



**Working Group to Ensure Inclusion of Underserved
Entrepreneurs: Conversation with Stakeholders**

April 24, 2014

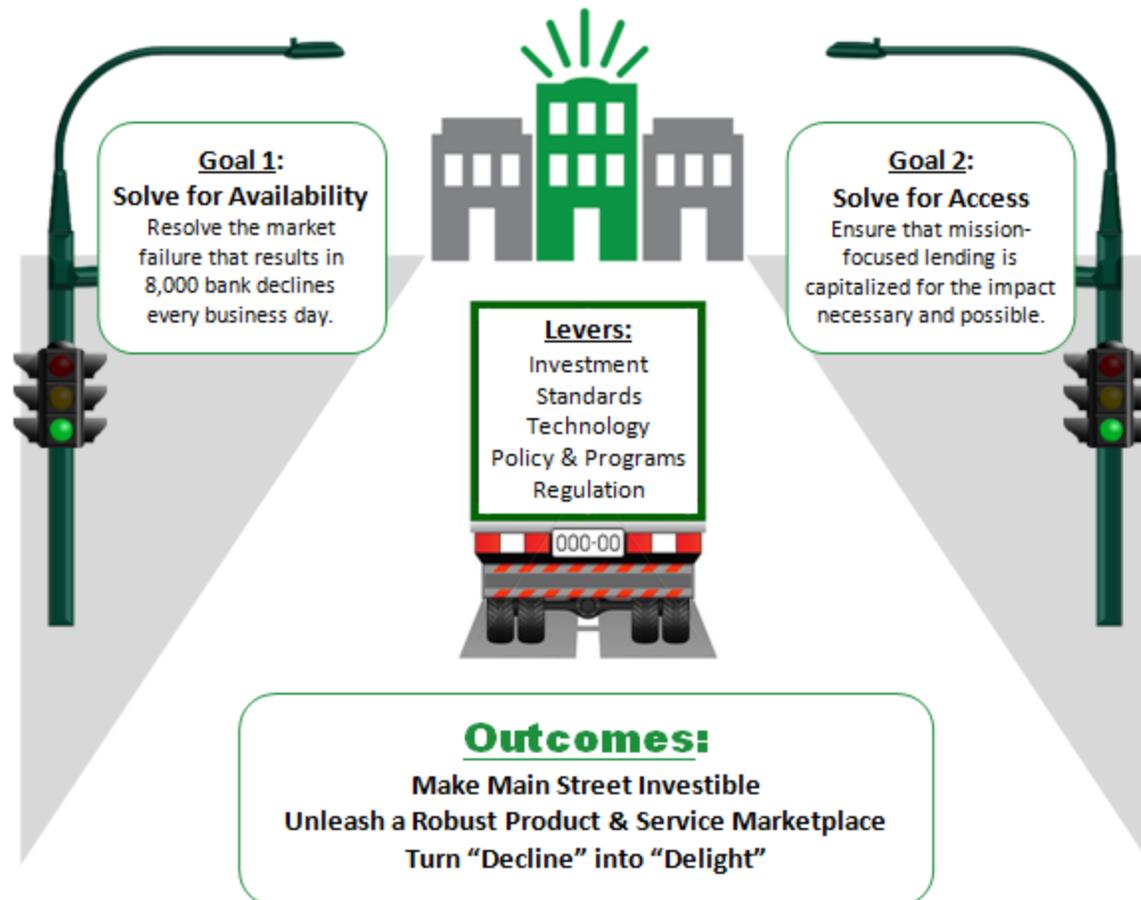
Micro Capital Task Force: Overview

The Vision:

Move Money to Main Street in Every Community

Stakeholders:

Main Street Businesses, Commercial Banks, Community Banks,
Credit Unions, Loan Funds, Alternative Lenders,
Infrastructure & Data Providers, Investors,
Regulatory & Policy Makers



Micro Capital Task Force: Structure

Micro Capital Task Force

Co-Chairs: Connie Evans, President & CEO, AEO & Mitch Jacobs, Founder, Tech on Main

Working Group to Ensure Inclusion of Underserved Entrepreneurs

Convenors: Ira Lieberman, President, LIPAM International & Grace Fricks, CEO, ACE

