

CONVERSATIONS WITH MIKE MILKEN



Robert F. Smith

Founder, Chairman, and CEO, Vista Equity Partners

July 2, 2020

Mike Milken: Robert, thank you for joining us today. We've had a lot of important discussions over the years, and I can't think of one that's more important than equality and equity. This is an area you and I have spent our lives working on that has been brought to the fore by two crises this year. One, a medical crisis. And another a problem that has not been solved and has lingered for generations. Now, when this happens, many people search for solutions. This is an area that you've really focused on for a considerable period of time.

One of the areas the Milken Institute has been so involved in has been the term food deserts. Yes, we'd like you to eat healthy, but there's no food that's healthy in the community. What [people] really haven't focused on and need to, is to rethink the idea that there are financial deserts. Take us to some of the solutions you've been working on.

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Robert F. Smith: Sure. And thanks again, Mike, for inviting me, and of course being a great partner in some of the work we've been doing. You and I have talked about this whole idea of it happening in our world today. We are truly seeing a reaction to generations of social and economic injustice. It started to unfold in the context of this virus. A number of other injustices have now come to bear; the whole dynamic around the food desert leading to healthcare deserts [and] some of the things we've been addressing with some of the work through the Prostate Cancer Foundation. What became very apparent is this whole idea of a banking desert. You know, 70 percent of African American communities actually don't have a branch bank in their community. And as the U.S. economy started to shut down because of the shelter in home, shelter in place, a number of these African American businesses were deeply affected just like they

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were in the seventies when I was growing up. And those businesses never reopened because they didn't have capital.

I think it was the *Wall Street Journal* last week reported that 41 percent of the African American businesses have stopped transacting, have stopped conducting business and have closed up, which is a true tragedy. What we discovered was because they don't have the banking systems that limited their ability to actually process the Payroll Protection Program [PPP] loans through

the CARES Act. And so we engaged one of our portfolio companies to enable Community Development Financial Institutions [CDFI] and Minority Depository Institutions [MDI] to transact digitally to actually process loans for the Payroll Protection Program. I think were fairly successful given the amount of time that we had and effort. We were able to carve out now \$10 billion to finish up the PPP process for that tranche, which ends at the end of June. But it just made all more stark the reality that these small businesses don't have banking, lending relationships, don't have capital access in ways that will help restore where they were, let alone kind of repair and regenerate the economic opportunity.

How many African American-owned banks are there?

There's basically 21 of those banks. When you look at the capitalization of really the CDIs, CDFIs, MBIs, and credit unions, they have about \$5 billion in assets versus the overall banking infrastructure of 4,700 banks with \$20 trillion. It puts it in context, how

not only under-banked in terms of capital, but under-banked in terms of reach. Again, 70 percent of these neighborhoods don't have branch banks that are available to them. When we saw certain large African-American businesses go to their large banks and they didn't get processed, they didn't hear back from them. We shifted them over to a Minority Depository Institution, or CDFI, and they got processed within days in the second tranche. It just brought even more to bear that there are some other forms of injustice that are occurring in the banking system that need to be repaired.

Of course, they're doing work and putting money and you saw Bank of America make a billion-dollar commitment over four years. But I think the real answer is to enable the small banks, the CDFIs, these capillary banking infrastructures, to actually be

more robust. You need to modernize the infrastructure of these banks and you need to drive true capital on the order of tens, if not hundreds of billions of dollars over time into these communities. That regenerative activity can be done today, leveraging technology that's available; we just need to figure out efficient mechanisms to drive, not just Tier One capital, but lending capacity and secondary-loan capacity to help those banks run more efficiently and drive the capital into these small businesses.

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Let's go over the acronyms for some of the people. So we talk about MDIs, we're talking about Minority Deposit Institutions?

Correct. And CDFIs are Community Development Financial Institutions. Most MDIs are actually CDFI, but not all CDFIs are lending institutions. In fact, during the PPP program, we took some CDFIs that were not lending institutions, partnered them with CDFIs that are technically enabled. To give you an example, we did one in Philadelphia where that CDFI actually only processed \$3 million worth of loans last year. When we partnered them with the technically enabled CDFI and we got approved through the help of Treasury and Secretary Steve Mnuchin and his team, they processed \$100 million worth of PPP loans in a week. So the technically enabled dynamic is an important part of what we're able to do by leveraging technology infrastructure with the reach into the community.

The good news, Mike, is there's a capillary system there's about just under 1,100 – there's 1,075 of these CDFIs, MDIs that are in existence – that know the customers that

are in the urban and rural communities that reach these communities. They just don't have the sort of the technical capability. So they need some technical training, they need the modernization of their infrastructure, and of course they need now capital to drive into that infrastructure. That's really what this initiative is about.

They need equity capital to grow in order to provide more loans and also to hire talented people in the community. It's just hard to believe when you give us these statistics of how few financial institutions are in these areas in our country. What is the strategy to get that equity capital?

