FULL COMMITTEE HEARING ON THE SMALL BUSINESS ADMINISTRATION'S MICROLOAN PROGRAM

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FULL COMMITTEE HEARING ON THE SMALL BUSINESS ADMINISTRATION'S MICROLOAN PROGRAM

THURSDAY, JUNE 14, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:04 a.m., in Room 2360 Rayburn House Office Building, Hon. Nydia Velázquez [Chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Shuler, Cuellar, Braley, Clarke, Ellsworth, Chabot, Akin, and Musgrave.

OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

ChairwomanVELÁZQUEZ. Good morning. I call this hearing to order. Today's hearing will focus on the reauthorization of the Small Business Administration's Microloan and PRIME Programs that are very important to the smallest businesses. One of our most basic rights is the freedom to pursue our dreams as far as our imagination and ability allows. According to a study by the Office of Advocacy, about 700,000 entrepreneurs realize their dreams each year and start up a new business. As a result at least 20 million firms operating in this country are very small with fewer than five employees.

Over 50 percent are home-based. Helping these businesses start and grow provides a significant benefit for our local economies. There is a simple model called microcredit that has drawn on being copied worldwide and is designed to nurture budding entrepreneurs. Microcredit programs combine loans, technical assistance and peer involvement. This has been remarkably successful in bringing opportunity to individuals that were never given a choice or a chance. Communities soon learn that these home-grown investments provide economic benefits and increased employment in return.

In 1992, Congress embraced ideas, started a Microloan Program and shortly after that, the PRIME Program. SBA Microloan Program makes funds available to nonprofit community-based lenders. In turn, these lenders make small loans to eligible borrowers who are often fledgling entrepreneurs that live in the same community where they work. This program reaches many who otherwise would not be served by the private sector or even the SBA's 7(a) loan program. For example, microloan borrowers may be unable to get a traditional loan from those sources due to poor credit history or a lack of business experience. It has provided an important source of capital for low-income women business owners and minority borrowers. Finally, the loans tend to be geographically diverse as roughly 1/3 of the microloans are made in rural America. Over the years, over $328 million was lent through this initiative. SBA had told us that there have been a total of two defaults, two defaults by intermediaries in the program's history and that 98.6 percent of the business loans are repaid, a remarkable record.

The Federal Government has shown its face in this simple rectifiable system by contributing millions of dollars in foreign aid to microloan programs overseas. Even in Iraq. After the fall of Saddam Hussein, our coalition provisional authority appointed by the President set up a $17 million direct microloan fund specifically for Iraq citizens that continues today.

So it is hard to understand why the administration is now recommending that we raise the fees that intermediaries pay to borrow funds and eliminate specialized assistance that supports the program here at home. Administrator Preston stated recently that he expected the high fees will reduce the usage of these loans. It is unclear why we will cripple a program where such a small investment generates economic activity and create jobs simply by making loans to deserving individuals who otherwise would not get a chance. Our local businesses are not less deserving than those we fund overseas. Given the success of this program, we will be building it up, using what we have learned to improve it and replicating it in as many ways as possible.

It is important that we strengthen the Microloan Program so that we can ensure that all will-be entrepreneurs have the opportunity to realize their dreams. We look forward to hearing our witnesses' opinions on the program, their suggestion for improvements and reaction to recent funding recommendations. I would like to take this opportunity to welcome all the witnesses, and to thank them in advance for their testimony. And I now yield to Ranking Member Chabot for his opening statement.

OPENING STATEMENT OF MR. CHABOT

Mr.CHABOT. Thank you, Madam Chair Velázquez. And we want to also thank the witness panel here this morning and thank you for holding this important hearing on the Small Business Administration's Microloan Program. The program needs to be reauthorized, and this is the first hearing to address this important subject in a number of years in this committee. According to Dr. Muhammad Yunus, whom I actually had the opportunity to have lunch with a couple of months ago in Bangladesh, the day before he announced that he was going to form a party and run for president, but apparently he ultimately didn't do that.

There is some turmoil going on in Bangladesh right now and there is a caretaker government, very interesting topic but not the topic of this hearing, I digress. He was the 2006 Nobel laureate and peace and founder of the Grameen Bank. ″microcredit views each person as a potential entrepreneur, and turns on the tiny economic engines of a rejected portion of a society″ is the quote. Unlike Bangladesh or other countries that have emulated the Grameen Bank, microcredit in the United States is not aimed at a rejected portion of society, but rather at those individuals who do not have access to commercial financial institutions and the technical resources to manage those funds. Despite the different target audiences, microlending in the United States represents a variation of the concept developed by Dr. Yunus.

Although there are no completely accurate statistics, there are approximately 550 organizations providing some type of microcredit in the United States. This hearing focuses on the approximately 170 lenders that operate as intermediaries under the Small Business Administration's Microloan Program. The SBA does not provide microcredit directly to entrepreneurs. Instead, the SBA provides below market rate loans to nonprofit intermediaries. These institutions then make loans to the entrepreneurs.

As with other SBA financing programs, the SBA does not provide all the funds for financing. Intermediaries must contribute 15 percent of the value of loans in non-Federal funds. But the key to the success of microlending is not the loans. Rather, it is the education and counseling that the intermediaries provide to their borrowers. With this knowledge, these entrepreneurs are able to manage their financial resources and ensure repayment of loans. This success is demonstrated by the very low number of defaults in the program. And I believe that the chairwoman referred to these figures, but I think to some degree, we should refer to them again.

According to the SBA's statistics, only 17 loans to borrowers defaulted between fiscal years 1992 and 2006. Another 38 were liquidated over the same period. To put that in context, intermediaries make about 2,500 loans a year, and there were only 7,700 loans to borrowers outstanding at the end of fiscal year 2006. Thus, the default rate was negligible. Despite its success, it is important to examine ways to improve the Microloan Program. Tight budgetary times call for efficient delivery of government programs no matter how valuable or useful they have been in the past. I am very interested in listening to the testimony of the witnesses that we have here this morning to see what improvements can be made in the program to maintain its success while recognizing the need to spend the taxpayers' dollars in the most responsible manner. Again, I want to thank Chairwoman Velázquez for holding this hearing this morning, and thank you to the panel of witnesses who will be testifying when we stop talking, and I would yield back the balance of my time.

ChairwomanVELÁZQUEZ. Thank you, Mr. Chabot. Our first witness is Ms. Janet Tasker. Ms. Tasker is the deputy associate administrator for Capital Access at the Small Business Administration. The associate administrator for Capital Access reports directly to Administrator Preston. Her office oversees and manages the SBA offices of lender oversight, international trade, financial assistance and investment division, which includes the SBDC program. Prior to becoming deputy director, Ms. Tasker headed a lender oversight office during the implementation of new lender money foreign system. Ms. Tasker, welcome.

STATEMENT OF JANET TASKER, DEPUTY ASSOCIATE ADMINISTRATOR FOR CAPITAL ACCESS, UNITED STATES SMALL BUSINESS ADMINISTRATION

Ms.TASKER. Thank you. Chairwoman Velázquez, Ranking Member Chabot and members of the committee, thank you for inviting me to testify about SBA's Microloan Program. As you noted, I am Janet Tasker, the deputy associate administrator for Capital Access. In its current design, SBA's Microloan Program combines the resources of the U.S. Small Business Administration with those of locally based nonprofit organizations acting as intermediary lenders to provide loan and technical assistance to small businesses.

ChairwomanVELÁZQUEZ. Ms. Tasker, would you please bring your microphone closer to you? Thank you.

Ms.TASKER. Is that better?

ChairwomanVELÁZQUEZ. Yes.

Ms.TASKER. In its current design SBA's Microloan Program combines the resources of the U.S. Small Business Administration with those of locally based nonprofit organizations acting as intermediary lenders to provide loan and technical assistance to small businesses. Under this program, SBA makes funds available to intermediaries which, in turn, make loans of up to $35,000 to eligible borrowers. In fiscal year 2006, SBA made 39 loans to intermediaries totaling $17.8 million and in turn, intermediary lenders made 2,542 microloans totaling $32.8 million to small business borrowers.

It is important to note that we approved almost 43,000 loans under $35,000 in our 7(a) loan program, which accounted for 44 percent of all loans made in the 7(a) program. Coupled with the approximately 2,500 loans made through the Microloan Program, SBA did close to 50,000 microloan activities in fiscal year 2006. SBA's Microloan Program can be an important and useful tool for those who are unable to obtain capital through traditional lenders, many of whom are in underserved markets. Reaching out to entrepreneurs in our underserved markets has been a top priority for Administrator Preston ever since he took office, and therefore, we support the continuation of the Microloan Program with some important reforms.

We are aware that the number of microloans has remained stagnant at 2,500 per year. We share the committee's goals of providing effective and efficient assistance to underserved markets. In order to accomplish this, it is crucial that SBA and this committee work together when drafting microloan reauthorization legislation to create a comprehensive and effective plan to help our underserved markets. We look forward to working with this committee on the reauthorizing legislation in the coming weeks to achieve our mutual goals. An important aspect of the Microloan Program provides technical assistance to small borrowers. Technical assistance for small businesses and entrepreneurs is a crucial tool. And as partners with SBA, intermediaries are required to provide business-based training and technical assistance to its microborrowers. SBA recognizes that these borrowers need more help with business planning and development than the average entrepreneur, and that is why it is important to ensure that resources are properly being used to serve the needs of the microborrowers.

Currently SBA supports the work of intermediaries by providing technical assistance grants intended to ensure microborrowers' success. In fiscal year 2006, SBA spent $11.7 million to provide 125 grants to nonprofit intermediaries for training and counseling to microenterprises. In the same year, over $100 million was provided for technical assistance through SBA's network of training and development resources. We believe the valuable experience of our existing resource partners can be helpful to microborrowers, particularly since 94 percent are located within 20 miles of an SBDC, a women's business center or SCORE partner. To ensure the success of the technical assistance programs, accountability and the use of technical assistance funds is important to SBA. This past Monday on June 11, the House Appropriations Committee approved a budget for SBA for fiscal year 2008 in which $17 million was provided for microloan subsidy and technical assistance.

By providing such resources we recognize that Congress views technical assistance programs as a crucial tool to the small business community. SBA also recognizes the importance of this program as well as ensuring that the resources provided to technical assistance providers are properly used to assist microborrowers, develop successful business plans. Again, we would appreciate the opportunity to work with the committee to achieve our shared goals of improved accountability and effectiveness of the Microloan Technical Assistance Grant Program.

In conclusion, I would like to thank the members of this committee for the opportunity to speak on behalf of SBA's Microloan Program. I appreciate your time and I value any questions you may have.

[The statement of Ms. Tasker may be found in the Appendix on page 31.]

ChairwomanVELÁZQUEZ. Thank you, Ms. Tasker. Our next witness is Mr. Daniel Betancourt. Mr. Betancourt is the president and CEO of the Community First Fund in Lancaster, Pennsylvania. His group has been an intermediary offering microloans and technical assistance since the inception of the SBA Microloan Program in 1992. The Fund serves 13 counties in central Pennsylvania. Mr. Betancourt is also the board chairman of the Association For Enterprise Opportunity, the national leadership organization for microenterprise development organizations across the country.

Mr. Betancourt, you have 5 minutes to make your presentation and the entire testimony of every witness will be entered into the record without objection.

STATEMENT OF DANIEL BETANCOURT, CEO OF COMMUNITY FIRST FUND, LANCASTER, PENNSYLVANIA, ON BEHALF OF THE ASSOCIATION FOR ENTERPRISE OPPORTUNITY

Mr.BETANCOURT. Thank you. Thank you for allowing us to speak before you, Chairwoman Velázquez and Ranking Member Chabot. We appreciate your time and other members as well. As you said, I am here to talk to you as a practitioner, one of those 70 intermediaries across the country. You already mentioned that we provide microlending across Pennsylvania, about a third of the State just north of here, and I am also the chairperson of the National

Association for Enterprise Opportunity, and we have about 600 members, many of which are intermediaries here. So I am also talking on behalf of the microlenders. But I want to talk to you today about the Microloan Program, we are a very successful program.

