BLACK PAPER 3.1

Relationship-Based Lending:

Driving Equity by Centering Trust in the Financial System

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 ICC

The Inclusive Capital Collective is a growing network of community fund managers and entrepreneur support organizations who have been designing and developing shared technical and financial infrastructure for aggregating and deploying financial capital and other resources to entrepreneurs and communities of color in the US.

Its purpose is to overcome systemic racism through equitable access to capital.

The ICC achieves this purpose by aiding and amplifying capital innovators and service providers who are building wealth in their communities using debt, equity and real estate instruments, and by connecting them in a jointly owned and governed network. With the ICC, capital innovators and service providers centering communities of color have created a novel kind of intermediary infrastructure to help each other accelerate the learning curve required to design, and redesign, for a more equitable future; mobilize capital; and grow their businesses.

ICC capital innovators are exploring alternative types of capital, developing more equitable ownership models, and structuring blended finance offerings that mobilize a range of philanthropic and private capital.

This work was important before the pandemic, and it has only become more urgent as we contemplate how to rebuild an economy and society that creates health and wealth for all.

The Black Papers are a series of briefings written by and for practitioners. They illuminate the systemic barriers in financial markets, focusing on specific areas and segments that are ripe for interventions by investors interested in deploying their resources for social justice. Each Black Paper spotlights scalable solutions developed by members of the ICC, and invites the reader to take action.

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Executive Summary

In the U.S. financial system, the primary goal is to accumulate capital.[1] But, what if the goal was to share capital and support others equally to build wealth?

Data from a 2021 credit survey shows that white-owned small businesses are twice as likely to be fully approved for financing than small businesses owned by entrepreneurs of color.[2] Further, in the event that businesses run by people of color are able to access loans, they pay higher interest rates on average as compared to white-owned small businesses.[3] So, not only are businesses owned by people of color less likely to be funded at the level that they need, but they also will be paying more for this capital. The economic cost of these practices are high. As a 2020 Citibank report noted, just for Black-owned businesses the lack of fair and equitable lending opportunities over the last 20-years has locked these same businesses out of $13 trillion in revenue that they could have invested in their businesses and communities.[4]

Exclusion and extraction are deeply rooted and reinforced in the financial system, by design. The multigenerational history of racially discriminatory behavior, practices, policies, and systems persist in denying wealth-building opportunities to Black people, Indigenous people, and People of Color (BIPOC). Many solutions in the market today are not created in conversation with these populations. These solutions also do not question the financial system's original goal of capital accumulation. As a result, these financial products perpetuate the lack of access to resources and affordability of capital in historically underestimated communities.

This Black Paper argues that how we lend, as well as the cost of that capital, are essential components to solving inequitable lending. And what is at the core of this is the recognition that we, as people and planet, are interdependent. Solutions that we develop to reduce inequality need to recognize, account for, and aim to reverse structural imbalances that continue to be perpetuated by mainstream frameworks and pricing methods to disburse capital.

[1] According to the Federal Reserve Bank of San Francisco, "financial markets help to efficiently direct the flow of savings and investment in the economy in ways that facilitate the accumulation of capital and the production of goods and services."

[2] Credit Survey Finds White-Owned Small Businesses Were Twice as Likely to be Fully Approved for Financing as Black- and Latino-Owned Firms

[3] To expand the economy, invest in Black businesses

[4] Closing Racial Inequality Gaps

The Systemic Problems

In this Black Paper, we start by examining how capital accumulation has led us to predominant frameworks often used together to evaluate "perceived risk" in lending. That is, who is deemed "credit worthy." We unpack how conventional lending techniques such as the 5 C's of Credit or derivatives of this framing in algorithmic lending and Risk-Based Pricing are reinforcing inequality in their design.

These frameworks create and reinforce obstacles to accessing capital by applying criteria that do not acknowledge the impacts of systemic discrimination on Black people, Indigenous people, and People of Color. As a result, people with fewer resources are charged more to access financial products and services. This poverty premium equates to fees and interest rates increasing as income and wealth decreases.[5] Lending within these confines further perpetuates discrimination and extraction through the traditional financial system.

To break the cycle of extraction and build a more equitable and sustainable financial system, we must reevaluate the premises on which our current financial system was built and how resources are shared within and across communities.

Centering Relationships & Trust for More Equitable Lending

For centuries, communities have lent to each other. The Black Paper shares how trust and relationship are not new concepts in the exchange of resources; though, the emphasis on who holds the relationship and how the relationship is cultivated and nurtured must be scrutinized for equitable access to affordable credit. Having a trusted relationship between lender and borrower creates the conditions and conversations that can enable the affordability of capital and center addressing the challenges that borrowers face when trying to access credit. This relationship makes room for recognizing our interdependence and allows for that to take shape across the entire lending process.

The following community-rooted solutions are provided as examples of how centering relationships and building a shared understanding of prosperity can help to create more equitable and affordable capital in underestimated communities.

[5] The Poverty Premium: Why It Costs So Much More to Be Poor

B:Side Fund: B:Side Fund provides long-term, fixed interest financing options to historically excluded groups including underrepresented, underserved and low-income communities. It accomplishes this with flexible collateral and credit requirements that help even the playing field for entrepreneurs, especially those with limited resources and opportunities. Its focus is on increasing accessibility and transparency in small business lending to provide a pathway for wealth generating opportunities.

Native Women Lead: The Matriarch Restorative Fund aims to increase access to equitable capital; small business sustainability and growth; economic safety nets; successful repayment; and credit enhancement for all Native women entrepreneurs. This gender lens pilot program has also been designed and led by Native women for Native women through their Matriarchal lens.

ConnectUP! Institute: The Integrated Capital Fund provides early second-stage Black, Brown, and Rural founders in Minnesota with integrated capital (grants, debt, equity), curated resources, and culturally responsive support to support the exponential growth of Black, Brown, and Rural entrepreneurs as business owners and as people.

New Majority Capital: Their Fund will support BIPOC entrepreneurs with down payment assistance to enable them to acquire existing businesses as a pathway to wealth generation by pairing the capital with tailored and high-touch support navigating the acquisition process.

Three of the above relationship-based pilot loan funds (Native Women Lead, ConnectUp! Institute and New Majority Capital) were designed in partnership with **Community Credit Lab**, a nonprofit shifting power through capital facilitation in relationship with people who face discrimination in the financial system.

The approach is three-fold: increasing access to credit, increasing affordability of credit, and shifting power in decision making.

