



WRITTEN STATEMENT
BEFORE THE U.S. SENATE COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
FIELD HEARING ON
“BARRIERS TO ENTRY IN THE TECH INDUSTRY FOR DIVERSE ENTREPRENEURS”

October 3, 2019

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Congresswoman Duckworth,

Thank you for inviting me to speak with you today about barriers facing diverse entrepreneurs and solutions that can address inequities in accessing capital.

As you know, small businesses are the foundation of our economy—one that ensures opportunity and prosperity for everyone. Small business ownership is a potent force that can help address the economic inequality that is holding our economy back from achieving its full potential—from providing sustainable high quality jobs to helping revitalize distressed neighborhoods and rural communities. A healthy entrepreneurial ecosystem provides an innovative and singular pathway for women, people of color, young adults, veterans, disabled people, immigrants and rural residents to enter the mainstream American economy and build income and independence.

As the Midwest Outreach Manager and National Women’s Entrepreneurship Manager for Small Business Majority, I’ve seen first-hand how entrepreneurship can create lasting impact for both an individual and their community. At Small Business Majority, our mission is to empower America’s entrepreneurs to build a thriving and inclusive economy. We actively engage small business owners and policymakers in support of public policy solutions, and deliver information and resources to entrepreneurs that promote small business growth and drive a strong, job-creating economy. Our extensive scientific opinion polling, focus groups and economic research help us educate and inform policymakers, the media and other stakeholders about key issues impacting small businesses and freelancers, including access to capital, taxes, healthcare, retirement and critical workforce issues.

Small Business Majority has a network of 58,000 small business owners across the country, with six regional offices, including an office here in Chicago. We work closely with our network and with more than 1,000 local business groups to create a strong small business voice in Washington and state capitals, and deliver critical education and resources to America’s job-creating entrepreneurs. Through our Entrepreneurship Program, we offer free education, tools and events to small business owners and aspiring entrepreneurs about access to responsible lending options, retirement, healthcare, wealth building tactics and more.

As part of our work supporting entrepreneurs, Small Business Majority has created a policy agenda that can promote a thriving economy and increase prosperity for all. Our agenda includes short and long-term recommendations that can be enacted at the national, state and local levels. Today, I will primarily focus on two key areas of our policy agenda that can be addressed to support diverse entrepreneurs: expanding access to traditional lending, and tackling predatory lending practices that are targeting underserved communities, understanding that these issues disproportionately impact women and people of color who historically have fewer assets to start and grow a business.

The small business credit gap for women and entrepreneurs of color

Despite the importance of small businesses to our economy, small business owners face significant hurdles accessing capital. Harvard Business School's 2016 report "The State of Small Business Lending" found that the small business share of total bank loans fell from 31% in 2010 to 21% in 2016.¹ Small Business Majority's scientific opinion polling has found that 9 in 10 small business owners believe the availability of small business loans is a problem.

This small business credit gap is even more significant for historically underrepresented entrepreneurs, including people of color, borrowers in rural communities, and for women and veterans. For example, women and minority-owned businesses receive just 4.4% and 5.5% of conventional small business loans respectively.² Indeed, Latino- and black-owned businesses were less than half as likely to use a bank loan to finance their startups as non-minority firms, instead relying more heavily on personal credit cards to start their businesses.³ According to the U.S. Minority Business Development Agency, businesses owned by people of color were three times more likely to be denied a loan than non-minority firms.⁴ Even more striking, the average loan amount for minority-owned firms was less than half the average for white-owned firms.⁵ And, in their 2016 State of Latino Entrepreneurship report, Stanford University researchers found a scant 6.1% of Latino entrepreneurs obtained a loan through a traditional bank, and less than 3% obtained financing through government loans.⁶ More than three quarters also were unaware of available U.S. Small Business Administration (SBA) loans and grants.

