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In the small towns of rural Nebraska, along the coast of Maine, in the immigrant centers of New York, Chicago, Los Angeles and San Antonio, and in a myriad of places in between, you'll find microentrepreneurs – owners of small businesses with five or fewer employees – engaged in earning a livelihood. They are street vendors and small shop owners, house and office cleaners and child-care providers. They grow, sell or transform food crops, herbs and flowers into high-demand specialty products. They are bakers, craft producers and tailors. They perform medical billing, run transport services, and create graphic designs. Across the United States, there are many millions of microentrepreneurs like these.

We are here today to take a close-up look at microenterprise development and microfinance in the U.S. – the fields that seek to help entrepreneurs like these.

What I'd like to do today is briefly offer some statistics that illustrate the place of microenterprise and microenterprise development in the United States, present some key accomplishments and then, most importantly, focus on what I see as five emerging trends that reveal the field's potential.

First, the place of microenterprise in the U.S. Using the definition that a microenterprise is a business with five or fewer employees including the owner, it's been estimated that there are 23.5 million microentrepreneurs across the U.S., responsible for nearly one-fifth of all private, non-farm employment. This represents a significant number of jobs – more than 30 million, in fact. Here in Texas, almost 89 percent of all businesses are microenterprises. They are responsible for more than two million jobs in the state.

We have estimated that of these larger numbers, approximately 10 million experience barriers to credit and other business development services, and could potentially benefit

from microenterprise program services as well as better designed, or more accessible, mainstream products and services. In addition to these counted entrepreneurs, there is a large and growing number of uncounted microentrepreneurs working in the informal economy. What this indicates is the pervasiveness of microenterprise and its importance in our economy.

What drives people to launch and grow these businesses? Our research has found an array of economic trends suggesting that microenterprise will remain important for some time to come.

- *The loss of well paying, secure “middle class” jobs*, and along with it, the opportunity for advancement, benefits and job security lead people to microenterprise as a way to replace or supplement wage income.
- *Outsourcing and the increasing use of temporary workers* push some who have lost jobs to start microenterprises, and pull others into self-employment in hopes of filling a lucrative niche.
- *Declines in the economic foundation of many rural communities* spur business creation as many families choose to stay rooted where they have strong family and community ties.
- *Changes in the social safety net* that encourage or require recipients of many forms of cash assistance to work. This leads some to choose self-employment to meet that requirement.
- *A need to balance work and family* has prompted many to value the flexibility that self-employment can offer, as the number of hours worked by women and couples with children has increased dramatically.
- *Growth in immigration* continues to fuel growth in the overall number of immigrant-owned firms, and
- *Aging of the population*: workers over 50 have a higher rate of self-employment than others in the population.

It is people experiencing these trends that reach out to the more than 500 organizations across the United States that provide financing, training, and technical assistance

services. We estimate that this industry serves approximately one-quarter million people annually. Further, 240 of these institutions are microlenders with more than \$100 million in outstanding loans to more than 13,000 entrepreneurs, with an average loan size of \$8,570.

Who are these aspiring entrepreneurs that seek program services? They include: women, minority and low-income entrepreneurs, individuals with disabilities, refugees and immigrants, welfare recipients, unemployed workers, and others who see the creation of a very small business as critical to their families' economic progress. In fact, consistently in our surveys of microenterprise programs, we find that:

- More than half of program clients are women, and more than half are persons of color, and/or ethnic and other minorities.
- More than two-thirds have low to moderate incomes, with incomes at or below 80 percent of the median income for their region, and about a third have incomes at or below 100 percent of the Federal poverty guidelines.
- In addition, more than half of all clients come to programs either to learn how to start a business or with businesses that are less than a year old. These very early-stage businesses would rarely be candidates for financing from mainstream financial institutions.
- Finally, many have limited collateral and are constrained by poor or limited credit histories, which also would disqualify them for business loans under the credit-scoring systems that lenders increasingly use to make them. The Association for Enterprise Opportunity – the trade association for the U.S. microenterprise industry – reports that microlenders that provide loans under the SBA Microloan program, a key source of loan funds for disadvantaged business owners – work with clients that have FICO credit scores as low as 550. We also are aware of programs that make loans to borrowers with lower scores than that and in some cases, no credit score at all. As a contrast, AEO also notes that 7(a) lenders usually serve borrowers with FICO scores of 700 or above. And our research indicates that banks are seeking to fund borrowers with scores of 680 or above.

