DEMOCRATIZING CAPITAL: HEALTHY BUSINESSES, HEALTHY COMMUNITIES

Partners
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Abstract
Growing small businesses have the power to promote community wellbeing by creating new jobs, offering health benefits to their employees, building stable and supportive work places, and, in some cases, providing healthy goods and services directly to neighborhoods that would otherwise lack access. Unfortunately, due to chronic undercapitalization and unsupportive traditional approaches to lending, small business owners are frequently unable to scale their operations and generate this critical community impact. While the San Francisco Bay Area features many sources of microloans and a strong ecosystem of nonprofit lenders and technical assistance providers, the landscape is incomplete. In fact, the most common reason for the failure of established small businesses, and the biggest barrier to their growth, continues to be the lack of appropriate forms of capital available through existing sources of funding. This is especially true for entrepreneurs who are women or people of color, further limiting the growth of businesses that might provide even greater community benefit. Our region is home to a thriving, civic-minded small business community that is motivated to do more to support its neighborhoods and employees. However, without the right blend of capital to fund the growth of established small businesses, their ambitions may never be realized.

Small Businesses and Healthy Communities

> "Americans increasingly recognize that life expectancy, disease rates, and other indicators of behavioral and physical health are impacted by both medical elements (such as access to health care) and social and environmental factors (such as availability of quality schools and clean air). We are also increasingly aware that in order for a community to be healthy, all of its members must be healthy and that communities must have full participation from – and access to opportunity for – all members." (Aspen Institute, 2016)

Thriving communities depend on the wellbeing and success of individuals and families. These, in turn, are influenced by a host of factors, including education, health equity, and economic opportunity. This paper focuses on the impact of the latter factor, economic opportunity, and what regional stakeholders can do to improve small business growth and the creation of good jobs that lead to healthier communities. We believe that good jobs are the essential foundation for individuals to access housing, food, and health care, and that community level economic development efforts must encourage entrepreneurship, investment, and equity in order to improve community wellbeing.

The benefits of entrepreneurship and small business growth are typically discussed in terms of job creation and wealth building opportunities for entrepreneurs and employees. Business ownership creates new wealth faster than wage employment, and minority business owners are wealthier than their non-business-owning peers. Moreover, businesses with fewer than 100 workers currently employ 33.4% of all private sector workers and contribute to net job growth significantly more than their larger counterparts. Small businesses accounted for 62% of net new jobs since 1993 (Small Business Administration, 2017). In addition to serving as valuable sources of new employment, small businesses provide a wide variety of additional benefits to the communities in which they operate, such as building local wealth, contributing to the local tax base, and adding a sense of community, making them significant drivers of economic development. Certainly, these are critical factors indicating the importance of building a thriving small business ecosystem. However, the growth of small businesses can also have wide-ranging impacts on the health and wellbeing of the communities they serve.

Factors ranging from community of residence to personal wealth to education level make up a set of indicators known broadly as social determinants of health, and are clearly linked to overall health and wellbeing. Household wealth shields families from economic shocks and serves as a critical social ladder. Unfortunately, wealth disparities often fall along racial lines, with Black and Latino households maintaining little if any retirement savings, real estate, or business equity (Urban Institute, 2017). In addition to providing access to health care, good jobs allow families to live more balanced lives, and relieve the constant stress of financial insecurity. Moreover, deep linkages exist between healthy workplaces and healthy communities, such that responsible employers have a strong interest in supporting both. Businesses that promote healthy communities reap benefits in both profits and a stronger local economy overall.

> “Productivity losses as a result of employees who don’t come to work or work while sick cost U.S. employers over $225 billion annually. In addition to better physical and mental health, healthy communities are associated with lower rates of obesity and smoking and higher levels of education. All of these factors contribute to a healthier, more productive workforce that misses fewer days of work and drives lower health care expenditures.” (Robert Wood Johnson Foundation, 2016)

In fact, many Bay Area entrepreneurs are mission-driven, and committed to creating good jobs and giving back to their communities in addition to earning a profit. Small businesses are more likely to hire individuals from their surrounding neighborhoods and provide opportunities for people who have lacked economic opportunity. This makes opportunities for minority entrepreneurs to succeed all the more critical for economic empowerment in communities of color. Regional polls show that the majority of regional entrepreneurs support policies that mandate paid sick leave and raise the minimum wage, which place intentional good employers on a level playing field with other businesses (Policy Link, 2018).

Small business leaders have considerable incentive and ability to work alongside policymakers and community-based organizations to improve the health of their communities by improving the quality of jobs they provide and promoting healthy and inclusive cultures focused on employee wellbeing and professional development. However, without access to a strong ecosystem of small business advisors, educators, and capital providers, many entrepreneurs never reach the stage of business that would allow them to have this broad impact.