By prioritizing people, centering relationships, and amplifying trust, these emerging models of lending bring an innovative lens of humanity to the financial system — where the collective thrives in a state of interdependence, well-being, and wealth-building.

Note: *Throughout this paper, we may reference "underestimated" or "marginalized" to encompass the diversity of identities of people that face discrimination within the financial system. We acknowledge these terms are imperfect and do not always convey who specifically is impacted. In using these terms, we hope to be inclusive, but also recognize that Indigenous Peoples, Black People, and People of Color, specifically, are disproportionately excluded from or extracted by our current financial systems.*

The Systemic Problems

"The promise of free market capitalism is that it does not discriminate. Yet history reveals that, in fact, markets do discriminate — the American economy has never born any resemblance to a free market."[6]

Mehrsa Baradaran, author of The Color of Money

Structural barriers built into our systems and policies that fail to address the root causes of societal issues reinforce the inequities that exist in our society. Intersections of race, gender, immigration status, class, and ability determine which communities benefit from economic systems and which communities are harmed by them.

While there are many root causes that can be examined, for this paper, let's start with the primary goal of our financial system — the accumulation of capital or wealth.[7] Centering the accumulation of capital pushes our financial system toward methodologies that try to efficiently identify and classify risk and that seek higher compensation when risks are identified. Our financial system is designed to be extractive in order to achieve its goal—charging some people more and other people less to access capital based on how we've understood their risk.

Further, whom the financial system systematically charges more or less is not objective. There is growing acknowledgment of how racism and discrimination woven into the standardized practices of institutions further exacerbate inequality. Often times solutions aimed to address the inequalities created by discriminatory financial practices fall short because they do not go deep enough to break out of the traditional frameworks that were built for extraction. To build toward a more equitable financial system together, we must interrogate the historical precedents that continue to shape and exacerbate how resources flow inequitably in the financial system.

In the remainder of this section, will unpack how widely used frameworks in lending that have been created as a result of centering the goal of wealth accumulation perpetuate the lack of access to and affordability of capital in underestimated communities. First, we show how frameworks like the 5 C's of Credit or derivatives of this framing in algorithmic lending reinforce discriminatory behaviors. Then we discuss how Risk-Based Pricing further exacerbates inequality by extracting from those who have been disproportionately discriminated against. These frameworks interact with one another and stem from historical approaches to evaluating "perceived risk" based on techniques that continue to extract from communities with the least resources in our society.

[6] The Color of Money: Black Banks and the Racial Wealth Gap
[7] According to the Federal Reserve Bank of San Francisco, "financial markets help to efficiently direct the flow of savings and investment in the economy in ways that facilitate the accumulation of capital and the production of goods and services."

The 5 C's of Credit

When applying for a business loan, banks and other lenders typically refer to the "5 C's of Credit" to evaluate a potential borrower's eligibility and creditworthiness: Capacity, Capital, Collateral, Conditions, and Character.[8] While the 5 C's are often touted as objective qualifiers, in practice we know this is not the case due to the prevalence of discrimination in the financial system. According to a 2021 McKinsey study, "even when controlling for [other] factors, Black-owned businesses are still 20% less likely than white-owned businesses to obtain a loan from a large bank."[9]

In recent years, in an effort to further increase efficiency in lending, there has been a push to use a wide variety of data points available to build algorithms that predict borrower behavior. While solutions like this might not directly map to the 5 C's of Credit framework, they are trying to answer similar questions around borrower behavior. The issue we find with some algorithmic lending models is that the underlying data being used itself has been impacted by all our systems that are racist and discriminatory by design. If algorithmic models are not correcting for this or working against this bias, we will further perpetuate the outcomes of inequality that we see today.

For the purposes of this paper, we highlight and share issues with the 5 C's framework given its prevalence and impact in business lending.

CAPITAL

Overview: The cash that people put towards starting their business is called capital, and it's a traditional way for a lender to evaluate the commitment of a borrower. Capital may come from a borrower's personal assets or potentially capital given to the borrower from friends, family or other investors that bolster their balance sheet.

Issues: Lenders often expect an individual or business to have invested or maintain a portion of the loan under consideration — whether it be 10%, 20%, or 30%. In the case of the Small Business Administration (SBA), they are looking for anywhere from 10-20% of the loan to come from the borrower.[10] Factors that influence this number may be the industry in which the business operates, time in business, or other indicators the financial institution deems applicable at the time, based on factors that are often external to the business. The capital requirement clearly and unfairly creates a barrier for people who have been systematically excluded from participating in programs and accessing affordable capital to support wealth accumulation. Historically, Black, Indigenous, and other communities of color do not have access to intergenerational wealth, assets passed by one generation of a family to the next, that can be transferred or injected.

[8] 5 C's of Credit
[9] Black-Owned Businesses Face an Unequal Path to Recovery
[10] Five C's to Understanding Small Business Credit

CAPACITY

Overview: Capacity is a business's ability to repay loans and lenders typically review historical financials, as well as a business plan that could outline a pathway to future repayment. Specifically, lenders look at revenue, expenses, cash flow, debt burden (debt to income ratio) and may review business and personal credit scores. Further, younger businesses and startups that are under three years old are at an immediate disadvantage by not being able to present years' worth of data.

Issues: Financial statement preparation is a challenge for most small businesses. Business owners have limited time, but also often tight cash flow which results in them taking the task of preparing financials on themselves rather than outsourcing. Depending on the business owner's capacity, the cadence and accuracy of the financials will vary, impacting the loan decision. We also know that small business owners of color may not have access to the non-financial resources and networks to support them to help them prepare ahead of time for applying for a loan.[11] This disconnection from information and technical assistance to support entrepreneurs of color is the outcome of a history of segregation and discrimination in the U.S. that has systematically excluded underestimated communities from accessing opportunities, education and networks of power.

When it comes to business plans, while this tool may support a business owner to think more deeply about the market they are entering and how they can be best positioned to sell their goods and services, "non-traditional" business plan formats are typically discouraged by lenders. This perpetuates a disadvantage for people who are not familiar with this format or do not have the time to create a conventional business plan. Further, a conventional and "correct" business plan may not fully be part of a lending decision given that much of a lender's analysis is typically based solely on the financial information in the plan. This leads to unnecessary time spent in the loan application process for the business owner and unnecessary costs spent by lenders to review longer plans—these costs translate to higher interest rates and fees for borrowers. Further, it is rarely the role of a lending institution to help a business achieve this capital readiness. A business owner may not have access to this specialized technical assistance in their local ecosystem.