Working Group on Technology & “Big Data”

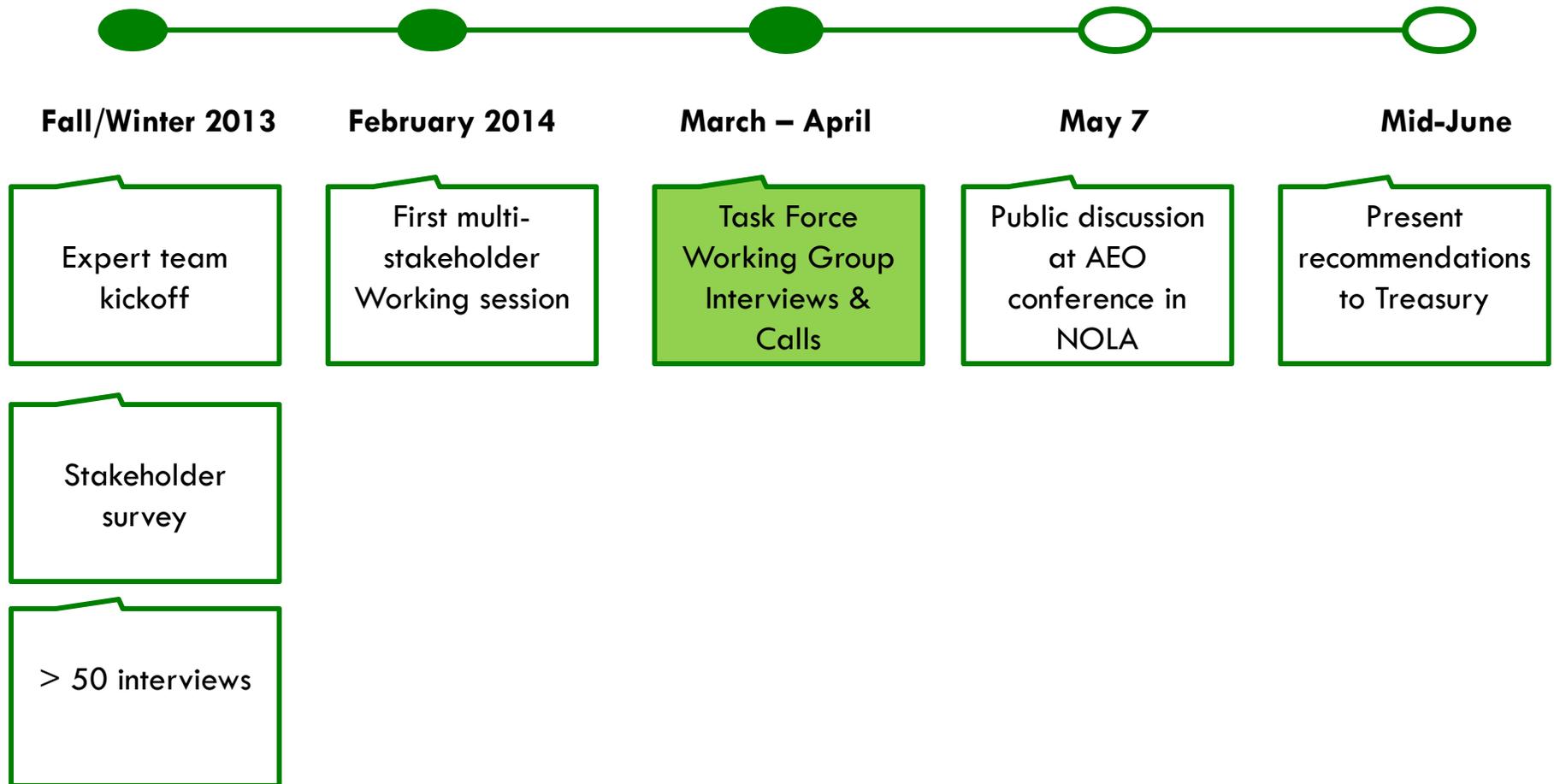
Convenor: Matt Harris, Bain Capital Ventures

Working Group on Capital

Convenors: Melissa Bradley, Managing Director, New Capitalist & Daniel Gorfine, Miliken Institute

Micro Capital Task Force: Process

■ Today's discussion



Micro Capital Task Force: Working Group Leaders



Ira W. Lieberman
Founding CEO, CGAP Secretariat
The World Bank



Grace Fricks
Founder & CEO
Access to Capital for Entrepreneurs, Inc.

