Association for Enterprise Opportunity

Testimony of

Connie Evans

On behalf of the Association for Enterprise Opportunity

to the

U.S. Senate

Committee on Small Business & Entrepreneurship

Re-Authorization of the SBA's Access to Capital Programs

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Thank you, Chairman Rubio, Ranking Member Cardin, and distinguished Members of the Committee, for the opportunity to share this testimony with you. My name is Connie Evans, and I serve as the President and CEO of the Association for Enterprise Opportunity.

The Association for Enterprise Opportunity (AEO) is the leading voice of innovation in microfinance and microbusiness in the United States. Since 1991, AEO and its member and partner organizations have helped millions of entrepreneurs contribute to economic growth while supporting themselves, their families and their communities.

Numbering more than 1,700, AEO's members and partners include a broad range of organizations that provide capital and services to assist underserved entrepreneurs in starting, stabilizing, and expanding their businesses. Together, we are working to change the way capital and services flow to underserved entrepreneurs so that they can create jobs and opportunities for all.

Beyond being the voice for financial inclusion through entrepreneurship, AEO is a fintech innovator that is responsible for creating myWay to Credit—the first bank referral marketplace for small business lending. myWay to Credit was developed with JP Morgan Chase, Woodforest National Bank, and the U.S. Treasury CDFI Fund. myWay to Credit gives options to small businesses that do not currently qualify for bank financing by connecting them to a vetted network of mission-based community lenders and small business mentors.

Today's hearing on capital access is critical as the Committee and this Congress consider broad improvements to the Small Business Administration. While our members leverage the differing authorities across the programs to meet entrepreneurs where they are, I am here today to focus on the SBA Microloan program created by Section 7(m) of the Small Business Act.

History of the Microloan Program

The Microloan Program was established by Congress in 1991 as a five-year pilot program and went into effect in 1992. The program was originally created to serve distinct populations that had historical barriers in accessing capital. The statute identified that the purpose was to "assist women, low-income, veteran…and minority entrepreneurs…possessing the capability to operate successful business concerns."[1]

The program was meant to offset "perceived disadvantages faced by very small businesses in gaining access to capital" by making funds available to nonprofit, community-based lenders who in turn make very small loans (up to $35,000) to eligible borrowers.[2]

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[1] 15 U.S.C. 636(m)(1)(A).

[2] CRS Report: Small Business Administration Microloan Program, pg. 2 (3/8/19); the loan amount was increased to $50,000 as part of the Small Business Jobs Act of 2010 (P.L. 111-240

The program also provides marketing, management, and technical assistance to microloan borrowers, who are often unable to access traditional bank loans due to poor credit, a lack of credit, or a lack of business experience. The program was made permanent in 1997.

AEO was involved in the early years of conceiving and launching the Microloan Program. We helped to draft and pass the legislation that created the original five-year pilot program. In fact, then Senator Bumpers (D-AR) visited the Women's Self-Employment Project (WSEP) in Chicago, which I founded as one of the first microlenders in the country. Together, we helped inform the creation of SBA Microloan Program. Later, AEO played a leading advocacy role that resulted in the increase of the micro loan limit from $35,000 to $50,000. We also worked with Congress and the SBA to strengthen the program by increasing the minimum number of loans required to be eligible for technical assistance grants. While that decision, at the time, was not necessarily popular with our membership, it is one of several instances where our commitment to accountability and the business owner came first.

The Microloan program is unique from other SBA lending programs. Most notably, the Microloan Program does not guarantee loans but instead provides direct loans. As such, the program includes specific eligibility standards and operating requirements for lenders and borrowers. Although these requirements are well documented by the Congressional Research Service, I will focus on a few today that illustrate how the program works and those that deserve your attention as you consider reauthorization and modernization.

Most importantly, our lenders cannot be new to the microlending space. For entry into the program, the applicant organization must have made and serviced loans for at least one year and have provided technical assistance for one year. This should inspire confidence that lenders know their local markets and, being mission-focused, will make sound program decisions.

