The Agenda for America's Entrepreneurs: Access to capital

Small Business Majority has created a comprehensive national and state policy agenda to ensure entrepreneurship is at the center of a thriving and inclusive economy. Access to capital is one of our seven topics of focus.

Despite the importance of entrepreneurship to our economy, small business owners—particularly women, people of color and other underserved populations—face significant hurdles accessing capital from banks and other traditional sources. According to the Federal Reserve Bank’s 2016 report on minority firms, 40% of firms owned by people of color received the full amount of capital sought, compared to 68% of nonminority-owned firms. Similarly, U.S Small Business Administration (SBA) loans to women-owned business accounted for only 18% of the total number of SBA 7(a) and 504 loans approved even though they represent 40% of all small companies.

Online and other alternative lending products have sprung up to fill this market need. While entrepreneurs welcome new innovative sources of capital, alternative financing operates in an almost entirely unregulated market—making many small business owners vulnerable to predatory practices.

To fully realize the economic potential of small businesses, we must ensure greater access and more options for entrepreneurs to obtain responsible capital by enacting the policy recommendations below.

**Promote innovation in small business lending, while ensuring transparency and other responsible practices**

While traditional lending should always play a crucial role in small business financing, there is a strong need for responsible innovation in fintech and other alternative lending. Small business owners struggling to access financing can now go online and find no-credit or bad-credit loans almost instantly. However, this is often accompanied by disastrous results, as these loans typically carry with them high interest rates and a lack of transparency regarding loan terms. While the federal Truth in Lending Act offers some protection to consumers from such exploitation, this law does not apply to small business borrowers. Furthermore, women and minority-owned businesses are more likely to rely on personally financing their business, which can subject them to predatory practices. It’s important that policy solutions not unduly restrict access to credit or reduce innovation, but it’s equally essential that small business owners are protected from predatory practices. Solutions include the following:

- Pass legislation extending Truth in Lending Act disclosure requirements to small business loans or credit products, similar to California’s small business truth in lending legislation enacted in late 2018.

- Promote responsible lending practices by lenders and brokers as set forth in the Small Business Borrowers’ Bill of Rights. Specifically, promote laws governing business lending that require: (1) transparency around rates and terms, including APR; (2) non-abusive products, including curbs against the practice of “double dripping,” in which borrowers are double-charged fees when they refinance; (3) responsible underwriting; (4) fair treatment from brokers; (5) nondiscrimination; (6) fair debt collection practices and (7) accurate credit reporting.

- Prohibit "confession of judgment" clauses in small business lending agreements whereby borrowers agree in advance to waive their right to contest any dispute with a lender, often costing
them their entire savings. This prohibition has been proposed in the bipartisan Small Business Lending Fairness Act.

- Support a special charter for fintech companies as proposed by the Office of the Comptroller of the Currency (OCC), but ensure that companies obtaining such a special purpose charter are required to serve the needs of entrepreneurs, especially those in underserved communities.

- Support the legal requirement that the Consumer Financial Protection Bureau (CFPB) collect small business lending data as mandated under section 1071 of the Dodd-Frank Act. It is important that this requirement is enacted in a way that is not burdensome on community banks.

- Pass legislation that protects small business owners against predatory debt collectors, especially women and minority-owned businesses who are particularly vulnerable to abusive debt collection practices. Small business owners often use their own capital to finance their business but do not have the same protections consumers do against collectors.

- Develop and promote underwriting policies that require the collection of cash flow and other relevant business information to ensure that small business loans are being made with the expectation of repayment out of normal business operations.

- Improve data sharing between the IRS and online lenders in order to speed up the loan approval process and give lenders a safer and faster sense of a business owner's creditworthiness to help entrepreneurs potentially lock in better loan interest rates, with responsible privacy provisions. This can be done by passing legislation in Congress that would require the IRS to provide Internet-based and quick reconnect to verify taxpayer income for legitimate business purposes.

