# Big Ideas for Small Business

## A Five-Step Roadmap for Rebuilding the U.S. Small-Business Sector, Reviving Entrepreneurship, and Closing the Racial Wealth Gap

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ISPS Working Paper
October 19, 2020
ISPS20-21

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# Acknowledgments

The authors are grateful to the many people who reviewed early drafts of the report. Special thanks go to Beth Bafford (Calvert Impact Capital), Ross Baird (Blueprint Local), Agnes Dasewicz (Kauffman Capital Access Lab), and Tim Ferguson, Charisse Conanan Johnson, and Spencer Lau (Next Street).

We would also like to thank the many individuals that provided expertise, insights, access to proprietary data, market feedback, or were simply kind enough to serve as a sounding board over the past six months, including Michael Barr (University of Michigan Law School), Kurt Chilcott (CDC Small Business Finance), George Farah and Derek Peebles (American Independent Business Alliance), Amias Gerety (QED Investors), Philip Gaskin, Larry Jacob and Melissa Roberts (Kauffman Foundation), Eric Groves (Alignable), Jared Hecht (Fundera), Michael Kades and Heather Boushey (Washington Center for Equitable Growth), Marshall Lux (BCG), Brayden McCarthy (Stripe), Rumi Morales (Outlier Ventures), Antoinette Schoar (MIT), John Shoraka (GovContract-Pros), Chris Slevin (Economic Innovation Group), John Friedman (Brown University), Esther Lee (Refraction), Jeni Britton-Bauer (Jeni's Ice Cream), Byron Auguste (Opportunity@Work), Paul Healy (Yale Law School), Stacy Mitchell (Institute for Local Self-Reliance), and Brett Taxin (BlueRidge Bank). The report would not have been possible without their help. We also spoke on the condition of anonymity to dozens of executives at major banks, credit card companies, fintech lenders, venture capital firms, small-business counseling organizations, CDFIs, and other institutions in addition to nearly one hundred small-business owners, and would like to thank all of them for their time.

The authors are also grateful to the teams at Drexel University (Ryan DeBold, Michael Greenle and Mary Tredway) and Yale's Institution for Social and Policy Studies (Alan Gerber, Limor Peer, Jacob Hacker, Tory Bilski), as well as a group of dedicated students and fellows at Yale Law School that assisted with research, formatting citations and copy editing, including Kyle Bigley, Ya Sheng

Lin, Emmett Witkovsky-Eldred, Leah Ferentinos, and Allen Xu. This paper would not have come together without their support.

Special thanks go to Ben Preis for providing thoughtful insights at key stages of the research and writing process, to Colin Higgins for his late-game assistance, and to Roni Lagin & Co. for his compelling design.

The views expressed in this report are those of its authors and do not represent the views of the above-mentioned individuals, their institutions, Yale's Institution for Social and Policy Studies, or Drexel University.

# Executive Summary

**SMALL BUSINESSES IN AMERICA ARE IN CRISIS.** Since COVID-19 hit in February, 2020, almost 25% of all U.S. small businesses have closed at least temporarily. In the hardest hit sectors, like restaurants, hotels, and retail, the numbers are far higher. In September, Yelp reported that for businesses on its platform, 60% of closures were permanent. Those closures have left millions of Americans out of work, transformed lively neighborhoods around the country into retail graveyards, and destroyed the wealth built by many families over generations.

The devastation of COVID-19 has forced the country to take stock of our small-business sector. Small businesses drive our economy, employing 47% of the U.S. workforce, generating two-thirds of new jobs, and serving as a critical path to economic self-sufficiency. Small businesses animate our neighborhoods, reflecting, embodying and sustaining the unique cultural fabric of their communities. **But notwithstanding their critical role, small businesses have never been a central focus for federal policymakers.** As a result, the federal government did not have the expertise or resources to meet the exigencies of the COVID-19 pandemic, as evidenced by the troubled launch and execution of the Paycheck Protection Program (PPP).

**The storms of COVID-19 were a fierce blow to an economic sector already battered by the unrelenting winds of economic centralization.** Since the late 1990s, more than two-thirds of all U.S. industries have grown more consolidated, from dog food to airline travel. Even more strikingly, the rate of business creation has fallen by half since the 1970s. **Entrepreneurs of color, meanwhile, have continued to struggle against structural constraints.** While Black Americans are 12.3% of the U.S. population, they own only 2% of U.S. small businesses. Latinx Americans are similarly underrepresented. **From the challenges of finding equity to launch a new venture to the difficulties in accessing bank credit for expansion, minority entrepreneurs must climb a far steeper path than their white counterparts.** Because minority businesses operate with less capital, they are also more suseptible to the financial pressure of COVID-19. The Federal Reserve of New York reported that from February to April the number of Black businesses declined by 41 percent.

Given current market conditions, it is clear that abesent major federal interventions, whole swathes of the small-business sector will never return, minority business owners will suffer more than their fair share of the burden, and entrepreneurship levels will remain depressed for a generation or more. But the collision of these forces—COVID-19, economic consolidation, and deep racial inequality—also create a window of opportunity for significant reform. **This report provides a five-step roadmap towards a more inclusive, dynamic, and productive small-business sector.** We break down the five steps into ten major policy recommendations. While the federal government must take the lead for many of our recommendations, we also suggest how it can galvanize the full energy of public, private and civic institutions.

Importantly, we do not believe that federal small-business programs need to be consolidated into a single agency. What matters is the focus, scale and scope of small-business programs across the federal government. That said, the U.S. Small Business Administration will be critical for executing on this roadmap and needs significant investment.

| ROADMAP | | |
|---|---|---|
| **Step** | **Action** | **Policy Recommendations** |
| 1 | **Respond to the COVID-19 Crisis in the Small-Business Sector** | I. Provide loan and grant products at scale, tailored to meet the unique needs of small businesses during the COVID-19 crisis |
| 2 | **Unleash America's Entrepreneurial Spirit** | II. Spur entrepreneurship among minority, female, and other disadvantaged founders<br>III. Reduce barriers to entry and strengthen antitrust law and enforcement<br>IV. Replicate proven organizations and models that help small businesses scale |
| 3 | **Strengthen financial institutions that focus on local business formation and growth** | V. Create a new generation of federally backed debt and equity products to meet diverse market demand<br>VI. Strengthen financial institutions that focus on local business formation and growth |
| 4 | **Harness the Power of Public and Private Procurement** | VII. Set ambitious new targets for federal procurement and push state and local governments to match these efforts<br>VIII. Mobilize the Corporate Sector and Medical and Educational Institutions Around Minority- and Women-Owned Small-Business Growth |
| 5 | **Measure to Manage: Evaluate for Continuous Improvement** | IX. Collect more and better data on federal programs and the small-business sector<br>X. Use data to rigorously evaluate impact and refine programs over time |

Many of our proposals build on existing programs, like the Obama-era State Small Business Credit Initiative (SSBCI). In other cases, we advocate for bills currently in Congress, like the RELIEF for Main Street Act. We also advance a number of novel ideas, including:

- A federally-backed, **first-loss guarantee loan program** for fintech lenders that operates at the portfolio level to enable disadvantaged entrepreneurs to access right-sized, federally subsidized loans without the onerous paperwork required under current law;
- The development of a **private sector Environmental, Social and Governance (ESG) standard for procurement from disadvantaged business owners**, around which the private sector could mobilize to bring the benefits of contracting set-asides to a broader market; and
- A new **federal Small Business Ecosystem Demonstration Project** to catalyze and evaluate ways of driving transformative small-business outcomes at the metropolitan level.

**There is no question that the COVID-19 crisis is a turning point for America's small businesses. Absent a broad national commitment to rethinking how we support those businesses, it will be a turn for the worse. But if we come together and follow this roadmap, over the next ten years we can:**

- **Create 1.5 million net new small businesses;**
- **Grow the small-business share of employment by 25%;**
- **Triple the number of small businesses owned by Black & Latinx Americans; and**
- **Grow average minority household net worth by 20%.**

Our hope is that this report serves as a rallying point for all those who care about small business in America. Together, we can build a more competitive, dynamic and fair economy with a flourishing small business sector that enriches our individual and collective lives.

This report, as well as standalone copies of the Executive Summary and a briefing deck, are available for download at
**www.bigideasforsmallbusiness.org**

# Contents

# Introduction

**THE COVID-19 CRISIS** is the greatest economic shock since the Great Depression. In the nearly 90 years since Franklin Delano Roosevelt first took office, the country has time and again called on the federal government to salvage critical sectors of the U.S. economy, from banking to automobile manufacturing to residential mortgage lending. The federal government has simultaneously used its unique regulatory powers to create smoothly functioning markets in sectors from securities trading to agriculture, and to pharmaceuticals.

But with its eye on national-scale challenges, the federal government and its leader rarely focused on small businesses, a sector of the economy that employs nearly one out of every two American workers.* From a policymaking perspective, small businesses are like a national family heirloom that can be trotted out once or twice a year for show-and-tell and then tucked back in the attic for safekeeping.

COVID-19 is a stark reminder that small businesses should not be considered an economic afterthought. Since February, 2020, almost 25 percent of all U.S. small businesses have closed at least temporarily.[1] In the hardest hit sectors, like restaurants, hotels, and retail, the numbers are far higher. In September, Yelp reported that for businesses on its platform, 60 percent of closures were permanent.[2] Those closures have left millions of Americans out of work and have transformed lively neighborhoods around the country into retail graveyards. The importance of small businesses to the texture and quality of our communities has always been clear. But the COVID-19 pandemic has, for the first time highlighted the centrality of Main Street businesses as a pillar of the national economy.

* The definition of "small business" varies, and the total number of small businesses in the United States varies based on the definition one chooses. For this report, unless noted otherwise, we consistently use the United States Census Bureau's definition for small employer firms. According to the U.S. Census, there were just under 6 million employer firms with under 500 employees in the U.S. in 2017, the last year for which data is available.

The pandemic also exposed the fault lines that run beneath the federal government's small-business programs and agencies. Prior to the onset of the COVID-19 pandemic, the typical annual federal budget for small-business programs was under $4 billion, approximately as much as the U.S. Navy spends on a single attack submarine.[3] The Small Business Administration, the flagship federal agency for the sector, has neither the deep expertise of agencies like the U.S. Department of the Treasury nor the programmatic scope and industry network of agencies like the U.S. Department of Agriculture. In a normal year, the SBA touches perhaps five percent of U.S. small businesses annually via lending and technical assistance programs.[4]

Limited in its scope, authorities, reach, and human resources, the SBA could not meet the exigencies of the COVID-19 pandemic. The launch of the Paycheck Protection Program (PPP) was marred by widespread miscommunication and confusion. Roughly 4 million small businesses took out loans without any clarity on whether the loans would be forgiven or not. Within three months, SBA had issued no fewer than 35 changes to PPP guidance. Because the federal government entered COVID-19 with limited tools for reaching small businesses directly, Congress determined that the SBA should enact and distribute the PPP loans via private sector lenders, primarily banks. With private sector lenders making individual decisions about who could apply for PPP loans and in what order they would be processed, larger, more sophisticated small businesses pushed to the front of the line, while small businesses without preexisting banking relationships struggled. These smaller small businesses are disproportionately owned by minorities, meaning that Black and Latinx* owned businesses suffered more as a result of SBA's shortcomings than white-owned businesses did.[5]

This distribution of funds could have gone in a different direction. For example, under current law, the SBA can make direct loans to small businesses. Had the agency invested in a technology-driven platform that could automate loan underwriting and processing, it would have been able to scale lending operations quickly and ensure fair access to PPP resources. SBA's Economic Injury Disaster Loan program was in theory organized to reach small businesses directly, but likewise suffered from a weak technology platform and confusing guidance that led to uncertainty for businesses and long delays in processing grants and loans.[6]

Other federal small-business programs do not fill the gaps left by the SBA. The Minority Business Development Agency is limited to providing technical assistance via 34[7] MBDA Centers in major

* We have generally chosen to use the term "Latinx" rather than "Hispanic" in this report. However, many public data sources collect information using the term "Hispanic", "Non-Hispanic White" and "Non-Hispanic Black". In these cases, we retained the terminology used in the original data source.

cities. Other programs scattered at HUD, Treasury, and USDA serve important but narrow constituencies, as we describe below.

Perhaps, historically, small businesses did not need a strong federal partner. But the pandemic comes at a historic inflection point in the push and pull between centrifugal and centripetal economic forces. Since the late 1990s, more than two-thirds of all U.S. industries have grown more consolidated, from dog food to airline travel.[8] At the same time, small-business creation declined sharply after the Great Recession of 2007–2009 and never fully recovered.[9]* Between 2005 and 2015, for example, the number of small retailers declined by more than 20 percent.[10] The COVID-19 crisis is accelerating this trend towards consolidation.[11] In the retail sector, for example, dominant corporations like Amazon are capitalizing on the closure of other retailers to expand their market share, in some cases literally setting up distribution centers in the physical locations of one-time competitors gone bankrupt.[12]

In other words, without major federal interventions, whole swathes of the small-business sector will never return, and entrepreneurship levels could remain depressed for a generation or more. This would be a catastrophe for the United States. Small businesses are a vital spoke in the wheel of American life. Small businesses drive our economy, employing 47 percent of the U.S. workforce, generating two-thirds of new jobs, and serving as a critical path to economic self-sufficiency, especially for immigrants.[13] Small businesses are locally owned, creating wealth that is reinvested in the community rather than distributed to distant shareholders. In many retail sectors, like pharmaceuticals, small businesses can offer better service and better prices than large chain stores.[14]

The role of small businesses in our society is just as important. Small businesses animate our communities, reflecting, embodying and sustaining the unique fabric and culture of the villages, towns and urban neighborhoods in which they are located, whether it's a barbershop, knitting store, or nursery. Independent breweries offer variety; independent bookstores, a curated book buying experience; a family-owned restaurant, traditional fare.[15]

As federal policymakers address the crisis in the small-business sector, they must simultaneously address long-standing barriers facing entrepreneurs of color.† While Black Americans are

* As we discuss in greater detail below, business formations spiked briefly in the third quarter of 2020 but by mid-October had returned to roughly pre-COVID levels. See footnote, pg. 20.

† This report focuses primarily on Black and Latinx business owners. Indigenous entrepreneurs face similar challenges and also need attention from federal policymakers. However, there are limited national data set on Indigenous business activity, making comprehensive comparisons difficult.

12.3 percent of the U.S. population, they own only two percent of U.S. small businesses. Latinx Americans are similarly underrepresented. This has nothing to do with entrepreneurial drive and everything to do with structural barriers. Black and Latinx Americans are just as likely to start businesses as white Americans, but are actually less likely to succeed.[16] At every step involved in building a new business, minority entrepreneurs face stumbling blocks. Most small-business owners start with capital borrowed from friends and family, leaving minority entrepreneurs, who, on average, have significantly lower household wealth, at a distinct disadvantage. Because minorities are more likely than white Americans to start life in a low-income household, they are also more likely to have struggled with consumer debt at some point in their lives, which leads to lower personal credit scores—which, in turn, negatively influences bank lending decisions.[17] At the individual level, this means it's much, much harder for a given Black or Latinx entrepreneur than a white entrepreneur to access start-up capital. Looking economy-wide, minority-owned businesses are significantly less likely than white-owned businesses to have strong, standing relationships with banks or other financial institutions. [18]

Because minority businesses operate with less capital, they are also more likely to fold under economic pressure.[19] COVID-19 is a case in point. Minority owned businesses were less likely to have pre-existing banking relationships, less likely to access loans from the Paycheck Protection Program, and more likely to face permanent closure.[20] The Great Recession and subprime mortgage crisis in 2008-2009 wiped out half of Black intergenerational wealth.[21] Without federal intervention, the COVID-19 crisis will have the same impact. The Federal Reserve of New York reported that from February to April of 2020, the number of active Black businesses declined by 41 percent.[22] Small business must be at the center of any meaningful effort to reverse the impacts of COVID-19 in Black and Latinx communities and to help those communities build wealth.[23]

In sum, the small-business sector lies at the crossroads of three powerful forces: the devastation of COVID-19, a long-term trend of economic consolidation, and a national reckoning with deep racial inequality. The collision of these forces creates both the necessity for and the political conditions that enable a broad rethinking of how our country supports small businesses. Like the banking sector or the automobile industry at previous moments in U.S. history, today small businesses need a friendly hand up from the federal government. In this report, we identify five steps that, together, form a roadmap towards a more inclusive, dynamic, and productive small-business sector:

1. First, come January, 2021, the federal government must **forcefully respond to the COVID-19 crisis** by providing debt relief and long-term loan products.

2. As the economy normalizes, the federal government in partnership with states can **unleash America's entrepreneurial spirit** by reducing barriers to entry, leveling the playing field so small businesses can compete against incumbents, and giving entrepreneurs the tools they need to succeed.

3. To ensure the long-term vitality of small businesses, the federal government should **shape a financial system that works for Main Street** by strengthening independent banks and community financial institutions and expanding the range of federally backed debt and equity products available to entrepreneurs of all stripes.

4. But these steps will not be enough for minority small-business owners, who struggle uphill against deficits of social and financial capital. To accelerate the growth of minority-owned businesses, especially Black and Latinx owned businesses, we call for a **dramatic expansion in both public and private procurement from minori-ty-owned small businesses**.

5. You can't manage what you can't measure. We must **collect more and better data** on the performance of the small-business sector generally and, specifically, the impact of current and new government programs so that we can **evaluate for continuous improvement**.

These five steps are further broken down into ten major policy recommendations:

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Within each of these ten policy proposals, we articulate in detail how to create, reform or expand federal programs and the scope of budgetary commitments required. Importantly, we do not believe that federal programs need to be consolidated into a single agency. The distribution of federal small-business programs into different agencies is reflective of the underlying heterogeneity of the small-business sector. Small farm owners may prefer to work with the U.S. Department of Agriculture while low-income minority entrepreneurs may have experience with the Minority Business Development Agency. What matters is the focus, scale and scope of small-business programs and the approach that the federal government takes, not the exact agency that houses which programs. That said, the U.S. Small Business Administration will be critical for executing on this roadmap. Congress must invest significantly in the budget and capacity of the SBA so that it can operate on par with agencies like the U.S. Treasury.

Many of the initiatives we recommend can be greatly enhanced by the smart use of technology. Across our proposals, we discuss how data analytics and the technologies pioneered by 'fintech' lenders can help leverage federal dollars to support small businesses at scale.

While we focus in particular on minority entrepreneurs, many of our recommendations will also help female entrepreneurs, disabled entrepreneurs, and other disadvantaged groups to succeed. If the United States follows the roadmap laid out in this report, we can achieve the following objectives over the next decade relative to pre-COVID levels:

- Create 1.5 million net new small businesses
- Grow the small business share of employment by 25%;
- Triple the number of small businesses owned by Black & Latinx Americans; and
- Grow average minority household net worth by 20%.

The scope of the resources required to achieve these objectives means that the federal government must take the lead in channelling and distributing national resources, and the report accordingly focuses in large part on federal policy. But the federal government must act in a way that galvanizes the full energy of networks of public, private and civic institutions at the local, metropolitan and state levels. As the response to the COVID-19 crisis has revealed, the reach and impact of federal investments are maximized when they engage the full range of institutions that serve small businesses and match them to the services, customers and capital they need to succeed. These institutions include traditional banks but also state and local governments, business chambers, incubators and accelerators, philanthropies, universities, community financial institutions, micro-lenders, and others. Wherever relevant, our recommendations include specific ways the federal government can mobilize public and private partners.

Ultimately, we believe a national commitment to small businesses will generate broadly shared prosperity. Mountains of academic research confirm the simple intuition that, as Paul Wellstone famously said, "we all do better when we all do better."[24] Doing better right now means investing in and supporting our small businesses build a more prosperous and just America as well as a more dynamic, inclusive American economy.

# Small Business in America

**SMALL BUSINESSES** are a critical engine of U.S. economic growth. They account for 99 percent of American employers, almost half of all private employment, and more net job creation than large firms.[25] The health of the U.S. economy, as well as America's entrepreneurial dynamism, is linked inextricably to the sector's future. However, since the 1970s, American business-formation rates have fallen by half[26] while firm-closure rates have risen.[27] The small-business sector stagnated—particularly after the 2008 financial crisis. And today, small businesses face unprecedented stress from the shutdowns and recession caused by COVID-19.

This chapter examines the importance of small businesses to America's economy and the barriers facing entrepreneurs. There is, of course, significant heterogeneity across the small-business sector and across the United States. However, three simple dynamics tell much of the story:

1. Small businesses are hugely important for American job growth and employment.
2. But beginning in the late 1970s, small-business formation slowed. The 2008 financial crisis further slowed entrepreneurship across all sectors. And absent major policy interventions, COVID-19 will decimate the small-business sector, tilting the scales in favor of large corporations for decades to come.
3. Minorities and other disadvantaged groups face persistent barriers to owning and growing small businesses, which holds back the sector's potential and helps perpetuate the racial wealth gap.

The following three sections explore each dynamic in turn. Throughout, this Chapter draws on several data sources to analyze the small-business landscape—including data from the Federal Reserve, Census Bureau, Bureau of Labor Statistics, Federal Deposit Insurance Corporation, and Kaufmann Foundation. These data sources have significant limitations, but together, they paint a clear picture of the three dynamics listed above. (Further information about these data sources, including their strengths and limitations, is provided in the Appendix.)

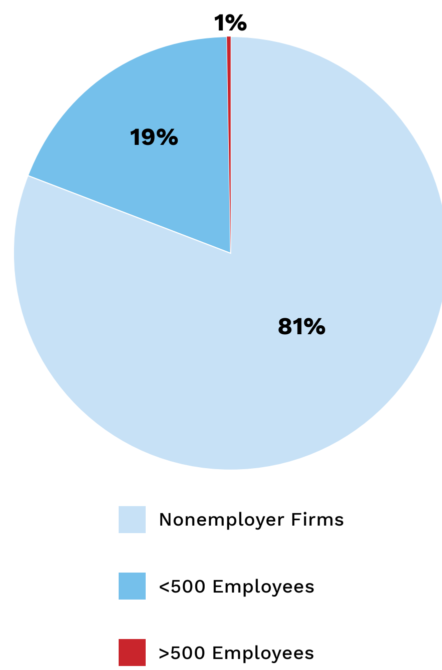
## Small-Business Employment

Small businesses represent the vast majority of American businesses. The most common size standards for small businesses, used across the federal government, categorize firms as "small" when they have fewer than 500 employees. Of all U.S. businesses, 99 percent have below 500 employees. And of all businesses with employees, more than half have between just one and five.

FIGURE 1

**UNITED STATES BUSINESSES BY SIZE, 2017**[28]

| Number of Employees | Number of Firms | Percent of Firms |
|---|---|---|
| Nonemployer Firms | 25,701,671 | 81% |
| <5 | 3,698,086 | 12% |
| 5-9 | 1,009,851 | 3% |
| 10-24 | 768,665 | 2% |
| 25-49 | 278,705 | 1% |
| 50-499 | 221,454 | 1% |
| 500+ | 20,139 | 0.1% |
| **Total** | **31,698,571** | **100%** |




Altogether, these firms employ almost half of all Americans. And the local spending and tax revenues that these businesses generate support many more jobs indirectly.

FIGURE 2

**UNITED STATES EMPLOYMENT BY FIRM SIZE, 2017[29]**

| Businesses Categories by Number of Employees | Total Employees of These Businesses | Percent of Total U.S. Employment |
|---|---|---|
| <5 | 5,937,081 | 5% |
| 5-9 | 6,656,073 | 5% |
| 10-24 | 11,484,321 | 9% |
| 25-49 | 9,527,810 | 7% |
| 50-499 | 26,950,796 | 21% |
| 500+ | 68,035,731 | 53% |

Small businesses also generate more new jobs than other businesses, making them vital for expanding employment nationwide. Between 2005 and 2019, small firms drove 64 percent of net private-sector job creation.[30] Figure 3 below shows that monthly job creation at small businesses typically exceeds job creation at large firms, with small firms generating more jobs in eight of the last twelve quarters with available data.[31] And startups account for many of these jobs—roughly one-third in most years, as Figure 4 shows.[32]

FIGURE 3

**MONTHLY JOB CREATION, LARGE (>500 EMPLOYEE) V. SMALL (<500 EMPLOYEE) FIRMS[33]**

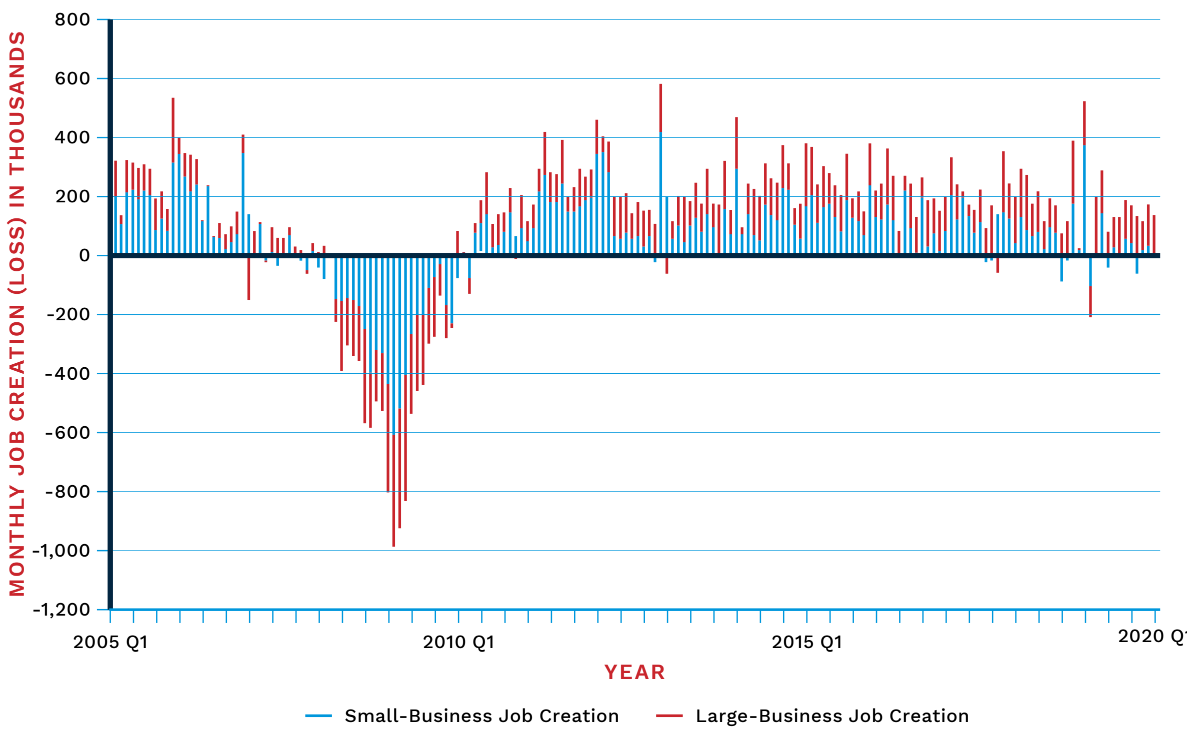


FIGURE 4

**SHARE OF EMPLOYMENT GAINS FROM STARTUP FIRMS**[34]

| Year | Net Employment Change | Gross Employment Gains Overall | Gross Employment Losses Overall | Gross Employment Gains from Opening Establishments (Startups) | Share of Gross Employment Gains from Opening Establishments (Startups) |
|---|---|---|---|---|---|
| 2010 | -2,684,236 | 10,075,086 | -12,759,322 | 3,236,266 | 32.1% |
| 2011 | 1,908,878 | 11,629,458 | -9,720,580 | 3,334,090 | 28.7% |
| 2012 | 2,669,299 | 12,215,725 | -9,546,426 | 3,554,059 | 29.1% |
| 2013 | 2,120,885 | 12,044,757 | -9,923,872 | 3,491,509 | 29.0% |
| 2014 | 2,274,379 | 12,282,246 | -10,007,867 | 3,582,256 | 29.2% |
| 2015 | 2,717,966 | 12,833,679 | -10,115,713 | 3,691,014 | 28.8% |
| 2016 | 2,511,589 | 13,167,936 | -10,656,347 | 3,773,906 | 28.7% |
| 2017 | 2,032,665 | 12,953,630 | -10,920,965 | 3,797,214 | 29.3% |
| 2018 | 2,168,233 | 13,116,333 | -10,948,100 | 3,757,496 | 28.6% |
| 2019 | 1,875,053 | 13,134,027 | -11,258,974 | 3,775,168 | 28.7% |

Small businesses are important parts of local American communities. Besides creating jobs themselves, small businesses generate local spending, which indirectly supports millions more jobs and raises local governments' tax revenues. And among small employer firms with under 500 employees, most operate in professional or other services (25 percent), construction (11.7 percent), health care (10.9 percent), retail (10.8 percent), and food services (nine percent). These firms, then, disproportionately provide our local restaurants, serve our local healthcare needs, and populate our Main Streets with vibrant shops. Small businesses, in short, build our communities and give them their character. Many of the roles small businesses play have become even more critical during the COVID-19 crisis.

FIGURE 5

**SMALL EMPLOYER FIRMS BY INDUSTRY, 2017[35]**

| Industry Description | Number of Small Firms | Percentage of Small Firms | Number of Employees of Small Firms | Percentage of Small-Firm Employment |
|---|---|---|---|---|
| Health Care and Social Assistance | 650,689 | 10.89% | 8,984,159 | 14.84% |
| Accommodation and Food Services | 537,443 | 8.99% | 8,542,661 | 14.11% |
| Retail Trade | 645,685 | 10.80% | 5,526,296 | 9.13% |
| Construction | 700,393 | 11.72% | 5,373,702 | 8.87% |
| Professional, Scientific, and Technical Services | 807,932 | 13.52% | 5,190,980 | 8.57% |
| Manufacturing | 244,098 | 4.08% | 5,039,772 | 8.32% |
| Other Services (Except Public Administration) | 695,268 | 11.63% | 4,697,878 | 7.76% |
| Administrative and Support and Waste Management and Remediation Services | 343,791 | 5.75% | 3,754,463 | 6.20% |
| Wholesale Trade | 294,909 | 4.93% | 3,413,157 | 5.64% |
| Finance and Insurance | 236,657 | 3.96% | 1,909,993 | 3.15% |
| Transportation and Warehousing | 182,688 | 3.06% | 1,685,388 | 2.78% |
| Educational Services | 92,148 | 1.54% | 1,645,962 | 2.72% |
| Real Estate and Rental and Leasing | 308,106 | 5.16% | 1,451,546 | 2.40% |
| Arts, Entertainment, and Recreation | 129,287 | 2.16% | 1,428,531 | 2.36% |
| Information | 78,430 | 1.31% | 984,379 | 1.63% |
| Management of Companies and Enterprises | 19,134 | 0.32% | 423,295 | 0.70% |
| Mining, Quarrying, and Oil and Gas Extraction | 18,720 | 0.31% | 244,367 | 0.40% |
| Agriculture, Forestry, Fishing and Hunting | 22,535 | 0.38% | 136,591 | 0.23% |
| Utilities | 5,752 | 0.10% | 111,747 | 0.18% |
| Industries Not Classified | 7,762 | 0.13% | 11,214 | 0.02% |

# New Business Formation

Despite smaller firms' critical role in American life, business dynamism has been on a long-term decline since the 1970s. The share of firms that are less than one year old fell by nearly half between 1978 and 2011—from about 15 percent to just over eight percent.[36] The total rate of business formation dropped by a similar amount. The rate of job reallocation, which occurs when closing firms shed workers and new firms hire them, has also declined precipitously.[37] And all of these trends are evident in almost every state and metro area.[38]

These trends grew starker after the Great Recession, from which the small-business sector never fully recovered. One metric that illustrates the sector's poor health today is new-business formation. Immediately after the financial crisis, the formation of new employer businesses plunged by nearly 50 percent. This initial drop was not surprising. However, even as the economy recovered over the subsequent decade, absolute and per-capita employer-business formation remained flat since 2010—as the two charts below show.*

FIGURE 6

**ABSOLUTE NUMBER OF NEW BUSINESS FORMATIONS WITH PLANNED EMPLOYEES[39]**

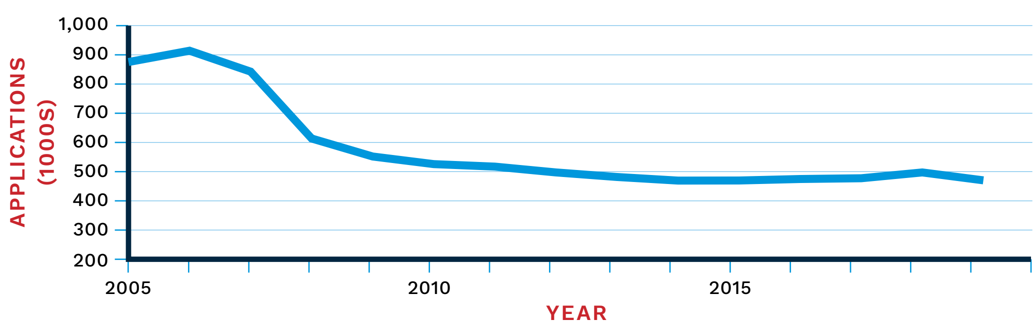
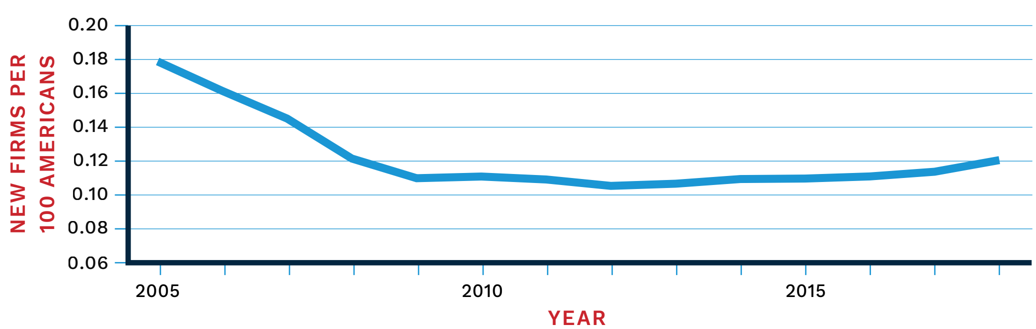



FIGURE 7

**PER CAPITA RATE OF NEW EMPLOYER-BUSINESS FORMATION[40]**

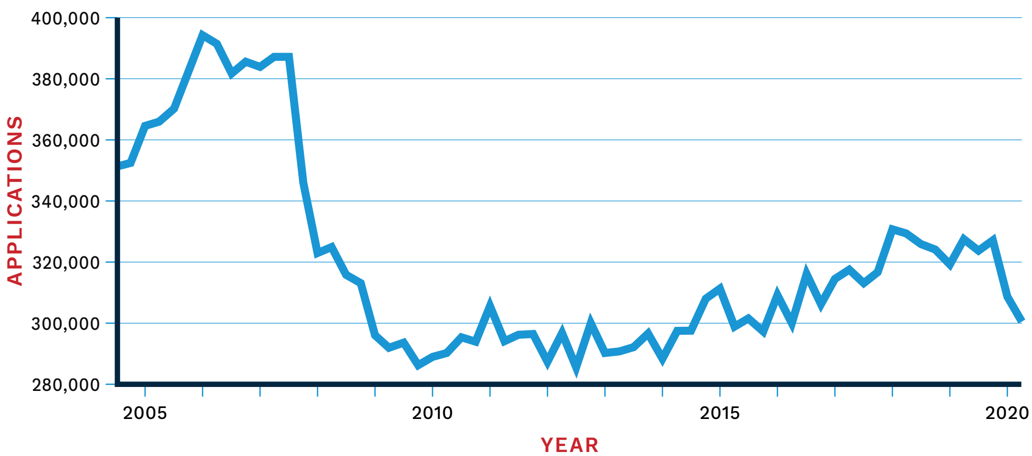



* This report was written using data as of the close of the second quarter of 2020. In the third quarter of 2020, new business formations including high-propensity business formations spiked, likely in response to pent-up demand from the preceding months and because of entrepreneurs looking to replace struggling incumbents. By mid-October, weekly high-propensity business applications had returned to roughly the levels seen prior to the onset of COVID-19. In other words, the short-term spike does not appear to have impacted the longer-term trajectory of small-business creation. *See* Business and Industry, U.S. Census Bureau (Oct. 16, 2020), https://www.census.gov/econ/currentdata/ (reporting data for employer businesses).

The rate of business formation is also falling for the firms most likely to hire many employees. Applications for businesses with "a relatively high likelihood of turning into job creators," the Census Bureau notes, are "still far below [their] pre-recession levels."[41] This decline has also occurred both in absolute terms and on a per-capita basis.

FIGURE 8

**NUMBER OF NEW HIGH-PROPENSITY BUSINESS FORMATIONS[42]**




Among businesses that *are* forming, a decreasing percentage quickly reach the point where they begin hiring workers onto payroll. New employer-firm actualizations—the percent of American businesses that proceed from formation to new payroll within two years—are down since 2008. The rate of business newness—the percent of new U.S. employer businesses that first made payroll in the last two years—is also in decline. These trends mean that today, existing firms are older and new businesses take on employees less quickly than at any point over the last 15 years.

FIGURE 9

**NEW EMPLOYER-FIRM ACTUALIZATION RATE[43]**

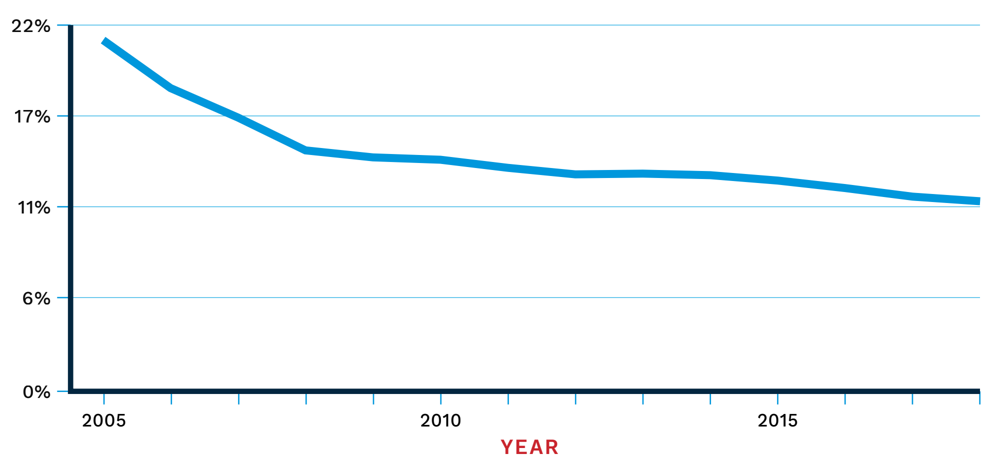
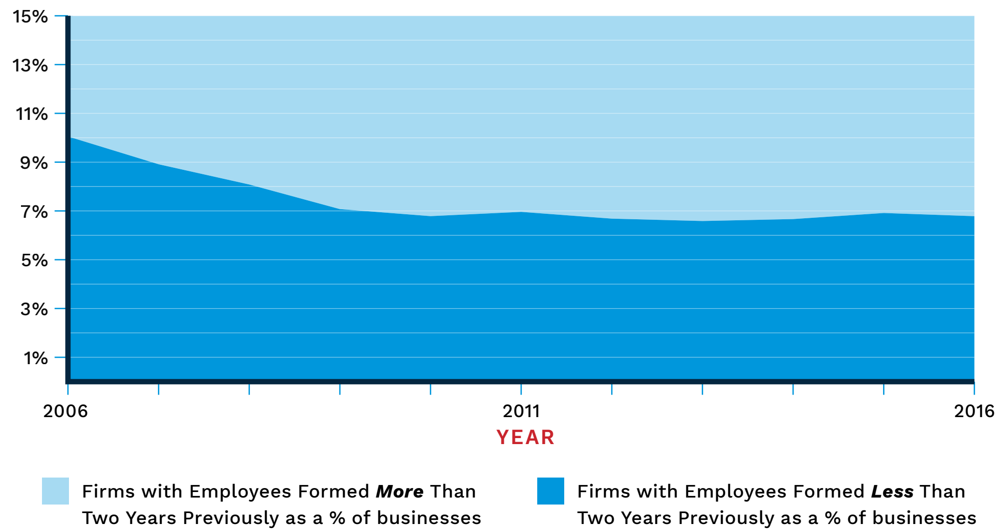


FIGURE 10

**RATE OF BUSINESS "NEWNESS"[44]**



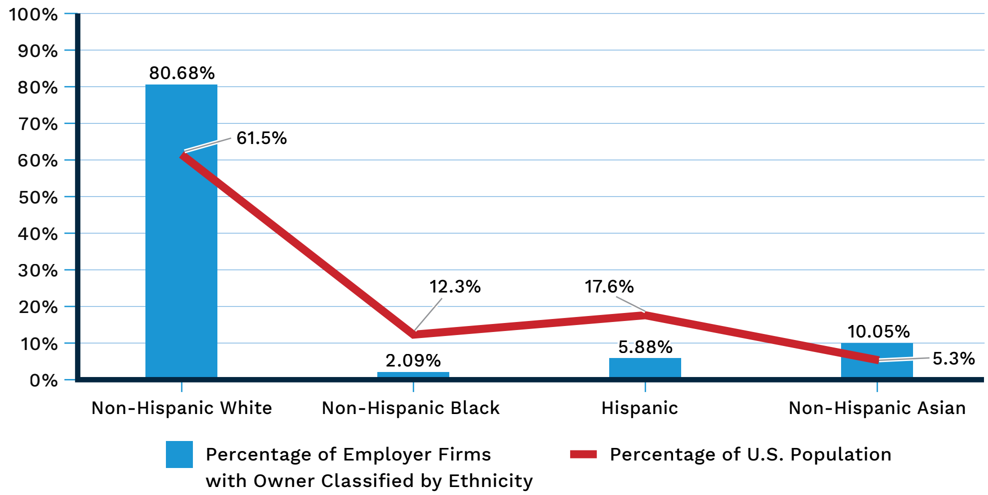

It is difficult to unravel the causal chain between weakened antitrust enforcement, the increasing age of the average firm,[45] pervasive, economy-wide business consolidation[46] (especially in the technology sector[47]), and a long-term decline in entrepreneurship.[48] What we can say is that small business creation has been in steady decline since the 1970s; and that the 2008-2009 economic crisis precipitated a further drop-off in small business creation and growth.

