

The Case for a Microloan Intermediary for South Carolina

The Role of Microenterprise in the Economy of South Carolina

- Microenterprise¹ is a critical sector of South Carolina's economy, accounting for 86% of total businesses and 17.3% of all employment in South Carolina. There are a total of 299,726 microenterprises in South Carolina, ranking 32nd in the United States, and these businesses provide employment for an estimated 393,921 South Carolinians. Despite the role of these very small businesses in the economy of the state, many microentrepreneurs face significant obstacles to establishing and operating a business. Many disadvantaged microentrepreneurs or those in distressed areas have difficulty accessing the commercial credit, training and technical assistance necessary to start and grow their businesses.
- However, the state faces challenges in creating a more entrepreneurial economy. On the 2007-2008 Assets and Opportunity Scorecard, published by the Corporation for Enterprise Development (CFED), South Carolina scored a "C" – ranking 36th in the nation in terms of business development outcomes. Specifically, the state ranked 41st in small business ownership; 39th in microenterprise ownership; 46th in women's business ownership; 45th in African-American business ownership, and 33rd in Hispanic business ownership.

The Role of State Government in Supporting Microenterprise Development

- State government support for microenterprise development makes sense for a number of reasons. Structural changes in the economy have made self-employment an option for many people. These economic changes include: deindustrialization and the associated loss of well-paying, secure industrial jobs and growth of low-paying service-sector jobs; stagnating wages and benefits; corporate downsizing and outsourcing; the need for working parents to balance work with care giving; the aging of the population, with more seniors seeking self-employment; growth in immigration; reforms in the safety net that require or support work; decline of rural economies; and the emergence of niche markets.
- Also, another key reason for state government intervention is to address the failure of the market to address the lack of access to capital for disadvantaged communities and entrepreneurs. Low-to moderate income and disadvantaged borrowers often have poor or non-existing credit histories and can't access commercial financing. The free market "fails" because the demand for credit among disadvantaged individuals remains untapped, thereby creating inefficiency in the market.

¹ Defined as businesses with five or fewer employees and with capital needs of \$50,000 or less.

- The overall success of the microlending field (high business survival rates as compared to the overall small business population as tracked by the U.S. SBA²) demonstrates that the extension of capital can, and does, assist in the start-up and stabilization of very small businesses.

Creation of a Statewide Microlending Intermediary

- To address this issue, state governments have supported the development of **State Microenterprise Intermediaries (SMIs)**. SMIs are non-profit financial institutions created to attract new capital at the federal, state or regional level and provide central underwriting, loan processing and servicing. They develop standardized data systems to collect and report aggregated data on client outcomes from the participating programs. As a result, the SMI can demonstrate the effectiveness of these programs in serving targeted populations and communities.
- A SMI in South Carolina could be structured as a community development financial institution (CDFI) to be eligible for federal CDFI funding, as well as funding from SBA, USDA and HUD and financial institutions. It would work with chambers of commerce, SBDCs, CDCs, the SCWBC, professional economic developers, community action agencies, Extension, banks and other organizations who work with small business to provide “build a pipeline” for microloans. With support from the SMI, these organizations would provide the essential business training for entrepreneurs, market and originate loans, and then provide post-loan counseling. The underwriting and servicing functions would be handled by the SMI. The SMIs are managed by professionals with expertise in microlending and entrepreneurial training and related supports.

The Practice of SMIs in Other States

- The SMIs in Nebraska and Oregon are relevant models to consider in South Carolina. In both cases, the state made a policy decision to acknowledge and support microenterprise development as part of its economic development strategy and felt it was more cost-effective and efficient to develop a non-profit entity that would be responsible for re-distributing state funds back out to local support organizations and leveraging federal and private funds. Also, the SMI can provide a “quality control” function for the state and other funders, by making renewal of program awards subject to meeting performance standards. To date, the loan loss rates of the programs funded by the intermediaries is 7%.

Nebraska

- The **Nebraska Microenterprise Partnership Fund (NMPF)** is a statewide financial intermediary dedicated to supporting microenterprise practitioners. NMPF raises funds from various national- and state level sources and then awards grants, loans,

² Else, John, et al, March 2001, *The Role of Microenterprise Development in the U.S.*, prepared for the International Labor Organization, p 33

and related products to microenterprise programs through an annual “request for proposal” process and reports to the Legislature.