And while women-owned firms are the fastest-growing segment of businesses, studies find that women do not get sufficient access to loans and venture investment. According to Biz2Credit's 2017 State of Women-Owned Small Business Finance Study, women business owners get nearly 50% less in funding than their male counterparts.⁷ Similarly, a SBA study found that African-American and Hispanic business owners were most likely to report unmet credit needs.⁸

The Federal Reserve also found in 2016 that while women entrepreneurs apply for loans at similar rates to men, only 47% of their applications were funded, compared to 61% of applications from male-owned firms.⁹ Among the women business owners who didn't apply for financing, the survey indicated they didn't apply because they were more likely to believe they wouldn't receive funding.

¹ Harvard Business School, "The State of Small Business Lending: Innovation and Technology and the Implications for Regulation," November, 2016, http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebb3e040e55.pdf

² Urban Institute, "Competitive and Special Competitive Opportunity Gap Analysis of the 7(a) and 504 Programs," January 2008, https://www.urban.org/research/publication/competitive-and-special-competitive-opportunity-gap-analysis-7a-and-504-programs/view/full_report

³ U.S. Small Business Administration, "Small Business Finance: Frequently Asked Questions," July 2016, https://www.sba.gov/sites/default/files/Finance-FAQ-2016_WEB.pdf

⁴ Minority Business Development Agency, "The MBDC: Vital to Making America Great," 2017, https://www.mbda.gov/sites/mbda.gov/files/migrated/files-attachments/MBDAVitaltoMakingAmericaGreat_170330.pdf

⁵ Minority Business Development Agency, "Disparities in Capital Access between Minority and Non-minority Businesses," January 2010, <https://www.mbda.gov/page/executive-summary-disparities-capital-access-between-minority-and-non-minority-businesses>

⁶ Stanford Graduate School of Business Latino Entrepreneurship Initiative, "State of Latino Entrepreneurship 2016," <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/report-slei-state-latino-entrepreneurship-2016.pdf>

⁷ Biz2Credit, "Credit Scores of Women-Owned Businesses Rose, Revenue Dropped in 2017; Digital Boom Leaves Women Behind," February 2018, <https://www.biz2credit.com/research-reports/women-owned-business-study-2017>

⁸ U.S. Small Business Administration, "Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms," February 2018, https://www.sba.gov/sites/default/files/rs440_financing_patterns_report_1.pdf

⁹ Federal Reserve, "2016 Small Business Credit Survey: Report on Women-Owned Firms," November 2017, <https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/sbcs-report-womenownedfirms-2016.pdf>

This credit gap hurts the bottom line of these small business owners and inhibits their ability to grow and create shared prosperity for their communities. Roughly 16% of Latino-owned businesses say their profits were negatively impacted due to a lack of access to capital.¹⁰ Similarly, black entrepreneurs are almost three times as likely as white business owners to report that a lack of access to capital negatively affects the profitability of their business.¹¹

This is why we urge policymakers to pursue policies that will address the lending gap for women, people of color and other underserved communities by: 1) Increasing entrepreneurs' access to traditional sources of capital, 2) Promoting innovation in small business lending while ensuring responsible lending practices.

Increase entrepreneurs' access to traditional sources of capital, particularly in underserved communities

Business lending as a whole may be on the rise post-recession, but as the statistics cited previously make clear, small businesses are still not getting enough capital to launch or grow their businesses. Indeed, since the recession ended, small business loans trail big business loans by trillions of dollars, there are far fewer community banks and most banks are making far fewer low dollar loans. This problem especially impacts underserved entrepreneurs, including those living in rural communities and among women and small business owners of color. And while innovations in alternative lending show some promise if offered responsibly, the small business credit gap will not be overcome without increasing traditional financing to small businesses.

