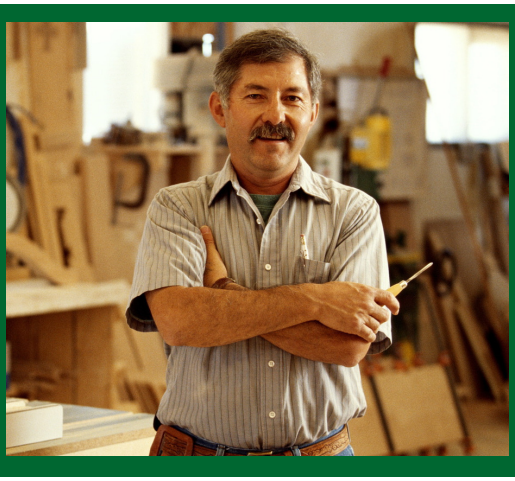
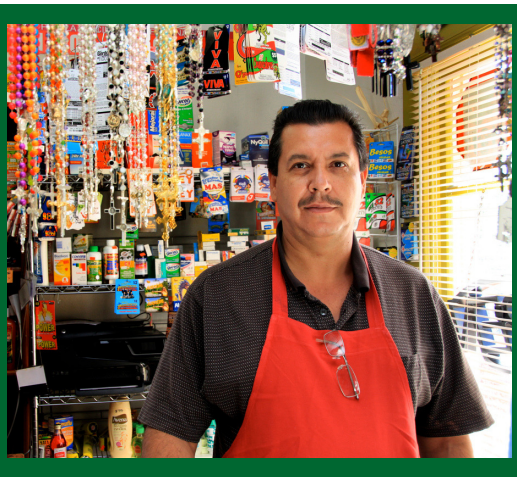
# FUELING CALIFORNIA'S ECONOMIC GROWTH:

## A Study on Latino Small Business and Capital Access



NATIONAL ASSOCIATION FOR LATINO COMMUNITY ASSET BUILDERS

CDC Small Business Finance

SBFF Small Business Finance Fund
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# Introduction

CDC Small Business Finance (CDCSBF), located in San Diego, California, is among the nation's largest nonprofit business lenders. CDCSBF offers a variety of financing options to small businesses so they can expand, grow, and create jobs in California, Arizona, and Nevada. Since 1978, CDCSBF has made over 10,980 loans to small businesses, primarily through a variety of Small Business Administration (SBA) programs. CDCSBF's lending has preserved or created 182,000 jobs, and has provided over $13,800,000,000 in capital to small business owners. CDCSBF's portfolio includes SBA 504, Community Advantage and Microloans, as well as loans made available through its subsidiary Community Development Financial Institution (CDFI), including Fast Fund, an online product specifically designated for Hispanic and African American borrowers in low- and moderate-income (LMI) communities.

With the generous support of JP Morgan Chase, CDCSBF contracted NALCAB - National Association for Latino Community Asset Builders, in partnership with Mr. Roberto Barragan, to undertake research to better understand opportunities for increasing business lending in Southern California specifically to Latino small business owners and aspiring entrepreneurs. NALCAB represents and serves a geographically and ethnically diverse network of nonprofit community development and asset building organizations that are anchor institutions in our nation's Latino communities. NALCAB's mission is to build assets for Latino families, communities and organizations, and NALCAB's work advances economic mobility for low- and moderate-income people.

This report synthesizes quantitative data from federal, state and local government agencies as well as the publically available literature from universities, think tanks, and other institutions. The Team has also undertaken original qualitative research through interviews with lending experts throughout the state of California, including national banks, regional banks, government entities, and CDFIs/non-profit lenders. The observations and recommendations presented herein reflect these data as well as the experience and expertise of the authors.

## I. The Research Team

*Noel Poyo, Executive Director- NALCAB:* Mr. Poyo is the primary Project Representative and is a co-author of this report. Mr. Poyo represents and serves a diverse national network of more than 100 Latino-led community and economic development organizations. Under Mr. Poyo's leadership, NALCAB has been the catalyst for more than $300 million in direct investment in community development and small business investment projects and has provided technical assistance to hundreds of nonprofits and local government agencies. Poyo advises the Board of Governors of the Federal Reserve as one of fifteen members of the Fed's Community Advisory Council and serves on the Board of Directors of the Center for Responsible Lending.

Previously as a private consultant, Mr. Poyo developed an outstanding reputation for his work in connection with neighborhood redevelopment, troubled municipal agency recovery projects (including housing departments, housing authorities and a school transportation division) and the evaluation of community development programs. He is a frequent public speaker on topics related to building assets in communities of color and nonprofit innovation. A graduate of Yale University with a Bachelor of Arts with a Distinction in History, Mr. Poyo is bicultural and bilingual.

*Roberto Barragan, Principal – Aquaria Funding Solutions:* Roberto Barragan is a researcher and co-author of this report. As the Principal of Aquaria Funding Solutions, Mr. Barragan is responsible for formulating Community Reinvestment Act solutions for financial institutions, raising small business loan capital and grant support for Community Development Financial Institutions and originating and funding small business loans to women and minority owned small businesses in low and moderate income communities nationally. Previously, Mr. Barragan was the President of Valley Economic Development Center (VEDC) for the last 17 years. He managed the largest small business development non-profit organization in Los Angeles, managing an $11 million budget with 80 employees in 8 offices in Los Angeles, Las Vegas, New York City, Miami and Chicago. VEDC served over 3,000 businesses yearly with financing, training and direct business assistance. Roberto led VEDC to build $60 million in assets with a small business loan portfolio of $35 million.

Mr. Barragan is also the founder and President of the San Fernando Valley Financial Development Corporation, a SBA 504 lender headquartered in Los Angeles County. In 2005, he founded the Pacoima Development Federal Credit Union by raising $2 million in deposits, $500,000 in capital and securing a charter from the National Credit Union Association. Over the last 6 years, Mr. Barragan has raised over $100 million in federal, state and local as well as private resources for small and medium sized business development.

Mr. Barragan has over 30 years of experience managing non-profit organizations, including the last twenty involved in community economic development, technical assistance to for-profit and non-profit entities and financial resource development. Mr. Barragan is a nationally recognized expert on loan funds and microlending, and is a regular lecturer and media expert on these subjects.

*Janet McIntyre, Manager Partner - McIntyre-St. Clair Strategy:* Ms. McIntyre is a communication, leadership, and strategy consultant who works with health care, education, business, and government clients across the United States. Ms McIntyre has consulted with the Joint Commission, the national and international leader in health care accreditation and patient safety, Joint Commission Resources, Joint Commission International, StayWell, and Cymetrix/Navigant Health Care. She has also taught communication, group dynamics, and conflict resolution in the organizational leadership program at Woodbury University and as a facilitator for leadership academies for the Southern California cities of Burbank, Glendale, and Pasadena and for Leadership Burbank. Janet was visiting assistant professor of organizational leadership at Woodbury University in 2013. She was a member of the board of directors of the Burbank Chamber of Commerce and is a 2011 Business Life Magazine Women Achievers honoree and a 2010 San Fernando Valley Business Journal Women in Business nominee. Janet, who holds a bachelor's degree in business administration and a master's degree in organizational leadership, is completing a doctorate in organizational leadership

*Nicole Goodman, Program Manager- NALCAB:* Ms. Goodman is a co-author of this report. She is a Program Manager at NALCAB and in her role, she manages NALCAB's portfolio of fee-for-service activity, including evaluations, analysis of NALCAB member projects, and technical assistance assignments. She also supports NALCAB's resource development and donor relations. Ms. Goodman has conducted numerous third-party evaluations of economic development projects implemented by CDCs and NALCAB member organizations nationwide. Ms. Goodman has a Bachelor of Arts in Urban Studies- Issues and Policy from Trinity University.

*Daniel Palacios, Policy Associate- NALCAB:* Daniel Palacios is a co-author of this report. Mr. Palacios helps advance NALCAB's policy priorities as a policy associate in the organization's Washington, DC office. In his role, he supports national policy partnerships and coordinates member engagement in the public policymaking process. He is also a Fellow in the Asset Building Policy Network (ABPN). Daniel previously worked as a Capitol Hill staffer in the office of U.S. Senator Richard J. Durbin, where he focused on economic policy issues. He holds a Bachelor of Arts in Economics and History from Northwestern University.

The authors thank Faith Larson and Don St. Clair for their contributions to the research and editing components of the report.

# A Study on Latino Businesses in California

## I. Demographic and Economic Characteristics of Latino Small Business Owners

***Latino Small Businesses in the United States***

The small business sector is a key pillar of the US economy and an important driver of post recessionary economic recovery. Business development is an important path to wealth creation and businesses in their first five years of existence are credited with being the primary source of net job creation in the United States. For Latinos in particular, small business development has an outsized economic importance and an even greater potential. Hispanics are the fastest growing racial/ ethnic segment of the U.S. population and are demographically younger than the US population as a whole – that is to say, Latinos are an enormous part the future of the US economy.