What ICA Fund Good Jobs Companies Are Saying

ICA Fund Good Jobs is committed to making one economy work for everyone by expanding opportunities for small business growth and new wealth creation. Our programs provide growth capital and consulting for mission-aligned entrepreneurs who have the desire to scale quickly, create good jobs, and increase wealth creation opportunities for their employees and themselves. Over 22 years of community engagement, we have developed a service model based on deep relationships with entrepreneurs formed over months or years, which allows us to see firsthand the kinds of challenges they face, and the gaps in the ecosystem that hinder their growth. Our services are industry agnostic and available to all demographic groups with mission-aligned business models. However, we focus our outreach to business sectors that are growing quickly across the Bay Area, including local artisan manufacturing, food and beverage production, and professional and technical services. Approximately 43% of the companies we support come from Oakland's booming restaurant and food manufacturing sectors. We specifically target under resourced entrepreneurs leading companies that:

- Have a scalable businesses model with a clear path to good job creation
- Have demonstrated their product's or service's fit and traction in the market
- Have tangible market expansion opportunities
- Face issues scaling due to capacity or capital constraints

We directly serve up to 150 small businesses each year and have a broad network of entrepreneurs actively seeking to grow their businesses and create good jobs. The businesses participating in our pre-accelerator offerings have average annual revenues of $683,324, and employ an average of 9 workers. The businesses we target for intensive Accelerator offerings have average revenues of $2 million, annualized growth rates of 30%, and employ an average of 30 workers. The businesses we've invested in through our seed fund have average revenues of $4 million, annualized growth rates of 17%, and employ an average of 28 workers.

Based on these characteristics, we felt that entrepreneurs in the ICA Fund Good Jobs network could offer uniquely relevant insights into the role that small businesses can play to support employee and community wellbeing, and the barriers that limit their ability to play that role. We distributed surveys to 169 companies that had engaged with ICA Fund Good Jobs services over the previous year, asking questions about the number of jobs they provide, the benefits they offer to employees, whether they are actively seeking investment capital, and if they are, what that capital would allow them to accomplish. Survey questions are included as an appendix.

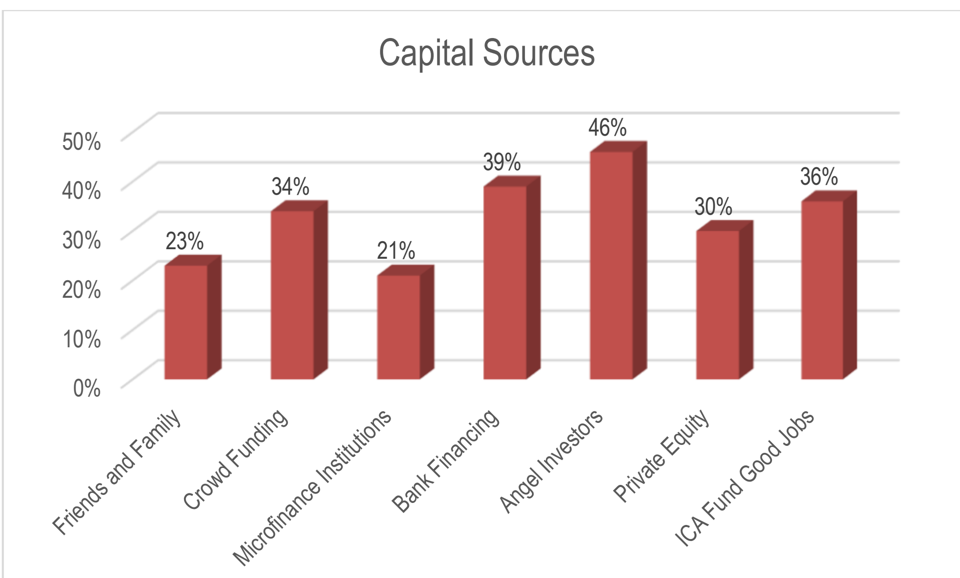
From the surveys distributed, we received 93 responses. The companies responding were founded between 1992 and 2015, with an average of six years in business. They earned annual revenues ranging from $20,000 to $9 million, with an average of $963,000. They also employed between 1 and 60 workers, with an average of 11 employees. As such, respondents represented a broad cross section of our network. However, the goals, needs, and challenges they discussed were remarkably similar.

In total, 47 respondents (51%) provided some benefits to employees, including health insurance, dental, and/or vision coverage, sick days, or general paid time off. Many provided other benefits, including training, meals, transportation stipends, bonuses, equity, retirement plans, employee discounts, tuition reimbursements, and flexible work schedules.

