LATINO ECONOMIC DEVELOPMENT CENTER

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Subcommittee on Economic Growth, Tax, and Capital Access
"***Exploring Challenges and Opportunities Faced by Underserved Businesses in the 21st Century***"
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Good Morning Subcommittee Chairman Kim and Members of the Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access. It is my sincere honor to be speaking with you all today about the challenges and opportunities faced by underserved businesses in this century. My name is Marla Bilonick and I am the Executive Director and CEO of the Latino Economic Development Center-LEDC.

LEDC is a 28-year old organization with the mission to drive the economic and social advancement of low-to moderate-income Latinos and other underserved communities in the D.C. and Baltimore Metropolitan Areas by equipping them with the skills and tools to achieve financial independence and become leaders in their communities. We operate out of 6 offices in the region, with over 40 professional and bilingual staff providing top-notch services to our clients. On an annual basis we serve well over 4,000 low- to moderate-income residents. Scanning all of our programs, the majority of our clients are Latino (60%) and a sizeable portion are African-American/Black (30%). The remaining portions are White/Caucasian and Asian (10%). Our core asset-building programs are: Housing Counseling, Affordable Housing Preservation; Small Business Capacity Building; and Small Business Lending. We are a SBA- Microlending Intermediary and certified Community Development Financial Institution (CDFI). LEDC receives support for our small business services from partners including the Small Business Administration, CDFI Fund (Treasury), private corporations, and philanthropic foundations.

Since we began lending in 1997, we have rolled out more than $15 million in capital in the form of over 1,200 small business loans. We've provided small business technical assistance services to thousands of aspiring and existing small business owners in the region. Last year, LEDC distributed close to 200 loans in the communities we serve. LEDC is a member of and I sit on the Board of the Opportunity Finance Network, a membership organization representing the over 1,000 CDFIs in the United States. The challenges I will outline are consistent with what we hear from our fellow CDFIs operating in similarly underserved communities around the nation.

Our reason for existence is to help underserved populations overcome the challenges that stand in the way of them reaching their full potential for achieving financial stability and income mobility. The entrepreneurs we serve face formidable hurdles in starting and expanding their businesses and it's our role to help them to overcome and eliminate those hurdles. While the challenges are countless, those that I would characterize as the most significant are:

- Lack of access to capital,
- Lack of access to information and educational resources;
- Poor or no credit history, and
- Systemic and institutional racism and sexism.

In my testimony, I will elaborate on each of these barriers to success and will close with a description of how nonprofit organizations and community development organizations like LEDC work every day to mitigate these challenges. As the head of a Latino-facing organization and member of the Board of Directors of the National Association of Latino Community Asset Builders-NALCAB, I will also include information on small business challenges that are specific to the Latinx community.

LACK OF ACCESS TO CAPITAL

According to an August, 2018 report from the Small Business Administration, the most common source of capital to finance business expansion is personal and family savings, with 22% of entrepreneurs relying on that source. However underserved entrepreneurs do not frequently have sufficient savings built up or friends and family that can personally invest in their business ventures. They do not have the proverbial "rich uncle" to reach out to for an interest-free family loan or grant. Thus, they turn to institutional lenders, credit cards, or alternative sources of financing that often come with a hefty price tag attached.

The traditional commercial banking system is often not a viable resource for underserved small businesses. Commercial banks typically have a fixed minimum credit score they will accept for loan approvals and are further hindered from serving small business due to restrictions around lending to start ups or providing smaller-dollar financing. A recent report from the Woodstock Institute cited that the number of CRA-reported loans under $100,000 in 2015 remained 58% lower than in 2007. What's more, bank branches are consolidating and closing at a steady clip, with 1,700 bank branches closing in the 12 months between June, 2016-June, 2017. This environment is not small-business friendly.

The alternative for underserved entrepreneurs operating in this climate is to take out credit cards that often charge high interest rates; access high-cost financing via the emerging online lending industry; tap into merchant service cash advances; obtain a loan from a loan shark; or tap into the Community Development Financial Institutions in their area. I will note that we have several loans in our portfolio that are restructured financing deals for entrepreneurs who fell prey to the allure of online lenders promising fast cash, only to realize they had signed off on deals that were, indeed, too good to be true.

On the other hand, data shows that CDFIs in OFN's membership alone have originated more than $65 billion in financing in urban, rural, and Native communities through 2016. To quote OFN's President, Lisa Mensah, "CDFIs exist to move money to places missed by traditional lenders." However, CDFIs face challenges in terms of reaching the very communities that need our services due to minimal or nonexistent marketing budgets; challenges to capitalizing our loan funds, and/or sustaining the high overhead costs associated with the labor-intensive loans we underwrite.

LACK OF ACCESS TO INFORMATION AND EDUCATIONAL RESOURCES

Starting or growing a business is not for the faint at heart. In an ideal scenario, an entrepreneur has the time and support to complete an in-depth business plan, complete with a detailed market analysis, elaborate revenue projections, a well-developed management plan, and options for financing their one-time start-up costs as well as the ongoing or variable costs to come. This plan provides a framework and sequencing that sets up the entrepreneur for success. Unfortunately, underserved entrepreneurs do not always have access to business planning information or resources. Nor, do they have time to invest in business planning as they are looking to their business idea as a source of income for themselves and their family. We have had many a client come to our doors with business cards and a signed lease in hand…BEFORE they have mapped out how their idea will play out as a living business.

In addition, the regulatory framework is a maze of processes and agencies that few could understand without outside support. Depending on the business type, entrepreneurs frequently need to go through several licensing agencies and register with their state and jurisdiction to be compliant. Layer on top of that the language barrier that many of our immigrant Latinx clients face, and it's doubly challenging to meet compliance requirements. Organizations that provide small business coaching and training are critical to helping underserved entrepreneurs to navigate the regulatory framework and adequately plan their businesses from concept to implementation.