- By the end of 2006, programs funded by the Partnership Fund have lent over \$6.8 million to businesses in nine years. The average loan size in 2006 was \$12,565 and over 16,000 individuals have received training and/or technical assistance since 1998.
- The Fund has been able to steadily increase its state and private funding. The original state appropriation for the Fund in 1998 was \$250,000, and was raised to \$500,000 in the 2000 legislative session. Funding was again increased to \$447,750 in 2006, and the state budget for 2008 triples funding to \$1.5 million for each of the next two years. Based on the matching requirements specified in the enabling state legislation, by 2006, a total of \$5.6 million has been made available for microlending and self-employment training and technical assistance.
- In terms of program costs, the Fund’s 2007 report to the Nebraska legislature notes that:
 - Average cost per outstanding loan: \$2,566.
 - Cost per job, that micro program services helped create/retain: \$1,193
 - Costs per active trainee: \$393
 - Cost per job micro program services helped create/retain: \$231

Oregon

- **The Oregon Microenterprise Network**, like NMPF, also provides grants for business training and technical assistance to local organizations. The state Department of Economic and Community Development provides \$200,000 in funding grants to nine local organizations to provide training and technical assistance. These funds leverage an additional \$400,000 in federal Community Development Block Grant (CDBG) Funds.
- In 2007, OMEN just began implementation of a \$670,000 statewide microloan program - **Oregon Micro-Capital Access Program (MCAP)**, which is funded by US Bank, Wells Fargo Bank, and philanthropic foundations. Under a competitive Request for Proposals (RFP), OMEN selected eight local microenterprise organizations to originate and package loans and provide post-loan technical assistance to borrowers.

Does it Make Sense to Create an SMI in South Carolina?

- An intermediary would be the most cost-effective and efficient mechanism for aggregating and disseminating capital to non-traditional borrowers and distressed populations. The SMI model has been well-received by financial institutions to meet their community reinvestment goals and to increase small business activity in the state.

- One key difference between South Carolina and Oregon and Nebraska is that South Carolina does not have a network of community-based small business development organizations that provide microloans and entrepreneurial training and support for underserved individuals and distressed communities. In both states, the intermediaries work through these local organizations to pass through public and private funding for entrepreneurial training, microloans and additional counseling and technical assistance.
- **Therefore, in South Carolina, the state also needs to address the “capacity gap” of local organizations that don’t have the requisite experience in working with underserved population and communities.** A key role of the SMI should be to help build the capacity of local agencies to provide these services and disseminate best practices. The SMI would serve as the industry “consultant” to local entrepreneurial development organizations, and build their skills in outreach, business training, and post-loan technical assistance. To accomplish this goal, the SMI will raise funds from the State, federal and private sector sources and then award grants and related products to local programs through an annual “request for proposal” process. For example, the state could provide annual funding for a *South Carolina Emerging Small Business Program* that provides up to \$75,000 for local organizations to provide the training, technical assistance and loan packaging services to small businesses in underserved communities. The goal is to level the playing field in terms of the best approaches and methods to build strong small businesses – *regardless of where the business is located.*

Additional Responsibilities of the SMI

- **Performance Metrics, Centralized Data Collection and Reporting:** Using national industry standards, the SMI will establish basic performance metrics and develop an online data collection and client tracking system. The SMI will gather data from organizations on a quarterly basis and provide a yearly report to the Legislature and Governor.
- **Public Education:** the intermediary will improve the working environment for emerging small businesses by educating the public and advocating on behalf of the sector.
- **Foster Private Sector Partnerships:** the SMI would take the lead in developing partnerships and collaborations with private sector institutions, i.e., banks, corporations, chambers of commerce, public and private institutions of higher education, etc. The objective is to leverage their expertise and resources to help local organizations to build strong neighborhood businesses.
- **Information Clearinghouse:** the SMI will be the central source of information on program funding, research, resources, and partnerships.
- **Advocacy:** the SMI will lead and coordinate advocacy on a federal, state, and local level.

Funding

- **Loan Capital:** the loan fund should be initially capitalized at a minimum of \$500,000. The SMI can then leverage other funds from government agencies (SBA, USDA, CDFI) and financial institutions.
- **Capacity-Building:** to help build the capacity of local agencies to serve underserved populations and communities, the state should provide \$750,000 for the *South Carolina Emerging Small Business Program* that provides up to \$75,000 for local organizations to provide the training, technical assistance and loan packaging services to small businesses in underserved communities. The program would be administered by the SMI through a competitive RFP process and would require local matching funds.
- **Administration:** the intermediary would need: \$XXX,XXX for initial operations, which would include a Director of Business Outreach and Education , Senior Business Development Manager (for loan underwriting), and a Loan Fund Manager.