Scaling Lending to Entrepreneurs of Color – Event Transcript

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Description

Infrastructure for lending has long been exclusionary and insufficient. As a result, entrepreneurs of color often lack access to needed capital to grow and sustain their businesses. The COVID-19 crisis has made an already difficult situation dire for many small business owners. How can we help entrepreneurs of color on the path to recovery? What is the role of community development financial institutions (CDFIs) as lenders, and what can we do to overcome some of the obstacles these organizations face?

Speakers

Michael Barr, Joan and Sanford Weill Dean, Gerald R. Ford School of Public Policy, University of Michigan

Marla Blow, Senior Vice President, Social Impact, Mastercard Center for Inclusive Growth

Tim Ogden, Financial Access Initiative, Wagner Graduate School of Public Service, New York University

Francisco Lopez, Vice President of Business Innovation and Partnerships, Dreamspring

Moderator

Joyce Klein, Director, Business Ownership Initiative, The Aspen Institute Economic Opportunities Program

Transcript

Joyce Klein (00:00)

Welcome all. I'm Joyce Klein, I'm Director of the Aspen Institute's Business Ownership Initiative and I'd like to welcome you to our discussion today on scaling lending to entrepreneurs of color. This conversation is part of the Global Inclusive Growth Partnership, which is a collaboration between the Aspen Institute and the Mastercard Center for Inclusive Growth. And our initiative at the Aspen Institute has been working for about 25 years to expand access to business ownership as a source of economic opportunity in the United States. And in that work, we've dug pretty deeply into the challenges that entrepreneurs of color face in starting and growing businesses. And so this topic is very much at the center of the work that we do. And so I'm delighted to be moderating this event today.

I think there's been really widespread media coverage of the fact that people and communities of color have been disproportionately affected by the economic impact of the COVID pandemic. I think we all have a sense of what's happening to small businesses. We see the businesses on our neighborhoods and our communities being really deeply impacted. And those owned by people of color have been in particular impacted more likely to close, more likely to face declining revenues. I think most of us have also probably seen the media coverage of the rollout of the small business administration's primary relief programs targeted to small businesses, the Paycheck Protection Program, or PPP as we might've heard it, the Economic Injury Disaster Loan.

And in that coverage, we heard about how difficult they were for many small businesses to access. But that was particularly true for business owners of color. And these outcomes were pretty predictable. Because of historic barriers to building wealth, people of color tend to start businesses in industries that don't require a lot of startup capital, industries that also often have thin profit margins. So things like food businesses, personal services businesses, construction, and those kinds of businesses. And the fact that they have more difficulty accessing capital makes them less appealing customers for banks or even for SBA programs, and that in turn limits their ability to invest or simply to save up to guard against economic and business downturns like we're seeing right now.

And those are the industries that have been in fact hardest hit in this particular pandemic. So the businesses that have the most need have also had the hardest time getting access to help right now. So, today what we're going to do in our conversation is talk about the challenges that entrepreneurs of color have faced, but we're also going to talk about the institutions that can and do reach entrepreneurs of color. They're working to help businesses and business owners right now, sometimes with loans, but also sometimes with other tools to help them survive this pandemic. And they're also going to be needed as we get the pandemic under control and try to help communities and businesses and individuals recover. And so we think there are ways that government, that philanthropy, that impact investors can support those organizations and that's what we're going to talk about today.

For our conversation, I'm joined by four people who have deep and varied perspectives and experiences on this topic. I'm going to introduce them to you now. I'm going to start with Francisco Lopez. Francisco is the Vice President of Business Innovation and Partnerships at Dreamspring. Dreamspring is what we call the community development financial institution or CDFI. It's based in Albuquerque, New Mexico, and it lends and provides support to entrepreneurs in the Southwest and the Mountain West. And before joining Dreamspring, Francisco worked with a financial institution that worked in the US and Hong Kong and Mexico. So he has both public and nonprofit expertise and expertise globally as well as here in the US. Welcome Francisco.

We are also joined by Marla Blow. Marla is the Senior Vice President for Social Impact at the Mastercard Center for Inclusive Growth. The center is focused on issues of financial inclusion broadly, but also has a deep focus on supporting small businesses and on inclusion of small businesses. And also I would note before joining Mastercard, Marla also had experience with issues of financial access and financial inclusion both in leading a startup that worked to provide consumers with access to more affordable credit cards and also at the Consumer Financial Protection Bureau. Hi Marla.

