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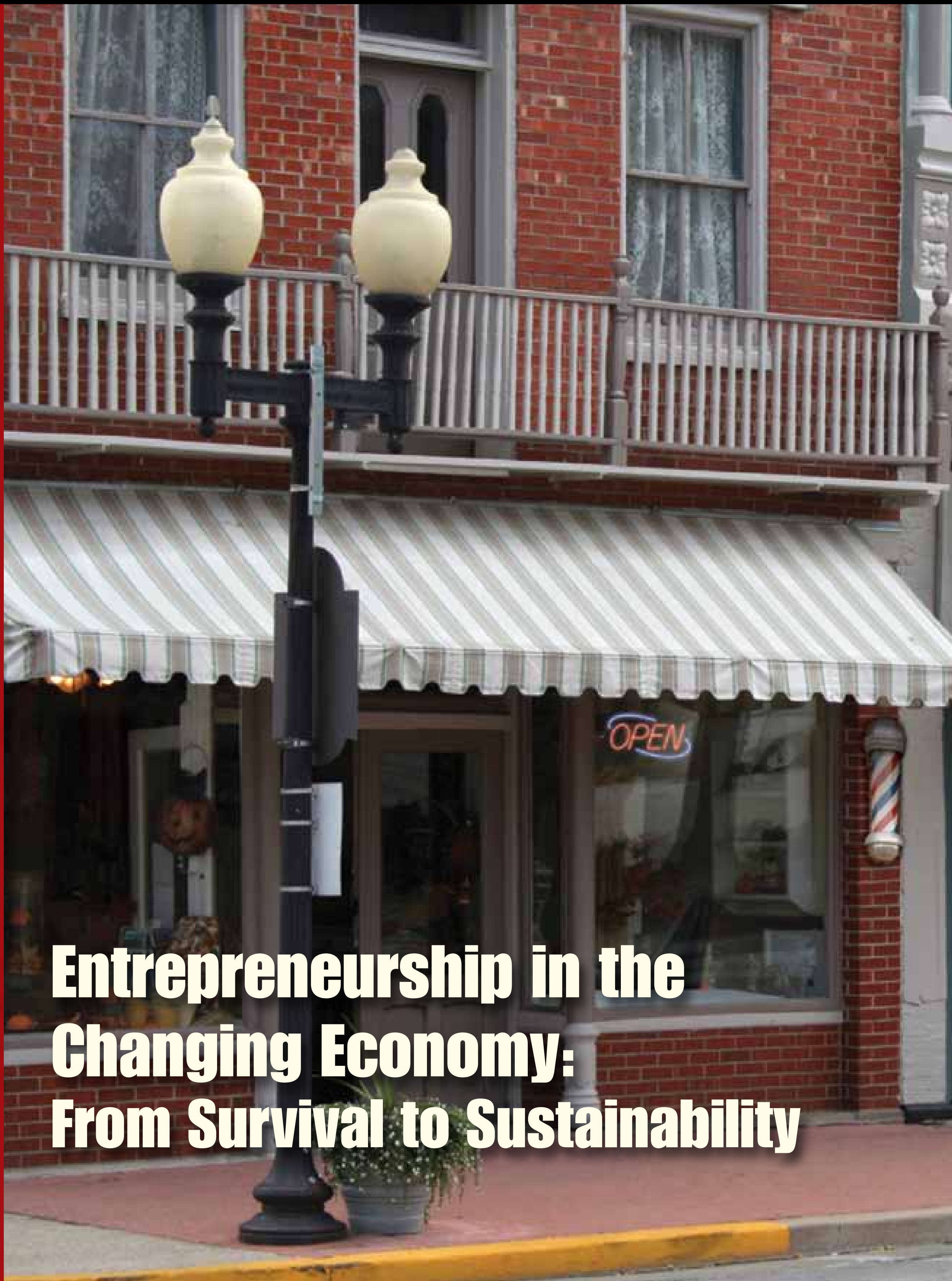
Prudent risk taking and entrepreneurship are the lifeblood of capitalism, especially in their American form, in which the new, the innovative and the more productive constantly sweep away the status quo. If we had not been a nation of entrepreneurs, we would have never built our $14 trillion economy.

—Richard W. Fisher
President and CEO
Federal Reserve Bank of Dallas



Entrepreneurship in the Changing Economy: From Survival to Sustainability

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Banking and Community **Perspectives**

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The Community Affairs Office of the Federal Reserve Bank of Dallas supports the Federal Reserve System's economic growth objectives by promoting community and economic development. We do so by facilitating partnerships and coalitions, organizing and hosting conferences and workshops, writing publications, and conducting research and training. Through our work, we have been learning about the challenges that entrepreneurs and small businesses face in the current recession. And we have asked national, state and local leaders what they are doing in response to these challenges.

This issue of Banking and Community Perspectives *offers an overview of the ideas presented at "Entrepreneurship in the Changing Economy: From Survival to Sustainability." This forum took place on Oct. 14, 2009, in Dallas, Houston and San Antonio. Speakers from the Ewing Marion Kauffman Foundation, Small Business Administration and Aspen Institute gave national perspectives on entrepreneurship in the changing economy.*

In addition, our forum featured Texas leaders who responded to the national speakers' insights by describing the issues they see their clients facing and the resources they and their colleagues provide to local entrepreneurs.

This report illustrates how public and private organizations are working together to support and grow small businesses. Accompanying this article is our forum website, www.dallasfed.org/news/ca/2009/09entre-vid/index.cfm, which has videos of the speakers' presentations and links to their handouts. We hope our publication and website provoke further thought, dialogue and action on promoting entrepreneurship.

Alfreda B. Norman

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Entrepreneurship in the Changing Economy: From Survival to Sustainability

In October 2009, the Federal Reserve Bank of Dallas facilitated discussions on national and local initiatives to support small business development. Speakers assessed current programs and some gave policy recommendations on how to advance entrepreneurship. Their ideas are presented here.

Entrepreneurship: An Overview

Roughly half of today's Fortune 500 companies were founded in recessions or bear markets, including Apple (1976), FedEx (1971), Microsoft (1975) and Southwest Airlines (1971). High-growth firms such as these are important because they have created a critical mass of new jobs, income and high-demand products and services. As a result, they have helped our economy bounce back from adversity on numerous occasions.[1]

Young, high-growth firms that employ fewer than 500 people also are important in good times. From 1980 to 2005, firms younger than five years old were responsible for nearly 100 percent of net new jobs.[2]

These trends tell us that entrepreneurs are vital to the growth of our economy and that, if the past is any guide to the future, entrepreneurs will be essential to a sustained recovery from the current recession.

