CDFI and Fintech Partnerships: A Promising Avenue for Affordable, Fast, and Equitably Distributed Small-Business Capital

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For more than 25 years, Accion Opportunity Fund (AOF)[1]—the nation's leading nonprofit microlender to small businesses and a Community Development Financial Institution (CDFI) through our lending arm, Opportunity Fund—has provided loans to low- and moderate-income people of color and immigrants. Our strategy combines microloans and business advising for small business owners with New Markets Tax Credit investments in high-impact community infrastructure projects. In 2019 alone, we deployed nearly $120 million in capital to over 3,200 small businesses across the nation, along with an additional $43 million in neighborhood revitalization efforts.

Despite our success, we knew the nationwide need for small business owners to access transparent, affordable, and responsible credit was far larger than what we had delivered to date—a gap estimated at $87 billion (pre-COVID). To help bridge this massive capital chasm, and to compete effectively with high-cost, online, small-dollar lenders that were wreaking havoc on Main Street, one strategy we pursued was an industry-leading collaboration with a best-in-class fintech, LendingClub, launched in 2016. That innovative program allowed us to be at the forefront of providing fast, responsible capital at scale when the crisis of a generation hit.

In March 2020, cities and towns across America made the difficult decision to shut down their Main Streets in the face of the deadly COVID-19 virus. Small businesses have borne the brunt of the economic shutdowns, and data from Yelp[2] find that more than half of the small businesses on its platform closed permanently as a result. What's more, Black-owned businesses are closing at rates twice as fast[3] as other businesses, nearly half of Latinx business owners expect to permanently

The Community Development Innovation Review focuses on bridging the gap between theory and practice, from as many viewpoints as possible. The goal of this journal is to promote cross-sector dialogue around a range of emerging issues and related investments that advance economic resilience and mobility for low- and moderate-income communities and communities of color. The views expressed are those of the authors and do not necessarily represent the views of the Federal Reserve Bank of San Francisco or the Federal Reserve System.

1 Opportunity Fund is a Community Development Financial Institution (CDFI) and the nation's leading nonprofit microlender to small businesses. In 2020, Opportunity Fund joined forces with Accion U.S. Network to create Accion Opportunity Fund (AOF) to provide national, scalable programs that leverage technology and data analytics with high-touch customer service to drive deep community impact. The organization will be referred to throughout the paper as Accion Opportunity Fund, or AOF.

2 Danielle Wiener-Bronner, "More Than Half of Businesses That Closed During the Pandemic Won't Reopen," CNN Business, September 17, 2020, www.cnn.com/2020/09/16/business/yelp-coronavirus-closures/index.html.

3 Lucas Misera, "An Uphill Battle: COVID-19's Outsized Toll on Minority-Owned Firms," Federal Reserve Bank of Cleveland, October 18, 2020.

close within six months,[4] and women-owned businesses disproportionately feel the impacts of COVID-19,[5] compared with their male-owned counterparts.

The Paycheck Protection Program (PPP)—created as part of the broader CARES Act relief package passed by Congress in March 2020—was intended to staunch the bleeding of America's small businesses. But in disbursing PPP loans, the Small Business Administration (SBA) relied on the biggest, most established banks to get money into the hands of their existing customers. The inevitable result was that big businesses received more than half of the funds, while many small business owners were left in the cold.[6] This problem was compounded for low-income communities and communities of color. A poll of Black and Latino business owners showed that only one in 10 received the relief funding they requested,[7] and secret shopper research demonstrated entrepreneurs of color experienced disparate treatment by banks, compared with their white counterparts.[8]

By overlooking nontraditional financiers—like fintechs and CDFIs—in the first round of PPP funding, government relief efforts missed a huge opportunity to reach the small businesses most in need. Fortunately, the flawed rollout of the PPP has put nontraditional lenders in the spotlight. Now the question is: How do we leverage the potential of these players to increase financial inclusion and provide financial services to more entrepreneurs of color?

Building partnerships between CDFIs and fintechs, as AOF and our fintech partners have done, provides a promising opportunity. In this way, we can capitalize on each sector's unique expertise to find solutions that work for both of us—and more important, for underfunded entrepreneurs. How do we build successful partnerships between such disparate entities? AOF's experience creating cross-sector partnerships with fintechs provides a roadmap.