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Hispanics experienced a 66% decline in net worth from 2005 - 2009. Disturbingly, the negative impact of the recession on the balance sheets of Latino families has calcified into a structural economic problem. According to the St. Louis Fed, the median wealth of Hispanic families in 2013 was $13,900, as compared to $134,008 for White families.[1] The Pew Research Center reported in a December 2014 release that, "even as the economic recovery has begun to mend asset prices, not all households have benefited alike, and wealth inequality has widened along racial and ethnic lines."[2] rebuild wealth among Latinos will become an increasingly critical macroeconomic risk for the United States.

Wealth loss among Latinos during and after the recession was due primarily to real estate-related losses (foreclosure and decreased home values). The fact that home equity made up 65% of mean wealth among Hispanics in 2005 (as compared to 59% for African Americans and 44% for Whites) indicates that Hispanics disproportionately invested their assets in housing, which was one major factor that ex-

1 Boshara, Emmons, Noeth. "The Demographics of Wealth, Essay # 1: Race, Ethnicity and Wealth." Federal Reserve of St. Louis, 2015.

2 Kochhar and Fry. Wealth inequality has widened along racial, ethnic lines since end of Great Recession, Dec 2014. http://www.pewresearch.org/fact-tank/2014/12/12/racial-wealth-gaps-great-recession/

plains why the real estate-led recession impacted Latinos so negatively.[3] This reality, together with the high rates of entrepreneurship among Hispanics (higher than any other major demographic segment),[4] suggests that small business development may be an important strategy for diversifying the balance sheets of Hispanic households.

***Failure to effectively rebuild wealth among Latinos will become an increasingly critical macro-economic risk for the United States.***

The challenges for many Latino business owners and aspiring entrepreneurs are formidable. While Latino-owned businesses have increased in number, they had less annual revenue than non-Latino small businesses, and grew at a slower rate. The reasons for these disparities are complex, but a lack of access to mainstream financial services and mainstream bank financing is key. When this financial disconnect is combined with a lack of familiarity with the legal system, tax law, local codes and standard accounting practices, business owners are left vulnerable to unanticipated costs and predatory business dealings that can sink even businesses with the greatest potential. Limited English proficiency can magnify these challenges.

While it is important to recognize these concerning trends, Latino entrepreneurship fundamentally represents an opportunity for the US economy. The U.S. Census Bureau's Survey of Business Owners (SBO), released in 2015, shows that Latinos were the fastest growing segment of business owners in the U.S. between 2007 and 2012, representing 86 percent of overall small business growth during this period.[5]

*Latino-Owned Businesses by the Numbers (US Census 2015)*

- 3.3 million businesses
    - 3 million (91.3 percent) firms without paid employees
    - 287,000 have paid employees (8.7 percent)
    - 71 percent have fewer than 100 employees
    - Top industries with the highest average number of employees per firm are employment services, warehousing, storage, and management of companies and enterprises
- $474 billion annual receipts[6]

3 Pew Hispanic Center, Rakesh Kochhar, Presentation on Dec. 1, 2011 (published in various articles)

4 Kauffman Index of Entrepreneurial Activity

5 Latino business ownership is defined as a business having people of Mexican, Puerto Rican, Cuban or other Hispanic origin (such as Dominican or Salvadoran) owning more than 50.0 percent of the stock or equity in a nonfarm business operating in the United States.

6 U.S. Census Bureau. 2015. 2012 survey of business owners. Available at www.census.gov/library/publications/2012/econ/2012-sbo.html

The number of Latino-owned businesses grew 46.3 percent in the U.S. from 2007 to 2012. This far outpaces much slower growth among all businesses, which was 3.4 percent in the U.S. (U.S. Census Bureau, 2015). Latino-owned firms totaled $473.6 billion in receipts in 2012, an increase of 35.1 percent from $350.7 billion in 2007. Receipts for all firms grew 11.7 percent during the same period, from $30.0 trillion in 2007 to $33.5 trillion in 2012. A report by Geoscape and the U.S. Hispanic Chamber of Commerce estimated the total receipts of Hispanic owned businesses in 2016 at $668 billion.[7]

This rise in Latino-owned businesses is not attributable solely to Latino population increases. For example, the Latino population increased by 17 percent while Latino-owned businesses increased by 46 percent. An analysis of SBO data show there was one Latino-owned business for every 13 Latino adults in 2007, and rose 20 percent to one Latino-owned business for every 11 Latino adults in 2012. This compares to one business for every 8 nonminority adults (Small Business Administration, 2016).

While the nation's Latino-owned firms account for 12 percent of the U.S. businesses in existence, significant disparities exist. For example, Latino-owned businesses represent only approximately 4 percent of all sales and all employment, respectively (Small Business Administration, 2016). A majority of Latino firms earn less than $100,000 in annual revenue and do not have any employees. Only 3 percent of Latino firms earn $1 million or more in revenue (U.S. Census Bureau, 2015). In addition, average gross receipts for Latino-owned businesses declined nearly 8 percent from 2007 to 2012, while Asian-American-owned businesses, for example, saw revenues rise 12 percent (U.S. Department of Commerce Economics & Statistics Administration, 2016).

Another survey found that less than 2 percent of Latino-owned businesses report $1 million or more in revenues, as compared to 4.9 percent of all businesses (Stanford Graduate School of Business, 2015). Specifically, a Latino-owned firm averaged $143,000 in sales per firm, as compared to $546,000 for a non-Hispanic white-owned firm; only African-American firms have lower per-firm sales averages at $58,000 (Small Business Administration, 2016). A Stanford University analysis extrapolated that the sales that Latino firms generate, versus what they would generate if on par with the average non-Latino owned business, present an opportunity gap of $1.38 trillion in the U.S. economy (Stanford Graduate School of Business, 2015).

Similar gaps are seen in employment at Latino-owned businesses despite a 22 percent growth in employment at Latino-owned businesses to 2.3 million jobs (U.S. Census Bureau, 2015). All but 8.7 percent of Latino-owned firms do not have paid employees (U.S. Census Bureau, 2015). Additionally,

7 "Hispanic Businesses and Entrepreneurs Drive Growth in the New Economy – 4th Annual Report – 2016," http://geoscape.com/wp-content/uploads/2015/12/2016-Hispanics-in-Business-Report_Final.pdf

Latino-owned businesses with employees average 8.1 employees as compared to 11.6 for a non-Latino, white-owned firms (Small Business Administration, 2016).

One commonly cited reason for the disparities in revenue and employment is the industries in which Latino-owned businesses operate. Data show that 44.5 percent of all Latino-owned businesses are in the 20 lowest sales industries identified by the SBO. Examples of these industries include child day care services, taxi and limousine services, and personal goods repair. In contrast, approximately 31 percent of all nonminority businesses are in these industries (Small Business Administration, 2016). The Kaufman Foundation reports that Latinos are disproportionately represented in industries with low capital requirements and high failure rates, which make it difficult to absorb losses or grow financially if they do survive (Kaufman Foundation, 2016).

The belief that industry selection contributes to lower sales for Latino-owned businesses has recently been challenged. Research showed no differences in the percentage of firms within industries between Latino-owned firms and businesses owned by non-Latinos (Stanford Graduate School of Business, 2015). The same research also found that Latino-owned businesses serve a wide customer base, with 80 percent of firms reporting that their customers are either predominantly non-Latinos or an equal mixture of Latinos and non-Latinos (Stanford Graduate School of Business, 2015).

