THE POWER OF
ONE IN THREE

Creating Opportunities for All Americans to Bounce Back

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The Challenge of the Decade: Economic Bounce Back

According to the Bureau of Labor Statistics, 9.6% of Americans were unemployed as of year-end 2010. That's 14,825,000 people. What's more, "nearly 11 percent of unemployed persons had been looking for work for about 2 years or more in the fourth quarter of 2010."

Faced with these staggering statistics, the single most important issue of this decade is "bounce back." It's imperative. The economy must continue to show signs of a rebound so confidence can return, demand can grow—and businesses on Main Street can recover and flourish.

The Power of One in Three

If the economy is going to bounce back, it must happen on Main Street. "Micro" or very small businesses represent more than 80% of all businesses in the U.S. Last year, more Americans became entrepreneurs than any time in the last 15 years. Whether these individuals are in construction, provide services, or run a restaurant, they are everywhere. In fact…

If just one in three microenterprises hired a single employee, the US would be at full employment.

Focusing on Main Street businesses is a high-impact, less risky path than simply betting on the next new, VC-backed game-changing innovation. The odds of turning a venture-backed start-up into a billion dollar business are at best 1 in 20,000. Placing all of our bets on the rare mix required for the next new thing to succeed will not solve our unemployment problems.

By contrast, business models for Main Street businesses are well understood. Success is primarily a matter of execution. Of course, there are barriers and hurdles, but they can be resolved. We're not saying this will be easy. Rather that it is possible and that it matters:

The median net worth of business owners is almost 2.5 times higher than non-business owners. For a black woman, the difference is more than 10x. For a Latino man, the difference is 5x.

Barriers to Impact: Availability and Access

There is no shortage of determined, committed, and capable entrepreneurs who need to be appropriately capitalized and coached. However, there is an availability, access, and impact problem—not just access to capital but access to opportunities.

Most Main Street business owners and aspiring business owners don't get what they need to succeed. It's not because of lack of effort. Main Street businesses tend to suffer from an availability problem. There are not enough services, products, or opportunities that meet the unique needs of these businesses and their owners.

The typical Main Street business is run by a passionate, tenacious, and determined owner. Odds are that person does not have a dedicated finance department, a marketing department, or an HR team—all resources that a larger company could deploy to plan, assess, and act.

> **"If just one in three Main Street businesses hired one employee, then the US would be at full employment."**

This reality, coupled with the high costs for traditional commercial banks and other companies to serve this market segment, frequently leaves Main Street business owners without capital, services, and products to meet their needs.

Some business owners and aspiring business owners must overcome additional hurdles of access. These underserved business owners are individuals who are unable to make use of available solutions to their needs typically as a consequence of their starting wealth.

If we can solve the twin problems of availability and access, we will increase the impact millions of business owners have on the economy and their communities, while unleashing the power of new markets.

Making it Happen

Unlocking Main Street's growth potential will require coordinated actions among individuals, companies, non-profits, foundations, and government. No single actor or group can solve the complex challenges of availability and access. The good news is that while the need is great, solutions are in reach.

For the last year, the Association for Enterprise Opportunity (AEO) has sought to understand the system in which underserved business owners operate. We started from the perspective of the business owners. Who are they? What do they need? We pored over data—much that others have seen and some that we collected for the first time. We talked to owners and experts.

We then turned to the organizations that we know best: hundreds of non-profit organizations around the country that provide services and capital to business owners and aspiring business owners. We talked to the leaders who seek to improve their communities and the lives of the people in them. We talked to their partners, investors, and funders. We also joined forces with the Nonprofit Finance Fund to analyze the financial health of their organizations.

And when we thought we saw a path forward, we began to engage other partners who are equally committed to uncovering opportunities to better reach underserved businesses and business owners. Together, we are launching the Catalyst Initiative, a suite of programs and partnerships to better reach underserved entrepreneurs and help the leadership of domestic microenterprise organizations prepare for inevitable change.

