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# Developing small businesses and leveraging resources in Detroit

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On October 16–17, 2012, the Federal Reserve Bank of Chicago, the Michigan Bankers Association, and the New Economy Initiative for Southeast Michigan co-sponsored a symposium that brought together business experts, business owners, policymakers, funders, and bankers to address the issues of small business credit and financing in Detroit.

Access some of the materials from the symposium and its agenda at www.chicagofed.org/webpages/events/2012/detroit_symposium.cfm.

**Perhaps** nowhere in the United States is the need for credit and other assistance for small business entrepreneurs more pronounced than in Detroit. The city of Detroit has been beleaguered by a declining population, high levels of unemployment, low home values, high crime rates, and an underperforming school system. For decades Detroit has been the bastion of mass employment from the big automotive industry, with little attention given to small business development. While the current local economic and industrial climate has posed major challenges for both large and small businesses, it has recently led to a reimagining of Detroit as a place with a more diverse economic base. Foundations, universities, corporations, and nonprofits are among the many entities that have embraced small business development as a critical component to economic stabilization and growth in the Motor City. The symposium brought together representatives from some of those key players to share their perspectives on the challenges and scope of opportunities for small businesses in Detroit. The symposium also helped draw banks more closely into the conversation about neighborhood revitalization.

The symposium was part of the Chicago Fed's Detroit Small Business Initiative, which follows up on efforts by the Federal Reserve System to address the financing needs of small businesses in vulnerable communities.[1] The symposium highlighted a multiyear study conducted by staff of the Chicago Fed's Community Development and Policy Studies division on the changing financial landscape of Detroit and its implications for access to financial services and for lending to small businesses in the city's low- and moderate-income neighborhoods. Other sessions of the symposium focused on the regulatory environment affecting the supply of credit to small businesses in Detroit, as well as on the opportunities for leveraging bank and nonbank resources to finance small businesses.

### A fragile business climate

The small business climate in Detroit is one of contrasts. From one view, Detroit's overall population loss and job cuts during the 2000s suggest shrinking markets for small businesses within city limits. From another view, population growth and investments in select neighborhoods within Detroit suggest opportunities for small businesses based on particular neighborhood characteristics and assets. Business start-ups in the city of Detroit increased during the 2000s, and the total number of small businesses increased in low- and moderate-income (LMI) neighborhoods, as well as middle- and upper-income (non-LMI) ones (see figure 1).[2] The growth in the number of small businesses in the Detroit area represents both opportunities and

**1. Distribution and growth of small businesses in the Detroit area, by annual revenue, 2003–10**

| Location/census tract income | Distribution, average over 2003–10: More than $1 million | $500,001 to $1 million | $50,001 to $500,000 | $50,000 or less | Growth, 2003–10: More than $1 million | $500,001 to $1 million | $50,001 to $500,000 | $50,000 or less |
|---|---|---|---|---|---|---|---|---|
| | (- - - - percent of total | | | - - - - ) | (- - - - percent change | | | - - - - ) |
| **City of Detroit** | 7.9 | 6.6 | 59.5 | 22.5 | –12.5 | 31.5 | 154.6 | 62.0 |
| Non-LMI | 7.2 | 5.9 | 62.6 | 22.5 | –9.9 | 14.5 | 162.9 | 87.3 |
| LMI | 7.8 | 7.3 | 58.3 | 19.8 | –11.7 | 35.3 | 145.4 | 51.6 |
| Status changed from LMI to non-LMI | 4.4 | 4.1 | 61.3 | 26.4 | –19.8 | 35.5 | 183.4 | 78.7 |
| **Surrounding counties** | 10.6 | 7.9 | 62.9 | 15.8 | –14.6 | 22.9 | 146.6 | 44.3 |
| Non-LMI | 8.4 | 9.3 | 56.5 | 15.8 | –14.8 | 22.9 | 151.3 | 45.5 |
| LMI | 13.7 | 7.7 | 64.3 | 15.5 | –14.0 | 22.2 | 121.7 | 36.6 |
| Status changed from LMI to non-LMI | 9.9 | 7.4 | 61.4 | 17.1 | –13.9 | 33.0 | 138.7 | 29.2 |
| Status changed from non-LMI to LMI | 13.5 | 8.9 | 57.9 | 15.1 | –15.8 | 15.7 | 135.6 | 59.5 |

