Concluding Remarks

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As a point of reference, I am the president of The Reinvestment Fund (TRF), which finances real estate and businesses in a four-state area. We are organized under a nonprofit charter with a mission to rebuild low-income (LI) areas and assist low- and moderate-income (LMI) families. The majority of our work is in the Philadelphia region, where TRF's main office is located.

TRF manages $300 million in assets across four funds capitalized by individual and institutional investors. We finance residential real estate; commercial real estate and community facilities, such as child-care centers and charter schools; and small businesses. We provide Small Business Administration (SBA) and non-SBA debt for small businesses and invest subdebt and equity to firms through a $50 million private equity fund. Along with our financing, we provide workforce services to portfolio companies and real estate development services to many borrowers. We also advise public- and private-sector clients on policy and data-related issues.

TRF has allocated a half a billion loans and investments into LI communities during the past decade, 40 percent of which were invested during the past three years. TRF investments have financed 12,000 housing units, 4 million square feet of commercial real estate, more than 250 businesses, 9,000 child-care slots, and 15,000 charter school seats.

Many of the possibilities and constraints we deal with on a daily basis have been discussed at this conference. I want to suggest four additional areas for further reflection: 1) the importance of noncredit-related barriers to small business development; 2) the role of residential real estate in generating entrepreneurship; 3) the capital and development assistance gap for existing firms with growth potential; and 4) the application of entrepreneurial energy to social problems usually framed as belonging to the public domain.

Barriers and supermarket operators

There is significant literature on financing barriers. One of the papers in this conference looked at the role of the SBA in LMI markets, and another commentary made significant mention of the Community Reinvestment Act. I also follow some of the research on venture capital availability and its role in business formation. And there is new research on the role of credit scoring in small business finance. Moreover, there are countless studies that examine the influence of tax rates on business development and the efficacy of targeted tax breaks through enterprise zones, abatements, and the like.

But what of the issues that have less to do with financing and tax rates? What role do they play? I was struck by the importance of nonfinancing issues in a new supermarket initiative we are managing in collaboration with the commonwealth of Pennsylvania. The idea for the program came from a coalition of business and civic leaders concerned by the lack of competitive food prices and choices in the inner city and the implication for household budgets and health.

As part of the program design, we spent time with supermarket operators from suburban and urban areas. We wanted to know more about the challenges for new stores in cities like Philadelphia, so we interviewed a diverse group, including sophisticated owners with multiple stores linked to national chains; emerging entrepreneurs building operating scale from early experiences with mom-and-pop shops; and retail managers interested in becoming owners.

While the availability of term debt financing was an issue for a segment of the group, there was an emphasis on three other barriers: 1) the existence of available sites and adequate public infrastructure investments; 2) public safety; and 3) workforce readiness and reliability.

Despite huge vacancy rates in Pennsylvania cities, it is time-consuming to find sites for appropriate-sized stores and adequate levels of parking. Land assembly obstacles were related to the politics of zoning and redevelopment, the complexity of bureaucratic process, design barriers posed by industrial era street grids, and a lack of proactive assembly and marketing on the part of many municipalities. Commercial development was constrained by the political and civic will to assemble commercially viable places.

A second issue had to do with public safety. Crime adds costs and social disincentives, such as insurance costs, the cost of increased security measures, limits to foot traffic at certain times of the night, etc. In a low-margin business, these costs can be decisive. In neighborhoods where there were signs of revitalization, operators (and community groups) did not want to use visible security markers (for example, metal grates, protective windows, etc.) that would send the wrong message to existing and potential residential customers. Retail store appearances linked to crime and disorder were barometers of the upward or downward spiral of a community.

A third issue was the cost and predictability of workforce recruitment and retention. Even in sophisticated union shops, there was an extraordinary cost to entrepreneurs for the identification and training of workers. We found this out in our first venture, only a few miles from Philadelphia International Airport. The new market had to work through more than 4,000 applications to get down to a pool of 400 workers who could pass basic standards related to skills, attitude, criminal justice issues, and a myriad of other hurdles. Eventually 200 workers were hired from this pool.

Local entrepreneurship in residential real estate

Based on more than two decades of investments in LMI communities, I believe that the greatest entrepreneurial opportunities are still linked to the

rehabilitation and exchange of the housing stock itself. We recognize that housing is the largest single asset on the balance sheet of most American families, and the lower the income, the more likely it is that family assets are contained in their primary residence. Just as important, however, residential real estate development, ownership, and management offer relatively low-cost entry points for moderate- and middle-income enterprise.

TRF finances urban entrepreneurs that rehabilitate houses either for sale or rent, and we finance small-scale contractors. Many small-scale rehabbers and contractors started off as skilled contractors and many are family-centered businesses. There are also a number of other business options linked to housing, such as mortgage and insurance brokerage and maintenance companies, in many of the communities in which we work.

Small-scale housing developers provide a fascinating contrast in opportunity and constraint, some of them in financing. They work in markets that do not suit larger developers because of scale and information barriers. The small rehabbers usually work in a single neighborhood or a few adjoining neighborhoods, do a few units (one to four) at a time, and do not make use of mainstream bank construction financing. They generally finance their activities using equity, credit cards, and/or single family mortgage loans. These mechanisms do not limit their ability to enter the market but their capacity to undertake more production.

As a nonregulated lender, TRF can work with these developers to help them grow their businesses and undertake projects of greater scale. Their deals are labor-intensive and generally relatively small ($250,000 to $750,000). They require a "technical assistance" period, where a loan officer works with them to help them conform to construction loan requirements. Even though we are flexible, many borrowers are not used to design reviews, construction requisition documentation, and construction inspections. TRF financing helps developers professionalize and ultimately work at a larger scale.

