loans in our 40 year history most of them not in the recent past due to competition with banks utilizing the 7a program over the 504 program, increased regulations, increased compliance and reporting requirements, loan submission software limitations and surprise new policies not clearly communicated or included in the SOP. Even though SBA has been responsive to our inquiries and addresses our questions rapidly, the latter makes utilizing the program more difficult and is a barrier to making more loans and creating more jobs. Of those 90 loans, 29 (or 32%) were to minority-owned businesses and 12 (or 13%) were to women-owned businesses.

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Dawn Medley, Vice President, Business Finance Programs
Prince George's Financial Services Corporation (FSC First)

We would like the opportunity to increase 504 lending again as our pipeline and our target market areas are revealing many new possibilities.

FSC First's specializes in blending our diverse loan products to create capital solutions for businesses that then create jobs and increase economic growth.

I thank you for inviting me to testify today.

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Senator CARDIN. Quite an impressive record. Well done.

Mr. Lewis.

I should point out that Joe Haskins, the founder of Harbor Bank, is an alum of Morgan State University. I want to point that out.

STATEMENT OF JOHN LEWIS, EXECUTIVE VICE PRESIDENT AND CHIEF OFFICER, THE HARBOR BANK OF MARYLAND, BALTIMORE, MD

Mr. LEWIS. Well, on behalf of our chairman and chief executive officer, Joseph Haskins, Jr., thank you for inviting The Harbor Bank of Maryland to testify at today's field hearing.

My name is John Lewis, and I serve as executive vice president and chief administrative officer of The Harbor Bank of Maryland.

Founded in 1982, The Harbor Bank of Maryland is a Maryland-chartered commercial bank headquartered in Baltimore, Maryland. The Harbor Bank of Maryland is one of few Baltimore-based community banks and was founded in part to make capital available to creditworthy borrowers who were otherwise unable to access bank capital.

Our portfolio has always been reflective of Baltimore and all of its communities. A point of pride and distinction is that we have been recognized an unprecedented 12 times by the United States Treasury with the Bank Enterprise Award for demonstrating an increase in lending, investment, and service activities in distressed communities within our footprint.

The Harbor Bank of Maryland is a U.S. Treasury-designated Community Development Financial Institution, or CDFI, a designation which requires 60 percent or more of our loans to be made in low-income communities.

Our designation also lists our CDFI target populations as low-income communities in Greater Baltimore and African-Americans.

The Harbor Bank of Maryland continues to work with the U.S. Small Business Administration as a 7(a) lender, a two-time awardee under the Program for Investment in Microentrepreneurs, known as PRIME, the Baltimore co-chair of the Partnership for Lending in Underserved Markets along with the U.S. Small Business Administration and the Milken Institute.

Since its founding, The Harbor Bank of Maryland and its affiliates have been innovative in providing capital access, advice, and financial services to underserved areas throughout its regional footprint of Maryland; Washington, D.C.; and Northern Virginia. Its subsidiary, Harbor Financial Services, is the first community bank-owned investment subsidiary in the country.

Its holding company, Harbor Bankshares Corporation, expanded the organization's ability to provide gap capital by winning competitive New Market Tax Credits awards seven times for a total allocation of $299 million. Those awards have created over 4,000 jobs and attracted over $2 billion in investment into local projects which, by definition, would not have happened but for Harbor's investment.

The provision of capital has continued with the growth of Harbor's mission-based non-profit affiliate, The Harbor Bank of Maryland Community Development Corporation, also a U.S. Treasury-designated CDFI. This affiliate provides gap capital in forms which

range from patient debt capital to equity. Its innovations include the formation of an EB–5 Immigrant Investor Program Regional Center, the creation of the Minority Business Pre-seed Venture Capital Fund. It also has dedicated technical assistance and acceleration programs for small businesses, neighborhood community development corporations, nonprofits, and small real estate developers.

These programs are all housed in the Joseph Haskins, Jr. Center for Community and Economic Development, a 6,000-square-foot coworking space located at the headquarters of The Harbor Bank of Maryland.

Harbor expects to continue its innovations in providing capital to underserved markets with its platform for Opportunity Funds, which were created by the Tax Cuts and Jobs Act of 2017.

In September 2016, The Harbor Bank of Maryland began a 2-year pilot program called The Partnership for Lending in Underserved Markets, co-chairing this initiative again with the SBA and the Milken Institute.

I request that the two white papers produced by this initiative be officially added to the record.

Senator CARDIN. Without objection.

[The information appears in the Appendix on page 99.]

Mr. LEWIS. Thank you.

The "Partnership for Lending in Underserved Markets" generated the following key considerations for increasing capital access. The first was the observation that a committed local partner who knows the market and its players well is essential to advancing any capital access solution.

The Harbor Bank of Maryland reintroduced SBA 7(a) lending in calendar year 2018 and is currently on track to close 10 deals totaling approximately $5 million. The range of those deals is from $100,000 to $1.5 million.

Eighty-five percent of those deals are to minority-owned companies, and with this measured reentry, we have zero dollars on advertising to date. Harbor will close the year as one of the most active lenders in the market by deal size and by number of deals. This makes the point that community banks are essential to small business capital access solutions. Small banks lend to small businesses.

Expert knowledge of local market and submarket conditions allows banks to properly assess risk and provide capital where other banks may be challenged.

Another observation of the PLUM initiative was that minority businesses benefit from targeted networks that prioritize their needs.

In minority communities, providing access to capital often means confronting two challenges. The first challenge is having capital in the right form to provide to businesses. Debt is the wrong form of capital for many businesses with significant operating risk in underserved communities.

The second challenge is preparing businesses for capital. The SBA's offerings through SCORE and similar technical assistance programs are key to meeting the specific needs of minority busi-

nesses. Minority businesses, just like startups in Silicon Valley, often need supplements to their human capital.

The Harbor Bank of Maryland provides technical assistance through its various programs and co-working space. Those programs were greatly aided by the receipt of two operating grants from the SBA's Program for Investment in Microentrepreneurs. Those grants allowed us to service hundreds of businesses.

The third observation of the PLUM initiative was the lack of understanding of cultural factors as a major factor in the barriers to access to capital for black and Hispanic entrepreneurs and small business owners.

The Harbor Bank of Maryland is one of 21 remaining African American Minority Depository Institutions, or MDIs. MDIs are designated by the Federal Deposit Insurance Corporation. These institutions have a long history of providing private capital and advice to minority businesses.

According to a recent study, MDI branches are located in Census tracts with an average of 74 percent minority population. That is compared to 28 percent for all FDIC-insured institutions.

Our 80 employees are part of the fabric of this community, with a depth of access that comes from being born, schooled, churched, and accepted by its members. In fact, our Chairman and CEO, Joseph Haskins, Jr., is a graduate of this fine university we are in today.

A study by AEO cites three gaps which must be addressed to overcome capital access issues: the wealth gap, the credit gap, and the trust gap. Earning the trust of minority communities takes the demonstrated and enduring commitment to their success, health, and inclusion. It is frankly the one area of finance where past performance may be indicative of future results.

The last thing I will mention is there are policy solutions that serve as barriers to minority capital access. Relationships and partnerships with policy champions can be the difference between good ideas being executed and good outcomes happening.

There are many aspects of capital access that work. The CDFI Fund works. SBA programs that foster small business lending and waive fees work. The Program for Investment in Microentrepreneurs works. Their continued support by policy champions is essential.

We also believe that the Opportunity Zones created by the Tax Cuts and Jobs Opportunities Act creates an outstanding opportunity, but we also believe that similar to other programs and other challenges to capital access, without having the proper intermediaries, capital will not flow through that program to minority communities as well.

A recent study on the MDI industry demonstrates that MDIs have the highest percentage of small business loans to total assets but also have the lowest median capital-to-asset ratio.

Thank you for the opportunity to provide this testimony, and I welcome your comments and questions.

[The prepared statement of Mr. Lewis follows:]

John D. Lewis
Executive Vice President & Chief Administrative Officer
The Harbor Bank of Maryland

Chairman Risch, Ranking Member Cardin, and Members of the Committee, On behalf of our Chairman and Chief Executive Officer, Joseph Haskins, Jr., thank you for inviting The Harbor Bank of Maryland to testify at today's field hearing. My name is John Lewis and I serve as the Executive Vice President and Chief Administrative Officer of The Harbor Bank of Maryland.

The Harbor Bank of Maryland

Founded in 1982, The Harbor Bank of Maryland is a Maryland Chartered Commercial Bank headquartered in Baltimore, Maryland. The Harbor Bank of Maryland is one of few remaining Baltimore-based community banks and was founded, in part, to make capital available to creditworthy borrowers who were otherwise unable to access bank capital. Our portfolio has always been reflective of Baltimore and all of its communities. A point of pride and distinction is that we have been recognized an unprecedented twelve times by the United States Treasury with the Bank Enterprise Award for demonstrating increased lending, investment, and service activities in distressed communities within our footprint.[1] The Harbor Bank of Maryland is a US Treasury Certified Community Development Financial Institution ("CDFI"), a designation which requires greater than 60% of our loans to be made in low-income communities. Our designation also lists our CDFI target populations as low-income areas of Greater Baltimore and African-Americans. The Harbor Bank of Maryland continues to work with the US Small Business Administration as a 7(a) lender, two time awardee under the Program for Investment in Microentrepreneurs ("PRIME"), and Baltimore Co-Chair of the Partnership for Lending in Underserved Markets ("PLUM") along with the US Small Business Administration and the Milken Institute.

Since its founding, The Harbor Bank of Maryland and its affiliates have been innovative in providing capital access, advice, and financial services to underserved areas throughout its regional footprint of Maryland, Washington, D.C., and Northern Virginia. Its subsidiary, Harbor Financial Services, is the first community bank-owned investment subsidiary. Its holding company, Harbor Bankshares Corporation ("Harbor"), expanded the organization's ability to provide gap capital by winning competitive New Markets Tax Credit awards seven times for a total allocation of $299 million. These awards have created over 4,000 jobs and attracted over $2 billion in investment into local projects, which, by definition, would not have happened but for Harbor's investment. The provision of capital has continued with the growth of Harbor's mission-based non-profit affiliate, The Harbor Bank of Maryland Community Development Corporation, also a US Treasury designated CDFI. This affiliate provides gap capital in forms which range from patient debt capital to equity. Its innovations include the formation of an EB-5 Immigrant Investor Program Regional Center and the creation of the Minority Business Pre-seed Venture Capital Fund. It also has dedicated technical assistance and acceleration programs for small businesses, neighborhood community development corporations, non-profits, and small real estate developers. These

[1] BEA Distressed Communities are defined as those where at least 30 percent of residents have incomes that are less than the national poverty level and where the unemployment rate is at least 1.5 times the national unemployment rate.

programs are all housed at the Joseph Haskins, Jr. Center for Community and Economic Development, a 6,000 SF co-working space located at The Harbor Bank of Maryland's Baltimore, Maryland, headquarters. Harbor expects to continue its innovations in providing capital to underserved markets with its platform for Opportunity Funds, which were created by the Tax Cuts and Jobs Act of 2017.

The Capital Gap for Minority-Owned Small Businesses

In September 2016, The Harbor Bank of Maryland began a two-year pilot program, The Partnership for Lending in Underserved Markets, co-chairing the initiative with the US Small Business Administration and the Milken Institute. I request that the two white papers produced by the initiative ("Phase I Summary: Developing Action-Oriented Solutions to the Financing Challenges Facing Minority-Owned Small Businesses" and "Phase II: Summary Lessons Learned for Advancing Minority Small Business Capital Access") be added to the record.

Data shows a persistent gap in the percentage minority small employer firms and their employees relative to percentages of the U.S. Population. In 2012 Blacks comprised 13.1% of the population and only 2.1% of small employer firms and 1.9% of employees. Hispanics comprised 16.9% of the population and only 5.6% of small employer firms and 4.5% of employees.[2] Conversely, non-minorities comprised 62.9% of the population and 80.9% of small employer firms and 84.6% of employees.[3] This under-indexing of minority business ownership and employment is relevant to our discussion of the capital gap for two primary reasons. First, community wealth disparities lead to major disparities in access to critical early-stage equity that can be leveraged to grow businesses and share risk. A Stanford Institute for Policy and Economic Research Study on Access to Capital for Minority-Owned Startups calculated the average outside equity of a black-owned business to be $500 at founding as compared to $18,500 for a white-owned business.[4] Another reflection of the disparity in access to outside equity is the fact that the median net worth of black business owners is (most likely by necessity) twelve times that of black non-business owners.[5] The second reason why the under-indexing of minority businesses is relevant is because it is reflective of the disparity in the flows of capital and resources to minority entrepreneurs to successfully grow their businesses. Across the capital spectrum, minorities show relatively smaller levels of capital access. For example, 1% of venture capital dollars go to African Americans, as compared to 87% going to non-minorities.[6] 2.5% of US Small Business Administration 7(a) approvals went to African Americans and 67.9% went to non-minorities.[7]

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[2] Small businesses employ half of the country's private sector workforce and have created approximately 60 percent of net new jobs since 1995.

[3] Karo, Carolyn, "Phase I Summary: Developing Action Oriented Solutions to the Financing Challenges Facing Minority-Owned Small Businesses" Partnership for Lending in Urban Markets. Milken Institute, September 2017.

[4] Fairlie, Robert, "Black and White: Access to Capital among Minority-Owned Startups" Stanford Institute for Economic Policy Research, 15 December 2016

[5] Gorman, Ingrid, "The Tapestry of Black Business Ownership in America: Untapped Opportunities for Success" Association for Enterprise Opportunity, 16 February 2017.

[6] American Sustainable Business Council, Fact Sheet: *Closing the Funding and Opportunity Gaps for women and Minority-Owned Businesses* (2015)

[7] Dilger, Robert, Congressional Research Service, Small Business Administration 7(a) Loan Guarantee Program, 27 June 2018

These factors affect the ultimate growth and success of minority businesses. A recent research report showed 28.4% of Black business owners responding reported that the lack of access to capital negatively impacted their profits, as compared to 10.1% of white respondents. It also showed 22.6% of Black business owners responding reported that the cost of capital negatively impacted their profits, as compared to 10.6% of white respondents.[8] Undercapitalization is also a leading cause of business failure.[9]

Recommendations for Improving Access to Capital for Minority-Owned Small Businesses

The Partnership for Lending in Underserved Markets generated the following key considerations for increasing capital access:

1. "A committed local partner, who knows the market and its players well, is essential to advancing any capital access solution"[10]

The Harbor Bank of Maryland reintroduced SBA 7(a) lending in calendar year 2017 and is currently on track to close ten deals totaling approximately $5 million (with deal sizes ranging from $100,000 to $1,500,000). Over 85% of those loans are to minority-led companies based in Baltimore. Even with this measured reentry (we have spent $0 on advertising to date), Harbor will close the year as one of the most active lenders in the market by number of deals. Community banks are essential to small business capital access solutions; small banks lend to small businesses. Expert knowledge of local market (and sub market) conditions allows banks to properly assess risk and provide capital where other banks may be challenged.

2. "Minority businesses benefit from targeted networks that prioritize their needs"[11]

In minority communities, providing access to capital often means confronting two challenges. The first challenge is having the capital (in the right form) to provide to businesses. Debt is the wrong form of capital for many businesses with significant operating risk in underserved communities. The second challenge is preparing the businesses for capital. The SBA's offerings through SCORE and similar technical assistance programs are key to meeting the specific needs of minority businesses. Minority businesses, just like start-ups in Silicon Valley, often need supplements to their human capital. The Harbor Bank of Maryland provides technical assistance through its various programs and co-working space. Those programs were greatly aided by the receipt of operating grant funding through the SBA's Program for Investment in Microentrepreneurs ("PRIME"), allowing Harbor to impact hundreds of local small businesses.

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[8] Robb, Alicia, "Startup Financing Trends by Race: How Access to Capital Impacts Profitability" Annual Survey of Entrepreneurs Data Briefing Series. Ewing Marion Kauffman Foundation, October 2016.
[9] "Venture Capital Demographics," CB Insights, *available at* https://www.cbinsights.com/blog/venture-capital-demographics-87-percent-vc-backed-founders-white-asian-teams-raise-largest-funding/
[10] Karo, Carolyn, "Phase II Summary: Lessons Learned for Advancing Minority Small Business Capital Access" Partnership for Lending in Urban Markets. Milken Institute, May 2018.
[11] Ibid.

3. "The lack of understanding and recognition of cultural factors is a major barrier to capital access for Black and Hispanic entrepreneurs and small business owners"[12]

The Harbor Bank of Maryland is one of 21 remaining African American Minority Depository Institutions ("MDIs"). MDIs are designated by the Federal Deposit Insurance Corporation ("FDIC"). These institutions have a long history of providing private capital and advice to minority businesses. According to a recent study, MDI branches are located in census tracts with an average of 74% minority population, as compared to 28% for all FDIC insured depository institutions.[13] Our 80 employees are part of the fabric of this community, with the depth of access that comes from being born, schooled, churched, and accepted by its members. In fact, our Chairman and CEO, Joseph Haskins, Jr. is a graduate of this fine University, Morgan State University, where we are gathered today. A study by AEO cites three gaps which must be addressed to overcome access to capital issues: wealth gap, credit gap, and trust gap.[14] Earning the trust of minority communities takes the demonstration of enduring commitment to their success, health, and inclusion. It is the one area in finance where past performance may be indicative of future results.

4. "There are policy solutions to minority barriers to capital access . . . relationships and partnerships with policy champions can be the difference between good ideas and executed outcomes"[15]

There are many aspects of capital access that work; however, many of these areas are continually challenged. The CDFI Fund and its programs (Bank Enterprise Award, New Markets Tax Credits, Bond Guarantee Fund, Financial Assistance/Technical Assistance Awards) work. SBA programs fostering small dollar lending and waiving fees work. The Program for Investment in Microentrpreneurs works. Their continued support by policy champions is essential. Harbor Bankshares Corporation also believes that the Opportunity Zones created by the Tax Cuts and Jobs Act of 2017 will bring catalytic market-based capital to low income communities and small businesses. While there is significant discussion around "guardrails" to somehow manage the distribution of market-based capital, our experience informs us that similar to the challenges of capital access in other capital markets, the solution to ensuring the funds get to minority small businesses is a matter of ensuring the proper intermediaries have access to opportunity fund capital. Accordingly, sound policy would make certified minority depository institutions eligible opportunity fund investments, by rights. A recent study on the MDI industry demonstrates that MDIs have the highest median percentage of small business loans to total assets (as compared to all financial institutions), but have the lowest median capital-to-asset ratio.[16]

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[12] Ibid.
[13] Barth, James "Minority-Owned Depository Institutions: A Market Overview" Access to Capital. Milken Institute, July 2018.
[14] Gorman, 26.
[15] Karo, vi.
[16] Barth, 29.

5. Data challenges may yield information that is insufficiently localized to be instructive. Moreover, "there is little demographic data on groups such as women and minority small business owners and their ability to access capital"[17]. "Supplementing the information with community insights and local knowledge and expertise will further facilitate identifying gaps and opportunities for minority business owners."[18]

Most of the organizations providing loans and investments to minority small businesses do not have research arms. They are subject to different reporting requirements than are large lenders, and they spend their time looking for opportunities, underwriting them, writing checks, and managing their portfolios. Much better efforts need to be made at getting their side of the story, both quantitatively and qualitatively. Across the country (and Baltimore is no exception), entire communities had their stories told by others for generations. It is no coincidence that these same communities have also been neglected by capital markets for generations.

I am pleased to continue this dialog with this committee to help form additional policies that support strengthening access to capital for minority-owned small businesses. Thank you for the opportunity.

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[17] The State of Small Business Lending: Innovation and Technology and the Implications for Innovation. 2016. Karen Gordon Mills (former SBA Administrator) and Brayden McCarthy. Harvard Business School. Working Paper.

[18] Caro, vi.

Senator CARDIN. Thank you very much for your testimony.

We will turn now to Ms. Bilonick.

STATEMENT OF MARLA BILONICK, EXECUTIVE DIRECTOR, LATINO ECONOMIC DEVELOPMENT CENTER, WASHINGTON, DC

Ms. BILONICK. Thank you.

Good morning. My name is Marla Bilonick, and I am the executive director of the Latino Economic Development Center, best known as LEDC. Thank you very much, Senator Cardin and the Committee on Small Business and Entrepreneurship for having me here today.

LEDC is a 27-year-old organization with the mission to drive the economic and social advancement of low- to moderate-income Latinos and other underserved communities in the D.C. and Baltimore Metropolitan Areas by equipping them with the skills and tools to achieve financial independence and become leaders in their communities.

We operate out of five offices in the region, with over 40 professional and bilingual staff providing top-notch services to our clients.

On an annual basis, we serve well over 4,000 low- to moderate-income residents. Scanning all of our programs, the majority of our clients are Latino at 60 percent. A sizeable portion are African American at 30 percent, and the remaining portions are white/Caucasian and Asian at 10 percent.

Our core asset-building programs are Housing Counseling, Affordable Housing Preservation; Small Business Capacity Building; and Small Business Lending, which will be the focus of my conversation today.

We are a SBA micro-lending intermediary and a certified Community Development Financial Institution. LEDC receives support for our lending services from partners including the SBA, CDFI fund or Treasury, private corporations, and philanthropic foundations.

Since we began lending in 1997, we have rolled out more than $15 million in capital in the form of over 1,200 small business loans. We have provided small business technical assistance services to thousands of aspiring and existing small business owners in the region. Last year, LEDC distributed close to 200 loans in the communities we serve.

Until recently, our loan products ranged from $500 to $2,000 on the consumer side and up to $50,000 for small businesses as an SBA micro lender.

So, for 20 years, we were limited to the $50,000 threshold, despite significantly rising costs of doing business in the neighborhoods where we operate.

In 2015, we were awarded a Community Economic Development Grant through the Department of Health and Human Services that allowed us to pilot lending to restaurants at the up-to-$100,000 level. This program has been wildly successful, as we have disbursed $300,000 to four businesses that have created over 100 jobs. These loans are performing, despite representing the highest-risk industry that we lend to.

Just 2 days ago, as you mentioned, we were informed that we have been approved as a SBA Community Advantage Lender. We are extremely pleased and eager to provide larger loans to our clients. The demand is there. While we do not have plans to abandon our core micro-lending business, we know that there is a market of clients with growing businesses that have graduated out of our micro-lending program and/or whose capital needs exceed our prior $50,000 threshold.

For example, Mobtown Fermentation, a Baltimore-based kombucha company on a growth trajectory that could further their market expansion through an additional capital injection. Between 2015 and 2016, they grew by 253 percent and continue to show remarkable growth of over 100 percent year over year.

They were capped at our $50,000 maximum loan amount when they received a loan from LEDC in January. However, they could use additional funding to expand outside of the Maryland, D.C., and Virginia markets where they currently have their products in 250 stores. They have their sights set on Pennsylvania, New Jersey, and New York, but they will not get there by patch-working together the microloans and the occasional pitch competition prize money they may win. Traditional bank financing has eluded them as a young start-up.

We currently have a pipeline of a dozen businesses like Mobtown that we will be putting on track for Community Advantage loans, now that we have the capacity to serve them. The Community Advantage Program is of utmost importance to scaling and supporting our small business communities.

While there is a pervasive belief that CDFIs and other community lenders are less equipped to underwrite and service larger loans, I would respectfully beg to differ. At LEDC, we have a team of 20 staff dedicated to underwriting, risk management, portfolio servicing, and providing advisory services available to our borrowers. We have a centralized underwriting function and staff designated to the sole task of monitoring our portfolio and managing risk. Each loan is underwritten to an internal algorithm that assesses factors including loan to value, cash flow, available collateral, business and personal credit profile, among other factors.

Using this algorithm, we assess each transaction with a grade reflecting its level of risk. Our current portfolio at risk, measured as loans late for over 30 days, is at 5.1 percent, with an annual write-off rate that oscillates between 2 and 2.5 percent.

We achieve these metrics by having an in-house loan servicing team working closely with clients and tracking closely the financial performance of their ventures, including providing business advisory support where needed.

We are doing deals that commercial banks would run from. However, our intensive underwriting process, coupled with constant attention to each deal and each client, keeps our loans performing and our portfolio sound.

The Community Advantage Program is a critical product for a specific set of our clients. The communities we serve deserve access to a full range of financial products that can be tailored to their needs, rather than having to tailor and compromise their needs to fit a limited set of offerings.

I am appreciative of the opportunity to testify and be with you today as well as your consideration of my perspective from the front line.

[The prepared statement of Ms. Bilonick follows:]

www.ledcmetro.org
@ledcmetro

September 14, 2018

Good morning, my name is Marla Bilonick and I am the Executive Director of the **Latino Economic Development Center,** best known as ***LEDC.*** Thank you very much for the opportunity to discuss the SBA's *Community Advantage* Program with you today.

LEDC is a 27-year old organization with the mission to drive the economic and social advancement of low-to moderate-income Latinos and other underserved communities in the D.C. and Baltimore Metropolitan Areas by equipping them with the skills and tools to achieve financial independence and become leaders in their communities. We operate out of 5 offices in the region, with over 40 professional and bilingual staff providing top-notch services to our clients. On an annual basis we serve well over 4,000 low- to moderate-income residents. Scanning all of our programs, the majority of our clients are Latino (60%) and a sizeable portion are African-American/Black (30%). The remaining portions are White/Caucasian and Asian (10%). Our core asset-building programs are: Housing Counseling, Affordable Housing Preservation; Small Business Capacity Building; and Small Business Lending. We are a SBA-Microlending Intermediary and certified Community Development Financial Institution. LEDC receives support for our lending services from partners including the SBA, CDFI Fund (Treasury), private corporations, and philanthropic foundations.

Since we began lending in 1997, we have rolled out more than $15 million in capital in the form of over 1,200 small business loans. We've provided small business technical assistance services to thousands of aspiring and existing small business owners in the region. Last year, LEDC distributed close to 200 loans in the communities we serve.