Notes: Small businesses are defined as businesses with 500 employees or fewer. The distribution categories may not add up to 100% because revenue data are missing for some businesses. LMI indicates low-to moderate-income census tracts, while non-LMI indicates middle- to upper-income census tracts. A change in the status of census tract income from 2000 to 2007 (if applicable) is identified by HUD. None of the census tracts in the city of Detroit changed in status from non-LMI to LMI. The surrounding counties are Wayne (excluding the city of Detroit), Macomb, and Oakland.

Sources: Authors' calculations based on data from D&B (Dun & Bradstreet) and the U.S. Department of Housing and Urban Development (HUD).

challenges. On the one hand, this growth suggests that these businesses are a potential source of economic diversification and revitalization in some communities. On the other hand, new businesses, smaller businesses, and those with lower revenues are more likely to be liquidity and credit constrained. Relationship-based lending and other creative means of providing capital are necessary to support this fragile business environment. The symposium was designed to spark ideas on how to leverage more resources for these businesses.

### Resources for Detroit small businesses

At the symposium, representatives of foundations, nonprofits, and government-sponsored organizations highlighted the array of training and financial resources that have long existed for business owners in the Detroit area. By one count, more than 26,000 funded programs help support entrepreneurs across Michigan with legal, financial, management, and marketing services. While some provide assistance or training to help individuals expand or diversify their businesses, others provide low-cost rent and networking opportunities to incubate new ventures, including those in the renewable energy and food processing sectors. Presenters from financing institutions similarly highlighted the various credit and credit-risk-mitigation programs that are available to Detroit small businesses. For example, it was noted that the Michigan District Office of the U.S. Small Business Administration (SBA) led the nation in terms of the number of SBA-guaranteed loans in 2011. Michigan credit unions (CUs) have provided small businesses with more than $1 billion in business loans in recent years, and have developed outreach programs, such as CU Lunch Local, to encourage credit unions to spend money at local businesses while promoting their presence in the small business credit market. Bankers discussed their use of federal tax credit programs to finance small business developers of multiunit properties in the city. Additionally, bankers acknowledged their contributions to loan pools for small business development; to microlending organizations, such as the Detroit Development Fund; to community development financial institutions, such as the Invest Detroit Foundation; and to other intermediaries that provide loans and grants to small businesses.

In addition to these resources, presenters described a new entrepreneurial paradigm, spearheaded by private foundations and other civic institutions, to support small businesses and entrepreneurs in Detroit. One example has been a procurement program for neighborhood-based companies that serve other businesses (such as janitorial services, landscaping, and waste management companies)—which city planners hope will net as many as 10,000 new jobs within Detroit neighborhoods. Presenters noted that these types of businesses have long been the focus of retention efforts, but the procurement initiative is designed to give them access to a new set of customers, including the large institutions that anchor the Midtown neighborhood. A different type of investment has been the First Step Fund—a revolving loan pool, administered through the Invest Detroit Foundation, that is attached to the infrastructure of high-tech incubators, such as TechTown, Macomb–Oakland University INCubator, Bizdom U, Ann Arbor SPARK, and Automation Alley. With a pool of $50 million, this fund provides financing to emerging and newly formed higher-growth companies in Southeast Michigan, whose members complete a training program through a qualified regional business incubator or accelerator. Both the procurement and accelerator initiatives reflect an attempt by city planners and funders to support the business clusters that they have determined offer the most promise for business and employment growth in Detroit neighborhoods. Presenters also discussed other clusters to target with investments—such as neighborhood-based manufacturing, transportation and logistics, construction and demolition, medical device technology, and design companies.