In addition to ensuring that only qualified organizations can access the program, Congress also wanted to ensure that all areas of the country could benefit, noting in statute that:

> In approving microloan program applicants and providing funding to intermediaries under this subsection, the Administration shall select and provide funding to such intermediaries as will ensure appropriate availability of loans for small businesses in all industries located throughout each State, particularly those located in urban and in rural areas.[3]

Furthermore, Congress created the 1/55th rule, which dictates that during the first six months of each fiscal year, at least $800,000 or 1/55th of available loan funds (whichever is less) is required to be made available for loans to intermediaries in each U.S. state and territory including the District of Columbia, Puerto Rico, the Virgin Islands, American Samoa, and Guam.[4]

[3] 15 U.S.C. 636(m)(8).
[4] 15 U.S.C. 636(m)(7)(B)(i).

Congress also wanted to ensure that not all technical assistance (TA) dollars were spent before a loan was originated (pre-loan) and that funds remained to help businesses thrive after the loan was made. This was a function of the perceived riskiness of the program. With an intent to protect those funds, Congress created the "25/75 rule", which caps (at 25%) the amount of TA that can be provided to a business before a loan is actually made.[5]

The Microloan Program Today

Currently, there are 144 active microloan intermediaries serving 49 states, the District of Colombia and Puerto Rico.[6] In Fiscal Year 2018, the SBA made 58 loans to intermediaries totaling $37.7 million, with an average intermediary loan of $643,724.[7] Microloan intermediaries in turn provided 5,459 microloans totaling $76.8 million. The average size of a microloan through the program was just over $14,000.[8] In Fiscal Year 2019, the SBA was expected to support around $42 million in lending to intermediaries.[9] In addition, an appropriation of $31 million was allotted for technical assistance given to the borrower by the lender or by third-party contractors.

Since the program's inception, a total of $845 million in loans to small businesses has been made by intermediaries, which has helped create or retain about 246,000 jobs.[10] Minority- owned or controlled firms received 48.7% of the microloans issued and 38.9% of the number of the amount issued.[11] This is compared to about 9.9% of conventional small business loans that are issued to minorities, according to data from a study conducted by the Urban Institute.[12] Microloans have also been a significant source of capital for women entrepreneurs, who received about 47% of those issued in FY 2018.[13] This data highlights the importance of the Microloan Program to communities and market segments without traditional capital access.[14]

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[5] Congress changed the rule to 50/50 as part of the Consolidated Appropriations Act of 2018.
[6] 6 SBA, "Fiscal Year 2019 Congressional Budget Justification and FY2017 Annual Performance Report," p. 37, at https://www.sba.gov/sites/default/files/aboutsbaarticle/SBA_FY_19_508Final5_1.pdf. For a list of all Microloan intermediaries, regardless of lending volume, see SBA, Microloan Program: Partner Identification & Management System Participating Intermediary Microlenders Report, June 21, 2017, at https://www.sba.gov/sites/default/files/articles/microlenderrpt5_20170621.pdf
[7] CRS Report: Small Business Administration Microloan Program
[8] CRS Report: Small Business Administration Microloan Program
[9] SBA FY19 Congressional Budget Justification Report (2018).
[10] House Small Business Committee Subcommittee on Economic Growth, Tax, and Capital Access hearing memo, "Small but Mighty: A Review of the SBA Microloan Program" (3/7/19)
[11] SBA, "Nationwide Loan Report, October 1, 2017 through September 30, 2018," October 26, 2018. 1,020 of 5,459 Microloan borrowers (18.7%) did not report their race. These borrowers received $11.3 million in loans. Because the race of these borrowers is unknown, their borrowing was removed from the calculation of the proportional share percentage figures provided for minority-owned or -controlled firms.
[12] Kenneth Temkin, Brett Theodos, with Kerstin Gentsch, Competitive and Special Competitive Opportunity Gap Analysis of the 7(A) and 504 Programs (Washington: The Urban Institute, 2008), p. 13, at http://www.urban.org/UploadedPDF/411596_504_gap_analysis.pdf.
[13] CRS Report: Small Business Administration Microloan Program
[14] Appendix B tracks recent statistics of the program by state.