Most who could identify specific needs to help scale their businesses over the coming years said that their greatest needs were for talent and capital. Sixty-one respondents (66%) planned to seek outside capital in the next 12 months. Not all of those who planned to seek capital knew how much they needed in order to achieve their business goals. Those who did have a specific capital target reported needs ranging from $7,000 to $10 million, with an average need of $664,024. This funding would allow them to complete a wide range of business goals, including marketing and market research, hiring new employees, purchasing equipment, expanding production and/or retail space, improving facilities, expanding inventory, or simply obtaining needed working capital. In addition to these goals, most could identify tangible ways they might increase job quality, given the resources. These included:

- Setting clear job expectations and improving performance feedback
- Developing workplace cultures rooted in the entrepreneur's mission, vision, and values
- Increasing hours and providing insurance for part time employees
- Increasing wages
- Improving hiring practices, training, and professional development

Not all respondents had sought outside investment capital in the past. Those who reported facing challenges accessing capital in the past sited lengthy processes and unfavorable terms as major barriers. Further highlighting the challenge of accessing growth capital, most respondents reported that they planned to seek capital from multiple sources, which included friends and family, crowd funding, microfinance institutions, banks, angel investors, private equity, and ICA Fund Good Jobs specifically:



We also interviewed entrepreneurs in our Good Jobs Accelerator and investment portfolio who have actively sought capital within the last year, to discuss their roles in supporting the wellbeing of their employees. We learned that the vast majority (87%) of companies in our network pay more than the local minimum wage, and that 42% adjust wages annually to account for increasing costs of living. Employee benefits were important considerations for our entrepreneurs, with 38% providing some type of medical coverage, 77% providing sick leave above the legal requirement, and 12% offering profit sharing programs such as stock options or an annual bonus savings plan. We know that a strong organizational culture provides structure, accountability, and a sense of belonging to employees. Thus, we were encouraged to see that 85% of our companies had a clearly defined mission statement, and 58% had a structured employee onboarding process, communicating the organization's mission and values. Finally, 69% of our entrepreneurs demonstrated a commitment to providing career ladders through promotions, regular performance reviews, and discussions about employee professional goals. When it came to promoting access to good jobs for individuals who had historically lacked economic opportunities, we found that our entrepreneurs fell into one of two categories:

1) They operated in industries that had historically very poor-quality jobs, which were most often held by populations that are typically under employed and underpaid. By committing to providing better quality jobs than the industry average, they were inherently improving access to good jobs.

2) They went into business specifically for the purpose of providing job opportunities for populations that had faced employment barriers, creating new opportunities for refugees, first generation immigrants, people with limited work experience, and others.

> "People don't want to be a part of an organization where they are just told what to do. We're trying to give everyone a role at Firebrand that is bigger than a job, and make our staff feel like they are a part of something. We want our employees to feel good about what they do, who they are, what they can accomplish at work and outside of work. We want that energy and empowerment to flow out into the community. Firebrand needs to be something bigger than a bakery." – Matt Kreutz, Firebrand Artisan Breads

The Challenge of Capital

A disproportionate amount of economic development attention is given to startups, which are often misunderstood and overstated as a force for solving today's economic challenges. In recent years, new businesses have been failing faster than they have been created (Brookings, 2014). In fact, little more than half of all startups survive their first five years of operation (Bureau of Labor Statistics, 2016). The fact remains that the jobs created by startups are highly unsustainable in the long run. The growth that takes place after the buzz has died down – the scale – is what matters most to communities that depend on the jobs these businesses create. In order to affect the long-term community transformation that small business are capable of generating, it is critical to finance the sustainable growth of existing companies dedicated to investing in the neighborhoods in which they do business.

Unfortunately, entrepreneurs who seek to scale their businesses are often unable to access the best fitting capital for their stage of growth. Though capital raising is a normal cyclical component of business growth, businesses that are undercapitalized from the start are in a perpetual state of "catching up," limiting their revenues, profits, and community impact. Newer, smaller businesses face significantly different challenges in raising debt and equity funding than large corporations. Both startup capital and ongoing growth capital injections at critical points of organizational development are crucial to the long-term survival of a business.

The Kauffman Firm Survey is the largest longitudinal data set of small business growth, comprised of all U.S. businesses launched in the year 2004. This survey provides a useful tool to examine how new businesses finance their operations over time. At the startup phase, most entrepreneurs rely on personal savings, capital from friends and family, and personal debt to finance their businesses. Over time, they must identify larger infusions of outside capital to finance their growth (Cotei and Farhat, 2016). This dynamic highlights the immediate disadvantage of entrepreneurs that come from low income communities, and cannot count on friends and family to provide the same startup support as their more privileged peers. These entrepreneurs rely on a constellation of outside capital providers that fill critical needs, but just as often reinforce patterns of undercapitalization. The inability of under resourced entrepreneurs to find appropriate forms of capital through existing channels at critical points in their development can hobble their growth and undermine their long-term sustainability. Some of these existing capital sources and their related challenges are included as an appendix. Some of the common gaps we see in the ecosystem include the following:

- ***Micro-finance Institutions*** provide seed capital that can help launch small businesses, or provide early stage working capital typically in the range of $5,000-$50,000. Unfortunately, they generally do not provide the larger amounts of capital or logistical support needed for growth-stage companies.