While Latino-owned businesses face sales and employment gaps, there appears to be no slowdown in Latino entrepreneurship. An estimated 4.23 million Latino-owned firms were projected to be operating in the U.S. by the end of 2016 (Stanford Graduate School of Business, 2016). These data should be no surprise given the resilience shown by Latino entrepreneurs in the depths of the Recession. Even as families saw their wealth plummet, small business ownership and self-employment were critical for many Latinos in weathering difficult economic circumstances.[8] In the face of dramatic job losses and plummeting home equity, entrepreneurship among Hispanics rose, though it dropped in other major-population segments.[9]

***Latino and immigrant entrepreneurs present a significantly underserved segment across many markets as well as untapped potential as economic drivers and job creators.***

8 http://www.wsj.com/articles/immigrants-latinos-helped-drive-business-creation-last-year-1432771383

9 Based on a multiyear analysis of data from the Kaufman Index of Enterpreneurship

***Who are Latino Small Business Owners?***

Most Latino small business owners are men and they are relatively young. Latinos who start their own businesses also rely on family when making business decisions. The following provides a snapshot of *Latino entrepreneurs who operate 3.3 million U.S. businesses:*

- *Men own the majority (56 percent) of Latino-owned businesses.*[10]
- Women are starting businesses at a rapid pace, going from 800,000 to 1.5 million firms between 2007 and 2012.[11] The top industries for Latinas include administrative and support and waste management and remediation services; other services; and health care and social assistance.[12]
- The majority of Latino-owned businesses are owned by a sole person, with husband and wife as the second-most common form of ownership (Stanford Graduate School of Business, 2015
- 55 percent of Latino entrepreneurs are ages 35-54, and 20 percent are under age 35 (this compares to nearly 48 percent and 14 percent, respectively, for non-Latino firms).[13] Latinos are the youngest racial or ethnic group in the U.S. [14]
- 52 percent (who reported citizenship information) were not born a U.S. citizen.[15]
- More than 35 percent (who provided the education information) hold a bachelor's degree or higher prior to establishing, purchasing, or acquiring their business.[16]
- 96 percent (who reported language information) conduct transactions in English, with roughly 67 percent conducting transactions in Spanish, potentially in addition to other languages.[17]
- 55 percent say family plays an influential role in business decisions and 63 percent rely on family to help operate their small business.[18]

10 U.S. Department of Commerce Economics & Statistics Administration. 2016. Deep dive into Hispanic business ownership. Available at http://www.esa.doc.gov/economic-briefings/deep-dive-hispanic-business-ownership

11 U.S. Department of Commerce Economics & Statistics Administration. 2016. Deep dive into Hispanic business ownership. Available at http://www.esa.doc.gov/economic-briefings/deep-dive-hispanic-business-ownership

12 National Women's Business Council. 2015. Latina women-owned businesses (WOBs) fact sheet. Available at www.nwbc.gov/sites/default/files/Latina%20Women%20Entrepreneurs.pdf

13 U.S. Department of Commerce Economics & Statistics Administration. 2016. Deep dive into Hispanic business ownership. Available at http://www.esa.doc.gov/economic-briefings/deep-dive-hispanic-business-ownership

14 Pew Research Center. 2016. "The nation's Latino population is defined by its youth." Available at http://www.pewhispanic.org/2016/04/20/the-nations-latino-population-is-defined-by-its-youth/#fn-24238-1

15 U.S. Census Bureau. 2016. Annual survey of entrepreneurs. Available at www.census.gov/programs-surveys/ase.html

16 Ibid.

17 Ibid.

18 Bank of America. 2017. Bank of America Hispanic small business owner spotlight. Available at http://about.bankofamerica.com/assets/pdf/BOA_2017-Hispanic-Spotlight-Report_.pdf

- 42 percent plan to pass their business on to family.[19]
- Nearly 70 percent view community as vital to business success and 77 percent support local nonprofits or charities.[20]

The reasons that Latinos start their own businesses are personal and practical. Rather than seeking to capitalize on an external opening in a particular market, Latinos say they want to pass something down to family, work with family or friends, or have greater control over their financial future (Stanford Graduate School of Business, 2015). Latino business owners are more than twice as likely as non-Latino entrepreneurs (42 percent vs. 18 percent) to say they plan to pass their firm on to a family member (Bank of America, 2017).

In 2016, in an effort to gather data and develop insights into Latino and immigrant entrepreneurs, NALCAB conducted a survey of small business owners that received services from NALCAB member organizations in 11 markets around the country. While data documenting the attitudes of small business owners have been collected through the SBA, U.S. Census, and Federal Reserve, few sources speak to the specific habits and aspirations of Latino and immigrant entrepreneurs. Highlights from this survey of owners served by the NALCAB network include the following:

- NALCAB members foster business and job creation in a wide range of industries, including healthcare, retail services, professional services, construction, and manufacturing, among others.
- Surveyed entrepreneurs are strongly oriented towards growth; 74% reported they expect their revenue to increase over the next 12 months.
- Surveyed entrepreneurs are hesitant to take on debt to finance their small business growth. This represents a significant market inefficiency given entrepreneur's immense desire for growth, but also a lack of quality loan products marketed to Latino and immigrant entrepreneurs.

NALCAB's findings regarding the strong growth-orientation of Latino business owners is consistent with findings from a report developed for Bank of America. Owners of Latino small businesses also appear to be more optimistic about their future than non-Latino firms (Bank of America, 2017). Approximately 71 percent of Latino entrepreneurs anticipated that their revenue would rise in 2017, as compared to 51 of non-Latino small business owners (Bank of America, 2017). More than half of Latino owners of small businesses planned to hire more employees during the next 12 months, and 76 percent predicted growth in their firms during the next five years. This compares with 25 percent of non-Latino entrepreneurs who forecasted additional hiring, and 55 percent of non-Latino small business owners who foresaw growth (Bank of America, 2017).

19 Ibid.
20 Ibid.

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NALCAB's finding about the hesitance of Latinos business owners to take on debt is also echoed in other research. According to the SBA and the Kaufman Foundation, Latinos are less likely than white business owners to apply for new loans during the early years of their operations. This tendency is more common among Latinos than for white small business loan applicants even after taking into account factors such as credit scores and industry (Small Business Administration, 2013; Kaufman Foundation, 2016). One survey found that Latino small business owners who reported that they needed credit were 23 percent more likely than non-minorities to refrain from applying for loans due to fear of denial (Bates & Robb, 2013). Other research shows that approximately 54 percent of Latino business owners report that they have either never asked or never been denied outside capital, and 42 percent said they had been denied capital (Stanford Graduate School of Business, 2015).

Research from the Stanford Graduate School of Buisness indicates that Latino entrepreneurs are often not well connected to business networks. Research show that Latino-owned businesses that have higher revenue levels and numbers of employees are more likely to be actively networking. Consider the following:

- Only one third of Latino business owners have business mentors.
- Approximately 45 percent of Latino-owned businesses belong to no organizations.
- Only 16 percent have engaged with general chambers of commerce and 14 percent with Hispanic chambers of commerce.

It is important to note that while Hispanic business owners may be hesitant to access capital from many mainstream financial instutions and lack connectivity to business networks, they show no reticence in accessing small business development services from microenterprise organizations. According to the Aspen Institute's FIELD program's 2014 microenterprise census, 61% of individuals receiving services from microenterprise organizations were Hispanic. According to a 2015 Gallup Poll of business owners, top sources of financial information in the general small business population are other business owners (64%), accountants (60%) and family members/friends (59%). Those in the Hispanic segment relied first on other business owners and family members/friends and then, on accountants.[21]

21 "Gallup, Small Business Diverse Segments Lending Study," May 2015 – Commissioned by Wells Fargo.

***The state's Latino population is growing at a faster rate than the general population, and Latinos are projected to make up nearly half of all Californians by 2050***

***Unbanked, Underbanked Latinos***

Nearly a quarter of Latino households (23.3 percent) believe that banks are not interested in serving households like theirs, according to a survey by the Federal Deposit Insurance Corporation (FDIC) (FDIC, 2016). Only 12.9 of white households shared that opinion (FDIC, 2016).

Latino households are also more likely than all American households (29.3 percent vs. 19.9 percent) to be "underbanked" in that they have a bank account but also have used alternative financial services (AFS), such as non-bank check cashing or payday loans in the past year (FDIC, 2016). This totals 4.7 million Latino households, and represents a nearly one percentage point increase in underbanked households from the FDIC's previous survey (FDIC, 2016). Approximately 16 percent of Latino households are unbanked. The reasons for being unbanked are varied and include not enough money to keep an account; privacy issues; distrust of banks; account fees too high or unpredictable; and identification, credit, or former bank account problems.

Other data from the FDIC includes the following (FDIC, 2016):

- Latinos are less likely to apply for bank credit. 11.5 percent of Latino households applied for bank credit as compared to 13.9 percent of all U.S. households and 14.9 percent of white households.
- Latinos have higher application denial rates. 3.6 percent of Latino households were denied bank credit vs. 2.8 percent of U.S. households and 2.6 percent of white households; the denial rate for Latinos is the highest of any racial or ethnic group.

The FDIC data suggests that unbanked and underbanked households present opportunities for financial institutions to expand access to products and services and forge relationships with underserved populations with the aim of increasing economic inclusion.

***Latino-Owned Small Businesses in California***

The economic importance of Latinos and Latino entrepreneurs in California cannot be overstated. California's 15 million Latinos represent 39 percent of the state's population and 27 percent of the Latino population in the entire U.S. (Pew Research Center. 2016). The state's Latino population is growing at a faster rate than the general population, and Latinos are projected to make up nearly half of

all Californians by 2050 (California Senate Office Research, 2014).

