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MICRO LENDING ACTION PLAN FOR CALIFORNIA

Prepared by the California Assoc. for Micro-Enterprise Opportunity
(CAMEO)

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PREFACE

Micro-Enterprise Development in California has not realized its potential. Last year, less than one in a thousand entrepreneurs were served by our system of nonprofit Micro-Enterprise Development Organizations (MDOs). This Action Plan proposes a major revitalization that includes substantial funding outside the current traditional funding streams of government and banks. It sets forth a plan that will attract new infusions of funding from corporations that have a stake in the growth of small enterprises, foundations that are exploring domestic Micro-Enterprise, high net worth individuals whose wealth accrued through entrepreneurship, and previously unexplored government, pension and insurance funds.

At a minimum, this Plan intends to increase the outreach and effectiveness of California Micro-Enterprise Development Organizations by five- fold within five years.

RATIONALE

Micro-Enterprise in the US has been compared unfavorably to Micro Finance in Bangladesh and developing countries because of its small scale and high costs. However, comparisons are inappropriate because of the vast differences in cultures and governmental structures. For example, in Bangladesh, the home of the Grameen Bank, the entire structure is operated by an NGO, which is sustained by the high interest rates charged, because no other capital structure exists. In developing countries, NGOs' microfinance programs charge between 30 and 100% interest rates, while in the US nonprofit MDOs charge between 7 and 18%.

In the US, the Micro-Enterprise movement evolved out of the anti poverty program culture in the late 1980s, as an alternative to job training and social welfare modalities. As a result, it has largely been funded by a patchwork of government grants through the SBA, HUD, USDA, OCS and CDFI. Yet Micro-Enterprise has never fully integrated into larger economic development and investment policies - it has been essentially an outlier, more than poverty alleviation, but too small and too difficult to measure in terms of long term economic impacts.

However, current trends in small business development are placing Micro-Enterprise front and center in the future US economy.

Self employment is the labor market trend: in CA, jobs in self employment grew by 24% between 2000 and 2005. Federal tax revenues from sole proprietors grew by 34 %.(¹) The Intuit Institute for the Future in its "Future of Small Business Report "(Feb. '08) describes how the economic transformation in the US economy is being driven by small business - as a result of changing demographics, evolving, low cost technology, and the emergence of a new "artisan economy" creating highly customized, niche-based products and services. Who are these entrepreneurs: they are women, immigrants, over 50s, locally owned retailers, home-based freelancers. They are 88% of all businesses in the US, creating 50% of all private sector jobs. Furthermore, dollars spent on and by these locally owned businesses have been shown to multiply three times more in the local economy than large multi-nationals and big box retailers. (M. Shuman, The Small-Mart Revolution, 2007). Micro business is a significant part of the US economy, so why don't we invest in it?

Micro-Enterprise Development has proven effective in poverty alleviation and in the creation of wealth and jobs in lower income communities.(²) It is the path that an increasing number of Americans are choosing to support their families, to fulfill their creative potential or to achieve a work/life balance. By taking a broader view of Micro-Enterprise Development, beyond poverty alleviation, to a strategy of economic integration, the rationale emerges to expand the tools that support success, reduce barriers to entry and achieve successful outcomes. It is generally accepted that 50-80% of small businesses fail due to poor management skills and lack of capital. Micro-Enterprise Development, with its business assistance and micro loans, has been shown to turn these numbers upside down - with 80% of client businesses surviving past the 3-5 years after start up.(³)

Unlike the international micro finance model, which has provided little evidence of long term economic self sufficiency, the US model of business assistance coupled with micro loans does work to bring new entrepreneurs into the economic mainstream through access to markets, access to financial institutions and access to asset building resources.(⁴)

Current Situation in CA: A huge opportunity to stimulate entrepreneurship

Today, the Aspen Institute reports an estimated 2 million low and moderate income entrepreneurs in California, yet less than 20,000 were served by CAMEO's 68 nonprofit member Micro-Enterprise Development Organizations (MDOs) in 2007. There are 28 nonprofit micro lenders in CA. Over the past two years they made 1900 loans, totaling \$17 million. The average loan size was \$8900.

Outside the nonprofit sector, just two banks in CA. focus on making small loans through the SBA guaranteed Community Express program. These banks generate 150 loans per month at amounts under \$10,000. Because the SBA has a cap on the lending volume, these banks can only serve 30% of the demand.