Michael Barr is also with us. Michael has a long title. He is the Joan and Sanford Weill Dean at the Gerald R. Ford School of Public Policy at the University of Michigan. Michael's looked at this issue from a research perspective but he's also held senior positions at the Treasury Department where he's led the development of policies and programs to address issues of access to capital, of community development and worked on issues related to domestic financial institutions.

And we also have Tim Ogden. Tim is a senior fellow with our program, the Business Initiative at the Aspen Institute, and also with our colleague program, the Financial Security Program. He's also the managing director of the Financial Access Initiative, which is a research center based at NYU Wagner. And in his work, Tim has led research projects and written extensively on issues of financial inclusion for households and also for businesses both in the US and globally.

So welcome to all of you. Thanks for being with us today. Let's start by addressing this question of why entrepreneurs of color are locked out of or have such difficulty accessing traditional lender. Michael, I'm going to start with you, and if you can tell us what you've learned. You've done the research, you've been in the policy roles. You also work directly with entrepreneurs in some of the work you do at the University of Michigan. So what have you learned from all of those experiences about the challenges business owners of color face in accessing capital?

Michael Barr (06:20)

Thanks Joyce and thanks for putting together this terrific panel. I'm glad to be here today. The experiences I've seen both at the federal level and in our work in Detroit suggest that even in very good times, entrepreneurs of color have difficulty getting access to capital. They have difficulty getting access to business networks for peer advice and for business opportunities. And they often have difficulty getting access to the range of skills they need to build out their business. And so skills, networks and capital really have to go together for businesses to be able to thrive. Oftentimes entrepreneurs of color don't have strong relationships for lending with local banks. They have difficulty getting access to the kind of old boys club in the community that they're working in.

And so these barriers really make it much harder for entrepreneurs of color. And then you add on top of that basic structural problems in our society that have led to massive black/white wealth gap. So entrepreneurs of color are starting out without the kind of resources internally that enable white entrepreneurs to succeed. So it really is super challenging for them. Now, on top of all that we're in the middle of a global pandemic. And as you pointed out in your introduction, entrepreneurs of color have gotten thwacked even harder by this COVID crisis than other small businesses, all of whom are suffering through this pandemic.

Entrepreneurs of color tend to be located more in communities that are hit worse by COVID-19. I've certainly seen that in Detroit in our work in the Detroit Neighborhood Entrepreneurs Project. It's just been devastating. And people of color have been hit worse by the disease. So on top of issues of economics, concentrated effects on economics, there've been concentrated public health effects in communities of color. So all these layers on top of each other make it really challenging for entrepreneurs of color in this environment.

Joyce Klein (08:45)

Great. Thanks, Michael. Tim, you've also got the research angle here. What has your research shown us about who gets access to financial capital and why, and how does that relate to race and ethnicity in the US?

Tim Ogden (09:01)

As Michael mentioned, this all starts with the black/white wealth gap. I think we have to start from the fact that serving customers who are not already highly visible and integrated into the financial system is more expensive. It requires a lot more outreach. It requires more marketing, it requires more underwriting. And that's a good thing that we want responsible lenders out there that are doing the right thing to make sure they're making loans that are affordable and useful and beneficial for the borrowers. But as a consequence, those loans are more expensive to make.

And as Michael was saying, these businesses are borrowing smaller amounts because of where they're coming from and what they're trying to do. And that matchup of expensive to underwrite plus smaller loans means loans to these communities, to these kinds of business owners, are going to be less profitable for any lender that makes them, and that has consequences in what kind of loans that the banks are willing to make. Are they willing to invest in that outreach? Are they willing to do the kinds of underwriting necessary to establish both credit worthiness and make sure that they are making a loan that's going to be beneficial to the borrower?

And we see this, this is the story of microfinance globally is making loans into poor communities as expensive. And so you've got to find some things that you can do to lower those costs. And that can come both from business model innovation but it also comes from the cost of capital to the lenders. And so, philanthropy has always played a big role historically going back thousands of years and in the present in making sure that the capital is available to lend in the first place and supporting institutions that are willing to bear those upfront costs necessary to make high quality beneficial loans to people who are not yet fully integrated into the system.