## Minority Representation Among Small-Business Owners

Although the small-business sector broadly is struggling, some demographic groups face particular difficulties in founding and running small businesses. Minority communities have much lower business ownership rates than other groups. Black men were one-third as likely to be self-employed as white men in 2014, with research highlighting lower wealth among black households as one of the main causes (and, in turn, effects).[49] Black-owned firms, further, composed only about two percent of total employer firms in 2017, even though Black Americans then represented 12.3 percent of the population. Data on Hispanic-owned employer firms reveal similar underrepresentation. Hispanics owned just 5.6 percent of employer firms in 2017 yet comprised 17.6 percent of the population.

FIGURE 11

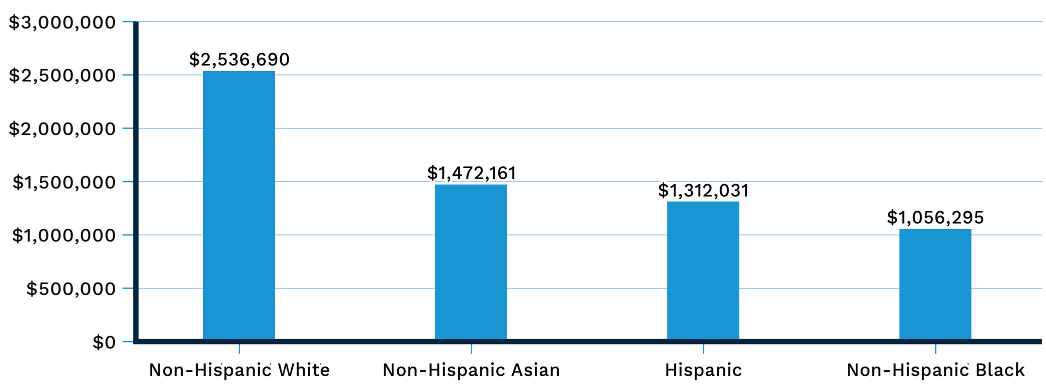
**ETHNIC OWNERSHIP OF EMPLOYER BUSINESSES V. PROPORTION OF U.S. POPULATION, 2017**[50]




Black- and Hispanic-owned firms are also less prosperous. These businesses in 2017 had substantially lower average revenues than white-owned firms. And during the COVID-19 pandemic, revenues at Black-owned firms appear to be falling much more quickly than at white-owned ones.[51]

FIGURE 12

**AVERAGE SMALL-FIRM ANNUAL REVENUE BY ETHNICITY OF OWNER, 2017**[52]




Despite the challenges they face, minority-owned businesses are vital contributors to the small-business sector. Minority-owned employer businesses support more than 8.7 million American jobs and annually generate over $1 trillion in economic output.[53] And when minority-owned businesses succeed, they help self-employed minority households accumulate net assets at a faster pace than other firms that employ minorities.[54]

The business achievements of Black and Latinx business owners—even in the face of social and economic inequality—show that the roadblocks these groups face do more than stifle the flourishing of disadvantaged communities. They also stymie the potential of America's entire small-business sector, by shutting out the contributions of potential founders, job creators, and innovators. Empowering disadvantaged groups to become business owners is a crucial component of revitalizing America's small-business landscape.

# The Federal Policy Landscape

## History of Federal Small-Business Support

Federal support for small businesses, which was virtually nonexistent before the Great Depression, underwent rapid transformation over the past century. The discussion below charts this evolution through four stages. Substantial federal support programs emerged, first, during the Depression and World War II, when lawmakers sought to solve acute, short-term obstacles that small businesses confronted. During the 1950s, small-business support grew dramatically, with the establishment of the federal Small Business Administration. Over the next two decades, federal support heightened its focus on certain classes of small businesses, typically those facing economic or social disadvantages.

Starting in the 1980s, however, some core elements of the federal small-business support system began to flag. Antitrust litigation, for instance, steadily declined, while federal policymakers failed to abate nationwide banking-industry consolidation, which slowed small-business lending. After the 2008 financial crisis, policymakers temporarily reversed course, enacting a series of programs that aided the hard-hit small-business sector. But most of these programs were short-lived, their effects dissipating well before 2020.

### TARGETED, TEMPORARY ASSISTANCE

Prior to the 1930s, the federal government did little to support small businesses directly. Congress had enacted none of the measures for small-business federal loan support, technical assistance, or contracting preferences seen today. To the extent that concern over small businesses did shape federal policy, it did so through antitrust law, including the Sherman Act of 1890, which prohibited monopolization and other restraints on trade. Laws like these were in large part reactions to a nationwide rise in powerful trusts, which consolidated industry power, choked off competition, and discouraged sector-wide innovation.[55] Antitrust policy, therefore, aimed to level the playing field for small businesses—in line with the broader American value of promoting economic competition[56]—but it did not offer direct assistance to these firms.

The federal government first began offering such aid, although on a temporary, targeted basis, during the Great Depression. In the summer of 1934, Congress authorized direct lending to companies from two government agencies: The Reconstruction Finance Corporation (RFC) and Federal Reserve Banks.[57] Government loans from these agencies were meant only to address what lawmakers perceived as exceptional credit-market failures. After a wave of bank failures throughout 1930 and 1931, cash-strapped private creditors were widely calling in their borrowers' debts, pushing many otherwise viable companies into bankruptcy.[58] The new loans compensated for the sudden private-sector pullback.[59] Still, even if considered temporary, Congress's foray into private credit markets was unprecedented. The Hoover administration had created the RFC to support credit markets by lending to financial intermediaries, but it had then resisted extending the RFC's mandate to permit loans to non-financial corporations.[60] These new maneuvers, under President Roosevelt, also coincided with efforts to leverage traditional policy tools to the greater benefit of small firms. President Roosevelt revitalized antitrust enforcement by appointing aggressive federal regulators, while Congress adopted new laws that cracked down on price discrimination.[61]

As the United States emerged from the Depression, and entered into World War II, small businesses encountered new sets of challenges. Conflict abroad led the U.S. government to enlist private companies to produce goods—like planes, warships, and arms—needed for the war effort. But these initiatives left many small businesses on the sidelines. Individually, small businesses were disadvantaged in obtaining government contracts due to their size, even though small-business productive capacity in the aggregate was significant.

Congress sought to promote small businesses' inclusion in government contracting, both to alleviate financial strain from the Depression and to utilize their capacity more fully in the war effort.[62] Congress passed the Small Business Mobilization Act in 1942, which created a new agency, the Small War Plants Corporation (SWPC).[63] Like the RFC, the SWPC loaned directly to businesses, but its most important authority was that of subcontracting with small businesses on behalf of other federal agencies.[64] Authority for the SWPC lapsed as World War II concluded. However, in 1951, Congress created a similar agency—the Small Defense Plants Administration—to promote small-business inclusion in production efforts for the Korean War.[65]

## DIRECT, LONG-TERM SUPPORT

Up until the early 1950s, then, federal assistance to small businesses was narrowly tailored to specific challenges, such as the credit-market collapse in the Great Depression and wartime production. Yet these experiences, together, transformed how policymakers viewed the place small businesses occupied in the American economy. Policymakers, who had long acknowledged that large businesses had economic advantages over small ones, started to believe that the government itself had a pro-business bias that made the playing field more uneven.[66] This sense was enhanced by rapid post-War technological and economic development in the United States. Congress perceived that, in the changing economy, small businesses needed managerial support and training, as well as financial support, to participate fully.[67]

Lawmakers, therefore, transitioned towards more direct, sustained assistance to small businesses with the Small Business Act of 1953. The 1953 act consolidated authorities for aiding small businesses into a new federal agency, the Small Business Administration (SBA). The SBA assumed other agencies' preexisting powers regarding small-business lending and contracting,[68] and it received new authorities altogether—such as a mandate to offer training and technical assistance to small businesses. Section 7(a) of the 1953 act, specifically, empowered the SBA to issue loans directly to companies.

Later that decade, lawmakers redoubled their efforts to give small businesses direct assistance. After the 1953 act's passage, one landmark study by the Federal Reserve concluded that Congress's efforts, to date, were too limited to cure shortfalls in small-business financing.[69] Congress, heeding this advice, passed the Small Business Investment Act in 1958 to give the SBA a more active role in stimulating private-sector lending.[70] The hallmark feature of the 1958 act was its provision for the SBA to charter Small Business Investment Companies (SBICs). SBICs are investment companies that operate in particular communities—sometimes managed by qualifying banks—and provide small businesses with long-term debt or equity financing.[71] The SBA encourages SBIC investments—which come as both debt and equity—by guaranteeing their loans.[72] SBICs sell these guarantees to obtain financial leverage at preferential rates, and they use this leverage to expand their investment portfolios.

The SBA, as it emerged from the 1950s legislation, then, was a substantially more powerful agency than its predecessors. This was true, moreover, not only because the SBA had a broader toolkit for assisting small businesses. It was true also because Congress charged the SBA, as a single agency, with designing much of the scope of the federal small-business support system. The 1953 act, for instance, effectively tasked the SBA with determining which businesses count as "small."[73] In 1957 the SBA promulgated its first rule regarding business-size standards, which defined most businesses with fewer than 500 employees as "small"[74]—a classification that the SBA still relies on today.

Federal officials, in this era, fostered a supportive small-business environment through means even beyond expanding the SBA's role. Reforms to the SBA coincided with proactive antitrust enforcement by the Department of Justice and other enforcement agencies, as well as a period of intense judicial scrutiny of anticompetitive practices. Under Chief Justice Earl Warren, who presided on the Supreme Court from 1954 to 1969, the Supreme Court's antitrust rulings consistently prohibited practices that even potentially had anticompetitive effects.[75]

## SHIFTING FOCUS TOWARDS DISADVANTAGED GROUPS

In the latter half of the 20th century, the federal government expanded many of its efforts to help small businesses—particularly in federal contracting and technical assistance. At the same time, the government began targeting the most disadvantaged small businesses, often as determined by their owners' economic or social status.

First, the government began to set more ambitious targets for including small businesses in federal contracting. As the Civil Rights movement gained traction in the 1960s, President Lyndon Johnson used the Small Business Act's once-dormant[76] Section 8(a) to award federal contracts to firms that relocated to urban areas and hired unemployed workers—who were disproportionately African-American.[77] The Nixon administration expanded on these efforts. In the early 1970s, the SBA issued guidance that relied on 8(a) to assist "disadvantaged" small businesses in federal contracting, and it created a legal presumption that certain minority groups qualified automatically as "socially disadvantaged."[78] Disadvantaged firms under 8(a) benefitted from accessing federal contracting opportunities with limited bidding competition.

In 1978, Congress first codified the above-listed contracting practices by statute, with an amendment to the original Small Business Act.[79] Congress also, for the first time mandated that federal agencies set reasonable targets for small-business contracting, and it charged them with justifying to the SBA any deviations from those targets.[80] Lawmakers later amended the 1978 legislation to include an overall federal small-business target, which, in 1997, was set to its current level of

23 percent. It also developed additional contract set-asides for disadvantaged,[81] women-owned,[82] and veteran-owned small businesses,[83] as well as contracting preferences for firms hiring in economically disadvantaged areas (termed HUBZones).[84]

The federal government also focused technical assistance toward specific sub-categories of small businesses. Section 7(j) of the Small Business Act charged the SBA with offering technical assistance, and it has worked since the 1950s to fulfill this mandate by partnering with volunteer business-services organizations.[85] At first, SBA targeted small businesses generally with its technical programs, which included SBA-sponsored managerial training offered through the nonprofit-organization SCORE[86] and the SBA's Small Business Development Center (SBDC) program.[87] Technical training launched in the late 1970s and 1980s, though, often targeted at specific groups. SBA's programs for disadvantaged minorities[88] and its Women's Business Centers[89] are two examples. Congress further charged the SBA, through the Small Business Expansion Act of 1980, to increase assistance to another group: small-business exporters.[90] The 1980 law tasked the SBA with guaranteeing certain amounts of commercial loans to exporting companies, and the agency, since then, has expanded export-specific technical support.

These developments, together, reflect a shift in federal focus away from one-size-fits-all programs directed at small businesses generally, and on towards targeted aid for particular groups of businesses, which are often the most disadvantaged ones.

## EMERGING HEADWINDS

Shortly after policymakers began refining the focus of federal programs, however, core pillars of the national small-business support system began showing in the 1980s and 1990s. One change was a decline in antitrust enforcement, which gained speed under President Reagan's administration.[91] Around this time, other federal support programs began scaling down, too. Policymakers during the 1990s began placing greater emphasis on reducing inefficiencies in small-business programs, and the SBA's operations in particular drew criticism for mismanagement and waste. These criticisms prompted the agency to restructure some of its operations. One major cost-saving shift at the SBA, completed in the 1990s, was the phase-out of most SBA direct loans to businesses.[92] The phase-out was spurred by agency findings that loan guarantees, compared to direct lending, required lower rates of Congressional subsidization.[93] These reforms also came in the wake of the Federal Reform Credit Act of 1990, which imposed higher standards for measuring subsidy rates across credit-issuing federal agencies.[94] Today, therefore, the SBA executes Section

7(a) of the Small Business Act, which authorizes it to promote small-business borrowing, by guaranteeing loans that qualifying banks make to small businesses.

Small businesses simultaneously suffered headwinds from nationwide banking consolidation, which federal policy did little to abate. The number of community banks across the United States began falling in the 1980s from its peak of roughly 14,500, down to 5,600 in 2018.[95] Most of the decline came from bank mergers involving smaller, less profitable banks. Both efficiency considerations and loosening banking regulations, at the state and federal level alike, motivated this consolidation.[96] These changes had substantial effects on small-business credit markets. Research has found that bank mergers involving large banks slow small-business lending growth, while the greater presence of community banks, conversely, is associated with more such loans.[97]

## RECOVERY FROM THE FINANCIAL CRISIS

Small-business support reemerged as a national priority, if only temporarily, after the 2008 financial crisis. In the wake of the crisis, small businesses widely had difficulty accessing credit—which exacerbated a plunge in business formation, discussed above. These developments increased policymakers' concerns about small businesses' health and the possibility that this sector would hold back economic recovery.[98]

Policymakers therefore increased support to small businesses, both in the early stages of crisis response and later during the recovery. Initial policy steps focused on stabilizing small-business lending markets, by assisting smaller banks that lend to small firms. From late 2008 through 2009, the Treasury, for instance, made advances totaling $205 billion to over 700 financial institutions across the country.[99] These advances' amounts ranged from just $300,000 to $25 million.[100] The Federal Depository Insurance Corporation, further, established the Temporary Liquidity Guarantee Program, which provided deposit insurance for many small businesses' bank accounts at smaller banks.[101] And Congress, backtracking from its recent focus on zero-subsidy support, passed legislation that temporarily subsidized SBA loan guarantees.[102] Congress also increased the SBA's 2009 funding by $730 million and temporarily increased the portion of loans that the agency could guarantee.[103]

Later, as the small-business sector continued to stagnate, the government introduced novel programs to help small firms during recovery. President Obama, in his 2010 State of the Union Address, pledged $30 billion "to help community banks give small businesses the credit to stay afloat."[104] The president's proposal became reality through the Small Business Jobs Act of 2010. The Small Business Jobs Act authorized the Treasury to create the Small Business Lending Fund, through which the Treasury would lend directly to community banks, and authorized up to $30 billion in loans (though only $4 billion were issued).[105] This legislation also introduced the State Small Business Credit Initiative, which disbursed $1.5 billion in grants for state-run small-business support programs, and other tax incentives for small businesses.[106]

Programs like these did much to stabilize small-business credit markets and help small companies regrow. But importantly, each was a one-time fix. Congress never renewed funding for programs like the Small Business Lending Fund and State Small Business Credit Initiative. Nor did it enact legislation that would revive these kinds of programs automatically during recession. And, despite the positive effects these programs *did* have, as shown above, they never brought small-business formation back to pre-crisis levels.

The following sections further explore the state of federal small-business support today. Federal policies, as this section suggests, can be grouped into three broad strategies: direct financial assistance, technical assistance, and contracting. The next sections provide detail on the scope and operations of these three policy areas.

## Pre-COVID Landscape

The federal government provides small businesses assistance through three distinct channels.* The first is **direct financial assistance**: programs that put financial resources into the hands of business owners. Direct financial assistance includes government loans and grants to small businesses. It also includes government measures to stimulate private investment, particularly in businesses with poor credit access. The SBA's loan guarantees—the single largest type of direct financial assistance—fall into this last category.

Second, the federal government provides **technical assistance** to small-business owners. Some technical programs offer general counseling services, while others advance specific goals, like promoting entrepreneurship or exports. Agencies provide assistance by operating their own

* The federal government also supports small businesses via disaster assistance. As this support is by definition episodic, we exclude it from this overview.

training centers or by funding third-party groups that administer training. The SBA supports or itself oversees most technical assistance itself.

The third means of support is **federal contracting**: acquiring goods and services from small businesses. Agencies employ various policies to advantage small businesses in procurement, including by limiting large businesses' bids on certain projects. Each agency uses these policies to meet an agency target, set in consultation with the SBA, for the total percentage of contracts awarded annually to small businesses. Federal contracting is the single largest source of federal money flowing into the small-business community—over $100 billion in FY2019, mostly from the Department of Defense.[107]

Within each support channel, federal programs further fall into two sub-categories. Some federal programs offer support to all kinds of small businesses. These include, for instance, major SBA loan guarantees, which can support loans to any small business. Other programs earmark support for particular regions, communities, or types of firms. These programs include technical and contracting assistance exclusively for minority-owned businesses.

The table below gives an overview of major federal small-business programs, listing the programs that each agency manages by their corresponding categories of support:

FIGURE 13

**FEDERAL SMALL-BUSINESS SUPPORT ECOSYSTEM**

| Agency | Direct Financial Assistance | Technical Assistance | Contracting | Disaster |
|---|---|---|---|---|
| **Small Business Administration** | 1. 7(a) Loan Guarantees<br>2. 504 CDC Loan Guarantees<br>3. Microloan Program | 1. Small Business Development Centers<br>2. Entrepreneurship Programs<br>3. Export Programs<br>4. Programs for Women, Veteran, and Native American Owners<br>5. Other Skills Training | 1. Small Business Development Centers (procurement assistance)<br>2. Surety Bond Guarantee Program | 1. Business Loans (Damaged Property)<br>2. Economic Injury Disaster Loans (Working Capital) |
| **Department of Commerce** | EDA Coal Community Assistance | 1. Minority Business Development Agency<br>2. Regional Innovation Strategies and Science Parks Programs<br>3. Other EDA Technical Assistance Programs | Minority Business Development Agency (procurement assistance) | 1. Economic Adjustment Assistance<br>2. Fishery Assistance |
| **Department of Treasury** | 1. CDFI Loan Guarantees<br>2. Small Business Lending Fund | - | - | - |
| **Housing and Urban Development** | 1. Appalachia Economic Development Initiative<br>2. Community Development Block Grants | Community Development Block Grants | - | - |
| **Department of Agriculture** | Rural Business-Cooperative Service | Rural Business-Cooperative Service | - | Farm Service Agency |
| **Department of Defense** | - | - | Procurement Technical Assistance Program (procurement assistance) | - |
| **Across Federal Agencies** | SBIR/STTR | - | **Each Federal Agency Sets Small-Business Contracting Goals With the SBA** | **Stafford Act Local-Business Contracting Requirement** |

The next three subsections describe core federal programs within each category of small-business support. They also evaluate each category's major strengths and weaknesses.

Throughout, each subsection explains the programs in place before the COVID-19 pandemic. The Congressional response to the pandemic has created substantial new programs that assist small businesses, across each of the four channels described here. The chapter following this one treats COVID-19 programs in detail.

## Direct Financial Assistance

The federal government offers direct financial assistance to small businesses through three main channels: loans, loan guarantees, and grants. The SBA supports the largest volume of loans, and its flagship program is the 7(a) loan-guarantee program. Section 7(a) of the Small Business Act lets the SBA lend "either directly or in cooperation with banks or other financial institutions" to "any qualified small business."[108] Today, the SBA mostly encourages private lending indirectly by backstopping eligible loans against default. It guarantees up to 85 percent of loans' value.[109]

In FY2019, about 2,000 SBA-approved lenders[110] issued almost 52,000 7(a) loans, worth over $23 billion. The maximum 7(a) loan value is $5 million,[111] but loan sizes vary significantly. The average approved loan in FY2019 was $450,000, but more than one-third were above $2 million.[112] In recent years, this average loan size has surged: in 2007 the average approved 7(a) loan was barely $140,000.[113] The maximum 7(a) loan term is generally ten years, although loans used to purchase real estate or certain types of equipment may have 25-year terms. Lenders originate loans by accepting borrowers' loan applications and certifying to the SBA that, without a guarantee, the borrower could not access credit on reasonable terms elsewhere.[114] Typically, the SBA exercises little oversight over loan approvals. Nearly two-thirds of SBA-backed loans, by value, come from lenders in the SBA's Preferred Lender Program, who have authority to make final loan determinations.[115]

The SBA runs other, smaller credit programs, which tend to have more refined focuses. For example, the SBA guarantees debentures sold by Certified Development Companies (CDCs),[116] which CDCs use to finance loans to small businesses buying major fixed assets—like land, buildings, and equipment.[117] CDCs are nonprofit organizations that promote economic development in particular regions; their borrowers must pledge to use loans to create jobs or serve other public-policy objectives.[118] CDCs are similar to, and sometimes also certified as, Community Development Financial Institutions (CDFIs).[119] The 504/CDC loan program in FY2019 guaranteed just over 6,000 loans, worth $5 billion in total.[120] Additional SBA lending initiatives fall under the umbrella of its 7(a) program. In 2011, for instance, the SBA launched its Community Advantage program, which lets borrowers in low-income areas—frequently minority-owned businesses—obtain loans from lenders offering technical assistance.[121] Community advantage loans carry rates slightly higher than standard 7(a) loans, and loans below $25,000 have no collateral requirements.

The SBA operates two other significant programs, which lie outside the 7(a) and 504/CDC facilities. One is its microloan program. To deliver microloans, the SBA lends directly to CDCs and other financial intermediaries, which must use that money to issue loans of up to $50,000 to small businesses, which are typically young.[122] Financial intermediaries borrow at an interest rate approximating the five-year Treasury rate and charge businesses interest rates between seven and nine percent.[123] In FY2019, the SBA used a $4 million credit subsidy to provide $42.3 million in loans to intermediaries, which, in turn, extended $80 million in credit to small businesses.[124]

## WHAT ARE CDCS AND CDFIS?

Community Development Corporations (CDCs) and Community Development Financial Institutions (CDFIs) are both organizations that aim to promote the economic development of underserved communities. The main differences between them are that CDFIs (1) fulfill their mission by offering financial services and (2) receive federal certification of their CDFI status.[125] Some CDFIs, but not all, also qualify as CDCs.[126]

The Treasury Department's CDFI Fund has the authority, under the Riegle Community Development and Regulatory Improvement Act of 1994, to certify financial institutions as CDFIs. To receive certification, a financial institution must demonstrate that it has a proven community-development mission and serves a particular geographic market. Many CDFIs are depository credit unions, but other organizations eligible for CDFI status include banks, loan funds, and venture-capital funds.[127] Typically, CDFIs offer more favorable and flexible terms than other lenders, and they often provide technical assistance to clients.

CDCs, by contrast, must be 501(c)(3) nonprofit organizations but include a broader range of development-focused organizations than simply financial institutions. Often, CDCs focus on providing affordable housing, but many also work to promote direct investment, business development, and other forms of advocacy. Organizations self-certify as CDCs, meaning that they can claim CDC status without applying to any government program.[128] Some state and local governments, however, have established their own CDC certification processes and operate programs that benefit CDCs. CDCs also frequently choose to apply for other kinds of government certification, including HUD's certification for Community Housing Development Organizations.[129]

The SBA also guarantees loans by Small-Business Investment Companies (SBICs), which are professional investment organizations that leverage SBA guarantees to borrow private capital at highly favorable rates.[130] Subject to the SBA's approval, SBICs can leverage the agency's guarantees at a ratio of up to two-to-one.[131] Importantly, the SBICs' leverage often goes towards equity investments—typically in small, fast-growing companies.[132] The SBIC program is therefore the SBA's primary initiative for helping firms find equity financing, rather than debt.

## THE SBIC PROGRAM

The Small Business Investment Company (SBIC) program was authorized by the Small Business Act of 1958 to improve small businesses' access to both debt and equity. SBICs are private investment organizations, licensed by the SBA, that must invest 75 percent of their total capital in U.S. small businesses—defined as those with net worth below $19.5 million and after-tax income below $6.5 million.[133] Investor organizations benefit from SBIC status because the SBA helps SBICs obtain cheap financial leverage.

SBA leverage comes in the form of an SBA commitment—termed a Leverage Commitment—that permits SBICs to draw down funds cheaply from an interim credit facility managed by the SBA.[134] An SBIC can typically obtain leverage up to two- to three-times their amount of committed private funding, or a cap of $175 million, whichever is lower.[135] Every six months, the SBA pools all SBIC obligations outstanding from drawdowns into a pool and, after guaranteeing that pool, sells shares of the pool to institutional investors.[136] SBICs' debt obligations, therefore, are ultimately privately held.

There are four subcategories of SBICs that receive SBA leverage, though only one remains open for new applications. Debenture SBICs, the type still open for applications, can access SBA leverage as described above. Applicants must pay a $10,000 fee to apply and are required to have at least $3 million in invested private capital.[137] The types of SBICs not still open for applications include impact SBICs, which focus their investments in underserved areas; early-stage SBICs, which focus investments on young, high-growth companies; and participating-securities SBICs, which also focus on early-stage companies and raise money through issuing equity-like securities.

Through these programs, the SBA supports about $28 billion in annual lending activity. Importantly, it does so with almost no incremental cost to taxpayers. Each initiative is entirely, or almost entirely, sponsored by participant fees and requires no Congressional subsidy.

## THE COMMUNITY REINVESTMENT ACT

The Community Reinvestment Act (CRA) was originally enacted in 1977 to combat redlining, or many financial institutions' practice of systematically denying mortgages, loans, and other financial services to applicants from low-income, minority-populated regions.[138] The CRA counteracts redlining by requiring banks to extend credit in their location of charter and in areas where they receive deposits. Nationally and state-chartered banking institutions and savings associations are covered by the act; credit unions, insurance companies, securities companies, and other nonbank institutions do not fall under its purview.[139]

Banks can receive CRA credit for a wide range of activities. Major categories of qualifying investments include consumer, business, and mortgage loans; low-cost education loans; and investments in infrastructure or projects that otherwise have a community-oriented purpose.[140] Banks also receive credit for providing other services to their communities, including financial-literacy education and consulting, discounted transaction processing, and physical facilities for disadvantaged categories of businesses.[141]

When assigning CRA credits, bank regulators examine banks' levels of CRA-credited activity in proportion to their size and issue banks one of four overall performance ratings: Outstanding, Satisfactory, Needs to Improve, or Substantial Noncompliance. From 2007-2018, about 2–4 percent of banks were rated Noncompliant or Needs to Improve, about 86–90 percent Satisfactory, and about 8–10 percent Outstanding.[142] Section 804 of the CRA requires federal banking regulators to consider these ratings when banks apply for charters, new branches, mergers, or other actions.[143] Although the CRA does not specify how regulators should weigh CRA ratings, banks rated below "Satisfactory" may be barred from merging or opening new branches altogether.[144] When banks receive a rating below "satisfactory," regulators expect them to address their deficiencies immediately and may reexamine such banks within twelve months.[145]

## THE STATE SMALL BUSINESS CREDIT INITIATIVE

The State Small Business Credit Initiative (SSBCI), originally enacted in 2010 to spur recovery from the 2008 financial crisis, allowed states to apply for Treasury funding for programs that improve small-business credit access. States could apply to operate the following five kinds of programs.[146]

1. **Capital Access Programs**, which let states contribute to reserve funds held by lenders to insure against future loan losses;
2. **Collateral Support Programs**, which let states provide collateral to lenders to enhance the collateral coverage of particular loans;
3. **Loan Guarantee Programs**, which let states partially guarantee small-business loans and cover origination fees;
4. **Loan Participation Programs**, which let states issue loans in tandem with private lenders or purchase lenders' loans on a secondary market;
5. **Venture Capital Programs**, which let states operate either a state-run venture-capital fund, or a fund of funds that invests in venture-capital funds with a small-business focus.

Applicants had to demonstrate that they had the operational capacity to implement their proposals[147] and that their programs would create $10 in new small-business financing for every $1 of SSBCI funding.[148] Applicants also had to explain how their plans would expand credit access for (1) low- and middle-income borrowers, (2) minority communities, (3) women- and minority-owned small businesses, and (4) other underserved groups.[149] In total, 47 states, the District of Columbia, five territories, and four municipalities applied and, by 2015, received funding for 152 programs.[150] (Municipalities could apply only if their state government did not do so.)

In most cases, states' development agencies administered SSBCI programs in partnership with lenders, including banks, credit unions, and CDFIs.[151] Treasury evaluations of states' programs have found that they relied heavily on local networks to reach their target borrowers, which were often very small and young businesses.[152] The most successful programs made use of distribution channels, technical assistance, and marketing strategies tailored to disadvantaged groups.[153]

Other agencies also offer significant financial support. In recent decades, one large driver of support has been the Community Reinvestment Act (CRA), enacted in 1977. The CRA tasks banking regulators, including the Federal Reserve, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency, with tracking the extent to which chartered banks provide financial services to their local communities.[154] These agencies give banks "credit" for making CRA-qualifying investments, which includes small business loans. Agencies consider banks' CRA track record when reviewing their applications to merge, expand, or gain other regulatory approval, incentivizing banks to invest locally.

The Department of Treasury manages other support programs. Today, its largest program is loan guarantees through its CDFI Fund, which backed $100 million in CDFI loans in FY2019. This office also supports CDFIs with about $160 million in annual grants, which CDFIs use to expand their lending or obtain technical assistance.[155] Following the financial crisis, though, Congress authorized the Treasury to run two temporary programs that channeled even more financial support. The first was the Treasury's Small Business Lending Fund (SBLF), created by the Small Business Jobs Act in 2011. The SBLF provided CDFIs $6 billion in direct loans, but this was a one-time capital injection, and borrowing institutions have nearly repaid these debts.[156] Second, the Small Business Act of 2010 authorized the Treasury to administer the State Small Business Credit Initiative (SSBCI). Through the SSBCI, state and municipal governments applied for funding to operate programs—which applicants designed and ran themselves[157]—to help small businesses access financing.[158] Recipient state and local governments had significant freedom in using their funds; one Treasury evaluation finds that 69 percent of funding supported programs that boosted lending and 31 percent supported venture-capital initiatives.[159] All applicants, however, had to demonstrate that their planned uses would benefit firms in low- and moderate-income areas. In total, the SSBCI disbursed $1.5 billion in credits until its funding lapsed in 2017, and it supported 21,000 loans worth almost $11 billion.[160]

Smaller-scale support programs lie scattered across various other agencies. In FY2019, the Department of Agriculture, through its Rural Business-Cooperative Service, loaned $80 million to businesses, guaranteed almost $2 billion in loans, and made $130 million in grants—many of which went to small businesses or financial intermediaries. These programs benefit enterprises primarily in rural areas. The Department of Housing and Urban Development (HUD) also supported business growth in the Appalachian region with $170 million in loans and grants.[161] HUD further authorized $5 billion in Community Development Block Grants (CDBGs) nationwide. States use CDBGs for many purposes, but they can,[162] and often do,[163] use them to sponsor loan funds, incubators, and similar services. The Department of Commerce's Economic Development

Administration (EDA) also makes loans and grants to businesses,[164] as part of its broader mission to further economic and infrastructure development. Since 2017, the Trump Administration has proposed shuttering the EDA,[165] although this July Congress proposed a bill that would appropriate $314 million for the agency.[166]

The table below displays the small-business programs discussed above, grouped by sponsoring agency. The middle column shows each program's "output": the total amount of loans and grants issued, or loans guaranteed, by those programs in FY2019. For programs involving direct loans or loan guaranties, the rightmost column shows the Congressional subsidy authorized to support the agency's loan activity.

FIGURE 14

**MAJOR FINANCIAL SUPPORT TO SMALL BUSINESS**

| Agency | Program | FY2019 Output | FY2019 Loan Subsidy |
|---|---|---|---|
| **Small Business Administration** | **1.** 7(a) Loan Guarantees | $23.2 billion in loans guaranteed | $0 |
| | **2.** 504 CDC Loan Guarantees | $5.0 billion in loans guaranteed | $0 |
| | **3.** Microloan Program | $42.3 million in loans to intermediaries | $4 million |
| **Department of Commerce** | EDA Coal Community Assistance | $32 million in loans guaranteed | $0 |
| | | $32 million in grants | - |
| **Department of Treasury** | **1.** CDFI Loan Guarantees | $100 million in loans guaranteed | $4.75 million |
| | **2.** Small Business Lending Fund | $82 million in loans outstanding | $1 million |
| | | $1 million in loans issued | $1 million |
| **Housing and Urban Development** | **1.** Appalachia Economic Development Initiative | $169 million in loans and grants | $169 million |
| | **2.** Community Development Block Grants | $5.02 billion in grants* | - |
| **Department of Agriculture** | Rural Development Program | $136 million in grants* | - |
| | | $77 million in loans issued | $18 million |
| | | $1.92 billion in loan guarantees | $135 million |
| **Across Federal Agencies** | Small Business Innovation Research & Technology Transfer | $1.71 billion in grants | - |

*Only a portion of budget item is available for direct financial assistance to small businesses.

# Technical Assistance

Federal small-business programs for technical support are less expansive than those providing financial support. However, technical assistance still accounts for hundreds of millions of dollars in annual federal expenditures. The SBA administers most technical programs; it oversees about a dozen major initiatives with overlapping purposes. Other agencies also run programs of their own.

The bulk of SBA technical funding—over $130 million annually—goes to Small Business Development Centers (SBDCs). The SBA directly administers over 1,000 SBDCs across the country, and each will help any small business within its state.[167] The agency funds each state's SBDCs proportionately to that state's populations.[168] Often, SBDCs are run as joint partnerships with colleges or universities. They run a wide range of programs: common offerings include multi-week entrepreneurship trainings and incubator services offering mentorship, export assistance, and general counseling services.[169] Businesses at all stages of development can access SBDCs, though about 40 percent of clients are startups.[170] Aside from SBDCs, the SBA also runs smaller programs for general counseling. The most significant is the SBA's partnership with the Service Corps of Retired Executives (SCORE), an independent nonprofit that receives SBA funding to offer free small-business consulting. SCORE relies on the volunteer services of over 10,000 experienced business professionals across the country.[171]

Some SBA initiatives focus on entrepreneurship, providing founders with services that range from general technical assistance to incubation. The SBA's Microloan Technical Assistance Program, costing about $35 million annually, issues grants to lending intermediaries in the agency's microloan program.[172] Lenders use grants primarily to assist their borrowers with functions like marketing and management; some funds also go to prospective borrowers.[173] In FY2019, 22,100 businesses received advice under this program.[174] Other entrepreneurship programs include the Program for Investment in Micro-entrepreneurs (PRIME), which makes small grants to groups that assist low-income founders.[175] The SBA also awards various grants to groups, generally nonprofits, that provide incubation services: the Entrepreneurial Development Initiative (focused on innovation clusters), the Entrepreneurial Training Initiative (which funds a 7-month training program), and the Growth Accelerators program (focused on entrepreneur-led accelerators).[176]

A final set of SBA programs exclusively assists disadvantaged groups. Women's Business Centers (WBCs) are the largest such initiative. WBCs are private, nonprofit organizations partially funded by the SBA that offer financial, management, and marketing assistance to women-owned firms.[177] Currently, there are 125 WBCs nationwide, and each receives an annual grant from the SBA of up to $150,000.[178] The SBA similarly sponsors veterans training by SBA partners,[179] and it operates 22 Veteran Business Outreach Centers, which help veterans develop business plans.[180] The SBA's centralized Office of Native American Affairs assisted over 2,000 Native American-owned businesses in FY2019 with courses, workshops, and incubator services.[181] And the SBA's State Trade Expansion Program (STEP) issues about $30 million in annual grants to organizations that run export training, foreign market trips, and trade shows.[182]

Agencies outside the SBA finance a smaller number of technical programs. Some assist particular regions. The Department of Commerce's Economic Development Administration (EDA), for instance, runs Trade Adjustment Assistance Centers in eleven states around the country, to help manufacturers compete in global markets.[183] The EDA, through its Regional Innovation Strategies (RIS) program, also funded grants to about 130 incubators from 2014-17.[184] The Minority Business Development Agency (MBDA), a division of the Department of Commerce, runs programs for minority-owned enterprises.[185] These are generally offered through MBDA Business Centers,[186] which sometimes partner with third-party entities.[187] The Department of Agriculture issues grants for technical assistance in rural areas, through its Rural Business-Cooperative Service. And Community Development Block Grant (CBDG) funds, granted to states by HUD, as discussed above, may be used to sponsor in-state technical support.

Different agencies and federal partners, then, run analogous technical-assistance programs across different parts of the federal government. Yet this occurs partly because many of these programs cater to distinct sectors, geographies, and demographics, reflecting the small-business sector's underlying heterogeneity.

The chart below displays major technical-assistance programs, grouped by agency, and the federal expenditures they incurred in FY2019. Each of the programs run by the SBA is broken out into an individual line item.