Non-profit organizations like The Grameen Foundation's Bankers without Borders™ program, California Resources & Training (CARAT), and Credit Builders Alliance have joined us, along with commercial banks like Citi and a growing list of other firms.

Together we can help America's Main Street businesses bounce back.

Let us share with you what we've learned and what we are doing…

ONE IN THREE: HOW THE AMERICAN ECONOMY CAN BOUNCE BACK

"If demand for microenterprise-intensive services and products was met locally in communities around the United States, we could create 10-16 million new jobs."*

Consider this astonishing fact:

Last year alone, the major U.S. commercial banks turned down roughly one million applications for small business financing.[2]

And this number reflects only Main Street businesses whose situations were sufficiently promising to even be considered for financing by commercial banks. At the other end of the spectrum, an additional one million U.S. households—without access to mainstream banking services—borrowed small-dollar short-term loans for business purposes.[3]

Yet even these numbers don't tell the whole story. Some groups of Main Street business owners struggle even more to succeed:

- ***Just over 5% of all businesses generate annual sales greater than $1 million.*** For women, Latinos, and Native Americans, the rate falls to only 2%. For Black business owners, the rate is under 1%.[4]
- ***The odds that a Black business owner in the U.S. will have annual revenues of less than $100,000 are almost 20% higher than for peers***.[5]
- ***A female business owner in the Pacific Northwest has only 14% chance of generating $100,000 in annual sales***—the highest odds compared to women in other regions of the country.[6]
- ***There are over 40 million people living at or below the poverty line for whom self-employment is likely to be their most viable economic option.***[7] If a million people who rely on mainstream banking services can't secure capital, what hope should these people have?

Fortunately, this is not the end of the story. It doesn't have to be this way:

- ***Current programs, products, and services could reach more people:*** Operating model innovations can reduce the costs to serve low-wealth business borrowers by more than 65% without necessarily sacrificing personal touch. Product innovations can push opportunities to businesses and business owners who previously lacked access.
- ***Businesses could become more competitive for procurement opportunities:*** As one example, each percentage point of procurement spend by the Federal government alone that could flow to small, disadvantaged businesses represents $5 billion.
- ***Micro-businesses could connect to international trade routes:*** Access to logistics services and distribution networks need not be a barrier for microbusinesses to participate in international trade. A 1% share of imports to developing countries is worth $37B USD. If U.S. micro-businesses increased their share of imports by countries in sub-Saharan Africa alone to parity with India and China, it would be worth ~$5B.

"A $5K increase in revenues per microbusiness per year would generate more than $20B. That's less than $500 in additional sales per month per business."

CONSTRAINED BY COST STRUCTURES AND CAPACITY

Traditional commercial banks are constrained in part by the relatively high costs of their business underwriting models. Rigorous and thus expensive processes to evaluate small loans manage risk but eat into profitability, often leaving Main Street business owners without the financing they need.

As a result, commercial banks typically work with non-profits to fill this gap since they tend to have trusted relationships with business owners and aspiring business owners in communities across the country. These organizations are on the ground and in the trenches. They can and do take risks that others are not able or willing to take.

However, in spite of often high-impact collaborations, bank executives raise concerns about the capacity of non-profits as well as the system's ability to absorb the capital and other resources that banks could deploy.

In order to gain a better understanding of the current situation, we conducted an analysis of the "financial health" of nearly 500 non-profit organizations that provide financing and services to underserved businesses across the country. The results of this analysis underscore capacity concerns. Moreover, despite historically strong capital structures and financial management among the non-profits in the sector, their current financial positions leave them unable to invest in change.