And so I think we see that continuing in the United States today is the process of integrating entrepreneurs of color does require additional investment upfront and therefore requires institutions that are committed to making that effort. And it requires those institutions to have access to the capital to invest in that upfront and to support those loans.

Joyce Klein (11:35)

That's a perfect segue to Francisco because he's in one of those organizations that is doing that kind of lending that's willing to build those relationships. Again, Francisco, you work at a community-based micro lender, Dreamspring. It's a nonprofit, but you're in the business of lending to folks who are generally not able to access capital from banks. Tell us about the kinds of businesses you work with, what it is that you do differently as a lender from maybe what a bank would do. Do you underwrite differently? Do you think about risk differently? Do you have money from different sources? What is different about what you do and how you operate that allows you to serve different kinds of customers?

Francisco Lopez (12:18)

One of the big differences, and I think Tim touched on it, is that we get funded by different sources. And when we're talking about lending capital, we might have lending capital that comes from banks in a traditional sense. We might get some unrestricted funds that we can lend out to traditional entrepreneurs. But then we also receive lending capital from philanthropic organizations. And when they come from philanthropic organizations, it's very focused, might be state restricted or for a different segment or particular segment of the economy which might be under some entrepreneurs of color or might be for rural communities, et cetera, et cetera.

What that does is that it allows us to take on... I would say allows us to take on a little bit more risk. That's one. Secondly, it also allows us to provide capital to small businesses that if you look at them, or if you look at the loan from a traditional sense, we're basically losing money, right? So any loan that is probably from $10,000 or below, we are losing money. And the only way that we can do it is with that philanthropical support. So that is a big difference as to what banks do, right?

We basically are obviously more mission oriented in what we are looking at besides the underwriting, which we might do a little bit differently as well. We look at the whole persona, not just at the business and how it will do, et cetera, et cetera. We also look at their personal history. We build that relationship, and if it makes sense, we'll bet on it. And we will lend to those underserved borrowers. But a big, big difference is how we source our capital.

Joyce Klein (14:09)

Thank you. So Marla, the Mastercard Center for Inclusive Growth and the work that it's really doing to try to work with small businesses around this issue of inclusion and access to capital is very much centered on working with community development financial institutions like Dreamspring. Talk a bit from your perspective about why these organizations are important in this moment and going forward as well.

Marla Blow (14:34)

Yeah, absolutely. We look at CDFIs as the frontline on being able to reach the smallest most local, hardest to reach businesses. The businesses that I think as Michael described earlier in his remarks may not have relationships with traditional banks and may not be able to participate in programs like PPP, which were delivered by and large through the large banks, and ultimately CDFI access to things like PPP was critical to being able to reach the businesses that are located in black communities, low income communities, communities of color, all of the parts of the country that are not in that big middle, in the big defined middle.

They're still meaningful activity, really important businesses that are important to their communities, important to the entrepreneurs, important to their customers, their end customers that they serve, that through other than CDFIs would have essentially almost no access to a financial institution at all. And ensuring for us, ensuring that the CDFI community has the liquidity, the technology. The wherewithal to be able to continue to provide that support has never been more important than it is right now. That is part and parcel of the work that we've done in the center and our ability to look at organizations that otherwise may not have the right kinds of registrations, the right kinds of reporting, the right kinds of submissions to be able to participate, to get through the requirements of the major banks and more traditional lender kinds of programs.

So Francisco's description of looking at the whole, looking at the totality of the organization, not just taking a set of reports that might not reflect the entirety of the receipts from the business, they might be reasons why entrepreneurs choose to incorporate or not incorporate and knowledge of those businesses is the critical enabling piece of being able to serve. The thing that's important to think about Mastercard is on the commercial level, we are a network and in very similar way on the philanthropic side in the Center for Inclusive Growth we operate as a network there as well.

And we see CDFIs as our partners in being able to act as that network. Where we can't have the knowledge in every local market and ability to understand what's going on, we count on our CDFI partners to have that local market knowledge. Bring that to bear, keep that sector thriving, be able to make the differentiated decisions on the margin and then be able to act quickly and be responsive and be able to provide what is needed in those communities to help them thrive. So we are huge believers and huge supporters in the CDFI universe floor for all of those reasons.

