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BANKS & THE BLACK COMMUNITY

What Can Major Commercial and Retail Banking Institutions Do to Better
Support Black Entrepreneurs and Businesses in the U.S.?

Congressional Black Caucus Foundation
Bank of America

I. EXCEUTIVE SUMMARY

Despite the Economic Recession of 2008 and its resulting impact, African American businesses have grown exponentially in the 21st century.[2] Between 2007 and 2012, the number of black owned businesses increased by approximately 35 percent; and currently an estimated 2.6 million businesses in the U.S. are black owned.[3]

The majority (95 percent) of these businesses are sole proprietorships, where there are no paid employees. However, of that five percent that are employer firms, these businesses employed nearly one million people, an increase of 5.9 percent since 2007. Furthermore, the payrolls of black owned employer firms totaled $27.7 billion, an increase of 15.9 percent since 2007. With the total combined revenue of all black owned businesses (sole proprietorships plus employer firms) exceeding that of $150 billion—a nearly ten percent increase over a ten-year span (2007-2017)—black business ownership is on the rise, and continues to trend in a positive direction.

However, while African American business ownership remains on the rise and is continually increasing, growth has been incremental. In 2014, African Americans owned 2% of U.S. based companies. In 2017, this figure increased by 1.5%, with African Americans now owning 3.5% of all U.S. businesses. Despite this increase, black owned businesses continue to lag behind that of whites, and other minorities in terms of market share. In 2017, white owned businesses accounted for 81% of all U.S. companies, with Asian and Hispanic-owned firms comprising 9.7% and 5.8% of the market share, respectively.

In light of the lagging progress surrounding black business ownership, the author(s) of this report were tasked with the responsibility of identifying the barriers that African Americans encounter at the business startup phase that help explain why the rate of business ownership among African Americans has grown so slowly. In the earlier reports, *Crowdfunding, Cryptocurrency, and Capital: Alternative Sources of Business Capital for Black Entrepreneurs (March 2019) and The State of Black Entrepreneurship in America: Evaluating the Relationship between Immigration and Minority Business Ownership* (April 2019), we determined that barriers to capital, particularly start-up capital, are crucial to discouraging black business ownership. More specifically, poor credit worthiness, institutional discrimination, and low levels of social capital function as key obstacles for African Americans and depress black entrepreneurship.

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[2] Thomas, Jaia. "2018 Is Shaping Up as a Pivotal Year for African-American Entrepreneurship". Entrepreneur. (2018, May). Available at https://www.entrepreneur.com/article/313103

[3] Ibid

Nonetheless, despite these barriers, we also determined that African Americans have been innovative in their use of technology and social media to overcome these barriers to business ownership. Black entrepreneurs are increasingly leveraging crowdsourcing and equity crowdfunding platforms to circumvent institutional obstacles to capital; while social media has also allowed black entrepreneurs to forge extensive social capital networks, which are vital to business creation and growth. Furthermore, more black businesses, particularly those owned and operated by the younger generation, have begun to recognize the advantages of cryptocurrency; and that by accepting cryptocurrency (i.e. Bitcoin) as a method of payment, they are able to eliminate third-party intermediaries, credit card transaction costs, and decrease transaction processing time so that their businesses receive payment faster.

In sum, the findings of our earlier reports reveal that despite persistent obstacles, African American entrepreneurs have been innovative in bypassing these barriers in order to pursue business ownership. At the same time, these hurdles still serve as a barrier of entry for many African Americans who are interested in business ownership, but are discouraged from pursuing that path. As a result, entrepreneurial minded African Americans end up entering other industries as employees, which means that is one less black business created.

Given the known impediments to black business ownership, this report focuses specifically on how traditional financial institutions (i.e. large retail and commercial banks)[4] can better support potential black entrepreneurs as well as existing black owned businesses. Large financial institutions have extensive resources and capital to help develop and grow small businesses. We know that undercapitalized businesses are much more likely to report lower sales, profits and employment options, and are at a much greater risk of failing within the five-year startup period, compared to businesses that obtained sufficient startup and growth capital. However, if there is not an avenue for African American business owners to access the resources offered by large banking institutions then that further impedes the opportunity for this business sector to expand and grow.

This report utilizes data from a number of sources. Aggregate data from the Small Business Credit Survey for the years 2017, 2018 and 2019 are used to provide a comprehensive picture of the factors that encourage and discourage black business ownership. Self-report survey data from the annual performance reports on the 2017 activities (submitted in 2018) by the Community Development Financial Institution (CDFI)

[4] In this report, large banks, large financial institutions, traditional financial institutions, and (large) banking institutions are used interchangeably to refer to the Big Four banks (i.e. JPMorgan Chase, Bank of America, Wells Fargo, and Citigroup), and other large FDIC insured national retail and commercial banks (i.e. U.S. Bancorp, PNC Bank, BB&T Corporation and TD Bank). These types of financial institutions represent the major retail and commercial banking institutions in the U.S. today.

Fund, are also used to assess the cumulative impact of CDFIs on black business ownership. Survey data collected by the authors and obtained from a non-random captive sample of young-adult African American participants in a series of financial literacy workshops from June-August 2019 are also used to contextualize the experiences of potential black entrepreneurs. Descriptive statistical analysis is used to bring meaning to the data; and the summative findings from existing evaluative reports are used to supplement the analysis.

This analysis is designed to meet the following key objectives: 1) Highlight existing strategies that have been successful in promoting black entrepreneurship; and 2) Identify potential initiatives that could feasibly be implemented by large banks to have a tangible impact on the promotion of black business ownership. The study observations and findings are outlined in Section III of this report, and are accompanied by practical, corresponding recommendations in Section IV.

II. INTRODUCTION

Across all indicators, black business ownership is on a consistent upward trajectory, but progress has been slow. Data reveal that black owned businesses are significantly underrepresented (Figure 1). More importantly, when looking at empirical measures of parity, it is evident that the total number of black firms has lagged significantly behind relative population growth (Figure 2). Evaluating group parity relative to small business share is important because it is an easily measurable and trackable benchmark. Assessments of group parity have typically been used to denote aspirational outcomes. Universities, corporations, and even entire industries evaluate their diversity and inclusion initiatives along the standards of parity, and whether a group's representation within that space is equivalent to their representation in the larger population. In this case, African Americans would have small business parity if their proportion of small businesses in the U.S. approximated their proportion of the adult population in the U.S.[5] However, that is not the case.