COLLATERAL

Overview: When evaluating a loan application, a traditional lender will generally look at collateral (i.e. physical assets including vehicles, inventory, equipment, etc.) as a potential secondary source of repayment for the loan if/when cash flows from the business are insufficient. Traditional lenders want to make sure that if the loan payments stop for some reason, they can recover what they're owed through collateral. Loan amounts will often be based on a percentage of the collateral's perceived value, which is called the loan-to-value ratio (LTV) and different types of collateral often have different LTVs.

Issues: Similar to the capital requirement, requiring collateral creates barriers for many individuals who have not had access to opportunities to build wealth and accumulate assets as a result of facing discrimination within the financial system. The requirement of collateral also creates a self-reinforcing cycle of exclusion — to access capital from a traditional lender you need to have collateral, but to have collateral, you most likely need to have access to capital to purchase the assets that can serve as collateral. In some instances, exceptions are made to provide a loan without "sufficient collateral" — but oftentimes that means that the individual or business will be charged a higher interest rate — creating yet another hurdle for a borrower to overcome over the long term. For numerous entrepreneurs on tribal lands, collateral cannot be leveraged because Native land is held in trust by the federal government and tribes are required to waive sovereign immunity with banks to allow them to take collateral. Moreover, next generation, technology-enabled companies often lack collateral entirely.

[11] Why networking is essential to the survival of Black-owned businesses

CONDITIONS

Overview: Traditional lenders often require businesses to demonstrate that there's a market for their business service(s) or product(s) and a clear purpose for the loan. Businesses are typically encouraged to base their arguments on local, regional, and national economic factors, the competitiveness of the business, the type of industry and the owners' experience in it, and the owners' experience managing a business.

Issues: At face value, the information requested can be helpful to a business owner to understand and support building their strategy. The barriers people may face with this requirement is that traditional lenders may be looking for this information in a specific format that someone with less mainstream experience may not know, or may have unstated assumptions about which industries are more successful, or how many years of "formal" management experience a business owner should have to successfully run a business. Often these benchmarks are not shared transparently and have been created based on who the traditional lender has historically lent to — which has been influenced by historical discrimination and all the other C's in this formula Transparency into how these factors are evaluated is required to untangle assumptions that continue to exclude individuals that face discrimination in the financial system.

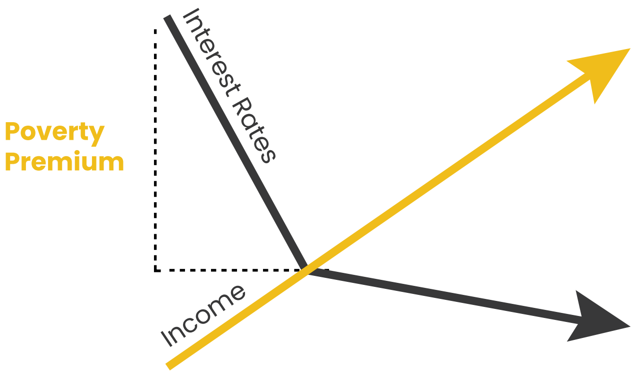
CHARACTER

Overview: The final C traditionally includes a review of the Borrower, including their educational background, business experience, and personal credit history. Personal credit history is deemed to be important by traditional lenders because they may require personal guarantees of the loan. References or other background information will typically also be considered under Character and it helps if owners and employees have experience and a positive reputation in their business's industry to be approved by traditional lenders.

Issues: Several issues and barriers are present with "Character" in its traditional use for evaluating credit worthiness: namely, the way to evaluate Character is inherently biased and subjective. For more subjective measures, we need to ask who is making the evaluation and whether they are equipped to make these assessments. In an effort to move away from more subjective measures, traditional lenders have also leaned heavily on credit scores to evaluate character. However, credit scores have proven to reinforce the negative perceptions of lenders — someone with no or limited credit history will often get a higher-cost loan. This may result in a person not being able to afford the monthly payments and subsequently may be late on payments or default on the loan, which then hurts their credit score. The next time they apply for a loan, they are stuck in the same cycle. Credit scores also may not include payments that many people are making on a monthly basis, like rent. Either due to the deficiency of the tool used to measure character or the way character is being evaluated, the current methods are insufficient in effectively evaluating a person's ability, willingness, and accountability to repay a loan.

Risk-Based Pricing & the Poverty Premium

Using a framework like the 5 C's of Credit claims to help lenders assess and evaluate risk or the potential of a person or business to default on credit extended to them. A standard practice that follows is that the higher the perceived or evaluated risk of the potential borrower, the higher the interest rate that is charged to compensate the lender for this potential risk. As shown in the prior section - those that are typically perceived as higher risk are people without access to intergenerational wealth, networks with access to capital, and opportunities to build assets.



