The Economic Viability of Microfinancing in Pennsylvania

By: Gayle A. Morris, Ph.D.
Edinboro University of Pennsylvania

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EXECUTIVE SUMMARY
This study analyzed the role of microfinancing programs in providing financial services to small businesses located in rural Pennsylvania counties. Microfinancing focuses on providing microloans, which are loans less than or equal to $50,000, to individuals who typically operate a very small business (five employees or fewer).

Specifically, the research goals were to: provide an overview of currently functioning microfinance programs in Pennsylvania; provide in-depth information on a select number of microfinance programs serving rural Pennsylvania counties; and provide an assessment of the barriers and opportunities for lending institutions in providing microfinancing services, and for borrowers in accessing these financial services.

According to the research results:
- Microloan borrowers sustained (and at times increased) the economic growth of a rural area/town in which they were located;
- The provision of microloans to small businesses in rural counties is a viable economic development strategy for specific rural areas with established economic growth potential but is not sufficient to jump-start or sustain growth in an area that is languishing economically;
- Continued constraints on the Pennsylvania state budget mean funding of small business lending will increasingly originate with the federal government and the private sector;
- Lenders will continue to play a pivotal role in providing loanable funds (through loans of \( \leq 50,000 \)) to very small businesses; and
- The economic downturn, beginning in 2008, increased the movement of small business borrowers from big banks to small banks and alternate lenders.

INTRODUCTION
Microfinancing focuses on providing financial services to individuals who typically operate a very small business but do not have access to such services. Traditionally, microfinance services have focused on the provision of lending and savings instruments to owners of small businesses. While

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For more information, contact the Center for Rural Pennsylvania, 625 Forster St., Room 902, Harrisburg, PA 17120, telephone (717) 787-9555, email: info@rural.palegislature.us.
the provision of microfinance services has become a popular antipoverty strategy in developing countries, it has only been widely endorsed in industrial countries in the last three decades (Armendariz and Labie, 2011). In a 2007 speech, Chairman of the Federal Reserve Board Benjamin Bernanke recognized the growing importance of the microfinancing field “…to expand economic opportunities for individuals and to foster community economic development by providing small loans and other business services to people who have been traditionally underserved by mainstream financial institutions”.

Very small businesses or microenterprises expanded in the U.S. during the 1990s. Now, these microenterprises number more than 20 million (Aspen Institute, 2005). A 2008 Pennsylvania estimate calculated the total number of microenterprises in the state at 897,602, which accounted for 16 percent of workforce employment (Kauffman, 2008). Nationally, microenterprises represented approximately 86 percent of all U.S. firms and constituted 17 percent of total nonfarm employment (Kokodoko, 2007).

As the number of microenterprises expanded, the demand for organizations providing financial services to these firms also grew. Research has shown that approximately 82 percent of the owners of microenterprises (microentrepreneurs) have never received a bank loan (Burrus, 2005). Of the 82 percent, 86 percent never applied for a bank loan, and 14 percent applied but were rejected. Burrus estimated that less than 1 percent of microentrepreneurs receive microfinance, which illustrates both an enormous growth potential in this market, and the difficulty of providing small loans to creditworthy applicants (Burrus, 2005).

Commercial banks have been reluctant to provide microcredit servicing for three main reasons: microloans require additional expenses related to borrower identification and vetting (including assistance with business plan preparation); the initiation and maintenance costs for a commercial bank are scale neutral (approximately the same regardless if a loan is $40,000 or $400,000); and microentrepreneurs often lack the requisite collateral to secure the loan, and the requisite business history to satisfy bank criteria. The reluctance of commercial banks to provide microloans to creditworthy microentrepreneurs has meant these potential borrowers have been unable to access small business loans (Wilkinson and Christensson, 2011).

Several organizations initiated microfinancing services to very small businesses in the U.S. in the 1990s to fill this void. In 1991, the U.S. Small Business Administration (SBA) recognized microenterprises as a separate category of business activity and established the Microloan Demonstration Project to provide funding to these firms. Many of the organizations providing financial services to these small businesses are outside of the commercial banking structure and are known as “alternate lenders.” Examples of alternate lenders include community development financial institutions and credit unions. These organizations provide a variety of services to microentrepreneurs that can include microfinancing, business training, and information on a variety of other topics such as health care and child rearing. The variety of services offered by these organizations reflects their multiple goals, which if put on a continuum, would run from charitable contributions to successful business operation to socio-economic community development.

Though these organizations charge interest on their loans and assess other fees on the services they provide, few of them are self-sufficient (Edgecomb and Klein, 2005). Funding from government sources, private donors, and religious groups continue to help defray their costs. Another opportunity to defray organizational (and small business) costs in Pennsylvania is the provision of a student intern to qualified entrepreneurs who are located in one of the defined Keystone Innovation Zones (KIZ). KIZ organizations, working with local university partners, pair qualified businesses and student interns. Internship Support Grants reimburse the business or university up to $2,000 per student per semester. Student interns have been used by microentrepreneurs, who qualified for microloans and/or micro grants, to develop websites, assist with software packages, and develop marketing campaigns. This has given microentrepreneurs

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2. A microenterprise or very small business is defined as a business that has five or fewer employees. A small business is defined by the Pennsylvania Department of Community and Economic Development as a business with 100 or fewer employees. A microfinancing program typically provides loans of $50,000 or less to microentrepreneurs to start or expand a small or very small business.
3. Self-sufficiency refers to the ability of organizations to provide funding for their services from fees and other income-earning measures (e.g., loan interest) without relying on outside infusions of revenue.
4. The Greater Susquehanna Keystone Innovation Zone has used the student internship program to assist its business clients.
low-cost access to innovative technology as well as low-cost training to student interns.

Interestingly, commercial banks have indirectly become involved in the provision of micro credit by cooperatively working with microfinancing organizations (Virani, 2008). The main impetus for commercial banks to become indirectly involved was the 1977 Community Reinvestment Act (CRA). The CRA created a legal obligation for banks insured by the Federal Deposit Insurance Corporation to meet credit needs in their defined market area. These needs included providing loans to various-sized businesses. In 1993, new regulations allowed and encouraged banks to cooperate with, and provide support to, alternate lenders as a way of satisfying CRA obligations.

Commercial banks provide resources to microfinancing organizations that include bank personnel sitting on lending committees and grants that are used to fund lending activities. Examples include the First Columbia Bank and Trust in Bloomsburg, Pa., which has bank personnel represented on microfinancing loan committees, and PNC Bank, which provides loanable funds to regional microfinancing organizations. Other areas of cooperation include governance support, marketing data, and referrals. With reference to the latter, the researcher uncovered several examples in this research that illustrated the positive impact of the referral system. Both PNC and Erie Bank personnel referred “good” clients to microfinancing organizations included in this study when their loan requests were too small to be profitably handled by the commercial bank. The channeling works both ways, as graduates of alternate lenders can be referred back to these banks if their second or third loan requests become too large for the microfinancing organization to service, or if the borrower requires financial services not offered by the alternate lender.

Pennsylvania offers a variety of state government programs designed to assist start-up and ongoing businesses, though not necessarily microentrepreneurs. A few state programs, while not microloan programs, offer smaller loans/grants to qualified business applicants through the Department of Community and Economic Development (DCED), such as the Enterprise Zone Program, Community Economic Development Loan Program, and Penn Capital Access Program. Municipalities and counties in Pennsylvania offer revolving loans through their redevelopment authorities or their county economic alliance organizations. State economic development agencies, such as DCED, can act as public partners with local development districts to lend microloans (≤$50,000) to small businesses. And alternate lenders, such as the Progress Fund and Bridgeway Capital, can act as intermediaries for loanable funds from both the state and federal government.

Municipal and state direct funding of microloan programs varies across the U.S. (Brash, 2008). Philadelphia funds one direct microloan program through its Public Housing Authority for public housing residents only. Pennsylvania (at the state level) has no direct microloan programs, but is involved indirectly in providing loans to small businesses. And in contrast to other states, such as New York and California, Pennsylvania spends none of its Community Development Block Grant monies on microenterprise lending.