Figure 1: Share of Small Business Ownership, by Race (2017)

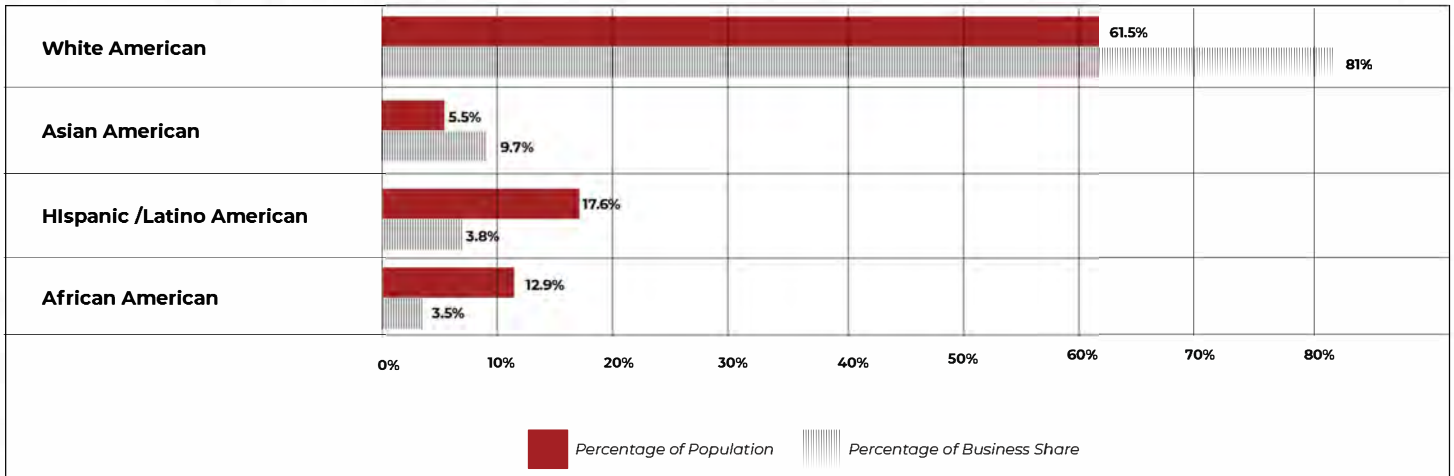
Source: The Partnership for Lending in Underserved Markets. https://milkeninstitute.org/sites/default/files/reports-pdf/PLUM-Capstone-Report.pdf

[5] Schulman, Carolyn. "The Partnership for Lending in Underserved Markets: Increasing Minority Entrepreneurs' Access to Capital." Milken Institute. (2018). Available at: https://milkeninstitute.org/reports/partnership-lending-underserved-markets-plum-increasing-minority-entrepreneurs-access

Across all indicators, black business ownership is on a consistent upward trajectory, but progress has been slow. Data reveal that black owned businesses are significantly underrepresented (Figure 1). More importantly, when looking at empirical measures of parity, it is evident that the total number of black firms has lagged significantly behind relative population growth (Figure 2).

In 2017, the adult age African American population in the U.S. was nearly 13 percent (12.9 percent). Consequently, for black entrepreneurship to be on par with population growth, approximately 13 percent of all U.S. businesses would also need to be black owned, and account for an equivalent percentage of total sales, employees, payroll, profits and revenue. Instead, however; in 2017 black business ownership accounted for just 3.5 percent of the market share (Figure2).

Figure 2: Percentage Share of Small Business Ownership Relative to Percentage of Population, by Race (2017)



Source: The Partnership for Lending in Underserved Markets. https://milkeninstitute.org/sites/default/files/reports-pdf/PLUM-Capstone-Report.pdf U.S. Census Bureau

To close this gap in parity and generate faster black business growth, there are several practical initiatives large financial institutions can implement or expand. However, they must be designed around an awareness of the main barriers that exist for African American business owners, and then operationalized to remove these barriers. Consequently, in the section that follows, Section III, we discuss our observations regarding these barriers and the tangible elements that can be effectively addressed to promote black business growth.[6]

[6] In our earlier reports we discuss in detail each barrier to African American business ownership, so we do not do this here. For a more detailed discussion of these barriers, see Howard, Tiffiany. (2019). Crowdfunding, Cryptocurrency, and Capital: Alternative Sources of Business Capital for Black Entrepreneurs. Available at: https://www.cbcfinc.org/wp-content/uploads/2019/03/CPAR-Report-Crowdfunding-Cryptocurrency-FINAL.pdf; Howard, Tiffiany. (2019). The State of Black Entrepreneurship in America: Evaluating the Relationship between Immigration and Minority Business Ownership. Available at: https://www.cbcfinc.org/wp-content/uploads/2019/05/CPAR-Report-Black-Entrepreneurship-in-America.pdf

III. Study Observations and Key Findings

A. Barrier 1: African American Credit Worthiness

Key Observation and Finding 1: The poor credit worthiness of African American entrepreneurs, relative to other racial and ethnic groups, is a function of a lack of financial literacy.

In our survey of young-adult (ages 18-30) African Americans interested in entrepreneurship, 82 percent of the respondents did not demonstrate financial literacy. The financial literacy indicator was generated by indexing responses to a series of questions that included, knowledge of one's own credit score, basic knowledge of the Minority Business Development Agency, basic knowledge of the Small Business Administration, and knowledge of the minimum years of operation (typically) required for a business owner to apply for a small business loan from a traditional bank.[7]

The requisite credit worthiness that is necessary to secure startup capital (and that is not accompanied by high fees and interest rates), requires an understanding of the factors lenders use to evaluate an individual's credit worthiness. The study results indicate that the majority of young African Americans interested in starting a business do not have a full comprehension of how to establish credit worthiness. Although, the survey is comprised of young African Americans, the findings of this study support the findings of other key studies, which indicate this knowledge deficit is not unique to black youth. The majority of African American entrepreneurs seeking startup capital struggle with financial literacy.

According to the Financial Literacy and Wellness among African-Americans report,[8] African American financial literacy lags behind that of whites. On average, African-Americans responded correctly to 38 percent of the Personal Finance (P-Fin) Index questions correctly, while whites responded correctly to 55 percent of the P-Fin Index questions. Additionally, only 28 percent of African Americans surveyed answered more than half of the Index questions correctly, while 62 percent of whites surveyed answered more than half of the Index questions correctly.[9]

[7] The study survey was conducted using a non-random sample of participants in three financial literacy workshops in June, July and August 2019 in Washington DC. N=68. The inclusion criteria were race (Non-Hispanic Black/African American), and age (18-30). Individual demographic data were not collected. For additional survey information, contact lead author at thoward@cbcfinc.org 8 Yakoboski, Paul J., Annamaria Lusardi, Andrea Hasler (2019). "Financial Literacy and Wellness among African-Americans: New Insights from the Personal Finance (P-Fin) Index." *TIAA and the Center for Global Financial Literacy Excellence*. Available at: https://gflec.org/initiatives/financial-literacy-and-wellness-among-african-americans/ 9 Ibid

Therefore, our key observation here is that poor credit worthiness is the result of a lack of financial literacy across the African American lifespan. Poor financial literacy is an educational issue, and there are existing programs and institutions that are capable of addressing this issue. In the findings and recommendations section we discuss specifically how banks can directly support African American entrepreneurship and help remove the barrier of poor credit worthiness by partnering with and investing in HBCU Entrepreneurial Development Centers[10] and through the expansion, enhanced marketing, and targeted advertisement of Individual Development Account (IDA) services.

