

## **Department of Economic Development Report (Draft)**

### **Program:**

*Empresarios Comunitarios*, Micro-Lending Pilot Program

### **Partners & Resources:**

ACCION San Diego

Azteca Community Loan fund (ACLF)

California Association for Micro-Enterprise Opportunity (CAMEO)

Community Development Financial Institution (CDFI) Coalition

Community Trust Credit Union (CTCU), A Division of Self-Help

Consultative Group to Assist the Poor (CGAP)

Esperanza International

Grameen America

Mission Asset Fund

Mission Community Services Corporation (MCSC)

Opportunity Fund

Portable Practical Educations Preparation (PPEP)

Valley Small Business Development Corporation (VSBDC)

WE Invest

### **History:**

The inception of the DHF Department of Economic Development coincided with the hiring of Brock Seraphin as “Micro-Lending Program Coordinator” in June of 2009. To date, the position remains unfunded.

In 2009, the DHF set out to launch a micro-lending pilot program, building capacity by researching small business curriculums and micro-enterprise development models. Additionally, site visits were made to Azteca Community Loan Fund (ACLF) in San Juan, TX and Portable Practical Education Preparation (PPEP) in Yuma, AZ to glean best practices and observe successful micro-lending operations. After David Arizmendi, founder of ACLF, provided us with hands on training in the Community Development Financial Institution (CDFI) application process, it became apparent that starting a CDFI was beyond the current monetary means and technical capacity of the DHF. Still, with a desire to test out a lending model in our communities, we pressed on.

Early in 2010, we entered discussions with Community Development Financial Institution Kern Central Credit Union (KCCU), the only full-service bank within miles of Lamont, CA, a community from which we eventually recruited some of our borrowers. Our partnership was delayed by a change in ownership when KCCU became Community Trust Credit Union (CTCU), but we eventually reached an agreement that allowed the DHF to set loan policies, including interest rates and repayment terms, for clients of our pilot program. A shared secured loan allowed the DHF to deposit money into an account to “secure” the business loans we issued. If loans were repaid, the initial deposit (plus interest comparable to that of a CD account) would be returned to the DHF to use at its discretion, but if a borrower defaulted, the DHF would incur

the loss. In effect, we were able to circumvent becoming a CDFI, and still legally test our lending model. While not ideal (from an economic or administrative standpoint), this partnership provided us with the opportunity to lend to borrowers regardless of credit history.

This point was crucial because in contrast to many micro-lending programs in the state of California, *Empresarios Comunitarios* was an attempt to replicate the ideals of Muhammad Yunus' Grameen Bank. As author of *Banker to the Poor* Muhammad Yunus often quips, "whatever banks did, I did the opposite". Whereas traditional banks made loans of large amounts to rich men with good credit, the Grameen Bank made small loans to groups of poor women with no credit. Yunus' thesis was that the poor know how to best spend their money because they are faced with survival scenarios, and as such they are more likely to repay loans if given the opportunity. Moreover, the Grameen Bank proved that relationships rather than collateral can be used as an effective means to securing loans. These precepts were the same ones that set our pilot program apart from preexisting micro-lending efforts in the state of California, many of which are credit based offering loans ranging from \$10,000 to \$30,000.

While we were developing the MOU with CTCU, The Community Financial Resource Center (CFRC) of Los Angeles played an instrumental role in the development of our loan program. With their tutelage, we settled on a "tiered group lending model" whereby a group of borrowers received \$500 each. Once all members of the group repaid their loan, they would be given the option to take out an additional loan of \$1,000 pending the completion of certain business related milestones. The loan process and selection criteria are detailed in the attached "Program Overview".

The final piece to launching our micro-lending program was identifying a Spanish speaking business trainer. We identified Ross Griego, a contractor with more than 15 years of small business training experience, to lead our classes. Mr. Griego worked with our borrowers as a group and individually, training them in issues from budgeting to licensing, and emphasizing the importance of transitioning informal business practices to the formalized economy. Griego pulled from a curriculum we adapted and his own teaching materials. With a wealth of knowledge and resources in place, we finally moved to launch our program in May of 2010.

## **Implementation**

In May of 2010 the Dolores Huerta Foundation began recruitment for the *Empresarios Comunitarios* program by presenting the opportunity to members of the DHF community organization *Vecinos Unidos* (United Neighbors). We presented the tiered group lending model to community members, and began hosting weekly business classes to assist interested parties with the application process which included a very informal version of a business plan. After almost a month of training, our participant pool narrowed to four businesses, which became our first lending group.

Our lending group included a married couple that sells Tamales (Irma & Benjamin), a woman who wanted to start a day-care (Rosa), a woman who wanted to sell jewelry (Gaby), and a man who worked as a welder (Trino). By June of 2010, these four businesses completed the peer approval process (outlined in the Program Overview) and were given loans of \$500. Borrowers

met 1-2 times per month with business trainer Ross Griego for the duration of the six month loan term in order to ensure loan repayment and continue obtaining technical assistance. While we achieved 100% loan repayment, we learned a number of lessons about the reality of working with low-income immigrant populations and the challenges they face in launching a micro-enterprise.

We hope the findings from our pilot program will inform micro-lenders working with a similar population base. We also hope that these lessons will prove meaningful enough to garner funding for a second round of experimental lending in low income immigrant communities. We believe our loan program fills an important gap in the world of financial services.

