SECAP

SMALL ENTERPRISE
CAPITAL ACCESS
PARTNERSHIP

Report to Partners

September 2000

Small Enterprise Capital Access Partnership

In Memory of Nancy Goodman

This report is dedicated to the memory of Nancy Goodman, who died tragically as the first phase of the SECAP initiative drew to a close. Nancy was a Senior Vice President at the Federal Reserve Bank of Chicago where she worked for 32 years, overseeing the Consumer and Community Affairs, Corporate Communications and Public Affairs divisions. Nancy was also a member of the SECAP Advisory Committee and played a key role in organizing the initiative in the year prior to its inception. Her contributions to SECAP and to the Reserve Bank during her career were immense. Nancy was a trusted colleague and friend, and she will be sorely missed.

Mission Statement

SECAP is an initiative of the Federal Reserve Bank of Chicago, established with the goal of improving access to credit and related resources by historically underserved small business owners. SECAP involves a voluntary collaborative of various stakeholders in the small business arena, including lenders, community-based organizations (CBOs), technical assistance providers, government organizations, trade associations, academic researchers and others. SECAP will assess the small business environment with the aim of identifying the greatest challenges for minority-owned, women-owned and other businesses with historically limited access to credit.

It is SECAP's charge to reach recommendations for changes or modifications to policies and practices that serve as barriers to capital access, to be instrumental in creating new resources where necessary, and to involve the appropriate organizations and individuals to bring the necessary resources to the table.

Foreword

Small businesses in the United States employ most of the nation's work force, and account for a significant proportion of the growth in our economy. Still, some entrepreneurs face obstacles to obtaining needed credit and capital to start or grow their businesses. To increase capital flow to historically underserved business owners in Greater Chicagoland, the Federal Reserve Bank of Chicago initiated a program called the Small Enterprise Capital Access Partnership (SECAP). This entirely voluntary program was designed to engage practitioners in the small business arena to examine the process and devise solutions to promote capital access by entrepreneurs and communities that have historically had less than their share of attention from sources of capital.

In October 1999, the Federal Reserve and six other co-conveners – the Chicago Association of Neighborhood Development Organizations (CANDO), the Chicagoland Chamber of Commerce, the Cosmopolitan Chamber of Commerce, the Illinois Bankers' Association, the United States Small Business Administration (U.S. SBA), and the Women's Business Development Center (WBDC) – convened 41 SECAP Partner organizations with almost 60 professionals to examine the relevant issues. Task groups were formed at that meeting to identify, and reach recommendations to bridge impediments in the areas of Underwriting, Technical Assistance, Equity Investment and Marketing and Delivery Systems.

Over the ensuing seven months, the task groups debated their respective topics and reached a total of 10 recommendations. They worked with great diligence and perseverance to confront the complex issues that affect minority and underserved business owners and to create strategies to address them. The report that follows contains the recommendations and action steps developed by the four task groups. It represents the result of much hard work, and I commend the members of those teams for their efforts. Every Partner may not fully support all the recommendations, but they have agreed that the ultimate goal is a worthy one, and they continue to support the principles of the program. It is up to each partner in SECAP to determine what role it will assume in implementing the recommendations taking into consideration any legal, regulatory or other constraints.

Ultimately, it was not our intent in initiating SECAP simply to create a document, or to suggest things that others might do, but rather to foster meaningful and

"SECAP is not about easy credit and handouts. It is about helping entrepreneurs help themselves. We hope to put business owners in a better position to obtain credit and capital in the financial mainstream."
Michael Moskow, SECAP Partners Meeting, 7/18/00

practical change by developing a blueprint for action. We must continue to work, challenge each other, and believe we can and will make a difference in many people's lives in our Chicago area communities. The results of those efforts will be the legacy of SECAP.

Once again, I want to thank all the partners and participants for their outstanding efforts and cooperation in this important initiative.

Michael H. Moskow
President and CEO
Federal Reserve Bank of Chicago

Conveners and Partners in the Small Enterprise Capital Access Partnership

Conveners

Chicago Association of Neighborhood Development Organizations (CANDO)

Chicagoland Chamber of Commerce

Cosmopolitan Chamber of Commerce

Federal Reserve Bank of Chicago

Illinois Bankers' Association

United States Small Business Administration, Illinois District Office

Women's Business Development Center

Partners

AIC Technologies, Inc.

Ardor Financial Group, LTD.

Associated Bank

Bank One

Business and Economic Revitalization Association

Chicago Association of Neighborhood Development Organizations (CANDO)

Chicagoland Chamber of Commerce

The Civic Committee of the Commercial Club of Chicago

Cole Taylor Bank

Community Economic Development Law Project

Community and Economic Development Association of Cook County, Inc.

Cook County Department of Planning and Development

Cosmopolitan Chamber of Commerce

Economic Development Council

Eighteenth Street Development Corporation

Federal Reserve Bank of Chicago

Greater North Pulaski Development Corporation

Harris Trust and Savings Bank

Hispanic Housing Development Corporation

Illinois Bankers' Association

Illinois Department of Commerce and Community Affairs

Jane Addams Hull House

KMN Growth Consultants

Lakeview Chamber of Commerce

LaSalle Street Project

Manufacturer's Bank

Metropolitan Bank

Mid-City Financial Corporation

New City YMCA LEED Council

North Business and Industrial Council (NORBIC)

Old Kent Bank

One Goal

Plaza Bank

SomerCor 504, Inc.

Southeast Chicago
Development Commission

South Shore Chamber, Inc.

Successful Independent Network

Uptown National Bank

United States Small Business
Administration Illinois District Office

Women's Business Development Center

Women's Self-Employment Project

Letter from the SECAP Advisory Committee

Small enterprises play a significant role in our communities, regions, and neighborhoods. They are a source of economic, social, and personal advancement and stability. Small businesses contribute in important ways by diversifying economic activity, improving competition, encouraging economic and social mobility, stimulating innovation, increasing productivity, spurring production, and promoting exports. They serve as a basis for growth in income and well-being by providing jobs, self-sufficiency, more rewarding opportunities for those with few options, and a significant avenue for drawing immigrants, women, Blacks, Hispanics, and other minorities into the economic mainstream.