B. Barrier 2: Institutional Discrimination

Key Observation and Finding 2a: CDFIs are currently the most optimal vehicle for banks to address institutional discrimination as a barrier to African American business ownership.

Institutional racism and discrimination cannot be addressed by any one program, policy or institution. However, to combat the structural elements of racism and discrimination that are pervasive in our political, economic, and social institutions; counter-institutions must be constructed that effectively promote equity and equality. CDFI's are one such counter-institution.

CDFIs are private financial institutions that provide development services and capital to assist the residents of underserved communities. CDFIs can be banks, credit unions, loan funds, microloan funds, or venture capital providers. CDFIs trace their origins to President Johnson's administration, with the establishment of community development corporations (CDCs). The purpose of CDFIs, then and now, is to provide loans and investments that promote economic growth in lower to middle income communities by creating permanent jobs, affordable housing, investing in small businesses and new entrepreneurs, and expanding health, educational, and social services. CDFIs are helping families finance their first homes, they are supporting community residents by helping them start businesses, and they are investing in underserved communities by economically developing local health clinics, schools, and community centers. The overarching goal of CDFIs is to foster economic opportunity and revitalize neighborhoods.

Although there are flaws within the CDFI model, which will be discussed in Section IV, overall, CDFIs have had a measurable impact on the economic development of African American communities, and have been directly involved in providing startup capital to a number of black owned businesses. Further, given that banks[11] are now the largest source

[10] Entrepreneurial Development Centers (EDCs) is a specific term used in Adebayo, Arinola O., Adeyemi A. Adekoya, and O. Felix Ayadi. "Historically black colleges and universities (HBCUs) as agents of change for the development of minority businesses." *Journal of Black Studies 32.2* (2001): 166-183. See page 174.

[11] Although banks are predominant, thrifts and credit unions, also comprise this category.

of funding for CDFI's, there is currently a vehicle through which large financial institutions can support black owned businesses. Nonetheless, revisions to the CDFI model are necessary if banks are committed to promoting a faster rise in the number of African American businesses; and one such revision, which is discussed in Section IV, is entirely within the purview of the banks.

Key Observation and Finding 2b: Using a fully or semi-automated process would help remove human bias from the small business loan approval process.

Artificial Intelligence (AI) technology has been used across a number of financial platforms—some, for many years.[12] Most notably, AI has been evident with the use of algorithms to trade stocks, machine learning to detect financial fraud, and intelligent automation to manage portfolios. More recently, AI is being used to establish credit worthiness and assist companies in making lending decisions. ZestFinance, Underwrite.ai, Upstart, and Lenddo are just a few of the AI firms that have partnered with corporations such as Ford Motor Services Company[13], Synchrony Financial, and Discover Financial Services[14] to improve the loan approval process and reduce the rate of loan default.

Furthermore, Amazon has been using machine learning data to identify eligible small businesses in order to provide these companies with a small business loan; while the Royal Bank of Canada and Ally Bank have been using cognitive banking company, Personistic, to make student loan decisions, as well as help borrowers pay off their student loans quicker. Personistic uses machine learning to analyze an individual's financial habits to assist the Royal Bank of Canada and Ally Bank with making student loan offers. Also, both the Royal Bank of Canada and Ally Bank are currently considering how Personistic can be used for the small business loan process.

At present, the traditional loan application process through a bank, is considered arduous and cumbersome. While the application can be started online, it must be completed at a physical bank, in person with a loan officer, and involves the collation of a number of documents. The entire process is time consuming, which, when surveyed, small business owners indicate that time is already scarce, and especially during the early stages of starting a business. Therefore, when considering the time involved in preparing the loan application, along with multiple visits to the lending banks, only to be denied, it ultimately does not translate into a productive use of a small business owner's limited time.

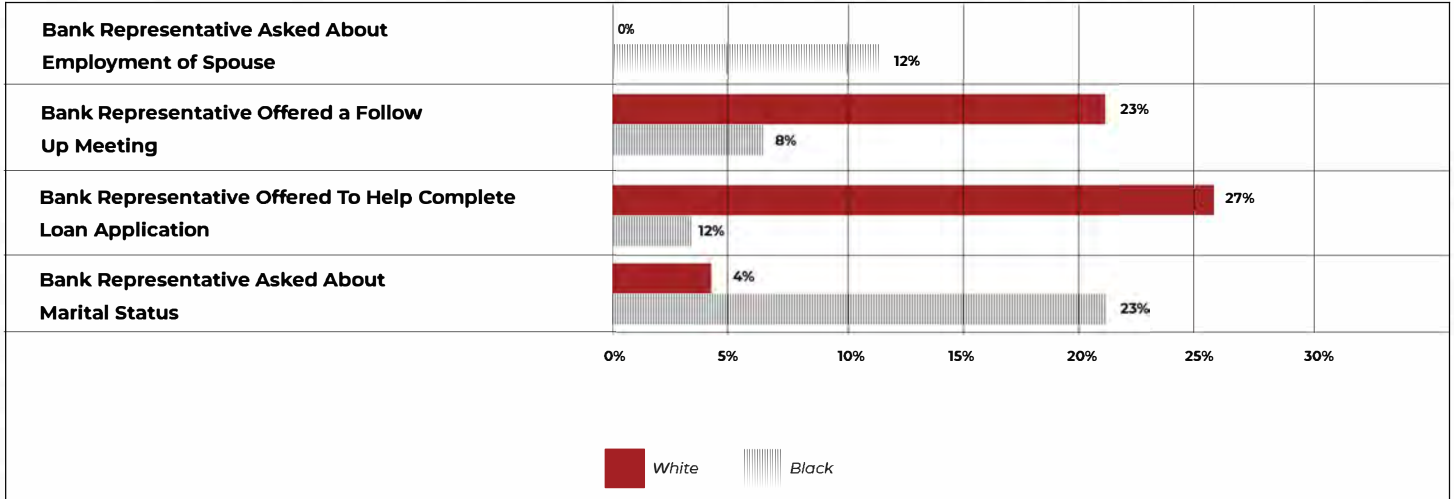
[12] Faggella, Daniel. "Machine Learning in Finance–Present and Future Applications." Emerj. (2019, October). Available at: https://emerj.com/ai-sector-overviews/machine-learning-in-finance/

[13] Ward, Paris. "Some lenders have started using AI to reduce risk, change approval process". Credit Karma. (2019, March). Available at: https://www.creditkarma.com/insights/i/some-lenders-using-ai-boost-business-improve-approval-process/

[14] Andriotis, Anna-Maria. "Shopping at Discount Stores Could Help Get You a Loan". The Wall Street Journal. (2019, March). Available at: https://www.wsj.com/articles/use-a-landline-that-could-help-you-get-a-loan-from-discover-11551695400.