Despite the serious disadvantages experienced by these entrepreneurs, our research has found that those who receive assistance from microenterprise programs do well. We have reviewed and implemented numerous outcomes studies that look at the changes clients experience after receiving services. This past summer, with support from the Citi Foundation, we assisted 25 microenterprise organizations across the country to collect data on their clients' experiences in 2006 – on average a year after having received program services. The survey results are based on a little more than 1,300 responses, which represents a 52 percent response rate from the overall sample that the organizations were attempting to survey. The results are consistent with other studies that we've done in the past.

For instance, clients start and grow their businesses at very high rates, and their survival rate is also strong. We also know from other studies that the longer-term survival rates of entrepreneurs who work with microenterprise programs are very similar to those of other firms: two-thirds survive 2 years, half at least 4 years.

These businesses increase household economic security as owners draw money from their business to pay household expenses and as these draws grow. In this sample, almost three-quarters of business owners report taking a draw and close to 60 percent report that the amount they took increased. Most importantly, there was a 42 percent net reduction in the number of people in poverty one year after receiving services. (In addition, 32 percent of those who were working poor – whose incomes were between 100 and 150 percent of the poverty line when they entered the programs – generated enough household income to move above 150 percent of the poverty line, to a level of greater self-sufficiency.)

Research also shows that businesses that receive microenterprise assistance also create employment for their owners and for others. While most of the businesses remain small, generating 1.5 jobs on average, some grow substantially, producing greater economic development benefits. The businesses in this sample support more than 2,300 full- and part-time jobs, in addition to the jobs of the owners, and their aggregate revenues were more than \$126 million. Importantly, our research and that of others have demonstrated

that overall, the quantitative benefits resulting from microenterprise services – in the form of increased employment, increases in household income, and reductions in public assistance – outweigh the costs of the services themselves

We have observed that microenterprise development programs are able to achieve these results because of several factors:

- Their careful assessment of potential borrowers, using alternative credit analysis methodologies, which allows them to look beyond the surface of a traditional consumer credit score, or an applicant's business experience, to better understand the character, commitment and capacity of a borrower.
- The training and technical assistance that they offer to all clients, borrowers and non-borrowers alike.
- Their attention to financial literacy and credit repair counseling to help strengthen clients' overall financial position. Some combine this with credit repair loans designed specifically to improve a borrower's personal credit score.

These aspects of relationship building, financing, and technical assistance all work together to help aspiring entrepreneurs who have been overlooked by traditional sources of financing. And when loans are made within this context, they are much more likely to succeed. In fact, our annual tracking of a set of microlenders finds that average loan loss rates for all microlending are 7 percent and the largest programs average 4 percent (n=50).

So if this is what the field has and can accomplish, where is it going? What is its potential? We see five trends that suggest that the industry will grow in complexity, with the potential to achieve even greater benefits if these emerging initiatives can find support.

Trend 1 is the pursuit of scale: The numbers clearly suggest that there are many more microentrepreneurs who can benefit from the services offered by microenterprise

programs than are currently being served. While the field has continued to grow, overall the growth has been steady and incremental, but not exponential.

There are reasons for this: The market is complex and dynamic, and the learning curve has been steep. While organizations can often find investments to fund the earliest stages of innovation, it is almost impossible to find money to finance the sustained work required to build products and services to scalable dimensions. Only recently have institutions begun to harness the power of technology. And, leaders that are seeking to grow dramatically have begun to outgrow the capital that is available to finance loans and operations.

Despite these challenges, we have seen a set of leading programs make some real strides – ACCION Texas itself is among the best in this regard, reaching thousands of borrowers across the state. Recently with the support of the Charles Stewart Mott Foundation and the Citi Foundation, we launched the Scale Academy for Microenterprise Development, to help accelerate the growth of leading organizations with organizational development grants, technical assistance and peer learning opportunities. We are now working with eight organizations that together serve more than 5,800 clients and plan to achieve growth rates of between 100 and 200 percent over the next three years. The strategies they are pursuing include Internet lending and distance learning, the development of new products and services to meet the needs of niche markets, new marketing and outreach strategies, and new partnerships.