**Literature Review**

Recent studies have provided different conclusions on the viability of microfinancing with some studies questioning whether microlending is sufficient, and other studies stressing the necessity of a microloan (Servon and Bates, 2008; ACCION, 2008; Microcredit, 2006). The impact of microloans on borrowers and their businesses has been documented in developing countries as well as the U.S. The research of Morris and Barnes on the impact of microloans in Uganda found similar impacts to other micro credit studies in developing countries: borrowers added new products or services, borrowers moved to new premises or sold

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5. At a minimum a market area is defined where a bank has its offices and takes deposits.
6. Citigroup started charitable funds accounts to assist wealthy clients who wanted to donate money to microfinancing organizations as reported by Kristen McNamara in “Citi Fund Backs Entrepreneurs” Wall Street Journal 6/13/2007, B3.
7. The Aspen Institute has estimated the cost of microfinancing programs acting as financial intermediaries to be $2,000 per loan (Corporation, 2009-2010). Sufficient state funding to intermediaries to help offset this cost is $500. Pennsylvania provides $7, with the majority of this money allocated to training through Small Business Development Center funding.
8. Pennsylvania used federal stimulus monies (set aside through SBA) to fund the American Recovery Capital Loan (ARC loan) program through commercial lenders. This program provided up to $35,000 to those businesses that could prove they had been negatively impacted by the most recent recession.
9. Microfinancing refers to all financial services (savings, lending, financial education) that a commercial bank or an organization provides to eligible clients. Microfinance delivery programs refer to those banks/organizations that provide the financial services. Microlending refers only to the availability of loans ≤$50,000 to businesses.
in new markets, borrowers reduced their costs by selling in bulk, and borrowers increased the size of their stock (Morris and Barnes, 2005; Sebstad and Chen, 1996).

Since 2003 the Aspen Institute, through its Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination (FIELD) program, has conducted an annual U.S. survey of microenterprise programs and their clients. FIELD research provides data that illustrate the positive socio-economic impact of both microentrepreneurs and the microenterprise organizations that assist them. According to the latest FIELD data, microloan recipients had strong positive results from their continued association with microfinancing programs (FIELD, 2010). Those positive results were based on a survey of 240 microloan borrowers who had a 5-year association (2004-2009) with a microfinancing program. For those respondents, business median revenues had increased 60 percent, paid workers per business had increased from 2.1 to 5.6, and 50 percent of all start-ups had paid employees (average of two per firm) (FIELD, 2010). Other FIELD studies have reported that microloan borrowers were more likely to operate a business full-time that generated higher revenues, and were more likely to withdraw a higher salary from business revenues than comparable non-borrowers (Thetford, 2010; FIELD, 2007, 2009). Microloan borrowers were also likely to have positive responses (73 percent indicated their expectations had been completely or mostly met by the microfinancing program) when asked to evaluate the services they had received from their microfinancing program (FIELD, 2010).

In Pennsylvania, microfinance delivery programs have been concentrated in urban areas servicing low-income microentrepreneurs, many of whom are minorities. Two of the largest programs are the Pennsylvania Microenterprise Program Coalition, focusing on clients in Philadelphia and surrounding urban counties, and the Bridgeway Capital program in southwestern Pennsylvania (Bridgeway Capital, 2008; Pennsylvania Microenterprise, 2006). Smaller programs serve rural counties exclusively, such as the North Central Pennsylvania Regional Planning and Development Commission (NCPRPDC).

SBA is the largest creditor in the U.S. of small businesses (Craig, Jackson, and Thomson, 2007). The main SBA loan programs include: 7(a) Loan Program, 504 Loan Program, Small Business Investment Company Program, and the Microloan Program (Gu, Karoly and Zissimopoulos, 2008; Brash, 2008). The Microloan Program was initiated in 1994 and has provided more than 3,000 new loans to small businesses (SBA Fact Sheet, August 2005). The objective of the SBA Microloan Program is to provide financing (up to $50,000) to U.S. small businesses through lending intermediaries.

GOALS AND OBJECTIVES
The goals of the research, which was conducted in 2011, were to: provide an overview of currently functioning microfinance programs in Pennsylvania; provide in-depth information on selected microfinance programs serving rural Pennsylvania counties; and provide an assessment of the barriers and opportunities for lending institutions in providing microfinancing services, and for borrowers in accessing these financial services.

METHODOLOGY
This study used an exploratory research design and focused on information and outcomes for organizations and business owners who participated in microfinancing programs in rural Pennsylvania counties. The research was built on previous studies of microenterprise lending (FIELD, 2007; Chrisman, Gatewood, and Donlevy, 2002; Chrisman and McMullan, 2000; Chrisman, Hoy, and Robinson, 1987), and provides an original contribution to the literature by focusing on outcomes for alternate lenders and business owners who participated in microfinancing programs in rural counties.

The research compiled an overview of currently functioning microfinance programs in Pennsylvania using Internet sources, referrals from existing program personnel, newspaper articles, and publications reporting on entrepreneurial activities in Pennsylvania.

The research examined 57 organizations in Pennsylvania to determine if they qualified as alternate lenders and found that 20 organizations provided microfinancing programs. The researcher developed and emailed a questionnaire to personnel from those

10. The U.S. Department of Treasury, through its Community Development Financial Institution Fund, and the U.S. Department of Agriculture, through its Rural Business Enterprise Grants Fund and Intermediary Relending Program, also provide loanable funds to small businesses.
11. Microfinancing programs are defined as alternate lenders (i.e., not commercial banks) who provide loans of ≤$50,000 to small businesses (≤100 employees but averaging ≤20 employees).
20 organizations. The researcher also examined the websites of the 20 programs and conducted numerous follow-up telephone interviews with the personnel of those programs to obtain requested information.

From the 20 programs, the researcher selected three microfinancing programs serving rural clients in Pennsylvania for in-depth analysis as follows: NCPRPDC, the Progress Fund, and Bridgeway Capital. The programs were selected because they: had a history of lending to microentrepreneurs, contributed to rural geographic diversity of the study, and were willing to provide data for the study.

Each organization supplied the researcher with contact information for small business borrowers who had a business located in a rural county and who had received a loan of ≤$50,000 in the past 6 years. Due to the small number of borrowers (20 for NCPRPDC, 17 for the Progress Fund, 11 for Bridgeway Capital) the researcher attempted to interview all identified borrowers. Given the similarity of responses and the number of borrowers (36) who responded to the interview requests, the researcher collapsed the borrower responses into one dataset. Borrowers who were delinquent on their loans, or whose businesses no longer existed were not interviewed per agreement with the lending organizations.

The researcher analyzed the borrower data using the Statistical Package for the Social Sciences (SPSS) and used descriptive statistics as well as Chi-Square and ANOVA statistical tests to present the data. The researcher used a Likert scale analysis to measure borrower perceptions of business training offered before and after the microloan was received, and to analyze lending procedures at the three selected microfinancing programs.

To examine barriers and opportunities for commercial banks to provide financial services and for borrowers to access these services, the researcher used primary and secondary data. Seven commercial bank lenders were interviewed for this study.

The researcher also used secondary data to identify and project the supply of and demand for microfinancing services.

RESULTS

In the U.S., microfinance refers to loans of $50,000 or less that target small business start-ups or expansion. Loan features such as collateral requirements, loan size, and loan terms are usually tailored to the needs of low-income and higher risk borrowers. Microfinance may also include business training components.

Microlending has targeted small businesses, defined by DCED as businesses with fewer than 100 workers, that are large enough to benefit from loans of ≤$50,000 but are too small to readily access commercial banking services. Start-up businesses are considered especially risky by commercial banks, but are more likely to be funded by microlending programs. The main reason for the increase in start-up lending costs is the additional time that is spent with the potential borrower by the loan officer, and a business site visit. Microlending programs are housed in relatively small operations offices with fewer than 10 employees, so clients often deal with the same one or two people throughout the application and repayment process. Microfinancing program lenders traditionally know a great deal about their borrower clients by the time the loan has been closed.

Microlending Programs in Pennsylvania

In this study, 20 out of 57 organizations were identified as providing microfinancing and 37 were identified as organizations not providing loans of ≤$50,000 to businesses. Of the 20 organizations that were participating in microfinancing programs, eight provided services to urban county clients only, five provided services to rural county clients only, and seven provided services to clients in both urban and rural counties. Table 1 on Page 6 provides additional information on the 20 organizations.

