



THE POWER OF ONE IN THREE

Micro Capital Task Force

Overview & Survey Results
March 2014



Context for this Document

The American dream is out of reach for millions of Main Street business owners. Hard work alone will not solve the problem given the current path of financial institutions and other market players, even with strong support from a range of community-based institutions. Solving this problem requires the emergence of a new financial system for Main Street.

Recognizing this massive market failure, AEO, the national trade association for US microfinance and Main Street businesses, formed a private multi-stakeholder task force to present fact-based and practical recommendations to the White House, the Department of Treasury and the Congress regarding access to capital in amounts of up to \$250,000 for the smallest businesses. In parallel, AEO commissioned Ira Lieberman, one of the pioneers in scaling microfinance internationally, to draft a strategic plan to scale Main Street microfinance in the United States.

Lieberman's team* worked from October 2013 through March 2014 to establish a fact base from which to make recommendations for structural change. The team evaluated existing data and industry reports; performed groundbreaking analyses to provide insight into the economics of emerging technology-led for-profit micro lenders; and conducted more than 50 interviews with senior leaders in mission-focused organizations and venture-backed technology companies, established financial institutions, and government agencies.

This document includes a high-level overview of the MCTF framework and process. Also included here are findings from a questionnaire distributed along with invitation to participate in the Task Force Working Groups. The document is intended to support your engagement with the task force. Should you have any questions about the Micro Capital Task Force, please contact either of us or Tammy Halevy, SVP, New Initiatives at AEO (thalevy@aeoworks.org). Thank you for your work to move money to Main Street!

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MCTF: Financial System 2.0

Critical Stakeholders

Commercial Banks

Community Banks

Credit Unions

CDFI Loan Funds

Alternative lenders

Infrastructure &
Data providers

Investors*

Regulators &
Policy Makers

Main Street
Businesses

The Vision: Moving Money to Main Street in Every Community

Levers

Investment

Standards

Policy & Programs

Regulation

Technology

*Including Private, Philanthropic, Government



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Goal 1: Solve for Availability

Resolve the market failure
that results in 8,000 bank
declines every business day

Goal 2: Solve for Access

Ensure that mission-focused
lending is capitalized for
the impact necessary and
possible

*Including Private, Philanthropic, Government



MCTF Working Groups

Working Group on Technology & “Big Data”

Scope and Objectives: Advise Department of Treasury on policy opportunities related to data access, standards, privacy issues and ownership

Composition: Industry thought-leaders, senior executives from start-ups and established companies, data and privacy advocates

Convenor: Matt Harris, Managing Director, Bain Capital Ventures

Working Group on Underserved Entrepreneurs

Scope and Objectives: Advise Department of Treasury, philanthropy and operating organizations on industry strategy and structure including policy issues, investment needs, and new models for CDFI business lending and entrepreneurship support in low-wealth communities

Composition: Thought-leaders, practitioners and investors from US and international microfinance, philanthropy and the private sector

Convenors: Ira Lieberman, President, LIPAM International & Grace Fricks, CEO, ACE