POOR OR NO CREDIT HISTORY

The 2017 Small Business Credit Survey found that 50% of small businesses rely exclusively on their owners' personal credit scores to secure debt and another 37% use both the owners' personal scores and business credit scores. According to Forbes 2018 article, *Why Minorities Have So Much Trouble Accessing Small Business Loans*, "The average minority small business owner has a credit score of about 707—15 points lower than the average small business owner in the U.S. A nearly perfect credit score is basically mandatory for the most advantageous bank loans, even though there are numerous plausible explanations as to why an otherwise responsible and dedicated business owner would have poor or very little credit history."

Meanwhile 50% of LEDC's lending goes to entrepreneurs with credit scores lower than 640, which is considered "Fair" by the credit bureaus and would never be sufficient to clear a traditional bank loan.

For Latinx communities, the culture of credit that prevails in the United States is not always culturally compatible with the cash-based and distrusting of financial institutions experience of their home countries. Many of our clients keep cash in their homes, rather than place it in a bank. In addition, given current anti-immigrant sentiments, there is a segment of our client base that distrusts institutions in general for perceived fear of undermining their ability to live in the United States.

SYSTEMIC AND INSTITUTIONAL DISCRIMINATION ON THE BASIS OF RACE, ETHNICITY, AND/OR SEX

Underserved small business clients face institutional and systemic discrimination on the basis of race, ethnicity, and/or sex. A 2016 Independent Business Survey conducted by the Institute for Local Self Reliance reported that of the business owners who applied for a bank loan in the past two years, 54% were rejected. The Minority Business Development Agency's (MBDA) research finds that minority business owners are denied loans at nearly three times the rate of non-minority owners. More troubling is that even when minority owners have access to capital it comes at inequitably high cost. A recent report in Forbes, co-authored by staff from the Kauffman Foundation, found that minority business owners receive higher borrowing costs, are offered smaller loans, and have their loan applications rejected more often than non-minority applicants. The study goes to on to describe that even when minority-owned businesses have identical business characteristics and credit reports compared to their non-minority-owned counterparts, they still gain less access to credit.

The lending gap for women is also dramatic. A prominent fintech company, reports that in 2017, women-owned businesses received nearly 50% less funding than men-owned businesses, and that funding for women-owned businesses declined by 42% between 2016 and 2017.

For immigrant and Latinx populations, the language barrier can present unfortunate opportunities for discrimination and abuse. Many of our clients sign off on contracts or leases with extremely unfavorable terms due to their lack of understanding. We also find that unethical characters prey on immigrant communities and charge exorbitant rates for services that are free or low-cost to the public such as registering a business or obtaining permits or business licenses.

CDFIs and small business technical assistance providers can mitigate the challenges posed by systemic and institutional discrimination by targeting the very populations that are victims of discrimination. In addition, small business support organizations must be active in advocacy at the local and national levels to ensure that discriminatory practices be called out and admonished and predatory lending practices be eliminated. Federal agencies such as the Consumer Financial Protection Bureau, Office of the Comptroller Currency, The Federal Reserve Bank, and Federal Depository Insurance Corporation should continue and deepen their evaluation of commercial bank activities with regard to the demographics of who is and is not receiving loans. Specifically, the CFPB should finalize its implementation of Section 1071 of the Dodd-Frank Act, which would require financial institutions to compile, maintain, and report information regarding credit applications made by women-owned, minority-owned, and small businesses. This kind of information would provide policymakers with insights into the precise shortcomings of diverse businesses in seeking credit, enabling policymakers to craft narrowly-tailored legislation designed to remedy the shortcomings within each of these entrepreneurial communities.

CLIENT PROFILES

To end on a positive note, I would like to highlight two client success stories that are exemplary of clients that have defied the aforementioned challenges. These American heroes are forging pathways to economic security for themselves and the families they support.

Ana Cecilia Mendoza got her start in construction nearly 15 years ago. When she first moved to the U.S. she cleaned hotels, waited tables, and flipped burgers. But the paychecks she was bringing in barely covered the cost of her babysitter. Desperate to provide for her family, she began working in construction after realizing how much more lucrative that industry was. She was not intimidated by the work, insisting “Since I was a little girl, my father took me to the fields (in El Salvador). He taught me how to be strong and do a man’s job.” She recently decided to open up her own construction company, Cecilia Construction, LLC. With an emphasis on hiring women, the business will provide interior construction services such as drywall installation. She began to work with one of our coaches in early 2018 and enrolled in our Entrepreneur Training for Success course in October of last year. She has developed a marketing strategy and is registering her business with the District. She plans to be open for business in June of this year.

Gabriela Febres and Ali Arellano are life and business partners who started off selling Venezuelan cheeses to a growing network of fans several years ago. From there, they began cooking traditional Venezuelan foods including Arepas, which spawned their food truck concept, *Arepa Zone* which was funded by LEDC through their initial loan in 2013 of $25,000. The food truck quickly grew to viral follower status and they could barely keep up with demand. From there, they won a business competition for a year’s free rent on a booth in DC’s Union Market. This growth was facilitated by LEDC’s second loan of $27,000. They took on their next goal of having their own brick and mortar restaurant and launched a fast casual location right off of Scott’s Circle in the District, catering to an active business and residential crowd. LEDC invested in the brick and mortar location with a $100,000 loan. These clients are direct recipients of loans originating from the following Federal sources: CDFI Fund, SBA, and HHS Community Economic Development. They are a shining example of success and have created 11 jobs in Washington, DC with potential for many more as they continue to grow.