Underserved Markets Capital Program Solutions

An elegant public-private market comprehensive solution for the capital needs of scaled or scalable minority companies, to allow them to maximize their potential and build ladders of opportunity.

We are living through a unique historical moment: the ending of the COVID-19 pandemic and its effect on the economy; unprecedented dialogues and calls to action for racial justice and equity; a rapidly growing impact investing global movement; accelerated demands from institutional investors and policy makers for transparency and accountability regarding Environmental, Social and Governance (ESG) goals including supplier diversity and talent inclusion, and consumer expectations for social and environmental impact efforts from businesses. All of these forces are inspiring and compelling market players to build the necessary architecture to maximize human potential, bolster disadvantaged communities and lay the foundation for a new future of our country.

What problem is the proposal seeking to solve?

In the context of the above premise, our proposal aims to fill a capital architecture void and provide an elegant public-private market solution to the capital needs of a significant part of the US economy: scaled or scalable minority companies, to allow them to maximize their potential. We estimate that the total need of scaled minority companies due to COVID-19 is at least $560 billion in debt and equity solutions, plus another $140 billion of lost revenue that has been addressed by the PPP program, for a total of $700 billion.

According to the MBDA, there are 8 million minority owned businesses, a 38% increase since 2007 (see infographic below). These businesses generate $1.4 trillion in annual gross receipts. Assuming a 40% loss of revenues over a three-month period during the pandemic, these companies would have lost $140 billion. If we assume an EBITDA (earnings before interest, taxes, depreciation, and amortization) margin of 10% (on the low end), the aggregate yearly EBITDA of these companies is $140 billion. Assuming a 2x EBITDA debt capacity and a 2x EBITDA equity capacity, these firms would need $560 billion in debt and equity solutions, in addition to $140 billion of three months of 40% revenue losses.
A subset of minority businesses are Latino-owned businesses, the fastest growing segment of the U.S. small business economy, achieving 34% growth over the past 10 years compared to just 1% growth for all other small businesses, according to the 2020 State of Latino Entrepreneurship Report published by the Stanford Latino Entrepreneurship Initiative. Even so, they face disproportionate challenges—including accessing capital.

Despite their remarkable growth and increasing significance to the U.S. economy and social fabric, minority owned businesses have only flourished on “the sidelines” of capital structures, and have lacked the appropriate architecture to thrive. The pandemic has only exacerbated these existing problems. We propose a lasting and systemic solution that brings together public-private and the non-profit sector.

Who are the key stakeholders and what is their role within the capital ecosystem?

Architectural capital solutions should enlist a variety of key stakeholders, from public policy leaders to corporations and entrepreneurs and the organizations that support their growth.

Public Policy: In our estimation, public policy plays a pivotal role. Many of the recent programs and laws created to provide relief to small and minority businesses have focused on Minority Depositary Institutions (MDIs) and Community Development Financial Institutions (CDFIs). As the graphic below explains, MDIs and CDFIs play a critical role providing minority businesses access to capital. However, these important institutions do not focus on the segment that the program we are proposing would encompass: scaled or scalable businesses with north of $2 million in capital needs. These firms might not be the largest percentage of the minority segment, yet they hold immense economic value potential both in terms of economic output and quality job creation.¹

Corporations: Call to action for Corporate Boards and CEO’s. As part of the racial equity commitments and dialogues happening in our country today, Corporations and their supplier diversity efforts can also play a fundamental role in uplifting the segment of the economy we are focusing on in this proposal. Corporations have the opportunity to elevate their supplier diversity efforts and include bold partnership goals with minority enterprises and minority investment managers that provide capital to diverse suppliers. In other words, diversity and inclusion efforts should extend to investment departments. Corporations can also take a step forward by accelerating proven models such as the Billion Dollar Roundtable BDR Triad—a strategic outcomes theory of change for scaling minority and women owned business enterprises (MWBEs) & diverse-owned companies by aligning corporate supplier strategic needs with capital partners to scale or create (through acquisitions or corporate divestitures) sizable minority enterprises. Finally, corporations can align their business leaders- and their innovative spirit- to diversity goals, hence enabling teams inside corporations to envision new models.

Entrepreneurs: It is imperative to support organizations that train entrepreneurial talent. We extend an invitation and a call to action to corporate executives with industry expertise to become leaders of diverse enterprises and support diverse entrepreneurs that can and should be created through tools such as the BDR Triad, through which a non-minority enterprise who experiences an owner transfer event, or a corporate divestiture can be converted into a minority owned firm. Small, lower middle market as well as buyout investment bankers can be important allies in these change of ownership opportunities, collaborating with diverse private equity capital providers. As supplier diversity efforts in financial institutions are enhanced and elevated, these types of collaboration can be possible.

What is the proposal?