Context for Today's Discussion

AEO asked Ira Lieberman, one of the pioneers in enabling microfinance to scale internationally, to assemble a team of experts to answer the question,

“What investments in infrastructure and capacity are required to ensure that mission-focused lenders and service providers remain relevant and achieve sustainability in the United States?”

Lieberman's team* worked from October 2013 through March 2014 to establish a fact base from which to make recommendations for structural change. Among other activities, they:

- Evaluated available data and industry reports;
- Performed ground-breaking analysis of emerging technology-led for-profit micro lender economics
- Conducted more than 50 interviews with leaders in mission-focused organizations, technology companies, established financial institutions, and government agencies.

*Keith Catanzano, Partner, 2Rivers Consulting; Paul DiLeo, Founder, Grassroots Capital; Alana Heath, Program Associate, LIPAM International; Jenifer Mudd, Consultant, LIPAM International; Jose Ruisanchez, Consultant, LIPAM International

Micro Capital & Main Street Businesses: Definitions

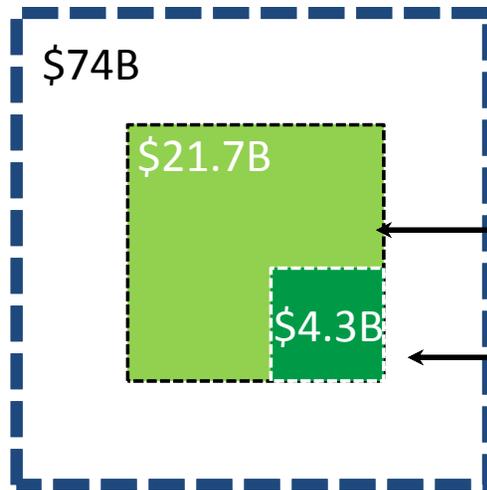
- “Micro Capital” defined as financing needs of up to \$250,000 for Main Street businesses
- Main Street businesses are the vast majority of the >25 million business establishments in the US
- Includes sole proprietors (e.g. solo); businesses with up to four employees (e.g. micro) and businesses with up to 50 employees (e.g. small)
- Several ways to characterize and segment:
 - **Number of employees:** Proxy for capacity
 - **Industry:** Broad range including construction, retail, services, etc.
 - **Age of business:** Less than one year operations to long established
 - **Growth aspirations of the owners**
 - **Geography**
- Capital needs include equity and credit building products (especially to start a business); short term or long-term working capital; and financing for major investments

Mission-Focused Lending: Restructuring Needed

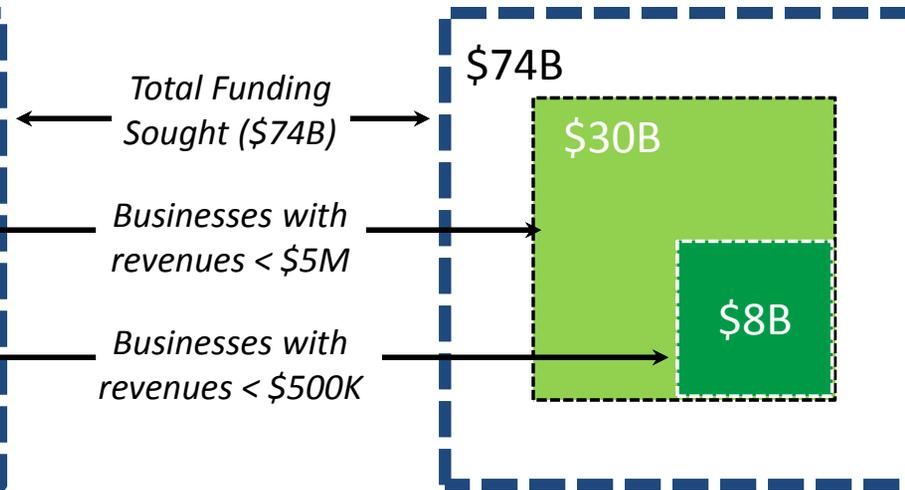
- The American dream is out of reach for millions of Main Street business owners. According to US Treasury Secretary Jacob Lew, each work day more than 8,000 businesses in communities across the country fail to qualify for a commercial bank loan. This capital gap to Main Street businesses represents \$44 billion to \$52 billion in unmet demand. CDFI loan funds today originate well-below \$1B in Main Street loans.
- The current system of financing Main Street is complex and fragmented. It includes an array of public and private sources of capital in the form of grants, concessionary loans and market-priced capital. Providers include mission-focused nonprofit loan funds; credit unions; community banks; emerging for-profit technology companies ; credit cards issuers and others.
- Business Development Services plays a critical role in the development and growth of small and micro business. Yet, business development services are all over the map resulting in highly inefficient resource allocation and uncertainty about the value of the current model.
- Technology enables explosive growth in product offers; new investment models and radically improved productivity for greater market reach. In particular, technology presents opportunities for significant productivity improvements in CDFI lending to Main Street. However, investments in technology are material and require scale benefits to capture value.
- Current approaches to pricing in mission-focused lending organizations constrain the ability to scale.

