

SECAP

SMALL ENTERPRISE
CAPITAL ACCESS
PARTNERSHIP

Final Report to Partners

First Quarter 2003



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Mission Statement

SECAP is an initiative of the Federal Reserve Bank of Chicago, established with the goal of improving access to credit and related resources by historically underserved small business owners. SECAP involves a voluntary collaborative of various stakeholders in the small business arena, including lenders, community-based organizations (CBOs), technical assistance providers, government organizations, trade associations, academic researchers and others. SECAP will assess the small business environment with the aim of identifying the greatest challenges for minority-owned, women-owned and other businesses with historically limited access to credit.

It is SECAP's charge to reach recommendations for changes or modifications to policies and practices that serve as barriers to capital access, to be instrumental in creating new resources where necessary, and to involve the appropriate organizations and individuals to bring the necessary resources to the table.

Foreword

SECAP Final Report to Partners

Just over three years ago, a group of dedicated individuals embarked on an important endeavor to promote fair access to business credit and capital among women- and minority-owned businesses and under-invested communities. The Small Enterprise Capital Access Partnership (SECAP) convened in 1999 with the goal of reaching and implementing recommendations to improve the prospects for current and aspiring entrepreneurs.

SECAP was conceived not as a theoretical exercise, but as an agenda for changes in policy and practices that would impact its target market. As an all-volunteer program, SECAP is all the more noteworthy. Co-conveners with the Federal Reserve Bank of Chicago included the U.S. Small Business Administration Illinois District Office, the Chicagoland Chamber of Commerce, the Cosmopolitan Chamber of Commerce, the Illinois Bankers Association, the Women's Business Development Center and the (recently disbanded) Chicago Association of Neighborhood Development Organizations.

SECAP Partners reached 10 recommendations in four areas: marketing and delivery systems, technical assistance, equity investment and underwriting. The Chicago Fed's role has been that of a conduit, bringing together organizations and individuals and helping to formulate an agenda for action. In some instances we have provided strategic support to implementation efforts. We have learned in undertaking similar initiatives that not all ideas reach implementation, but we take great satisfaction in the fact that our Partners have committed themselves to implementing some of the key recommendations reached by SECAP's four work groups, as detailed in this report.

Finally, we are proud to have been recognized by the Economic Development Council of Chicago for "Support and Advocacy of Economic Development in Chicago and Illinois" in October 2001. Most of the credit for the award belongs to our dedicated Partners, who brought commitment and enthusiasm to the process. I would like to express my personal thanks to all who took part in making SECAP a successful initiative.



Michael H. Moskow
President and CEO
Federal Reserve Bank of Chicago

The Small Enterprise Capital Access Partnership (SECAP) Final Report

First Quarter 2003

Introduction

The Small Enterprise Capital Access Partnership (SECAP) is a collaboration of organizations and individuals with the goal of improving access to small business capital by historically underserved business owners and communities. The geographic focus of SECAP is the metropolitan Chicago area, though the issues explored are more far-reaching. This report highlights the significant accomplishments to date of SECAP. All further progress on recommendations stemming from the SECAP initiative will be reported in *Profitwise News and Views*, a publication of the Federal Reserve Bank of Chicago's Consumer and Community Affairs Division.

SECAP was formally convened in October 1999 at the Federal Reserve Bank of Chicago. Co-conveners with the Fed included the Chicago Association of Neighborhood Development Organizations (CANDO), the Chicagoland Chamber of Commerce, the Cosmopolitan Chamber of Commerce, the Illinois Bankers' Association, the U.S. Small Business Administration Illinois District Office and the Women's Business Development Center. In all, 41 organizations registered as partners in SECAP.

Four task groups were formed at the initial meeting to address technical assistance, equity investment, marketing/delivery systems and underwriting issues. By August 2000, each task group had reached recommendations, which were then published and presented to the Partnership the following month.