Access to both debt and equity capital is vital for small businesses and their needs for different types of financing as they move from initial start-up through early formative development to expansion and long-term viability. Given the need and demand for financing, some small business owners, especially the historically underserved and aspiring entrepreneurs, may find it difficult to obtain financing from traditional sources. An underlying issue is the widespread disparity in the distribution of small business funding among different demographic groups and communities.

To alleviate capital related impediments to small business development, we have organized and led, with the direct assistance of the Federal Reserve Bank of Chicago, the Small Enterprise Capital Access Partnership (SECAP). After much deliberation within the SECAP Advisory Committee during the 18 months prior to the inception of the program, it was decided that SECAP would focus on four areas: Equity Investment, Marketing and Delivery Systems, Pre- and Post-Loan Technical Assistance and Underwriting. In October of 1999, the Federal Reserve Bank of Chicago held a one-day conference to identify and prioritize key barriers to small business growth and capital access within these areas. To address the variety of issues involved, a task group was formed around each topic. The task groups consist of individuals, representing virtually every discipline within and related to the small business financing process, from 41 SECAP Partner organizations. Our objective in bringing industry practitioners to the table was to get a perspective from the active participants in the industries involved.

Over the period of seven months, the task groups met to examine the essence of each issue and develop recommendations to stem disparities with respect to each of the four areas. As the Advisory Committee for the Small Enterprise Capital Access Partnership, we have attempted to provide the four task groups guidance and direction when needed, while keeping each group open to a broad range of views. The groups worked diligently to identify, research, and provide advice on the real problems faced by small enterprises, the types of assistance they need, and steps that could be taken to address those needs. They have recommended new approaches and action plans to ensure continued sustainable small enterprise growth.

Although the SECAP initiative is primarily focused on practical approaches to promoting capital access by small businesses in Chicago area communities, there are certain public policy issues that are highly relevant to serving the capital needs of historically underserved entrepreneurs and communities. Several organizations involved in SECAP have recognized the need to raise awareness of public policy issues that directly or indirectly affect access to capital. A variety of public policy issues have significant impact on access to credit and capital by historically underserved entrepreneurs and communities. Some key issues are outlined below.

"New Market" tax credits and investment programs: Low-income housing tax credits have done much to foster development of quality affordable housing. Private investors purchase the credits to provide equity to worthy projects. Members of the SECAP partnership have suggested that tax credits might serve a similar purpose for investments in commercial real estate and to provide patient capital for businesses in traditionally underserved markets.

Funding for technical assistance: The need for additional funding for SBDCs (Small Business Development Centers) and other technical assistance providers to provide technical assistance to small firms was recognized as a potential obstacle to business development in underserved communities.

Regulation B/Equal Credit Opportunity Act: Under the Home Mortgage Disclosure Act (Regulation C), mortgage lenders are required to collect demographic data about borrowers. This data in turn assists bank regulators in determining whether potential fair lending violations are present, though the data in itself is not conclusive. Under Regulation B, banks are currently not permitted, even voluntarily, to collect demographic (i.e., race and gender) data for business loans that might serve a similar purpose.

Community Reinvestment Act (CRA) enforcement: Concern has been raised among SECAP Partners that the geographic distribution of small business loans is neither a clear nor an integral part of CRA examinations. By extension, the physical location of bank branches seems to influence examination results only insignificantly: banks with branches located primarily in affluent communities tend to be rated no worse than banks with a significant proportion of branches in lower-income communities for purposes of CRA.

Although these issues have not been fully discussed or directly addressed in the Partnership Report, as the Advisory Committee continues to meet, we will examine these and other overriding public policy issues carefully, seeking input and possibly forming another group to explore these issues further.

The task groups are moving toward implementing their ideas with the help of some organizations that have offered to play a leading role. They will seek the participation and assistance of the specific industry and organizations affected by the recommendations, both to help with the process and to stay abreast of specific developments pertaining to implementation.

We are proud to serve as the Advisory Committee for SECAP and would like to commend the task groups for their enormous devotion and energy. We must continue to work together in hopes of achieving the goals of SECAP. The solutions will not be realized without organizations committed to their success. Therefore, we encourage all those involved to carefully review the recommendations and commit the resources, effort, and action as appropriate to ensure that success. As we begin implementation heartened by a broad consensus of groups, we can move toward our vision.

The SECAP Advisory Committee

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The SECAP Task Group Recommendations and Blueprint for Action

Equity Investment Task Group Blueprint

	Description of Recommendation	Subject Area	Affected Organizations or Industries
1	Develop and provide a venture capital fund targeted to smaller businesses owned by women, minorities, and/or those located in lower- and moderate-income communities.	Targeted Venture Capital Fund	Growth Businesses Growth-Potential Businesses
2	Develop and offer training and technical assistance programs to all Chicagoland communities on accessing equity investment.	Training and Technical Assistance for Entrepreneurs Seeking Equity Financing	Growth Businesses Growth-Potential Businesses
3	Form a semi-formal committee to organize and provide a method in which angel investors can gain a better understanding of seed investment and learn of available resources.	Private (Angel) Investment Networking and Infrastructure	Pre-institutional Investors/ Financiers Resource Providers Foundations Trusts Corporate Venture Funds