Sizing the “Micro Capital Gap”: ~\$44B - \$52B in Unmet Need

Capital Sought v. Provided - Baseline
(model based results)



Capital Sought v. Provided - Alt 1
(model based results)

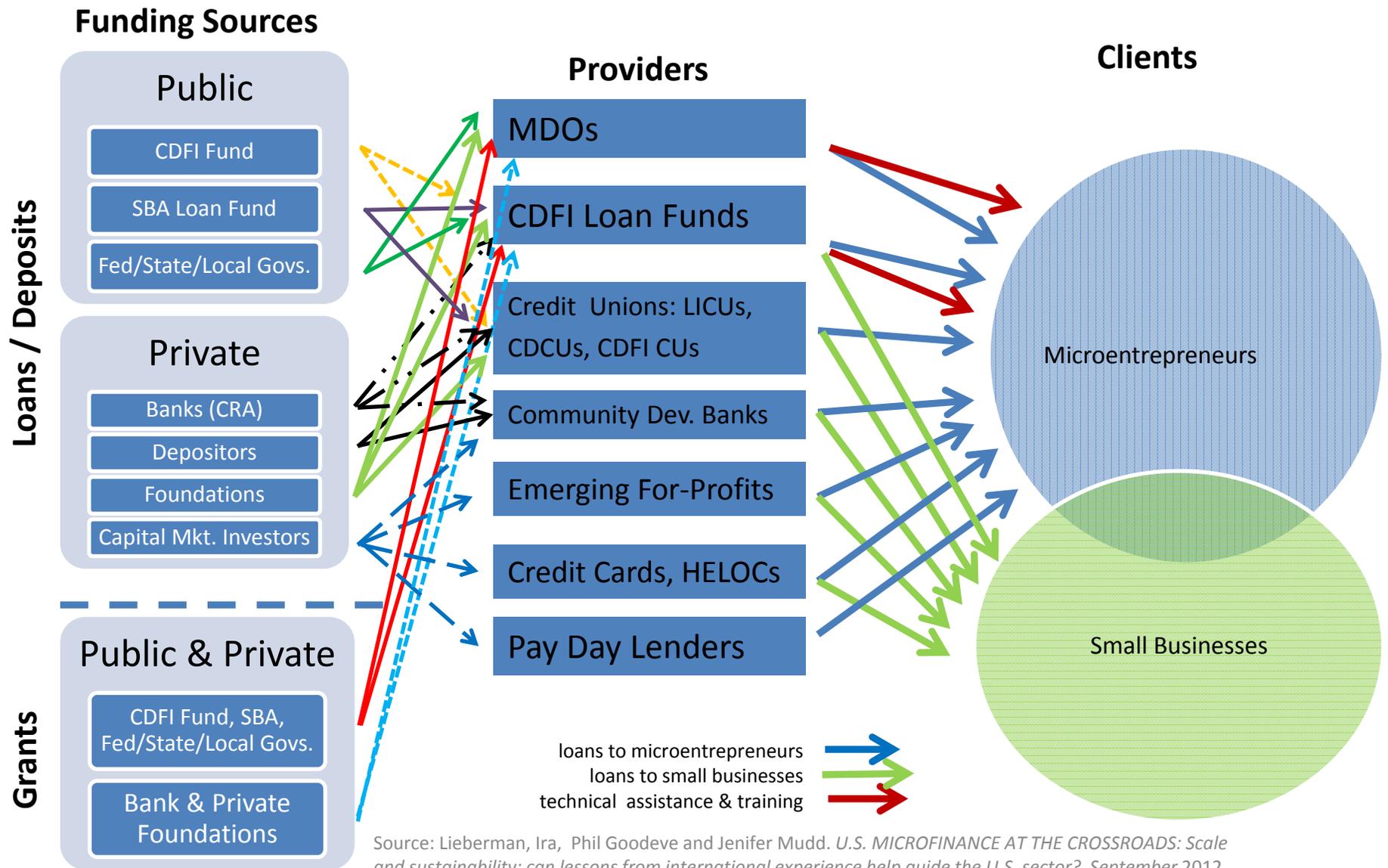


- Businesses owned by women, African Americans, Latinos and others are affected disproportionately by this capital gap.
- If even 5% of this unmet need is credit-worthy, CDFIs in partnership with alternative lenders could create significant impact
- No silver bullet answers: Solutions must include increasing the availability of suitable credit products and strengthening the underlying performance of these Main Street businesses.

Source: “Micro and Small Business Finance in the USA: A Strategy for Structural and Policy Changes in the Sector,” Ira Lieberman, Jose Ruisanchez, Paul DiLeo, Jenifer Mudd, Keith Catanzano and Alana Heath, (January 2014).

For empirical analysis of the capital gap by race, see for example, Robert W. Fairlie and Alicia M. Robb, “Race and Entrepreneurial Success,” (MIT Press, 2009). Surveys by a variety of organizations consistently demonstrate a capital gap to women-owned businesses as well. For a discussion of causality including the different capital structures of firms owned by women and minorities, see Alicia M. Robb, “Access to Capital among Young Firms, Minority-Owned Firms, Women-Owned Firms and High-tech Firms,” (SBA Office of Advocacy, April 2013)