FIGURE 15

**MAJOR TECHNICAL ASSISTANCE TO SMALL BUSINESSES**

| Agency | Program | FY2019 Expenditure |
|---|---|---|
| **Small Business Administration** | **1.** Small Business Development Centers | $131 million |
| | **2.** Microloan Technical Assistance Program | $31 million |
| | **3.** Women Business Development Centers | $18.5 million |
| | **4.** State Trade Expansion Program | $18 million |
| | **5.** Veterans Program | $12.7 million |
| | **6.** SCORE Program | $11.7 million |
| | **7.** Program for Investment in Microentrepreneurs | $5 million |
| | **8.** Entrepreneurship Development Initiative | $5 million |
| | **9.** Entrepreneurship Education Initiative | $3.5 million |
| | **10.** 7(j) Technical Assistance Program | $2.8 million |
| | **11.** Native American Outreach Program | $2 million |
| | **12.** Growth Accelerators Initiative | $2 million |
| | **13.** National Women's Business Council | $1.5 million |
| | **SBA Subtotal** | **$244.7 million** |
| **Department of Commerce** | **1.** Minority Business Development Agency | $40 million |
| | **2.** Regional Innovation Strategies and Science Parks Programs | $44 million in grants and loan guarantees |
| | **3.** Other EDA Technical Assistance Programs | $67 million |
| **Housing and Urban Development** | Community Development Block Grants | $5.02 billion in grants* |
| **Department of Agriculture** | Rural Development Program | $136 million in grants* |

*Only a portion of budget item is available for technical assistance to small businesses.

# Federal Contracting

The federal government supports businesses of all sizes most directly through procurement. The United States federal government is the largest procurer of goods and services in the world, with over $500 billion in contracts in FY2019. More than $100 billion of this amount went to small businesses.

Section 15(g) of the Small Business Act charges federal agencies to dedicate a target percentage of their contracts to small businesses.[188] The act also sets government-wide goals for small-business contracting. The SBA is responsible for working with each agency to set reasonable targets, in view of the overall federal goals. There is no formal enforcement mechanism for these targets, but the SBA incentivizes compliance by publishing data on agencies' contracting track records.

Today, the government's aggregate small-business target is 23 percent of all federal contracts, by value.[189] Section 15(g) also specifies contracting goals for subsets of small businesses that have historically encountered difficulty in federal procurement.[190] Under the statute, the government aims to spend five percent of federal contracting dollars on women-owned businesses and three percent on service-disabled veteran-owned businesses.[191] It allocates a further five percent for "small disadvantaged businesses"—those owned by individuals deemed socially or economically disadvantaged, who are primarily underserved racial minorities. The statute also targets three percent for businesses in areas deemed Historically Underutilized Business Zones (HUBZones). The HUBZone Act of 1997 provides for five "classes" of HUBZones, which collectively cover regions with low levels of income or high unemployment, Indian reservations, disaster areas, and areas in which a military base has recently closed.[192] In all cases, the SBA must certify individual contractors "disadvantaged," or as operating in a HUBZone, in order for them to benefit from these initiatives. Contracts with businesses falling into more than one of these four subcategories count towards each subcategories' targets, although they count only once toward the overall federal small-business goal.

FIGURE 16

**FEDERAL CONTRACTING TARGETS AND OUTCOMES**

| Small-Business Category | FY2019 Target Awards (%) | FY2019 Actual Awards (%) | FY2019 Actual Awards ($, billions) |
|---|---|---|---|
| Total | 25 | 26.5 | 132.9 |
| Disadvantaged | 5 | 10.3 | 51.6 |
| Service-Disabled Veteran-Owned | 5 | 4.4 | 22.0 |
| Women-Owned | 3 | 5.2 | 26.0 |
| HUBZone | 3 | 2.3 | 11.4 |

Federal contracting law seeks to balance the objective of small-business support with that of maintaining fair, competitive bidding processes that yield reasonable prices and protect taxpayer dollars. Agencies, therefore, may use three tools to achieve their small-business goals.[193] First, agencies can create "set-aside" contracts, which limit bidding to certain businesses. Agencies must generally set aside contracts for small businesses when those contracts are below $250,000[194]—a threshold termed the Simplified Acquisition Threshold—or when they can expect competitive offers from at least two small businesses.[195] Set-asides are permissible in other cases for 8(a) firms, or those that fall in the subcategory for small and disadvantaged businesses. Second, agencies can issue sole-source contracts, which are awarded to a particular firm without any bidding at all. Agencies generally have discretion to award sole-source contracts to 8(a) small businesses. Finally, agencies can give a "price-evaluation preference" to HUBZone contractors. This rule stipulates that, during competitive bids, HUBZone businesses must prevail against non-small business offerors even if their price is up to ten percent higher.[196]

By far the largest contracting agency in the federal government is the Department of Defense, which awarded $72 billion to small businesses in FY2019 (24 percent of its total contracts). The next largest small-business contractor, the Department of Veterans Affairs, awarded substantially less—$8.4 billion. Only four other agencies awarded more than $4 billion to small businesses in FY2019: The Departments of Homeland Security, Health and Human Services, Agriculture, and Energy.

Importantly, a subset of contracts falls under the SBA-coordinated Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) initiatives, which span eleven federal agencies. These programs, which the SBA references collectively as America's "seed fund," allocate contracts to small businesses for the purposes of research and development.[197] Research projects simultaneously advance federal priorities, stimulate innovation and technology transfer for small businesses, and connect businesses to federal buyers.[198] SBIR/STTR contracts totaled about $2 billion in FY2019, with $1.8 billion from the Department of Defense, and most of the rest from NASA.[199] (These programs also award research-and-development grants, serving similar federal research purposes; agencies made over $1.7 billion in such grants in FY2019.)[200]

The government also runs programs to help small businesses navigate federal procurement. The Department of Defense's Procurement Technical Assistance Program (PTAP) is the most significant, accounting for $25 million in expenditures in FY2019. PTAP consists of 94 Procurement Technical Assistance Centers nationwide that connect local small businesses to contracting opportunities.[201] And the Minority Business Development agency, which lies within the Department of Commerce, helps minority-owned businesses bid for contracts.[202] Much of the MBDA's procurement advising is delivered through its Business Centers, which administer broader technical training, as discussed above.

FIGURE 17

**FEDERAL CONTRACTING TO SMALL BUSINESSES**

| Agency | Small-Business Contracts | |
|---|---|---|
| | Contract Value ($, billions) | Share of Agency's Total (%) |
| Defense | 75.4 | 24 |
| Veterans Affairs | 8.9 | 32 |
| Homeland Security | 6.7 | 37 |
| Health and Human Services | 6.7 | 25 |
| Energy | 5 | 18 |
| Agriculture | 4.3 | 58 |
| NASA | 3.1 | 15 |
| State | 2.9 | 32 |
| Justice | 2.5 | 31 |
| Transportation | 2.4 | 37 |
| Commerce | 2.4 | 43 |
| General Services Administration | 2.4 | 43 |
| Treasury | 2 | 43 |
| Interior | 1.8 | 57 |
| Education | 1.0 | 35 |
| Labor | 0.8 | 40 |
| USAID | 0.8 | 15 |
| Environmental Protection Agency | 0.7 | 43 |
| Social Security Administration | 0.7 | 36 |
| Housing and Urban Development | 0.4 | 28 |
| Office of Personnel Management | 0.3 | 30 |
| SBA | 0.1 | 81 |
| Nuclear Regulatory Commission | 0.1 | 57 |
| National Science Foundation | 0.1 | 16 |

Finally, the SBA's surety bond program also helps businesses access federal procurement. Most government prime contractors are legally required to obtain surety bonds—financial instruments that insure contracting agencies against contractor nonperformance—from third-party companies.[203] To encourage third parties to insure small businesses, the SBA's surety bond program guarantees up to 90 percent of insurers' losses on approved contracts.[204] Minority- and women-owned businesses, who have historically had difficulty accessing surety,[205] benefit in particular from this program. The maximum eligible contract size for the SBA's program is $10 million,[206] and in FY2019 the agency guaranteed nearly 10,000 projects worth almost $6.5 billion.[207] Apart from its small administrative budget, the program operates a net zero subsidy.[208]

FIGURE 18

**MAJOR FEDERAL CONTRACTING TECHNICAL ASSISTANCE TO SMALL BUSINESSES**

| Agency | Program | FY2019 Expenditure |
|---|---|---|
| Small Business Administration | 1. Small Business Development Centers | $131 million* |
| | 2. Surety Bond Guarantee Program | $0 ($1.84 billion in bonds guaranteed) |
| Department of Commerce | Minority Business Development Agency | $40 million* |
| Department of Defense | Procurement Technical Assistance Program | $42.3 million |

*Only a portion of budget item is available for contracting technical assistance to small businesses.

## STEP 1

# Respond to the COVID-19 Crisis in the Small-Business Sector

**SUMMARY:** *COVID-19 has devastated the small-business sector. Roughly 1.5 million small businesses closed at least temporarily over the past six months, roughly a million remain closed, and small-business revenue was down 21 percent on average between January and August of 2020. Without substantial federal intervention, up to a million more businesses could close permanently. We recommend establishing a "second wave" of PPP loans to help businesses survive the next six to twelve months and establishing a new, highly flexible federal loan program for hard-hit businesses to rebuild post-pandemic. In the short term, the federal government should prioritize working through community-focused lenders to aid the smallest and most disadvantaged businesses, as well as injecting new funds into CDFIs and other local financial institutions.*

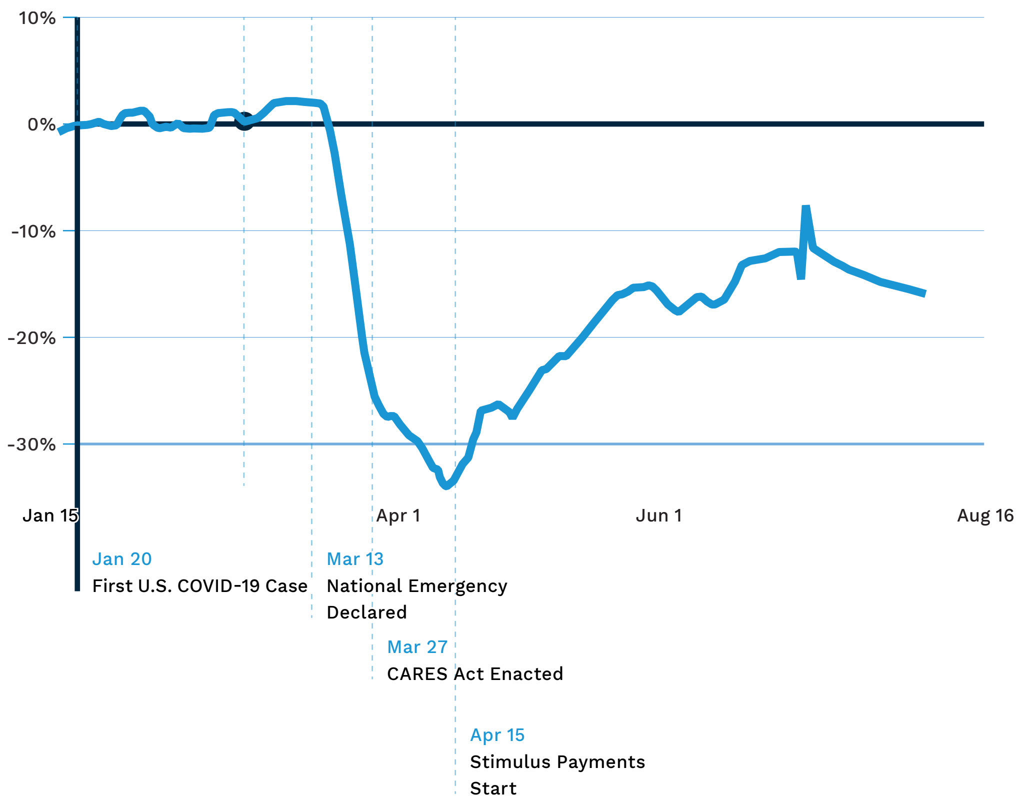
## COVID's Impacts on Small Businesses

The American small-business sector was struggling even before COVID-19. However, the pandemic has ushered in a wholly unprecedented set of challenges that put increased pressure on the sector's preexisting fault lines. Since March 2020, state lockdown orders have restricted the operations of nearly every small retail business in the country. And even in states that eased their lockdowns, public health concerns are suppressing business activity, with consumers avoiding the virus by staying home. Total visits to all businesses have fallen almost one-fourth from the previous year, as of this August.[209] As a result of these trends, small-business revenues fell 21 percent on average between January and August this year.[210]

With revenues drying up, many small businesses have been forced to close their doors. Fully 16 percent are no longer operating at all, as shown below. And some industries are especially hard-hit. Leisure and hospitality, for instance, has suffered a 47 percent decline in revenues[211] and disproportionate closures. Data on the business-platform Yelp also points to outsize closures among restaurants and retail enterprises.[212]

FIGURE 19

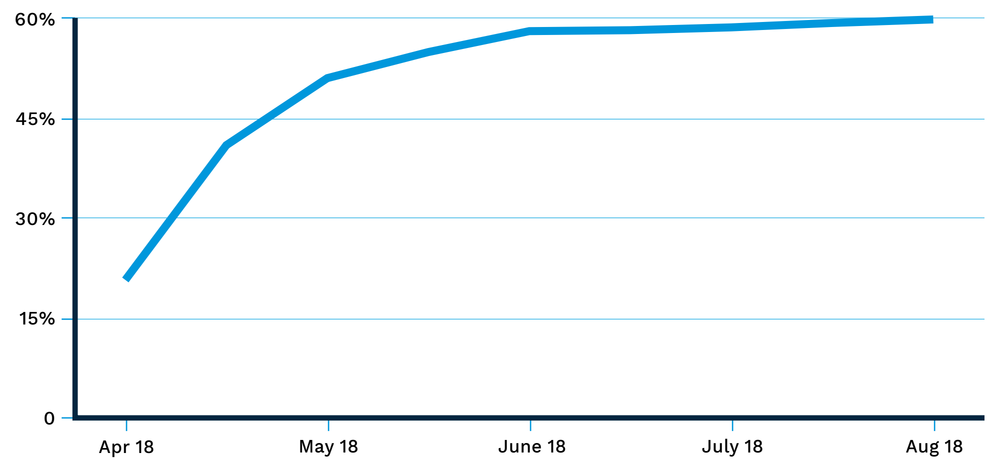
**NUMBER OF SMALL BUSINESSES OPEN, PERCENT CHANGE FROM JANUARY 2020**[213]




Many of these business shutdowns are permanent, not temporary. Among all small businesses listing on Yelp that have closed, more than half have shut their doors for good. And the proportion of closed businesses that will never reopen has only risen over the course of the pandemic.

FIGURE 20

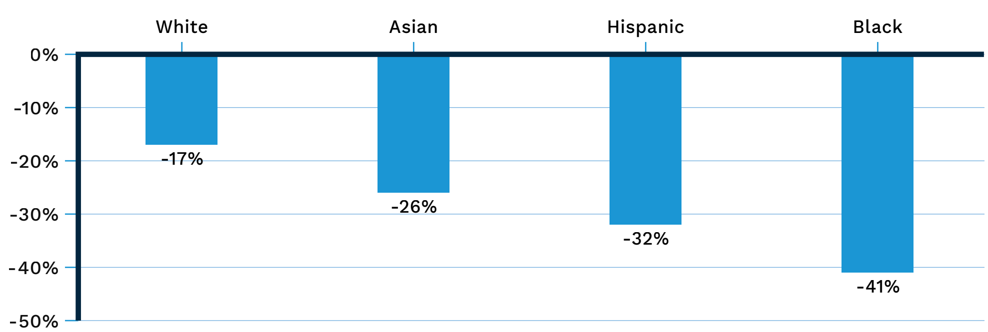
**PERCENT OF SMALL FIRM CLOSURES THAT ARE PERMANENT**[214]




Black and Hispanic business owners have been especially hard-hit. As the chart below shows, fully 41 percent of Black small-business owners—and 32 percent of Hispanic ones—stopped working altogether between February and April of 2020. White small-business owners, by contrast, ceased work at only about half the rate of Hispanic owners. Minority-owned businesses' greater probability of shutting down likely stems both from their weaker financial position going into the crisis, and from their overrepresentation in hard-hit consumer-services sectors, like restaurants.[215] Black-owned businesses, further, were significantly more likely than others to be located in COVID-19 hotspots.[216]

FIGURE 21

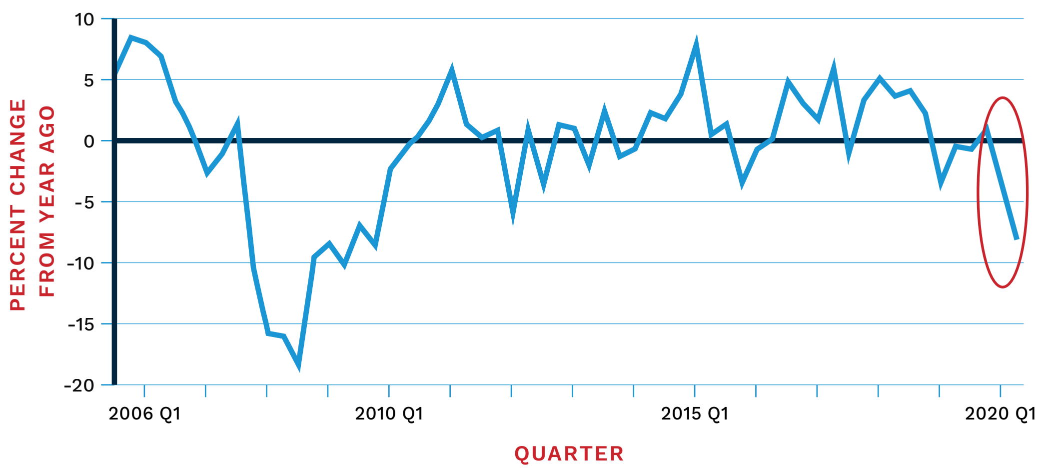
**NUMBER OF SMALL-BUSINESS OWNERS ACTIVELY WORKING, PERCENT CHANGE FROM FEBRUARY TO MAY 2020**[217]



Further, while existing businesses end operations, few new employer firms may be forming to replace them. Adjusting for seasonal fluctuations, high-propensity businesses—those especially likely to hire employees—are forming at a rate eight percent lower than the year before.[218] This is the sharpest downturn in these businesses' formation rates since 2009, following the financial crisis.[219] While there was a brief spike in overall business formations in June, July and August of 2020, the trend line has subsequently moved downwards towards the five-year average.[220]

FIGURE 22

**HIGH-PROPENSITY BUSINESS APPLICATIONS, PERCENT CHANGE FROM LAST YEAR***




In short, then, the small-business sector is facing profound dislocation. Many millions of small businesses are losing income, shutting down, and staying closed. Few entrepreneurs are founding companies to replace them. And minority-owned firms have borne far more than their fair share of the burden.

* This figure shows data through the second quarter of 2020. *See High-Propensity Business Applications for the United States*, Fed. Res. Bank St. Louis (Oct. 6, 2020), https://fred.stlouisfed.org/series/HPBUSAPPSAUS#0.

# Federal Policy Response to Date

## COVID-19 LEGISLATION

Through July 1, 2020 Congress passed five pandemic-response legislative packages that include measures for assisting small businesses. A brief summary of each law is below.

**Coronavirus Preparedness and Response Supplemental Appropriations Act (CPRSAA)**, signed into law March 6. The CPRSAA declared the pandemic a nationwide disaster, activating SBA measures for disaster response.

**Families First Coronavirus Response Act (FFCRA)**, signed into law March 18. The FFCRA primarily includes provisions to enable workers to take paid sick leave during the pandemic.

**Coronavirus Aid, Relief, and Economic Security Act (CARES Act)**, signed into law March 27. The CARES Act includes a wide array of economic relief measures, the most important of which was the creation of the Paycheck Protection Program (PPP).

**Paycheck Protection Program and Health Care Enhancement Act (PPP Enhancement Act)**, signed into law April 24. The PPP Enhancement Act injected more funds into the PPP and amended some rules regarding the distribution of funds.

**Paycheck Protection Program Flexibility Act (PPP Flexibility Act)**, signed into law June 8. The PPP Flexibility Act relaxes various requirements that PPP recipients must follow in order to have their loans under the program forgiven.

Since the pandemic started, the federal government's most significant small-business aid has been its Paycheck Protection Program (PPP). Established by the CARES Act, the PPP let the SBA backstop emergency, forgivable loans to small businesses.[221] In total, Congress authorized $659 billion in such loans,[222] and businesses claimed $525 billion of this sum by the program's August 8, 2020 closing.[223]

Through PPP, small businesses could borrow up to 2.5 times their monthly payroll costs, up to a total of $10 million. The SBA set loan duration to two years, with one-percent interest.[224] The program aimed to help small businesses keep workers employed during initial public-health lockdowns in cities and states. Loan forgiveness was the main incentive for employers to use PPP funds for payroll: the CARES Act forgives loans to employers who maintained their workforce size and used 75 percent of their loan on payroll.[225] The CARES Act gave all banks that are allowed to lend under 7(a), which essentially included every bank in the U.S., the authority to originate PPP loans.[226] However, after PPP's launch, the SBA approved some alternative lenders, including "fintech" companies like Square and PayPal, to originate the loans as well. The agency also expanded borrower eligibility beyond the normal 7(a) criteria. It permitted participation by nonprofit organizations, veterans organizations, sole proprietorships, and independent contractors—a group that includes most workers in the gig economy.[227]

The CARES Act originally authorized $349 billion for PPP loans,[228] which lenders committed entirely by April 16, 2020, just thirteen days after applications opened. In response to high loan demand, Congress authorized another $310 billion in the PPP Enhancement Act, which took effect on April 24, 2020.[229] However, borrowers were only allowed to apply for PPP funding once. Loan demand slowed by July, and approvals rose just a few billion dollars in the month leading up to August 8, 2020.

The PPP Enhancement Act also enacted changes to PPP in response to perceptions that the original PPP legislation was biased toward larger businesses.[230] PPP loans had gone to individual franchises belonging to nationwide chains, like McDonald's and Denny's.[231] Additionally the program's application process, which was burdensome and largely overseen by banks, worked in favor of larger businesses with preexisting bank relationships.[232] In response, the PPP Enhancement Act set aside $30 billion for loans by community financial institutions, a group that includes CDFIs.[233] Congress also carved out another $30 billion for loans by small financial institutions, which it defined as lenders whose assets totaled between $10 billion and $50 billion.[234] Lawmakers hoped that these carve-outs would spur lending by smaller institutions, which typically lend to smaller small businesses.

Congress further altered the program rules with the PPP Flexibility Act, passed on June 5, 2020 which addressed businesses' complaints that fixed costs were growing onerous during the pandemic.[235] This act lowered the proportion of PPP funds recipients must devote to payroll, in order to be eligible for loan forgiveness, from 75 percent to 60 percent. It created exceptions to the requirement that employers must maintain their full workforce,[236] including for businesses who cannot find workers or those affected by federal health regulations.[237] It also allowed recipients to defer payroll taxes while remaining eligible for full forgiveness (which was previously disallowed).[238]

While PPP has been the government's flagship support strategy during COVID-19, it has offered other direct financial assistance. The CARES Act lets the SBA cover principal payments, interest, and fees on most of its loans through September 27, 2020.[239] It further raised the maximum SBA Express loan size from $350,000 to $1 million, effective through the end of 2020.[240] The SBA also amended the Community Advantage Program, effective through September 2020, to let lenders offer more robust, pandemic-oriented technical assistance, in exchange for higher fees.[241] Pandemic legislation also includes important small-business tax provisions. The FFCRA mandates that small businesses provide employees sick leave if they or a relative contract COVID-19,[242] but it also reimburses leave expenses dollar-per-dollar. The Congressional Budget Office (CBO) pegs the cost of these credits at $105 billion.[243] The CARES Act also gives firms an Employee Retention Tax Credit (ERTC) of up to $5,000 per employee that's kept on payroll. The ERTC includes favorable terms for smaller businesses: it reimburses large employers only for employees kept on payroll while unable to work,[244] but reimburses firms with fewer than 100 people for *all* employees on payroll.[245] According to CBO projections, the ERTC will cost taxpayers $55 billion.[246]

Finally, the Federal Reserve created a COVID-19 program for buying bank-issued loans to small- and medium-sized businesses: The Main Street Lending Program (MSLP), which launched on June 15, 2020. The Fed has authorized $600 billion in MSLP purchases, though it has indicated it may increase this sum.[247] Through the MSLP, the Fed may purchase 95 percent of eligible loans from the banks originating them. Banks must retain ownership of the remaining five percent.[248] The minimum eligible loan size eligible is $250,000, and the program only allows the Fed to buy debt to firms with (i) fewer than 15,000 employees or (ii) 2019 revenues below $5 billion.[249] As of August 12, the date of the Fed's most recent MSLP update, the MSLP had purchased or begun review of 87 loans, worth $857 million.[250]

The SBA has also issued disaster loans to companies, ever since the CPRSAA declared COVID-19 a nationwide emergency.[251] It has made loans through its Economic Injury Disaster Loan (EIDL) program, which lends working capital to small businesses at interest rates of four percent or less. In total, Congress authorized $60 billion for EIDL loans.

Following the CPRSAA, the SBA began drawing on its standard appropriations for EIDL loans.[252] But the CARES Act then significantly expanded EIDL activity, authorizing $10 billion in emergency appropriations.[253] During the program, the SBA also broadened EIDL eligibility to include sole proprietorships, independent contractors, and cooperatives[254] and waived many borrowing requirements—including that borrowers be in operation for over one year and collateralize loans below $200,000.[255] For the first time ever, the CARES Act also let the SBA deliver up to $10 billion total in non-repayable grants to EIDL participants. The agency was able to make grants of up to $10,000 within three days of receiving borrowers' EIDL applications.[256] Its practice was to issue grants equal to $1,000 per borrower employee (up to the $10,000 maximum).[257] With the PPP Enhancement Act, Congress appropriated another $50 billion for EIDL loans and $10 billion for grants.[258] It also expanded EIDL eligibility to farmers and agricultural businesses.[259] The SBA disbursed all $20 billion authorized for EIDL grants by July 11, and it continues to make EIDL loans.[260]

The federal government has done less to help small businesses via contracting and technical assistance. In these areas, Congress has mainly passed laws preventing firms from losing money previously obligated to them. As for contracting, the CARES Act absolves small contractors for work not completed due to COVID-19;[261] it also lets agencies reimburse contractors for paid-leave expenses through September 30, 2020.[262]

As for technical assistance, Congress has allowed those receiving federal support to spend federal dollars more flexibly. The CARES Act allows grants from the State Trade Expansion Program since FY2018 to be spent through FY2021,[263] and it reimburses recipients for events cancelled due to COVID-19.[264] The act also appropriated $240 million for SBDCs and WBCs, which must use these funds to address the pandemic's challenges.[265] It also allocated $25 million for this purpose to technical-assistance organizations that partner with the SBA[266] and $10 million to the Minority Business Development Agency for technical assistance.[267]

# POLICY RECOMMENDATION I:
## Provide loan and grant products at scale, tailored to meet the unique needs of small businesses during the COVID-19 crisis

### LAUNCH A SECOND ROUND OF PPP

Despite flaws in its rollout and design, the Paycheck Protection Program kept millions of workers on their employers' payrolls. Early research found that PPP, through the first week of June, created or preserved 3.2 million American jobs.[268] By May, small businesses in metro areas that received disproportionate PPP disbursals reported revenue losses less frequently than those in other cities.[269] But PPP's effect on employment wore off rapidly. Congress, when initially passing PPP, intended the program only to be a short-term stopgap—a means of keeping workers on payroll until the United States brought the pandemic under control. Lawmakers therefore let firms apply just once for PPP funding and receive no more than 250 percent of their monthly payroll costs.

The pandemic, however, has raged through the United States longer than lawmakers expected. Congress should expand access to PPP funding accordingly. Simultaneously, Congress should refine PPP to direct funds to where they are needed most. Large numbers of PPP loans, particularly in early application rounds, went to companies that may not have needed emergency loans to retain workers. In PPP's first phase, each job saved cost the government a full $224,000,[270] far more than the average small-business employee earns over 2.5 months.

Congress should therefore establish and allow businesses to apply for a second round of PPP with the following terms:

- Businesses must self-certify as having lost 40 percent or more of their revenues during any four-week period since the pandemic began.
- Businesses may apply for up to 300 percent of their monthly payroll.
- The portions of employees' salaries greater than $100,000 would be ineligible for relief, as was the case with the first round of PPP.

- All loans would be 50 percent forgivable regardless of businesses' hiring decisions, and if businesses retain at least 90 percent of their payroll, loans would be fully forgiven.
- Unlike for the first round of PPP, businesses' maximum loans would be calculated to include monthly payments to contractors whose contracts with the applicant predate the pandemic.
- The SBA would cover lenders' administrative costs of issuing loans to encourage them to prioritize smaller applicants.

As a final measure, Congress should forgive outstanding PPP debts for all businesses who borrowed $150,000 or less under the program.

## ESTABLISH A NEW, HIGHLY FLEXIBLE LOAN PROGRAM FOR HARD-HIT BUSINESSES

Federal programs like the Payment Protection Program, if expanded as above, will help many firms stay afloat until a COVID-19 vaccine becomes widespread. But rebuilding businesses over the coming years will be a different challenge altogether. Rebuilding will require policymakers to provide access to credit on flexible terms to hard-hit firms that are nevertheless viable so that they have resources to rebuild.

Congress should therefore authorize a new SBA lending program specifically for firms whose revenues have plunged during the crisis. This loan program should follow the outline of the RESTART Act, sponsored by Senator Michael Bennet and Representative Jared Golden, which was proposed in May, 2020.[271] This new initiative should provide more flexibility than PPP in how borrowers spend borrowed capital and when they repay it. In particular, it should have the following loan terms:

- Eligible borrowers must be small- and medium-sized businesses—those with fewer than 5,000 employees—that can demonstrate an annual revenue decline of at least 25 percent in 2020, as a direct result of the pandemic. Eligible borrowers must also not be publicly traded.
- The SBA would guarantee 90 percent of qualifying loans and have no requirement to operate the program on a zero-subsidy basis.

- Principal payments would be deferred for up to three years after loan origination.
- The SBA would waive service fees for qualifying loans.
- Loans would be repayable within thirty years and subject to standard 7(a) interest-rate requirements. Loans would not require collateral.
- Loans would not be forgivable.
- The maximum loan size would be the lesser of $15 million or 45 percent of a business's 2019 revenues.
- Borrowers would be permitted to spend the loan on a broad range of business purposes, including payroll, capital expenditures, customer acquisition, and rent and utilities.

The loans would also be available to start new businesses if small-business owners self-certify that their businesses had been profitable for four consecutive years or more and had closed directly as a result of COVID-19.

Congress should authorize the SBA to guarantee $100 billion of such loans as soon as vaccine distribution begins. It should increase this maximum, and make general appropriations for the program, as needed.

## WORK THROUGH LOCAL LENDERS TO AID THE SMALLEST AND MOST DISADVANTAGED BUSINESSES

Many of the firms hit hardest by COVID-19, like family-owned restaurants and small retailers, are also those most disconnected from banking institutions. The small businesses in the sectors impacted by COVID-19 are also disproportionately owned by minorities: roughly a quarter of restaurants, hotels, and non-professional service firms are minority-owned.[272] By early April, businesses with under 20 employees were over 50 percent more likely than those with above 100 employees to have shut down.[273] Smaller and minority-owned businesses are precisely those businesses to which traditional bank lenders lend the least. It is for this reason that many of these firms faced significant challenges obtaining bank-delivered PPP loans during the program's first round.[274]

Ensuring that these businesses survive and new ones grow requires a targeted, localized approach. Across the country, states, cities, counties, and towns have established state and local relief funds to provide emergency support to small businesses impacted by COVID-19. These relief funds use a broad array of distribution channels for capital, helping them quickly reach a diverse set of businesses. Local funds also offer financing, primarily through grants but also low-interest loans, tailored to the particular needs of small businesses in their communities. Finally, local relief funds enable local partnerships with entities like community foundations, Black and Hispanic Chambers of Commerce, and others to ensure high-need businesses can participate. As a result, they have provided much-needed assistance to the very small businesses that are on the financial brink, or those attempting to reconfigure operations during a slow path to stability.

Congress has already taken notice of these state and local efforts, which are uniformly undercapitalized and oversubscribed. Lawmakers have proposed the RELIEF for Main Street Act—a bipartisan bill co-sponsored by Senators Cory Booker and Steve Daines and Representatives Dan Kildee and Fred Upton—to help expand them. The act would provide $50 billion in direct assistance to cities, counties and states to scale existing (or newly created) relief measures explicitly targeted towards small businesses.[275] Eligible uses of this money would also include varying kinds of technical assistance.[276] Qualifying funds must either (i) serve existing or new businesses with 20 employees or fewer *or* (ii) be located in low-income census tracts.[277] Recipients must also have experienced a COVID-19 related loss of income.[278] The Secretary of Treasury would administer the program.

The RELIEF for Main Street Act was originally introduced in May 2020. Given that much time has passed since then, we recommend expanding its reach to permit investments in new enterprises and business-district regeneration. Beyond this act, Congress should also appropriate an additional $25 billion for the Treasury to distribute to state governments to run relief efforts. State governments would submit proposals outlining how they will use funds to aid minority-owned businesses, rural businesses, and microbusinesses in their states. This application process would operate similarly to the SSBCI, which also had states apply for federal funding, with a focus on aiding underserved businesses. States' SSBCI proposals, which have often involved close partnerships with local lenders, demonstrate that state policymakers are well positioned to execute these kinds of programs.

## INJECT NEW FUNDS INTO LOCAL FINANCIAL INSTITUTIONS.

Community lenders can play an invaluable role in the rebuilding after COVID-19, as well as the immediate crisis response. CDFIs are better equipped than large lenders to understand local small businesses' needs, which have evolved rapidly during the pandemic's twin health and economic crises. Lenders like CDFIs can also reach borrowers outside the traditional banking sector through personal and community-based networks. This makes them a helpful complement to state or local government lending programs. Because they can move nimbly and pinpoint struggling businesses, small lenders punched well above their weight in making PPP loans during the Program's tumultuous first phase.[279]

Policymakers should provide financial assistance to help these institutions sustain and expand their critical work. There is precedent for this. In 2009, Congress spurred post-crisis investment with a one-time injection of $3 billion into the New Markets Tax Credit program, which lets investors claim tax credits after investing in low-income areas.[280] In 2011, it additionally authorized the Small Business Lending Fund to make $6 billion in loans to community banks.

Rebuilding after this latest crisis will require a similar response. Congress, therefore, should immediately take the following three steps:

- Authorize $3 billion in emergency appropriations to the CDFI Fund to expand its grant-making and loan guarantees.
- Authorize $3 billion in emergency New Markets Tax Credit appropriations.
- Authorize $6 billion in emergency appropriations to the Small Business Lending Fund.

## STEP 2

# Unleash America's Entrepreneurial Spirit

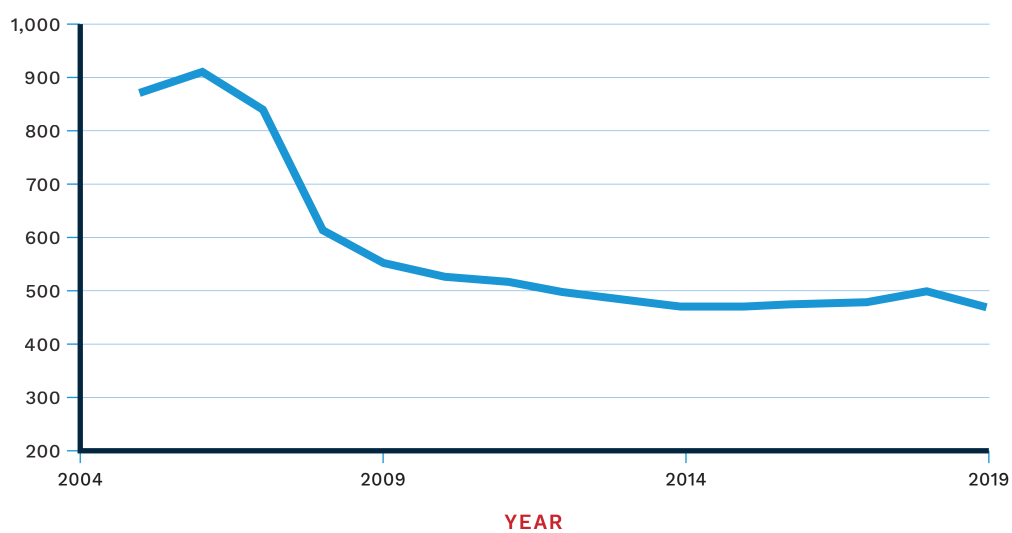
**SUMMARY:** *U.S. small-business formations have stalled over the past decade, whether measured by total business formations or job creation. Over the same time period, the U.S. economy grew increasingly consolidated, with an increasingly small number of major corporations controlling ever larger market shares. Meanwhile, minorities remain underrepresented among business owners. To reverse these declines and to give minority founders the tools they need to succeed, we suggest three tacks. First, spur entrepreneurship among minority, female, and other disadvantaged founders by investing more in federal programs, like the SBA's Growth Accelerator Fund Competition, that specifically help founders launch new businesses. Second, reduce barriers to entry by, for example, by cutting onerous state licensing requirements, and strengthening antitrust law and enforcement. Third, invest in stronger local small-business support ecosystems that can collect and publish market data and data on public and private procurement; provide education, mentorship, and networking opportunities; create channels to access capital; and support business districts. To help regions build stronger ecosystems that can perform these functions, we recommend among other steps that Congress establish a multi-year Small Business Ecosystem Demonstration Project, increase funding for community lenders to provide technical assistance, and expand the SBA's Regional Innovation Cluster program and Department of Commerce's Regional Innovation Strategies program.*

## Understanding Negative Trends in Entrepreneurship and How to Reverse Them

As highlighted above, U.S. small-business formations have stalled over the past decade. Total business formations, formations of businesses with planned employees, and formations of businesses most likely to hire, have all fallen since the Great Recession.[281] While there was a brief spike in business formations in June, July and August of 2020, the trend line has subsequently moved downwards towards the five-year average.[282] These declines are the latest in a more general decline in the relative strength of the small-business sector dating back to the 1970s.[283]

FIGURE 23

**NUMBER OF NEW BUSINESS FORMATIONS WITH PLANNED EMPLOYEES[284]**




Moreover, minorities are under-represented among business owners, in particular Black and Latinx individuals.[285] When minorities do own businesses, their firms generate less income and hire fewer employees, as the first two tables below show. Black and Latinx households also hold less equity in businesses of all sizes, shown in the third table below. These trends reflect social and economic barriers facing entrepreneurs of color.

## FIGURE 24

### AVERAGE NUMBER OF EMPLOYEES AND ANNUAL REVENUES, 2017[286]

| Ethnicity of Owner | Average Number of Employees | Average Revenues ($, thousands) |
|---|---|---|
| Non-Hispanic White | 12.1 | $2,537 |
| Non-Hispanic Asian | 8.4 | $1,472 |
| Hispanic | 8.9 | $1,312 |
| Non-Hispanic Black | 10.1 | $1,056 |

## FIGURE 25

### AVERAGE BUSINESS INCOME, 2015[287]

| Group | Black | Latino | Asian | Non-Latino Whites |
|---|---|---|---|---|
| Number of Business Owners | 773,448 | 1,817,236 | 794,606 | 8,820,771 |
| Mean Business Income | $39,170 | $34,475 | $60,950 | $63,329 |
| 75th Percentile | $45,070 | $37,558 | $63,563 | $70,088 |
| Median | $23,608 | $20,192 | $31,297 | $35,335 |
| 25th Percentile | $10,429 | $10,429 | $16,096 | $15,643 |
| | | | | |
| Number of Business Owners (Working 15+ Hours) | 709,536 | 1,692,007 | 751,493 | 8,277,854 |
| Mean Business Income (Working 15+ Hours) | $41,694 | $36,246 | $63,492 | $66,618 |
| 75th Percentile | $48,289 | $40,051 | $66,083 | $73,815 |
| Median | $25,442 | $20,857 | $33,893 | $37,558 |
| 25th Percentile | $12,303 | $12,015 | $18,023 | $18,672 |

## FIGURE 26

### SHARE OF HOUSEHOLDS THAT OWN SOME BUSINESS EQUITY, BY RACE, 2016[288]

| | Ownership of Business Equity (Family Business, etc.) | Direct and Indirect Equity (Including Stocks) |
|---|---|---|
| White | 15% | 61% |
| Black | 7% | 31% |
| Hispanic | 6% | 28% |
| Other | 13% | 47% |

The challenge of declining entrepreneurship, as well as and the barriers facing entrepreneurs have attracted the attention of federal policymakers. As outlined above, there are many national programs that attempt to boost entrepreneurship and provide small-business owners with advice and support. However, little is known about which programs actually work. Just as with lending programs, neither the SBA nor any other federal agency collects outcomes-based data for technical training. One SBA working group found that poor data collection may make it "impossible" to evaluate major programs like Minority Business Development Centers and SBDCs.[289] And the SBA's Office of the Inspector General found in 2019 that the agency uses just *one* outcome-based measure to assess SCORE offices.[290] Agencies do sometimes hire third parties to audit technical programs, particularly those involving entrepreneurship.[291] But these studies do not use rigorous methodologies and cannot demonstrate causal links between programs and business outcomes.[292] And recent SBA data reforms, including last year's push to start tracking the total number of distinct businesses that use agency services,[293] have not solved this problem.

