

## Microenterprise Development: A Primer

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### Introduction

Entrepreneurship is commonly viewed as an avenue to personal and national economic prosperity in the United States. Encouraging entrepreneurship through small business formation and expansion is a prominent public policy goal, as small businesses provide the majority of new jobs. During periods of high unemployment, many individuals turn to self-employment. Others view self-employment as a pathway out of poverty; it can provide cash flow and the opportunity for income growth that may not otherwise be feasible.

This article begins with a background on small businesses and small business lending and the challenges small businesses face in the current economic environment. It then focuses on the poverty alleviation aspect of entrepreneurship through microenterprise development. Microenterprise development refers to helping a segment of small business owners—low- and moderate-income (LMI) individuals, those who lack full access to mainstream financial services, and other disadvantaged people—create or expand a small business.

This article describes the scope of microenterprise development and the benefits to small business owners and their communities, and includes case studies of organizations that participate in microenterprise development activities. It also describes the benefits to banks of participating in microenterprise development, including how they may receive positive consideration under the Community Reinvestment Act (CRA) for microenterprise development activities.

### The Current Economic Environment Is Difficult for Small Businesses

Of the estimated 27.8 million businesses in the United States in 2007, 27.7 million were small businesses, which the U.S. Small Business Administration (SBA) defines as firms with fewer than 500 employees.<sup>1</sup> Small

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<sup>1</sup> US Small Business Administration (SBA), Office of Advocacy, Statistics of US Businesses and Nonemployer Statistics, <http://www.sba.gov/advo/research/data.html#us>.

businesses employ just over half of all private sector employees and have generated 64 percent of net new jobs over the past 15 years.<sup>2</sup> Small firms also tend to fill underserved niches in the labor market that often have higher rates of unemployment. For example, compared with large firms, small firms employ a higher percentage of individuals with a high school degree or less, teens and people age 65 and older, disabled workers, Latinos, and rural residents.<sup>3</sup>

Like other firms, small businesses have been significantly challenged by current macroeconomic trends such as high unemployment, low consumer confidence, and volatility in consumer spending as households deleverage and repair their balance sheets. In two recent surveys, small business owners cited depressed sales as the principal operating problem with the current economic environment. The National Federation of Independent Business (NFIB) Research Foundation found that 51 percent of small business owners cited slowing or lost sales as the most important immediate problem facing their businesses.<sup>4</sup> Similarly, the National Small Business Association (NSBA) found that 64 percent of survey respondents reported a net decrease in sales in 2009, the most recent full year of data available.<sup>5</sup> These surveys also showed that small business owners are concerned about many other issues, including uncertainty in business conditions and access to affordable credit.

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<sup>2</sup> SBA, Office of Advocacy, FAQs: How important are small businesses to the US Economy? <http://www.sba.gov/advocacy/7495/8420>.

<sup>3</sup> Brian Headd, "An Analysis of Small Business and Jobs," SBA, Office of Advocacy, March 2010, <http://www.sba.gov/advo/research/rs359tot.pdf>.

<sup>4</sup> William Dennis, Jr., "Small Business Credit in a Deep Recession," NFIB Research Foundation, Washington, DC, February 2010. The Gallup Organization collected data for this survey between mid-November and mid-December 2009 from 750 firms with no fewer than one employee, in addition to the owner, and no more than 250 employees.

<sup>5</sup> NSBA, 2009 Year-End Economic Report, [http://www.nsba.biz/docs/10eoy\\_survey.pdf](http://www.nsba.biz/docs/10eoy_survey.pdf). This survey was conducted between December 14 and 31, 2009, and indicates that 450 small business owners were polled. The size of the firms interviewed is not detailed in the report.

**Authors' Note:** Examples of banks, companies, nonprofits, and products are used in this article for illustrative purposes only. The FDIC does not endorse specific entities or products.

## Banks Are the Primary Source for Small Business Credit

Funding Source	August 2008	December 2008	July 2009	December 2009	July 2010
Credit Cards	41%	49%	43%	41%	39%
Bank Loans	50%	44%	53%	46%	43%
Vendor Credit	22%	27%	29%	24%	20%
No Financing	17%	22%	16%	21%	21%
Private Loans (friend or family)	12%	16%	20%	18%	19%
SBA	5%	3%	4%	4%	4%

Source: National Small Business Association 2010 Mid-Year Economic Report.

Note: Response data do not sum to 100 percent because respondents could choose more than one answer.

### Small Business Lending

Banks are the largest source for small business credit, including term loans, credit cards, credit lines, commercial mortgages, and capital leases.<sup>6</sup> Responses from an NSBA survey question—“What type of financing has your company used within the past 12 months to meet your capital needs?”—show that for the approximately four out of five respondents who use credit to finance their businesses, dependence on bank credit is high, although less than in the recent past (see table).