***FDIC data suggests that unbanked and underbanked households present opportunities for financial institutions to expand access to products and services and forge relationships with underserved populations with the aim of increasing economic inclusion.***

An estimated 815,304 Latino-owned business were operating in California as of 2012, according to the U.S. Census Survey of Business Owners. Latino business grew at an impressive rate of nearly 44 percent between 2007 and 2012, demonstrating resilience in the spite of the economic effects of the Great Recession. While the Census Survey of Business Owners was not explicitly limited to small businesses, two key indicators point to a significant number of Latino small businesses within the data: average receipts and average number of employees for Latino businesses. With average receipts at $121,306 per firm and average number of employees at 8 per firm, most Latino businesses fall firmly within the definition of a small business. A Geoscape report indicated that California, Texas and Florida have seen the largest number of new Hispanic businesses as compared to the rest of the country.

Some of most significant markets for Latino businesses in the state include Los Angeles, with 48 percent of all California Latino business, San Diego, with 8 percent, and San Francisco, with 7 percent. In terms of some of the most significant industry concentrations for Latino firms across the state, 18 percent are categorized in Other Services (such as equipment and machinery repair, laundry and dry cleaning services, etc.), 17 percent within Administrative and Support and Waste Management and Remediation Services, and 11 percent within Healthcare and Social Assistance.

*California Hispanic Business Profile Highlights*

| Region | Total Number of Hispanic Firms | Percent of California Hispanic Firms | 2007-2012 Growth Rate | Average Receipts of Hispanic Firms | Total Number of Hispanic Firms with Paid Employees | Average Number of Employees | Total Number of Hispanic Firms without Paid Employees |
|---|---|---|---|---|---|---|---|
| ***California*** | 815,304 | - | 43.90% | $121,306.14 | 64,463 | 8.02 | 750,841 |
| ***Bakersfield*** | 17,780 | 2.18% | 39.70% | $97,989.76 | 1,262 | 8.70 | 16,518 |
| ***Fresno*** | 19,409 | 2.38% | 54.60% | $776,603.02 | 1,695 | 8.40 | 17,714 |
| ***Los Angeles-Long Beach-Santa Ana*** | 393,051 | 48.21% | 47.40% | $108,001.02 | 27,037 | 8.33 | 366,014 |
| ***San Diego-Carlsbad-San Marcos*** | 62,753 | 7.70% | 42.10% | $175,307.92 | 6,299 | 7.01 | 56,499 |
| ***San Francisco-Oakland-Hayward*** | 54,669 | 6.71% | *32.70% | $170,731.88 | 5,957 | 7.75 | 48,713 |
| ***Visalia-Porterville*** | 9,147 | 1.12% | 40.70% | $191,450.31 | 886 | 9.30 | 8,261 |

**Calculations based on the U.S. Census Bureau's 2007 and 2012 Survey of Business Owners; Approximate Estimation*

The Los Angeles-Long Beach-Anaheim area of California tops the list of largest American metropolitan areas by Latino population with 6 million Latinos – that number is more than the Latino population in all states except for California and Texas (Pew Research Center, 2016). Approximately one in 10 Latinos in the U.S. live in the metropolitan Los Angeles area. From 2000 to 2014, the number of Latinos in Los Angeles County grew by 15.5 percent, compared to a 1.1 percent decline in the non-Latino population (Beacon Economics, 2016). Put another way, Latinos made up 48 percent of the population in Los Angeles County and 37 percent of all households in Los Angeles County (Beacon Economics, 2016).

***Latino-owned businesses now comprise nearly one-quarter (23.4 percent) of all California businesses***

Adjacent to Los Angeles County, the Riverside-San Bernardino-Ontario metropolitan area of Southern California boasts the fifth largest Latino population (2.2 million) in

the U.S. (Pew Research Center, 2016). The San Diego-Carlsbad area is home to 1.1 million Latinos, San Francisco-Oakland-Hayward has a population of roughly 1 million Latinos, and Fresno County has more than 507,000 Latino residents (U.S. Census Bureau, 2015).

From 2007 to 2012, the number of Latino-owned businesses grew 43.9 percent in California (U.S. Census Bureau, 2015). Comparatively, the rate of growth among all businesses in the state was much slower at 5.0 percent (U.S. Census Bureau, 2015). Latino-owned businesses now comprise nearly one-quarter (23.4 percent) of all California businesses (U.S. Census Bureau, 2015). Specifically, California was one of only three states that had more than a half-million Latino-owned firms in 2012 with 815,304 businesses; Texas had 687,570 and Florida had 604,128 (U.S. Census Bureau, 2015). A majority (580,450) of those California firms were owned by people of Mexican, Mexican-American, or Chicano background. (U.S. Census Bureau, 2015). More than 365,576 firms (42 percent) in California are owned by Latinas (U.S. Census Bureau, 2015).

While a majority of Latino-owned firms do not have paid employees, approximately 22 percent of those with paid employees are located in California (U.S. Census Bureau Annual Survey of Entrepreneurs, 2016). Nearly 29,000 of those 66,487 Latino-owned small businesses with paid employees in California are located in the Los Angeles-Long Beach-Anaheim metropolitan area (U.S. Census Bureau Annual Survey of Entrepreneurs, 2016). Los Angeles County also leads the nation in the number of Latino-owned businesses with 332,967 or 29 percent of all firms.

Other data from the Census Bureau's most recent Small Business Owners survey shows that the Inland Southern California region of San Bernardino and Riverside counties is second to Los Angeles County with 122,200 Latino-owned businesses. This represents growth of more than 50 percent from 2007 to 2012, and means that more than one third of all businesses in Inland Southern California are Latino-owned (University of California Riverside, 2016). Additional Census data for California reveals the following (U.S. Census Bureau, 2015):

- San Diego County had 62,793 Latino-owned businesses
- The San Francisco-Oakland-Hayward area had 54,669 Latino-owned businesses
- 32 percent of businesses (19,409) in Fresno County were owned by Latinos
- Ventura County has 16,471 Latino-owned businesses

Reflecting national disparities in revenues and employment, California's Latino-owned businesses generate 6.5 percent of all revenues and employ 8 percent of the state's workforce despite comprising 23.4 percent of all businesses (U.S. Census Bureau, 2015). In addition to the information previously

provided in this report explaining the reason for these disparities, many Latino-owned businesses in California have been established within the past five years and are not considered mature enterprises (University of California Riverside, 2016).

## II. Access to Capital for Latino-owned Small Businesses

***Small Business Lending Conditions***

Access to capital is an issue for all entrepreneurs, whether the funding is needed for start-up or growth purposes. Common sources of capital include term loans, merchant cash advances, receivables financing or factoring, bank lines of credit, personal credit cards, and personal/family wealth. Small business lending by traditional financial institutions and household wealth contracted substantially as a result of the Great Recession, and access to capital remains problematic for entrepreneurs despite the economic recovery.

Banks significantly tightened credit as a result of the Great Recession, which has had lingering effects for small businesses seeking access to capital. Consider that small business loans, defined as loans less than $1 million, represented approximately 40 percent of total bank loans in 1995, but had dropped to roughly 21 percent in 2016 (Harvard Business School, 2016). The reasons that small business loans are less attractive to lenders include the following (Harvard Business School, 2016):

- Relative to larger businesses, small businesses have higher failure rates, fewer assets to use as collateral, and are more sensitive to economic shifts
- Small businesses have less information about their creditworthiness (e.g., detailed balance sheets, tax returns, income statements)
- Underwriting costs for small loans tend to be similar to the costs for larger loans, however they produce less revenue and are therefore less profitable (i.e. a $1 million loan may require a substantially similar assessment process as a $100,000 loan)
- Banking consolidation (14,507 commercial banks in 1984 vs. 5,210 in 2015) has created larger lending institutions that are less likely to approve small business loans than smaller community banks

These factors have prompted some banks to reduce or eliminate loans of less than $250,000, a serious issue given that 60 percent of small businesses seek loans of under $100,000 and more than 70 percent of small businesses seek loans of less than $250,000 (Harvard Business School, 2016). In her 2014 report, "The State of Small Business Lending," former SBA Adminsitrator Karen Mills pointed out the propensity of some banks to push businesses with less than $2 million in revenue toward more expensive business credit cards rather than toward traditional business loans (Harvard Business School).