Joyce Klein (17:37)

And I would note. Francisco, you participated, Dreamspring participated in the PPP program. You did a lot of lending in much smaller dollar amounts than most banks were making PPP loans. Can you just give us an update on what volume you did, like how much lending did you do and what kind of borrowers you served through the PPP?

Francisco Lopez (18:00)

Of course. I'd love to talk about PPP because it was a process that evolved in a very interesting way since round one back in March. To give you some numbers, we were able to serve around 2,500 borrowers of which 80% of those were new clients for us, meaning they were not part of our portfolio, completely new clients, and for a total of around $70 million. And also just to give you an idea, we normally lend out, last year we lent out close to $23 million. So we basically were able to lend out about close to four times what we do in a year, we did it in five months. And I think that 50% of those 70 million were done in the first two to three months of the pandemic, meaning they were done in April, May and June.

Joyce Klein (18:56)

Fantastic. We talked a lot during that and you guys really stepped up and moved into and really what is interesting, I think, about that story, and Michael, I don't know if you have a comment to that as well, but one of the criticisms of the PPP was that banks were starting with their existing customers. They weren't reaching out to new businesses who weren't part of that infrastructure. Anything else you'd add or observations on what Francisco shared?

Michael Barr (19:20)

I think that's exactly right Joyce. I'm super impressed by what Francisco is able to pull off in such a short period of time, it's really hard work and I think people maybe don't appreciate just how hard the work is that Francisco is describing. So, a great example. I do think that the PPP program, the small business program that the administration set up from the beginning was really not well designed to reach small businesses, certainly the smallest of businesses and not well designed to reach entrepreneurs of color and not well designed to reach businesses in economically distressed rural communities or economically distressed urban communities.

And that's in part because of the phenomenon that you described Joyce. A lot of the banks started with their, not just their existing customers, but their existing bank customers who had loans already from the bank. So lots of small businesses that had transaction accounts with banks couldn't get access to business capital in the beginning stages. And early on in the PPP, CDFIs were largely shut out and it took an enormous work on the ground, lots of effort by many in the coalition that Marla and Joyce and others have been working in to get CDFIs at the table, and then to have funds directed towards CDFI programming. And that made a big difference in CDFIs getting access to PPP funding to be able to go out and do more lending.

But there's still lots more work to do and the PPP program did not meet in any way the demand for small business capital out there. We need to see, I think, a massive infusion of investment into the CDFI sector which as all of you have been describing is really on the frontline of serving entrepreneurs of color and businesses in distressed communities. So I think we need to see really just a significant uptick in that through the CDFI fund to treasury, and also the kinds of programs Joyce that you and Aspen have been working on to try and develop a secondary market liquidity facility for CDFIs to be able to lend more to distressed businesses. So I think all of these measures are going to be required. We're really still quite in the middle of a terrible economic crisis and small businesses are being hammered every day. We need to figure out how to do more.

Joyce Klein (22:03)

So Tim, I'm going to bring you in here again, because we've been focused a lot on sort of what's been happening now and where we are with relief programs. Michael started to get us looking forward. We want to look forward, but in looking forward it's also, this is the first time for many of us we've lived through this kind of an economic shock, but it's not our first recession. We just got through a great recession, well, it seems like not that long ago. So talk a little bit, like based on what we've seen in the past when our economy has been in recession, what happens in the small business credit markets and what should we be thinking about is going to happen going forward based on those experiences?

Tim Ogden (22:44)

Yeah. I mean, I think Michael sort of hinted at this when he was talking about how the banks were thinking about approaching PPP is you only serve your existing customers and you only serve those customers who you're really confident are going to repay based on the fact that you've lent money to them already, that they're already your loan customers, you already know their underwriting is. When a bank looks into a recession, they have demands on their capital. They have to start believing that some of their loans are not going to repay and therefore banks understandably become a lot more cautious about their lending.

And so when they have these standards that are very difficult for entrepreneurs of color to meet in the first place, in a recessionary environment, the gulf just gets that much bigger. And that's certainly what we saw in 2008 is everybody in the financial services industry fleas to safety to make sure that they maintain their own stability. We have lots of regulations to maintain the stability of the financial system for reasons that we saw in 2008. But if we care about communities of color, about poor neighborhoods, they bear the brunt of that retreat because they were on the margins already and as we've talked about, are more deeply impacted in recessions.