I was really glad to hear Ranking Member Chabot mention Dr. Yunus, because I actually met him just about a month ago in Kansas City, and we were able to ask him a question. What was the key element to making microenterprise work? And he actually mentioned creating financial institutions which I found really interesting because this is what we are here to talk about today, to really enhance what we are doing.

As you know, this program, SBA Microloan Program has been compared to the 7(a) program. The last time I spoke before your committee, Chairwoman, we were just a microlender. Today we also have the 7(a) program. So I can talk to you both as a 7(a) lender. By the way, we were approved back in the fall. And they are really different clients. We find that we have been unable to approve any of our clients in the 7(a) program, so this is a program that is very unique, of all of the programs that are available at the SBA. We all know it is unique because it provides technical assistance, all that training, and there is a reason why people pay back.

You just don't give money to folks and expect it to come back. You really do have to provide that training, technical assistance that we all understand. Really what we are talking about is providing access to capital. Many of these clients, aspiring entrepreneurs, do get the training. They really have a lot of experience. They know what they are doing. They might have worked in the pizza shop and now they want to buy it. They really understand the business, they understand the training we provide to them, and what they really need is access to capital. When you don't have a history, financial history, you are unable to get bank financing, including 7(a). You just don't qualify for that.

This program as you know also provides low cost capital to intermediaries. And one of the initiatives that is being proposed here is to increase that capital. I want to talk a bit more about the impact of that on our program. As you mentioned, both the ranking member and chairwoman, the default rate here is 1 to 2 percent. It is extremely low. And one of the reasons for that again is the technical assistance. I do want to just introduce a gentleman that you are going to be hearing from in a few minutes, Edward "Champ" Hall, one of our borrowers. He has received three microloans from us over the past 5 years. He has a very successful barber school. You are going to hear a lot about that. He spinned off a lot of barber shops in the neighborhood and created many, many jobs. We have also provided business counseling.

He has a very interesting story about how he came to our organization, challenged us. We said no to him a few times. He kept coming back, kept working with us. And because of his labor and his love and the passion for his work, you will see a very interesting success story. He will talk more about that. He is kind of shy so we will have to get him going here as well.

Again, we obviously oppose the President's recommendation to eliminate the technical assistance. Interestingly enough, this is the first time in 4 years that there is not a proposal to eliminate the program in its entirety, which is, I think, an acknowledgement that this program is working, although there is some tweaking going on here. We are not sure why. The interest rate—what I heard is being recommended to increase, is really going to impact our program, and I am a banker, former banker, worked at a very large commercial institution, and I want to tell you—I won't get into the technical aspects of this. But let's just say the interest rate that we get is about 2 percent, and one of the reasons why the default rate is so low is that we are taking the losses. You heard Ranking Member Chabot mention that we are putting 15 percent reserve away for any losses.

And so if we are putting—let's just say that we put away 5 percent even though we locked away 15, and if we are getting a 2 percent rate, and we put a 5 percent reserve rate which is a requirement of our auditors, and then we are trying to recover some of our costs, let's say 2 percent above that, already you are talking about a 9 percent rate. The maximum rate, I believe, is 9.3 or something like that. If you increase that rate even by 2 percent, you are talking about increasing these rates substantially for borrowers. And then if you eliminate the technical assistance, my reserve rates are going to have to go up. So quite frankly, this program would not work for us. We wouldn't even be able to borrow from this program. And I don't say that lightly because this is a fantastic program. We have used—we will talk a little bit more about our activity. But I am not trying to get too technical. But I want to you to understand the impact of a rate increase on an organization like ours. So as I said, the elimination of the technical assistance doesn't make sense with the low default rate. There is a proposal to have other technical assistance intermediaries provide technical assistance to our clients. In other words, and we love—we work with the SBDCs and the SCOREs. We think they do a fantastic job. But I want to tell you, what is the incentive of a technical assistance organization to collect my loans?

ChairwomanVELÁZQUEZ. Mr. Betancourt, your time is expired. So if you please—

Mr.BETANCOURT. I will summarize. I see 44 seconds there. But I will summarize.

I also want to just talk about the PRIME Program. You know that is a program that works with very low income entrepreneurs. It is one of the few in the Federal Government that is there. To date, it is only working in a few States. It does not include Pennsylvania. We really ask that you will expand that program. And finally, I just want to thank you for the opportunity to speak in front of you today. Thank you.

ChairwomanVELÁZQUEZ. Thank you.

[The statement of Mr. Betancourt may be found in the Appendix on page 36.]

ChairwomanVELÁZQUEZ. Our next witness is Mr. Edward "Champ" Hall. Mr. Hall is the owner of Champ's Barber Shop and Champ's Barber School located in Lancaster, Pennsylvania. Mr. Hall is a microloan recipient who built a successful barbering business and then opened a successful barber school in his home community. From that start, Champ has been able to help many others to find productive work or start businesses of their own. Welcome, sir.

STATEMENT OF EDWARD ″CHAMP″ HALL, OWNER, CHAMP HALL'S BARBER SHOP AND BARBER COLLEGE, LANCASTER CITY, PENNSYLVANIA

Mr.HALL. Good morning. Chairwoman Velázquez, Ranking Member Chabot, members of the committee. I am very elated and humbled to be here to share with you my personal story on how the Small Business Administration Microloan Program assisted me with my small business.

I want to acknowledge Dan Betancourt with Community First Fund for the business advice and working capital I received because of the Microloan Program and the Association For the Enterprise Opportunity, which is the national leadership organization for microenterprise in the United States.

My name is Edward hall. I am the owner of Champ's Barber Shop and Barber School in Lancaster, Pennsylvania. The Microloan Program played a key role in helping me to achieve the level of success that I have obtained. In 2003, I called Dan Betancourt from Community First Fund, and I shared my idea of opening a barber school. I was unable to get a loan from a bank because of my credit history and my exact words to Mr. Betancourt was, ″just give me a chance.″ before receiving the microloan, Community First Fund provided counseling, they reviewed my business plan. The loan, along with the second loan I received, was used to renovate my barber shop and to furnish my barber school. The loans were paid back in approximately 2 years. In 2005, I won the business development award for all the businesses that had opened under my tutelage.

And thus far, it has been 13 businesses that have opened, and several are in the process of striving to become self-sufficient entrepreneurs. It is very gratifying to me to see these students who have trained in my barber school facility become business owners and providers to their families. And the entire State of Pennsylvania, there are approximately 6 barber schools. My school was chosen to host the State barber exam.

Students come from different parts of the State to my school to take the barber test to be licensed as a professional barber. I am currently in the process of getting accredited to receive financial aid. And this will allow me to grow my school. I am presently in with what is called candidate status. There is approximately 300 customers that come into my school for haircuts per week. That is over a thousand a month, and the haircuts are at budget prices which helps assist parents with multiple children.

If the Microloan Program does not receive the support and funding it deserves, many of the entrepreneurs throughout the country will find it difficult, if not impossible, to get the financial assistance that they need to fund their new or growing small businesses. Furthermore, the business assistance which accompanies the loans is a big help to entrepreneurs. And therefore, I respectfully request that the committee show its support for the small business in

America by working to ensure that the SBA Microloan Program is provided with adequate funds.

Without the SBA Microloan Program, such as Community First Fund, I would not be here today to share my personal story as a small business owner.

In my conclusion, prior to opening my barber school, people told me it wouldn't work, no one is going to go in there to allow students to practice on them, which reminds me of the story of the man who went into a foreign country and he had the intention in mind to sell shoes. But when he got into the country he noticed that no one wore shoes, and so he packed his boxes of shoes up and he fled the country.

Another man went into the country with the same idea in mind. He wanted to sell shoes, and when he got there, he noticed too that no one wore shoes in this country. And so he called back to the States and said, send me more boxes of shoes because he saw an opportunity, and I saw an opportunity. And so my school was the first school in Lancaster. I saw that opportunity. And I am asking you, on behalf of many aspiring and existing entrepreneurs who are just like myself, to give them an opportunity. Thank you for listening to my story.

ChairwomanVELÁZQUEZ. Thank you, Mr. Hall, for your passion and congratulations for your vision.

Mr.HALL. Thank you.

[The statement of Mr. Hall may be found in the Appendix on page 40.]

ChairwomanVELÁZQUEZ. Our next witness is Lisa Servon. Ms. Servon is a Ph.D., is the senior research fellow for the New York America Foundation. She is also an associate professor at the Milano Graduate School of Management and Urban Policy of the New School in New York City and acting director of the Community Development Resource Center located there. Ms. Servon has written numerous articles and papers on microenterprise development, including strategies for the futures of such programs. Her most recent articles on this subject include Policy Options to Support Entrepreneurship Among Low-Income Americans written in 2005—or published in 2005 and Microenterprise Development in the United States, 2004. Welcome.

STATEMENT OF LISA SERVON, ASSOCIATE PROFESSOR, MILANO THE NEW SCHOOL FOR MANAGEMENT AND URBAN POLICY

Ms.SERVON. Good morning. Thank you so much for having me. Madam Chair Velázquez, Ranking Member Chabot and other members of the House Committee on Small Business, I am really glad to be here today. As Chair Velázquez mentioned, I am a professor. I am a scholar, not an advocate. So that puts me in a bit of a different position from some of the other people here today. In my work, which has spanned about 13 years looking at microenterprise development in the U.S., I have interviewed literally hundreds of entrepreneurs like Mr. Hall across the country as well as policymakers, bankers and other field experts, the people who provide these services. My research and analysis over those 13 years leads me to conclude that both the microloan and PRIME programs are incredibly important, particularly the training and technical assistance pieces. Primarily because—or one of the reasons being that as you mentioned talking to Mr. Yunus and other people here, the contexts in which entrepreneurship is done is very different in the U.S. than it is in the developing world.

The fact that U.S. entrepreneurs need to—we were just talking about the barber exam before the proceedings started this morning. The regulations, the licensing and certification requirements, filing taxes in the U.S. makes this a very different environment and requires that people have much more sophisticated skills than they do in the developing world which is why these training and technical assistance subsidies are incredibly necessary.

My co panelists, other witnesses here have really testified to the importance of the program. And so I really want to focus my remarks today on how we could strengthen the Microloan Program and make it better in the coming years. Recognizing, as the ranking member mentioned in his opening remarks, that the burden of proof is on us to demonstrate that a dollar spent on microenterprise development has to bring at least as much bang for the buck as it would be spent on anything else, and I think that the research that I have done as well as others in the room really does demonstrate that.

So I have written about—one of the ideas that I have written about is the idea of separating training from lending in some of these programs. The training and lending functions of microenterprise development programs in order to make them field more efficient. The microloan and PRIME programs essentially do this, in that, the Microloan Program focuses on lenders and the PRIME Program focuses on training. But I think that they could do it better, do a better job of that by creating the appropriate incentive environment and rewarding programs that perform these functions best.

With respect to their Microloan Program, I think one of the things that we need to do at this juncture—and it is great to do it with support coming from both sides of the aisle—is to recognize that conditions are different now than they were when these programs were created in the 1990s, and that some of the assumptions that guided the creation of the program might not be as true today as they were before. In other words, the program hasn't kept pace with the changes in the financial services environment and the regulatory environment. So having said that, I think that the Microloan Program should be revised in the four following ways:

First, implement performance standards and data collection requirements that would help to sort of make sure that the dollars are getting into the hands of the right programs that are really focussing on microentrepreneurship. One of those performance standards I think should be raising the minimum number of loans that a program makes every year. The current number is four, and the Association For Enterprise Opportunity has recommended that good programs should work toward making at least 40 loans a year.

If you raise that floor then what happens is that the dollars for the program are really going into the people's programs that have the mission of making a lot of loans and getting the dollars into the hands of entrepreneurs rather than making just a few loans.