- ***Crowdfunding Platforms*** provide a great opportunity to test the market for a new product or idea, and can, in rare cases, be used to raise large amounts of capital if the campaign goes viral. However, these platforms don't provide the technical support entrepreneurs need to scale an idea into a thriving business that creates jobs. Moreover, depending on the benefits offered to campaign supporters, order fulfillment can be costly and erode profits in exchange for short term cash.

- ***Angel Investors*** often provide seed funding to companies, but they bear a high level of risk and therefore require a very high return on investment in addition to a defined exit strategy and participation in certain high-growth industries.

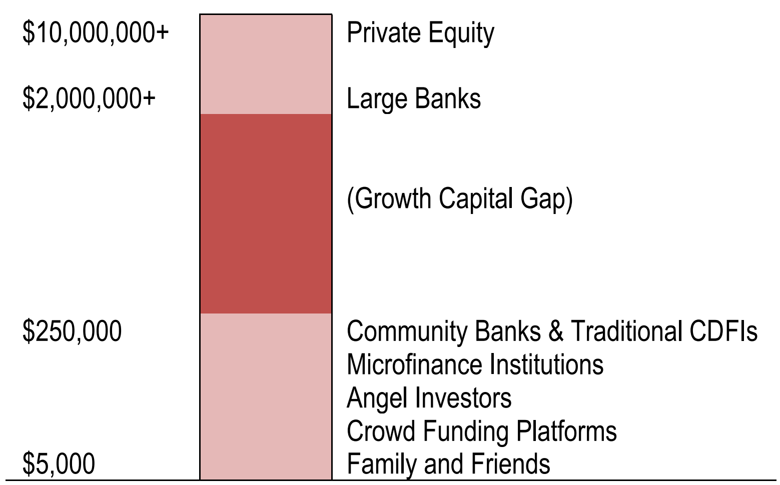
- ***Commercial Banks*** can provide growth capital, but typically impose stringent loan requirements that small businesses struggle to meet and require collateral and a personal guarantee that most under resourced entrepreneurs cannot provide.

- ***Social Impact Investors*** can sometimes be counted on for appropriate capital. However, most "double-bottom line" firms are unwilling to accept lower rates of return to achieve their social goals, putting pressure on entrepreneurs to be both socially impactful and highly profitable from an early stage.

- ***Traditional CDFIs*** can provide some working capital in a range of dollar amounts but are rarely willing or able to make equity-like investments, which are a critical part of the capital stack, and typically the most difficult form of capital for entrepreneurs with less personal wealth to access.

- ***Friends and Family*** provide startup capital for many businesses. However, entrepreneurs of color and those from low-income communities rarely have access to these resources.

- ***Alternative Loans and Merchant Cash Advances*** are sources of last resort for entrepreneurs in need of immediate working capital, who cannot rely on friends and family. These resources come at a high cost, often to the long-term detriment of the business.



Due to the limitations of available capital, companies that have reached a critical point in their growth frequently find themselves unable to obtain capital of the type and amount that they need to reach their goals. The Silicon Valley Microfinance Network includes 34 micro-lenders and impact investors who can provide loans of up to $300K to support targeted small businesses. However, there are no organized networks of lenders capable of funding larger capital needs, clearly demonstrating why entrepreneurs feel they need to seek capital from multiple sources.

Meanwhile, those entrepreneurs seeking bank financing face a discouraging set of challenges. The 2008 financial crisis took a significant toll on the role of bank debt in small business financing that has not recovered in the years since. Business debt represented 7.6% of total small business financing in 2008, and dropped to 5.9% in 2009 – a decline of 22% overall. Rates of business lending had not recovered in 2011, when the Kauffman Firm Survey ended. On a more granular level, the survey also reveals stark differences in different types of business debt. Lines of credit decreased by 14.6% immediately after the recession, but had nearly recovered by the end of the survey. Credit cards decreased by 25.8% immediately after the recession, and showed almost no recovery by 2011. Bank loans, meanwhile, decreased by 18.3% from 2008 to 2009, and continued to decline every year (Cotei and Farhat, 2016).

In order to be considered for bank loans, entrepreneurs must pass stringent screening requirements, often requiring collateral, strong personal credit scores, and established records of profitability that few small businesses can meet, even if they are otherwise successful. Importantly, the success of these undercapitalized businesses is the result of resourcefulness and bootstrapping on the part of the entrepreneur – often at the expense of their personal credit ratings and collateral assets. As of 2015, the 10 largest banks issuing small business loans had cut their total lending by 38% over the preceding 10 years. Moreover, the high costs of providing those loans had caused traditional lenders to trend away from making small business loans of less than $1 million, adopting an industry-wide practice of risk aversion. Commercial banks originated only 43% of business loans less than $1 million in the first three quarters of 2015, down from 58% in 2009 (Wall Street Journal, 2015). Karen Mills, the former head of the Small Business Administration, has said she doubts that banks will ever fully return to the small business market following the financial crisis, citing high transaction costs and low profit margins on the loans.