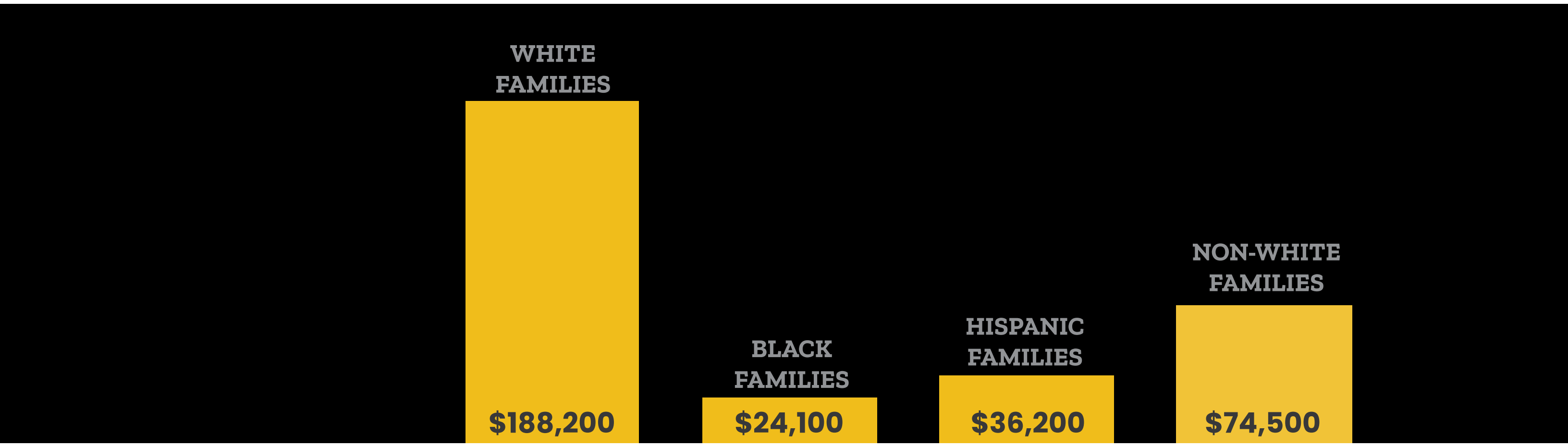
Traditional Approach to Credit

As a result, we see that markets implicitly discriminate by charging people with fewer resources more to access financial products and services. This inequity is known as the poverty premium.[12] Under our existing financial system and as a result of using frameworks like the 5 C's of Credit and Risk-Based Pricing, the poverty premium equates to fees and interest rates increasing as income and wealth decrease.

When we look at wealth in the United States, disparities lie clearly along the lines of racial identity. Inequities in wealth reflect the multigenerational history of racially discriminatory behavior, practices, policies, and systems that denied and continue to deny wealth-building opportunities to Black people, Indigenous people, and People of Color.

As a result, according to the Federal Reserve's 2019 data provided by Business Insider,[13] the median net worth was $188,200 for White families, $24,100 for Black families, $36,200 for Hispanic families, and $74,500 for other non-White families. Since markets charge people with less wealth more to access capital, the poverty premium has an outsized effect on People of Color and, specifically, Black and Indigenous people in our country.

Median Net Worth



12 The Poverty Premium: Why It Costs So Much More to Be Poor
13 The Average Net Worth in America by Age, Race, Education, and Location

Further, due to the risk-based pricing practices and the poverty premium, financially underestimated consumers in the U.S. spent $189 billion in fees and interest on financial products in 2018,[14] and this number is expected to increase in the coming years as "access" to financial products and services increases.

For perspective, $189 billion translates to extracting about $1,062 in fees and interest per financially coping or vulnerable adult in the U.S.[15] These same adults are unable to cover a $400 cash emergency and have $0 or negative wealth to dip into. For financially underserved people, these fees and interest are the true costs of accessing financial products and services in our country.[16] As we focus on building toward an equitable society by increasing access and designing to support financially vulnerable communities, we cannot continue using traditional credit risk evaluations, fees, and pricing methods based on perceived financial risk.

Summary

Centering on wealth accumulation as a primary goal in the financial system has created frameworks like the 5 C's of Credit and Risk-Based Pricing that work together to create a self-reinforcing cycle that perpetuates the exclusion from affordable and supportive financial services and enables the extraction of wealth from primarily BIPOC communities in the United States. Moving forward, we need to champion solutions that center the people who we want to receive capital in the practices of how capital can be designed and distributed — over centering the interests, biases or inaccurate "risk assessments" of financial intermediaries. Without this, we cannot reimagine a financial system that breaks away from the confines of these frameworks and we will be unable to build toward a more equitable future together.

[14] 2019 Financially Underserved Market Size Study
[15] The Financial Health Network estimates that 178 million adults are financially coping or vulnerable as of 2018.
[16] Many Americans who can't afford a $400 emergency blame debt

Centering Relationships & Trust for More Equitable Lending

As the U.S. financial system rapidly reorients around fintech solutions for financial products and services (most of which currently use traditional credit pricing models based on algorithms that determine perceived risk), there is an opportunity to innovate and move beyond our mainstream approaches to credit and community investment. There is increasing urgency to drive more equitable outcomes in our financial system, and we have the tools at our disposal to do it. Now is the time to decide whether we will continue to perpetuate practices that harm and disenfranchise our communities or build toward a financial system and society that positions all people for economic stability and success.

How we share and lend our collective resources as well as the cost at which we are distributing capital in an effort to build wealth are essential components that need to be brought into solutions around lending. And what is at the core of this is the recognition that we, as people and planet, are interdependent. Solutions that we develop to reduce inequality need to recognize, account for, and aim to reverse the imbalance that continues to be perpetuated by mainstream frameworks and pricing methods to disburse capital.

By increasing our awareness of the interconnectedness of our financial system, we can change our decisions as investors, borrowers, and community members.

By understanding our past and reorienting the systems that continue to perpetuate deep inequalities, we can commit to doing better for one another.

By recognizing that there are people at the end of each financial transaction, we can return to prioritizing humanity in our financial system.

Examples of – Relationship & Trust-Based Lending

Recently, we have seen organizations think beyond mainstream financing models to avoid the end-users bearing outsized risk and exorbitant costs of capital. Some lenders are also increasing their focus on decentralization, trust-based lending, and affordability of credit. However, the concepts of prioritizing relationships and affordable credit are not new: communities have lent to each other at no cost for centuries via SouSous (informal lending clubs) and other community lending circles.[17]

We also know that trust and relationships are how capital tends to be allocated in more mainstream financial institutions as well — the reason Relationship Managers exist at these institutions is to bring in trusted contacts and financial opportunities. New relationship-based lending models are proving that who holds the relationship and how that relationship is developed is important to be able to create equitable access to affordable credit and eventually build wealth. Examples from other community lenders that stem from affordable community lending principles are increasingly prevalent in the U.S. today as well.

[17] What is a savings circle and how it can help your money goals?

Solutions from Inclusive Capital Collective Members

Organization Name: B:Side Fund

All the information and ideas shared below are the product of B:Side Fund's work, lived experiences and interactions with their community. This information has been synthesized from various sources crafted by B:Side Fund.

Challenge:

Entrepreneurship and small business ownership is a proven pathway toward building individual, family and community wealth. As reported by the Association for Enterprise Opportunity, the median net worth of business owners is almost 2.5 times higher than that of non-business owners.[18] Yet operating a small business almost always requires capital to grow and thrive. However, mainstream financial institutions typically have eligibility criteria linked to historical cash flow, a positive personal credit history and the ability to provide collateral. Unfortunately, this can unintentionally exclude under-represented and under-resourced communities that are in need of affordable capital. For example, the Minority Business Development Agency reported that loan denial rates were about three times higher for BIPOC-owned firms than for white-owned firms.[19]

As a result, these businesses often resort to expensive, short-term debt from online lenders that offer hard-to-understand terms that are unsustainable in the long-term. These types of loans put businesses at risk and in the worst case scenario, can force them to close their doors. These dangerous alternatives do not have the best interests of small businesses in mind. Furthermore, even if a business gets the capital it needs, it rarely has access to long-term insight and support to help those businesses succeed.