¹ Micro-Enterprises Give California's Economy a Boost, Ca. Senate Office of Research, July 2008

² Closing the Wealth Gap through Self-employment, Jagger & DeRenzy, July 2008. www.womensinitiative.org/; Aspen Institute FIELD Study: Opening Opportunities, Building Ownership: Fulfilling the Promise of ME in the US

³ Based on long term feedback from CAMEO members; studies on impact of business incubation by the National Business Incubation Assoc.; Aspen's FIELD studies

⁴ vid. Aspen Institute FIELD study, www.fieldus.org/fastfacts.

These banks pay a referral fee of \$150 to a technical assistance provider. This fee represents about 25% of the actual costs of providing technical assistance, i.e., consulting, loan packaging, to a client.

Therefore, an estimated 3300 micro loans were made by the combined nonprofit lenders and Community Express banks - .165% of the projected 2 million entrepreneurs whose businesses could benefit from technical assistance and small amounts of capital.

Because the scale of micro lending is so small, with the exception of a few banks, corporate America does not participate, the foundation world does not participate in a meaningful way, and wealthy individuals and entrepreneurs don't participate.

Recent data on small business points to the fact that self employment is the labor market trend, accounting for almost 50% of private sector jobs (Intuit Institute for the Future, Feb. 08). While 88% of businesses in CA are micro - have 5 or less employees-- almost no Dept. Of Labor Workforce Investment Board funding in CA supports self employment . There is currently no State tax funding for Micro-Enterprise Development. The estimated amount of Federal grants and loans for Micro-Enterprise Development in CA. is \$17 million. (See Attachment 1)

According to Forbes magazine there are more billionaires living in CA. than in any country in the world. Many of them succeeded as entrepreneurs. Yet, despite our state's high income taxes, they are still committed to living in CA, and might be likely to take an interest in expanding entrepreneurial training and micro lending, if approached with a clear strategy.

The gap between the numbers of micro business owners currently served by the nonprofit sector and the estimated 2 million, who could benefit, represents a tremendous opportunity for our State to stimulate sustainable entrepreneurship with the new businesses, jobs, revenues and local community building that will result.

A New Vision for Micro-Enterprise in California...

CAMEO proposes a new vision for Micro-Enterprise in California. Our vision is one in which government, corporations, foundations and private individuals will join with CAMEO and our members to support the distinctly American form of Micro-Enterprise that will reach those 2 million entrepreneurs in our state to help them grow and prosper.

To begin, we need to increase by five fold, to \$50 million, the amount of capital available for micro loans, defined as under \$25,000. This amount would fund an additional estimated 5,500 clients with an average loan size of \$8700. And, to enable these micro business owners to access this capital, we need to create a pool of \$15 million in grants to Micro-Enterprise Development Organizations. This \$15 million can be viewed as initial seed money that would allow California MDOs to ramp up operations to serve five times more clients per year. (This assumes an organization with existing infrastructure and proven track record in pre-qualifying and financing low and moderate income micro-entrepreneurs.) With the additional capital and larger loan portfolio, the MDO would be able to generate revenues to cover their underwriting and loan servicing and a portion of the technical assistance costs.

Granted, this is still a drop in the bucket. However, a build- up of this scale would generate more public awareness and more interest from new players e.g. investors, grant makers and providers. Additional support and new distribution mechanisms would follow the funding.

Background on CAMEO

CAMEO's mission is to promote economic opportunity and community well being through Micro-Enterprise development. CAMEO operates a statewide network of 130 members, 68 of whom are nonprofit groups providing business training, technical assistance and financing to micro and small businesses throughout the diverse regions of California. The Aspen Institute has estimated a potential pool of 2 million low and moderate income entrepreneurs in CA who could benefit from Micro-Enterprise development. In 2007, CAMEO's nonprofit members served an estimated 18,000 clients, less than 1% of this need. Over the past two years, 28 nonprofit lenders made micro loans to 1900 clients, with estimated total loan value of \$17 million. The average loan size was \$8900.

In order to move forward to close this gap, CAMEO's convened the state's first Micro Lending Summit on Nov. 8, 2007. Twenty-two micro lenders from urban and rural regions attended this one- day event, hosted by the Federal Reserve, SF. Subsequently, a Working Group met to recommend actions that are summarized in this report. Recommendations addressed two primary themes: how to increase the pool of available capital and how to create partnerships between organizations in order to reach new markets of entrepreneurs and achieve greater efficiencies of scale.

