Addressing the Racial Wealth Gap with a Local Economy Preservation Fund

From: Marjorie Kelly, Executive Vice President, The Democracy Collaborative
Rebecca Regan, Fellow, The Democracy Collaborative
Date: March 23, 2021

States have an opportunity to direct significant amounts of capital toward Black and Brown business owners and employees, who have been disproportionately affected by the pandemic shutdown. By April 2020, the number of active Black business owners nationwide fell 41 percent, compared with 20 percent overall. Women business owners were also hit harder than their male counterparts. These kinds of businesses, often located in disadvantaged communities, will need catalytic capital to thrive in a post-COVID environment.

States have an opportunity to create an innovative program bringing the needed long-term capital—equity investment—all too often unavailable to these underserved businesses while keeping that wealth locally rooted for the long term. The racial and gender inequities long at play in the small business ecosystem can be rebalanced with a **"local economy preservation fund" (LEPF)**—a concept developed by The Democracy Collaborative and being advanced by the Council of Development Finance Agencies and others.

Funding for this type of program could come from U.S. Treasury dollars on their way to states from the American Rescue Plan Act of 2021, the recently enacted $1.9 trillion stimulus package to support COVID-19 recovery and relief. That bill includes $10 billion to reauthorize the **State Small Business Credit Initiative (SSBCI)**, which will make funds available to each state in two rounds of $5 billion each. The funding approved under a state's application will in turn be deployed to support the recovery of small businesses, particularly in ways benefitting the "socially and economically disadvantaged."

SSBCI funding, originally allocated in 2010 (oversight ended in 2017), was historically used by development finance agencies (DFAs) nationally for loan participation programs (eg. credit support programs). But in the post-COVID environment, businesses—particularly those owned by women and people of color—are hard-pressed to take on debt. What disadvantaged yet viable businesses need now is equity or flexible, equity-like capital.

Black and Brown owners and women have historically had unequal access to equity, more readily available to White men. With a local economy preservation fund, SSBCI funding could make equity investments in businesses owned by disadvantaged owners, and place those investments in a holding company. When businesses are stable and ready to transition, the LEPF would ensure firms remain locally owned and in the public interest by shifting only to local owners, emphasizing ownership by women, people of color, and employees. This allows entrepreneurs to realize the value they have built while preserving the living legacy of their firm. This use of public dollars as equity enables long-term community wealth creation through ownership that stays local and benefits those normally excluded.

Supporting local businesses—and ensuring ownership is not limited to an elite—strengthens employees and communities. Studies show locally owned firms keep three times more dollars circulating locally than absentee-owned firms. Black-owned businesses hire more people of color. Employee-owned firms, in the last downturn, were one-fourth as likely as traditionally owned firms to resort to layoffs.

Keeping small businesses in the hands of the community is at the heart of the LEPF idea. To allow for long-term ownership models to work, long-term, flexible capital is required. A state-sponsored or CDFI-sponsored LEPF is a game-changing model under development now in several communities and urgently needed nationwide.

Proven Concept: A public holding company owning shares in businesses is a proven model worldwide. In the Great Depression, the Reconstruction Finance Corporation became the nation's single largest investor, owning thousands of firms. In an October poll by The Democracy Collaborative and YouGov, 70 percent of respondents said the government should help keep small businesses from shuttering or being acquired by big business. A majority supported the concept of local economy preservation funds.

Here is how it might work: The state applicant for an SSBCI allocation would provide a carveout in its application for a local economy preservation fund. SSBCI requires the federal dollars to be leveraged with private dollars; the leverage requirements are aggregated for all SSBCI programs in a state. A local economy preservation fund program would attempt to find leverage, but would not be required to do so, given the nature of challenges the model seeks to address. The state would meet overall leverage requirements through other SSBCI programs.

The LEPF fund would be set up like a holding company, capitalized with the designated carveout. These funds would be available for investment in small businesses, with certain criteria (i.e. disadvantaged cities, Black- and Brown-owned, women-owned, firms employing majority people of color, essential local industries appropriate for employee ownership, etc.). Investments would be made in firms viable pre-COVID and likely to be viable after. Funding would be deployed on behalf of the LEPF via designated investment officers at CDFIs or state staff. Funds can also be placed with CDFIs.

Historically, federally provided SSBCI funds remain in the state at the end of the program, for ongoing use or redeployment to new uses. This LEPF vehicle would also hold capital on a revolving basis—in perpetuity. The equity would be repaid by the businesses and reinvested. This allows a LEPF to become an ongoing community wealth creation institution, working to keep more and more businesses locally owned over the long term, directing more wealth to owners and employees as assets grow.

Performance Tracking: Clear performance metrics, both financial and social, will be critical to tracking LEPF success. Program design should give clear guidance requiring the creation of citizen oversight bodies to design and monitor outcome metrics and shape program design overall, with annual reporting required. Metrics collected should include the number of people of color and women in jobs and in ownership, jobs preserved, percent paying living wage, number of employee-owners created, etc.

How funds return and stay local: Investments can be structured with various mechanisms to require the return of capital to the vehicle. Once stabilized, businesses could be required to engage in milestone-based repayment, with additional LEPF investments similarly triggered. In recognition of the need to preserve wealth within the community, when a business is sold, preference will be given to local stakeholders: worker ownership, people of color, local strategic buyers, and community entities.

The LEPF model is a bold move to reverse capital access inequalities and support wealth creation for those long denied it—creating more prosperous, locally rooted, inclusive economies. ■