In terms of data collection, the Aspen Institute has implemented its MicroTest program which provides standardized data and performance indicators for the field. And one idea would be to require that participating programs in the Microloan Program use MicroTest, recognizing also the data collection costs money, and one of the reasons we don't have more programs doing MicroTests now is that they need the support to do that. So if you create the requirement, you also have to create the means to do it.

Second, change the funding formula by which technical assistance funding is determined. Right now, I think as we all know, technical assistance dollars are tied to loan dollars. And that creates two problems. One, it fails to acknowledge the amount of assessment and screening and training that goes to people who are not ready to borrow. Sometimes a program might have to see 5 or 10 entrepreneurs to find one who is ready to borrow. And that is money that is well spent because they get good financial literacy education and other outcomes out of that money.

The second problem is that tying TA dollars to loan dollars creates an incentive to cream, to take only the very best people who are really ready to borrow and to ignore the people who with a little bit extra assistance might be willing, might be able to step it up a little bit.

Third, provide support to build the capacity of microlenders. There is a rarely used provision in the legislation to fund training for low income fund managers and other staff and the SBA should continue to invest in the field by supporting peer training and capacity building efforts. And finally, consider eliminating the interest rate cap of 8 1/4 percent, allowing programs to implement risk-based pricing, charging different rates to different types of borrowers. Now, I want to be clear that I don't mean that the higher interest rate should be required.

I think the program should have the flexibility to decide to charge whatever interest rate they think is acceptable as long as it is done in a socially responsible way. And I also want to be clear that if higher interest rates are charged, it will not be enough to subsidize these programs and eliminate the training component. I realize I am slightly over time. So I want to say thank you very much. I look forward to questions, and I appreciate the ability to be here today.

[The statement of Ms. Servon may be found in the Appendix on page 43.]

ChairwomanVELÁZQUEZ. Thank you, Dr. Servon. Our next witness is Ms. Elaine Edgcomb. Ms. Edgcomb spearheads the Microenterprise Fund for Innovation Effectiveness Learning and Dissemination known as the FIELD Project which is part of the Aspen Institute. FIELD focuses on microenterprise development. She has also served as the founder and executive director of the Small Enterprise Education and Promotion Network an association of nonprofits that supports small business and microenterprise in the developing world. She has written extensively on evaluation practice, institutional development and international and U.S. microenterprise strategies. Welcome.

STATEMENT OF ELAINE EDGCOMB, DIRECTOR OF THE FIELD STUDY, THE ASPEN INSTITUTE

Ms.EDGCOMB. Thank you very much. Chairwoman Velázquez, Ranking Member Chabot and other members of the Committee on Small Business, thank you for inviting me to appear before you today. The purpose of my testimony is to offer a context for understanding 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. While an array of economic trends prompt 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 the more than 500 microenterprise programs across the U.S. seek to serve with microloans, such as those made through the SBA Microloan Program, and with training and technical assistance services such as those supported by the PRIME Program.

Who are these aspiring entrepreneurs? Consistently in our surveys of programs, we find that more than half of their clients are women and more than half are persons of color ethnic or other minorities. More than 2/3 have incomes below 80 percent of their area's median income, and about a third have incomes at or below 100 percent of the Federal poverty guidelines. More than half of all clients come to programs either to learn to start a business or with businesses that are less than a year old.

And finally, many are limited by limited collateral and constrained by poor or limited credit histories, which would disqualify them for business loans under credit scoring systems that lenders increasingly use 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 at all.

As a contrast, AEO also notes that the 7(a) lenders usually serve borrowers with FICO scores of 700 and above. And in our research, we have found that most banks won't lend to borrowers with a score below 680. 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, their businesses survive at rates comparable to other small businesses, they create employment for their owners and others. Research also demonstrates that overall, the quantitative benefits resulting from these 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 three factors.

First, their careful assessment of potential borrowers using alternative credit analysis methodologies allows them to look under the surface of a traditional credit score to better understand the character commitment and capacity of a borrower.

Second, the training and technical assistance that they offer to all clients makes a critical difference in business success. Within the Microloan Program, the technical assistance is intimately connected to the loan process itself. In addition, the majority of clients, more than 80 percent, come to microenterprise programs seeking training and technical assistance rather than a loan. This underscores the value of the PRIME Program as it provides resources to assist those 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 report that their business has grown than those who do not complete training. Finally, programs' attention to financial literacy and credit repair counseling help clients strengthen their overall financial position.

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. And when loans are made within this context, they are much more likely to succeed. Our research has shown that as Federal resources have become more constrained in the past few years, the microenterprise field has found itself increasingly challenged to maintain let alone expand the level of services it can provide to these entrepreneurs. The Federal Government, working in concert with the nonprofit microenterprise field has a critical role to play in ensuring the dreams of these entrepreneurs and the benefits that they provide to our communities. Thank you very much, and I look forward to your questions.

[The statement of Ms. Edgcomb may be found in the Appendix on page 49.]

ChairwomanVELÁZQUEZ. Thank you, Ms. Edgcomb. Ms. Tasker, I would like to address my first question to you. During this year's hearing on SBA's fiscal year 2008 budget proposal, Administrator Preston came before the committee and he made helping underserved communities a central point in his testimony. And today we heard testimony about the importance of the microloan and PRIME programs in helping these communities.

So I would like for to you explain to us, how does this continuing the microloan technical assistance and PRIME programs further SBA's ability to help low-income individuals?

Ms.TASKER. Thank you, Chairwoman. We aren't eliminating technical assistance. We are suggesting that they are proposing that the technical assistance would be provided by our existing technical assistance providers. Approximately 94 percent of our existing technical assistance providers are within 20 miles of our microlenders, and so we believe we have an extensive network that would be able to continue to meet the needs of the underserved markets.

ChairwomanVELÁZQUEZ. Okay. In your budget request, how much money did you request for all these providers to be able to add this new responsibility?

Ms.TASKER. I apologize. I am not sure if I know the exact number.

ChairwomanVELÁZQUEZ. Zero.

Ms.TASKER. Zero. Thank you. I knew it was minimal.

ChairwomanVELÁZQUEZ. Minimum? Zero is minimum?

Ms.TASKER. Minimal. I apologize.

ChairwomanVELÁZQUEZ. Uh-huh.

Ms.TASKER. But the fact is, these technical assistance providers serve over 1 million businesses that are coming in, and so to add 2,500 to that number, you know, it is around less than 1/10 of a percent increase in terms of what we are doing.

ChairwomanVELÁZQUEZ. Let me ask you, did the SBA do an assessment of replacing the technical assistance component of the microloan and PRIME programs with SBDCs and women's business centers?

Ms.TASKER. An assessment? We certainly looked at the numbers and looked at who was being served, yes.

ChairwomanVELÁZQUEZ. Did you do a cost, how much it would mean for them?

Ms.TASKER. I would have to check on that. I am not aware of it, but I just don't want to—

ChairwomanVELÁZQUEZ. So it is hard for me to believe that you could present a request to this committee and to Congress for a significant change in this important program without preparing even a basic estimate of the costs involved to provide the service.

Ms.TASKER. Chairwoman, we did provide a basic estimate. We looked at the numbers they are already serving and the numbers they would add, and we didn't believe that that would significantly increase the cost.

ChairwomanVELÁZQUEZ. Well, I want for you to provide the assessment to this committee.

Ms.TASKER. Yes, ma'am.

ChairwomanVELÁZQUEZ. Ms. Tasker, the model of combining microloans with technical assistance is supported broadly by, as you saw, foundations, national, State, local governments, relief organization, the World Bank, the United Nations and the Nobel committee. So it is not surprising that the current administration funds microloan lending program for businesses overseas, like we are doing in Iraq. And I mentioned in my opening statement that we provided $17 million to provide such microlending in Iraq. So I want for you to explain to this committee, why is it good for Iraq, but it is not good here at home?

Ms.TASKER. Well, we would certainly agree that it is good for both Iraq and for the U.S. And we do have programs and as we said in technical assistance.

ChairwomanVELÁZQUEZ. Wait. The difference that we are asking the microlenders and the borrowers here at home to shoulder the burden.

Ms.TASKER. We are simply saying, Chairwoman, that we believe there are other avenues from which the technical assistance can be provided. That said, we certainly want to work with you. We share your concerns and want to see how we can come out to you know a solution that you know works for everybody, and provides transparency and accountability.

ChairwomanVELÁZQUEZ. I welcome that.

Ms.TASKER. We certainly want to work with you.

ChairwomanVELÁZQUEZ. We heard that the default rate is very low and only less than 2 percent. And Mr. Betancourt and Mr. Hall, in their testimony they said that a good reason for that is the technical assistance portion of that. So I want to ask you, what will be the effect if the SBA eliminates the technical assistance component or moves it well outside of the microlending's operation?

Ms.TASKER. First, may I just clarify one thing? The default rate that we are talking about that is less than 2 percent is the loans that SBA makes to the microintermediaries. The actual default rate on the microloans themselves or the borrowers default on is actually around 12 percent. So there are losses and there are losses associated with the borrowers themselves. That said, we do believe you know there is—

ChairwomanVELÁZQUEZ. What was it in 2006?

Ms.TASKER. The numbers I have are about around 12 percent.

ChairwomanVELÁZQUEZ. We are going to get back to you on this default rate.

Ms.TASKER. Okay. I just wanted to clarify. Because there is two dynamics going on here.

ChairwomanVELÁZQUEZ. Let me ask you, will you State for the record that defaults will not increase and that the program costs will not rise?

Ms.TASKER. I can't predict the future, Chairwoman. Certainly any program we have in place we want to manage so that we can limit those to you know the least amount possible.

ChairwomanVELÁZQUEZ. Mr. Betancourt, you mentioned that you would like to be able to offer other variable terms in the microloans that you make. What sort of terms do you think will be most helpful that you cannot now offer?

Mr.BETANCOURT. Well, right now you can't use it for a line of credit. You can only use it for term loans. So, for example, if Mr. Hall wanted a working capital line to increase his business—he mentioned about—he is going to be getting a financial aid program. In other words, his students can borrow money from the government to go to his school. In the meantime, he needs to fund his business until that happens and we don't have the ability through his program to do that. We gave him money for the equipment to renovate but not working capital to grow his business. So that is a limitation.

ChairwomanVELÁZQUEZ. Dr. Servon, SBA has described that what they are doing is preserving the program and protecting it in terms of the proposals and the changes that they are proposing.

How will raising the costs of microloans to low-income borrowers and eliminating funding for the individualized technical assistance affect the program?

Ms.SERVON. I think there are two things that could happen. The default rates would go up if there is no technical assistance, the other is you will get this creaming effect that I described before, which is that if there is no technical assistance and the pressure is on the program, the providers to keep the default rates low, then they will take more qualified borrowers who are people who are more likely to be able to get say a 7(a) loan or a bank loan, and that defeats the whole purpose of the program to begin with. Because the purpose is to target people who with some help with some technical assistance can actually move into the ranks of entrepreneurs, and then move on to mainstream financial institutions.

There is a third effect, which I just thought of which is I just finished doing a round of about 100 interviews with entrepreneurs in New York City for the economic development corporation. And what we see there is where there isn't provision, people are using loan sharks and paying it up to 740 percent interest. So if these sources are not available, then that is the other place that people go, either there or credit cards.

ChairwomanVELÁZQUEZ. Thank you. Ms. Edgcomb. And this will be my last question before I turn to Mr. Chabot on this round.

We really value your 20 years of experience in this FIELD, and the studies that you have conducted on the microloan programs' success. I would like to ask you, do the administration's proposal for this program jeopardize the successful structure of the programming review? How exactly?

Ms.EDGCOMB. I think they do jeopardize the structure of the program. The thing that is important to recognize about the technical assistance provided within the Microloan Program is that it is different than general business development technical assistance. That is provided to other entrepreneurs. We distinguish between two types of technical assistance that programs offer. Within a lending process, the kind of technical assistance that is offered is intimately tied from the start of that loan to the end of the loan.