Data regarding access to capital for small businesses in the United States, and particularly for specific demographic/ethnic market segments, is limited. While the Home Mortgage Disclosure Act (HMDA)

requires financial institutions to report data on mortgage applications and transactions, no such requirements have been implemented for small business lending. The lack of a representative, industry-wide data set severley limits understanding of the market opportunities and inefficiencies present in the small business lending industry. According to FFIEC data reported in 2015, more than $4 billion was lent to small businesses earning less than $1 million annually in Los Angeles. This data is not broken down by race and ethnicity. The majority of this lending was made by six of the nation's financial institutions.

| ***Market*** | ***Total # loans made to businesses w/ gross annual revenue < $1 million*** | ***Total amount of loans made to businesses w/ gross annual revenue < $1 million*** |
|---|---|---|
| ***Bakersfield*** | 6769 | $122,619,000 |
| ***Fresno*** | 7470 | $159,990,000 |
| ***LA/LongBeach/SantaAna*** | 216225 | $4,152,772,000 |
| ***SanDiego/Carlsbad/SanMarcos*** | 46736 | $953,015,000 |
| ***SanFrancisco/Oakland/Hayward*** | 17228 | $402,237,000 |
| ***Visalia/Porterville*** | 3182 | $70,534,000 |

*Source: FFIEC CRA 2015 Aggregate Reports data, "Table 1-1 Small Business Loans - Originations"*

***Access to Capital for Latino-owned Small Businesses***

Extensive evidence demonstrates that Hispanic and African-American small business owners are disproportionately denied credit, even after controlling for variables including business credit scores and personal wealth.[22] A report from the Stanford Graduate School of Business documents that 42 percent of Latino entrepreneurs had been denied capital by a bank, commercial lender, or other outside source (Stanford Graduate School of Business, 2015). Latino business owners are denied credit more often, charged higher interest rates, or discouraged from applying for loans than white counterparts because they have lower credit scores, no or low collateral, and less start-up capital (Stanford Graduate School of Business, 2015; Kaufman Foundation, 2016).

22 Kymn, Christine. "Access to Capital for Women- and Minority-owned Businesses: Revisiting Key Variables"SBA Issue Brief available at: https://www.sba.gov/sites/default/files/Issue%20Brief%203%20Access%20to%20Capital.pdf
Cole, R. 2014. Credit Scores and Credit Market Outcomes. Available at: https://www.sba.gov/sites/default/files/files/rs419.pdf
Asiedu, E., Freeman, J., Nti-Addae, A. 2012. "Access to Credit by Small Businesses: How Relevant Are Race Ethnicity, and Gender?" *American Economic Review* 102, 532-537.
Cavaluzzo K. and Wolken J. 2005. Small Business Loan Turndowns, Personal Wealth, and Discrimination. *Journal of Business* 78 (6), 2153-2177. Hereinafter "Calavuzzo & Wolken 2005."

The reasons for these disparities are complex, but a lack of access to mainstream financial services and mainstream bank financing, is key. When this financial disconnect is combined, in many cases, with a lack of familiarity with the legal system, tax law, local codes and standard accounting practices, business owners are left vulnerable to unanticipated costs and predatory business dealings that can sink even businesses with great potential. Limited English proficiency can magnify these challenges.

According to a 2015 Gallup Poll, when asked about their general experience with discrimination without specifying any context, 30% of Hispanic business owners said they experienced some form of discrimination based on race, ethnicity, gender or sexual orientation. Very few indicated that they had reported the discrimination.

In 2015 and 2016, NALCAB conducted capital scans in five markets (Chicago, Seattle, Minneapolis, Philadelphia and San Antonio) to assess access to capital specifically for Latino and immigrant-owned small businesses. Themes from this research included the following.

- *Lack of transparency in loan requirements and terms* - Across all five markets, researchers found it difficult to determine the most basic loan requirements, such as minimum credit score, interest rate range, minimum loan size and origination fee. While underwriting standards vary by institution, the variability and unwillingness of lenders to commit to providing basic terms makes it difficult for a potential borrower to obtain concrete information in advance of applying for a loan.
- *Community banks may not offer greater access to Latino and immigrant business owners* - In the five markets studied, community banks were less likely to offer the full complement of start-up, micro and larger business loans, and instead tended to focus on personal loans and lines of credit. Further, community banks were less likely to be able to do business effectively with primarily Spanish language speakers.
- *Geographic location of bank branches are not typically accessible to Latino and immigrant business owners* - All five market studies demonstrated a consistent narrative with respect to the geographic distribution of traditional lending institutions. Across all markets bank presence is far scarcer in communities with high concentration of minorities, pointing to significant constraints in the accessibility of capital for entrepreneurs of color within their local communities.
- *Online lenders provide access but low satisfaction* - A rise in online business lending coincided with tightening of lending standards and available credit during the recession. In all markets, borrowers have the option to turn to online lenders to fill the gaps in service and accessibility. Though an increasing number of borrowers are approved through online platforms, small businesses who obtain financing from online marketplace lenders report low satisfaction rates.

- *The Role of CDFIs* - The challenges of accessing credit through conventional lenders and in determining even the basic terms of loan products points to the outsized importance of culturally-relevant CDFIs for filling gaps in small business lending to Latino and immigrant business owners. However, CDFI lenders often face their own sets of constraints in terms of organizational capacity and the depth of funds available for lending.

These findings suggest that Latino and immigrant entrepreneurs present a significantly underserved segment across many markets as well as untapped potential as economic drivers and job creators.

***Extensive evidence demonstrates that Hispanic and African-American small business owners are disproportionately denied credit, even after controlling for variables including business credit scores and personal wealth.***

***Bootstrapping***

Research shows that Latino business owners rely disproportionately on owner and household wealth and less on debt from outside sources such as banks, meaning that Latino entrepreneurs operate with less capital at startup and in subsequent years than nonminorities (Small Business Administration, 2013). Rather than seeking capital from banks or commercial lenders, 70 percent of Latinos in one recent study cited personal savings as their most common source of capital, with credit cards, personal bank loans, and loans from friends coming next as the most-used options (Stanford Graduate School of Business, 2016). Over 25% of Latino immigrant-owned businesses have zero startup capital available to them when they launch their business, a higher percentage than any other racial/ethnic sub sector. By relying mainly on personal savings and assets and assistance from family, Latino entrepreneurs may not have the capital necessary to sustain their firms or to grow their businesses.

The heavy reliance of Latino businesses on the personal financial resources and capacity of the business owner to leverage investment suggests that the gap in homeownership between Hispanics and White non-hispanics may be an important factor in limiting access to capital. Approximately 72 percent of white households own their homes in the United States compared with 45 percent of Latino households (Pew Research Center, 2016). This disparity is somewhat less in California, but still pronounced. Forty-six percent of California Latinos own their homes in contrast to 57 percent of all Californians (California Senate Office of Research, 2014). Given that a house is typically the largest asset of American households, Hispanics are far less able to leverage personal assets to leveage capital for a small business.

***US Small Business Administration Lending***

In the wake of the economic crisis, the U.S. Small Business Administration (SBA) has become a critical source of loans for start-up and existing small businesses. Banks, savings and loans, credit unions, and other specialized lenders participate with the SBA in the 7(a) loan program, which provides government guarantees for loans made by participating lending institutions. By guaranteeing 7(a) loans, the SBA promotes access to credit for small borrowers who might otherwise be considered by lenders as too risky. The SBA sought to spur lending following the economic collapse by raising the 7(a) loan guarantee rate to 90 percent and eliminating fees. This action prompted more than 1,000 banks to again make SBA loans and resulted in record SBA lending (Harvard Business School, 2016).

In 2011, six percent (6%) of SBA 7 (a) loans went to Hispanic-owned businesses, representing four percent (4%) of the toal dollar value of lending. There has been a slight and steady increase in lending to Hispancis since that time. Nine percent (9%) of SBA 7(a) loans in 2016 went to Hispanic-owned businesses in 2016, representing six percent (6%) of the total dollar value of lending. (Small Business Administration, 2017). Hispanics are accessing larger SBA 504 real-estate-backed loans at similar rates, with eight percent (8%) of 504 loans going to Hispanic-owned businesses, representing six percent (6%) of the total dollar value of lending.

***Over 25% of Latino immigrant-owned businesses have zero startup capital available to them when they launch their business, a higher percentage than any other racial/ethnic sub sector.***

A national study of Latino business owners offers a possible explanation for this underrepresentation: more than one quarter (27 percent) said that they have never heard of the SBA (Stanford Graduate School of Business, 2015). The same study also showed that 71 percent of respondents had never heard of SBA Small Business Investment Companies (SBIC), and 79 percent did not know about SBA's Small Business Innovation Resource (SBIR) grants (Stanford Graduate School of Business, 2015). SBIC is a government investment program that has provided more than $21 billion in capital to growth stage businesses over the past five years (Small Business Administration, Office of Investment and Innovation, 2017). SBIR, dubbed "America's Seed Fund," offers monetary awards to encourage small businesses to engage in research and development that has the potential for commercialization (Small Business Innovation Resource, 2017).