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

Business lending has been on the rise since the recession, yet small businesses are still not getting enough capital to launch or grow their businesses. Indeed, since the recession ended, small business loans trail big business loans by trillions of dollars, there are far fewer community banks, and most banks are making far fewer low dollar loans. This problem especially impacts underserved entrepreneurs, including those living in rural communities and among women and small business owners of color. And while innovations in alternative lending show some promise if offered responsibly, the small business credit gap will not be overcome without increasing traditional financing to small businesses. Policy solutions include the following:

- Strengthen responsible sources of capital by expanding SBA loan programs such as the 7(a) Loan Guaranty Program, the 504 Loan Guaranty Program and the Microloan Program.

- Make the SBA’s 7(a) Community Advantage Pilot Program permanent. This program, which is set to expire in 2022, must make a majority of its loans to underserved markets, such as small firms owned by women, entrepreneurs of color and veterans. Making the program permanent would support entrepreneurs that face greater barriers to accessing business loans, ensuring more small businesses have the opportunity to start and grow.

- Ensure women and entrepreneurs of color get fair access to capital by increasing both funding for and awareness of Women’s Business Centers, Small Business Development Centers (SBDCs) and the Minority Business Development Agency. Research shows women and people of color struggle to access credit and gain access to mentoring and networking opportunities.

- Maintain and expand lending programs for rural entrepreneurs. The 2018 Farm Bill provided outreach and assistance to socially disadvantaged farmers and proposed funding for such programs, including the Rural Microentrepreneur Assistance Program, Rural Business Development Grants and the Intermediary Relending Program. Lawmakers must work together to
continue to pass bipartisan legislation that will give rural entrepreneurs, their families and their communities opportunities to succeed.

- Establish policies that encourage venture capital investment for startup businesses to include rural cities and towns instead of just metro areas.

- Dramatically expand the annual budget of the Community Development Financial Institutions (CDFI) Fund from $250 million to $1 billion. CDFIs are fundamental in breaking down barriers to capital access for small businesses. Expanding the Fund will further increase investment in small firms, especially those in underserved communities.

- Reaffirm the Community Reinvestment Act’s (CRA) mission of stimulating lending in low- and moderate-income areas to ensure business owners in these areas maintain access to capital, and consider additional proposals to improve small business lending. The CRA is an important tool for stimulating small business lending, particularly in low- and moderate-income areas. According to a 2016 FDIC report, 71% of all small business loans originate from a bank subject to CRA reporting requirements. However, the Federal Reserve found that small business lending by CRA respondents dropped by more than half between 2007 and 2010.
  - Revise the OCC’s proposed rule to update CRA regulations that could undermine its current level of small business lending and lending in disadvantaged communities. This includes maintaining the importance of assessment areas, rejecting the “one ratio” of evaluating and rejecting changes that would allow a bank to receive CRA credit for lending activities in higher-income areas.
  - Amend CRA rules to allow CRA credit for loans given to entrepreneurs in the newly created Opportunity Zones. This would leverage the benefits of the tax-advantaged equity investments being made under the Opportunity Zones legislation.
  - Consider other changes to the CRA to further stimulate small business lending and acknowledge the ways in which the small business lending landscape has changed due to fintech and alternative lending, including modernizing and streamlining CRA assessment criteria and by clarifying how much small business lending a bank will have to do to receive a top rating.

- Establish state banks, such as the Bank of North Dakota, that make low-interest loans for infrastructure, agriculture, affordable housing, student loans and small businesses. These banks will spur economic growth and lead to thriving community banks with higher lending totals. A feasibility study done in Vermont found that a state bank would boost gross domestic product 0.64% and create 2,500 jobs.

- Quadruple SBA lending guarantees—for example, by raising the maximum guaranteed annual loan amount from $25 billion to $100 billion—and thereby increasing the volume of small business loans guaranteed by the SBA to $1 trillion over the next decade. This provides small businesses, particularly minority- and women-owned businesses and rural enterprises, with increased opportunities to participate in SBA loan programs and SBDC programs.