The story of Fatimah Ray brings these statistics to life. Fatimah is a client of one of our members, Access to Capital for Entrepreneurs (ACE). In March 2017, she began searching for funding to open a personal training business, but she was turned down from multiple lenders because she didn't meet all of their requirements. Growing frustrated, she Googled "business loans for minorities and women" and found a link to ACE's website. After attending a workshop at ACE's Women's Business Center on access to capital, she applied for a $50,000 loan. She was denied due to her credit. Her story didn't end there, however, because ACE arranged for her to have one-on-one consultation with a financial expert who advised her on how to improve her credit score. Fatimah eventually closed on a loan for $20,000 in August 2017, and one year after opening the doors of Edgy Girl Fitness Studio, she is ready to expand her business. Fatimah's success would not have been possible without both the funds and the technical assistance she found at ACE.

While sufficient capital and credit enable entrepreneurs to get their businesses off the ground, sometimes those with a vision and a passion lack the technical skills necessary to keep their doors open. Nurse practitioner Mary Williams saw a need in her community for an urgent and after-hours clinic in Clarksdale, Mississippi. Before she opened the Urgent and Primary Clinic of Clarksdale, patients could only seek care at the hospital emergency room on nights and weekends, which required high copays and long waits. While her business fulfilled a critical need in a poor, rural community, she had no outside financing and her billing system for insurance companies was not established. She sought assistance from AEO member, Communities Unlimited (CU), who helped her secure a $12,000 microloan and provided her with technical assistance from a CU management consultant to ensure that her business was properly credentialed with various insurance providers. The emergency loan and TA which Mary received helped her keep her doors open. Urgent and Primary Clinic of Clarksdale now employs 9 full time people and provides health care to 25 to 45 people a day who could not previously access care without waiting in the emergency room.

Modernizing & Improving the Microloan Program

The Microloan Program has been tremendously successful, and AEO is committed to working alongside Congress to ensure it continues to generate positive impact in communities across the country. In order for this impact to continue, Congress must modernize the program and align it with today's marketplace and the needs of diverse business owners. Additional funding and streamlined reporting requirements will help the SBA and its intermediaries better serve entrepreneurs and their communities. I call your attention to additional pressing needs, namely: elimination of both the 1/55th rule and the 50/50 rule; increased access to SBA data; and, increasing the aggregate loan limit for intermediaries after their first year of participation from $6 million to $7 million.

Eliminate the 1/55th Rule

The 1/55th rule has long been a concern for AEO and the SBA as it distorts the lending market in an effort to ensure each state has access to resources needed for lenders, regardless of the size of the state or the needs of the small business community. The reality, however, is that it simply becomes a burden on states like Florida and Maryland who face unnecessary delays in loans made to entrepreneurs. Changing this rule can be done while still making sure states have access to needed resources based on historical need.[15]

Eliminate 50/50 TA Restrictions

Another operating requirement for lenders is the 50/50 technical assistance (TA) rule. When the Microloan program first launched, it required that 25% of the technical assistance given to the entrepreneur by the lender be provided pre-loan and 75% post-loan. In 2018, Congress changed these percentages from 25/75 to 50/50 in the Consolidated Appropriations Act of 2018.[16] While this change was valued, the 50/50 rule is still a reporting burden on both lenders and the SBA which stymies intermediaries by dictating how much of their TA grant fund can be used during the pre-loan phase vs. borrower support.