At the up front stage, there is a very close assessment of the business, and an education of the borrowers with respect to the financial underpinnings of the business and how credit can be effectively used to grow that business and how credit can be effectively managed.

The program is also proactive during the course of the loan. So whenever a problem may arise around repayment, the program can intervene and provide support on operational and other issues. If you take that relationship and break it apart, another resource provider, no matter how good in many technical ways, will not be as intimately engaged with that borrower and cannot support that borrower effectively in the same way.

ChairwomanVELÁZQUEZ. Ms. Edgcomb, I know that you have been doing annual tracking on the set of microlenders regarding the default rate. And in your testimony, you say that the SBA Microloan Program experienced a default rate of less than 1 percent in fiscal year 2006. You stand by that data?

Ms.EDGCOMB. Yeah. I do stand by that. I think Ms. Tasker is correct that that is what the program's default rate—the Microloan Program's default rate is to the SBA. When we look at overall loan loss rates and we track between 50 and 60 programs annually, we find that the median and average loan loss rate is around 7 percent and leading programs are at 3 percent and under. So there may be some that are higher than that. But overall, we find that those are where the rates are.

Chairwoman VELÁZQUEZ. Thank you. Mr. Chabot.

Mr. CHABOT. Thank you, Madam Chair. Let me begin with you, Ms. Tasker, if I can. I have to say our chairwoman, it is hard to believe she wasn't a trial attorney because she is one of the most effective cross-examiners that I have ever seen. I would hate to have come up against her in the 15 years that I practiced law in a courtroom.

Chairwoman VELÁZQUEZ. I have to tell you that my father was so disappointed when I said to him that I will not go to law school when I was accepted, by the way, in New York. So I decided to get into the business of politics.

Mr. CHABOT. I am going to check you out and make sure you weren't a trial lawyer because you are much more effective than most lawyers that I have seen in the courtrooms. Ms. Tasker, I thought it would be fair to give you the opportunity if there were any comments you might have relative to any of the questions you were asked that you perhaps didn't have time to maybe give an answer if there was anything there you would like to say.

Ms. TASKER. Thank you very much. I would very much like to reiterate that we are not trying to eliminate technical assistance. I have heard what the other witnesses have said about you know the various other forms of technical assistance that is available, and certainly that is something that we think is important to understand. We really would like to have better you know accountability and transparency around what technical assistance is provided, both through our larger network of technical assistance providers as well as on the microloan microintermediaries.

We do understand that some of the technical assistance grants that are provided are used for overhead costs and things of that nature. So we would welcome the opportunity to work with you to get more accountability and understanding about what kind of technical assistance is being provided and how it is being provided, so we all understand you know that the microborrower itself is benefiting from that.

Mr. CHABOT. Thank you. Mr. Betancourt, Mr. Hall and Dr. Servon, let me ask all of you this question if I could.

Relative to the technical assistance that we have referred to this morning, could you give us some real-world kind of examples of what kind of assistance that we are talking about here and how it would help those small businesses that are going to benefit from the Microloan Program that we are addressing here this morning? Maybe we will start with you, Mr. Betancourt.

Mr. BETANCOURT. Yes. If I can address just for a moment my colleague here, Ms. Tasker, in terms of technical assistance that she believes could be provided somewhere else and then I will come home to your question if I could just for a moment. The profile by the SBDC, the clients that they work with by their own admissions to this committee, I have been at these committees before—they really don't work with the profile of clients that we work with. And from their own research they will tell you, they do not work with these very low monetary individuals and the percentages bear that out. And so to say that they are going to be able to take care of our clients by their own research, that doesn't even bear that out.

The kind of assistance that we do, and I think Elaine Edgcomb said it very well—the kind of technical assistance has to do with the core competency of lending. And when you have a training or technical assistance organization try to provide technical assistance to my client, it is very general, it is very good but it doesn't deal with the core competency of lending. In other words, the due diligence that we have to do to get them through the sophistication that has been talked about here by both the research folks here that deals with zoning, deals with helping them start the business, file a name.

That is very specific to lending and also the credit repair piece that we have to do. That is specific to lending, expertise in the lending field that generalists really may not understand those nuances. In Mr. Hall's case, yes, he may have worked with another organization with the business plan. We reviewed that, critiqued that specifically to lending. So what I would say is that there are other folks that provide technical assistance and do a fantastic job. A, their profile is not the same and B, it is not specifically to lending.

One final point is—and this is experience that we have had in Pennsylvania, the economic development department actually had a program that the TA organization would provide TA for our loan clients. And what we found is, there was not an incentive for them to make sure that we got paid on our loans. It just—it just isn't. They can go out and meet with them. But to get that dollar back to us, we had the incentive to get it back because it was obviously lent to us. So our particular experience it did not work out in Pennsylvania for us. The program went away, and we went back to us providing technical assistance to our borrowers.

Mr.CHABOT. Thank you. Mr. Hall, did you want to talk about the a technical aspects, how it benefited your business detect directly or what the details were?

Mr.HALL. Yes. Thank you. If it had not been for Community First Fund, I would not have been able to open a barber school. They helped me to furnish the entire place. Not only did they help me, but I look at the future. They created jobs for other people through the help of me. As I indicated in my testimony, 13 other businesses that have opened through my school and I get calls all the time for students. So as far as jobs go, it created many jobs in our community and outside of Lancaster County in terms of providing employment for the students.

Mr.CHABOT. Thank you. Dr. Servon?

Ms.SERVON. I think one of the important things to think about is to sort of set the context for this discussion of what the training offers, is that over the past, say, 15 years, the financial services environment has gotten incredibly complex, right? So particularly in the low-income neighborhoods that these programs target, you have on the one hand, mergers and consolidations in the finance industry that are bringing banks the traditional mainstream financial institutions farther away from the borrowers.

Secondly, you have increasingly sort of technological technical decision processes for making loans, like the small business credit scoring system, that really eliminates the kind of relationship lending that these programs do. Third, you have a huge increase in the number of alternative or what I would call fringe financial assistance, fringe financial services providers like check cashiers and predatory lenders. So the people who are living in the neighborhoods that these microenterprise programs target are much more likely to walk outside their doors and see a check casher than to see a bank branch.

So given that environment, you often have people coming into these programs that have, as Elaine mentioned, poor or no credit history, little or no collateral, and perhaps a big credit card debt if they were able to get a credit card because they really don't understand the way to use different credit tools. So a program like the ones that we are talking about would traditionally start out with some basic financial education, depending on where the potential borrower entrepreneur is at, possibly some credit repair and some of these programs are actually offering credit builder loans that help a person get a credit score or get a better credit score. A $500 loan they pay back quickly and it gets them a score that can be used to leapfrog them into the mainstream financial services institutions.

That would be followed by a screening that weeds out people who might not be serious about starting a business or not be ready so that they don't take a lot of training resources away from other people. That is an important element that many of these programs already have in place. Then those that are screened would go into a multi-week course that would end up with them doing a business plan, a market analysis, presenting some cash flow statements that they could bring to a bank or a lender or get a loan at that particular lender.

Sometimes they offer sector-specific training. So there are programs that look at the needs in a particular neighborhood, like for example, WHEDCo in the South Bronx offers home-based child care training and a commercial kitchen because a lot of the entrepreneurs in that neighborhood either provide home-based childcare or food. So the actual hands-on business experience is combined with the sector specific kind of training. Often they provide specialized workshops in marketing in budgeting in other kinds of finance. And then importantly post-loan technical assistance so that once you graduate from that program and you get your loan, you learn more about what the next step is in terms of the kinds of credit you might need.

So for example, moving from a traditional term loan to a line of credit and understanding the differences and how to use those different forms of credit. I would agree with Mr. Betancourt that the SBDCs and the SCORE are not really equipped to deal with that range of technical assistance needs that entrepreneurs like Mr. Hall face.

Mr.CHABOT. Thank you. And Madam Chair, if I have time I would like to ask one question of Ms. Edgcomb, if I could. I believe in your testimony you said that 50 percent of the small companies that are started under these are women-owned companies. Is that correct?

Ms.EDGCOMB. At least 50 percent are clients of microenterprise programs, yes.

Mr.CHABOT. Could you discuss the dynamics that are at work there, and do you anticipate that that would be the case in the future, and if there is a pattern towards what type of businesses they might be, that sort of thing?RPTS DEANDCMN HERZFELD[11:04 a.m.]

Ms.EDGCOMB. We have consistently seen over the years that the majority of clients served by programs are women. We assume that that will continue to be so in the future. In fact, AEO has a standard that microenterprise programs should serve at least the number of women in their programs that are, you know, proportion of our population, but we have seen microenterprise programs serve many more women than that.

There are a variety, some programs totally dedicated to women, such as WEDCO, which Lisa just mentioned, some that serve both men and women, and there are more women creating businesses year after year.

Right now the microenterprise program served—I think what I had seen was there's about 33 percent of all businesses in the U.S. Are women-owned, and microenterprise programs serve more than 50 percent of women business owners, so you can see that they served many more women in their position in the economy.

Mr.CHABOT. Thank you very much. I yield back my time, Madam Chair.

ChairwomanVELÁZQUEZ. Mr. Ellsworth.

Mr.ELLSWORTH. Thank you, Madame Chair. I was thinking of what Mr. Chabot said about a trial attorney, and I was thinking of my former life as a detective. We would have solved a lot more crimes had you been on my detective squad. We are glad you are here, too.

Mr.CHABOT. If the gentleman would yield?

Mr.ELLSWORTH. I would.

Mr.CHABOT. She wouldn't have been on your squad, you would have been on her squad.

Mr.ELLSWORTH. I would have hated also to have to arrest her if that were to ever have happened.

My first questions are for Mr. Hall. Could you tell me the range in price of a haircut in your shops.

Mr.HALL. In the barber school there are budgeted haircuts, and it helps parents with multiple children. Five dollars, and we do over 1,000 people a month. In the barber shop if you make an appointment, it is $15; or as a walk-in, $10; if you have additional facial hairs it is $3.

Mr.ELLSWORTH. I heard a rumor that haircuts were approaching $400. I am glad that is not true. There is still hope for guys like me out there. I appreciate that.

What is the average barber when he graduates from the school salary in your area, a yearly salary?

Mr.HALL. I would estimate anywhere from 20- to 35,000 annually.

Mr.ELLSWORTH. What about health insurance; do they then provide it on their own or in the school? Your employees, do you have a health insurance program also?

Mr. HALL. No. Usually the individual barber would provide their individual health coverage.

Mr. ELLSWORTH. And could you have done what you have done starting with that bad haircut you got when you were a young man that I read about over here—I didn't just guess that—could you have done and been where you are today without this program?

Mr. HALL. No, no. I would say without Community First Fund, I wouldn't have been able to open the school. They gave me a chance when I couldn't get a loan because of my credit history, since then I was able to clean up my credit history, but I wouldn't have been able to do it without Community First Fund.

Mr. ELLSWORTH. Congratulations.

Mr. Betancourt, I am really excited that sometimes we don't think Federal programs work very well. This seems to be at least one. A lot of what I have seen in the small business since I have been here for 6 months, a lot of our programs seem to work pretty well, and I am proud of that.

With this program being successful, and the pay-back rate, and the training is really—can you tell through kind of a day in the life of the curriculum? You touched on it a little bit, but just go through the areas you would teach somebody from start to finish that brings that rate of pay back up.

Mr. BETANCOURT. What is interesting is that every intermediary is able to see what the needs are in their community. So if you ask this question to 170 organizations, you are going to get different responses. I know there is one organization in Milwaukee, they primarily work with women, and they have a whole series of things all the way through.

In our particular program we have an 8-week small business training program. If you can imagine—I went to business school, and I take for granted what the difference between a partnership is, and a sole proprietorship, and an S Corp. and C Corp. You know, our entrepreneurs don't even know the difference between that. We teach them bookkeeping. Now, granted this is 8 weeks, 3 nights, so it is a little fast-paced, but I want to distinguish that between the one-on-one technical assistance, which is really good.