And that's exactly what we saw in 2008 is that capital going into poor communities dried up and it didn't come back. So if we look at the data from 2008 on, lending to small businesses did not recover to the point where it was in 2007, and especially never recovered for urban communities for distressed rural communities, some of the people that Michael's been talking about. And that put a lot of pressure on organizations like Dreamspring because not only was Dreamspring trying to reach these communities, but even people who are better off were being turned down by the banks and were coming to CDFIs looking for lending.

And of course, Dreamspring and its brethren and its peers are under pressure because they are trying to work out with their customers and supporting them; offering concessions, keeping those businesses open, giving them the space to be able to recover. And so the need to capitalize CDFIs gets even greater if we want to address a recession. And I think we need to be honest here, we are headed into a recession, a recession that's disproportionately going to affect low income communities where a larger percentage of the workers can't work from home or a larger percentage of the businesses can't just go virtual.

And if we're going to have institutions that are able to respond, then they have to have access to capital to be able to do the right thing by their customers, to not be the people who are knocking down the doors demanding the repayments so they can keep their lights on, so they can keep their doors open. And so we need the people who have access to capital: the banks, other large corporations, the government, philanthropy, to be channeling the capital to these organizations who have the boots on the ground, as Francisco said, to go and work with these businesses. And if we don't do that now, we're going to see this repeat of the recovery from 2008, which is a recovery that works really well for better off communities, for better off people and stays flat for an enormous amount of time for low income communities.

Joyce Klein (26:18)

We've talked about the importance of institutions that really want to serve this market. We've talked about some of the specific barriers of entrepreneurs of color. But Francisco also talked about an issue here that some of this is not specific to the race or ethnicity of the borrower, it's simply something that's about how expensive and hard it is to make smaller loans. And because more entrepreneurs of color need smaller loans, that's a more difficult business challenge to deal with. So let's talk a little bit about this smaller dollar loan problem. And Marla, I'm going to come back to you because you've had experiences less on the business side, but more on the consumer side, but you tried to build a credit card company that was getting small amounts of credit to consumers who are having difficulty accessing affordable credit. So from your experience as well as your current work, what are the challenges about really doing smaller dollar lending on a large scale for underserved or hardly served borrowers?

Marla Blow (27:16)

It's a great question and there are many dimensions to this problem. I certainly found in building FS Card, which was the credit company that I previously founded prior to joining Mastercard, that the challenges of accessing capital and accessing credit that my customers face, the customer base we were trying to serve, was a consumer oriented, subprime, deep kind of subprime small dollar customer base. We face those same problems accessing credit as a business, right? Finding the capital that would enable us to offer products to this customer was in and of itself incredibly difficult. And that capital that we could find was extremely expensive.

And that cost of capital informs the price that that customer then has to pay. And that's where the whole chain starts is where the capital comes from, who is willing to provide it, on what terms, and what are the proclivities of the founder, right? And so I was the founder, brought my own perspective to it and really wanted to create a fair transaction and fair access opportunity for this customer base, but also had to face the demands of the market I was in, of the cost of service customer, of the cost of the capital. And all of that makes it really, really challenging to offer this product.

I was operating in the consumer space where there is actually quite a bit of very structured data that's available and some fairly well-defined rules of the road. But when you get into the small business space, the data starts to really vary quite widely on what's available. The rules of the road are very different and may not have the same kinds of guardrails that consumers have. So some of the practices that your competition might be willing to engage in, if you are trying to be an ethical market participant, it's really hard to compete with that and you face challenges of making a fair deal in the business space, in the small business space. That's just a very different problem and a very different proposition from what we're facing in the consumer space.

But that said, the same challenges about access to the capital to enable that kind of lending and that kind of lending at as reasonable and efficient a price as possible is still the same challenge. And that has, we haven't found an answer for that yet. I think we are looking right now in response to the moment that we're in at the capital structure and up the chain what's going on in the limited partner arenas where they make capital available to the typical investor classes that we might think of, right? Think of venture capital funds, private equity funds, some of those kinds of entities that act as intermediaries.