Main Street Lending: Current Snapshot

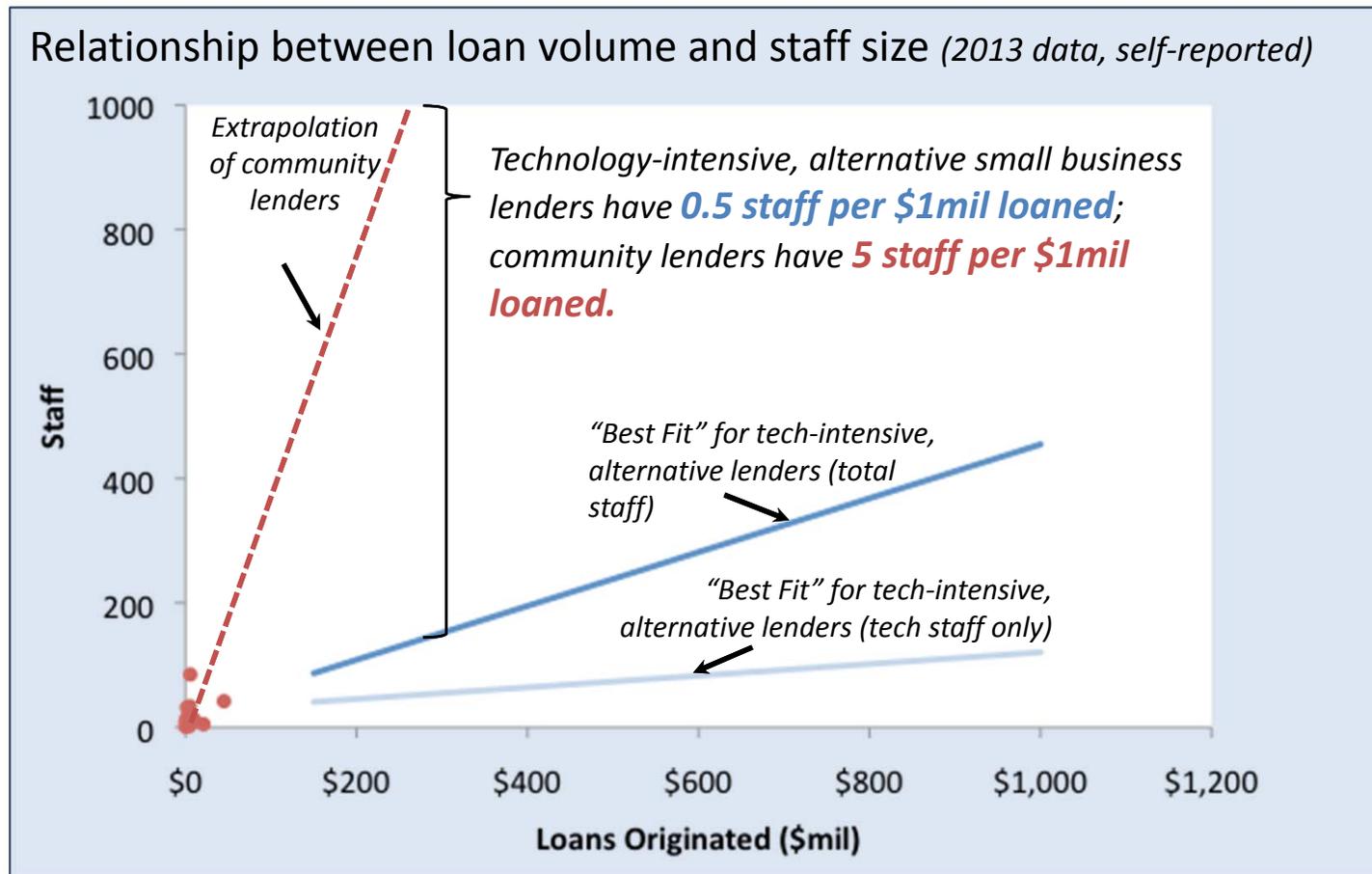


Source: Lieberman, Ira, Phil Goodeve and Jenifer Mudd. *U.S. MICROFINANCE AT THE CROSSROADS: Scale and sustainability: can lessons from international experience help guide the U.S. sector?* September 2012

Business Development Services: Critical But Not Optimal

- Business Development Services – frequently described as “technical assistance” when provided by CDFIs and other nonprofits – plays a critical role in the development and growth of small and micro business.
 - Provision of targeted support to fill gaps in experience or capacity along the path to capital can have material and measurable results on the performance of the business
 - Moreover, several proven solutions exist
- Business development services are all over the map resulting in highly inefficient resource allocation:
 - No generally accepted framework or performance metrics
 - Available performance data is inadequate and provides little evidence of impact
 - Significant duplication in preparing BDS materials
- While recognizing the importance of “high touch” community presence, there is substantial scope for standardization facilitated by technology
- Potential to enhance efficiency and productivity through networks and partnering with financial institutions

Technology Presents Significant Opportunities for Productivity Improvements for Mission-Focused Lenders



While the staff of community lenders certainly offer additional “high touch” services that alternative lenders do not, there are opportunities to improve efficiency.

Source: 2River analysis, AEO “Unit Cost Survey

Pricing: Interest Rate Culture Constrains Sustainability & Impact

- For CDFI loan funds to be relevant, they have to charge interest rates consistent with sustainability of an efficient operation
- A deep seated culture of subsidized rates is impeding mission-focused lending
- Cost recovery interest rates are not incompatible with social mission

Selected Recommendations: For Discussion

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Make Every Main Street Investible

- Create a Main Street window in the CDFI Fund to provide capital and targeted capacity building to a select set of high-impact/high-potential institutions including networks
- Mobilize and pool capital from financial institutions and other corporations, impact investors and philanthropy

Unleash a Robust Product & Service Marketplace

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- Form networks for marketing, distribution and product development
 - Fund incubation and scaling of products, services and delivery models ranging from niche market credit products to business development services along the “Path to Capital”
 - Permit each qualified program participant in government backed direct loan programs to set pricing in line with specific borrower profiles and market based conditions in its operating area

