U.S. Senate Committee
Small Business and Entrepreneurship

PAUL C. HUDSON
Chairman, CEO Broadway Federal Bank
Statement Submitted
Thursday, April 15, 2010

Chairman Landrieu and Committee members, thank you for inviting me to appear before you today and for the opportunity to provide my perspective on both the obstacles and opportunities that minority small business owners have in accessing capital and technical assistance.

Capital

Minority small business owners use the term capital, even when they are really talking about debt financing. This is based on certain realities in our community, which include the following.

1. The primary source of funds to finance minority business operations and expansion is often in the form of debt. These sources include credit card debt, loans collateralized by personal and business assets, which is most often the business owner's personal residence and/or loans from family members and friends.
2. Capital is a foreign commodity in minority communities. The lack of capital in minority communities results from past discriminatory policies and practices that created a wealth gap. Minorities have substantially less wealth than the rest of

Americans.[1] The lack of wealth accumulation within minority communities has resulted in limited investable capital from local sources for minority business owners.

As a result of this broader definition of capital within minority communities, I have found that minority business owners often blur the distinction between short term debt and longer term equity. For purposes of this statement, I will address access to both sources of financing.

Access to Capital

Obstacles

For all of my adult life, minority business owners have complained about the obstacles to accessing capital. Based on my experience, there are five major obstacles.

1. The lack of wealth accumulation within minority communities. This has meant limited opportunities to access local sources of capital. Local networks of friends, associates and organizations are often the connectors between business owner and investor. The lack of local sources of capital has historically contributed to the unequal access to capital by minorities.
2. Redlining of minority communities and minority business owners by financial institutions due to race and income and collateral disparities caused by discriminatory practices. Many studies have shown that African American borrowers and small businesses owned by African Americans were less likely than

[1] Meizhu Lui, March, 2009, "Laying the Foundation for National Prosperity. The Imperative of Closing the Racial Wealth Gap."

their white counterparts to have their commercial loans approved, even when borrower traits, including credit history were controlled for statistically.[2]

3. Minority business owners do not have a nexus to investment networks, which is another by product of discrimination and segregation. I am often asked about making an equity investment in a small business, even though we are a bank not a private equity fund. The financial network of most borrowers does not extend to angel investors or more traditional equity funds outside the minority community. Thus, Broadway Federal Bank (Broadway), the local community bank, is the logical and often only finance option.
4. Minority businesses are often not organized or structured in a way that facilitates investment. Many small minority businesses are organized as sole proprietorships with a strong preference for ownership control, which limits the investment vehicles and opportunities.
5. Some minority business owners lack the financial sophistication to source investment opportunities, prepare investment materials and structure investment terms. This impairment coupled with limited access to a network of financial resources also impacts their ability to identify and retain consultants and advisors to assist them. The lesser degree of financial literacy

[2] Faith Ando, 1988, "Capital Issues and Minority-Owned Business", The Review of Black Political Economy; Ken and Linda Cavalluzzo, 2002, "Competition, Small Business Financing, and Discrimination: Evidence from a New Survey." Journal of Business 75(4): 641-79; David Blanchflower, Philip Levine, and David Zimmerman, 2003, "Discrimination in the Small Business Credit Market." Review of Economics and Statistics.

is not due to a lack of ability or intelligence, but reflects limited access to financial education and technical assistance.

In addition to the above obstacles, the current economy has weakened the balance sheets and income statements of minority small businesses, thereby reducing the number of investment grade opportunities. The depressed economy has also contributed to the steepest drop in lending since 1942, exacerbating the problem of access to credit for minority small businesses.[3]

<u>Opportunities</u>

Broadway, as a small minority business, provides a case study of the possibilities and creative solutions to providing capital opportunities for minority small businesses.

1. In the last thirty years, minority businesses have grown larger and more mature. Broadway is 63 years old with assets slightly in excess of $500 million and annual gross revenues of close to $30 million.
2. Minority businesses make an important contribution to the economy and job creation. Broadway is a certified Community Development Financial Institution based on its delivery of financial services and products to underserved communities and its support of economic development in minority communities.

[3] Whitehouse, Mark, March 15, 2010, Wall Street Journal, "Loan Squeeze Thwarts Small-Business Revival"

3. The U.S. Treasury invested $15 million of capital in Broadway under the Troubled Asset Relief Program in the form of preferred shares at a dividend of 5%. The additional capital supported net new lending in 2009 of $109 million, the majority of which was invested in commercial operations in urban minority communities. If the capital is not repaid in five years, then the dividend yield increases to 9%.

Recommendations

I make the following recommendations for the Committee's consideration.

1. Allocate $10 billion of Stimulus Funds to the Small Business Administration (SBA) for capital investments in small and minority businesses (the "Capital Fund"). The Capital Fund investments should be targeted to support job creation and economic growth in low to moderate income communities.
2. SBA should develop investment criteria to maximize job creation and minimize investment default.
3. In lieu of a minimum number of years in operation, require applicants with less than the minimum operational history to accept technical assistance training and business education prior to receipt of funds.
4. SBA should receive a current dividend and participate in the appreciation of the business' value that results from the SBA

investment. SBA should incorporate many of the characteristics of Treasury's investment model.

5. Contract with minority asset managers to help source and manage small business investments and to provide technical assistance and business education.