Displacement, Discrimination and Determination:

Small Business Owners Struggle to Access Affordable Credit

Results from a Statewide Survey in California

CALIFORNIA REINVESTMENT COALITION

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Results from a State-Wide Survey in California

"Lending discrimination definitely still occurs today, particularly with race and sex. Data shows a lack [of] credit issued to the African American business community, as well as the Latino community, particularly immigrants. That is one of the reasons why the business community needs the 1071 data rule to ensure red-lining doesn't continue to happen in business lending."

-Staff to a neighborhood organization serving small businesses in the Inland Empire in California

California Reinvestment Coalition
September 2017

This report was prepared by Kevin Stein and Gina Charusombat. CRC thanks Roberto Barragan (Aquaria Funding Solutions), Gwendy Donaker Brown (Opportunity Fund), Dory Rand (Woodstock Institute), Stephon Taylor (California Resources and Training), Robert Villarreal (CDC Small Business Finance), and Clarence Williams (California Capital FDC) for helpful comments.

Cover picture: Paula Tejeda, owner of Chile Lindo in front of her store in San Francisco's Mission District. Photo credit:Timothy Mack.

The California Reinvestment Coalition builds an inclusive and fair economy that meets the needs of communities of color and low-income communities by ensuring that banks and other corporations invest and conduct business in our communities in a just and equitable manner.

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Introduction

Everyone says they love small businesses. After all, they create jobs, help business owners and their employees provide for their families, pay taxes, and are the bedrocks of local communities. Politicians and regulators often act *in the name of* small businesses. But are they always acting *in the interest of* small businesses?

CRC member organizations directly work with and support small business owners in a variety of ways, including through originating loans to them, and by providing technical, legal, financial capability and other assistance to help them run their businesses better. CRC member organizations include Community Development Financial Institutions (CDFIs), community lenders, small business technical assistance providers, financial counseling and capability agencies, small business advocacy and policy organizations, and legal service offices.

The catalyst for this survey was the Request for Information (RFI) released by the Consumer Financial Protection Bureau (CFPB) at a May 10, 2017 field hearing held in Los Angeles. The field hearing included a panel discussion where two CRC members and two CRC allies participated as panelists, as well as a hearing where several CRC members and their clients testified. Through this RFI, the CFPB is seeking additional feedback from stakeholders about current challenges faced by small businesses, as well as potential challenges to lenders from data collection efforts.

For years, CRC members urged Congress and federal banking regulators to require the collection of small business lending data in order to better understand the needs of small business owners, to highlight and thereby reduce discrimination against women and minority small business owners, and to ensure financial institutions, regulators and all stakeholders are working to ensure equal access to small business credit. Under §1071 of the Dodd-Frank Act reform bill, Congress responded to advocate and small business concerns by authorizing the CFPB to write a rule to require small business lenders to collect and disclose this data. The CFPB's RFI was a first step in the Bureau's process to write a rule to require this data collection.

In light of the CFPB moving forward with the §1071 data collection effort, this report provides a snapshot into the small business lending outlook in California, including what unique barriers minority-owned and women-owned small businesses face.

Story of Ventura Small Business Owner

“The client's business, a medical uniform supply company, started small as a mobile business. She began by traveling to local clinics and selling from her SUV. Her business was filling an unmet need in the community. Being a mother of two young children, working an 8-5 job was becoming more difficult. She was concerned she’d soon be unemployed due to her family needs. As the business grew, she decided to quit her job and open a retail location.

She didn’t have sufficient capital to do that so she downsized her home, cut back on personal spending, and relied on credit cards for financing. The need for additional inventory prompted her to apply for a bank loan. She was denied.

In 2014, she came to Women’s Economic Ventures (WEV) for a loan to replenish her inventory. She heard a radio ad and about WEV and our loan program. She got the loan and joined the "Thrive in Five" program which gave her the kind of support she needed to help her business expand. The WEV loan also helped her hire her first part-time employee.

Today, with the help of two other WEV loans she has three locations, four employees, and the business continues to grow. And still, she’s unable to secure traditional financing.”

Methodology

CRC created a survey with fifteen questions, some that were tailored to address questions raised in CFPB’s RFI, and some that were broader and meant to paint a picture of the small business landscape in California. We conducted outreach via email and phone to CRC member and allied organizations that have worked with small businesses. In total, forty-two respondents answered the survey based on their experience working with over 10,237 small businesses since the beginning of 2017.

Findings

1. The CFPB 1071 small business data collection rule is critically important to the ability of small business owners to access responsible credit.

Ninety-five percent (95%) of respondents indicated that small business data collection is of critical importance (57%) or very important (38%).

This is the most important finding from the survey. CRC members have advocated for small business data collection for at least two decades. For years, homeowners have benefitted from the detailed and comprehensive mortgage data that are collected pursuant to the Home Mortgage Disclosure Act (HMDA).

As it did with HMDA, small business data collection will lead to more transparency related to access to credit by race, ethnicity, gender and geography of borrowers, can help policymakers and lenders identify unmet credit needs, and will help ferret out and thereby eradicate discrimination and fair lending violations. A thoughtful, comprehensive and public small business lending data collection system would be a game changer that will bolster equal access to responsible credit for qualified small business owners.

Opposition: Unfortunately for small businesses, strong forces are arrayed to oppose this effort. The Treasury Department has called for repeal of the CPFB's section 1071 data collection authority,[1] the Acting Comptroller of the Currency has argued against the rule,[2] and the House of Representatives passed the Financial Choice Act[3] which included several anti-consumer provisions, including a repeal of section 1071. Opponents of the small business lending data collection rule seem much more concerned about lenders than they do about small businesses.

What are they so afraid of?

What might be revealed?

> "There is a lot of research showing that implicit bias and systemic discrimination exists within small business lending. We need to have this transparency to provide the hard data to force policy changes and changes in lending practices among bank lenders."
>
> *Community lender in the San Francisco Bay Area*

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[1] U.S. Department of the Treasury, "A Financial System That Creates Economic Opportunities: Banks and Credit Unions." June 2017, p. 108.