There are signs that the entrepreneurial spirit is alive and well, says Robert E. Litan, vice president of research and policy at the Ewing Marion Kauffman Foundation. According to the foundation's entrepreneurship index, which tracks the percentage of the working-age population starting a business each month, new business formation has been steady over the past 10-plus years and in 2008 rose modestly over the previous year.

Nonetheless, it never hurts for policymakers to "help history along," according to Litan. He outlines seven policy recommendations to help launch and support emerging high-growth firms.


Robert E. Litan

Litan's recommendation #1: Unhamper peer-to-peer lending.

The Securities and Exchange Commission (SEC) requires that when people or firms offer a loan through a peer-to-peer lending company such as Prosper, they have to register with the SEC. In Litan's opinion, any such registration requirements should not apply to lending (or securities collateralized by such loans) under certain thresholds, such as loans or securities under $1,000 or $10,000. Providing such an exemption would expand lending for entrepreneurial companies.

Litan's recommendation #2: Make Sarbanes–Oxley optional.

The Sarbanes–Oxley Act of 2002 made it significantly more expensive for companies to go public. Litan suggests that if this were changed so that shareholders could choose if their company should be regulated under all or portions of this act, some companies would opt out. This would make it easier for companies to go public rather than having to sell to larger companies, which are less likely to carry forward the creativity and energy of the entrepreneurs who launched the companies in the first place.

Litan's recommendation #3: Grow, develop and support networks for entrepreneurs.

Research has shown that networks are probably even more important than money for the success of entrepreneurs. Networks lead to customers, suppliers, partners and other key stakeholders. Examples of organizations that support strong entrepreneurial networks are the IC² Institute at the University of Texas at Austin and the Massachusetts Institute of Technology's Venture Mentoring Service.

Litan's recommendation #4: Give high-skilled immigrants green cards or job creator's visas.

Immigrants disproportionately account for new businesses. According to Kauffman-sponsored research, one quarter of new high-tech businesses are formed or coformed by immigrants.[3] To facilitate the formation and growth of more such enterprises, the U.S. government could give immigrants who have earned science, technology, engineering or math degrees from American universities a green card. If this idea is too politically sensitive, Litan says, then why not at least give a job creator's visa to immigrants who, after a grace period, form businesses here and employ Americans? By attracting skilled immigrants to stay in the country, the U.S. could increase employment and demand for housing at the same time.

Litan's recommendation #5: Make health insurance more affordable and accessible to entrepreneurs.

Health insurance is more expensive for small businesses than for larger businesses. Litan recommends leveling the playing field so that small businesses have lower health care costs. The current health insurance market also deters entrepreneurship. Aspiring entrepreneurs who are employed at large companies with health care benefits may be reluctant to leave to start a new business because individual insurance is expensive and especially hard to get if the individual or family members have preexisting health conditions. By making health care more affordable and accessible to entrepreneurs, the U.S. can help stimulate entrepreneurship.

Litan's recommendation #6: Get rid of monopolies at universities' technology licensing offices.

When professors want to commercialize their technological innovations, they have to go through their host university's technology licensing office regardless of the office's level of expertise in the area of innovation. Litan suggests that professors should have the freedom to go to any university, lawyer or other commercialization agent to get their products to market. The host university would still have access to the revenues generated by the innovation under the terms of the professor's contract with the university. But more competition in licensing would speed up commercialization of ideas funded by the federal government, benefiting consumers, universities and faculty innovators all at the same time.

Litan's recommendation #7: Fund robust data collection on entrepreneurial firms.

There is not enough longitudinal data on entrepreneurial firms and not enough information about small businesses' access to and use of capital. The Kauffman Foundation is trying to fill this gap with its own Kauffman Firm Survey. But in the long run, the governmental statistical agencies are better positioned to collect these data. The job is important, Litan says, because the more data there are about the entrepreneurial process, the better able public and private entities will be in supporting entrepreneurship.

SBA and Entrepreneurship

Small businesses are struggling. Their customer bases, access to capital and credit, and asset values have significantly shrunk. In response to these severe challenges—and recognizing that a major part of the problem is the secondary markets, which were frozen in October 2008—the federal government allocated $730 million of American Recovery and Reinvestment Act (ARRA) funds to the Small Business Administration (SBA) when the act was signed in February 2009.[4]

The ARRA highlights nine areas intended to assist small businesses, and the SBA is implementing the provisions through its 68 district offices, 900 Small Business Development Centers, 110 Women's Business Centers, SCORE and other partners.

How the SBA Is Deploying Federal Stimulus Funds

1. *Temporary elimination or reduction of fees on the SBA's 7(a) loans and 504 loans.* Over half the ARRA's funding has gone to these lending programs, which are the SBA's largest lending products.
2. *Raised guarantees on 7(a) loans*: The SBA is offering up to a 90 percent guarantee for most 7(a) loans.
3. *Secondary market liquidity*: The SBA has the authority to purchase loan guarantees from broker-dealers.
4. *America's Recovery Capital (ARC) loan*: This new product for viable small businesses carries a 100 percent SBA guarantee. Borrowers pay no fees or interest. Repayment of the principal, which can be up to $35,000, starts 12 months after the last disbursement. To date, the SBA has made just over 4,700 ARC loans. The SBA's Penny Pickett estimates that if Congress does not expand funding of this program, the SBA will only be able to offer about 10,000 ARC loans.
5. *Expanded microlending*: The SBA is offering $50 million in microloans (these range from under $500 to up to $35,000) and $24 million in technical assistance to microlenders.
6. *Surety bond guarantees*: The SBA is offering up to $5 million in surety bond guarantees and, in some cases, will consider a guarantee up to $10 million. These guarantees can help small businesses be more competitive when they bid for larger government contracts.
7. *Changes in federal guarantees on pools of first-lien positions on 504 loans.*
8. *Expanded refinancing for 504 loans.*
9. *Expansion of Small Business Investment Company (SBIC) program*: The pool of investment funding for SBICs was increased; the limit on the percentage of an SBIC's total capital that can go to one portfolio company was raised; and SBA funding levels to an SBIC can now go as high as three times the private capital raised by the SBIC (up to a prescribed limit).

The SBIC's expansion is the only permanent change to the SBA. All other changes will expire by the end of 2010 or when the funding for a particular loan vehicle runs out. The SBA began the transition to post-ARRA lending on Nov. 23, 2009, as the loan authority was exhausted. A waiting list for ARRA terms on 7(a) loans is being maintained while an extension of funding is being considered.