Key Lessons for Building Fintech-CDFI Partnerships

Uncover shared interests.

CDFIs and fintechs are very different entities, with very different raison d'êtres. Both are private financial institutions, but CDFIs are, by definition, dedicated to delivering responsible, affordable capital and other supports to help low-income and other disadvantaged borrowers. Furthermore, the vast majority of CDFIs are structured as nonprofits, operating in the public's trust. Fintechs, on the other hand, are for-profit companies that aim to disrupt and compete with the traditional banking industry by providing customers with fast, efficient, and easily accessible lending products enabled by technology and data analytics. Fintech investors seek sizable returns in exchange for the risk associated with scaling disruptive new business models.

4 Robert Fairlie, "The Impact of COVID-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey," Stanford Institute for Economic Policy Research, May 2020.

5 U.S. Chamber of Commerce, "Special Report on Women-Owned Small Businesses During the Pandemic," August 26, 2020.

6 Jonathan O'Connell et al., "More Than Half of Emergency Small-Business Funds Went to Larger Businesses, New Data Shows," Washington Post, December 2, 2020, https://www.washingtonpost.com/business/2020/12/01/ppp-sba-data/.

7 Color of Change / Unidos US, "First COVID-19 Survey of Black and Latino Small-Business Owners Reveals Dire Economic Future, Inaccessible and Insufficient Government Relief Funds." Press release (Oakland, CA: Color of Change / Unidos US, May 18, 2020), colorofchange.org/press_release/first-covid-19-survey-of-black-and-latino-small-business-owners-reveals-dire-economic-future/.

8 Anneliese Lederer and Sara Oros, "More Tests and More Signs of Discrimination in PPP Lending by Banks." Press release (Washington, DC: National Community Reinvestment Coalition, November 12, 2020), ncrc.org/more-tests-and-more-signs-of-discrimination-in-ppp-lending-by-banks/.

Despite these differences, CDFIs and fintechs do have shared interests. Both are overshadowed by big banks, and both are important resources for small business owners. Since the 2008 recession, the traditional banking system has pulled back from lending to small businesses and increased their minimum loan sizes—resulting in huge gaps for these businesses looking for financing. We expect those gaps to increase, particularly after COVID-19. In fact, 80 percent of small-business owners who apply for a bank loan get rejected.[9] Often, small businesses then find their ways to CDFIs or fintechs in their search for financing.

However, unscrupulous lenders that are high-cost and entirely unregulated prey upon too many small businesses looking for capital. The financial services sector as a whole provides minimal protections for commercial financial products. Harmful and unregulated products threaten the livelihoods of business owners and their employees—and thus threaten already struggling communities across our nation.

CDFIs and fintechs are well positioned to tackle this problem collaboratively. Accion Opportunity Fund, alongside fintech partners LendingClub and Funding Circle, are founders of the Small Business Borrowers' Bill of Rights.[10] These organizations took action because they believe that the lack of industry-wide responsible practices is a risk to their business—either to losing market share and/or to creating harm for individuals and communities. Collectively, we advocated for California and New York to pass Truth-in-Lending laws and are continuing to advocate for such a law at the federal level. These laws require fintechs, CDFIs, and other alternative lenders to provide clear and comprehensive pricing disclosures to borrowers, among other guidelines.[11] In doing so, we're pushing industry practices to become more responsible.

However, not all fintechs share this commitment; some have deployed predatory financial products that trap small business owners in harmful cycles of debt and have strongly opposed efforts to disclose their pricing. It is therefore critical to identify shared interests before embarking on a partnership and finding fintech partners who align with CDFI values.

Exchange Expertise That Benefits Your Partners' Bottom Line.

The differences between CDFIs and fintechs can be a boon in any partnership. Each has specific traits and expertise that can help the other advance its mission and its bottom line. The fact is that CDFIs and fintechs can be stronger—and better able to serve small business customers—when we work together.