[2] TESTIMONY OF KEITH A. NOREIKA, ACTING COMPTROLLER OF THE CURRENCY before the COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE, June 22, 2017, p. 14.

[3] Geoff Bennett, "House Passes Bill Aimed At Reversing Dodd-Frank Financial Regulations," NPR, June 8, 2017.

2. Small business owners seek a variety of financing options but often are stuck with a limited and higher cost product suite, such as credit cards, nonbank online loans, and Merchant Cash Advances.

Big Banks: *81% of respondents note that small businesses often or sometimes apply for this type of financing; but only 48% note small businesses often or sometimes receive this financing.* Bank loans often come with more reasonable rates and repayment terms as compared to other options. Yet, small businesses are not often able to secure this type of financing.

Small Banks*: 79% of respondents note that small businesses often or sometimes apply for financing from small banks, a percentage similar to that for small businesses applying to big banks. However, in contrast to big banks, 74% believed small businesses often or sometimes were able to obtain financing from small banks.*

This highlights the importance of community banks in meeting small business credit needs at the local level, and the critical importance of including such banks in a section 1071 data collection system.

And yet, community banks, which tout their commitment to small business lending, are seeking exemption from the small business data collection rule. Sadly, several Congressional representatives have indicated initial support for such an exemption, which would significantly weaken the value of the data collection effort and analysis, especially in rural communities where smaller lenders may have a larger market share.

> "Big banks have scaled back their small business lending, because small businesses seek lower dollar loans while the cost of underwriting such loans is the same as a bigger loan for the banks. Micro lenders and mission-driven lenders attempt to fill the gap, but they lack the capital to meet the need."
>
> *Small business advocate*

Credit Cards *57% of respondents note that small businesses "often" apply for this financing; but an even higher 69% said that small businesses often receive this financing.* Credit cards are the loan product obtained by small businesses more often than any other product mentioned in this survey, yet credit card loans can be problematic. Credit card loans provide shorter term financing subject to unpredictable and often higher rates, and come with fewer consumer protections than consumer credit card loans.

While credit cards may be the right product for some small businesses, CRC members believe the product is sold by banks more often than it is needed by small businesses and that it is not the best product for many small business credit needs.

CDFIs or Other Community Lenders*: 78% of respondents say small businesses often or sometimes apply for this financing; 80% say they often or sometimes receive this financing*.

Community Development Financial Institutions (CDFIs) are institutions dedicated to providing responsible, affordable lending to low-income communities.

Small businesses have more stability when working with CDFIs or community lenders because they are mission driven and offer more responsible and sustainable products.

A recent survey of over 15,000 small businesses conducted by the Federal Reserve revealed that though CDFIs had the *lowest application rates* from small businesses surveyed, they had the *highest approval rates* and the *highest satisfaction rates* when compared to Large Banks, Small Banks, Credit Unions, and Nonbank Online Lenders.[4]

Nonbanks[5]: *40% of respondents say that small businesses "often" apply for this financing; but an even higher 50% say they often receive this financing*. Nonbank lenders are good at marketing and selling their products to small businesses. But whether the products are *good* for small businesses and help to responsibly meet business credit needs is a different question.

CRC's CDFI members have reported a recent trend of having to refinance small businesses out of problematic high cost nonbank loans.

Families and/or friends: *55% of respondents say that small businesses often seek this financing; and 35% report small businesses often receive this financing.* While families and friends can serve as important social networks to provide affordable financial support, small business owners cannot often rely on these networks as a stable funding source. Moreover, given the wealth gap in this country, minority owned businesses are less likely to have access to this option.

> "On-Line high interest lenders often take advantage of small business owners due to lack of access to capital from banking institutions."
>
> *Community lender in the San Diego Region*

[4] Presentation by Leilani Barrett, Regional Manager, Community Development, Federal Reserve Bank of San Francisco, "Small Business Credit Survey: Report on Employer Firms," Federal Reserve Bank of Atlanta, April 2017.

[5] Nonbank lenders are lenders other than deposit-taking banks regulated by federal banking regulators. Nonbank lenders include online lenders that do not have a retail store facility, as well as nonbank firms that have storefronts.

Merchant Cash Advance (MCA) Providers: *Despite concerns about the cost and negative impact of many MCAs, 79% of respondents say small business often or sometimes apply for this financing; 69% say small business often or sometimes receive this financing.*

MCAs offer a cash amount that is repaid through a percentage of future credit card or other receivables.[6]

MCAs are subject to less regulation, and borrowers who use MCAs have few to no consumer protections.

The lack of regulatory oversight makes MCAs risky for small businesses. According to an Opportunity Fund report, MCAs can come with Annual Percentage Rates as high as 400%.[7] And more injurious are the amortization periods for paying off the debt, in some cases as short as three months.

Anecdotally, at both the CFPB small business field hearing in Los Angeles and at a roundtable on small business lending with banking regulators hosted by CRC, Main Street Alliance, People's Action, and Woodstock Institute, small business owners shared that
<u>MCAs are dangerous in that:</u>

1) They are very easy to obtain, with approval in minutes even when such loans were not sought by the business borrower;

2) It is very hard for small business owners to appreciate the negative impacts such loans can have on one's business;

3) They generally do not report repayment to credit bureaus, so they do not enable small businesses to build good credit histories that can lead to more traditional credit; and

4) They are often followed by regret.

> "The alt-loan boom has also become synonymous with vaguely worded pricing terms, ultra-high interest rates and questions about how the firms should be classified and regulated."
>
> *Orange County Register:* "You can now get online loans within minutes, but at what cost?" (Jan 12, 2016)

[6] Opportunity Fund. May 2016. http://opportunityfundloan.org/the-ugly-truth-about-mcas-and-how-opportunity-fund-can-help/

[7] Opportunity Fund. May 2016. http://opportunityfundloan.org/the-ugly-truth-about-mcas-and-how-opportunity-fund-can-help/

3. For the purpose of CFPB's small business data collection rule, "small businesses" should be defined broadly, with a focus on gross revenue, and data should be available to analyze lending to small businesses based on the number of employees and other factors.