In addition, institutional discrimination and racism are promulgated by individuals, and individuals are a central component of the traditional loan process. More often than not, a single individual is conferred the responsibility of making the final decision on a small business loan. A number of studies have found empirical evidence that loan officers in the position of making small business lending decisions have engaged in discriminatory practices with respect to African American business owners (Figure 3). Therefore, the potential with using AI technology, is that it would minimize the negative impact human bias has on the loan decision process.

Figure 3: Personal and Financial Scrutiny of Black Entrepreneurs and White Entrepreneurs



Source: Bone et al., 2017; Compiled by author.

C. Barrier 3: Social Capital Deficit

Key Observation and Finding 3: Supportive networks and institutions that invest in and support African American business ownership are beginning to address the social capital deficit among African Americans.

The social capital deficit among African Americans disadvantages up and coming black entrepreneurs as well as established black business owners. Small business owners rely upon social networks to acquire startup capital, promote their business, and expand their consumer base. Although, black entrepreneurs and business owners are taking initiative and using social media platforms to overcome this social capital deficit, there are still opportunities for banks and large financial institutions to also address the social capital deficit that negatively impacts black entrepreneurs.

One of the ways that banks can do this involves investing in supportive institutions that promote black businesses and African American entrepreneurship; and this can largely be done by funding mission driven programs that provide startup capital and technical resources to African American entrepreneurs. Banks currently invest in supportive institutions, such as CDFIs which lend to black businesses and provide black entrepreneurs with technical assistance. However, large banks can do more to promote these supportive institutions by incentivizing the same lending and training institutions they partner with to engage in more diverse hiring practices across positions of leadership. In addition, large banks and financial institutions can also expand their contributions to the types of organizations that "might [directly] contribute to developing entrepreneurial ecosystems" such as HBCUs and their Entrepreneurial Development Centers.[15]

Supportive institutions are the vehicles through which social trust and social capital are cultivated. And there are many unexplored areas where banks can better develop the supportive institutions that are the most directly involved in helping to create and sustain black businesses. This report focuses on the continued investment in CDFIs, and how diversifying the CDFI leadership can help build a deeper social network of investors for black entrepreneurs. In addition, this study highlights the importance of funding those organizations that are committed to developing a broader culture of black entrepreneurship, such as Entrepreneurial Development Centers at HBCUs, which in addition to being incubators for innovations in entrepreneurship, these Centers also represent hubs for networking.

IV. Key Recommendations

The preceding section, Section III, outlines our observations regarding the major barriers that African American entrepreneurs face when starting, maintaining and growing their businesses. In Section III we also identify our key findings surrounding these observations in an effort to develop practical recommendations that large national retail and commercial banks can use to promote the growth of black business ownership in the U.S. In this section, Section IV, we discuss these key recommendations, and our rationale for each one.

[15] Myers, Spectra, and Pamela Chan. "Stuck from the Start: The Financial Challenges of Low-and Moderate-Income African-American Entrepreneurs in the South." *Prosperity Now*, July (2017). Available at: https://prosperitynow.org/files/PDFs/07-2017_stuck_from_the_start.pdf

Key Recommendation 1: Partner with Entrepreneurial Development Centers at HBCUs

Historically Black Colleges and Universities (HBCUs) have played, and continue to play, a central role in the education, training, and professional development of African Americans. Also, due to historic patterns of geographical segregation, HBCUs are generally located in predominantly African American communities, which has led to HBCUs fulfilling governmental responsibilities, such as the provision of goods, resources and services, when municipalities have neglected these communities.

Given the centrality of HBCUs to the advancement of African American students and the larger black community, several initiatives have focused on developing business partnerships with these institutions. For instance, in 2014, the Association of Public and Land-grant Universities (APLU), VentureWell, the United States Patent and Trademark Office (USPTO) and the United Negro College Fund (UNCF) partnered with fifteen public and private HBCUs to establish the HBCU Innovations and Entrepreneurship Collaborative (i.e. HBCU Collaborative).[16]

The HBCU Collaborative is a multi-year project that fosters innovation, commercialization, and entrepreneurship on the campuses of the member institutions. Since its inception, there have been several positive outcomes. One of the more direct results is the annual summit held by the HBCU Collaborative. This annual summit takes place every year in Silicon Valley, and is where college students from the member institutions have the opportunity to network with businesses and tech hubs from across the country. Another positive outcome has been the impact the creation of the Collaborative has had on other HBCUs. As a result of the establishment of the Collaborative, non-member HBCUs have been prompted to launch entrepreneurship centers on their own campuses (i.e. the Center for Entrepreneurship Studies at Bennett College, the Entrepreneurship Academy at Bowie State). Also, member institutions of the Collaborative have gone on to establish their own collaborations with other non-member institutions (i.e. The Capital Builders Center between Morgan State University, Bowie State University, and the University of the District of Columbia).

Recognizing the importance of creating entrepreneurial hubs on HBCU campuses, in May 2019, Congressional Black Caucus (CBC) member, the late Representative Elijah Cummings (MD), introduced legislation out of the House Committee on Small Business to “establish a pilot program at the Small Business Administration that grants awards to HBCUs to establish an entrepreneurship curriculum and placement of a Small Business Development Center on the physical campus of the institution,” (H.R. 2981, p. 1).

[15] Myers, Spectra, and Pamela Chan. "Stuck from the Start: The Financial Challenges of Low-and Moderate-Income African American Entrepreneurs in the South." *Prosperity Now*, July (2017). Available at: https://prosperitynow.org/files/PDFs/07-2017_stuck_from_the_start.pdf

Since the bill's introduction, the legislation has been referred to the Committee on Education and Labor, where it currently remains under review. The introduction of this legislation—especially in light of the ongoing collaborations between HBCUs and private industry—illustrates that many societal sectors understand the significance of stimulating entrepreneurship in the black community, with HBCUs at the center

Therefore, we recommend that financial institutions promote African American entrepreneurship and business development through collaboration and partnership with HBCUs. The main criticism against such a proposal is that only nine percent of African American students attend one of the 101 HBCUs, and they award less than a quarter (22%) of all bachelor's degrees granted to African American students; therefore, HBCUs are no longer educating and graduating the majority of black students.