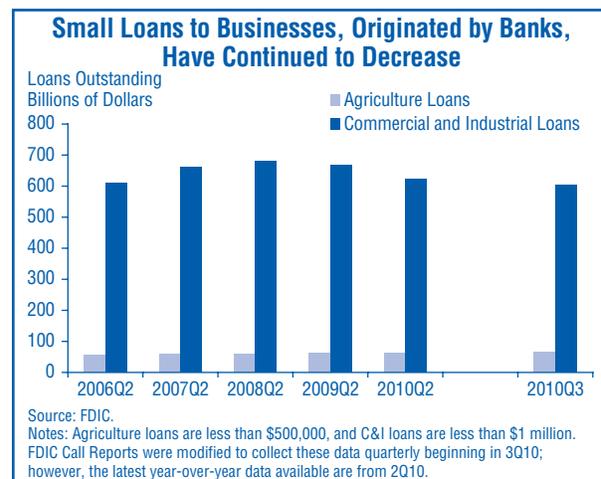
Bank Call Report data show that the general category of commercial and industrial (C&I) lending has rebounded somewhat to \$1.2 trillion as of third quarter 2010 but remains significantly lower than two years ago. With respect to small business lending, no single measure directly demonstrates trends. Banks do not report loans to small businesses separately on Call Reports, but they do report on business loans less than \$1 million and farm loans less than \$500,000. Using these data as a proxy for small business lending suggests that small business lending by FDIC-insured financial institutions has declined (see Chart 1).

A number of interrelated reasons account for the decline in small business lending, including the general dislocation in overall credit availability related to the recent mortgage crisis. The ensuing tightening of credit terms by banks adversely affected virtually all credit types, including small business lending. Loan officers reported tightened C&I loan standards for small firms in 2007 through 2009. At perhaps the peak of the crisis, in fourth quarter 2008, nearly three-quarters of loan officers reported tightened standards for small business loans. In 2010, loan officers began to report a slight

easing of C&I loan standards for small firms as the economy began to recover.<sup>7</sup>

In addition, as evidenced by sharp increases in bank failures and problem banks, the recession has negatively affected the ability of some individual banks to lend as they focus on correcting existing problems. Further, balance sheets of small business owners have been adversely affected by the cumulative effects of declining sales as well as falling real estate values, which can restrict borrowing capacity; 95 percent of small business owners own real estate.<sup>8</sup> Depressed sales and profits also have contributed to a decline in small business loan demand. Indeed, loan officers have reported declining demand for small business C&I loans since fourth quarter 2006.<sup>9</sup>

Chart 1



<sup>7</sup> Information about loan officers' views regarding lending standards was derived from the Board of Governors of the Federal Reserve System (Federal Reserve Board), "Senior Loan Officer Opinion Survey on Bank Lending Practices," October 2010, <http://www.federalreserve.gov/boarddocs/snloansurvey/>. The survey defines small businesses as those with annual sales of less than \$50 million.

<sup>8</sup> Dennis, "Small Business Credit in a Deep Recession."

<sup>9</sup> Federal Reserve Board, "Senior Loan Officer Opinion Survey," October 2010.

<sup>6</sup> Congressional Oversight Panel, "The Small Business Credit Crunch and the Impact of the TARP," May 13, 2010.

## Efforts to Spur Small Business Lending

Multiple efforts have been under way to counter the many issues facing small businesses. For example, several banks have made public pledges and announced specific programs with the goal of increasing small business lending.<sup>10</sup> In addition, the government has initiated various policies and programs specifically to spur small business lending and investment, including the following:

- **The American Recovery and Reinvestment Act of 2009 (Recovery Act)** – Enacted on February 17, 2009, the Recovery Act, among other things, attempted to make small business lending under the SBA’s most popular 7(a) and 504 loan programs more attractive to banks and borrowers. Specifically, the Recovery Act temporarily increased the maximum guarantee for 7(a) loans from 85 percent to 90 percent and eliminated borrower fees for the 7(a) program and both borrower and lender fees for the 504 programs.<sup>11</sup>
- **The Small Business Jobs and Credit Act of 2010 (Jobs Act)** – Enacted on September 27, 2010, the Jobs Act, among other things:
  - Established a \$30 billion Small Business Lending Fund (SBLF) to provide low-cost funding to banks with assets of \$10 billion or less in order to increase small business lending.
  - Extended through 2010 the temporary guarantee increases and fee reductions on the SBA’s 7(a) and 504 loan programs.
  - Increased the size limits for borrowers eligible for SBA-guaranteed loans and the maximum amount of the loans.
  - Established a grant program for states that encourage small business lending.
  - Provided a mix of temporary and permanent tax benefits to encourage small business owners to increase investment and hiring.<sup>12</sup>

<sup>10</sup> John Tozzi, “Big Banks’ Small-Business Lending Promises,” *Bloomberg Businessweek*, May 4, 2010, [http://www.businessweek.com/print/smallbiz/content/may2010/sb2010053\\_204200.htm](http://www.businessweek.com/print/smallbiz/content/may2010/sb2010053_204200.htm).

<sup>11</sup> Public Law 111-5, 123 Stat. 115, 151-161 (2009). The SBA does not directly originate 7(a) or 504 loans but provides guarantees to lenders that participate in the program. Proceeds from 7(a) loans can be used for any purpose, while proceeds from 504 loans primarily are used for real estate purchases and improvements.