Following is a description of the opportunities for developing the entrepreneurial potential of local communities, as well as specific challenges faced by CAMEO's members as they attempt to expand:

Opportunities and Challenges

A. Opportunity: California has some of the most talented, innovative micro lending organizations in the nation.

1. California has twice the number of micro lenders as any other state and some of the best known, well run, nonprofit micro loan funds are in this state.
2. California's 30 micro lenders are fairly well distributed throughout the state's 53 Counties. Their clients are not yet bankable, due to start up status, lack of collateral, lack of credit history or lower credit scores.
3. The large majority of CAMEO members who do micro lending have been operating for more than 10 years; There exists, therefore, a strong infrastructure of experienced and reputable nonprofit lenders who have proved themselves ready to increase the scale of their services both locally and regionally.
4. Partnerships are beginning to form between larger, experienced nonprofit lenders and smaller or new entrants serving emerging markets in immigrant, rural or low income communities. Banks are starting to support such partnerships as a way to reduce the risk for their CRA investments. Smaller organizations want to

reduce their underwriting and servicing costs and focus on providing business assistance and loan packaging; larger nonprofit lenders see partnerships as a business development model for increasing earned income.

A. Challenge: Shrinking Grant Funding:

International micro credit offers the promise of a self sustaining, profitable business model, primarily because of its high interest rates and low costs. California micro lenders cannot offer the same promise, because of the low interest rates they charge and their tradition of providing technical assistance, both pre and post loan, to ensure business success. Instead of "subsidizing" the micro loan through 30-100% interest rates, domestic micro lenders rely on public and private grants to subsidize credit, operations and technical assistance.

1. Almost all government grant funding for micro lending and technical assistance has shrunk or stagnated (CDFI funds were increased, but only a small proportion goes to micro loans).
2. Bank grant funding is flat (unless mergers occur) and some cutbacks are occurring due to the mortgage crisis and lowered profits.
3. Foundation grant funding is flat (micro lending is no longer the "new idea")
4. Grants from individuals and family foundations are going to international micro credit.
5. The California housing foreclosure crisis will absorb some grants that might have otherwise gone to micro credit.

B. Opportunity: A growing number of capital providers want to provide capital to Micro Lending in the US.

1. The visibility and interest in international Microcredit is driving new interest in US Micro Lending.
2. California is a leader in both socially motivated investment, by wealthy individuals and institutions, and in entrepreneurial spirit - both of which Microcredit appeals to:
3. CRA motivated banks are interested in expanding investments in micro lending.
4. Some foundations are making PRIs and community foundations are exploring this type of investment.
5. More individual investors want to provide capital for Micro Finance (vid. Kiva.org, Prosper.com, and MicroPlace) and are potentially interested in domestic micro lending.
6. Current sources of microlending capital include: HUD, CDBG in both cities and in non-entitlement, rural regions; bank CRA grants and investments; CEDLI; State Loan Guarantee Trust Fund; State Treasurer's Office, Cal Cap, for loan loss reserves; CDFI funding; SBA Micro Loan Funds; USDA; some foundation Program Related Investments (PRIs).

B. Challenge: There are lots of capital providers who want to lend to micro loan funds, but some expect market rates of interest, thereby driving up MDO's interest rates for low income entrepreneurs. A case needs to be made for creating a hybrid investment/donation with a lower ROI in exchange for lower risk.

C. Opportunity: Advances in technology are providing opportunities for micro lenders to drive down costs to serve borrowers in underserved markets.

1. ACCION USA: online micro loan funding is available throughout the US and to entrepreneurs irrespective of any affiliation with an MDO.
2. Community Express lenders with online applications are funding 150 loans a month.
3. Larger lenders such as Valley Economic Development Corp. in the Los Angeles region and Valley Small Business Development in the Central Valley region are able to service loans for smaller MDOs in distant locations,
4. Micro Mentor is an online advising service currently matching 30 entrepreneurs a month with pre-qualified experts in specific fields and business sectors. Micro Mentor is seeking to ramp up its technology and go national in scope and thus could be an important source of low cost technical assistance.

C. Challenge: Grants to cover R&D, start up and operating costs are needed for the nonprofit sector to:

1. Adopt new software
2. Explore/establish strategic alliances and partnerships
3. Add program components that will build capacity and increase scale.

D. Opportunity: Banks are becoming less likely to lend to cash-based businesses and immigrants. Thus, these niches are open for others, including micro lenders. For example, Women's Initiative for Self Employment has been especially successful with its relationship- based model in making small loans to immigrant Latinas.

