Microenterprise Assistance Toolkit

(excerpted from the Economic Development Toolkit)

Microenterprise Development

- CDBG recipients have flexibility in serving a special subset of the small business community (24 CFR Section 570.201(o) for Entitlements, and for States HCDA Section 105(a)(22)).

- Microenterprises range in type and capacity. They include a range of service providers and retail businesses that typically serve a specific need of their community. Some examples are the home-based daycare provider, the roving automobile mechanic, or the hairdresser who serves the neighborhood. Some microenterprise businesses are operated part-time by owners who want or need to supplement their income.

- With careful planning, microenterprise development can be an effective self-sufficiency and empowerment strategy for a variety of special populations, including:
  - Displaced workers;
  - Women and minority entrepreneurs; and
  - Former public assistance recipients.

Definition of Microenterprise

- The CDBG regulations provide the following definitions:
  - A “microenterprise” is a commercial enterprise that has five or fewer employees, one or more of whom owns the enterprise.
  - "Persons developing microenterprises" means persons who have expressed interest in and who are, or after an initial screening process are expected to be, actively working toward developing businesses, each of which is expected to be a microenterprise at the time it is formed. (24 CFR Part 570.201(o)(3) for Entitlements, and HCDA Section 105(a)(22) for States).

Eligible Activities for Microenterprises

- Eligible microenterprise activities under the CDBG program include providing:
  - Credit, including, but not limited to, grants, loans, loan guarantees, Individual Development Accounts (IDAs), and other forms of financial support for the establishment, stabilization, and expansion of microenterprises;
  - Technical assistance, advice, and business services to owners of microenterprises and persons developing microenterprises;
  - General support to owners of microenterprises and persons developing microenterprises. General support may include such activities as peer support programs, counseling, childcare, or transportation; and
  - Training, technical assistance, or other support services to increase the capacity of recipients or subrecipients to carryout microenterprise activities.

- The CDBG program does not cap the amount of assistance that may be provided to a microenterprise.
  - However, many recipients limit the level of microenterprise financial assistance in order to target small startups, minimize the recipient's financial exposure, and help the assisted business maintain a reasonable debt level.
- While some recipients provide microenterprise assistance as grants, others choose to provide loans.
  - The choice of type of loan or grant assistance, and their terms and conditions, depends on the use of funds, the needs of the user, and the goals of the recipient's program. For example, grants may be better for businesses that cannot support any additional debt or are seeking only a small amount of funds.
  - A grant may be more appropriate for a very small business needing less than a few thousand dollars as most private lenders will not make loans of such size because it is not cost effective.
  - It should be noted that providing assistance as grants may lead to lack of commitment by the business since it is not liable for repayment.
  - Given their size and level of development, loans to microenterprises are usually quite small, ranging from $500 to $20,000. The small size of the loans, combined with the cost of large amounts of technical assistance, means that such programs usually require ongoing public subsidy.
  - If recipients choose to provide assistance in the form of debt, underwriting criteria must be established. See the chapter on underwriting in the Economic Development Toolkit.
- Applicability of public benefit standards.
  - Microenterprise assistance provided pursuant to 24 CFR 570.201(o) is not subject to the Public Benefit Standards applicable to other economic development activities (see 24 CFR 570.209 for the categories of activities subject to these Standards).
  - However, in order to take advantage of the special advantages available under the Microenterprise Assistance category, the recipient would need to establish an activity in IDIS under matrix code 18C: **Micro-Enterprise Assist. – 570.201(o)**.
- Many recipients require that the microenterprise borrower obtain technical assistance on issues such as budgeting, marketing, or business planning in conjunction with the microloan in order to help alleviate risk and increase the chance for success.
  - Training and technical assistance are critical for microenterprises, many of which are startup enterprises requiring intensive business planning, basic accounting, and market research assistance.
  - TA requirements may make microenterprise development a very labor intensive and expensive strategy. Recipients should determine their level of capacity before undertaking a microenterprise program.