Financial Health Assessment and Sector Scan

Here's a snapshot of the financial health of the non-profit organizations that provide capital and services to underserved businesses and aspiring business owners:

- Current cost structures preclude non-profit organizations in the sector from meeting the needs of underserved entrepreneurs: Reaching ~80% of underserved business owners at current costs would require more than $20B, which represents just under half of total giving by U.S. foundations in 2009.[8]
- As demand for capital and services increases, expense is generally growing much faster than revenue. As a result, margins are decreasing across the board. This puts serious constraints on operating liquidity and in the near term will put some organizations at risk.
- Liquidity constraints threaten both large and small organizations. Although large organizations may be more accustomed to managing against these constraints, neither big or small organizations are well-positioned to invest in capacity building and growth.
- Service providers are by far the most precarious: median months of unrestricted liquid net assets have been steadily declining since 2006. In 2009, the median value among pure service providers was one month of liquidity.
- Government generally represents an increasing share of the source of operating budgets for all organizations. The median across the entire sample is almost 50%. Not surprisingly, the growth has been most pronounced in organizations with annual operating budgets below $1M. Yet the dollar value is highest among the largest organizations. Given the current fiscal environment, this presents a significant risk.

Not surprisingly, the lack of liquidity and funds to invest in capacity-building and growth is seen by practitioners as one of their most serious challenges. As the Executive Director of one large, high performing lending organization told us, "We're so busy trying to raise operating funds to do what we do that it's a challenge to raise funds for innovation, growth, and getting to the next level."

THE PATH FORWARD: UNLEASHING THE POWER OF ONE IN THREE

We recognize that the frustration expressed by that Executive Director is real. However, there seems to be a chicken and egg problem: Demand is growing, cost structures make it nearly impossible to meet needs, and practically no one has capital to invest in building capacity or in growth.

Yet funds won't flow from traditional or new sources until and unless investors have confidence that the needs of underserved business owners or aspiring entrepreneurs can be met and that the odds of success are high.

We need to think about solutions differently than we have to date. Organizations need to think about how they best serve their communities. We all need to think about our collective impact.

Each organization needs to make critical choices about how it will contribute to more effectively and efficiently reaching underserved entrepreneurs. In some cases, this will mean doing more of the same and pushing performance to the next level. In other cases, it will require re-thinking operating models and activities.

Reaching underserved businesses and aspiring business owners is not about the size of any single organization but rather impact and total coverage from the ecosystem of organizations and resources available nationally, regionally or locally.

There isn't a simple answer or a one-size-fits-all approach. Funding is an issue for everyone, but there is much more that needs to be addressed. It's about enabling thoughtful and deliberate resource allocation decisions. It's about investing in building capacity for the activities that drive impact. Lastly, it's about connecting people, ideas, and organizations quickly and effectively.

Introducing the Catalyst Initiative

In response to what we have found, we are launching a suite of programs and partnerships designed to unlock the potential of low-wealth entrepreneurs by strengthening the capacity and reach of the non-profits that serve them. By design, the Catalyst Initiative seeks to combine a solid fact base as well as insights into performance drivers with resources to help leadership teams of domestic microenterprise development organizations plan and prepare for change.

In order to create a space to unleash the power of One in Three, the Catalyst Initiative programs and partnerships are focused on four primary areas:

1. ***Enabling better decision-making and resource allocation:*** AEO has joined forces with Bankers without Borders™, the volunteer arm of The Grameen Foundation, to deploy their pro bono consulting teams in the United States. These skilled volunteers will be able to provide non-profit executives decision support in a range of areas including market sizing and loan fund economics. We are also partnering with national law firms to channel pro bono legal support to our members.
2. ***Channeling funds to invest in capacity and growth:*** Based on the findings of our "financial health" analysis, AEO and the Nonprofit Finance Fund are working on the design and development of an investment vehicle to provide much needed funds to support capacity-building and change where needed.
3. ***Scaling services and products that work and developing new ones:*** AEO members represent both fertile testing ground for innovation and sources of insight into market needs. Our reach and relationships provide us with the opportunity to change the economics of scale by replicating proven programs without sacrificing local control and creating "toolkits" to promote innovation and experimentation.[9]

4. *Rationalizing the policy framework:* At present, efforts to support underserved business owners and aspiring business owners are at best a patchwork of programs and policies designed for a different era. The world has changed and we believe that policies must catch up. AEO is joining forces with other advocacy organizations under the umbrella of One in Three. Our aim is to create a policy framework that aligns incentives and promotes wealth and job creation through self-employment.