The eight organizations that provided services in only urban counties were more likely to focus on the development of individuals as well as their businesses. Besides providing business training in accounting and the preparation of financial statements, individual development also included basic financial literacy, credit counseling, and GED certification. In addition

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12. In 2008 there were 139 microlenders who provided lending information to FIELD. Of those microlenders the median number of microloans made was 13 and the mean was 44 (FIELD-Wide Survey, 2010).
13. The loan amount was $35,000 until the Small Business Administration increased the amount to $50,000 in the summer of 2010.
14. Information in this paragraph is summarized by the researcher from statements made by personnel at commercial banks and microlending organizations used in this research.
to community development being listed as a goal, these urban organizations also listed poverty alleviation and business development. These organizations were also more likely to mention social and economic self-sufficiency as a reason for offering training.\(^{15}\)

The five organizations that provided services in rural counties only did not focus on financial literacy training or credit counseling for borrowers. Instead they focused on business development as a primary objective, with small town sustainability as a secondary objective.

Client location was an explanatory factor in this lack of focus on individual education. Rural clients often found themselves several hours from education/training and/or with unreliable access to Internet services. Organizations that required business training often made clients complete the training before a loan was approved. For example, NCPRPDC required 20 hours of entrepreneurial training prior to the extension of a loan to a small business owner.

The seven organizations that provided services to clients in both urban and rural counties focused on lending to qualified borrowers who would grow their businesses and contribute to the economic growth of an area. These organizations focused on developing new businesses, expanding existing businesses, and/or creating jobs to increase the level of community economic activity. An example of this type of organization was the Community Action Committee of the Lehigh Valley, which offered both individual (such as credit counseling) and business training. It was cost-effective to offer two types of training due to the high density population service area of southeastern Pennsylvania where the program is located.

All 20 microfinancing programs researched provided services to both women and men. Four of the 20 organizations (Bridgeway Capital, Community Action Committee of the Lehigh Valley, Entrepreneur Works, and Women’s Opportunities Resource Center) provided more than 50 percent of their loans to women business borrowers. The higher percentage of women borrowers for these four organizations reflected a concerted effort on the part of the organizations to recruit qualified female applicants.

Each of the 20 organizations provided information on the average loan size and repayment period of its microfinancing program. Microloan sizes ranged from $2,000 to $41,000. The average repayment period was 5 years, and the average repayment rate

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\(^{15}\) Social self-sufficiency refers to the development of independent thinking and behavior.
was greater than 80 percent. The average number of loans disbursed over the life of the organizations was 261, with 45 loans representing the lowest number (NCPRPDC), and 920 the highest (Community First Fund).

Community development financing is frequently concentrated in urban counties with rural counties often neglected. One explanation for this is the large geographic area that must be covered by rural programs, and their relatively smaller scale. Thus, rural programs may seem to have less impact than urban programs, which are concentrated in densely populated areas. Another explanation is the difficulty in bringing together the three major players in microfinancing in rural areas: alternate lender, commercial bank (both in terms of funds provision and personnel availability for lending committees and boards), and the small business borrower.

In terms of the number of clients served and the number of loans provided by the organizations, the urban-located programs dwarfed the other programs. Community First Fund, Entrepreneur Works, North-eastern Pennsylvania Alliance, and Women’s Opportunities Resource Center served the Philadelphia, Scranton, and Chester areas. Each of these programs provided services to more than 3,000 participants, and had provided loans to 8 percent of them over the life of the program. The rural-only programs averaged 115 participants and provided loans to 13 percent. Thus rural microfinancing programs were not able to take advantage of economies of scale in the provision of microfinancing services that existed for urban programs.

Funding sources for these 20 organizations included the federal government (SBA, U.S. Treasury, U.S. Department of Agriculture), Pennsylvania state government, and others, such as foundations, religious organizations and private sector businesses. All 20 organizations also used earned income from loan fees and training fees to offset expenses.

The number of organizations involved in microlending in Pennsylvania is not a static number. Organizations, such as the Johnstown Area Regional Industries, began extending microloans in 2012 in coordination with SBA. These microloans complement an established lending portfolio that has historically received money from private business foundations, DCED, and SBA in extending loans greater than $50,000, and providing other forms of business assistance to the Greater Johnstown Area.

In contrast, organizations such as the Southern Alleghenies Planning and Development Commission and Starting Gate have ceased to provide microloans on a regular basis citing an unwillingness of small business owners to provide the necessary effort to complete structured business plans (despite the willingness of personnel to assist them in this process) and other paperwork required to apply for funding. Additionally many of the potential borrowers have been deemed not creditworthy due to previous debt issues or lack of collateral 16.

Another platform for the extension of microfinance products is student-run microfinance organizations (Haralson, 2011), which provide microloans (on average <$10,000) to small community businesses. Student-run microfinance organizations began in 2001, and to date, 12 campus organizations nationwide have been identified (Edgcomb and Gomez, 2009). The majority of these organizations provide microloans, business development training, and financial literacy materials. Two examples of these student-run organizations in Pennsylvania are the Lehigh University Microfinance Club (2007) and the University of Pennsylvania Penn Microfinance Club (2005). These organizations provide multiple opportunities for students to learn about microfinance and to share their business skills in accounting, marketing, and management with small businesses located near their respective campuses. Funding for loans originates with commercial banks (to partially satisfy their Community Reinvestment Act requirements), private foundations, and university funds.

### Pennsylvania Small Business Funding

Pennsylvania provides loans and grants indirectly to small businesses17 primarily through DCED, the State Treasurer’s office, the Department of Conservation and Natural Resources, and the Department of Environmental Protection. Federal and state funds are channeled through these offices/departments to lending organizations such as the Progress Fund, Bridgeway Capital, and NCPRPDC. In 2010, through a Microlending Investment Initiative, the State Treasurer’s

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16. Starting Gate has continued to participate in the USDA Small Business Loan Program, which provides loans up to $35,000 for qualified borrowers. The retention of this program justifies its placement as a microfinancing organization.

17. DCED defines small business as a firm having ≤100 employees. A microenterprise has ≤five employees.
office allocated $10 million of state money to eligible Community Development Financial Institutions (Pennsylvania Treasury, 2010). Bridgeway Capital and the Progress Fund were two of the Community Development Financial Institutions (CDFIs) receiving these funds, which were to be loaned to small businesses at market rates of interest. The twin objectives of the initiative were to increase economic growth of local businesses and to strengthen local communities. DCED is generally considered the most important state agency involved in small business lending18. In the 2011-2012 Pennsylvania state budget, Governor Corbett streamlined DCED’s funding 32 percent to $224 million. The number of funded programs fell from 127 to 56. The objectives of DCED were then consolidated into four areas: (1) promote job creation; (2) attract businesses to relocate to Pennsylvania and/or expand; (3) create attractive livable communities; and (4) encourage a coordinated regional approach to delivery of economic development services and tools. All funded programs must achieve at least one of these four objectives. To accomplish these objectives, five key programs were identified. Table 2 provides an overview of this consolidation and the impact on small business funding.

The Small Business First Fund is housed within the Liberty Loan Fund program and provides loans up to 50 percent of the estimated cost (not to exceed $200,000) of the project. Small Business First loans are divided into sectors focusing on manufacturing, hospitality, industrial, tourism, and agriculture. Financial products provided include loan guarantees, loans, and grants. Loans may be used for real estate, machinery, and working capital. DCED does not lend directly to businesses, but channels funding through economic development organizations that include alternate lenders. These alternate lenders are designated as Area Loan Organizations (ALOs), of which there are 28 in Pennsylvania. The three lending organizations examined in this study (Bridgeway Capital, the Progress Fund, and NCPRPDC) are certified as ALOs. ALOs package and underwrite Small Business First loans. After borrowers have been approved by their respective ALO, the loans are submitted to DCED personnel for final approval. From 2008-2011, the number of loan requests to the Small Business First Fund and the loan volume decreased due to the economic downturn. Between July 1, 2008 and March 9, 2012, DCED approved 460 loans, of which 19 (4 percent) were approved for $50,000 or less.