Businesses come in all shapes and sizes, and policymakers, lenders and the public should be able to analyze how well the market is serving all of them, especially the smallest businesses that are often owned by people of color and located in working class communities.

For the purpose of small business data collection rules, over half of all respondents (52%) recommended defining "small business" by annual receipts, revenue, or income. Thirty percent of respondents suggested the definition should consider the number of employees at a business. Respondents indicated a wide revenue and income range from $300,000 to $10 million, with $1 million the most common suggestion, as well as a wide range for the number of employees, from5-100. Several respondents indicated that more than one variable should be used to set the definition of small business.

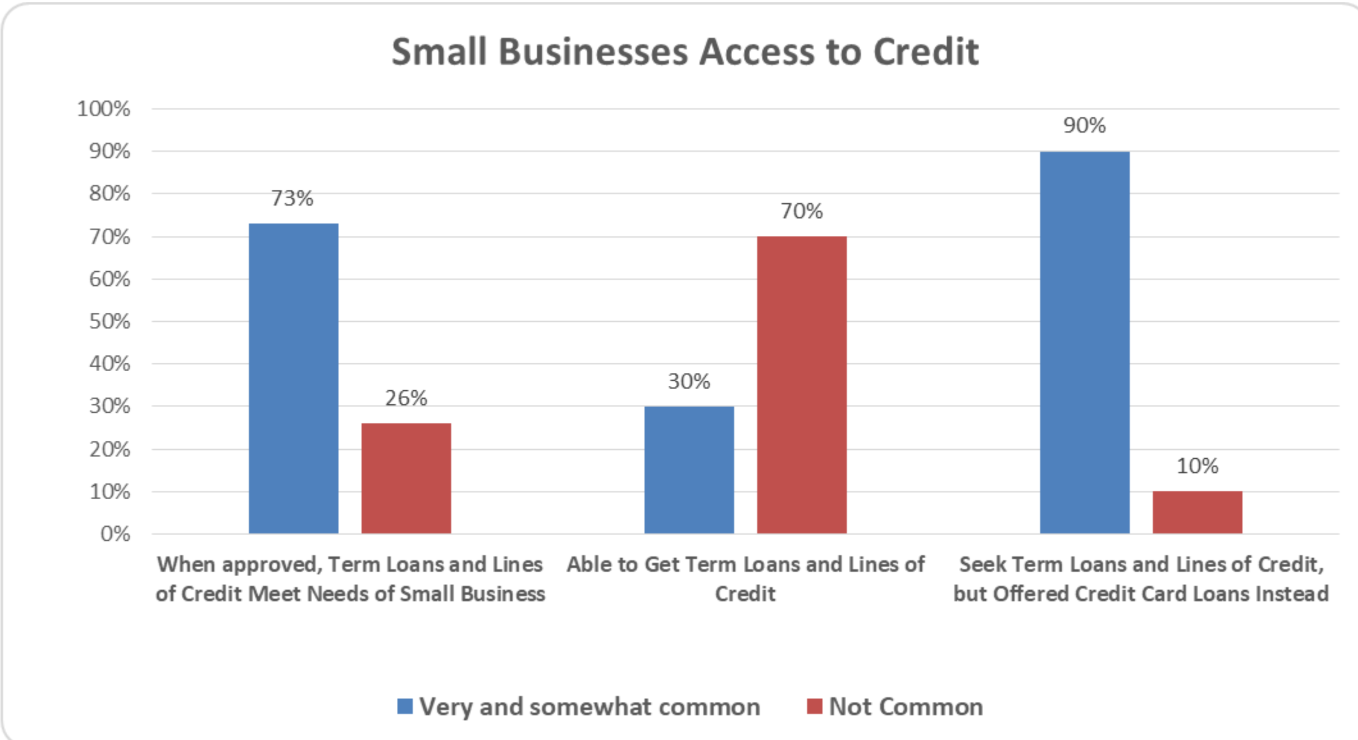
4. In dealing with banks, small businesses have difficulty accessing term loans and lines of credit, banks are more likely to offer credit cards, and small banks are more accessible than big banks.

Only 31% of respondents said it was "very" or "somewhat common" for small business owners to obtain term loans and lines of credit from banks, though respondents indicated that these are good products that are helpful to small businesses.

In contrast, 62% of respondents said that it was very common for small businesses to apply for term loans and lines of credit from banks, only to be offered credit cards instead, with 40% of respondents saying it was not common that bank credit cards actually met small business credit needs.

Finally, fully 90% of respondents felt it was "very common" (49%) or "somewhat common" (41%) for small banks to be more responsive to small business credit needs than big banks.

<u>This is why it is so important to ensure that smaller community banks are covered by the CFPB's final data collection rule.</u>