If you think about overall capital driven into these communities of \$300 billion over 10 years will give you an annual GDP uplift of \$1 trillion to \$1.5 trillion. Now you can't infuse it all at once because you have to build out the infrastructure, but we've built the plan. We've been working with obviously your Institute, we've been working with Microsoft, my team at Finastra, and we believe in the next 24 months we can enable all of those CDFIs to actually now drive that capital into the community to actually get that sort of economic uplift and GDP output out of these small to medium businesses.

Ninety percent of African-American businesses are sole proprietorships and they have four or fewer employees. That is about 60-plus percent or so of the actual employment base in the communities. So the dynamic is, rebuild that infrastructure with capital. How do you get the capital? One of the ideas, which I called the "2 Percent Solution" is let's go by industry. Let's start with banking. If you take the top 10 banks, and say all right, of their \$970 billion of earnings over the last 10 years, if you took 2 percent of that over the next 10 years – 2 percent per year – you can now charge that infrastructure with Tier One capital, leverage capability on that Tier One capital, and financial and technical capability so that those small

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financial institutions can now lend effectively into those communities. And by the way, Mike, those institutions actually have a lower default rate than actually the FDIC-insured businesses or financial institutions over the last 10 years.

If we're talking 2 percent of a trillion, you're talking about \$20 billion over 10 years. Now, the capital becomes available, now let's talk about technology. The most-valuable

financial institution in the world at this time is Visa. We have PayPal that's worth more than American Express, Goldman Sachs or Citibank. How are we going to get the technology into these institutions?

There are a number of financial fintech-type companies that can enable the small capillary banking systems. We call it "Lender in a Box," where you actually have components that add to customer engagement, the lending, and back-office capabilities. There are multiple sizes of deployment. There can be for the smallest of banks, \$25 million in smaller and assets, \$50 million, \$100 million up to a billion or whatever it might be. You can actually do it in a native cloud environment. So it makes it not only just affordable, but gives you some certainty and transparency around how they're actually doing the lending and managing the customer relationships.

And so I have one of the heads of the CDFI group put this together and say, take 1,075 and put them into cohorts of 50 and how quickly can we get them trained and up to speed. It would be two years, but we can actually bring them all up to speed, implement all of the technology

infrastructure, and they can be processing similar to some of the largest banks in the U.S. And those banks don't have to open the branches they actually can just leverage the capillary banking system and enable them to do the loan and mortgage processing at volumes well above what they're doing today.

*"We built a platform called [InternX](#) and it's really designed to onboard African American, Latinx and women STEM students into internships. We now have 170 business partners - everyone from, *AIG, Cisco, Dell, etc.* - and 12,000 students in our pipeline."*

By getting rid of these financial deserts in sense, we'll increase our economy by more than \$1 trillion a year. And in fact, we will all benefit from that. Let's talk about the people now and the focus on how we get the talent to come and join these organizations. What do you see the steps in that area?

One of the first things to do is as you bring the training systems in, is to create also mentoring relationships. It isn't just go to these largest banks and tap them for 2 percent of their net income. It is also now, let's pick some partnering relationships, mentoring relationships, to help not just the bank managers run those businesses, but also help them develop their pipeline of talent from those communities who will actually be operating in those financial institutions. We have a pipeline of young STEM-trained graduates who are coming out of HBCUs [Historically Black Colleges and Universities], for instance, who can go naturally into these organizations and get trained; not only in

this financial institution, but also work with these mentoring organizations so they can build their own capability to expand their personal opportunity as a professional in those banks, but also the bank's opportunity to reach out to the community more adeptly.

It's really a three-part program. One, equity capital; it's going to have to be structured so they remain minority banks. Two, technology; and three mentoring. Now, besides the banks, some of the technology firms when they were formed, like Salesforce, set aside a percentage of their profits to go into their foundations. So, they've had experience with this and applying that, Marc Benioff and Salesforce being one. What do you see the role of the technology firms? And as I've pointed out to you, Visa and PayPal, who are both financial firms, are among the most valuable in the United States.

There's a corresponding opportunity on the small business side as well. We are technically enabling the lenders, the banks, these financial institutions. Well, each of the small businesses in these communities also needs to be technically enabled. You think about some of the companies you just mentioned, in addition to payroll processing companies, most of have some native cloud instincts, which means they have the ability to deliver a high-quality, technical infrastructure to these small businesses. So if you're running a beauty salon, a florist shop, a real estate office, a dentist's office, leveraging that technology and enabling those businesses to capture the benefits is an efficient way

to do it. I think each of the companies in the tech space should be focused on 'how do I deliver kind of low footprint, high-quality, high-transparency technical solutions and training to the small, to medium businesses?'

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If you look at our tech industry that same metric of \$298 billion other financial services, the tech folks made almost \$850 billion in that same period of time. If you let

me take that 2 percent and say, let me deliver broadband services to all communities in the U.S., and if you say, 'well, I can't afford it because of the rates.' Well, this can be part of what I'll call your "giving pledge" or "giving dynamic" to technically enable through broadband, the communities that currently don't have access to it, urban and rural.