<sup>12</sup> Public Law 111-240, 124 Stat. 2504 (2010). The Jobs Act affects many areas of small business that are beyond the scope of this article. For more information about the Jobs Act, see the SBA’s Web site at <http://www.sba.gov/content/small-business-jobs-act-2010>.

- **State Small Business Lending Programs** – Various states also have enacted laws and policy changes to encourage more small business lending and investment, by, among other things, increasing guarantees and streamlining access to state loan funds, establishing loan loss reserve pools for banks participating in state-sponsored small business lending programs, and directing deposits and other state-funded investments to qualified small business lenders.<sup>13</sup>

In addition to government policies and programs, bank regulatory agencies have taken the following steps to encourage banks to continue making sound small business loans and working with financially distressed borrowers:

- **Examination Guidance Regarding Small Business Lending** – Bank regulators issued guidance on underwriting standards for lending conducted pursuant to the \$30 billion SBLF and on promoting prudent small business lending and workouts of problem loans.<sup>14</sup>
- **FDIC Forum on Overcoming Obstacles to Small Business Lending** – Held on January 13, 2011, this forum explored ways to make credit more accessible to the small business sector by bringing together policymakers, regulators, small business owners, lenders, and other stakeholders to identify key issues and focus on solutions. Speakers included FDIC Chairman Sheila C. Bair; Chairman of the Board of Governors of the Federal Reserve System, Ben S. Bernanke; Senator Mark R. Warner; Thomas D. Bell, Jr., Chairman of the U.S. Chamber of Commerce; and Karen Mills, Administrator of the Small Business Administration.<sup>15</sup>

<sup>13</sup> Congressional Oversight Panel, May 13, 2010. This report cites examples of small business lending programs and policies in Colorado, Delaware, Illinois, Maryland, Michigan, New Jersey, New York, Ohio, and Virginia.

<sup>14</sup> See FDIC, the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS), “Underwriting Standards for Small Business Loans Originated under the Small Business Lending Fund Program,” December 2010, <http://www.fdic.gov/news/news/financial/2010/fil10090.html>; and FDIC, Federal Reserve Board, OCC, OTS, National Credit Union Administration, and Conference of State Bank Supervisors, “Inter-agency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers,” February 5, 2010, <http://www.fdic.gov/news/news/press/2010/pr10029.html>. The February 2010 guidance also references other guidance issued in 2008 and 2009 that broadly addresses prudent lending and loan administration, including for small business borrowers.

<sup>15</sup> FDIC Forum on Overcoming Obstacles to Small Business Lending, <http://www.fdic.gov/news/conferences/sbl.html>.

- **FDIC Hotline for Small Businesses** – In recognition of the importance of making credit available to small businesses, the FDIC created a dedicated, toll-free hotline for small business owners to make inquiries of FDIC officials or to register concerns about the availability of credit. The FDIC will respond to inquiries about policies and financial institutions it regulates as well as make referrals to other governmental agencies where appropriate.<sup>16</sup>

## Microenterprises and Microenterprise Development

A number of positive efforts are beginning to counter the effects of the sluggish pace of economic growth on U.S. businesses. Yet, the very smallest businesses—microenterprises—tend to be affected most deeply by business cycles, given their size and limited access to the capital markets and other funding options. A microenterprise is commonly defined as a business with five or fewer employees that requires no more than \$35,000 in start-up capital.<sup>17</sup> Although it is difficult to quantify how many businesses need \$35,000 or less of capital, the vast majority of all U.S. businesses—25.4 million out of a total 27.8 million in 2007—employ fewer than five employees.<sup>18</sup>

To illustrate the effects of economic problems on microenterprises, 25.6 percent of the smallest businesses in the NFIB Survey indicated that they were unable to obtain any of the credit they wanted in the past year, compared with 19.2 percent for medium-sized companies and 14 percent for the largest companies in the survey.<sup>19</sup> In addition, 2.4 percent of the smallest companies in the survey indicated that they are unbanked in that they do not use a financial institution for business purposes, including for deposit accounts.<sup>20</sup>

<sup>16</sup> FDIC, “FDIC Announces Hotline for Small Businesses Regarding Availability of Credit,” news release, January 13, 2011, <http://www.fdic.gov/news/news/press/2011/pr11005.html>. The FDIC small business Web page also provides a Business Assistance Form, available at <https://www2.fdic.gov/Starsmail/BAF/index.asp>, for small business owners who prefer to inquire in writing.

<sup>17</sup> Elaine L. Edgcomb and Joyce A. Klein, “Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprises in the United States,” FIELD, February 2005, <http://www.fieldus.org/publications/FulfillingthePromise.pdf>.

<sup>18</sup> SBA, Office of Advocacy, Statistics of U.S. Businesses and Non-employer Statistics, <http://www.sba.gov/advo/research/data.html#us>.

<sup>19</sup> Dennis, “Small Business Credit in a Deep Recession.” The survey showed three groups of companies by employment: those with 1 to 9 employees, 10 to 19 employees, and more than 20 to 250 employees.

