

UC Berkeley

Cal-in-Sac Undergraduate Research on Diversity and Entrepreneurship

Title

Lending Practices for Formerly Incarcerated Entrepreneurs of Color: The Considerations from Community Development Financial Institutions

Permalink

<https://escholarship.org/uc/item/9871t6mf>

Author

Kou, Irene

Publication Date

2024-10-06

Lending Practices for Formerly Incarcerated Entrepreneurs of Color: The Considerations from Community Development Financial Institutions

A Policy Brief by Irene Kou

Wells Fargo & IGS Diversity and Entrepreneurship Research Fellow



(Illustration, Artist: Michael Meier, <https://www.mrmeier.com/>)

Introduction

Community Development Financial Institutions (CDFIs) are private financial institutions that provide economic support services to assist underserved populations that face low-wealth barriers in securing the financing needed to start and grow a small business.¹ CDFIs offer access to capital and support programs that help entrepreneurs and small business owners make better financial decisions. In the U.S., research suggests that CDFIs play a critical role in providing the financing and tools that are essential for historically underserved populations – especially those

¹ Getter, Daryl E. (2023). “Community Development Financial Institutions (CDFIs): Overview and Selected Issues.” (Report No. R47217). Congressional Research Service (CRS).

who identify as African American, Hispanic, Asian, and low-income – to start and grow a small business.

“Entrepreneurship not only provides greater economic incentives to desist from crime through higher earnings, but also provides crucial social and psychological incentives like self-esteem, work satisfaction, commitment, and responsibility.”

- Kylie Jiwon Hwang²

Despite nearly 4 percent of small business owners in the U.S. having a criminal history, there is not much information on how CDFIs have engaged in lending practices for small business owners and entrepreneurs who identify as formerly incarcerated and a person of color.³ As a result, there is a potential consequence of neglecting re-entry individuals as they are at a high risk of recidivism due to their lack of financial knowledge.⁴ Another potential risk would be society’s continued lack of sympathy for repeated criminal offenders as citizens often feel frustrated with society’s crime problem.⁵ To address these issues, research suggests that CDFIs would not only provide economic stability for these non-traditional groups but would also ensure a successful reentry through our financial system.⁶

Thus, this research project investigates CDFIs and their lending considerations for formerly incarcerated entrepreneurs of color as they continue re-entering society. Understanding these practices is crucial in addressing economic disparities to contribute to the economy through their financial endeavors and personal journeys in reintegration. Suppose we are unable to provide support through CDFIs. In that case, its negative effects can perpetuate even larger work and wealth inequalities as entrepreneurs struggle to maintain their businesses without their support – especially if they identify as a person of color and formerly incarcerated. The findings presented below are based on interviews with 2 Californian CDFI leaders regarding their lending practices and considerations.

Key Findings

Typically, CDFIs choose not to consider incarceration or criminal background in their loan application processes as they aim to eliminate any biases or other barriers for entrepreneurs

² Hwang, K. J. (2022). “From Prison to Entrepreneurship: Can Entrepreneurship be a Reentry Strategy for Justice-Impacted Individuals?” *The ANNALS of the American Academy of Political and Social Science*, 701(1), 114-133.

³ Bushway, Shawn D., Woods, Dulani, Agniel, Denis, Adamson, David M. (2021). “Small Businesses, Criminal Histories, and The Paycheck Protection Program.” RAND Corporation.

⁴ Mielitz, Kate S., MacDonald, Maurice, & Lurtz, Meghaan. (2018). “Financial Literacy Education in a Work Release Program for an Incarcerated Sample.” *Financial Counseling and Planning*, 29(2), 316–327.

⁵ Turner, Susan, & Petersilia, Joan. 1996. “Work Release in Washington: Effects on Recidivism and Corrections Costs.” *Prison Journal*, 76(2), 138-164.

⁶ Kolkey, Sean. (2022). “People Over Profit: The Case for Abolishing the Prison Financial System.” *California Law Review*, 110(1), 257-295.

seeking access to capital. For lending purposes to evaluate lending patterns, CDFIs generally ask demographic questions to meet their target population goals which include but are not limited to race, ethnicity, sex, gender, age, languages spoken, income, etc.

Despite not factoring in criminal backgrounds with every applicant, one CDFI application evaluator indicated that they proceeded with caution regarding the severity, recency, and repetition of the offense when such information is disclosed.

“It's a character thing that we go through. We might consider that they may have a problem [of reoffending] and we might not want to move forward with a loan in that respect.”