Trend 2, which is related to scale, is the deepening of outreach and service to the emerging immigrant market. The Center for an Urban Future has noted that small businesses are fueling much of the economic growth in major American cities, like New York, Los Angeles, Houston and Boston, in part due to the increase in immigrant businesses. Yet the Center reports that none of the major cities have yet to incorporate these immigrant firms into their economic development planning in any significant way. Microenterprise programs, however, are already doing that using special outreach strategies, offering training and technical assistance services designed to introduce these

entrepreneurs to U.S. business and financial practice, using alternative underwriting to address risk and developing financial products that help clients build their credit.

Trend 3 is the broadening of products and services to meet the needs of more entrepreneurs. In some instances, product expansion means moving up the ladder to provide larger investments of up to \$50,000 – and sometimes more – to entrepreneurs that still can't meet the requirements of the formal financial system. In many others, it means increasing the focus on asset development services that recognize the important role that assets play in moving people out of poverty. Microenterprise programs have always helped clients build their business assets. Now, the use of Individual Development Accounts, a matched savings tool, can help risk-averse clients grow their businesses through savings rather than debt. In addition, organizations are increasing their efforts around credit repair and financial literacy services to help clients improve what is today an extremely important asset, their credit score. Joining with others, many in the field have helped launch Credit Builders Alliance, a program that enables small organizations to report the credit performance of their customers to the major credit bureaus, incentivizing performance and helping clients get recognition for it.

Trend 4 is increased focus on entrepreneurial development as a way of revitalizing communities that have been hard hit by some of the trends we discussed earlier. In some regions, microenterprise institutions are joining with other public and nonprofit institutions, academic and policy organizations to create “entrepreneurship development systems” designed to nurture the entrepreneurial aspirations and talent of both young people and adults in an inclusive way across a broad spectrum of race, ethnicity, economic level and experience. These efforts also are designed to offer more comprehensive services, both financial and technical, to meet the needs of entrepreneurs at every stage of business development – from start-up to high growth. In still other, particularly rural communities, microenterprise programs are supporting *entrepreneurs in the creative economy, or developing “regional flavor” initiatives, that build economic development around the unique characteristics and creative expression of a place.* We have seen initiatives working with food producers, artisans, furniture producers, bed and

breakfast owners, recreational facilities, historic preservation efforts and the like, seeking to increase the attractiveness of communities to tourists, and attract new residents and business investments.

Trend 5 reflects efforts to use the tax system as a portal for reaching entrepreneurs, using the annual opportunity of tax time to connect them with business services. Some leaders in the field have observed the challenges that microentrepreneurs, operating solo, face to understand and comply with tax requirements. While those of us who are employed have our employers serve as the guides to and implementers of tax policy – withholding our taxes, and managing our contributions to Social Security – the self-employed are largely on their own trying to figure this out. And many who would qualify for the Earned Income Tax Credit do not get it because they may not know they qualify, or they cannot get appropriate tax preparation assistance through many free tax preparation sites. Yet, tax time and the tax form – incorporating Schedule C – could be an important teachable moment for entrepreneurs. Current pilot projects, supported by CFED – a policy organization – and others, are combining outreach around EITC with tax preparation services and education, and in many cases integrating microenterprise training, and access to other financial services as well. In at least one state, Nebraska, microentrepreneurs can access tax benefits through tax filing, and other initiatives of this type may follow.

These five trends demonstrate the continuing evolution of microenterprise development and microfinance in the United States to become an ever more effective tool for poverty alleviation, economic development and community development. There are opportunities for financial institutions, foundations, government, academics, nonprofit practitioners and others to offer their treasure and talent to advance it further.

In particular, it's time for more market research and for a research and development fund to help create scalable products and services. It's time to expand partnerships between banks and microfinance institutions to ensure that more aspiring entrepreneurs don't fall through the cracks. It's time to increase the flow of investment to capital-constrained

leaders. It's time to build new technologies. It's time to recognize the need for more operational support to fund the value-added services that organizations provide. In short, it's time to help move the field to a place where we can finally see a system that truly does support economic and entrepreneurial opportunity for all who aspire to it. I look forward to working with many of you to make it happen.