While it will take better data to diagnose federal training programs fully, the best available evidence suggests existing programs do much too little for minority-owned businesses. Minority founders tend to be far less able than others to launch businesses without outside support, largely due to lower average household wealth. These wealth disparities also make it harder for minority owners to expand their firms or weather revenue shortfalls, absent external support networks.*

FIGURE 27

**AVERAGE NET WORTH BY RACIAL GROUP, 2016[294]**

| | Median Net Worth | Percent of White Net Worth | Mean Net Worth | Percent of White Net Worth |
|---|---|---|---|---|
| **White** | $171,000 | 100% | $933,700 | 100% |
| **Black** | $17,600 | 10% | $138,200 | 15% |
| **Hispanic** | $20,700 | 12% | $191,200 | 20% |
| **Other** | $64,800 | 38% | $457,800 | 49% |

* Variations in educational outcomes between racial groups also impact rates of small-business creation and success. As of 2017, just 15 percent of Black Americans and 12 percent of Latinx Americans possessed a college degree, compared to 25 percent of White Americans. These gaps, which themselves are driven by minority households' lower wealth and greater likelihood of living in low-income areas, inhibit minorities' access to training programs, credentials, and professional networking. Given scope of this report, however, we do not discuss this issue in detail. *See generally,* Sean Reardon et al., *Is Separate Still Unequal? New Evidence on School Segregation and Racial Academic Achievement Gaps* (Stanford Center for Education Policy, CEPA Analysis Working Paper No. 19-06, 2019), https://cepa.stanford.edu/sites/default/files/wp19-06-v092019.pdf.

FIGURE 28

**AVERAGE HOUSEHOLD INCOME BY RACIAL GROUP, 2016**[295]

| | Median Income | As a Percent of White | Mean Income | As a Percent of White |
|---|---|---|---|---|
| White | $61,200 | 100% | $123,400 | 100% |
| Black | $35,400 | 58% | $54,000 | 44% |
| Hispanic | $38,500 | 63% | $57,300 | 46% |
| Other | $50,600 | 83% | $86,900 | 70% |

FIGURE 29

**AVERAGE NET WORTH IN HOME BY RACIAL GROUP, 2016**[296]

| | Mean Net Housing Wealth | As a Percent of White |
|---|---|---|
| White | $215,800 | 100% |
| Black | $94,400 | 44% |
| Hispanic | $129,800 | 60% |
| Other | $220,700 | 102% |

Some regions of the country, however, have found greater success in fostering entrepreneurship among disadvantaged groups. Business formation and expansion, particularly for minority- and women-owned businesses, benefit from strong ecosystems of public, private, and nonprofit institutions. By ecosystems, we mean overlapping networks of institutions that deliver coordinated, multifaceted support to small businesses. We call these institutions "intermediaries" in the sense of serving as connections between public sources of funding, entrepreneurs of color, and potential private sector customers, investors and partners. Intermediary institutions provide mentoring, help access capital, create marketplaces to connect companies and potential clients, aggregate supply from small companies to match with demand of large institutions, foster communities of practice, and help with critical transition points in the business life cycle. These institutions can be incubators, accelerators, angel and seed funds, CDFIs, mentor groups, or counseling services, and can be housed at universities, Chambers of Commerce, development corporations, or elsewhere.

One example of a successful regional ecosystem is Cincinnati, Ohio. By forging tight networks of supportive community institutions, Cincinnati has jumpstarted the growth of small businesses generally and minority-owned ones in particular.

The Cincinnati metro area boasts a sophisticated network of organizations to mentor companies and play helpful match-making roles. This network first took shape in the 1970s when Procter & Gamble, which is headquartered in the city, pledged to buy from diverse suppliers. In 1972, P&G's leadership led regional business communities to found the Ohio Minority Supplier Development Council, a non-profit group that connects minority-owned businesses to procurement opportunities.[297] Cincinnati later implemented its own minority-owned business set-aside ordinance in 1978.[298] These simultaneous developments aligned public, private, and nonprofit actors alike around the goals forming, stabilizing, and growing minority businesses.

Today, a key driver within Cincinnati's model is the Minority Business Accelerator (MBA), housed within the Cincinnati Regional Chamber of Commerce. The MBA aims to develop sizable minority businesses as part of its efforts around business and talent attraction. Long backed by major corporations, it has a portfolio of Black- and Latinx-owned firms with annual revenues above $1 million or more and an articulated business plan or strategy that "indicates strong potential for accelerated growth in 2-5 years."[299] While the MBA is sector agnostic, 35 firms with thousands of workers in the construction, facilities management, packaging, and consulting industries are currently in its portfolio.

Armed with a Kauffman Foundation grant, the MBA helps local firms through a four-pronged strategy. First, it continues to help minority-owned businesses of scale grow by providing "individually-tailored advisory support and coaching to help Minority Business Enterprises (MBEs) acquire . . . a strong business strategy, access to capital, and connections within corporate organizations."[300] Second, the MBA is building a pipeline of future minority-owned businesses to join its program. Third, it works with REDI Cincinnati, the region's lead economic development agency, to recruit more minority-owned firms to Cincinnati in the manufacturing, aerospace and chemicals sectors—where Cincinnati has a strong competitive advantage. Finally, the MBA works with minority-owned businesses that lack succession plans to identify other minority-owned business acquirers.

While the MBA focuses on employer firms with sizable revenues, another intermediary organization in Cincinnati, MORTAR, helps unconventional entrepreneurs build businesses. MORTAR offers a nationally recognized 15-week entrepreneurship training curriculum, and, to date, has successfully graduated 21 classes—infusing the Cincinnati economy with more than 275 entrepreneurs.

Cincinnati's success in supporting minority-owned businesses has earned the region national recognition. A 2019 study conducted by LendingTree[301] ranked it among the top 10 large metro areas for minority-owned businesses.

FIGURE 30

**TOP TEN LOCATIONS WHERE MINORITY ENTREPRENEURS ARE SUCCEEDING[302]**

| Rank | Metro | Final Score | Percent of Minorities Who Are Self-Employed | Minority Business-Ownership Parity Index | Percent of Minority-Owned Businesses That Have $500K+ Revenues | Percent of Minority-Owned Businesses in Operation for 6+ Years |
|---|---|---|---|---|---|---|
| 1 | San Francisco | 83.9 | 4.3% | 68 | 42.6% | 56.7% |
| 2 | San Jose, Calif. | 83.2 | 3.8% | 73 | 42.6% | 56.6% |
| 3 | Washington, D.C. | 78.8 | 4.0% | 68 | 39.9% | 55.8% |
| 4 | Los Angeles | 78.7 | 4.2% | 61 | 42.4% | 56.7% |
| 5 | Seattle | 78.5 | 4.6% | 69 | 36.3% | 53.2% |
| 6 | Portland, OR | 75.9 | 4.4% | 61 | 38.8% | 55.5% |
| 7 | Sacramento, CA | 74.5 | 3.0% | 65 | 41.8% | 60.0% |
| 8 | Pittsburgh | 70.0 | 3.7% | 52 | 39.4% | 61.0% |
| 9 | Atalanta | 69.8 | 4.8% | 55 | 37.4% | 49.7% |
| 10 | Cincinnati | 68.8 | 3.1% | 50 | 43.3% | 62.3% |

Case studies like Cincinnati reveal what it takes to help minority-owned firms launch and expand. Cincinnati's success stems from its rich business ecosystem, with dedicated intermediaries that link owners with mentors, buyers, and capital sources. Intermediaries like Cincinnati's MBA proactively identify and connect with minority-owned firms; they leverage relationships with anchor institutions, like Procter & Gamble, to ensure these firms find buyers. Training programs elsewhere that fail to engage potential employers or customers have much poorer results.[303]

Historically, the federal government has invested in an ad hoc fashion in intermediary institutions like incubators and accelerators. These investments have paid off. Accelerators in the SBA's GAFC program, for instance, have proven highly effective at helping startups forge professional connections and attract outside capital.[304] Auditors likewise found that EDA's RIS program is one of the government's most efficient job-creation programs.[305] Unfortunately, these initiatives remain a low priority while the large majority of federal resources flow to the SBA's Small Business Development Centers.

The challenge with current federal technical assistance, in other words, is that it is piecemeal. Any given SBDC or accelerator may help an individual small business succeed. But absent a broader ecosystem, like the one in Cincinnati, one-off mentoring or support programs will not generate consistent outcomes at the metropolitan or regional level. Conversely, investing in a range of organizations and institutions that provide entrepreneurs with tools and services for each step in a business's lifecycle can create a virtuous cycle of growth for disadvantaged entrepreneurs and minority-owned businesses.

Instead of investing in strong ecosystems, the federal government has been cutting back on support for existing programs. For example, EDA's RIS program is consistently understaffed.[306] And recently the Trump administration slashed training resources. The FY2021 budget proposes reducing the SBA's microloan technical-assistance budget by a third and cutting programs like GAFC and PRIME entirely.[307]

## Policy Recommendation II:
## Spur entrepreneurship among minority, female, and other disadvantaged founders

### EXPAND THE SBA'S MICROLOAN PROGRAM

The SBA's microloan program, through which the agency partnered with lending intermediaries to make $81 million of loans in FY2019, has had strong results at building lasting companies. Roughly 88 percent of microloan recipients remained in operation five years beyond their funding date—a much lower exit rate than comparable small businesses not receiving funds.[308] Currently, of the roughly 150 lending intermediaries participating in the microloan program, 86 percent report seeing greater demand from qualifying businesses than they can fund.[309] Contingent upon developing better outcome-tracking metrics, as discussed below, the SBA should double its funding for this promising program and expand the maximum loan size to $100,000. It should also do more to expand the program to new lending intermediaries, which can then reach more borrowers. The SBA requires that lenders have at least one year of experience offering technical support before participating.[310] To facilitate enrollment, the SBA should provide small grants to qualifying lenders interested in expanding their technical offerings so that they can meet program requirements.

## EXPAND THE SBA'S GROWTH ACCELERATOR FUND COMPETITION

Since 2014, the SBA has awarded a few dozen business accelerators and incubators, through its Growth Accelerator Fund Competition (GAFC), with $50,000 each in funding to scale up operations. Audits suggest that funded accelerators, in part because of the SBA stamp of approval, proved highly effective at helping entrepreneurs grow and attract outside capital.[311] Lawmakers, including Senator Cory Booker, have recently proposed injecting more funds into the program—and they are right to do so. We recommend doubling annual funding from $3 million to $6 million, in line with Senator Booker's Startup Opportunity Accelerator Act (SOAR).[312]

The GAFC program, however, should be adjusted to let it reach a more diverse range of businesses, in addition to receiving more funds. Among companies benefitting from GFAC winners, 77 percent report having previously been involved in SBIR/STTR programs, and 31 percent have displayed "strong engagement" with SBA field offices.[313] In short, accelerators winning the competition may be doing little to bring new businesses into the federal support system. The SBA should set aside portions of its GAFC awards to incubators in underserved regions to broaden the range of benefiting companies. To help ensure that accelerators have the capacity and expertise to execute on accelerator programs, the SBA should require winners to obtain private-sector matching, something past participants see as both manageable and desirable.[314]

## AWARD SBIR/STTR FUNDS TO MORE DIVERSE, FIRST-TIME RECIPIENTS

The SBIR/STTR program can be transformative for companies receiving its awards. However, its impacts are by far the greatest for younger, smaller companies.[315] Younger businesses are more likely to face financing constraints, yet they are also in greatest need of external funds to develop their products.

To have the largest possible impact on innovation, business growth, and employment, the SBIR/STTR programs must prioritize enabling these businesses to benefit from awards. It can do so through three concrete steps.

1. **Set-asides:** SBIR/STTR awards frequently go to repeat winners—"SBIR mills"—who hire staff dedicated to researching and applying for these awards.[316] Unlike startups from disadvantaged communities, firms like these do not need federal awards to survive, and after winning awards they are less likely to create jobs. Meanwhile, the share of economically disadvantaged SBIR/STTR grant winners has stayed constant at eight percent since 2005, and minorities in particular are underrepresented in the program. Women-owned businesses, further, accounted for just 11 percent of SBIR/STTR grants in 2017, even though women own over one-third of American businesses.[317] This share is even less than the proportion of all venture-capital lending that goes to women-owned firms.[318] To give smaller firms a fairer chance of competing against "SBIR mills," agencies should set aside 20 percent of their SBIR/STTR budgets for first-time winners. Agencies' research budgets would be trimmed should they fail to hit this target, without compelling justifications as to why they could not meet it.

2. **Increased outreach and mentorship:** Federal agencies must take greater steps to facilitate first-time applications for SBIR/STTR funding. The SBA should spearhead a joint federal initiative to promote awareness of the program in areas with low historic representation. Past winners of the SBIR/STTR program should also, as a condition of receiving funds, be required to serve as mentors to applicants and eventual winners in future years. The SBA should launch an SBIR/STTR mentor-protégé program, where past winners counsel first-time applicants in preparing successful applications to particular agencies. Mentors would also be responsible for guiding award winners in product development.[319]

3. **Greater funding to earlier seed rounds:** SBIR/STTR funding is awarded in two phases. Applicants first apply for phase one funding, and then, if their product development goes smoothly, they reapply years later to expand their projects with phase two funding. Currently, phase two awards dominate agencies' SBIR/STTR budgets, accounting for 80 percent of total awards. Yet the most impactful awards for businesses, which catalyze their ability to attract outside finance, are those in phase one. To ensure SBIR/STTR benefits more than just a few companies each year—and to harness federal funds efficiently—agencies should increase their funding for phase one from 20 percent of funds to 30 percent of funds. Investing in more phase one projects will generate more innovation and increase the ratio of private-sector follow-on investment. The mentorship program just described will help keep loss ratios steady—i.e., the percentage of phase one projects that don't move onto phase two projects.

Finally, agencies should also consider letting SBIR/STTR awardees spend their awards more flexibly. First-time winners would reap long-term benefits, for instance, if they were permitted dedicate a portion of funding to commercializing their products and building a customer base.

## PARTNER WITH COLLEGES AND BUSINESS SCHOOLS TO PROMOTE FINANCIAL-LITERACY TRAINING

Growing up, students from low-income backgrounds are less likely to learn financial-management skills from their parents than students from higher-income families. Minority students are also less likely to have parents with experience in business or high-skill industries, who could more easily pass on such skills.[320] High schools rarely cover these subjects in depth, and after school, students have fewer opportunities to study them.[321] But accounting and financial planning are essential elements of nearly every business. Of course, many low-income entrepreneurs build successful businesses without formal financial training, but for other would-be entrepreneurs, such training can be an important asset.[322]

Existing technical centers, including SBDCs and MBDCs, should work to close these gaps by devoting more resources to free financial-management courses. In providing these courses they should also partner with local community colleges, universities, and business schools, which all have expertise teaching these subjects. Community intermediary platforms, too, should connect business faculty and MBA students at colleges and universities with growing local companies, to form mentoring relationships. The SBA can publicize schools whose faculty collaborate with such initiatives; lawmakers can create other incentives, as needed, for schools receiving public funds to encourage faculty participation. Policymakers and intermediary platforms can similarly push business schools to support more in-depth training and individualized mentorship, including entrepreneurship programs.

Lawmakers can also take steps to integrate financial education into federally backed training programs. Congress should authorize funding for vouchers, administered by the U.S. Department of Education, for individuals from low-income backgrounds to take accounting and other courses tuition-free at community colleges. It should also allocate funds for the U.S. Department of Education to make grants to business schools and faculty that develop programs for supporting local disadvantaged small business entrepreneurs and owners.

## Policy Recommendation III:
Reduce barriers to entry and strengthen antitrust law and enforcement

### HELP STATES CUT ONEROUS LICENSING REQUIREMENTS AND WHERE POSSIBLE REPLACE LICENSING WITH CERTIFICATIONS

Policymakers can facilitate business creation by slashing regulations that make launching businesses difficult. Today, over one-fourth of the American labor force works in an occupation subject to federal or state licensing requirements—some of which take hundreds of hours to fulfill.[323] While licensing requirements can serve important public policy purposes, many licensing systems are the product of industry lobbying to help reduce competition against incumbents. These requirements can prove difficult to navigate for those looking to found new or expand existing businesses.

Most occupational rules impacting small businesses are state or municipal regulations, not federal. The U.S. Department of Labor already runs a small grant program for certain states to help streamline licensing.[324] Congress should build on these efforts by rewarding regional governments that trim significant amounts of overly burdensome licensing regulations or develop interstate pacts to recognize licenses granted by other participating states.[325] To provide proper incentives, the fund should allocate credits in proportion to the total hours, or compliance costs, that small businesses are estimated to save from the policy changes. The fund should also accept applications from state or municipal governments to fund feasibility studies, to help policymakers deregulate efficiently and responsibly.

One way to ease regulatory burdens is implementing certification systems instead of licensing requirements. Business certifications help consumers identify high-quality service providers without blocking the entry of new providers. Federal lawmakers should establish a commission to identify federal licenses—in sectors that do not implicate public health or safety—that could easily be replaced with certifications. The new federal incentive fund for states should also reward states that replace licenses with certificates.

Policies like this have been proposed before, though never implemented. Former Democratic nominee Hillary Clinton, during her 2016 presidential campaign, advocated creating "new federal incentives" for state and local governments to cut red tape.[326]

### EXTEND UNEMPLOYMENT BENEFITS TO FOUNDERS TO DE-RISK ENTREPRENEURSHIP

The risk of business failure is one of the biggest barriers to entry for any entrepreneur. And for low-income and minority founders, this risk is particularly acute. Lower household wealth in Black and Latinx communities—roughly equal to one-tenth of median white household wealth—means many minority founders have no cushion against business failure.

But the government can reduce these risks—and give disadvantaged founders the runway to launch companies—by extending unemployment benefits to entrepreneurs. Founders dedicate themselves full-time to their new ventures, often leaving other jobs with stable income to do so. Starting a company, though, typically disqualifies them from unemployment benefits, even if their business ultimately fails. Many more prospective entrepreneurs, and particularly disadvantaged ones, would take the risk of launching their businesses if they knew they could access benefits in the worst-case scenario.

The federal government should create a financial cushion for entrepreneurs by:

1. Allowing unemployed workers to claim full unemployment benefits after their business fails, if it fails within three years of their having left a previous job to found it. These unemployment benefits would extend for the same length of time that the unemployment policies currently in place within each state provide.

2. Creating new incentives for state governments to offer unemployed workers Self-Employment Assistance (SEA). SEA programs pay unemployed workers full benefits for working full-time to launch a new venture, rather than searching for a job. Five states—Delaware, Mississippi, New Hampshire, New York, and Oregon—have already collaborated with the Department of Labor to set up SEA systems.[327] To incentivize more to follow suit, lawmakers should offer grants for states that start offering SEA.

Policies like these have been tried before. In 2001, the French government passed unemployment reforms that expanded benefits to entrepreneurs whose businesses had failed.[328] Right after they did so, business formation jumped 25 percent. Subsequent research attributes much of this jump to the new law.[329] Firms launched under the new policy, moreover, were more likely than others to hire workers and tended to be more productive.[330] Similarly, past research on New York's SEA program finds that roughly one-third of beneficiaries successfully launched their ventures.[331] These findings only reinforce the idea that the downsides of business failure keep qualified, talented founders from launching ventures—and that policymakers can empower these individuals.

## STRENGTHEN ANTITRUST LAW AND ENFORCEMENT

Historically, the federal government used antitrust law as a counterweight to corporate consolidation. Beginning in the 1970s, however, conservative courts began reinterpreting antitrust law in ways that weakened existing statutes. In particular, courts moved from examining restraints on trade in terms of impact on competitive businesses to impacts on consumer welfare. This ultimately led courts to accept forms of vertical integration and vertical restraints on trade that had previously been seen as anti-competitive. Courts also made it more difficult to prove that dominant firms had engaged in anti-competitive pricing; grew more permissive with respect to mergers even when they resulted in substantial industry consolidation;[332] and made it more difficult to establish standing for bringing antitrust suits.[333] The shifts in the courts were mirrored by shifting Congressional sentiment and by federal agencies' greater tolerance of anticompetitive behavior.[334] Federal antitrust investigations, despite a temporary uptick in the 1990s, have plunged from their 1971 peak of nearly 600 to barely 100 in 2018.[335]

Not coincidentally, rates of new business formation over the same time period have declined, as have the number of small enterprises in sectors like retail and manufacturing.[336] The past 15 years, in particular, have witnessed substantial industry consolidation, with a small number of large corporations in most sectors controlling an ever-larger percentage of market share.[337] For example, afour companies control 60 percent of the global market in agricultural seeds and the top four airlines in the United States. account for roughly 65 percent of domestic air travel.[338]

Establishing more competitive markets is a critical step in reviving the entrepreneurial energies of the United States. While a full treatment of antitrust reform is outside the scope of this report, we recommend:

1. Passing new legislation to:

    A. **Address the market power of dominant digital platforms.** These companies function as gatekeepers to online markets, a position they can exploit to impose onerous fees and extract valuable data from small businesses, including data that they can use to compete against them.[339] New legislation is needed to remove these conflicts of interest and ensure that the essential infrastructure of modern commerce is available to small businesses on fair and non-discriminatory terms.

    B. **Strengthen existing antitrust law by** (a) vacating case law that inappropriately limits the ability of enforcers and private plaintiffs to challenge exclusionary conduct like predatory pricing by dominant firms in general and two-sided markets, such as online platforms, in particular, (b) clarifying that antitrust laws protect potential competition, (c) establishing legal rules that, in appropriate cases, require defendants to prove their conduct does not harm competition and

2. **Updating merger guidelines** to more strongly consider overall market structure and how further market consolidation will impact potential new entrants.

3. **Vigorously enforcing existing antitrust law** at the federal level, including via coordination with State Attorneys General.

4. **Establishing a new federal funding program at the U.S. Department of Justice** to support State Attorneys General to build capacity for antitrust lawsuits.

## Policy Recommendation IV:
### Replicate proven organizations and models that help small businesses scale

As we laid out above, small businesses flourish with the support of institutions designed for financing, counseling, market-making, and other services. Federal programs are not a substitute for strong local incubators, Community Development Financial Institutions (CDFIs), public development corporations, Chambers of Commerce and other organizations. Rather, federal programs are a complement, and have the greatest impact when local organizations help small businesses access federal resources and leverage federal dollars through additional public and private investment.

However, not all regions of the country benefit from the same quantity or quality of these "ecosystem" institutions. Some metropolitan areas like Los Angeles and Philadelphia, for example, have a strong network of CDFIs, which has enabled them to design and deliver special initiatives that are tailored to particular communities or segments of the business community. But many other areas do not have this.

We identified six functions of government, nonprofit, and private organizations that help make up small-business ecosystems. To best support small businesses, these actors should individually or collectively perform each of the following:

- **Market Data:** First, maintain real-time information on the number, size and sector of small businesses in general and minority and women-owned business enterprise (MWBE) in particular. Local 'scorecards' of this kind will help communities set reasonable targets for recovery from COVID-19 and measure progress against ambitious targets for small-business creation. A local scorecard should also capture capital flows into small businesses, the availability of debt financing, and similar measures.
- **Procurement Data:** Second, routinely collect data, set goals and publicly report progress on the procurement spend of large "anchor institutions" from minority- and women-owned businesses. By anchor institutions, we mean public-sector entities, educational and medical institutions and major corporations. Ideally, a strong ecosystem should be capable of matching the demand coming from anchor institutions with the supply of minority- and women-owned businesses that can meet these needs; in other words, market-making.
- **Education & Mentorship:** Third, identify, nurture, mentor, support and help firms develop intentional business strategies and gain access to the network of providers that offer the most up-to-date information on such practices as accounting, borrowing, leasing, legal, tax, hiring, technology, marketing and customer and supplier relationships. A strong ecosystem should also provide access to investor networks to marry technical assistance with capital provision, along with practices to support financial planning and fundraising.
- **Access to Capital:** Fourth, provide access to high-quality, affordable, and responsible capital across a broad continuum that is aligned with the needs of small businesses at different stages of their lifecycles and in disparate sectors. The continuum of capital should extend beyond traditional debt products and include grants, equity investments, equity-like products (e.g., revenue-based financing) and tax advantaged capital. Doing

this well takes skilled small-business finance professionals who understand how to structure transactions and the full range of capital sources. Good delivery systems also have robust customer-referral mechanisms, to ensure different organizations meet the unique needs of small firms.

- **Business Districts:** Fifth, manage and market the business districts and commercial corridors where many small businesses congregate and co-locate. Special intermediaries include merchant associations, business-improvement districts, community development corporations, and (where they exist) entrepreneurial incubators and accelerators.
- **Networking:** Finally, foster peer-to-peer networks among small-business owners and entrepreneurs to share resources and advice, serve as prospective buyers of other local businesses, and build collective action to inform and influence ecosystem strategies and initiatives

In performing these functions, these institutions should mobilize local, state and federal resources as available and create channels to help entrepreneurs navigate public programs.

Currently, the federal government only provides resources for a small portion of the capacities that strong local ecosystems need. To their credit, the SBA and MBDA do support groups that provide technical assistance to small businesses—SBDCs and MBDCs, respectively. However, much more can be done, and by supporting the right intermediary organizations, federal small-business programs can have a dramatically greater impact.

## PIONEER NEW LOCAL ECOSYSTEMS THAT MAXIMIZE FEDERAL RESOURCES AND SMALL-BUSINESS OUTCOMES

Congress should establish a multi-year Small Business Ecosystem Demonstration Project to catalyze and evaluate new ways of driving transformative small-business outcomes through integrated systems of business support, capital access, business district regeneration, and anchor demand.

The Demonstration would be authorized at $275 million per year. Funding would be allocated via competition. Eligible applicants would include networks of key small-business stakeholders, including key representatives from the public, corporate, philanthropic, university, community, financial, and small-business sectors. Applicants could represent a city, county, metropolitan area or state.

Applicants would present concrete plans for investing in intermediaries that match up the demand side (e.g., purchasing of goods and services), the supply side (e.g., formation, growth, and interconnectivity of companies) and capital access in ways that are synergistic and sustained. Applicants would present baseline information on the number, scale and sector of underserved businesses and offer concrete goals around impact and reach.

The Demonstration would provide ten winning applicants $25 million over five years; the Demonstration would require one-to-one matching to extend impact.

The Demonstration would also award $25 million in planning grants to help communities prepare to apply in subsequent years. The Department of Housing and Urban Development has used planning grants to great effect in the Choice Neighborhoods Program. Technical assistance from reputable national organizations would be provided to awardees.

The Small Business Ecosystem Initiative Demonstration would be a key component of the enhanced Policy Development & Research function, described below. The scaling of Business Ecosystems will depend on the rapid codification and sharing of successful models as they emerge.

## EXPAND FUNDING FOR COMMUNITY LENDERS TO PROVIDE TECHNICAL ASSISTANCE

CDFIs and other community lenders, as discussed above, are highly adept at finding promising businesses in low-income communities. Some CDFIs, in addition to financing such businesses, also provide technical assistance. But not enough do.

The SBA already sponsors some community lenders' technical assistance with grants through its Microloan Technical Assistance program. Congress can kickstart more high-impact technical assistance, delivered through CDFIs, by boosting appropriations for these grants threefold, to at least $100 million. To ensure recipient lenders spend these grants effectively, the SBA should also place greater requirements on lenders to track the outcomes of firms using their technical assistance—along the lines of the data recommendations, below. The Treasury, drawing from its expertise from the CDFI Fund, and the SBA should then establish a working group to determine, based on this data, a set of best practices for CDFI-provided technical assistance. These reforms would empower the institutions best situated to identifying and funding viable businesses in underserved areas.

### MARSHAL COMMUNITY RESOURCES FOR COMMUNITY LENDERS TO RECEIVE TECHNICAL ASSISTANCE

Many community lenders, particularly small ones, are in sore need of technical training themselves.[340] Small, younger lenders in particular could widely benefit from business coaching and training in accounting and financial analysis—skills that they might then pass on to borrower businesses. The federal government can provide some such support, including by increasing technical-assistance grants through the CDFI Fund, proposed in Pillar 1 above. But platform organizations that serve as the focal points for local business ecosystems could play an even larger role. Intermediaries should connect larger financial institutions with smaller community lenders to provide pro bono mentorship. They should also place requirements on growing community lenders that benefit from such mentorship to help train other small lenders in future.

Importantly, community-lender technical assistance should focus on responding to the unique challenges of the COVID-19 crisis. In many communities, for instance, mixed-use commercial and residential buildings have been hit hard by recent retail closures,[341] yet these buildings' developers often have trouble accessing federal loans.[342] Platform organizations should convene community lenders and the operators of these buildings to develop financial products that serve mixed-use buildings' particular needs. And platforms should do the same for other borrower interests in their communities.

### EXPAND THE SBA'S REGIONAL INNOVATION CLUSTER (RIC) PROGRAM AND THE DEPARTMENT OF COMMERCE'S REGIONAL INNOVATION STRATEGIES (RIS) PROGRAM

Innovation clusters are place-based networks of interdependent firms, including producers, suppliers, research institutions, customers, and investors within a specific industry or set of related industries that collaborate and compete with each other.[343] Clusters, in recent years, have gained increasing recognition as powerful hubs for innovation. For example, the Water Council in

Milwaukee has situated Milwaukee as a global leader in the water industry. The Council runs water technology innovation contests, intensive tech training programs, publishes research on industry trends, and works closely with small businesses in the water industry, providing capital, training, networks, supply chains and technical assistance.[344]

The federal government runs multiple programs that make grants to organizations like The Water Council (that support industry clusters), most notably the SBA's Regional Innovation Cluster (RIC) program and the EDA's Regional Innovation Strategies (RIS) program. Support for clusters surged during the Obama administration, after a series of studies documented clusters' positive impacts on innovation, job creation, and regional development.[345] By President Obama's second term, over 70 clusters had received $250 million funding from the SBA and EDA.[346] These initiatives delivered impressive results. Within SBA-backed clusters, business revenue and wage growth significantly exceed other businesses' in comparable industries and geographies.[347]

In recent years, RIC funding has been well below its post-financial crisis peak of $10 million annually, and the Trump administration has recommended no RIC appropriations for FY2021.[348] To address this latest crisis, which has hit small businesses even more severely, the government must expand RIC funding, rather than contracting it. Lawmakers should commit another $100 million to RIC grants over the next four years. They should appropriate this same amount over the next four years for additional RIS grants, which would double the program's current grantmaking. Doing so will simultaneously advance cutting-edge innovation and support struggling communities. Federal funding, importantly, can be of huge consequences to clusters. Survey data show that clusters perform best when they have multiple funding sources—including both public and private backing—which simplifies their budgeting process and reduces time spent on fundraising.[349]

## TAILOR EXISTING PROGRAMS TO MINORITY COMMUNITIES

Federal agencies sponsor hundreds of technical offices around the country. But apart from the centers run by the MBDA, few of the centers are currently reaching disadvantaged minority business owners. Federally sponsored technical-assistance centers should make the following three reforms to expand their programs' reach and improve minority-owned businesses' experience:

1. Solicit minority clients: SBDCs and other federal centers field questions from businesses that seek their help, but they rarely advertise their services to nearby commu-

nities. This practice should change. SBDCs and other centers should receive a budget allocation dedicated solely to community outreach. As part of their outreach strategies, technical centers should receive funding for focus groups that can inform their marketing strategies for minority groups.[350]

2. Make existing programs accessible: Even when minority-owned businesses locate federal assistance centers, those centers' training programs materials may benefit them less than other businesses. Immigrant founders, for instance, may require training in languages other than English.[351] Many SBDCs also limit access to minorities by not adopting mobile-friendly curriculum, as minorities rely more heavily on mobile devices to consume information than other groups.[352] Training centers should tailor their programs in these ways to the communities they serve.

3. Introduce role models: Research shows that mentorship is most effective when mentees perceive similarities between their mentors and themselves.[353] To help disadvantaged minorities get the most out of training, technical centers should commit to hiring staffers and mentors from the communities they serve. Centers should also retain connections with minority alumni of their programs and ask these alumni to return for periodic seminars or other training. Seeing the successes of minority business leaders helps other minority founders succeed.[354] Alumni programs, which could connect new founders to high-achieving minority entrepreneurs, could also help minority founders build long-term business relationships that boost their success.[355]

SBDCs and other centers are most likely to achieve these goals when they collaborate with existing community intermediaries, like Chambers of Commerce, counseling programs, and community lenders.

## STEP 3

# Shape a Financial System that Works for Main Street

**SUMMARY:** *Small businesses cannot launch, grow, or survive downturns without access to credit. There is a deep market for credit in the United States., with products that range from traditional, secured, short-term, low-interest bank loans to business credit cards to unsecured, high-interest, short-term loans from alternative and "fintech" lenders. But minority small-business owners still struggle to access credit because they are more likely to have had personal credit challenges that make it difficult to get bank lending, and are less likely to be connected by strong social and business ties to bankers. Meanwhile, the consolidation of the banking sector has dramatically reduced the number of community banks in the United States—which invest a significantly higher percentage of their assets in small-business loans and are more likely to lend on a holistic basis. The combination of these factors means that many small businesses which could successfully borrow and repay capital cannot get loans. At the same time, would-be minority entrepreneurs face additional barriers in finding start-up capital because they are more likely to come from low-income backgrounds and are therefore less likely to have access to capital from friends and family, and additionally, because equity investing is a highly networked industry.*

*To address these challenges, we recommend creating a new generation of federally backed debt and equity products that can meet diverse market demand, including launching a new first-loss guarantee loan program for technology-driven, non-bank lenders and giving as well as allowing existing lenders permission to offer traditional SBA 7(a) loans but with much shorter duration and more flexibility on interest rates. Congress should also permanently increase the 7(a) guarantee for disadvantaged borrowers to 90 percent and eliminate the fees it collects from banks on those loans; help CDFIs get into the 7(a) lending business; prioritize Community Advantage lending; restore the State Small Business Credit Initiative (SSBCI); and take steps to make Small Business Investment Companies (SBCICs) more impactful.*

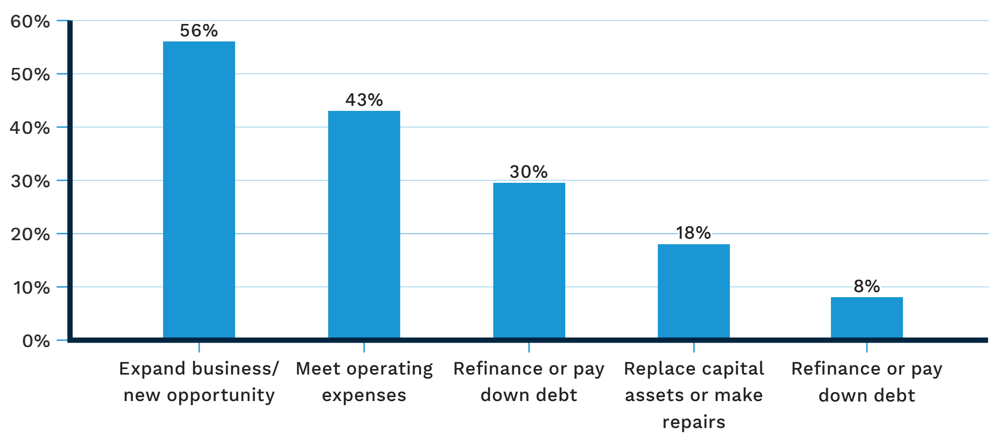
*We also recommend taking steps to strengthen financial institutions that focus on small-business formation and growth, including making interest on deposits held by independent community banks tax exempt; reducing regulations and fees on community banks; restarting the Small Business Lending Fund at the U.S. Treasury Department; updating the Community Reinvestment Act to drive investments in low-income communities; strengthening programs to support CDFIs; and expanding and making the permanent New Markets Tax Credits.*

## How Small Businesses Access Capital

Credit is essential for all aspects of small businesses' operations. In 2019, 43 percent of small employer businesses applied for external financing, and from 2015 through 2019, 85 percent used external credit.[356] Small businesses rely on credit to cover operating costs like payroll, to finance expansions, and to weather economic slowdowns or unexpected sales shortfalls.

FIGURE 31

**REASONS SMALL EMPLOYER FIRMS SOUGHT FINANCING IN LAST 12 MONTHS[357]**

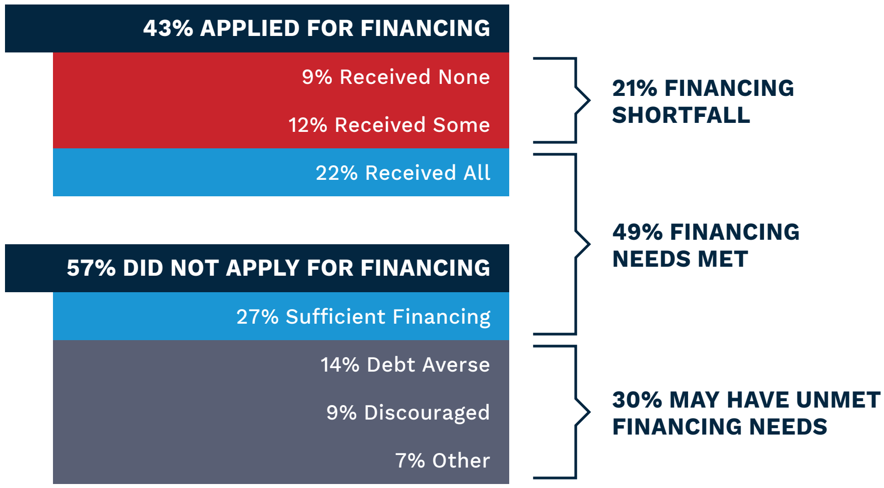



Percentage of firms selecting each option, may select multiple responses, N:2384

Of course, lenders do not find all firms equally creditworthy.[358] Among employer applicants for credit over the past year, 78 percent of businesses report receiving at least some of the credit they sought.[359] Applicants who were denied credit overwhelmingly attribute their denial to issues with their creditworthiness.[360]

FIGURE 32

**SMALL EMPLOYER-BUSINESS FUNDING UNIVERSE, LAST 12 MONTHS**[361]

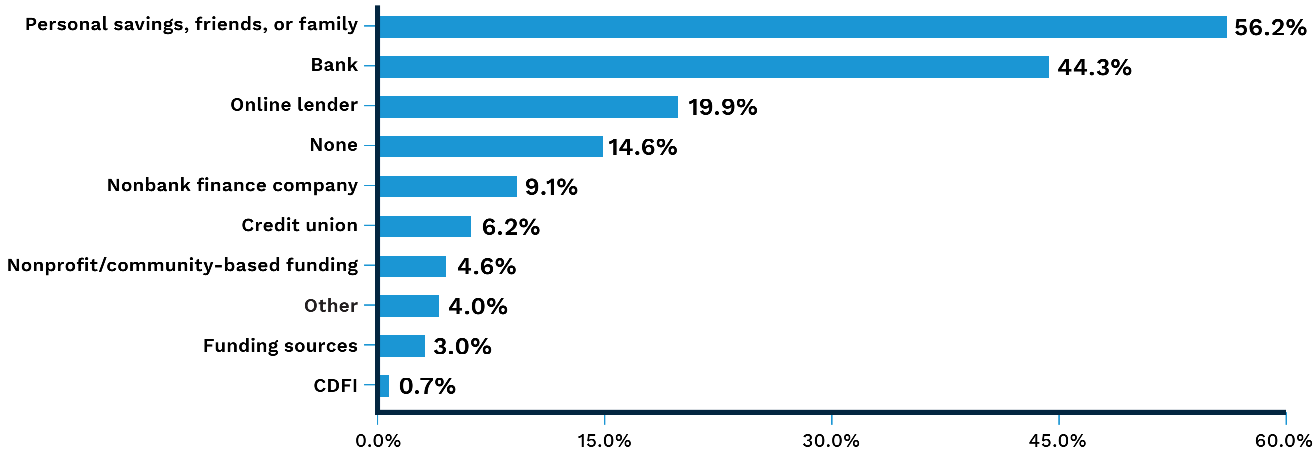



There is variety, however, in where and how small businesses access capital. Business owners' most common sources of financing are their own assets, or the assets of their friends and family. Between 2015 and 2019, 56 percent of small employer businesses drew from such assets, more than any other source.[362] And in 2018, 41 percent non-employer business owners described personal funds as their primary business funding source.[363] Personal and related-party assets are also the first financing source that most small businesses use, as lenders prefer founders that contribute reasonable equity to their firm. At startups, just 35 percent of small businesses access funds besides personal and related-party assets.[364] And owners' personal assets continue to play a key role after founding. In the event of a two-month revenue loss, 47 percent of business owners report they would support their firm with personal funds.[365] For many small businesses, in other words, the lines between personal credit and firm credit are blurry.