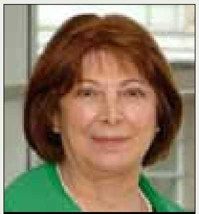
The SBA reports that nearly 50,000 loans worth $16.5 billion have been made under the ARRA. These numbers do not include ARC loans; 1,000 lenders have made just over 4,700 ARC loans worth approximately $153.2 million.

Approximately one quarter of the stimulus loans have gone to rural areas, one-fifth have gone to minority-owned firms, one-fifth to women-owned firms and one-tenth to veterans. Each borrower may fall into more than one of these self-reported categories.

The SBA's weekly loan volume—the gross loan value in dollars approved for a customer—has bounced back close to 2008's average weekly volume. This is in part attributable to the nearly 1,000 lenders that have come back to the SBA. None of them had made SBA loans since October 2008; over half had not made SBA loans since 2007. An estimated 93 percent of them are community and regional lenders.

In addition to about 50 new banks a week offering SBA products in the fall, the SBA network has observed a 7.5 percent increase in the number of entrepreneurs receiving technical assistance. Established small businesses are asking for help in repurposing their companies, changing their market plans, retaining employees and devising other survival strategies. When the SBA measured the effect of its technical assistance, which can reduce a company's risk profile through the work of its resource partners, the SBA found that small businesses that have had at least three hours of counseling generate higher revenues and stay in business longer than those that have not.[5]

Q&A: Questions from Entrepreneurship Forum Participants on the SBA and Responses from Penny Pickett, Associate Administrator for Entrepreneurial Development, SBA


Penny Pickett

Can you elaborate on what the SBA is considering to address seed and early-stage investment for gazelles?

Pickett: SBA Administrator Karen Mills frequently mentions that the SBA serves America's Main Street businesses and the high-growth, high-impact businesses that have the potential to grow into the next great American companies. For these innovative gazelles, SBA programs such as the Small Business Innovation Research program and the Small Business Investment Company program provide critical funding. The SBA is exploring numerous ideas, suggestions and possible structures for deploying capital to these high-impact companies that will help earlier-stage small businesses through new seed and venture capital. These funds would leverage public and private sources of capital to boost the development of emerging, innovative businesses across the country that will keep America competitive, provide robust high-wage job creation and spur local revenue generation.

Regarding ARC loans, what is the definition of viable small business?

Pickett: In the ARC loan program, "viable" means that the business is an established, for-profit business with evidence of profitability or positive cash flow in at least one of the past two years. An analysis of financial statements going back two years is also used. Future cash flow projections based on reasonable growth going out two years should show that the business will be able to meet current and future debt obligations, including future repayment of the ARC loan and operating expenses. Also, the borrower must certify that he or she is currently no more than 60 days past due on any loan being paid with an ARC loan and must have an acceptable business credit score as determined by the SBA. For more information, please see www.sba.gov/recovery/arcloanprogram/REC_ARCLOAN_ELIGIBLE.html.

Are new Women's Business Centers (WBCs) being funded?

Pickett: Yes. Five new centers are being funded in fiscal year 2010. They are in Montana, Oregon, South Dakota, Washington, D.C., and Wyoming.

What percent of WBCs over five years old are self-sufficient?

Pickett: After the five-year initial stage, all WBCs have reached self-sufficiency. From the beginning stage, all are required to provide a match for federal dollars received (1-to-1 or 2-to-1, depending on the number of years in the program). This requirement encourages WBCs to seek state and local funding in addition to corporate funds. We have found, however, that continuing funding by the SBA is a strong leverage point for obtaining funds from those additional sources.

What changes are proposed for the SBA 504 program, if any, as a result of the recession?

Pickett: The SBA made a permanent change (authorized through the ARRA) to the 504 program to allow businesses to refinance existing loans used to purchase real estate and other fixed assets. The permanent change enables small businesses to restructure eligible debt to help improve their cash flow, which in turn will enhance their viability and support growth and job creation. We have already processed over $60 million in 504 debt refinancing for small businesses across the country.

Many banks say they would lend to small businesses if they could find good deals, while small businesses consistently cite the difficulty in accessing credit. Banks also cite the need to keep their portfolios healthy due to concerns with bank examiners, which causes them to tighten underwriting standards. Why does it seem that the SBA incentives (higher guarantees) have not been enough to encourage banks to lend? Are heightened concerns by bank examiners regarding portfolio health too excessive, or are heightened portfolio concerns originating more from internal bank staff (chief financial officers, chief credit officers, etc.)?

Pickett: The SBA is very committed to understanding the challenges in the small-business credit market, and we have worked hard to expand access to capital for small businesses to survive and grow in this difficult economy.

Fortunately, the SBA has seen early signs of improvement in increasing access to capital for small businesses since the implementation of the ARRA, demonstrating the effectiveness of the higher guarantee and reduced fees. For instance, we have seen significant and increased loan activity. As of Nov. 13, the SBA has approved $10.9 billion in ARRA loans, supporting $14.7 billion in lending to small businesses. Since the signing of the ARRA, weekly loan dollar volumes have risen 79 percent in the 7(a) and 504 programs, compared with the weeks preceding the ARRA's passage. In addition, we have seen increased secondary market participation that is critical to providing liquidity to our lending partners, and we have seen more lenders join or return to our programs.

However, we know that there is much more work to be done, which is why we are working diligently across the administration to identify the next set of solutions to address the credit gap. For instance, President Obama asked the Small Business Administration and Department of the Treasury to convene a forum to discuss how we can best get credit flowing to small businesses to help them make it through this recession and put them in a position to grow and create jobs. On Nov. 18, Administrator Mills and Treasury Secretary Geithner held an all-day forum to engage with small businesses, lenders and other community members to hear ideas and potential solutions in expanding access to capital for small businesses. We are continuing to develop these ideas, and we will be releasing a follow-up report on our website.

Will there be more grants available for technical assistance, as training is very important to the success of small businesses?

Pickett: While many of the SBA's district offices (68 throughout the U.S.) often conduct training classes and meetings, our network of resource providers handles most of the technical training, counseling and assistance to small businesses. Through that network, more than 14,000 trained counselors are available through the Small Business Development Centers, the Women's Business Centers, SCORE and the numerous microlending intermediaries, U.S. Export Assistance Centers and Veterans Business Centers nationwide. Most of the services are provided without charge or with only a nominal fee. Online lists of all these resources may be found at www.sba.gov/localresources.

