



Encouraging Entrepreneurship

A Microenterprise Development Policy Agenda

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For more than 20 years, community-based microenterprise programs have been assisting emerging entrepreneurs start and sustain small businesses. They work with home day care providers, landscapers, caterers, salsa makers, woodworkers and car service owners. Their primary customers are women, racial and ethnic minorities, immigrants, individuals with disabilities, people with prison records and others who lack access to banks, business networks and paid sources of management expertise. In helping these entrepreneurs to start and grow their businesses, microenterprise programs provide classes in business management, marketing advice, access to loans and matched savings, financial education and peer networks.

These microenterprises, generally defined as very small businesses with five or fewer employees, play an important role in the U.S. economy. There are nearly 25 million microenterprises in our nation's urban and rural areas. They make up nearly 90 percent of all business establishments, and are important providers of goods and services in local communities.²

As our nation faces an economic recession and a crisis in its financial sector, the tightening of business credit will likely hit these enterprises the hardest. In fact, microenterprise programs are already seeing demand from more advantaged entrepreneurs who can no longer access traditional financing sources. At the same time, however, it is precisely these small businesses that will play a key role in creating needed new jobs and income – especially for the individuals and communities likely to be hardest hit by these economic forces.

As we move into a new presidential administration, there are a number of opportunities for public policy to help microenterprise programs support emerging entrepreneurs as they contend with the current economic environment. As we describe below, policy can play a key role in five areas:

- Expand the existing infrastructure of community-based microenterprise programs that provide technical assistance and financing;
- Implement policies that expand access to private markets and sources of capital;
- Craft tax policies that aid emerging entrepreneurs;
- Enable low-income individuals to use entrepreneurship as a pathway out of poverty; and
- Provide access to affordable health care to small businesses and microenterprises.

There are a number of opportunities for public policy to help microenterprise programs support emerging entrepreneurs as they contend with the current economic environment.

Expand the Existing Infrastructure of Community-based Organizations Supporting Entrepreneurs

Over the past two decades, the federal government has invested in nonprofit organizations that help low-income and disadvantaged entrepreneurs to start and sustain businesses. These programs are operated through a half-dozen agencies. The three most highly targeted programs are the Microloan, PRIME, and Women's Business Center programs, administered by the Small Business Administration, which offer small start up loans to entrepreneurs as well as funding for training, counseling and technical assistance to minority, women, and low-income entrepreneurs. Other important microenterprise support programs include the Community Development Financial Institutions (CDFI) Fund, the USDA's Rural Business Enterprise Grants and Intermediary Relending programs, the Department of Health and Human Services' Job Opportunities for Low Income Individuals, and the Community Development Block Grant, which many cities and counties use to fund local microenterprise efforts. Nearly all of these programs experienced severe funding cuts during the Bush Administration; reinstating full funding and even expanding these programs would provide an important boost to the nonprofit community organizations that provide technical assistance and financing to small businesses. Expansion of this existing infrastructure may well be on the agenda of the incoming administration, as during his campaign President-elect Obama stated his support for microenterprise development and expanded small business opportunities. He proposed providing additional resources to economic development agencies such as the SBA, and investing \$250 million in the creation of public-private business incubators in underserved communities across the country. President-elect Obama also proposed the

creation of a small business and microenterprise initiative for rural communities.

In addition to federal programs that provide resources to emerging entrepreneurs, the federal government can provide additional sources of sorely needed capital for microenterprise and other community and economic development efforts:

- The Housing and Economic Recovery Act of 2008 (PL: 110-289) enabled Treasury-certified CDFIs to join the Federal Home Loan Bank (FHLB) system. Membership provides CDFIs with access to collateral, which could increase their access to low-cost lending capital. Lenders are eager to review the rules developed by the Federal Housing Finance Agency.
- The Full Faith in Our Communities Act of 2007 (S. 2528) would provide below market-rate capital in the form of a bond guaranteed by the U.S. Treasury Department to a nonprofit lender for community or economic development purposes for low-income people and communities.
- Advocates are supporting efforts to permit Congress to create an economic development grant program, which would provide grants for community economic development purposes to organizations including microenterprise development organizations and CDFIs. The program would be analogous to the FHLB's Affordable Housing Program, which provides a subsidy to developers for the cost of owner-occupied and rental housing for low-income households.