Marketing and Delivery Systems Blueprint

	Description of Recommendation	Subject Area	Affected Organizations or Industries
1	Create a central clearinghouse of information for small business owners to serve as an interactive self-assessment tool and provide links to consultants, local chambers, technical assistance providers, financial institutions, credit-counseling organizations, and city and state programs.	Web-Based Information Resource for Entrepreneurs Seeking Technical Assistance, Financing, and other Resources	Lenders Venture Capital Firms/Funds Technical Assistance Providers Government Agencies Community Lending Intermediaries
2	Create an interactive self-assessment tool for entrepreneurs, enabling them to assess the growth stage of their business and compile the necessary materials to present to a financing source.	Self-Assessment Tool for Entrepreneurs	Entrepreneurs Technical Assistance Providers Lenders Venture Capital Providers

Pre- and Post-Loan Technical Assistance Blueprint

	Description of Recommendation	Subject Area	Affected Organizations or Industries
1	Establish a certificate course for technical assistance providers that will promote a more consistent quality of services rendered.	Training Course for Technical Assistance Providers	Technical Assistance Providers Current Business Owners Prospective Entrepreneurs Financial Institutions
2	Develop a pilot program, involving experienced professionals, to begin the process of setting uniform quality standards for technical assistance providers.	Facilitation of Quality Standards Being Set	Technical Assistance Providers Current Business Owners Prospective Entrepreneurs Financial Institutions
3	Create a program that would serve to inform the loan officers of the current technical assistance resources available and provide an atmosphere for loan officers and technical assistance providers to build awareness and continuing relationships.	Loan Officer and Technical Assistance Provider Relationship Building Development	Financial Institutions Technical Assistance Providers

Underwriting Blueprint

	Description of Recommendation	Subject Area	Affected Organizations or Industries
1	Encourage lending institutions to explore options to deal with and extend loans to non-asset based and service-oriented firms that do not have sufficient collateral.	Methods to Facilitate Greater Access to Commercial Credit by Cash-Based Businesses	Financial Institutions Non-Asset Based Businesses Lenders Small Business Administration
2	Encourage the establishment and implementation of a second level review process for credit scored loan declinations.	Secondary Review Process	Financial Institutions Banking Regulatory Agencies Credit Reporting Agencies

Equity Investment Task Group

Small businesses often need "patient capital" to grow. Patient capital is not available through traditional debt financing, but rather through equity investment. In the early stages of growth, businesses rarely find equity capital through venture capital firms. Although it may be available through "angel" or individual investors, businesses may be unable to locate and access angel capital due to the unstructured nature of the market, unfamiliarity with the negotiation process, or the current trend for angel investors to favor technology and bio-medical firms. There are significant differences in the availability of venture capital for technology-based firms that require a million dollars or more, compared to smaller, traditional neighborhood businesses looking for less than $1 million. The Equity Investment task group looked at the sources and availability of equity capital to women- and minority-owned businesses, as well as those located in low- and moderate-income communities. As was the case with all of the other task groups, the Equity Investment group recognized the potential of a central information source, a web- and/or paper-based clearinghouse which entrepreneurs could use to learn about seminars, technical assistance providers, financing sources and other resources. The clearinghouse is formally recommended by Marketing and Delivery Systems task group.

The three issues raised by the group were those concerning education, infra-structure/network, and ways to make equity capital available to smaller ventures that have traditionally had little or no access to venture capital investors. The task group divided itself into three subcommittees, each focusing on one issue. The subcommittee that worked on “making small investments attractive to investors” recommended the establishment of a small enterprise equity fund targeted primarily to smaller ventures with female or minority owners. The education sub-committee researched and found that that there is limited education available to entrepreneurs who do not know the nature of equity markets, how such investments can affect their business, and where to obtain such resources. The committee compiled best practices from programs across the nation that assist entrepreneurs in obtaining equity and hope to develop assistance programs in the Chicago area. The third subcommittee explored issues involving the infrastructure and networking aspects of equity investment. They found that there is no centralized or consistent place in the Chicago metropolitan area for angel investors, entrepreneurs, and other professionals to go for support or resource identification. Their recommendation, with the objective to connect entrepreneurs, investors, and resource providers, would address the challenges in developing an angel network and would fill a void in funding small businesses.

1. Targeted Venture Capital Fund

Industries or Organizations Affected by the Recommendation

The recommendation is targeted to growth and growth-potential businesses in all industries that want to access patient/equity capital in the Chicago metropolitan area.

Issue(s) Being Addressed

Venture capital and other forms of risk-taking capital are fueling new innovations and new businesses that are transforming our economy. In the recent past, the target of most risk capital has been technology-based companies requiring more than $1 million in investment capital. However, there is a major gap in the market for those businesses that need less than $1 million, ones perceived as non-high tech businesses, and/or those businesses that are outside the "investor network." Many of the businesses that find themselves in this "equity gap" are businesses owned by women, minorities or are located in lower- and moderate-income (LMI) communities.

Narrative Description of the Recommendation

After reviewing various programs around the nation that provide equity funding for smaller ventures, the Equity Investment task group developed an equity fund model that would address issues in the Chicago area. The Equity Investment task group spent considerable time outlining the nature of this fund and has now moved forward on the action steps to initiate it. Below are some of the key components of the Venture Fund ("Fund").

It is intended that the Fund will target the capital needs of businesses seeking financing from $250,000 to $1.5 million, and that 50% of the transactions will be under $750,000, the largest gap in equity financing. No more than 30% of deals will be located outside the target market. The target market has been defined as companies located within LMI areas, companies owned and operated by women and minorities, companies that employ a significant number of individuals that live within LMI areas, and growth companies with the potential to increase their employees.

The Fund's objectives are two-fold: to achieve an attractive return on investment for the limited partners in the Fund, and to promote meaningful employment opportunities, business ownership, and community stability within the target markets. The capital for the Fund could be secured through limited partners, the U.S. Small Business Administration (SBA) Small Business Investment Company (SBIC) program or New Markets Initiative (if authorized) and similar public and/or private sector programs.

The Fund will not only have its own capital base, but through its network will also have access to senior debt providers through banks, public sector subsidized loan programs, and commercial credit companies, access to markets through the limited partners, private and public sector contacts, minority and female certification providers, and trade associations.