D. Challenge:

1. Banks will now handle loans under \$25,000, using credit scoring, which leave the more difficult, time- intensive loans for the nonprofit micro lenders.
2. Predatory, Payday Lenders offer quick and easy loans that erode assets and exacerbate poverty, especially among immigrant and non-English speakers.

* * * * *

Micro Lending Action Plan Recommendations

Following are CAMEO's recommendations to increase the outreach and effectiveness of California's Micro-Enterprise Development Organizations by five-fold within five years.

1. CAMEO micro lending members reported an immediate need for additional low-cost capital in order to serve their existing customer base and to grow their pipeline of new loan applicants.

Objective 1: Raise \$10 million in low cost capital in 2008-09 - to be used to increase loan pools, for lines of credit and for loan guarantees. CAMEO's role will be to create access to capital, not to manage funds. CAMEO will

provide marketing strategy, program coordination; report on impacts achieved. Capital raising efforts will focus on three areas:

- A flexible pool of capital for pre-approved groups at interest rates of 0-3%
- Guarantees for interested private investors and foundation PRIs, where concern is more about the risk issue than realizing a competitive rate of return.
- Identification of new sources of capital, beyond foundations and banking institutions
- Short term "bridge funding", e.g. a streamlined, pre-approved line of credit available to draw down until renewed government loan funding comes through.

Actions:

1. Develop marketing materials for use and cost of funds, etc. including profiles of qualified micro lenders, regions served.
 2. Create PR campaign to raise profile of micro lenders and their impacts.
 3. Identify prospect sources; make cultivation calls
 4. Convene Micro Lending Forum to market to potential partners, including institutional social investors, private foundations/individuals, religious groups, and banks
 5. Negotiate with Cal Cap to leverage private investment from socially responsible individuals and foundations.
 6. Approach pension funds (e.g. CalPers and CalSters) and insurance fund (COIN) to invest smaller amounts of equity and debt capital.
 7. Advocate with State BTH to direct State Loan Guarantees to micro loans made by the State Financial Development Corps.
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2. CAMEO micro lending members reported that an increase in capital would not be sufficient to reach significant numbers of additional entrepreneurs. To substantially increase loan volume, micro lending organizations will also need capacity-building grants.

Objective: Raise \$1 million in grants for operations and Technical Assistance (Year1). The following are potential sources for both operational and technical assistance funding that should be tapped:

- Promote support for Micro-Enterprise to Fortune 500 corporations that depend on the well-being of small entrepreneurs, e.g. AT&T, PG&E, Microsoft, etc.
- Convince foundations to invest in domestic Micro Lending by providing very low interest PRIs and commensurate grant funding for technical assistance.
- Promote involvement and support of Micro Finance among CA's high net worth individuals.

- Advocate for Rural Micro-Enterprise funding through the new Farm Bill. California's fair share could be between \$600-800,000.
- Channel government funds spent on workforce development (WIA) to self employment training and technical assistance.

Actions:

1. Target foundations, individuals and banks with specific interest in Micro-Enterprise based on regions, interest in Micro Finance in general, in minority entrepreneurship, in locally owned business development.
2. CAMEO convene a Funder's Forum to facilitate relationships between funders and CAMEO members
3. Create public relations campaign for California Micro Lending as part of CAMEO's current Branding Project.

3. CAMEO micro lending members are beginning to collaborate with other MDOs to reach new markets and increase scale and efficiency.

Objective: Facilitate collaborative partnerships between new/emerging MDOs and larger, experienced nonprofit lenders to expand lending to underserved groups.

Actions:

1. Develop standard assessment tool for banks, funders and potential partners to use to evaluate organizational capacity to manage collaborative relationship and lending requirements.
 2. Create marketing plan and materials to promote partner opportunities, especially in rural regions where there is often enough capital but not enough staffing or infrastructure to help entrepreneurs to become loan ready.
 3. CAMEO offer consulting services to MDOs to facilitate partnerships.
 4. Develop fee structure and funding mechanism to support facilitation efforts for initial two years. Banks currently involved or considering microcredit investments could create a special grant pool for this purpose. A facilitated partnership would reduce the bank's risk of making an investment with a new and inexperienced organization, while allowing its investment to fulfill CRA goals of reaching underserved markets.
 5. Provide training opportunities for rural Micro-Enterprise Lenders to improve operational capacity. Offer funding for scholarships to existing training offered by CARAT and other reputable providers.
 6. Hold annual Micro Lender Forums offering training on micro lending standards and practices with opportunities to network with potential partners.
 7. Evaluate outcomes in terms of partnerships started and sustained, new capital generated, new loans originated, new markets served.
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4. CAMEO believes that financial institutions and foundations, by themselves, will be insufficient to provide the financial support that micro lending organizations will require to achieve a five-fold increase in capacity. Micro lending organizations will need increased support from the public sector. CAMEO needs to develop an advocacy strategy that will make self employment and micro business development a core element of local economic development.