The rule also ignores how microlenders help future borrowers become credit-ready with business training and counseling. This is an essential function to support non-bankable borrowers. The 50/50 rule should be re-considered in light of these challenges, as every business's needs are unique, and intermediaries are the most appropriate party to determine the best use of their grants to support the local market, as they work so closely with borrowers and potential borrowers day in and day out. Take the case of Mary Williams previously mentioned. Mary's story is unique in that she received the majority of her TA post-loan, yet many of CU's loans are made to micro-enterprises in persistently poor, rural communities, and thus CU must provide a significant amount of TA before making a loan in order to mitigate their risk. The current 50/50 rule for pre-and-post TA is very challenging to manage for CU, and many other microlenders, and it is not reflective of the needs of their clients.

Streamline Reporting Requirements and Make the Data Available

While intermediaries invest precious time and resources into burdensome reporting requirements, this data is unfortunately not made publicly available by the SBA, similar to data available for the 7(a) program. This data could provide valuable insights to supporters of the program on the borrowers who use the Microloan program, such as geographical location, loan amount, interest rate, and terms, to name a few. Currently, the only way to access this data is to file a Freedom of Information Act (FOIA) request, which is time consuming, burdensome, and the data often takes over 6 months to obtain.

Ensure Adequate Funding for Lending and TA & Related Programs

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[15] Appendix A notes states impacted by the 1/55th rule.

[16] P.L. 115-141

Robust funding is an important part of the Microloan program, a program that has a proven track record helping small businesses thrive, create jobs, and support communities. Only two-thirds of small businesses survive two years in business, and half of all businesses do not survive five years.[17] Small businesses who receive financing and technical assistance through the Microloan program have much higher rates of success. In the research publication, *The Power of One in Three: Creating Opportunities for All Americans to Bounce Back,* AEO found that the median annual revenue growth was 30 percentage points higher for micro businesses who received capital and technical assistance as compared to those businesses who received only capital.[18]

Increase Aggregate Loan Amount
The aggregate loan limit for intermediaries after their first year of participation in the Microloan Program is currently set at $6 million. The Consolidated Appropriations Act of 2018 made this increase from $5 million, but this cap is still too low for a number of microlenders who cannot meet their communities' needs with $6 million. AEO proposes the aggregate loan limit be increased to $7 million. These additional funds will allow microlenders in high-need areas, as well as those who are the sole microlenders in their state, such as the Economic and Community Development Institute in Ohio, to service a larger number of in-need entrepreneurs in their communities.

Role of Microloan in SBA Continuum

Today's hearing is a discussion of the broad capital access options at SBA. We are pleased this Committee is viewing the entirety of the system as a continuum and is considering modernizations and re-authorization comprehensively. We believe the Microloan Program is a critical underpinning of the broader capital access programs.

Many of our members are not only Microloan intermediaries, but also engage in other lending programs. The ability to offer a suite of SBA-related products furthers our goal to meet entrepreneurs where they are – and with the product that meets their needs. There's no question that all small businesses share some common characteristics, yet they have unique needs and the programs on the SBA Capital Access continuum helps to meet those diverse needs.

One program that our membership is keenly aware of is the Community Advantage pilot program in the 7(a) program. While others today are providing an in-depth overview of that program, AEO is committed to ensuring it remains a strong option for entrepreneurs who are unable to access bank credit. As this Committee considers SBA capital access legislation, we would urge

consideration of legislation that makes permanent this vital program. We commend Ranking Member Cardin for his leadership on legislation to make this change.

[17] United States Department of Labor, Bureau of Statistics, Business Employment Dynamics, available at https://www.bls.gov/bdm/entrepreneurship.htm.
[18] The Power of One in Three: Creating Opportunities for all Americans to Bounce Back, Association for Enterprise Opportunity, https://aeoworks.org/publications/One_in_Three.pdf

Conclusion

Many of the ideas we have put forth today are included in Senator Duckworth's recently introduced bill, the Microloan Program Enhancement Act of 2019. As a resident of Illinois, I want to thank you for your efforts on behalf of the hundreds of thousands of underserved entrepreneurs that benefit from this critical program and the modernizations called for in this bill, which will allow these entrepreneurs – and many more – to access much-needed capital.