SECAP Today

The SECAP initiative is now in its third and final phase, implementation of the recommendations reached by the task groups. At this point and looking forward, the role of the Chicago Fed is to provide strategic support to implementation efforts when necessary. The SECAP framework, with an advisory group and task groups meeting regularly, was not designed as a permanent structure.

A hallmark of the SECAP participants has been a focus on reaching practical, achievable recommendations. The SECAP task groups and the advisory committee worked hard to ensure that any recommendation they reached would have a basis of support and an advocate to carry the idea through to implementation. This focus, and the work of dedicated partners, has resulted in most of the recommendations being implemented. However, implementation efforts will be ongoing for the foreseeable future.

Following is a summary of progress, where there is progress to report, on the recommendations issued in September 2000. Copies of the full report issued in September 2000 are available by contacting the Federal Reserve Bank of Chicago's Consumer and Community Affairs Division at (312) 322-8232, or at:

<http://www.chicagofed.org/publications/secap/secapsept00.pdf>

I. Marketing and Delivery Systems Task Group

Recommendations:

- 1. Create a central clearinghouse of information for small business owners that will provide links to chambers of commerce, technical assistance providers, financial institutions, credit counseling organizations and city and state programs.**
- 2. Create an interactive business assessment tool for entrepreneurs, enabling them to assess the growth stage of their business and determine appropriate financing sources and/or courses of action to grow their business.**

In September 2000, when the recommendations developed by the SECAP task groups were published, the Chicagoland Chamber of Commerce agreed to take a lead role in creating a web-based information clearinghouse for entrepreneurs. All four of the SECAP task groups noted the need for an information clearinghouse for small business owners. The site content includes data on lenders, technical assistance providers, events and other resources, and is gathered from SECAP Partners and other organizations. The web address is **www.secaponline.org**.

There are two parts to the project. The first was creating the static site as an information resource with events, lenders, counselors and other resources. Though the site is still under development, some informational elements are in place. There is a directory of chambers of commerce, counseling organizations, government programs for small businesses, financial institutions, investors, Small Business Development Centers (SBDCs), other relevant websites and associations. The Chicagoland Chamber continues to spearhead this recommendation. The Chamber was granted \$15,000 by the State of Illinois to defray some of the cost of establishing and operating the website. Additional financial partners in the clearinghouse website will be necessary to maintain its ongoing viability.

The second and more difficult part is to develop an interactive business assessment tool (BAT) that entrepreneurs will use to determine the growth stage of their business, financing options and steps required to be “credit-ready.” The Federal Reserve Bank of Chicago Consumer and Community Affairs Division held two focus groups in April of 2002 to learn from various stakeholders in the small business arena the features and functions that the BAT should include. The BAT is partially funded and the Chamber will administer the site through its Chicagoland Entrepreneurial Center. The BAT, though not yet created, will be a central feature of the clearinghouse website. As envisioned, it will offer users not only suggestions as to courses of action, but also links to financing sources, technical assistance providers and other useful websites.

For more information about SecapOnline, please contact:

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II. Equity Investment Task Group

Recommendations:

- 1. Develop and provide a venture capital fund targeted to smaller businesses owned by women, minorities, and/or businesses located in lower- and moderate-income communities.**
- 2. Develop and offer training and technical assistance to Chicago area communities on accessing equity investments.**
- 3. Organize networking events to inform angel investors to gain a better understanding of seed investment and learn of available resources.**

LMI Fund

The creation of a targeted venture capital fund is a key, though highly challenging in the current environment, goal of SECAP. The original recommendation called for establishing a fund targeting businesses needing between \$250,000 and \$1.5 million. The target market is companies located within low- and moderate-income (LMI) communities, companies owned and operated by women and/or minorities and companies with a significant proportion of their workforce living in LMI areas (by HUD definitions).