For example, CDFIs like AOF know, from experience, how to underwrite customers who do not meet the credit criteria for many fintechs, including small business owners with thin credit files or cash-based businesses. This represents a business opportunity for fintechs, which are not typically set up to underwrite and serve these customer segments on their own. By partnering with a CDFI, fintechs can expand the number of businesses that they can say "yes" to and earn additional fees.

9 Brayden McCarthy, "Why Bank Lending to Small Businesses Isn't Recovering" (New York: Fundera, September 9, 2020), www.fundera.com/business-loans/guides/bank-lending-small-businesses-isnt-recovering.
10 Responsible Business Lending Coalition, "Small Business Borrowers' Bill of Rights," www.borrowersbillofrights.org/.
11 Responsible Business Lending Coalition, "Statement: New York Enacts Strongest Commercial Lending Disclosure Law in the Nation," December 23, 2020, www.borrowersbillofrights.org/newyorkenactsstrongestcommercial.html.

On the flip side, fintechs can help CDFIs increase their customer acquisition volumes and improve their efficiency in highly beneficial ways. Enabled by technology and data analytics, CDFIs can learn how to streamline their operations, develop scalable solutions, offer affordable credit to more businesses, and access different types of capital beyond that of traditional CRA-motivated investments.

Invest in the Necessary Capabilities.

To build out these types of relationships, CDFIs will require upfront investment in new technology, data analytics, and staff capabilities. At AOF, we've found that in order to compete with other alternative lending offers, we needed to combine the mission focus of a CDFI with the online lending expertise of a fintech, creating a new model for transparent and affordable lending to meet the needs of small business owners across the country. We've worked hard to raise the significant funds to support these investments, which not all CDFIs are in a position to do. However, a promising CDFI-tech model is Connect2Capital, which serves as a technology gateway to connect a network of CDFIs, investors, and small-business owners seeking capital. Connect2Capital made it possible for many smaller CDFIs without robust, in-house technology to participate in various statewide relief efforts in California, New York, and Illinois during the pandemic.

Even before small businesses were facing an existential crisis, for many it wasn't enough to simply access affordable capital in the traditional CDFI method and timeframe (which may replicate bank processes more than we like to think). Small business owners are often frustrated or overwhelmed by onerous document requirements when applying for credit and may instead opt for a loan with less favorable terms if that process is simpler and faster. But partnerships with fintechs, coupled with changing customer expectations and AOF's desire to scale, compelled us to create an online lending experience and offer a personalized service in a faster, more standardized way.

However, these changes require investments in technology, data analytics, and human and capital resources. Fortunately, our partnership with LendingClub was made possible, in large part, by a $2.6 million grant from JPMorgan Chase's PRO Neighborhoods initiative, which was used for technology, staffing, loan capital, and program evaluation.[12]

Recognize the Limitations of Your Partnership.

Although fintech partnerships can help CDFIs scale their reach, they can't fill all the persistent and systemic gaps that prevent us from fully serving our target markets. Even though we consider our fintech partnerships successful, customers we currently obtain through these partners are less likely to fit into our target market—low/moderate income and entrepreneurs of color.

Fintech tools can be part of a CDFI's efforts to serve our communities, but they must be coupled with others from the CDFI toolbox: subsidized capital and loan loss reserves, mutually beneficial community partnerships, and culturally responsive staffing and services.

12 Jenny Boyer and Gwendy Brown, "Building Technology for Cross-Sector Collaboration: A Case Study of Fintech-CDFI Partnership Success" (New York: Opportunity Fund, September 2017), www.opportunityfund.org/wp-content/uploads/2019/09/BUILDING-TECHNOLOGY-FOR-CROSS-SECTOR-COLLABORATION-1.pdf.

When entering into fintech partnerships, we carefully vet our potential partners to make sure they share our values and are committed, as we are, to responsible lending to underserved markets. For example, in an initial evaluation[13] of AOF's partnership with LendingClub, we identified four key lessons that we use to assess and grow future partners. These themes are: 1) focus on relationships and values alignment at the outset; 2) ensure strong leadership commitment and resource allocation by both partners; 3) maintain a learning mindset and be flexible to how the partnership can evolve over time; and 4) develop a nimble, nuanced approach to goal-setting and partnership evaluation. Successful partnerships require understanding limitations while still pushing against them in pursuit of our mission and end goals.