It will have access to capital through investor referral networks, equity and quasi-equity co-investors, and next stage investors, and management and technical assistance through existing government-subsidized and academic small business development centers.

In order to further address the gap in equity funds for small businesses, Chicago Early Stage Fund, a non-profit 501(c)(3) affiliated with the Fund, will provide equity investments from $50,000 to $250,000 for start-ups and early-stage companies within the target markets.

An advisory board, composed of major limited partners, business and industry leaders, and community representatives, will govern both the Venture Capital Fund and the Early Stage Fund. The advisory board will maintain an adequate deal flow for the Fund, review portfolio investments and valuations, resolve conflicts, and have general oversight. In addition, an investment committee of three to five members including the fund managers and two private equity specialists representing the limited partners will review the deals. All deals must have unanimous consent. This body will also monitor compliance related to the goals and objectives of the Fund as well as the performance of the fund manager.

Action Steps

- Conduct a formal market analysis of equity funds available and the market segments they serve to help refine the target deal size, projected returns and target market for the Venture Fund.

- Secure a sponsor or host organization that will serve as the "driver" of the project until a fund manager is hired.
  a) Identify key organizations that can serve as the "sponsor and driver" of the Fund.
  b) Obtain initial grant funding or in-kind staff resources for the sponsor organization to lead the project through the hiring of the fund manager and securing initial commitments from leading banks.
  c) Once a sponsor organization has been determined, that organization will decide upon an appropriate name for the Fund.

- Select a fund manager to lead the Fund from the fundraising period and the first closing to the full operation of the Fund.
  a) Develop criteria for the fund manager.
  b) Issue an RFP (Request For Proposals) for the fund manager, and review proposals.
  c) Select and announce the fund manager.

- Once selected by the sponsoring organization, the fund manager will prepare offering materials, initiate targeted fundraising, and close the Fund within 8 months of starting the project. The fund manager will also apply for the SBIC license and funding. The SECAP Equity Investment task group participants will assist the fund manager in introductions to Fund stakeholders and strategic investors.

Expected Results

The Fund will help to fill the gap of patient capital for small business, increasing the deal flow from underserved markets. This will result in more minorities and women understanding and participating in the equity/venture capital arena that has been fairly inaccessible to these business owner profiles. A secondary result will be an increase in well-paying jobs in LMI neighborhoods.

Potential Obstacles

The greatest potential obstacle to launching the Fund is securing a sponsoring organization that has the time, staff, and capital resources to serve as the driver of the project until a fund manager has been hired. Additional obstacles are ones that most new equity funds confront: the potential inability to profitably provide equity investments, poor returns on portfolio investments, and a downturn in the economy that slows the availability of investment capital into the Fund.

2. Training and Technical Assistance for Entrepreneurs Seeking Equity Financing

Industries or Organizations Affected by the Recommendation

The recommendation is targeted to growth and growth-potential businesses that seek to access equity capital in the Chicago metropolitan area.

Issue(s) Being Addressed

In the past decade, financial literacy programs have focused on the process of obtaining a loan, assisting entrepreneurs to prepare loan packages and linking them to lending institutions. However, at the same time, there has been little education available to entrepreneurs on how to access equity capital. Equity capital is often needed by all types and sizes of businesses and yet many entrepreneurs know very little about the nature of equity markets and how equity investments can affect their businesses.

Narrative Description of the Recommendation

It is recommended that more training and technical assistance programs focusing on equity financing be developed and made available.

The Equity Investment task group reviewed a variety of programs offered in the U.S. that assist entrepreneurs to obtain equity. The task group identified the following types of programs that have been successful in assisting entrepreneurs:

- Entrepreneurial training programs
- Networking groups
- Business plan review assistance
- Mentor programs (with one or multiple advisors)

- Incubators
- Investor forums

The task group then spoke to local groups to determine what is already available in the Chicago area and where the gaps in service are. The following observations were made:

- There are a variety of programs already available in Chicago but they are primarily focused on technology and Internet businesses.
- There are relatively few businesses owned by women, minorities or that are located in LMI areas that participate in any of the existing programs.

Action Steps

- Offer entrepreneurial education programs on accessing equity investment to all communties in the Chicago area.
  a) Identify key business assistance organizations offering financial assistance to entrepreneurs (e.g., SBDCs, SCORE, community colleges).
  b) Develop a training curriculum for entrepreneurs on how to access equity capital.
  c) Train the business assistance centers on the equity markets and how to teach the curriculum on accessing equity.

- Establish in-depth counseling and mentoring/incubator programs for businesses with potential to access equity.
  a) Using examples of model programs, develop a list of programmatic elements that should be included in an in-depth counseling/mentoring program.
  b) Develop several programs in the Chicago area that are supported through adequate funding and strategic partnerships.

- Establish a database/clearinghouse for information on equity resources and events in the Chicago area as well as resources outside of the area that will support projects in this geographic area.

Expected Results

- Increased understanding by entrepreneurs on the process and parameters of accessing equity investments.

- Increased "deal flow" from businesses owned by women, minorities and those that are located in LMI areas or with a high level of potential employment within LMI areas.

- Increased equity funding to the targeted businesses.

Potential Obstacles

Lack of consistent funding to provide necessary training and staffing of the business assistance centers on a long-term basis.

3. Private (Angel) Investment Networking and Infrastructure

Industries or Organizations Affected by the Recommendation

Pre-institutional investors/financiers; resource providers such as lawyers, accountants, developers, etc.; foundations; trusts; corporate venture funds.

Issue(s) Being Addressed

Funding from associates such as friends, relatives, and angel investors is one of the most widespread sources of seed capital. However, this type of capital is hard to track or identify, and providers of such funds often lack the sophistication of professional investors.