Banks are the next most common credit provider. Between 2015 and 2019, more than 44 percent of small employer businesses report accessing bank credit. Online lenders and non-bank finance companies, however, are also important sources, as the chart below shows. Financing from non-bank sources picked up after the 2008-2009 financial crisis, when large banks significantly cut back their small-business lending.[366]

FIGURE 33

**EXTERNAL FUNDING SOURCES USED IN PAST 5 YEARS BY SMALL EMPLOYER FIRMS**[367]

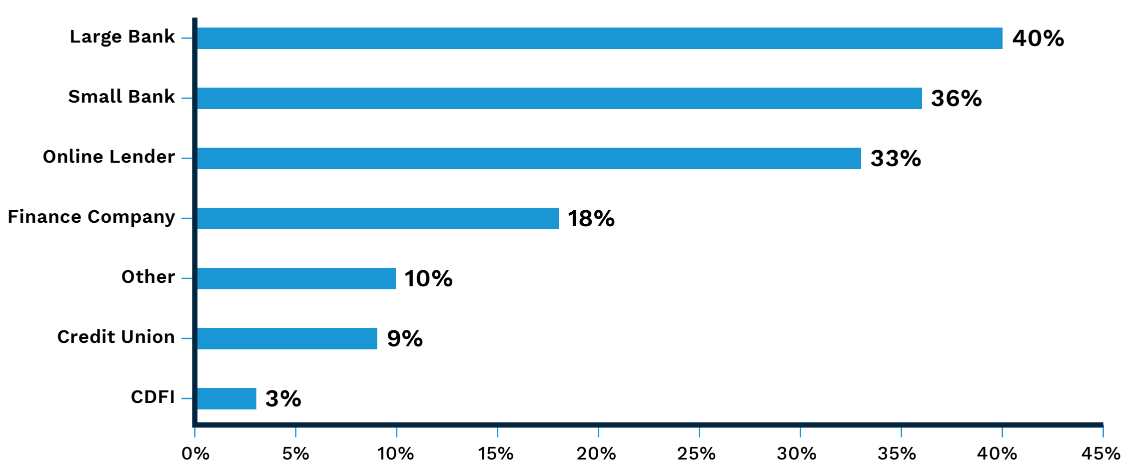



May select multiple responses, percentage of firms, N: 5148

As Figure 34 indicates, data on small-business credit *applications* tell a similar story, with small businesses preferring banks, then online lenders, then alternative lenders. Notably, small banks punch well above their weight in small-business lending. Small banks* accounted for just 5.6 percent of industry assets in Q1 2020 but received almost as many loans applications from small businesses as large banks (36 percent vs. 40 percent).[368]

FIGURE 34

**CREDIT SOURCES APPLIED TO FINANCING IN LAST 12 MONTHS BY SMALL EMPLOYER FIRMS**[369]



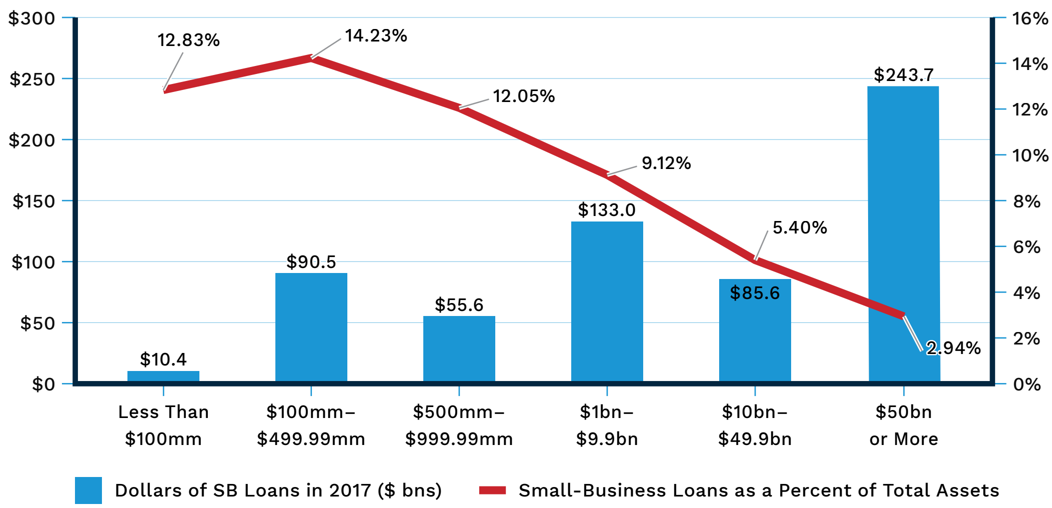

May select multiple responses, percentage of firms, N: 1901

* The definition of "small bank" varies. The 5.6 percent figure refers to banks with under $1 billion in assets.

An extensive literature on small banking explains why small businesses disproportionately borrow from small banks. Small "community banks" usually have a regional focus and are independently owned.[370] Community banks use their personal expertise and local knowledge to extend credit where other banks have less information, and where standard underwriting methodologies may pass over good lending opportunities.[371] Not surprisingly, smaller banks' portfolios include greater shares of commercial loans under $1 million, which is a proxy for lending to small businesses, as the chart below illustrates.

FIGURE 35

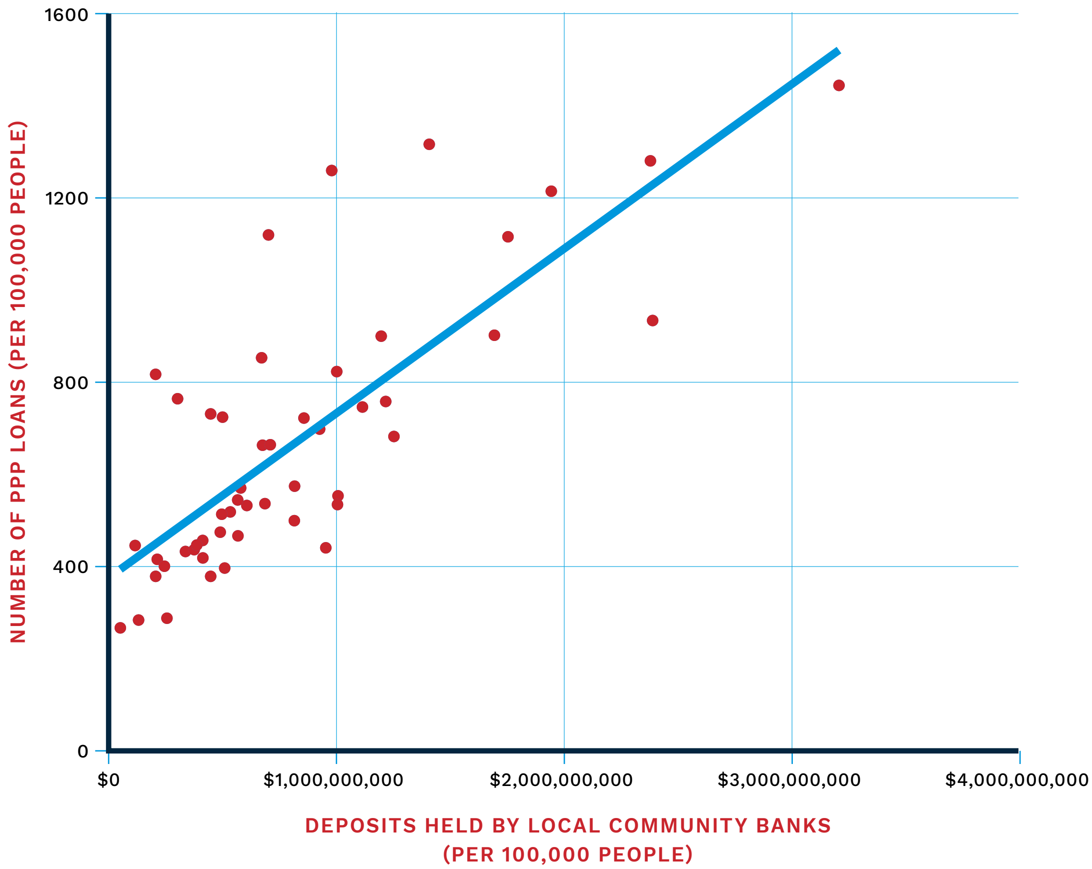
**SMALL-DOLLAR LOAN PORTFOLIO BY SIZE OF BANK, 2017**[372]




Community banks' outsized role in lending to small businesses was visible in the distribution of PPP loans in March and April of 2020. During the first phase of PPP, a state's concentration of community banks strongly predicted the number of loans received during the first phase of PPP.[373] This is largely because these banks tend to have close-knit relationships with small businesses and more staff dedicated to serving them.[374]

FIGURE 36

**LOAN APPROVALS BY COMMUNITY-BANK PRESENCE**[375]

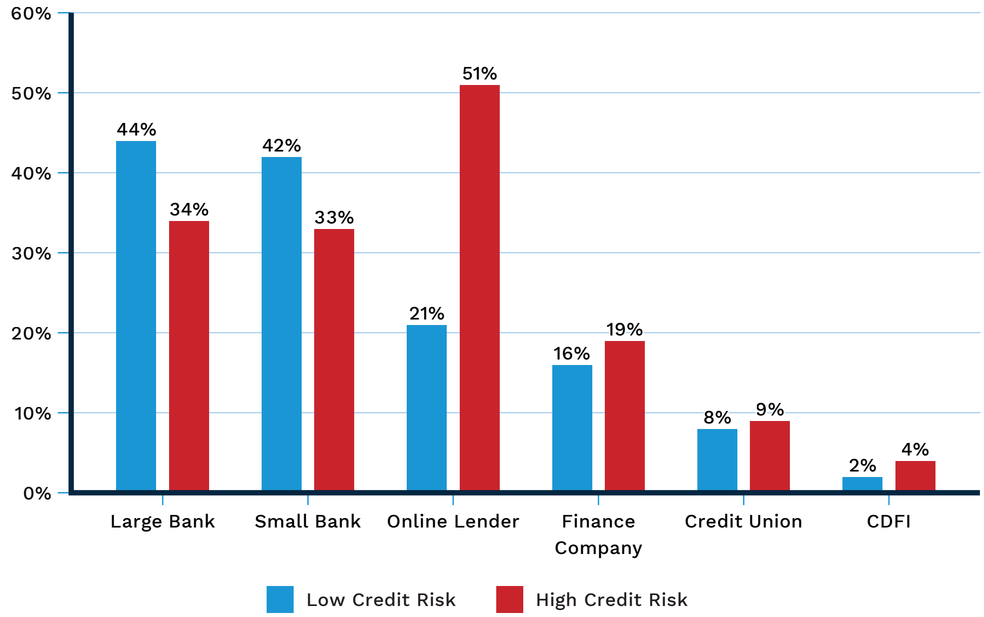



When small businesses cannot borrow from banks, many use alternative lenders, like non-bank finance companies, often operating primarily online. Businesses report turning to these lenders for reasons including like speed and greater likelihood of approval.[376] These lenders are more likely to offer unsecured, shorter-term loans with higher interest rates.

The small businesses borrowing from these non-bank lenders tend to be firms with riskier credit ratings, to which banks are unlikely to lend. The chart below, which shows the credit-rating distribution of applicants to various lenders, illustrates this trend. Low credit-risk firms overwhelmingly prefer to apply to banks and are less likely to apply to alternatives.

FIGURE 37

**CREDIT SOURCES APPLIED TO BY CREDIT RISK OF SMALL-FIRM APPLICANT**[377]




May select multiple responses, percentage of firms, N: 861 (low risk), 665 (high risk)

This segmentation in capital markets reflects variation in lender risk appetite and capital-return expectations. Because of their role in the economy, banks are subject to significant capital and liquidity regulations. These rules require banks to monitor regulatory metrics of balance-sheet risk closely and constrain banks' risk appetite. As a result, banks' small-business lending usually involves secured lending at moderate rates to small businesses with relatively limited risk. This is a viable business model for institutions that source inexpensive funding from deposits and must place a priority on consistent, safe, returns.[378]

Alternative lenders are different. They are not subject to the balance sheet regulation of banks and have more diverse sources of capital from investors with greater risk tolerance. This allows them to offer riskier loans—usually without collateral or other traditional underwriting requirements—at higher interest rates. Higher returns are necessary to compensate investors for the higher risk of this lending model.

Alternative lenders fill multiple niches for businesses that do not receive bank financing. Some lenders, relying on business models that give them speed and information advantages over banks, make short-term loans that provide companies working capital. These lenders' products include conventional business credit cards, as well as facilities that price credit based on firms' historic revenue patterns. Many payments-processing companies—from Amex and MasterCard to newcomers like Stripe and Square—are substantial lenders in this space. Payments processors' insights into clients' revenue streams let them underwrite risk cheaply and accurately and make loans accordingly. These fintech newcomers offer credit mainly as a service to their network members, whereas these loans drive significant revenues for longtime lenders like Amex and MasterCard. Other alternative lenders extend loans to riskier companies over longer time horizons, on terms between short-term, unsecured credit card debt and traditional, secured bank loans. Companies of this type succeed by looking past traditional metrics like credit ratings and relying instead on other, often alterative-data-driven, metrics of business and customer behavior.[379] The economic effects of COVID-19, however, have caused some upheavals in this space. Already this year, major online lenders OnDeck and Kabbage have announced they will be acquired, respectively, by Enova International and Amex.[380]

Some alternative lenders act primarily as intermediaries, originating loans on behalf of investors or quickly securitizing loans for resale. These lenders typically hold only a small portion of the loans they originate on their balance sheets for investment.[381] Banks sometimes also sell off significant amounts of the small-business loans they originate, especially in the 7(a) market. Banks like Live Oaks and First Home run robust lending operations for small businesses borrowing 7(a) and 504/CDC loans, and in some cases these banks sell or securitize the guaranteed portions of those loans, which have characteristics similar to a federal bond.[382]

The first chart below categorizes lenders according to the two axes referenced above: (1) the extent to which they hold loans on their balance sheets or originate and resell and (2) the time horizon of their lending. Traditional banks are in the top-right corner, lending long-term and keeping most of their small-business loans on their balance sheet. Credit-card companies are in the top left, extending loans of shorter duration than banks. Online lenders, which more commonly resell loans, are spread across the bottom of the table. And, as the following two tables illustrate, these lenders' interest rates vary widely by lender and loan product.

FIGURE 38

**EXAMPLE LENDERS***

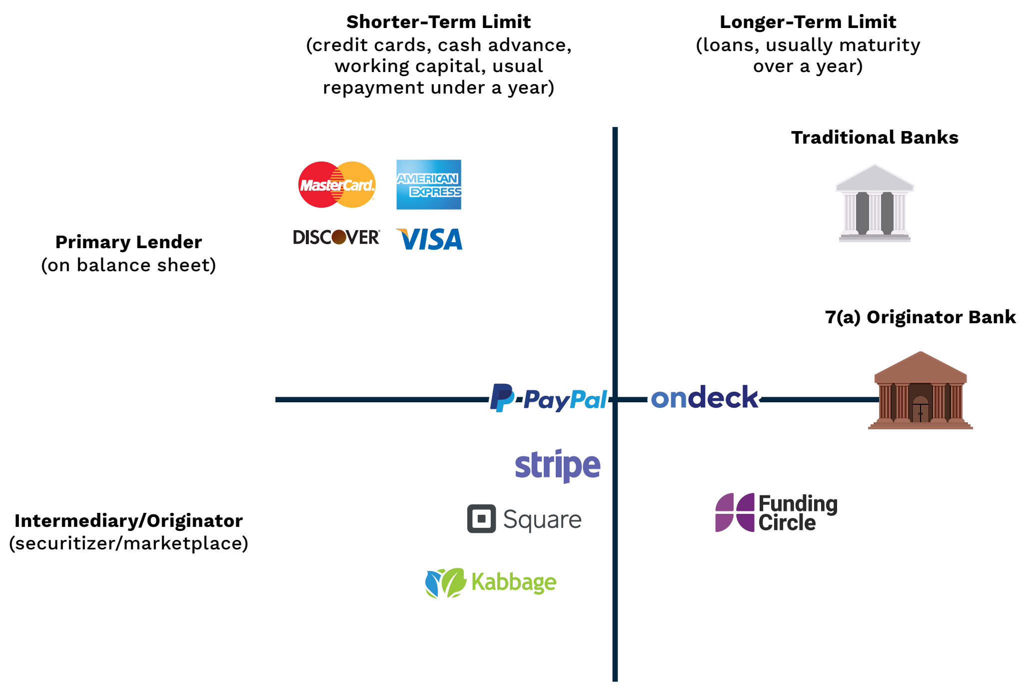



FIGURE 39

**AVERAGE ANNUAL INTEREST RATE BY LENDER**[383]

| Type of Lender | Average Annual Interest Rate (AIR) | AIR for SBA Loans |
|---|---|---|
| **Large National Banks** | 2.55%–5.14% | 6.24% |
| **Small National and Regional Banks** | 2.48%–5.40% | 5.96% |
| **Foreign Banks (U.S. Branches)** | 1.45%–5.66% | N/A |
| **Online or Alternative Lenders** | 13%–71% | 4.39%–7.01% |

* See Appendix 2 for a brief review of the activities of these lenders.

FIGURE 40

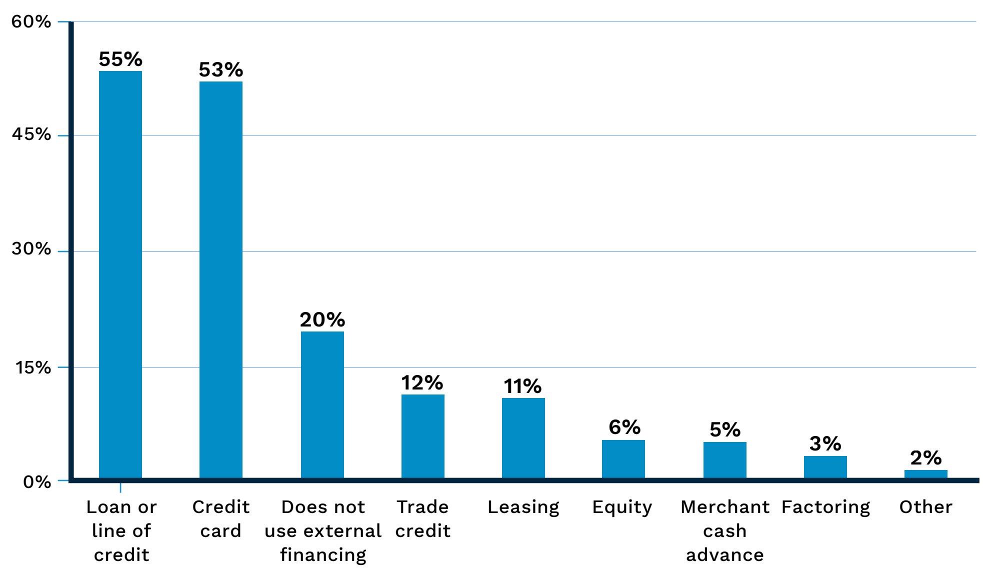
**AVERAGE ANNUAL INTEREST RATE BY PRODUCT**[384]

| Type of Loan Product | Average APRs |
|---|---|
| Bank Loans | 4%–13% |
| SBA 7(a) Loans | 6.30%–10% |
| Online Term Loans | 7%–99.70% |
| Lines of Credit | 8%–80% |
| Merchant Cash Advances | 20%–250% |
| Invoice Factoring | 13%–60% |

As for the *types* of credit that small businesses use, the first chart below shows that borrowers favor two forms of lending: (i) loans and lines of credit, which 55 percent of small employer firms use regularly, and (ii) credit cards, which 53 percent use regularly. Businesses often obtain loans and credit lines to support a specific long-term project, and these products are usually secured when issued by banks. (Loan-like products from online lenders, however, are rarely secured.) Conversely, credit cards provide short-term, unsecured, borrowing drawable for any reason. Survey responses suggest credit card drawings usually fill temporary liquidity gaps for small firms.[385] And among credit-card users, as the second chart below shows, over 50 percent of small employer businesses use a personal card at least some of the time.

FIGURE 41

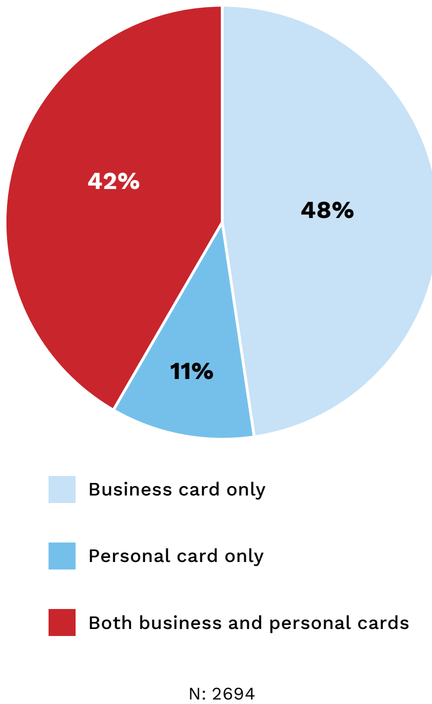
**TYPE OF FUNDING REGULARLY USED BY SMALL EMPLOYER BUSINESSES**[386]




May select multiple options, N: 5100

FIGURE 42

**TYPES OF CREDIT CARD USED TO FUND SMALL EMPLOYER BUSINESS**[387]



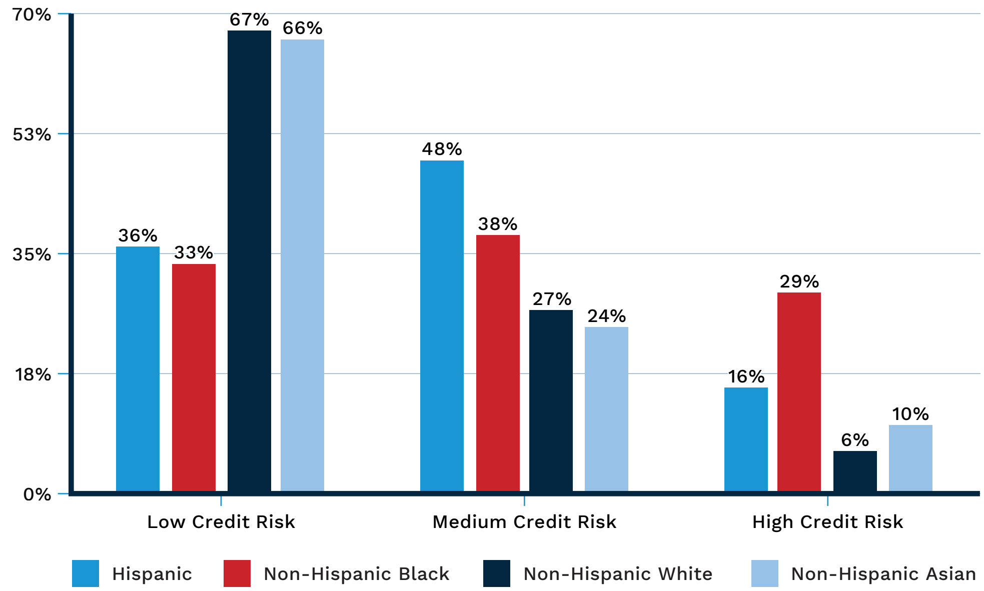

## Understanding Gaps in Capital Markets for Small Businesses

Despite the range of lenders and loan products available, many minority borrowers still struggle to access capital. Black and Latinx businesses owners, even after controlling for other factors, are significantly less likely than other borrowers to receive bank loans.[388] And when minority-owned businesses do receive credit, they frequently get less than they are seeking.[389]

Much of the racial disparity comes down to credit quality. Hispanic- and Black-owned small businesses, as the first chart below shows, report much worse credit quality than white- and Asian-owned small businesses. Nearly 30 percent of Black-owned employer businesses report being in the highest credit-risk category, along with almost 16 percent of Hispanic-owned businesses. In contrast, white and Asian-owned employer businesses are in the high-risk category just six percent and ten percent of the time, respectively. Academic research since the early 2000s documents a similar trend.[390] And as the second chart below indicates, Black and Hispanic owners' higher risk ratings translate directly into credit denials.

FIGURE 43

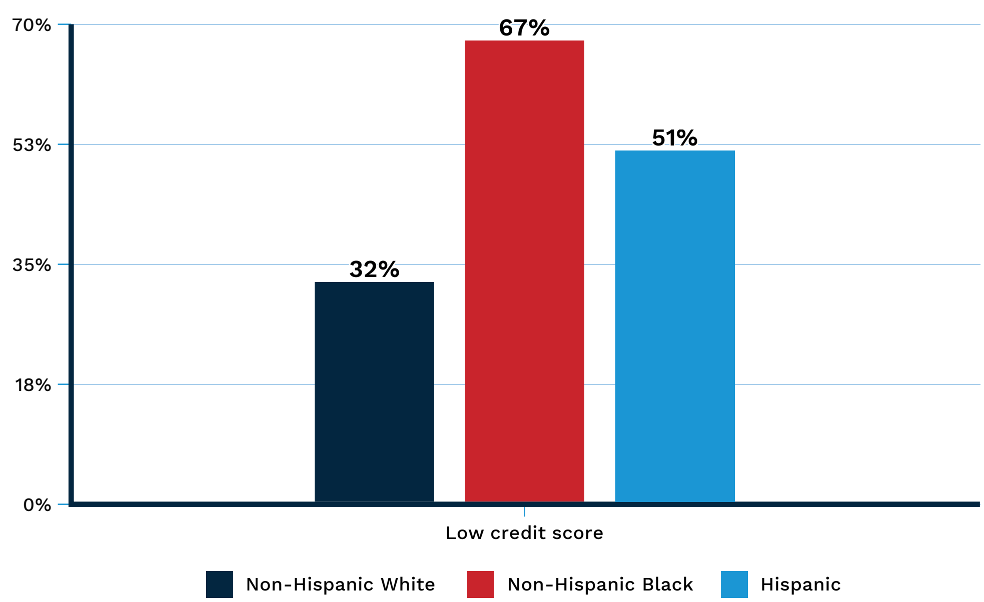
## DISTRIBUTION OF SMALL EMPLOYER BUSINESSES BETWEEN LOW, MEDIUM, AND HIGH CREDIT-RISK CATEGORIES BY ETHNICITY OF OWNER[391]




Percentage of firms, N: 292 (Hispanic), 438 (White), 95 (Black), 72 (Asian)

FIGURE 44

## EMPLOYER BUSINESSES CITING LOW CREDIT SCORE AS A REASON FOR CREDIT DENIAL IN LAST 12 MONTHS[392]




Percentage of respondents, may select multiple options, N: 438 (White), 95 (Black), 72 (Hispanic)

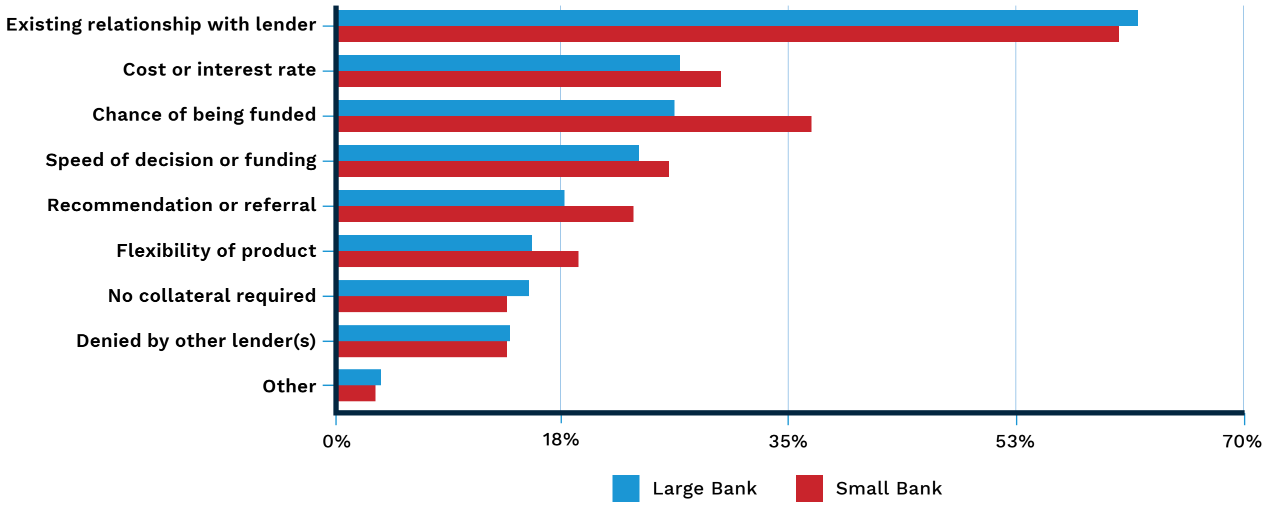
The credit challenges of minority-owned *businesses* stem, at least in part, from the lower *personal*-credit ratings of their owners. For small-business loans, banks typically look at personal credit when making lending decisions, which in essence translates owner-level credit disparities into business borrowing. Indeed, as the Federal Reserve points out, personal credit scores are often the most important indicator to which lenders look, especially lenders without a personal relationship to the borrower.[393] Banks can also require borrowers to collateralize loans with personal assets or personally guarantee loans: 30 percent of small employer-business owners report directly collateralizing loans with personal assets, and 59 percent offered personal guarantees to business loans.[394] Black and Hispanic Americans, however, are less well positioned than other business owners to have assets available to use as collateral or to guarantee credit personally. These groups tend to have lower personal credit ratings,[395] lower incomes, and less household wealth than others.[396] As highlighted above, the median Black and Hispanic household income is 59 percent and 88 percent, respectively, of the white household average.[397] These households' average net worth is 15 percent and 20 percent, respectively, of the White household average.[398]

These wealth disparities make it hard for Black and Latinx business owners to source investments from their own assets or family's assets—businesses' most common funding source. Wealth disparities, as a result, influence not only how businesses grow but who launches businesses in the first place. Lower wealth reduces minority entrepreneurs' access to startup capital, and it hinders minority business owners' abilities to expand operations and weather downturns. Small businesses, to a large extent, remain only as creditworthy as their owners.

Importantly, the negative impacts of low credit ratings compound over time. As the following chart shows, most borrowers point to preexisting relationships as their main reason for sourcing loans from banks. For firms starting out with low personal or business credit, however, these bank relationships that facilitate future borrowing are hard to forge, especially because of the consolidation of the banking sector.

FIGURE 45

**REASONS SMALL EMPLOYER FIRMS APPLY TO BANKS FOR FINANCING**[399]




May select multiple responses, percentage of firms, N: 708 (large banks), 690 (small banks)

For firms starting out with low personal or business credit, however, these bank relationships that facilitate future borrowing are hard to forge.

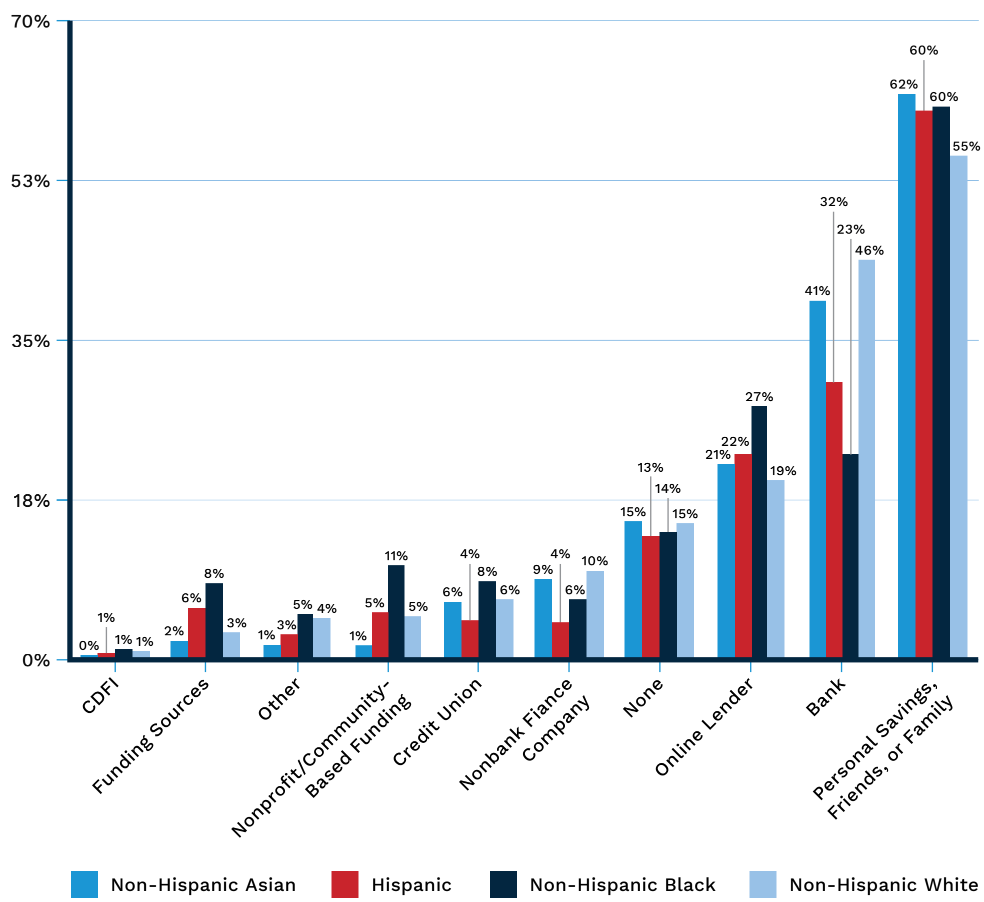
From bank lenders' standpoints, credit scores are a useful indicator of creditworthiness; banks have strong incentives against lending to low-rated firms. Lending to low-rated borrowers can also harm banks' standing with regulators, whose capital assessments penalize banks for risky loan portfolios.[400] Disparities in credit scores harm the small-business sector, whereby low personal credit scores disqualify otherwise strong loan applicants.

Credit scores, to be sure, are not the only reason that minority-owned businesses may face difficulty accessing bank credit. Research documents that Black and Latinx business owners, when seeking loans from banks, have worse customer-service experiences than other borrowers and receive less information about loan products.[401] And these types of biases in bank lending practices were also found in the PPP distribution process.[402]

The overall result of these trends is that Black- and Latinx-owned small businesses work more with alternative lenders and less with banks than other firms. They therefore obtain credit less often and at a greater cost, as indicated in the figure below. Importantly, these figures do not fully capture the inequalities, since the survey only captures those minority entrepreneurs that have successfully launched and maintained small businesses notwithstanding the challenges in accessing equity and debt.

FIGURE 46

**FUNDING SOURCES USED IN LAST FIVE YEARS BY ETHNICITY OF SMALL EMPLOYER-BUSINESS OWNER[403]**




May select multiple options, percentage of firms, N: 3993 (White), 468 (Black), 198 (Asian), 422 (Hispanic)

Given this backdrop, the federal government has ample room to help underserved minority-owned businesses. This is one of the purposes of the SBA's 7(a) loan program, which provides partial loan guarantees for specific borrowers. The 7(a) loan guarantees help banks form relationships with firms that are risky under conventional metrics. However, the percentage of SBA loans going to Black- and Latinx-owned businesses closely mirrors the percentage of those businesses overall. Two percent of small businesses are owned by Black Americans and five-and-a-half percent by Hispanic Americans. Black-owned businesses received just three percent of 7(a) loans by volume and Latinx-owned businesses got six percent.[404] In other words, the 7(a) program does not help to close the financing gap for minority-owned businesses.

One reason for this trend is that the SBA and banks making 7(a) loans also consider personal credit score in their lending decisions.[405] A related problem is that bank-issued 7(a) loans come with rigorous borrowing requirements including high collateralization. The SBA mandates that for most 7(a) loans under $350,000, lenders must apply standard collateral practices, and lenders must also fully collateralize loans above this range.[406] For minority borrowers, however, who tend to have fewer assets, collateral requirements only make getting SBA loans harder. Another issue is that few federal programs target loans or other financial assistance *specifically* to minority-owned firms. And the ones that do focus on minorities have very small budgets. For instance, in FY2019, the Department of Commerce received just $4.5 million for its Minority Business Resource Development program, and in FY2020 the SBA received just $1.5 million for Native-American business outreach.

The regulatory structure of the 7(a) program also creates economics that constrain the kinds of loans that can be made profitably. The 7(a) program is designed to guarantee individual loans, rather than loan portfolios. The transaction costs associated with processing and approving a loan means that half of all 7(a) loans are for more than $150,000, and many of the top SBA lenders will not originate loans below $250,000.[407] But the smaller small businesses typically need loans under $100,000, and often under $50,000.[408] And while the SBA does run a microloan program, geared towards the smallest borrowers, the program is small in scope, supporting only approximately $80 million in total lending.

Community institutions can help fill the gap in minority business lending. Local organizations, like CDCs and CDFIs, have impressive track records at identifying viable businesses in disadvantaged communities and lifting them up.[409] Roughly two-thirds of CDFI business loans go to underserved businesses, including minority-owned ones as well as those in low-income areas.[410] Fully half by volume go to high-poverty census tracts,[411] compared to just a quarter* of the small-business loans that banks make under the Community Reinvestment Act (CRA).[412]

* Since CRA loans are a small fraction of banks' portfolios, banks lend to underserved areas overall at a far lower rate than CDFIs.

Some federal programs do support and partner with these institutions. The State Small Business Credit Initiative (SSBCI) program leaned heavily on CDFIs to help disadvantaged borrowers.[413] Through 2016, 42 percent of SSBCI-supported loans went to businesses in low- and middle-income (LMI) areas.[414] And the CRA also encourages larger banks to lend through CDCs.[415] However, much more can be done. For one, community lenders play only a small role in the SBA's 7(a) program, even though they can reach many excluded borrowers. With large majorities of CDFIs reporting that staffing shortfalls limit their operations,[416] this may be partly because compliance burdens, as well as the total time needed for a CDFI to file individual applications for 7(a) loans, discourage CDFIs from participating. Further, policymakers have ended many programs that capitalize on community institutions. Congress has not renewed either the SSBCI or the Small Business Lending Fund (SBLF) and President Trump has proposed eliminating the Treasury's CDFI programs altogether.[417] And absent from federal programs today are any sizeable initiatives that, like the SSBCI, work through state and local governments to bolster community groups.