***Online Lenders***

Online lenders have stepped in to fill some of the small business need for capital, with numerous lenders seeking to connect with the underserved Latino small business market. The products and loan terms offered by these lenders differ greatly. Borrowers who have high credit scores and are willing to wait up to 45 days for funding may find loans at 10 percent annual percentage rate (APR) or less. For business owners who have lower credit scores and need short-term lines of credit that can be accessed within a few days' time, APR may run from 50 to 300 percent. These riskier loans may not necessarily be predatory, but they can put small businesses in peril if entrepreneurs do not fully understand the risks. There is also concern that some online lenders engage purposely in the "four D's" of predation – deception, debt traps, debt spirals, and discrimination.

In early 2016, the California Department of Business Oversight issued a report on aggregated data provided by 14 major online "marketplace" lenders operating in California in response to a survey by the DBO. The firms that responded include: Affirm, Avant, Bond Street, CAN Capital, Fundbox, Funding Circle, Kabbage, LendingClub, OnDeck, PayPal, Prosper, SoFi and Square. The only company that did not respond was CircleBack. Major findings included the following.

- Nationally, from 2010-2014, the dollar amount of the companies' small business financing transactions increased by 629.5 percent, to $2.94 billion. Through the first half of 2015, transactions totaled $2.26 billion. In California, the aggregate dollar amount increased by 786.3 percent, to $452.2 million in 2014. The total through the first half of 2015 was $350.7 million.
- In the first half of 2015, the companies' U.S. median APR for small business transactions ranged from 15.50 percent to 51.80 percent. The California numbers were similar, with the median ranging from 18.56 percent to 51.40 percent.
- As a share of total outstanding transactions at the end of the first half of 2015, the firms' number of delinquent small business financings in the U.S. ranged from 0.36 percent to 8.96 percent. In California, the range was 0.48 percent to 8.45 percent. Though not prevalent throughout the group, much higher numbers were seen in prior years, particularly in California. There, double-digit delinquency rates up to 25 percent were reported.

## III. Observations of the Business Lending Environment in California for Latino-owned Small Businesses

To better understand the lending environment that California's Latino small business owners navigate, one-on-one interviews were conducted early in 2017 with lending professionals representing 15 different institutions across the state. The lenders represent community development financial institutions (CDFIs), nonprofit lenders, national banks, regional banks, and government agencies. These experts shared their perspectives on the Latino small business lending market, which is particularly robust in California given the state's majority Latino population. The information gathered from these interviews also informs this report's recommendations (see next section, Discussion and Recommendations) to increase access to capital for Latino-owned small businesses.

***Little Geographic Differentiation***

There is very little differentiation or customization in the approach to small business lending between geographic markets in the state. Small and micro lending in the state's urban areas share similar characteristics, and lending in rural markets is more a function of availability, or lack thereof, than any variation in credit standards. Loans between $35,000 and $250,000 are a critical need for Latino small businesses, which are, on average, smaller in size and revenues. Although organizations such as the California Reinvestment Coalition (CRC) actively advocate for fair and equal access to credit in low-income communities and communities of color, there are fewer banks, bank branches, loan officers, and investments to support lending in rural markets. This makes credit unions more important in these areas, but credit unions are generally less focused on small business lending than other financial institutions. There are a few CDFIs in these rural areas, but much like their urban counterparts, they suffer from limited resources.

***Limited Targeted Outreach to Latino-owned Small Business***

The California small business lending environment is characterized by limited outreach into the Latino small business market.

- Most national banks have diverse staff and branches in LMI and minority communities, but they have no specific Latino outreach program beyond their bilingual access in person and online. A small number of national banks see the Latino community as a market worthy of specific programming as well as marketing. All national banks, however, have centralized small business lending operations that make it difficult to adjust underwriting and credit analysis to specific market segements, such as startups and fledging businesses with global household, but not business-specific

profitability. SBA loans are also seen as a profit center in today's low interest environment with a focus on real estate lending and earnings from the secondary market rather than small business lending.

- Regional and community banks have the ability to offer more individualized assessments and underwriting for Latino borrowers, but are currently eschewing these opportunities for more and more real estate lending, SBA-supported and otherwise. Some, such as City National and Cathay, are implementing small loan programs that provide a more user-friendly product to Latino small businesses, but the majority of community banks with assets below $10 billion are not targeting Latino small business in any manner.
- Online lenders are focused on cash flow in making credit decisions. Because Latino businesses are of a size and/or structure that limits access to bank products, they are perfect targets for merchant cash advances (the product of choice of online lenders). Online lenders do not focus on debt service coverage as an "ability to pay," instead these lenders concentrate on cash flow, gross revenues, and charge a percentage of sales to pay back their loans. Latino startups or fledging businesses that cannot borrow from a bank due to lack of profitability can borrow on their gross revenues, but that decision may negatively impact future ability to meet payroll and pay rent.
- Credit unions are not active small business lenders to any targeted populations, including Latinos. National Credit Union Association (NCUA) rules limit the amount of assets that credit unions can hold in small business loans, thus discouraging credit unions from becoming SBA lenders.
- CDFIs in California that focus on loans below $100,000 have loan portfolios with a significant Latino presence. Whether it is Opportunity Fund with their truck loans or Accion San Diego with startup loans, Latinos are big customers for micro loans. In addition, CDFIs making direct or SBA Community Advantage loans are doing a fair job with this population, especially if they have good referral relationships with commercial banks.

***Strong Progress in Language Access***

Language access, or Spanish translation, has experienced dramatic improvement over the past twenty years as the Latino population has grown in California. The employment of Spanish-speaking staff at national banks in particular has been robust. Bilingual staff are available at most of the state's banks and credit unions, as well as most online lenders and CDFIs. The majority of automatic teller machines (ATMs) now have bilingual access as well. Access drops off, however, in online banking. Most online banking, except for online services offered by national banks, does not provide Spanish language web pages. However more expensive, online banking offers real-time assistance and access that could dissuade Latinos from using online predatory lenders as a resource in its stead.

***Credit Scores as a Hurdle***

Credit scores continue to be a limiting factor in the ability of Latino small business borrowers to access credit from banks and other financial institutions, which typically seek FICO scores (Experian, TransUnion and Equifax) of at least 720. California's housing market was hit particularly hard during the economic crisis, and real estate short sales and voluntary foreclosures continue to depress credit scores for borrowers in the state. Lenders made wary by losses incurred during the financial crisis now rely on loan processes, particularly for applications completed online, that start and often end with a denial based on lower credit scores. Banks and credit unions, fearful more of examiner risk rating downgrades and additional loan loss allowances, would rather deny smaller business loans than potentially suffer lower profitability. This conservative approach does not differ much between national banks, community banks, and credit unions, although some community development credit unions have offered consumer look-alike loans at higher rates to reach lower credit scores.

Online lenders are less interested in credit scores if they can connect to cash flow via merchant cash advance or automated clearing house (ACH) payments from a strong bank account. Bank statements that show robust deposits or credit card deposit accounts encourage these lenders and allow them to look past credit challenges. In fact, a shorter amortization will be sought in order to secure an early exit from a cash flow rich relationship. This approach is especially helpful when dealing with Latino entrepreneurs who may have limited experience with credit, or residency challenges that also may result in limited credit history. In these cases, cash flow is more important that credit. When credit scores are available, however, 640 seems to be the current cutoff.

CDFIs rarely venture into small business loans with applicants who have FICO scores below 580. Similarly, micro lenders score their loans and use FICO among other metrics. This creates a catch-22 situation in that borrowers cannot obtain loans to rebuild credit, and thus cannot get larger loans or qualify for SBA-guaranteed loans with the lower credit scores.

***Perspectives from Lenders***

The following section documents specific comments and quotations from the interviews with industry experts, categorized by topic, which offer texture to the findings in this report.

*Targeted Outreach*

Just as the SBA established a website in Spanish to better serve Latino entrepreneurs, lenders in California are employing tactics specifically to reach Latino small businesses. The tactics used vary widely. Several lenders report advertising their technical assistance and lending services, or events targeting new clients, through Spanish-language publications or broadcasting networks. Generally speaking,

most community-based lending organizations interviewed noted that small business technical assistance services and pre-development services offered by their organizations played a substantial role in bringing in new small business clients, including Latino business owners, and preparing said clients to be viable applicants.

Many loan officers interviewed noted that they have built relationships with local banks through which they receive referrals for clients that were rejected for financing or require significant technical assistance before they are ready to submit a viable application. Several loan officers noted that most referrals occur due to issues with credit score because of a lack of credit history. Loan officers also note that they have built relationships with other community-based organizations, which have close ties with the community, as well as with local business development centers. Engagement with Latino chambers of commerce as well as with broad-based diversity programs that encompass all minority- and women-owned businesses were also popular tactics. One lender reported offering SCORE's Simple Steps for Starting Your Business workshops in Spanish. While lenders also employ Spanish-speaking staff on site or at call centers, several noted that employing bicultural staff aids in building the level of trust with some Latino business owners. Many interviewees provide marketing materials in Spanish, including on their respective websites and through printed material. Some community-based lenders go so far as to provide bilingual loan applications and technical assistance materials, such as profit and loss templates and guides for developing a formal business plan. One lender recently developed its first online bilingual loan application. However, several lenders only offer these materials in English and note that while Latino business owners may be more comfortable completing forms in Spanish, they are oftentimes able to complete them in English.