Working Group on Capital

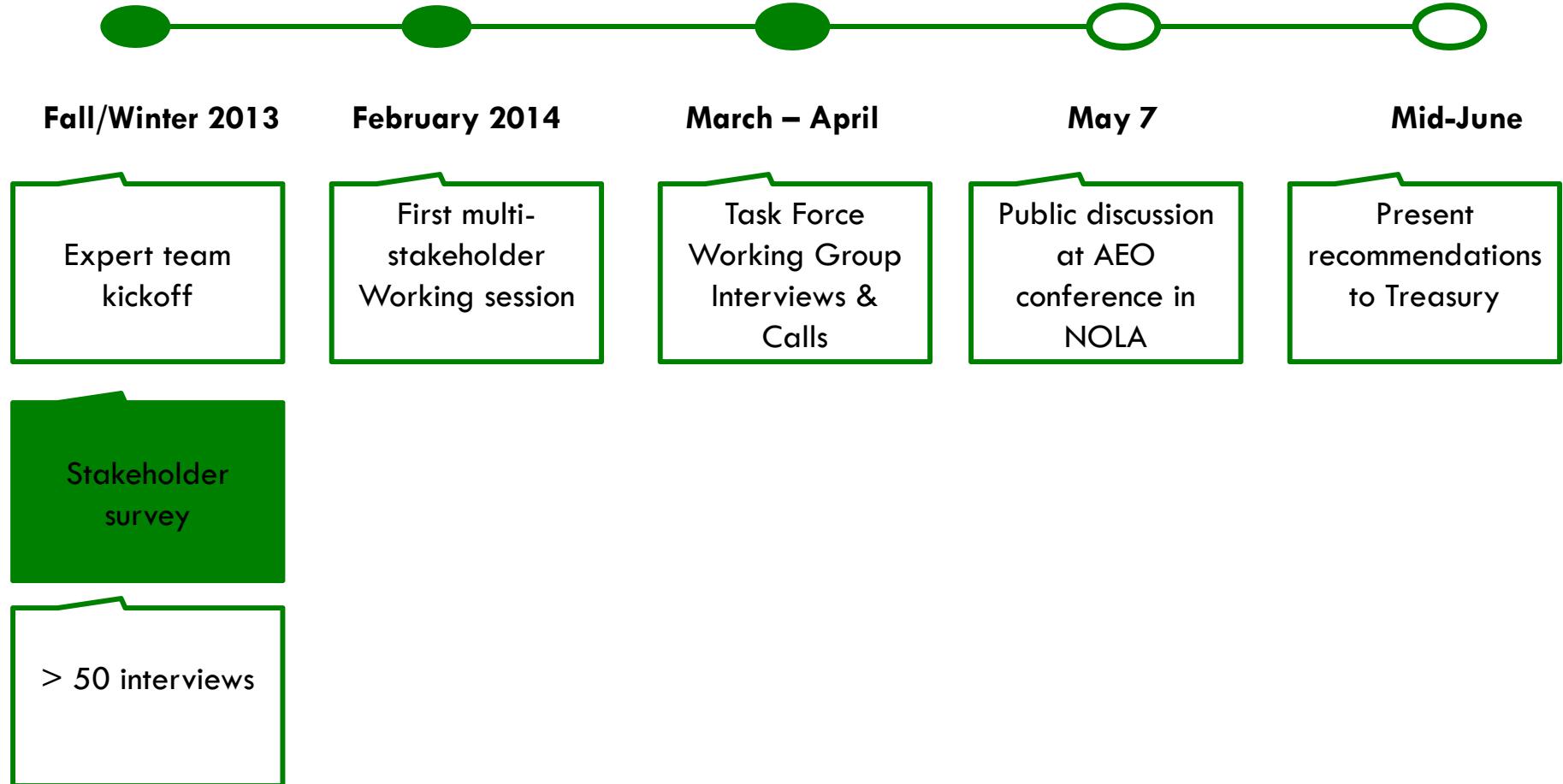
Scope and Objectives: Advise Department of Treasury, philanthropic investors, social impact investors and others on policy issues, investment opportunities, and new models

Composition: Thought-leaders, practitioners and investors from US microfinance, impact investing, philanthropy

Convenors: Melissa Bradley, Managing Director, New Capitalist & Daniel Gorfine, Director, Financial Markets Policy, Milken Institute