Key recommendations include, but are not limited to, the following:

- Strengthen responsible sources of capital by expanding SBA loan programs such as the 7(a) Loan Guaranty Program, the 504 Loan Guaranty Program and the Microloan Program. For example, Congress should pass the Microloan Expansion Act of 2019, which will help improve the SBA's Microloan Program to serve more small business owners who are struggling to access capital by increasing the total amount of loans that lenders may keep on their books. This legislation would eliminate an outdated rule that prevents SBA from distributing more than 1/55th of its funding in any given state during the first half of the year, and it would require SBA to report to Congress and the public on the success of the program and how the loans help small businesses remain in business. Since the majority of small businesses are seeking small-dollar loans (those under \$100,000) that are difficult to secure from a traditional lender, the Microloan Program is a vital resource for small and emerging businesses.
- Make the SBA's 7(a) Community Advantage Pilot Program permanent. This program, which is set to expire in 2022, must make a majority of its loans to underserved markets, such as small firms owned by women, entrepreneurs of color and veterans. Making the program permanent would support entrepreneurs that face greater barriers to accessing business loans, ensuring more small businesses have the opportunity to start and grow.
- Ensure women and entrepreneurs of color get fair access to capital by increasing funding for the counseling, capital and contracting services provided by Women's Business Centers, Small Business Development Centers and the Minority Business Development Agency. This includes increasing the cap on matching grants for Women's Business Centers and funding bilingual counseling services for immigrant entrepreneurs.

¹⁰ Stanford Graduate School of Business Latino Entrepreneurship Initiative, "The U.S. Entrepreneurship Gap: A comparative measure of Latino Entrepreneurship Activity," 2018, <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/report-slei-2018-latino-entrepreneurship-gap.pdf>

¹¹ Kauffman Foundation, "Startup Financing Trends by Race: How Access to Capital Impact Profitability," October 2016, <https://www.kauffman.org/what-we-do/research/2016/startup-financing-trends-by-race-how-access-to-capital-impacts-profitability>

- Maintain and expand lending programs for rural entrepreneurs funded through the U.S. Department of Agriculture, including the Rural Microentrepreneur Assistance Program, Rural Business Development Grants and the Intermediary Relending Program.
- Dramatically expand the annual budget of the Community Development Financial Institutions (CDFI) Fund from \$250 million to \$1 billion.
- Reaffirm the Community Reinvestment Act's (CRA) mission of stimulating lending in low- and moderate-income areas to ensure business owners in these areas maintain access to capital.
- Quadruple SBA lending guarantees—for example, by raising the maximum guaranteed annual loan amount from \$25 billion to \$100 billion—and thereby increasing the volume of small business loans guaranteed by the SBA to \$1 trillion over the next decade.
- Reduce the risk of small business lending for banks by increasing the loan guarantee percentages from 85% to 90% for loans up to \$150,000, and from 75% to 85% for loans between \$150,000 and \$700,000. This will make it less risky for banks to lend to startups, particularly those looking for smaller lines of credit.
- Reduce SBA loan fees to 0% for the guaranteed portion of loans under \$150,000 and 1% for loans between \$150,000 and \$700,000. The current fee structure unnecessarily adds extra costs for small business owners and dampens their ability to get credit.
- Make permanent the New Markets Tax Credit (NMTC), which has helped to attract more than \$60 billion in private sector funding to community development financing intermediaries that create opportunities for small business development in economically-distressed communities across the United States.
- Enact policies to strengthen and expand community bank lending, which provides more than half of all small business lending. Smart initiatives include encouraging state and local governments to shift public funds into community banks and increasing community bank lending in rural areas.