Also housed within the Liberty Loan Fund key program is the Pennsylvania Minority Business Development Authority (PMBDA). PMBDA provides loans to small businesses through a revolving loan fund. Businesses must be owned by a person who meets the minority ethnic/racial criteria. There have been no additional direct state appropriations to PMBDA since 2002; the program continues to function on revolving loan funds. PMBDA funds up to 75 percent of project costs and provides small and micro business lending by channeling funds through alternate lenders such as the Progress Fund, Bridgeway Capital, and Keystone.

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18. Information on DCED programming is from DCED websites and interviews with DCED program directors.
Innovation Zones (KIZs). Discovered in Pennsylvania, Developed in Pennsylvania (D2L), a third key area program, focuses on building capacity and increasing creativity and marketing for Pennsylvania businesses. D2L provides grant funding to KIZs through the Benjamin Franklin Technology Development Authority (BFTDA). It works with the Partnership for Regional Economic Performance (PREP) to provide a “knowledge neighborhood” that businesses designated as KIZ partners can access. There are 29 KIZs in Pennsylvania that are funded through BFTDA. Businesses may apply for grants and/or tax credits as long as they operate within a KIZ area, have been operating for at least 2 years, and are involved in a target industry (such as clean or green technology, information technology, or life sciences). Qualified businesses can receive grants, funding for student interns, loans, and tax credits. Up to $100,000 per year in transferable tax credits can be earned by qualified KIZ businesses. An eligible business can use the tax credits during the current year, carry them over into another tax year, or sell them to tax credit brokers for cash.

Initially a legislated program, BFTDA became a competitive program in 2010 resulting in 17 of 29 KIZ organizations applying for funding, and only 12 receiving grants of ≤$100,000. These grants must be matched by respective KIZ partners that include education institutions, private businesses, commercial banks, and business support organizations, such as chambers of commerce. BFTDA funds must be used for non-salaried programming activities.

DCED also channeled and divided $29.2 million in federal funds from the 2011-2012 U.S. Treasury’s State Small Business Credit Initiative (SSBCI) between four existing state programs: Machinery and Equipment Loan Fund (MELF), Ben Franklin Partnership/Life Sciences Greenhouse (BFP/LSG), Pennsylvania Economic Development Financing Authority (PEDFA), and the Pennsylvania Community Development Bank (PCD Bank). Information on targeted loan categories and the existing state programs that received SSBCI funds is detailed in Table 3.

All of the programs mentioned in Table 3 are ongoing, and, while all provide financing for small businesses, not all provide funding for microenterprises. Both MELF and BFP/LSG provide average loans in excess of $50,000. MELF is administered by DCED and provides low-interest loans for a percentage of equipment purchases to stimulate growth and retain businesses in Pennsylvania. The average loan size has been $684,747 over the past 5 years. Firms who borrow from MELF are expected to generate or retain one full-time job for each $25,000 that is borrowed. The BFP/LSG acts as a non-profit economic development intermediary created by the commonwealth to accelerate innovation, economic growth, and create jobs in the high-tech economy.

The average loan generated by SSBCI funding is $249,118.

The remaining two programs (PEDFA and PCD Bank) provide financing to small businesses and microenterprises. PEDFA provides funding to small businesses through five sub-programs located between Bradford and Philadelphia. Loans range from $50,000 to $500,000. Established in 1998, PCD Bank is administered by PEDFA and extends loans and provides grants to CDFIs and other organizations under the monitoring jurisdiction of PEDFA. Since 1998, 35 organizations have received more than $29 million in loans and grants. PCD Bank leverages public sector funds with private sector investment that is then reinvested in distressed regions in Pennsylvania. Two of the five organizations receiving PCD Bank funding are Bridgeway

Table 3. Targeted Loan Categories of the U.S. Treasury SSBCI Channeled through DCED

<table>
<thead>
<tr>
<th>Targeted Loan Categories</th>
<th>Program Servicing</th>
<th>Average Loan Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Job-generating state programs</td>
<td>MELF</td>
<td>$684,747</td>
</tr>
<tr>
<td>Early-stage high technology companies</td>
<td>BFP/LSG</td>
<td>$294,118</td>
</tr>
<tr>
<td>Indigenous Marcellus Shale supply chain businesses &amp; regional job-generating programs</td>
<td>PEDFA - funding through 5 programs to small businesses</td>
<td>Range from $50,000 to $500,000 depending on 4 separate revolving loan funds</td>
</tr>
<tr>
<td>Small business financing through community development financial institutions (CDFIs)</td>
<td>PCD Bank - funding through 5 programs to microenterprises and small businesses</td>
<td>Bridgeway Capital ($36,000 entrepreneur loans) Community First Fund ($15,000 microenterprise loans) Progress Fund ($105,000) Northside Community Development Fund ($20,000) Economic Opportunities Fund ($12,200 covering 5 loan products)</td>
</tr>
</tbody>
</table>

Source: Pennsylvania SSBCI.

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19. A knowledge neighborhood includes educational institutions, private businesses, commercial lenders, business support organizations, and small business development centers that can provide assistance to businesses.

Capital and the Northside Community Development Fund, which both target low-income Pittsburgh neighborhoods. In addition, Bridgeway Capital provides financing to stimulate economic growth in western Pennsylvania through three loan programs. Its microenterprise activity is concentrated in its entrepreneur loan program, which has an average loan size of $36,000. Northside Community Development Fund finances small business and real estate projects in 14 low-income neighborhoods, with an average loan size of $100,000. In 2010, it formed the Northside Micro Enterprise Fund and at the time of the research had loaned $40,000 to two businesses.

The remaining three organizations receiving SSBCI funding through the PCD Bank are: the Progress Fund, Community First Fund, and Economic Opportunities Fund. Founded in 1997, the Progress Fund focuses on businesses in the tourism industry in rural counties by providing financing and entrepreneurship training. While the Progress Fund provides microfinancing, its average loan size is $105,000. The Community First Fund provides small business loans as well as loans for development of affordable housing. The fund targets women (36 percent) and persons of color (46 percent) in its small business loan activity. SSBCI funds were to be used to provide loans (average size $15,000) to minority-owned microenterprises with less access to credit due to the 2008-2009 recession. The Economic Opportunities Fund (EOF) (1999) is an organization within a larger entity known as the Women’s Opportunities Resource Center (WORC). It is a microenterprise development fund created to provide credit to graduates of the WORC entrepreneurship training course who encounter difficulty in accessing financing. Targeting minority graduates of the training course, the SSBCI monies were to be used to increase the pool of loanable funds available through five loan product categories. The average loan size across these five product categories is $12,200. (The EOF was considering a sixth loan product category using SSBCI funds to allow loans up to $50,000 to take advantage of SBA’s new microloan definition.) The EOF is the only microenterprise loan fund in Philadelphia that offers training and technical assistance through its WORC affiliation.

Information on DCED programming is available online from DCED’s “Investment Tracker.” According to posted information, no new programs were listed as having been funded from 2006-2012. Prior to 2006, “Tracker” funds had been allocated directly for organization operational expenses to three alternate lenders with microfinancing programs (the Progress Fund, Bridgeway Capital, NCPRPDC), and indirectly through these alternate lenders to 33 individual borrowers. The three alternate lenders received direct funding to develop new programming, such as establishing a licensed practical nursing program (NCPRPDC), expanding a locally grown food network initiative (the Progress Fund), and expanding a loan program for minority entrepreneurs (Bridgeway Capital). Of the 33 business owners who received funding, only four received microloans ≤$50,000.

In-depth Analysis of Three Microfinancing Organizations in Rural Counties

The three microfinancing programs serving rural clients in Pennsylvania that were selected for in-depth analysis were: NCPRPDC, the Progress Fund, and Bridgeway Capital. Information on the geographic location and people interviewed at each organization is presented in Table 4.

North Central Pennsylvania Regional Planning and Development Commission

NCPRPDC is a local development district, which is a multi-county organization providing such services as community and economic development, transportation, international trade, and strategic planning, serving the north central counties of Cameron, Clearfield, Elk, Jefferson, McKean and Potter.

NCPRPDC focuses on three planning areas associated with economic growth: community development/regional planning, enterprise/economic development, and workforce investment and development.