AEO is grateful for this Committee's continued bipartisan support of this very essential program, and I appreciate the opportunity to testify today. I will be submitting additional success stories from across the country in the coming days. I look forward to answering any questions.

APPENDIX A – States Impacted by 1/55th Rule: Current (FY2019) and FY2018

Based on data provided by the SBA, AEO understands that the following states are impacted by the 1/55th Rule (i.e. loan delays).

In FY2019 (current year) the following states were delayed:

- MA
- NY
- PA
- MN
- NC
- MT
- ME

In FY18 the following states were delayed:

- NC
- VT
- MO
- MA
- NY
- MI
- CA
- NE
- PA
- GA
- ND

APPENDIX B – Microloan Production by State: FY2017 and FY2018

Microloan Production by State - FY2018

Row Labels	Sum of LOANAMT	Count of LOANSEQNMB
AL	468,092.69	22
AR	932,976.00	40
AZ	704,422.51	31
CA	5,817,642.44	254
CO	3,156,910.20	168
CT	1,069,750.00	54
DC	2,277,680.65	620
DE	260,000.00	7
FL	293,500.00	20
GA	946,126.42	46
IA	239,000.00	9
ID	78,769.00	14
IL	288,235.91	33
IN	2,639,366.66	97
KS	182,563.00	13
KY	1,653,256.74	144
MA	1,761,735.27	81
MD	153,650.00	16
ME	1,490,234.00	93
MI	1,810,506.03	73
MN	3,881,741.12	196
MO	1,746,652.64	392
MS	268,636.00	13
MT	512,248.40	15
NC	2,473,083.06	71
ND	285,291.49	10
NE	2,044,024.92	128
NH	380,000.00	9
NJ	2,805,931.17	150
NM	1,125,953.43	68
NY	11,117,749.03	1028
OH	1,894,786.24	257
OK	501,148.00	25
OR	2,511,390.60	226
PA	4,448,226.02	359
PR	235,521.30	10
SC	2,301,245.19	86
SD	199,500.00	14
TN	594,659.50	33
TX	2,900,263.19	157
UT	1,260,617.43	37
VA	3,152,948.70	124
VT	413,691.96	24
WA	984,223.80	59
WI	2,214,168.14	122
WY	265,351.60	9
Grand Total	**76,743,470.45**	**5457**

Microloan Production by State - FY2017

State and Intermediary	$ of Loans Closed	# of Loans Closed
AL	216,857.00	14
AR	1,254,056.41	54
AZ	1,053,849.11	33
CA	4,801,511.31	223
CO	2,236,011.60	126
CT	1,168,096.37	54
DC	726,227.12	124
DE	335,000.00	9
FL	1,097,840.77	67
GA	1,237,666.33	49
IA	368,500.00	10
ID	112,611.95	13
IL	779,183.22	152
IN	1,647,623.87	93
KS	500,225.87	33
KY	2,234,802.06	166
LA	93,763.68	9
MA	1,874,126.17	109
MD	1,845,834.13	196
ME	848,987.95	45
MI	1,845,466.07	81
MN	2,766,024.81	149
MO	1,892,398.31	376
MS	315,462.24	14
MT	84,852.50	7
NC	1,800,758.31	64
ND	237,165.87	8
NE	1,501,314.62	138
NH	121,048.90	7
NJ	3,615,416.66	202
NM	807,627.84	57
NV	29,000.00	2
NY	8,622,089.36	842
OH	1,516,023.63	223
OK	294,774.55	24
OR	1,085,345.60	150
PA	3,598,914.17	280
PR	482,223.69	23
RI	247,969.34	12
SC	1,262,159.03	50
SD	244,900.00	13
TN	738,427.44	34
TX	4,327,374.46	264
UT	842,152.00	27
VA	1,833,553.55	118
VT	652,615.24	45
WA	1,283,497.06	72
WI	1,998,809.08	106
WV	617,774.12	15
WY	209,871.73	10
Grand Total	**69,307,785.10**	**4,992**