At the same time, while HBCUs may not serve the majority of African American students, they have measurably higher retention and six-year graduation rates for African American students, in comparison to predominantly white institutions (PWIs).[17] In addition, nearly half (40 percent) of the current African American congressional leaders graduated from HBCUs[18]; half of all African American lawyers and half of all African American professors who teach at non-HBCU institutions graduated from an HBCU; forty percent of all black engineers and forty percent of all black health professionals graduated from an HBCU; half of all the African American teachers graduated from an HBCU; eighty percent of all African American judges in the U.S. graduated from an HBCU; ninety percent of all African Americans with bachelor's degrees in a STEM field graduated from an. HBCU; and lastly, 12.5 percent of all African American CEOs graduated from an HBCU (Figure 4).[19]

Figure 4: Percentage of HBCU Graduates Among African Americans in Each Profession (2017)

Source: Congressional Black Caucus. https://cbc.house.gov/cbcontheyard/; Thurgood Marshall College Fund. https://www.tmcf.org/about-us/our-schools/hbcus

[16] The HBCU Collaborative institutions include: 1) Clark Atlanta University, 2) Fayetteville State University, 3) Florida A&M University, 4) Hampton University, 5) Howard University, 6) Jackson State University, 7) Morehouse College, 8) Morgan State University, 9) North Carolina A&T University, 10) Prairie View A&M University, 11) Tuskegee University, 12) University of Maryland Eastern Shore, 13) University of the Virgin Islands, 14) Virginia State University, 15) Xavier University of Louisiana

[17] Nichols, Andrew H., and Denzel Evans-Bell. "A look at Black student success: Identifying top-and bottom-performing institutions." (2017). Available at: https://vtechworks.lib.vt.edu/bitstream/handle/10919/83663/ALookAtBlackStudentSuccess.pdf?sequence=1

[18] As of 2017

[19] See Congressional Black Caucus. https://cbc.house.gov/cbcontheyard/; Thurgood Marshall College Fund. https://www.tmcf.org/about-us/our-schools/hbcus

What these figures indicate is that a substantial proportion of African American political, business and industry leaders in the U.S. have been educated at an HBCU; therefore, investing in Entrepreneurial Development Centers at HBCUs would have a tangibly significant impact on increasing the number of black entrepreneurs and black businesses in the U.S., more so than any other initiative discussed in this report.

Key Recommendation 2: Develop and Expand IDA Services

Individual development accounts (IDAs) are savings accounts that allow low-income families[20] to save money toward a specific goal, such as purchasing a home, paying for college, or starting a business. IDAs are matched savings plans, similar to a 401K in that the program's sponsor matches the individual's contribution. The main purpose of an IDA is to support asset building for low-income families and help narrow the wealth gap for minorities in the United States.

IDAs emerged in the U.S. in the nineties in response to criticism regarding existing anti-poverty policies. Programs, such as Temporary Assistance for Needy Families (TANF) and the Supplemental Nutrition Assistance Program (SNAP), are essential to supporting low-income families, but are designed to address short-term financial constraints. However, accumulating financial assets, such as buying a home or establishing a savings, investment, and/or retirement account, creates long-term solutions for families, and allows them to build wealth, which can be passed on to subsequent generations. In addition, an IDA, which is considered an asset-based program, arms participants with financial literacy knowledge they can use to make better financial decisions in all areas of their lives, and most importantly, it is information they can share with their children in order to promote and sustain generational wealth.

Initially, IDAs were funded under the mandate of the Assets for Financial Independence Act (AFI), and competitive grants were made to non-profits, faith-based institutions, and organizations designated by the Department of Treasury as CDFIs.

[20] A low-income family is defined as a family that lives at or below the poverty threshold as determined by family size and income level. With respect to African Americans, more than one-third of African Americans (36 percent), including 38 percent of black women, are employed in low wage jobs (i.e. jobs earning wages at or below the poverty level). See Appendix, Figure 1 for the most recent data on the poverty rate for each racial/ethnic group in the U.S.

At present, the program has been suspended and funds have not been appropriated since 2017, despite an impact report conducted by the Urban Institute,[21] which determined there were beneficial effects directly attributable to program participation. For example, individuals opened IDAs with an average of $528, but over a mean participation time of 24.5 months, the average participant had accumulated a total of $2,755. And overall, there was a 34.5 percent reduction in the number of emergency financial hardships faced by participants, a four percent decrease in participant use of non-bank financial services, and a seven percent increase in the share of participants with liquid assets.

Despite evidence that IDAs have had a tangible, measurable and sustained impact on poverty reduction and asset building for participants, the program was suspended due to two main criticisms. First, from its inception, the program was underfunded by the government, and program sponsors (i.e. participating non-profits) relied heavily on program donations to sustain operations. And second, while IDAs were the cornerstone of the AFI program, these services were accompanied by additional educational resources to improve participant financial literacy. Although, financial literacy is critical to any program's success, and necessary for the administration of an asset building program, the AFI guidelines made this financial literacy component a mandatory criterion for participating organizations, and left little flexibility for how this criterion could be met. As a result, this stipulation contributed extra costs to the program that made continuation inefficient and unsustainable.

Although, there were flaws in the federally supported IDA program, the asset building model of IDAs is promising and sustainable. Also, there are many positive benefits for banks that offer IDA services. First, banks can use IDAs to access new markets by building relationships with individuals who have limited to non-existing banking relationships.

As a result of offering IDAs, while the initial investment may not be profitable, in the long-term the customer now has a formal banking relationship through a modest savings account (IDA), which they can continue to grow, and as that asset grows, banks will have the opportunity to expand this relationship and offer customers additional products, such as small business checking accounts, small business credit accounts, and small business loans. There is tremendous potential in IDAs, but of all the recommendations presented in this report, this one carries with it a higher level of financial risk to banks, and the return on their investment would be most evident in the long-term, but not in the short-term.