[18] https://www.aeoworks.org/wp-content/uploads/2019/03/One_in_Three.pdf
[19] https://archive.mbda.gov/page/executive-summary-disparities-capital-access-between-minority-and-non-minority-businesses.html

Fund Thesis:

Fostering the economic growth of diverse businesses will create wealth building opportunities for historically overlooked communities. One way to achieve this is to make responsible capital and long-term strategic support available to under-represented and under-resourced populations. B:Side Fund accomplishes this through:

Inclusive lending practices, such as providing a loan application process that is less intimidating, which can often be a barrier to historically excluded communities.

Transparent, fixed interest rate pricing, to provide the business owner(s) the predictability of knowing exactly what their monthly payment will be for the life of the loan. Furthermore, unlike other lenders, interest rate is determined by program, not perceived "credit risk" tied to personal credit scores.

Fully-amortized, long-term maturities, to lower the monthly payment for the business owner(s) to help improve cash flow. This allows the profits of the company to be reinvested in the business to help it grow.

Flexible collateral requirements, which will not turn away an applicant solely due to lack of collateral, which is a common reason a business owner may be declined by a traditional lender. This is a particular hurdle for low-to-moderate income communities and those who have not benefited from intergenerational wealth.

Emphasis on character and repayment ability in lending decisions which gives credence to a business owners' plans and potential for future growth. This approach ensures that a project is evaluated in its entirety, providing space for the business owner to share their lived experience, current circumstances and projections for the future.

Absence of prepayment penalties which is a common practice in the lending industry. Unlike other lenders, who may be incentivized to keep loans in their portfolios for a certain period of time, B:Side Fund encourages small business borrowers to refinance or pay off their debt as soon as they are able. Prepayments free up capital that can then be used to assist another business in need.

By providing access to responsible capital, B:Side Fund fills a small business lending gap which diverts businesses from obtaining impossibly expensive capital. Instead, it affordably provides the runway a small business owner needs to open up future wealth-building opportunities.

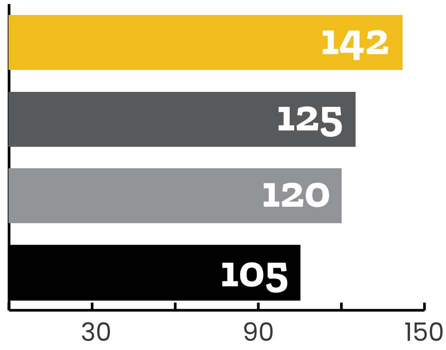
Furthermore, to support small businesses' long-term growth, B:Side Fund has the framework to build a platform that can enable its small business borrowers to better understand their financial and cash flow management. With a tool that can analyze cash flows, small business owners can be given the data they need to understand fluctuations in sales and expenses that will help them better manage their operations. This includes, but is not limited to, understanding when to seek capital for growth opportunities and/or hire additional staff to meet demand.

Often these types of tools are available and accessible to larger, better resourced businesses that can afford this guidance. B:Side's tool will provide access to small businesses in low- to moderate-income and other under-represented and under-resourced communities.

Lastly, B:Side Fund strives to support businesses that are not yet loan ready with grants which do not need to be repaid. This will set the business on a pathway for success to be loan ready in the future. B:Side Fund is also raising funds in order to make equity investments in small businesses.

Statistics on Business:

CAPITAL DEPLOYED THROUGH PILOT FUND AS OF SEPTEMBER 2022
$9,505,691.00



- #of Loans Made to Women-Owned Businesses
- # of Loans Made to Rural-Based Businesses
- #of Loans Made to Early Stage Enterprises *which is defined as less than 24 months in business*
- # of Loans Made to Businesses Located in Low-to-Moderate Income Census Tracts or Community Development Financial Institution (CDFI) Investment Areas

Capital Provided:

NUMBER OF BUSINESSES SERVED
288

AVERAGE LOAN SIZE
$33,006

AVERAGE REPAYMENT TERMS
65-months

AVERAGE INTEREST RATE
5.32% per annum

How B:Side Fund Employs Relationship Based Lending:

B:Side Fund lends responsible capital to small businesses by implementing inclusive lending practices. In doing so, it has put a different emphasis in its underwriting. In traditional settings, character is solely based on a person's credit history. Instead, a personal credit report helps B:Side Fund understand if an applicant has disclosed any/all of their personal credit issues that may exist. If an applicant knowingly misrepresents themselves and their history, the dishonesty is the problem, not the credit issue itself. B:Side Fund requires an explanation for any previous bankruptcies, unpaid taxes (payment plan required), past due accounts and/or late payments. It gives an applicant the opportunity to provide an explanation on why their personal credit score may be low, or in some cases non-existent. This gives space for business owners to share their lived experience and how it has contributed to their current circumstances.

Note: Over its 10+ year history, capital and loan loss reserves for this fund have been provided by the **Bank of Estes Park, B:Side Capital, Citywide Banks, Colorado Housing & Finance Authority, Colorado Office of Economic Development & International Trade, The Dakota Foundation, DreamSpring, Gates Family Foundation, Independent Bank, Kenneth King Foundation, PacWest Bancorp, Realize Impact, U.S. Department of Agriculture, U.S. Small Business Administration, The Women's Foundation of Colorado, Zebras Unite,** *and the* **ZOMA Foundation**.

Solutions from Inclusive Capital Collective Members

Organization Name: Native Women Lead

Fund: Matriarch Restorative Fund

All the information and ideas shared below are the product of Native Women Lead's work, lived experiences and interactions with their community. This information has been synthesized from various sources crafted by Native Women Lead.

Challenge:

Native American women experience the highest poverty rates and pay inequity, and face challenges to building wealth as a result of systemic barriers and economic policies enacted to exclude and extract from Native communities. Representing less than 1% of the US population, Indigenous women make 60 cents to the dollar compared to their non-Hispanic, white male counterparts.[20] They are, however, the primary economic stabilizers in their communities and families, accounting for 2/3 of family providers and growing businesses twice as fast as their peers.[21]

Native women entrepreneurs face significant gaps in accessing safe, affordable, supportive, and culturally relevant credit and business support to stabilize, grow or scale their businesses — especially in Native Women Lead's local footprint of New Mexico and Arizona. Native Women Lead addresses these gaps by providing business support and directing affordable credit.