Where is the innovation in jump-starting entrepreneurship in America? Many of the SBA programs are the same old thing.

Pickett: While the underlying principles for founding, running and growing companies are relatively unchanged, we see innovation in many ways. Some of these innovations include the emphasis on identifying and training new entrepreneurs of all ages and stages of life, the tools and techniques utilized for

(Continued on page 6)

Q&A: SBA Questions from Entrepreneurship Forum and Responses

(*Continued from page 5*)

communicating with greater numbers of entrepreneurs, the establishment and growth of entrepreneurial networking communities in both place-based and virtual environments, and the importance of breaking down arbitrary state or county lines to identify regional assets that can be leveraged with innovative technologies to build more businesses and create jobs in an area (clusters).

Do you believe that rural entrepreneurs have different challenges (for example, access to credit) than urban entrepreneurs? Or do they have additional challenges?

Pickett: Many rural areas identify some challenges to robust economic growth, such as remote and difficult-to-access locations, lack of infrastructure, inadequate resources for education, or an outward migration of residents unable to find adequate and sustainable jobs. While these factors remain problematic in some areas, access to broadband has had a huge impact on many rural areas. Not only do residents have greater access to technical assistance and training, sources of capital, research information, new products and services, but entrepreneurs can now operate sophisticated and successful companies in a virtual environment so that location is not prohibitive to running good companies. Since the Telecommunications Act of 1996, funds have been raised and used to deploy broadband to rural areas, schools and hospitals to connect more Americans and most communities to the information and systems that are overcoming the challenges to entrepreneurial activity in more remote areas.

Entrepreneurship Forum Website

Videos of the entrepreneurship forum's speakers and links to their handouts can be found on the Dallas Fed website at http://dallasfed.org/news/ca/2009/09entre-vid/index.cfm

Microentrepreneurship

The Association for Enterprise Opportunity (AEO), a microenterprise trade organization, estimates that there are over 23 million microenterprises in the United States and that they generate 18 percent of private employment.

These businesses, which employ up to five employees (including the owner), represent 87 percent of businesses in the U.S. and can serve as a pathway out of poverty by increasing household income and building business and household assets.

Microenterprise programs provide financial, technical and other services to these very small businesses. Such investments can generate significant positive returns. The Aspen Institute's Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination (FIELD) surveyed 10 microenterprise programs and found they generated an economic return that was 1.3 to 1.4 times the investment. This return was in the form of increases in owners' draw, in wages paid to employees and in taxes paid by the businesses. FIELD Director Elaine Edgcomb adds that their actual return is likely to be higher because microentrepreneurship also reduces owners' and employees' use of public benefits, increases their income taxes and generates other economic benefits.[6]

In Texas, the two statewide microlenders are ACCION Texas, a nonprofit loan fund, and the Texas Mezzanine Fund, a for-profit community development financial institution (CDFI). In 2009, ACCION Texas measured its economic impact from 1994 to 2008 and found that the $76.8 million in loans it disbursed generated approximately $142.6 million in economic activity. The resulting $45.3 million in earnings, $8.3 million in tax revenues and 1,802 new jobs represent a 60 percent social return on ACCION Texas' investment.[7]

Across the country, CDFIs, a major funding source of microentrepreneurs, are facing significant challenges in the current economic environment. According to Opportunity Finance Network's (OFN) CDFI Market Conditions Report, demand for microloans has been increasing steadily over the past year: 69 percent of CDFIs primarily engaged in microlending that responded to OFN's third quarter 2009 market conditions survey reported that demand for loans had increased over the previous quarter and 77 percent reported that demand had increased over the previous year. At the same time, CDFIs are experiencing a number of challenges that make it more difficult to meet demand. Portfolio quality is down: 62 percent of survey respondents primarily engaged in microlending reported that the number of loan delinquencies increased over the previous quarter; the same percentage reported that the number of loans in workout increased over the previous quarter; and 46 percent reported that their number of loan extensions had increased in third quarter 2009.[8]

In response to declining portfolio quality, microlenders are increasing their loan loss reserves, tightening their underwriting criteria and devoting additional staff resources to portfolio monitoring. For the first two quarters of 2009, new loan originations did not keep pace with demand. While this held true in the third quarter, the gap is narrowing, with 62 percent of CDFIs reporting increases in originations.

In some instances, the supply of loans could not meet demand because of the poor quality of loan applications, tighter underwriting criteria and slower processing time, which was a result of increased due diligence or staff resources being diverted to manage problem loans. Many potential borrowers do not have strong enough business proposals to merit financing, and many have poor credit due to heavy mortgage debt and other types of consumer debt. Microlenders also report being approached by a noticeably higher number of aspiring entrepreneurs who are trying to start a business because they lost their jobs and need a new source of income.

When potential clients lack a secondary source of income, such as from a spouse, it is difficult for microlenders to offer a loan because of the associated risk. Lenders also find it complicated to determine the appropriate level of debt to extend.

To help meet CDFIs' financial needs, the Treasury Department's CDFI Fund awarded 121 CDFI grants totaling $142.7 million through its fiscal year 2009 round of funding. This included $90 million of additional resources provided by the ARRA. Applications for CDFI program grants in fiscal year 2010 rose to $467.4 million.[9] This represents a 97 percent increase over the $237.7 million requested in its pre-ARRA 2009 round. While some of this dramatic increase may be due to the CDFI Fund waiving its matching funds requirement in the 2009 round, it suggests that the supply of funds is far from covering demand. Compounding this challenge to CDFIs are reduced commitments from foundations and delays in receiving these funds.

In addition to tightening lending criteria and seeking new funds, CDFIs are implementing new strategies to support entrepreneurship in this environment. One strategy is to help clients build credit.

According to the Aspen Institute's Edgcomb, there is a lot of experimentation around credit building. One example is a credit-building loan program in which clients take out a small loan and make required payments on time and in full to demonstrate their repayment discipline. During this time, they also take financial literacy training. Participating lenders report borrowers' payment performance to Credit Builders Alliance, which reports this information to credit bureaus. At the end of this program, successful borrowers are those who have increased their credit scores and therefore their creditworthiness.[10]

Entrepreneurship Development Systems

Another strategy to support entrepreneurship is through entrepreneurship development systems (EDS). It is a systems approach to better connect the demand for entrepreneurship to the supply of resource providers, as well as to influence stakeholders from the community level to the policy level to be vocal advocates of entrepreneurship. This approach has five core components: (1) entrepreneurship education, which involves teaching entrepreneurship concepts to students from kindergarten through post-secondary schools, promoting youth entrepreneurship and teaching entrepreneurship as a career path; (2) adult entrepreneurship training and technical assistance, which includes financial education and business development training for current and aspiring entrepreneurs; (3) access to capital—both debt and equity; (4) access to networks, which coordinate the supply of services to entrepreneurs, inform them about available resources and best practices, and connect entrepreneurs to markets, capital sources, employees, partners and service providers; and (5) fostering an entrepreneurial culture in which the entire community supports and advocates entrepreneurship.