Until recently, our loan products ranged from $500-$2,000 on the consumer side and up to $50,000 for small businesses. So, for 20 years, we were limited to the $50,000 threshold, despite significantly rising costs of doing business in the neighborhoods where we operate. In 2015, we were awarded a Community Economic Development grant through the Department of Health & Human Services that allowed us to pilot lending to restaurants at the up to $100,000 level. This program has been wildly successful as we have disbursed $300,000 to four businesses that have created over one hundred jobs. These loans are performing, despite representing the highest-risk industry that we lend to.

Just two days ago, we were informed that we have been approved as a SBA Community Advantage Lender. We are extremely pleased and eager to provide larger loans to our clients. The demand is there. While we do not have plans to abandon our core microlending business; we know there is a market of clients with growing businesses that have graduated out of our microlending program and/or whose capital needs exceed our prior $50,000 threshold.

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For example, Mobtown Fermentation, a Baltimore-based kombucha company on a growth trajectory that could further their market expansion through an additional capital injection. Between 2015 and 2016 they grew by 253% and continue to show remarkable growth of over 100% year over year. They were capped at our $50,000 maximum loan amount when they received a loan from LEDC in January. However, they could use additional funding to expand outside of the Maryland, D.C., and Virginia markets where they currently have their products in 250 stores. They have their sights set on Pennsylvania, New Jersey, and New York. But they won't get there by patch working together microloans and the occasional pitch competition prize money they may win. Traditional bank financing has eluded them as a young start-up.

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-Marla Bilonick, *Executive Director*

Senator CARDIN. Thank you very much for your testimony.

We have been joined by Dr. Wilson, who is the president of Morgan State University, one of the great educators in our country and doing a great job at Morgan. One of the things I like about Dr. Wilson is the way that he works very closely with this community and recognizing that the growth of the community and both Morgan are indeterminately intertwined.

So thank you for your leadership, and we would welcome if you would like to make a comment, fine, but I just really wanted to thank you.

STATEMENT OF DR. DAVID WILSON, PRESIDENT, MORGAN STATE UNIVERSITY

Dr. WILSON. Thank you, Senator.

Good morning, everyone. First of all, let me thank you, Senator Cardin, for creating this opportunity here, so we can hear, you can hear, and the Senate can hear from small business owners and entrepreneurs. We certainly have appreciated your support of Morgan's growth and maturation and the role that we play here in spurring economic development.

We have the Earl G. Graves School of Business and Management here, and out of that school, we have an entrepreneurship program. We recently partnered with Goldman Sachs, and there are 10,000 small businesses programmed that are unfolding here in Baltimore.

We have graduated three cohorts of entrepreneurs now out of that program, and so we are delighted that you are creating this opportunity to hear from small business owners and entrepreneurs as to really what they need in order to grow that business, so that businesses can continue to employ more individuals in our city and in our region.

I do know that our honorable mayor, Catherine Pugh, wanted to be here today. She had an unfortunate conflict, but Mayor Pugh is a two-time graduate of Morgan. She also has an MBA from Morgan and started her own businesses along the way. So on behalf of our mayor and on behalf of the entire Morgan State University community, welcome to our university.

Senator CARDIN. Thank you, Dr. Wilson. I appreciate it very, very much.

[Applause.]

Mr. Manger, I would like to start with a question to you, and I want to put this in context. You rightly so have showcased the Microloan Program and the Community Advantage Program as to the success in reaching underserved communities, minority businesses, and how you have been reaching out to improve the programs themselves to meet the mission of the SBA. And that is noted.

Administrator McMahon is well respected in our Committee. She has been very vocal about her commitment to make sure that the programs are diverse and fairly representative of this country.

So I put that in context to three decisions that were recently made by the SBA that I am having a hard time understanding how they fit into the mission.

So let me start with the Community Advantage Pilot Program, but I also will want to get on the record the fee waiver changes

that are being suggested in the 7(a) program, also your mission rating, withdrawal of the mission-rating process.

Mr. MANGER. Mm-hmm.

Senator CARDIN. But we have had a lot of testimony from all these witnesses on the Community Advantage Pilot Program and the importance of that program.

Administrator McMahon, when asked about that program, was very complimentary about it. Recognizing that it is through 2020, we have been trying to make it permanent, she suggested that we wait until closer to 2020 before making those decisions so that we can properly evaluate it.

So we were surprised to learn of modifications that were put in to the program by the SBA that could very well affect its ability to reach underserved communities. Can you just share with us the changes? One is to put a moratorium on additional certifications. As you have heard here, there are some questions about additional needs in that regard.

Mr. MANGER. Mm-hmm.

Senator CARDIN. Another dealt with increasing the reserve, and one of our witnesses already said the reserve is hampering her ability to make loans. The other deals with the size of the loan and different communities.

So there were changes that were made. Can you just go over the rationale for that and whether there is now a change in SBA's position on whether we should try to make this permanent? You extended it for 2 years to 2022, but perhaps we should be looking at making it permanent.

Mr. MANGER. Sure. So let me start by saying, Senator Cardin, that Administrator McMahon and I are very committed to seeing the Community Advantage Program succeed. As you know, it has been a pilot program for several years now, and we want to do everything we can to make it strong and bolster it so that it does have long-term sustainability. And we want the additional time that we have called for. It is actually 2 years that we have called for it. It was to expire in March. We are letting it go through the end of the fiscal year to September 30th, 2022. We want to make sure that we have the time to adequately observe the performance of the program based on some of the changes that we have made.

And let me just go into some of the changes that we have made. We have extended the pilot, as I said, by 2 years. I want to say that we did take a suggestion actually that John Lewis made, and it was actually incorporated before we even heard from John today, that we have now expanded the "underserved market" definition to include opportunity zones. So that is an expansion of the areas that the loans may be used in.

The eligibility for delegated status will be contemplated after seven loans are made. Right now, we are able to look at a lender and see after five loans if they should be given delegated status, which is very important. We have decided that we would like to see two more loans be disbursed before delegated status is reached because we have seen some earlier issues, not with any of the programs of my colleagues here on the panel—and they have spoken to their performance, but we had a report done in conjunction with Dunn and Bradstreet, which I brought a copy of here today, that

shows that there are some lenders in the program that are stressed and seeing stressed portfolios that are affecting the program. So we want to take steps to make it as strong as possible so that we can eventually take it to permanency, just a couple of things that we are doing here.

So we have also looked at the credit scores, credit scores of 139 or lower on scores show a much more significant problem, three times as great as loans that are at 140.

So what we are saying is for those Community Advantage lenders that want to make a delegated loan, the lowest they can go is 140. If they want to go below that, we will let them do that, but they have to go through our centers for SBA staff to underwrite as opposed to just doing it delegated on behalf of the lender.

So, again, it is just a change to try and tighten up where we have seen and identified numerically where we have seen some issues.

We have increased the loan loss reserve correct on only the portion—on only the portion that is sold in the secondary market.

When this program was first developed, actually, it was prohibited to sell these loans in the secondary market, and in fact, initially, under the Obama administration when this program was rolled out, the loan loss reserve was 15 percent. It was lowered to 5 percent for the portion that is not sold in the secondary market, and the portion that is sold in the secondary market went down to 3 percent when they allowed them to be sold in the secondary market.

All we are asking is to increase that on the sold in the secondary market by 2 percentage points to 5 percentage points, so it is going to be 5 percent across the board. It is still lower than the program started with under the previous Administration, and the reason why we are doing that is because any loans that are sold into the secondary market, the SBA must make the money available to the investor who is holding that loan immediately before we can take any recovery. So we think that by adding an additional 2 percent that it will be in the loan loss reserve will help us be able to have some of that money to, again, pay the investor that has the loan on the secondary market.

Most importantly, actually we took some steps here that I think the Community Advantage lenders should be appreciative of as well as our small business borrowers. We are limiting the fees that may be charged to a borrower, and we are also limiting the fees that a lender service provider can charge a Community Advantage lender because we have seen—again, the reports show it—that there have been some very stiff fees charged to not only borrowers but then to Community Advantage lenders who use a lender service provider. And we want to limit that because that is not the point of the program. We want to make sure we are getting capital out to small businesses. We do not want people to take huge fees away from the small business borrower or the Community Advantage lender.

So these are steps that we are taking to strengthen the program. We want the additional time to observe the program with these changes in hopes that then, yes, we will be able to make the program permanent.

Senator CARDIN. Thank you.

We were just somewhat taken aback that the changes were made when we thought all that would be made when the decision on permanency was made.

Each of our other panelists have talked somewhat about different changes. Ms. Medley, you mentioned the reserve as affecting your ability to make loans. You have had a perfect record, and yet—so you were, I think, arguing that the reserves could even be lower. So I do not know if you want to comment or not about the increase from 3 to 5 percent in regards to part of these loans.

Ms. MEDLEY. Thank you, Senator Cardin.

The reserves, the regular reserves that you must have on the portfolio at 5 percent are a challenge enough.

When we explored selling loans on the secondary market, our analysis at the lower loan loss reserve amount was that it made no economic sense for our organization to be in the secondary market because of the additional reserves.

If they are higher, there is no way that we would ever get to the point where we would be able to sell loans on the secondary market, which does improve cash flow. But when we did the long-term analysis on whether we should sell the loans or keep them in portfolio and just continue in that direction and not sell, it was more cost effective for us not to sell in the secondary market because of the reserve amount. And, certainly, with them increasing, there would be no possibility in the near future.

Senator CARDIN. Mr. Lewis, you mentioned the gaps that we have in regards to minority communities. You mentioned the gaps on wealth and on trust, but you also mentioned it on credit.

Here, we are talking about increasing the credit score for participation. Does that present a problem as you see it?

Mr. LEWIS. So, generally, when we look at credit scores, particularly with entrepreneurs, anyone who has walked that path knows when you are starting a business, you do what you do to keep the business going, right? And that in itself, if you are starting from a position of not having wealth and your own cushion and not having family and friends and other investors, means that sometimes you may have a history of paying some bills slow. You may still pay them, but you may pay them slow.

And that walk in that progression, certainly from someone who is not starting from a position of strength, would say by the time you get to actually having a successful business that is ready to grow, that is ready to meet with a lender or CDFI, that experience getting up to that point may have impaired your credit.

And it speaks—a lot of the work that we do is not formulaic. It is relationship based. It is getting to understand borrowers, not only where they are going, but where they have been. And that relationship base basis of doing your underwriting and considering credit diminishes the importance of credit scores and things holistically about the opportunity to lend.

But, certainly, anything that speaks to raising the required credit scores will be punitive to borrowers ultimately.

Senator CARDIN. Ms. Bilonick, my numbers show there are 113 Community Advantage providers. I do not know if that includes you or not, so maybe it is 114.

Ms. BILONICK. Probably not.

[Laughter.]

Senator CARDIN. And they are located in 39 states.

But my information also shows that we do have regional gaps in having the availability of these programs. With a moratorium being imposed, if it was imposed last week, you would not be eligible.

From the Latino community, which is an emerging community in so many parts of the country, do we have enough CA-authorized providers to make these loans, or will the moratorium have an impact? There is a growing change in this country.

Ms. BILONICK. I will say that I do not know the geographic disbursement of the current CA lenders to make an educated answer for that question, but I would imagine that it will have an impact on minority communities that need this financing to be able to successfully grow their businesses.

You know, apologies for not knowing this correct scenario.

Senator CARDIN. No, no. But the Latino community seems to be a growing community.

Ms. BILONICK. Absolutely.

Senator CARDIN. And the fact that you just got certified points out that there is a growing need in the community——

Ms. BILONICK. Definitely.

Senator CARDIN [continuing]. And trying to be filled. My concern is that imposing a moratorium freezes the CA lenders that we currently have.

In the Latino community, it seems like it is a more dynamic community that may not now be able to get a CA lender in order to take advantage of this program.

Ms. BILONICK. I think that is absolutely right.

And I did want to just also add onto what John was saying. I think the other issue in terms of credit score that our clients have is not only late payments but using sort of—as I said, patch-working together alternative methods so that they can put together what does not exist in the market, which is the funding that they need.

So they may be overleveraged, which is bringing their credit score down, just because they have maxed-out credit cards and other forms of credit that they have creatively put together in order to be able to finance their businesses.

Senator CARDIN. And, Mr. Manger, I would just hope that we will get this input because I think we all want to make this program work as effectively as possible. I would just hope that there will be an opportunity for this type of input as we look toward the ultimate resolution of the permanency of this program and how it should be configured.

Mr. MANGER. Certainly.

Senator CARDIN. And how we can learn from this program in regards to the 7(a) program itself and the 504 program as to how we can make it more effective in reaching underserved communities.

Mr. MANGER. Senator, that is really exactly why we are taking the actions that we are taking now. We want to make sure, again, we can bolster the program and make it as strong as possible.

What we are seeing, again—and the numbers were provided—the last 12-month default rate for those Community Advantage loans that were made with scores below 140 is over 10 percent. That is

much higher than any other cohort in our 7(a) portfolio, and all we are saying is that you can still make a loan below 140 credit score, but it has to be done through one of our centers.

If you want to be a delegated lender, then you will have to make the loans above that 140 level, just because of the evidence that we have seen in the default rate.

Just to give you the balance, those over 140, the last 12-month default rate is below 4 percent. So you see how dramatically it increases when you go below 140. That is what our concern is.

Senator CARDIN. But I would just counter that, and I think Mr. Lewis might be the best to respond to this.

One of the trends that we have seen that has been just a trend that has hurt us in making credit available to small businesses has been the banking consolidation, the loss of headquarters, more branch banks, et cetera.

You look at a Harbor Bank, and you see an institution that is a community institution. They cannot run away from the community. We will find them, and their record is incredible in underserved communities.

But as we move more to the consolidation and branches, yes, it may seem like a simple process to have a different entity make that determination, but it becomes intimidating for minority businesses.

Mr. Lewis.

Mr. LEWIS. Certainly.

So I would say the key point here is that scoring in itself can be challenging for small businesses, for minority businesses, for the things that we talked about before. There are gaps in access.

So when you get to distribution, which is really the score of this, which is how do I get to these businesses, in getting to the businesses, you have got to be able to get to a point where you understand them and understand them not from a score perspective. Even if that is the best that you have, it is an inferior way to make loans because lending is like any investing. If you know your neighborhoods, if you know your entrepreneurs, if you know your business opportunities better than anyone else, you can make a loan that other people may not be able to make. And, if anything, that is the distinction of community banks, of MDIs, of local lenders.

The other thing that I would lift, though, that is very important, when we talk about low-income communities or communities that have been disinvested for generations and generations and generations, they have particular challenges. There is a heightened risk profile generally in those communities, which does not say that you cannot lend in those communities. It says that you have to be an expert at lending in those communities.

One of the things that has been very effective for us—and in doing that, you may be taking on a heightened risk in your portfolio, and you have to acknowledge that. You have to price it well. You have to structure well.

But in doing that, one of the things that has been effective for us in taking that increased level of risk has been the Bank Enterprise Award that we won 12 times. Essentially what that does is it allows us to take the risk, have a riskier portfolio, and then be compensated for having made those loans, in arrears which is not

perfect, but it still is a compensation for taking those risks. And we are able to do it effectively.

So one of the things that I would offer and think of, if it is that you want to get to the point where you have got lower credit scores and still have the flexibility of doing it the way that we do it is to have some consideration of how you helped those lenders through capital support, so they continue to make those loans on a riskier level.

Senator CARDIN. Good suggestion.

Yes.

Ms. BILONICK. I just had a question with regard to the amount of time that would be added to the process by needing to refer to the SBA to underwrite.

My fear would be that doing that would just drive the businesses to alternative sources like online predatory lenders, just because it will add a significant time to the underwriting process versus doing it in-house.

Senator CARDIN. And these are areas I hope that the SBA will take into consideration as we are continuing.

I know our Committee is going to take a good deal of interest in this and try to be constructive in working with the SBA. I share that concern.

You have a process now. If you do a different process, one of the things that we find with minority businesses, they do not make applications because they think they are going to get rejected, and they use the alternative sources, which are not good. And you wonder why there are more failures. There are more failures because they are undercapitalized.

It is a cycle that we are trying to break, and I understand the logic behind every change you suggested. I would just urge that we look at the results. We have had really good results from the CA program. Let us make sure that we are improving those results, not moving in the wrong direction.

I want to ask you quickly about the fee waiver.

Ms. BILONICK. Yeah.

Senator CARDIN. This was an area of major interest in the last hearing we had. Congress is very much interested in the fee waiver program.

As I understand it, you have modified the fee waiver program for loans under $150,000 under 7(a). That will only give partial fee waiver unless the loan is in one of the HUBZones or rural areas. Is that——

Mr. MANGER. That is correct.

Senator CARDIN. So does not that work to the disadvantage of the other 7(a) loans, small loans?

Mr. MANGER. So, currently, you are correct. This year, any loan under $125,000 gets fee relief. Again, the decision was made, though, that we wanted to offer fee relief targeted to help those communities that are underserved.

If you get a small loan in the suburbs, should that person really get the fee relief or should the fee relief be targeted to HUBZones and rural areas that are underserved and underbanked, as you were talking about?

So we have changed, shifted this year, the goal or the initiative so that fee relief will be offered up to $150,000, slightly higher, but again zones made in HUBZones or rural areas.

Senator CARDIN. I would just make this observation. I do not know if that is accurate. The fee waiver seems to have been very effective in helping underserved businesses.

Mr. MANGER. And that is what we are trying to still target.

Senator CARDIN. We are not sure if the definition of rural and HUBZone equates to underserved businesses, and I just hope we can evaluate that because we do think there are a lot—I mean, I know a lot of parts of Maryland that have had designations, are losing their designations. We have used a longer average time, so that they can continue to get some of the advantages of being in an economic zone. But these are businesses that cannot get the conventional types of interest.

We used a smaller loan amount as the barometer to give the relief on fees because they are the ones that go more to the targeted businesses that we are trying to get help to, the women and minority businesses, et cetera.

So I am not sure limiting it to HUBZone and rural—it may very well exclude a target group that we are trying to get to.

Mr. MANGER. I would just say, Senator Cardin, with all due respect, I think there are some small businesses that are getting loans of up to $150,000 that are really not an underserved market, and again, it could be a business that is located in a suburb of Washington, D.C., that then gets the fee relief, and the question is do they really need the fee relief or should it be going to historically underutilized business zones, which is the definition of a HUBZone?

Senator CARDIN. Well, we might differ on this.

Mr. MANGER. Okay.

Senator CARDIN. Let us share the information back and forth.

Mr. MANGER. Yes.

Senator CARDIN. I know of a lot of businesses that are minority-owned, women-owned businesses that do not fall in rural and do not fall in a HUBZone that should qualify for the maximum amount of help that we could give them to get loans. They cannot otherwise get those loans. I do not know if the observation here of anyone else on the panel on this or——

[No response.]

Let me move to my last point, and I will try to cover this quickly.

Mr. MANGER. Sure.

Senator CARDIN. And that is this mission rating. I understand you have pulled that, and the mission rating was an effort to try to identify those lenders that are giving smaller loans, rural loans, minority businesses, women businesses, veterans businesses, export businesses. Basically, we are trying to give them a mission rating so they could be identified as carrying out the mission that we want them to do in regards to underserved areas.

It is also my understanding that you pulled that because this is a self-reporting information, and you were not clear as to the reliability of the self-reporting information, even though you do use self-reporting information for a lot of other purposes within the SBA.

It seems to me that was sort of a sledgehammer approach to a program that is aimed at trying to identify those lenders that are carrying out the mission that we want them to, and now we have nothing.

Mr. MANGER. Well, Senator, I would just say that you are exactly correct that all of that data is reported on a self-reporting basis, and we actually caveat any of the information that we put out and publish the data, and that it is captured on a self-reported basis.

In fact, actually over 10 percent come in with undefined, undisclosed. So we thought it was not fair to rate a lending institution based on incomplete self-reported data. That is the issue.

Senator CARDIN. Do you have an alternative?

Mr. MANGER. I think we can continue to look at it, Senator, but we want to make sure that, again, in terms of credit risk oversight—and we just passed the 7(a) oversight bill—we want to make sure that we have as much oversight over those programs as possible, and trying to come up with some way to give someone extra credit based on unsubstantiated information just does not seem the right way to do it. So we will continue to look at other ways we can go about getting the mission accomplished.

Senator CARDIN. I want to thank all of the panelists. This has been, I think, extremely helpful.

As I said in the introduction to Mr. Manger's question, our Committee wants to work with the SBA to accomplish the mission in helping underserved communities. We recognize it is a difficult definition of "underserved communities," and that is why some of our concern on how you have drawn some of these lines.

So we will continue to have this dialogue. We welcome our witnesses to continue to share with us your success.

Very impressive record, Ms. Medley, in your business.

And Harbor has an incredible record in helping our community.

Ms. Bilonick, we look forward to your record. We do not have a record yet from you.

[Laughter.]

Although it has been 24 hours.

Ms. BILONICK. Right.

Senator CARDIN. But we look forward to the growth of your business in our community.

So thank all of our witnesses for the testimony.

Ms. BILONICK. Thank you

[Applause.]

Senator CARDIN. We have a second panel. We are looking forward to that. Our second panel—as we are making the transition, I will do the introductions in order to save a little bit of time.

On our second panel, we have Ken Clark, who I believe is also a graduate of Morgan State University.

Mr. CLARK. Yes, sir.

Senator CARDIN. All right. We want to make sure we get that in there, Dr. Wilson. The use of this room is contingent upon promoting Morgan State every time we can.

He is a business consultant in the Minority Business Development Agency Business Center representing the Capital Region Minority Supplier Development Council. In this role, Mr. Clark pro-

vides strategic counseling and business development services to local and national minority businesses.

We will then hear from Tim Smoot, senior vice president and co-founder, CFO of Meridian Management Group, who will speak to us about the investment capital for minority-owned firms. We are happy to have Meridian Management Group back with us today, as we had the president and CEO, Stanley Tucker, join us in 2015. Mr. Tucker is a frequent advisor to many of us here in the State of Maryland.

And then we will hear from Mary Miller, who is a senior fellow at the Johns Hopkins University, 21st Century Cities Initiative. She will present findings from the 21st Century Cities eye-opening report entitled "Financing Baltimore's Growth: Strengthening Lending to Small Businesses." Ms. Miller is the lead author of the report, and her team conducted critical research and identified causes for the decrease in small business lending throughout Baltimore County.

Finally, we will hear from Will Holmes, who is representing Morgan State University in his role as the director of outreach for the Goldman Sachs 10,000 Small Businesses Initiative. As a consultant and small business owner, Mr. Holmes is living the access-to-capital issue, while helping expand opportunities for other minority businesses in Baltimore.

So we will start first with Mr. Clark.

STATEMENT OF KENNETH E. CLARK, BUSINESS CONSULTANT, MBDA BUSINESS CENTER–CAPITAL REGION, CAPITAL REGION MINORITY SUPPLIER DEVELOPMENT COUNCIL, SILVER SPRING, MD

Mr. CLARK. Good morning, Senator Cardin. Thank you very much for the opportunity to be here. Kenneth Clark, business consultant in the Minority Business Development Agency Business Center-Capital Region.

This business center is operated by the Capital Region Minority Supplier Development Council under the leadership of Sharon Pinder, our president and CEO who could not be here today.

I am delighted to be here at Morgan State in the newest building on campus, as both Ms. Pinder and I are alumni of this great institution.

You have my written testimony, and I would like to reserve the option to offer some clarity and minor corrections in an updated submission in a few days.

I will summarize some of the points in my testimony at this time. The original testimony is a little longer than 5 minutes.

For clarity, I would like to explain the roles of the Capital Region Minority Supplier Development Council and its relationship with Minority Business Development Agency in the operation of MBDA Business Centers.

The Capital Region Minority Supplier Development Council, CRMSDC, is one of the 23 regional councils of the National Minority Supplier Development Council, which was formed in the aftermath of the riots following the assassination of Dr. Martin Luther King. The significance of the establishment of the NMSDC was that it was built on the idea of economic development and wealth

creation in the minority communities. NMSDC was established—they established regional counsels to certify minority businesses and to provide a linkage to their corporate procurement departments.

The councils continue to host trades fairs, conferences, one-on-one matchmaking, and various networking events to foster interaction between MBEs and corporate buyers, most often through corporate supplier diversity professionals.

CRMSDC also offers highly impactful training to the leadership of minority firms at major university business schools like Tuck, Kellogg, and others, and supplement that with local training opportunities. This has helped minority firms to move from startup and subcontractor status to more sustainable businesses.

The impact of CRMSDC's activities is that its nearly 350 minority businesses generate over $3 billion in revenue and employ approximately 20,000 people, and that is within this region.

This tracks well with the National Minorities Supplier Development Council, where 15-, 1,600 corporations work with 12,000 certified minority businesses to create $400 billion in output and $2.2 million in jobs. And I provided a graphic for your information on that.

The Minority Business Development Agency developed along a similar path following the riots, only this way in the Federal Government with people like Parren Mitchell and others, Executive Order—putting pressure on the Administration—Executive Order 11625, over 45 years ago, started OMB, the Office of Minority Business Enterprise, OMB.

The Minority Business Development Agency, which was the name change, serves as the only Federal agency tasked to help minority businesses realize their full economic potential through technical assistance centers, public and private contracting opportunities, advocacy, research, and education for Minority Business Enterprise growth and development.

The bulk of this work is accomplished throughout a nationwide network of 35 Minority Development Agency Business Centers.

Included in that number are four manufacturing centers, which promote capacity building among minority manufacturers and one Federal Procurement Center.

There is an Minority Business Development Agency manufacturing center located—operated by the City of Baltimore here at Morgan State University in the Business School.

Each center provides services that assist businesses in accessing capital, accessing contracts, accessing new markets, as well as helping them in their growth in size and scale, providing strategy consulting.

In 2016, CRMSDC, under the leadership of Sharon Pinder, competed to win an MBDA grant to run a business center here in the Washington, D.C., area. Later, in 2016, CRMSDC won a bid to run a Federal Procurement Center, the only one of its kind in the Nation. The Federal Procurement Center is designed to specifically help minority businesses with access to Federal and federally funded contracts.