To facilitate development of the fund, the task group led by Bank One, LaSalle Bank and Bank of America, sought an intermediary organization to further develop the parameters of the fund (transaction size, geographic scope, etc.) and bring a fund manager with the requisite qualifications to the table. The LaSalle Street Project, also a SECAP Partner and participant in the Equity Investment Task Group, indicated an interest in assuming this role. The organization had already conducted research on equity needs in the Chicago metropolitan area and secured a state grant to conduct a search for potential fund managers.

Several potential fund managers submitted their qualifications for consideration, and a team was chosen. The fund managers will be announced to the SECAP Partners after the relationship is formalized. The fund envisioned will deliver market rate returns to investors, while creating jobs and providing needed services for LMI communities. The fund will deploy a proactive “buy and build” strategy that has been successfully used in non-LMI communities by some of the country’s foremost private equity firms. In brief, buy and build represents the process of identifying an attractive market niche, partnering with an entrepreneurial team to buy a platform company, and building and consolidating a series of companies around this platform to achieve economies of scale and substantial equity value.

The investment team will identify and target fragmented industries that would benefit from economies of scale and little nearby competition. Properly executed, these investments will become acquisition targets and may be eligible for an employee stock ownership program (ESOP) or other exit alternatives. LMI areas represent an opportunity because of their large, unmet market needs (particularly in the service sectors) and historically low capital investment.

Current (or potential) investors in LMI communities are also constrained by the limited number of existing companies and dearth of entrepreneurial talent in LMI communities. The buy and build approach will focus on identifying services that should be available in LMI communities and recruit seasoned entrepreneurs to acquire, create and grow companies that will provide needed services. The buy and build strategy has been successfully executed in a variety of industries in non-LMI areas. These industries include outsourced health care services, consumer services and technology-leveraged businesses.

Chicago Community Ventures Inner City Fund

Chicago Community Ventures (CCV) is a nonprofit business development organization that provides financing, consulting and technology services to small businesses and entrepreneurs in Chicago's underserved urban markets. CCV was originally formed as the Chicago One Stop Capital Shop to address the credit needs of the business community in the Empowerment Zones (EZ) and Enterprise Communities (EC) located in the metropolitan area of the city of Chicago. Through its Revolving Loan Fund, CCV provides loans in amounts from \$50,000 to \$400,000 to businesses within Chicago's EZ and EC neighborhoods. The Fund is initially capitalized at \$1.5 million and is raising an additional \$18.5 from foundations, banks and governmental sources over the next several years.

Inner City Fund Partners, LLC (ICF), is an early stage community development venture capital fund with the goal of raising \$20 to \$50 million to invest in firms located in or near low-income communities in the Chicago metropolitan area. This private, for-profit fund will be managed by CCV and is designed to provide both financial and social returns. CCV employs an active, aggressive, and hands-on management style essential to the success of early stage firms. CCV's collective organizational experience provides deep insight into the conditions, challenges and opportunities unique to early stage companies.

ICF Investment Strategy

ICF will make investments of \$250,000 to \$1 million and will maintain an industry-neutral policy to better increase the diversification of its portfolio. CCV expects to deliver financial results commensurate with successful community development venture capital funds across the country, meaning moderate to high returns to investors. In addition, CCV expects to deliver measurable social returns. In evaluating social returns, CCV underwrites the potential social impact of each investment and scores each investment according to its social return on an investment metric tool. The CCV social return on investment metric tool measures some of the following criteria: employee wealth creation, corporate social responsibility, job creation potential, low-income/community hires ratio, environmental impacts and the ability to provide health care and livable wages to under-employed individuals.

ICF Investment Products

- **Equity:** Preferred and common equity can be used depending on ICF's analysis of which terms best suit the needs of each venture and whether an equity position offers a realistic prospect for capital gain.
- **Convertible debt:** ICF will enjoy a position senior to stockholders, but junior to most other creditors. To compensate for this higher risk level, ICF's subordinated debt will carry provisions whereby the fund can convert its position to common stock at an attractive price.
- **Debt with warrants:** This instrument gives CCV the immediate financial benefit of debt payments, but gives ICF the option to participate in any equity appreciation at a pre-negotiated price.
- **Debt with royalties:** Royalty investments require payments as a percentage of gross revenues, but generally do not have the rights of secured lenders or the voting rights of equity investors.