In 2005 the W. K. Kellogg Foundation invested $12 million over three years in an EDS demonstration project to promote learning and encourage replication of these systems. The project had six programs that covered diverse regions and communities (*see box below*).

FIELD evaluated these demonstration programs and reported on lessons learned.[11] One main finding was that it is easier to demonstrate tangible results in the short-term by taking a demand-side "transformational" approach than by taking a supply-side "big tent" approach to systems building. The transformational approach focuses first on the development of entrepreneurs by creating a support structure of coaching relationships, peer groups and community organizations dedicated to helping growth-oriented entrepreneurs. This approach connects service providers to participating entrepreneurs as needed, and all partners' roles are clearly defined. The system is designed to be demand-driven and responsive to the articulated needs of the entrepreneurs.

In addition to tightening lending criteria and seeking new funds, CDFIs are implementing new strategies to support entrepreneurship in this environment. One strategy is to help clients build credit.

In contrast, in the big tent approach, the emphasis is first on the supply side: All entrepreneurship supporters convene to create a set of common goals and commitments. This can be a complicated, time- and energy-intensive process and may not simplify how clients are matched to services that best meet their needs. In some of the EDS demonstration programs, there was resistance among service providers to making cross-referrals when they had different priorities and operational models and were concerned about the quality of others' services.

Another lesson learned is that entrepreneurship service providers must be proactive if their goal is to serve traditionally underserved populations. They need a strategy and dedicated resources to target these populations, such as by funding training scholarships and partnering with organizations that represent these populations. Finally, FIELD concludes that EDS is a marathon and not a sprint. It is

The W. K. Kellogg Foundation's Demonstration Project on Entrepreneurship Development Systems

Advantage Valley EDS is in 12 counties in West Virginia, Kentucky and southeast Ohio.

Connecting Oregon for Rural Entrepreneurship is in five distressed regions in northeast Oregon, Lincoln County, southwest Oregon, Lake County and the Warm Springs Indian Reservation.

Empowering Business Spirit Initiative is in four northern New Mexico counties: San Miguel, Rio Arriba, Mora and Taos.

HomeTown Competitiveness is in rural counties and communities in geographically isolated areas of Nebraska that have defined their most critical indicator of distress as "depopulation."

North Carolina Rural Outreach Collaborative is in all 85 of North Carolina's rural counties.

Oweesta Collaborative is on three Indian reservations in the Great Plains: the Pine Ridge and Cheyenne River reservations in South Dakota and the Wind River Reservation in Wyoming.

unrealistic to expect communities that embrace EDS to implement all its principles and goals in a few years. Dedicated time, energy, resources, strategies and policies are needed to make a real and sustainable impact.

Policy Recommendations for Microentrepreneurs

In "Encouraging Entrepreneurship: A Microenterprise Development Policy Agenda," Joyce Klein of FIELD and Carol Wayman of Washington, D.C.-based nonprofit CFED (Corporation for Enterprise Development) propose five policy goals for the microenterprise development industry. Following is a paraphrase of their recommendations.[12]

Klein and Wayman's recommendation #1: Expand the existing infrastructure of community-based organizations supporting entrepreneurs.

Reinstate full funding and/or expand the SBA Women's Business Center, PRIME and Microloan programs, the Department of Agriculture's Rural Business Enterprise Grants and Intermediary Relending programs, the Department of Health and Human Services' Job Opportunities for Low-Income Individuals program and the Department of Housing and Urban Development's Community Development Block Grant program.

Add capital for microenterprises and other community and economic development efforts through the Full Faith and Credit in Our Communities Act of 2007 and the Housing and Economic Recovery Act of 2008.[13] Also, create and capitalize a federal economic development grant program for microenterprise development organizations and CDFIs.

Klein and Wayman's recommendation #2: Implement policies that expand access to private markets and sources of capital.

Expand the Community Reinvestment Act so that it requires data on the gender, race, income or sales characteristics of business borrowers. This information would help make it possible to determine if the business loans are received by small, locally owned enterprises or franchises of large corporations.

Permit full reporting of utility and telecom payment information to credit bureaus so that they include timely payment information. These data could raise credit scores, which would give borrowers access to lower-cost private capital.

To open the door to another source of private capital, allow individuals to access their retirement accounts for business investments as easily as they can for homeownership and college education. Also let entrepreneurs more easily borrow against their retirement savings.

Improve enforcement of the SBA's Historically Underutilized Business Zone program and the federal government's small business contracting targets. Also, many larger firms have received preferences under the small business contracting targets but should not have. Therefore, correct this problem.

Include microenterprises and small business in the federal government's energy and environmental initiatives to "green" the economy.

Klein and Wayman's recommendation #3: Create tax policies that support emerging entrepreneurs.

The Internal Revenue Service (IRS) should make a more welcoming environment to small businesses by creating a self-employment tax credit and actively extending the capacity of its Volunteer Income Tax Assistance (VITA) program so that it serves low-income taxpayers with self-employment income. In addition, the IRS should advocate that the grant program be used to establish VITA demonstration projects to serve low-income, self-employed households.

The IRS should require its Small Business/Self-Employed division to expand its first-time filer initiative through demonstration projects that identify how the IRS and nonprofits can better serve these filers.

Klein and Wayman's recommendation #4: Enable low-income individuals to use microenterprise as a pathway out of poverty.

Change the asset means tests in the Supplemental Nutrition Assistance Program (SNAP), Temporary Assistance for Needy Families (TANF) and other public assistance programs across all 50 states to make it easier for recipients to accumulate savings and build business assets.

Policymakers should recognize microenterprise as an eligible work activity for TANF and Social Security Disability Insurance (SSDI) program participants and promote microenterprise by advising local and state governments on how to support it through their TANF programs.

The Department of Justice and states should start a microenterprise development pilot program for prisoners as a reentry strategy because it is particularly difficult for them to find employment.

Expand the resources available for Individual Development Accounts so that more business capital is available for current and aspiring low-income entrepreneurs. Congress could accomplish this by enacting the Savings for Working Families Act and funding the Beginning Farmer and Rancher Act, which was part of the Food, Conservation and Energy Act of 2008.