The business centers can help work with MBEs operating in Federal, State, local as well as corporate contracts. So our result is that we have a dual, two-pronged approach.

Both teams use information systems tools provided by MBDA. They use our personal contacts and our personal knowledge of the various commercial and governmental sectors to help their clients win and—find and win contracts.

They also assist their clients with finding loans, working capital, and other financial instruments from minority-friendly sources of which they have identified.

At a recent training conference, both of our centers were recognized as being outstanding for our ability to provide contract activity, financial access, job creation, and retention of goals.

The two centers combined have about 220 clients, and they have won over $240 million in contracts and have created 1,700 jobs in the last year's program.

There are a number of barriers that we operate to try to eliminate. Those barriers are timely bid notification, explicit discrimination due to stereotypes, higher and double standards, and MBE/DBE stigma.

We compete with larger—we try to help against large project sizes, bonding and insurance requirements, and timely payment.

We also try to combat the barrier of good faith to use minorities, except when they are required in a contract. There is explicit discrimination, and this whole issue of MBE and DBE stigma is a problem.

The issues boil down to access to capital, contract and network access, and marketplace discrimination.

I see my time is out, so I will thank you very much for the opportunity to present this testimony, and I will answer any questions you might have.

[The prepared statement of Mr. Clark follows:]

Written Testimony of
Mr. Kenneth E. Clark
Business Consultant, MBDA Business Center – Capital Region
Capital Region Minority Supplier Development Council
Before the
Senate Small Business Committee at a hearing in
Morgan State University, Baltimore, MD
Friday, September 14, 2018.

Good Morning, Senator Cardin. I am Kenneth Clark, Business Consultant in the Minority Business Development Agency Business Center – Capital Region and Past President of the Maryland/District of Columbia Minority Supplier Development Council, the precursor to the Capital Region Minority Supplier Development Council. This business center is operated by the Capital Region Minority Supplier Development Council under the leadership of Sharon Pinder, President and CEO, who could not be here today. I am delighted to be here at Morgan State as both Ms. Pinder and I are alumni of this great institution.

For clarity, I would like to explain the roles of the Capital Region Minority Supplier Development Council and its relationship with Minority Business Development Agency in the operation of an MBDA Business Centers.

The Capital Region Minority Supplier Development Council CRMSDC) is one of the 23 regional councils of the National Minority Supplier Development Council (NMSDC). NMSDC was founded in the aftermath of the riots following the assassination of Dr. Martin Luther King. As various federal commissions undertook studies to determine the root causes of violence in the cities, so did corporate America. Their studies determined that the root cause of unrest was lack of access to the American Dream of life, liberty, and the pursuit of happiness. This dream requires money, i.e., jobs, income and business revenue. The study led those corporate executives to the implementation of trade fairs and job fairs to provide jobs for residents and business opportunities for minority businesses. Their activities coalesced into the establishment of the corporate-led National Minority Purchasing Council with regional affiliates. The Greater Baltimore Minority Purchasing Council was founded in 1972. It later merged with the Greater Washington Minority Purchasing Council and, with subsequent national name changes, became the MD/DC Minority Supplier Development Council. I had the privilege of serving as a Board Member, including a term as board chair, and, later, president of this council.

The significance of the establishment of NMSDC was that it was built of the idea of economic development and wealth creation in the minority communities. It was the hope of NMSDC's corporate founders that an employed minority community and a vibrant minority business community would help to generate income that could be spent by that community to buy the products and services of corporate America. It would also create an economic sense of wellness that would lessen chances for violence in the streets. NMSDC established the regional councils to certify minority businesses and to provide a link to their corporate procurement departments. The regional councils continue to host trades fairs, conferences, one-on-one matching, and various networking events to foster interaction between MBEs and corporate buyers. This work is most often managed through corporate supplier diversity professionals whose job is to find and advocate for minority businesses within the corporate

procurement process. CRMSDC also offers highly impactful training to the leadership of MBE firms at business schools such as Kellogg, Tuck and others. Additionally, it has offered similar training locally, with the result that many minority business leaders are able to move their firms from start-up and sub-contractor status to fully sustainable businesses. The impact of CRMSDC's activities is that its nearly 350 MBE firms generate over $3 Billion in revenue and employ approximately 20, 000 people. This tracks well with the data from NMSDC nationally where 1,595 corporations work with 12,000 certified minority firms to create $400 Billion in output and 2.2 million jobs. (See attached graphic data from NMSDC)

After the 1968 riots, the Commerce Department developed along a similar path as corporate America with the creation the Office of Minority Business Enterprise, the precursor to the Minority Business Development Agency under Executive Order 11625. Since 1972, MBDA has been working aggressively to support the growth of MBEs. MBDA serves as the only federal agency tasked to help MBEs realize their full economic potential through technical assistance, public and private contracting opportunities, advocacy, research, and education for MBE growth and development. The bulk of this work is accomplished through a nationwide network of now 35 MBDA Business Centers (there were as many as 44 at one point.) There is an MBDA Manufacturing Center operated by the City of Baltimore here at Morgan State. Each MBDA Business Center provides services that assist MBEs in accessing capital, contracts, and new markets, as well as helping them to grow in size and scale. The Business Centers can work with MBEs seeking federal, state and local as well as corporate contracts. Included in the 35 centers are four MBDA Manufacturing Centers and one Federal Procurement Center. The Manufacturing Centers promote capacity building of minority manufacturers. The Federal Procurement Center is designed to specifically help MBEs with access to federal and federally funded contracts.

In 2016, CRMSDC competed to win an MBDA grant to run a business center in the Washington, DC area. Later, also in 2016, CRMSDC also won the bid to run a Federal Procurement Center, the only one of its kind in the Nation. Both centers use information systems tools provided by MBDA, personal contacts and knowledge of the various commercial and governmental sectors to help their clients find and win contracts. They also assist their clients in finding loans, working capital and other financial instruments from minority-friendly sources of which they have become aware. At the recent MBDA National Training Conference, both the Business Center and the Federal Procurement Center were recognized as "Outstanding" for meetings or exceeding the rigorous contract, financial, and job creation and retention goals required in the MBDA grants. In order to create greater synergy for business development and increased support to minority businesses, Sharon Pinder has created a Minority Business Consortium in which the three organizations collaborate to offer a more full slate of services to regional minority businesses. In addition to the economic impact of CRMSDC stated above, together our Capital Region MBDA business centers helped its 220 clients win over $240 million in contracts that created 1700 jobs in the last program year.

While both CRMSDC and its MBDA centers, and MBDA and NMSDC as a whole, work hard at assisting minority enterprises grow their businesses and develop their teams, there are still many barriers to minority contracting. A summarization of disparity studies from several state and local jurisdictions was released in January by MBDA. It showed that very significant disparity still exists in minority contracting. It was most distressing to see that the disparities still existed even after remedies proposed from prior disparity studies had been implemented in these areas. The barriers to contracting were the following based on specific and verifiable data and anecdotal experiences:

- At the Prime level - timely bid notification, explicit discrimination due to stereotypes, and higher and double standards, MBE/DBE stigma.

- Prime level non-discriminatory – large project sizes, bonding/insurance requirements, timely payment
- Sub-contractor – timely bid notification, bid shopping, held bid, lack of good faith effort to use, only taking an MBE if required, explicit discrimination (same as above), MBD/DBE stigma (See Attached graphic from MBDA website for details)

Basically this boils down to Access to capital, contract network access, and marketplace discrimination.

To help address issues around access to capital, our business center held a finance seminar to educate MBEs on the intricacies of working with various sources. Mr. Tim Smoot, on this panel, was one of those experts along with four national and regional banks and an alternative lender. These "minority business friendly" institutions shared how to best work with banks, when to go to alternative sources, how to develop the relationships that might help off-set some of the stereotypes associated with being an MBE or DBE. One client said that this was exactly what she needed to hear to be better prepared. This panelist has also just received approval for a line of credit based my referral to one the minority-friendly lender at a bank after she had been previously denied a loan at several banks.

This is the environment in which CRMSDC, the MBDA Business Centers and the Federal Procurement Center work to try to alleviate as many of these barriers as possible. It is work that is done in the field, holding hands with MBEs, and talking to, calling and visiting contracting personnel in the corporations and state and federal agencies to help get deals done. Policy personnel in the federal or state capitals do not and cannot impact the problems faced daily by MBEs. I say this because, as you aware, it has been proposed that MBDA discontinue the funding of business centers and that the agency is to become strictly a policy organization. This action will be done to the great detriment of the minority business community. I urge your strong support to continue full funding of the MBDA, its Business Centers and the Federal Procurement Center.

Thank you, Senator Cardin, for the opportunity to speak. I thank you for your interest and leadership in this important area of supporting minority business growth and development. In 20 years, the complexion of the Nation will reach a major transition. Many people fear a future in which minorities are a majority and are trying to hold back the tide. If we don't create strong and viable minority businesses and build wealth in the minority communities now, the cycle of economic life in these United States will spin out of control into a downward spiral. Effective leadership can guide the Nation to a great future.

Thank you again,

Respectfully submitted,

Kenneth Clark

Senator CARDIN. Thank you, Mr. Clark.
Mr. Smoot.

STATEMENT OF TIM SMOOT, SENIOR VICE PRESIDENT, CHIEF FINANCIAL OFFICER, CO–FOUNDER, MERIDIAN MANAGEMENT GROUP, INC., BALTIMORE, MD

Mr. SMOOT. Thank you, Senator. I appreciate you inviting us today. I would like to thank you guys.

My name is Tim Smoot, senior vice president and co-founder and CFO of Meridian Management Group, hereafter called MMG, a minority fund manager that provides capital to small-, minority-, women-, and veteran-owned businesses primarily based in Maryland. The majority of our funds managed by MMG are from Federal and State sources. The lion's share of the businesses we assist are unable to obtain financing from banks and other traditional financial institutions. MMG has a 23-year track record of excellence in managing funds in this arena. Over the years, we have financed $275 million in financing to more than 1,100 companies.

Specifically, we manage the Maryland Small Business Development Financing Authority and one of the VLT funds. Ours is called MCBIF.

Having said that, access to capital has always been a number one obstacle for expansion of minority businesses.

My partners and I have been in the commercial lending business for 35 years or more. I recall disparity study after disparity study concluding that relatively then same predicament. Minorities are being much more likely to be declined for financing than their white counterparts by significant numbers, being approved for loans on a much smaller level, and being forced to use expensive forms of financing from many others.

Most studies found that the majority of the minority businesses have become more successful in obtaining credit card and microloan funding, which is helpful. However, they also concluded that, as stated in a study, those loans cannot replace the importance of larger working capital loans needed to actually grow businesses in a significant way.

They also appear to be gaining more access to higher interest rate funding, including online financing, but it is very difficult to try to grow a business when the cost to capital is 15 to 30 percent.

One of our relatively frequent requests for funding involves the refinancing of existing debt, the majority of which is expensive and has very short repayment terms, crippling a business' efforts to generate cash flow and sustain operations. The refinancing is designed to offer conventional bank lending rates and more traditional terms and in some cases deferments of principal and interest.

The overall objective of this particular element of the program is to offer more "patient capital" to allow the businesses to grow and create jobs in minority communities, which is the very reason we are here today.

It is pretty obvious that minority businesses tend to hire minorities, as you mentioned earlier, and much more willing to hire individuals in low-income communities and those who are not as well

educated and those who are returning citizens from our penal institutions.

Maryland is rather fortunate in that over the years, over the decades actually, MMG, its governors, and its Maryland lawmakers, including you, Mr. Senator—you would be interested in knowing I have a picture in our office of you and Mickey Steinberg and I think Governor Hughes signing some legislation for our Equity Franchising Program.

Senator CARDIN. Oh, wow.

Mr. SMOOT. It goes back a while, right? When we both had hair, right?

[Laughter.]

Particularly, the legislative Black Caucus has been extremely helpful, having strategically established programs to cover the majority of the most common needed resources for small businesses, which are term loans, lines of credit, letters of credit, loan guarantees, subordinated debt, equity financing, and surety bonding, again, at affordable rates. In fact, Maryland's Small Business Development Financing Authority has been recognized as a national model by the Wall Street Journal and several other publications for having the most comprehensive group of financing programs to assist minority businesses.

The State's Video Lottery Terminal Fun is also the first of its kind in this country that is funded by revenue from the gambling casinos. MCBIF is one of the eight fund managers in Maryland managing up to $11 million in capital.

Over the course of the last 5 years, these funds managed by MCBIF have provided 227 financings totaling $42 million to 175 companies, with an average loan size of $245,000. On average, 61 percent of the funds provided were provided to minority businesses, ethnic minorities, and 27 to women-owned businesses.

One might ask, What is the risk/reward profile for these businesses? Well, in the case of MSBDFA, the loan loss rate grew from less than 5 percent prior to the recession and nearly 11 percent during the recovery. This is the obvious result of businesses being undercapitalized from the start, not having sufficient reserves to survive the decline in business activity.

On the other hand, the overall impact of helping such businesses grow is substantial. For example, during the 20-year period in 1995 to 2014, the State invested $32 million of general funds in the MSBDFA programs. This lending activity generated $343 million in local and State tax revenue, $7.7 bill in commercial sales, $2.3 billion in personal income, and 3,820 jobs on average annually. This resulted in a return on investment to the State of 9.3 times. This is good economic policy for both the private sector and the public sector, Mr. Senator.

[The prepared statement of Mr. Smoot follows:]

TESTIMONY OF TIMOTHY L. SMOOT
SR. VICE PRESIDENT AND CFO
MERIDIA MANAGEMENT GROUP, INC.
BALTIMORE, MARYLAND

Before the

U.S. Senate Small Business Committee
The Honorable Ben Cardin, Ranking Member

on

"Strengthening Access to Capital for Minority-Owned Small Businesses"

Mr. Chairman and Members: First, I would like to thank you for the opportunity to appear before you today, and also thank you for convening this hearing on such an important topic to the State of Maryland and, indeed, our entire country as a whole.

My name is Timothy Smoot, Sr. Vice President, Co-Founder and CFO of Meridian Management Group, Inc. (hereafter "MMG"), a minority-owned fund manager that provides capital to small, minority, women and veteran-owned businesses, primarily based in the state of Maryland. The majority of fund's managed by MMG are from federal and state resources. The lion's share of businesses we assist are unable to obtain financing from Banks and other traditional sources of financing. MMG has a 23-year track record of excellence in managing funds in this arena.

That being said, "Access to Capital" has always been the "Number One" obstacle of the expansion of minority businesses. My partners and I have been in the commercial lending business for 35 years or more. I recall, disparity study after disparity study concluding the relatively same predicament – minority entrepreneurs being much more likely to be declined for financing than their white counterparts (by significant margins), being approved for loans in much smaller amounts or being forced to use more expensive forms of financing among many others. Some of the most recent studies include the U.S. Small Business Administration, the Maryland Department of Transportation, the Federal Reserve Bank of Cleveland, Harvard University and Johns Hopkins University. An executive summary from the Cleveland study is attached to this study for your reference and support for my testimony.

Most of studies found that more minority businesses have become more successful in obtaining credit cards and microloans, which are helpful. However, they also conclude that, as stated in one study, "those loans cannot replace the importance of larger working capital loans needed to grow" small businesses in a significant way. They also appear to be gaining more access to higher interest rate funding. But, it very diffieult trying to grow a business when the cost of capital is 15 – 30% per annum.

One of our relatively frequent requests for funding involves the refinancing of existing debt, the majority of which is expensive and has very short repayment terms – crippling the businesses' efforts to generate cash flow and sustain operations. The refinancing is designed to offer conventional bank lending rates and more traditional terms and, in some cases, deferments of principal and interest. The overall objective of this particular element of the programs is to offer forms of more "Patient Capital" to allow the businesses to grow and create more jobs in minority communities, which is the very idea behind this hearing. It is pretty obvious that minority businesses tend to hire more minorities and are much more willing to hire individuals in low income communities, those who are not as well educated and those who are returning to society from our penal institutions.

Maryland is rather fortunate in that, over the course of several decades, MMG, its Governs and Maryland law makers – particularly, the Legislative Black Caucus - have strategically established financing programs that cover the majority of the most commonly needed resources for small businesses (i.e. term loans, lines of credit, letters of credit, loan guarantees, subordinated debt, equity financing and surety bonding) – *at affordable rates*. In fact, Maryland's Small Business Development Financing Authority has been recognized as a national model on several occasions for offering the most comprehensive group of financing programs to assist minority businesses by the Wall Street Journal, The National Franchise Association, the Center for Insight Center for Community Economic Development and the Center for Regional Economic Competitiveness.

The State's Video Lottery Terminal Fund is the first of its kind in the country to be funded by revenue from its gaming casinos. Maryland has a total of eight (8) fund managers. MMG's fund is referred to as the Maryland Casino Business Investment Fund ("MCBIF") – capitalized with $11 million.

Over the course of the past 5 years, these two funds managed by MMG provided 227 financings totaling $41.8 million to 175 companies. On average, 61% of the funds were provided to companies owned and operated by ethnic minorities. One might ask, what is the risk/reward profile of financing these businesses.

Well, in the case of MSBDFA, the loss ratio grew from less than 5% prior to the economic recession to nearly 11% during the recovery. This was the obvious result of businesses undercapitalized from the start not having sufficient reserves to survive the decline in business activity. On the other hand, the overall economic impact of helping such businesses grow was substantial. For example, during the 20-year period (1995-2014), the State invested $32 million of general funds into the MSBDFA programs. The lending and investment activity generated:

- $343 million in local and state tax revenues,
- $7.7 billion in commercial sales,

- $2.3 billion in personal income; and
- 3,820 full-time equivalent jobs on average per year.

The result was a net return on investment of 9.3x. This is good economic policy for both the private sector and the public sector.

My partners and I clearly agree that it is more difficult lending to many minority firms. The firms lack sufficient start-up equity capital, credit scores are lower on average and they generally have less collateral to secure the loans. But, there is all ton of underutilized talent that could be extracted to strengthen minority communities that can provide tremendous economic benefits to the municipalities and state where they are located and ultimately this great country of ours.

Senator CARDIN. Thank you very much.

I would like to see a picture, a copy of that picture. I will go over later.

[Laughter.]

Ms. Miller.

STATEMENT OF MARY MILLER, SENIOR FELLOW, 21ST CENTURY CITIES INITIATIVE, JOHNS HOPKINS UNIVERSITY, BALTIMORE, MD

Ms. MILLER. Good morning, Senator Cardin, and thank you for the opportunity to make some remarks at this field hearing.

I would also like to thank your staff and Morgan State University for hosting us in this beautiful building.

I am a 30-plus-year resident of the City of Baltimore. I came here in 1983 to work for a small private company called T. Rowe Price that today is one of the city's largest employers, and I saw firsthand how a growing company can create jobs and economic benefits.

I left T. Rowe Price in 2009 to work at the U.S. Treasury in a time of incredible turmoil following the financial crisis. My office at the Treasury oversaw both community development financial institutions as well as the country's largest and most complex banks.

Nearly 5 years of public service gave me a great opportunity to work on the regulation of our financial institutions and public policy goals in this sector.

You have probably forgotten this, but in 2011, you introduced me to the Senate Finance Committee for my confirmation hearing as the Under Secretary for Domestic Finance. Thank you.

Senator CARDIN. I did not forget that.

Ms. MILLER. Okay.

Senator CARDIN. I should have mentioned that in your introduction.

Ms. MILLER. That is okay.

I resigned from Treasury 4 years ago and returned to Baltimore as a full-time resident. I have become intensely interested in the question of how much financial capacity we have to support economic growth in this city.

The Johns Hopkins University 21st Century Cities Initiative was the perfect platform to research and write about this question. I would like to submit for the record my written statement about our most recent work on small business lending activity in Baltimore over the past 10 years.

Senator CARDIN. Without objection, it will be included.

[The information can be found in the footnotes in Ms. Miller's prepared statement.]

Ms. MILLER. Our research is focused on every loan made to a small business located in this city, including minority-owned businesses, and I think our findings are relevant to all.

Rather than restate all the findings in this report, I would like to focus on a few important themes in my time here.

First, loans to small businesses have dropped by more than 30 percent over the decade ending in 2016, while bank deposits in the city have doubled to $26 billion. This is a serious impediment to growth, and we need to change that.

If banks that take deposits in Baltimore had maintained the same loan-to-deposit ratio in 2016 as in 2007, we would have seen $600 million in small business loans made in 2016, compared to the actual level of $200 million.

Baltimore takes less advantage of the federally guaranteed loans offered by the Small Business Administration than comparable cities, as few of our banks have built the internal resources to originate these loans. I was very pleased this morning to hear about Harbor Bank's entry into the market in 2018 because I think that is critical.

Baltimore lenders also predominantly focus on real estate lending with hard assets as collateral versus small business loans backed by operating revenues. Our banks largely rely on offering small credit card loans to small businesses, which require fewer resources. The average credit card loan is about $10,000.

The decline in overall small business lending here mirrors changes in the marketplace generally, although Baltimore has been particularly hard hit by bank consolidations and the loss of locally headquarters banks. Our leading banks today lend more into their home communities than they do in Baltimore.

Our recommendations tie directly into the facts that we collected. We need to ask our largest depository banks to do more, whether as direct lenders to small businesses, as SBA loan originators, or through providing capital to CDFIs to help them lend.

The city and the State have small public loan programs to reach higher-risk borrowers, but we believe those dollars could be more useful if used to leverage loans from the private sector by providing a backstop against losses.

While not a focus of this report, which focused on banks, we also need to understand the value that nonbank lenders can bring to this marketplace to see whether technological solutions can reduce barriers to finding credit, lower borrowing costs, and bring more capital to Baltimore.

Finally, our work showed how Community Reinvestment Act reports shed little light on small business lending shortfalls in Baltimore. This is a real opportunity to modernize this 40-year-old law to better measure the banking sector's contribution to the real economy in cities like Baltimore.

As our work has shown, we need to build a continuum of capital to allow small businesses to thrive.

Senator Cardin, I appreciate your focus on these important issues. Thank you for all of your work on behalf of the citizens of Maryland.

[The prepared statement of Ms. Miller follows:]

"Strengthening Access to Capital for Minority-Owned Small Businesses"

United States Senate, Committee on Small Business and Entrepreneurship
Field Hearing, Morgan State University, Baltimore, MD
September 14, 2018

Written Testimony
Mary Miller, Senior Fellow, Johns Hopkins 21st Century Cities Initiative

Baltimore is home to more than 50,000 small businesses. Roughly 37,500 of these businesses are sole proprietorships and about 12,500 have at least one employee.[1] Small businesses form the backbone of the local economy, providing jobs for residents, tax revenues for the city, and a sense of identity to neighborhoods and commercial districts. But for new and established small businesses to thrive, the city needs a financing system with capacity to meet their needs. Capital is certainly not the only ingredient necessary for successful business growth, but it is a critical input. If companies lack access to appropriate types of capital at critical stages of growth, they are likely to never take off and achieve scale, or even worse, to go out of business or leave Baltimore and relocate where financial support is more readily available, depriving the local economy of jobs and economic growth.

To better understand whether Baltimore's financing system and the flow of capital to small businesses is sufficiently expansive and diverse to support the entire landscape of the city's small businesses and their varying needs, the Johns Hopkins 21st Century Cities Initiative (21CC) has spent the past two years analyzing data, interviewing experts, and convening stakeholders. 21CC has published two reports over the past year presenting a robust set of findings and recommendations relating to the local financing system. These reports are summarized below. The data provided here are drawn from the reports, where all original sourcing is provided.[2]

The first report, published in September 2017 and titled **Financing Baltimore's Growth: Measuring Small Companies' Access to Capital** analyzed 40 separate public and private funding programs and data sources to quantify loan, equity, and grant investments in small businesses located in Baltimore City. Over the five-year period from 2011 through 2015 about $560 million per year totaling about 7,000 individual transactions flowed to startups and small businesses in Baltimore City.

Of the total dollar amount invested, 60 percent came in the form of loans, 30 percent in equity investments, and 10 percent in grants. There was significant annual growth in equity investments, increasing from $50 million per year in the mid-2000s to over $200 million per

[1] Figures from the U.S. Census Bureau's 2012 Survey of Business Owners and 2016 County Business Patterns.
[2] To view the full reports, visit http://21cc.jhu.edu/wp-content/uploads/2017/09/21cc-financing-baltimores-growth-sept-2017.pdf and http://21cc.jhu.edu/wp-content/uploads/2018/07/financing-baltimores-growth-strengthening-lending-to-small-businesses.pdf.

year a decade later. On the loan side, the report showed declines in the total amount of loans originated to Baltimore City's small firms over the past decade.

Last month, 21CC published the second report, **Financing Baltimore's Growth: Strengthening Lending to Small Businesses**, that takes a deeper look into the dynamics of bank lending to small businesses in Baltimore City. The report covers the period from 2007 to 2016, which is the most recent available 10 years of loan and deposit data that banks are required to report to federal regulators.

The report organized bank lenders into three categories: 1) banks with branches in Baltimore City (referred to as depository banks); 2) banks that have branches elsewhere, but do not have any branches or take deposits in Baltimore City (referred to as non-branch banks); and 3) regulated financial institutions that specialize in credit card loans. Overall, small business bank lending in Baltimore was significantly lower in 2016 than 2007, falling from $457 million in 2007 to $307 million in 2016. Across the board, all three types of institutions were greatly impacted by the Great Recession, with the number and dollar amount of loans both decreasing significantly from 2007 levels and hitting low marks in the 2010 to 2012 period. Since then, all three types of institutions have expanded their activity, but non-branch banks are the only category of lender that has surpassed 2007 levels in total dollar amount loaned.

Depository banks are consistently responsible for about 70 percent of all loan amounts on an annual basis. Their small business lending, however, has not kept pace with their growth in deposits. Over the 10-year period from 2007 to 2016, total outstanding bank deposits among banks with branches in Baltimore nearly doubled (from $13.5 billion to $26.5 billion), while annual small business lending activity for these same types of banks fell 32 percent (from $311 million to $212 million). The top five depository banks in Baltimore City in 2016, based on small business loans originated, were: M&T Bank, PNC Bank, Wells Fargo Bank, Bank of America, and BB&T Bank.