Equally concerning, federal policy has done little to halt an ongoing decline in community banks, which is harming small firms all over the country.[418] Community banks are a critical source of credit for small businesses. Their tight integration into local communities positions these banks well to forge lasting relationships with firms of all sizes. But banking-sector consolidation over the past 25 years has caused the number of community banks nationwide to fall by 70 percent—as the first chart below shows. These banks' shares of total banking assets and of issued loans and leases, shown in the subsequent two charts, have also plunged. There are a variety of factors driving this consolidation, including demands for very expensive technology systems. As we discuss below, since 2009, federal regulations have also placed a substantial regulatory burden on community banks, aggravating other challenges.[419]

FIGURE 47

**NUMBER OF COMMUNITY AND NON-COMMUNITY BANKING INSTITUTIONS, FDIC DEFINITION** [420]

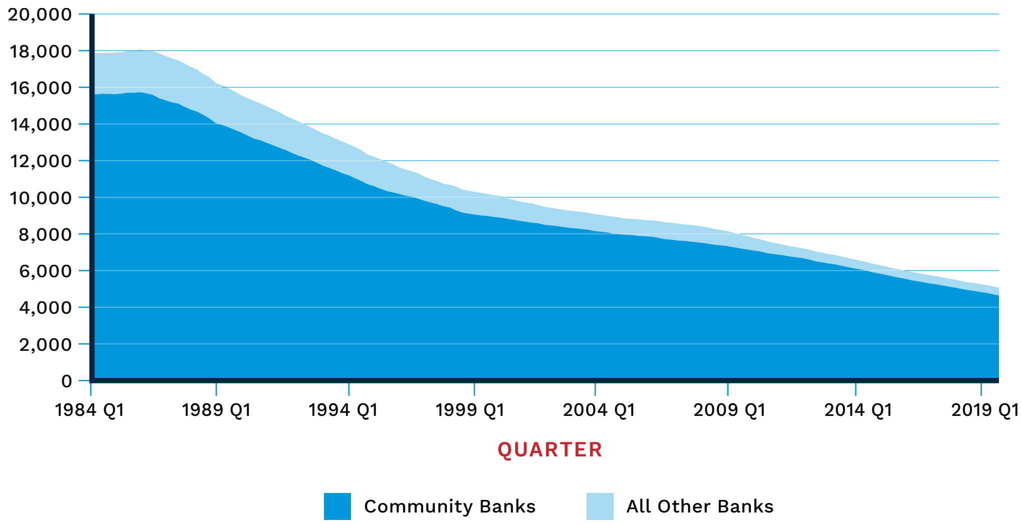



FIGURE 48

**SHARE OF BANKING ASSETS IN COMMUNITY BANKS, FDIC DEFINITION** [421]

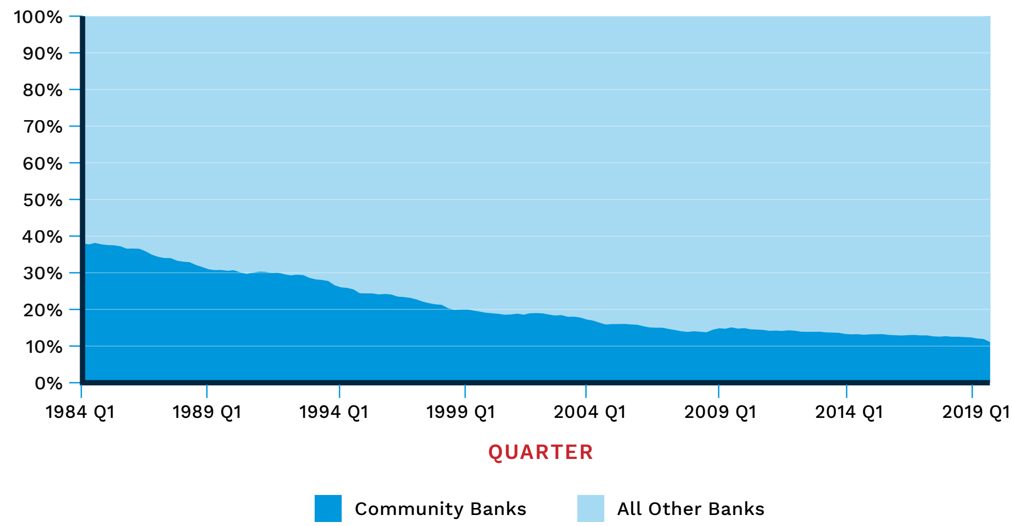
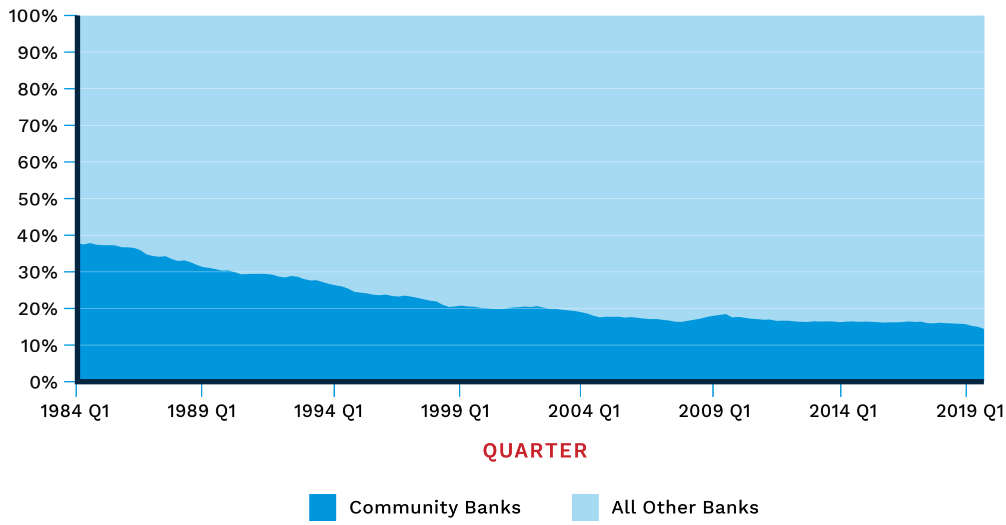


FIGURE 49

**SHARE OF LOANS & LEASES ISSUED BY COMMUNITY BANKS, FDIC DEFINITION**[422]




CDFIs face a different challenge: sharp limits on equity.[423] In one survey, 41 percent of CDFIs cite lack of equity capital as a limiting factor.[424] Today, there are no federal sources for such equity. The CRA has long served to channel private capital into CDFIs, but following banking consolidation nationwide, this funding has stagnated in places where banks have closed.[425] As a result, the benefits of the CRA do not extend to large areas of the country. In May 2020, the Office of the Comptroller of the Currency updated CRA rules to let banks receive credit for larger investments with less community impact.[426] Today, CDFIs, which have provided much support to the most vulnerable businesses during COVID-19, report that funding shortages are limiting their potential to operate during the pandemic.[427]

But even a stronger network of community banks and CDFIs will not help address the shortage of equity investments for minority entrepreneurs. Of existing federal programs, only the SBIC program is a source of equity financing, and SBICs rarely invest in minority or other disadvantaged founders. The need for federal programs that spur equity investments is even more acute after the SSBCI's recent winddown. SSBCI funding to state and local governments has supported locally administered venture-capital investments in underserved firms.

A further structural barrier to solving all these problems is the lack of adequate financial data on the impacts of small-business programs. The SBA gathers virtually no data on how its programs actually benefit borrowers. With “no information” on borrower outcomes, concluded one recent GAO report, current data simply “do not indicate” whether the SBA helps “small businesses succeed.”[428] In 2017, the SBA’s OIG also found that data problems undermined the SBA’s microloan program.[429] Both the SBA’s OIG and the GAO find that the agency’s general inability to monitor and oversee 7(a) lenders detracts from its goals.[430]

The SBA has taken some steps to improve data collection. It launched a data-practices working group in 2014, and it has pledged to “broaden” its “use of impact evaluations.”[431] In 2019, the agency also started collecting borrower-reported data on “jobs supported” by SBA offerings. But these reforms are not enough. The SBA still does not track loans’ effect on economic growth, business revenue, or capital expenditures. And the “jobs supported” metric measures only *intended* job creation at the time businesses apply for loans, not total jobs created in reality. Without outcomes-based data, policymakers are handicapped when trying to fix federal programs.

To restore dynamism to America’s small-business sector, policymakers must create new federally backed financial products to help businesses, owners find capital, launch, and expand. The federal government must also reestablish the critical financial pillars upon which small businesses are built.

# Policy Recommendation V:
## Create a New Generation of Federally Backed Debt and Equity Products to Meet Diverse Market Demand

### ESTABLISH AN INAUGURAL FIRST-LOSS GUARANTEE LOAN PROGRAM FOR LENDERS

Traditional banks have long sidelined the smallest small businesses seeking credit. Many banks report being unwilling to originate loans below $250,000, because issuing loans of this size costs them just as much as issuing loans of $1 million or greater.[432] As a result, there is substantial unmet small-business demand, especially for loans below $100,000.[433]

Non-bank lenders, including fintech companies, which have grown rapidly in the past decade, are stepping in to meet this demand. Fintech companies can make unsecured loans to smaller small businesses at a fraction of the cost of traditional banks, owing it to algorithms they use to analyze historical financial data in lieu of standard underwriting. SBA guarantees could help these lenders reach marginally riskier borrowers—for example, lower income borrowers with poor personal credit scores—or pass savings on to disadvantaged borrowers in the form of lower interest rates, or both.

However, the business models of fintech lenders are generally to issue large numbers of small loans to very small businesses, on terms that vary more than traditional bank loans. They would therefore find it cumbersome and costly to transact with the SBA on a loan-by-loan basis. To solve this challenge, the SBA should launch a new first-loss guarantee loan program for alternative lenders that operates at the portfolio level. Under this program, the SBA would guarantee the first 20 percent of losses for all loans made to business owned by economically or socially disadvantaged individuals or individuals living in low-income census tracts. In other words, all loans that a given lender makes to qualified small business owners would form a loan portfolio for purposes of this program, and SBA would reimburse lenders for all of this portfolio's losses up to 20% of the portfolio's total value. Traditional banks, community development financial institutions, and other certified lenders would be allowed to participate.

At the same time, the SBA must also impose safeguards against abusive lending practices—which have become an area of concern since the rise of online lending.[434] The SBA should conduct rigorous vetting of alternative lenders' lending processes and historical performance before accepting applications for its program. And it should ensure that all loans within guaranteed portfolios meet rigorous fairness standards. Among other steps, the SBA should establish a reasonable cap on interest rates, perhaps in the 20 to 25 percent range. This rate will necessarily be well above a typical small-business bank-loan rate but below the rates of many alternative lenders' short-term business loans today. Loan standards would also require fintech lenders to clearly disclose covered loans' annual percentage rates (APRs), repayment terms, and default conditions. Covered loans would additionally include fair arbitration and dispute-resolution clauses that allow borrowers to bring claims in a convenient forum.

And finally, to achieve fair lending, the SBA should also consider requiring participants to sign a broader pledge to adopt responsible lending practices. One such model is the Small Business Borrowers' Bill of Rights[435]—developed by the Responsible Business Lending Coalition, a group of lenders and small-business advocates. The SBA alternatively could consult with lending-market leaders and small businesses to develop similarly comprehensive standards and guidelines.

## ALLOW HIGHER MAXIMUM INTEREST RATES ON SHORT-TERM SBA-BACKED LOANS

Banks, in recent years, have also underserved a growing number of businesses seeking short-term, higher-rate credit arrangements—more resembling lines of credit than traditional bank loans. Offering these kinds of flexible products, in fact, is one way that non-bank creditors like Amazon have rapidly expanded lending operations.[436] At the same time, bank lenders shy away from issuing SBA 7(a) loans under $100,000 because the transaction costs involved do not justify the returns given the cap on 7(a) interest rates. The SBA should help banks serve the evolving needs of small businesses by letting them charge higher maximum rates on short-duration 7(a) loans.

As of April 2020, the maximum 7(a) lending rate for loans below $25,000 is 11.25 percent. This maximum rate declines over higher loan-size categories until it reaches 8.25 percent for loans above $250,000.[437] The SBA should set a reasonable maximum interest rate for loans below $100,000 of one-year duration or less, perhaps in the 20 to 25 percent range. To ameliorate concerns about responsible lending practices, the SBA should require lenders making high-interest loans to certify that they adhere to comprehensive fair-lending standards—like the Small Business Borrowers' Bill of Rights, described above. Providing 7(a) banks with this option would significantly expand their potential for impact on Main Streets around the country. This policy change would also let existing SBA lenders maintain their business models while offering loan products competitive with those from lenders using the first-loss guarantee loan program model, described above.

### REDUCE SBA FEES FOR 7(A) BORROWERS AND INCREASE MAXIMUM LOAN GUARANTEES TO 90 PERCENT

The SBA's programs already enable lending to viable businesses that banks, relying on conventional credit metrics, often overlook. And 7(a) loans, importantly, can help low-income firms access stable, long-term credit, which banks would normally be reluctant to extend. But banks lending through 7(a) still fail to reach many viable borrowers. The 7(a) program could reach substantially more borrowers by increasing the guarantied portion of loans to 90 percent. Guarantees of this size would reduce banks' lending risks without eliminating their accountability for sound lending practices. And reducing 7(a) service fees, which banks pay to the SBA and may not be passed on to borrowers,[438] would encourage lending to smaller borrowers, where banks run lower margins.

Congress should enact permanent fee cuts and higher maximum guaranties for the current set of 7(a) loans for 8(a) firms, including service-disabled veteran-owned firms, and those operating in low-income areas. The SBA has recently taken positive steps in this direction: for small 7(a) borrowers in HUBZones and rural areas, it waived bank service fees for FY2019.[439] It should now extend this policy to a wider group.

Additional measures along these lines will also be essential during recovery from the COVID-19 pandemic, as lenders are especially reluctant to make small-business loans during economic downturns.[440] Congress should extend the above changes to *all* 7(a) and 504/CDC borrowers as long as the recession continues. It should also enact legislation that makes fee waivers and loan-guaranty increases automatic when the economy enters recession.

These policies have already been tested as crisis measures following the 2008 financial meltdown. The American Recovery and Reinvestment Act (ARRA) of 2009 appropriated $375 million for the SBA to reduce 7(a) and 504/CDC program fees; it also raised the agency's maximum guarantee for loans above $150,000 to 90 percent.[441] Making these reforms drove a significant rebound in lending. In the seven weeks before the ARRA's passage, the SBA backstopped on average just $170 million per week. After its passage, this amount rose to $330 million until ARRA funding lapsed.[442]

## STUDY A PREFERENTIAL 7(A) PROGRAM FOR CERTIFIED CDFIS THAT LEND TO DISADVANTAGED FIRMS

Because CDFIs are vital for access to credit in low-income communities, policymakers must carefully consider how CDFIs can better utilize SBA programs. Congress should commission an SBA taskforce to review the 7(a) program to recommend changes that would make it more favorable for lending by CDFIs. The taskforce would aim to design a 7(a) facility that lets qualified CDFIs make SBA-guaranteed loans on advantageous terms. CDFIs would be eligible so long as they have a strong lending track record and they issue large proportions of their loans to disadvantaged communities.

Specifically, this new program's terms could include higher SBA guarantees, greater origination fees, and lower interest rates on guaranteed loans. Congress, in consultation with this taskforce, should also consider letting qualified CDFI banks hold fewer reserves against their 7(a) loans, which would leverage their capital.

It is possible, of course, that the SBA's study will find that the agency can best involve CDFIs by working outside the 7(a) loan program. In this case, the SBA should craft a new, CDFI-specific program that might incorporate some of the elements discussed above.

## PRIORITIZE COMMUNITY ADVANTAGE LOANS AND LOANS TO HISTORICALLY DISADVANTAGED BUSINESSES

The SBA must take aggressive steps to ensure its programs help spur growth among minority business owners as well as small-business owners in low-income areas, whether rural, urban or suburban.

The SBA's Community Advantage program, which lets community lenders in low-income areas offer 7(a) loans without collateral requirements, has been an important step in this direction. Yet the program's small size stymies its impact. Community Advantage lenders made fewer than 1,000 loans under the program in FY2019, totaling just $122 million.[443]

To revitalize struggling communities, the SBA must dramatically upscale lending to disadvantaged businesses. In particular, the SBA should set a target of issuing ten percent of 7(a) loans through the Community Advantage program, up from less than one percent today.

To meet these new targets, the SBA should take the following three concrete steps:

1. Make Community Advantage Permanent: The Community Advantage program has been in its pilot phase since 2011, and it is set to expire in 2022. To ensure that the program can continue to grow and improve, Congress must make it permanent.
2. Subsidization: The SBA should subsidize loans by community institutions participating in the Community Advantage program. It can do so by eliminating fees or reducing reserve requirements for such loans, as well as offering lenders origination fees or further subsidies as necessary.
3. Reporting: Congress should require institutions lending under SBA programs to report the percentages of 8(a), women-owned, veteran-owned, and HUBZone businesses to which they issue SBA-backed loans annually. (While the Equal Credit Opportunity Act generally bars creditors from collecting such demographic information, creditors may collect it when directed to by law or agency directive.)[444] The SBA should then publicize this information and use the data to further refine programs.

## RESTORE THE STATE SMALL BUSINESS CREDIT INITIATIVE

The State Small Business Credit Initiative (SSBCI) disbursed $1.5 billion for state governments to run their own programs that capitalize small businesses. To address the COVID-19 crisis, this program should be renewed immediately, with at least $3 billion in funding. Congress should also make a smaller amount of funding available on an annual basis, beyond the current crisis. Projects funded by SSBCI credits, as discussed previously,[445] aided minority and rural businesses and created new jobs.

In renewing the program, Congress should make reforms, including authorizing alternative lenders, including fintech companies, to participate in SSBCI initiatives, as long as they follow responsible lending practices. The Treasury should also issue guidance establishing that state proposals' which set SSBCI funds aside for community lenders will be significantly favored in the application process. A key reason behind SSBCI's original success, after all, was that state-tailored programs often leaned on community lenders to capitalize local businesses.

## EXPAND THE SBIC PROGRAM AND PUSH SBICS TO INVEST IN UNDERSERVED BUSINESSES

The SBA's Small Business Investment Company (SBIC) program provides the most flexible financing arrangements of all SBA initiatives. Supported by SBA leverage, SBICs make both debt and equity investments in small businesses. The kinds of firms SBICs invest in, however, differ from traditional venture capital investments. SBICs are much more likely than venture capital firms to invest in companies outside the technology sector; their investments are also smaller and more geographically dispersed.[446]

However, SBICs investments are not racially diverse. Less than five percent of SBIC investments, and less than *three percent* of investments by dollar volume, go to minority-owned firms of any kind.[447] SBICs also invest just 19 percent of their total dollars in low- and middle-income businesses.[448] While this is a better track record than that of traditional venture capital, there is ample room for improvement.

The SBA should expand the SBIC program, while pushing SBICs to invest more in underserved companies. To expand the program, the SBA's first step should be undoing recent measures to scale it down. In 2017, the SBA suspended license applications for two of the four SBIC types: those investing in regions or sectors that the SBA designates as national priorities, and those investing in early-stage companies.[449] The SBA should reverse course and reopen these applications. It should also lower the amount of outside capital that SBIC applicants are required to raise from $5 million to $2.5 million.[450] Doing so would encourage applications from smaller, more diverse investment managers, which are more likely to invest in underserved businesses.

To improve diversity in SBIC investments, the SBA should increase the financial leverage it gives SBICs in proportion to their investments in low-income and minority-owned firms.

# Policy Recommendation VI:
## Strengthen financial institutions that focus on local business formation and growth

### MAKE THE INTEREST ON DEPOSITS HELD BY COMMUNITY BANKS TAX EXEMPT

The decline in community banks has made it significantly more challenging for small businesses in many areas of the country to access credit. As the distribution of PPP loans showed, community banks are a critical element of a community's financial infrastructure. The federal government can support a more independent banking sector by making interest payments on deposits held at community banks tax exempt. These exemptions would apply for deposits held at banks with under $1 billion in assets and that operate independently within a specific geographic region. Such exemptions should also apply to credit unions, and other depository institutions, serving particular communities. This exemption would allow these banks to make lower interest payments, while remaining competitive with other depository institutions. The federal government uses tax exemptions like these to encourage other kinds of investments, like those in municipal bonds.[451] Not unlike the public roads and other infrastructure projects that municipal bonds fund, community banks are an integral part of the financial infrastructure of a community.

### REDUCE REGULATIONS AND FEES ON COMMUNITY BANKS

Another headwind facing community banking institutions comes from the federal government itself. Today, community banks are forced to comply with some regulations that almost exclusively affect large banks. Such regulations include the Volcker Rule and Dodd-Frank Section 956, which prohibits employee compensation arrangements that regulators deem to encourage risky investments. Congress should exempt independent community banks from these requirements. Although they rarely implicate community banks' transactions, their applicability to these banks increases legal and administrative costs, while creating uncertainty that deters expansion efforts.[452] (Importantly, lawmakers should not exempt community banks from federal laws requiring banks to collect demographic and other data from their business-loan recipients.)

Regulators should also:

- Further reduce compliance burdens by streamlining capital requirements for community banks. Smaller banks must generally follow the same risk-weighted capital requirements as larger banks do, despite being better capitalized.[453]
- Permit healthy community banks with under $10B in assets to stop making payments into the Deposit Insurance Fund (DIF) until the DIF drops below its target rate of 1.35 percent, which it currently exceeds. Banks with more than $10B in assets will continue to pay into the DIF so that the balance still grows, but reductions will be provided for banks that outperform on their CRA activities.
- Amend Financial Institutions Letter-16-2016 (Supervisory Guidance) to let smaller banks use more professional judgment around loan evaluations, for example, not requiring in-person appraisals.
- Amend Regulation W in regards to enterprise risk-management expectations and liquidity, capital, and interest-rate risk testing, including an end to the requirement for deposit decay rate studies.

## STRENGTHEN THE SMALL BUSINESS LENDING FUND

Congress in 2011 authorized the Treasury's Small Business Lending Fund (SBLF) to make $6 billion in loans to community banks, which kickstarted post-crisis lending in neighborhoods across the country. As recommended under Step 1, above, Congress should once again appropriate at least this much in SBLF funding, in response to COVID-19. Moreover, lawmakers should permanently authorize countercyclical appropriations to the SBLF, so that the vehicle automatically receives new funds at the onset of a recession. The SBLF will be most effective at forestalling credit shortfalls when it capitalizes community banks swiftly.

## UPDATE THE COMMUNITY REINVESTMENT ACT TO DRIVE INVESTMENTS IN LOW-INCOME COMMUNITIES

The CRA was intended to ensure that banks give back to the communities that provide them with cash deposits. Pushing banks to lend locally is a critical goal. But the CRA, as currently written, does not do enough to ensure bank capital goes to the local businesses that need it most. It also provides little recourse to communities that, given the past three decades of banking-sector consolidation, have sparse local capital to draw upon.

Congress should make three amendments to the CRA so that it can better stimulates lending to Main Streets across the country.

1. High-impact financing: Banks should receive CRA credit for business loans only when those loans' beneficiaries operate in low-income census tracts, employ primarily from such areas, or are otherwise disadvantaged. Without requirements like these, the CRA has failed to spur lending to low-income businesses.[454] This change would also bring the CRA's treatment of business lending in line with its treatment of household loans, which only yield CRA credit when borrowers come from low-income census tracts.[455]
2. Flexible financing: Large banking institutions often meet CRA requirements by operating through CDFIs, which are more familiar with local business communities. The CRA, therefore, has been an important source of CDFI capital. To help CDFIs obtain financing on the terms they need, regulators should grant banks extra CRA credit for making equity investments in qualifying CDFIs.[456] Incentivizing these kinds of flexible financing arrangements will help CDFIs expand in today's low-interest rate environment.[457]
3. Equitable financing: Banks in regions saturated with CRA funding should be allowed to receive a small number of credits by investing outside their assessment areas, in regions with sparse CRA funding. This change would ensure the CRA benefits all communities given the modern reality of banking consolidation, which has left banks heavily concentrated in certain parts of the country.[458]

Finally, the Office of the Comptroller of the Currency (OCC) should reevaluate the CRA rule it promulgated in May 2020, which received support from a "minority" of those submitting comments.[459] The OCC, specifically, should reverse its expansion of CRA-eligible investments, which let banks more easily receive credit for certain large investments that may have little impact on communities. The OCC should also convene a working group, including small-business and community-lender representatives, to consider additional rule changes that boost investments' impacts on communities.

## REVITALIZE THE CDFI FUND AND UPDATE FEDERAL CDFI REGULATIONS

The Treasury's CDFI Fund provides most direct federal support to CDFIs. In FY2018, the CDFI Fund awarded $165 million in grants, investments, and loans for CDFIs to expand their lending products and access technical assistance.[460] (The office itself received a $250 million appropriation.[461]) But CDFIs across the country, many of which are seeking capital to expand their operations,[462] annually apply for more than twice this much funding.[463] The federal government should expand this fund to help CDFIs overcome national banking-sector headwinds—while also better leveraging CDFIs to serve disadvantaged communities.

To accomplish this, first, Congress should double appropriations for CDFI Fund grants. It should also increase the maximum size of its technical-assistance grants, which CDFIs can use for a wide range of capacity-building purposes, from $125,000 to $250,000.[464] These grants will be especially important to help community lenders modernize their technology infrastructure, systems architecture, and user interfaces.

Second, policymakers must expand access to CDFI certification and funding, particularly for smaller organizations with fewer institutional resources. The current processes for receiving CDFI certification and applying for federal grants are burdensome.[465] Many CDFIs hire consultants simply to fill them out.[466] Other eligible organizations opt not to apply altogether; CDFI registration growth among credit unions, for instance, has slowed markedly in recent years.[467] To reverse this trend, and make support available to lenders working in the most disadvantaged communities, the Treasury should commission a working group—which would include CDFI leaders—to redesign these applications and eliminate nonessential requirements. Congress should also authorize funds for hiring staff at the Treasury and the National Credit Union Association who are dedicated to application assistance. These personnel would further work with state governments to run targeted outreach programs soliciting applications from lenders in low-income and historically disadvantaged communities.

## FUND CDFIS TO EXPAND EQUITY INVESTMENTS IN DISADVANTAGED BUSINESSES

Federal support for small-business credit is vital for the sector's growth. But particularly in the wake of COVID-19, the federal government must find new ways to help small firms and entrepreneurs access equity financing. Equity offers many business owners the best terms for expanding their operations, and large numbers of hard-hit firms need equity to get back on their feet.

Federal agencies like the SBA, however, lack the expertise to administer an equity fund, itself, that invests in small businesses. Local investing institutions are better positioned to make equity investments in their communities. Congress, therefore, should authorize $200 million in annual grant money—termed CDFI Equity Grants—to support CDFI equity investments. The Treasury's CDFI Fund would administer this money, which would be separate from the office's existing CDFI grants, and would accept funding applications from community investors. Applicants would be eligible to receive Equity Grants used both to originate equity investments directly and to improve their capacity for equity investing. Recipients of Equity Grants would be required to direct at least 80 percent of the investments financed by their grants to minority-owned firms or firms in low-income census tracts. To maximize the program's impact, the Treasury would give preference to applicants demonstrating an ability to originate large volumes of equity investments per grant dollar awarded. The CDFI Fund should also consult with SBA officials that administer the agency's SBIC program to establish best practices for making these grants.

### CREATE FEDERAL PLATFORMS FOR CONNECTING CDFIS TO CAPITAL AND TRAINING

Many community lenders, as discussed above, report that they want to expand operations but have a hard time locating capital to do so.[468] One big reason is that large private institutions—including mission-oriented impact investors—find it challenging to invest in CDFIs at scale. CDFIs' credit instruments are not structured uniformly, and individual community lenders can rarely support large investments in the tens or hundreds of millions.[469] CDFIs have also found it challenging to communicate their impact to private backers.

Federal policymakers, including those at the Treasury and the SBA, must work to overcome the disconnect between CDFIs and private sources of capital, particularly impact investors. Congress can help the SBA do so by appropriating funds for it to hire staff whose sole focus is improving small businesses' access to credit—operating out of a new SBA Office of Equitable Financing. The office can then achieve this mission through a three-pronged approach:

1. Help CDFIs network with investors: Immediately, the Office of Equitable Financing should start sponsoring regular, regional events for CDFIs to pitch their work to

outside investors. The office should also cooperate with the Treasury, and draw upon appropriations to its CDFI Fund, to develop programs to train CDFIs in soliciting private capital.

2. Pool investor funds for CDFIs: Over the longer term, the SBA's Office of Equitable Financing and the Treasury should create investment funds that pool CDFI lending obligations. Each fund would pool a specific CDFI product, including microloans, term loans, lines of credit, and community-facilities loans. Investors would purchase interest in a fund and receive diversified exposure to all underlying assets. Certified CDFIs that meet creditworthiness standards would contribute debt to these funds if the debt's terms meet the funds' standardization requirements. And CDFIs would issue fund-eligible debt through the same qualified-issuer intermediaries that the Treasury currently uses to underwrite its loans to CDFIs. Under national coordination, these funding pools could absorb large volumes of institutional investments, help investors meet impact-investment and ESG goals, and work to standardize CDFI lending markets.
    - To incentivize participation, the Treasury's CDFI Fund could also partially guarantee the funds' obligations.[470] The CDFI Fund, which has operated zero-subsidy loan guarantees for over a decade, could continue to guarantee these loans on a zero-subsidy basis. Congress must grant the Treasury new authority to do this, but it would not have to raise the agency's total amount of authorized CDFI loan guarantees. In FY2019, the CDFI Fund issued full guarantees on $100 million of CDFI bonds, despite permission to guarantee up to $500 million.[471] If the CDFI Fund guaranteed the new funds' loans at a twenty-percent rate, then, it could leverage up to $400 million in guarantees to support $2 billion in pooled lending.

3. Connect CDFIs to technical assistance and mentorship: The SBA should encourage investors attending regional events, and participating in its pooled investment fund, to provide technical assistance to CDFIs. The Office of Equitable Financing should incentivize mentorship by publishing the names of the institutions that offer their services. Congress also has a role to play here. Congress should appropriate funding for the SBA to partially compensate investor institutions that provide capacity-building mentorship and training to certified CDFIs. Lawmakers, additionally, should pass legislation that allows financial institutions to receive credit under the Community Reinvestment Act for pro bono hours spent mentoring small CDFIs.

## EXPAND THE NEW MARKETS TAX CREDIT AND MAKE IT PERMANENT

The New Markets Tax Credit (NMTC), launched in the year 2000, lets community investors apply for tax credits after equity investments in low-income areas. Over the seven years following an investment, investors can claim tax credits totaling 39 percent of the investment's cost.[472] To date, the NMTC program has had a large positive impact on the balance sheets of CDFIs around the country, facilitating their expansion.[473]

Expanding the NMTC program will be important for helping CDFIs grow even further. Recently, Congress has already taken steps in this direction. At the end of 2019, Congress extended the NMTC program and increased annual credits from $3.5 billion to $5 billion—the first expansion since 2007.[474] This is a step in the right direction, but Congress must go further, particularly in response to the COVID-19 crisis, which is putting enormous stress on the banking system. Community lenders' demand for credits far exceeds available supply.[475]

Congress must make the NMTC program permanent and inject more funds into the program. This includes increasing not just the program's standard annual appropriations, but also its emergency appropriations this year. As discussed in Chapter 3, Congress should immediately authorize $3 billion in emergency NMTC appropriations to address the COVID-19 crisis. Lawmakers should also double annual NMTC appropriations from $5 billion to $10 billion.

Lawmakers, additionally, should consider reforms to the NMTC's design to ensure funding benefits communities that stand to gain most from credits. Smaller CDFIs or those operating in persistently low-income areas—which have the hardest time accessing private-sector funding—should get priority in NMTC credit applications.[476] This could occur through set-asides for community lenders with total assets below a particular threshold (e.g., $10 million) or within certain census tracts. Lenders could also receive greater credits, with earlier disbursal schedules, for lending to 8(a) or other disadvantaged borrowers.

## STEP 4

# Harness the Power of Public and Private Procurement

**SUMMARY:** *Procurement is an important tool for growing minority-owned and women-owned small businesses and small businesses in low-income areas. Today, the federal government, a small set of Fortune 500 companies, and a handful of states account for the large majority of disadvantaged small-business procurement. But the collective "spend" of these entities is only a small share of total public and private procurement in the United States. To meaningfully reduce racial inequalities in small-business ownership, we must dramatically expand such efforts. The federal government can do more, including dedicating a higher overall percentage of procurement to small businesses generally and to each of the disadvantaged small-business groups, expanding outreach efforts to bring more small businesses into the federal-contracting marketplace, and simplifying the process for certification, bidding, and winning contracts.*

*At the same time, local and state governments, medical and educational institutions, nonprofits, and additional public and private corporations must join this effort and commit to disadvantaged-business procurement. To speed these commitments, we call for a new set of private-sector Environmental, Social and Governance (ESG) standards for minority- and women-owned business procurement. Such standards would give corporations and institutions tools to set ambitious targets, verify their progress, benchmark themselves against others in their industry, and report publicly on their performance. Like analogous standards related to climate risk or other ESG indicators, procurement standards will also give institutional investors a new way to evaluate whether their investments are aligning with their stated values.*

# The Small-Business Procurement Landscape

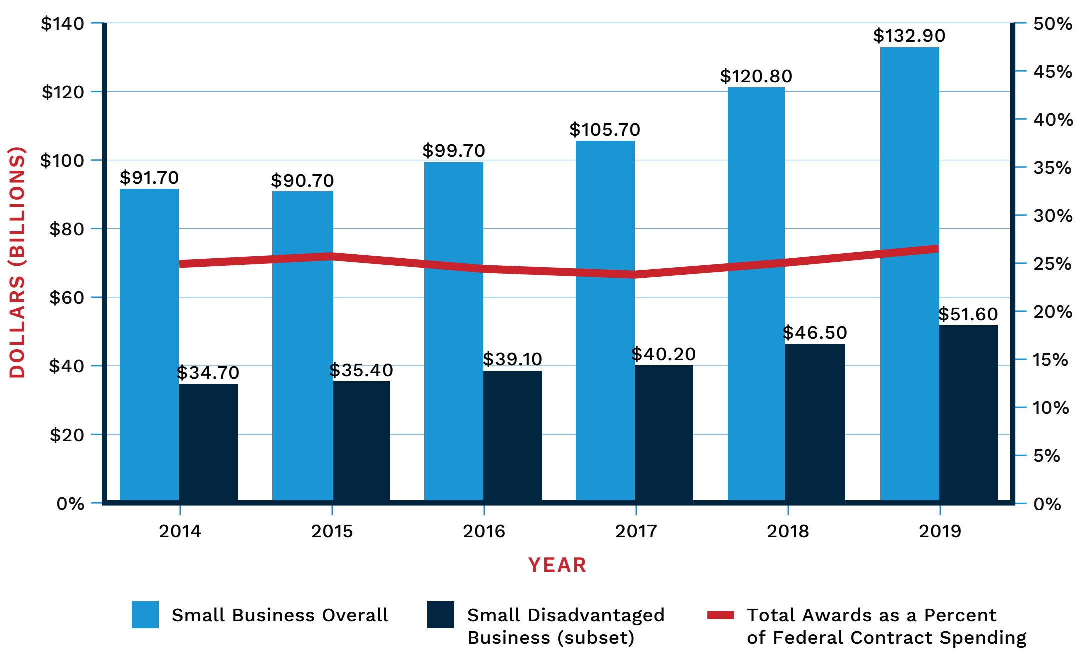
This section describes the current small-business procurement practices at the federal, state and local government levels as well as in the nonprofit and private sector.

Federal contracting accounts for more than $500 billion in American business revenue annually. Larger businesses have inherent advantages in winning these contracts. Larger, established firms often have past experience navigating the bidding process. And they are better-positioned to fill large orders and scale up capacity for large, single-provider contracts.

Federal contracting policies and small-business targets, however, ensure that agencies buy from small businesses, too. As the chart below shows, federal small-business procurement has totaled over $90 billion each of the past five years and rose to $133 billion in 2019. Procurement specifically from minority-owned and disadvantaged small businesses totaled $51.6 billion in 2019.[477]

FIGURE 50

**FEDERAL SMALL-BUSINESS PROCUREMENT SPENDING, 2014-2019**[478]



While federal contracts are a critical revenue source for many firms, contracting today benefits fewer small businesses than it could. The federal government generally fails to meet its targets for women-owned and HUBZone firms.* In addition, federal contracting skews towards a tiny subset of small businesses that win a disproportionate share of dollars. In part due to the government's increasing use of Best in Class Vehicles, which bundle contracts across agencies and source them together,[479] total small federal contractors have *fallen* from 120,000 in 2016 to 102,000 in 2019.[480] Of 266 HUBZone businesses in Washington, D.C., 40 firms receive 70 percent of that region's HUBZone dollars.[481] In San Diego, just *one* business claimed 60 percent of all the city's HUBZone dollars since 2009.[482] And SBIR/STTR awards frequently go to repeat winners—"SBIR mills"—with staff dedicated to applying to the program.[483]

To be sure, some repeat winning happens because federal agencies demand specialized, high-quality products that few producers make. But the government also does poorly at ensuring qualified small businesses participate in bids. Few agencies run sophisticated programs for identifying and sourcing disadvantaged contractors,[484] and the SBA gives little guidance on how to do so.[485] Technical assistance staffers do not proactively raise awareness of HUBZone benefits.[486] Many businesses, therefore, do not know how to navigate federal contracting programs,[487] which involve time-consuming applications and reporting obligations.[488]

To address this challenge, federal contracting programs could enlist more businesses that *do* have contracting experience to mentor those that do not—which could help make procurement more inclusive. The SBA did take steps in 2016 to encourage mentorship by launching the All Small Mentor-Protégé program.[489] This government-wide initiative lets experienced contractors form joint ventures with disadvantaged firms eligible for contracting set-asides; these joint venture then receive preferential procurement treatment.[490] However, the program is still small, with fewer than 800 total mentorship relationships,[491] and could do more to help proteges sustain long-term growth.[492] Many agencies also run their own mentor-protégé programs, and some, like the Department of Defense's program, get good results. Over half of participants in this program say mentorship increased their contract awards, and large majorities report that it advanced their business capabilities.[493] Other agencies, however, have invested less in mentorship.

Federal programs, additionally, underuse contracting as a means to promote entrepreneurship and innovation. A few initiatives, particularly the Small Business Innovation Research (SBIR) and

* The federal government has only twice met or exceeded the five percent target for women-owned businesses since it was first instituted in 1994.

Small Business Technology Transfer (STTR) programs, do have an innovation focus. But contracting under this initiative represents less than one percent of the federal procurement budget. And even SBIR/STTR operates far below potential, as the program's structural features stymie its impact on entrepreneurship. Applicants can receive two phases of SBIR/STTR funding: they initially apply for phase one funding, and if phase one winners' projects go smoothly, they reapply to expand their projects in phase two. Phase two accounts for eighty percent of SBIR/STTR awards,[494] yet phase one awards drive far more patenting, innovation, and job creation.[495]

Managerial problems, including poor data management and ineffective enforcement, further hamper contracting initiatives across agencies. As for data, agencies record robust information on prime contractors, but *subcontractor* data is notoriously bad. Agencies require that prime contractors set targets for the percentage of their subcontracts they award to small businesses—and to disadvantaged ones in particular. But agencies do not make prime contractors share detailed information on individual subcontracts. It is therefore "not feasible," as the GAO has concluded, to locate data on federal subcontractors, their small-business status, and the prime contracts they support.[496] Federal systems simply were "not intended" to track this.[497] This makes it nearly impossible to evaluate whether contracting set-asides benefit target communities. Compounding this problem, contracting offices within agencies lack manpower to process this data, monitor compliance, and enforce targets.[498] Additionally, the SBA has little ability to hold agencies accountable to targets.