This is the fantastic thing about the program. If someone is coming up short on a particular part that we are teaching in teaching the marketing—one of the things when he opened up his barber school, the first question was, what are other people doing, what is your price, what research have you done?

We force them to think about what other schools are doing, not, hey, just because you have a great idea, put your sign up, and people are going to come. Yes, maybe they'll see a need, like he talked the shoes, in this case a barber school, but we challenged them to do the market research.

So the basic of a business, the accounting side and marketing side, the management side and the structure side, those are the things they are getting. More importantly, the one on one, we tailor-make that one on one with each client. We actually have a technical assistance plan which varies with every entrepreneur.

Mr. ELLSWORTH. Thanks to all the witnesses. I yield back what little time is apparently left.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Shuler.

Mr.SHULER. Madame Chair, thank you so much for again your commitment to small business.

Ms. Tasker, we heard the testimony from Administrator Preston. He showed us a budget, and the only increase that we really saw, and I may be wrong about this, was increase in administratively here in Washington, increasing the number of employees here, but yet almost every single program—and we have got all these witnesses here, and I just met with a group in my own district before I came up about them working with the SBA and how important—they were looking at a small company, that they could grow it to get it out of small business, over 1,000 employees, possible in my district, but they need help and assistance.

North Carolina alone since 2004 went from 103 loans to 58, 103 to 58, and that is just 2004. What is it going to be—and that is microloans. What will it be in 2 years?

If we increase the percentage, if we go up 2 percent on our interest rate, what is the number of delinquents, defaults that we are going to have with these loans, and what will it push that number to? Are we looking to totally do away with—is this just a way for the administration to say, this is something we don't want, that we will just phase this out, because we will say nobody is using the program anymore?

We are certainly seeing every time the SBA comes to our—there is nothing I have seen in a positive manner there to do its real job, that is to increase the amount of assistance to, increase the programs, not to pull back. Every single time, every time I see the SBA is on the panel, I say to myself, I can't believe they have shown up again, because it has been so difficult.

Looking in my district, I want more entrepreneurs. Entrepreneurs must be a thing of the future because we got an invention entrepreneurship reality show on TV. It seems more people want to be self-sufficient, be their own boss; that we should be increasing the funding, and obviously part of that lies upon us, no doubt about it. But we have to have your vision and your direction. So feel free to elaborate as long as we have.

Ms.TASKER. Thank you.

A couple of broader things with what you said. Certainly we are here to support entrepreneurs, and that is what SBA is about. And I think we do a lot of really good work and good things, both whether it is the technical assistance that the entrepreneurial development does and promotes, and whether it is the loan programs that we generally do.

We have in the past—in the past budgets actually proposed eliminating the microloan program. The Administrator Preston came in and really spent a lot of time looking at it and really spent a lot of time trying to see that this program served a different need and a different group of potential entrepreneurs than our other programs do. We certainly agree with that.

He worked with us and worked with OMB to come up with a proposal that we felt leveraged the resources that we had, and to come up with a program that we would continue to meet the needs of the very beginning entrepreneurs, if we want to put it that way, in terms of who we understand the microloan program serves.

So it is not an attempt to reduce and eliminate the program. With that said, we have budget constraints that we have to live within and do believe that $100 million devoted towards technical assistance is a significant amount in our broader network.

We definitely want to work with you to come up with a legislation for the microloan program that works. Administrators are very, very committed to it and are very committed to using this as one of the tools we use to reach underserved markets. We do believe accountability around it is important so that we really understand what kind of assistance. We don't have good data about it, so understanding what kind of technical assistance is being provided and the effectiveness of it, we believe, is a key part of what we want to work with you to achieve as we go forward.

Mr.ELLSWORTH. Madame Chair, could I—

ChairwomanVELÁZQUEZ. Sure.

Mr.ELLSWORTH. If we increase the percent of loans and cut the assistance program, doesn't that seem we are only going to increase the number of delinquencies and increase the number of defaults on the loans if you don't have that technical assistance in the people that are there? You are raising the rate, plus you are taking away something that could actually help benefit—pay back these loans.

Ms.TASKER. As I said, I can't predict what is going to happen. We certainly are not going into this—

Mr.ELLSWORTH. But you are not predicting it. That has to be a part of the analysis to know if you are going to cut some program and increase a rate; that has to be part of the overall picture to realize that, hey, we are going to make two major changes that is going to impact the rate of which people pay their loans or pay off their loans or the number of defaults—I personally feel you take those away, increase the rate, you will increase the number of defaults and increase the number of delinquent payments.

Ms.TASKER. Again, we—that is not our intent in terms of the proposal that we made. The proposal that we made we felt we had service—I understand what the panel is saying, but the intent of our program, we are spending $100 million on our legislative proposal on technical assistance. So we acknowledge that is an important key part of it.

Again, I think really being able to link up and as we go forward understanding—you are saying it just makes sense, and I am not disagreeing. A lot of things make sense if you think about it, but we don't know to what degree the technical assistance is linked up other than just anecdotally. So we do believe if we are going to continue to use technical assistance as a key part of that, we have to have the transparency around what is used and the benefits associated with it so we can come to those firm conclusions based on empirical information as opposed to it makes sense to me when I say that.

Mr.ELLSWORTH. I suggest we reach out to other people who can put this analysis together before we make such—what I feel—a horrible mistake. I would reach out to people that actually know and can actually see some of the analysis that could be possibly done.

Thank you so much, Madam Chair. Thank you.

ChairwomanVELÁZQUEZ. Mr. Chabot.

Mr.CHABOT. I will be very brief, thank you, Madam Chair.

Somewhat in response to Mr. Shuler's comments, I agree with him in some respects, but I think one other point that should be made, I am inclined to agree with my colleagues that it is probably not a good idea to deemphasize the technical assistance within the programs that we have been discussing here this morning and go a different route. So I agree with my colleagues there for the most part.

I, however, relative to businesses on a more macro level, the business growth, et cetera, I would say the administration, the jobs that are created, businesses that have been started, the general welfare of the economy right now, the Small Business Association has a role to play in those jobs, but when one considers the health of the economy, that is much more significant in the creation of businesses than the SBA's role in it, when we are really fair about it. They are involved in some of them, but the overall health of the economy is much larger and more significant than businesses being created, et cetera.

I think this administration's tax policies, to the extent in cutting marginal rates, cutting capital gains rates, attempting to do away with the death tax and a whole range of things, has had a significant impact on the economy, has benefited the economy, and we have seen considerable growth. We see unemployment right now, whereas we would like to see it even lower, it is at historically lower levels of 4-1/2 percent; the stock market at or near all-time highs, although they have dropped, and they are heading back up, and who knows where they are going to be in the future. We would certainly like to see gas prices lower.

Things are far from perfect, however overall I think the economy, due to the administration's policy's, especially tax cuts, that is why we have to make them permanent, have been helpful in the economy. So I wouldn't want to leave that out there that they made errors relative to small business which have hurt business overall in the economy.

I am losing my voice. I yield back.

ChairwomanVELÁZQUEZ. Ms. Edgcomb or Dr. Servon, I would just like to ask you in terms of the population that we serve through microenterprise and microlending, how much effect the 1.3 trillion tax cuts have on that population. What is the benefit of the tax cut for the low-income 50 percent of women who participate?

Ms.EDGCOMB. I am not sure I am an expert on tax policy and the effect of the tax cuts, but I can say that regardless of the macroeconomic effects, we know that there are communities of disadvantage that remain in the United States, communities of disadvantage with respect to enterprise opportunity, particularly women, persons of color, low-income, people living in disadvantaged communities, both urban and rural. Those people exist. We also know there are a set of economic factors or trends in the U.S. That, again, regardless of the macroeconomic policies of the government, are trends that have been negatively affecting a number of people, and that includes people who have lost jobs because of outsourcing and trends and globalization, people who are heavily constrained to work multiple jobs because of low wage rates, people who live in communities where industry has left. There is a set of trends that we also have to keep in mind, and there are people hurt and left behind by those trends.

ChairwomanVELÁZQUEZ. Thank you.

Ms. Tasker, what we have seen here regarding the low percentage of default rate shows that both borrowers and lenders have been doing quite a good job at borrowing the money, providing the technical assistance so that this individual will not default, that they will pay back. And it has been stated here that the type of individuals who come to Mr. Betancourt to ask for money, to get access to capital are the type of individuals that do not have a credit history or any credit at all.

Since they repaid, my question to you is how can we, SBA, help these individuals go to the next level in terms of building up their credit history? I know, for example, that most of the intermediaries have only such a small volume of repayment records that it makes them ineligible to report for the major credit reporting agencies. So I want to ask you, what can you do to help these individuals to build up a credit history or a credit record?

Ms.TASKER. That is my understanding as well, that a lot of the micro intermediaries, because they don't have sufficient volume, can't report credit. One of the things we talked about doing and can certainly pursue further to see if it is feasible is group them together and have them report in groups so that we can get that information out, because it does—at the end of the day, it drives a lot of the long-term financing for—getting established as a business. We can certainly do that. And we would certainly be willing to work with you and the industry to see if there are other ways to help support getting that information out.

ChairwomanVELÁZQUEZ. Thank you.

Mr. Betancourt, can you tell us how much of the money you used for microloan costs, how much it costs you and how much it will cost under the administration proposals?

Mr.BETANCOURT. I think under this proposal, we wouldn't even be able to use it, quite frankly; we just wouldn't be able to borrow at those rates. And so in many respects we wouldn't be able to lend to gentlemen like—

ChairwomanVELÁZQUEZ. Let me say that if you use it, will the increased costs be passed through the borrowers?

Mr.BETANCOURT. Well, if we were to pass it along—we would have to pass it along if we were to borrow it, yes, say it that way.

ChairwomanVELÁZQUEZ. All right. Any other question from any of the Members.

Mr.ELLSWORTH. I have one more.

ChairwomanVELÁZQUEZ. Sure, Mr. Ellsworth.

Mr.ELLSWORTH. Ms. Tasker, the total budget of this program, $13 million, is that pretty close, pretty accurate.

Ms.TASKER. Yes, sir, 13-, 14 million, yes.

Mr.ELLSWORTH. And I agree with the Ranking Member that in tough financial times, back home they used to say I was tied like bark to a tree. I like to always call it thrifty or frugal, but that is the way they described it at home.

When I look at successful programs like this, and we were talking about Iraq earlier, and they say, where will you find the money and the offsets? When we lose skid loads of billions of dollars in Iraq, not just what we are doing in business, but when you lose cash in the billions, that is one way you can offset it. When 1.6 billion a year doesn't get paid in Federal taxes from companies that get Federal contracts, that could offset a lot of years of a program like this. I am not specifically—I am just talking in general. I can find that money in about a minute and a half of where we could supplement this and keep a successful program like this, and I just wanted to get that on the record.

ChairwomanVELÁZQUEZ. Mr. Betancourt.

Mr.BETANCOURT. If I could make one point, I noted we were talking about the technical assistance to borrowers, I wanted to talk about the technical assistance we provide to nonborrowers for a moment.

We are all familiar with the PRIME program, the unique program that provides technical assistance to nonborrowers. This program works with extremely low-income borrowers. One of the best things you can do for a borrower is to let them know maybe they shouldn't go with a business and maybe provide that technical assistance you were talking about earlier. In many respects that program—it is the same profile that we do, but it does all that upfront time that we are all concerned about that needs to happen before they can borrow from us. Unfortunately this program over the past couple of years has been reduced to just a few States. We all know 5-plus years ago it worked in all the States. We really want you to think about that program. In Pennsylvania and other States we have a hard time working with nonborrowers at this profile level. And so we want you to consider that, the PRIME program, maybe adding to all 50 States and maybe increasing that appropriation.