2020: A Year of Unprecedented Challenges—and Opportunities

The past year introduced unprecedented rates of change and complexity to the financial sector. The needs of small businesses are vast and urgent, and the limited public resources we have at our disposal change minute by minute. But in many ways, these challenges also have the potential to be turned into opportunities for enhanced partnerships between CDFIs and fintechs.

Early in the pandemic, one of our fintech partners, Gusto, a human resource software company, was desperate to get PPP loans for its customers. But we were all at the back of the line together, with government programs overlooking fintechs and CDFIs alike. However, this presented the opportunity for joint advocacy. Collectively, we advocated strongly and loudly before decision-makers acknowledged the flaws in existing small-business relief and the critical role of nontraditional lenders. And thanks to this advocacy, we were able to collaborate with Gusto to get much-needed money into the hands of its customers. One such customer was My Financial Counsel, Inc., a Brooklyn-based business with two employees that connects millennial professionals and young families with independent, fiduciary Certified Financial Planners. My Financial Counsel uses the Gusto platform to manage the company's payroll. Thanks to our partnership, they were also able to use Gusto's platform to connect with AOF and obtain a PPP loan that kept basic operations running through the pandemic. Without the loan, business would have come to a standstill.

Another unintended, but positive, consequence of the pandemic is that we—like so many organizations—have had to accelerate our digital transformation. A few years ago, it wouldn't have seemed possible to do all of our lending remotely, and still be able to find and serve our target customers, but we have. Our customers' use of digital tools, coupled with our phone support when they need us, has changed and increased substantially, and we've met them where they are.

Finally, the events of 2020 have resulted in more attention being paid than ever before to the importance of small businesses and to people knowing what a CDFI is. The real-life consequences of systemic racism and underinvestment in communities of color have been front and center over the past year, both because of the economic impact of COVID-19 and the racial justice protests. More than ever, we need partnerships that are strong enough to serve these markets that have been locked out for

13 Boyer and Brown, "Building Technology."

so long. This requires both CDFIs and fintechs to examine our practices and ensure that we are doing our best to counteract centuries of neglect and financial exclusion towards these communities.

Looking Ahead

We've learned important lessons from our for-profit fintech partnerships over the years, and we continue to adapt these partnerships to changing circumstances. In the future, we plan to identify even more areas of shared interest in order to best serve small business owners.

We know that, in the years ahead, the lines between fintechs, CDFIs, traditional banks, and other lenders will continue to blur. Even now, there are many actors that straddle these different categories—from LendingClub purchasing Radius Bank[14] to American Express acquiring Kabbage.[15] Thus, it is more important than ever to find ways to work together to increase financial inclusion and build a sector that works for all.

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Luz Urrutia *joined Opportunity Fund as CEO in 2017. Luz is helping to scale the non-profit CDFI to deepen its impact in California and expand nationwide. Already the nation's leading nonprofit small business lender – with over $170 million in small business loans under management – Luz is focused on expanding nationally and quadrupling impact nationally by 2025. Under Luz's leadership, in 2020, Opportunity Fund and Accion, The US Network, joined forces to establish Accion Opportunity Fund – developing new products, establishing new partnerships, and promoting research and financial education to support mission-driven lending. Luz spent her career in banking and financial services and has won numerous awards for her leadership in the field. She began her career at Wachovia before founding El Banco de Nuestra Comunidad. As VP of Retail Sales and Services at Oportun, Luz's team expanded Oportun's footprint across five states. In 2016, Luz joined Dollar Financial Group as CEO for the Americas to help transform the organization into a responsible consumer finance lender for underserved communities.*

14 Hugh Son, "LendingClub Buys Radius Bank for $185 Million in First Fintech Takeover of a Regulated US Bank," CNBC, February 18, 2020, www.cnbc.com/2020/02/18/lendingclub-buys-radius-bank-in-first-fintech-takeover-of-a-bank.html.

15 American Express, "American Express to Acquire Kabbage." Press release (New York: American Express, August 17, 2020), about.americanexpress.com/all-news/news-details/2020/American-Express-to-Acquire-Kabbage/default.aspx.