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<table>
<thead>
<tr>
<th>Program</th>
<th>Location</th>
<th>Personnel Interviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCPRPDC</td>
<td>Ridgway</td>
<td>Deputy Director; Enterprise Development; Loan Program Director; Loan Portfolio Manager; Business Consultant “At Risk” Program</td>
</tr>
<tr>
<td>The Progress Fund</td>
<td>Greensburg</td>
<td>President/CEO; Executive Asst.</td>
</tr>
<tr>
<td>Bridgeway Capital</td>
<td>Pittsburgh</td>
<td>Vice President Development; Vice President Senior Loan Officer; Marketing Manager; Credit Officer; Team Leader; Loan Officers; Business Education Coordinator; 504 Loan Officer, Erie Office</td>
</tr>
</tbody>
</table>

21. Information on NCPRPDC is from personal interviews with staff, materials provided by staff during these interviews, and various websites.
NCPRPDC’s microlending activities are housed in the Enterprise/Economic Development Program (Enterprise). The Enterprise program promotes economic growth by providing businesses with low-interest loans, and access to business workspace and technologies.

Business loans are overseen by the Enterprise program and approved by North Central’s Loan Review Committee. There are eight types of loan funds available, but only the following two are for microloans ≤$50,000: SBA’s loan fund, and USDA’s Intermediary Relending Program Microloan Fund. The SBA loan fund provides financing up to $50,000 for machinery and equipment, inventory, advertising, and working capital. Loan terms are from 3 to 5 years. The USDA loan fund finances similar projects in addition to real estate. Loan terms are 3 to 10 years. There is a technical assistance component for both funds. Loans are secured by lien positions on collateral and personal guarantees from those owning greater than 20 percent of the business.

State monies have also been used by borrowers. Pennsylvania was one of seven states allowing self-employment assistance funds to be used in place of regular unemployment benefits for those unemployed workers who want to become entrepreneurs. From 2000-2011, 10 of 45 (22 percent) eligible NCPRPDC rural small businesses with 20 or fewer employees. With these loans, NCPRPDC acts as an intermediary between federal and state programs and the local business borrower. Loan payments are made directly to NCPRPDC. Commercial banks, such as North West Savings Bank, Farmers National, and First Commonwealth, provide funding to NCPRPDC as part of their Community Reinvestment Act requirements. Additionally representatives from these banks sit on loan review committees.

NCPRPDC has been in operation since 1966 and began microlending in 2001. Between 2001 and 2011, NCPRPDC provided microloans to 38 borrowers for a total dollar value of $742,118. Table 5 provides additional information on the microfinancing activities of NCPRPDC.

Since 2000, a variety of state and federal programs provided funding sources for NCPRPDC. The majority of state funds were through two of the Small Business First Fund programs overseen by DCED: the Enterprise Development Authority and First Industries Tourism.

An additional program provided grants for community revitalization (Local Government Municipal Resources and Development Program) and also funded NCPRPDC projects related to Internet acquisition and practical nursing program licensing. Federal monies came from USDA and SBA. USDA provided monies for business activities in Elk County through the Enterprise/Economic Development Program for

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Table 5. NCPRPDC’s Microfinancing Program

<table>
<thead>
<tr>
<th>Requested Program Information</th>
<th>Program Responses to Requested Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Information</td>
<td></td>
</tr>
<tr>
<td>Program Goals</td>
<td>Job Creation; Business Development; Community Development</td>
</tr>
<tr>
<td>Years in Operation</td>
<td>10 years</td>
</tr>
<tr>
<td>Services Provided</td>
<td>Microlending; Training; Technical Assistance</td>
</tr>
<tr>
<td>Urban/Rural Services Provision</td>
<td>100% Rural</td>
</tr>
<tr>
<td>Total Microborrowers 2000+ (Percent Female)</td>
<td>38 Microborrowers (42% Female)</td>
</tr>
<tr>
<td>2011 Micro Borrower Questionnaire Response Rate</td>
<td>20 Active Borrowers; 14 Completed Interviews (78% Response Rate)</td>
</tr>
</tbody>
</table>

Microloan Characteristics

- Average Loan Size: $16,600
- Average Repayment Period: 5 Years
- Average Microloan Repayment Rate: 75% Repayment Rate
- Percent Microfinancing Funds Loaned in 2010: 100%

Loan Funding Sources

- Private Sources: Commercial Banks
- Federal Sources: SBA; USDA Programs (Enterprise Development, Conservation Reserve, Intermediary Relending)
- State Sources: DCED; Small Business First; Local Government Municipal Resources & Development Program

Earned Income Sources of Funds

- Loan Interest Fees; Loan Service Fees

Program Changes Since SBA Increased Loan Limits*

- None

Future Challenges (2012+)

- Identifying Viable Borrowers

Source: Field Work 2011. *In fall 2010, SBA redefined microloan as a loan ≤ $50,000.

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22. CDFIs are private-sector, mission-driven financial institutions providing financial products and services to people and communities in distressed urban and rural areas underserved by commercial banks.
farmland improvement. The majority of loan funding sources, however, was through DCED, SBA and USDA. The majority of operating budget monies was from earned income, such as interest rate charges and training fees.

The transaction costs of lending and borrowing were labor-intensive for both the lender and borrower. Transaction costs incurred by the lender included staff time spent explaining the loan application process to potential borrowers as well as processing and monitoring time once the loan had been requested and then funded (average of 5 hours staff time per microloan). All microloan borrowers were contacted annually to assess their financial position and to compile state-required job creation requirements (average of 1 hour staff time per loan). Start-up businesses were contacted quarterly for the above information. Borrowers who required assistance in business plan preparation were referred to Small Business Development Centers (SBDCs). NCPRPDC staff estimated that approximately 5 hours of staff time were expended for each microloan extended. Additional staff time was required for site visits and annual reviews. Staff reiterated several times how difficult it was to receive any type of information requested from their micro borrowers, despite the fact that their organization had loaned them money. Less than 20 percent of the microloan borrowers “graduated” to become commercial bank borrowers.

Transaction costs for borrowers included completing a 2-hour class and an initial pre-loan application. If the application were accepted, then a detailed business plan with assistance from an area SBDC was required. Business and personal financial statements were also required. At the time of closing a surcharge of 1 percent of the loan value was assessed.

Of the three microfinancing organizations included for in-depth analysis in this research, NCPRPDC was the only one that required a 20-hour training session for new borrowers. The course was taught in one-to-two hour sessions over four evenings by an outside business consultant. Topics included: business and marketing plans, accounting statements, strategic planning, and financial plan construction. The cost of the program was $750. Attendance was mandatory, with missed classes being made up individually with the business consultant. The majority of training expenses were paid by SBA funding.

During the course of the lending period, borrowers were deemed “at risk” by staff if they had missed more than one loan payment. Those borrowers were referred to the above business consultant who worked with them to improve their financial management and marketing skills to increase their ability to repay their loan on-time. Frequently the consultant met with the borrower at her/his site of business. The consultant also worked to strengthen the professional relationship between the borrower and his/her accountant, and if necessary recommended he/she select another accountant. From 2009-2012, the owners of 26 firms had been contacted by the business consultant involved with the “at risk” program. At the time of the study, 18 firms were doing well after making changes suggested by the consultant, three firms were working with the consultant, three firms refused to work with the consultant, and two firms were no longer in business.

NCPRPDC established an entrepreneurs’ club in 1997-1998 to serve as a resource group for start-up and established business owners. Initially there was state funding to pay for business speakers and refreshments to encourage attendance, but this funding was eliminated in 2003. According to NCPRPDC personnel, the entrepreneurs’ club continues to meet.

The principal challenges to the microfinancing initiatives of NCPRPDC were: the large geographic area it served, the provision of meaningful technical assistance, and the ongoing economic growth problems in the region. Over the past 5 years, NCPRPDC initiated a series of changes in its lending procedures to decrease the number of at-risk micro loans. Staff estimated about 25 percent of micro loans were at-risk or in default and said the majority of businesses with these micro loans were beauty shops and daycare centers. These changes included: increasing personal credit scores for loan applicants, expanding collateral required to include personal residences, raising the value of personal assets required to be used for loan collateral to 1:1, seeking aggressive repayment using commercial bank procedures, and increasing the filing of judgments. Implementation of these procedures has led staff to question whether they would be able to meet lending targets (for example, SBA microloan programs require four loans to be completed annually).

