

Connecting Communities



Virtual CDFI Symposium – CDFIs and Minority-Owned Firms

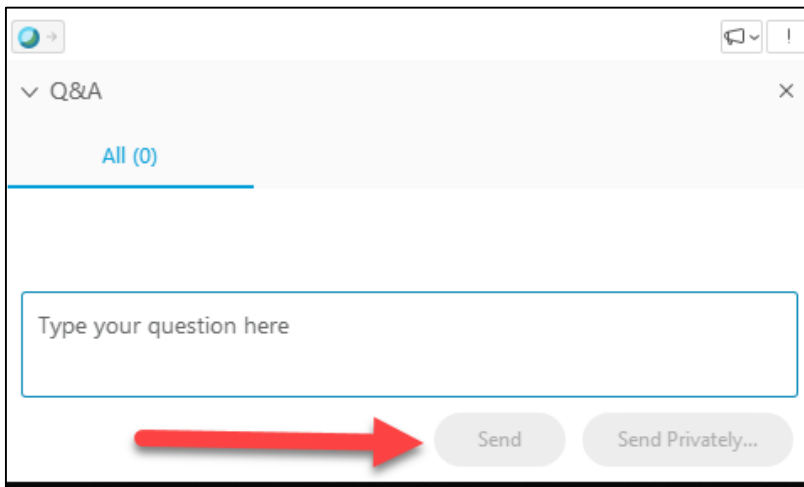
May 27, 2020

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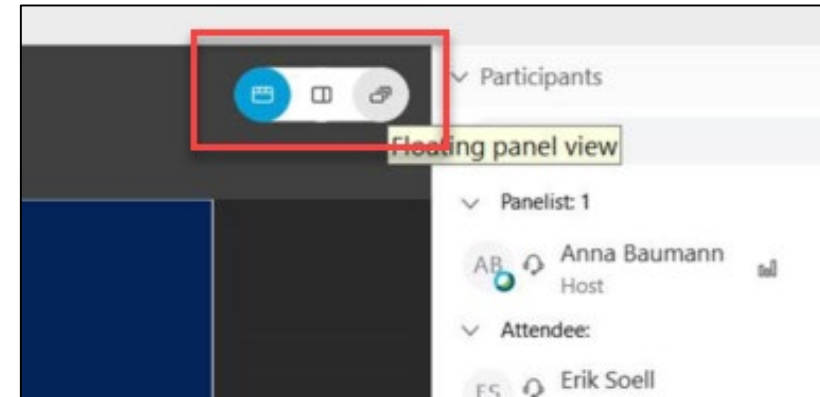


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This event is hosted by the following organizations.



Community Development

The mission of the Federal Reserve's community development function is to promote the economic resilience and mobility of low- to moderate-income and underserved individuals and communities.



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The information, analyses, and conclusion set forth are those of the presenters and do not necessarily indicate concurrence by the Board of Governors of the Federal Reserve System, The Federal Reserve Banks, or members of their staffs.

Welcome



Amanda Roberts

Board of Governors for
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Kim Saunders

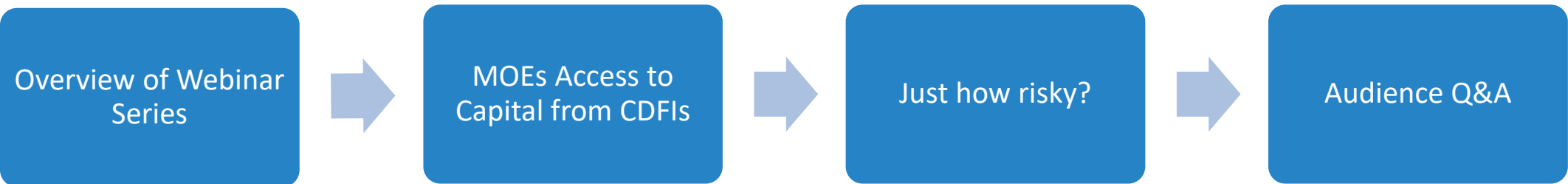
National Bankers
Association



Russell Kashian

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Agenda for this webinar



Minority-Owned Enterprises and Access to Capital from CDFIs



Victor Motta



Minority-Owned Enterprises and Access to Capital from CDFIs

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Small Businesses and MOEs

- Small businesses are critical to local economic development in the U.S.
 - Added 1.4 million net new Jobs in 2017 (Robb, Barkley and de Zeeuw, 2018)
 - Employed 48% of the U.S. workforce in 2016 (US Census Bureau, 2016)
- Minority-owned enterprises (MOEs) has seen rapid growth in recent years
 - Increased 11% between 2014 and 2016 (U.S. SBA, 2019)
 - MOEs create a significant share of jobs in low and moderate-income neighborhoods (Bates and Robb, 2014).