Existing firms and competitive growth

While TRF often works with entrepreneurs to establish new enterprises in distressed markets (in other words, the supermarket initiative), we also work

with existing firms in older cities and towns that are profitable and have growth capacity. Economic development strategies tend to focus on attracting and catalyzing new companies and technologies and to overlook the growth potential of existing firms that need to adapt to new market conditions.

Many of these firms are "lifestyle" companies dominated by a founder, founding partnership, and family. They are not able to keep up with changes in the marketplace, such as new technologies, supplier and customer networks, and business processes. They are sometimes profitable but lack a longer-term competitive strategy. And they often suffer from limited new capital and strategic investment. In some instances, owners may want to get out of the business, but they have limited liquidity options. Finally, many firms have never had private equity investors and are understandably wary of giving up any control to outside investors.

A potential market gap, and economic development strategy, exists in trying to provide liquidity and growth for these companies through the provision of equity or equity-like financing. TRF invests preferred equity and subordinated debt in these companies, many of which have sales up to $20 million. Unlike conventional venture funds, we are not looking for technology companies but conventional operating companies—high-end manufacturing, medical outsourcing, service companies—that need growth capital to expand. We are able to entertain transactions (up to $4 million) that are smaller than larger private equity firms would review.

In order to be effective at growth-oriented conversions, you must be a proactive investor willing to take company board seats and function as a key business adviser. You have to play a strong role in building out new management teams capable of business execution. And you have to be able to raise new rounds of capital to support future growth and liquidity. Finally, the equity fund has to have a business model that can sustain expected write-offs common to private equity without the legendary "home runs" of the venture industry. This is a strategy that lives on singles and doubles, although it generally will have fewer write-offs than higher-risk, early-stage venture finance.

Social entrepreneurship in child care and schools

A fourth strategy has to do with the application of business investment to firms or nonprofit organizations that take an entrepreneurial approach to managing social or public services. TRF is one of the major financing agents in Philadelphia for urban child-care centers and charter schools.

While many of our child-care centers are organized as nonprofit institutions, there are an increasing number of for-profit centers and small chains that have been moving into the market. A reasonable percentage of our small business portfolio provides day-care loans to mom-and-pop providers that may have started in a residence and then expanded to a small storefront. Our private equity fund invested in what is now the largest for-profit chain of inner-city child-care centers in the nation, serving almost exclusively subsidized households. The centers serve more than 3,000 Philadelphia families and have created more than 600 local jobs. They are located on transit lines and offer late-night services in order to accommodate staggered work schedules.

Our school portfolio represents some of the most innovative thinking about how to deliver educational services to inner-city kids. We now have within our portfolio facilities loans to more than 30 schools that represent about 15,000 students. One of our high schools, Mastery Charter, whose board I chair, has opened a second school this year and will be given two additional schools by the district next year. The second school is a nonprofit charter run by a former entrepreneur. The board members are some of the most successful entrepreneurs in the region, all of whom have a great interest in how to best apply business logic to the management and delivery of these services.

Topics for future discussion and research

The four examples just discussed come from our portfolio, but they are not specific to TRF by any means. Together, topics such as these point us toward new policy-related discussion and research. The following are a few thoughts on each.

- Nonfinance barriers are not yet quantified adequately and have not been given the importance that they deserve in public policy. We continue to allocate federal and state community development resources to places without demanding that the basics of public infrastructure—safety, land regulations and transfer, and training—be fixed. If the supermarket operators I interviewed could design enterprise or empowerment zone legislation, for example, they would focus the resources differently.

- Small-scale housing entrepreneurs do not receive the policy emphasis one would expect. Despite the remarkable success of this strategy by institutions such as ShoreBank in Chicago, LMI housing policy de-emphasizes support for local entrepreneurs and plows large subsidies into nonprofit housing developers and larger for-profits that have the ability to successfully compete for LI housing tax credits. While the latter two constituencies may play an important role, there is a local business development process going on in these communities that is statistically significant but under the policy and research radar screen.

- A focus on building the growth potential of existing firms, most of which seem to be decidedly "old" economy companies, does not get you on the consulting circuit for economic development conferences. It however, may help to revitalize older cities and towns. The technological revolution is not so much about new technology firms as it is about the application of new technologies and business processes to existing products and services. The research and policy agenda has to help cities like Akron, Ohio; Baltimore; and St. Louis understand what they have, what has a domestic future, and how to deliver growth capital and new management capacity to the shop floor.

- Social enterprise in schools, child care, and other services is redefining the possibilities of public-oriented management. The Philadelphia School District no longer runs a uniform public utility. It has district schools, magnets, charters, and contract relationships with a variety of for-profit and nonprofit firms. This structural revolution is bringing new talent into the field through operations and boards. Successful entrepreneurs who never would have had a way to affect urban schools are providing social capital connections, financial resources, and management expertise. While we rightfully have focused on the outcomes of these transformations—test scores, quality care indicators, etc.—there is a business development aspect

to these changes that has received less attention. Yet they may represent some of the most successful new businesses in these communities.

One of the contributions of this conference is that the papers were written from an abstract, mile-high level. This provides an opportunity to frame issues broadly and consider comparative approaches to research and practice. A future conference on entrepreneurship and LI communities might complement this effort by taking a case study approach linked to examples such as the four I provided. By working from the particular to the general, we might be able to engage an even broader group of researchers, investors, and policy entrepreneurs.