[20] State by State Earnings for American Indian and Alaska Native Women: Wage Gaps Across the States.
[21] How the Government Can End Poverty for Native American Women: Achieving Equitable Pay and Other Federal Investments

Fund Thesis

Indigenous women entrepreneurs bring unique cultural worldviews and approaches to how business is done — weaving the importance of culture, family, community, Mother Earth, economic opportunity and stabilization, and a unique approach to wealth redistribution and future impact. The Matriarch Restorative Fund aims to increase access to equitable capital; small business sustainability and growth; economic safety nets; successful repayment; and credit enhancement for all Native women entrepreneurs. This gender lens pilot program has also been designed and led by Native women for Native women through their Matriarchal lens.

Using a relationship-based framework for allocating capital responsibly, Native Women Lead is proving that Native women entrepreneurs are investable. They actively:

Build trust with Indigenous women entrepreneurs, mitigating financial trauma, and cultivating relationships rooted in reciprocity;

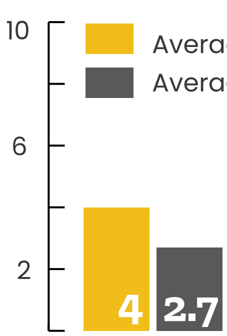
Invest in mission, vision, and values-aligned Native women-founded/owned businesses that are legally structured, have been in operation, and are positioned to grow;

Provide right-sized and patient funding for businesses between $10,000 - $50,000; and

Engage entrepreneurs in their network of business support to support positive repayment planning, business development, entrepreneur learning, support, success, growth, and care.

At the forefront of the Matriarch Restorative Fund is the intention to honor and protect the self-determination of Native women, increase agency, uphold sovereignty, and enhance economic empowerment. The Fund is designed to share power with their community and pursue the advancement of collective wellbeing.

Statistics on Business:

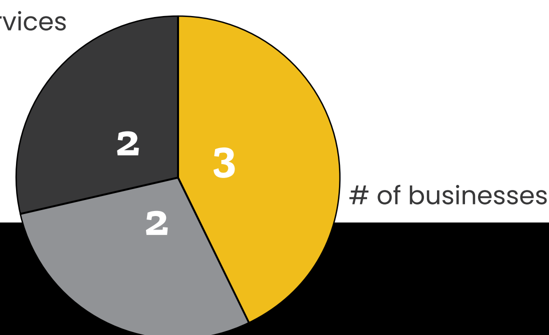


Average Number of Years in Business
Average Number of Employees

CAPITAL DEPLOYED THROUGH PILOT FUND AS OF JULY 2022
$270,000.00

Personal Services (e.g. Beauty, Fitness, Entertainment, Cleaning, Events)
Business & Information (e.g., Consulting, Retail, Technology, Nonprofit)
Health Services

AVERAGE ANNUAL REVENUE
$101,782.57



Capital Provided:

AVERAGE LOAN SIZE
$38,570.00

AVERAGE PAYMENT DEFERRAL PERIOD
6-months

AVERAGE REPAYMENT TERM
60-months

AVERAGE INTEREST RATE
3% per annum

Note: *Initial capital for this fund was provided in partnership with* **Common Future** *as a part of their* **Character Based Lending Fund** *and* **Community Credit Lab.**

How the Matriarch Restorative Fund Employs Relationship Based Lending:

The current pathway for Native women to access capital is not designed to meet them where they are with products that give them the support they need to thrive. Native Women Lead has worked to build trust and provide support to Indigenous women entrepreneurs for several years. Creating culturally relevant programming, enabling deep connections through in-person and virtual gatherings, and enabling the conditions for entrepreneurs to engage in mutual support has all led to the strength of the Native Women Lead network. This deep work within their community to support, uplift, and amplify the work of their local entrepreneurs created the environment that established accountability, trust, and relationship. Without this — Native Women Lead has acknowledged that it would be much more difficult to cultivate a positive experience by which entrepreneurs feel cared for throughout the experience of accessing capital from the Fund and thereby a desire for entrepreneurs to remain in relationship and engage in positive repayment.

Through this pilot, Native Women Lead is applying and activating the 5 R's of Rematriation as a primary values and underwriting framework. These are:

5 R's of Rematriation

Relational:	Rooted:	Restorative:	Regenerative:	Revolutionary:
Are reciprocity and relationships honored?	Is the founder and business rooted in Indigenous values and communal needs?	Does the business aim to support employees and business owners to close their racial wealth gap?	Is there a seventh-generation impact on Indigenous families, communities, and economies?	Is this business game-changing or solving a problem?

These attributes of the business are assessed not only by people working for Native Women Lead, but also by their peers within the network. The fund's decision-making process and power are spearheaded and intentionally held and protected for Native women to mitigate racial and gender bias, dismantle systemic and structural inequities and challenge traditional frameworks in finance and underwriting that are often shaped by western systems of capitalism and patriarchy.

In addition to the relationship as the driver to extend credit, Native Women Lead also ensures that the business has a dedicated use for the capital requested and has demonstrated an ability to fit loan repayments within their budget — to not overburden the business through coaching, consulting, and mentorship.

For Native Women Lead, reciprocal relationships are centered in every aspect of the lending process. From establishing how credit is extended, to the credit evaluation process, to the ongoing support post-loan for businesses, these processes are built on a foundation of established trust that have enabled high (99%) and early repayment rates in prior relationship-based funds Native Women Lead has facilitated in the past.[22]

Learn More About How Native Women Lead thinks about Relationship Based Lending:
Nonprofit Quarterly: **Moving Beyond the 5 C's of Lending: A New Model of Credit for Indian Country**

Nonprofit Quarterly: **Challenging the 5 C's of Credit: A Vision for Rematriating Capital**

[22] Native Women Lead 2021 Impact Report

Solutions from Inclusive Capital Collective Members

Organization Name: ConnectUP! Institute

Fund: Integrated Capital Fund

All the information and ideas shared below are the product of ConnectUP! Institute's work, lived experiences and interactions with their community. This information has been synthesized from various sources crafted by ConnectUP! Institute.

Challenge:

Across Minnesota, Black-led, Brown-led and rural-based small businesses lack affordable financial and tailored non-financial support to grow their businesses and build personal and community wealth. In the local ecosystem, ConnectUP! Institute sees opportunities and resources for early stage start-ups, but businesses, especially Black and Brown-led and rural-based, face a significant challenge in getting to the next level (second-stage) as access to non-extractive capital and one-on-one support dries up. They want to address this gap and show that these businesses are worthy of investment and can be a pathway for individuals to build multi-generational wealth.