ChairwomanVELÁZQUEZ. Mr. Betancourt, the PRIME program statute was authorized as part of the Gramm-Leach-Bliley Act, and it is not codified in the Small Business Act even though it is operated by SBA. Do you see a value of moving the statutory authority for the PRIME program to the Small Business Act.

Mr.BETANCOURT. I would have to refer to my policy folks.

Mr.KELLY. Yeah, yeah.

ChairwomanVELÁZQUEZ. You can stand up, identify your name for the record, and can answer the question.

Mr.KELLY. My name is Kevin Kelly. I am with the Association For Enterprise Opportunity. I am the managing director for policy and advocacy.

And, yes, that has been one of our recommendations that we have forwarded in the past year to committee staff here asking that that could be done so that, in fact, it is in the proper place. SBA had been running that program, but you are right, it was authorized in a different place. So to put it where it belongs, it should be in there.

ChairwomanVELÁZQUEZ. Thank you very much.

Any other questions?

Hearing none, I want to thank all the witnesses. This has been an important hearing today, and I would just like to announce the fact that in the next few months we will be working on the reauthorization of these programs. I want to thank all the witnesses for their testimony today.

Members have 5 legislative days to submit statements or other material for the hearing record. And with that, the hearing is adjourned.

[Whereupon, at 11:34 a.m., the committee was adjourned.]

STATEMENT
of the
Honorable Nydia Velázquez, Chair
Committee on Small Business
Hearing on the SBA's Microloan Program.
June 14, 2006

I call this hearing to order. Today's hearing will focus on the reauthorization of the Small Business Administration's Microloan and PRIME programs that are very important to the smallest businesses.

One of our most basic rights is the freedom to pursue our dreams as far as our imagination and ability allows. According to a study by the Office of Advocacy, about 700,000 entrepreneurs realize their dreams each year and start up a new business. As a result, at least 20 million firms operating in this country are very small, with fewer than 5 employees. Over 50 percent are home-based. Helping these small businesses start and grow provides a significant benefit for our local economies.

There is a simple model called micro-credit that has grown and been copied worldwide and is designed to nurture budding entrepreneurs. Micro-credit programs combine loans, technical assistance and peer involvement. These have been remarkably successful in bringing opportunity to individuals that were never given a chance. Communities soon learned that these home-grown investments provide economic benefits and increased employment in return.

In 1992, Congress embraced the idea and started the Microloan program and shortly after that the PRIME program. The SBA Microloan program makes funds available to nonprofit, community-based lenders. In turn, these lenders make small loans to eligible borrowers—who are often fledgling entrepreneurs that live in the same community where they work.

These programs reach many that otherwise would not be served by the private sector or even the SBA's 7(a) program. For example, Microloan borrowers may be unable to get a traditional loan from those sources due to poor credit history or a lack of business experience. It has provided an important source of capital for low-income women business owners and minority borrowers. Finally, the loans tend to be geographically diverse – as roughly one-third of the Microloans are made in rural areas.

Over the years, over $328 million dollars was lent through this initiative. SBA has told us that there have been a total of two defaults by intermediaries in the program's history and that 98.6 percent of the business loans are repaid. A remarkable record.

The federal government has shown its faith in this simple, repeatable system by contributing millions of dollars in foreign aid to Microloan programs overseas. Even in Iraq, after the fall of Saddam Hussein, our Coalition Provisional Authority, appointed by the President, set up a $17 million dollar direct micro-loan fund specifically for Iraqi citizens that continues today.

So it is hard to understand why the administration is now recommending that we raise the fees intermediaries pay to borrow funds and eliminate specialized assistance that supports the program here at home. Administrator Preston stated recently that he expected the higher fees would *reduce* the usage of these loans. It is unclear why we would cripple a program where such a small investment generates economic activity and creates jobs simply by making loans to deserving individuals who otherwise would not get a chance. Our local businesses are no less deserving than those we fund overseas.

Given the success of this program, we should be building it up, using what we have learned to improve it and replicating it in as cost effective way as possible. It is important that we strengthen the Microloan program so that we can ensure that all would-be entrepreneurs have the opportunity to realize their dreams. We look forward to hearing our witnesses' opinions on the program, their suggestions for improvements and reaction to recent funding recommendations.

I now yield to Ranking Member Chabot for his opening statement.

Opening Statement

Hearing Name	Small Business Administration's Microloan and PRIME Programs
Committee	Full Committee
Date	6/14/2007

Opening Statement of Ranking Member Chabot

I would like to thank the Chairwoman for holding this important hearing on the Small Business Administration's microloan program. The program needs to be reauthorized and this is the first hearing to address this important subject in a number of years at the Committee.

According to Dr. Mohamed Yunus, the 2006 Nobel Laureate in Peace and founder of the Grameen Bank, "microcredit views each person as a potential entrepreneur and turn on the tiny economic engines of a rejected portion of society." Unlike Bangladesh or other countries that have emulated the Grameen Bank, microcredit in the United States is not aimed at a rejected portion of society but rather at those individuals who do not have access to commercial financial institutions and the technical resources to manage those funds. Despite the different target audiences, microlending in the United States represents a variation of the concept developed by Dr. Yunus.

Although there are no completely accurate statistics, there are approximately 550 organizations providing some type of microcredit in the United States. This hearing focuses on the approximately 170 lenders that operate as intermediaries under the Small Business Administration's microloan program.

The SBA does not provide microcredit directly to entrepreneurs. Instead, the SBA provides below-market rate loans to non-profit intermediaries. These institutions then make loans to entrepreneurs. As with other SBA financing programs, the SBA does not provide all the funds for financing. Intermediaries must contribute 15 percent of the value of loans in non-federal funds.

But the key to the success of microlending is not the loans; rather, it is the education and counseling that the intermediaries provide to their borrowers. With this knowledge, these entrepreneurs are able to manage their financial resources and ensure repayment of loans. This success is demonstrated by the very low number of defaults in the program. According to SBA statistics, 17 loans to borrowers defaulted between fiscal years 1992 and 2006. Another 38 were liquidated over the same time period. To put that in context, intermediaries make about 2,500 loans a year and there were about 7,700 loans to borrowers outstanding at the end of FY 2006. Thus, the default rate is negligible.

Despite its success, it is important to examine ways to improve the microloan program. Tight budgetary times call for efficient delivery of government programs no matter how valuable or useful they have been in the past. I am very interested in listening to the testimony of the witnesses to see what improvements can be made in the program to maintain its success while recognizing the need to spend the taxpayer's dollars in the most responsible manner.

Again, I thank the Chairwoman for holding this hearing and yield back.

Testimony of
Deputy Associate Administrator Janet Tasker
presented to the
House Committee on Small Business
Thursday, June 14, 2007

Chairwoman Velazquez, Ranking Member Chabot, and members of the Committee, thank you for inviting me to testify about SBA's Microloan program. I am Janet Tasker, Deputy Associate Administrator for Capital Access. The Office of Capital Access manages the business loan programs, the investment programs, the surety bond program, international trade programs, and the lender oversight function at SBA.

I am here today to discuss small business loans under $35,000, which provide a helpful level of capital to certain sectors in our economy, many of which are in underserved communities. While I understand that you wish to focus on SBA's Microloan program during today's hearing, I would also like to point out that our regular 7(a) program reaches many members of this community.

In FY 2006, we approved almost 43,000 loans under $35,000 in our 7(a) program, which accounted for 44 percent of all loans made in this program, our largest and most widespread loan program. We made more than 5,000 loans of $35,000 or less under our Community Express program, in which the SBA makes the loan guarantee and the lending organization provides the borrower with technical assistance. So, in total last year, we did close to 50,000 'microloan' activities, when you add in the approximately 2500 loans made through the Microloan program.

<u>SBA's Microloan Program</u>

In its current design, SBA's Microloan program combines the resources of the U.S. Small Business Administration with those of locally based nonprofit organizations, acting as intermediary lenders, to provide loan and technical assistance to small businesses. Under this program, SBA makes funds available to intermediaries which, in turn, make loans to eligible borrowers.

Currently, about 600 microenterprise development organizations are operating in the U.S., and 174 of those are SBA microloan intermediary lenders. In FY 2006, SBA made 39 loans to intermediaries totaling $17.8 million, a 29 percent increase over FY 2005 lending levels. Intermediary lenders, in turn, made 2,542 microloans totaling $32.8 million to small business borrowers.[1] Those loans helped small businesses retain 6,273 employees, and also created 3,941 new jobs. It is also worth noting that our 7(a) loan program helped small businesses create 206,608 new jobs and retain 583,562 during the last fiscal year.

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[1] These FY 2006 numbers include previously cancelled loan funds.

The maximum loan amount under the Microloan program is $35,000; however, the average loan amount is currently around $13,000. The maximum term allowed for a microloan is six years, though loan terms vary according to the size of the loan, the planned use of funds, the requirements of the intermediary lender, and the needs of the small business borrower.

Interest rates vary, depending upon the intermediary lender and costs to the intermediary from the U.S. Treasury. All interest rates on loans to the intermediary are based on the 5 year T-bill rate in effect at the time of closing. That "Base Rate" is fixed for the life of the loan to the intermediary. However, during the first year, SBA "buys down" the base rate by two percent. If the intermediary's total outstanding loan portfolio averages $7,500 or less, the two percent buy down remains in effect for a second year. If the average size of the intermediary's outstanding loan portfolio averages more than $7,500, the buy down is reduced to 1.25 percent and remains in effect for the second year.

Intermediaries' interest accrual rates are reviewed annually and are modified based on loan portfolio averages, as described above. This interest accrual rate is referred to as the intermediary's "cost of funds." If a microloan is made in an amount of $7,500 or less, the intermediary may charge the microborrower a significant markup of up to 8.5 percent over its cost of funds. If a microloan is made for more than $7,500, the intermediary may charge the microborrower up to 7.75 percent over its cost of funds. We believe this is one reason why many borrowers use our 7(a) products instead of the Microloan program.

Most intermediaries charge a much higher rate than their cost of funds, resulting in a significant spread with interest rates to borrowers of up to thirteen percent (based on the current T-bill rate of 4.98 percent). The average spread between the intermediaries' cost of funds and the rate at which they loan money to the borrower is 6.7 percent.

Focus on Underserved Markets

The Agency has a renewed focus on ensuring that its products and services are accessible to entrepreneurs in the nation's most underserved markets – those with higher rates of unemployment and poverty and lower rates of economic progress. Businesses in these target markets can be reached through non-bank microlenders. According to our FY 2006 data, almost 46 percent of microloans were made to woman-owned firms, 55 percent were made to racial or ethnic minorities, and 10 percent went to veteran-owned businesses.

We recognize that the Microloan program can be useful to those who are unable to obtain capital through traditional lenders. Many of those potential borrowers are in underserved markets. SBA therefore supports a continuation of the program, with some important changes, in our FY 2008 budget request.

The Microloan program as currently structured is costly to the taxpayer. In FY 2006, it cost 85 cents to the government for each dollar loaned to a Microloan intermediary, as compared to 3 cents for a 7(a) loan. In FY 2006, the total appropriation required to maintain the subsidy was $1.3 million, and $12.8 million was provided for administrative costs and technical assistance.

The Agency is proposing a zero subsidy Microloan program for FY 2008. By raising the very preferential rate at which intermediaries borrow from 3.77 percent (below the government's cost of funds) in FY 2008 to 5.99 percent (which covers the credit subsidy cost of the loans), the Agency can eliminate the credit subsidy cost of this program and greatly expand funding to microloan intermediaries. Intermediaries will continue to receive a better than market rate of interest on loans and SBA will be able to offer loans to any eligible intermediary.

The zero subsidy policy has enjoyed great success in our 7(a) program. In the last two years, since the policy was enacted, 7(a) loans and dollars approved have hit all time highs. We think the same would happen in the Microloan program with a zero-subsidy, and we would reach more intermediaries and more borrowers than ever before.