Key Recommendation 3: Continue to Invest in CDFIs and Set Aside Funding Specifically for CDFIs that Operate Under A Diverse Leadership Structure

A number of impact analyses have been conducted across multi-year time periods by a number of government entities and research organizations, including the CDFI Fund, the Opportunity Finance Network, the Aspen Institute, Brookings, and the Urban Institute; and what these studies have all determined is that across nearly all measures, CDFIs have been successful in meeting their benchmark of promoting economic development in minority and underserved communities.[22]

- The Brookings report found that since the initial granting of awards in 1996, that as of 2001, CDFIs had provided more than $29 billion in financing; and of the 81 CDFIs that (at that time) managed $1.8 billion in financial assets, they had provided more than $2.9 billion in loans and investments, with a 1.8 percent cumulative loss rate, a low rate of default, and zero losses of investor principle.[23]

- The CDFI Fund report[24] examined 333 CDFIs over a ten-year time period (2003-2013) and determined that CDFI funding led to the following:

  · **63,249** permanent jobs and **47,866** construction jobs were created

  · **159,739** units of affordable rental housing were created and **23,302** units of affordable housing were redeveloped or preserved

  · **515,384** educational facility seats were created

[22] Balboni, Elise and Travers, Christina. CDFIs and Impact Investing: An Industry Review (2017). Available at: https://www.newyorkfed.org/medialibrary/media/outreach-and-education/2017/CDFIs-Impact-Investing.pdf

[23] Pinsky, Mark. "Taking stock: CDFIs look ahead after 25 years of community development finance." Capital Xchange (2001). Available at: https://community-wealth.org/sites/clone.community-wealth.org/files/downloads/paper-pinsky_0.pdf

[24] Swack, Michael E.; Hangen, Eric; and Northrup, Jack, "CDFIs Stepping into the Breach: An Impact Evaluation—Summary Report" (2015). The Carsey School of Public Policy at the Scholars' Repository. 236. Available at: https://scholars.unh.edu/carsey/236

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Community Development Financial Institutions Fund. (2017). CDFI Certification. Available at: Community Development Financial Institutions Fund, U.S. Department of the Treasury: https://www. cdfifund.gov/programs-training/certification/cdfi/Pages/default.aspx Community Development Financial Institutions Fund. (2017). Introduction to the New Markets Tax Credit Program. Available at: Community Development Financial Institutions Fund, U.S. Department of the Treasury: https://www.cdfifund.gov/Documents/2017%20Introduction%20to%20 NMTC%20Program%20Presentation%20For%20Release.pdf

- **31,895** child-care facility seats were developed
- **66,402** capacity unit increase in Community-arts facilities
- **13.4 million** square feet of office space was created
- **4.7 million** square feet of retail space was created
- **1 million** square feet of manufacturing space was created

- The Opportunity Finance Network report evaluated their two-hundred member CDFIs over a thirty-year time period (1985-2015) and determined that 73 percent of the people who received loan investments were low-income, 48 percent were minorities, 48 percent were women, and 25 percent were rural residents.

- Overall, the success of CDFIs has illustrated several key points with substantive implications for black entrepreneurs:

  - Investing in women and people of color, and providing the financing to Investing in women and people of color, and providing the financing to allow them to purchase a home and start a business is profitable
  - Race and gender do not serve as sufficiently reliable measures of financial performance
  - Financial risk has evolved with changing parameters (i.e. providing technical support to minority business owners has lowered risk) while financial risk assessment models remain outdated
  - Community-based financial organizations are capable of generating and managing capital and investing it to have tangible and measurable community impact
  - Perceived high risk customers (i.e. individuals who would benefit most from IDA services) are important to banking institutions because of the future potential these customers present.

Inarguably, CDFIs have had a direct impact on increasing the number of black businesses in the U.S.[25] The incidence of new business creation by entrepreneurs of color currently exceeds that of whites, and remains on an upward trajectory.[26] However, CDFIs are not perfect, and there are areas for improvement. For example, while African Americans (and Hispanics/Latinos as well) are successfully creating new businesses, they continue to experience challenges with growing and expanding their businesses. This is because black business owners have comparatively less wealth. Therefore, African American entrepreneurs face constraints when seeking external capital and operate their business with less than optimal levels of equity.

In this regard, large banking institutions are well positioned to support CDFIs and assist them in expanding their impact by addressing this problem facing black businesses. Although, large banks should certainly continue investing in CDFIs, the recommendation here is that banks should also commit a specific percentage of their lending funds to CDFIs that directly invest in black owned businesses and startups. And one mechanism for doing this effectively is to identify and invest in CDFIs led by African Americans and other minorities (Table 1).

Returning to the previously mentioned 2014 CDFI Fund report, of the 244 CDFI loan funds for which data were collected, fifty-three, or 22 percent, were owned or controlled by people of color.[27,28,29] And the mean total assets of the CDFIs operated by people of color was $14.1 million, while their cumulative total assets were $749.6 million, which accounted for 10 percent of all assets for the 244 CDFI loan funds included in the analysis. In comparison, the mean total assets for CDFIs led by whites, was $36.4 million, and their cumulative total assets were nearly $7 billion, which accounted for 90 percent of all assets for the 244 CDFI loan funds included in the analysis.

The Opportunity Finance Network identifies similar disparities and echoes the findings of the CDFI Fund.[30] Of the average CDFI, thirty-three percent of the staff are comprised of people of color, and the numbers decline for positions of leadership. The board composition of the average CDFI is twenty-eight percent minority, and only seventeen

[25] Expanding Black Business Credit Initiative. Creating Viral Impact in Black Communities through Small Business Expansion. (2016). Available at: https://nextcity.org/pdf/EBBC_Report.pdf

[26] Klein, Joyce A. "Bridging the Divide: How Business Ownership Can Help Close the Racial Wealth Gap." FIELD at the Aspen Institute (2017). Available at: https://assets.aspeninstitute.org/content/uploads/2017/01/Briding-the-Divide.pdf

[27] Long, Lenwood V. CDFIs Led by People of Color Face Financial Disparities Too. (2017). Available at: https://shelterforce.org/2017/08/23/15028/

[28] Barber, Ruth. "Perception versus Reality: Women and Change in the CDFI Industry." FUND Community Institute. (2018). Available at: http://www.fundconsulting.com/wp-content/uploads/2018/10/FUNDCI-Perception_vs_Reality.pdf

[29] Swack, Michael E.; Hangen, Eric; and Northrup, Jack, "CDFIs Stepping into the Breach: An Impact Evaluation—Summary Report" (2015). The Carsey School of Public Policy at the Scholars' Repository. 236. Available at: https://scholars.unh.edu/carsey/236

[30] Network Opportunity Finance. Twenty Years of Opportunity Finance: 1994-2013: An Analysis of Trends and Growth. (2015). Available at: https://ofn.org/sites/default/files/OFN_20_Years_Opportunity_Finance_Report.pdf

percent of CDFIs are comprised of a majority female and/or minority board. Furthermore, patterns of inequity in CDFI leadership have barely shifted in the twenty-year period (1994-2014) for which the Opportunity Finance Network collected data (Table 1).