Further, seed investment in LMI areas can be especially scarce due to the lack of independent wealth in these communities. By pooling various sources of capital, risk to the individual investor can be reduced and diversified, and he/she may be able to invest in deals that were previously too expensive. Thus, the pooling of funds not only increases the investment base, it also enables the entrepreneur to seek the required amount without draining any individual local resource.

Narrative Description of the Recommendation

Although venture capital investment is at record levels, it appears that only the multi-million dollar deals are flourishing. Equity financing to smaller projects has not attracted the attention of investors. In part, the reason is that even though smaller projects can have similar rates of return to larger ones, it is the *amount* of the return that makes larger projects so enticing to professional investors. Furthermore, these investors are more likely to allocate their top resources to larger projects, thus leaving smaller projects to take whatever resources remain.

In order to tap the potential of informal investors and encourage the further development of investment syndicates, a semi-formal committee should be developed to provide a method whereby angel investors (seasoned and non-seasoned) can better understand seed investing, become more sophisticated in regard to the investment process, increase access to new deal flow (especially in under-served markets) and learn of available resources. Ideally, the committee would consist of 10-20 core participants and cover various aspects of investing.

In pooling investors together according to their investment goals, the committee's objectives would be to identify and classify investment opportunities, provide developmental assistance to small businesses, and help structure smaller deal amounts. The committee's efforts should lead to an improvement in helping small companies access capital to develop their businesses and to build informed relationships between business owners and capital providers.

Action Steps

- Develop a semi-formal committee that will encompass specialists in all aspects of equity investing (valuations, structuring the deal, pricing, term sheets, due diligence, etc.). The committee will be responsible for organizing and offering monthly training seminars on these issues to angels and potential angel investors.
- Develop a website that concisely identifies and publicizes investment training seminars and other networking opportunities/events.
- Market the committee's activity and website to potential sources of angel investors, including: banks, legal firms, accounting firms, corporate executives, and entrepreneurs.

Expected Results

- Increase in the number of investment syndicates
- More sophisticated angel investors with regard to the private equity process
- Increase in circulation of deal flow among investment networks

Potential Obstacles

- Lack of commitment or time constraints among committee members
- Straying from the "educational" approach
- Lack of quality deal flow

Equity Investment Task Group

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Women's Business Development Center

Lewis Matuszewich
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Edward Powers
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Susanne Schnell
The Civic Committee of the Commercial Club of Chicago

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LaSalle Street Project

Marketing and Delivery Systems Task Group

The Marketing and Delivery Systems task group's concerns fit into three broad categories: 1) knowledge gap between borrowers, lenders, and technical assistance providers; 2) lack of a central information resource about small business programs and organizations; and 3) the costs lenders assume to find and market to entrepreneurs. The first and second issues are essentially different perspectives of the same issue. The Technical Assistance task group dealt with the knowledge gap between loan officers and technical assistance providers, and the Underwriting group addressed the issue of borrowers' unfamiliarity with underwriting standards. Accordingly, the Marketing and Delivery Systems task group was able to focus attention primarily on the creation of a clearinghouse of information on small business financing, technical assistance and other resources.

A fundamental premise of the SECAP program is that there is a need to increase the flow of debt and equity capital to traditionally underserved small business owners (women and minority-owned businesses in particular) and LMI communities. In order to accomplish this goal, it is necessary first to understand the needs of the target audience: underserved, from the standpoint of credit and capital access, businesses and communities. Over the seven-month period from October 1999 to May 2000, the group engaged in extensive discussions and developed recommendations based on the diverse expertise and backgrounds of the group members.

Considerable resources have been spent by the banking industry on marketing campaigns aimed at borrowers in LMI communities, with limited success. The task group chose not to address the quality or content of these marketing campaigns, as the appropriate analysis would be beyond the scope and capacity of the group. Instead, the task group set out to determine the barriers that prevent entrepreneurs from acting on information about loan products and other resources, and to reach recommendations to help lenders and technical assistance providers to bridge those barriers.

One issue that has been highlighted by each of the task groups is the knowledge gap between borrowers, entrepreneurs, loan officers, technical assistance providers, and investors. Each group launched into the issue and saw that a clearinghouse of information on small business financing is a vital but lacking resource. The Marketing and Underwriting task groups made similar recommendations to create a web-based resource, potentially augmented with paper-based resources and tools for entrepreneurs. As the two recommendations are essentially the same, they have been combined; the recommendation is presented in this section.

1. A Web-Based Information Resource for Entrepreneurs Seeking Technical Assistance, Financing and Other Resources

Industries or Organizations Affected by the Recommendation

- Lenders
- Venture Capital Firms/Funds
- Technical Assistance Providers
- Government Agencies including SBA and various city and county departments
- Other Community Lending Intermediaries

Issue(s)Being Addressed

Potential borrowers are reluctant to apply for small business loans for various reasons. They may:

- be unfamiliar with the loan application process including information they must provide or be prepared to explain;
- have concerns about past negative personal or business credit issues that may require resolution before an application is considered;
- simply be intimidated by the process for fear of being rejected;
- not have the time to work through a lengthy, complicated and intrusive process, particularly one with an uncertain outcome.

Compounding this situation are unclear underwriting criteria from banks, particularly in the area of lending to non-asset based businesses, and the lack of a single source of information where a small business owner can learn the process and the specific criteria of applying for a bank loan or an equity investment.

Further, many entrepreneurs may have access to informal venture capital networks, or they may be unaware of the requirements to access venture capital. A myriad of business support institutions and lending institutions operate in the Chicago area; however, true linkages do not exist among these groups. Banks and community lending intermediaries do not work together to the extent necessary to create an environment and resources whereby small businesses can receive the information, technical assistance, and training in order to make the decision to apply for a loan, finance a business through equity, or a combination of both.