Presenters also described the progress they have made in studying the geographic areas that represent the best opportunities for small business growth. In addition to the Downtown and Midtown neighborhoods of Detroit, planners have identified places with dynamic employment—such as Southwest Detroit, the McNichols corridor, and the Mt. Elliott corridor—as neighborhoods where investors should coordinate investments in order to make a more efficient use of resources. By singling out these districts as target areas for investments, planners are attempting to create concentrated pockets of entrepreneurship that in turn increase the chances for small business success. Moreover, planners view these neighborhood clusters as providing opportunities for collaboration among business owners, leading to accelerated economic output, more hiring, and greater tax revenues. Presenters explained that one of the next steps in developing the new entrepreneurial paradigm involves constructing a network that connects entrepreneurs to the most appropriate resources within these neighborhood clusters. This network—made up of the intellectual property, talent, entrepreneurial services, business incubators, and capital required to make enterprises thrive—would provide business owners and everyone else participating in it a way to navigate these numerous resources.

### Recommendations for expanding financial resources

Despite the range of resources available to Detroit businesses, many symposium participants contended that more could be done to help small businesses, particularly in terms of expanding bank financing. Presenters from the financial sector acknowledged the constraints on small business lending that financial institutions are facing. It was reported that 13 banks have failed in Michigan since the economic downturn, and 11 of those were located in the auto industry counties of Wayne, Oakland, and Macomb. Meanwhile, no new banks have entered the Detroit market in recent years, given, among other reasons, the poor track record of Michigan de novos in the 2000s. Of the 13 banks that failed in Michigan, eight were opened in the mid-1990s or 2000s. Bankers also noted the difficulty of raising the estimated $20 million in capital needed to receive approval for a new charter. The result has been fewer institutions serving Detroit as smaller banks have consolidated or have been purchased by out-of-state institutions.[3] Symposium presenters also acknowledged the regulatory considerations banks must bear in mind when lending outside of their footprints, including those related to the Community Reinvestment Act.

With respect to credit access for small businesses, presenters from financial institutions acknowledged that Michigan bankers have become more selective about the loans they put on their books following the most recent economic downturn. Appraisal values have challenged any bank looking to expand its construction or land development portfolios, since appraisers use distressed sales as comparables, further driving down the value of real estate. Bankers also explained that the underwriting process becomes more complicated when a bank must consider a borrower's global cash flow and ability to repay debt on an entire real estate investment portfolio (rather than on a single project). In addition, according to bankers, the underwriting process may become more complex when bank examiners are able to exercise considerable judgment in assessing the collectibility of loans. According to the presenter from the Michigan Economic Development Corporation, the state has taken some steps to address the issue of declining real estate values. For example, Michigan's Collateral Support Program supplies cash collateral accounts to lending institutions to cover a portion of the collateral shortfall of potential borrowers.[4] Providing collateral support has been particularly important for would-be borrowers in low-wealth areas, given that some of the steepest declines in asset values during the recession have been in low- and moderate-income communities.

Presenters also argued that banks could do more to provide working capital to small businesses. According to this perspective, businesses approaching $1 million in annual sales are important for local economic development, since they tend to generate about 65% of jobs coming from the small business sector. Yet many die an early and preventable death because of a lack of working capital. One suggestion offered at the symposium was for banks to look to nonbank intermediaries for models to reach traditionally underserved niches in minority and immigrant communities. The inference was that banks could be competitive relative to these nonbank intermediaries by charging comparatively lower interest rates for working capital. Other presenters noted the variety of nonbank resources that fill the niches that banks do not serve. One presenter identified over 25 financing options for small businesses—including asset-based lending, peer-to-peer lending, and microlending—many of which take other factors into consideration besides credit scores and other more traditional measures.