<sup>20</sup> *Ibid.*

Microenterprise development refers to helping small business owners most at risk—namely LMI and other disadvantaged individuals who do not typically have access to the full range of mainstream financial services—create or expand their small business. Microenterprise development involves providing these business owners with loans, capital, deposit accounts, budgeting services, tax preparation services, business-specific technical assistance, and other support. Microenterprise development is a poverty alleviation strategy intended to generate income and build assets for LMI or disadvantaged and underserved business owners and increase employment in their communities.

Entrepreneurship has long been key to the vibrancy and resilience of the U.S. economy, and encouraging small business ownership is a prominent public policy goal. However, microenterprise development in the United States is relatively new; it is commonly thought to have emerged in the early 1980s as a response to limited earnings and business ownership potential for women and as an option for countering high unemployment through self-employment.<sup>21</sup>

Microenterprise development in the United States was also influenced by international microenterprise strategies in the developing world, such as the micro loan program instituted by Grameen Bank in Bangladesh and elsewhere (see text box on page 41). Although important parallels exist between international and U.S. microenterprise development, the scale of loans and capital investments tends to be much larger in the United States, given the size and complexity of the U.S. economy and banking system; the breadth of the public safety net; the lower poverty rate; and the nation’s more mature physical, technological, and social infrastructures. For example, in the United States, a “microloan” has been generally defined as a business loan of \$35,000 or less, whereas in the developing world, microlending often refers to loans in the hundreds of dollars or even less.

## Microenterprise Development Organizations

Clearly, not all of the more than 25 million U.S. microenterprises are owned by LMI or otherwise disadvantaged individuals, nor are all LMI and disadvantaged entrepreneurs receiving microenterprise assistance. To understand the general size of microenterprise development and coverage areas, FIELD, a microenterprise policy project of the nonprofit Aspen Institute,

<sup>21</sup> Edgcomb and Klein, “Opening Opportunities, Building Ownership.”

conducts periodic surveys of groups that serve microenterprises, called microenterprise development organizations (MDOs).

MDOs are generally nonprofit organizations, but they perform many of the same functions on behalf of microenterprises as banks, private equity funds, and financial planners, such as lending, capital investments, budgeting, and financial advisory services. In addition, they provide a range of business-specific technical training, coaching and mentoring, counseling, legal assistance, and other types of nonfinancial services. Some MDOs exist solely to conduct microenterprise development activities, and some are part of larger organizations with broader missions. The text box on page 42 describes the operations of four U.S. MDOs: Grameen America, ACCION USA, Washington CASH, and the Lakota Funds.

A FIELD survey conducted in 2009, using data as of 2008, estimated the scope of microenterprise development activities as follows:

- Nearly 700 MDOs in the United States served more than 274,000 individuals.
- More than 300 of these MDOs engaged in micro-lending and originated over 9,000 loans totaling more than \$100 million.
- MDOs held an estimated \$174 million in outstanding loans and \$235 million in microenterprise capital.
- The most common services provided by MDOs were “microloans,” business loans of \$35,000 or less, and general technical assistance; more than 90 percent of MDOs provide these services.<sup>22</sup>

MDOs serve entrepreneurs in a wide variety of businesses. For example, Web sites for the MDOs profiled in the text box on page 42 feature clients with catering businesses, hair salons, clothing designers, child care providers, and others. Demographic information gathered through the 2009 survey also showed that, on average, recipients of microenterprise development

<sup>22</sup> FIELD, “U.S. Microenterprise Census Highlights FY 2008 Data,” July 13, 2010, <http://fieldus.org/Publications/HighlightsFY2008.pdf>. This study identified 696 MDOs; it presents data provided by 369 MDOs that completed a survey in 2009 detailing information on programs, products, and customer demographics.

services tend to be female, minorities, and in the LMI income band:

- Fifty-nine percent of individuals served by MDOs were women.
- Sixty percent were people of color or members of traditionally disadvantaged racial or ethnic groups.
- Sixty-eight percent of the people served were LMI, in that they had household incomes at or below 80 percent of the Housing and Urban Development median for their location.<sup>23</sup>

### Microenterprise Development Impacts and Costs

Over a five-year period, clients of MDOs have reported that their businesses have had positive effects on household income and their communities, such as the following:

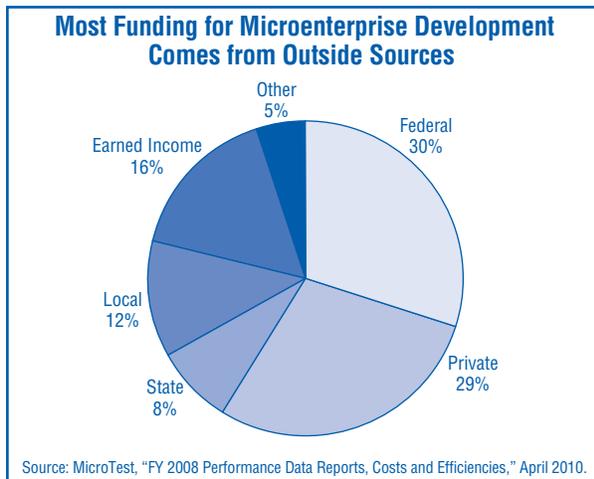
- The median revenue for business owners increased 60 percent, from about \$50,000 at program intake to just over \$82,000.
- The median “draw,” or the amount business owners take for personal compensation, more than doubled, from about \$11,000 to \$25,000.
- The median contribution of draw to household income increased from 52 percent to 71 percent.
- For the approximately 40 percent of business owners who employed workers other than the owner, the number of paid workers more than doubled, from 2.1 workers per business to 5.6.<sup>24</sup>