Technical Assistance for Microborrowers

One of the most important missions of the SBA is to help small businesses start, grow and compete by supporting quality training and counseling. Technical assistance for small businesses and entrepreneurs is an important tool, and as partners with SBA, intermediaries are required to provide business-based training and technical assistance to its microborrowers.

SBA currently supports the work of intermediaries by providing technical assistance grants intended to help ensure microborrowers' success. In FY 2006, SBA spent $11.7 million to provide 125 grants to 174 non profit intermediaries for training and counseling to microenterprises. In the same year, over $100 million was provided for technical assistance through SBA's network of training and development resources, including 388 locally organized SCORE chapters in almost 800 locations in the U.S., approximately 950 Small Business Development Center (SBDC) service centers, the Small Business Training Network (SBTN) and 96 Women's Business Centers (WBCs).

In order to leverage the skills of our technical resource partners, SBA is proposing that instead of separate Microloan Technical Assistance funding, SBDCs, SCORE and WBCs should train and counsel microborrowers. This has the potential of tripling the number of outlets providing training to micro-entrepreneurs for microenterprise training and will save almost $13 million in FY 2008. Further, of the 174 intermediaries we work with, the vast majority – 94 percent – are located within 20 miles of one of these existing resource partners.

Under the current Microloan Technical Assistance program, very little is known about how grant monies are used by intermediaries and what outcomes result from this investment. The current network of resource partners has established reporting requirements and processes that would better inform us as to the program's effectiveness so that we can ensure that microborrowers are receiving quality technical assistance which contributes to their success as small business owners.

Taxpayer Funded Microenterprise Assistance

Microenterprise funding assistance is available from 18 sources within the Federa government, including Agriculture (for rural enterprise development), Labor (offering self employment as an option for the unemployed) and Housing and Urban Development (focusing on low and moderate-income people). The latter is the source of the substantial Community Development Block Grant (CDBG) monies which are given to state and municipal governments for local distribution.

Program funding from most of these sources is divided into support for technical assistance and loan funds. A typical program will seek core funding from federal and/or state funds, local government agencies, foundations, banks and businesses. The largest percentage of funding typically comes from the Federal government, and often multiple Federal sources contribute to the same program.

We recognize the importance of microenterprise funding and the role it plays in helping entrepreneurs in underserved markets. However, we have concerns about the duplication of such funding across multiple agencies in the Federal government. We believe our microlending reform proposal in an important step in moving this funding to a more cost-effective approach.

In Conclusion

SBA's new management team, led by Administrator Steven Preston, is very focused on helping underserved markets. Although 94% of microborrowers are served by other SBA products, including 7(a) and Community Express, we understand the Microloan program may still be serving markets not reached by our other products. Therefore, we want to continue the program.

To sustain support for the program, to ensure no possibility for program interruption (e.g., during continuing resolutions), and to make most effective use of taxpayers' funds, we propose a zero subsidy for the program. Currently, intermediaries pay less than the 5-Year Treasury rate to SBA for their loans. We are proposing they pay just over 1 point more than that rate – still a very favorable rate for them. This would bring their interest rate to 5.99%. In comparison, note that on the average, the intermediaries charge 10.5% to borrowers.

With regard to Microloan technical assistance, SBA already supports a nationwide network of resource partners who provide counseling and training to entrepreneurs, including SBDCs, WBCs, and SCORE. Through the Microloan intermediaries and district office staff, SBA would direct microborrowers to these source of technical assistance. This will save taxpayers about $13 million from the Microloan technical assistance line item.

Chairwoman Velazquez, that concludes my testimony. I look forward to answering any questions you may have.

HOUSE COMMITTEE ON SMALL BUSINESS

Hearing on

SBA Microloan Program

June 14, 2007

Written Statement of
Daniel Betancourt, President & CEO
Community First Fund
Lancaster, Pennsylvania

Dear Chairwoman Velazquez, Ranking Member Chabot, and other members of the House Small Business Committee:

My name is Daniel Betancourt and I am President and CEO of the Community First Fund in Pennsylvania. Community First Fund's mission is to create lasting economic growth in the communities that we serve. I am also the Board Chairman of the Association for Enterprise Opportunity (AEO), the national leadership organization for microenterprise development organizations across the country.

I am pleased to be here today to discuss the SBA Microloan Program. As an SBA Microloan Intermediary since 1992, I know this program is of great assistance to the entrepreneurs within the 13 counties in central Pennsylvania that my organization serves. Entrepreneurs served by the Microloan Program are not served by the private sector, nor do they qualify to receive SBA guaranteed loans like 7(a) or Community Express. As a former banker, I know that traditional banks will simply not lend to these borrowers, with or without a SBA guarantee.

The Microloan Program is unique in that it provides both loan capital and funds for technical assistance and business training. The loan capital is offered at a lower than market rate, which allows my organization to make loans that are less costly and easier for our local entrepreneurs to pay back. This enables the businesses to grow more quickly and hire additional employees sooner.

Many of the entrepreneurs that we assist have had trouble accessing capital through commercial banks and also need substantial training and technical assistance to succeed in launching their businesses. The Microloan Program has enabled us to help these entrepreneurs, who have been very successful when given the assistance that they need. Without the assistance that we are able to provide for them, most of these small businesses would not be able to get off the ground or to succeed for very long.

From the perspective of a practitioner, the Microloan Program is a program that really works. In order to carry out our mission to assist entrepreneurs, we need to be able to access low-cost capital for our loan pool and to access funds to cover the costs of the training and technical assistance that we provide to the entrepreneurs. The Microloan Program provides funding for both components of our work.

The Microloan Program has been a very good use of federal dollars. It has a low default rate, since the combination of training and technical assistance with lending has insured that the entrepreneurs are well prepared prior to receiving their loan funds. We also work closely with the entrepreneur after the loan is made, so that any problems that arise can be dealt with before they become serious. This program would not work nearly as effectively if the technical assistance was not provided or if it was provided by someone else. The intimate knowledge of the business that we gain by providing both the loan capital and technical assistance is one of the key strengths of the program and should not be underestimated.

Edward "Champ" Hall is the owner of Champ's Barber Shop and Champ's Barber School is an example of a client that Community First Fund has assisted. Community First Fund provided Mr. Hall with three small business loans for inventory/supplies, small renovations, equipment, working capital and real estate purchase. Prior to obtaining the loans, a Community First Fund lender provided business counseling and reviewed Mr. Hall's business plan for soundness. Community First Fund also helped Mr. Hall in negotiating a lease and helped him to find additional funding through Lancaster city.

I want to comment on the President's proposal to eliminate all funding for Microloan lending capital and technical assistance, and to raise the interest rate on the funds borrowed by Microloan Intermediaries. While the President has not recommended terminating the Microloan Program for the first time in four years, the proposed elimination of all funding would make this program unworkable for Microloan Intermediaries and the entrepreneurs they serve.

The proposal to eliminate funding for loan capital would require the interest rate on Microloans be increased, which would make this program much less appealing to microenterprise development organizations. The value of the program is that it allows Microloan Intermediaries to keep interest rates down and provide their borrowers with affordable financing. By raising the interest rate for the Intermediaries, they will be forced to pass on this increased cost by raising interest rates paid by microentrepreneurs, which will create an economic hardship for them and make it more difficult for them to grow their businesses. This would lead to fewer jobs created and fewer tax dollars paid. This strategy is counter to the original reason that Congress created the Microloan Program.

The President also wants to eliminate the technical assistance portion of the program. As a practitioner, I know that this proposal will make this program unworkable. The reason that the Microloan Program has been very successful over the years has been this pairing of technical assistance funds with loan capital. This combination has led to a loan default rate of less than 1%, the lowest of any SBA lending program. Taking away the technical assistance dollars and asking SBDCs and other SBA technical resource partners to take on the technical assistance function will disrupt this winning formula and is likely to increase the default rate. This is a cost-effective program that has been very successful at creating and retaining jobs in communities throughout the country, while maintaining a very low default rate.

Over the last fifteen years Community First Fund has made a measurable impact in the region. Its service area has expanded from Lancaster County to a thirteen-county region in south central Pennsylvania which has a population in excess of 3.5 million people. Since its founding, Community First Fund has made over $11.5 million in loans. During its first ten years, Community First Fund made approximately $1 million in total loans; however, during the last fiscal year alone, Community First Fund made 126 loans totaling over $3.2 million dollars and brought Community First Funds total current loan portfolio to over $5.2 million. Also in the last fiscal year, (July 1, 2005 – June 30, 2006) Community First Fund provided services, including training and counseling, to more than 4,000 individuals.

This growth has led to the creation or retention of over 800 jobs in the past three years, and the development of 73 new affordable housing units. As a result of its new efforts in the area of commercial real estate loans, Community First Fund financed the development of over 34,000 square feet of commercial space, primarily in lower income urban neighborhoods. In the next four years, Community First Fund's strategic efforts will continue this growth and will create or sustain over 1,800 jobs, over 80 new affordable housing units and over 375,000 square feet of commercial real estate. Community First Fund anticipates the growth of its loan portfolio to $25 million by 2010.

I also want to mention that Community First Fund is a designated Women's Business Center. We use funds through this program to provide technical assistance and training to women entrepreneurs in our service area. The Pennsylvania Women's Business Center's (PWBC) Director of Training provides five different training courses in four different counties including an Introduction Business class and a six-week Core Four Business course. The Core Four course consists of: personal evaluation: business ownership preparedness; market and product analysis; financial projections and cash flow budgeting; business operations; and marketing and promotion. PWBC offers one-on-one counseling whereby a staff member meets individually with entrepreneurs to discuss business information, assess client needs, provide information and assistance and design on-going client "assignments" to support business development and aid in follow-up meetings.

One other federal program that assists microentrepreneurs is PRIME, the Program for Investment in Microentrepreneurs, which provides grants to microenterprise development organizations to provide training and technical assistance to microentrepreneurs that do not need a loan. PRIME was developed as a result of feedback from the microenterprise development field, which recognized that many entrepreneurs in their communities were not being served by other programs. Some entrepreneurs need help before they are ready to consider taking a loan and some have businesses with such small capital needs that they don't need a loan.

Unfortunately, PRIME has been cut back to only $2 million and it is restricted to only certain states. As Pennsylvania is not one of the eligible states, I am not able to serve a certain segment of the microentrepreneurs in my target area. I recommend that Congress restore sufficient funding to PRIME, so that it can become a national program once again and these entrepreneurs can receive the assistance they need.

Thank you for this opportunity to testify and I look forward to answering your questions.

TESTIMONY OF EDWARD "CHAMP" HALL
OWNER OF CHAMP'S BARBER SHOP AND CHAMP'S BARBER SCHOOL
BEFORE THE COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES
JUNE 14, 2007

Good morning Chairwoman Velazquez, Ranking Member Chabot, and other members of the Committee. I am pleased to be here to share with you my personal story on how the Small Business Administration's Microloan Program assisted me with my small business. I would like to acknowledge Dan Betancourt with Community First Fund for the business advice and working capital that I received because of the Microloan Program, and the Association for Enterprise Opportunity which is the national leadership organization for microenterprise in the United States.

My name is Edward Hall, and I am the owner of Champ's Barber Shop and Champ's Barber School in Lancaster, Pennsylvania. The business names are based on my nickname by which most people know me. Ever since I was born my father has called me Champ because he just knew I was going to be huge...physically. It turns out that I have the width, but not the height.

The Microloan Program played a key role in helping me to achieve the level of success I have had with my barber shop and my barber school. For as long as I can remember, I have always wanted to be a barber. In fact, I was one of the youngest barbers in Pennsylvania in the 1980s. I was a teenager in high school when I first got my barbers license. Since then, I have not only been a barber but also the owner of my own small business and, most recently, an owner and certified teacher at my barber school.

When I first contacted Community First Fund several years ago, I could not get a loan from a commercial bank because my credit history wasn't good due to some blemishes on my record that happened in the past. With some business advice and access to working capital, I knew that I could be the owner of a thriving small business. "Just give me a chance" is all that I asked of Community First Fund, and they did just that.