Without access to loans, businesses are increasingly relying on owner equity, lines of credit, and trade credit financing. This leaves microbusinesses, those with fewer than 10 employees and less than $2 million in annual revenues, in a particularly precarious position. As of 2014, only one third of these businesses nationwide used credit of any kind, though 12% planned to apply for loans in the future. Approximately one in four microbusinesses cited bad or nonexistent credit history as a challenge that impacted their access to business lines of credit, but this rate was significantly higher among the most vulnerable populations.

> "Microbusinesses with few years in operation and minority owners are more likely to experience difficulty accessing financial products that suit their needs. And, since microbusiness finances are often deeply entwined with personal finances, weaknesses on either front can significantly impact overall household wellbeing." (Prosperity Now, 2014)

For instance, 61% of entrepreneurs with annual household incomes of less than $19,000, reported difficulty accessing credit, and 37% reported facing high interest rates if they applied. Meanwhile, only 16% of entrepreneurs with household incomes of greater than $150,000 faced such challenges, and only 17% reported high interest rates when they applied. Among entrepreneurs of color, 32% of black entrepreneurs, and 22% of Latino entrepreneurs reported having been denied for loans in the past, compared to only 9% of white entrepreneurs. Lack of access to credit puts these businesses at significant risk. More than half (55%) of microbusinesses had savings equal to less than one month's business expenses.

Additional Barriers for Women and Entrepreneurs of Color

Women and people of color who seek to start and build businesses face all of the typical challenges of entrepreneurship, but must also contend with additional barriers that limit their success. It is well-documented that women and people of color experience lower rates of business ownership and success. Businesses owned by entrepreneurs of color tend to be both younger and smaller than employer firms overall. Moreover, while minority-owned businesses make up 17.5% of all employer firms, they generate only 3.3% of total sales. Businesses owned by women entrepreneurs underperform along similar lines. While they make up 19.4% of all employer firms, they generate only 4% of total sales. Likewise, though they were more likely than minority-owned businesses to make it past the startup phase, they struggled to maintain long term sustainability, with only 1.9% of women owned businesses in operation for longer than 15 years (Annual Survey of Entrepreneurs, 2014).

If the number of employer firms owned by people of color were proportional to their distribution in the labor force, the United States would see approximately 1.1 million more firms, 9 million more jobs, and $300 billion more employee wages (Center for Global Policy Solutions, 2016). As such, it is critical to dig deeper into the particular challenges that put these entrepreneurs at even greater disadvantage.

Black entrepreneurs must overcome significant gaps in wealth, capital access, and trust in order for their businesses to succeed (Association for Enterprise Opportunity, 2017). Black communities face high unemployment, low household incomes, and nearly zero liquid wealth. In fact, black households possess only one tenth the median net worth of white households. While constituting approximately 13% of the nation’s population, black households collectively own less than 3% of the nation’s wealth, significantly suppressing their ability to take advantage of asset building activities like home-buying and entrepreneurship (Samuel DuBois Cook Center of Social Equity, 2018). Meanwhile, the network effect of entire under-resourced communities prevents black entrepreneurs from accessing start up capital from friends and family, which in turn leads to early undercapitalization of black-owned firms. While the average white entrepreneur starts their business with approximately $106,000 in startup capital, the average black entrepreneur starts their business with only $35,000 – a gap that persists and widens over time (Farlie, Robb, and Robinson, 2015).

Unsurprisingly, the sources of early capital differ significantly by race. Lack of assets often forces entrepreneurs of color to turn to financial options of last resort, including credit card debt, payday loans, auto-title loans, and check cashing institutions, which are subject to significantly higher fees and interest payments than more mainstream options. While these services often provide the only way forward for low-asset borrowers, they can also damage entrepreneurs’ personal credit scores, hurting their ability to access loans later on (Samuel DuBois Cook Center of Social Equity, 2018). The majority of black entrepreneurs report insufficient collateral or assets to qualify for loans from traditional lenders, and this perceived lack of credit-worthiness prevents black entrepreneurs from applying for credit at the same rate as their white counterparts. Their fears are well substantiated. Even considering recent cuts in bank lending, this is still the largest source of capital for most white-owned businesses, which typically leverage their own assets 1.7 times, compared to 0.5 times for black-owned businesses (Farlie, Robb, and Robinson, 2015). Likewise, credit approval rates for minority-owned firms are less than half the rate for white-owned firms, and those that are approved receive an average of only $25,000, compared to $58,000 for their white peers. Nearly 80% of black business owners reported that the business financing environment restricts growth opportunities for their businesses, while 73% report that it restricts their ability to hire new employees (Association for Enterprise Opportunity, 2017).