MCTF Process Overview

 Focus of this document



MCTF: Stakeholder Survey Overview

Overview

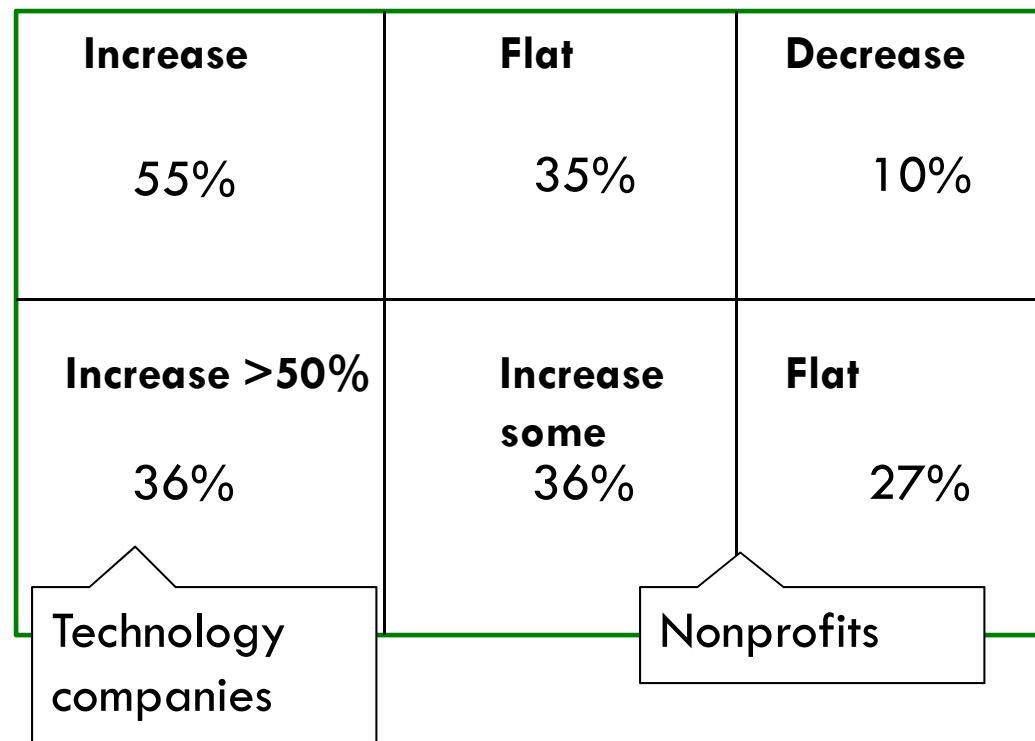
- Online questionnaire distributed to 186 senior leaders in credit technology companies CDFIs, and other nonprofit institutions
- Distributed in December 2013 and responses collected through January 2014
- 31 responses
 - 61% nonprofit vs 39 % for-profit
 - 71% of for-profits are privately-held
 - 32% of respondents are direct lenders
 - 30% of the direct lenders are self described specialty finance players and peer to peer platforms
 - 70% of the direct lenders are designated CDFIs
 - 13% of respondents are business advisors (nonprofit and for-profit)
 - 6% of respondents are consultants /researchers
 - 6% of respondents are investors

MCTF: Stakeholder Survey Selected Insights / Findings

- Expectations for growth in lending to Main Street businesses are mixed: Those who expect their growth to increase dramatically tend to be credit technology companies and those who expect flat tend to be nonprofits. No respondent expects a surge in loans of up to \$250,000 by banks.
- Big Data is generally seen as the future of lending to Main Street. In parallel, strong call from both tech companies and nonprofits for data standards, increased access and clear privacy rules.
- Financial inclusion is a priority issue. Limited confidence that private markets alone will solve the problem of Main Street. However, government programs don't get strong marks for achieving intended results to date. Support for public-private partnerships to increase the flow of capital to main Street. Recognition of the power of regulation to shape the flow of capital to Main Street. Concerns expressed related to complex and sometimes competing regulations.
- Consensus view that government can play two roles in moving money to Main Street in every community:
 - Bring early stage products to market for Main Street
 - Ensure access in low-wealth communities

Growth Expectations are Mixed

- Looking ahead over the next year, do you expect the **OVERALL VOLUME** of lending to Main Street businesses to...
- Looking ahead over the next year, do you expect the **volume of YOUR ORGANIZATION'S** lending to Main Street businesses to



Source: MCTF Survey

Constraints on Banks: Respondents in Their Own Words

Banks will not solve this problem. Regulators should not stand in the way of innovators who are finding new ways to provide capital to small businesses.

— Investor

Banks are not set up to deliver capital in sub-\$250,000 increments to small businesses. It is very unlikely that they will ever play again in this size of loan and therefore, we need to consider a new framework for non-bank lenders and investors

— Technology Company CEO

Banks continue to be conservative in their bank lending, possibly because of their own fears of having regulators deem their portfolios too risky.