MOEs and Access to Capital

- Previous research established positive links between access to capital and performance outcomes (Black and Strahan, 2002; Servon et al., 2010)
- MOEs relatively more likely to encounter constraints in accessing capital from traditional banks
 - Lower levels of wealth (Bates and Robb, 2016; Robb et al., 2018)
 - Higher loan application rejection rates (Blanchflower et al., 2003; Cavalluzzo and Wolken, 2005; Blanchflower, 2009)
 - MOEs receive lower loan amounts and pay higher interest rates (Bates and Robb, 2013)

MOE Access to Capital and CDFIs

- Community Development Financial Institutions (CDFIs) provide a means to bridge limited access to capital between banks and MOEs
- CDFIs' main social objectives include:
 - Supporting job growth in disadvantaged communities
 - Providing access to financial services to MOEs at affordable rates (Affleck and Mellor, 2006)
 - Revitalizing economic conditions in disadvantaged communities (Harger et al, 2019)

Purpose of the Study

- We examined the likelihood of MOEs applying for CDFI loans.
 - We also aimed to investigate whether MOEs are more likely to have their application accepted from CDFIs.
- Two research questions:
 1. Are MOEs more likely to apply for loans from CDFIs than non-MOEs?
 2. Are MOEs more likely to have their loan application accepted in CDFIs than non-MOEs?

Methods

- We use 2016 through 2019 data from the Federal Reserve Banks' Small Business Credit Survey (SBCS).
 - Samples both non-employer and employer businesses with less than 500 employees.
 - *Advantage*: provides info on applicants that pursued financing elsewhere.

$$\begin{aligned} Apply_i = & \beta_0 + \beta_1 Size_i + \beta_2 CreditRisk_i + \beta_3 Rural_i + \beta_4 WomenOwned_i + \\ & \beta_5 Profitability_i + \beta_6 FirmAge_i + \beta_7 Industry_i + \beta_8 Race_i + \beta_9 ZipCode_i + \\ & \beta_{10} VeteranStatus_i + \beta_{11} year_i \end{aligned} \quad (1)$$

$$\begin{aligned} Approval_i = & \beta_0 + \beta_1 Size_i + \beta_2 CreditRisk_i + \beta_3 Rural_i + \beta_4 WomenOwned_i + \\ & \beta_5 Profitability_i + \beta_6 FirmAge_i + \beta_7 Industry_i + \beta_8 Race_i + \beta_9 ZipCode_i + \\ & \beta_{10} Collateral + \beta_{11} Debts_i + \beta_{12} VeteranStatus_i + \beta_{13} year_i \end{aligned} \quad (2)$$

Results

Table 2: Probability of Small Business Applicants Applying at a CDFI for a Loan, Line of Credit, or Cash Advance (Odds Ratios)

Key Covariates	White-Owned Firms	Black-Owned Firms	All Firms	All Firms (with LMI zip code)
Race/Ethnicity of Firm Ownership (White-Owned is base group)				
Black or African American			1.859***	1.677***
Asian			1.377	1.270
Hispanic			1.420**	1.562**
Low Income Zip Code				1.355**
Size of Firm (Non-employer is base group)				
1-4 employees	0.845	1.321	1.010	1.043
5-9 employees	0.773	1.095	0.938	0.905
10-19 employees	0.876	1.233	0.943	0.798
20-49 employees	0.470***	0.492	0.523***	0.504***
50-499 employees	0.455**	0.584	0.568**	0.608*
Credit Risk (low risk is base group)				
Medium risk	1.583***	1.458	1.587***	1.608***
High risk	1.470*	1.275	1.449**	1.504**
Did not respond	1.212	1.406	1.134	1.070
Rural	0.994	0.244*	0.887	0.758*
Female-owned	1.406***	1.168	1.416***	1.494***
Profitable	0.881	0.893	0.932	1.062
Age of Firm (0-2 years is base group)				
3-5 years	0.958	1.337	0.968	0.882
6-10 years	0.651**	1.410	0.783*	0.823
11-15 years	0.574**	0.899	0.598***	0.595**
16-20 years	0.803	0.946	0.715*	0.760
21+ years	0.327***	1.075	0.364***	0.467***
Observations	8,516	1,354	11,012	6,860

*** p<0.01, ** p<0.05, * p<0.1

Note: Applicants applied for a loan, line of credit, or cash advance. Coefficients are displayed as odds ratios.