A key data point analyzed in the report was the annual ratio of small business loan amounts to outstanding deposit amounts, or the loan-to-deposit ratio. Among the top 14 depository banks in 2016, annual small business lending data is publicly available for 11. The total loan-to-deposit ratio for these 11 banks was 0.82 percent in 2016. Bank of America had the lowest loan-to-deposit ratio at 0.21 percent, although the bank originated the fourth most loans to Baltimore's small businesses at $22 million. Maryland headquartered Howard Bank and Columbia Bank had the highest loan-to-deposit ratios at 6.3 percent and 8.1 percent, respectively.

Looking back to 2007, the loan-to-deposit ratio was 2.4 percent among the top banks, combined. If the loan-to-deposit ratio for 2016 was the same as in 2007, then the top depository banks would have provided over $600 million in small business loans in 2016, rather than the $203 million in small business loans that were in fact provided. In other words, just by maintaining the 2007 loan-to-deposit ratio, banks would have originated nearly $400 million more in small business loans in 2016 than was actually the case.

Non-branch banks in Baltimore have grown in both number of loans and total dollar amount, with increased growth over the past six years. In 2016, these banks provided nearly four times the number of loans and loan amounts they provided in 2010. They are the only lender type that is doing more small business lending in total dollar amount compared to 2007. One example is the First National Bank of Pennsylvania, which began originating small business loans in Baltimore in 2012 and steadily increased their lending in the city to 2016 when the bank made 35 loans totaling $8.5 million, for an average of over $240,000 per loan, indicating a focus on larger working capital term loans. In a sign of a long-term commitment to the Baltimore market, in 2016 the bank established its regional headquarters in Baltimore and opened its first branch in the city.

Credit card lenders have made some gains over the past five years, but their activity today is well below what it was prior to the Great Recession. The number of credit card transactions in 2016 was about one-third what it was in 2007, and the total dollar amount was less than half what it was a decade prior. The top lender in terms of number of transactions in Baltimore City for every year from 2007 to 2016 was American Express, although their average loan size was only $12,000 in 2016.

The report also looked closely at U.S. Small Business Administration (SBA) 7(a) loans in Baltimore. In the overall landscape of small business lending by banks in Baltimore, SBA 7(a) loans represent a small portion of loan activity. However, they are an important tool for banks to expand their small business offerings, particularly because they are generally larger loans and a way banks can provide working capital to small businesses through loans that are guaranteed by SBA.

From 2007 to 2016, the total dollar amount of all types of SBA 7(a) loans made to Baltimore City small businesses increased from $19.2 million in 2007 to $28.3 million in 2016, while the number of loans during that same time period decreased from 152 in 2007 to 108 in 2016, resulting in an average loan size that was twice as high. In 2016, 26 banks originated SBA 7(a) loans to Baltimore City small businesses. An important observation in SBA 7(a) lending in Baltimore is the dominance of M&T Bank in the market, which accounted for over half the number of loan transactions and more than one-third of total loan amounts in 2016. Overall, however, SBA loans are under-leveraged in Baltimore compared to their use in cities such as Atlanta, Buffalo, Cleveland, and Pittsburgh.

The decline in overall small business lending over the past decade did not happen by accident. Rather, it largely mirrors changes in the marketplace, some of which are national and some Baltimore specific. The report highlighted three reasons for small business lending declines in Baltimore: bank consolidation, headquarters effect, and shrinking average loan sizes.

The national consolidation of the banking industry hit Baltimore particularly hard. In each case where a locally headquartered bank was acquired by a larger national bank, the amount of combined small business lending dropped. Examples include the acquisition of Mercantile Bank by PNC Bank and Provident Bank by M&T Bank. These four banks were together originating

over $130 million in small business loans in 2007. The two acquiring banks originated $98 million in 2016.

For Baltimore, it is challenging to be a branch town and attract the same level of investment as a bank's headquarters city. The report looked at overall loan data and found that the two largest small business lenders in Baltimore, M&T Bank and PNC Bank lend at higher rates in their headquarters communities, when controlled for population. In Buffalo, M&T's small business lending was 2.5 times its Baltimore area activity. In Pittsburgh, PNC's small business lending was three times that of its Baltimore area lending. It's also the case that these banks have much higher deposits in the headquarters communities, which supports higher local lending.

The average loan amount to small businesses by all depository banks has declined from $191,819 per loan in 2007 to $70,877 per loan in 2016. Decreasing average loan amounts appear to be driven by the growth of small business credit cards and smaller lines of credit being offered by some depository banks.

The report also analyzed Community Reinvestment Act (CRA) evaluations for depository banks active in Baltimore. The evaluations shed little insight into small business lending activity in Baltimore. CRA guidelines, with regard to geographic assessment areas and lending criteria, do not capture the decline in small business lending nor recognize the banks that are serving Baltimore City's need for these loans.

In closing, the report offered several recommendations:

- Encourage the largest banks in Baltimore to increase small business lending activity by making more direct loans, becoming more active with SBA loans, and/or capitalizing local small business loan funds, such as community development financial institutions (CDFIs).
- More effectively utilize state and city loan programs to provide loan loss reserves or guarantees for private bank loans targeting new and/or higher-risk borrowers.
- A concerted effort should be made to attract and welcome banks and other types of lenders from outside of Baltimore and Maryland that have identified market opportunities in Baltimore's small businesses and startups.
- Reports like the one developed by 21CC, which rely on CRA data focused on a specific market, could be used as a case study for regulators and stakeholders currently working on modernizing this 40-year-old legislation. Baltimore is an example of how CRA's geographic assessment areas and scoring need improvement to better measure community reinvestment.

Senator CARDIN. Well, thank you very much.

Mr. Holmes.

STATEMENT OF WILL HOLMES, DIRECTOR OF OUTREACH, GOLDMAN SACHS 10,000 SMALL BUSINESSES, MORGAN STATE UNIVERSITY, BALTIMORE, MD

Mr. HOLMES. I would like to thank Senator Cardin and the Committee for the opportunity to speak to you today. Good morning, Senator Cardin.

My name is Will Holmes, and I am director of Outreach for the Goldman Sachs 10,000 Small Businesses Program in Maryland, and I am the founder of WHC, a business management and technology consulting firm based in Baltimore. We work with government agencies, financial institutions, universities, and growing companies in North America, Africa, and Asia.

My testimony today will outline the fundamentals of the Goldman Sachs 10,000 Small Businesses Program and detail my observations on the challenges small minority- and women-owned businesses face when attempting to access capital.

First, the Goldman Sachs 10,000 Small Businesses Program. Here in Maryland, the Goldman Sachs program is funded by Goldman Sachs and Bloomberg Philanthropies, and it is facilitated by Morgan State University, Johns Hopkins University, and the Community College of Baltimore County. I am based at Morgan State, and I am contracted to promote the benefits of this highly effective program to business owners in Maryland who meet the following criteria: at least 2 years in business, at least two employees; at least $100,000 in revenue.

There is no cost to be in this 11-week program. It is free, but there is a tremendous time commitment. Scholars are in class one full day per week and often meet outside of class to work on their growth plans and share ideas with the other scholars and their assigned business advisor.

The program is intense, and it is working. Across the U.S., graduates are increasing their revenues and creating new jobs in their communities. Here are some statistics from Goldman Sachs: 99 percent of business owners who start the program complete the program, 67 percent of graduates report an increase in revenue after finishing the program, 47 percent of graduates report creating new jobs in their communities, 88 percent of graduates report they do business with other Goldman Sachs graduates.

The scholars' investment is their time, but the returns are a more sustainable business, higher revenue, the opportunity to employ more people in their communities, and a new network of thousands of graduates across the country. The Goldman Sachs Program teaches business owners how to work on their businesses instead of working in their businesses. Plus, upon graduation, business owners have a better understanding of what is needed to attract investors and lenders while pursuing capital to grow their businesses.

Now, in regard to accessing capital, in my experience, the two greatest barriers for small businesses are lack of information and low credit scores.

As for lack of information, Baltimore is rich in resources. So acquiring knowledge is possible if business owners took full advantage of consultants like me or they utilized the Small Business Development Center, the Small Business Administration, Minority Business Development Agency, Small Business Resource Center under Paul Taylor and Jim Peterson, or the many incubators in the city. But I believe all business owners would benefit from more coordination between these State, Federal, and local resources. Also, better marketing of programs and some integrated case management would surely help push new entrepreneurs to fully utilize these services.

I believe that for first generation or minority or women entrepreneurs, the information they need to grow, it exists here in the city. We just need to develop a better system for connecting entrepreneurs with the knowledge they need to develop sustainable business models, access capital, and pursue RFPs and contract opportunities.

But low credit scores, that is a different problem. When it comes to low credit scores, my experience is that minority and women entrepreneurs usually do not lack moral character or have some insidious desire to be delinquent on payments. That is not it at all. Instead, entrepreneurs often have low credit scores because of three simple reasons.

First, their biggest customers are late paying them. Often business owners wait for months for payments from large agencies or organizations, well past the agreed-upon 30- or 45-day net payment terms.

Second, they have little to no accumulated assets or wealth. Minority- and women-owned businesses often do not have adequate savings, investment accounts, or wealthy family and friends to provide startup cash or short-term personal loans.

Third, overwhelming debt. Ideal debt-to-income ratios set by banks are hard to meet when business owners have high student loans and maxed-out credit cards. Minority and women business owners often use their personal credit cards to start their businesses, but if they run into slow periods or emergencies and they cannot get additional funding, they often shut down. And their employees, suppliers, and community suffer, all due to lack of funding and no access to capital.

In conclusion, the Goldman Sachs 10,000 Small Businesses Program offers an amazing opportunity to businesses who make over $100,000 in annual revenue. Graduates are adding jobs and positively changing communities, but Baltimore entrepreneurs who have not made $100,000 yet need help also. They need to be better connected to existing free and low-cost resources. They also need to be better supported by programs created by legislators, lendings, and investors to help them better prepare to access capital.

Access to capital is the key to stronger small businesses, and I firmly believe that stronger small businesses who employ local residents are a cornerstone in the foundation of healthier, wealthier, and safer communities in Baltimore.

I want to thank you and the Committee for allowing me to speak to you today on behalf of Morgan State University and the Goldman Sachs 10,000 Small Businesses Program.

I am happy to answer any questions you may have. Thank you.
[The prepared statement of Mr. Holmes follows:]

Will Holmes | Director of Outreach | *Goldman Sachs 10,000 Small Businesses* | Morgan State University

Good morning. My name is Will Holmes and I am Director of Outreach for the Goldman Sachs 10,000 Small Businesses program in Maryland and I am the Founder of WHC, a business management and technology consulting firm.

My testimony today will outline the fundamentals of the *Goldman Sachs 10,000 Small Businesses* program, briefly explain my role in Baltimore's entrepreneur ecosystem, and detail my observations on the challenges small, minority and women-owned business owners face when attempting to access capital.

Goldman Sachs 10,000 Small Businesses

Here in Maryland, the *Goldman Sachs 10,000 Small Businesses* program is facilitated by Morgan State University, Johns Hopkins University and the Community College of Baltimore County. I am based at Morgan State and I am contracted to promote the benefits of this highly effective program to business owners in Maryland who meet the following criteria:

- At least 2 years in business
- At least 2 employees (including the business owner)
- At least $100,000 in revenue

After talking to me, Business owners apply online. If they meet the criteria, they are invited to an interview. If selected, they are placed in a Cohort and they become a Goldman Sachs Scholar. Once they graduate from the program, they are called Alumni.

There is no cost to be in the 11 week program. It is free. But there is a tremendous time commitment. Scholars are in class one full day per week and often meet outside of class to work on their growth plans and share ideas with the other scholars.

The program is intense and it is working! Across the U.S., *Goldman Sachs 10,000 Small Businesses* graduates are increasing their revenues and creating new jobs in their communities. Here are some statistics from Goldman Sachs:

- 99% of business owners who start the program, complete the program
- 67% of graduates report an increase in revenues after finishing the program
- 47% of graduates report creating new jobs in their communities
- 88% of graduates report that they do business with other graduates

When talking to graduates, I often ask them how the program has helped them. The most common answers usually include:

- *They have an appreciation for the peer-to-peer learning environment.* (They are often surprised that they were able to learn from business owners in other industries; but extremely happy that they had the opportunity to meet them and learn from them.)
- *They have a noticeable increase in their confidence.* (They are always very pleased with the knowledge they received and how that new knowledge has helped them to be more confident when negotiating, selling, hiring and leading their teams.)
- *They have a fantastic new network.* (They are usually ecstatic about the new trusted colleagues and new business partners they acquired by going through the program. Many mention that they have started an Advisory Board for their businesses and plan to fill their Board with the people from their cohort.
- *They feel more ready to grow and hire staff.* (They often mention that before the program, how difficult it was to take the risk of investing in new hires; but now, they feel ready to hire and expand.)

The Scholar's investment is their time. But, the returns are a more sustainable business, higher revenue, the opportunity to employ more people in their communities and a new network of thousands of graduates across the

country. Plus, they have a better understanding of what is needed to attract investors and lenders when pursuing capital to grow their businesses.

Furthermore, the Goldman Sachs initiative brings attention and partnerships to the educational institutions that host the program. For example, our Referral Partners Program brings local banks and business organizations to outreach events on the Morgan State University campus. Partners are introduced to all the resources Morgan State University can offer in addition to the quality of the faculty and facilities. These new relationships are fantastic for creating employment pathways for graduates and internship opportunities for students.

The Goldman Sachs program teaches business owners how to work ON their businesses instead of working IN their businesses. The program also gives business owners the tools to create positive change in their communities through job creation. More jobs mean more stability in the community, a greater tax base and eventually better schools, more homeowners and a stronger local economy.

My role in Baltimore...

To give you some background about me, I am a business consultant. I opened WHC, my business management and technology consulting firm, in 2009. Our clients are government agencies, financial institutions, universities and growing companies in North America, Africa and Asia. Additionally, I am on the Board of Directors for the Baltimore City Chamber of Commerce. And I often partner with the U.S. Small Business Administration, Department of Commerce, the Department of Treasury and the Greater Baltimore Urban League to provide free training to new business owners and help connect them to new tools and growth opportunities. Additionally, I founded Baltimore Professionals and Entrepreneurs. BPE has over 5400 members and we have hosted over 800 professional development events since 2011.

So, as a consultant and business owner, I know first-hand the difficulties entrepreneurs have in qualifying for business capital.

Barriers to Accessing Capital

In my experience, the 2 greatest barriers for small businesses, to accessing capital, are:

- Lack of information
- Low credit scores

As for lack of information, Baltimore is rich in resources. So acquiring knowledge is possible if business owners took full advantage of consultants like me or utilized the SBA, Small Business Resource Center, The Small Business Development Center, The Urban League Entrepreneurship Center, The Baltimore City Chamber of Commerce, The Minority Business Development Agency or the dozens of incubators in the city.

But, I believe all business owners would benefit from more coordination between these state, federal and local resources. Also, better marketing of programs and some integrated case management would help push new entrepreneurs to fully utilize these services. I believe that, for first generation or minority or women entrepreneurs, the information they need to grow exists. We just need to develop a better system for connecting entrepreneurs to the knowledge they need to develop sustainable business models, access capital and pursue RFPs and contract opportunities.

But, low credit scores... That is a different problem. When it comes to low credit scores, my experience is that minority and women entrepreneurs usually do not lack moral character or have some insidious desire to be delinquent on payments. Instead, entrepreneurs often have low credit scores because of three simple reasons:

- **First, their biggest customers are late paying them.** I can attest, set asides and government contracts don't always mean smooth sailing for growing companies. Often business owners wait for months for

payments from large agencies or organizations, well past agreed upon 30 or 45 day net payment terms. When big clients are late paying a business owner, that business owner needs to go into savings or find other sources to pay their employees. Then, they wait to get paid by the client. That delay often causes business owners to be late paying their creditors. And of course, those late payments negatively affect their credit scores. Then, their bad credit scores and inconsistent income prevent business owners from qualifying for the loans or credit lines they need from banks to cover payroll, add staff, buy new equipment or pay fees. It can eventually reach the point where a business can't grow because they experience an artificial cap on their capacity that is set by their limited financial resources. Not because their service is poor or their products are inferior, it is because they don't have the money to market effectively, buy equipment, pay accountants and attorneys or make investments in their infrastructure. This also means they can't hire people from their communities and help grow the local economy.

- **Second, they have little to no accumulated assets or wealth-** Minority and women owned businesses often don't have adequate savings, investment accounts or wealthy family and friends to provide start-up cash or short term personal loans. And it is the nature of business, that unforeseen situations occur that cause slow periods or create emergency situations that require immediate attention. With no cushion provided by savings or go-to sources of short term capital, that business owner is forced to close temporarily or permanently, lay off staff and possibly stop the streams that are providing revenue. And of course, no assets and slow Account Receivables are not attractive to investors or lenders. As I've grown my business, I have met more wealthy business owners. Wealthy entrepreneurs throw money at their mistakes and emergencies and have the financial cushion to outlast the situation, then regroup and begin again. But, an underfunded business owner, without access to capital, must develop some long-term, complicated, bootstrap plan to dig themselves out of their situation. And if that doesn't work, another small business fails and the local economic ecosystem takes a loss.
- **Third, overwhelming debt...** Ideal debt-to-income ratios set by banks are hard to meet when business owners have high student loans and maxed out credit cards. Minority and women business owners often use their personal credit cards to start their businesses. But, if they run into slow periods or emergencies, which are normal in business, and they can't get additional funding, they max out their credit lines, tighten their belts, grind harder and cross their fingers in hopes of making it through until business picks up. But, if that doesn't work, they shut down and their employees, suppliers and community suffer. All due to lack of funding and no access to capital.

Conclusion

As a management consultant, I understand the need for financial institutions to limit risk and set standards to protect their shareholders. But, as a Baltimore business owner who works with thousands of Baltimore business owners, I also see how our local economy and communities suffer when small businesses are not able to grow and offer long term jobs to the thousands of residents who want to work and take better care of their families.

The *Goldman Sachs 10,000 Businesses* program offers an amazing opportunity to businesses who make over $100,000 in annual revenue. Graduates come from diverse backgrounds and communities, and because of the opportunities the program affords, these business owners are adding jobs, positively affecting their communities and are prepared to access capital.

But, Baltimore entrepreneurs who haven't made $100,000 yet need help also! To be successful, small, minority and women business owners need to better access available free and low cost resources and be better supported by legislators, lenders and investors. I believe greater access to capital is the key to stronger small businesses. And I firmly believe that stronger small businesses, who employ local residents, are a cornerstone in the foundation of healthier, wealthier and safer communities in Baltimore.

I want to thank you and the committee for allowing me to speak to you today. On behalf of Morgan State University and the *Goldman Sachs 10,000 Small Businesses* program, I am happy to answer any questions you may have. Thank you.

Senator CARDIN. Well, let me thank all four of you for your contributions to this hearing, and I am going to have some specific questions.

But I am going to ask the general question first, and I welcome you supplementing this. And it does not have to be in a formal sense, but just giving your thoughts.

We had these tools available through the Federal Government to help access to capital for minority businesses, women-owned businesses. We talked about the 7(a) program. We have talked about the Community Advantage, the Community Advantage's attempt to get the 7(a) program more effective in the targeted areas that we are talking about.

We can argue whether it can be made more effective or less. We have some modifications that are being suggested. We need to respond to that.

We have the 504 program, which provides a longer-term capital for expanding businesses. The record in minority community, women-owned community in the 504 program is not impressive at all.

What changes can we make in the 504 program to have it better targeted for the communities that are not getting their fair share of these 504 loans? What concrete suggestions do you have to modify that program?

Then in regards to an area we have not really talked much today, which is one of the key resources the Federal Government makes available to small businesses, and that is the contracting, the Federal contracting 23 percent set-aside.

The Federal Government is the largest purchaser of services and goods in the world. So it is the largest source of business for small business in the world. How can we better—and by the way, we are doing a better job of meeting our 23 percent. I thank the SBA for its leadership and being an advocate for it.

I was responsible for getting an amendment in the National Defense Authorization Act, and I thanked Senator Risch and our Committee for the Offices of Small and Disadvantaged Business Utilization, which are included in all of the departments on their procurement side to make sure that they are doing their 23 percent. The amendment requires the SBA to see whether in fact they are carrying that out and report back to Congress on that.

We also passed in the National Defense Authorization Act a prompt payment provision, 15 days for small businesses, so that we could also deal with one of the issues you were talking about on slow pay.

My question generally is, What can we do to target that program more toward minority businesses, women-owned businesses? The record there is not as promising as the 23 percent, which we are doing a better job in reaching, and by the way, what can we do better for prime contracts rather than subcontracts? Because we know the power is in the prime, and how many more prime when they bundle—we passed anti-bundling legislation, but we need to have I think your input how we can make these programs more effective because having business gives you access to capital.

So if you want to respond now, fine. If not, I would just challenge you to give us information in that regard. I am more than happy to

Mr. CLARK. Senator, I would like to comment about the contracting piece.

The Federal Government has goals, 22 percent for small businesses.

Senator CARDIN. Right.

Mr. CLARK. Our issues in the country much more are directed toward minority business and for which we do not generally create goals because we have the whole issue of Croson and many other court cases, which limit the issue of race-based requirements and goals.

Only in the Federal 8(a) program—and you talked primarily about disability—do you have the disability—disadvantage—not disability—disadvantage do you have that item where you can look at if you are disabled or disadvantaged—disadvantaged.

And the problem there is that minority businesses are generally capped with size standards and with net worth requirements, which limit our ability to grow, and so I think it would be much more effective if we were to eliminate some of those standards for minority businesses to allow them to grow. We cannot become—many businesses can go up and get $6 million of revenue or a few million dollars in net worth, and all of a sudden, they are capped. And no longer can they get any of the set-asides or any other programs. So we need to open up these programs.

The most radical change would be if we were to open up our contracting for minorities to be the same for—as we have for American Indians, Alaska Natives, and Hawaiian, where there are no caps on wealth and which allow those companies to grow as much as they can. MSDC has that as their objective. They do not have any cap for the certification programs for corporate America. They want you to grow as large as you can so that you can provide their services to not only locally but regionally, nationally, and internationally where they do business. So why are we continuing to limit our minority businesses to being subcontractor programs with very small areas where we are allowed to grow?

Mr. SMOOT. I just have a couple of comments, and this is on the contracting side as well, Mr. Senator.

As you know, a lot of the minority businesses, to become primes, they need capital, and a lot of times, one of the things that we have done with the Maryland programs is to provide what we call "mobilization funding" because there are contract opportunities, but unless they have the capital up front to even get the contract started, they cannot compete. In a lot of cases, they just forego the contract because they just do not have the capital.

In terms of the banks, I have heard a lot of stories through the disparity studies that when they become sizeable and competitive, the banks have the larger contractors in their portfolios, and they are discouraged from lending to the minority businesses in order to—because it would create competition for them.

So we think that more access to substantial capital to graduate these companies from becoming continuous subcontractors to be-

coming prime contractors—the talent and the ability is there, but you just have to have that capital.

And one other comment, even on the State side, I think the State's minority participation program is not sufficient enough. In a lot of cases, what happens, the prime contractors are required for a year to meet those requirements, but after a year, they are no longer required. I think the participation efforts ought to be longer than a year because you want the continuous work for minority businesses.

Senator CARDIN. Ms. Miller, you mention in your article about modernizing the CRAs in regards to small business lending. Can you just elaborate a little bit more?

You point out the problems of bank consolidations and not having the headquarters. The CRA is not without controversy. We have had significant discussions about that in the United States Senate. It might be useful for the Small Business Committee to get input into the Banking Committee as we deal with this issue, and I would welcome your thoughts as to how that could be used to help achieve this objective of this hearing.

Ms. MILLER. So you may be aware that one of the banking regulators, the OCC, has just asked for a comment on a proposal to modernize the execution of the Community Reinvestment Act, and just for the benefit of our audience, this is a law that says if you are taking deposits in a particular area, you need to have an effort—or you need to have evidence that you are making loans back into particularly low- and moderate-income communities.

What we found in our work is that banks get to choose their assessment areas for where they are measured for their Community Reinvestment Act lending, and Baltimore, because it is not a headquarter bank location, is typically not the assessment area for the leading banks in the city today. So that is one problem because we are not getting attention on the activity in a particular market if the leading bank's headquarters are elsewhere. They might choose Charlotte, or they might choose Pittsburgh or Buffalo to get their Community Reinvestment Act ratings.

The banks that we do have in Baltimore, the largest banks are choosing as an assessment area the entire State of Maryland for looking at their lending activity.

So we lose the perspective and the focus on a small area when we can draw very large assessment areas. That is one problem.

I think that also small business lending is not particularly culled out of the data that banks provided on this measure, and I think it would be good to get more focus on particular kinds of lending that the banks are making.

The last thing I would say is that the ratings are very out of date in some cases. They are conducted irregularly. We do not conduct ratings for a long period of time, and we did not see any connection between small business lending that is taking place in Baltimore and the Community Reinvestment Act ratings for the banks that are active in this area, like Howard Bank or Harbor Bank.

So our suggestion would be in this age of big data, where it is much easier to get the information, that we try to modernize this to look at how banking is conducted in a world where there are

fewer branches and to really connected place-based data and activity.

That is a long complicated answer, but I would be glad to——

Senator CARDIN. What really got me, the information that was presented to me by staff. It is so shocking I did not think it was accurate, so I am going to say it anyway. The leading bank gave out 58 SBA 7(a) loans, and one of our largest banks gave out zero. That is kind of shocking.

Ms. MILLER. Yeah.

Senator CARDIN. And if CRA means anything in regards to community activities, how can you have zero for a big bank?

Ms. MILLER. To be fair, I think one of the bank's responses would be, "Well, we are doing some home mortgage lending. We are making larger loans."

Our focus was really zeroing in on small business lending, and you are correct. The numbers are pretty shocking. It does not mean that banks are not doing other things.