Klein and Wayman's recommendation #5: Ensure that health coverage reforms address the particular needs of low-income entrepreneurs.

Because health issues prevent many aspiring business owners from becoming entrepreneurs and often contribute to the closure of existing small enterprises, it should be easier for entrepreneurs to access affordable health insurance coverage. One way to address this issue is through tax credits, such as the one President Obama proposed during his campaign—that the federal government provide a refundable small business health tax credit of up to 50 percent on employee premiums paid by small businesses on behalf of their employees.

Q&A: Questions from Entrepreneurship Forum Participants on Microentrepreneurship and Responses from Elaine Edgcomb, Director, FIELD, Aspen Institute

Elaine Edgcomb

Are there examples of how entrepreneurship development systems (EDS) have or can work in urban communities?

Edgcomb: I don't know of any examples in large urban settings, but there are some examples in small to medium-size cities that participate in an economic development or entrepreneurship strategy that is designed to help not only their residents but those of the region around them. EDS approaches tend to take a regional focus, recognizing that economic development often is more effective when considered in that context. One example is the Central Louisiana Entrepreneurial League System, working under the CENLA Advantage Partnership (http://cenla.org/drupal/). The center of the region is Alexandria, a city of about 50,000.

A second example is in Taylor County, Ky.; its population center is Campbellsville, a community of about 10,000. The county's economic turnaround was based on both industrial recruitment and entrepreneurship strategies. For more information, see www.energizingentrepreneurs.org/content/cr_3/2_000269.pdf.

Are there any funding sources for communities interested in EDS?

Edgcomb: We have observed that those pursuing EDS-like strategies are drawing resources from a variety of sources. In some instances, state resources have supported these initiatives; in other instances, there is foundation support. Usually the foundations are not national but committed to and interested in regions in which the EDS programs are operating. At the local level, communities interested in developing support for entrepreneurship strategies have also been able to tap local community foundations for seed money. And some have creatively worked to raise community resources precisely to fund these efforts. For some examples of this, see our case study on the HomeTown Competitiveness program in Nebraska (http://fieldus.org/Publications/EDS08/EDS_2008NebCS.pdf).

Do you believe that rural entrepreneurs have challenges different from those of urban entrepreneurs (for example, access to credit)?

Edgcomb: Rural entrepreneurs often feel the lack of access to entrepreneurial development services due to the distances that must be traveled to reach services, and in some cases, due to the gaps in services. For example, in New Mexico there were fewer resources available to residents in the north of the state at the start of the EDS project, Empowering Business Spirit. One of the initiatives that this EDS focused on was getting service providers from Albuquerque to deliver services to the northern population. For more information, see http://fieldus.org/Publications/EDS08/EDS_2008NMCS.pdf.

What are ways to identify and/or assist microentrepreneurs in going from a micro-level business to a high-growth/"sweet spot" job creator?

Edgcomb: There are a couple of examples of how microenterprise programs are doing that. The best is the Northeast Entrepreneur Fund's (NEF) Greenstone Group (www.greenstonegroup.org). NEF has a long history working with microentrepreneurs and building on that experience as well as on lessons from other entrepreneurship development systems. It is implementing a program that provides coaching, peer learning, mentoring and access to other technical resources and capital to growth-oriented entrepreneurs. These are the elements that microenterprise programs can build into their own services to retain and provide meaningful services to entrepreneurs who are interested in growth and thereby job creation. Microenterprise programs already understand the importance of both personal development and business development; they appreciate the transformational power of entrepreneurship; and they also resonate with the notions of customized consulting and peer learning. These strategies can be applied to those with growth goals and achieve some real impact for the investment of resources.

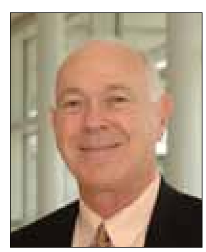
Other microenterprise programs, such as Good Work in North Carolina, are focusing on community coaching: working with leaders in local communities to develop a culture and support structures that nurture entrepreneurial talent in their local communities. Creating these nurturing communities and then building links for entrepreneurs in these communities to technical assistance and capital is also a powerful way to support job-creating entrepreneurs. I think it's important to recognize that sometimes it's hard to identify at the start who will be growth-oriented and who will not. It's also important that local communities have a wide variety of entrepreneurs and a culture that's welcoming to all of them. Having that orientation creates a local community that is attractive to other entrepreneurs and can lead to multiple impacts. So it's not just one thing that can lead to results.

Entrepreneurship: Local Leaders' Perspectives

Many businesses that were bankable before the recession are no longer able to access the capital they need. Banks cite a number of factors that are making it difficult to extend credit. They have higher loan loss reserve requirements, and they expect lower loan-to-value ratios and higher credit scores and debt service coverage from their clients. As real estate values and consumer demand fall, small businesses are finding it harder to find sufficient loan collateral and to forecast demand over the next six months. The SBA's recent actions, such as lifting fees and increasing loan guarantees, are helping banks increase their lending but are limited in their impact because they are temporary.

As small businesses are not able to access the capital they need, they are turning to nontraditional lenders, which are reporting a jump in demand. These lenders, such as microlenders, face the question of how to stay aligned with their mission of providing services to traditionally underserved markets (that is, low- and moderate-income individuals and communities) when the newly underserved markets are knocking on their doors.

Following are highlights of what Texas lenders and other entities are doing to help entrepreneurs survive and grow in the changing economy.



Karl Zavitkovsky, City of Dallas

According to Karl Zavitkovsky, director of economic development with the city of Dallas, revenues generated from Dallas area commercial property values and sales taxes declined in 2009 and are not expected to stabilize for several years. This, combined with tighter credit standards and reduced lending capacity at financial institutions, has created a need for municipalities to seek additional funding sources to sustain economic growth and job creation.

In addition to seeking federal stimulus funding and receiving a $55 million New Markets Tax Credit allocation, the city of Dallas received designation as a regional center by the U.S. Citizenship and Immigration Service. This enables the city to capitalize on an employment-based visa program (EB-5) that allocates visas to foreign nationals who invest $1 million in enterprises and projects that create 10 or more full-time jobs for U.S. citizens.[14]

These investors initially receive a two-year conditional green card for themselves, their spouses and dependents under the age of 21. Once the investment and job criteria are satisfied, the temporary visas are converted to permanent status. Due to the green card benefit, investors are willing to accept a reduced return on their capital.[15]

This will enable Dallas to tap a new source of inexpensive foreign capital that can be aligned with the city's Public/Private Partnership Program to fuel a targeted growth strategy with special emphasis on southern Dallas.[16]

Cynthia Blankenship, Bank of the West

Community banks play an integral role in supporting small businesses. They represent 12 percent of bank assets in the U.S. but make 31 percent of all small business loans under $1 million and half of all small business loans under $100,000.[17] Cynthia Blankenship, vice chairman and chief operating officer of Bank of the West, describes her bank's ties to Main Street: "We have a civic responsibility to make financial services available to small businesses to do relationship lending. This means offering not only loans but also financial literacy and training." Blankenship recommends that the SBA further support small businesses by expanding its programs that provide access to capital.