Documenting National Objective for Microenterprise Activities

- There is substantial flexibility in how CDBG-funded microenterprise activities can meet a National Objective. The most typical approaches are:
    - Microenterprise assistance can qualify under the limited clientele criteria for LMI benefit, if the business owner is LMI. This eliminates the need to track job creation or retention numbers. In certifying LMI status, the recipient only needs to document the owner's income, not that of any employees. Furthermore, there is a 3-year presumption of LMI status to allow for continued assistance. (Note, however, that in order to qualify as an eligible microenterprise activity, the business must still meet the definition of "microenterprise" each time new financing is provided.)
    - If the owner is not LMI, the recipient can still provide microenterprise assistance by meeting the LMI job creation/retention criteria. Job retention is documented at the time of the assistance is provided. Jobs created must be documented when the activity is completed; typically, activities are completed 3 to 5 years after the assistance is provided.

Program Design for Microenterprise

- There are several key steps in setting up a microenterprise development program. These include:
    - Defining the goals of the program;
    - Identifying and researching the target market;
    - Determining technical and/or credit needs;
    - Finding partners, such as a small business development center, Community Development Finance Institution (CDFI), Economic Development Agency (EDA);
    - Establishing a lending program;
    - Developing support services and technical assistance;
    - Designing training programs and methods;
    - Securing funds and services;
    - Implementing the program;
    - Monitoring and evaluating program results;
    - Tracking outcomes; and
    - Making updates as needed.
- The remainder of this section will describe these steps. See Chapter 7 of the Economic Development Toolkit also for a discussion on establishing a revolving loan fund as a means for assisting economic development strategies.

- Define program goals.
  - What do you want to achieve by setting up a microenterprise development program? How will you integrate your microenterprise development efforts with larger community concerns? Are you trying to create jobs, service businesses, or generate more income in a specific area?

Remember: There is no one program that can possibly address all the needs of the area. Select the type of program model or models that will achieve your goals and long-term strategy.

- Identify and research the target market.
  - What is the geographic area you want to serve?
  - What kinds of industries/businesses are needed to improve the community?
  - What model do you want to adopt (location, population, industry, or maybe a combination of these models)?
    - Location: When availability and access to jobs is a barrier for LMI people, targeted lending to businesses located in and around LMI areas may be an effective mechanism for new job creation.
    - Population: Targeted lending to increase job opportunity and wealth among minority or other disadvantaged residents of the community.
    - Industry: A sectoral approach can be used when a particular industry (retail, commercial, technology, or industrial) would spur economic growth in the community and create job opportunities.
  - Many times, objectives will require integrating two or more of these target markets. The recipient must carefully incorporate all these models into one program to address similar objectives.
- Determine technical and credit needs in the target market.
  - This may be done through a variety of methods, such as interviews with conventional lenders, focus groups with microbusiness hopefuls, community leaders and research on existing programs and resources.
  - Some questions to ask when assessing the credit needs and gaps in the community.
    - What sources of commercial debt and equity are available in the community?
    - Are banks and other lenders serving all or any markets in the area?
    - What are the most common reasons why certain segments have difficulty accessing credit?
    - What types of credit services are most needed by the target market?
    - What type of lending mechanisms (capital access or incentive programs) would best serve the target market?
  - What organizations can train and support businesses in underserved market segments?