Table 1: Opportunity Finance Network Member CDFIs Led by Underrepresented Racial/Ethnic Minorities, 1994-2014

CDFI LEADERSHIP	# OF CDFIS	% OF CDFIS
1994		
CDFI Lead by People of Color	4	10%
CDFI Lead by Whites	38	90%
2004		
CDFI Lead by People of Color	13	9%
CDFI Lead by Whites	127	91%
2013		
CDFI Lead by People of Color	34	16%
CDFI Lead by Whites	175	84%

Source: Network Opportunity Finance. Twenty Years of Opportunity Finance: 1994-2013: An Analysis of Trends and Growth. (2015). Available at: https://ofn.org/sites/default/files/OFN_20_Years_Opportunity_Finance_Report.pdf; See page 20

Note: This table does not include data from CDFI Banks (i.e. CDBs), which are not-for-profit banks

This disparity in CDFI leadership has significant implications for minority business owners:

> "CDFIs led by people of color are central to reducing inequalityand revitalizing communities. These CDFIs, often relatively smaller in size, maintain close ties to the communities they serve and more often than not, have [deep] roots within these communities. They [also] have a deep knowledge of the challenges these communities face. With limited resources, these smaller CDFIs leverage their roots to help level the playing field and support the revitalization of communities of color. Community members see themselves reflected in the leadership, staff, and board of directors of these CDFIs, which engenders trust. [And] these CDFIs can often leverage this social capital to bring stakeholders together to overcome the specific challenges faced in communities of color."[31]

Given that CDFIs, led by people of color, have extremely close community ties, they are more aware of the unique challenges facing their consumer business owners, and can tailor their programs and products to meet their applicants' specific needs to ensure business success and longevity. For example, the Carolina Small Business Development Fund (CSBDF) and their Carolina Small Business Cares, is a working model, where a minority led CDFI has been successful in meeting the specific needs of the black and Latino small business owners in its community. Most notably, in 2017 the CSBDF opened the Innovation and Entrepreneurship Center in southeast Raleigh, in partnership with HBCU Shaw University to serve the predominantly African American neighborhood and provide expanded opportunities to young and emerging entrepreneurs, as well as support existing minority business owners. This initiative also highlights the significance of establishing Entrepreneurial Development Centers at HBCUs, which is discussed in Key Recommendation One. [32]

In comparison to large CDFIs, with a predominant white leadership, CDFIs led by minorities tend to be small and have less assets. They also have comparatively weaker balance sheets, less extensive partnerships, and their programs have not been in operation for a significant period of time to assess impact. Therefore, when competing for national funding opportunities, minority led CDFIs are at a disadvantage, because they represent a greater risk for funders. As the single largest contributor to CDFI loan funds (approximately 40 percent of CDFI funding comes from large banking institutions)[33]; banks can address the lack of diversity in CDFI leadership by taking a flexible and individualized approach to funding minority led CDFIs.

If banks are committed to addressing the equity and capital disadvantages of minority led CDFIs, and by extension are equally committed to promoting faster growth in black business ownership, then banks will need to make intentional efforts in partnering with CDFIs led by people of color.

Key Recommendation 4: Adopt AI Technology Across Small Business Platforms

A recent study[34,35] on the future of work in the United States and how the shifting labor market will affect African Americans has signaled that increasing reliance upon artificial intelligence (AI) automated technology will only widen the racial wealth gap. Research in this space isn't new, but the findings of the McKinsey report provided figures, which readers could easily digest.

[32] CSBDF has also established the Programa Empresarial Latino, which serves the entrepreneurial needs of the burgeoning Hispanic/Latino community in North Carolina. This program is operated by the CSBDF's bilingual and bicultural staff, thus illustrating a key understanding of their community and its evolving needs.

[33] Network Opportunity Finance. Twenty Years of Opportunity Finance: 1994-2013: An Analysis of Trends and Growth. (2015). Available at: https://ofn.org/sites/default/files/OFN_20_Years_Opportunity_Finance_Report.pdf

[34] Vanian, Jonathan. A.I.s Negative Impact on African American Workers: Data Sheet. (2019). Available at: https://fortune.com/2019/10/09/a-i-and-automations-chilling-effect-on-african-american-workers-data-sheet/

The authors of the study determined that by 2030 white workers would be displaced by automation at a rate of 22.4 percent, while African American worker displacement is only slightly higher at 23.1 percent.

Without delving too deeply into the study's weaknesses, the authors and others fail to make two key observations in their overestimation of the impact of automation on the American workforce. First, with the exception of the manufacturing industry, there are greater demands for human labor as the aging population continues to increase at an exponential rate.[36] And second, the increase in automation demand is consistent with the increase in the rate of workers choosing to self-automate their jobs. With workers increasingly prioritizing time with families, and work-life balance, these individuals are using automation to improve their productivity, manage mundane labor-intensive tasks, and remove the necessity for in-person meetings. Thus, it is not a surprise that as automation use has risen, telecommuting and teleworking have followed similar patterns—increasing by 115 percent across a ten-year time period (2007-2017).

Consequently, while automated technology will displace predominantly manufacturing workers, other labor sectors that can't be efficiently automated, and where human discretion and decision making are essential, those industries will grow.[37] Further, instead of displacing African American workers, automation has the potential to significantly improve the quality of life for African American families, without diminishing worker productivity. However, for the latter to be realized, it is critical that assessments of the future impact of automation on the black community be approached not from an adversarial position, but from one that is innovative and expansive. Building upon this assertion, the recommendation here explores how banks can use automated technology to improve the small business loan process for African Americans and remove human bias. Also, while not discussed in this report, over the past two decades there has been a marked and steady increase in the number of African American businesses entering the technology and AI sectors[38,39,40] indicating that black entrepreneurs recognize the benefits of automation and are poised to take advantage of this technological advancement.

It is no secret that with respect to providing small business loans, for banks there is a small profit of return on their investment. Nonetheless, banks continue to grant loans to small business owners because of the potential to grow that relationship. As discussed in preceding sections, in the short-term, while not all financial products offered by banks will yield a substantial profit, the long-term potential is what most banks are investing in when they invest in a small business.

[36] Department of Labor. Fastest Growing Occupations, 2018-2028. Available at: https://www.bls.gov/ooh/fastest-growing.htm

[37] Ibid

[38] Anthony, Robert. "Funding Black Tech Entrepreneurs." Network Journal 23.4 (2016): 10-12

[39] "Black Tech Week to Expand Support for Black Entrepreneurs with $1.2 Million from Knight Foundation." Westside Gazette [Ft. Lauderdale, Fla.] 2017: 13

[40] Judith Messina. "Minority Tech Founders Seek VC Connections; Black and Latino Entrepreneurs Push an Insular and Often Risk-averse Industry in New Directions." Crain's New York Business 30 (2014): 0003.