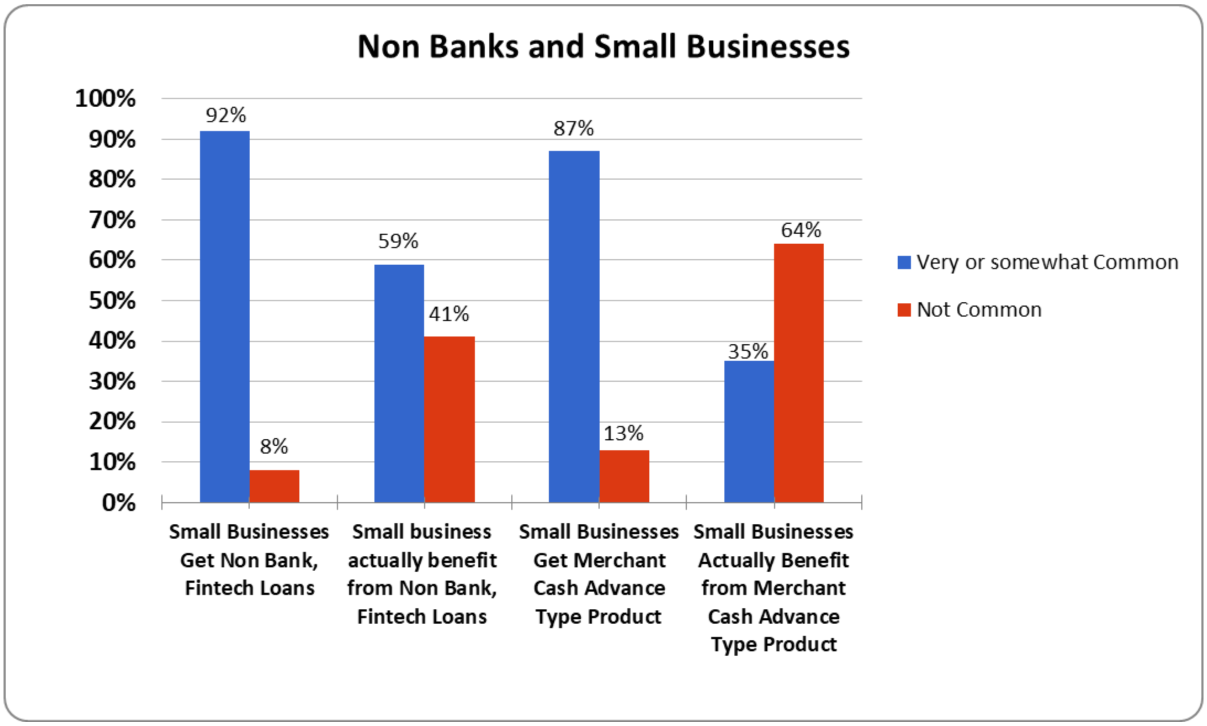
Respondents Weigh In

"People of color may have a 680+ credit score but are still not being provided loans but credit cards, it's the old unconscious bias [that] still holds true." *Statewide small business consultant*

"Most people when looking for a small loan, they often think of the banks. They don't know most banks are not interested in small loans, especially big banks, so they cannot receive the loan from the bank, but they don't know non-profit lenders like us, so they end up going to pay day lenders or high interest lenders that take all of their revenue and could lead them to file bankruptcy." *LA based CDFI*

"Sometimes regional small banks have relationships with the state guarantee program that they will work with to do small business loans or other credit enhancement programs. They may also have more of a relationship with a local CDFI from which they honor referrals." *Staff to a statewide small business technical assistance organization.*

5. Small businesses are commonly able to secure non-bank, fintech and Merchant Cash Advance loans, but the benefits are far from clear.



While a large percent of respondents indicated that small businesses are able to secure non-bank, fintech loans, a significantly smaller percent of respondents indicated that small businesses actually **benefit** from these types of loans.

91% of respondents indicated small businesses were able to obtain non-bank, fintech loans (which include various online loans, such as term loans, lines of credit, or revenue based products such as Merchant Cash Advance).

When asked specifically about MCAs, 87% percent of respondents indicated that small businesses get Merchant Cash Advance (MCA) or similar products that commit a percent of future credit card or other receivables and revenue to repayment.

Fully 64% of respondents said it was “not common” for MCAs to benefit small businesses, and zero respondents indicated it was “very common” for MCAs to help small businesses.

But 41% of respondents indicated it was “not common” for this financing to be beneficial to the small business borrower, while an additional 46% of respondents indicated it was only “somewhat common’ for the non-bank loans to be beneficial to small businesses.

Respondents weigh in on Merchant Cash Advances

- “Banks largely do not make small dollar loans <$250k to small businesses. Small businesses face few options besides alternative lenders/MCA which charge predatory rates.” *Bay Area based CDFI*

- “MCAs are rarely beneficial to a business, and often are simply preying on a business in a desperate situation. But the MCA rarely makes the situation better. Therefore, they should be highly regulated.” *Bay Area community lender*

- “Borrowers are not aware of the prepayment penalties and often want to leave this product when they figure out how expensive it actually is! Also the MCA's keep Borrower's addicted to fast expensive cash by constantly soliciting for the next loan and in the long run the borrower is NOT getting ahead financially but it takes many months to learn the reality.” *Local government economic development agency staff*

- “MCA's high costs are subprime and predatory in nature, and business owners can get caught up in a cycle of trying to play catch up on future repayments. Fintech is also an issue since access is streamlined, but borrowing costs are subprime.” *Neighborhood organization in the Inland Empire*

6. **Respondents overwhelmingly believe that, given the large increase in nonbank online lending in the state, the California Department of Business Oversight (DBO) should *increase* regulation and enforcement of non-bank and fintech lending practices, including products such as Merchant Cash Advance, in order to protect small businesses.**

The Department of Business Oversight reports a huge increase in nonbank online lending in the state. In California, the aggregate dollar amount of such lending increased from 2010 to 2014 by 786.3 percent, to $452.2 million in 2014. The total through the first half of 2015 was $350.7 million.[8]