Before I received my first Microloan, Community First Fund provided business counseling and reviewed my business plan for soundness. The loan, along with a second loan I received, was used to fund the purchase of a building and renovate my barber shop which was in the building. If it weren't for the Microloan program, I would not have been able to get the working capital I needed to expand my business and make it a success. My barber shop has enough clients to provide full-time employment to five barbers, and I am looking to hire one more full-time barber.

After working as a barber for many years, I opened Champ's Barber School in 2003. For several years I wanted to open a school for barbers since there was none in the area. A lot of the guys were going to beauty school instead of a barber school. After getting my barbers teaching license, I received a third Microloan which I used to purchase equipment and make renovations to the space in which the barber school is located. In the whole state of Pennsylvania, there are only six barber schools, and my school is the first and only one in Lancaster City. The success of the school enabled me to pay off all of my loans by September 2005. Furthermore, my credit record was also cleaned up by this time which made it possible for me to get a long-term loan from the Lancaster City Government.

In addition to meeting the training needs of barbers in the local area, I am pleased that the barber school has made it possible for me to give back to my community. The school not only provides a place where I can share my knowledge and passion for being a barber, but it provides the youth and others in the community with skills they can use to get jobs as barbers. The classes last nine months and start at different times during the year. Each year there are about 20 people from all over the state, and even some from outside of Pennsylvania, who graduate. After passing the state test and receiving their barber licenses, students are then able to get jobs as barbers or open their own businesses.

None of the graduating students have had any problems with getting jobs. In fact, 11 of the students who I trained at my barber school have gone on to open their own barber shops in Pennsylvania. To this day, I get many calls from my former students and other barber shops which want to hire the graduating students. I also get contacted by others in the community who are starting their own barber shops and would like my advice. I am more than happy to share with them what I have learned from being a barber who is fortunate to have a barber shop and barber school which are doing well.

Since I received my first Microloan several years ago, I have learned how important the work of the Community First Fund is to aspiring and existing entrepreneurs in central Pennsylvania. Without the SBA Microloan Program and Microloan Intermediaries such as the Community First Fund, I would not be here today to share with you my personal story as a small business owner.

If the Microloan program does not receive the support and funding it deserves, many entrepreneurs throughout the country will find it difficult, if not impossible, to get the financing they need to fund their new or growing small businesses. Furthermore, the business assistance which accompanies the loans is a big help to entrepreneurs. Therefore, I respectfully request that the Committee show its support for small business in America by working to ensure that the SBA Microloan Program is provided with adequate funding.

Again, thank you for listening to my story on how the SBA Microloan Program helped me to achieve the small business success I have had with Champ's Barber Shop and Champ's Barber School. Just like I asked Community First Fund several years ago, I am asking you on behalf of the many aspiring and existing entrepreneurs who are just like me to "just give them a chance."

Thank you.

HOUSE COMMITTEE ON SMALL BUSINESS

Hearing on the SBA's Microloan Program

14 June 2007

Written Statement of:
Lisa J. Servon
Associate Professor
Milano the New School for Management and Urban Policy
New York, NY

Madam Chair Velazquez, Ranking Member Chabot, and other Members of the House Committee on Small Business, thank you for the invitation to speak to you today. My name is Lisa Servon, and I am a professor in the Urban Policy Program at Milano the New School for Management and Urban Policy. I have been researching and writing about microenterprise development in the US for 13 years. I authored a book called *Bootstrap Capital: Microenterprises and the American Poor,* and am currently working with the New York City Economic Development Corporation to come up with strategies to better support that city's smallest businesses. During the time that I have worked in this field I have interviewed hundreds of small business owners across the country as well as countless bankers, policy makers, and staff at microenterprise development programs. I am a scholar, not an advocate. My own research and analysis of the microenterprise development field leads me to conclude that the SBA should continue to support the Microloan and PRIME programs, and that these programs can be strengthened in important ways.

I will make three main points in my oral testimony: 1) that the US and developing world contexts for entrepreneurship are very different; 2) that microenterprise development organizations fill a critical niche in the financial services industry; and 3) that the SBA could do a better job of serving the smallest businesses. My written statement expands on these points.

Point #1. The US and developing world contexts for entrepreneurship are very different. Muhammed Yunus's Nobel Peace Prize for founding the Grameen Bank generated interest worldwide for the microenterprise strategy. However, the differences between the US and developing world contexts for entrepreneurs are critical and are often overlooked. First, entrepreneurs in the US need much more sophisticated financial literacy and business skills than do their developing world counterparts in order to deal with the complex legal and regulatory environment surrounding business ownership in the US. Business owners must file tax returns; they must often also complete licensing, certification, and inspection requirements. A child care or food-related business in the US must undergo inspections and meet licensing requirements that are unlikely to be required in the developing world.

As a result of these differences, US entrepreneurs require more advanced training to start, stabilize, and grow their businesses. The PRIME and Microloan programs are the only federal programs that support this training and counseling, which is why it is critical that they be maintained and funded.

Point #2. Microenterprise development organizations fill a critical niche in the financial services industry. Three trends characterize the current financial services environment: 1) mergers and consolidations among mainstream financial institutions, which take them farther away from neighborhoods; 2) increased reliance on formulaic lending decisions such as Small Business Credit Scoring; and 3) tremendous growth in fringe financial services that tend to prey on people who are not financially sophisticated.

It is important to note that SBA Microlenders are financial institutions. As such, they have demonstrated that it is possible to lend or invest money in markets that mainstream financial institutions perceive as risky. By working in these markets, microlenders show that if you lend or invest wisely, it is possible to provide a solid return to your investors and manage capital responsibly while connecting nonconforming customers to the economic mainstream. Microlenders' demonstration of the market potential of these customers is one reason for the explosive growth in predatory lenders.

The microlenders funded by the Microloan program are relationship lenders. Their niche is that they understand the needs and capacities of their clients, who often have no credit histories or a poor credit history, no collateral and live in neighborhoods where check cashers and payday lenders are far more prevalent than bank branches. Microenterprise programs use a different set of information than do banks—which tend to require two years of financial statements before considering a client for a loan. Microlenders look at alternative ways to evaluate risk – such as the borrower's history in paying rent and utility bills on time, completion of a business plan, their involvement in the community, and references from their pastor or former employers. As a loan officer at one Women's Initiative in San Francisco told me:

> Collateral is almost a joke. There's minimal collateral, somebody's TV. So in part we're banking on a relationship that's not strictly business but that gives us some sense of who this woman is. And if this woman has had all of these difficulties with her family and her children, but she's managed to hold it together, that's a character thing. Well, banks aren't asking about your character.

MDOs gear their financial products and training to the specific needs of these clients.

As mainstream financial institutions have merged and consolidated, the need for financial institutions that serve groups that have historically had little access to financial services has intensified. The functions that these community-based financial institutions must continue to serve include: 1) developing products that meet the needs of their constituents; 2) providing pre- and post-loan training and technical assistance to these entrepreneurs and would-be entrepreneurs to mitigate risk; and 3) originating and/or making loans to promising entrepreneurs who do not fit banks' profile, even under the SBA's other programs such as 7A. It is critical to understand that microlenders are mission driven while banks are profit-driven.

Point #3. The SBA could do a better job of serving the smallest businesses.
In my work, I have written about the idea of separating the training and lending functions of microenterprise development programs in order to make the field more efficient. The Microloan and PRIME programs essentially do this, with the Microloan program focusing more on credit-oriented programs and the PRIME program focusing more on training. However, the SBA could do a much better job of creating the appropriate incentive environment and rewarding programs that perform these functions best.

With respect to the Microloan Program, the SBA needs to revisit the assumptions it made back when the program was created in the early 1990s. The program has not kept pace with the dynamism in the environment in which lenders and microentrepreneurs operate, including:

changes in the economy; new learning about lending to underserved populations, changes in the financial services sector, and what it takes to make microenterprise organizations succeed in reaching the market. Do banks operate the same way today they did 15 years ago? The program needs to respond to the realities of the current market for alternative capital products and the role of microlenders in their communities. Specifically, the Microloan program should be revised in the following ways:

1. **Eliminate the current interest rate cap of 8 ¼ percent** and allow lending programs to implement risk-based pricing, charging different interest rates to different types of borrowers. The cost of funds is not a major factor for these borrowers given that their other options are high-interest credit cards, payday lenders or loan sharks. We know that in Harlem, *prestamistas* – loan sharks - are getting 780% on an annualized basis for loans. Microlenders should be allowed to charge what the market will bear as long as they do it in a socially responsible way. ACCION New York charges between 11.99 - 17.99 percent based on risk. Using these rates, ANY made 1,400 microloans last year; its current portfolio is valued at about $17 million. If we expect these organizations to be more sustainable and market-driven we need to provide them with flexibility. .
2. **Raise the minimum number of loans qualified programs must make annually**. The current minimum is four. The Association for Enterprise Opportunity's Microenterprise Standards and Accreditation Program maintains that microlenders should make 40 loans annually to achieve some reasonable level of efficiency and effectiveness. The four loan minimum may have been a good idea when the Microloan program was initiated because the field was new and the tools to evaluate risk were not well developed. Also, we know that for many organizations, the SBA Microloan program is a peripheral activity. The Microloan program should reward programs that have achieved some scale, rather than fund programs that see lending as only a peripheral activity.
3. **Change the funding formula by which technical assistance funding is determined**. The current funding formula ties technical assistance dollars to loan dollars, which does reward programs that make more loans. However, a higher loan floor (recommendation #2, above) accomplishes this more efficiently. The problem with tying TA dollars to loan dollars is that it fails to acknowledge the amount of assessment, screening and training that goes to people who are not ready to borrow. A program may have to work with 10

clients to find one who is ready to borrow; the screening and financial literacy work that occurs on the front end of programs is a valid and necessary use of funds. Also, the TA funds are used for risk-mitigation by providing borrowers with individual counseling, specialized workshops on record keeping and cash flow management and marketing, among other things. Tying TA to loan dollars also has the negative externality of incentivizing programs to "cream," targeting people who are relatively less needy. The SBA should see TA investment as an insurance policy to insure that loans go to the appropriate target population and are also used for post-loan support to reduce delinquency and defaults. As it stands, the TA funding formula fails to take into account the true costs involved in developing the pipeline for making and servicing loans

4. **Provide support to build the capacity of microlenders**. The SBA program has a rarely used provision to fund training for loan fund managers and other staff. Several years ago, SBA contracted with the Association for Enterprise Opportunity (AEO) to conduct a three day conference in best practices in microlending. My colleague, Jason Friedman, who previously directed AEO's training and education division and managed that conference, said that participant evaluations indicated that it was one of the best learning opportunities to improve skills and learn best practices. SBA should continue to invest in the field by supporting peer training and capacity-building efforts.

With respect to the PRIME program, I have already discussed the rationale for training. The PRIME program provides critical funding to MDOs to provide needed training and technical assistance and to engage in capacity building activities. This program should be maintained and supported. I also recommend that the SBA:

1. Work with field experts to create standards for PRIME recipients. Specifically, programs that receive PRIME funds should be:
    a. Comply with the standards approved by the Association for Enterprise Opportunity;
    b. Sreened, with a program in place to ensure that the lion's share of training dollars go to those entrepreneurs most likely to start businesses; and

c. Awarded on a performance basis in order to ensure that programs receiving PRIME awards produce stable businesses and "graduate" clients to banks and other lending institutions.

2. Work with field experts to collect data on PRIME recipients to track program outcomes, results and performance. For example, the SBA could require PRIME recipients to participate in MicroTest, a data collection effort initiated by the Aspen Institute, if additional funds are provided to support the costs of data collection.

Thank you very much for the opportunity to testify.

HOUSE COMMITTEE ON SMALL BUSINESS

Hearing on

SBA Microloan Program

June 14, 2007

Written Statement of
Elaine L. Edgcomb, Director, FIELD
The Aspen Institute
Washington, D.C.

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.