A number of other policy changes could enable entrepreneurs to build their own sources of capital, and to access it through the private market.

Implement Policies that Expand Access to Private Markets and Sources of Capital

The federal government can also play an important role in expanding the ability of low-income entrepreneurs to access private sources of capital. In fact, the Community Reinvestment Act (CRA) encourages financial institutions to support microenterprise initiatives by providing favorable CRA treatment to both loans to and investments in microenterprise programs. As a result, many microenterprise organizations count financial institutions among their key partners. Currently, CRA reporting includes only the census tract in which the small business loan was made. Ideally, the CRA would be expanded to require the gender, racial, income (or sales) characteristics of the business borrower to determine whether the actual loans are received by small, locally-owned enterprises or franchises of corporate chains.³

Table 4.1 *Microenterprise businesses comprise a significant portion of the market that provides job and economic development opportunities in the 12th District.*

State	Total Enterprises	Percent of Businesses that are Microenterprises w/Employees
Alaska	62,462	89.89
Arizona	429,031	87.63
California	3,087,607	88.99
Hawaii	104,529	87.18
Idaho	131,244	87.78
Nevada	195,353	88.02
Oregon	306,966	86.57
Utah	212,082	88.93
Washington	486,504	86.51

Source: Association for Enterprise Opportunity

A number of other policy changes could enable entrepreneurs to build their own sources of capital, and to access it through the private market. One such reform would permit full reporting of utility and telecom payment information to consumer reporting agencies. Under current practices, typically only late payments are reported. Reporting of timely payments could raise the credit score of millions of Americans, moving many African American, Latino, and young people into a prime rate credit score, giving them access to lower-cost private capital. At present, many utility firms' counsels believe that full payment reporting may be prohibited by The Telecom Act of 1996, a legislative effort to move all telecommunications markets toward competition, and some states prohibit full payment credit reporting. Both Congress and states could take steps to rectify this issue and provide clear regulatory authority.

Allowing individuals to access their retirement accounts for business investment as easily as they can for homeownership and college education would open the door to another source of private capital. Employer-based retirement accounts are the primary source of savings for Americans. In addition, there are employer matches and federal tax benefits including the Saver's Credit that help these plans grow in value. At present, individuals can access their IRA and 401(k) to purchase a house or pay for higher education. However, increasingly older Americans are turning to self-employment as a second career, or as a supplement to their retirement income. It is possible to capitalize a business with retirement funds if a person sets up a separate C corporation and creates a profit sharing retirement plan within that corporation, but this option can be complex and time-consuming.⁴ Allowing older entrepreneurs, and others, to more easily borrow against their retirement savings could support their efforts.

Microloan Program

The Microloan Program provides very small loans to start-up, newly established, or growing small business concerns. Under this program, SBA makes funds available to nonprofit community based lenders (intermediaries) which, in turn, make loans to eligible borrowers in amounts up to a maximum of \$35,000. The average loan size is about \$13,000. Applications are submitted to the local intermediary and all credit decisions are made on the local level. Each intermediary is required to provide business based training and technical assistance to its microborrowers. Individuals and small businesses applying for microloan financing may be required to fulfill training and/or planning requirements before a loan application is considered.

PRIME Program

The PRIME Program is a complement to the Microloan program, providing grants to microenterprise development organizations throughout the country to offer valuable training and technical assistance to low-income and very low-income entrepreneurs, regardless of whether they are seeking a loan. PRIME also provides limited grant funding for capacity building among community-based microenterprise organizations. The funds allow microenterprise development organizations to build their management, outreach and program design capacity to more effectively serve their clients.

Women's Business Center

The Office of Women's Business Ownership and the Women's Business Center provide valuable training and counseling services. This network of over 100 centers throughout the country is designed to assist women achieve their entrepreneurial goals and improve their communities by helping them start and run successful businesses through training and technical assistance.

Source: U.S. Small Business Administration

The Historically Underutilized Business Zone program at the Small Business Administration provides incentives for federal agencies to contract with businesses located in low-income distressed communities. Unfortunately, this contracting provision is rarely implemented. At the same time, recent reports indicate that the federal government has not met its small business contracting targets, and a number of larger firms have erroneously received preferences under these policies. Enforcement of these programs must be improved.