Establishing trust and loyalty, and building upon that relationship, ultimately leads consumers to utilize additional products from their lending institution. Consequently, for banks, the goal is to make small business loans to low-risk businesses, and over time develop a mutually beneficial relationship with the small business owner. The main problem with this model, is that currently, loan processing and approval is done manually by human beings. As a result, the process is inefficient, both with respect to time and costs, which further decreases the profit margin for banks. However, for African American entrepreneurs, this model puts them at a significant disadvantage given all of the evidence that racism, discrimination, and bias factor into the small business loan approval process.[41.]

The recommendation here is that if banks are committed to increasing the rate of black business ownership, they will begin to automate all, or significant parts, of the small business loan processing and approval process. The expectation is that automating this process will remove an element of human bias. At the same time, using AI technology for this task is more cost and time efficient for banks.

Automated decision making can lead to more responsible banking practices, overall. By using an algorithm, the process is more objective, and resistant to biases, which ensures compliance. Furthermore, the entire process would now be more transparent, and business owners would have the ability to track each step of the process. Therefore, even if a business owner is ultimately denied, they can use the feedback provided to strengthen their credit profile. Also, transparency engenders trust, and consumers are more likely to utilize a bank and their products if they believe they can trust the institution.

There are many advantages to automating the small business loan process. However, there are also disadvantages. First, algorithms are created by humans, therefore, there is the potential that the human creator will inject the same human bias into the algorithm, which could continue to exclude African Americans and other minority business owners. Second, there is the problem that lenders will never allow for the complete automation of the loan process; therefore, human beings will still be required at some stage, which then diminishes the impact of automating the process. Lastly, with all technology, the automated loan process would also now be vulnerable to hacking, doxing, and other forms of cybersecurity breaches and information theft.

Of all the recommendations presented in this report, this one is the most speculative; therefore, it is currently not possible to assess the impact of using AI to automate the small business loan approval process.

[41] See Howard, Tiffiany. (2019). Crowdfunding, Cryptocurrency, and Capital: Alternative Sources of Business Capital for Black Entrepreneurs. Available at:

https://www.cbcfinc.org/wp-content/uploads/2019/03/CPAR-Report-Crowdfunding-Cryptocurrency-FINAL.pdf; Howard, Tiffiany. (2019). The State of Black Entrepreneurship in

America: Evaluating the Relationship between Immigration and Minority Business Ownership. Available at:

https://www.cbcfinc.org/wp-content/uploads/2019/05/CPAR-Report-Black-Entrepreneurship-in-America.pdf

V. Conclusion

The aim of this report has been to outline tangible, practical strategies that banks could implement in order to have a measurable impact on increasing the number of black-owned businesses in the U.S. To develop these strategies, we first had to reflect on the existing challenges that black business owners encounter. In earlier studies, we discovered that black entrepreneurs consider the lack of startup and growth capital to be their biggest impediments. We also determined that African American business owners face these startup and growth capital constraints because they have comparatively poor credit worthiness, comparatively low levels of social capital, and they must contend with institutional racism and discrimination when trying to obtain a small business loan from banks.

Several study observations were made that led to several key findings; and the aggregation and synthesis of this information helped us frame our recommendations. First, we determined that the poor credit worthiness of African American entrepreneurs, relative to other racial and ethnic groups, was a function of a lack of financial literacy. Second, that CDFIs have a proven record of investing in African American businesses. Third, that automating the small business loan process would remove the human element that contributes to the biases, which disadvantage black business owners when seeking a loan. And lastly, the supportive networks and institutions, such as faith-based institutions, HBCUs, and community non-profits, which invest in and support African American business ownership are beginning to address the social capital deficit among African Americans.

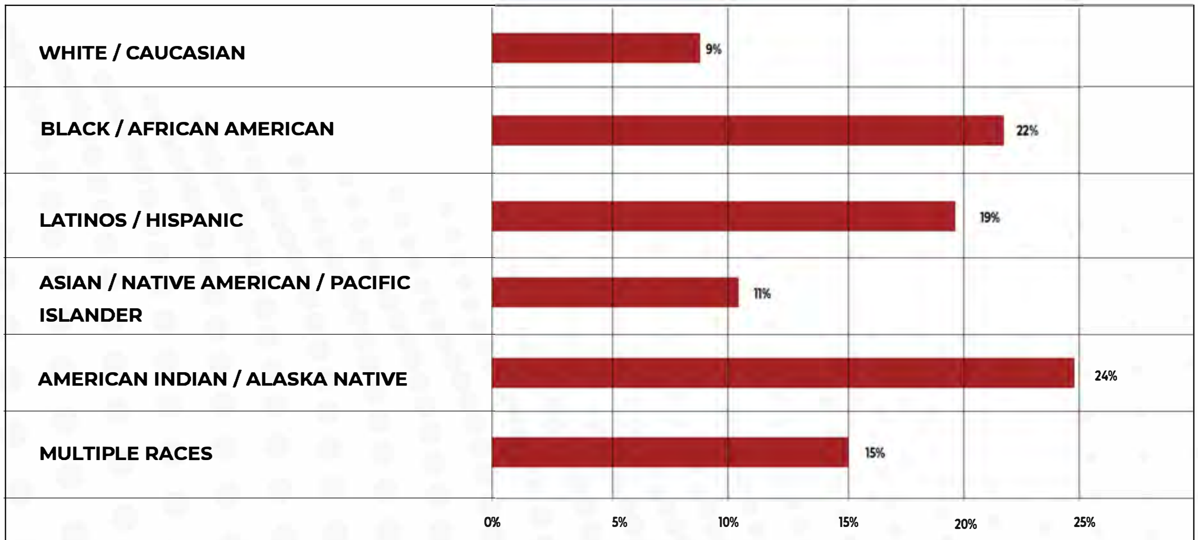
In consideration of the barriers we identified, the observations that were made, and the key findings of the study, we developed the following four recommendations:

- Partner with HBCUs (and other entities) to establish Entrepreneurial Development Centers at HBCUs
- Expand IDA Services
- Continue to Invest in CDFIs and Set Aside Funding Specifically for CDFIs that Operate Under A Diverse Leadership Structure
- Adopt AI Technology Across Small Business Platforms

The recommendations presented in this report are not exhaustive, and no single recommendation is all-encompassing. Undoubtedly, there are limitations, some of which have been explored, while others have yet to be considered. Nonetheless, we assert that these four recommendations take into consideration the goals of large traditional banks to minimize their risk exposure, while simultaneously having a measurable impact on increasing the number of black owned businesses over time.

Appendix

Figure 1: Percentage of U.S. Families Living in Poverty, by Race/Ethnicity (2018)



Source: U.S. Census Bureau-American Community Survey, 2018; Compiled by Author