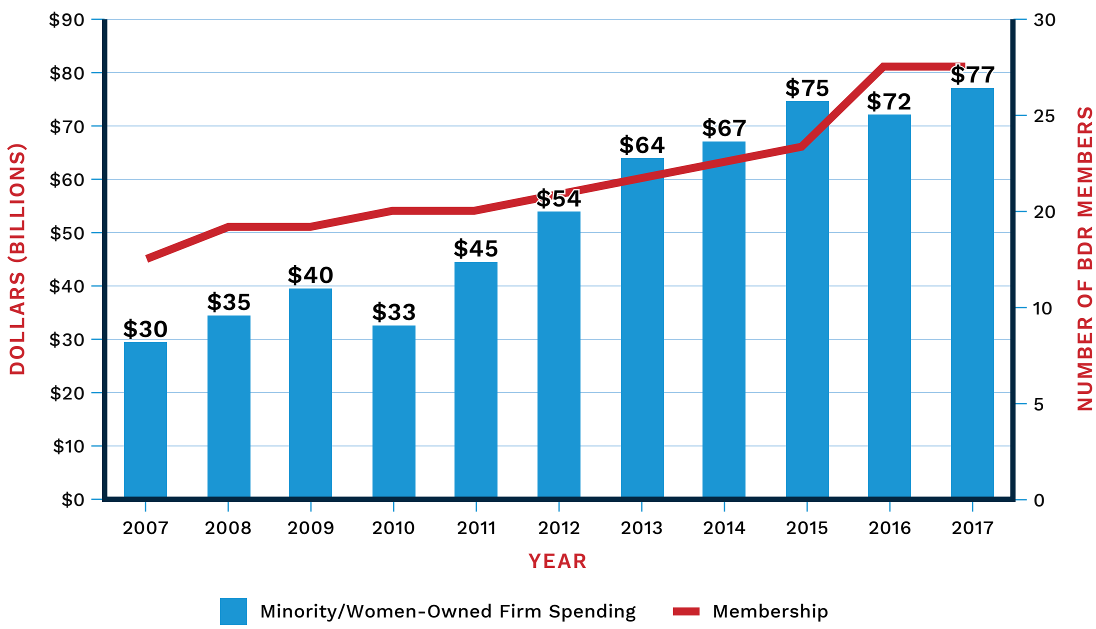
The federal government is the largest individual procurer in the country, but represents only a sliver of national procurement spend. A far greater volume of public contracting takes place at the state and local level. State governments, municipalities, and public educational institutions procure an estimated $1.5 trillion annually, three times as much as federal agencies alone.[499] Procurement from private organizations similarly dwarfs federal contracting. While precise numbers are hard to come by, one 2005 report finds that Fortune 1000 companies on average each spent $1 billion on annual procurement.[500] This research implies that these companies spend well above $1 trillion annually, today. Private non-profits are similarly huge procurers. Non-profit educational institutions spend about $200 billion on non-salary procurement,[501] and as of 2009, hospitals spent at least another $300 billion.[502]

Some of these players have made significant commitments to procuring from small and minority-owned businesses. California, for instance, has a 25 percent procurement target for small businesses and gives bidding preferences to such firms.[503] Texas[504] and Florida[505] have similar policies for contracts involving particular industries or agencies. And many cities implemented targets for small and minority-owned businesses in the 1980s,[506] which propelled minority self-employment and small-business growth.[507] However, commitments to buying from small and minority-owned firms are far from uniform across states. Many municipalities, following judicial challenges in the 1990s, have also scaled back their small-business targets.[508]

The private sector has made some of the largest commitments. In 2001, a group of public companies formed the Billion Dollar Roundtable ("BDR"), with each participating company pledging to buy at least $1 billion annually from minority- and women-owned suppliers.[509] BDR membership has doubled between 2007 and 2017; during these years, the group's spending rose rapidly, from $30 billion to $77 billion. In 2017, the total expenditures by the 28 BDR companies alone—shown in the chart below—surpassed the federal 8(a) procurement set-aside.

FIGURE 51

**BILLION DOLLAR ROUNDTABLE PROCUREMENT SPENDING AND MEMBERSHIP**[510]




But while 97 percent of Fortune 500 companies set some kind of target for supplier diversity, most companies' commitments are far lower than those of the BDR participants.[511] If every Fortune 500 company made a BDR-style pledge to buy from minority- and women-owned businesses, their total procurement from these minority- and women-owned businesses would be roughly $500 billion, equal to the entire federal procurement budget.

## Policy Recommendation VII:
Set ambitious new targets for federal procurement and push state and local governments to match these efforts

### HOLD FEDERAL AGENCIES TO HIGHER PROCUREMENT STANDARDS

Federal agencies, as discussed previously, set targets in consultation with the SBA for the percentage of their procurement contracts that go to small businesses. The SBA helps agencies set targets in view of the federal government's overall contracting goals, laid out in the Small Business Act. Congress should immediately increase these statutory targets. Specifically, it should raise the target for small businesses to 30 percent. It should further increase the targets for each subcategory—minority-owned, women-owned, service-disabled veteran-owned, and HUBZONE small businesses—as laid out in the table below.

FIGURE 52
**SMALL-BUSINESS PRIME CONTRACTING AS A PERCENT OF FEDERAL PROCUREMENT**[512]

| Category | 2019 Federal Goal (%) | 2019 Acheived % | Proposed Goal (%) |
|---|---|---|---|
| Small Business | 23% | 26.5% | 30% |
| Small Disadvantaged Business | 5% | 10.3% | 10% |
| Women-Owned Small Business | 5% | 5.2 | 7% |
| Service-Disabled Veteran-Owned Small Business | 3% | 4.4% | 5% |
| HUBZone | 3% | 2.3% | 5% |

But raising these targets alone is not sufficient. In recent years, federal agencies collectively have failed to meet many government-wide goals. The government last year did manage to hit its target for women-owned businesses and came close to its HUBZone target. But in prior years, contracting to these groups has consistently fallen short. Although each agency has an office that advocates for small-business contracting, as mandated by the Small Business Act,[513] these offices are typically understaffed and excluded from managerial decisions.[514]

The president can take further steps to keep agencies accountable. First, the president should sign an executive order that would reduce agencies' budgets, or senior executives' bonus compensation, in proportion to small-business contracting shortfalls. Agencies would avoid such penalties only by providing robust written documentation explaining why they could not reasonably hit their targets. In tandem with this order, the SBA, when helping agencies adopt targets, must adopt a strong presumption against letting agencies lower their targets when confronted with greater accountability.

Second, the president should establish a standing interagency committee on federal procurement, like the one that existed under the Obama administration to oversee the implementation of these targets. The interagency committee should also work to ensure that agencies, even as they hit their targets, award contracts to a broad range of small firms. The committee can help agencies develop protocols to balance efficiency gains from contract bundling, an increasingly common practice,[515] with the imperative of including more small businesses in procurement.

## RAISE THRESHOLDS FOR FEDERAL SOLE-SOURCE AWARDS AND SET-ASIDES

Sole-source contacts, or those awarded to an individual small business without a formal bidding process, have been a valuable tool for including disadvantaged businesses in federal procurement. Under current law, most federal agencies may allocate sole-source awards to 8(a) businesses, without providing a justification, for contracts below $4 million (or $7 million for manufacturing companies).[516] Laws governing tribal, Native-Hawaiian, and Alaskan-Native companies are more generous;[517] these firms can receive non-justified sole-source awards of up to $22 million[518] (or up to $100 million for Department of Defense contracts).

Congress should double the $4 million and $7 million thresholds. The $4 million sole-source threshold has not been updated since 2015, when it was adjusted for inflation.[519] As recent government contracts have grown increasingly complex and expensive,[520] raising this threshold will have a marked impact on sole-source awards to small businesses. One GAO report found that, after the Department of Defense was required in 2011 to justify 8(a) sole-source awards over $20 million, the number of sole-source awards in this range fell to zero.[521] At the same time, Congress should double the Simplified Acquisition Threshold, the contract value below which agencies *must* procure from small-businesses, from $250,000 to $500,000.

Congress should also make procedural changes to sole-source and set-aside laws, including:

- Excluding the value of contract option periods, which are subject to future exercise, when calculating contract values for purposes of these awards.
- Aligning the policies for making sole-source awards to HUBZone, women-owned, and service-disabled veteran-owned small businesses with those of 8(a) businesses.[522] Contracting officers, currently, may not independently initiate sole-source awards to these businesses, and they instead must provide justifications for these awards. Sole-source contracting with these businesses is therefore uncommon.

## LAUNCH A NEW FEDERAL-STATE INITIATIVE TO CONNECT SMALL BUSINESSES TO PROCUREMENT

With a few exceptions, federal agencies do not have strategies or programs in place to solicit bids from small businesses that have not previously participated in contracting.[523] And technical training to assist with contract bidding, as discussed previously, is offered in disparate, often understaffed[524] centers scattered across the country, mostly sponsored by the SBA.[525]

The SBA should spearhead a comprehensive federal campaign, to make contracting more accessible. It can do this by overhauling its Office of Government Contracting and Business Development, and empowering this office to run procurement assistance centers in every state, with matching funds from state officials. The SBA's joint-run Procurement Centers will be expanded to serve as one-stop shops with expertise to assist businesses in bidding contracts at the federal, state, and municipal levels. Center staff will help, in particular, with the time-consuming HUBZone certification process and newly instituted certification processes for women-owned businesses.[526]

To ensure they are serving the needs of stakeholders at all levels of government, the Procurement Centers will also remain in close communication with federal agencies, as well as state authorities. At the same time, the centers will proactively monitor the total number of contracts their business clients receive. For small businesses whose earnings depend heavily on one or two federal contracts, Procurement Centers will counsel them in developing plans to diversify revenue streams.

Importantly, Procurement Centers will also be tasked with actively recruiting small businesses—particularly those owned by minorities, women, and those in low-income and rural areas—to apply for contracts. To this end, the centers may collaborate with states in creating local-level or state-level mentor-protégé programs. By actively connecting new small businesses to government procurers, the SBA can ensure that public dollars are spent on the best-quality service providers and spur innovation where most needed.

### STREAMLINE FRONT-END APPLICATIONS TO SMALL-BUSINESS CONTRACTING PROGRAMS

In addition to helping small businesses fill out onerous certification applications, the SBA should take steps to simplify applications themselves and process them more quickly. First, the SBA should consolidate its application-review procedures into one centralized office. Congress should also increase personnel appropriations to the SBA for hiring additional officers dedicated solely to application review. The agency should target a two- to four-week turnaround on HUBZone and women-owned business applications—instead of its current practice of four- to six-months.[527] Second, the SBA should establish a working group to identify ways to streamline these applications, including by eliminating unnecessary document requirements. No small business should have to hire private consultants to navigate certification, as many do today.[528]

## Policy Recommendation VIII:
## Mobilize the Corporate Sector and Medical and Educational Institutions Around Minority- and Women-Owned Small-Business Growth

### ESTABLISH A NEW, TRANSPARENT REPORTING REGIME FOR PUBLIC, CORPORATE, AND ANCHOR INSTITUTIONS

As discussed above, federal contracting accounts for more than $500 billion in American business revenue annually. But this represents only a sliver of the multi-trillion-dollar market in public and private procurement below the federal level. Non-federal procurers include state and local governments; quasi-public entities, like federally funded universities and hospitals; other nonprofit organizations; and, of course, the private sector. Any comprehensive plan to increase the flow contracting dollars to small, disadvantaged businesses must engage these institutions and companies.

The supplier diversity field has evolved markedly in recent decades, with the emergence of movements like the Billion Dollar Roundtable. And these efforts are now being extended at the metropolitan scale. The Cincinnati Minority Business Accelerator highlighted above, for example, maintains a list of companies that have pledged to "diversify their supplier pipeline" while also "improving" Cincinnati's "local community and economy."[529] The list consists of 42 companies ranging from legacy firms like Kroger's and P&G to newly created partnerships like the Uptown Consortium—a coalition of anchor institutions (universities and hospitals) supporting five Cincinnati neighborhoods. These companies have committed to minority-owned business set-asides and sharing best practices for diverse procurement.

At the same time, the increasing importance of ESG (Environmental, Social and Governance) factors in institutional investing illustrates how a new system of transparent data collection and reporting around supplier diversity might evolve in the United States. ESG has its roots in the 1960's-inspired movement around Socially Responsible Investing, which strove to divest from companies engaging in environmentally or socially irresponsible practices. By the early 2000s, with risks emerging from global population growth, climate change, and natural-resources pressures, investors and corporate leaders saw that embedding ESG values into capital markets made good business sense. What has emerged is a sophisticated set of practices regarding how corporations evaluate and communicate risks surrounding their relationships with workers, conformity with international human-rights standards, and environmental impacts, among other factors. Institutional investors correspondingly incorporate these factors into their investment decisions.[530] In the past few years, for example, companies' climate-emissions profiles and exposures to climate-change risks have become central to the investment decisions of major institutional investors like BlackRock.[531] By some estimates, approximately 25 percent of all assets under management globally now incorporate ESG factors into investment decision-making.[532]

The supplier diversity field should follow a similar path. The next President of the United States should convene a blue-ribbon commission of leaders in supplier diversity from the public and private sectors, including leaders from major universities and hospital systems, Fortune 500 companies, and local and state governments. These leaders would be tasked with devising a unified standard for tracking and reporting on corporate and institutional procurement from minority-owned small businesses and other disadvantaged small businesses. As with other standards, like those set by the Sustainability Accounting Standards Board and the Task Force on

Climate-related Disclosures, these standards would include rules for reporting on small-business procurement. All reporting would be verifiable by independent audit firms, giving institutional investors confidence in relying on this data and helping corporations measure themselves against industry benchmarks. As with climate-risk standards, these new small-business procurement standards will not only help institutional investors make value-based investment decisions. They will also let consumers and the broader public understand the scope of a given company's commitment to disadvantaged small-business owners.

Once these standards are finalized, the president should use his or her soft power to organize commitments from major corporations, hospitals, and universities to maintaining high procurement standards and commitments from major asset managers to incorporating these measurements into their investment decisions. This would quickly put pressure on other public and private entities to follow suit. The federal government should further consider requiring major recipients of federal grants or contracts to report their disadvantaged business procurement performance using the new standards.

## AGGREGATE DEMAND VIA INTERMEDIARY MARKETPLACES

Data collection, reporting requirements, and goal setting are essential elements of a new procurement system that can transform small businesses. However, large institutions that do not have the experience and internal capacity of the federal government for small-business procurement efforts may struggle to find small-business suppliers to meet their needs, especially disadvantaged small-business suppliers. To match increased procurement demand with supply, many industries will need intermediary organizations with the capacity, capital, and standing to play a market-making role—i.e. matching the procurement demand of large organizations, like governments, corporations, financial institutions, universities, and hospitals, with the available aggregate supply from small businesses.

Intermediaries like this already exist in some industries, like Group Purchasing Organizations (GPOs) in healthcare. Group purchasing organizations represent a huge percentage of hospital procurement and are a good model for how other industries can establish intermediaries. According to a 2009 study, 73 percent of non-labor hospital purchases go through a GPO.[533] A 2010 Government Accountability Office (GAO) study estimated that 98 percent of hospitals use GPOs and are often members of 2-4 GPOs.[534] Although there are more than 600 hospital-focused GPOs operating in the United States, the top six GPOs capture 90 percent of the market, with over $100 billion in average purchasing volume, as of 2008.[535] While the primary purpose of GPOs is to pool demand and supply, lowering costs for purchasers, they also provide services like custom contracting, technology assessments, and supply chain analysis, among others.[536] In recent years, GPOs have taken small but important steps forward to diversify the supply chains of hospitals.*

These intermediaries are the keystone that will support meaningful growth in minority- and women-owned small-business procurement growth. In addition to aggregating demand and supply, such intermediaries may also need to help small businesses mature to handle the logistics and reporting requirements for large corporate and institutional contracts by providing financing, establishing mentor-protégé programs, etc.

We recommend that the SBA establish a new Office of Procurement Impact that can partner with industry to lift up such organizations and identify best practices for intermediary organizational structure and activities. Industry will also need to develop a set of best practices to support enhanced supplier diversity. For example, companies may want to create incentives, like variable pay structures, for mid-level managers to prioritize diverse contracting or establish internal ombudsman offices to advocate for supplier diversity.

## EMPOWER WORKFORCES TO SUSTAIN LOCAL BUSINESSES

Anchor institutions are a vital source of demand for local businesses. But another vital source is well-compensated workers themselves. Ample research finds that increasing workers' salaries in a particular region, particularly those of workers who earn the least, has a large effect on spending and business revenues within that region. One study shows that a one-dollar minimum-wage increase pushes workers and their families to spend $800 more over three months.[537] Polling has also found that majorities of small-business owners *support* raising minimum wages, despite the costs of doing so, for precisely this reason.[538]

Boosting worker compensation, however, yields widespread local benefits only if all employers participate. Without community-level buy-in, individual employers who raise wages risk taking on higher costs without an increase in sales. To rally entire communities around the goal of

* The Healthcare Supplier Diversity Alliance was established in 2003 by a consortium of GPOs and today a number of GPOs have specific contracting goals, although more remains to be done. See *The Healthcare Supply Chain: Supplier Diversity Increases Competition*, Health Care Supply Chain Assoc., https://www.supplychainassociation.org/wp-content/uploads/2018/05/HSCA__HSDA__Supplier__Diversity.pdf

empowering workers and consumers, state and city governments should pass ordinances to raise minimum wages and worker benefits—as cities like Oakland, California, have done.[539] But short of laws like these, federal policymakers, anchor institutions, and intermediary organizations can take other steps to catalyze change.

The SBA's new Office of Procurement Impact, proposed above, should collect data on anchor institutions that pay workers living wages—as well as providing equitable paid leave, healthcare coverage, and other benefits. It should publicize the names of anchor institutions that commit to compensating workers well. And intermediary platforms, discussed in Pillar 2, should push both anchor institutions and small businesses, themselves, to commit to fair compensation. Platforms can do this by connecting businesses with technical assistance opportunities, to help them raise compensation cost-effectively, survey their workers' needs, and add new benefits. Platforms can also make other services they provide contingent upon businesses' developing plans to compensate workers fairly. And they can push community lenders to place similar requirements on borrowers.

Specific steps that anchor institutions and small businesses can take to compensate workers fairly include the following:

- *Pay workers a livable wage.* Employers should commit to paying their workers a livable wage, above and beyond minimum-wage requirements. Employers should set wages fairly in consultation with ecosystem intermediaries, according to cost of living in their community and industry pay standards. Additionally, employers should ensure they compensate workers well across all experience levels. Building financially empowered workforces requires more than just raising the pay of the very lowest wage-earners.
- *Provide employees consistent working hours.* When employees work irregular hours, they shoulder higher costs, including for transportation and childcare, just to show up to work. Employees earning decent wages but working less than full-time also struggle financially. Businesses can empower workers without meaningfully raising their own costs by working with employees to develop work schedules that work for them. Some employers, like those in retail, can also mitigate the effects of irregular hours by providing workers a baseline level of compensation every time they show up to work.
- *Develop flexible paid-leave policies and expand other benefits, including healthcare.* Employee compensation goes beyond wages; it includes the full range of benefits that employers offer workers. Intermediary platforms should ensure that small businesses receive the

technical help they need to improve healthcare and other benefits programs—which are often costly and complex to redesign.

- *Institute worker cooperative or employee stock-ownership models.* Giving employees themselves a say in business managements—and a stake in business profits—will proliferate quality job opportunities throughout communities and build wealth for the long term. Transitioning to these models takes time. But intermediaries should push small businesses to plan for such transitions over the period of a few years—and provide them technical support to do so.
- *Solicit regular feedback from employees.* Employers should tailor their compensation packages to the particular needs of their workforces. Doing this effectively requires employers to listen to what workers say they want—through the use of employment surveys or other, informal means of collecting feedback.

The SBA, finally, can help small businesses access the financial support they need to make these changes. The agency should issue regulations specifying that borrowers may use 7(a) loans to sponsor transitions to worker-cooperative and employee stock-ownership models, as well as to institute other policies listed above.

**STEP 5**

# Measure to Manage: Evaluate for Continuous Improvement

**SUMMARY:** *You can't manage what you don't measure. Today, federal data collection on the small-business marketplace provides only rudimentary data on critical issues like access to credit, regional variations in the demographics of small-business owners, and the size and industry of their firms, and business sentiment. There is little to no rigorous evaluation of the performance of small-business programs. We recommend separating SBA's Office of Economic Research from the SBA Office of Advocacy and giving that office greater budget and authority, including funding for research grants and partnerships to foster a stronger national research ecosystem. We also recommend increasing funding for the U.S. Census Bureau's Economic Census and moving to a quick final rule for Section 1071 of the Dodd-Frank Act, which deals with lending data. Finally, we recommend systematically evaluating federal technical-assistance programs and providing funding for program experimentation.*

## Small-Business Data Collection & Program Evaluation Today

The United States needs a new approach to experimentation, data collection, and evaluation on small business programs and policies. For the past 50 years, the federal government has focused on inputs (e.g., new capital programs, new contracting requirements) rather than outcomes (e.g., jobs and firms created). As a result, little has changed. In 1992, nearly 30 years ago, Black-owned businesses made up 2.1 percent of employer businesses, while Women-owned businesses made up 26 percent of employer businesses. Today, Black-owned businesses make up 2.1 percent of employer businesses, and women-owned businesses make up 19.7 percent. Something must be done.

Currently, data collection on small businesses in the United States is spread among numerous federal agencies, including the U.S. Census Bureau, Federal Reserve, Small Business Administration, Bureau of Labor Statistics, and U.S. Department of Agriculture, among others. Ironically, SBA's Office of Economic Research is housed within the Office of Advocacy, whose stated purpose is to "reduce the burdens that federal regulations and other policies impose on small entities."[540] The Office of Advocacy itself notes in its Congressional Budget Justification documents that it "is not a data collection agency" and tends to produce flashy briefs rather than substantive research. One of the results, as discussed throughout this report, is that many SBA programs today cannot be rigorously evaluated.

In addition to publicly collected data, private data sources, such as those from the Kauffman Foundation, ADP, and the National Small Business Association supplement federally collected data.* These resources are currently indexed by the Small Business Administration's Office of Advocacy, and their chart can be found at the end of this section.[541] In addition to these sources, the COVID-19 crisis has spurred many private companies to publish free data on small-business performance, including companies like Womply and Alignable.

Collectively, these data sources provide information on owner demographics, employment numbers, revenues, finance, firm size, and payroll, at varying levels of geography. However, this data is often time-lagged, in some cases by years; is not available at census-tract, zip code, or metropolitan area level; and cannot be filtered across multiple variables at once. As a result, and unlike many other areas of the economy, researchers can at best put together only a limited snapshot of the successes and difficulties facing small businesses.

It is a business truism that you can't manage what you can't measure. To rebuild the small-business sector over the long-term, the United States must substantially increase investment in data collection, create new demonstration projects, and engage in rigorous program evaluation in order to advance in its mission to grow small businesses. In order to do so, it must also create a national ecosystem of researchers, at the federal government, in academia, and among practitioners, in order to promote and expand evidence-based programs to support small businesses.

* As indicated below, the Kauffman Foundation helped fund this research report. All mentions of and references to Kauffman programs and data sources reflect the important role the Foundation plays in research on entrepreneurship and where included by the authors without input from the Foundation.

# Policy Recommendation IX:
Collect more and better data on federal programs and the small-business sector

## MAKE SMALL BUSINESS DATA COLLECTION AND RESEARCH A FEDERAL-PRIORITY

The vast majority of the data collected by the federal government comes from the U.S. Census Bureau's Economic Census. However, the Economic Census has seen substantial reductions in funding over the previous 20 years. For example, while the U.S. Census Bureau spent $127 million on the Economic Census in Fiscal Year (FY) 2008, that number had shrunk to $105 million in 2018, a reduction of 30 percent when accounting for inflation. This reduction in funding has resulted in a substantial reduction in sample size, and thus in quality of the data output. For example, while the 2007 Survey of Business Owners had a sample size of well over 2 million businesses, the 2018 Annual Business Survey had shrunk to a sample of 850,000. Previously, the U.S. Census could report the number of businesses by industry and race of owner, at the city level. Today's reduced data quality means that the data is available only at the Metropolitan Statistical Area level, and even then, with substantially higher error rates.

In addition to the Economic Census, other valuable sources of information, such as the Federal Reserve, provide helpful, but limited, information. In order to continue to grow small businesses in the United States, the government must know not only census-count information, but also qualitative information about pressing challenges to growing entrepreneurship, business, and job creation. The Federal Reserve historically conducted the Survey of Small Business Finance, which included such information as the "most important problem faced by small business owners." That survey has not been conducted since 2003. Though the annual Federal Reserve Small Business Credit Survey provides an important view on the credit challenges faces small businesses, such a view is a limited purview into the myriad challenges facing small-business owners. Such information is only available at the national and state levels, obscuring variations among cities and states.

The federal government should take several concrete steps to ensure that information on the small-business sector is timely, comprehensive and actionable:

- The Office of Economic Research in the Small Business Administration must be expanded and promoted, in order to play a more central role in coordinating the collection of statistics and information about the state of small business in the United States. The Office of Economic Research should be moved out of the Office of Advocacy, in order to support impartiality and to help the office coordinate research across the federal government. The Office of Advocacy has been funded at a constant $9.1 million since at least FY 2012, and 95 percent of the funding goes towards staff salaries and benefits.[542] As a point of comparison, core appropriations to HUD's Research and Technology account received $85 million in FY 2016.[543]
- Funding for the U.S. Census Bureau's Economic Census must be increased to support greater data granularity. The United States must know at the city level and ideally at the census tract level the number of firms, by race, ethnicity, gender of owner, and industry. Additional information, such as payroll, sales, and number of employees, are also vital. This should be supplemented with regular collections of a new and expanded Survey of Small Business Finance, which would collect information on the financial challenges of small-business owners. As a point of comparison, HUD's Housing Market Surveys received appropriations of $42 million in FY 2016.[544]
- A rule must finally (after 10 years' delay) be promulgated for **Section 1071 of Dodd-Frank**, which requires the collection of demographic information on lending to small businesses owned by women and minorities. This is the purview of the Consumer Protection Financial Bureau. The Bureau has already announced, in September 2020, that it will convene a Small Business Advocacy Review panel in October 2020 to address proposed rulemaking for Section 1071's lending-data requirements.[545] The agency should adopt a rule promptly after the panel issues its recommendations.

## CREATING A RESEARCH ECOSYSTEM

In order to advance evidence-based practice, there must be an ecosystem of researchers in the federal government, academia, and the social and private sectors, committed to understanding the barriers to growing small businesses, and the programs that will enable small-business growth. Over the past 50 years, HUD has built a remarkable research ecosystem, and the Small Business Administration must begin to do the same. Dissertation Grants, supporting research through academic journals, research fellowships at the SBA, and research dissemination activities broadly, would all support the creation of a new cadre of researchers committed to creating a successful small-business ecosystem in the United States. SBA's expanded Office of Economic Research should establish a program on University Partnerships, and begin to cultivate a research pipeline to ensure better outcomes for small businesses in the United States. These researchers can contribute both to program evaluation and in understanding small-business market dynamics. Research Dissemination at HUD received $5.7 million in FY 2016.

## Policy Recommendation X:
Use data to rigorously evaluate impact and refine programs over time

### SYSTEMATICALLY EVALUATE FEDERAL TECHNICAL-ASSISTANCE PROGRAMS

Policymakers cannot craft effective training programs without knowing what makes training effective. Lawmakers and federal agencies, therefore, must substantially boost investments in rigorous program evaluation, an area they have long overlooked.

First, lawmakers must improve institutional capacity to design and interpret evaluations. Congress should reinstate, expand, and make permanent the Social and Behavioral Sciences Team (SBST)—an interagency group that President Obama created in 2015,[546] but that disbanded two years later. The SBST was a team of experts in economics and social sciences experts—with years of experience in study design—that helped federal agencies collect and leverage actionable data on their programs.[547] Once given new life by Congress, the SBST can advise agencies on how to evaluate small-business programs in timely, cost-effective ways.

The federal government must also take immediate steps to figure out which training programs work, and which do not. Congress should create a $1 billion fund for agencies to use for launching high-quality program evaluations over the next year. Agencies like the SBA and Department of Commerce would be required to use this fund to evaluate their major technical programs. Other agencies, like the Department of Defense, would also draw from this fund to assess their mentor-protégé programs.

To access this fund, agencies should be tasked with designing rigorous evaluations for their programs that follow social-scientific standards and rely on outcomes-based data. Agencies should develop their evaluations, and submit them for Congressional review, in collaboration with the SBST. Whenever possible, agencies should assess their programs with randomized control trials (RCTs). RCTs involve assigning program beneficiaries randomly to control and experimental groups and are considered the “gold standard” of program assessment.[548] Of course, RCTs are not feasible or cost effective for all federal programs. Agencies should determine whether to use RCTs or alternative studies in consultation with the SBST.[549]

Finally, lawmakers should take steps to integrate rigorous program evaluation into future initiatives. Going forward, Congress should explicitly reserve funds for research and evaluation when authorizing new small-business programs, and it should give the SBST an advisory role in such assessments. Future Congressional statutes should also mandate that agencies consider results from past evaluations when implementing technical assistance.

## EXPAND PROGRAM EXPERIMENTATION AND EVALUATION

Like other federal agencies, the Small Business Administration has guidelines to inform the evaluation of programs to ensure that agency efforts can improve continuously through objective assessment.[550] However, the SBA has little funding to catalyze innovative financial approaches, so that new products and distribution vehicles can be tested and ultimately codified if successful. HUD, by contrast, has spent hundreds of millions of dollars on the Moving to Opportunity and Moving to Work Demonstration Projects, in addition to numerous smaller studies every year. Congress should fund similar efforts at the SBA. The Capital Access Lab, funded by the Kauffman Foundation and informed by their report on the Barriers on Access to Capital,[551] is a good example of this kind of effort.

FIGURE 53

## EXISTING DATA SOURCES ON SMALL BUSINESS, ACCORDING TO THE SBA

| Data Program | Agency | Owner Demographics | Employment | International Trade | Finance | Firm Size | Firm / Establishment Level | Payroll / Benefits | Income / Sales / Expenses | Industry / Geography | Tax | Procurement | Earliest Data | Frequency |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Small Business Data Resources: U.S. Federal Government** | | | | | | | | | | | | | | |
| **Main Data Resources** | | | | | | | | | | | | | | |
| **Annual Business Survey** | Census Bureau | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | 2017 | Annual |
| **Business Dynamics Statistics** | Census Bureau | | ✓ | | | ✓ | ✓ | | | ✓ | | | 1977 | Annual |
| **Business Employment Dynamics** | Bureau of Labor Statistics | | ✓ | | | ✓ | ✓ | | | ✓ | | | 1992 | Quarterly |
| **Nonemplyer Statistics** | Census Bureau | | | | | ✓ | ✓ | | ✓ | ✓ | | | 1997 | Annual |
| **Quarterly Banking Profile** | FDIC/FFIEC | | | | ✓ | | | | | | | | 1995 | Biennial |
| **Small Business Credit Survey** | Federal Reserve Board | ✓ | ✓ | | ✓ | ✓ | ✓ | | ✓ | ✓ | ✓ | | 2010 | Annual |
| **Small Business Profiles** | SBA Office of Advocacy | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | — | Annual |
| **Sennior Loan Officer Opinion Survey** | Federal Reserve Board | | | | ✓ | ✓ | | | ✓ | | | | 1990 | Quarterly |
| **Statistics of U.S. Businesses** | Census Bureau | | ✓ | | | ✓ | ✓ | ✓ | ✓ | ✓ | | | 1987 | Annual |
| **Other Data Resources** | | | | | | | | | | | | | | |
| **Agriculture, Farm, Rural Data** | USDA Economic Research Service | ✓ | | ✓ | | ✓ | | | ✓ | ✓ | | | — | Varies |
| **Agricultural Data and Statistics** | USDA | | | ✓ | | | | | | ✓ | | | — | Varies |
| **American Community Survey** | Census Bureau | ✓ | ✓ | | | | | ✓ | ✓ | ✓ | ✓ | | 1993 | Annual, Every 5 years |
| **Annual Capital Expend. Survey** | Census Bureau | | | | | | | | ✓ | ✓ | | | 1994 | Annual |
| **Bankruptcy Filings** | Administrative Office, U.S. Courts | | | | | | | | | ✓ | | | 1899 | Quarterly |
| **Business Expenses** | Census Bureau | | | | | | | | ✓ | ✓ | | | 1992 | Annual, varies |
| **Business Formation Statistics** | Census Bureau | | | | | | | | | ✓ | | | 2004 | Quarterly |
| **Call Reports** | FDIC/FFIEC | | | | ✓ | | | | | | | | 1976 | Quarterly |
| **Community Reinvestment Act Data** | FFIEC | | | | ✓ | | | | | ✓ | | | 1996 | Annual |
| **County Business Patterns** | Census Bureau | | ✓ | | | | ✓ | ✓ | ✓ | ✓ | | | 1962 | Annual |
| **Current Population Survey** | Census/Bureau of Labor Statistics | ✓ | ✓ | | | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | 1942 | Monthly |
| **Earnings and Employment Data** | Social Security Administration | | ✓ | | | | ✓ | ✓ | | | ✓ | | — | Varies |
| **EDGAR Database** | Securities and Exchange Comm. | | | | ✓ | ✓ | ✓ | | ✓ | ✓ | | | — | Varies |
| **Exporter Database** | International Trade Admin. | | | ✓ | | | ✓ | | | | | | 1997 | Varies |
| **Flow of Funds** | Federal Reserve Board | | | | ✓ | | | | | | | | 1945 | Quarterly |
| **Income for Prop./Corp., GDP** | Bureau of Economic Analysis | | ✓ | ✓ | | | | | ✓ | ✓ | | | — | Varies |
| **Jon Openings/Labor Turnover Survey** | Bureau of Labor Statistics | | ✓ | | | ✓ | ✓ | | | ✓ | | | 2000 | Monthly |
| **Profile US Importing/Exporting Co.** | Census Bureau | | | ✓ | | ✓ | ✓ | | | ✓ | | | — | Annual |
| **SBA Weekly Lending Data** | Small Business Administration | ✓ | | ✓ | ✓ | | | | | | | | 2010 | Weekly |
| **Small Business Lending Survey** | Federal Reserve Board | | | | ✓ | | | | | | | | 2017 | Quarterly |
| **Small Business Goaling Report** | Federal Procurement Data System | | | | | ✓ | | | | | | ✓ | 2000 | Annual |
| **SBA Loan Data** | Small Business Administration | | ✓ | | ✓ | | | | | ✓ | | | 1991 | Biennial |

FIGURE 54

## EXISTING DATA SOURCES ON SMALL BUSINESS, ACCORDING TO THE SBA (CONTINUED)

| Data Program | Agency | Owner Demographics | Employment | International Trade | Finance | Firm Size | Firm / Establishment Level | Payroll / Benefits | Income / Sales / Expenses | Industry / Geography | Tax | Procurement | Earliest Data | Frequency |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Other Federal Government Data Resources, continued** | | | | | | | | | | | | | | |
| **Statistics of Income** | Treasury, IRS, SOI | | ✓ | | | ✓ | | ✓ | ✓ | ✓ | | | 2017 | Varies |
| **Survey of Consumer Financials** | Federal Reserve Board | ✓ | ✓ | | ✓ | | | ✓ | | | | | 1977 | Every 3 Years |
| **Surv. of Income and Program Particip.** | Census Bureau | ✓ | ✓ | | | | | ✓ | | | ✓ | | 1992 | Varies |
| **USASpending.gov** | U.S. Federal Govt. Portal | | | | | | | | | | | ✓ | 1997 | Annual |
| **Annual Survey of Entrepreneurs** | Census Bureau | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | 1995 | Annual |
| **Survey of Business Owners** | Census Bureau | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | | 2010 | Every 5 Years |
| **Survey of Small Business Finances** | Federal Reserve Board | | | | ✓ | | | | | | | | — | Varies |
| **Survey of Terms of Bus. Lending** | Federal Reserve Board | | | | ✓ | | | | | | | | 1990 | Quarterly |
| **Small Business Data Resources: Other Than U.S. Federal Government** | | | | | | | | | | | | | | |
| **Economic Health Tracker** | Dun & Bradstreet | | ✓ | | ✓ | ✓ | | | | ✓ | | | — | Monthly |
| **Economic Report** | National Small Business Assoc. | | ✓ | | ✓ | | | ✓ | ✓ | ✓ | ✓ | | — | Biennial |
| **Empl. Health Benefits Survey** | Kaiser Family Foundation | | | | | ✓ | | ✓ | | | | | 1993 | Annual |
| **GEM** | Global Entrep. Monitor | ✓ | ✓ | ✓ | ✓ | | | | | | ✓ | | 1994 | Annual |
| **Initial Public Offerings Anal.** | Univ. of Fl., Prof. Jay Ritter | | | | ✓ | | | | | | | | 1899 | Annual |
| **Institute For Veteran and Mil. Fam.** | Syracuse University | ✓ | ✓ | | | | | | | ✓ | | | 1992 | Varies |
| **Kauffman Indicators** | Kauffman Foundation | ✓ | ✓ | | | | | | ✓ | ✓ | | | 2004 | Annual |
| **Latino Entrepreneurship Initiative** | Stanford GSB | ✓ | | | | | ✓ | | | ✓ | | | 1976 | Varies |
| **National Emplyment Report** | ADP, Inc. | | ✓ | | | ✓ | | | | ✓ | | | 1996 | Monthly |
| **Outplacement Reports** | Challenger, Gray and Christ. | ✓ | ✓ | | | | ✓ | ✓ | | ✓ | | | 1962 | Monthly |
| **Panel Study of Entrepr. Dynamics** | University of Michigan | ✓ | | | ✓ | ✓ | ✓ | | | | | | 1942 | Varies |
| **Pitchbook** | National Venture Cap. Assoc. | | | | ✓ | | | | | | | | — | Quarterly |
| **Private Capital Access Index** | Pepperdine / D&B | ✓ | | | ✓ | | | | ✓ | ✓ | | | — | Quarterly |
| **Small Business Friendliness Survey** | Thumbtack | | ✓ | | | | | | | ✓ | ✓ | | 1997 | Annual |
| **Small Business Lending Index** | Biz2Credit | | | | ✓ | | | | | | | | 1945 | Monthly |
| **Small Business Employment Watch** | Paychex | | ✓ | | | | | ✓ | | ✓ | | | — | Monthly |
| **Small Business Index** | U.S. Chamber of Commerce | ✓ | | | | | | | | ✓ | ✓ | | 2000 | Quarterly |
| **Small Business Index** | Wells Fargo / Gallup | | ✓ | | ✓ | | | | ✓ | | ✓ | | — | Quarterly |
| **Small Business Trends** | National Fed. of Ind. Business | | ✓ | | ✓ | | | ✓ | ✓ | | ✓ | | 2010 | Monthly |
| **Kauffman Firm Survey** | Kauffman Foundation | ✓ | ✓ | | ✓ | ✓ | ✓ | | ✓ | ✓ | | | 2017 | Quarterly |

# Conclusion

**THE AUTHORS** of this report come from different backgrounds. We work in venture capital, finance, law, economic development, and politics. We are Black, Latinx, Asian, and white. We hail from both coasts and states in-between. We are united now by three simple ideas: Small business matters; there is more we can do to support them; and this is the time to act.

As we have laid out in detail in this report, small businesses innovate, keep markets competitive, animate our neighborhoods, and are a pathway to building wealth for low-income and minority Americans. Small businesses employ just under half of all working Americans and create more jobs than large companies.

Notwithstanding the vital role of small businesses in our economy and in our lives, as a country we have hitherto failed to focus the requisite attention on how public policy can and should support entrepreneurs and small businesses. Unlike the federal government's role in many sectors of the economy, small businesses are on their own. Since COVID-19 hit in the United States in February 2020, the federal government strove to sustain the small-business sector, trying in eight months of work to make up for eighty years of policy neglect. But without strong institutions and tools for reaching small businesses, the federal response missed the mark, leaving between one and two million small businesses facing extinction.

While the challenges facing the small-business sector are now obvious, for those who were looking, the cracks were visible under the surface long before COVID-19. Over the past 25 years, and especially the past 15 years, the U.S. economy has grown ever more concentrated. The result is a winners-take-all marketplace that hurts consumers and small businesses alike. Meanwhile, women and minorities, especially Black and Latinx Americans, remain underrepresented among small-business owners. As the powerful calls for racial justice this past summer highlighted, it is impossible to untangle the twin injustices of discrimination and poverty in our country. Helping minority entrepreneurs and women build businesses is among the most important ways policy-makers can help bridge the wealth gaps in this country.

Led by the federal government, we must collectively commit to rebuilding the small-business sector. To get there, we must take five steps: address the COVID-19 crisis in the small-business sector, level the playing field for entrepreneurs, build a financial sector that actually works for small businesses, use public and private procurement to grow minority- and women-owned firms, and collect the data to understand, evaluate and improve public programs and policies at the local, state and federal level.