- Establish a lending program.
  - Decide on the appropriate lending mechanism (direct loans, co-lending, third-party guarantees, etc.) by measuring anticipated loan demand against potential sources of loan capital.
  - Identify the underwriting criteria.
    - What types of borrowers will be eligible?
    - What uses of funds will be eligible?
    - How will ability to repay be analyzed (cash flow ratios/debt service coverage ratios)?
    - What kind of collateral will be required, at what value will it be deemed sufficient?
    - How will credit history be assessed?
    - How will owner commitment be assessed?
  - Be sensitive to the circumstances of your clients. Since microenterprises may not be able to meet traditional lending criteria, the public lender may want to consider some other factors on a case-by-case basis:
    - Does the business plan outline the financial and planning objectives and activities of the potential owner, and give an indication of the fiscal soundness of the business?
    - What is the commitment of the owner to his/her business venture and repayment of the loan (e.g., will the borrower personally guarantee the loan)?
    - What are the skills of the entrepreneur? Is he/she flexible enough to make quick adjustments in order to address ever changing circumstances?
  - Develop/adopt administrative procedures for administering the loans (or select an administering entity). How will the loan program be managed and by whom? Determine staff and capacity needs to operate the loan program.
  - Identify the loan processing fees, interest rates, and required level of equity to be injected with each loan.
- Design training and technical assistance components (classes, workshops, lectures, and/or group meetings) to help entrepreneurs establish the basic skills needed to start and run a business.
  - Some topics that may be considered are: self-esteem building; skill development; and training in accounting, budgeting, financial management, marketing, sales, planning, technology, etc.
  - Teach applicants how to write a business plan and present a loan application.
  - Business development centers (SBDCs), community colleges, and others may already offer supporting services such as business planning, so do not duplicate available services.
- Secure funds and services.
  - Establish relationships with all partners (banks, CDFIs, economic development agencies, etc.) to ensure as smooth a transition to implementation as possible.

- Implementation.
  - Market the program and accept applications for assistance.
- Monitoring/evaluation.
  - It is important to continuously evaluate the program, as implemented, to determine if it is meeting its target constituencies' needs. Seek regular input from customers, partners, and the public, and make adjustments as necessary. Be sure to document and track outcomes to report successes and lesson learned.
- Track outcomes.
  - Microenterprise development programs should have clearly defined outcomes, such as numbers of jobs created, amount of assistance provided, success rate of microenterprise businesses assisted, and technical assistance provided. It is important that recipients track and measure these outcomes to ensure the program is meeting the defined goals and requirements.
- Make updates as needed.
  - Programs should be flexible and able to adapt to business needs as they arise. Program managers should make updates or changes to microenterprise development programs, including securing new sources of funding, setting new goals and targets, and identifying new clients.

Implementing Microenterprise Programs

- A large number of microenterprise funding programs are managed for recipients by subrecipients.
  - These subrecipients can be for-profit companies (such as lenders) or non-profit organizations.
  - A recipient must determine up front the roles that it will play versus the roles the subrecipient will play in managing a lending program.
- Regardless of who manages the program, the recipient must be aware of limits on how the microbusiness loans may be made under CDBG.
  - Current requirements prohibit any lump sum drawdown of grant funds (except for rehabilitation of properties as allowed by HUD statute).
  - Thus, the actual funding for a microenterprise activity may not be disbursed until the recipient's program has borrowers ready to receive and spend the funds.
  - Local governments, however, can create a "line of credit" (similar to a line of credit provided by a private lender) for the subrecipient intermediary by assigning a specified amount of CDBG funds for the intermediary to draw against when it is ready to make a loan.
- There are many ways to reduce the risk and cost of a microenterprise program, including:

- Early and effective screening/underwriting of participants to ascertain commitment and feasibility of the business or concept;
- Emphasis on careful business planning to identify risks and develop contingency strategies;
- Group-training formats, with donated services from local business professionals, in order to reduce training and technical assistance delivery costs per entrepreneur;
- Equity investments or favorable payment plans to allow businesses to stabilize;
- "Stepped" lending, in which the amount of available financing gradually increases as the entrepreneur establishes a business and credit track record;
- Peer groups, (e.g., self-selecting groups of 5 to 10 entrepreneurs) who meet regularly to discuss business plans, review loan applications, and monitor loan delinquencies;
- Partnerships with local banks to provide low-cost loan capital and/or to collect loan payments at no or minimal cost; and
- Partnering with existing community-based agencies to enable participants to access affordable childcare, transportation, and education services.

■ If the assistance is being provided in the form of loans, the program should expect some amount of losses because not all microenterprises will succeed. However, recipients are cautioned to not become so conservative that few applicants will qualify. A well-balanced loan portfolio will be composed of a majority of healthy loans to balance some riskier loans with a large community impact.