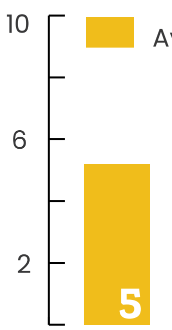
Fund Thesis:

Enabling Black, Brown, and Rural entrepreneurs to pay themselves and hire one additional person in their business reduces unemployment in the local workforce and increases revenue to the local economy.[23] ConnectUP! Institute wants to contribute to this positive change in their local ecosystem by providing early second-stage Black, Brown, and Rural founders in Minnesota with integrated capital (grants, debt, equity), curated resources, and culturally responsive support to support their exponential growth as a business and as a person. ConnectUP! Institute calls this combination their 3 C's — capital, capacity, and community.[24] They know that engaging with entrepreneurs in this tailored and wrap-around way at a critical stage where they are growing their business and have access to few supportive resources provides a pathway to long-term sustainable growth of an organization.

As they partner with organizations, they aim to build the relationship by providing bespoke business support and network connections — as a foundation on which to establish trust. Once this trust and reciprocal relationship have been established, they can work together with the business to extend capital up to $75,000 needed to support incremental growth of the business.

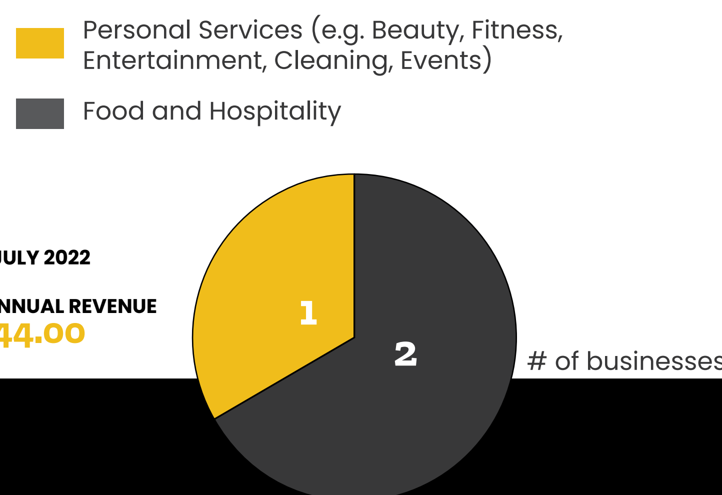
This fund is also testing an equitable rate of return by considering what is a financial return on the loans that will enable the business to continue to grow rather than setting an interest rate that would be prohibitive to the long-term sustainability of the business.

Statistics on Business:



CAPITAL DEPLOYED THROUGH PILOT FUND AS OF JULY 2022
$110,000.00

AVERAGE ANNUAL REVENUE
$109,044.00



Capital Provided:

AVERAGE LOAN SIZE
$36,660.00

AVERAGE PAYMENT DEFERRAL PERIOD
5-months

AVERAGE REPAYMENT TERM
35-months

AVERAGE INTEREST RATE
2.3% per annum

Note: *Initial capital for this fund was provided by* **Common Future** *as a part of their* **Character Based Lending Fund**.

[23] AEO Black Tapestry Report
[24] ConnectUP! Integrated Capital Fund

How the Integrated Capital Fund Employs Relationship Based Lending:

ConnectUP! Institute has been establishing connections and building networks of support within the local Minnesota small-business community for many years. Through their gatherings, they have brought Black, Brown, and rural entrepreneurs and local investors together to learn and share with each other, engage in relationship-building, provide best and next practices from the field, as well as engage in active problem solving to build thriving, diverse, and sustainable enterprises and co-design an ecosystem that prioritizes equitable access to resources, capital, and networks. The organization has deeply embedded itself in the entrepreneur ecosystem and is viewed as a trusted partner. Through their sister organization, Social Impact Strategies Group, they have also been providing these same entrepreneurs with tailored business support and understanding the gaps in affordable capital that they face. ConnectUP! Institute is able to leverage this shared understanding to extend capital to those businesses that are seeking financial and nonfinancial support.

Because they have been able to build a relationship with the business through gatherings, providing connections, and one-on-one support, entrepreneurs are willing to work closely with ConnectUP! Institute to share financials and business plans, as well as ask for support navigating challenges. It is through this process that ConnectUP! Institute is able to design and deploy right-sized capital to businesses and build accountability to one another that enables repayment. But the relationship does not end once capital is deployed, ConnectUP! Institute is committed to ensuring that capital and non-financial support provided is helping. They are also implementing a survey designed to test if access to this capital was improving the well-being of entrepreneurs, defined as the Happiness Quotient. This continues to build this reciprocal relationship; entrepreneurs feel heard and know that their happiness and wellbeing are at the center of ConnectUP!'s design process.

Solutions from Inclusive Capital Collective Members

Organization Name: New Majority Capital

Fund: Business Acquisition Down Payment Assistance Fund

All the information and ideas shared below are the product of New Majority Capital's work, lived experiences and interactions with their community. This information has been synthesized from various sources crafted by New Majority Capital.

Challenge:

The path that has been most promoted for business ownership has been that of traditional entrepreneurship of starting a business. Starting a business can be challenging, especially for BIPOC entrepreneurs given a history of exclusion and predatory financing practices that limit wealth building opportunities and connection to networks that enable opportunity. While there is more money flowing through to venture capital funds focused on underestimated entrepreneurs or money flowing to venture funds managed by underestimated General Partners, this is just making a small dent in business ownership. Further, this path of venture-backed entrepreneurship to close the wealth gap is also highly dependent on the concept of meritocracy, which is not relevant to solving the problem of wealth inequality.

New Majority Capital believes that a more widely accessible pathway to business ownership is through acquisition — typically from a business owner that is retiring. It means stepping into a business that has a book of customers and revenue streams and is looking for someone to carry the organization forward. However, for people who did not grow up in a family business, or get an MBA, purchasing a business may seem daunting — the process of where to begin may feel overwhelming. Further, standard financing options (SBA 7(a) or other mainstream lenders) may require the entrepreneur to put down 10-15% of the total acquisition cost from their own capital and may need to take on a personal guarantee for the entire acquisition debt.[25] These requirements often create barriers for BIPOC entrepreneurs and perpetuates the cycle of needing money to make money.