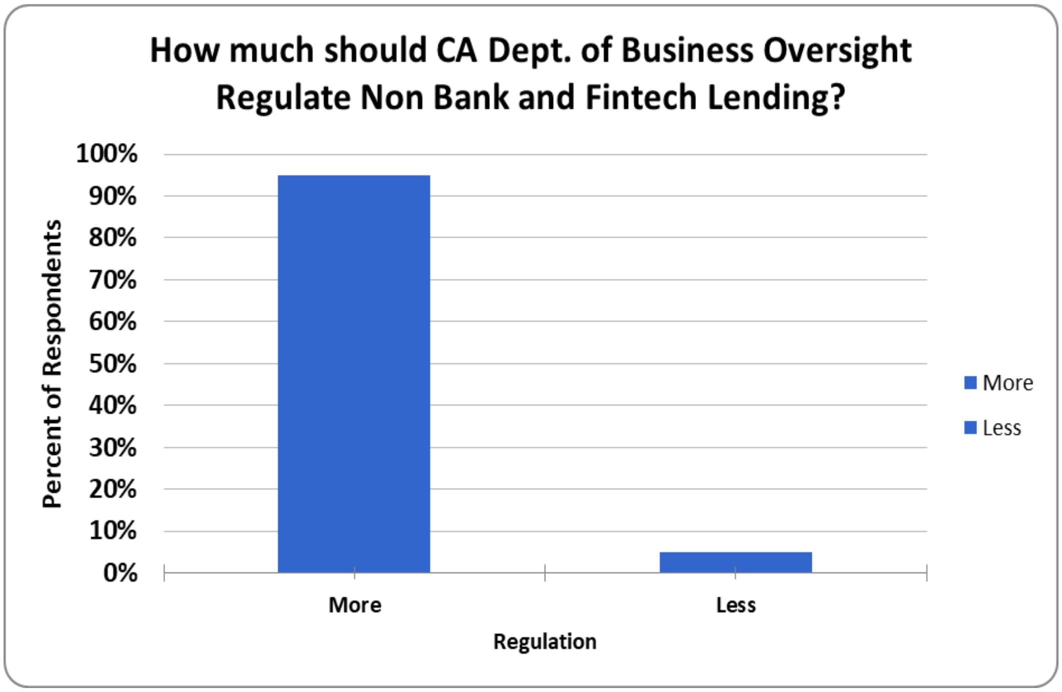
95% of CRC survey respondents indicated that DBO should further regulate this corner of the small business lending market.

Respondents note:

- Nonbank online lenders do not underwrite to ensure that individuals can afford the capital.
- High interest rates of non-bank and fintech lending practices hurt small businesses.
- Increased supervision is needed to keep institutions from charging excessive Annual Percentage Rates and to ensure the terms of the product are transparent to small business borrowers.
- Regulation can lead to better terms for small businesses.

> "More regulation is definitely needed at a state and federal level as current regulations are not enough to ensure consumers are protected from bad practice and usury. The online lending space is incredibly unregulated and more order is required for the chaos. This is primarily due to how easily it is to access capital by just submitting basic information and minimal documentation.
> What a lot of these lenders don't do is screen applicants to see if they can AFFORD this type of capital much less see if they actually need it."
>
> *Bay Area community lender*

[8] California Department of Business Oversight, "SURVEY OF ONLINE CON SUMER AND SMALL BUSINESS FINANCING COMPANIES – 01/01/2010 through 06/30/2015 SUMMARY REPORT OF AGGREGATE TRANSACTION DATA



In response to a question asking if *more, less, or the current level of regulation* and enforcement is appropriate to deal with nonbank and fintech lending, such as Merchant Cash Advance, **members gave a number of suggestions and feedback on the loans:**

"Online lenders charge incredibly high interest rates and small businesses fail under the terms of these lenders." *Sacramento area organization working with immigrant owned small businesses*

"Businesses can and are getting hurt by some of the fintech lenders. Not all fintech is bad, but some players need to be reined in." *LA based community lender*

"They can hide red-lining and charge more in their algorithms." *LA based small business consultant*

"While we support innovative means of delivering capital to small business owners, not all actors in the nonbank lending space do so in transparent, responsible terms." *Small business advocacy group*

"With the deep inequality emerging in our society, there are many more small business owners struggling to survive. In their desperation, they are turning to non-bank and fintech lenders who are quite willing to prey on their desperate situations. This demands regulations that force restraint on these lenders." *Bay Area CDFI*

"It's a wild west - terms are not transparent and often bankrupt a business." *Statewide microenterprise organization*

7. Small business owners face discrimination based on race, sex, age, national origin, or marital status, or because they receive public assistance.

Several studies and reports have documented small business lending disparities by race, ethnicity, gender and neighborhood.[9]

CRC survey respondents confirm these concerns:

90% percent of respondents indicated that small business owners often (57%) or sometimes (33.3%) face discrimination.

Respondent feedback:

"Discrimination does exist, particularly around race. It has been my experience that a lender's loan portfolio (especially with banks) will generally mirror the ethnicity of those in control." *LA based community lender*

"Small Businesses, just as with consumers, face discriminatory practices when applying for loans simply based on their zip code." *Statewide technical assistance organization*

"Lending discrimination definitely still occurs today, particularly with race and sex. Data shows a lack [of] credit issued to the African American business community, as well as the Latino community, particularly immigrants. That is one of the

