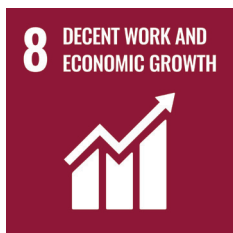


Supporting small business through impact investing



November 2023



In 2015, the United Nations General Assembly adopted the Sustainable Development Goals (SDGs) – a global agenda aiming to end poverty, protect the

planet and ensure prosperity for all by the year 2030. The framework established 17 overarching goals detailing specific actions that governments, non-profit organizations, corporations, and individuals can take to make progress toward these ambitious goals. While each goal has its own specific focus, it is often the case that a particular investment objective – such as supporting small businesses – promotes several goals simultaneously. For example, investments in support of small business development not only endorse Goal #8: fostering good jobs and economic growth, but also Goal #9: building industry, innovation, and infrastructure; Goal #11: making sustainable cities and communities; and Goal #12: ensuring responsible consumption and production patterns. Ultimately, one investment into supporting small business can further the reach of additional SDGs, compounding the effect of those assets.

Small Businesses within the US

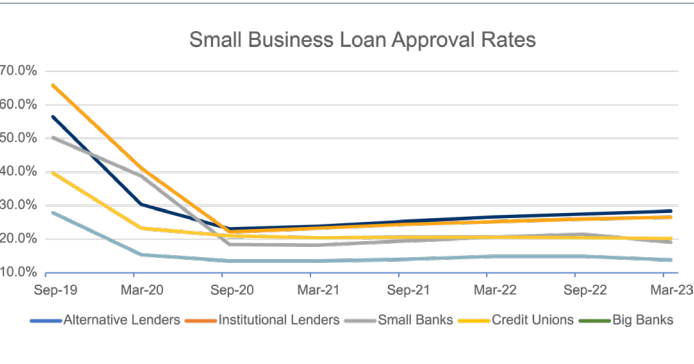
A small business is defined by the firm's size (number of employees) and/or its annual revenue. These definitions depend on the business industry and can change from one year to the next. The US Small Business Administration (SBA) determines these definitions and manages the big industry that is small business in the US. The US is home to some of the largest corporations in the world but the bread-and-butter of our economy is small business. There are approximately 33 million small businesses in the US that employ nearly 62 million people (approximately 47% of all employed individuals). In addition to driving US employment, small businesses are notable for the following reasons:

- 99.9% of businesses in the US are small businesses (with fewer than 500 employees).
- Small businesses have created an average of 525,000 new jobs each year since 2000.
- 88% of small businesses have fewer than 20 employees.
- 45% of US economic activity (GDP) is tied to small businesses.

All the statisticsⁱ referenced above highlight the important role that small businesses play in both their communities and in the gross domestic product of the US economy. However, small business owners and entrepreneurs face a host of challenges. First and foremost is the critical issue of finding capital to either start, maintain, or grow their business.

According to many specialists, money and funding are the reasons behind most small business failures. The US Census Bureau’s Annual Survey of Entrepreneurs reported that approximately 25% of small businesses each year shut down operations because of insufficient sales and/or cash flow, while an additional 10% close their businesses due to challenges associated with obtaining essential business credit.ⁱⁱ However, a US Bank study found that as high as 82% of businesses fail because of cash flow issues while the National Small Business Association (NSBA) found that nearly a third, or 27%, of businesses aren’t able to receive needed funding.ⁱⁱⁱ

While the SBA estimates that typical start-up costs are between \$2,000-\$5,000, the average annual operating cost of a newly established five-person business is close to \$185,000.^{iv} Hence the need for start-up loans. However, the approval rates for small business loans in the US have dropped significantly in a short time. The chart below outlines the decline from 2019-2023.^v



According to the data above, small business owners had less than a 14% chance of big banks approving their loan requests. Their chances of a loan approval at small banks were only marginally better at 19%. Their best chance for approval was at an alternative lender, which are typically online-based, private companies or fintech firms that offer lending services like those of a bank. Fintech firms are playing an increasingly important role in improving financial literacy and access to much-needed small business loans. More than ever before, fintech and more specifically social media, are being used to teach potential borrowers how to obtain small business loans. Low-cost, high-reach technologies are key to improving access to needed funds and growing communities at the local level.

In addition to funding and cash flow, small business owners encounter any number of hurdles in keeping their doors open. One significant challenge is stagnant growth. Scaling a small business can be daunting, as factors like limited resources and market competition can stall expansion efforts. Finding and retaining top talent is another obstacle. Finding skilled employees who align with the company’s vision can be difficult given the competition with larger firms and limited resources for attracting and compensating talent. Additionally, the need for management training is crucial for small business owners. Many entrepreneurs lack the formal training required to navigate complex business operations effectively. These challenges often require innovative solutions and a strong entrepreneurial spirit to overcome.