Senator CARDIN. If you are going to deal with the disparities that we heard about, the wealth disparity in this country, you have got to deal with entrepreneurship, and what do banks do? And they are not responding to the small business community? You are absolutely right. We have got to tailor it to minority businesses, but they are not even dealing with small businesses.

Ms. MILLER. I cannot disagree with you, Senator.

I would say that we need to think about it very holistically in terms of finding equity, capital for small companies that are not yet ready to borrow, but we also need to be right there next to them to provide loans when they are ready to grow.

It is going to take a lot of cultural change, I think, to improve the environment.

And, again, our focus is on a city, and a lot of the data that we see are based on much broader metropolitan areas or States or regions, and we lose that particular focus.

Senator CARDIN. Mr. Holmes, thank you for your presentation, and it is wonderful to see Goldman Sachs private entities get involved and trying to deal with this issue.

What have you learned from the Goldman Sachs participation that we could get more private interest in leveraging access to capital for minority businesses?

Mr. HOLMES. Well, I think that the Goldman Sachs program does a fantastic job of combining information with essentially a push-pull hand holding along the way. What I mean in particular is every single person who comes through the program is assigned a business advisor, and that business advisor, very knowledgeable, experienced, not only are they helping them to understand what they are learning each day in the program, but also to put together a growth plan that they can use after they graduate.

And so the reason why I think that is so important and I think that other entities should consider the importance of more coaching and more hand holding or case management, per se, is because it works.

Another example besides the Goldman Sachs program, I was a subcontractor on a program through the Department of Defense called the DoD Velociter Program for a few years, and that was

very effective, the same amount of great information. What really made those companies that have received a SBIR grant and they were going for Phase I, Phase II, Phase III, helping them to really move along, it was the coaching that allowed them to do it, teaching them how to create a bid/no-bid process, teaching them how to identify which parts of the budget were actually funded by Congress, and so which agencies to target. But it was that coaching that really taught them how to do it. A lot of them were first generation business owners, or they really were just focused on technology. So they did not really understand the business side of marketing and sales and how to really grow a sustainable company.

So I think—and let me also mention that Bloomberg—I want to thank them for—Bloomberg Philanthropies for also partnering with Goldman Sachs here in Maryland to be a part of this initiative, and I think more of that will only really help the economy.

I think the Goldman Sachs does a great job of focusing on affecting small businesses because if you can affect a small business, help them to be more sustainable, they are going to hire more people. If they hire more people in that community, that means the community will probably become more stable. That means there will be a greater tax base. There will be better roads, better schools, more firefighters, more police officers. That is really the avenue or the approach we take.

I think if more organizations did that here in the city but then also across the United States, we would have a stronger local economy, so I think it would turn into a greater national economy.

Senator CARDIN. Thank you. That was very helpful.

Mr. Clark, I appreciate you mentioning the Minority Business Development agencies. The Trump administration zeroed out the budget. Congress restored it. So the Senate in this year's budget has restored the funds. We recognize the value of the program. It has been a 50-year program.

You mentioned it. You talked about it. Are there ways that we can strengthen that agency to be more effective in carrying out the mission?

Mr. CLARK. Yes, Senator. I appreciate Congress re-appropriating more money to the agency.

The significant thing that I am not sure everyone is aware, though, that while it was refunded more for FY 2018, for FY 2019, many of the centers are—their contracts, even though they may last for a year from September to September, they are being terminated March 21st of 2019. So there is a move under foot in the Administration.

Senator CARDIN. Determined by the Administration?

Mr. CLARK. Yes.

Senator CARDIN. Administrative action.

Mr. CLARK. They have been cut by administrative action.

And the problem is that MBDA was created on the executive order. So, therefore, it is not a regulation that was passed by Congress, so the President and the Administration can make some changes in it.

Senator CARDIN. So one way to improve it would be to give it a statutory basis.

Mr. CLARK. That would be the first thing, give statutory approval, and—well, that is probably the only way that you can do it.

And it is very important that we do be maintained. As I mentioned in the testimony, we are the hands-on people. We get calls every day. Some, we have to defer off. Our goal is to work with companies that are million dollars in revenue. That is the general objective.

We get a lot of calls from people less than that, and we refer them off to the SBDCs or other PTACs and other places to try to get startup help, but we have to continue to work with them. And we try to direct people who are looking for capital, for example, to minority-friendly institutions.

The issue about capital and minorities is that, as Ms. Miller said, there is a cultural change necessary, tactfully stated. What she means is that we have to end the problem with a minority walking into the door and you already lose a few points on your credit rating just because—the rules are objective rules, but they are subjectively applied. And so we need to figure out how to take away the subjectivity.

One of the ways of doing that is to make a requirement that if you do not—big banks, if you are not giving out a certain number of loans, you will not have access to something else, like Federal deposits that are coming in from which they make all the money. So there are ways of trying to improve those processes.

But back to MBDA, it is imperative that we try to do everything we can to maintain them. A statutory situation is the best—and also to figure out if there are ways to incent other organizations to pick up the ball that should the Administration drop it, that we provide all the monies for organizations like the Minority Supplier Development Council to still be able to do that developmental-type services.

Senator CARDIN. Mr. Smoot, you mentioned returning citizens, and I appreciate you doing that. It is of particular interest to me. It should be an interest to everyone. We have too many people who we lose in our economy that need an opportunity.

Can you just elaborate suggestions you might have on how we can better target these programs to a very vulnerable group of people returning from our prison systems?

Mr. SMOOT. I think in general, they may benefit from the Goldman Sachs program model where—because many of them have not gone to college, have not gotten business degrees and what have you. And the training, I think is critical, and I think the business community, including folks like myself and Stanley Tucker, would participate in a real hands-on training. I think mentorship programs would be very valuable and internship programs. There is a plumbing company that was one of our former portfolio companies that actually has internships. Probably 40 percent of his workforce are returning citizens, and I think that is a tremendous model to follow.

Senator CARDIN. And you can imagine how challenging it is for minority business owners to get access to capital. We have already talked about that. If you are coming out of prison, I am sure your

credit score is not exactly that high. To be able to participate in any of these programs is going to be extremely challenging.

So I would just urge us to think of ways that we can offer opportunities for people that have really been disadvantaged in our community, and there is a lot of creativity that is out there that is untapped that can help the individual in our community. We need to think somewhat out of the box.

I was impressed by the response that our regulations may try to fit into a cookie-cutter type of setup. Individuals do not fit into that, so we have to be flexible enough, and that is why—I think it was Harbor Bank. They know their customers, and they get that sense.

Sometimes the banking regulations and the rules and regulations make it difficult to do what you think is right, and we got to make sure that you can do what is right.

In most cases, it will pay off big dividends. There will be failures, but failures are part of life, and that is part of what we are dealing with.

Mr. SMOOT. I thought John made a great point because many of us come from the communities that those guys and ladies came from. So we can relate to some of the things and issues that they have, and that goes a long way, particularly in terms of—Ken was speaking about in terms of the cultural awareness, so being able—having the right people to do that is a great asset.

Mr. CLARK. An example of that, I had a client come into our center a few days ago. I filled out a contract for her to do LED lighting, and she said, "I am sorry. I cannot take the contract because I cannot get a lot of credit in order to buy the product in order to sell it." And so I was able to find what I call—well, I am not calling it—minority-friendly lender within a big bank who knows the people and knows how to apply the rules. He was able to get her only $25,000, not very much, line of credit, but that was enough for her to get started.

Now, next time, she will be successful. She now has past performance. She will be able to take a larger contract the next time and to also extend her line of credit.

But it is a matter of having what we refer to as minority-friendly lenders even within the big banks, someone who is culturally sensitive.

Senator CARDIN. Well, I want to thank this panel. Both panels have been extremely helpful.

We clearly—as I mentioned in the beginning of this hearing, this is an oversight hearing for us to get input as to how our Committee can work with the SBA to improve the opportunities for access of capital in the targeted areas that we have talked about.

This is an issue that Democrats and Republicans can come together with. We can get something done, and I think this hearing has been very helpful.

You will notice that there are a lot of people around us that are taking in this information. It is shared with all members of our Committee and all members of the United States Senate, and I know that this will be very helpful in carrying out our function.

I do urge you to let us have additional thoughts on how we can refine the specific programs for access to capital or whether there

are additional suggestions you have on new opportunities for access to capital, and it can be outside of the traditional norms. Please let us know, and we will try to partner and make that a reality.

As is the tradition of our Committee, the record will remain open for 2 weeks for additional statements or questions that may be asked, and again, I thank all the witnesses for their participation.

And with that, this hearing is adjourned. Thank you all.

[Applause.]

[Whereupon, at 12:05 p.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

Ranking Member Benjamin L. Cardin
Opening Statement
Senate Small Business and Entrepreneurship Committee
"Strengthening Access to Capital for Minority-Owned Small Businesses"
Field Hearing
Morgan State University
September 14, 2018

Good morning and thank you for joining us for this Senate Small Business and Entrepreneurship Committee hearing entitled, "Strengthening Access to Capital for Minority-Owned Small Businesses."

I want to thank Senator Risch, the Chair of the Senate Committee on Small Business and Entrepreneurship, for consenting to this field hearing. Unfortunately, Senator Risch is unable to be with us today,

but I appreciate his interest in the subject and the many bills and initiatives we have partnered on during my time as Ranking Member of the Committee. I want thank his Deputy Staff Director, Meredith West, and his lead staffer for small-business capital, Renee Bender (Ben-dur), and the Committee's Chief Clerk, Kathryn Eden (ee-done), for joining us today. Welcome to Baltimore.

I want to thank President David Wilson of Morgan State University for allowing us to host this field hearing on their campus. I want to mention that Morgan State has graduated some of the finest leaders on the issue of minority-owned businesses. Related to today's hearing, we have our witnesses Mr. Smoot and Mr. Clark.

Mr. Clark is representing the Capital Region Minority Supplier Development Council, which is headed by a Morgan State alum, Ms. Sharon Pinder. The Harbor Bank of Maryland, represented by Mr. Lewis today, is headed by Mr. Joe Haskin's Jr. – also a Morgan State alum.

We have two panels of distinguished witnesses today, and I thank them all for making time to be here. I also want to thank all of the members of the public who have taken time out of their day to join us as we hear testimony on the important issue of access to capital for minority-owned small businesses and how to strengthen it.

Increasing opportunities for minority-owned businesses is a priority for me.

As some may know, this is my second time serving as the top Democrat of the Senate Small Business Committee. I was briefly the Ranking Member in 2015 before taking over the Senate Foreign Relations Committee. During that short time, I held a hearing on minority access to capital at Bowie State University to raise awareness of the unique barriers that affect minority-owned small businesses.

Thanks in part to the testimony of those witnesses, some of whom are represented here again today – such as FSC First from Largo and Meridian Management Group from Baltimore – we were able to build a record to support the continuation of fee waivers for small-dollar 7(a) loans and boost the capacity of the SBA microloan program – two SBA resources that disproportionately help small businesses owned by minorities.

That field hearing also raised awareness of the need to look at resources for minorities and women to buy businesses of baby boomers as they retire over the next ten years and sell their businesses. Related to succession planning for baby-boomer businesses, the Small Business Committee ended up enacting bi-partisan legislation to expand financing through the SBA's largest loan program to small businesses that want transition to employee-ownership as the owners retire.

Now that I'm Ranking Member of the Small Business Committee again, I feel it is important that we build on what we started in 2015. The fastest growing group of firms in the U.S. are owned by minority entrepreneurs.

The great state of Maryland is no exception. In fact, Maryland is home to the highest average number of minority-owned businesses in the country, and ranks second for minority women-owned businesses. In 2012, minority businesses accounted for 38% of all Maryland small firms, compared to 29% nationally.

Despite this growth, gaps in key areas remain between Maryland's minority-owned and non-minority owned businesses. In 2012, minority-owned businesses in Maryland contributed an average of 0.8 jobs to the economy, compared to 2.3 jobs for non-minority-owned businesses.

Non-minority-owned firms also reported gross receipts four times that of minority-owned businesses.

This gap results in part from the significant obstacles that minority business owners face in accessing capital, including capital through contracting opportunities.

Here's what we know: Minority-owned businesses are two to three times more likely to be denied credit, more likely to avoid applying for loans based on the belief that they will be turned down, and more likely to receive smaller loans and pay higher interest rates on the loans that they do receive. In addition, minority-owned firms are more likely to seek credit from an online lender – despite low satisfaction rates and virtually no regulation.

Adding to these barriers, we know banking consolidation has harmed small business lending in Baltimore.

According to a recent report from Johns Hopkins – which will be presented during our second panel by Mary Miller – between 2007 and 2016, bank deposits in Baltimore nearly doubled while the ratio of small business loans to deposits plummeted. This hurts all small businesses, but it most likely exacerbates the disparities that minority-owned small businesses face.

Access to capital matters because it correlates to hiring, closing the wealth gap between minorities and non-minorities, and fueling the general economy.

Based on data from the National Small Business Association, there is a clear correlation between a small business's ability to get financing and its ability to hire.

If minorities aren't getting access to capital, the economy is losing job opportunities.

As Stanley Tucker testified in 2015 on this topic: "...there is a direct correlation between the growth of these businesses [minority- and women-owned] and who they are – minorities hire minorities; women hire women."

Entrepreneurship is one way to chip away at the wealth gap experienced in many minority communities, particularly in the black community. According to the Association for Enterprise Opportunity, the median net worth for black business owners is 12 times higher than that of black non-business owners, and not simply because those who start businesses start out with more assets.

The Small Business Administration has programs that exist to increase access to capital. They do a lot of good, and I support them, but some of these programs struggle to adequately serve minorities and have been struggling for quite some time.

In the 7(a) Loan Guaranty Program, the SBA's flagship loan program, black business owners received only 4 percent of approvals and 2 percent of dollars in Fiscal Year 2017, despite owning 9 percent of the country's small businesses. Hispanic or Latino borrowers received only 8 percent of 7(a) approvals and 6 percent of dollars, despite owning 12 percent of small businesses.

In Baltimore, the lending environment is even more disparate, with black business owners receiving only 19 percent of approvals and 12 percent of dollars despite owning 47 percent of businesses.

The SBA's 504 Program, which finances buildings or equipment for small businesses that are poised to create or save local jobs, also does a lot of essential financing in this country, but it consistently fails to reach black and Hispanic or Latino borrowers at a level equal to their small business ownership.

But it's not all bad: the SBA's Microloan program and the 7(a) Community Advantage Pilot Program have shown promise of reaching more minorities,

and I look forward to hearing more from our witnesses about what makes these programs effective.

Lack of access to credit for minorities is not a new problem, and the trends show that the situation is not improving as quickly as it needs to.

We can and must do better.

Today we will hear from witnesses who can talk about the programs I just mentioned. If SBA's programs are not working to adequately reach all Americans, I want to have a constructive exchange about how to make them better. I also want to hear about non-SBA products and services that are helping minority-owned small businesses in Maryland.

Let me now turn to our witnesses.

First, we will hear from **Bill Manger (Main-Grr),** Associate Administrator of the SBA's Office of Capital Access. Mr. Manger oversees the SBA's loan program policy and oversight, managing a $120 billion portfolio of direct and guaranteed loans, nine operation centers, and 560 employees.

Our next witness will be **Dawn Medley**, Vice President of Business Finance Programs for FSC First, a non-profit organization whose mission is to provide local, small, and minority-owned businesses in Prince George's County and the State of Maryland access to creative and innovative finance solutions through direct and indirect loans.

Prior to her current position at FSC First, Ms. Medley served as the Director of Business Lending Programs at the Maryland Department of Housing and Community Development. FSC First President, Ms. Shelly Gross-Wade, testified at our 2015 field hearing on minority access to capital, and I want to thank FSC First for their continued commitment to finding solutions for Maryland's small businesses.

Following Ms. Medley's remarks, we will hear from **John Lewis**, Executive VP and Chief Administrative Officer of The Harbor Bank of Maryland – the only Maryland chartered African–American owned and managed commercial bank. Harbor Bank is an important fixture in Baltimore, especially to the black business community,

providing underserved entrepreneurs with SBA loans and business assistance, checking and savings accounts, and crucial financial guidance. Mr. Lewis has over 20 years of experience in financial services and has contributed to the creation of Harbor Bank's social impact programs, including the Minority Pre-seed Venture Capital Fund and Emerging Real Estate Developer Program, which are supporting the success of minority-owned businesses in 21st century industries.

After Mr. Lewis, we will hear from **Marla Bilonick (Bih-law-nick)**, Executive Director of the Latino Economic Development Center (LEDC), on the importance of SBA's microloan programs for business owners – and particularly Latino business owners – in the Baltimore area and D.C.

Ms. Bilonick leads LEDC's regional efforts to drive the economic independence and social advancement of working class Latinos and minorities. LEDC is the second largest SBA microlender in Maryland, and found out this week they have been approved to participate in the SBA's 7(a) Community Advantage Pilot program. (A quick thank-you to Mr. Manger for any role he played in that.)

Our second panel will commence with **Ken Clark**, a business consultant in the Minority Business Development Agency (MBDA) Business Center representing the Capital Region Minority Supplier Development Council. In this role, Mr. Clark provides strategic counselling and business development services to local and national minority businesses.

Mr. Clark will discuss the challenges minority small businesses face in obtaining federal contracts – an essential resource for small businesses here in Maryland.

Following Mr. Clark's testimony, **Tim Smoot**, Senior Vice President, co-founder and CFO of Meridian Management Group, will speak to us about investment capital for minority-owned firms. We are happy to have Meridian Management Group back with us today as we had the President and CEO, Stanley Tucker, join us in 2015 as well. Mr. Smoot handles the preparation of financial reports involved in the approval of investment proposals at Meridian Management Group and has advised minority- and women- owned businesses in Baltimore throughout his 30+ year career in financial services.

Next we'll hear from **Mary Miller**, who is a senior fellow at the Johns Hopkins University's 21st Century Cities Initiative. Today she will present findings in the 21st Century Cities' eye-opening report entitled "Financing Baltimore's Growth: Strengthening Lending to Small Businesses." Ms. Miller – the lead author of the report – and her team conducted critical research that identified causes for the decrease in small-business lending throughout Baltimore County.

This report and her testimony today will serve as another resource in finding solutions to level the playing field for all business owners in the region. I had the pleasure of introducing Ms. Miller to the Senate Finance Committee before her 2011 confirmation hearing to become Treasury's Under Secretary for Domestic Finance.

Finally, we will hear from **Will Holmes**, who is representing Morgan State University in his role as the Director of Outreach for the Goldman Sachs 10,000 Small Business Initiative. As a consultant and a small-business owner, Mr. Holmes is "living the access to capital issue" while helping expand opportunities for other minority-business owners in Baltimore.

The Baltimore City Chamber of Commerce recently awarded Mr. Holmes the Business Development Advocate Award for his deep passion for the community of fellow business owners and his action on their behalf. His insight from both sides of the issues is highly valued.

I would like to now turn our attention to our first witness – **Mr. Bill Manger (Main-Grr)** – to hear his testimony.

Closing. I'd like to thank the witnesses and attendees for coming today. The record will remain open for statements and questions for two weeks. The hearing is adjourned.

Statement for the Record
Chairman Jim Risch
U.S. Senate Committee on Small Business & Entrepreneurship
"Strengthening Access to Capital for Minority-Owned Small Businesses"
September 14, 2018

First let me thank Ranking Member Cardin for holding this hearing on access to capital. Access to capital has, and continues, to be an issue of huge importance to entrepreneurs and small businesses – access to the necessary capital is often the deciding factor in whether an entrepreneur is able to get their business off the ground, and whether a small business is able to be successful past the crucial first two years of operation.

As Chairman of the Senate Small Business and Entrepreneurship Committee, I strive to advance and support policies that will break down barriers for small businesses seeking to access capital, both through the Committee, and the larger Senate. For example, I strongly supported the efforts of the senior senator and Senate Banking Committee Chairman Mike Crapo to provide regulatory relief to the nation's community banks that provide critical access to capital in their communities. The Economic Growth, Regulatory Relief and Consumer Protection Act (P.L. 115-174) provides an appropriate level of regulation for smaller financial institutions to allow them to invest further in their communities. I believe the continued downward trend in lending to entrepreneurs and small businesses is directly related to the over-regulation of our community banks who have had to comply with regulations meant for the biggest banks and whose ability to invest in their communities has been stymied by compliance burdens and complex rules not meant for smaller institutions.

Overregulation and the tightening of traditional lending by banks has made the programs offered by the Small Business Administration (SBA) a vital resource for small

businesses. These programs are intended to provide some peace of mind for lenders in the form of a government guarantee for a portion of the loan in order to facilitate lending to entrepreneurs and small businesses that would otherwise be unable to obtain credit. I understand Ranking Member Cardin has focused this hearing on minority-owned businesses as an example of one of the groups that is served by SBA loan products. One program that has been mentioned heavily in this hearing is Community Advantage, a pilot program at SBA. This program is mandated to do 60 percent of its lending to underserved groups, including minorities and women. On September 12, 2018, the SBA published a notice extending the Community Advantage program past its expiration date of March 31, 2020 to September 30, 2022.

The notice also revises the definition of an underserved market to include Opportunity Zones and Rural Areas. This change will be instrumental to providing capital to borrowers that need it. I have long advocated for, and held hearings on, the needs of entrepreneurs and small businesses in rural areas and I'm pleased to see that SBA has made this change. Additionally, the Tax Cuts and Jobs Act of 2017 (P.L. 115-97) included a provision helmed by Small Business Committee member Tim Scott (R-SC) that would provide tax incentives for long-term equity investment in struggling communities. John Lewis, the Executive Vice President and Chief Administrative Officer of Harbor Bank Maryland and a witness at this hearing, underscored the positive impact the Opportunity Zones will provide for distressed communities, both rural and urban, across the country. All-in-all, the notice released by SBA provides stability to this program, expands it in important ways, and balances the need to lend in underserved communities with good governance policies.

I'm pleased the conversation about access to capital continues and I look forward to working with Senator Cardin to advance bipartisan efforts to ensure entrepreneurs and small businesses across the country have access to the capital they need to grow, continue to contribute to our economy, and create jobs.

"Strengthening Access to Capital for Minority-Owned Small Businesses"
September 14, 2018, 10:00 a.m.
Morgan State University – Earl G. Graves School of Business and Management,
Martin Jenkins Hall, Room 514,
Baltimore, MD 21251

Supplemental Testimony from Mr. Kenneth Clark
(Based on questions raised during the Hearing)

1. The Importance of the Minority Business Development Agency

As I mentioned briefly in my testimony, the 35 business centers respond daily to calls for advice and guidance in how to access contracts, how to get financing, or how to position themselves to meet the right people that can help them. The MBDA guideline for business centers is to work with firms with greater than $1Million in revenue and 2 -3 years in business so that our efforts are concentrated on firms with the ability to grow. They have already passed the threshold of start-ups. We refer many callers to the Small Business Development Centers in the region. Sometimes we are compelled to take on an MBE with the potential for rapid growth or a unique product. MBEs are desperate for help. Some are in the 8(a) program and nearing the end of their 9 year time and haven't been successful. Others are newly into 8(a) without clear direction on how to proceed. These people need someone who take the time to listen and understand where they are and help them determine what their next steps should be. They need the business centers to use the following tools the MBDA provides them to find contracts or contacts for contracts:

- GovPurchase that can provide data on all federal, state and local contracts, past and present and with contact information on contract officers and prime contractors involved in the federal, state and local contracts;
- Dodge that provides on construction projects throughout the country; and
- DNB/Hoover with its business intelligence data.

These tools and our knowledge of the local environment in which these MBEs operate allow us to provide strategic business counseling to our clients.
Ex. 1. Recent call from a MBE who has a contact that says there is an opportunity to a certain programming language but she doesn't know where to find the people. We scanned our database for IT clients and put out a request for the language and have provided her with 7 or 8 firms that can supply the talent. We are helping that client better frame the opportunity with the contract officer and helping her narrow her choices of firms with which to partner for the opportunity.
2. We became aware of a contract opportunity and we called the firms that we believe qualify and we sat up the contacts, got them the firm to register on the right websites and a $500K contract was won.
3. I called an MBE about an LED lighting contract. She said she couldn't bid because she could get a line of credit to fund the purchase. I put her in touch with an MBE-friendly banker and within days, she got a small LOC which allows her to start working toward larger contracts.

2. Contracting Goals

I commented earlier that the biggest challenge areas are access to capital and access to the information about contracting opportunities. The Business Centers help to address these problems. However, the biggest challenge to contracting was stated in the analysis of disparity studies is being a minority and the stigma that goes with it. The studies used the term MBE/DBE bias – not wanting to use minorities. Therefore, RACISM and BIAS are the biggest challenges in federal contracting for minorities. I know we don't want to use those words, so we say "disadvantaged" and make believe that there are some other issues involved rather than skin color. Biased bank officials won't give an MBE the money. Biased contract officers won't give information about a contract or are reluctant to award a contract to a minority. Biased outreach staff and other staff positions certainly won't help the MBE learn about procurement processes. With their bias, they automatically withhold points on applications for capital and the qualifications for a contract. Because they don't know the MBE firm, they think the MBE cannot do quality work or will repay the loan. They also won't try to get to know the MBE to build a level of trust. Biased persons in the lending and contracting processes all use what seem to be objective standards but often they are subjectively applied.

So how do we deal with the issues? The best models to support increased minority spend are those in which senior leadership in an organization have made it clear that diverse procurement is an organizational imperative and it backed by both performance measures and salary treatment. Corporations with successful supplier diversity programs get reports up to the boardroom level. A portion of managers evaluations top to bottom include what they did or didn't do to support diverse procurement. This extends beyond just the procurement departments but the end user organizations. Supplier diversity mangers are empowered to make sure minorities are included in every procurement opportunity under consideration. In some corporations, they have to sign off on the procurement that minorities have been fairly included in the procurement decision and that there were valid reasons why they did not get the contract. In the federal government structure, cabinet secretaries and top civil servants need to be charged with meeting diversity goals and called out if their departments are not meeting objectives. This can be effective. A few years ago, I was leading a business conference in Washington and we wanted to also hear about federal opportunities. We had difficulty getting federal agencies to attend. By coincidence, President Obama stated in a cabinet meeting that week that he wanted more outreach to minority businesses. The very next day, we were getting calls asking to appear at our conference from agencies we had not even called earlier. When corporate Chairmen & CEOs Wes Bush at Northrop Grumman or Ivan Seidenberg at Verizon used to ask about supplier diversity, contract managers knew that it is important and extra effort went into it. The President and Cabinet Secretaries have the same power to change the working rules in their organizations.