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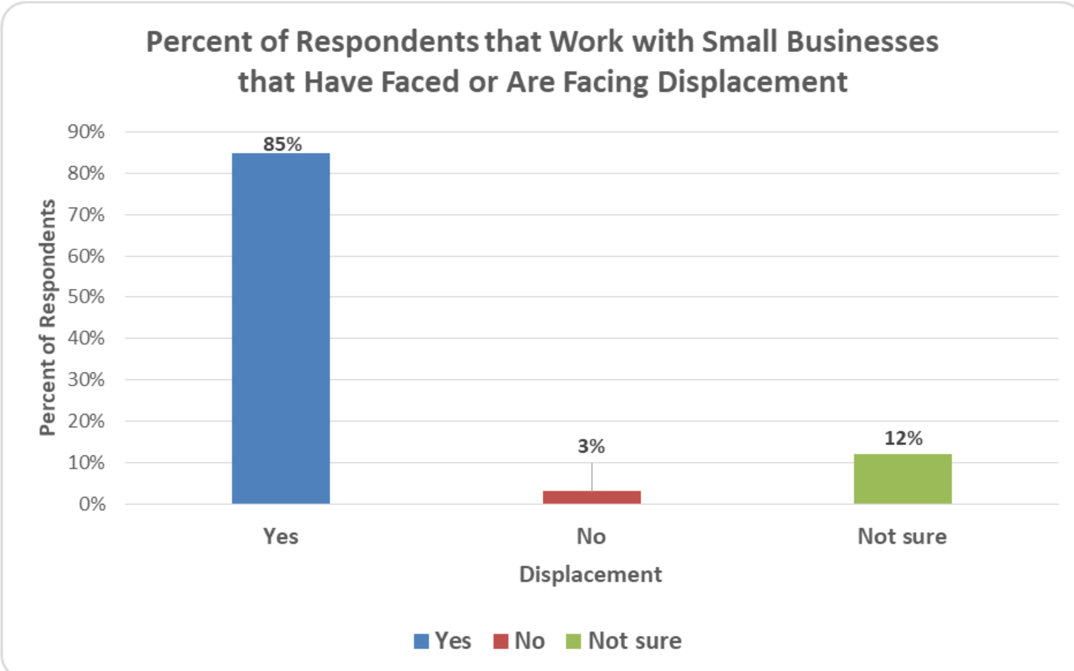
[9] See Eric Weaver, Gwendy Donaker Brown, Caitlin McShane, "Unaffordable and Unsustainable: The New Business Lending on Main Street," Opportunity Fund, May 2016, p. 7. (finding higher costs paid for loans by Latino owned businesses analyzed); Spencer M. Cowan, "Patterns of Disparity: Small Business Lending in the Chicago and Los Angeles-San Diego Regions," Woodstock Institute, January 2017. (finding less CRA small business lending in neighborhoods of color in the LA-San Diego region); "Gallup: Small Business Diverse Segments Lending Study: Asian, African American and Hispanic Business Owners," Sponsored by Wells Fargo, May 2015. (finding high small business denial rates reported by Asian owned businesses and other minority owned businesses, in a survey of over 1,000 small businesses); National Association of Latino Community Asset Builders (NALCAB) and CDC Small Business Finance, "Fueling California's Economic Growth: A Study on Latino Small Business and Capital Access," forthcoming, citing a Stanford Graduate School of Business Study, 2015. (finding high small business loan denial rates for Latino owned businesses); and Alan Fisher, "Small Business Access to Credit: The Little Engine that Could, If Banks Helped," California Reinvestment Coalition, December 2013.(finding a decrease in SBA and conventional lending to minority owned businesses in California), as well as National Community Reinvestment Coalition mystery shopping analysis, finding disparities in treatment of women and minority owned businesses in the pre application stage (NCRC published analysis forthcoming).

reasons why the business community needs the 1071 data rule to ensure red-lining doesn't continue to happen in business lending." *Inland Empire neighborhood organization*

"Almost all lenders offer only English options. No lenders have financial inclusion mandates which require service to minority and women owned businesses." *Survey respondent*

8. **Small business owners face, or are facing displacement as gentrification pressures come to their neighborhood.**



In a stark and disturbing finding, fifty-four percent of respondents said that small business owners “often” face displacement, and another 32% report that small businesses “sometimes” face displacement as neighborhoods are changing.

As gentrification and property appreciation pressures escalate in California communities, the story of displacement of residential tenants is sadly commonplace.

“I've seen many business owners had to close their business because the rent was increasing rapidly. That's why I created and often conduct the workshop "Secure your business with Commercial Real Estate Financing Programs" to give them solutions to secure their business for the next generations.”

LA based CDFI

Less common is the story of displacement and its impact on small businesses.

Respondents indicate that:

- Minority owned businesses relocate due to landlords increasing rents and increased costs for commercial space or farm land.
- Strategic support is needed to stabilize small businesses during the gentrification process.
- Transit-oriented development has facilitated the gentrification process.

“MBEs are reporting to us that they have to relocate because of skyrocketing rents.”

Bay Area community lender and technical assistance provider

9. **The CFPB complaint database should be made more accessible to small businesses to enable them to more easily file complaints relating to possible discrimination or problems accessing credit.**

The CFPB has a Consumer Complaint Database that has received over one million complaints from consumers, though, perhaps understandably, less than a thousand complaints have been filed by small businesses. The CFPB's primary small business authority relates to developing the 1071 lending data rule, and to enforcing the Equal Credit Opportunity Act (ECOA).

100% of respondents felt the CFPB should work to make the consumer complaint database more user-friendly to small businesses and to conduct outreach to small businesses about the database and ECOA.

A review of CFPB's Consumer Complaint Database, based on key search terms of complaint narratives related to small business, found 911 complaints from small business owners related to their businesses. Of this amount, the most complaints were from California. At the national level, the most complaints were filed against national banks such as Bank of America, Wells Fargo, and JPMorgan Chase. The company most complained about that was not a bank was Experian.

Complaints related to different aspects of the small business consumer experience including:

- arbitrary account closings and fees;
- business credit cards and lending;
- account, overdraft or over limit fees;
- credit reporting;
- awards and promotions;
- merchant services;
- customer service errors; and
- discrimination.[10]

Consumers speak out: "I asked them if they were using my race and location of my business as factor for denying me a business line of credit. Of course, they responded that 'this was not the case' but no good explanation was given for my denial of a business credit line other than a 'consumer credit card charge off'…which is no longer on my credit report. I believe Wells Fargo is using unfair business practices and discriminated towards my application based on my location." California *Business Owner, filing complaint with CFPB*

"Where else can a small business go to?" *LA based organization serving small businesses*

[10] Analysis of CFPB complaint data provided to CRC by Garrett Andrew Schneider, PhD, September 2017. Further analysis forthcoming.

10. **Respondents believe both traditional and non-traditional lenders *already* collect data about small businesses, either relying on self-reported data or seeking verification.**

Lenders often complain about regulatory and administrative burden, but much of the data that would be part of the CFPB's 1071 small business data collection rule is already being collected.

The data collected by most traditional and nontraditional financial institutions include: revenue of the business, number of employees, type of business, location of business, size of loan, type of loan, cash flow of businesses, tax returns, and collateral or guarantee for loan.