Why is this important

Small businesses comprise most economic and trade activity within the US. When comparing small businesses to large, small businesses stand out. They provide more jobs than their large counterparts, tend to pay increased and closer attention to their customers, and can pivot faster if the need arises. There are many reasons why it is important to support small business creation, development, and longevity, but it is the impact that they have on their communities that makes the biggest difference. Consider the following:

- **COMMUNITY DEVELOPMENT.** The sales taxes derived from small business revenue stay local and, in most cases, get invested back into the community. So, the higher the tax revenue derived from these businesses, the more money that could be used to fund community improvements such as parks, infrastructure, or recreation centers. For every dollar spent at a small business, 67 cents stay in the community, with 44 cents of every dollar going directly to the small business owner and their employees.^{vi}
- **PHILANTHROPY.** Small business owners often tend to band together and support each other. Owners frequently sponsor local youth sports teams, take part in holiday celebrations, and donate to nonprofits and charities that support their communities. According to one source, small businesses donate 250% more than large businesses to local nonprofits and community causes.^{vii} Furthermore, these activities contribute to the vibrancy of a community, which attracts higher levels of interest from potential residents and other business owners who may decide to move or even start their business in that community.
- **EMPLOYMENT FIGURES.** Small businesses often hire employees from within their community. Because of this, individuals with less experience or that are just beginning their careers are more likely to be hired by a small business. According to the SBA Small Business Facts Report, small businesses are responsible for 2 out of every 3 jobs created in the past 25 years.^{viii} As previously mentioned, there are nearly 33 million small businesses that employ nearly half of all working individuals within the US and this labor pool has become increasingly diverse. While the majority of US small businesses are owned by men, American Express female entrepreneur statistics show that 42% of all businesses in the US are women-owned.^{ix} In addition, there are approximately 4 million minority-owned companies in the United States.^x
- **AMERICAN DREAM.** Owning your own business is the dream of many Americans. Entrepreneurship and interest in business ownership are growing every year. Twenty years ago, only 49 US schools offered an advanced degree in entrepreneurship; in 2023 more than 150 schools offer an entrepreneurship major.^{xi} However, owning your own business is not easy - 33% of small business owners work more than 50 hours a week and 25% work more than 60 hours a week.^{xii} Despite this, 74% of the owners of these businesses report being very happy or somewhat happy with their jobs.^{xiii}

- **INNOVATION.** Small businesses are often sources of innovation and invention. The need to remain competitive requires smaller firms to do things not only differently to stand out, but smarter to stay afloat. Most of the time, business owners have only themselves to rely on to stay in business. On the plus side, they tend to be nimbler and more adaptable to change than the larger firms, which often have layers of management to get through before a decision can be made. This increases their chances of survival over the long term.

Assistance from the federal government plays a vital role in sustaining the growth of small businesses, but consumer support is just as important, particularly given the prominence of social media. The days of online shopping are here to stay but it is important to shop local. By actively investing in the primary drivers of our economy, we can contribute to keeping these businesses afloat and fostering a spirit of entrepreneurship and enterprise.

Investing in Small Businesses

Recognizing the important role that small businesses play in the economic development of communities across the country, the US federal government provides a number of opportunities for small business owners to obtain assistance. The main engine for this is the Small Business Administration, or the SBA. Small business owners may obtain a loan for up to \$5.5 million through several programs run by the SBA. There are various requirements for programs and these loans are obtained through an SBA-approved lender. Such loans include the SBA's flagship 7(a) program, loans for veterans, bridge loans options, and 504 loans which are for small businesses in underserved communities. There are also government grants, which are important to business owners as they do not need to be repaid; government contracts, which can help smaller businesses compete with larger ones; and various entities within state, regional and county governments which may act in much the same role as the SBA but on a smaller, more localized scale.



While these are all governmental initiatives, it is important to realize that the financial sector, including private and institutional investors, can support small businesses by investing in ways that increase access to capital, management training and education, and employment support while promoting the SDGs. The high quality, liquid fixed income market provides many opportunities to do this without sacrificing liquidity or safety. Some ways to do this include:

- Connecting with Community Development Financial Institutions (CDFIs) and other mission-driven lenders to increase access to capital for small businesses.
- Investing in Small Business Administration (SBA) loans supporting entrepreneurs and businesses offering products or services that support and foster job creation for their communities.

- Supporting fintech companies provides a way for financial institutions, municipalities and states to deploy capital to underserved markets. The advent of fintech solutions has dramatically reduced transaction costs, making lending more accessible, and provided more opportunities to structure securities to meet impact investors' goals for returns and positive impact.