We believe there is a broad political coalition that will support these steps. The roadmap we have laid out focuses in particular on minority-owned businesses and to a lesser extent women-owned businesses. But the ideas we are recommending will bring benefits to all small-business owners, regardless of race or geography. Community Development Financial Institutions (CDFIs) operate in west Philadelphia and in Chadron, Nebraska (pop: 5,851). Creating new federally-backed small-business loans powered by fintech platforms will equally help business owners in down-town Detroit, Michigan and in Itta Bena, Mississippi, a town with no banks and just four ATMs.

There is no question that the COVID-19 crisis is a turning point for America's small businesses. Absent a broad national commitment to rethinking how we collectively support those businesses, it will be a turn for the worse, to the detriment of tens of millions of Americans for decades to come. But if we come together and follow the steps outlined in this report, a more competitive, dynamic and fair economy, with a flourishing small-business sector that enriches our individual and collective lives, is within reach.

# Appendix 1: Data Notes

**Small Business Credit Survey**: A primary data source for this analysis is the 2019 Federal Reserve Small Business Credit Survey.[552] The Credit Survey was in the field in Q3 and Q4 of 2019, and thus provides a picture of the small-business credit environment in the United States, before the COVID-19 pandemic impacted the economy. The survey draws from up to 4,000 respondent businesses, but not all questions received responses from all participants. Because several lines of question segment the sample as they "branch" (for instance, "did you apply for credit in the last 12 months?," and if yes, "what sources did you apply to?") some questions have much smaller response rates. In some cases, less than 100. The Credit Survey reports the eventual size of respondents for each question, and, where possible, this information has been included in the analysis as a note to each graphic. Additionally, the Credit Survey is a survey "of convenience," meaning that a less-than-perfect random sampling of small businesses produced its respondents. In order to account for this, the Federal Reserve survey team "weighted" certain respondents more strongly than others, in an attempt to produce results which fairly reflected the demographics of the total small-business population of the United States. The analysis of this report continues under the assumption that the survey team has correctly utilized these statistical techniques, and that the resulting data is accurate in understanding the American small-business credit landscape in late 2019. However, as the survey team has not publicly released the raw survey data for reasons of respondent anonymization, authors of this report cannot personally attest to the techniques performed by the team at the Federal Reserve Banks.

The methodology of the Credit Survey is discussed in detail on the final two pages of the Federal Reserve Bank's partial presentation of findings, available at https://www.fedsmallbusiness.org/survey/2020/report-on-employer-firms.[553]

**Annual Business Survey**: "The Annual Business Survey (ABS) provides information on selected economic and demographic characteristics for businesses and business owners by sex, ethnicity, race, and veteran status. Further, the survey measures research and development (for microbusinesses), new business topics such as innovation and technology, as well as other business characteristics. The ABS is conducted jointly by the U.S. Census Bureau and the National Center for Science and Engineering Statistics within the National Science Foundation. The ABS replaces the five-year Survey of Business Owners (SBO) for employer businesses, the Annual Survey of Entrepreneurs (ASE), the Business R&D and Innovation for Microbusinesses survey (BRDI-M), and the innovation section of the Business R&D and Innovation Survey (BRDI-S).

Included are all nonfarm employer businesses filing the 941, 944, or 1120 tax forms. The ABS is conducted on a company or firm basis rather than an establishment basis. A company or firm is a business consisting of one or more domestic establishments that the reporting firm specified under its ownership or control."[554]

**Statistics of U.S. Businesses**: "Statistics of U.S. Businesses (SUSB) is an annual series that provides national and subnational data on the distribution of economic data by enterprise size and industry. SUSB covers most of the country's economic activity. The series excludes data on non-employer businesses, private households, railroads, agricultural production, and most government entities.

Tabulations providing data by employment size of enterprise have been assembled as far back as 1989. These data were developed in cooperation with, and partially funded by, the Office of Advocacy of the U.S. Small Business Administration (SBA)."[555]

**Kaufmann Indicators of entrepreneurship**: "The U.S. Census's Current Population Survey (CPS) and the Bureau of Labor Statistics (BLS) Business Employment Dynamics (BED) are the underlying data sources for the Early-Stage Indicators. The Business Formation Statistics (BFS), Business Dynamics Statistics (BDS), and Population Estimates Program (PEP) are the underlying data sources for the New Employer Business Indicators."[556]

**Census Business Formation Statistics**: "The Business Formation Statistics (BFS) are an experimental data product of the U.S. Census Bureau developed in research collaboration with economists affiliated with Board of Governors of the Federal Reserve System, Federal Reserve Bank of Atlanta, University of Maryland, and University of Notre Dame. The BFS provide timely and high frequency information on new business applications and formations in the United States"[557]

Demographic Calculations. In using available data to make demographic calculations, where possible "Hispanic" has been calculated to include respondents of any race who also certify "Hispanic." Other demographic categories (Black, White, Asian) have been constructed to include only persons identifying as that race, and also not as Hispanic.

# Appendix 2: Brief Review of Credit Provider Business Models

- **Credit Card Companies:** Almost all loans are held on balance sheet; customer loans are almost universally short term. *Categorized as balance-sheet lenders, short-term credit.*
- **Traditional Banks:** Most small-business loans held on balance sheet; much of the significant lending to small firms is long-term. *Categorized as balance-sheet lenders, long-term credit.*
- **7(a) Banks:** Oak Tree, First Home, and other banks originating 7(a) loans typically sell off the majority of the guaranteed portion of 7(a) loans; 7(a) loans are for maximum maturity of 10-25 yrs. *Categorized as originators, long-term credit.*
- **Stripe:** Public coverage indicates that Stripe is focused on shorter-duration cash advances, originated based on payment info, similarly to credit-card companies.[558] Some may make longer-duration loans are an option, but this is not emphasized in public information. *Categorized as balance-sheet lender, short-term credit.*
- **Square:** Square Capital extends loans to providers on the Square network. Square makes "these loans from arrangements with institutional third-party investors who purchase these loans on a forward-flow basis."[559] Maximum loan duration appears to be one year, and loans are structured to be repaid directly from sales revenues, imitating merchant cash advances.[560] *Categorized as an originator, short-term credit.*
- **PayPal:** PayPal lends through working-capital facilities with a one-time fee (PayPal Working Capital) and also issues normal business loans (PayPal Business Loans).[561] No mention is made of selling off these products in the 10Q, although a 2017 article quoted the

CFO as saying he would consider selling the business-loan portfolio if it reached sufficient size.[562] The entire credit portfolio is classified as a current asset, and so the assumption is made that short-term loans and working capital are its predominant character.[563] *Categorized as balance-sheet lender, short-term credit.*

- **Funding Circle:** Funding Circle traditionally acted as a pure "marketplace" intermediary. In 2019, it grew its securitization business.[564] It retains some small exposure to loans. *Categorized as an intermediary, long-term credit.*
- **OnDeck:** OnDeck originates loans of short and long duration, as well as lines of credit, but its average duration has generally been around a year, or slightly longer.[565] OnDeck appears to hold a significant interest in some of the loans it originates.[566] *Categorized as between an originator and balance-sheet lender, long-term credit.*
- **Kabbage:** Kabbage lends in shorter duration, with facilities drawable at will over a six- to twelve-month period and accruing interest only based on actual drawings.[567] Although Kabbage is private, it finances its operations through securitization of its originated loans.[568] *Categorized as between an originator and securitizer, short-term credit.*

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**Bruce Katz** is the Founding Director of the Nowak Metro Finance Lab at Drexel University in Philadelphia. Previously he served as inaugural Centennial Scholar at Brookings Institution and as vice president and director of Brooking's Metropolitan Policy Program for 20 years. He is a Partner with Accelerator for America and a Visiting Professor in Practice at the London School of Economics and previously served as chief of staff to the secretary of Housing and Urban Development and staff director of the Senate Subcommittee on Housing and Urban Affairs. Katz co-led the Obama administration's housing and urban transition team. He is coauthor of The Metropolitan Revolution and The New Localism: How Cities Can Thrive in the Age of Populism, editor or coeditor of several books on urban and metropolitan issues, and a frequent media commentator.

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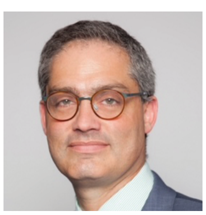

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# Project Sponsors

The authors would like to thank the Ewing Marion Kauffman Foundation for its ongoing support of this project.

# About Drexel University's Nowak Metro Finance Lab

The Nowak Metro Finance Lab was founded in 2018 to help cities design, finance and deliver transformative initiatives, with a focus on supporting inclusive and equitable growth. The Lab honors the legacy of Jeremy Nowak, the widely respected urban thought leader and practitioner. Read more about Jeremy's work and legacy.

As an initiative of Drexel's Lindy Institute for Urban Innovation, the Lab leverage Lindy's deep expertise in practice-based, interdisciplinary urban problem solving.

# About Yale's Institution for Social and Policy Studies

The Institution for Social and Policy Studies (ISPS) at Yale University advances interdisciplinary research in the social sciences that aims to shape public policy and inform democratic deliberation.

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By supporting policy education, fellowship programs and extracurricular activities, we also develop future leaders who will themselves inform—and perhaps even join—the policymaking community in years to come, bringing with them the commitments to inquiry and scholarship that lie at the heart of ISPS.

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55. Herbert J. Hovenkamp, *Progressive Antitrust*, 2018 U. Ill. L. Rev. 71, 77 (2018). These concerns were particularly acute in the railroad-transit and banking industries, and they extended to disadvantages suffered by single-family farmers. *See* Sandra M. Anglund, Small Business Policy and the American Creed 27 (2000) (noting that one goal of the Sherman Act was to counteract "inequality" arising from the greater presence of trusts).
56. *See* Anglund, *supra* note 55, at 25-43.
57. Tim Sablik, *Fed Credit Policy During the Great Depression*, Fed. Res. Bank Richmond 2 (2013), https://fraser.stlouisfed.org/files/docs/historical/frbrich/econbrief/frbrich_eb_13-03.pdf. Federal Reserve Banks were allowed to lend only to companies on an intrastate basis. The RFC prioritized loans to the smallest businesses from the outset: it established a "small small-business division," which exclusively made decisions and recommendations on business loans totaling $100,000 or less. *See* Nancy Y. Moore, Clifford A. Grammrich & Judith D. Mele, Small Business and Strategic Sourcing: Lessons From Past Research and Current Data 7 (2014).
58. *See* Mary Eschelbach Hansen & Bradley Hansen, *Making It Easier to Declare Bankruptcy Could Avert Economic Catastrophe*, Wash. Post (Apr. 24, 2020), https://www.washingtonpost.com/outlook/2020/04/24/making-it-easier-declare-bankruptcy-could-avert-economic-catastrophe/.
59. The intent was not to "compete with local banks," wrote the Federal Reserve Board in 1934, "but rather [to] assist and cooperate with them" in providing companies with "working capital." *Review of the Month—Recent Banking Legislation*, 20 Fed. Res. Bull. 429, 430 (1934).
60. *See* Sablik, *supra* note 57, at 2.
61. *See* Hovenkamp, *supra* note 55, at 80-81 (discussing President Roosevelt's appointments of Thurman Arnold and William O. Douglas, as heads of the Securities and Exchange Commission and the Department of Justice's Antitrust Division, respectively, and Congress's Robinson-Patman Act of 1936). Immediately before President Roosevelt's election and implementation of the New Deal, antitrust policy entered a period of decline relative to the Progressive Era—a period some scholars have termed the "Antitrust Hiatus." Laura Phillips Sawyer, *US Antitrust Law and Policy in Historical Perspective* 12 (Harv. Bus. Sch., Working Paper 19-110, 2019), https://www.hbs.edu/faculty/Publication%20Files/19-110_e21447ad-d98a-451f-8ef0-ba42209018e6.pdf.
62. Cong. Research Serv., R44844, SBA's "8(a) Program": Overview, History, and Current Issues 3 (2019) (noting that one Congressional goal was "mobiliz[ing] the productive facilities of small business in the interest of successful prosecution of the war") (quoting the Small Business Mobilization Act).
63. Small Business Mobilization Act, Pub L. No, 77-603, 56 Stat. 351 (1942).
64. Cong. Research Serv., R44844, SBA's "8(a) Program": Overview, History, and Current Issues 3 (2019); *see also* Moore, Grammrich & Mele, *supra* note 57, at 7.
65. Cong. Research Serv., R44844, SBA's "8(a) Program": Overview, History, and Current Issues 3 (2019).
66. *See* Anglund, *supra* note 55, at 26; *see also* Martin Giraudeau, *Remembering the Future: Entrepreneurship Guidebooks in the US, From Meditation to Method (1945-1975)*, 13 Foucault Stud. 53 (2012) (describing how the state "stopped being only an intermediary, a mere 'broker state,' and began involving itself directly in the world and practices of business").

67. *See* Anglund, *supra* note 55, at 26.
68. Cong. Research Serv., RL33243, Small Business Administration: A Primer on Programs and Funding 1 (2020). The RFC was disbanded in the early 1950s. The Small Business Act also repealed the Federal Reserve's authority to issue loans directly to companies. *See* Sablik, *supra* note 57, at 5.
69. Elijah Brewer & Hesna Genay, *Funding Small Business Through the SBIC Program*, 18 Econ. Persp. 22, 22 (1994). Contemporary commentators generally considered the SBA's pre-1958 scope "severely limited" in part because it could not provide equity financing—to take longer-term stakes in corporations—and it lacked the tools to stimulate large amounts of private-sector capital. *See* William John Martin & Ralph J. Moore, *The Small Business Investment Act of 1958*, 47 Calif. L. Rev. 144, 145 (1959).
70. Congress also that year passed the Small Business Act of 1958, which provided for the SBA to become a permanent federal agency. Small Business Act Amendments of 1958, Pub. L. No. 85-536, 72 Stat. 384.
71. Brewer & Genay, *supra* note 69, at 22.
72. *What to Know About Small Business Investment Companies (SBICs)*, Minority Bus. Dev. Agency (Dec. 2014), https://www.mbda.gov/news/blog/2014/12/what-know-about-small-business-investment-companies-sbics.
73. The Small Business Act of 1953 defines a small business only as "one which is independently owned and operated and which is not dominant in its field of operation." Small Business Act of 1953, 15 U.S.C. § 632(a)(1) (2018).
74. Cong. Research Serv., R40860, Small Business Size Standards: A Historical Analysis of Contemporary Issues 9-10 (2019).
75. *See* Hovenkamp, *supra* note 55, at 85-87.
76. Cong. Research Serv., R44844, SBA's "8(a) Program": Overview, History, and Current Issues 3-4, n.17 (2019).
77. *Id.* at 4. President Johnson invoked these powers as part of his President's Test Cities Program, a pilot initiative that was aimed in part at promoting employment among Black populations.
78. *See id.* at 4-5.
79. Small Business Act Amendments, Pub. L. No. 95-507, 92 Stat. 1757 (1978).
80. *See* Philip G. Bail, Jr., *The Demise of the Federal Government Small Business Program*, Def. Acquisition U. 81 (2010) https://www.dau.edu/library/arj/ARJ/arj53/Bail53.pdf. Agency targets are set in terms of percentage of contracting dollars awarded to small businesses. The SBA collaborates with each agency to set reasonable goals and to ensure that, in total, federal small-business contracting meets aggregate targets laid out by statute. *See* Bailey Wolff, *Federal Government Achieves Small Business Contracting Goal for Sixth Consecutive Year with Record-Breaking $120 Billion to Small Businesses*, U.S. Small Bus. Admin. (July 17, 2019), https://www.sba.gov/node/1645066.
81. National Defense Authorization Act for Fiscal Year 1987, Pub. L. No. 99-661, 100 Stat. 3816 (1986).
82. Business Opportunity Development Reform Act of 1988, Pub. L. No. 100-656, 102 Stat. 3853.
83. Veterans Entrepreneurship and Small Business Development Act of 1999, Pub. L. No. 106-50, 113 Stat. 233 (1999).
84. *See* Cong. Research Serv., R41268, Small Business Administration HUBZone Program 7 (2019).
85. Cong. Research Serv., R41352, Small Business Management and Technical Assistance Training Programs 17 (2020).
86. *Id.*
87. *Id.* at 6. SBDCs, which are typically hosted by partner universities, offer intensive training to small businesses, particularly in early stages of development. Congress a few years later authorized the SBDC program by statute, see Small Business Act Amendments, Pub. L. No. 96-302 (1980).
88. Cong. Research Serv., R41352, Small Business Management and Technical Assistance Training Programs 23 (2020).
89. *Id.* at 11-12.
90. Toni P. Lester, *Does the Government Really Help Small Business Exporters?*, 13 Nw. J. Int'l L. & Bus. 374, 375 (1992).
91. Sam Peltzman, *The Decline of Antitrust Enforcement*, 19 Rev. Ind. Org. 49, 51 (2001).
92. The SBA last used its Section 7(a) powers to issue loans, outside of its microloan program and disaster-loan initiatives, in 1998. Cong. Research Serv., RL33243, Small Business Administration: A Primer on Programs and Funding 6-7 (2020).
93. *Id.*
94. *See* Cong. Research Serv., R43846, Small Business Administration (SBA) Funding: Overview and Recent Trends 1 (2020).
95. Michal Kowalik, Troy Davig, Charles S. Morris & Kristin Regehr, *Bank Consolidation and Merger Activity Following the Crisis*, Fed. Res. Bank Kan. City 5 (2015), https://www.kansascityfed.org/publicat/econrev/pdf/15q1Kowalik-Davig-Morris-regehr.pdf.
96. *See id.* at 5-10.

97. *See, e.g.*, Robert B. Avery & Katherine A. Samolyk, *Bank Consolidation and Small Business Lending: The Role of Community Banks* 2 (Fed. Reserve Bd. of Governors, Working Paper 2003-05, Oct. 2003), https://www.fdic.gov/bank/analytical/working/wp03-05.pdf. Some research finds that bank acquisitions tend to result in the acquirer's reshaping of the acquisition target's loan portfolio to mirror the acquirer's existing portfolio. Joe Peek & Eric S. Rosengren, *Bank Consolidation and Small Business Lending: It's Not Just Bank Size That Matters*, 22 J. Banking & Fin. 799, 799 (1998).
98. Ann Marie Wiersch & Scott Shane, *Why Small Business Lending Isn't What It Used To Be*, Fed. Res. Bank Cleveland (Aug. 14, 2013), https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2013-economic-commentaries/ec-201310-why-small-business-lending-isnt-what-it-used-to-be.aspx.
99. Richard G. Anderson & Charles S. Gascon, *A Closer Look: Assistance Programs in the Wake of the Crisis*, Fed. Res. Bank St. Louis (Jan. 1, 2011), https://www.stlouisfed.org/publications/regional-economist/january-2011/a-closer-look-brassistance-programs-in-the-wake-of-the-crisis.
100. *Id.*
101. *Id.*
102. Cong. Research Serv., R42045, The Small Business Lending Fund 1 (2020) (discussing the American Recovery and Reinvestment Act of 2009).
103. *Id.*
104. President Barack Obama, Remarks in the State of the Union Address (Jan. 27, 2010), https://obamawhitehouse.archives.gov/the-press-office/remarks-president-state-union-address.
105. Cong. Research Serv., R42045, The Small Business Lending Fund 8 (2020).
106. *Id.*
107. The federal government also offers disaster assistance to small businesses. In federally declared emergencies, disaster aid is delivered through each of the three channels above, but in greater amounts and on terms tailored to the special circumstances. This assistance is a critical aspect of small-business support; however, disaster aid comes sporadically and lies removed from the government's overall strategy for strengthening small businesses. We therefore omit it from this discussion. *See generally* Cong. Research Serv., R41981, Congressional Primer on Responding to and Recovering from Major Disaster and Emergencies (2020).
108. Small Business Act of 1953 § 7(a), 15 U.S.C. § 636 (2018).
109. 7(a) loans above $150,000 are eligible for up to a 75 percent guarantee, while loans below this amount are eligible for up to 85 percent. *See* Rebecca Lake, *How Does an SBA 7(a) Loan Work?*, U.S. News & World Rep. (Oct. 2, 2019), https://loans.usnews.com/articles/how-does-an-sba-7a-loan-work.
110. Cong. Research Serv., R41146, Small Business Administration 7(a) Loan Guaranty Program 1 (2019).
111. Small Business Jobs Act of 2010, 15 U.S.C. § 631 (2018).
112. Cong. Research Serv., R41146, Small Business Administration 7(a) Loan Guaranty Program 13 (2019).
113. *See id.* at 24.
114. *Id.* at 16.
115. *Id.* at 15.
116. Small Business Investment Act of 1958 § 503, 15 U.S.C. § 697 (2018).
117. Cong. Research Serv., R41184, Small Business Administration 504/CDC Loan Guaranty Program 1–2 (2019). CDC funds supplement private-lender financing and direct business contributions to the projects, and they are usual for new building construction or land acquisition. Many CDCs make much of their profits from financing second mortgages, where the first mortgage was privately financed.
118. *Id.* at 8.
119. Twelve percent of CDCs are also registered as CDFIs. *CDFI Funds*, CDC Financing, https://cdcfinancing.com/cdfi.
120. Cong. Research Serv., R41184, Small Business Administration 504/CDC Loan Guaranty Program 2 (2019).
121. Collateral for loans under $25,000 is waived, but this program otherwise operates like the standard 7(a) program, with normal collateral requirements. *See Community Advantage Participant Guide*, U.S. Small Bus. Admin. 16 (Oct. 1, 2018), https://www.sba.gov/sites/default/files/2018-09/Community%20Advantage%20Guide%205.0.pdf.
122. Cong. Research Serv., R41057, Small Business Administration Microloan Program 4 (2020).
123. Robert Jay Dilger, Cong. Research Serv., R43083, SBA Assistance to Small Business Startups: Client Experiences and Program Impact 15 (2020).

124. *See* U.S. Small Bus. Admin., FY2020 Congressional Justification FY 2018 Annual Performance Report 39 (2019); Cong. Research Serv., R41057, Small Business Administration Microloan Program 12, (2020).
125. For further discussion of CDCs' and CDFIs' missions and examples of each, see *Certified CDCs and CDFIs in South Carolina*, S.C. Ass'n Community Econ. Dev. (2017), https://www.scaced.org/certified-cdcs-cdfis.
126. *Community Development Financial Institutions*, CDC Financing (2020), https://cdcfinancing.com/cdfi.
127. Cmty. Dev. Fin. Inst. Fund, *CDFI Certification: Your Gateway to the CDFI Community,* U.S. Dep't Treasury (Jan. 2016), https://www.cdfifund.gov/Documents/CDFI_PROGRAM_FACT_SHEET_CERTIFICATION_updatedJAN2016.pdf.
128. Rachid Erekaini, *What Is a Community Development Corporation?*, Nat'l Alliance Community Econ. Dev. Ass'ns (Sept. 17, 2014), https://www.naceda.org/index.php?option=com_dailyplanetblog&view=entry&category=bright-ideas&id=25%3Awhat-is-a-community-development-corporation-&Itemid=171.
129. Nancy Thompson, *Recognition as a Community Development Corporation*, Useful Community Dev. (2020), https://www.useful-community-development.org/recognition-as-a-community-development-corporation.html.
130. Small Business Investment and Opportunity Act of 2017 § 2, 15 U.S.C. § 683. Prior to this act's passage, the SBA was authorized to guarantee only $150 million in SBIC lending. *See id.*; *see also Bridging the Capital Formation Gap*, Ass'n for Corp. Growth 9 (2016), https://www.acg.org/sites/files/SBIC_Overview_12_April_2016.pdf (describing the SBIC public-private partnership at work).
131. *The Small Business Investment Company (SBIC)* Program, U.S. Small Bus. Admin. 2 (Oct. 1, 2018), https://www.sba.gov/sites/default/files/2019-02/2018%20SBIC%20Program%20Overview.pdf.
132. Cong. Research Serv., R41456, SBA Small Business Investment Company Program 7 (2020).
133. *Apply to Be an SBIC*, U.S. Small Bus. Admin., https://www.sba.gov/partners/sbics/apply-be-sbic.
134. Martin D. Teckler, *The SBIC Program: An Opportunity for Bank Investors*, Kelley Drye & Warren LLP 4 (Feb. 2016), http://colemanreport.com/wp-content/uploads/2016/03/The-SBIC-Program-Overview_An-Opportunity-for-Bank-Investors_Feb-2016.pdf.
135. Cong. Research Serv., R41456, SBA Small Business Investment Company Program, at i (2020).
136. Teckler, *supra* note 134, at 4.
137. Cong. Research Serv., R41456, SBA Small Business Investment Company Program 5-6(2020).
138. Sarah Friedman, *Redlining Revisited: Why the Community Reinvestment Act Needs to Do More to End Lending Discrimination*, Daily Beast (June 6, 2019), https://www.thedailybeast.com/redlining-revisited-why-the-community-reinvestment-act-needs-to-do-more-to-end-lending-discrimination.
139. Will Kenton, *Community Reinvestment Act (CRA)*, Investopedia (Aug. 18, 2020), https://www.investopedia.com/terms/c/community_reinvestment_act.asp.
140. *See* Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice, 78 Fed. Reg. 69,671, 69,671-73 (Nov. 20, 2013) (discussing regulators' standards and holistic methodology for evaluating whether some investments are CRA-eligible).
141. *Id.* at 69,679.
142. Cong. Research Serv., R43661, The Effectiveness of the Community Reinvestment Act 11 (2019).
143. *Id.* at 1.
144. *What Happens If a Bank Gets a Bad CRA Rating?* FindCRA.com (Nov. 27, 2016), https://www.learncra.com/knowledge-base/what-happens-if-a-bank-gets-a-bad-cra-rating/.
145. *Id.*; *see also* 12 C.F.R. § 225.84 (2020).
146. Robert Jay Dilger, Cong. Research Serv., R42581, State Small Business Credit Initiative: Implementation and Funding Issues 6-9 (2017).
147. *Id.* at 10.
148. *Id.*
149. U.S. Dep't of Treasury, Using the SSBCI Program to Improve Access to Capital in Underserved Communities 1 (2014).
150. U.S. Dep't of Treasury, Program Evaluation of The US Department of Treasury State Small Business Credit Initiative 11–12 (2016).
151. Michael Eggleston & Lisa Locke, *The State Small Business Credit Initiative*, Fed. Res. Bank St. Louis (May 9, 2018), https://www.stlouisfed.org/community-development/publications/policy-insights/state-small-business-credit-initiative.
152. U.S. Dep't of Treasury, Program Evaluation of The US Department of Treasury State Small Business Credit Initiative 11–12 (2016).

153. U.S. Dep't of Treasury, Using the SSBCI Program to Improve Access to Capital in Underserved Communities 1 (2014).
154. *See generally* Cong. Research Serv., R43661, The Effectiveness of the Community Reinvestment Act (2019) (providing an overview of the CRA).
155. Cmty. Dev. Fin. Inst. Fund, U.S. Dep't Treasury, CDFI Fund's Year in Review 2018, at 19 (2019).
156. Office of Mgmt. & Budget, A Budget for America's Future: Appendix 931 (2020).
157. U.S. Dep't of Treasury, Using the SSBCI Program to Improve Access to Capital in Underserved Communities 1 (2014).
158. Municipal governments could apply for credits only if their state's government had not applied under the program. All states except Alaska, North Dakota, and Wyoming applied and received funding at the state level. *See* Cong. Research Serv., R42581, State Small Business Credit Initiative: Implementation and Funding Issues 11 (2018).
159. Ctr. for Econ. Reg'l Competitiveness & Cromwell Schmisseur, U.S. Dep't of Treasury, Program Evaluation of the US Department of Treasury Stat e Small Business Credit Initiative 1 (2016).
160. *See* Cong. Research Serv., R42581, State Small Business Credit Initiative: Implementation and Funding Issues 3 (2018).
161. This assistance is delivered through HUD's Appalachian Economic Development Initiative. The Appalachian Economic Development Initiative is formally managed as a joint collaboration between HUD, Treasury, and the Department of Agriculture. It takes as its goal "to increase access to capital for business lending and economic development in the chronically underserved and undercapitalized Appalachia Region," and it cites small-business development, in particular, as its core focus. *U.S. Department of Housing and Urban Development*, Grants.gov (2020), https://www.grants.gov/learn-grants/grant-making-agencies/department-of-housing-and-urban-development.html.
162. *See* U.S. Dep't of Housing & Urban Dev., Policy Guidance on Using CDBG Funds for Small Business Incubators, CPD-89-33 (May 19, 1989), https://files.hudexchange.info/resources/documents/CDBG-Memorandum-Guidance-on-Use-Funds-for-Small-Business-Incubators.pdf.
163. *See*, *e.g.*, *Community Development Block Grant (CDBG) Small Business Loan Program (SBLP) Guidelines*, City of Morganton, N.C. (2019) https://www.morgantonnc.gov/index.php/component/jdownloads/send/4-grant-and-loan-information/1073-cdbg-small-business-loan-program-guidelines.
164. *Funding Opportunities*, U.S. Econ. Dev. Admin., https://www.eda.gov/funding-opportunities/.
165. Editorial, *Trump Cuts the EDA; Why Is He Punishing His Supporters?* Roanoke Times (Mar. 22, 2017), https://www.roanoke.com/opinion/editorials/editorial-trump-cuts-the-eda-why-is-he-punishing-his-supporters/article_671f9c1f-7744-5751-b85e-c9f88e4c9ca1.html.
166. H.R. 7667, 116th Cong. 5-6 (2020).
167. *SBA's Entrepreneurial Development Programs: Resources to Assist Small Businesses: Hearing Before the Subcomm. on Contracting & Workforce of the H. Comm. on Small Bus.*, 115th Cong. 8-9 (2017) (statement of Tee Rowe, President, America's Small Business Development Center).
168. Cong. Research Serv., R41352, Small Business Management and Technical Assistance Training Programs 8 (2020).
169. *Hearing Before the Subcomm. on Contracting & Workforce*, *supra* note 167, at 9-10 (statement of Tee Rowe, President, America's Small Business Development Center).
170. *Id.* at 8-9.
171. *Id.* at 5-6 (statement of W. Kenneth Yancey, Jr., President, SCORE).
172. There are 144 such lending intermediaries across the United States, and beneficiaries of Microloan Technical Assistance Program grants are eligible to receive up to 25 percent of their total SBA loans outstanding. Cong. Research Serv., R41352, Small Business Management and Technical Assistance Training Programs 10 (2020).
173. *Id.*
174. *Id.* at 11.
175. Grants may be up to $250,000 and require at least 50 percent matching from nonfederal sources. *Id.* at 21.
176. *Id.* at 25-29.
177. *Id.* at 11-12.
178. WBC grants come with a nonfederal matching requirement of at least 50 percent. *Id.*
179. *See* Release No. 19-48, U.S. Small Bus. Admin., SBA Awards $100,000 to Syracuse University's Institute for Veterans and Military Families to Offer Additional Entrepreneurship Training to Service-Disabled Veterans (Sep. 16, 2019),

https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sba-awards-100000-syracuse-universitys-institute-veterans-and-military-families-offer-additional.

180. Cong. Research Serv., R41352, Small Business Management and Technical Assistance Training Programs 16 (2020).
181. U.S. Small Bus. Admin., FY2021 Congressional Justification FY2019 Annual Performance Report 99 (2020).
182. Sean Lowry, Cong. Research Serv., R43155, Small Business Administration Trade and Export Promotion Programs 8 (2016).
183. Press Release, U.S. Econ. Dev. Admin., U.S. Department of Commerce Announces $13 Million in Investments to Support Manufacturers Damaged by Imports (Sep. 5, 2018), https://www.eda.gov/news/press-releases/2018/09/05/taac-imports.htm. Trade Assistance Centers have the additional goal of helping unemployed manufacturing workers find new jobs within the sector.
184. Fourth Econ., *Evaluation of the EDA Regional Innovation Strategies Program From 2014-2017: Seed Fund Support and i6 Challenge Program*, U.S. Econ. Dev. Admin. 6 (July 2019), https://www.eda.gov/files/oie/ris/EDA-RIS-Full-Program-Evaluation.pdf.
185. *See Programs*, Minority Bus. Dev. Agency, https://www.mbda.gov/page/programs.
186. For a full list of MBDA Business Centers around the country, see *List of MBDA Business Centers*, Minority Bus. Dev. Agency, https://www.mbda.gov/businesscenters.
187. *See* Carolyn M. Brown, *Minority Business Development Agency Puts $7.7 Million Toward New Business Centers*, Black Enterprise (Nov. 5, 2015), https://www.blackenterprise.com/minority-business-development-agency-puts-7-7-million-toward-new-business-centers/.
188. Small Business Act, § 15(g), 15 U.S.C. § 644 (2018).
189. Cong. Research Serv., IF10138, Small Business Contracting Law 1 (2015).
190. *See id.* If a business falls under more than one category—for instance, when a company is both minority-owned and woman-owned—then it counts towards each category (but only once towards the overall small-business target).
191. *Id.*
192. *See* HUBZone Act of 1997 § 602, 15 U.S.C. § 631 (2018).
193. The following tools may not be used to give preference to small businesses, however, when doing so results in a contract price that exceeds a "fair market price" for the agency. *See* 15 U.S.C. § 637(a)(1)(A).
194. National Defense Authorization Act for Fiscal Year 2018, Pub. L. No. 115-91, § 805, 131 Stat. 1283, 1456.
195. Cong. Research Serv., IF10138, Small Business Contracting Law 1 (2015).
196. This rule also only applies when one contract will be awarded after bidding, rather than multiple contracts. *Price Evaluation Preference HUBZone Program*, U.S. Small Bus. Admin. 6-7 (Aug. 2012), https://www.sba.gov/sites/default/files/files/workbook%20HUBZone%20PEP-1.pdf.
197. *Leveraging America's Seed Fund*, U. S. Small Bus. Admin. 5 (Mar. 2020), https://www.sbir.gov/sites/default/files/SBA__SBIR__Overview__March2020.pdf.
198. *Id.* at 3.
199. *Id.* at 9. Procurement Technical Assistance Centers are further subdivided into local offices, to provide more concentrated support to particular communities. There are 300 such local offices nationwide. *See id.* at 21.
200. *Id.*
201. *About the PTAP and APTAC*, Ass'n Procurement Technical Assistance Ctrs. (2020), https://www.aptac-us.org/about-us/.
202. Cong. Research Serv., R41352, Small Business Management and Technical Assistance Training Programs 3 (2020); *see also Innovation Initiative*, U.S. Minority Bus. Dev. Agency, https://www.mbda.gov/innovation (describing the Inclusive Innovation Initiative, a "national effort to increase" minority businesses' participation in "technology transfer" and "the federal innovation ecosystem").
203. Cong. Research Serv., R42037, SBA Surety Bond Guarantee Program 2 (2020).
204. *Id.* at 3.
205. *Id.* at 24.
206. *Id.* at 10.
207. *Id.* at 1.
208. *Id.* at 17.
209. Jennifer Valentino-DeVries, Ella Koeze, & Sapna Maheshwari, *Virus Alters Where People Open Their Wallets, Hinting at a*

*Halting Recovery*, N.Y. Times (Aug. 18, 2020), https://www.nytimes.com/interactive/2020/08/18/business/economy/coronavirus-economic-recovery-states.html.

210. *Economic Tracker*, Opportunity Insights (2020), https://www.tracktherecovery.org/.
211. *Id.*
212. *Q2 2020 Yelp Economic Average: Increased Consumer Interest in May Correlates with COVID-19 Hot Spots in June, According to the Yelp Economic Average*, Yelp (July 22, 2020), https://www.yelpeconomicaverage.com/yea-q2-2020.html.
213. *Economic Tracker*, Opportunity Insights (2020), https://www.tracktherecovery.org/. To retrieve data, see *Opportunity Insights/Economic Tracker*, GitHub, https://github.com/OpportunityInsights/EconomicTracker/blob/main/data/Womply%20Merchants%20-%20National%20-%20Daily.csv.
214. *Yelp: Local Economic Impact Report*, Yelp (Sept. 2020), https://www.yelpeconomicaverage.com/business-closures-update-sep-2020.html.
215. Robert Fairlie, *The Impact of Covid-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey* 9 (Stanford Inst. for Econ. Policy Research, Working Paper No. 20-022, 2020), https://siepr.stanford.edu/sites/default/files/publications/20-022.pdf.
216. Claire Kramer Mills & Jessica Battisto, *Double Jeopardy: COVID-19's Concentrated Health and Wealth Effects in Black Communities*, Fed. Res. Bank N.Y. 1 (Aug. 2020), https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses.
217. Lauren Leatherby, *Coronavirus Is Hitting Black Business Owners Hardest*, N.Y. Times (June 18, 2020), https://www.nytimes.com/interactive/2020/06/18/us/coronavirus-black-owned-small-business.html (drawing on work of Fairlie).
218. *High-Propensity Business Applications for the United States*, Fed. Res. Bank St. Louis (July 23, 2020), https://fred.stlouisfed.org/series/HPBUSAPPSAUS (showing data from the U.S. Census Bureau).
219. Some weekly data for July and August 2020 show high-propensity business formations increasing compared to the same weeks of 2019, despite this metric's overall decline during this period. This may be partly due to delayed business plans dating from before the pandemic shutdowns being revisited, or to individuals forced into self-employment by layoffs. Quarterly data for the third quarter of 2020, however, are unavailable as of this report's publishing.
220. The increase in high-propensity small-business formations likely resulted from business launches paused during the pandemic shutdowns and from individuals forced into self-employment by layoffs. *Weekly Update on COVID-19's Impact on Business Formation and Entrepreneurship,* Econ. Innovation Group (Sept 4, 2020), https://eig.org/news/weekly-update-covid-19-business-formation.
221. Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, § 1107 (2020).
222. Cong. Research Serv, RL33243, Small Business Administration: A Primer on Programs and Funding 2 (2020).
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369. Fed Small Bus., Bd. of Governors of the Fed. Reserve Sys., Report on Employer Firms: 2020 Small Business Credit Survey (2020), https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2020/2020-sbcs-employer-firms-report (reporting data in the data appendix).
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371. *See* Fed. Deposit Ins. Corp., FDIC Community Banking Study 1-5 (2012).
372. *See* Office of Advocacy, U.S. Small Bus. Admin., Small Business Lending in the United States, 2017, at 12, 19 (2017), https://cdn.advocacy.sba.gov/wp-content/uploads/2020/01/28154019/Small-Business-Lending-in-the-US-2017.pdf.
373. *See* Della Rocca & Loewentheil, *supra* note 232, at 3. The impact of community bank concentration, however, appeared to decline in subsequent rounds of PPP distribution. *See* Parilla & Liu, *supra* note 269.
374. *See, e.g.*, Peter Rudegeair, Orla McCaffrey & Liz Hoffman, *Small Businesses Were at a Breaking Point. Small Banks Came to the Rescue.*, Wall St. J. (May 4, 2020), https://www.wsj.com/articles/small-businesses-were-at-a-breaking-point-small-banks-came-to-the-rescue-11588590013.
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381. Intermediary online lenders typically require a specialty bank to act as a partner when they originate loans. This is predominantly a legal technicality, however, that has little substantive impact on the origination chain.
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383. Justin Song, *Average Small Business Loan Interest Rates in 2020: Comparing Top Lenders*, ValuePenguin (Jan. 21, 2020), https://www.valuepenguin.com/average-small-business-loan-interest-rates.
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388. *See, e.g.*, Alicia Robb, *Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms*, U.S. Small Bus. Admin. 10-11 (Feb. 2018), https://cdn.advocacy.sba.gov/wp-content/uploads/2019/04/25141724/Financing_Patterns_and_Credit_Market_Experiences_report.pdf.
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390. *See, e.g.*, Bd. of Governors of the Fed. Reserve Sys., Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit, at S-3 (2007); Fed. Trade Comm'n, Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance 3-4 (2007); Matt Fellowes, *Credit Scores, Reports, and Getting Ahead in America*, Brookings (May. 1, 2006), https://www.brookings.edu/research/credit-scores-reports-and-getting-ahead-in-america. Newer research

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395. *See supra* note 390 and accompanying text.
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ISPS Working Paper
October 19, 2020
ISPS20-21

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Design by Roni Lagin & Co.