Narrative Description of the Recommendation

Create a central clearinghouse of information for small business owners and potential entrepreneurs. The clearinghouse is envisioned as an Internet resource with the following features:

- Interactive self-assessment tool
- Directory of/links to consultants and local chambers
- Directory of/links to technical assistance providers
- Description of loan products and lenders
- Directory of/links to lenders, factorers, and financial institutions

- Directory of/links to venture capital investors
- Directory of/links to city and state programs
- Directory of/links to credit counseling organizations
- Calendar of seminars and relevant events

In order to launch the website within a reasonable time frame, the task group anticipates that the site will initially provide only static resources including most of the directories listed above. Links and interactive tools will be developed and added on an ongoing basis as funding and technical resources are identified and deployed.

Action Steps

- Gather information to include on initial, static site.
- Obtain web address.
- Develop format for web page and demonstration page for presentation purposes.
- Build capabilities and resources of site in conjunction with other task groups.

Expected Results

The goal and expected result of creating and maintaining the website/clearinghouse is that traditionally underserved entrepreneurs and communities will have enhanced access to needed resources, including debt and equity capital.

Potential Obstacles

The so-called "digital divide," the issue that much of the target audience may not have access to the Internet, presents a challenge for creating a vehicle that will benefit traditionally underserved business owner profiles. Ideally, the clearinghouse would be available as a phone referral service, a written resource guide, and be accessible via a web page, and provide a broad base of information useful to entrepreneurs. The media to convey needed information will largely be defined by the organization(s) that implements or provides resources to implement the recommendation. Funding sources, technical support and ongoing maintenance of the site also represent potential obstacles.

2. Establish a Self-Assessment Tool for Entrepreneurs to Determine the Growth Stage of Their Business, Appropriate Financing for Their Growth Stage and Information Needed to Obtain Financing

Industries or Organizations Affected by the Recommendation

- Technical Assistance Providers
- Lenders
- Venture Capital Providers

Issue(s) Being Addressed

Entrepreneurs who do not have prior business experience and are not exposed to or belong to established networks often have difficulty qualifying for traditional business financing and may not know where to turn for assistance. A first step for business owners is to have awareness of the growth stage of their business, and in relation, awareness of the type of financing that is appropriate at their stage and how to obtain it.

Narrative Description of the Recommendation

Create an interactive tool for entrepreneurs that allows them to assess, on a fundamental level, the stage of growth of their business, covers information they should compile and have ready to present to a financing source, and how to present the venture's growth prospects to potential financing sources. The tool is envisioned as paper-based and also as an interactive, web-based tool that will be available through the planned clearinghouse website. It is not envisioned as a proprietary or copy righted tool, but one that will be made widely available.

Action Steps

- Outline elements needed to be addressed with the tool (e.g. record keeping, business plan).
- Recruit technical assistance, debt/equity financing and other experts to discuss questions and assessment factors for the tool.
- Develop paper-based version which can be eventually turned into web-based interactive version.

Expected Results

The self-assessment tool will help business owners and potential entrepreneurs to begin the process of gaining a better understanding of their venture's position and growth potential. It will also better prepare owners for the process of obtaining financing. The expected result is greater access to sources of financing by traditionally underserved business owner profiles.

Potential Obstacles

- Recruiting the appropriate cross-section of experts to develop the tool.
- Identifying and utilizing all the appropriate distribution channels.

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Pre- and Post-Loan Technical Assistance Task Group

The essence of discussions by the Pre- and Post-Loan Technical Assistance task group centered on the gap in knowledge between borrowers, technical assistance providers, and lenders. Although it was found that abundant help and training resources are available, the underlying issue is linking borrowers to the right organizations for their needs. For this to happen, entrepreneurs, lenders, and technical assistance providers alike must be well informed and up-to-date on the multitude of resources available. Accordingly, the task group recognized the value of a central clearinghouse of information, both web- and paper-based, for entrepreneurs. The Marketing and Delivery Systems task group made the recommendation for a clearinghouse.

Another mechanism for relaying information would be a training program for both loan officers and technical assistance providers. Since a prospective business owner's first point of contact is usually a bank, the loan officers could play a key role in referring borrowers to the appropriate resources. A training program would continually inform and educate lenders on the kinds of technical assistance resources available, and would also serve as a "networking event" for loan officers and technical assistance providers.

Another issue the Technical Assistance group explored was the quality of technical assistance provided. It was unanimously agreed that there is a need for greater uniformity in the quality of services rendered and criteria covered by organizations and individuals that provide technical assistance in the Chicago metropolitan area. Since the scope of the recommendation is very wide, to initiate the process, the group recommends the establishment of a pilot program. Once the quality standards and criteria have been established, and depending on the success of the pilot, a training course for the technical assistance providers would be instituted for certification.

1. A Training Course for Technical Assistance Providers to Facilitate the Adoption of and Adherence to Quality Standards

Industries or Organizations Affected by the Recommendation

All organizations, companies and individuals that provide technical assistance, either pre- or post-loan, would be affected by this recommendation. Additionally, business owners, both current and prospective, as well as lenders who provide loans to small businesses are affected by this recommendation.

Issue(s) Being Addressed

The issue being addressed is the quality of services provided to LMI individuals and businesses as well as all others involved with the operation of a small or micro business, including technical assistance providers, lenders and business owners.

Narrative Description of the Recommendation

Establish a certificate course for technical assistance providers that will facilitate a more consistent quality of services rendered. The course would have various components based on different areas of small and micro business development that might be required by a business owner. Based on the specialty of the service provider, possibly only one component of the training course might be taken. Ideally, the course would include not only business subjects such as marketing, finance, internal operating system design, record keeping and pricing, but it would also include topics such as assessing the needs of the client. The course would be conducted two to four times a year on an ongoing basis.

Action Steps

- Identify a trainer or institution capable of developing a course that meets the requirements.
- Negotiate with the trainer or institution to take on the assignment.
- Identify location(s), dates and times for the training.
- Develop curriculum with separate components for those focusing only on specific topics.
- Seek accreditation for the course.
- Notify participants (organizations and individuals).
- Print the necessary materials, identify books and other learning aids.
- Conduct course on a regular basis.