Objective: CAMEO will advocate at the local, state and federal level to obtain additional financial support from:

- a) CDFI Fund- to increase micro lending
- b) HUD-CDBG
- c) CA. Employment & Training Panel
- d) USDA
- e) Small Business Administration- Office of Women's Business Ownership; PRIME
- f) CA. Workforce Investment Board

Building CAMEO's Capacity to Implement Micro Lending Action Plan

It is part of CAMEO's purpose to build the capacity of MDOs so that they may scale up services to reach more entrepreneurs. CAMEO will develop strategies for cultivating the sources listed above. In order to do this, CAMEO will need to increase its budget (from \$500K to \$750K) to staff the following activities:

1. Cultivate foundations with assets in excess of \$250 million to make PRIs to qualified (as certified by CARAT) Micro Lenders
2. Reach high net worth persons through current networks and through community foundations who have expressed interest in Micro Finance and pitch them on investing in CA. Micro Lending, i.e., in their own "back yard".
3. Work in Washington DC with new administration to shape policy on self employment, micro business and entrepreneurship; organize visit with CAMEO members for 3/09.
4. Assist CAMEO members to scale up services by training staff, consulting on organizational development and by facilitating partnerships between TA providers and CDFIs to build capacity.

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Attachments:

1. Sources of Federal funding for Micro-Enterprise Development in CA.
2. List of CA Micro lenders and loans made 2006-07

Attachment 1:

Sources of Federal funding for Micro-Enterprise Development in CA

Federal funding for Micro Enterprise Development - 2007 estimated funding levels

SBA Microloan Program				2,900,000	for lending	
				1,300,000	for TA	
SBA Women's Business Centers				1,500,000	(\$125K x 12)	
CDFI Fund				1,050,000	For microloans only	
Community Dev. Block Grants				3,800,000		
Rural Business Opportunities Grants				300,000	(est. @ 10% of national total)	
Rural Business Enterprise Grants				4,000,000	(est. @ 10% national total)	
Rural Comm. Dev. Initiative				630,000	(est. @ 10% national total)	
OCS				\$600,000	(rough est.)	
JOLI grants				916,000		
TOTAL				16,996,000		

Attachment 2:

List of CA Micro-lenders and Loans Made (2006-07)

Organization			No. Loans		\$ Amount
SE Asian Refugee Center			5		\$54,000
PACE			3		\$6,000
Telacu Corp.			4		\$105,000
AEDC-Arcata Econ. Dev. Corp.			11		\$217,000
Daly City Econ. Dev. Office			10		\$87,000
Mabuhay Alliance			10		\$87,000
El Futuro Community Credit Union			12		\$100,000
Opening Doors			12		\$96,000
TMC Working Solutions			12		\$96,000
OBDC Small Business Finance			21		\$350,348
California Coastal Rural Dev.			16		\$407,000
Jewish Free Loan Women's Fund			26		\$260,000
Sierra Economic Development Corp.			30		\$375,000
Superior California Economic Dev.			35		\$304,500
VSBCD Fresno			45		\$724,493
Calif. Farm Link			50		\$435,000
California Capital			60		\$522,000
WEV			60		\$375,000
Santa Cruz Community Credit Union			75		\$652,500
Pacific Coast Regional Corp.			80		\$696,000
CHARO Corp			86		\$905,000
CFRC			100		\$875,000

VEDC			100		\$1,250,000
Nor-Cal			102		\$1,200,000
CDC Small Business Finance			175		\$2,500,000
Women's Initiative			200		\$475,000
ACCION San Diego			255		\$1,800,000
Opportunity Fund			288		\$1,626,881
TOTAL			1883		\$16,581,722

Distribution of Loans in Categories (2006-07)

Groups of Loans	Number of organizations in Group			
Under 12	9			
13 - 35	5			
36 - 50	2			
51 - 86	5			
87 - 199	4			
200 - 288	3			

Disrtibution of loans in Categories (2006-07)