They have incentives that are set by their limited partners. Their limited partners are big pension funds, big endowments, big family offices. They have opportunities to change some of those incentives and maybe change some of those return requirements for capital. All of that can flow down through this system and change some of these dynamics. But my view is it starts at the top of that funnel and it's a difficult place to engage and it's not a place that people are as widely familiar with.

But I think if we think about what are the upstream things that contribute to the challenges that Francisco faces now, the challenges that I faced as an entrepreneur and the challenges that we're trying to address from the perspective of a market actor and as a philanthropic entity at the center, it's all the challenges up and down the chain in what I just described. And so I think with a few opportunities to intervene, we might see some of this loosen up. So I'm hopeful that we have an opportunity here to intervene and change some of this.

Joyce Klein (31:14)

Great. Tim, I'm going to come to you because you have the global experience in micro-finance as well as in the US. And people look at the... Micro-finance industry sector is larger in many emerging countries than it is in the US. So, tell us what you've learned about what it takes from those experiences to scale this smaller dollar lending, which is essentially what we mean when we say micro-finance.

Tim Ogden (31:42)

Right. And obviously how micro is an absolute basis varies from country to country, but we are by and large talking about the same challenge that led to the modern microfinance movement, which is how do you make loans at these small amounts to these somewhat opaque, small businesses that require building relationships? And understandably and rightly, there's been a lot of attention focused on the business model innovations that led to the modern microfinance movement and a lot of coverage of that. But even more important, I honestly believe, and something that doesn't get attention is what really has allowed the microfinance movement to get to the scale it is globally isn't the group lending and the tweaks that they made in how they process loans in weekly meetings and repayments.

It's the modern microfinance movement got access to capital from outside the communities that they were operating in very, very early on. And so those institutions were able to fund their lending without pulling that capital back out of the communities. They weren't limited to that pool of capital. And that scalability that then very quickly went from a grant and a loan from the Ford Foundation to Grameen, to a global industry that's channeling capital into microfinance institutions around the world, that gives those institutions the ability to do what they've done; to innovate their business models, to find ways to reach out to people, to make transitions, to learn about how to make loans best, to figure out all of those things they can do on the technology side.

And that's something, honestly, we haven't done nearly as well in the United States, and I attribute some of the challenge we've had in scalability and lending in the United States to specifically that challenge, how do we connect organizations like Dreamspring to more and more reliable sources of capital? And as Marla was saying, more and more reliable sources of capital at affordable rates. And so one of the things we've been working on within the Aspen Business Ownership Initiative is particularly something called the entrepreneur-backed assets fund.

And that is a market Michael referenced earlier. The idea of the entrepreneur-backed assets fund is largely modeled on a lot of what we've seen internationally, which is the ability for organizations like Dreamspring and other CDFIs to do the work that they do best, get on the ground, identify borrowers, make loans that are good for the borrower, and then sell that loan on to others who don't have the capability to do that on that groundwork. And then Dreamspring gets the capital back in hand that allows them to make another loan much more quickly. They don't have to wait for the loan that they've made to be repaid before they can get back out there and find another business that needs that capital can put that capital to work.

And if we can do that at scale so that we're not doing it sort of one load at a time, which is incredibly expensive in and of itself, but if we can do that at scale so that Dreamspring and other CDFIs like it can recapitalize themselves on a rolling basis, that just has a real multiplier effect on the amount of lending that we can do to lower income communities.

Joyce Klein (35:04)

Thank you. Michael, I'm going to come back to you because you've been in policy roles where you've thought a lot about how we scale up the work of CDFIs, how we get more access to capital, and the federal government has a range of different tools. It can provide funding itself. It can also create various kinds of incentives for the private sector to invest in certain ways. So, what are your thoughts about what kind of policy initiatives may have worked in the past that we should be looking at and what we should be doing going forward to try to really enable this kind of capital to flow?

Michael Barr (35:43)

Well, there are a number of different strategies. I do think that one of the strategies can be the one Tim described, which is helping to develop a secondary market for small business lending by CDFIs. Joyce, you'll recall that's something we've been talking about for 20 years, really since the end of the 1990s. I think it makes sense as a strategy. I think that treasury and the federal reserve in the current environment could work together in this emergency to set up such a program. I've urged them to do that. I think it would be really helpful for CDFIs and small businesses they serve in the middle of this crisis.