23. Business owners appeared willing to be more forthcoming with their financial information when working with the business consultant as opposed to NCPRPDC personnel. The main explanation for this was that the majority of business owners had the opportunity to work directly with someone who had business experience and could potentially assist them in improving their business finances.
24. The default rate on SBA-backed loans increased from 2.4 percent in 2004 to 12 percent in 2011. The historical default rate mean for all U.S. loans was 3.5 percent.
The Progress Fund

The Progress Fund is one of four major CDFIs in Pennsylvania. Since 1997, the Progress Fund has targeted the tourism industry (75 percent of funding), including the rehabilitation of historic properties in Pennsylvania, West Virginia, Ohio and Maryland. An additional program focus is family farmers who grow and market locally grown foods. At the time of the research, the Progress Fund had loaned more than $35 million to 206 small businesses and created or sustained more than 2,447 jobs. The Progress Fund has received funding from DCED and from federal programs to provide financing to small businesses.

The Progress Fund has also accessed private monies from religious organizations and private foundations. In 2011, the U.S. Treasury Community Development Financial Institutions Fund awarded the Progress Fund $1.5 million to continue its financing of small businesses to spur local economic growth and recovery. A 2011-2012 State Small Business Credit Initiative (SSBCI), also from the U.S. Treasury, channeled $29.2 million to the Progress Fund through various DCED programs. (The Progress Fund was to receive $2 million of the SSBCI funds through PCD Bank.) The Progress Fund has also been successful in competing for $2.75 million in the 2011 Wachovia Wells Fargo NEXT Awards for Opportunity Finance. The award money was to be used to continue the Progress Fund’s innovative financial services through its Trail Town Program.

The Progress Fund extends loans ranging from $20,000 to $400,000 to start-ups or expanding businesses. The loan committee for loans ≤$100,000 is composed of the CEO and CFO. The loan committee for larger loans is composed of board members. Loans may be used to purchase property and/or equipment, restore and rehabilitate structures, purchase inventory, purchase business assets of an existing business, or for working capital. Microloans (loans ≤$50,000) represent 41 percent of all loans and 10 percent of all capital financed.

The majority of microlending activities are part of its Trail Town Program, which funds businesses catering to tourists using the Great Allegheny Passage bike trail. The Progress Fund has been designated an ALO by DCED.

Businesses receiving microloans from the Progress Fund have historically been defined as rural small businesses with 20 or fewer employees. With these loans, the Progress Fund acts as an intermediary between the federal program and the local business borrower. Loan payments are made directly to the Progress Fund. Commercial banks provide funding to the Progress Fund as part of their Community Reinvestment Act requirements. Additionally representatives from these banks sit on loan review committees for loans ≤$400,000. Table 6 provides additional information on the microfinancing activities of the Progress Fund.

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Table 6. The Progress Fund’s Microfinancing Program

<table>
<thead>
<tr>
<th>Requested Program Information</th>
<th>Program Responses to Requested Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Information</td>
<td></td>
</tr>
<tr>
<td>Program Goals</td>
<td>Community Development</td>
</tr>
<tr>
<td>Years in Operation</td>
<td>14 years</td>
</tr>
<tr>
<td>Services Provided</td>
<td>Microlending; Technical Assistance</td>
</tr>
<tr>
<td>Urban/Rural Services Provision</td>
<td>100% Rural</td>
</tr>
<tr>
<td>Total Microborrowers 2000+* (Percent Female)</td>
<td>135 Microborrowers (24% Female)</td>
</tr>
<tr>
<td>2011 Micro Borrower Questionnaire Response Rate</td>
<td>17 Active Borrowers; 13 Completed Interviews (76% Response Rate)</td>
</tr>
</tbody>
</table>

Microloan Characteristics
- Average Loan Size: $28,841
- Average Repayment Period: 5 Years
- Average Microloan Repayment Rate: 94%
- Percent Microfinancing Funds Loaned in 2010: Do Not Have Specific Funds Allocated to Microlending

Loan Funding Sources
- Private Sources: Commercial Banks; Foundations; Religious Institutions
- Federal Sources: SBA; USDA Programs (Enterprise Development, Conservation Reserve, Intermediary Relending)
- State Sources: DCED: First Industries Tourism; Pennsylvania Community Development Bank

Earned Income Sources of Funds
- Loan Interest Fees, Loan Service Fees

Program Changes Since SBA Increased Loan Limits* |
- Increased Number of Loans

Future Challenges (2012+): |
- Identifying Viable Borrowers

Source: Field Research, 2011. *In fall 2010, SBA redefined microloan as a loan ≤$50,000. **Pennsylvania Community Development Bank has provided an expansion and a development services grant since 2000.

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25. Information on the Progress Fund is from personal interviews with staff, materials provided by staff during the interviews, and various websites.
26. A 2007 study by Hughes and Shields on the regional economic impact of tourism used data from tourism businesses that had received loans from the Progress Fund. The tourism businesses studied had substantial impacts on regional employment and income, with the majority of benefits concentrated in low-income households.
27. For the majority of loans ≤$50,000 provided by the Progress Fund, the “micro” loan is one piece of a larger lending puzzle.
Lending transaction costs included staff time spent explaining the loan application process to potential borrowers as well as processing and monitoring time once the loan had been requested and then funded. Staff estimated it required 30 to 90 days from initial contact to loan approval, and 45 days on average from loan approval to closure. Microloans were approved by the CEO and CFO. Personnel also completed two site visits during the loan review process, and annually collected information to complete state reporting requirements.

Borrower transaction costs included completion of a business plan and lending forms, preparation for site visits by program personnel, and annual progress reports. Borrowers who required assistance in business plan preparation were referred to regional SBDCs. Loan closing fees of 1 to 1.5 percent were paid by all borrowers.

Commercial banks’ unwillingness to lend to small borrowers, in general, and their aversion to lending to start-ups and businesses in hotel and restaurant management in particular, resulted in the Progress Fund receiving loan applications from borrowers with higher credit scores. The lending trend for the Progress Fund has been as the primary lender on projects rather than partnering with a commercial bank. Staff described its role as being proactive rather than reactive to business growth opportunities in its lending regions. The principal challenge to the microfinancing initiatives of the Progress Fund were finding viable borrowers.

Bridgeway Capital

Bridgeway Capital, a designated CDFI, has worked in 15 Pennsylvania counties since 1990. Its mission is to improve economic growth in western Pennsylvania by building entrepreneurial capacity through increasing the number of businesses and the number of family-wage jobs and benefits. It provides lending capital and entrepreneurial education.

Since 1991, Bridgeway Capital has made more than 700 loans, which have provided $77 million of lending in western Pennsylvania and sustained or created more than 5,000 jobs. Its lending has leveraged more than $260 million as businesses were able to source venture capital or other funding after the Bridgeway Capital loan had been secured. According to Bridgeway Capital personnel, 51 percent of its lending portfolio benefitted low-income people.

Bridgeway Capital partners with state and federal lending programs to provide financing to small businesses. At the time of the study, it received additional funding from both the private and public sectors. For example, it received $2 million in funding through the U.S. Treasury’s SSBCI and almost $100,000 in grants from the privately funded Create Jobs for USA Fund.

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28. Information on Bridgeway Capital is from personal interviews with staff, materials provided by staff during the interviews, and various websites.

29. Bridgeway Capital lending centers are located in three urban counties. One of the 2012 goals of Bridgeway Capital was to expand its presence in rural areas. In March 2012, it opened an office in Erie to serve northwestern Pennsylvania counties.