[25] Small Business Administration - 7(a) Loan Funding Program

Fund Thesis:

New Majority Capital believes that providing skills training, bespoke support navigating the acquisition process before and after the transaction closes, and down payment assistance capital together will enable BIPOC entrepreneurs to successfully acquire and build businesses within their area of expertise.

Capital provided will enable the business owner to make the down payment needed to acquire the business and will be provided at 0% interest to support the entrepreneur to access capital affordably and safely. As a part of their process of high-touch wrap-around services and support, New Majority Capital is building a relationship with the entrepreneur and building a mutual understanding how the entrepreneur's lived and professional experiences to date can support them to take on ownership of a business. The team deeply understands the challenges that BIPOC entrepreneurs face when navigating the process to acquire a business and as such are able to bridge gaps where necessary. Through this one-on-one supportive process, New Majority Capital aims to build trust and relationship and is the foundation from which they are able to offer capital support in tandem when the business owner is ready to take the next step and initiate the business acquisition process.

Community Credit Lab

Native Women Lead, ConnectUP! Institute and New Majority Capital's relationship-based pilot loan funds shared above were designed and are being implemented in partnership with **Community Credit Lab**. Community Credit Lab (CCL) is focused on affordable lending as the basis for approaching a more responsible and just financial system. Credit can (and does) play an enormous role in building the future of our society — as a result, CCL seeks to use loans as a tool to remove socioeconomic barriers in collaboration with community partners. They work with partners like Native Women Lead, ConnectUP! Institute, New Majority Capital, **MORTAR**, **Common Future**, **Equitable Food Oriented Development Collaborative**, and **others** to design relationship-based lending programs that think about:

Shifting Power: How can we shift power by shifting resources and decentralizing capital allocation decisions?

Increasing Access: How can we use technology and relationships to facilitate increased and transparent access to credit?

Increasing Affordability: How can we collaborate to reduce the cost of capital to borrowers to reverse the long-term impacts of extraction?

As a facilitator, Community Credit Lab aims to pilot community-led funds that use non-traditional underwriting techniques and are designed by and with those who face challenges to accessing credit affordably.

Summary

Because these organizations prioritize people, relationships, and trust, these models of lending have the potential to serve as examples to increase balance in financial systems and address the racial wealth gap, rather than perpetuate inequitable power dynamics that maintain the status quo. By shifting the decision-making power over capital design and allocations to those who have spent time building relationships with entrepreneurs in their communities, we see that borrowers feel more supported in the process. They have shared sentiments like this one: "I felt heard and seen. I did not feel alone throughout the entire process." These solutions are radically different because they create reciprocal accountability and in the process share resources and power.

With these models and many others as beacons, we know it is possible to address deep inequalities in our financial system while focusing on eliminating the poverty premium with affordable credit. We also know that change happens incrementally and the easiest thing to scale is ideas — as ideas scale, new models will follow at scale over time.

Conclusion

As we look ahead, we see many fintech solutions entering the market focused on aggregating and using alternative data to predict the “character” and “creditworthiness” of individuals. Many of these solutions aim for efficiency and in doing so simplify our understanding of people and create yet another layer of abstraction between us. These tools assign scores to people’s experiences that we may have little control over due to discriminatory practices built into the policies and practices of our systems, and further penalize people with lower scores by charging them more to get what they need. This, as we’ve shown, further exacerbates inequality.

Focusing solely on increasing access to credit through solutions that prioritize predictive modeling of creditworthiness or even through relationship building, like many of the solutions presented in this paper, will not ultimately address the root causes of inequality that we see in economic outcomes and wealth in our society. What makes the solutions in this paper different is that they are not assigning interest rates based on any perceived risk; they’re based on an equitable rate of return as defined by people who understand their communities best within parameters that are based on relevant benchmarks to increase equitable access to affordable credit. They are in relationship with their borrowers to understand the return they can expect that will support the borrower to repay, rather than assign a rate that would prohibit the sustainability of the business or organization.

The solutions presented are different because they think about our interdependence and collective well-being and wealth building. These and other similar solutions are radically shifting away from the frameworks and practices that perpetuate inequality and now is the time to place capital into these types of funds. However, it is not enough to place the same type of capital into these funds as we would into solutions that use extractive practices — the way we invest in these funds, people, and small businesses, also needs to evolve.

If the goal is to build greater economic and financial equity by increasing access to affordable, equitable financial products and services for people and small businesses, we need to redefine the benchmarks and practices we use to evaluate community-led investments, both with respect to investor returns and with respect to interest rates and fees to people and the businesses they run. Similar to how the organizations in this paper set an equitable rate of return based on the sustainability of the business, investors in these funds need to also be in conversation with fund managers to understand equitable rates of return to support their communities.

Ultimately, understanding our collective power will help us build towards a more equitable financial system, a more just society, and a more sustainable planet. There is no single model that will solve the disparities we see because there are so many tools that we can wield and so many more for us to forge and test together. If we orient ourselves to prioritize our shared humanity and our interdependence when we pilot new models it will push us to think beyond standard frameworks and center social outcomes. And if we share what we learn from our explorations, we will be able to amplify new ideas, translate solutions so that they are accessible to others, and learn from collective challenges. If this experimentation is led by those who see and experience social and environmental challenges and problems firsthand, we will be able to reorient our approaches to best support those who are most deserving of affordable resources based on historical discrimination. And, if we are capable of this reorientation, we will ultimately serve the whole of our society by building towards a society where we all can thrive.

Our current financial system is far from this vision, but we know that change is possible. We see it happening because we are in conversation and designing with so many others that are building a long term vision together. We are finding hope in models that shift power structures and address both the affordability and accessibility of capital. And we are energized by working to shift the paradigm of what is possible.

In the Inclusive Capital Collective, we are busy creating the financial and support infrastructure for relationship-based lending innovators like those featured in this Black Paper. In the fall of 2022, we are launching the ICC Credit Enhancement Facility to serve as a shared resource for these fund operators.

We invite readers of this Black Paper interested in learning more to reach out directly to the institutions profiled here, and to join the Inclusive Capital Collective at
https://www.inclusive-capital.us/

Thank You

The ICC is being incubated by the **Zebras Unite Co-Operative,** in partnership with **Zebras Unite.org**, the **Surdna Foundation**, **Common Future** and **SecondMuse Foundation**, and with support from **Wells Fargo**, **UBS**, **One Project**, the **Economic Development Administration** for Cultural Innovation.

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