A second major strategy is to increase funding from Congress for the CDFI fund, which is a fund in the treasury department that supports community development financial institutions around the country. And that program has proven to be very successful since its inception more than 20 years ago now. And I think that that can continue to be invested in. I think that it would make sense to dramatically expand the funding for that program. And the CDFI fund then can provide grants and loans and capital investments, technical assistance grants into CDFIs to help continue to build that network around the country to help them serve low income communities and entrepreneurs of color.

A third strategy that has been very successful in reaching entrepreneurs of color are programs that are done in partnership with the private sector in the states all over the country. Early on those were known as capital access programs. I think Michigan had the first one established in the late 1980s. And in the Obama administration, we created a $3 billion program called the State Small Business Credit Initiative to bolster those state programs, those state partnerships with the private sector. And those proved to be highly effective in reaching small businesses and entrepreneurs of color in addition to more mid-sized firms. And I think it would be a really prudent strategy for Congress to reauthorize that program now in the middle of the crisis and get those funds out to the states and to the private sector to help support small businesses right now.

The last thing I'll say is there are some particular circumstances facing small businesses that are really unusual and that require kinds of support that are not usual in most normal times. A lot of really small businesses need grant funding. It's not something we normally do for a small business for all kinds of good reasons, but in the middle of a global pandemic where our public health measures and the public's rightful concern about their own public health has meant dramatically lower revenues for many small businesses and dramatically higher costs to operate safely, I think that we need to have significant grant programs in place for small businesses to help them write out the current crisis.

Joyce Klein (38:57)

So Francisco, how does that list line up with what you think you need right now and what's going to help you to be able to continue to lend and do more lending coming out of this crisis?

Francisco Lopez (39:10)

It aligns perfectly. Definitely capital source is a big issue. But it's our day to day, we work on it constantly. We are getting much more creative in the way we address our capital needs. We are basically right now taking a three tier or a three basically pillar approach. One is we are looking for funding that will provide equity for us because for example with PPP, we are over our leverage as the PPP loans still sit in our books. So in order for us to get more funding, we need equity, even though that might seem like a paradox as a nonprofit, but that's how it works.

The other one is, we have a significant amount of loan loss reserves because of the type of borrowers that we serve. So we're also looking for support and capital can be used for loan loss reserves as well, and might be even less riskier than just providing grant money or lending capital. And then of course we're looking for phil, right? We will always need philanthropic money to cover our costs of operations although we also have been working for some time now to make our process much, much more efficient, and we have been doing it with technology. We've learned so much from the financial technology space that we are basically also embarking on what we're calling impact tech, right?

We need to find ways where we can make loans in a much more efficient way. Still keep our high touch but at the same time make the processes as efficient as possible. Partnerships are an important part of making a process efficient. If we want to reach more and more borrowers at scale, it might turn out that our main constraint is not capital. Our main constraint is how do we reach and how do we actually make the amount of loans and the amount of impact that we know that we can do. So I think falls completely in line and these are the big challenges.

Joyce Klein (41:14)

Marla, what would you add here in terms of policy or things that impact investors or philanthropy can do? What is it you're trying to make happen at Mastercard on that front?

Marla Blow (41:25)

So a lot of what Francisco just articulated at the very end there especially resonates very much. We think about how can a big business like Mastercard be a friend to small business? What can we do? How do we form partnerships? How do we support an ecosystem, a healthy ecosystem of market actors by bringing into bear all of Mastercard's tools, right? That can include a commercial relationship with Mastercard for a small company. That can be a huge difference maker for an organization that's looking for demonstrations of credibility to attract other and be able to compete for other market opportunities by virtue of that kind of demonstration.

From a philanthropic perspective and from other parts of Mastercard, we also think a lot about how to ensure CDFIs have a voice, and that we know individual CDFI is going in and interacting at the federal level, which is where CDFI decisions are generally made. That's a tough proposition but with some support from a large market player like Mastercard, we can bring voice to that CDFI sector in a way that's really, really hard for Francisco on his own to climb the mountain and go to Capitol Hill and try to get a fair hearing. So finding ways that we can use some of our access and some of our opportunity to highlight the importance of these market actors and the importance of this sector and this type of financial institution is another one of the ways we demonstrate the importance of this.