In addition, as the country works to address its energy and environmental challenges, policy makers should consider the role that small businesses and microenterprises can play in these initiatives. For example, President-elect Obama has stated his support for businesses that advance energy technology, and for ensuring that "21st century jobs" are increased throughout the country. Within these initiatives, it will be important to recognize the roles that very small businesses can play in supporting the "greening" of our economy.

Create Tax Policies that Support Emerging Entrepreneurs

In her 2006 Report to Congress, the National Taxpayer Advocate, Nina E. Olson, stated that the IRS's Small Business/Self-Employed division was not adequately helping small business filers.⁵ She cited the "complex tax laws" and the inability of many small business taxpayers to afford professional tax advice. Rather than serve as a welcoming gateway that helps new businesses to "get their business

right" and to grow, the Schedule C tax interface (part of the Form 1040 used to report profit or loss from business) tends to have the opposite effect and taxes are not filed. There are several ways the IRS could create a more welcoming environment:

- Create a self-employment tax credit. President-elect Obama has proposed the creation of a "Making Work Pay" tax credit that will assist all workers, including the self-employed. With the tax credit, each worker in America would receive a \$500 tax credit to offset federal income and payroll taxes;
- Encourage the IRS to actively extend the capacity of its successful Voluntary Income Tax Assistance (VITA) program to serve low-income taxpayers with self-employment income (the program offers free tax help to low- and moderate-income people who cannot prepare their own tax returns). Currently many IRS offices discourage or forbid volunteers from filing Schedule C self-employment returns;
- Advocate that the recently passed "community VITA" appropriation, which provides \$8 million to be available through September 30, 2009, be used to establish VITA demonstration projects to serve low-income, self-employed households;
- Require the IRS Small Business/Self-Employment division to expand its "first-time filer" initiative through demonstration projects that would explore how the IRS and non-profits can better serve this constituency; and

- Ask Congress and the IRS to study the specific needs of first-time filers and how to better resolve the cash-flow dilemma faced by the self-employed.

Enable Low-Income Individuals to Use Microenterprise as a Pathway Out of Poverty

Many of our lowest income Americans turn to self-employment as a means to create a job or to supplement a low-wage job. But too often, federal programs that support these individuals – by providing a safety net or workplace skills – fail to recognize that self-employment can and should be an option. For example, asset limits in programs such as the Supplemental Nutrition Assistance Program (SNAP, previously known as the Food Stamp program) and Temporary Assistance for Needy Families (TANF) make it difficult for recipients to save and acquire business assets, while training initiatives for recipients of these supports often do not offer self-employment as an option. And even when policy makers do find ways to support the self-employment option under current law, caseworkers often struggle with how to deal with these atypical cases. We recommend four steps that policy-makers can take to open the self-employment path for our poorest Americans.

Microenterprise is a time-tested wealth creation strategy, particularly for the low-income and minority communities that are at financial peril in the current economic climate.

First, both state and federal policy makers should reform the asset means tests in public assistance programs, such as SNAP, TANF, and Supplemental Security Income (SSI). States currently have the flexibility to raise or remove the asset limits from SNAP and TANF and should take advantage of it. States also have the option of exempting certain classes of assets from their asset means test, so that individuals are not hindered from building up the resources and assets needed to achieve self sufficiency. Since 1996, a number of states across the country have taken advantage of the opportunity to reform their asset limits. To date, 15 states have eliminated asset tests for SNAP and several states have implemented TANF asset test reform by abolishing the limits or raising them substantially.

Table 4.2 *Size Estimates of Key Components of the Market for Microenterprise Services*

Market Segment*	Number of Microentrepreneurs
Microenterprises with difficulty accessing bank financing	10.8 million
Women-owned microenterprises	5.13 million
Business owners with personal incomes <\$10,000	4.3 million
Low-income self-employed individuals	1.7 million
African American-owned microenterprises	650,000
Hispanic-owned microenterprises	800,000
Asian-owned microenterprises	650,000
Native American-owned microenterprises	170,083
Individuals with disabilities**	3.12 million
Welfare recipients who would become self-employed	140,377
Unemployed individuals who would become self-employed	251,430

*These components of the market overlap. For example, many of the entrepreneurs who have difficulty accessing bank financing are women or minorities.