Building Momentum from Where We Are

The Catalyst Initiative isn't about reinventing the wheel. It's about taking what works, spreading it, and channeling resources for change. There is already much good work underway upon which to build.

Around the country, high performing organizations like the Community First Fund and The Good Work Network are enabling underserved businesses to start and grow. In 2010, the Community First Fund lent more than $2 million to underserved businesses in a 13-county footprint of Pennsylvania that includes 5 cities designated as "economically struggling." The Good Work Network serves more than 700 clients in New Orleans each year and connects contractors with market opportunities. By developing trusted relationships in the communities in which they work, these local organizations are making a difference for underserved entrepreneurs.

At the same time we are seeing new services and service delivery models, new operating models with supporting tools, new capitalization strategies as well new entrants engaging with existing non-profits and networks.

Enterprise Virginia is creating an innovative and replicable public-private partnership model that seeks to connect underserved communities in the state of Virginia to financial, intellectual, social capital and ultimately international trade routes. Credit Builders Alliance has pioneered a shared technology platform to enable more than 100 non-profit lenders to report business loan repayments to the major national credit bureaus. To date, nearly 10,000 entrepreneurs have built their credit histories as a result of this service.

These organizations and others like them leave us confident that high impact activity and experimentation is underway. By launching the Catalyst Initiative, AEO is committed to providing the support and the resources to accelerate much needed change in the sector.

To unleash the power of One in Three, we must all engage. AEO can lead the way but we'll need your help. Won't you join us?

[1] Kauffman Foundation Index of Entrepreneurial Activity 1996 -2010
[2] AEO analysis of TARP data and interviews with commercial bankers
[3] Center for Financial Services Innovation survey; FDIC National Survey of Unbanked and Underbanked Households; Interviews
[4] Survey of Business Owners (2007)
[5] Survey of Business Owners (2007)
[6] Survey of Business Owners (2007)
[7] US Census Bureau
[8] Estimates for the number of underserved entrepreneurs vary. The FIELD program of The Aspen Institute estimates ~10 million are denied access to capital. Their 2009 MicroTest data reported median costs to serve a client as ~$2700.
[9] See Eric von Hippel, "User Toolkits for Innovation" in the Journal of Product Innovation Management (July 2001) for corporate examples and Stanford Social Innovation Review, Spring 2009 for non-profit examples.

* We analyzed the Survey of Business Owners to identify the 20 most microenterprise intense industry sectors. Then we used BALLE's calculator to identify the job creation potential if local consumption was met with local production around the country.

WHERE THE CATALYST INITIATIVE BEGAN

In May 2010 at our annual conference, AEO convened a group of non-profit CEOs, Executive Directors, and finance experts for a roundtable discussion. This dialogue uncovered both a need for funds and preliminary insights into many of the obstacles non-profits face when trying to resource their work.

Following that session, AEO began a systematic assessment of the current state of the U.S. micro-enterprise sector with the intent of uncovering opportunities to better reach underserved businesses and business owners. We began by asking a series of fundamental questions including:

- What is an "underserved entrepreneur," how many of them are there, and where are they?
- What does the current landscape of programs, services, and products targeted to support underserved entrepreneurs and business owners look like?
- Where are the highest potential opportunities to significantly increase the odds of success for these business owners and would-be business owners?