The average cost to service a microenterprise is about \$2,700, and MDOs recoup only approximately one-fifth of their costs through interest and fees on loans and other income sources. MDOs derive the remainder of their funding from a mix of public and private sources, as shown in Chart 2 and described on the following page.

<sup>23</sup> FIELD, “Microtest Measures 2008 Data,” <http://fieldus.org/MicroTest/FY08PerformanceOverview.pdf>. Microtest measures are benchmarks to assess performance across the MDO industry and are based on data gathered in the FIELD survey of MDOs described in footnote 22.

<sup>24</sup> Tamra Thetford, Elaine Edgcomb, and Ilgar Alisultanov, “At the Five-Year Mark: Outcomes Reported by US Microenterprise Clients,” FIELD, March 2010, <http://www.fieldus.org/Publications/MultiyearDataRpt09.pdf>.

Chart 2



**Federal MDO funding sources.** With respect to public funding, MDOs primarily use the federal programs offered by the SBA and the U.S. Department of the Treasury. SBA's Microloan Program provides funds to specially designated intermediary lenders, which are generally nonprofit community-based MDOs with experience in lending and providing technical assistance to microenterprise owners. The loan amount to each microloan recipient has been capped at \$35,000, although it was recently raised to \$50,000 pursuant to the Jobs Act, and the average loan is about \$13,000. For fiscal year 2010, the SBA budget provided \$25 million for the Microloan Program.<sup>25</sup>

The SBA also recently introduced two new loan programs—Small Loan Advantage and Community Advantage—aimed at increasing the availability of loans in underserved communities by offering a streamlined application process for SBA-guaranteed 7(a) loans up to \$250,000. Small Loan Advantage is available through existing SBA preferred lenders, including many FDIC-insured banks. The Community Advantage Program is a three-year pilot program that will allow MDOs and other lenders that focus on underserved populations to access the SBA 7(a) program. The programs are targeted to be launched in first quarter 2011.<sup>26</sup>

The SBA's Program for Investment in Micro-Entrepreneurs (PRIME) is a grant program available to MDOs and other nonprofit organizations that help

<sup>25</sup> US Small Business Administration, "Small Business Jobs Act of 2010," September 27, 2010, <http://www.sba.gov/jobsact/>.

<sup>26</sup> Information about the SBA's Small Loan Advantage and Community Advantage Programs was derived from the SBA Web site, <http://www.sba.gov/advantage>.

underserved entrepreneurs. Grants up to \$250,000 can be awarded to fund direct assistance to customers of MDOs or to build the MDO's own resources or research capabilities. The SBA awarded approximately \$8 million in PRIME grants to 92 recipients in 2010.<sup>27</sup>

The U.S. Department of the Treasury also provides funding for microenterprise through administration of the Community Development Financial Institution (CDFI) Fund. The CDFI Fund has various programs that provide grants, tax credit allocations, and other monetary awards that further public policy goals such as job creation, business development, commercial real estate development, affordable housing development and homeownership, financial education, and provision of basic banking services.

To participate in most of the CDFI Fund programs, an entity must be certified by the Fund as either a CDFI or a community development entity (CDE). As of August 31, 2010, the CDFI Fund had certified 900 CDFIs, including approximately 70 insured banks and thrifts. Many MDOs also carry the CDFI or CDE designations and receive CDFI funding. CDFI funding that supports microenterprise development is not separately reported, but, overall, since its creation in 1994, the CDFI Fund has awarded \$1.11 billion to community development organizations and financial institutions and \$26 billion in tax credits related to private-sector investments.<sup>28</sup>

**State Programs.** Several states also provide funding for MDOs through Capital Access Programs (CAPs), which are lending partnerships between participating financial institutions, the state, and small businesses. CAPs operate slightly differently in each state. However, in general, the financial institution and the borrower each pay an upfront insurance premium, typically between 3 and 7 percent of the loan amount, into a reserve fund held at the originating bank that can be tapped in the event of a loan default. The state then matches the contribution. The reserve fund allows a lending bank to originate loans for microenterprises that otherwise would not qualify for a regular small business loan because of their risk profile.<sup>29</sup>

<sup>27</sup> Information on the PRIME program was derived from the SBA Web site, <http://www.sba.gov/content/prime-program-0>.

<sup>28</sup> Information regarding the CDFI Fund was derived from their Web site, <http://www.cdfifund.gov/>.

