

HOUSE COMMITTEE ON SMALL BUSINESS

Hearing on

SBA Microloan Program

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Written Statement of
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Madam Chair Velazquez, Ranking Member Chabot, and other Members of the House Committee on Small Business, thank you for inviting me to appear before you today. My name is Elaine Edgcomb, and I am Director of the FIELD program (the Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination) at the Aspen Institute, a program which conducts research on microenterprise in the United States. The purpose of my testimony is to offer a context for understanding the role of the SBA Microloan Program and PRIME in the United States, and the importance that Federal funds play in opening enterprise opportunity to critical groups of emerging entrepreneurs.

I have been involved in the field of microenterprise development for more than 20 years, and have worked in both international and U.S. microenterprise development, doing research, training and consulting. I founded the SEEP Network, an association of U.S. and Canadian nonprofits that support microenterprise development in developing countries, and I have studied the U.S. field since 1991. Through all this work, I have been able to observe not only the role that microfinance plays in catalyzing economic opportunity, but also how Federal support not only can provide direct benefits to thousands, but also lead others to invest in microfinance as well.

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 craft producers and tailors. They perform medical billing, run transport services, and create graphic designs.

Across the United States, there are some 23.5 million such entrepreneurs creating economic opportunities that offer a chance to move out of low-paying wage work and build an asset a family can be proud of. And these entrepreneurs create jobs for others as well – U.S. Census Bureau and Department of Commerce data reveal that they're responsible for more than 30 million jobs, or 18.2 percent of all private (non-farm) employment in the nation.

An array of economic trends suggests that microenterprise will remain important in the U.S. for some time to come. Key among those trends are:

- *The loss of well paying, secure "middle class" jobs*, and along with it, the potential for advancement and wage growth, benefits and job security.
- *Outsourcing and increasing use of temporary workers*, which 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*, which 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, and lead some to choose self-employment to meet that requirement.
- *A need to balance work and family*, as the number of hours worked by women and couples with children has increased dramatically, and has prompted many to value the

flexibility that self-employment can offer to better accommodate family responsibilities.

- *Growth in immigration*, which continues to fuel growth in the overall number of immigrant-owned firms, and
- *Aging of the population*, which will lead to an increase in self-employment as the “Baby Boomers” move toward retirement. (Workers over 50 have a higher rate of self-employment than others in the population.)

Although these and other factors are prompting millions in America to pursue self-employment, many face barriers to credit, knowledge and networks that are available to better-off entrepreneurs. We have evidence that there are some 10 million individuals who face these barriers, and they are the clients that more than 500 microenterprise programs across the U.S. seek to serve with microloans, such as those made available through the SBA Microloan Program, and with training and technical assistance services, such as those supported by the PRIME program. Currently these organizations serve approximately a quarter of a million individuals annually, helping those who experience the greatest disadvantages in accessing capital and other business development services.

Who are these aspiring entrepreneurs? 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 their clients are women, and more than half are persons of color, and/or ethnic and other minorities. Nationally only 33 percent of the self-employed are women, and just under 15 percent of businesses are owned by minorities. So these programs are reaching out significantly to these populations.
- More than two-thirds have incomes 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 any mainstream financial institution.
- Finally, many have limited collateral and are constrained by poor or limited credit histories, which would disqualify them for business loans under the credit-scoring systems that banks and other lenders increasingly are using to make small loans. The Association for Enterprise Opportunity reports that SBA Microloan intermediaries work with clients that have FICO credit scores as low as 550 and we are aware of programs that make loans to borrowers with no credit score. As a contrast, AEO also notes that 7(a) lenders usually serve borrowers with FICO scores of 700 or above. Our research indicates that banks are seeking to fund borrowers with scores of 680 or above.

Despite the serious disadvantages experienced by these entrepreneurs, FIELD's research has found that those who receive assistance from microenterprise programs do well. Studies that track their outcomes after receiving services find that they start and grow businesses, show more resilience in the labor market and increase their income and assets. Their businesses survive at rates comparable to other small businesses. They create employment for their owners and for others. While most businesses remain small, generating 1.5 jobs on average, some grow substantially, producing greater economic development benefits. 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.¹

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

¹ For detailed information on these findings, please see: Elaine L. Edgcomb and Joyce A. Klein, *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States*, Washington, D.C.: The Aspen Institute, February 2005, pages 55-77, available at: www.fieldus.org/Publications/FulfillingthePromise.pdf.

- 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. These services are highly prized by clients who come to microenterprise programs, and in fact the majority of clients come seeking this assistance before, or rather than, a loan. We have calculated that more than 80 percent of them receive only these services in any given year. This underscores the value of the PRIME program in addition to the SBA Microloan Program as it provides resources to assist the many aspiring entrepreneurs who would not be served under the Microloan Program. Further, our research has found that clients who participate in and complete training are more likely to have a business after receiving services, or are more likely to report that their business has grown, than those who do not complete training. We also have found that microenterprise programs are very successful in helping most clients who start training to complete it. Training completion rates across the sample of programs we track average 75 percent.
- 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.

Recognizing that personal and business financial matters are intertwined, and that education and financing are equally important, microenterprise programs work with clients holistically to position them for future advancement. These aspects of relationship building, training and technical assistance all work together to help aspiring entrepreneurs who have been, or would continue to be 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 leading programs report rates of 3 percent or less. The SBA Microloan Program experienced a default rate of less than 1 percent in FY 2006.

The somewhat higher rates for programs overall is due, in part, to the additional risks that microlenders are willing to take to serve even more marginal borrowers when using loan capital that comes from grant funds rather than borrowed money. But this data also demonstrates why it is important to maintain the technical assistance component of the SBA Microloan Program.

In conclusion, over the past 20 years we have seen the emergence of the microenterprise field in this country, spurred by community leaders who see the critical role it can play in assisting individuals and communities that are disconnected from our economy. Federal resources from programs such as the SBA Microloan, PRIME and Women's Business Center programs have played a critical role in enabling this growth. Importantly, we have seen a growing recognition among key private sector actors – financial institutions and others – that the microenterprise market has important value. They are investing philanthropic dollars, and in some cases beginning to look at whether and how they can offer products that serve these individuals. While these trends hold promise, at the same time, there are still too many individuals in this country who cannot access the resources – training, technical assistance, financial education and capital – needed to realize their business dreams. Our research has shown that as Federal resources have become more constrained in the past few years, the microenterprise field has found it increasingly challenging to maintain, let alone expand, the level of services it can provide to these entrepreneurs. As I mentioned earlier, we estimate that there are 10 million such entrepreneurs, of whom only a small number are currently served. The federal government, working in concert with the nonprofit microenterprise field, has a critical role to play, in ensuring that the dreams of these entrepreneurs – and the benefits they provide to our communities – can be realized. Thank you.