You've got Geo Telecommunications in India creating 4G networks for 1.4 billion people. Why can't we do it for an extra 35 million or 40 million people who don't have access to it today? We have the capabilities, we have the technology. These large companies clearly have the capital. We just need to funnel it into the right channels of delivery to enable it. When you

have the broadband infrastructure, you can now technically enable those small businesses and you have the ability to deliver educational systems to those communities as well.

We ran into that problem with PPP, or when we went to shelter-from-home, our company PowerSchool, we said, listen, there's a lot of kids are out of school. Let's go to the communities who may not have the PowerSchool instincts. We offered it, and then we found out a lot of them didn't actually have broadband capacity in urban environments. Partnering with the carriers to deliver that and install it fulltime should be another part of the process. The broadband desert needs to be addressed in this metric as well.

I really want to have people focus on a call to action. There were a lot of graduates that didn't get to go through a ceremony. They really never got closure and maybe their summer job or maybe their permanent job is not there. Whether it was in high school or whether it was in college. And so the question here is, many people, thousands are going to try to figure out, how do I develop an intern network? How do I develop a mentoring network? How are we going to accelerate jobs?

I heard a number of our young people saying that their internships were being canceled. This is the exact wrong time to do that. We built a platform called InternX and it's really designed to onboard African American, Latinx and women STEM students into internships. We now have 170 business partners – everyone from, AIG, Cisco, Dell, etc. – and 12,000 students in our pipeline. We've also built 640 modules for learning management to help these interns think about, address, and engage in the internship process. We've also built a handbook for companies and say, how do you actually manage, maintain a virtual internship?

That process is probably one of the most important things that any executive can do today – figure out how many interns you have and frankly, double, triple, quadruple that number. Expand your mentoring capacity. Do it virtually because if you have engaged citizens who are of that late twenties group, it's better that they're engaged here and thinking about what business opportunities and access to the American Dream than being idle at home. And do it in a way that it enhances your ability to manage diversity and advance young people of color in this

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country into the great American capitalism system. That's is one of the most important things that we can do today.

Robert, I think you've underlined an important point and that is, capitalism, inequality was being challenged before this year started. And the COVID crisis has pointed out even more inequality that exists and that we haven't solved these problems of racial discrimination that have gone on for decades. The challenge that you've given us is that the cost to our society and the challenge to the free enterprise system, if we don't address it today, tomorrow, next week, the cost is going to be substantially larger a year from now. It is so telling when you spoke about that 41 percent of all these small African-American businesses are essentially out of business at the moment. This is a call to action we need to respond to. And the point I wanted to make is that you've built these platforms already. Companies don't have to go out right now and say, 'okay, how can I build this platform? What can we do?' You've built it and it works. In building the largest software firm with your partner, Brian Sheth, over the period of time, you've learned a great deal. How could I, if I was a company, engage with you in this mentoring internship platform that you've already created?

You can first just go to internx.org and we will get our team to engage immediately. Like I said, we've got 170 business partners that we're working with 12,000-plus interns and it's increasing every day as interns are understanding what we can do. We have handbooks and capacity digital capacity to show you how to actually bring these folks on. Look, you also have to do your job to train your mentors, your supervisors, on what it is, and we a learning management system for that. So they can actually go through the same sort of training to say, how do I handle the virtual intern? How do I handle an intern who comes from a background very different than mine? But to your point, if we don't do that I think we're going to put our whole economic system at jeopardy.

I think it's incumbent upon all of us as executives and CEOs to do our part. And look, we'll still continue to push. I think the right answer is us to get leaders in the industries for the 2 Percent Solution opportunity and take the lead and say, 'okay, we're going to make a commitment to re-fertilizing and revitalizing these deserts.' I call it restore, repair and regenerate these communities; these American communities filled with Americans that need the opportunity and access to the American Dream.

You spoke about HBCU. Now many people know that by a different name, mostly black colleges, etc. What percent of the students in those colleges are STEM today? So as we have a lot of people that might want to hire what is the breakdown?

There's over 40 percent that are STEM students in those schools today. We're initially announcing a program tomorrow called the Student Freedom Initiative, and we're focusing on 11, but we want to get to all of them eventually. And the 11 that we're focused on, over 68 percent are STEM students; 68 percent. These HBCUs graduate more engineers in STEM than all the other colleges combined; that's the best place to find these students. And Mike one really interesting point our initiatives focused on alleviating the debt burden. Seventy percent of African American wealth is actually consumed by student debt; 70 percent. So if you eliminate/alleviate that problem that creates a massive wealth lift for the entire community.

Why does the majority of young people under 30 think a socialist or a communist system might be better than our system of free enterprise today? One of the reasons is their life has been so burdened by student loans and memories of potentially losing their parent's or their home during the financial crisis. They're wondering, 'what is the financial system doing for us?' I think this is a real core that you've addressed. So one, I want to thank you for joining us today on your initiatives. And we hope after this session that your phone is ringing off the hook for internships and mentor ideas. Thank you, Robert and thank you for what you do.

You as well, sir. Thank you. Be well.