I'd like to add one more point here. Because of the historic national programs that appropriated the lands and wealth of these indigenous peoples and subsequent subjugation and repression of their livelihood that resulted extreme poverty, the federal government has made special regulations regarding Native American, Hawaiian and Alaskan Native Corporations as follows:

> Special Rights Under the SBA 8(a) Program. - Tribal and ANC 8(a) firms are eligible to receive sole source 8(a) contracts regardless of dollar size, with no upper limit, while all other 8(a) firms may not receive sole source contracts in excess of $3 million for services and $5 million for manufacturing.

The full rules are more expansive but under this rule, Alaska Native 8(a) firms can compete more openly and fully without having to watch wealth or revenue caps that normally apply to other 8(a) and DBE firms. Essentially, they can grow to be as large as they able to grow. The majority of other minority firms are trapped into sub-contractor status because to personal net worth and net revenue caps. If we were serious about support to minority businesses, and I have to say especially in this case, African American minorities whose families survived the institution of slavery and its spin-off, the "Jim Crow Laws", minority businesses should have the same program as the Native American and Alaskan Natives in doing business. The fact that a few minority firms have managed to reach excellent heights in business, the majority of minority firms have not. Note that corporate America does not have these artificial standards for their procurement programs. There are no size standards or wealth caps. They want the companies that work for them to grow as large as possible in order to provide services to them throughout their national and international footprint. The federal government could also benefit from the services of capable minority firms.

3. Small Business Advocacy with the Federal Government: OSDBUs

I have met and worked with OSDBU personnel. I see them regularly at conferences and trade fairs. OSDBU started under Public Law 95-507 which addressed SMALL BUSINESS ISSUES. They do outreach, help with policy in their agencies, and provide information. We occasionally learn about forecasts and contracts with their agencies.

The OSDBU directors and staffs are like the Supplier Diversity Staffs in corporations. Not all are created equal. I would strongly endorse your efforts to have them meet the federal requirements. To meet the statutory requirement is the bare minimum of performance we need. OSDBUs are somewhat held accountable for the results in their agencies but they can't be if they have no power other than outreach and helping to set goals. The words of the regulations is "at least 23% small business" with certain breakdowns for various sub-categories – Black, Hispanic, Women, Hub-Zone, etc. I've found goals for construction for disadvantaged businesses. Due to various court cases, the federal government can't specify race – but race is the most critical issue on the table.

I often feel that they could empowered to do more to advocate for minorities in the contracting process. They should have the authority to make sure minorities are considered and included in every procurement possible. Let's use the "Roony Rule" for contracting. (As required for football coaching jobs, the team must look at 5 minority candidates for the job.) Every federal contract must have at 5 minority businesses actively considered for the contract and signed off by the OSDBU.

4. Prompt Payment for Small Business Contractors

Thanks for your effort to support prompt payment for minority contractors. It is absolutely critical to small businesses – and even more important to small minority businesses. Without question:

- Minority businesses will often have financed projects with high-interest debt financing, e.g., credit cards, alternative lending sources, factoring, lines of credit.
- They will need to pay their employees as soon as they can in order to keep them for the next job.
- They need to pay their suppliers quickly in order to maintain business ties with them. Late payments will cause their suppliers to demand payments up-front which many firms will not have the capital to do. They will then lose more contracts.

SEPTEMBER 2013

Partnership for Lending in Underserved Markets

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

Carolyn Karo and Jackson Mueller

ACCESS TO
CAPITAL

MILKEN INSTITUTE

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.

EXECUTIVE SUMMARY

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

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.

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 Innovation 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

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.

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]

BACKGROUND

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

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%

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).

Table 4. U.S. Population, 2012

		2012
Total	313,914,040	
Black	41,204,793	[illegible]
Asian	16,145,821	5.14%
Hispanic	53,027,708	[illegible]
Minority	116,208,385	[illegible]
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

[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 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 Prptection 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

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.

- **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.

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

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
Eugene Cornelius, Jr., Deputy Associate Administrator, Field Operations, SBA
Joe Haskins, Jr., Chairman, President, and CEO, The Harbor Bank of Maryland

Baltimore Steering Committee

Jorge Eduardo Castillo, Chairman, Board of Directors, Maryland Hispanic Chamber of Commerce
Gordon Cooley, Commissioner, Division of Financial Regulation, Maryland Department of Labor, Licensing and Regulation
Jayfus Doswell, President & CEO, The Juxtopia Group
Howard Henderson, President & CEO, Greater Baltimore Urban League
Sean McCabe, Administrative Vice President, Business and Professional Banking, M&T Bank
Diane McKoy, President & CEO, Associated Black Charities
Paul Taylor, Executive Director, Baltimore City Small Business Resource Center
Stanley Tucker, President & CEO, Meridian Management Group
Arnold Williams, Managing Director, Abrams, Foster, Nole & Williams, P. A.
Alicia Wilson, Vice President for Community Affairs and Legal Advisor, Sagamore Development

Los Angeles Steering Committee Co-Chairs

Kevin Klowden, Executive Director, Milken Institute California Center
Victor Parker, Los Angeles District Director, Small Business Administration
Mark Robertson, President & CEO, PCR Corp

Los Angeles Steering Committee

Frank Aguirre, Business Development Manager, City of Los Angeles
Michael Banner, Chief Executive Officer, LA LDC
Sandy Cajas, President & CEO, Regional Hispanic Chamber of Commerce
Earl "Skip" Cooper, President & CEO, Black Business Association
Angela Gibson, President, Greater Los Angeles African American Chamber of Commerce
Ruben Guerra, Chairman & CEO, Latin Business Association
Antonio Manning, Global Philanthropy Executive, JP Morgan Chase
Ann Sewill, Vice President, California Community Foundation
Tunua Thrash-Ntuk, Executive Director, Local Initiatives Support Corporation (LISC)
Sal Varela, Director, Pan American Bank
Gilbert Vasquez, LA Latino Chamber of Commerce
Jose Villalobos, Senior Vice President, TELACU
Eric Weaver, Chief Executive Officer, Opportunity Fund

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

PHASE I: PROBLEM DEFINITION

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	Lender Working Group
Policy and Regulatory Working Group	Policy and Regulatory Working Group
Economic Development 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

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.

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.

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]

[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.

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-

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

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.

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

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.

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 midsized 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.

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

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.

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

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

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

(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 contact is secured.

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

- 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

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]

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

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.

[x] "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

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

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

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).[38]
	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.

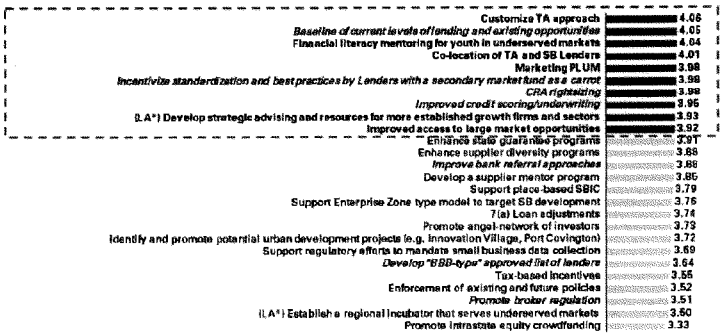
Strategy	Activity	Description
5. Improve technical assistance.	Support co-location of TA and small-business lenders.	In key zip codes, work with select small-business lenders to have embedded TA providers that can assist with both education or lenders and provide support for small businesses.
	Customize 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 provider(s).
	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.

* While MI still believes the amount of small business data that is collected and published is insufficient, after further research and discussion with stakeholders we have concluded supporting Dodd Frank 1071 small business data collection requirements may not be the most appropriate means of collection. During Phase II we are continuing to learn more about the mandate as well as alternatives.

APPENDIX C. PLUM SURVEY RESULTS

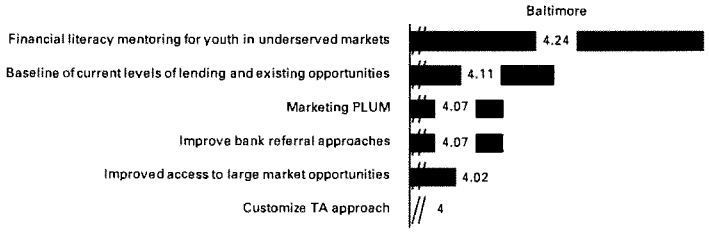
Methodology: In early 2017, the Milken Institute prepared a survey for participants on the Los Angeles and Baltimore PLUM task forces. Participants were asked to rank each of the activities (see Appendix B) from one to five, with one being least important and five representing most important. As can 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

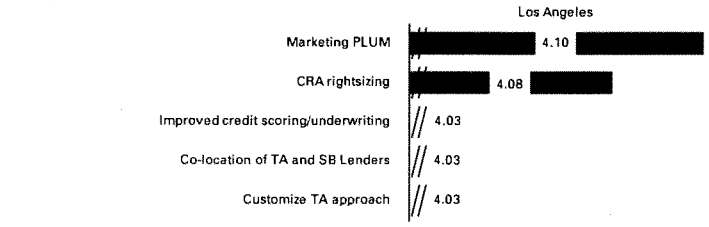


*Note: Sample size: 86. *Only included in LA survey (sample size: 40)*

Los Angeles and Baltimore Survey Results: Top Activities Broken Out

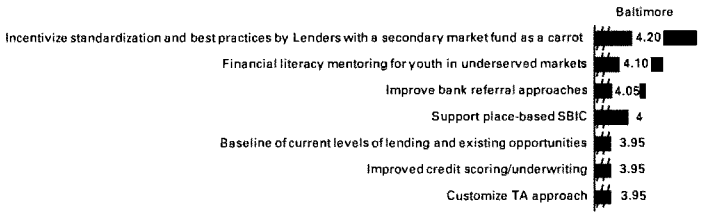


Note: Sample size: 46

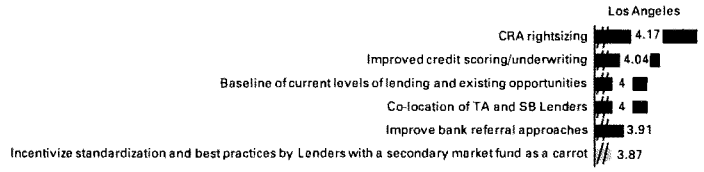


Note: Sample size: 40

Los Angeles and Baltimore Survey Results: Lender Working Groups

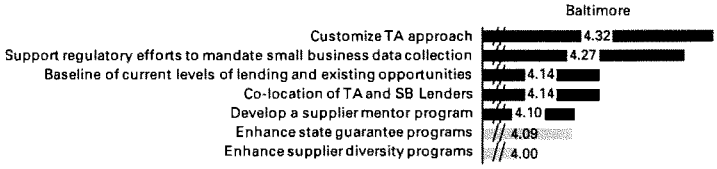


Note: Sample size: 20

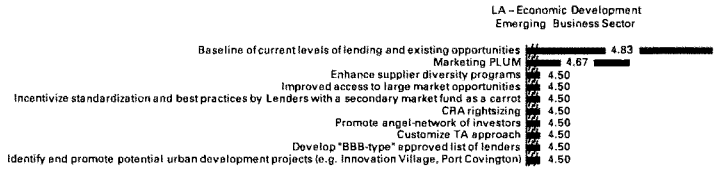


Note: Sample size: 23

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

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 INTITIATIVE

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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Partnership for Lending in Underserved Markets

Phase II Summary: Lessons Learned for Advancing Minority Small Business Capital Access

CAROLYN KIRK SCHULMAN

MILKEN INSTITUTE

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The Center for Regional Economy promotes development and innovation that drive regional economies and expand opportunity for people and communities. Our research, convening, and partnerships develop and implement new approaches to economic growth, workforce development, and inclusion that prepare regions to succeed.

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Partnership for Lending in Underserved Markets

Phase II Summary: Lessons Learned for Advancing Minority Small Business Capital Access

CAROLYN KARO SCHULMAN

LESSONS LEARNED

OVERCOME DATA DEFICITS TO IDENTIFY OPPORTUNITY

ENGAGE ANCHOR INSTITUTIONS AND LOCAL STAKEHOLDERS, AND RECOGNIZE COMPETITION

DEVELOP CULTURALLY-COMPETENT MARKETING, OUTREACH, PRODUCTS, AND SERVICES

BUILD WIDER AND MORE TARGETED NETWORKS

USE TECHNOLOGY AS A TOOL, NOT A SOLUTION

IDENTIFY CHAMPIONS TO PROMOTE LOCAL POLICY

EXECUTIVE SUMMARY: LESSONS LEARNED FOR COLLABORATION

Through the Milken Institute and U.S. Small Business Administration (SBA) Partnership for Lending in Underserved Markets (PLUM) initiative, we are learning how to improve collaborative efforts in a given market and around specific capital access solutions. There have been many across-the-board lessons learned through our local pilot programs and national work to date. Some speak to approaches to partnership and coalition-building while others are reflections and recommendations for existing capital and technical service providers.

Overcome Data Deficits to Identify Opportunity

Maximum opportunity for economic growth lay in the overlap among industries in which Blacks and Hispanics are strong (i.e., own businesses and are employed), in the industries that are growing regionally, and the communities in which Blacks and Hispanics live and work. The challenge is identifying and accessing data that is sufficiently localized to be instructive. Yet, it is possible to piece together the minority small business and capital landscapes 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 will further facilitate identifying gaps and opportunities for minority business owners.

Engage Anchor Institutions and Local Stakeholders, and Recognize Competition

A committed local partner, who knows the market and its players well, is essential to advancing any capital access solution. 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 be a part of long-term, sustainable impact. With providers engaged, it is more likely clients, borrowers, and small businesses will embrace new opportunities.

However, there are challenges when casting the net widely. Competition for clients and resources can hinder collaboration, and some organizations and institutions fear that new solutions will disrupt the status quo. Moreover, some local organizations can be hesitant to engage with national partners because they lack the 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 the tensions, but it is helpful to recognize that these tensions exist with regard to outreach, expectations for participation, and buy in for new ideas. Furthermore, embedding a sustainable strategy requires a long lead time for both a diagnostic of the issues and potential solutions, as well as a runway for executing efforts with local ownership driving the way forward.

Build Wider and More Targeted Networks

The current networks among debt and equity providers are disparate, and shifting the discussion can result in an entirely different set of stakeholders. Often, capital and service providers have narrow channels of relationships or even 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.

At the same time, minority businesses benefit from targeted networks that prioritize their needs. Deliberate, targeted matchmaking will support connections between capital providers to minority entrepreneurs and business owners.

Use Technology as a Tool, Not a Solution

Technology offers tools to support improved data collection, networking, and collaboration, as well as operational efficiencies, yet there is much mistrust, apprehension, and doubt around its application. Some providers are hesitant to leverage online platforms because they rely on algorithms versus human relationships to bridge the disconnect between providers and clients. There is no substitute for a personal relationship, but there are FinTech companies who seek to integrate high-tech and high-touch in their models. Any online matchmaking should be routing small businesses to the most cost-efficient products and services available that are tailored to 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 and reach more people, particularly the unbanked and underbanked.

Develop Culturally-Competent Marketing, Outreach, Products, and Services

In the context of capital access, cultural competence refers to an institution or organization's ability to understand how race, ethnicity, gender, age, national origin, disability, language, and other demographics shape a population's relationship to financial products and services. The lack of understanding and recognition of cultural factors is a major barrier to capital access for Black and Hispanic entrepreneurs and small business owners. For example, lack of generational wealth and experience-based human capital (professional and management experience), as well as poor or limited credit histories change what business readiness means to minority entrepreneurs and for which products they may qualify.

Developing cultural competence is a dynamic and complex process requiring ongoing assessment and feedback. It is important to building trust between providers and clients, and increases the likelihood that products and services reach their target audience.

Identify Champions to Promote Public Policy

In addition to programmatic efforts, there are policy solutions to minority barriers to capital access. 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.

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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 urban and rural 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.[1]

In 2015, Blacks made up 12.7 percent of the population, yet only owned 2.2 percent of classifiable small employer firms that made up 1.0 percent of sales (average receipts of $818,512), 2.0 percent of employees, and 1.4 percent of payroll (average wages of $28,241). Hispanics were 17.6 percent of the population, yet owned 6.0 percent of classifiable small employer firms that accounted for 3.5 percent of sales (average receipts of $1,020,706), 5.0 percent of employees, and 3.8 percent of payroll (average wages of $30,534).[2] See Figure 1.

These employee and payroll figures reflect a history of disadvantage and its lasting economic effects—the number of employed workers and how well those workers are paid.

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. Generally, all Americans rely mostly on personal and family savings to finance their startups and acquisitions (66.7 percent).[3] However, nationally, the second most used capital product is business loans (17.9 percent); among Black and Hispanic small firms it is credit cards (17.9 percent and 14.2 percent, respectively). As seen in Figure 2, heavy reliance on credit cards reflects the difficulty minorities face securing a loan due to poor or limited credit history, lower net worth, and lack of assets to leverage as collateral, among other factors.[4]

To address minority capital access barriers, the Milken Institute (the Institute) and the U.S. Small Business Administration (SBA) convened financial institutions, regulatory agencies, community groups, and research institutes at a national roundtable at the White House in June 2016. The product of that meeting was the Partnership for Lending in Underserved Markets (PLUM), a Milken Institute and SBA initiative to develop actionable solutions to long-standing barriers that constrain minority entrepreneurs from accessing capital to start and grow businesses. The objective is to increase not only the amount of capital reaching minority-owned businesses, but also the number of successful (growing) minority businesses in Black and Hispanic communities employing Black and Hispanic workers.

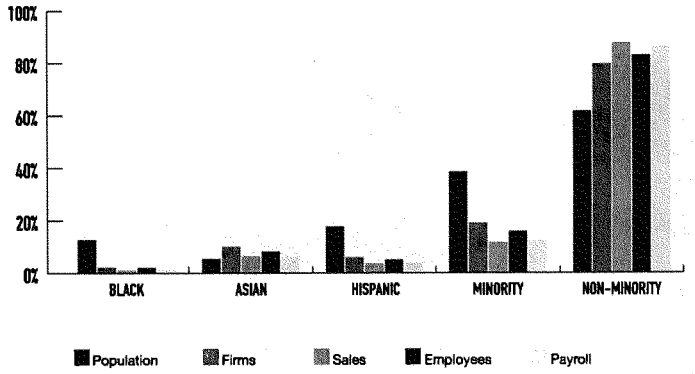
1 The Milken Institute recognizes the difference between "Hispanic" and "Latino" designations and the ongoing debate regarding which is most appropriate. When citing others' works, we defer to the designation used by each organization or agency. Otherwise, for consistency, we use "Hispanic" versus "Latino," and "Black" versus "African American," per U.S. Census Bureau classifications.

2 2015 population data: U.S. Census Bureau, 2015 American Community Survey 1-Year Estimates. 2015 business data: U.S. Census Bureau, 2015 Annual Survey of Entrepreneurs.

3 U.S. Census Bureau, "2015 Annual Survey of Entrepreneurs." Percentages are based on 3,511,285 classifiable employer firms who reported their source of capital to start or acquire a business.

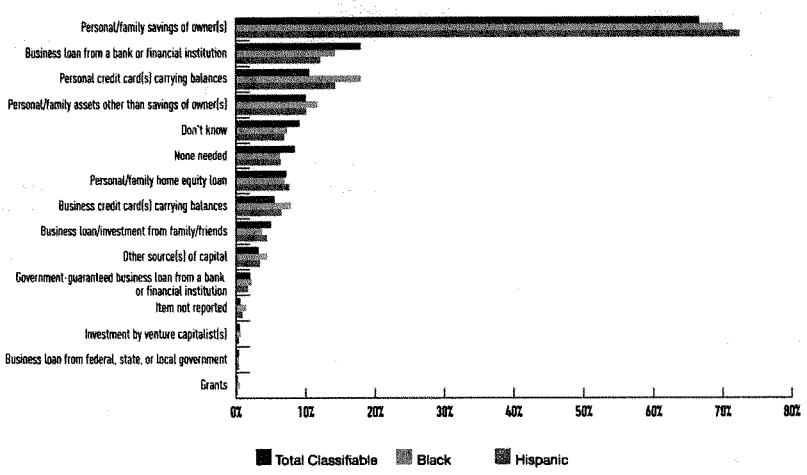
4 Fairlie, Robert W. and Robb, Alicia M. "Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs." U.S. Department of Commerce, Minority Business Development Agency. January 2010.

FIGURE 1: **RACE AND ETHNICITY AS A PERCENT OF POPULATION AND BUSINESS (2015)**



Sources: U.S. Census Bureau, "2015 American Community Survey 1-Year Estimates" and U.S. Census Bureau, "2015 Survey of Entrepreneurs"

FIGURE 2: **SOURCES OF CAPITAL TO START OR ACQUIRE A BUSINESS (2015)**



Source: U.S. Census Bureau, "2015 Survey of Entrepreneurs"

THE PARTNERSHIP FOR LENDING IN UNDERSERVED MARKETS

National Efforts

Nationally, the Milken Institute committed to initiate research, explore improvements to federal policies and institutions that affect minority small business capital access, and identify broader opportunities to address investor capacity and alternative credit underwriting criteria.

Congressional Engagement

The Institute participated in a Congressional Black Caucus (CBC) Wealth Creation and Economic Development Task Force event covering the Community Reinvestment Act (CRA), small business data collection, and the role of FinTech in providing capital to underserved communities. We continue to engage with the 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, including Section 1071 of the Dodd-Frank Act, and other public policies that affect minority entrepreneurship, economic development, and community revitalization.

Comment Letters

We submitted several comment letters to federal agencies. First was in response to an SBA request for comment regarding reducing or eliminating unnecessary regulatory burdens and bringing greater efficiencies to the agency.[5] In our mission to also 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, making permanent the Community Advantage 7(a) Loan Program and refining specific protocols, relaxing requirements for minimum SBIC capitalization thresholds to encourage smaller investment, 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 Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[6] 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 (RFI) regarding the use of alternative data and modeling techniques in the credit process.[7] 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 when 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 and take into account the local economies within which small business operate.

5 Klowden, K., & Betru, A. Comment Letter to the SBA: Small Business Administration's Request for Information Aimed at Reducing Regulatory Burden, Docket No. SBA-2017-0005. November 2017. Retrieved from: https://www.regulations.gov/document?D=SBA-2017-0005-0254.

6 Mueller, J., & Betru, A. Comment Letter to the CFPB for Information Regarding the Small Business Lending Market, Docket No. CFPB-2017-0011. September 2017. Retrieved from: http://www.milkeninstitute.org/publications/view/882.

7 Betru, A., & Mueller, J. Comment Letter to the CFPB: Alternative Data and Modeling Techniques in the Credit Process, Docket No. CFPB-2017-0005. March 2017. Retrieved from: http://www.milkeninstitute.org/publications/view/861.

Research and Initiatives

In response to the 40th anniversary of the Community Reinvestment Act (CRA) and our continued engagement with the CBC, the Institute has initiated a series of meetings with stakeholders to determine what CRA policy should look like for 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 regulators to consider in efforts to redirect capital to otherwise credit-worthy small businesses.

Finally, the Institute is researching the potential impact of increasing Minority Depository Institution (MDI) 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 (LMI) 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. We also will explore the effects on job growth and wealth creation in underserved markets.

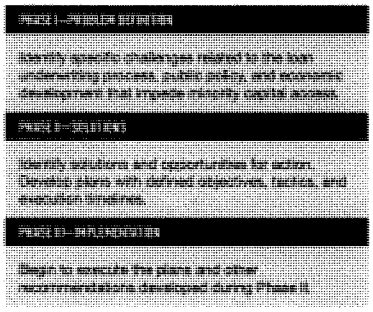
Milken Institute Events

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

Looking ahead, the Milken Institute will continue to engage stakeholders, conduct research, and inform public policies that affect minority entrepreneurs, economic development, and community revitalization.

Pilot Cities

In 2016, the Milken Institute and the SBA also initiated two-year local pilots in Baltimore, Maryland and Los Angeles, California to better understand how local dynamics affect capital access in a given market and test solutions. 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. We formed Steering Committees of community leaders and broader task forces of partners in both cities, and divided the pilot into three phases:

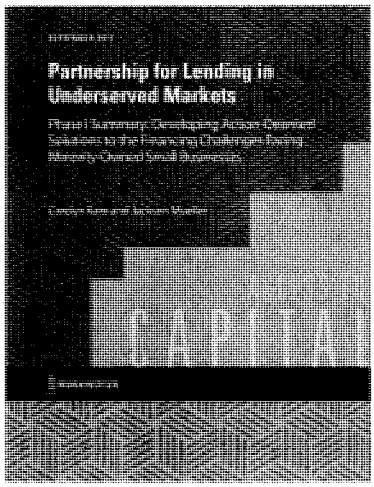


Phase I

Phase I launched in the fall of 2016 and concluded in early 2017. Government officials, data providers, economic development workers, traditional and alternative capital providers, and others participated in kick-off events and

joined working groups to identify specific issues related to lending, public policy, and economic development. They provided on-the-ground evidence, presented qualitative and quantitative survey data, shared local studies, and engaged with additional stakeholders.

The task forces reconvened in January and February of 2017 to summarize the discussions thus far, share what had been learned, and ask the groups to choose a path forward. The Milken Institute presented landscaping data on the Los Angeles and Baltimore small business and lending environments, a summary of root causes for the capital access gap, and potential solutions.



