



Financing Entrepreneurship in Distressed Areas

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for

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Introduction

- ◆ “The persistent economic distress of inner cities in the United States challenges us to find more innovative approaches to economic opportunity for inner-city residents...Sustainable economic development will occur only as it has elsewhere, by employing an economic strategy that emphasizes private, for-profit business growth and job development.”

Initiative for a Competitive Inner City

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Overview

- ◆ What is the value of small business to the economy?
- ◆ How is entrepreneurship funded?
- ◆ What kinds of examples show promise in funding entrepreneurship in distressed areas?
- ◆ Recommendations for policy makers.

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What is the value of small business to the economy?

According to the U.S. Small Business Administration...

- ◆ 22.9 million small businesses in 2002
- ◆ 75 percent of net new jobs
- ◆ 50.1 percent of the private work force
- ◆ 39.1 percent of high technology jobs 2001
- ◆ 40.9 percent of private sales
- ◆ 97 percent of all US exporters

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What role does entrepreneurship have in the economy?

- ◆ Entrepreneurship is the way the economy takes advantage of new wealth-creating opportunities that arise daily from constant change.
 - In 2002 alone, more than 500,000 new employer businesses were created. (SBA)
 - Entrepreneurs are responsible for 67 percent of inventions and 95 percent of radical innovations of existing technologies. (Nat'l Commission on Entrepreneurship)

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How is entrepreneurship funded?

- ◆ Personal Credit
- ◆ Micro-angels (\$54 Billion)
- ◆ Banks and Credit Unions
- ◆ Government Assisted Financing (\$45 Billion)
- ◆ Hybrid – Bank / Government / Foundation (\$855 Million)
- ◆ Private Venture Capital (\$48 Billion)

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Visa, MasterCard, and American Express

- ◆ Personal credit cards are the No. 1 source of financing for small businesses.
 - 46 percent of all businesses fund their operations with the use of personal credit cards.
 - 71 percent of businesses use personal credit cards or loans from the business owner.
 - 52.2 percent of businesses 10-19 employees used personal credit cards to fund business operations.
 - 23.7 percent of businesses 100-499 employees used personal credit cards to fund business operations.

“Financing Patterns of Small Firms” US Small Business Administration 1998
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Informal Investors “Micro Angels”

- ◆ In 1999, 7 percent of adults in the US were considered informal investors.
- ◆ Informal investors invest in new ventures started by family members, work colleagues, neighbors, and friends.
- ◆ Micro-angels invest \$54 billion per year
Global Entrepreneurship Monitor 2000

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Private Banks and Credit Unions

- ◆ Only 55 % of businesses fund their businesses with loans from banks or credit unions.
- ◆ Less than 6 % of bank lending reaches businesses in low income areas.

“Financing Patterns of Small Firms” US Small Business Administration
1998

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SBA: Fifty Years of Assistance

- ◆ The US Small Business Administration has provided business financial assistance for the past 50 years. Total financial assistance has amounted to \$232.9 billion dollars in loans and venture capital financing to small businesses, creating more than 6 million jobs. More than 56 % of business development assistance goes to businesses operating in distressed areas.

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SBA by the Numbers

From August 1, 1953 to July 31, 2003, the SBA has provided the following:

- 1,182,707 direct and guaranteed 7(a), 504 loans and microloans, totaling \$193.11 billion.
- 136,000 SBIC financings of venture capital for \$39.8 billion to 96,050 businesses since 1958.
- 322,582 SBP bids guaranteed for \$64 billion contracts.
- 1.57 million disaster loans for \$30.9 billion.
- 64,000 SBIR awards worth \$11 billion.
- 2,900 SBTT awards worth \$549 million.
- 542,000 US Government contracts worth \$88 billion.

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Hybrid – Bank / Government / Foundation

- ◆ Microloan or microcredit programs are hybrid funded lending programs for businesses with fewer than 5 employees, needing less than \$35,000 in start up funding. Nearly 100% of funding goes to low income entrepreneurs in distressed areas.
 - SBA estimates that there are 2,000,000 microenterprises.
 - Association for Enterprise Opportunity estimates that 57,000 new businesses are created annually with the assistance of microloan programs.
 - Loans range from \$500 to \$35,000, average microloans are \$15,000.
 - Loss ratios for microcredit programs are equivalent to bank lending programs.