Turn “Decline” into “Delight”

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- Enable Main Street business loan applicants to opt in to an automated referral network of approved lenders and service providers

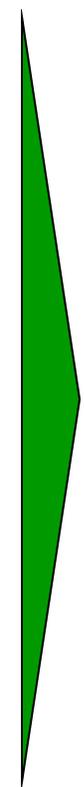
Create a Main Street Window at the CDFI Fund

DRAFT FOR DISCUSSION

Issue

Recommendations

- CDFI Fund is effective mechanism to finance critical activities in underserved communities
- However, the largest CDFI Fund programs not well suited to finance Main Street micro capital needs
 - Bond Guarantee: In spite of legislative intent and sufficient demand, none of the Bond proceeds used to finance small business
 - New Markets Tax Credits: Some Main Street microlenders participate, but limited use of proceeds for micro lending
- Capacity building grant programs to date not designed to accommodate structural challenges of fragmentation, lacked attention to underlying performance of participating organizations and limited incentives or support to invest in change where critical



1. Create a dedicated funding window for Main Street including
 - a. 5-year program with competitive multi-year grants structured to align performance and participation incentives
 - b. Rigorous selection criteria including impact potential; innovation; competitive unit cost economics
 - c. Harmonized with SBA programs (e.g. Community Advantage, Microloan, etc.)
 - d. Transparent regular performance reporting framework tailored specifically for financing Main Street (e.g. penetration of target market(s); portfolio quality; operating metrics)
 - e. Transparent, regular outcome and impact reporting
 - f. Mechanisms to permit program churn (e.g. additions and drop outs)
2. Permit certified CDFIs to serve target markets nationally (e.g. women, Veterans, etc.) by removing requirement to secure state by state licensing

Mobilize Capital from Financial Institutions & Other Private Sources

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Issue

Recommendations

- Community Reinvestment Act (CRA) represents a critical source of capital in underserved communities
- In spite of its impact to date and potential for the future, CRA is not without challenges for all stakeholders (e.g. persistence of credit deserts; short-term nature of expected impact; limited incentives for replication and scale; high costs of compliance; etc.)



1. Create pooling mechanisms and incentives for bank CRA investment and other forms of private capital in business lending and “path to capital” services
2. Encourage formation of pooled funds that would make performance-based allocations nationally into areas of highest need
 - a. Pool contributions of national banks into a national pool
 - b. Pool contributions of regional banks into supplementary regional pools
 - c. Allocate portion of pooled funds on a “pay for performance” basis to move declined applicants on the path to capital (e.g. “Technical Assistance”)
 - d. Allocate portion of the pooled funds to finance product and service development to ensure that proven and scalable offers available for every business owner need and business type use case
 - e. Ensure incentives for other investors
3. Rate and score banks on transparent basis based on specific, objective and measurable inputs.
4. Ensure standardized outcome and impact reporting (linked to CDFI Fund Main Street window requirements through organizations that compete for funds

Form Networks for Marketing, Product Development & Distribution

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Issue	Recommendations
<ul style="list-style-type: none">• Current landscape of mission-focused lenders and services providers is extremely fragmented.• Fragmentation results in higher than necessary costs to serve• Economies of scale are possible to achieve in core operating functions without consolidation through formation of networks supported by shared utilities	<ol style="list-style-type: none">1. Mobilize investment to launch and operate networks and shared utilities2. Define specific goals, objectives, targets and metrics over three to five year horizon3. Identify 12-15 initial network members4. Define optimal network governance5. Define reporting requirements6. Define criteria for network expansion

Next Steps

- Join **MCTF call with capital and “Big Data” working groups** on 30 April at 3:30 pm eastern
- Participate in person at the **Micro Capital Task Force Summit** as part of the AEO conference in New Orleans on **7 May from 8am – 1 pm**
- Continue to share your feedback and ideas with the Task Force team
 - <https://aeoworks.wufoo.com/forms/micro-capital-task-force-your-recommendations/>
- Contact us with questions or feedback

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Thanks!

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