These challenges have led some to refer to the solution of black capitalism as a myth, highlighting that under-resourced communities cannot bootstrap their way into greater opportunity (Samuel DuBois Cook Center of Social Equity, 2018). Significant infusions of new capital are required to help communities of color overcome self-reinforcing cycles of under-development.

Women face a distinct set of challenges as they seek to establish and grow small businesses. Women are half as likely as men to start a new business, or to manage their own businesses (Jennings and Brush, 2013). Furthermore, women's businesses tend to be smaller in terms of jobs and revenues, receive less financing, and grow more slowly. To put a finer point on these trends, women entrepreneurs are majority owners of 36% of all businesses in the U.S. (19.4% of businesses with employees, as noted above), and 36% of all women entrepreneurs with established businesses want to grow those businesses (Brush, Greene, Balachandra, and Davis, 2014). However, in 2017, only 17% of funded startups were led by at least one woman founder, and less than 4% of this subset was led by black women. Though 34 black women were able to raise more than $1 million in venture funding that year, the median funding raised by all black women was $0 (digitalundivided's ProjectDiane, 2018).

Decades of academic research have studied these trends and their causes. Summarizing these findings, the Kauffman Foundation's "State of the Field" analysis outlines four critical sources of equality:

1) Gender differences in key forms of human, social, and financial capital, including "leaky pipelines" from start up to accelerator programs,

2) Differences in men's and women's culturally constructed perceptions about the abilities and risks associated with entrepreneurship,

3) The widely held stereotype of entrepreneurship as associated largely within technology-based industries and as a male-typed or masculine activity, and the power of this stereotype to discourage women from pursuing entrepreneurship and/or detract from their ability to garner support for a new venture, and

4) Differences in the opportunities and incentives that men and women experience in workplaces and in families to become entrepreneurs.

Opportunities and Challenges in the San Francisco Bay Area

By many measures, the Bay Area economy is thriving. Unfortunately, the success of the region overall obscures some harsh economic challenges. Local inequality of income and opportunity is among the worst in the nation and the gap is widening, with household incomes at the top 5% now earning 11 times more than those at the bottom 20%. In fact, the San Francisco and San Jose metropolitan areas now have the 3rd and 6th highest levels of income inequality in the United States (Brookings, 2018).

Even more alarming than income inequality is the disparity in household wealth, which is built primarily by transfers of assets across generations and has the potential to cement deep divides between high net worth households and the rest of the region. Family wealth is a major contributor to college completion, homeownership, business ownership, and health outcomes. Unfortunately, wealth disparities often fall along racial lines, threatening the region's economic health, and eroding opportunities for people of color to start and scale small businesses. Without the opportunity to build new wealth in communities of color, no isolated solution will help to bridge this gap (Samuel DuBois Cook Center on Social Equity, 2018).

The Bay Area's Black communities have been shrinking for decades and are projected to make up only 5% of the region by the year 2050, down from 12% in 1980. As the vast majority of residents have watched their incomes rise amid an explosion of wealth that has reshaped the region, Black entrepreneurs have seen their earnings decline. In 2016, median White household income climbed to $104,300, a 14% spike since 2011, while median Black household income fell by nearly 5% to a meager $29,500. In fact, the regional Black poverty rate (21.8%) is more than three times the rate for non-Hispanic whites (7.1%). Today, Black communities face the lowest labor force participation, highest unemployment rates, and lowest median household wealth of any demographic group; they are the only group that has seen their wealth consistently decline since the year 2000. Meanwhile, Latinos are significant drivers of Bay Area population growth and are projected to make up the largest share of the regional population by the year 2050. Unfortunately, Latinos take the most "low opportunity jobs" (defined as those with low wages and low growth prospects), make the lowest median hourly wages, and are the most likely to be considered "working poor" (defined as working full time with income below 200% of the poverty level) of any demographic group (Policy Link, 2017). These trends pose particular challenges for the Bay Area's entrepreneurs of color.

Our region has a significant opportunity to support the growth and sustainability of businesses owned by people of color. As a whole, 32% of California's employer firms are owned by people of color – the second highest rate of minority business ownership in the nation. The opportunities in the San Francisco Bay Area are particularly great, as 39.4% of businesses in the San Jose-Sunnyvale-Santa Clara MSA are owned by people of color, as are 31.9% of businesses in the San Francisco-Oakland-Hayward MSA (Annual Survey of Entrepreneurs, 2014).

Unfortunately, the Bay Area also exemplifies national lending trends putting these entrepreneurs at a disadvantage. The SBA San Francisco District Office's 2015 guaranteed loans show stark contrasts in lending among different racial groups. In total, 986 loans were given to white entrepreneurs along Northern California's coastal counties, representing more than 53% of capital lent. Meanwhile, only 48 loans were made to black entrepreneurs, and these were for significantly smaller amounts, constituting only 1.2% of the capital guaranteed by the region's SBA last year. Latino applicants were similarly challenged, receiving only 6.7% of the total capital invested. With these indicators in mind, we know that removing barriers to capital access is critical for reducing our region's inequality.