The only data points that most respondents did not feel lenders currently collect are race, ethnicity, and gender of the borrowers.

This suggests that, as with HMDA, complying with new small business lending data requirements will not be overly burdensome on lenders that *already* collect much of these data.[11] This also suggests that the CFPB should work with small business lenders and provide guidance so that they can efficiently and accurately report the critical race and ethnicity data that is reported under HMDA and which has been much sought after in the small business lending context.

[11] Adam Levitin, "New HMDA Regs Require Banks to Collect Lots of Data...That They Already Have," Credit Slips, June 15, 2017.

11. **Small businesses face many challenges accessing credit.**

Women and minority business owners face particular obstacles according to survey respondents, including:

- Banks not making loans less than $250K to small businesses;
- Alternative lenders charging predatory rates;
- Discrimination in the marketplace as well as language and cultural barriers;
- Financial history: lack of credit history, low credit score
- Low annual revenues, and insufficient debt to equity ratio;
- Lack of confidence in applying for loan;
- Lack of education and information about resources and CDFI lenders;
- Lack of proper record keeping; and
- The US wealth gap means loans from family and friends may be less viable, lack of collateral.

What challenges do small business face in accessing credit? What obstacles do minority and women owned businesses in particular face?

"In general, all small businesses are challenged with proper record keeping. In addition, minorities and women are faced with ongoing discrimination in the marketplace."

"Big banks have scaled back their small business lending, because small businesses seek lower dollar loans while the cost of underwriting such loans is the same as a bigger loan for the banks. Micro lenders and mission-driven lenders attempt to fill the gap, but they lack the capital to meet the need. Minority and women entrepreneurs face a trust gap (they want to develop relationships with the lenders), ingrained systemic biases and confidence gaps (women entrepreneurs, for example, tend to ask for smaller dollar loans than their male counterparts)."

"People of color are still having challenges accessing affordable credit."

"Limited or no collateral, poor credit scores, prejudice of lenders."

"Age of business, business credit profile. Many minority and women owned businesses suffer because the owner's credit has been compromised keeping undercapitalized businesses afloat."

"Language and cultural barriers."

"One of the largest issues small businesses face accessing credit is how much they have to overextend their personal credit since developing business credit is a challenge. Minority and women owned businesses still face discrimination when applying for business loans. Minority business owners face obstacles in record-keeping, documentation, and thin or poor credit history."

“Minorities need more credit repair classes and financial literacy classes, banks have stopped funding this activity.”

“Can't get affordable credit - high interest rates and balloon payments.”

“Historically minority businesses have lower credit scores, lack collateral and do not have access to friends and families with wealth that can be shared.”

“Lack of equity, lack of initial investment from family/friends, less access to lucrative customer markets, inherent and implicit bias that assumes they aren't as capable or successful.”

12. **Respondents indicated several impactful ways to help small businesses grow, including**:

- More robust Community Reinvestment Act loan commitments at reasonable rates.

- Technical assistance in the first three years of business operation to build capacity and skills to run a business.

- Advocate for the financial health, strength and capacity of CDFIs and other non-bank lenders that are doing this work.

- Access to free credit restoration programs for business owners that report less than $250K in revenue and/or lower the importance of credit score when funding is connected to a contract.

- Less reliance on collateral requirements and more consideration of good character and life circumstances of small business owners.

CRC Recommendations

1. CFPB should move forward as quickly as possible to collect data on small business lending, particularly to women and minority-owned small business. The definition of a small business should be broad enough to capture most transactions, but data fields should allow for more granular analysis, especially as it relates to the smallest and youngest of businesses. Race and ethnicity data should be collected as well as disaggregated in order to better understand the needs of specific populations, such as segments of the Asian Pacific Islander and Latino communities (as with new HMDA enhancements). It is critical to require reporting from all lenders, including community banks and non-bank, fintech lenders. We are doomed to repeat the mistakes of the housing crisis if we fail to make transparent the pricing and costs of small business loans that are being sold today.

2. Bank regulators should hold financial institutions, especially big banks, accountable to meet local credit needs by lending to small businesses. Big banks should not be permitted to abandon small businesses or offer them only business credit card loans which come with higher and adjustable costs and fewer consumer protections, and are not well suited for long term capital needs. Financial institutions should work to better design financial products for women and minority-owned small businesses, hire and train diverse lending and underwriting staff, create incentives to originate small business loans in LMI communities and communities of color, and ensure all services and products are available in multiple languages. Product offerings could include lower cost lending in smaller loan amounts, such as under $250,000. Small business owners and leaders, advocates, community lenders and technical assistance providers can collaborate with financial institutions to tailor products and services to the needs of their specific communities.

3. CFPB should make enhancements to the consumer complaint database and vigorously enforce fair lending and anti-discrimination laws. Small business owners that have been discriminated against or otherwise harmed have no meaningful place to turn for help. The CFPB should make the complaint database more small business user friendly, encourage small business owners to consider filing a complaint when there are problems, and use the results of these complaints to inform a vigorous enforcement strategy.

4. The CFPB and California Dept. of Business Oversight should more closely regulate non-traditional nonbank financial institutions, including Merchant Cash Advance providers. CRC continues to urge regulators to hold big banks accountable for more equitable lending practices. However, it is also important to hold non-traditional financial institutions, which often work more with small businesses, accountable for fair lending practices. MCA lenders should be subject to Truth in Lending type transparency requirements, and abusive products should be banned. The CA DBO should require MCAs to report on and make public all of their MCA transactions in the state in order to maintain a state license to operate.

5. The state of California and local governments should work to develop anti-displacement strategies to keep small businesses in place. Such efforts could include zoning that supports historic preservation of business districts in low and moderate income neighborhoods and communities of color, funding to help small businesses buy their buildings, legal assistance to help small business owners negotiate long term leases with their landlords, financing programs to help businesses grow and succeed, and local procurement contracting that allows local government to support local small businesses through the purchase of needed products and services.