One symposium attendee also spoke of the need to improve lender knowledge of local business conditions. Given the growing distance between the locus of underwriting decisions and the location of Detroit businesses, some argued that funders could get a more realistic representation of business capacity by increasing their visits to neighborhood commercial corridors. Hearing from the business owners themselves and visiting with neighborhood business coalitions were viewed as practical ways for lenders to better understand the markets where small business entrepreneurs see growth opportunities, as well as to learn about the business sectors that bankers tend to be less familiar with. It was noted that the Detroit Neighborhood



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Forum has already made progress on this front by convening foundations and banks on a monthly basis to discuss investment opportunities for targeted neighborhoods and share best practices on how to augment revitalization efforts across the city. One presenter proposed that the ultimate goal of these types of efforts would be for banks to become not only economic multipliers but also institutions of trust within a neighborhood.

In addition, presenters and attendees spoke about the benefits of bankers taking a longer-term view of customer development. Just as business owners need to develop relationships with bankers long before they apply for a loan, it was recommended that bankers work more closely with the organizations and services that provide technical assistance to businesses that will ultimately seek bank credit. While it is understood that banks do not generally finance start-ups, bankers should develop and strengthen relationships with other resource providers in a way that ultimately leads borrowers back to the banks. Resource providers agreed that they often hear from business owners that they wished they had known about the available (nonbank) resources sooner. Some presenters stated that this type of information sharing would be particularly helpful to second-stage businesses—i.e., those that have been in operation at least one year and have started to build their sales; such businesses generally do not seek help from technical assistance providers but often fail to grow because they cannot get financing. If bankers would cultivate relationships with nonbank funders, then loan rejections by banks could actually lead to small business owners having a better idea about their options. By the same token, if nonbank funders had better data on the businesses that tried to get bank loans, they could create new financial tools and products that might be appropriate for small businesses before they qualified for bank credit.

## Conclusion

As Detroit seeks to overcome its challenges, opportunities exist for the philanthropic community, the public sector, and financial institutions to work together to reinforce a new "entrepreneurial ecosystem" and support the small business sector through innovative approaches. Some symposium participants focused on business development strategies with proven records of success, such as procurement programs or business incubators. And some proposed additional actions that foundations could take—such as providing credit enhancements for small business borrowers or transferring foundation deposits to institutions that have been the most aggressive in lending to small businesses. Many funders themselves expressed support for new models to ignite the marketplace for small business development and induce more funders to enter this space. Some of the presenters most experienced with developing small businesses agreed that the hardest part of reaching these goals may be figuring out how to align the interests of a diverse range of institutions to foster new and ongoing collaborations.

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[1] The Federal Reserve System's community affairs departments hosted more than 40 meetings in 2010. For a summary of the meetings, see Jeremiah Boyle, 2010, "Addressing the financing needs of small businesses in the Seventh Federal Reserve District," *Profitwise News and Views*, December, available at www.chicagofed.org/webpages/publications/profitwise_news_and_views/2010/pnv_december2010.cfm.

[2] In community development studies, census tracts (see www.census.gov/geo/www/cen_tract.html) sometimes serve as proxies for neighborhoods. For details on how census tracts of certain metropolitan statistical areas are classified by income level status (low, moderate, middle, or upper), see www.ffiec.gov/census/censusInfo.aspx#2000.

[3] For a more in-depth analysis of bank presence in Detroit and the surrounding counties, see our conference presentation summarizing the study conducted by staff of the Chicago Fed's Community Development and Policy Studies division, available at www.chicagofed.org/digital_assets/others/events/2012/detroit_symposium/maude_toussaint_pptpresentation.pdf, and the associated white paper, available at www.chicagofed.org/digital_assets/others/events/2012/detroit_symposium/white_paper_detroit_symposium.pdf.

[4] For more information, see www.michiganadvantage.org/cm/Files/Fact-Sheets/MCSP_fact_sheet.pdf.