- Reduce the risk of small business lending for banks by increasing the loan guarantee percentages from 85% to 90% for loans up to $150,000 and from 75% to 85% for loans between $150,000 and $700,000. This will make it less risky for banks to lend to startups, particularly those looking for smaller lines of credit.

- Reduce SBA loan fees to 0% for the guaranteed portion of loans under $150,000 and 1% for loans between $150,000 and $700,000. The current fee structure unnecessarily adds extra costs for small business owners and dampens their ability to get credit.
• Make permanent the New Markets Tax Credit NMTC, which has helped to attract more than $60 billion in private sector funding to community development financing intermediaries that provide loans to businesses in economically-distressed communities across the United States.

• Enact policies to strengthen and expand community bank lending, which provides more than half of all small business lending. Smart initiatives include the following:

  o Encourage state and local governments to shift public funds into community banks and ensure those deposits are used to increase small business lending by requiring them to regularly report on small business lending. For example, Massachusetts launched the Small Business Banking Partnership in 2011, which moves at least $100 million in state deposits to community banks in an effort to increase lending to small business and create jobs.

  o Encourage the FCC, OCC and FDIC to heed the Government Accountability Office’s recommendation to re-evaluate, and modify as needed, the requirements for the data that community banks report to better reflect lending to small businesses.

  o Increase community bank lending in rural areas. USDA’s guaranteed loan programs, including the Business & Industry Loan Guarantees, allow community banks to lend to rural small businesses. We recommend increasing the program’s loan limits in order to raise the number of loans made and provide additional funding to meet increased demand.

• Implement policies that provide low-interest loans to small businesses impacted by future government shutdowns.

• Remove barriers to obtaining government-backed loans in order to expand the reach of the loan program to borrowers who may not have the necessary credentials or credit score or may be carrying student loans. This will be especially critical to ensure equitable access to loans for women and people of color.

• Reauthorize and reinstate the State Small Business Credit Initiative, which from a $1.5 billion initial investment successfully funded new and existing state programs that supported more than $10.7 billion in lending to and investment in small businesses.

• Increase the artificial lending cap for credit unions from 12.25% to 27.5% of assets.

• Significantly expand state small business technical assistance programs. For example, California included in its 2018-19 budget $23 million for small business technical assistance centers across the state, which is roughly a $20 million increase from the previous year.

**Promote expanded use of equity investments for small businesses**

While many small businesses have historically self-financed or turned to debt financing to fund their business, innovative policies are increasing the amount of equity funding available to small business owners. Policymakers should encourage new models of financing or allow for innovation in existing financial products to allow more small business owners to access equity financing. Specific proposals include:

• Facilitate access to equity financing to small businesses within new Opportunity Zones investments. While investments in Opportunity Zones hold the potential to benefit small businesses, especially those in underserved communities, they must be implemented responsibly. This includes requiring reporting metrics that measure program success based on the number of jobs created, where those jobs are located, employee wages and the number of businesses created, particularly businesses formed by women or people of color.

• Support innovations like equity crowdfunding while ensuring safeguards that make sense for both small business owners and investors. For example, we recommend increasing investment limits for people making less than $150,000 per year.
• Allow crowdfunding investors to pool their money together into a fund advised by a registered investment adviser, as proposed in the JOBS and Investor Confidence Act of 2018. This will attract both businesses and prospective investors and boost the crowdfunding market.

• Engage and mobilize potential angel investors by creating more tax incentives. According to the Securities and Exchange Commission, there are nine million American households that meet the accredited investor criteria, in addition to the already existing 300,000 angel investors. More than half of states offer tax incentives for angel investors. Creating a 5% tax credit for angel investors that invest in businesses with less than $2 million in gross receipts would increase financing for qualifying small businesses, especially those that are traditionally underrepresented.