Expected Results

Ideally, the results will be better quality controls for organizations, technical assistance providers and overall better guidance and services provided the client. Additionally, lenders will receive better prospects for loans. The greatest benefit is to the client who will be better empowered to operate a business with a better chance at profitability.

Potential Obstacles

- Lack of cooperation from organizations and individual technical assistance providers.
- Lack of consistency in training provided, especially by different instructors.

2. Facilitation of Quality Standards Being Set

Industries or Organizations Affected by the Recommendation

All organizations, companies and individuals that provide technical assistance either pre- or post-loan would be affected by this recommendation. Additionally, business owners, both current and prospective, and lenders who provide loans to small businesses are affected by this recommendation.

Issue(s) Being Addressed

The issue being addressed is the widely varying quality of services provided to low- and moderate-income individuals who are prospective business owners and current business owners as well as all others involved with the operation of a small or micro business including technical assistance providers and lenders.

Narrative Description of the Recommendation

To begin the process of uniformed quality standards being set for organizations and individuals that provide technical assistance, it is recommended that a pilot program be undertaken. The pilot program would be a precursor to uniformed quality standards being proposed to all organizations and individuals providing technical assistance in the metropolitan Chicago area. Eventually, if effective, the standards set would be offered as a model to other metropolitan areas and technical assistance providers in the United States.

The pilot program would involve a set of standards being written by a team or teams of professionals experienced in providing technical assistance or entrepreneurial training to micro and small business owners. Once the standards are developed, a pre-determined group of technical assistance providers will test the standards to determine their effectiveness. Progress of technical assistance recipients will be monitored to measure effectiveness. Evaluation forms will be used for this purpose.

Quality standards will also be developed for the individual technical assistance provider to ensure that the level of knowledge is appropriate for the assistance required. Once the designated organizations and individuals have been identified and the proposed quality standards have been developed, they will be presented to the designees for their approval. This process should include a series of meetings to discuss the standards. The quality standards will be monitored and adjusted over time, requiring a board or organization to assume this responsibility. Additionally, provisions must be made for “training the trainers,” and adjusting the content and scope of that training as the business landscape changes.

Action Steps

- Identify a team or teams of qualified professionals to develop a set of quality standards for the most common areas of business development.

- Assemble several small groups of professionals to develop quality standards for different areas of technical assistance including marketing, finance, internal operating systems, record keeping, business planning and others as required.
- Approach financial institutions, government agencies, foundations and private corporations to sponsor portions of the pilot program.
- Determine criteria for selection of the pilot group and guidelines for the pilot program (i.e. length of pilot, procedures, scope of training, objectives of setting standards, etc.)
- Approach technical assistance providers to identify pilot group participants.
- Facilitate a series of meetings with the pilot group to establish consensus of the standards set and to address other pertinent issues.
- Assist in establishing a group or organization (possibly one already in existence) to monitor the standards and assist pilot group participants in implementing them.
- Develop an evaluation instrument to compile data to measure the effectiveness of the quality standards set, if feasible.
- Determine assessment criteria for the pilot program and assess its effectiveness once it is completed.
- Should the pilot prove successful, begin the process of presenting the model to the metropolitan Chicago area technical assistance providers to gain buy-in and begin the process of implementing the standards.
- Conduct informational meetings in various communities to maintain community involvement of lenders in each area.

Expected Results

Ultimately, the expected results would be better quality technical assistance offered by participating organizations and individuals and improved access to capital.It is also expected that banks would support the standards and develop links with those organizations and individuals that adhere to the quality standards.

Potential Obstacles

- The cost of organizing an association
- Service providing organizations not being willing to self-regulate
- Service providers not supporting the need for quality controls
- Lengthy process involved in reaching the goal
- Cost of developing and implementing the recommendation

3. Loan Officer and Technical Assistance Provider Training and Development

Industries or Organizations Affected by the Recommendation

All lending officers of financial institutions and technical assistance providers located in the metropolitan area of Chicago.

Issue(s) Being Addressed

The issue being addressed is the quality of contact between potential business credit applicants and the loan officers of financial institutions throughout the Chicago area. A long-standing issue in making capital more available has been between loan officers, particularly at local community branches, and the entrepreneurs and small business owners. Frequently, the relationship is strained because clients many times do not have the communicative skill, collateral, credit record, and/or business acumen to obtain capital from a financial institution. Frustration is further heightened by the lack of direction by the loan officer to the applicant on what type of assistance is required and where to go for assistance. Loan officers maintain that they know of few, if any, technical assistance providers to which to refer clients.

Narrative Description of the Recommendation

The purpose of the recommendation is to create a program where loan officers have an opportunity to hear and understand some of the needs of entrepreneurs and potential entrepreneurs. This program would bring loan officers and technical assistance providers together to build awareness and lasting relationships where clients can be handled in a positive and effective manner.

Program and discussion topics would include:

- Effective client interaction
- Value of relationships with technical assistance providers
- Role of loan officers and technical assistance providers in the community
- Resource communication tools

This program will be conducted semi-annually at a location to be determined. Invitations will be given to all Chicago area financial institutions and technical assistance providers.

Action Steps

- Identify sponsors to support this effort financially and programmatically.
- Create a team to design a comprehensive program and curriculum.
- Select dates.
- Market events to financial institutions, technical assistance providers and others.
- Hold events at multiple locations within a brief timespan.
- De-brief the team after each event and continually improve the content.