6. Strengthen the capacity of CDFIs and other mission driven community lenders. CDFIs already provide sound financial products to small businesses, expanding the potential for small businesses to maintain financial stability. CDFIs and community lenders have high approval and customer satisfaction rates, but don't have the capital to operate at scale and to successfully compete with problematic high cost nonbank online lenders and MCA lenders. Especially in this time of fear and anti-immigrant rhetoric and policy, financial institutions should support CDFIs and community lenders, and in particular build capacity of those mission driven lenders that lend to immigrant borrowers. Regulators should reward such behavior by banks, for example through Community Reinvestment Act credit.

7. Support the provision of training and technical assistance regarding financial management and other factors in order to help small business owners understand lending criteria and requirements from banks, as well as to receive additional support as to how best to build their businesses. Small business owners could benefit from credit building programs or products to help build their personal credit. Training and technical assistance is also useful in moving the small business owner to the point of loan readiness. Business assessment training and tools that allow small business owners to recognize new market opportunities, or effectively manage cash flow, are examples of programs that position the owner for long term business success.

8. Banks should develop and formalize small business loan referral programs. If a bank will not be able to originate a loan, it can provide a warm hand-off of the customer to a nonprofit CDFI, community lender or technical assistance provider who can make the loan and/or help the business to become bankable. This is a win-win-win situation, and banks should develop programs so that bank loan denials are funneled seamlessly through these referral programs.

9. Reduce the maximum loan amount under the SBA 7(a) program, from $5 million to $2 million.

The maximum amount was increased from $2 million to $5 million in 2009 as a response to the financial crisis and resulting credit crunch. Today, banks use this higher limit to finance larger real estate transactions that don't need the support of government enhancement and that generate significant secondary market income. Accordingly the average bank SBA 7 (a) is over $500,000, not the smaller loan size that most small businesses seek and need.

APPENDIX A: In your view, what would be the most impactful way to help small businesses grow? What should CRC do to advance a small business agenda?

- Continue to open pathways to greater access to capital. Small business loan data goes a long way in shining a light on the problem of insufficient capital in minority communities with solid data.
- Efforts to keep CFPB alive!
- Small business owners need training/ongoing coaching and access to sufficient capital.
- More robust CRA commitments to minority businesses, especially in LMI Census tracts
- Advocate for small and micro loans. Some of our clients need startup capital and this is usually under $10,000. These small loans are not available through traditional lenders.
- The most impactful way for a small business to grow would be honestly through formal financial training and having business owners better manage their books. When small business owners are empowered and can understand their financial statements and the current state of their business, they can make better decisions as it pertains to what they can afford and what type of capital they can get. They can also better assess types of capital being offered and see if it is a good thing or bad thing for their respective businesses.
- Ensure access to capital; large banks not likely to lend to small businesses; provide technical assistance over first 3 years of startups - back office, marketing, etc.
- Inexpensive capital, mentoring programs
- Develop a product that allows for small businesses to graduate and take advantage of attractive financing opportunities.
- The most impactful thing that CRC could do to help small businesses grow is to advocate for the financial health, strength and capacity of CDFIs and other non-bank lenders that are doing this work.

- Access to capital and access to a network of business development support from the appropriate professionals

- Increase accessibility to business assistance programs

- Advocate for greater support and loan fund investment in small CDFI and community lenders

- We must ensure small businesses can access the capital they need to grow their enterprises, while ensuring this capital is offered in responsible ways.

- Help them secure new contracts.

- Provide more training and technical assistance to support businesses in building capacity. It’s not only about the loans.

- Have more exposure in order for small business to know where to get help.

- Endorse the Small Business Borrower's Bill of Rights 2. Support CFPB data collection 3. Support regulations that balance consumer protection and financial inclusion with supporting innovation.

- Make access to capital easier and faster.

- Provide more training and technical assistance.

- Streamline the process to make it easier to apply for financing.

- Providing loans. Crc is to promote loan and build credit

- Access to TA [Technical Assistance] and capital.

- Financial inclusion from banks for small dollar small business loans. Regulation and financial inclusion mandates for non-bank/alt lenders/MCA

- Free credit restoration program for every business owner under $250K revenue

- Have reasonably priced sources of financing and foster contract procurement

- Small businesses can greatly benefit from increased technical assistance and training on financial management to help owners understand the lending criteria and requirements from banks. Additionally, small business owners could benefit from credit building programs or products to help build their personal credit, but also help them understand how business credit is developed.

- Lending should look at behavioral science, rather than credit history.

- SBA has done an excellent job in loading training webinars on hits sight. But no one knows about them, banks may want to partner to promote as PSAs. 2. Banks may want to consider offer MCAs now that they have Zelle to compete with Venmo. 3. Banks should create more specific products tied to new contracts awarded, that lower the importance of credit score when funding is tied to a contract.

- That is a hard question, so many factors to consider, but in terms of CRC, CRC needs to grow so it can hold all the banks accountable to the excellent process in place.

- Support strategies [that] cluster small businesses within industry clusters focused on growing markets.

- Get us more CRA $s at reasonable rates and we will work on establishing successful and sustainable small business entrepreneurs in Central Valley.

- Small businesses, particularly minority small businesses, need TA/advising and flexible credit terms. There is an interesting program in Cleveland right now that involves the Urban League, NDC and Morgan Stanley that is getting credit and TA to black owned businesses. CRC should continue to advocate for TA $$ and referrals. But let's use technology for referrals.

- Invest in business assistance to create the pipeline.

- Reduce the amount of collateral requirements, be more investigative and reasonable in understanding "life situations" that can impact credit for a time a consider a borrower's course of rebound that establishes good character, establishing business mentoring after funds are disbursed to ensure less chance of default. Consider if the Borrower's lending request will under- capitalize and ultimately lead to failure; and provide a path of incremental funding that grows with the business to ensure greater chance for success over time, coupled with business mentoring!

- Fewer restrictions for government-backed loans for minority and women-owned businesses.