Results

Table 3: Likelihood of Applicants Receiving Approval at a CDFI for at Least Part of the Loan, Line of Credit, or Cash Advance Requested (Odds Ratios)

Key Covariates	White-Owned Firms	Black-Owned Firms	All Firms	All Firms (with LMI zip code)
Size of Firm (Non-employer is base group)				
1-4 employees	1.075	3.680*	1.666	1.620
5-9 employees	0.664	0.884	1.133	1.321
10-19 employees	0.681	1.242	1.081	1.310
20-49 employees	0.190**	0.454	0.492	0.846
50-499 employees	0.715	0.263	2.183	1.986
Credit Risk (low risk is base group)				
Medium risk	0.440*	0.364	0.917	0.963
High risk	0.135***	0.192*	0.252***	0.233***
Did not respond	2.265	0.332	2.046	1.363
Rural	1.961	0.294	1.576	1.288
Female-owned	1.307	1.162	1.278	1.191
Profitable	1.458	3.233*	1.649*	1.477
Age of Firm (0-2 years is base group)				
3-5 years	0.450	0.238	0.362**	0.340**
6-10 years	0.667	0.481	0.453*	0.430
11-15 years	0.246**	0.267	0.255***	0.188***
16-20 years	0.359	0.107	0.305**	0.245**
21+ years	0.388	0.480	0.492	0.417
Collateral Used to Secure Debt (no collateral is base group)				
Business Collateral	4.512**	3.796	3.224**	2.862*
Other type of collateral	1.680	1.575	1.660	1.347
Race/Ethnicity of Firm Ownership (White-Owned is base group)				
Black or African American			0.634	0.485*
Asian			1.051	0.487
Hispanic			1.370	0.961
Low Income Zip Code				1.009
Observations	258	94	408	272

*** p<0.01, ** p<0.05, * p<0.1

Note: Applicants applied for a loan, line of credit, or cash advance. Coefficients are displayed as Odds Ratios.

Take-Away Results

- ***Black-owned enterprises*** are more likely to apply for CDFI loans and less likely to be approved.
- Firms with ***business collateral*** are more likely to be approved
- Negative relationship between ***firm age*** and ***firm size*** and the likelihood of applying for CDFI loans and being approved
- ***Women-owned firms*** are more likely to apply and be approved
- ***Riskier firms*** are more likely to turn to CDFIs for credit

Black-Owned Enterprises and Future Research

- Why is loan approval less likely for Black-owned enterprises?
- Two potential explanations (Bates and Robb, 2016; Robb et al, 2018):
 - Black-owned firms may have higher *credit risk*
 - Black-owned firms may lack the necessary *collateral guarantees*
- **Next steps:** use CDFI Fund data to examine the impact of collateral size on terms of loan agreement (size, maturity and interest rate) for MOEs in comparison to white-owned enterprises.

Thank You!

Just How Risky? Comparative Institutional Risks of Mission-Based Depository Institutions



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Just How Risky?

Comparative Institutional Risks of Mission-Based Depository Institutions

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THE CONTEXT

The context in which MDDIs operate

THE MODEL

Analysis using CAMEL model

THE IMPLICATIONS

Thoughts for policy makers





THE CONTEXT

The context in which MDDIs operate



MISSION-DRIVEN DEPOSITORY INSTITUTIONS

- MDDIs designate depository Community Development Financial Institutions and Minority Depository Institutions.
- Because of their mission, MDDIs locate in LMI & minority neighborhoods.
- This leads to questions about health and viability of these institutions.



POTENTIAL INSTITUTIONAL FAIL RISKS

- Clients
- Capability Endowments
- Information Asymmetry
- Contagion
- Captive markets





THE MODEL

Analysis using CAMEL model



CAMEL MODEL

CAMEL MODEL	VARIABLES
Capital Adequacy	Gearing Ratio
Assets Quality	Return on Assets, NPA Asset Ratio, Total Assets (Log), Equity-to-Asset Ratio
Management	[None]
Earnings	Cost of Funds, Yield-Cost Ratio, Operating Ratio
Liquidity	Liquidity Ratio

ADDITIONAL INFORMATION	VARIABLES
Mission-Driven	CDFI & MDI (Asian, Black, Hispanic, & Native American)
Market Area	Rural-Urban, Community Poverty, Co-ethnic

FFIEC Call Reports, Q1 2001 – Q4 2018. Community variables from U.S. Census Bureau; CDFI variable from U.S. Department of Treasury Community Development; MDIs from FDIC.