While many of the loan officers interviewed employ the aforementioned tactics as a means to specifically reach Latino business owners in their service areas, a significant portion of the interviewees noted that their outreach to Latino business owners is not fundamentally different than it is to non-Latino business owners. However, interviewees noted that barriers to successfully accessing capital can be fundamentally different for Latino business owners when compared to non-Latino business owners. More on this can be found in the following section, *Access to Capital*.

Interview responses included the following:

- *"All of our programs and services are available to any small business,"* a lender said. *"The key is that we try to make sure that the needs of every business category are being addressed. In our (area), we have identified Hispanic-owned businesses as an underserved group. So we do have some products and services that, in my area, are specifically tailored*

*to Hispanic-owned businesses."*

- One lender noted that products and services cannot be tailored too specifically for Latinos. *"What we try to do is to make sure that our outreach targets this underserved group in our (market), Hispanic-owned businesses. But, that is also true of other underserved areas that we have in our (market), like the (Asian) population and black Americans. I think we have more responsibility to make sure that our products and services are reaching out proportionally."*
- Echoing those comments about proportion, another lender said that his institution's 60-70 percent concentration of Latino borrowers is representative of the target market. *"We specifically market to low- and moderate-income people, which in that demographic and geography, tend to be more Latino. Also, our staff is heavily Latino."*
- An interview participant said the types of businesses pursued drive the ethnic mix for his institution. *"We target cash-based businesses which include a higher population of Latinos. These are mostly informal opportunities without business licenses. These borrowers have limited options – it's us or the car loan title lenders. Even so, we are still not meeting the need. It is much bigger than our resources will allow in the $1,000 to $100,000 arena."* The decision to seek out cash-based Latino small businesses is a strategic one. *"We help people obtain economic sustainability and this is the best way to move toward that. Credit creates sustainability. Some people can't pay/file taxes because of affordability or immigration status. We strive to help those people move towards affordability."*

***We help people obtain economic sustainability and this is the best way to move toward that. Credit creates sustainability.***

<u>*Access to Capital*</u>

The lenders participating in the research advised that the availability of credit for Latino-owned businesses is equal to other small businesses, with one lender noting that all small businesses share common challenges such as cash flow, market share, and product viability. "Mature Latino-owned businesses look a lot like other minority-owned businesses at the same stage. The challenges of Latino-owned business are not any different than, for example, Asian-owned businesses." The challenges that this lender identified as facing all minority-owned businesses include:

- distrust of the financial system;
- access to capital to start and sustain the business;
- credit history;

- cash-based businesses;
- conducting business if English is a second language; and
- social capital that will help entrepreneurs weather the inevitable ups and downs of the business

.

One lender said that large banks do not offer the products that many Latino small businesses owners need. "Mostly what they require is $5,000, $10,000, $50,000 so it makes it hard for them to get loans. In (our) area, it is very difficult…serving those loan opportunities for small businesses. A lot of times, they need $10,000, $20,000, $50,000 for equipment, for revamping of the place, for things like that so they're unsecured in a sense."

One interview participant underscored the problem that Latino businesses have with access to capital. "Today, the biggest Latino businesses are with the big banks. But, (big banks) don't like to take the risk up front. They want the businesses that grow, and make the money and have huge deposits and then they can bank them." He added that Latino businesses in early-stage development are cautious. "(Latinos) take steps very carefully. They don't just take on loans or aggressively grow."

A fellow lender affirmed the view that banks are willing to lend, but that there is a mismatch between loan amounts offered and loan amounts sought. "The availability of credit to Latino-owned businesses is better than ever. This is definitely a borrowers' market. Lenders are more easily able to deploy capital to small businesses due to relaxed credit rules. This is a good time for businesses to borrow, and Latino-owned business are included. However, larger loans between $100,000 and $500,000 are hard. The credit risk is higher and the profit is lower. Those types of loans are getting harder to find, not easier. Those loans are difficult because of size, complexity, risk, and profitability – this is not just for Latino-owned businesses, but all small businesses that want loans in this range."

Interview participants identified a number factors that are unique to Latino entrepreneurs and small businesses. These include:

- *Nonexistent/incomplete records and inadequate documentation*. "The cash-based nature of this demographic is a challenge. There may be no tax return or proof of income," a lender said. Another lender said that bringing these clients to a point where traditional financial institutions will consider their loan requests requires time. "When clients come to me in that position, I direct them to a certified public accountant (CPA), to an attorney, to incorporate them, to get them all cleaned up and actually be able to grow, not just in their businesses but also in the administration part of it. I really take a lot of time to kind of say, 'Hey, if you don't qualify today ... you're doing some things wrong. You maybe don't have an accountant, you

have a bookkeeper that's not helping you much. But that takes years. It takes two to three years, four years, before they get to that point, but eventually these people come back and they say, 'Thanks for referring me to so-and-so and so-and-so. We weren't ready; we're growing now, we're doing the things right.'"

Another lender noted that one of the biggest issues they see among Latino business owners without adequate documentation to apply for a loan is a lack of financial literacy. This is oftentimes compounded with a lack of knowledge that predevelopment and technical assistance resources exist, and/or a lack of access to those services. The same lender noted that some of the areas in the state of California with the largest gaps in access to capital are areas where there are no community-based organizations or lenders that are able to provide the technical assistance necessary to get Latino-owned businesses prepared to apply for capital. These services may include technical assistance to prepare proper documentation such as a business plan and profit and loss statements.

- *Immigration status.* "This causes hesitancy, and is likely to increase under the current Administration," a lender explained. "There is discrimination, as well as a lack of comfort with different cultures among mainstream lenders. Big lenders have not made the effort with Latinos regardless of residency." "Coming out of the recession, it was slow, but has been steadily increasing. We haven't reached the number of loans pre-recession, but have realized the dollar volume we had pre-recession. Most Hispanic businesses don't want/aren't ready for larger loans. Credit-worthiness is not as good as it should be, and there's language barrier, so the banks aren't prepared to fully embrace Spanish, as well as the legal status issue. The current immigration climate scares people (prospective clients) away." Another lender also noted that because their major sources of capital included programs provided by institutions such as the Department of Commerce, the Department of the Treasury, and the Small Business Administration, they are restricted to lending only to borrowers who are permanent residents of the U.S. or who are U.S. citizens.

  The charged climate under the current Administration was echoed in anecdotes shared by other lenders interviewed. One lender noted that small business development clients have reported lower sales made to their Latino clientele in recent months, possibly connected to a decision to save money and make contingency plans in response to national immigration action. However, this same lender noted that, in response, the organization has made the decision to double down on creating access to capital to undocumented immigrants. Rather than moving away from providing these higher-risk loans, the lender is preparing to diversify their portfolio and the products they offer so that they are able to absorb any losses due to federal immigration action.

- *Access to capital in their own communities through personalized outreach.* "With the older Latino business owners, it's important that I speak the language (Spanish)," a lender explained. "I go in person and meet with the business, understand their business, and go over their business plan to understand where they're going in the next 5, 7, 10 years. Latino business owners especially take pride in what they've done. We go…to talk about what they've done and what their future holds. They really appreciate that, when you come out to their business and look at the business. It's not like (other customers) who say 'Just email me, just send me this, text me.' I think (Latino entrepreneurs) really like the face-to-face contact and they have to trust you before you can do business with them."

Lenders also noted differences in established Latino businesses and in Latinos whose families have been in California over many years. "The Latino small business segment of the market has become mature, and more closely resembles the mainstream small business market," one lender explained. "The younger generation, the third, fourth generation, now have (college) degrees," said another interview participant. "They're…more business savvy. They've studied business administration, they've gone to college, they're professionals. The kids that are taking over are taking these businesses to a different level. I think it also has a lot to do with social media. Before, marketing was so expensive for any type of business, where now, all these young people are able to market their businesses in social media without having to have this huge expense and take them to different levels that weren't there before. Look at downtown Los Angeles. These guys open up a restaurant in an industrial area, they'll be sold out every night, and it's mostly through social media."