The proposal is the creation of the UMCP (Underserved Markets Capital Program), an investment program to fully mobilize and deploy at least $10 billion to invest in small and middle market businesses with an emphasis on women, minority and diverse owned businesses. UMCP would be run by the Treasury and the Federal Reserve, who would issue an RFP to seek program asset managers and fiduciaries who are minority owned asset management firms with at least 10 years of experience, with an Impact and LMI proven track record, and investing experience, as well as having experience with government public private programs during prior recessions. The Program would work closely with
Federal and State Government and Corporate supplier Diversity programs to ensure full utilization of the products and services produced by the companies they work with. The UMCP seeks to include a large fund of fund, a coalition of minority managers, and a wide variety of minority and diverse business groups and chambers, to provide much needed technical assistance to the businesses that will benefit from the Program. The key objective is to create a sustainable, profitable and repeatable model to continue to allocate to the undeserved markets with continued private sector participation. The UMCP will aim to partner with 4,300 scaled or scalable small businesses to ensure their survival, growth and multiplier effect among the communities they are part of.

UMCP key characteristics include:

- Short, mid and long term capital solutions, both debt and equity.
- Implementation by proven asset managers with links to and knowledge of the diverse and underserved markets.
- Pricing and valuations to follow small, lower middle market standards.
- Some capital may serve as a bridge facility, some other would serve as growth capital.
- Multi-diverse/comprehensive outreach: The Program would be executed by a coalition of Latino, African American and diverse firms, as well as business and training organizations, and would include other diverse and non-diverse firms committed to the space.
- A sustainable, profitable and repeatable model that will serve to recycle capital and help more businesses.
- A budget for a robust technical assistance program. The formula includes proactive support and technical assistance and participation of a wide variety of diverse businesses and corporate industry associations. The UMCP would oversee the standardization and implementation of such technical assistance.
- The Program would actively engage with CFDIs, MDIs and Community banks to create an efficient pipeline of business opportunities and technical assistance.
- Ability to multiply resources via a public-private solution, in line with the model of PPIP utilized during the last recession.
- Two business segments and one tech assistance grant component:
  - At least 1,000 top diverse businesses. The Program would include a $1 billion direct allocation for 1,000 top diverse and pre-Covid profitable small and middle market businesses, especially diverse owned businesses with EBITDA north of $500,000. The program would seek an IRR above 10%.
  - At least 4,200 smaller diverse businesses. The Program would include a $200 million direct allocation for 4,200 diverse and pre-Covid profitable small businesses, especially diverse owned businesses with revenues between $24,000 and $2 million. The program would seek an IRR above 5%.
  - A $100 million grant allocation to provide technical assistance to a multi-diverse group of industry associations and chambers who would go through a training, standardization and capacity building program run by UMCP.

What root cause does the proposal address?

As mentioned above, despite their impressive growth and increasing significance to the US economy and social fabric, scaled and scalable minority owned businesses have been disconnected to capital—a reality exacerbated by the COVID-19 pandemic. **Capital providers, from banks to private equity funds, operate on the premise of relationships and affinity. For diverse communities to flourish they must**
be architects of their own capital solutions. The Proposal offers a lasting and systemic solution that brings together public-private and the non-profit sector.

What is the mechanism behind it?

Treasury and the Fed have the power to restart the economy and provide architectural debt and equity facilities for segments of the economy that have been historically starved of the right capital solutions. The proposed Program taps on the public-private partnership mechanisms that were activated by Treasury and the Federal Reserve during the last recession, which included both debt and equity solutions. Moreover, the Program incorporates market returns. It's a sustainable, profitable and repeatable model that will serve to recycle capital and help more businesses.

How will you know that it has worked?

The Program would have two measures of success:

- Market ROI for investors
- Capacity building of diverse businesses, expressed in increased revenues, margins, EBITDA and high-quality job creation.

The intention is to rally a wide variety of capital providers and technical resources, integrating their efforts through a programmatic Master Plan, the UMCP program.

How feasible is this proposal? What conditions would improve its feasibility?

Twelve years ago during the last recession, Treasury opened discussions with asset managers, including diverse managers, and issued RFPs. The proposed public-private solutions would repeat a similar process. We believe the Federal Reserve and Treasury have the existing toolset to stand up a solution like the one we describe, following the 3-to-1 public to private assets that was followed during the PPIP (Public-Private Investment Program) program, which included equity investment provisions. Similarly, to what happened with PPIP, Treasury and the Federal Reserve could provide a window to raise the matching private capital. Treasury originally committed approximately $22 billion of equity and debt financing to nine Public-Private Investment Funds (PPIFs).

Treasury fully recovered its original investment of $18.6 billion in PPIP, plus a net positive return of more than $3.9 billion through interest, and proceeds in excess of original equity capital, including warrant proceeds (https://home.treasury.gov/data/troubled-assets-relief-program/credit-market-programs/ppip).