The Future of Bay Area Small Business

The Bay Area's economic development sector includes a broad cross-section of approaches, including organizations focused on networking, education and technical assistance; startup and growth capital; and research and advocacy. Companies within this network often touch multiple components to get the resources they need. However, there remains a great need to reach across silos and fill in gaps where entrepreneurs still do not have access to appropriate capital and networks. More innovative capital solutions are necessary to address the particular needs of women entrepreneurs and entrepreneurs of color, and a more integrated support ecosystem is necessary to ensure that high potential companies do not fall through the cracks.

Innovative credit products, powerful technical supports, outreach strategies that rebuild trust and renew connections, and freshly designed pathways for entrepreneurs to establish firms in high-revenue sectors are required to help black-owned firms to grow revenues and supply new jobs in their communities. Several banks are already taking steps to address bias in their lending criteria and exploring opportunities to strengthen capital flows to under resourced entrepreneurs. These include more intentional marketing and outreach to entrepreneurs of color; fostering equity in lending practices; developing more flexible products and targeted underwriting solutions that reflect more realistic expectations of risk and return; improvement of referral and technical assistance programs; increasing investments in locally anchored and diverse small business lenders and technical assistance ecosystems; and directly supporting increased technical assistance including small business mentoring, loan packaging services, and post-loan support (Greenlining Institute, 2017).

Additional innovations in support systems and capital delivery vehicles could have immense impact on the long-term sustainability of businesses owned by women and people of color. Impact investors must appreciate that the source of the capital provided by small business loan funds often dictates the form that loans are able to take, and when investors require high interest rates and short repayment terms, under resourced entrepreneurs are put under even greater pressure. Meanwhile, direct service providers must deploy capital thoughtfully, with an eye toward capacity building. We believe the following considerations are critical to meeting entrepreneurs where they are at, and helping their companies grow sustainably:

IMPACT INVESTORS	DIRECT SERVICE PROVIDERS
▪ **Program Related Investments:** While low-interest debt can be a valuable tool, debt alone can result in over leveraged intermediaries and in turn, small businesses. This can ultimately hinder growth, especially when equity-like financial instruments may be more appropriate for the business' stage of development. ▪ **Loan Guarantees:** Requiring a 100% guarantee on deployable capital symbolizes an unwillingness to take any financial risk. This limits capital deployment for entrepreneurs of color, and keeps capital concentrated amongst wealthy individuals and institutions. ▪ **Terms:** Recognizing the barriers to growth faced by POC-owned businesses, there is increased need for patient capital. Expecting financial and impact returns in 3-5 years can be unrealistic and creates little room for trial and error. ▪ **Track record:** Traditional forms of capital require successful track records, however the data shows us capital is not reaching entrepreneurs of color and will require new and innovative funding models with room for learning and iteration. ▪ **Technical Assistance:** little funding today is dedicated to the extended wrap around support services necessary to set up under resourced entrepreneurs for success. At best, this cost is either passed on to the entrepreneur or requires intermediaries to rely on inconsistent volunteer networks rather than paying for experienced and committed in-house expertise. At worse, adequate support is not delivered.	● **Thoughtful deployment**: Investments in early-stage companies must include sufficient capital for capacity building and infrastructure to manage financial performance, cashflow, and people. Instead of penalizing entrepreneurs for taking shortcuts, lenders should provide tools and set thoughtful benchmarks around the disbursement of capital. ● **Investor Management & Accountability**: Clearly delineate lender roles as stewards of capital and ensure transparency around investor expectations. Prepare entrepreneurs to effectively manage to higher expectations around growth and financial performance, especially if they lack experience with investor relationships. ● **Flexible & patient capital:** Lenders should be receptive to adjusting their expectations when a company is undercapitalized from the onset. It is critical not to put unrealistic pressure on a company's ability to deliver on growth. Analysis of high potential, entrepreneur of color led businesses in our pipeline, demonstrated an average of 9 years needed to reach $1 million in revenue, further highlighting the need for support and capital in order to realize these companies' growth potential. ● **Recruit the right advisors, mentors, and board members:** Direct service providers must build mission-aligned leaders that understand the needs of entrepreneurs of color, treat these businesses seriously, maintain high expectations, and provide honest feedback along with respect and compassion. Diversity in advisors, and training in cross-cultural communication is critical to maximize the effectiveness of entrepreneur support.

These incremental improvements in small business support are critical. However, we know that more radical approaches are necessary to truly reverse the centuries of harm that created the imbalances we see today. Several alternative approaches to community development are now underway, which we believe provide excellent examples for the Bay Area to emulate.