Small businesses need protection from predatory lending practices

New alternative and online lending opportunities have sprung up to fill the gap in small business lending need, which is a potentially positive development for small businesses. Innovators are providing faster and easier ways to borrow and increasing access to credit in communities that have historically been underserved. Indeed, research data confirms small business owners are increasingly turning to online lenders to fulfill their credit needs. The 2019 Federal Reserve Small Business Credit Survey found applications to online lenders continue to rise, with 32% of applicants seeking financing from an online lender in 2018, compared to 24% in 2017 and 19% in 2016.¹²

It's clear that the way small businesses borrow money is undergoing historic transformation, but this transformation will achieve its potential only if it is built on transparency and fairness and by putting the rights of borrowers at the center of the lending process. This is necessary because alternative sources of financing operate in an almost entirely unregulated market—making many small business owners vulnerable to predatory practices. While some financing institutions are doing their part to disclose their terms and rates, not all lenders are playing by these rules and are offering desperate entrepreneurs loans with predatory terms. Often loan characteristics are not disclosed at the time a loan offer is made and borrowers learn only after the loan was disbursed that there are hidden fees or unfavorable loan terms, leaving them on the hook for much more than expected.

¹² The Federal Reserve Banks of the United States, "Report on Employer Firms 2019: Small Business Credit Survey," April 2019, <https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/sbcs-employer-firms-report.pdf>

It's clear that small business borrowers face risks from this lack of regulation. Indeed, a May 2016 report from the U.S. Department of the Treasury found an uneven regulatory and supervisory regime creates risks for small business borrowers and that more robust small business borrower protections are needed.¹³ These findings are supported by Small Business Majority polling, which revealed 78% of small business owners agree that high interest, high-fee products offered to small businesses are a problem.¹⁴ Additionally, 3 in 4 small business owners felt that while online small business lending opened up new sources of capital and credit for small business owners, it should be regulated to ensure small business borrowers are protected from predatory practices. What's more, an overwhelming majority of 8 in 10 small business owners reported they were in favor of regulating online lenders to ensure interest rates and fees are clearly disclosed to borrowers.

While the federal Truth in Lending Act offers some protection to consumers from such exploitation, this law does not apply to small business borrowers. It's important that policy solutions not unduly restrict access to credit or reduce innovation, but it's equally essential that small business owners are protected from predatory practices. Solutions include the following:

- Pass legislation extending Truth in Lending Act disclosure requirements to small business loans or credit products, such as California's small business truth in lending legislation enacted in 2018.
- Promote responsible lending practices by lenders and brokers as set forth in the Small Business Borrowers' Bill of Rights. Specifically, promote laws and industry practices governing business lending to require: (1) transparency around rates and terms, including APR, (2) non-abusive products, including curbs against the practice of "double dipping," in which borrowers are double-charged fees when they refinance, (3) responsible underwriting, (4) fair treatment from brokers, (5) nondiscrimination, (6) fair debt collection practices and (7) accurate credit reporting.
- Prohibit "confession of judgment" clauses in small business lending agreements whereby borrowers agree in advance to waive their right to contest any dispute with a lender, often costing them their entire savings. This prohibition has been proposed in the bipartisan Small Business Lending Fairness Act.
- Enforce the existing legal requirement that the Consumer Financial Protection Bureau (CFPB) collect small business lending data as mandated under section 1071 of the Dodd-Frank consumer protection law.

Conclusion

Small business owners are poised to inject life and vitality into their communities, provide quality jobs and boost prosperity for all, but they need the proper resources and public policies to support them in unleashing their potential. What's more, federal policy must emphasize solutions that lift up those entrepreneurs who have traditionally struggled to access resources and economic security most, including women, entrepreneurs of color and rural small business owners. Pursuing this such an agenda will create a thriving small business ecosystem that will in turn create a dynamic and inclusive American economy for all.

Thank you for the opportunity to comment on this important issues for small business here in Illinois and across the country. I am happy to answer any questions.

¹³ U.S. Department of the Treasury, "Opportunities and Challenges in Online Marketplace Lending," May 10, 2016, https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_whte_paper.pdf

¹⁴ Small Business Majority, "Opinion Poll: Small Business Owners Concerned with Predatory Lending, Support More Regulation of Alternative Lenders," December 12, 2017, <https://smallbusinessmajority.org/sites/default/files/research-reports/121217-Small-Business-Access-To-Capital-Poll.pdf>