30. Begun in the fall of 2011, Create Jobs USA Fund is a collaboration between Starbucks and the Opportunity Finance Network (OFN). Starbucks customers, employees/partners, and others contribute at area Starbucks stores. The contributions are leveraged into loanable funds by OFN through CDFIs.
Recent lending activity targeted both small businesses and community service providers (e.g., daycare centers). Data indicated Bridgeway Capital loans to community service providers (accessing almost 3,000 clients) was $1.3 million in fiscal year 2009. In fiscal year 2010, Bridgeway Capital made a total of 89 loans totaling $9 million. The average size loan over the lending portfolio was $101,124. In the same year, entrepreneur loans (which included microloans of ≤$50,000) were almost $1.4 million to 43 entrepreneurs (46 percent female), with an average loan size of $32,558. Loan losses across the entire portfolio were between 2 and 3 percent prior to 2008. Losses increased to 6 percent in 2010, with the loan loss rate for those loans ≤$100,000 increasing to 6.4 percent at the close of 2011. Table 7 provides additional information on the microfinancing activities of Bridgeway Capital.

Bridgeway Capital offers entrepreneur loans, growth loans, 504 loans, non-profit loans, and green loans. Entrepreneur loans are loans typically ≤$100,000 and include microloans of ≤$50,000. The loan may be used for start-up or expansion activities. The loan period is 5-6 years and technical and business assistance is available. All Bridgeway Capital borrowers in this study received an entrepreneur microloan. SBA provides part of the funding for loans up to $50,000.

Women and minorities who own or want to start a construction business can take advantage of the Minority and Women Education Labor Agency (MWE-LA) partnership with Bridgeway Capital. Through the partnership, Bridgeway Capital acts as the fiscal agent for a guarantee fund for bond companies to provide bid and performance bonds for participating contractors. Additionally, financing is provided if eligible contractors require working capital to complete bonded projects.

Borrowers can take advantage of training ranging from e-newsletters to skilled consultants to technical assistance projects. Training for smaller businesses focused on preparation and reading financial statements, marketing and branding, and accounting software. For larger businesses, training focused on strategic objectives. Training was paid through an SBA grant (75 percent) and Bridgeway Capital matching funds. Thus training resources have historically been more available for microloan borrowers than larger borrowers due to SBA targeting. When a business owner qualified for a Bridgeway Capital loan the organization paid outside firms or individuals for training. Borrowers also accessed skilled consultants at no charge and paid reduced fees for education/training and/or technical assistance. The business education coordinator at Bridgeway Capital confirmed that 90 percent of her time was spent with microloan recipients. She visited microloan borrowers after their closing and assessed their training requirements. Additional area resources, such as the Center for Women’s Entrepreneurship at Chatham University, provided mentoring and opportunities for women entrepreneurs to meet and discuss topics of interest.

Lender transaction costs included evaluating each business loan in terms of jobs created or retained, production capability, community impact, and overall individual empowerment. Additional information for start-up loans included lien information, cash equity position, source of income independent of business proposed, and documented previous experience in operating a business or as owner of another business. A site visit is required during the first six months after funding a microloan. Quarterly financial statements are required as well as annual impact information from each business. Loan production wages and benefits (includes lenders, credit analysts, credit officer, and team leader-loan officers) in 2010 were $6,471 for each entrepreneur loan produced (loans ≤$100,000) and $2,765 for each entrepreneur loans outstanding. There were 11 loan administration hours for each outstanding entrepreneur loan.

Borrower transaction costs included completion of a business plan, and providing additional information on liens, cash equity, and prior business experience. Closing costs of 1 to 1.5 percent of the loan value were paid by the borrower to Bridgeway Capital at the loan closing. Other borrower costs included meeting with the education coordinator and site visits by the lending team. While training was available, and was encouraged for all borrowers, training was not mandated for loan recipients.

The principal challenges to the microfinancing initiatives of Bridgeway Capital were the provision of meaningful technical assistance, and locating viable small businesses. Lending criteria has been tightened to include higher credit scores and better repayment histories. While 35 to 40 microloans were made before the economic downturn in 2008, only six new microloans were extended in 2011. Losses increased to 6 percent in 2010, with the loan loss rate for those loans ≤$100,000 increasing to 6.39 percent at the
close of 2011. For 2012, the outlook was to fund fewer small business start-ups and more businesses that had some minor financial problems but better growth potential.

Bridgeway Capital became more proactive in accessing small borrowers by calling commercial banks weekly for potential borrower referrals. As part of this proactive environment, referrals were to be followed-up with a site visit, and, if appropriate, a loan application. The decision by Bridgeway Capital to hire a full-time microloan lender in the fall of 2011 was part of its proactive microlending activities.

Geographic Challenges Faced by Microfinancing Organizations Operating in Rural Counties

The three organizations analyzed in this study all served rural areas covering several counties and hundreds of miles. While the offices for each of these organizations are located in a city or small town, their clients are located hundreds of miles from their offices.

Due to the large geographical area served by these organizations, there were fewer clients receiving program services per square mile. The small number of clients increased program lending costs and prevented any scale economies from emerging.

Analysis of Borrowers

Selection of Borrowers

The three organizations chosen for in-depth analysis provided the researcher with a list of borrowers who had received microloans during the past 10 years. The number of borrowers interviewed and the response rates for each organization are provided in Table 8. Due to the similarity of responses, and the total number of borrowers (36), the researcher collapsed the responses of all borrowers into one dataset. As there were relatively few borrowers who met the definition of owning a firm in a rural county and borrowing $50,000 or less from the three identified organizations, the researcher contacted all identified borrowers and attempted to interview them for the research. Borrowers who were delinquent in their loans, or whose businesses no longer existed were not interviewed per agreement with the lending organizations.

Overall Characteristics of Borrowers and their Businesses

Half of the respondents were female (18) and half were male (18). The age of borrowers ranged from 21 years to 68 years, with the median age of 43. One third of all respondents had either completed high school (10) or technical school (2). Other educational attainment levels included a 4-year degree (9 or 25 percent), and a master’s degree or higher (7 or 19 percent).

The age of the businesses indicated the willingness of microfinancing organizations to lend to start-up firms. Of the 36 borrowers, 15 (42 percent) had start-up businesses and 21 (58 percent) had ongoing businesses. The median age of an ongoing business was 1.5 years with ranges between start-up and 30 years. There were 27 business owners (75 percent) who indicated they had been in business for 5 years or less. More than half of the business owners (19 or 53 percent) were making monthly mortgage payments and 36 percent (13 respondents) were paying rent.

Given the small size of the interviewed businesses and the seasonal characteristics of 16 firms who were dependent on tourism sales, the majority of businesses (21) were primarily service-oriented. Five businesses were involved in manufacturing: three manufactured art items and two produced assorted food and drink products. The remaining businesses were retail (7) and construction (3). Frequently, businesses involved in services and food preparation also had retail stores attached to the business property.

The percent of household income contributed by the business receiving the loan was ≤50

Table 8. Number of Borrowers Interviewed and Response Rates by Financing Organization

<table>
<thead>
<tr>
<th>Organization</th>
<th># Microloan Borrowers</th>
<th># Microloan Borrowers Interviewed</th>
<th>Response Rate</th>
<th>Loan Origination Dates</th>
<th>Contact Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCPRPDC</td>
<td>20</td>
<td>14</td>
<td>70 %</td>
<td>2003 – 2011</td>
<td>Telephone, Mail, Personal Interview</td>
</tr>
<tr>
<td>The Progress Fund</td>
<td>17</td>
<td>13</td>
<td>76 %</td>
<td>2001 – 2011</td>
<td>Telephone, Mail, Personal Interview</td>
</tr>
<tr>
<td>Bridgeway Capital</td>
<td>11</td>
<td>9</td>
<td>82 %</td>
<td>2004 – 2010</td>
<td>Telephone, Mail, Personal Interview</td>
</tr>
<tr>
<td>Total</td>
<td>48</td>
<td>36</td>
<td>75 %</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Work, 2011.
percent of total household income for 23 (64 percent) of the respondents. Those respondents had spouses who worked full-time. The majority of those spouses also accessed health care benefits for the household. Eleven (31 percent) interviewees stated their business contributed to more than 75 percent of household income.

Based on employment data, all firms in the survey qualified as small businesses as defined by DCED. Two-thirds of all respondents (24) owned businesses that employed five or fewer people, and only one-third (12) employed six or more people. Five firms employed more than 10 people, but the majority of those workers were part-time, and three of the businesses were seasonal.