## **Observations**

### *Resistance to Business Registration*

It takes little more than a stroll through a predominantly Latino neighborhood to discover that this is an entrepreneurial segment of the population. Be it the sale of bacon-wrapped hot dogs or pork rinds from a shopping cart, low-income Latinos find a way to put food on the table for their families. Unfortunately, this entrepreneurial spirit is often channeled into the informal economy, and cash businesses are run without proper licenses and permits. The end result is twofold. First, the informal business is doomed to remain a small cash-only enterprise, and it has little opportunity to create jobs or generate wealth beyond subsistence. The second is that the local and state government loses opportunities to collect much needed business taxes which could benefit the communities where entrepreneurs reside.

Many people in these communities are resistant to registering businesses because it is a difficult and expensive process (especially when many documents are only provided in English), and because doing so necessitates claiming business income. Also, many persons operating illegitimate businesses in these low-income communities furnish others with misinformation about ways to get around registering a business. Similarly, regulations in Mexico and other Latin American countries are less stringent, so there is a cultural misunderstanding of the necessary registration process in the US. These realities make working with low-income immigrant entrepreneurs an uphill battle, but it is a battle that can be won. The task is to reframe the entrepreneur's perspective so that they understand formalization as being to their benefit rather than to their detriment.

### *Success Takes Time*

Of the four loans we issued, zero of our borrowers were able to go legitimate in the six month loan term. The woman interested in starting a day care ultimately opted out of the business idea due to the inherent liability in caring for children. The man who was already working as a welder was hesitant to formalize his business due to a pending divorce, fearing his ex might acquire his assets. The woman selling jewelry left to Mexico for over a month in the middle of our lending cycle, forcing her to look for new employment rather than focus on launching her business. Our final couple, the food vendors, simply did not have the financial means to legitimize their business as it would take access to a commercial kitchen to obtain the necessary health permits to do so. While these four cases are isolated circumstances, they speak to a truth about the reality of launching a small business; namely, that it takes time.

### *Casting a Wider Net*

If we are going to enact change through micro-enterprise development, we need to offer technical service and business capital on a much larger scale. We believe that using our group and relationship based model, we can mitigate the loss of loan capital and provide low income entrepreneurs with opportunities for success. Merely repaying a loan is a small victory for our borrowers as it creates positive credit history. When successful repayment is paired with success in business, we are scoring victories on a number of levels. If we could expand our program to 100 clients and achieve repayment rates in the ninetieth percentile and business success in just ten percent of our loans, the impact would be measurable.

### *Individualized Time Lines*

Different businesses have different monetary and procedural requirements to move into the formal economy, and as such, each business should have an individualized time-frame for registration. Our initial hope was to have all businesses registered after the completion of the \$500 loan level, but this simply is not realistic. For instance, the process to register for a jewelry resale business is infinitely simpler than it would be for a food vendor. For this reason, our group model needs to be restructured in such a way that it accounts for these discrepancies, while still building upon the idea of creating social capital amongst borrowers.

### *Individualized Loan Amounts*

While the \$500 loans we provided gave capital support to entrepreneurs and proved to be a repayable amount, \$500 was not a large enough amount for some businesses to reach milestones. Still, the \$500 loan level is a perfect introductory service and a way to assess the quality of our program applicants by ensuring their ability to make consistent payments and their willingness to attend trainings. We believe that a \$500 loan is a low risk way to bring potential clients into our program, and it allows us the opportunity to provide them with preliminary technical assistance. If they meet the requirements of this loan level, it will give us increasing confidence in working with them towards their future.

Once borrowers have demonstrated a capacity to make monthly payments, we would like them to be able to apply for a long term loan in an amount that can meet their business needs. A formal business plan and budget could serve as the application process for the second round of funding.

## **Successes**

The aforementioned observations do not translate to failures. In fact, they put us in a position to amend our program to have a deeper impact. Even in the pilot stage, the program did achieve a number of measurable successes including:

- 100% repayment of loans
- Assisting a borrower in opening her first bank account
- Building successful credit history amongst program participants
- Providing over 100 hours of technical assistance to low income entrepreneurs

- Proving that hands-on lending translates to successful loan repayments
- Bringing to light predatory business practices in the area of food cart vendors
- Generating interest amongst residents about micro-enterprise
- Assisted borrowers in drafting business plans
- Trained low income entrepreneurs about requirements for operating a small business

### **Next Steps**

We hope to continue to work with our existing clients in assisting them to launch their businesses in the group model, but in order to best serve their needs, we need A) loan capital and B) funding for technical assistance and administration. Moreover, while our partnership with CTCU helped us in issuing loans, it was a short sighted and temporary arrangement from the start. If we are going to scale up the program, we will need to set up a more comprehensive partnership with CTCU that includes interest sharing to generate some revenue for the program.

We envision a loan model whereby:

- Potential participants attend an orientation
- Interested parties attend additional workshops to assist with the application process
- Applicants are accepted according to the DHF lending criteria
- Participants receive a \$500 six month “introductory loan”
- During introductory loan period, participants attend 10-12 weeks of business training
- Individual technical assistance is provided as needed
- Successful repayment of introductory loans qualifies borrowers to apply for a second round of funding
- To be eligible for a second round of funding, borrowers must submit a formal business plan and a detailed budget explaining how the loan funds will be used – loan requests will not exceed \$5,000 with a repayment term of no more than 3 years
- For business purchases of \$500 or more, loan money will be issued to the borrower in the form of a check to the place of purchase for the desired business equipment/supplies (this will ensure that borrowers are actually spending loan money on a business purchase)
- Additional rounds of funding will be dependent upon completion of business milestones including successful registration and acquisition of necessary permits