These are just a few examples of how investors can align their assets with their intentions to support the four SDGs mentioned above: fostering good jobs and economic growth; building industry, innovation, and infrastructure; making sustainable cities and communities; and ensuring responsible consumption and production patterns. Investments in small businesses can result in social and economic progress that ultimately benefit all economic activity.

Sample investments

Below are some examples of investments that can be made to further economic development and small business growth. These and other similar investments may be made within the high quality, liquid fixed income market by targeting key sectors that can directly assist entrepreneurs and small business owners and the communities they serve.



Supporting early childhood education

Childcare / Preschool – Seaside, CA

- Early childhood development center providing year-round care for children age 6 weeks through first grade
- Woman-owned business
- Facility serves a moderate income, predominantly BIPOC neighborhood (64% Latinx)
- Mission to provide services & develop community collaborations to create high quality learning experiences for young children
- Affordable tuition with subsidized care available for qualifying families



Supporting Black-owned business

Construction – Baltimore, MD

- Black veteran owned construction firm - licensed, certified minority contractor
- Located in a low income tract where 92% of the population is Black
- Employs 50 full-time employees
- Professional team has experience in completing projects in challenging work environments; meeting budget and scheduling terms and conditions; and providing state of the art technology and equipment to accomplish its client's goals
- Specializes in demolition, crushing, screening and hauling



Healthcare for adults with disabilities

Adult daycare – Kansas City, MO

- Provides compassionate and individualized care of adults with disabilities
- Transportation is provided to and from the center as well as to appointments, pharmacy and shopping
- Services include nursing care, music therapy, fitness, and support groups
- Goal is to see participants thrive while avoiding unnecessary ER trips and delaying or avoiding being institutionalized
- 100% funded by Missouri Medicaid
- Black owned and located in 80% BIPOC low income tract

Closing

The investments outlined above are a small sampling of how impact investing can help to foster jobs and economic growth; build industry, innovation, and infrastructure; and work towards sustainable communities and consumption/production. Small business owners and their employees power the US economic engine; it is crucial that entrepreneurs are able to access the resources that they need to keep their businesses running.

While much of the help provided to small business comes from the federal government, there is an important role for impact investors to play as well. Small businesses are often the backbone of local economies, driving job creation and economic growth. By investing in them, impact investors can foster community development. Additionally, small businesses tend to be more innovative and agile, making them better equipped to address pressing social and environmental challenges. Impact investors can play a pivotal role in nurturing and scaling these innovative solutions. Moreover, supporting small businesses can promote diversity and inclusivity, as they often serve as a lifeline for underserved communities. Impact investors can further social equity by channeling their resources into enterprises that are committed to fair employment practices and community engagement. In sum, by supporting small business, impact investors can generate meaningful, sustainable change that benefits not only their portfolios but society as a whole.

Learn more about RBC's Impact Investing strategies.

With a legacy of deep expertise in impact investing, the **RBC Impact Bond** strategy provides market returns on liquid fixed income investments while also producing measurable positive impacts on communities and the environment.

The **RBC Access Capital Community Investing** strategy presents investors with excellent opportunities to help build stronger communities through fixed income investments offering safety, liquidity and competitive returns.

ⁱ All statistics referenced in the above paragraph are from: zipppia.com/advice/small-business-statistics/#Small_Business_Employees

ⁱⁱ Ibid

ⁱⁱⁱ fundera.com/blog/small-business-statistics#source

^{iv} zipppia.com/advice/small-business-statistics/#Small_Business_Employees

^v statista.com/statistics/754738/small-businesses-loan-approval-rates-usa/

^{vi} zipppia.com/advice/small-business-statistics/#Small_Business_Employees

^{vii} score.org/resource/blog-post/small-businesses-giving-back-makes-a-big-impact-local-communities#:~:text=According%20to%20one%20survey%2C%20small%20businesses%20donate%2025%25,plan%20on%20giving%20back%20to%20their%20community%202019.

^{viii} luisazhou.com/blog/small-business-statistics/

^{ix} s1.q4cdn.com/692158879/files/doc_library/file/2019-state-of-women-owned-businesses-report.pdf

^x sbc.senate.gov/public/index.cfm/minorityentrepreneurs

^{xi} bestcolleges.com/business/going-back-to-college-for-entrepreneurship-degree/#:~:text=Entrepreneurship%20majors%20are%20on%20the%20rise.%20Just%20two,major%20in%20entrepreneurship%2C%20including%20most%20top%20business%20schools.

^{xii} inc.com/news/articles/200604/overworked.html

^{xiii} Ibid

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