*Methods to increase access to capital*

The lending experts interviewed offered the following strategies to increase access to capital for Latino entrepreneurs:

- "SBA loans and other government-back programs are critical to being able to deploy more capital to Latino entrepreneurs."
- "Ongoing education programs are important to help small business owners with technical assistance. Small business owners frequently do not know what they do not know."
- "Public-private programs are also important. Nonprofit organizations have the best interest of people at heart, and banks can give support to these organizations. These partnerships assist banks to meet Community Reinvestment Act (CRA) requirements and are very helpful in making loans in smaller amounts."
- Many of the lenders interviewed commented on the ways in which they are flexible in addressing the barriers that exist among Latino small business owners. When faced with a client

with a low or nonexistent credit score or with financial statements that do not show sufficient cash flow, these lenders work to obtain additional and unconventional documentation. This may include electric bills or several years of mortgage payments to show that clients are able to meet their obligations. These alternative methods of assessing risk allow lenders to provide access to capital to small business owners who may not be able to access capital from a more conventional institution or bank.

*The Future*

Lenders interviewed for this report identified the growing Latino population, political uncertainty, the regulatory climate, and structural access as issues that will impact the future of Latino entrepreneurship. Interview participants offered the following comments:

***The future of business in America is the future of Latino-owned business. It's not separate.***

- "We have to wait and see what the new administration does for the SBA. The (Latino) demographic is going to grow, and we need to be prepared to lend and provide the funds/support."
- "Over the next four years, federal funding tied to immigration is a major concern. There will be more caution doing business with the undocumented population."
- "The future of business in America is the future of Latino-owned business. It's not separate."
- The more flexibility we have with regulations, the better we'll all be. Anything we can do ease credit, for example, through SBA and state programs, we need to support."
- "The number of successful Latino-owned business has continued to grow and will continue to grow."
- "We want to help hard-working people with credit that moves them toward being economically sustainable. The new administration will have an impact. If people get deported, we don't get paid back. However, CDFIs will take that risk."
- "Competition among banks is on the rise, and the pricing and structure of loan products have been relaxed – although not in the $100,000 to $500,000 loan category."
- "Small businesses are not borrowing what is available – loans are below pre-recession levels even though interest rates continue at record low levels. Business owners are cautious, particularly those who would seek loans of less than $500,000. Business owners with lines of credit are not using the lines unless they know where the money is going and how it will benefit their operations. We have a much more conservative population of business owners post-recession. The recession either weeded out those business owners who were not cautious, or those who have started businesses post-recession have seen what happened to those before them who were not cautious."

- "While there have been credit unions lending, CDFIs need to form special initiatives where they can obtain money from banks, raise funds and lend. Everyone needs to support more start-ups. Sometimes the owner doesn't meet the requirements for owner equity. There needs to be some investment (from banks) so that CDFIs can bridge some of the equity missing from the entrepreneur. I think this will help."
- "One of the challenges that Hispanic-owned businesses face is their legal status. As you know, here in California, we have a large group of the population that doesn't have their legal papers."
- "I would estimate 20 percent of Latinos are undocumented. A decent proportion (of Latino entrepreneurs) are 'credit invisible' without a FICO score, unbanked."
- "Residency, visa, green card status has not been an issue in the past, but we anticipate that it could be even more because the current administration may enact new regulations. This is not an issue that banks control, and California's approach to this may be at odds with any changes at the federal level. Banks could be forced into a law enforcement/immigration role."
- "Most Hispanic (small businesses) ask for $150,000 or less loans. The key is to have the banks help out non-profit organizations to enable them to make usable loans."

## Discussion and Recommendations

Latinos play a crucial role in the nation's economic well-being, and their success as entrepreneurs will take on even greater importance as the Latino population expands. The research presented in this report presents a portrait of a growing Latino entrepreneur population with distinct challenges and opportunities. While Latino entrepreneurship has skyrocketed, average gross receipts for Latino-owned small businesses lag behind those of non-minority firms and the number of Latino businesses is not commensurate with the growth of the Latino population. Real growth among Latino small businesses is being hampered by a lack of access to capital. Latino entrepreneurs struggle to secure loans from traditional financial institutions, and are often only given smaller loan amounts at higher interest rates.

Difficulty in accessing business capital is a problem that reaches far beyond ending one Latino entrepreneur's dream. Small businesses are an essential component of thriving communities and a strong national economy, as well as being one of the few ways to create family and household wealth. When Latino small business owners access capital, they can thrive, create good jobs, and generate local community wealth. These same Latino small businesses are vital to the local, state, and federal tax base improving economic mobility for their employees and their families, and building strong communities and sustainable local tax revenues.

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Specialized strategies and resources tailored to the specific needs of Latino entrepreneurs are necessary to achieve parity. The NALCAB team recommends the following to increase access to capital for Latino entrepreneurs.

## 1. Strengthen Community Development Financial Institutions (CDFIs), SBICs, and other mission-driven lenders that provide culturally-relevant products and services targeted to the Latino market

Mission-driven loan funds help people in underserved communities join the economic mainstream. While there are nearly 500 CDFI loan funds nationally, few provide an economic focus on predominantly Latino communities. There is only one Latino-owned SBIC and few Latino-led social impact funds in the nation.

***Real growth among Latino small businesses is being hampered by a lack of access to capital.***

- Banks can designate funds to CDFIs and other lenders that focus on Latino communities to meet their respective Community Reinvestment Act (CRA) obligations. Banks such as UBS, Wells Fargo, and Goldman Sachs are already engaged in branded national efforts to deploy capital to small businesses. Banks can also collaborate to invest in loan pools and consortia that benefit Latino CDFIs and lenders. Banks should provide capacity-building support to Latino-led CDFIs and lenders with corresponding loan portfolios in order to grow and create larger impact. Goldman's strategy to develop, fund, and implement "Remediation Plans" was extremely beneficial to the long-term health of a number of CDFIs nationally. Catalyzing real growth for CDFIs requires equity investments (whether grants or with an expectation of return) that allow the fund to leverage debt and grow, without over-leveraging the balance sheet.
- A standardized referral system should be developed that enables traditional financial institutions to guide Latino entrepreneurs to mission-based lenders rather than simply rejecting an application for credit. This collaboration would provide greater access to capital, expand the reach of CDFIs, and provide additional data about the needs of Latino small business owners. The Association for Enterprise Opportunity (AEO)'s Project CUE offers a potentially impactful model for matching financial instutitions and CDFIs in a national referral network.
- Philanthropic organizations can provide program related investments and grants to Latino CDFIs. For example, the Surdna Foundation recently launched a consortium model as a more impactful and efficient means of getting financing to Latino entrepreneurs. The Surdna Foundation provided $2 million in loan capital to a consoritium of Latino-led CDFIs, which deployed the capital in four different markets. Through this model, Surdna invested in a small business sector that is underserved by traditional lenders while reducing the risks associated with supporting local small business lenders. The goal is not only to reach Latino small businesses nationally, but to attract additional capital and expand the consortium to include greater numbers of Latino CDFIs. The

CDFIs are all members of the National Association for Latino Community Asset Builders (NALCAB) that make loans to entrepreneurs in predominantly Latino communities.

## 2. Provide Technical Support to Potential Borrowers and Develop Social Capital

Rather than using rigid credit guidelines, flexible eligibility criteria should address the unique credit, collateral, and cash flow situation of Latino entrepreneurs. Banks and other lending institutions should also work with community partners to provide Latino entrepreneurs guidance while applying for loans, along with finance, accounting technology, marketing, procurement, and other business assistance after the loan has been granted. This credit coaching and business mentoring is important for both start-up and existing Latino small businesses.

The absence of social capital is a critical factor for Latino small businesses. Minority entrepreneurs, especially first generation business owners, may not have the intimate understanding of business that those raised in a business environment possess. Support for networking, advising, and counseling opportunities is crucial to closing this gap in social capital. This can be accomplished through philanthropic support of business incubators and accelerators as well as mentorship programs. In addition, organizations such as Junior Achievement and community and four-year colleges that serve Latino populations should support initiatives which introduce young Latinos to entrepreneurship as a career option far earlier.

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## 3. Coordination Among Latino Serving Institutions

Real change, though, will require more vigorous engagement. Bringing disparate organizations together in a more coordinated effort to address deficiencies in development of Latino businesses is vital. Competitiveness among organizations seeking to promote Latino entrepreneurship diffuses their strength. A unified front is crucial. Engagement with municipal economic development departments, chambers of commerce, lenders, and political leaders across community and ethnic boundaries will embed Latino entrepreneurs in the broader social and business establishment in a way which will bring about lasting change. Lenders, economic development organizations, Latino chambers of commerce, and Latino business oriented nonprofits should also seek opportunities for more networking with and between Latino small business owners.

## 4. Need for Further Study of Undocumented Entrepreneurs

After working in a trade or business for a period of time, undocumented workers often establish businesses (e.g., contractor or retail shop). Historically, these entrepreneurs have not been able to access financing from mainstream financial institutions. The number and characteristics of undocumented entrepreneurs needs to be studied along with the positive economic impacts that would flow from changes in federal immigration policies and enforcement tactics.