LOGIT RESULTS: BANK FAILED

Variable	Significance	Direction
MDI	p < 0.01	Negative
CDFI	p < 0.01	Negative
Gearing Ratio	p < 0.01	Positive
Return on Assets	p < 0.01	Negative
NPA Asset Ratio	p < 0.10	Positive
Total Assets (log)	Insignificant	Positive
Equity-to-Asset Ratio	p < 0.01	Positive
Cost of Funds	Insignificant	Positive
Yield-Cost Ratio	p < 0.01	Positive
Operating Ratio	p < 0.01	Negative
Liquidity Ratio	Insignificant	Negative
Community (RUCA & Co-Ethnic)	p < 0.01	Negative





THE IMPLICATIONS

Thoughts for policy makers



IMPLICATIONS FOR POLICY MAKERS

Expansions of these institutional types is not only consistent with desires for safety and soundness, but increased investments in these institutions could result in enhanced LMI and minority participation in financial services.





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Discussants



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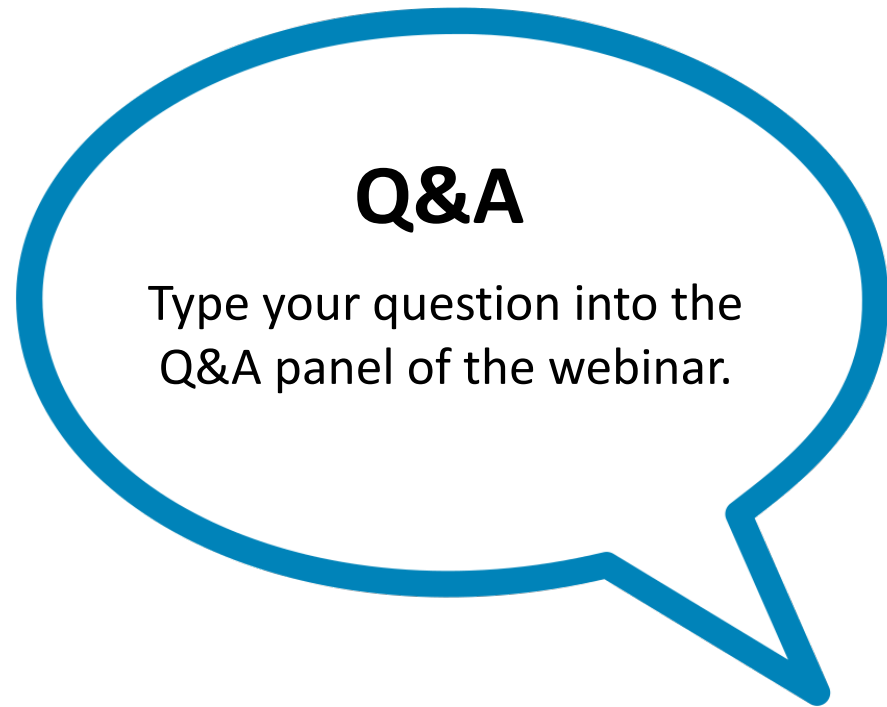
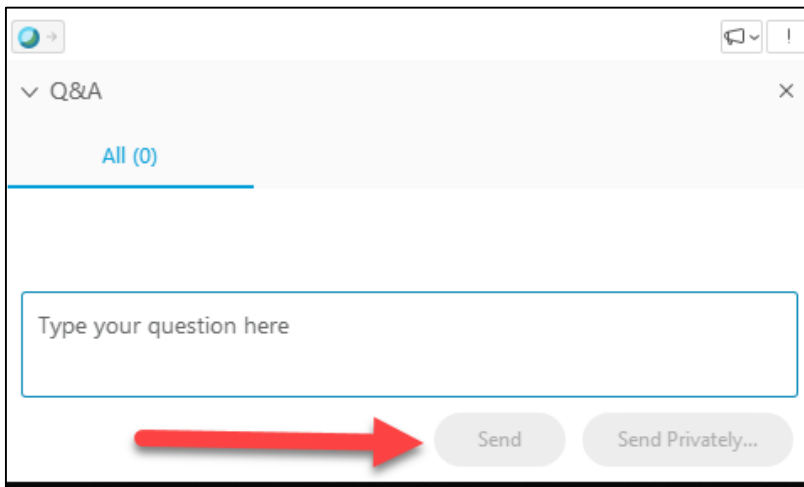
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Next Steps

- All session materials are available on our web site and in the next few days we will post an audio file of today's session.
- Information about future sessions will be posted on our website along with archived materials from past sessions: <https://bsr.stlouisfed.org/connectingcommunities>
- The third installment of the Virtual CDFI Symposium is next **Wednesday, June 3rd at 3 pm ET**. It will focus on research pertaining to Capitalizing CDFIs and registration is now open at stlouisfed.org/events/cd