— CDFI CEO

Traditional bank lenders have very little incentive to make small business loans. There are more lucrative ways to allocate capital. They are comfortable with the risk but the returns are simply not big enough to allocate significant capital. We need alternative products to meet Main Street business needs

— Technology Company CEO

Source: MCTF Survey

“Big Data” & Privacy Issues: Respondents in Their Own Words

Bright line tests around data ownership and privacy would help the market innovate while reducing regulatory oversight. The more clear the guidelines, the easier to play the game.

— Tech Company CEO

Small businesses do not have privacy concerns. In fact, their best interests are served by having greater access to data so as to prove credit worthiness

— Tech Company CEO

The government should find a way to provide data on small businesses in the aggregate, while also protecting confidentiality, so those data can be used for business transactions. The public will want reassurances that private data is being protected as well.

— Technology Company CEO

It would be helpful if there was a simple way for banks to refer customers...Perhaps referrals could be part of bank CRA criteria and some kind of automated referral mechanism could be developed.

— Nonprofit CDFI CEO

“Big data” has been created by lots of “small users” who unfortunately are not necessarily receiving the benefits of having done so.... Nonprofits that serve low to moderate income populations and those populations themselves, would benefit from being able to access and create processes and systems that use big data

— Nonprofit CDFI CEO

Provide lenders with automated, customer-authorized access to data that can be used to mitigate risk, including tax returns and other government data Access to data would have the biggest impact on SMB lending, especially for businesses that need less than \$50K.

—Tech company COO

Government should help improve the data that's available on small business by leveraging data collected by the IRS. — Nonprofit CEO

The government can play an important role by creating standards for information access, providing clearer regulatory oversight, and sponsoring data sharing arrangements. — Tech CEO

Source: MCTF Survey

Equity & Financial Inclusion: Respondents in Their Own Words

Main Street businesses in low-wealth communities are in greatest need of lending but are also provide the best means of transforming those communities through business growth.

– Nonprofit CEO

Government should look to create incentives for local lending and procurement that mirrors the programs set up for disadvantaged groups (MBE, WBE, VDBE, etc.). In addition, any financing products should be combined with business management education or advisory services to ensure that loans are effectively utilized.

– Nonprofit CEO

If the government wants to ensure that low-wealth communities have access to capital, it will be necessary for it to increase the funds it provides to high-risk borrowers, particularly those with FICO scores below 600.

– Tech Company CEO

There is no alternative to this one. Any policy and program supporting Main Street business lending must focus in low-wealth communities.

– CDFI CFO

CRA is vital. Redlining is still a very real issue and without CRA the lack of affordable capital in low-income communities would be an even larger problem. These communities have a prevalence of check cashers, title lenders, etc. that are sucking the relatively small amounts of capital out. This lending will only be done by predatory lenders if CRA isn't maintained and subsidy (and the bully pulpit) aren't used to invest in the growth of microenterprise.

– CDFI CEO

Only technology driven platform can solve this properly....by necessity, improving financial and business literacy needs to leverage the low cost scalability and availability of online education and online resources.

– Tech Company CEO

Regulatory Barriers: Respondents in Their Own Words

The current legal and regulatory constraints (federal and state) on prospective lenders to small businesses make it exceptionally difficult for us to get capital to those who need and deserve it. Specifically, conflicting and overlapping rules (both on the lending side as well as on the capital formation side) make small business lending a relatively unattractive segment for most organizations (and potential entrepreneurs) to understand and to attack.

— Tech Company CEO

Much of the regulatory scheme is clearly designed around banks -- but banks are not set up to deliver capital in sub-\$250,000 increments to small businesses. It is very unlikely that they will ever again play in this size of loan, and therefore we need to consider a new framework for non-bank lenders and investors.

— Tech Company CEO

Our business is a marketplace for small business loans; we have a network of private (non-bank) investors who are excited about lending money to small businesses in increments of \$25,000 up to \$500,000. However, there's very limited clarity around what sort of regulatory structures will allow us to serve these investors, form their capital, and get that capital to small businesses in a way that is fully compliant and doesn't expose us (and our market participants) to regulatory risk.

