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Good morning, Madame Chairperson, members of the Senate Committee on Small Business and Entrepreneurship, and guests. Thank you for this opportunity to testify before you this morning about the proposed termination of the SBA Microloan Program and PRIME in the President's FY2005 budget.

My name is Mary Mathews. I am President of the Northeast Entrepreneur Fund in Virginia, Minnesota. The Entrepreneur Fund is a microenterprise and small business development organization. We provide training, technical assistance and financing to emerging and existing businesses in eleven counties in northeastern Minnesota and northwestern Wisconsin.

As a former Board Chair and a member of the Policy Committee, I am here representing the Association for Enterprise Opportunity (AEO). AEO is a national association representing more than 450 microenterprise development organizations across the country. Many of our members are SBA Microloan Programs, PRIME Grantees, or Women Business Centers.

Microenterprises are small businesses with five or fewer employees with initial capital needs of $35,000 or less. Many microentrepreneurs are low income, women, minorities, or disabled individuals who may face other challenges to business success. Both the Microloan program and Women's Business Centers predominately serve women and minorities, while PRIME predominately serves very-low-income clients.

Microenterprise development organizations (MDOs) run community-based programs that provide assistance to entrepreneurs in three core areas: credit, training, and technical assistance. MDOs can be small, large, urban, rural or faith-based. Credit is supplied by MDOs to entrepreneurs with solid business plans and the potential to succeed. Training often takes place over the course of several weeks and requires a significant time investment on behalf of both the MDO and the microentrepreneur. Microenterprise technical assistance involves intensive and continuous business support that meets the particular needs of our target market.

Conventional sources of business credit are often beyond the reach of entrepreneurs who need small amounts of financing to start or grow a business when they are economically disadvantaged due to lack of business experience, sound credit history, or collateral to secure a business loan. The SBA Microloan Program continues to solve this problem by funding community-based intermediaries to help micro business owners gain access to credit.

The SBA Microloan Program was created in 1991 to help small business owners in need of small amounts of capital that are not yet “bankable” in the private sector lending community. The Program has grown from a small pilot program with 35 intermediaries in 1991 to a permanent program with over 185 organizations. The Microloan program is the single largest source of funding for microenterprise programs.

SBA Microloan Program Intermediaries have made over 19,000 micro loans totaling over $214 million. In FY2003, Intermediaries made 2,422 loans, totaling $29,932,410.49. This program exceeded SBA’s Microloan goal of $28 million in new loans. Most of those loans went to women, minority, and low-income entrepreneurs. These loans would not have been made but for the SBA because in order to get an SBA Microloan, borrowers must demonstrate that they are unable to get comparable credit, at reasonable rates, from an area lender.

The Microloan program has two parts. The SBA makes low-interest, 10-year loans to Intermediaries who, like the Entrepreneur Fund, make very small loans to micro-entrepreneurs. The SBA also provides the Intermediary with an annual technical assistance grant that helps support the cost of training and technical assistance to borrowers. Microloans are high-risk loans, usually to start-up and early stage businesses. Technical assistance protects the Federal government’s investment and it increases the entrepreneur’s potential for success.

AEO and its members are asking Congress to appropriate $35 million in FY2005 for loan capital, $25 million for Technical Assistance grants through the Microloan program, and $15 million for PRIME. PRIME is specifically targeted to provide technical assistance to very low-income people. After 11 years, the SBA Microloan Program is just hitting its stride. Loan volume continues to increase each year.

As you know, the President’s budget for FY2005 terminates the SBA Microloan program and zero funds PRIME. The SBA contends that the program is too expensive and that the 7a and Express Loan guarantee programs will serve market demand for microloans. While we applaud the growth in these guarantee programs and commend the SBA for program efficiencies that have helped build demand, we disagree. The SBA Microloan Program and SBA loan guarantee programs serve different markets.

To illustrate, I will use the Northeast Entrepreneur Fund as an example.