<sup>29</sup> Information about CAPs was derived from Alan Berube, "Capital Access Programs: A Summary of Nationwide Performance," US Department of the Treasury, January 2001.

**Private Donors.** Private donors are another important source of MDO funding and sometimes provide staff assistance and other support to MDOs. Although data are not available on the aggregate amount of private support for MDOs, numerous foundations and other philanthropic groups fund MDOs. For example, the Laurie M. Tisch Illumination Fund granted \$1.5 million for microloans and technical assistance to support ACCION USA's Green Cart program in New York City, which helps fruit and vegetable cart vendors from low-income neighborhoods.<sup>30</sup> Also, the Ford Foundation provided grant funding to ACCION USA to develop a standardized lending scorecard for underserved microenterprises with impaired or no credit history.<sup>31</sup>

## Banks Support Microenterprise Development

Banks contribute to microenterprise development in many of the same ways as nonprofit MDOs. They often make microloans directly to microenterprises; invest in microenterprise loan pools; make capital investments; and provide budgeting, financial education, account management, and other types of assistance to microentrepreneurs and MDOs. The Association for Enterprise Opportunity, an MDO trade association, has banks and credit unions among its members, although it does not report specific membership statistics.

A number of banks also have philanthropic foundations that support MDOs and others focused on underserved entrepreneurs. Other banks directly participate in microenterprise development through corporate partnerships with MDOs. For example, the Citi Foundation has provided more than \$1 million in grants to MDO ACCION Texas.<sup>32</sup> At the same time, the corporate entity, Citibank, has agreed to purchase \$30 million in microloans from ACCION Texas over five years as an additional source of funding for the MDO.<sup>33</sup> Citibank has also partnered with MDO Grameen America to

offer savings accounts to LMI owners of microenterprises (see text box on page 42).<sup>34</sup>

In another example, Northeast Bank, a community bank headquartered in Minneapolis, Minnesota, has partnered with the Minneapolis Community Planning and Economic Development Agency in the Microloan Program, which provides loans of up to \$25,000 for small businesses in LMI neighborhoods.<sup>35</sup> Other banks participate in microenterprise loan pools. For example, Kent County, Michigan, partnered with 18 banks in its Micro Business loan program, which combined small business loans of up to \$15,000 with a small business resource center that provided technical assistance and counseling to small business owners.<sup>36</sup>

Banks that participate in microenterprise development can benefit in a number of ways. Operationally, banks benefit from revenue from loans, introduction to new and potentially profitable business customers, and goodwill created by serving the community. Also, banks could potentially obtain positive consideration for microenterprise development as community development activities under the CRA regulations.<sup>37</sup> The opportunity for CRA credit would vary based on applicable size-based examination procedures. Banks could potentially receive positive consideration for microloan originations, investments in microloan pools, or for other activities to support these qualifying small businesses, such as by volunteering on bank time to lend financial expertise with MDOs and other organizations that benefit small businesses.

## Microenterprise Development through Alternative Delivery Channels

Although banks have historically been the largest provider of direct small business funding, nonbank financial entities have recently increased efforts to lend to small business customers. One innovative form of

<sup>30</sup> New York City Department of Health and Mental Hygiene, "NYC Green Cart," 2010, [http://prtl-drprd-web.nyc.gov/html/doh/html/cdp/green\\_carts\\_resources.shtml](http://prtl-drprd-web.nyc.gov/html/doh/html/cdp/green_carts_resources.shtml), accessed October 20, 2010.

<sup>31</sup> FIELD, "Scaling-Up Services," <http://www.fieldus.org/projects/scale.html>, accessed October 21, 2010.

<sup>32</sup> Citi, "Citi and ACCION Texas Report Significant Progress Helping Microentrepreneurs through Economic Downturn," news release, December 8, 2009, <http://www.citigroup.com/citi/press/2009/091208c.htm>.

<sup>33</sup> Citi, "Citi Agrees to Purchase up to \$30 Million in New Loans from ACCION Texas," August 19, 2008.

<sup>34</sup> Business Wire, "Grameen America and Citi Partner to Open More Than 2,500 Savings Accounts for Low-Income Entrepreneurs," September 20, 2010, <http://www.businesswire.com/news/home/20100920006842/en/Grameen-America-Citi-Partner-Open-2500-Savings>.

<sup>35</sup> Metropolitan Consortium of Community Developers, <http://mccdmn.org/>.

<sup>36</sup> Kent Area Micro Business Loan Services.

<sup>37</sup> See 13 CFR 121.301. The CRA regulations define *community development* as "Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs or have gross annual revenues of \$1 million or less."