- Anonymous CDFI Loan Manager

For the evaluator, minor offenses or crimes committed more than five years ago were not nearly as significant, whereas severe or recent offenses (within the past five years) were subject to closer evaluation on their application. The evaluator did not want to impede the application process due to bias, but rather, the CDFI wanted to ensure that applicants with a criminal background would be successful in their endeavors if they were to receive a loan. However, it is important to note that many CDFIs do not have many applicants with criminal backgrounds or previously incarcerated status (or, at least, this is often not reported).

“There's such a huge, enormous number of small businesses in the ecosystem that needs support. [Therefore,] we [Accion] really want to just focus on what we're good at right now.”

- Adriana Eiriez, Senior Vice President of Accion Opportunity Fund

CDFIs do not have specialized funds for subgroups as their funding is intended to support a broader scale of entrepreneurs who identify as a person of color or low-income. Therefore, CDFIs in California typically do not have dedicated funding for formerly incarcerated individuals, single mothers, and other similar groups. CDFIs deliberately choose to consider each application on a first-come, first-served basis and prioritize their support on a larger scale rather than creating specific funds or loans for these smaller populations. CDFIs believe that their work should continue functioning in this capacity and that these larger demographics – people of color and/or low-income – tend to include the demographic of someone with a criminal background. Thus, they do not have the intention of creating specific or additional funding to support these specific populations.

Lastly, CDFIs do not have unique or tailored business development strategies or resources for specific subgroups. They have brochures, pamphlets, and other informational materials that people can access. However, accessing these materials may have broader implications that would benefit everyone, including someone with a criminal background. To entrepreneurs with a criminal background, there is often a negative stigma and lack of access to many programs and services – especially throughout a screening process that requires certain documentation, history, and other forms of identification or background checks.

Policy Recommendations

While evaluating applications impartially is beneficial in many ways to eliminate bias and other barriers to being accepted for a loan application, formerly incarcerated entrepreneurs need support mechanisms to ensure success throughout their endeavors – especially those with more recent offenses. Policymakers should encourage CDFIs to learn about the barriers faced by formerly incarcerated entrepreneurs and go through an additional consideration process that prioritizes the applicants' current financial status and business plans holistically rather than their past. They should also provide training efforts to eliminate bias that could occur due to a criminal background. As Adriana Eiriez explains, Accion CDFI considers applications aside from monetary and other numerical successes by looking at the history and patterns of its applicants.

“We look more at how a business is functioning today because what we don't want to do is to add more burden. [...] We're more about lending them the money that they'll be able to repay.”
- Adriana Eiriez, Senior Vice President of Accion Opportunity Fund

Another form of support includes financial education and financial literacy training before an application is received to ensure that applicants are better equipped to handle the challenges of entrepreneurship and re-entry. Examples of programs from CDFIs could cover credit management, business planning, and loan application ‘tips and tricks’ to enhance financial stability and ensure business success. These additional financial courses and comprehensive information for applicants can ease evaluators' cautious approach and ensure better readiness for these entrepreneurs.

Policymakers should also consider creating dedicated funding for formerly incarcerated entrepreneurs and other specific populations to provide incentives for these specific groups of entrepreneurs to apply. Not only would this encourage applications, but CDFIs with designated funding can focus their attention on serving these populations and meeting their quotas for a broader and diverse pool of borrowers. CDFIs can also implement mentoring programs, networking opportunities, and business development resources that are tailored to these entrepreneurs' needs without invalidating their experiences.

Policymakers should look to make strong partnerships between CDFIs and reentry organizations that can provide a holistic support system for formerly incarcerated entrepreneurs who are in all stages of their entrepreneurship journey. With these partnerships between CDFIs and reentry programs, tracking and evaluating the services provided with lending opportunities can ensure the success of not only formerly incarcerated entrepreneurs of color – but also future entrepreneurs who fall under these categories.

Conclusion

CDFIs play a significant role in providing economic support to historically underserved populations. However, in their current practices of a neutral assessment lending model and focus on serving a broader population, CDFIs need more support strategies to address the challenges faced by formerly incarcerated entrepreneurs of color. If CDFIs can enhance their evaluators' screening capabilities, form partnerships with reentry programs to come up with targeted mentoring programs, and provide dedicated funding – these strategies would drastically increase the financial inclusion of formerly incarcerated people of color. Implementing these considerations would continue to promote better CDFIs and their mission to support underserved communities regarding financial inclusion and economic well-being.