In the past 14 years, the Entrepreneur Fund has provided business development training and technical assistance to over 5800 men and women – all local residents – for many of whom this is their first exposure to business concepts. So far, this has resulted in the start-up, stabilization or growth of 692 businesses. Over 85% of the businesses, mostly start-ups, are still operating two years after receiving assistance. These are very small businesses, each owned and operated by a local resident who is creating their own economic opportunity. As a group, the business owners have generated a significant level of employment for themselves and others—over 1800 jobs have been created or retained so far.

The Entrepreneur Fund has been an SBA Microloan Intermediary since the program began in 1992. We have made 186 SBA microloans totaling $1,462,226. We have analyzed our SBA Microloan portfolio, comparing loan attributes against SBA7a, SBA Express and Community Express lending criteria. The results are as follows:

- 85% of the loans in our portfolio did not meet the minimum guidelines for equity injection by the customer in order to qualify for an SBA 7a loan. According to the SBA “Typically, an applicant should inject one-third to one-half of the total funds needed to start a business.”

- Two thirds (66.67%) of the loans would not meet most commercial lending institutions credit worthiness guidelines. Many of these customers show recent bankruptcy activity or judgments. We recently started collecting credit scores. The average credit score of our approved loans has been 600, with a low of 485 and a high of 700. Half of the loans had good credit but low credit scores.

- The ability of individuals to manage the resources of their business, sometimes referred to as "character," is a prime consideration when determining whether or not an SBA 7a loan will be made. For over half of the loans in the portfolio, the entrepreneur had no experience in the business they started and more lacked the ability to manage a business in general. The Entrepreneur Fund’s technical assistance program helps to educate and motivate the borrower until they gain the experience needed to manage the business and its resources.

So, given the characteristics of the borrowers, you probably wonder how our portfolio is performing. The Entrepreneur Fund’s Microloan portfolio delinquency rate (over 30 days) is 2.1%. 10.1% of the portfolio has been charged off since 1992.

What makes the difference is the training and technical assistance provided by the lender. Our performance is not unique among Microloan programs. It is why, in 12 years, the SBA has only lost money due to a default once.

The SBA’s premise in terminating the Microloan program is that banks will use the guarantee programs to make small loans. I would ask the bankers in the room whether, with a guarantee, they would make loans to the borrowers with the characteristics I just described. Not only that, the average loan size for 7a loans in FY2003 declined to $167,000. The Entrepreneur Fund’s average loan size was $9000.

Bankers have often said that they don’t make microloans because it costs them too much. It takes as much, or maybe more, time to make a small loan to a start-up entrepreneur as a large loan to an experienced borrower. And a large loan generates more revenue from interest. Most banks cannot afford to make microloans because of the time intensive nature of loan servicing and monitoring the loan, even with a guarantee.

We agree with the SBA that this is more expensive than their other credit programs, but the SBA is also not comparing “apples to apples” in assessing the true cost. Where else in the SBA is the cost of technical assistance and program operations counted directly in determining the cost of the loan? Both PRIME and Microloan Technical Assistance are Entrepreneurial Development functions, yet they are budgeted and housed on the credit side at the SBA.

AEO and the Intermediaries have worked with the SBA to make process improvements in the Microloan Program in the past. In the past two years we have made recommendations for changes in the allocation of Technical Assistance grants to make them performance-based. We have supported program changes that enhanced performance. As I said before, this program is just hitting its stride. Annual outcomes can only increase if the program is continued and the funding maintained. I hope I have helped make the case that other guarantee programs are not serving the same market. It is my understanding that there are 39 requests from Intermediaries at the SBA seeking additional loan capital as soon as the FY2004 budget is completed. There is demand for the product.

In closing, I would again ask that this committee support funding in the FY2005 budget for PRIME at $15 million, $35 million for loans to SBA Microloan Intermediaries, and $25 million for Microloan Technical Assistance.

The SBA’s budget summary states an intent to re-design programs. We stand ready to work with the SBA on continuous improvement.

Don’t terminate these programs and close the door to economic opportunity for the people these programs serve!

Thank you.