Expected Results

- Relationships established between local area loan officers and technical assistance providers
- Loan officers will have increased ability to assess the needs of potential applicants and better awareness of the technical assistance provider network
- Improved relations between financial institutions, technical assistance providers and the greater community
- Increase in the number of applicants receiving debt or equity investment
- Increase in the number of applicants receiving technical assistance

Potential Obstacles

- Lack of funding or sponsor to finance and execute this recommendation
- Lack of participation on the part of financial institutions allowing loan officers to participate

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Underwriting Task Group

The Underwriting task group focused much of its attention on the ambiguities in the underwriting process. Most of the discussions revolved around broadening and promoting understanding of underwriting criteria among potential borrowers. The task group felt that further knowledge and understanding of underwriting criteria was important to help small business owners determine the necessary steps they need to take and the type of financing they should seek. To provide clarity on the underwriting guidelines, the task force determined several steps that need to be taken. One recommendation is for the development of a detailed and comprehensive resource guide for small business owners seeking financing. This recommendation has been listed with the Marketing and Delivery Systems recommendations. The guide would cover a wide array of information: sources and types of financing, preparation for a business plan and loan application, funding resources, a glossary of finance terms, agencies, and fair lending regulations, definitions of the various stages of a business and the resources the borrower should seek depending on the stage of development, specific information on what banks look for and review during the lending process, key underwriting criteria in the credit decisions, portfolio information on types of loans made each year by various banks, and personal financial management advice. Not only will it serve as a complete resource and reference guide, but it will also serve as a self-assessment mechanism for potential borrowers.

With the advent of credit scoring, a method of evaluating the credit risk of loan applicants with the use of historical data and statistical techniques that assigns a single quantitative measure (the score) to represent the borrower's probable future loan performance, many issues and questions have come up. Not only are potential small business owners seeking financing more uncertain about the factors that affect the outcome of their loan applications, but also by its nature, credit scoring can preclude the necessary human element involved in the lending process. To ensure accurate and fair measures of a borrower's candidacy for a loan, a human underwriter should complement the credit scoring process by reviewing files for creditworthiness. Secondary reviews of loan applications would serve to identify factors that the borrower may be able to enhance resulting in an approval. Also, to further promote current and prospective small businesses into entering the conventional lending market, financial institutions could modify their underwriting criteria to non-asset based small businesses. The loan decision would be based more on character, cash flow, and performance history of the borrower.

1. Explore Methods to Facilitate Greater Access to Commercial Credit by Cash-Based Businesses

Industries or Organizations Affected by the Recommendation

Banks, Non-Asset based service sector businesses, lenders, SBA, technical assistance providers

Issue(s) Being Addressed

Non-Asset based (cash-based, service sector) businesses are not obtaining an adequate number of loans from lenders because they are considered high-risk.

Narrative Description of the Recommendation

One of the biggest and most intractable problems for certain small businesses, and particularly non-asset based and service-oriented firms, is the lack of availability of loans because these types of enterprises traditionally do not have sufficient collateral in case of default. Banks need to be persuaded to be more flexible in dealing with these types of businesses and more willing to extend loans if the businesses have the cash flow and performance history to justify the desired loans or lines of credit. This goal may be furthered by gathering data on the types of programs that already exist that help to meet the needs of cash-based small businesses. More SBA support for these types of loans might also prod banks to extend these types of loans because of the reduced risk they would then assume.

Action Steps

- Document the successes of existing programs that deal with non-asset based small businesses both locally and nationally.
- Publish notable success stories.
- Involve the SBA to create new products that assume some of the risk for increased lending to small non-asset based businesses.
- Increase the size of the loans so that products above the $50,000 range are more available to firms needing traditionally difficult-to-obtain middle-tier funding.

Expected Results

- Increase in the number of loans to cash-based, service sector businesses
- Profitability to lenders through new loan programs targeting cash-based businesses

Potential Obstacles

- Banks will not disclose information regarding loan programs for competitive reasons.
- Banks will not develop new programs because target group is viewed as high-risk.

2. Encourage Commercial Lenders to Institute a Secondary Review Process for Loan Applications Evaluated Using Automated Underwriting Technology

Industries or Organizations Affected by the Recommendation

Banks, Bank Regulatory Agencies, and Credit Reporting Agencies.

Issue(s) Being Addressed

While credit scoring has decreased the time in which many credit decisions are now made, it has taken away the human element vital in making loans. As a result, some minority-owned, women-owned and small, fledgling businesses may have been precluded from obtaining debt financing because the underwriting process offers no form of reconsideration in the event of a low score.

There is a lack of understanding about what comprises a credit score. As a result, most people are not sure which elements affect a decision more than others. For example, while it is prudent to shop for the best "deals" outside the banking arena, the number of inquiries on a credit report often raises unnecessary flags regarding creditworthiness (by negatively impacting the credit score) when it comes to getting a small business loan. In many instances, there is no direct correlation between the number of inquiries made about a borrower and their creditworthiness. For these situations, a secondary review process could lead to a more appropriate decision.

Narrative Description of the Recommendation

Each bank should be encouraged to establish a secondary review committee to review declined applications. This secondary committee would review all credit-scored declinations to determine if there is a program or enhancement available to convert a decline to an approval.

While the bank regulatory agencies would not likely issue a mandate on secondary reviews, it could establish guidelines for banks to use in setting up such a committee. These guidelines would be based on knowledge of how the components of a credit score are weighted and what correlation there is between the different weightings and default.

Action Steps

- Convene forum of bankers and credit reporting agencies to discuss the elements of a credit score and how each element is viewed/weighted.
- Compile statistical data on default rates related to the different elements of the credit score.
- Investigate the feasibility of the regulatory agencies developing general guidelines.
- Each bank determines whether a secondary review process is feasible and under what situations a secondary review will occur.

Expected Results

- More loans can be considered for credit enhancement programs
- Better understanding of credit reporting process leading to better understanding of how credit decisions are made

Potential Obstacles

- Insufficient data to determine whether secondary reviews are necessary
- Reluctance of credit agencies to share their proprietary information
- Reluctance of banks to commit resources when a scoring model has been deemed to be cost effective

- Lack of internal resources to assemble a review committee
- Dealing with auditors who may deem reconsidered loans to be substandard
- Lack of standard underwriting guidelines across banks, making it difficult to standardize a review process

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