What we have done:

- ***Demand - Side Analysis.*** To understand the universe of underserved entrepreneurs, we worked with Robert Fairlie, a Professor of Economics and the Director of the Master's Program in Applied Economics at the University of Santa Cruz, and others to analyze data on the numbers of business owners and the relationship between business ownership and wealth.
- ***Supply-Side Analysis.*** We needed a perspective on what is currently available to meet the needs of underserved entrepreneurs. We built a database of organizations and programs that offer financing and services to underserved businesses. In an effort to better assess coverage, we segmented the data by geography, and then segmented based on: a) mission, b) strategic focus, c) product/service offerings, and d) operating model.
- ***Size-of-the-Prize Analysis.*** We tried to measure what solving for availability and access could be worth to the economy, communities, and businesses. Working with Michael Shuman, Director of Research and Economic Development at the Business Alliance for Local Living Economies (BALLE) and his colleague Kate Poole, we calculated the potential impact on job creation from the top sectors for microenterprise in each state using a proprietary tool BALLE created. We also looked at trade flows (e.g. imports) within developing countries to get a sense of the value that could be available to microbusinesses from global trade.
- ***Funds Flow Scan.*** We studied funds sources and their dynamics in order to get a sense of how resources are allocated. This included interviews with expert practitioners to understand trends and uncover new financing opportunities for both underserved businesses and the non-profits that serve them.
- ***Financial Health Assessment.*** Working with the Nonprofit Finance Fund, we developed a perspective on the financial health of ~500 non-profit organizations in this sector.
- ***Interviews.*** We talked with more than 100 practitioners, stakeholders, and business owners around the country to more fully understand their aspirations, challenges, and situations.
- ***Idea and Inspiration Catalog.*** We started collecting ideas and interesting approaches from other sectors and geographies that could be applied here. Going forward, we hope to make this effort "open source" in order to unlock ideas for others.

OUR THANKS

What began as a discussion at the 2010 AEO conference has taken on a life of its own. Many people and organizations have contributed to this work. It is truly a group effort reflecting the breadth and diversity of the individuals and organizations committed to reaching underserved business owners and aspiring business owners.

We would like to express our gratitude to many individuals and organizations for their generosity and support for this project: The panelists at the 2010 CEO Forum who provoked so much rich dialogue and thought. This includes Joy Anderson, Founder and President of Criterion Ventures; Lisa Hall, President & CEO of the Calvert Foundation; Jennifer Henderson, CEO/Manager & Co-Founder, Strategic Decisions, LLC; and Garvester Kelly, Vice President of the Nonprofit Finance Fund. We would also like to thank the Citi Foundation for its generous support in underwriting the report and the first phase of the Catalyst work. We are especially grateful to Graham Macmillan for his insight and guidance on the work. Additional thanks to the team at the Nonprofit Finance Fund who began this journey and have shepherded it through with Garvester Kelly, including Shilpi Shah, Garret Brinkerhoff, Paul Bennett, and Kim Cook; the AEO Board of Directors for their active engagement in shaping the ideas and opportunities represented by this initiative. All of the practitioners and experts who took the time to speak with us about the work that they do and the ways that we could make it better; Rob Fairlie for his thoughtful guidance on the academic literature and patient explanation of various datasets; Michael Shuman and BALLE for use of their "Economic Leakage" calculators and guidance through the process; Vikki Frank, Executive Director of the Credit Builders Alliance for her thoughtful perspectives on the sector and her feedback on the report; Elaine Edgcomb, Joyce Klein, Tamra Thetford and all of the participants in the Scale Academy, whose experience and insights provided a consistent "reality check" on the real constraints and opportunities for practitioners; Tom Givens, Anne Schaffer, Rick Terrell, and Deb Yuhas, the extraordinary creative team at Capital One for their generous pro bono work on the design and copy of the report; and finally the team at AEO who contributed to this work: Archana Chidanandan, Mumbi Carter, Matt Crandall, Katie Glerum, Michael McVicker, Nikita T. Mitchell, and Erika White.

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THE POWER OF ONE IN THREE

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[THE VOICE OF MICROENTERPRISE]

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