She also advocates reforms to Subchapter S corporation laws, such as increasing the number of eligible shareholders from 100 to 150 and allowing individuals to hold S corporation shares in their individual retirement accounts. Both reforms would enable Subchapter S community banks to have more investors.

Theresa Acosta Lee, Texas Mezzanine Fund

"Where a bank ends, we begin," explains Theresa Acosta Lee, chief lending officer and vice president of the Texas Mezzanine Fund (TMF), a $14 million CDFI. TMF makes loans to growth-oriented businesses that cannot get all their financing needs met through traditional lending institutions. Clients range from larger businesses with revenues of up to $30 million, to mom and pop businesses, to affordable housing developers and nonprofits needing financing for their community facilities. TMF has a double bottom line: Make money to put back in the fund so that it has more money to lend to future clients, and second, community impact, which is job creation or lending into underserved, low-income areas or to women- or minority-owned businesses.[18]

Lee points out that the recession has significantly impacted TMF. First, there is higher demand for its services. Second, its focus used to be job creation but now is becoming job retention or business sustainability. Third, its bank partners used to make larger loans. For example, a bank partner used to be able to put $750,000 into a deal, while TMF would put in $250,000. Now, TMF is asked to put in $500,000 because its bank partners have tightened credit, particularly to reduce their loan-to-value ratios. Fourth, real estate deals that might have taken 30 to 60 days now may take up to six months because real estate appraisal values are coming in lower than expected.

Marlon Mitchell, Houston Business Development Inc.

Created by the city of Houston in 1986, Houston Business Development Inc. (HBD) is a community-based, nonprofit corporation engaged in promoting entrepreneurship and economic development. HBD is able to assist small business owners and aspiring entrepreneurs by providing access to capital as well as management and technical assistance services. As a nonbank lending institution, HBD is funded through the Community Development Block Grant program and is not held to the capital reserve and compliance requirements of banking regulators. This, along with its lower cost of funds, enables the corporation to absorb greater risks than conventional banks and offer more flexible lending terms, including lower rates, longer terms, lower loan-to-value ratios and reduced collateral requirements. HBD also serves as a credit enhancement vehicle by working closely with banks to mitigate the risks associated with marginal credits (loans with higher risk factors than normal and typically outside a bank's standard lending guidelines).

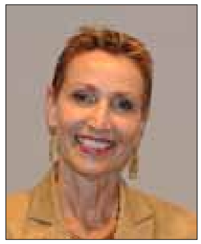
Marlon Mitchell, executive director of HBD, says that extending credit to clients has become more challenging with the tightening of the market due to the weakening financial positions and plunging profitability of small businesses coupled with the regulatory constraints imposed on conventional lenders. As the majority of HBD loans are made in tandem with bank loans, HBD relies largely on bank partnerships in extending credit, and so as not to supplant bank lending efforts, loans are limited to less than $100,000. However, given adequate funding, community development financial institutions and community-based lenders like HBD can become a conduit for providing larger direct loans, particularly during tough economic times, while also providing some relief to banks by purchasing toxic assets from their portfolios. Small businesses would benefit by having better access to capital, lower fixed interest rates, more flexible repayment terms and minimal collateral requirements. According to Mitchell, the combined impact would help stimulate our national economy by assisting small businesses to expand and create jobs while also enabling banks to resume lending activities.

Gary Lindner, ACCION Texas

ACCION Texas, which operates statewide and just started operations in Louisiana, was recognized as the nation's fastest-growing community development corporation (CDC) in 2008. Its objective is to help startups and existing small businesses—particularly those that help revitalize communities by creating new jobs—to become bankable. ACCION Texas partners with banks and other institutions that support entrepreneurs, such as small business development centers and SCORE, an SBA partner that counsels small businesses.

ACCION Texas extends loans ranging from $500 to $100,000. Minority-owned businesses receive 86 percent of its loans, and almost half go to women-owned businesses, while 35 percent go to businesses younger than six months. During the past three years, ACCION Texas lent more than $1 million every month. This CDC's average loan size is $15,000, and 2,000 loans are on the street at a time; in Texas, they total approximately $28 million.

Since opening in 1994, ACCION Texas has extended approximately 10,000 loans. It has been able to standardize its risk assessment by creating an underwriting system called Microloan Management Services (MMS), which identifies common characteristics of successful borrowers, and pairing it with loan applicants' credit scores. MMS is a powerful tool because it enables loan officers to take a consistent look at each client and more quickly get good-quality applicants into the system and poor-quality applicants out of the system. As a result, it can process a higher volume of applicants at a significantly lower cost, which gives ACCION Texas more time to prospect for new clients. Ten CDFIs are MMS subscribers, and altogether they have processed over 5,000 loans using this system.



Jacqueline Taylor, University of Houston Small Business Development Center Network

Small Business Development Centers (SBDCs) provide a wide spectrum of services to entrepreneurs. They help entrepreneurs put together their paperwork correctly so that their loan applications are complete and help them identify banks that are the most appropriate to work with. SBDCs offer workshops on how to sell to the government, training on how to adjust business plans to survive in the recession and information on how to tap into programs offered to help small businesses. For example, the SBA's 8(a) Business Development program provides an opportunity for socially and economically disadvantaged business owners to gain a competitive edge when bidding on federal contracts.

Jacqueline Taylor, associate region director of the University of Houston Small Business Development Center Network, summarizes the effectiveness of her SBDC's programs: In the past three years, her clients accessed over $450 million in capital to expand their businesses, created more than 9,700 new jobs and retained over 11,000 jobs.

Citi and ACCION Texas: A Partnership

In September 2008, Citi and ACCION Texas created a partnership in which Citi agreed to buy up to $30 million of ACCION Texas' loans over five years. Citi buys the loans at 90 percent of their value and ACCION Texas services these loans for a fee.