At the end of Phase I, we produced a Phase I summary report that included information and data on the minority small business and lending environments, the genesis of the PLUM initiative, and key findings from Phase I working groups around capital access challenges related to lending, policy, and economic development.[8]

Phase II

39 ACTION GROUP MEETINGS

7 MATCHMAKING, NETWORKING, AND CONFERENCE EVENTS

300+ PARTICIPANTS

Based on task force feedback, survey results, additional discussions with PLUM participants and stakeholders, as well as consideration of what other partners and groups were doing, the steering committees decided to move forward on the following:

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.

8 Karo, C., & Mueller, J. Partnership for Lending in Underserved Markets Phase I Summary: Developing Action-Oriented Solutions to the Financing Challenges Facing Minority-Owned Small Businesses. Milken Institute. September 2017. Retrieved from: http://www.milkeninstitute.org/publications/view/879.

Solutions to Root Causes of Minority Capital Access Gap

EXPAND AND CUSTOMIZE TECHNICAL ASSISTANCE

Technical assistance programs are not tailored for minority entrepreneurs and small business owners

Businesses are not bankable without sound operations and attention to business fundamentals

Financial illiteracy limits capital opportunities

OVERCOME 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 homogeneous and not responsive to borrower profiles

The Community Reinvestment Act favors compliance with compulsory obligations behind rewarding innovative and flexible lending practices

Lenders (CDFIs, MDIs) in underserved markets are undercapitalized

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

INCREASE EQUITY/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

COORDINATE URBAN DEVELOPMENT

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

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

IMPROVE 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

Technical Assistance (TA) and Lender Referral Best Practices: Support efforts to identify best practices and standardize TA and lender referral efforts focused on individual TA providers, lenders, and new and established small businesses.

Local steering committees then met to tailor local approaches for next steps. In Baltimore, steering committee members facilitated local policy, local TA, and local research discussions. In Los Angeles, steering committee members formed action groups to address priority topics. These groups met monthly for the remainder of 2017 to pinpoint specific opportunities for impact—a challenging process that required consideration of a host of factors including resources, political viability, relevance, and likelihood for success.

In February 2018, the Los Angeles action group chairs presented to the broader task force activities to date, lessons learned, solutions identified, and details around Phase III execution, which include short-term solutions and promotion of long-term opportunities. The Milken Institute will host a similar event in Baltimore to reiterate opportunities and present a path forward. Current action items include:

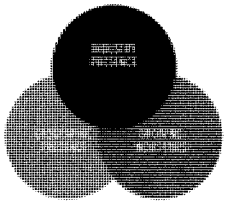
- A best practices report about culturally-competent technical assistance, which is critical to building the capacity of entrepreneurs and small business owners to access capital and start and grow businesses
- Matchmaking and networking events to expand local lender referral networks and facilitate inbound and outbound deal flow
- A series of local policy briefs for municipal, county, and statewide audiences about economic incentives to promote opportunities for Black and Hispanic businesses, addressing challenges in city and county contracting; coordination of federal resources to more effectively channel capital to local communities, and FinTech opportunities to automate several areas of the capital access ecosystem including government to business transfer, accounting, and marketing and delivery of technical assistance

In some cases, execution on these solutions began last year. And with the ultimate goal of increasing access to capital in mind, we have been and will continue to facilitate direct matchmaking between capital providers and minority small businesses. The PLUM pilots will conclude at the end of 2018, at which point we will document outcomes and lessons learned around execution and implementation.

LESSONS LEARNED FOR COLLABORATION

In addition to supporting local outcomes, the PLUM pilots are helping us to improve collaborative efforts in a given market and around specific capital access solutions. There have been many across-the-board lessons learned throughout Phase II, as well as through our national work. Some speak to approaches to partnership and coalition-building, while others are reflections and recommendations for existing capital and technical service providers.

Overcome Data Deficits to Identify Opportunity



Maximum opportunity for economic growth lies in the overlap among industries in which Blacks and Hispanics are strong (i.e., own businesses and are employed), in the industries that are growing regionally, and the communities in which Blacks and Hispanics live and work. The challenge is identifying and accessing the data to piece this information together.

Minority Small Business Landscape

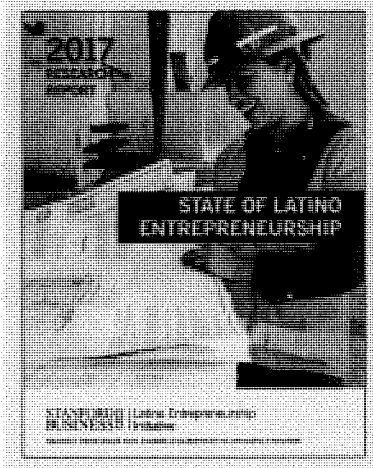
There is no one source to tell us where minority businesses are located. The U.S. Census collects this information at the metropolitan statistical area (MSA) and county level including industry, number of employees, average sales, and average wages. Municipal-level data, however, are scarce or difficult to acquire. For example, the City of Los Angeles 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 break out businesses by the race, ethnicity, or gender of the business owner, nor is there sales, employee, or wage data. The data is not in a downloadable format, and ultimately it is not representative of the minority small business population at large because certification primarily helps businesses compete for contracting and procurement opportunities; businesses outside this scope likely will not register.

Efforts to address the data gap come in a variety of shapes and forms, and despite how important these efforts are, we still lack a consistent, standardized set of nationwide data on small businesses. There are databases to purchase, such as Dun & Bradstreet, Hoovers, and Resource USA, but they are costly, and it is often difficult to verify methodology and accuracy.

Information about regional clusters and growth industries can be more accessible via city, county, and state economic development agencies and quasi-agencies, but may not be to the level of detail to capture community nuances. Los Angeles County includes 88 cities and 11 unincorporated areas which do not align neatly with ethnic communities. Per the Los Angeles County Economic Development Corporation (LAEDC), Latinos in the county are more likely to be employed in manufacturing and construction firms than the average LA County worker,[9] and construction and selected

9 Los Angeles County Development Corporation, "An Economic Profile of the Latino Community in Los Angeles County." February 2017. Retrieved from: https://laedc.org/2017/02/21/economic-profile-latino-community-l-county/.

The Stanford Latino Entrepreneurship Initiative (SLEI)



The Stanford Latino Entrepreneurship Initiative (SLEI) is a Stanford University research initiative housed within Stanford Graduate School of Business. SLEI explores and expands knowledge of the Latino entrepreneurship segment in the economy through research, knowledge dissemination, and facilitated collaboration. As of 2017, they have a database of more than 1.3 million U.S. Latino-owned companies and a survey panel of more than 3,000 independent companies. SLEI is digging deep into the Latino business experience, and yet they too do not have data localized at the city level.

manufacturing are growth industries in the county.[10] Major development projects including overhauling Los Angeles International Airport (LAX), building the 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, 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 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 projects, but also to coordinate agencies and resources to help firms identify and navigate opportunities.

10 Los Angeles County Economic Development Corporation, "People, Industry and Jobs: 2016-2021." June 2017. Retrieved from: https://laedc.org/2017/06/30/pij-2017/

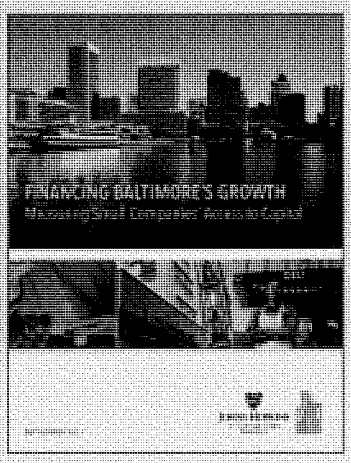
Capital Landscape

Another information challenge is mapping the capital landscape. What lenders, investors, and technical assistance providers are in the market, including local and statewide, national, or online providers? Are there adequate providers in place to serve Black and Hispanic entrepreneurs and business owners? Are they accessible to businesses who need them? To examine credit product offerings and gauge their capacity to meet ethnic market needs, we need to understand who is in the market.

Several initiatives are underway to provide an accurate mapping of the capital landscape in the local economies of Los Angeles and Baltimore.

In Los Angeles, the task force initiated a manual process of mapping the capital and service landscape. The technical assistance groups surveyed TA providers, including incubators and accelerators and other public, private, and nonprofit programs. To support networking opportunities, the Lender Referral group plans to survey regulated financial institutions' programs and products. One local partner, Business Resource Group (BRG),

Johns Hopkins 21st Century Cities Initiative



To understand the Baltimore market, Johns Hopkins University's 21st Century Cities Initiative researched 40 public and private funding sources and programs from 2003 to 2005 and interviewed more than 50 stakeholders in government, banks, investment firms, community development financial institutions, incubators, nonprofits, and small businesses. Their final report cites 18 sources across the public and private sectors covering capital products ranging from guaranteed loans, bank loans, non-bank SBA loans, equity investments, research grants, and others. 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." The report states that while venture capital investment in Baltimore-based companies has increased markedly over the last decade, most of it originates outside the city. The report also found that the city needs revitalized lending programs to fill gaps left by banking consolidation, a national trend that has hit Baltimore especially hard.

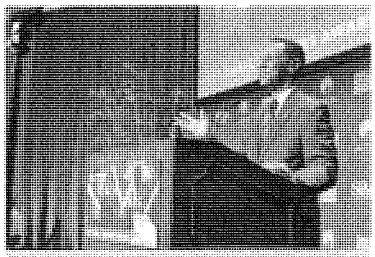
While the Johns Hopkins report provides a foundation to understanding the small business financing landscape in Baltimore, it does not address the racial and ethnic financing landscape. Given national statistics around minority capital access, we can surmise that if all Baltimore businesses need revitalized lending programs, it is likely that the opportunity for minority businesses is even greater.

leveraged its own proprietary data along with third party data to compile a pool of more than 700,000 African American and Latino businesses; they also surveyed 1,200 non-bank lenders and 100+ technical assistance providers serving the Los Angeles market. BRG is comparing their data to growth industries in the region and plans to develop Scalability Toolkits in key industry clusters. Toolkits would include a scalability scorecard, capacity assessments, capital and integrated technical assistance, opportunity paths, and industry referrals.

Encouraging data collection, whether through regulation (e.g., Dodd Frank 1071), or other industry-led efforts such as the Marketplace Lending Association's "Marketplace Lending Best Practices," will provide a much stronger evidence-base for developing capital access solutions and support-related marketing and outreach efforts. In the absence of standardized and accessible data, however, we have seen how to piece together the minority small business and capital landscape with existing resources, community insights, and local knowledge and expertise to identify both gaps and opportunities for minority business owners.

Engage Anchor Institutions and Local Stakeholders, and Recognize Competition

We cannot overstate the value of a committed local partner who knows the market and its players well in order to advance any capital access solution. In the absence of local level data, we can tap those who know their communities best for information. Yet local stakeholders are far more than information resources. In Los Angeles, the SBA district office has been a critical factor in legitimizing the LA PLUM pilot and creating trust among stakeholders. The district director, Victor Parker, and his staff have strong relationships in the community with CDFIs, banks, and



Victor Parker, SBA Los Angeles District Director

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

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 steering committee was co-chaired by the Milken Institute, SBA, and Chairman, President, and CEO of the Harbor Bank of Maryland, Joseph Haskins, Jr. The bank, a minority depository institution (MDI), is an anchor in the city with close connections to and knowledge of the Black community in Baltimore.

Anchor institutions also provide local leadership and support buy-in from service providers and potential clients to new capital solutions. Local ownership matters because it empowers communities to be a part of long-term and sustainable impact. With local capital and technical assistance providers engaged, clients, borrowers, and small businesses are more likely to embrace new opportunities.

Challenges arise, however, when we cast the net widely. Competition for clients and resources can hinder collaboration. For example, lenders recognize that by working together they could pool their lending data (e.g., approvals, declinations, referrals) and gain a better understanding of the small business and capital landscapes. However, sharing data may not make good business sense by revealing proprietary information around business models, relationships, and outcomes. The conflict of interest points to where policy could help by establishing an objective third party (government agency or nonprofit organization) to collect and aggregate data and share high level conclusions.

Also inhibiting collaboration is a fear among some organizations and institutions that new solutions will disrupt the status quo. Most mission-driven lenders and TA providers already compete for the same resources (e.g., bank CRA dollars, government and foundation grants), and are cognizant that solutions outside the existing framework may limit or reduce their capacity. Moreover, some local organizations are hesitant to engage with national partners because they lack the 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 the tensions, but it is helpful to recognize that these tensions exist with regard to outreach, expectations for participation, and buy-in for new ideas. Furthermore, embedding a sustainable strategy requires a long lead time for both a diagnostic of the issues and potential solutions, as well as a runway for executing efforts with local ownership driving the way forward.

Build Wider and More Targeted Networks

The current networks among debt and equity providers are disparate, and shifting the discussion can result in an entirely different set of stakeholders. Often, capital and service providers have narrow channels of relationships or even 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. One of the strongest outcomes of the PLUM pilots is the number of relationships facilitated through events and working groups.

At the same time, minority businesses benefit from targeted networks that prioritize their needs. Targeted matchmaking will support connections between capital providers to minority entrepreneurs and business owners. For example, the Milken Institute and SBA held Small Business Investment Company (SBIC) events in Baltimore and Los Angeles around minority businesses looking to scale up and included asset managers, service professionals (lawyers, accountants), and minority small businesses. The SBIC program provides an important avenue for qualified small businesses to raise debt or equity capital to grow their operations. Licensed and regulated by the SBA, SBIC's are privately owned and managed investment funds that, together with the SBA, committed $6 billion in financing to 1,200

Ryan McGovern, Managing Director, Star Mountain Capital, moderates a panel at a Million Dollar Round, SBIC, Star Mountain Capital SBIC event in Los Angeles.

small businesses in FY2016. Altogether, SBICs manage upwards of $28 billion in assets. That investment, however, is geographically concentrated in a few U.S. states, with five states (California, New York, Texas, Massachusetts, Illinois, and Florida) receiving more than half of all SBIC investment in 2014. Additionally, less than a quarter of SBIC investments were made to low- and middle-income areas in 2014. There is huge potential, if done right, to mobilize capital from SBICs to small business in underserved markets.

The Baltimore and Los Angeles events connected capital providers to small businesses and educated a broader audience about capital solutions. These events broadened the network of providers and businesses, and targeted minority businesses and their specific capital needs.

Use Technology as a Tool, Not a Solution

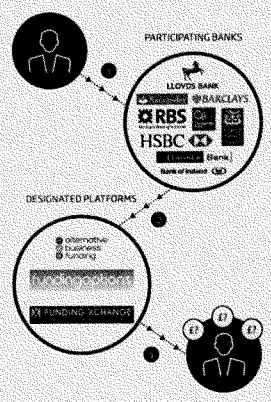
Technology offers tools to address many of the concepts we have been discussing—including data collection, networks, and collaboration, as well as operational efficiencies—yet there is much mistrust, apprehension, and doubt around its application.

CDFIs and other TA providers report that once a bank declines a potential borrower, that person is less likely to reapply for more financing or TA programs. Online platforms can reduce paperwork by carrying borrower information from one provider to the next, making the process less onerous for the borrower. New technology also may help disrupt the current service

UK Bank Referral Scheme

In 2015, the United Kingdom (UK) Treasury released a report which found that of the 26 percent of small businesses that were declined for a bank loan, only three percent turned to alternative providers to access the financing they needed to grow. Launched in November 2016, the Bank Referral Scheme requires nine designated banks (the 6 largest UK Small- and Medium-sized Enterprises (SME) lenders and the 3 largest Northern Irish SME lenders) to offer small businesses a referral to alternative lenders at the point of decline. If the referral is accepted, a small business' application is routed to three regulatory-approved finance platforms that seek to match the small business' funding needs to alternative finance providers on their lending panels.

The initiative was developed as a way to encourage SMEs who have been unable to secure the financing they need to seek out alternative sources of capital and address the information gap that exists between small businesses and alternative providers.



1. Your business approaches a participating bank for an eligible lending facility (see eligibility criteria).
2. If your business is unsuccessful, you will automatically be offered a referral to the designated online platforms, who may be able to help you find the finance you are looking for- if you agree to the referral, your details will be passed on by the end of the next working day.
3. The lenders on these platforms may be able to offer you funding, if a suitable match is found.

delivery system by increasing transparency and building accountability through improved data collection and a virtual paper trail. Organizations such as the Community Reinvestment Fund (CRF) and the Association for Enterprise Opportunity (AEO) are leveraging tech-driven solutions to derive greater efficiencies in the loan origination process (SPARK), and connecting small business providers with capital-starved businesses who are declined by traditional lenders and unaware of alternative options (Project Cue).[11]

In the U.S., several online marketplaces have surfaced over the past several years to connect small businesses with the right financing provider. Firms such as Fundera, Lendio, Intuit, and others connect borrowers with a range of both traditional and alternative financial providers and products. Separate from industry-driven solutions, at the federal level, the SBA unveiled Lender Match, an online referral tool connecting small business borrowers with participating SBA lenders.[12] Lender Match is the successor to the SBA's former matchmaking program, LINC, introduced in 2015.

11 Spark, "Product Features." April 23, 2018. Retrieved from: http://www.lendwithspark.com/features-loan-origination-tool/; AEO, "Project CUE: Connecting Underserved Entrepreneurs." February 2016. Retrieved from: https://aeoworks.org/item/project-cue-connects-underserved-entrpreneurs-with-funding.

12 Small Business Administration. Lender Match helps you find lenders. Retrieved from: https://www.sba.gov/lendermatch.

Despite the real potential of technology to deliver capital to those most in need, local stakeholders in Los Angeles and Baltimore were hesitant to engage with these types of platforms because they rely on algorithms versus human relationships to bridge the disconnect between provider and borrower. There is no substitute for a personal relationship, but some online lenders do strive for high-tech and high-touch relationships. Lendio, for example, partners borrowers with personal funding managers to support small business throughout the financing process. The funding manager will discuss loan options, help to calculate how much financing is needed, walk the customer through collecting all the necessary documents and forms, and ultimately stay in touch throughout the life of the business to help with loan renewals, term adjustments, and goal-setting for different kinds of financing as business needs change.[13]

Moreover, any online matchmaking should be routing small businesses to the most cost-efficient products and services available that are tailored to 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 seve time and money and reach more people, particularly the unbanked and underbanked.

13 Lendio, "Small Business Loans." March 16, 2018. Retrieved from: https://www.lendio.com/small-business-loans/.

Develop Culturally-Competent Marketing, Outreach, Products, and Services

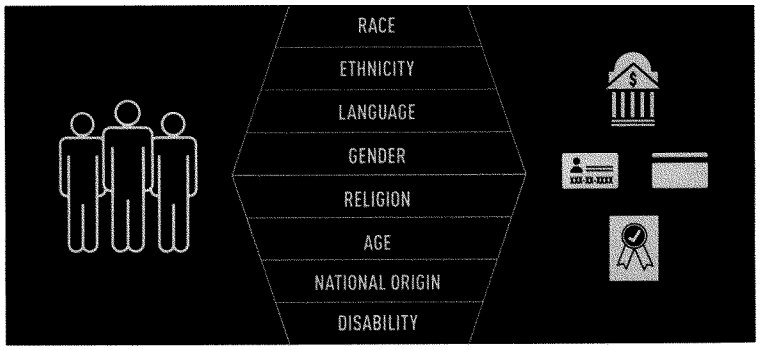
In the context of capital access, cultural competence refers to an institution or organization's ability to understand how race, ethnicity, gender, age, national origin, religion, language, disability, and other demographics shape a population's relationship to financial products and services. The lack of understanding and recognition of cultural factors is a major barrier to capital access for Black and Hispanic entrepreneurs and small business owners. For example, lack of generational wealth and experience-based human capital (professional and management experience), as well as poor or limited credit histories change what business readiness means to minority entrepreneurs and for which products they may qualify.

Among Black business owners, the trust gap and a double negative bias loom large. The trust gap refers to the wariness of Blacks to engage banks, other capital providers, and potential would-be mentors and consultants based on a history of discrimination, bias, and continued disappointment.[14] The double negative bias is the added pressure an entrepreneur of color, who also is female, bears to prove herself and the value of her work and ideas.[15]

For Hispanics, country of origin, immigration status, and language can act as barriers in obtaining capital. For

14 Association for Enterprise Opportunity. The Tapestry of Black Business Ownership in America: Untapped Opportunities for Success. March 2017. Retrieved from: https://aeoworks.org/item/Report-Black-Business-Ownership-US.

15 Ewing Marion Kauffman Foundation. "Including People of Color in the Promise of Entrepreneurship." Entrepreneurship Policy Digest. December 2016. Retrieved from: https://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/including-people-of-color-in-the-promise-of-entrepreneurship.



instance, the Individual Taxpayer Identification Number (ITIN) is a tax-processing number issued by the Internal Revenue Service to help individuals who do not have, and are not eligible to obtain, a Social Security number (e.g. non-U.S. citizens) comply with U.S. tax laws. While some banks offer products and services to people who have ITINs, others do not.[16] Separately, marketing materials and technical assistance may only be provided in the English language, presenting problems to immigrants whose first language is not English.

Developing cultural competence is a dynamic and complex process requiring ongoing assessment and feedback. It is important to building trust between providers and clients, and increases the likelihood that products and services reach their target audience. In 2017, PLUM task forces spent considerable time discussing how to tailor marketing, outreach, products, and services to best serve these populations. The Institute is in the process of documenting best practices for culturally-competent technical assistance for Black and Hispanic entrepreneurs and business owners, and will release a follow-up report in the coming months.

16 Kokodoko, M. "Hispanic entrepreneurship grows, but barriers persist." Community Dividend. April 2011. Retrieved March 7, 2018 from: https://www.minneapolisfed.org/publications/community-dividend/hispanic-entrepreneurship-grows-but-barriers-persist.

Identify Champions to Promote Public Policy

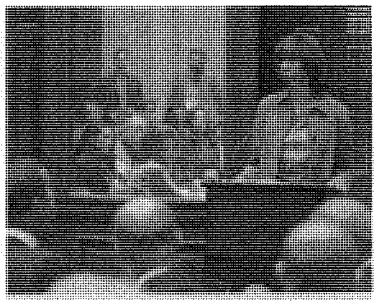
In addition to programmatic efforts, there are policy solutions to minority barriers to capital access. Identifying policy champions, individuals with the influence, access, and credibility to promote solutions to legislators and other policymakers is paramount. Whether locally, statewide, or nationally, relationships and partnerships with policy champions can be the difference between good ideas and executed outcomes.

In 2016, the Baltimore task force prepared a series of recommendations for then incoming Baltimore Mayor Catherine Pugh. In 2017 she included several recommendations in the Mayor's Transition Report and requested follow-up next steps.

The task force then identified action items for the city, including to appoint and empower a Small Business Ombudsperson to advocate, navigate and troubleshoot for small businesses; establish a one-stop shop in the city

economic development department to coordinate and streamline business licensing and permitting requirements; empower and resource the Baltimore Resource Center to execute its mandate of providing customized technical assistance to support small businesses in minority communities; and, finally, leverage the City's HUD funding as equity injection for matching SBA loan guarantees for strategic community development investments.

In Los Angeles, lawmakers and city and county agencies have attended PLUM events and meetings, and are taking information back to their organizations to inform policies and programs. The aforementioned policy briefs are in process and task force members will then engage policymakers, including the Los Angeles Mayor's Office of Economic Development as well as California State Assemblymembers, to promote recommendations.



Baltimore Mayor Catherine Pugh speaking at a PLUM event in January 2017.

In Los Angeles, California Assemblymember Autumn Burke (far left) participated in a panel at the PLUM Million Institute California Summit with Henry Fernandez, Co-Founder and CEO, Center for Leadership, Equity, and Research; Director of Strategic Initiatives, Million Institute, Center for Regional Economics, and Chris Hernandez, Chairman, Tech Clubs Angeles.

CONCLUSION

Partnership for Lending in Underserved Markets stakeholders have had many healthy debates as to what approach best supports driving job creation, raising wages, and elevating better standards of living in minority communities in the first place. There are the sole proprietors (consultants, online craft sellers, gardeners) who generate income for themselves, but are less likely to make an economic impact in communities since they do not create jobs and therefore do not achieve the multiplier effects of associated additional economic activity. Some argued that the focus should be on the smallest of businesses where the most people work—the dry cleaners, health care provider facilities, and beauty salons. Others see the future in technology and want to explore how to create minority "unicorn" companies. Still others say focus on the top 2 percent, 5 percent, 10 percent... "a rising tide lifts all boats."

When confronted with the magnitude of capital access challenges and the scope of the ecosystem, narrowing the focus can be difficult. Yet there is no one right answer. Organizations will be most effective when leveraging their assets and strengths, and it will be the contributions of all types of organizations—think tanks, regulators, community groups, capital providers, and universities—that ultimately overcome the capital access barriers that constrain minority entrepreneurs from starting and growing businesses. As the PLUM initiative advances, the Milken Institute will apply the lessons learned to date and continue collaborative efforts to promote public policies that support Black and Hispanic economic growth, initiate research to grow the evidence-base to enhance capital access support and identify opportunities, and convene stakeholders who do not typically interact to generate and implement creative community development financing strategies.