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nonbank lending that has emerged in recent years is peer-to-peer lending, which involves an Internet-based platform that directly connects borrowers and lenders. Kiva is a peer-to-peer lending Web site specifically devoted to matching borrowers and lenders in the microfinance area. Kiva operates in 207 countries, including the United States; it has facilitated the origination of more than \$165 million in loans, with an average size of US\$381, and reports a repayment rate of 98.9 percent.<sup>38</sup>

Other nonbank entities, such as finance companies, suppliers, and even retailers, lend to microenterprises. For example, Wal-Mart Inc.'s Sam's Club warehouse chain is testing the concept of offering online small business loans up to \$25,000 to club members, focusing on businesses owned by racial and ethnic minorities, women, and veterans. Sam's Club identified a need for credit among its members after a November 2009 survey indicated that nearly 15 percent of its business members reported being denied loans elsewhere.<sup>39</sup>

## Conclusion

Small businesses are crucial to the health of the U.S. economy, but they can be especially vulnerable to an economic downturn. The smallest businesses, microenterprises, are especially challenged, given their limited resources and funding options, which are further exacerbated for business owners who do not have access to mainstream financial services. Microenterprise development is an effective strategy to help LMI, underserved, or otherwise disadvantaged entrepreneurs create or expand small businesses that have significant positive effects on the owner's financial well-being and the community at large. Participation in microenterprise development provides several benefits to banks, including new sources of revenue and customer relationships, community goodwill, and the potential for positive CRA consideration.

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<sup>38</sup> Data on Kiva were obtained from its Web site, <http://www.kiva.org/>.

<sup>39</sup> Karen Talley, "Sam's Club to Offer Loans Up to \$25,000," *Wall Street Journal*, July 6, 2010, [http://online.wsj.com/article/NA\\_WSJ\\_PUB:SB10001424052748704862404575350813891562150.html](http://online.wsj.com/article/NA_WSJ_PUB:SB10001424052748704862404575350813891562150.html).

## *International Microfinance*

Internationally, microfinance is a concept that refers to providing basic financial services, such as savings accounts, credit products, money transfer services, and insurance, as a poverty alleviation strategy to very poor families who lack access to traditional financial institutions. Typical microfinance clients are very low-income individuals in rural areas who engage in farming or small trade or processing transactions with farmers. The Rural Development Institute estimates that the world's poorest 1.4 billion people, 75 percent of whom live in rural areas, subsist on less than \$1.25 per day.<sup>1</sup>

The roots of microfinance are often traced to government-sponsored rural development programs of the 1950s that offered subsidized loans targeted to specific communities. Problems arose because funds did not always reach the intended targets and repayment rates were low. Beginning in the 1970s, private firms in Bangladesh (Grameen Bank), Brazil (ACCION International), and other countries began to experiment with extending very small business loans, often to women in small groups. This became known as solidarity lending, where members of the group apply "soft" pressure to borrower-members to encourage loan payment.<sup>2</sup>

These programs and other products targeted to the poor were expanded through the 1980s and 1990s. The Grameen Bank model is likely the oldest and most well-known of the microfinance models. The bank and its founder, Mohammed Yunus, were awarded the Nobel Peace Prize in 2006. Grameen Bank is owned primarily by

its poor borrowers, who hold a 95 percent share; the government of Bangladesh owns the remaining 5 percent. The bank has 8.3 million borrowers, 97 percent of whom are women. Grameen Bank loans are unsecured, and no legal documents evidencing the loan are required. The bank's average microenterprise loan is about US\$400, and the average loan yield is about 19 percent.<sup>3</sup>

In 2009, 1,884 international microfinance companies reported holding \$26.8 billion in deposits and making \$64.8 billion in loans with an average balance of about US\$522 and an average yield of 21.7 percent.<sup>4</sup> As the number of organizations providing international microfinance has grown, some have begun to criticize the usefulness of microfinance as a poverty alleviation strategy in light of high interest charged in some countries, which can exceed an annual percentage rate of 100 percent.

Concerns about microfinance stem from different political, economic, legal, and cultural circumstances in various countries. However, as the microfinance industry matures internationally, industry experts have acknowledged that improvements could include development of a credit bureau to reduce overlending, emphasis on client poverty reduction rather than lender profit to measure success, and expansion of other mainstream financial products beyond loans, such as savings accounts.<sup>5</sup>

<sup>3</sup> Grameen Bank Web site, "Grameen Bank at a Glance," [http://www.grameen-info.org/index.php?option=com\\_content&task=view&id=26&Itemid=175](http://www.grameen-info.org/index.php?option=com_content&task=view&id=26&Itemid=175).

<sup>4</sup> Microfinance Information Exchange, "Microfinance at a Glance," <http://www.mixmarket.org/>.

<sup>5</sup> See Vikas Bajaj, "Microlenders, Honored With Nobel, Are Struggling," *New York Times*, January 5, 2011; Eric Bellman and Arlene Chang, "India's Major Crisis in Microlending," *Wall Street Journal*, October 29, 2010; and Neil MacFarquhar, "Banks Making Big Profits From Tiny Loans," *New York Times*, April 13, 2010.

<sup>1</sup> Rural Development Institute. The demographic data are for 2005.

<sup>2</sup> Background information about international finance was derived from the CGAP Web site, <http://www.cgap.org/p/site/c/home/>, and the Global Envision Web site, <http://www.globalenvision.org/library/4/1051/>.