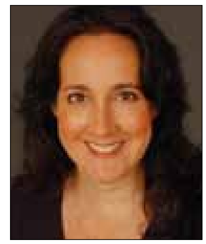
Since September 2008, ACCION Texas has sold Citi approximately 300 loans worth approximately $6.5 million. The partners split the risk equally.

ACCION Texas Chief Operating Officer Gary Lindner highlights major points of this partnership:

1. Citi cannot cherry-pick loans. Which ones it buys are based on their order in the queue.
2. This partnership gives liquidity to ACCION Texas, which enables it to extend more loans. Without this capital, it would have to take the more expensive route of borrowing or getting lines of credit. It would also have more difficulty meeting the covenant requirements of its creditors and funders.
3. This partnership demonstrates that domestic microfinance can be a profitable investment.

Looking Forward

As speakers at the entrepreneurship forum discussed, small businesses and their service providers face major challenges in the changing economy. Nevertheless, there is a vast network of public and private organizations working together to support entrepreneurs.



Margo Weisz, PeopleFund

Margo Weisz, executive director of the Texas-based CDFI PeopleFund, proposes steps that can be taken at the state level to further support small businesses. She emphasizes that these recommendations are particularly relevant to businesses in underserved communities because even in strong economies small businesses need assistance with capital, business sophistication, networks, quality jobs, and research and development to survive and thrive in the global marketplace.

Weisz's proposals include teaching financial literacy and entrepreneurship to students in kindergarten through 12th grade; requiring that a certain percentage of public projects be outsourced to small businesses; resuming the Texas Capital Access program, which provides a source for loan loss reserves; creating a statewide CDFI program that is modeled after the federal program; and allocating a percentage of state CAPCO dollars to fund CARS-rated, federally certified CDFIs.[19] CAPCOs are state-regulated, privately owned venture capital companies that facilitate economic development by investing in small businesses in low-income areas whose growth is hampered because they lack access to capital.[20]

The Dallas Fed encourages financial institutions, economic and community development organizations, cities, universities and others to continue leveraging their skills and resources so that all entrepreneurs—whether in traditionally underserved markets or newly strained ones—have the opportunity to create another entrepreneurial revolution.

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Notes

[1] Information in the Entrepreneurship: An Overview section was provided by Robert E. Litan, vice president of research and policy, Ewing Marion Kauffman Foundation.
[2] “Where Will the Jobs Come From?” by Dane Stangler and Robert E. Litan, Kauffman Foundation Research Series: Firm Formation and Economic Growth, Ewing Marion Kauffman Foundation, November 2009.
[3] Time period is 1995–2005. “America’s New Immigrant Entrepreneurs,” Duke University Master of Engineering Management Program and University of California at Berkeley School of Information, Jan. 4, 2007, www.kauffman.org/uploadedFiles/entrep_immigrants_1_61207.pdf.
[4] Information in the SBA and Entrepreneurship section was provided by Penny Pickett, associate administrator for entrepreneurial development, Small Business Administration.
[5] Data are as of Dec. 1, 2009.
[6] These 10 were not the only programs surveyed, but these were the only ones that provided pre- and post-program data on three key variables: business ownership, owners’ draw or salary, and employment in the business. For details, see pp. 49–50 of “Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States,” by Elaine L. Edgcomb and Joyce A. Klein, Aspen Institute, February 2005, www.fieldus.org/Publications/FulfillingthePromise.pdf.
[7] “Economic and Community Impact of ACCION Texas,” TXP Inc. and ACCION Texas, January 2009, www.acciontexas.org/pdf/economic_impact_study.pdf.
[8] The sample size is 13. “CDFI Market Conditions Report, Third Quarter 2009,” Opportunity Finance Network, December 2009, www.opportunityfinance.net/store/downloads/CDFI_market_conditions_Q309.pdf.
[9] In December 2009, the CDFI Fund announced that its fiscal year 2010 appropriation is almost $247 million. This is the largest annual appropriation in the fund’s history.
[10] For more information, see the Credit Builders Alliance website: www.creditbuildersalliance.org.
[11] “Revitalizing Rural Economies Through Entrepreneurship Development Systems,” by Elaine L. Edgcomb, Joyce A. Klein and David Black, FIELD, Aspen Institute, December 2008, http://fieldus.org/publications/EDS2008.html.
[12] “Encouraging Entrepreneurship: A Microenterprise Development Policy Agenda,” by Joyce Klein and Carol Wayman, Federal Reserve Bank of San Francisco *Community Investments*, Winter 2008, www.frbsf.org/publications/community/investments/0812/klein_wayman.pdf.
[13] At the time of Klein and Wayman’s publication and Edgcomb’s presentation at the Dallas Fed, the Housing and Economic Recovery Act of 2008 (HERA) had not authorized these CDFIs to become members of the Federal Home Loan Bank system. However, in January 2010, the Federal Housing Finance Agency amended its membership regulations to implement provisions of the HERA that authorize CDFIs that have been certified by the CDFI Fund to become members of a Federal Home Loan Bank.
[14] If the investment is in a targeted employment area, which has an unemployment rate of at least 150 percent of the national average, it has to be at least $500,000. For more information, see the U.S. Citizenship and Immigration Service website, www.uscis.gov.
[15] Returns are tied to investment risk and individual transactions. Returns are anticipated to be significantly below market rates.
[16] Southern Dallas is traditionally defined as the geographic area south of the Trinity River west of downtown and south of Interstate 30 east of downtown. For details on the partnership program, see www.dallascityhall.com/committee_briefings/briefings1109/ECO_PublicPrivatPartnership_110209.pdf.
[17] 2008 data from FDIC Call Report database. The Independent Community Bankers of America reports on 2009 data: “Comprising only 11.4 percent of industry assets, banks with less than $1 billion in assets made 48 percent of loans outstanding and held 40 percent of outstanding loan balances as of 6/30/2009. For loans of less than $100,000, the numbers were 58 percent of loans and 57 percent of balances. In contrast, banks with more than $100 billion in assets made only 22 percent of small business loans and held only 25 percent of balances.”
[18] For information on the Texas Mezzanine Fund’s statewide impact and the types of deals it does, see http://dallasfed.org/news/ca/2009/09entre_lee.pdf.
[19] CARS is the CDFI Assessment and Ratings System. For details, see www.carsratingsystem.net/.
[20] For a more detailed explanation of CAPCOs, see “Community Development Finance: Challenges, Choices, Change,” Federal Reserve Bank of Dallas *Banking and Community Perspectives*, Issue 1, 2005, http://dallasfed.org/ca/bcp/2005/bcp0501.html.