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Baltimore Steering Committee Co-Chairs

Aron Betru, Managing Director, Center for Financial Markets, Milken Institute

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

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Jayfus Doswell, President & CEO, The Juxtopia Group

Howard Henderson, President & CEO, Greater Baltimore Urban League

Sean McCabe, Administrative Vice President, Business and Professional Banking, M&T Bank

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Paul Taylor, Executive Director, Baltimore City Small Business Resource Center

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MILKEN INSTITUTE

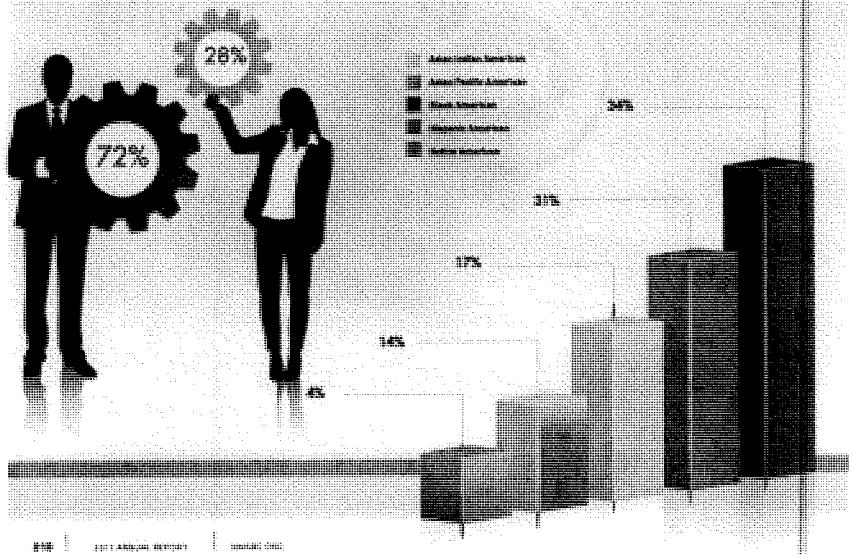
SANTA MONICA WASHINGTON LONDON SINGAPORE

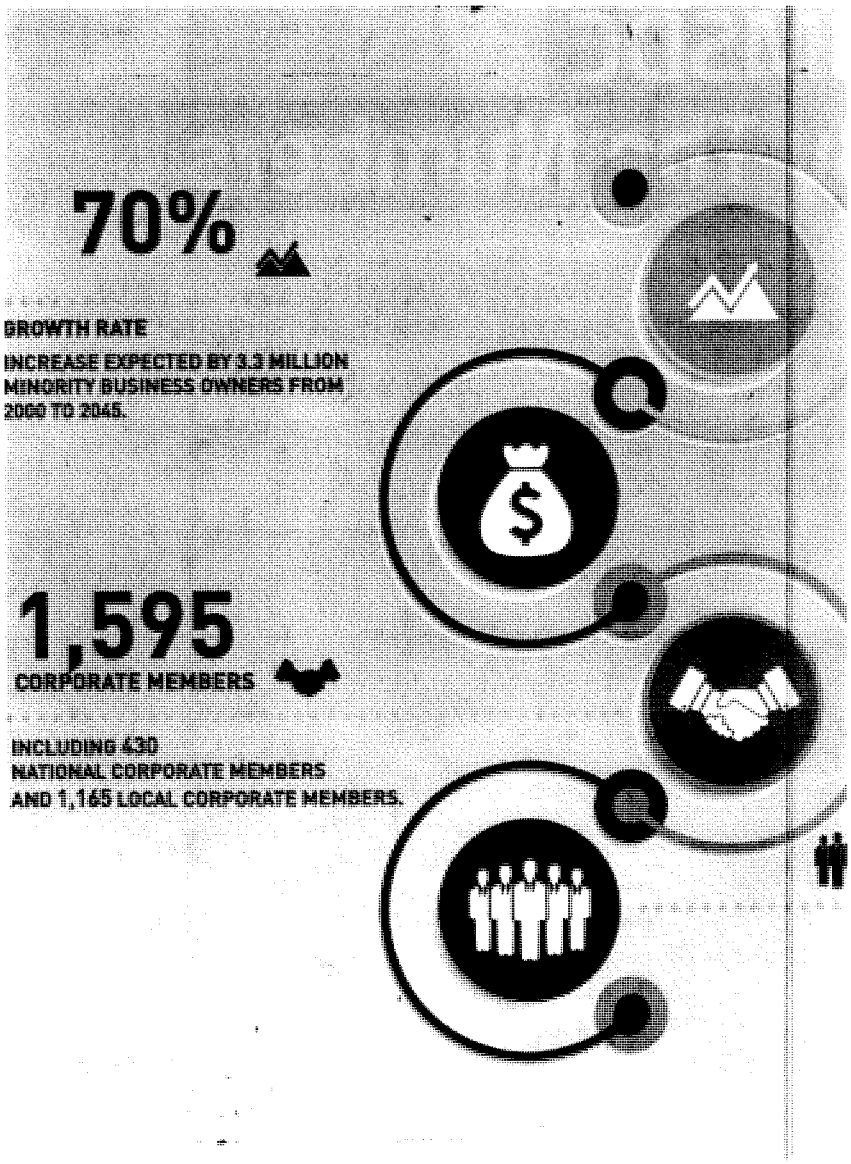
NMSDC By The Numbers

NMSDC connects 1,595 corporations (including 430 national corporate members and 1,165 local corporate members) with nearly 12,000 nationally-certified Asian, Black, Hispanic and Native American-owned businesses.

MBE Gender

Currently, the number of NMSDC certified MBEs is 12,000. Of that total, 72% are male and 28% are female.




70%
GROWTH RATE
INCREASE EXPECTED BY 3.3 MILLION
MINORITY BUSINESS OWNERS FROM
2000 TO 2045.
1,595
CORPORATE MEMBERS
INCLUDING 430
NATIONAL CORPORATE MEMBERS
AND 1,165 LOCAL CORPORATE MEMBERS.

NMSDC By The Numbers

NMSDC MBE Community EMPLOYMENT IMPACT

3.1 MILLION

Multi-cultural women-owned firms employ an estimated 1.6 million workers in addition to an estimated $268 billion in revenue.

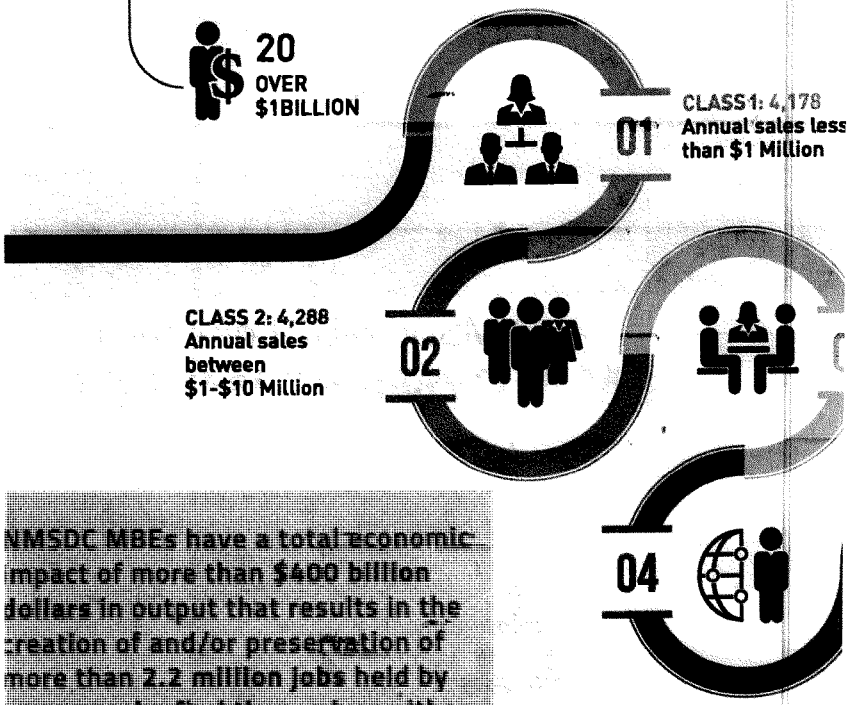
12,000

NMSDC certified MBEs disbursed over $53 billion in salary, wages and benefits.

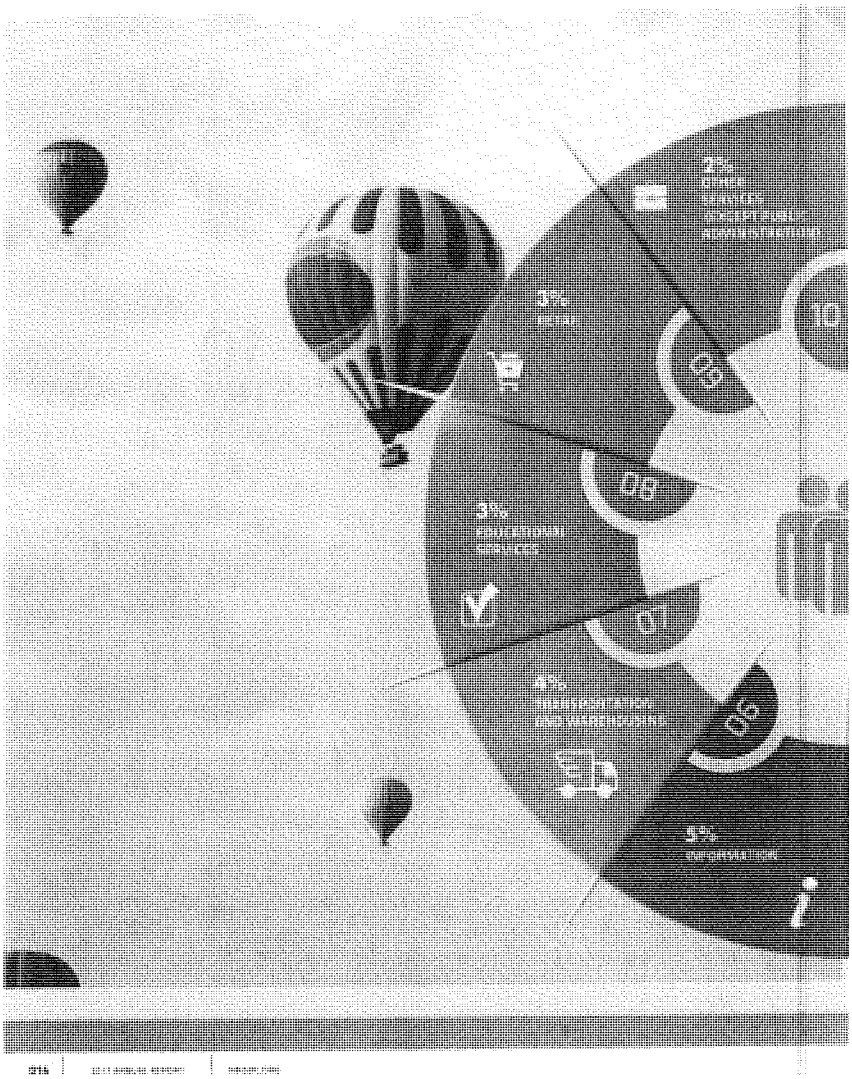
$379 MILLION

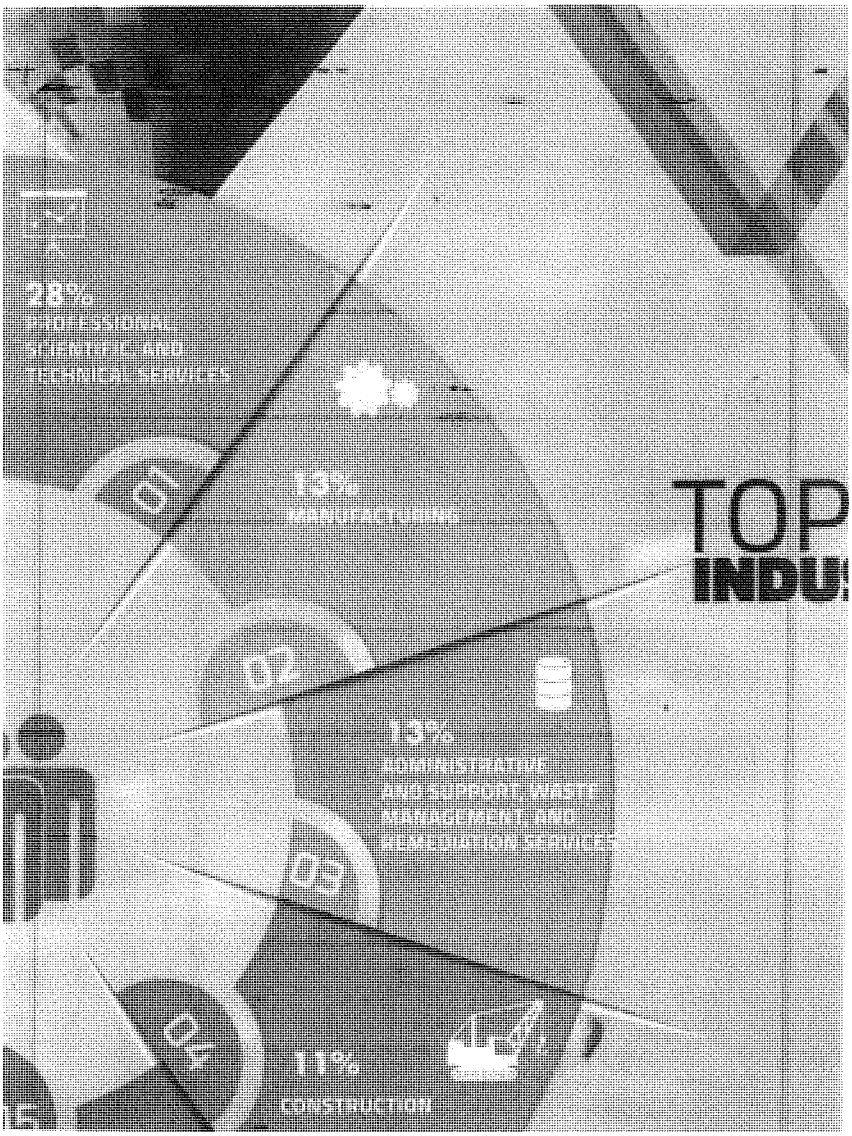
Daily labor income

Annual Sales of Certified MBEs



NMSDC MBEs have a total economic impact of more than $400 billion dollars in output that results in the creation of and/or preservation of more than 2.2 million jobs held by persons who find themselves either directly or indirectly employed by NMSDC-certified MBEs.



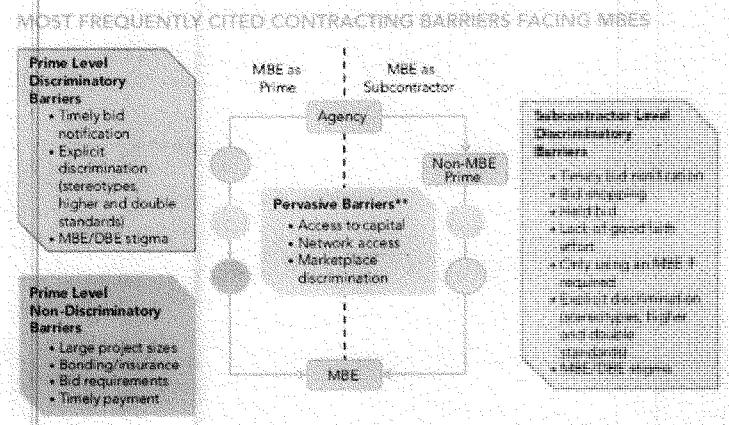

28%
PROFESSIONAL, SCIENTIFIC AND TECHNICAL SERVICES
13%
MANUFACTURING
19%
ADMINISTRATIVE AND SUPPORT, WASTE MANAGEMENT AND REMEDIATION SERVICES
11%
CONSTRUCTION
TOP
INDU

discrimination, the evidence may only present perceptions of discrimination. Yet, legal proceedings have varied on the level of verification needed to support the importance and relevance of anecdotal evidence. In order to address these concerns, the most robust disparity studies will draw on multiple techniques to obtain anecdotal accounts from individuals that have had actual, verifiable experiences in working with a procurement agency. It is through a wide number of reliable sources that disparity studies can include instances of discrimination which are representative of the experiences of multiple minority business owners.

The disparity studies reviewed for this study provided specific, verifiable instances of discrimination which were recorded, cataloged, and analyzed using content analysis. The most robust studies identified barriers, discussed the harm that the improper conduct inflicted on the businesses in question, and examined the extent to which discriminatory exclusion and impaired contracting opportunities are systemic rather than isolated or sporadic. Figure ES-2 summarizes the most frequently cited barriers in the disparity studies.

FIGURE ES-2

MOST FREQUENTLY CITED CONTRACTING BARRIERS FACING MBES



**Access to Capital and Network Access barriers can arise due to both discriminatory and non-discriminatory reasons and also influence non-discriminatory barriers such as bonding and insurance

Discrimination influenced multiple contracting barriers, both from the marketplace, as well as driven by either a contracting agency or non-MBE prime in the context of subcontracting. The barriers identified varied from outright prejudicial treatment and instances of exclusion based on racism, to marketplace barriers erected by systemic discrimination in both the private and public market (e.g., access to capital). Disparity studies with substantial anecdotal evidence supporting the presence of discriminatory barriers provide justification for the use of race- conscious programs in those jurisdictions. In addition, there are multiple non-discriminatory barriers, such as large project sizes, timely payment, and bid requirements that present challenges to potential bidders regardless of the race or ethnicity of the owners. However, the anecdotal evidence indicates that cert c discriminatory barriers can influence the perception of exclusionary practices with respect to some n discriminatory barriers.

EXECUTIVE SUMMARY

This report is the third in a series of reports based on the 2016 Small Business Credit Survey (SBCS), a national collaboration of the Community Development Offices of the 12 Federal Reserve Banks. As a key financial regulator and economic policymaker, the Federal Reserve System plays an important role in ensuring fair access to credit and promoting economic growth for the well-being of all Americans. Small businesses are an important component of economic success and strong communities; they are responsible for 48% of private sector employees nationwide,[4] are important drivers of local and regional economic growth,[5] and are an important source of household wealth.[6] A healthy small business environment depends on an array of factors, not least of which is the ability to access funds for starting up, scaling up, or maintaining operations. However, as a growing number of studies document, access to funds—whether debt, equity, or personal resources—can vary across race and ethnicity even when business owners are similar in other respects such as business performance and credit risk.[7]

The SBCS provides new data on minority-owned small business performance, financing needs, decisions, and outcomes. This report shares the descriptive comparison of the SBCS results by different firm ownership types (with emphasis placed on results that are statistically significant).[8] A subsequent paper will investigate the independent marginal effects of race and ethnicity on credit experience. That paper will include analysis that controls for firm age, size, and other available variables. The 2016 SBCS, which was fielded in Q3 and Q4 2016, yielded 7,916 responses from employer firms with race/ethnicity information in 50 states and the District of Columbia. We primarily report results by four race/ethnicity categories: white, black or African American, Hispanic, and Asian or Pacific Islander.[9] However, when the respondent sample size by race for a particular survey question is too small, we report results in terms of minority- versus nonminority-owned firms [i.e., we compare the experience of minority-owned businesses to businesses with more than 50% ownership by white individual(s)][10]. For select key statistics, we also report results for the 4,365 nonemployer respondents who provided race/ethnicity information. The SBCS Report on Minority-Owned Firms, therefore, offers unique insight into important, often underserved, segments of the small business population.

OVERALL, THE RESULTS SHOW

- **More white-owned firms are profitable than minority-owned firms. The gap is most pronounced between white- (57%) and black-owned (42%) firms.**
- **Black-owned firm application rates for new funding are 10 percentage points higher than white-owned firms, but their approval rates are 19 percentage points lower.**
- **Forty percent of nonapplicant black-owned firms did not apply for financing because they were discouraged (i.e., they did not think they would be approved), compared with 14% of white-owned firms and 21% of Hispanic- and Asian-owned firms.**
- **Looking at just firms that were approved for at least some financing, when comparing minority- and nonminority-owned firms with good personal and/or business credit scores,[11] 40% of minority-owned firms received full amount sought compared to 68% of nonminority-owned firms.**
- **Large banks are the most common type of lender applied to overall, regardless of race. Black- and Hispanic-owned firms are less likely to apply for financing at small banks and more likely to apply at community development financial institutions (CDFIs) and online lenders, relative to white-owned firms.**

MORE DETAILED RESULTS INCLUDE

Black-, Asian-, and Hispanic-owned firms tend to be younger and smaller in terms of revenue size and are concentrated across different industries

- **Approximately 28% of black-owned firms, 28% of Asian-owned firms, and 25% of Hispanic-owned firms are 0–2 years old, compared with 19% of white-owned firms.**

4 *Small Business Administration (2016). United States Small Business Profile. Retrieved from https://www.sba.gov/sites/default/files/advocacy/United_States.pdf*
5 *Delle, S.C. (2016). Spatial Variations in the Role of Microenterprises in Economic Growth. The Review of Regional Studies, 46(1), 71–97; Stephens, H., & Partridge, M. (2010). Do Small Businesses Matter for Economic Growth in Appalachia? Working Paper presented to the 49th Southern Regional Science Association Meeting; Fleming, D.A., & S.J. Goetz. (2011). Does Local Firm Ownership Matter? Economic Development Quarterly, 25(3), 277–91.*
6 *Klein, J. (2017). Bridging the Divide: How Business Ownership Can Help Close the Racial Wealth Gap. Washington DC: The Aspen Institute.*
7 *Robb, A. (2013). Access to Capital among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms. Washington DC: Small Business Administration; Fairlie, R.W., and Robb, A.M. (2010). Disparities in Capital Access between Minority and Non-Minority-Owned Businesses: The Troubling Reality of Capital Limitations Faced by MBEs. Washington DC: U.S. Department of Commerce, Minority Business Development Agency.*
8 *Credibility intervals for each estimate in the report can be found in the Appendix. For additional information on how the credibility intervals were calculated, see the Methodology section.*
9 *The SBCS asks a combined race/ethnicity question. See Methodology section for more details. Firms are categorized according to the race/ethnicity group that owns more than 50% of the business. Respondents could identify race/ethnicity as "Native American," as well, but the sample size for this group is too small to report results.*
10 *Firms that are equally owned by white and minority individuals are also categorized as nonminority-owned firms. They comprise approximately 3% of the 7,916 firms in the SBCS data.*
11 *Self-reported business credit score or personal credit score, depending on which is used to obtain financing for their business. If the firm uses both, the highest risk rating is used. "Low credit risk" is an 80–100 business credit score or 720+ personal credit score. "Medium credit risk" is a 50–79 business credit score or a 620–719 personal credit score. "High credit risk" is a 1–49 business credit score or a <620 personal credit score.*

EXECUTIVE SUMMARY

- Black-owned firms are most concentrated in the healthcare and education industry (24%). Asian-owned firms are most concentrated in the professional services and real estate industry (28%). Hispanic-owned firms are most concentrated in the nonmanufacturing goods production and associated services industry, which includes building trades and construction (27%). White-owned firms are more evenly distributed across several industries but most commonly operate in the professional services and real estate industry (19%) and the nonmanufacturing goods production and associated services industry (18%).
- Forty-two percent of black-owned firms, 21% of Asian-owned firms, and 24% of Hispanic-owned firms are smaller than $100k in revenue size, compared with 17% of white-owned firms.

The profitability performance index[12] of minority-owned firms remains well below that experienced by nonminority-owned firms

- In 2016, 42% of black-owned firms, 51% of Asian-owned firms, and 51% of Hispanic-owned firms reported operating at a profit, compared with 57% of white-owned firms.
- Black-owned firms report significantly higher expectations for revenue growth (86%) and employment growth (65%) than white-owned firms (70% and 43%, respectively).

The credit gap is most pronounced for black-owned firms, which are most likely to rely on personal funds

- Black-owned firms report more credit availability challenges (58% vs. 32%) and difficulty obtaining funds for expansion (62% vs. 31%) than white-owned firms—even among firms with revenues more than $1M (49% vs. 24% and 53% vs. 23%, respectively). A similar gap exists between Hispanic- and Asian-owned firms compared with white-owned firms, but it is less pronounced.
- The use of personal funds is the most common action taken as a result of financial challenges, with 86% of black-owned firms, 77% of Asian-owned firms, 76% of white-owned firms, and 74% of Hispanic-owned firms using this source of financing. This is true even though black business owners tend to have lower personal wealth levels than white business owners.[13]
- Cutting staff is also a common action taken as a result of financial challenges. Asian-owned firms cited this action most at 48%.

A greater share of black- and Hispanic-owned firms increased debt in the past 12 months, but these firms still have lower debt levels than white- and Asian-owned firms

- Thirty-six percent of black-owned firms and 33% of Hispanic-owned firms have existing debt less than $100k, compared with 21% of white-owned firms and 14% of Asian-owned firms.
- The share of minority-owned firms with outstanding debt increased from 51% in 2015 to 70% in 2016; in comparison, the share of nonminority-owned firms increased from 63% in 2015 to 71% in 2016.
- A greater share of black- (25%), Hispanic- (26%), and Asian-owned (25%) firms also expect to increase their debt levels in the next 12 months, compared with white-owned firms (16%).
- However, minority-owned firms take on greater risk to obtain debt, with black-, Hispanic-, and Asian-owned firms using future sales as collateral more often than white-owned firms. For example, 18% of Hispanic-owned firms more than 5 years old use future sales as collateral, compared with only 6% of similarly aged white-owned firms.

Black-owned firms apply for credit at a higher rate and tend to submit more applications—but seek lower amounts of financing—than white-owned firms

- Fifty-three percent of black-owned firms and 43% of white-owned firms applied for financing in 2016. Forty-three percent of black-owned firms submitted three or more applications, compared with 31% of white-owned firms.
- Regardless of race, the top reason for applying for financing is to expand business or pursue a new opportunity.
- Thirty-two percent of black business owners and 39% of Hispanic business owners sought more than $100k in financing, compared with 46% of white business owners and 49% of Asian business owners.
- Of black-owned firms that did not apply for financing in the past 12 months, only 22% cited sufficient financing as the primary reason compared to 52% of white-, 37% of Asian-, and 32% of Hispanic-owned firms. Of the nonapplicant firms, 35% of black- and 30% of Hispanic-owned firms do not use external financing on a regular basis, compared to 21% of Asian- and 21% of white-owned firms.

Black- and Hispanic-owned firms tend to apply for higher-cost products and are more likely to apply to online lenders compared with white-owned firms

- Black- (17%) and Hispanic-owned (19%) firms are at least twice as likely to seek financing via merchant cash advances and factoring (i.e., the sale of accounts receivable) compared with white-owned firms (7%).
- Black-, Hispanic, and Asian-owned firms applied to large banks for financing more than they applied to any other source of financing.

12 *Index equals the share of firms profitable in the previous 12 months minus the share of firms operating at a loss.*
13 *Bostwick, R., Eisenous, W.R., and Noeth, Bryan J. (2015). The Demographics of Wealth: New Age, Education and Race Separate Winners from Strugglers in Today's Economy. St. Louis, MO: Federal Reserve Bank of St. Louis.*