## Microenterprise Development Organizations in the United States

### Leaders in International Microfinance Operate U.S. MDOs

Two of the largest and best known organizations in international microfinance, Grameen and ACCION, apply many of their lessons learned abroad to promoting microenterprise development in the United States. **Grameen America** began operating in the United States in January 2008 and has four branches in New York City and one in Omaha, Nebraska, with other offices planned for major cities. Grameen's customers fall below the poverty line, and many are single mothers and recent immigrants.

To simulate the "solidarity" approach to international microfinance, Grameen America requires borrowers to form groups, receive financial training, and open a savings account before receiving a loan to start or expand a small business. Thereafter, the groups meet weekly for follow-up training and support. The basic loan is capped at \$1,500 per year for 6 or 12 months, with a 15 percent interest rate. Higher amounts and lower rates are available for borrowers who perform satisfactorily on their initial loans. As of August 2010, Grameen America reported serving a total of 4,000 borrowers with a nearly 99 percent repayment rate and that borrowers were successful in establishing or improving their credit scores. It also reported that customers accumulated more than \$500,000 in savings in accounts held at Citibank.<sup>1</sup>

**ACCION USA** is one of the largest and most established U.S. MDOs. Since 1991, it has originated more than 19,000 microloans totaling more than \$119 million. It currently has 2,300 active borrowers; 61 percent are Hispanic or Latino, 27 percent are African American, and 40 percent are female. ACCION USA provides loans ranging from \$500 to \$50,000, with a \$30,000 cap for firms that have been in operation for less than six months. ACCION USA also provides technical advice and other support, such as seminars on how to raise credit scores and write a business plan. One-on-one credit training is provided during the loan process, online resources and group workshops reinforce credit-building skills, and repayment histories are reported to credit bureaus. ACCION USA measures its success in terms of impact on the community and reports that each loan contributes to the creation or retention of 2.4 jobs, not including that of the borrower.<sup>2</sup>

<sup>1</sup> Information about Grameen America was obtained from its Web site, <http://www.grameenamerica.com/>. Citibank is participating in the FDIC Model Safe Accounts Pilot with the Grameen America accounts. The pilot launched on January 1, 2011, and is a one-year case study designed to evaluate the feasibility of insured institutions offering safe, low-cost transactional and savings accounts. See <http://www.fdic.gov/consumers/template/>.

<sup>2</sup> Information about ACCION USA was derived from their Web site, <http://www.ACCIONusa.org/>, and ACCION USA, "Sustaining Businesses and Jobs Amid the Financial Crisis: Outcomes Data in the ACCION USA Footprint, 2007–2008," January 11, 2009.

### Local MDOs Benefit Their Communities

**Washington Community Alliance for Self-Help (CASH)** is an MDO in the state of Washington that provides access to capital and business development training to low-income individuals. CASH provides loans ranging from \$1,000 to \$35,000 and charges an interest rate of 4 percent above local bank prime rates. In addition to loans, CASH provides technical business assistance, business consulting, mentoring, marketing assistance, Individual Development Accounts, and access to a peer support network.

The average CASH client supports a family of three on \$20,400 annually when starting the program. Sixty-six percent of CASH clients are women, 63 percent are people of color, and 95 percent have low incomes. One year after graduation, CASH clients experience, on average, a 73 percent increase in their household income. Moreover, 82 percent of Washington CASH clients' income levels were above the poverty line within 18 months of receiving services. Also, 18 months after graduation, 71 percent of clients are still in business. As of November 2009, approximately 2,800 low-income entrepreneurs had participated in CASH's business development courses, and more than 800 businesses had opened or expanded. In addition, CASH had extended 383 loans, totaling \$802,000; these loans have a repayment rate of 96 percent.<sup>3</sup>

**Lakota Funds** is a Native American community development financial institution serving the Oglala Lakota Nation in South Dakota. This group, primarily located in an area known as the Pine Ridge Indian Reservation, has an unemployment rate of more than 70 percent. The median household income of residents is 58 percent lower than the rest of South Dakota and 52 percent lower than the national average. Lakota Funds helps promote economic development by providing access to capital, business-specific technical assistance, financial education, home ownership counseling, mentoring, and assistance in overcoming bureaucratic hurdles to land access on the Lakota reservation.

From 1986 to 2009, Lakota Funds originated more than 660 small business loans totaling over \$4.7 million, provided training to more than 1,200 people, and helped create more than 1,000 permanent jobs in a community of fewer than 40,000 people. In addition, this organization developed the first Native American-owned, tax credit-financed housing project in the nation and co-founded the first Native American Chamber of Commerce on an Indian reservation in the United States.<sup>4</sup>

<sup>3</sup> Information about Washington Cash was derived from its Web site, <http://washingtoncash.org/what-we-do/program-overview>.

<sup>4</sup> Lakota Funds, "Lakota Fund's Mission – Accomplishments and Challenges," <http://www.lakotafunds.org/mission.html>, and Red Cloud Indian School, "Pine Ridge Indian Reservation Demographics," [http://www.redcloudschool.org/history/072409\\_PineRidge\\_FactSheet.pdf](http://www.redcloudschool.org/history/072409_PineRidge_FactSheet.pdf).