And then some of what Tim was talking about on the secondary market side on ensuring that there is reliable access to some kind of outlet to create balance sheet space, that is of paramount importance. And so one of the things we are really, really proud of is the work that we've done with you Joyce and the Center for Inclusive Growth to fund BOI that has now shifted into the entrepreneurial-backed assets fund that Tim was talking about. That is one of the things that we think is incredibly compelling and incredibly important for the sector. I compare it, again, I've spent a lot of my time in consumer finance.

If the auto lending space, for example, didn't have trusts and a secondary market to securitize all those loans that they create, the auto lending market would lock up right away, right? And we've seen these markets lock up right away the minute that liquidity disappears. CDFIs have the same need for that kind of liquidity, that same kind of outlet for the assets on their balance sheet. And it needs to be reliable, right? It needs to create the confidence so that Dreamspring and others like Dreamspring can go out and make loans available and put up a shingle that says, "We are open for business," and not be worried that I'm going to run out of balance sheet capacity because I can't count on my secondary market outlet. We have to fix that. And that's where our support of things like EBA and other kinds of creative activities is really exciting, and that's the work we intend to continue to do.

Tim Ogden (44:30)

I want to return to something that Michael said about as we start to look forward in what comes next, we do have to be very aware of the possibility of putting a lot of our best and most creative entrepreneurs in communities of color behind the debt eight ball. This is going to be a difficult recovery. Michael referenced grants but providing capital to CDFIs so that they can work with those organizations, so that they can defer a few payments, so that they can offer concessions in many ways operates the same as a grant, right? The loan term, if Dreamspring and other CDFIs have the ability to be creative in working with those entrepreneurs to help them through bumps and ups and downs through the process, it effectively serves as a grant that doesn't put that entrepreneur in a place where they have to declare bankruptcy.

And because of the way the bankruptcy system works in the United States, potentially permanently limit their ability to be an asset in their community because it ruins their personal credit. If I was really dreaming, I would love to see a policy initiative that revisits our bankruptcy laws particularly around entrepreneurs of color, that doesn't put them in a position of permanently essentially impairing their personal credit when they decide to take that risk to invest in their community and start a business and guaranteeing those loans in ways that can really put them not able to start another business, not able to try again, but also it endangers their credit rating, it endangers all sorts of other things in their personal lives. And so if I was reaching for the stars on a policy basis, it is recognizing this environment that we're in and reforming some of our bankruptcy laws to enable low-income communities to continue to take risks in their own communities for their own development.

Joyce Klein (46:36)

Michael, do you have a parting shot for us? I'm going to whisper one thing in your ear, which is Community Reinvestment Act.

Michael Barr (46:41)

Thanks Joyce. As you know, the federal reserve and the OCC have issued dueling proposals to update the Community Reinvestment Act. I think it's really important to get that right, both to update CRA for the current financial system that we live in, but also to protect and preserve the way that it has helped to advance community development since its enactment in 1977. And particularly its strong work in the late 1990s when there was a serious regulatory effort to make it meaningful. So I do think we need to update CRA, but we need to be sure we're protecting its core values, and I think there's going to be a lot more work that needs to happen on that.

I do think that I've hit on the major federal investments that I think are important investment in the CDFI fund, creation of a secondary market, support for the State Small Business Credit Initiative and figuring out whether directly or indirectly how to support the small business sector through the crisis. Last thing I'll just say is that none of this is really going to matter unless we have a national strategy on defeating the pandemic, and we don't. And until we have a national public health strategy, none of this is going to matter. The small businesses we want to serve are going to keep failing. So at bottom, we can do all the steps that we want on bolstering CDFIs, but we're not going to actually get there until we have a real strategy on the pandemic.

Joyce Klein (48:25)

Thank you, Michael. And I will note for alternate programming on lots of issues related to the pandemic, there's another issue that we're really working on at the Aspen Institute. Well, I think we're at time. I want to thank everyone for joining us today and for this really rich conversation. I will invite folks who are watching this to check out the Aspen Institute website. This is part of our body of work that the Business Ownership Initiative has been doing around this issue. We also have colleague programs at the Aspen Institute, the Community Strategies Group, the Latinos and Society Program, which are also really focused on these issues as well. Thanks for joining us today and please continue to stay abreast of our work and engage with us on these issues. Thanks everyone.