Business Advisory Services

A cornerstone of the resources offered by CCV is its Business Advisory Services (BAS). BAS provides a blend of services to entrepreneurs and emerging businesses. BAS will support the ICF portfolio and selected non-portfolio companies by leveraging the 30 years of domestic and international economic development experience and expertise of CCV staff, and an advisory network of entrepreneurs, industry professionals and paid consultants.

Community Information Systems

CCV plans to narrow the digital divide between Chicago's low-income communities and the larger economy through services provided by Community Information Systems (CIS). CIS maintains a Geographic Information Systems website that provides small businesses and emerging entrepreneurs located in low-income communities, with demographic and economic data, and a dynamic site selector database of available commercial real estate by community.

Questions about the Fund, Chicago Community Ventures or Inner City Fund Partners, LLC should be directed to:

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Technical Assistance for Entrepreneurs Seeking Equity Investment

The Women's Business Development Center (WBDC) provides counseling to high growth businesses to assess their business model and offer recommendations to strengthen and accelerate their growth. The WBDC has a pool of almost 200 coaches to draw from with expertise in biotechnology and medical devices, health services, telecommunications, software and other emerging technologies.

The WBDC organized *Springboard 2001: Midwest*, a national women's venture forum. This event resulted in 26 women-led businesses presenting to investors, and brought together over 200 members of the investor and professional community. Many of the presenters are funded or in active discussions with investors. The WBDC initiated a new, follow-up forum – *Springboard: Midwest 2003*, to “accelerate women's access to the equity markets as both entrepreneurs and investors.” The program officially launched November 7, 2002.

III. Pre- and Post-Loan Technical Assistance Task Group

Recommendations:

- 1. Establish a certificate course for technical assistance providers that will promote consistent quality of services rendered.**
- 2. Develop a pilot program, involving experienced professionals, to begin the process of setting uniform quality standards for technical assistance providers.**
- 3. Create a program that would serve to inform loan officers of available technical assistance resources, and create networking opportunities for loan officers and technical assistance providers.**

Representatives of KMN Growth Consultants, Associated Bank, the JVS Chicago and Jane Addams Hull House comprise the technical assistance task group membership. The task group, recognizing the critical need for uniformity of quality services, set out to develop quality standards for the delivery of training and individual counseling to small and microbusiness owners. A group of small business experts was impaneled in February 2001. The Federal Reserve Bank of Chicago hosted a meeting with the panel and the task group members the following month. All of the quality standards, developed in the four critical areas of marketing, management, finance and accounting, have been delivered to the task group and are being used to develop a reference guide for technical assistance providers to be called *TAP Basics*. The guide is scheduled for release in the second quarter of 2003.

Discussions between the task group members and Illinois Small Business Development Association (ISBDA) and the Illinois Department of Commerce and Community Affairs (DCCA) have taken place. ISBDA and DCCA have expressed a desire to expand their training and certification, and to include elements recommended by the task group—such as making the training available to technical assistance providers outside of their network.

The committee also has begun work on a standardized test to be offered to technical assistance providers in conjunction with a major university. As envisioned, the test will be offered twice yearly and will allow individuals seeking the credential to draw upon personal experience and knowledge in addition to or in lieu of formal business counseling training.

For more information, please contact:

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Acknowledgement

On behalf of the Consumer and Community Division of the Federal Reserve Bank of Chicago, we would like to express our gratitude to everyone involved in making SECAP a successful endeavor. Ultimately, credit for the success of the initiative belongs to the individuals and organizations that stepped forward to implement the recommendations reached. The role of the Federal Reserve Bank of Chicago has been to bring the relevant groups and individuals together, and to act as a conduit and facilitator. However, SECAP and initiatives like it promulgated by the Federal Reserve could not succeed without the efforts of committed partners.