— Tech Company CEO

Source: MCTF Survey

MCTF: Stakeholder Survey Areas of Consensus

Strongest support

- Government programs should ensure that businesses in low-wealth communities have access to fairly priced capital (67%)
- Regulations and policy can change the flow of capital to Main Street (77%)
- Private investment and government subsidy can be combined effectively to increase lending to Main Street businesses (71%)
- My organization would (or does) participate in government programs designed to lower the cost of capital for lending to Main Street businesses (67%)

Strongest disagreement

- There is no role for government incentives and/or subsidies in lending to Main Street (86%)

Mixed views – But General Consensus

- “Big Data” and automation represent the future of lending to Main Street (57%)
- Private companies will deliver fairly priced financial products to business owners regardless of where the business is located (57%)
- Increasing the flow of capital to Main Street businesses will require public-private partnerships (52%)
- My organization would participate in government programs designed to test and scale new products (57%)

MCTF: Stakeholder Survey Top Line Findings: What Matters?

- **Data and Privacy**
- **Equity & Financial Inclusion**
- **Pricing**
- **Government Guarantee Programs**
- **Tax & Investment**

	Significant concern/Among the most critical issues to resolve	Not an issue of concern
• Data and Privacy	42%	21%
• Equity & Financial Inclusion	75%	10%
• Pricing	55%	5%
• Government Guarantee Programs	47%	26%
• Tax & Investment	45%	20%

Thinking of the experience of your organization -- or more generally, what you observe about the industry -- which, if any, of the following issue areas present policy and regulatory barriers to lending to Main Street?

Source: MCTF Survey

Pricing: Respondents in Their Own Words

Many on line lenders have entered the marketplace. For various reasons their pricing is much higher than nonprofit lenders. But their processes are much faster because they deploy big data to build algorithms that automate what is a very time consuming, manual process for non profits. Where one hour turn around time, and minimal investment of time on behalf of the applicant appear to be competitive advantages - it is the power of the data behind the software that will allow these companies to compete.

– Nonprofit CEO

Right now the business owners can either get a bank loan at low interest rate but with stringent underwriting criteria or they are forced to borrow in alternative lending market where the APRs start at 30% and go up to 100%. There needs to be a middle ground.

– CDFI CFO

A growing number of for profit lenders (and relatively large amounts of capital) are entering the market and making loans at interest rates that are going to suppress the profitability, and resulting growth, of these small businesses.

– CDFI CFO

MCTF: Stakeholder Survey Top Line Findings: Role of Government

	Strongly Agree or Agree*	Strongly Disagree or disagree*
• There is no role for government incentives and/or subsidies in lending to Main Street	10%	86%
• Government programs should ensure that businesses in low-wealth communities have access to fairly priced capital	67%	5%
• Regulations and policy can change the flow of capital to Main Street	67%	0%
• Government incentives and subsidies designed to increase the flow of capital to Main Street have been successful at achieving their objectives	5%	29%
• Government programs should be used to bring early stage products for Main Street businesses to market	57%	5%
• Government subsidy of lending to Main Street risks crowding out private investment flows	5%	50%

*Based on a 7 point scale

Source: MCTF Survey

MCTF: Stakeholder Survey Top Line Findings: Investment Flows

	Strongly Agree or Agree*	Strongly Disagree or disagree*
• Private companies will deliver fairly priced financial products to business owners regardless of where the business is located	5%	57%
• Private investment and government subsidy can be combined effectively to increase lending to Main Street businesses	71%	14%
• Increasing the flow of capital to Main Street businesses will require public-private partnerships	52%	14%

*Based on a 7 point scale
Source: MCTF Survey

MCTF: Stakeholder Survey Top Line Findings: Likelihood of Engagement?

	Strongly Agree or Agree	Strongly Disagree or disagree
<ul style="list-style-type: none">• My organization would participate in government programs designed to test and scale new products	57%	5%
<ul style="list-style-type: none">• My organization would (or does) participate in government programs designed to lower the cost of capital for lending to Main Street businesses	67%	24%

*Based on a 7 point scale
Source: MCTF Survey