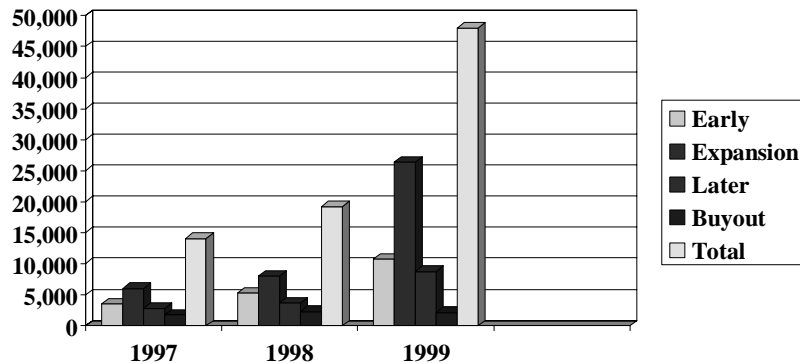
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Amount of Venture Capital Invested by Stage (\$ millions)

Global Enterprise Monitor 2000



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How do women entrepreneurs fare in attracting capital for their businesses?

- ◆ Women own nearly 40 percent, approximately 9 million businesses, of all businesses in the US.
- ◆ Women led firms circulate 4,000-5,000 business plans to VC funders each year.
- ◆ Women secure less than 5 percent of all venture capital funding.
- ◆ In the 45 years from 1953 to 1998, only 395 women led businesses received VC funding.

The Diana Project (Women Business Owners and Equity Capital: The Myths Dispelled) Kauffman Center for Entrepreneurial Leadership

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How do minority entrepreneurs fare in attracting capital?

- ◆ There are 3 million minority owned businesses in the US, representing 15 % of all businesses, creating 4.5 million jobs, and \$96 billion in payroll to workers.
 - Minority owned firms received an average 2.7 % of US government contract dollars in 1996-2000.
 - Minority owned firms received an average 20.7 % of SBA lending in 1996-2000.
 - 1.4 million Hispanic businesses in the US, Hispanic businesses grew by 82 % between 1992-1997. (US Economic Census 1997) yet received only 4.25 % of venture capital funding.

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Summary Conclusions

- ◆ There is not enough equity funding available for new and growing firms, especially for women and minorities.
- ◆ Lack of debt and equity funding prevents new firm creation and growth.
- ◆ Public subsidies have a major impact promoting firm creation and growth.
- ◆ Informal investors are the primary source of support for new and growing firms.

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Promising examples of funding for entrepreneurship in distressed areas.

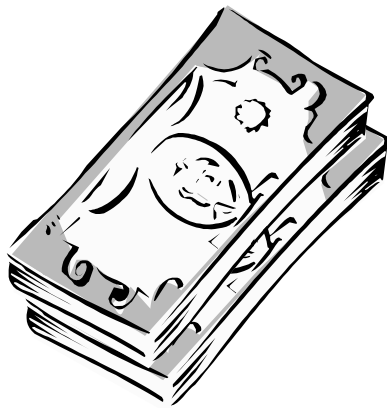
- ◆ Government leveraged funding – Southeast Community Capital, Oakridge, Tennessee; and CDC Small Business Finance Corporation, San Diego, California
- ◆ Foundation leveraged funding – Initiative for a Competitive Milwaukee, Milwaukee, Wisconsin
- ◆ Non-profit leveraged funding – Gary Urban Enterprise Association, Gary, Indiana

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Government Leveraged Funding



Southeast
Community
Capital
Oakridge, Tennessee

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Southeast Community Capital

SCC is a certified Community Development Financial Institution, (CDFI), established in 1999, that provides loans and investments to start up and early stage small businesses in communities in Tennessee and southern Appalachia that do not have access to traditional financing.

- ◆ 75 % of its lending in low income communities.
- ◆ 44 loans totaling \$2,268,043, creating 238 jobs, providing sustainable wages of \$34,240 per year. (\$10,000 per job)
- ◆ 99 % percent of recovery of dollars lent to date.
- ◆ \$45.5 million venture fund.