** The estimated number of individuals (most of whom are currently not working) who would be self-employed given the availability of services and more conducive policies.

Source: FIELD, Aspen Institute (2005)

In recent years, there have been efforts at the federal level to reform asset means tests in public benefit programs. One major development in this effort occurred this year in the 2008 Farm Bill (the Food, Conservation and Energy Act) which exempted Individual Retirement Accounts, Coverdell savings accounts and 529 College Savings Accounts from asset limits in SNAP. In 2007, the Freedom to Save Act was introduced in the House, which proposed excluding certain assets in determining eligibility for TANF, SNAP, SSI and the State children's health insurance programs. There has also been interest in the Senate in introducing legislation that reforms the asset limits for SSI and the Social Security Disability Insurance Program (SSDI).

Second, policymakers, at both the state and local level, should promote microenterprise as an eligible work activity for recipients of TANF and SSDI. While welfare reform has resulted in many successes, some low-income Americans are still failing to connect to our economy. At the federal level, Congress should modernize the TANF program such that it focuses on providing sustainable employment and movement out of poverty for needy families. In doing so, it should clarify that self-employment preparation and engagement in self-employment are eligible work activities, and provide clear guidance as to how states and localities can support microenterprise through their TANF programs.

Third, policy should encourage microenterprise as a prisoner re-entry strategy. As prisoners are released from incarceration, finding employment becomes a major concern. Many jobs are not available to those with a prison record and many returning prisoners have limited job experience and skills. Self-employment can be a natural fit for this population. At the federal level, we recommend the creation within the Justice Department of a pilot program on microenterprise development for returning prisoners. State policymakers should consider similar programs.

Finally, we need policy to expand matched savings accounts for business capitalization. Most businesses start with savings, not debt. Nationwide, there are more than 83,000 matched savings accounts known as Individual Development Accounts (IDAs). These accounts match the savings, up to \$2,000, of low-income entrepreneurs, homeowners, or college students to help them become financially self-reliant. To date, more than 35,000 asset purchases have been made including 6,300 small business capitalization investments.⁶ Congress should expand the resources available for IDAs by enacting the Savings for Working Families Act

(S. 871/HR 1514) which would make matched savings accounts available to up to 900,000 low-income Americans. Congress should also fully fund the Beginning Farmer and Rancher Act included in The Food, Conservation and Energy Act of 2008. This new program would provide matched savings accounts for up to 4,000 farmers and ranchers to encourage food security and economic growth.

Ensure that Health Coverage Reforms Address the Particular Needs of Low-Income Entrepreneurs

Under our current health insurance system, small business owners struggle mightily to pay for coverage for themselves and their employees. Microenterprise and low-income business owners struggle the most. Research conducted by the Aspen Institute has found that illness and other health concerns often contribute to the closure (or failure to open) of businesses owned by low-income entrepreneurs.⁷ President-elect Obama has also recognized the burden of health care costs to small business owners. His proposed health care plan would lower health care costs for small businesses by creating a new refundable small business health tax credit of up to 50 percent on premiums paid by small businesses on behalf of their employees.

Conclusion

Microenterprise is a time-tested wealth creation strategy, particularly for the low-income and minority communities that are at financial peril in the current economic climate. The time is now to envision and secure policy options that produce abundant, sustainable and enduring sources of funding for the microenterprise field.

The microenterprise field has had some notable policy successes in the past year. After several difficult years of diminished and then zero funding, efforts to restore funding to federal programs supporting the field were successful. Policies increasing access to capital and supporting entrepreneurship also achieved some success. However, to truly meet the growing demand for microenterprise services in the United States, more must be done. With the advent of a new administration in 2009, the microenterprise field is poised to pursue opportunities for growth and innovation. Together, advocates, researchers, practitioners, financial institutions and entrepreneurs can seize these opportunities by promoting an ambitious new policy agenda for low-income microentrepreneurs and the programs that serve them. 

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