The Buen Vivir Fund (BVF) by Thousand Currents brought grassroots innovators from around the globe to design a different kind of investment fund, along with investors who were committed to supporting communities' holistic wellbeing. The fund launched its first round of investment in early 2018, featuring a blend of loan capital, grant capital, advising, learning-exchanges, and sharing of tools and practices. The BVF model features five key innovations in impact investment:

1) **Members Assembly:** Rather than restricting governance to a sitting Board of Directors, all BVF participants go through the same application process, and all are expected to invest through whichever form of contribution is possible for them, whether it be financial capital, participation in the governing fund, or sharing expertise and connections.

2) **Risk Management:** Rather than forcing invested projects to assume the total risk associated with their performance, financial investors take on the majority of the risk. In this way, all members share responsibility for learning from investments and continually improving the fund over time.

3) ***Aporte* Payments:** Rather than imposing set interest rates, BVF invested projects contribute an amount in addition to the original loan principle by choice, based on their individual capacity. Typically, these payments are comparable to rates charged by impact funds and contribute to a shared sense of success and contribution to the fund.

4) **Returns:** Rather than focusing exclusively on financial returns, BVF investors also measure social and environmental returns achieved by invested projects.

5) **Shared Learning:** Rather than emphasizing the benefit that investors provide to borrowers, BVF promotes the benefits that all members can gain by learning from each other.

The Boston Ujima Project has launched a pilot to revitalize working class neighborhoods without allowing development to displace existing residents. Using a unique "cooperative economics" approach, Ujima is amplifying the voices of historically under recognized communities, leveraging their knowledge of their own neighborhoods, and organizing the resources they need to build community wealth. The project's key innovation is pooling the resources of a multi-stakeholder group comprised of community members, small business owners, workers, grassroots activists, impact investors, unions, and faith and civic organizations to make collective decisions on community development priorities through:

- **Raising Capital:** A Community Capital Fund allows community members to invest as little as $50 and help decide how the crowdfunded dollars should be directed. The process takes a step beyond typical crowdfunding platforms, which enable unaccredited investors to drive small business development, but still preserve the fundamental relationship between the influence of the investor and the amount of capital they can afford to invest. Ujima's Fund decouples the degree of each investor's influence from the amount they have invested – everyone has an equal vote in where the fund allocates its dollars. The collective decisions are made by local residents with stakes as both investors and neighbors and intimate knowledge of the local business landscape, competition, and consumer market.

- **Neighborhood Planning:** Ujima works with grassroots partners to organize neighborhood assemblies that facilitate discussions and decisions about the type of economic development needed in their communities. Then, the organization issues RFPs to local entrepreneurs to address the business and development goals of each neighborhood.

- **Community Investing:** Community driven, accountable economic development – integrated approach tailoring capital to meet the needs of diverse enterprises at different stages of growth. Diversity of capital instruments that include planning grants, traditional debt, private equity, and convertible notes.

Bay Area stakeholders are beginning to develop their own innovative practices, which we hold up as foundational approaches from which to build a more equitable economy overall. The Runway Project, founded by women entrepreneurs and grassroots organizers, is raising funds to bridge the gap in startup capital for black entrepreneurs who cannot rely on friends and family to take their ideas off the ground. Meanwhile, critical partnerships are forming between capital and technical assistance providers who are beginning to break down silos and work together to support entrepreneurs on their paths to growth.

Through the Entrepreneurs of Color Fund, sponsored by JPMorgan Chase, ICA fund Good Jobs, Working Solutions, and Pacific Community Ventures are changing the landscape of collaboration among nonprofit CDFI's in support of the Bay Area's entrepreneurs of color. Our approach provides a blend of tailored support, iterates on the lessons learned from a collaborative approach to impact, and responds to gaps in the ecosystem as they are observed. On a systems level, we have formalized a continuum of capital and consulting support that existed as a loose referral network prior to the collaborative effort, but that is now stronger and better coordinated. Where there was initially some overlap of products and services, our organizations have agreed to define and differentiate our roles in the ecosystem, and where there was separate language about our services, we have created a joint narrative to describe how we work together to serve the region. On a programs level, we provided 21 loans totaling more than $900,000 for entrepreneurs of color in our first year of collaboration. We are also jointly leveraging our resources to ensure that the entrepreneurs we support have access to the appropriate capital for their stage of business. We know that small business growth patterns are not linear, and that solutions must be tailored to the factors relevant to businesses at different stages of development. The key innovation of this collaboration is a joint, documented flow of products and services to entrepreneurs of color, prioritizing relationships over transactions, and ensuring a truly seamless continuum of support to ensure that under resourced entrepreneurs achieve their full growth potential.

The Bay Area is home to a diverse and committed entrepreneurial ecosystem that is revolutionizing the ways that capital moves through communities. What is needed today is additional creativity and resources to continue building meaningful collaboration, experimenting with innovative new approaches to growth capital, and iterating on the lessons learned from each new round of investment. We look forward to continuing to contribute to the effort to democratize capital, and to building a region of healthy, thriving communities.

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