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Southeast Community Capital Sources of Funding

- ◆ Federal: SBA Microloan, USDA Intermediary Relending, New Markets Venture Capital, New Markets Tax Credits
- ◆ State and Local: Community Impact Loan Fund, Telecommunications Assistance Fund, Chattanooga Opportunity Fund, Nashville Opportunity Fund
- ◆ Private: Banks and Foundations - SCC Revolving Loan Fund, Chattanooga Opportunity Fund, Nashville Opportunity Fund; Investors – TennesSeed Fund, Southern Appalachia Fund, Center for Entrepreneurial Growth

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Government Leveraged Funding



CDC Small
Business Finance
Corporation
San Diego, California

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CDC Small Business Finance

- ◆ Founded in 1978, CDC is a non-profit financial intermediary serving the capital needs of small businesses in San Diego, Orange, Riverside, and Imperial Counties of California. In 2002, CDC was the nation's No.1 SBA 504 lender, received a total of 312 SBA 504 loans approvals, representing a record \$152 million financing for projects exceeding \$445 million, creating 6500 job in this year. CDC is the largest of 260 Certified Development Companies working with the SBA.

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CDC Deal Stats

- ◆ More than 50 bank funding partners.
- ◆ 90 % fixed rate financing.
- ◆ 72 hour prequalification.
- ◆ Average deal is \$1.2 million, 40 % CDC, 50 % bank debt, 10 % borrower equity.
- ◆ Small business purchase of industrial or commercial building, 10 % down, 20-year, fixed rate, 6.5%.

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Foundation Leveraged Funding



Initiative for a
Competitive
Milwaukee
Milwaukee, Wisconsin

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Initiative for a Competitive Milwaukee

- ◆ In 2001, the Helen Bader Foundation invited the Initiative for a Competitive Inner City (ICIC) and CEO Michael Porter to develop a new approach to improving the situation for 5,000 businesses and 376,000 residents of inner city Milwaukee. Refocused energies on creating jobs and wealth, untapped opportunities, new investment, and private sector leadership.

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Initiative for a Competitive Milwaukee – Preliminary Results

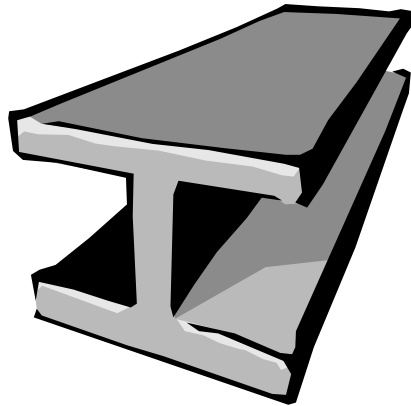
- ◆ Uncovered untapped growth in inner city - \$1.4 billion retail spending power.
- ◆ Identified four business clusters with growth potential – metal manufacturing, health services, construction, and financial services.
- ◆ 15 % of inner city workers are underemployed based on skill levels.
- ◆ 78 % of vacant industrial land is in the inner city.
- ◆ Focused and prioritized local economic development funding.
- ◆ New venture capital fund in formation.

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Non-profit Leveraged Funding



Urban Construction
and Training
Program, Gary
Urban Enterprise
Association
Gary, Indiana

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Gary Urban Enterprise Association

- ◆ The GUEA is a non-profit corporation formed in 1985 to redevelop the Gary, Indiana enterprise zone. Unemployment is 37 % and 38 % of residents live in poverty. Tax and financial incentives encourage investment and job creation within the designated zone. Though many jobs have been created few resulted in employment for zone residents. With the expiration of the zone looming, the GUEA focused nearly all of its efforts and resources on creating new businesses and employment in construction.

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Three – Year Results

- ◆ Extensive market research shows underserved market; high demand for new housing in Gary and surrounding region.
- ◆ Urban Construction and Training Program created, 60 week training in carpentry, plumbing, electrical, painting, drywall, design, estimating, and blueprints.
- ◆ GUEA Housing Corporation founded.
- ◆ 44 units of new housing built, first housing built since 1970.
- ◆ 30 trainees employed by area contractors building area homes.
- ◆ 40 trainees employed by local housing authority and GUEA Housing Corporation.
- ◆ Three spin-off businesses planned.

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What Preliminary Research Suggests

- ◆ Bias to money making, market oriented approaches, over social investing.
- ◆ Research base to establish the market, attract additional capital, and prioritize funding.
- ◆ Recognizing and legitimizing all sources of capital.
- ◆ Particular emphasis on women and minority owned companies because of their proliferation in inner city and rural distressed areas.

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Sources for More Information

- ◆ Global Entrepreneurship Monitor
- ◆ Helen Bader Foundation
- ◆ Initiative for a Competitive Inner City
- ◆ Kauffman Center for Entrepreneurial Research
- ◆ National Association of Seed and Venture Funds
- ◆ National Commission on Entrepreneurship
- ◆ US Small Business Administration

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