**Loan Information**

Loan information is provided separately for the three organizations in Table 9. The Progress Fund, on average, provided larger value microloans than NCPRPDC or Bridgeway Capital, possibly because smaller loans ($\leq$ $50,000) from the Progress Fund were often second or third loans to previous borrowers. The current round of funding to this group of Progress Fund borrowers was generally for value-added additions to ongoing businesses, such as inventory expansion, addition of a retail store to ongoing services offered, and expansion of services.

**Training and Loan Process Evaluation by Loan Recipients, Organizations, and Loan Size**

The three organizations approached training differently. NCPRPDC mandated training for all of its microloan recipients, and followed-up with additional training for those borrowers who missed more than one loan payment. The Progress Fund and Bridgeway Capital had training available for loan recipients, but did not require it. All three organizations used local SBDCs to work with potential borrowers on their business plans. Other organizations involved in training that were used voluntarily by loan recipients included the Center for Women’s Entrepreneurship at Chatham University (both the Progress Fund and Bridgeway Capital referred clients) and monthly meetings of local entrepreneurs that were initially organized by NCPRPDC for its clients.

Training information offered by the three organizations during the loan application process and after the loan had been secured varied among the respondents. Table 10 provides training participation information. Approximately half of all respondents (19 or 53 percent) who received a business loan said they had been offered business training. Of those who had been offered training, 13 used it. Follow-up training (both offered and used) after the loan had been received was less prevalent. Fourteen businesses (39 percent) indicated follow-up training was offered and eight of those businesses used it. The three main reasons given for not accessing training before (if such training was not mandated) or after the loan was received were: lack of time by the business owner, inconvenience of training location, or forgetting training was available once the loan had been secured. Three respondents suggested emailing borrowers to remind them of various training opportunities.

Borrowers were asked to evaluate their training experience using a five-point Likert Scale ranging from “strongly agree” to “strongly disagree.” For each question, at least 40 percent of the respondents had no opinion because they had not participated in the training opportunity.

Of the respondents who answered the questions about training before receiving the loan, 15 “strongly agreed” or

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Table 9. Loan Information by Financing Organization

<table>
<thead>
<tr>
<th>Organization</th>
<th>Mean Loan Value</th>
<th>Median Loan Value**</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCPRPDC</td>
<td>$26,850</td>
<td>$25,500</td>
</tr>
<tr>
<td>The Progress Fund</td>
<td>$41,154</td>
<td>$50,000</td>
</tr>
<tr>
<td>Bridgeway Capital</td>
<td>$30,889</td>
<td>$35,000</td>
</tr>
</tbody>
</table>

Source: Field Work 2011. **Median loan value for all loans is $35,000.

Table 10. Training Availability and Participation Before and After Loan Received

<table>
<thead>
<tr>
<th>Response</th>
<th>Number Responding and Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Training Offered Before Loan (N=36)</td>
<td>19 (53 %) 17 (47 %)</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Business Training Used Before Loan (N=36)</td>
<td>13 (36 %) 23 (64 %)</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Business Training Offered After Loan (N=36)</td>
<td>14 (39 %) 22 (61 %)</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Business Training Used After Loan (N=36)</td>
<td>8 (22 %) 28 (78 %)</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Field Work, 2011.

---

31. Funding for SBDCs is provided by DCED through the Partnership for Regional Economic Performance (PREP).
“agreed” that business training was readily available. Although the results show that less than 50 percent acknowledged that training was available, two of the organizations did not require training to receive a loan so borrowers would not have been expected to have necessarily known about training opportunities. Borrowers who used the business training thought it was effective, though again the relatively high “no response” rate indicated many did not use it.

The analysis also indicated that neither the loan size nor the microfinancing organization affected the evaluation of the training experience before the loan was received.

Thirteen borrowers “strongly agreed” or “agreed” that business training was readily available after the loan monies had been allocated. In terms of the evaluation of training after the loan was received, fewer borrowers seemed satisfied (eight) and more expressed a neutral reaction (10). The highest number of respondents had no response (more than 45 percent for each question) because they did not access training after the loan had been received. Training that was accessed by those respondents included marketing strategies, website development, increasing financial statement familiarity, and technical information specific to the business (e.g., bonding requirements on construction sites).

The analysis indicated that while the loan size did not affect the evaluation of the training experience after the loan was received, the microfinancing organization did. However, 17 respondents did not hear about any training and/or did not take advantage of training after the loan was received.

Loan recipients also were asked to evaluate the lending process using two criteria: explanation of the borrowing process by organization personnel and the amount of time between the loan application and receiving the loan. These evaluations also used a five-point Likert Scale range of “strongly agree” to “strongly disagree.” The majority of respondents “strongly agreed” with the following two statements:

- The lending process was adequately explained (20 or 56 percent “strongly agreed”); and
- The time between the loan application and the receipt of loan monies did not seem excessive (17 or 47 percent “strongly agreed”).

Further analysis showed the loan size did not affect the evaluation of the lending process. Similarly there were no statistically significant relationships between the loan size and timing of the application process, nor between the microfinancing organization and timing of the application process.

In terms of the evaluation of the loan process, the results indicated that the organization that provided the loan to the borrower affected the borrower’s evaluation of the loan application process.

### Use of Loan Funds and Alternative to Not Receiving Loan Funds

Borrowers were asked to indicate their use of loan funds from the three organizations. The results are displayed in Table 11. The largest number of responses was recorded for the purchase of additional equipment (17). Since the majority of businesses identified themselves as service businesses (21), the decision to buy additional equipment complemented this response as businesses sought to expand their current service offerings.

The purchase of additional supplies and business renovations received the second and third highest response rates (13 and 12), which also complemented previous responses related to the expansion of inventories and the addition of retail outlets in some businesses. Again, the seasonal nature of many of the firms receiving financing (16 of 36 firms) accounted for renovations and supply purchases as businesses attempted to increase their appeal to tourists and supply unique goods and services. Borrowers comments indicated that two of the difficulties of business renovations were state regulations and costly multiple step inspections.

While loan funds used for employment decisions were indicated by only eight of the respondents, it is important to note that those respondents were beginning to feel that sales revenues were increasing to the point of requiring additional workers. Businesses that indicated they were hiring part-time (≤34 hours per week) or full-time workers were in the following sec-

<table>
<thead>
<tr>
<th>Use of Loan Funds</th>
<th>Number Responding and Percentage*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchased Additional Equipment</td>
<td>17 (47%)</td>
</tr>
<tr>
<td>Purchased Additional Supplies</td>
<td>13 (36%)</td>
</tr>
<tr>
<td>Renovated Business</td>
<td>12 (33%)</td>
</tr>
<tr>
<td>Hired Additional Part-Time Workers</td>
<td>8 (22%)</td>
</tr>
<tr>
<td>Hired Additional Full-Time Workers</td>
<td>8 (22%)</td>
</tr>
</tbody>
</table>


32. When the “no response” category was removed there were no significant results.
33. Given that six of the 36 borrowers did not respond to the evaluation of the lending process statement, the sample size was small for the ANOVA test.
tors: retail (two hiring part-time and two hiring full-time), manufacturing (one each) and services (five each). Part-time wages as recorded by respondents averaged $8.50 per hour, which was above both the federal and state minimum wage of $7.25. The majority of counties with unemployment rates above the state average of 7.6 percent in 2011 were rural counties. Business owners who responded that they were hiring part-time or full-time workers with their loan funds were located in eight rural counties. While the number of people projected to be hired was low from those respondents, they were still contributing positively to the overall employment picture in counties with unemployment rates between 8.6 percent (Fayette) and 7.8 percent (Jefferson).

Respondents were asked to indicate what they would have done if they had not received the loan. Fourteen respondents (39 percent) said they would have either applied to commercial banks immediately, or waited and reapplied to the organization again. Only four (11 percent) said they would have closed their business, and five (14 percent) said they would have continued current operations. Those involved with start-ups (eight) were more likely to indicate they would not have opened or purchased the business (five).

Small businesses across the U.S. tended to purchase a higher percentage of their goods and services from local firms (Robinson, 2010). They also have a positive impact on the following economic indicators: job creation, the amount of dollars that remained within the local economy, entrepreneurship, and consumer choices (Shuman, 2000). When asked to indicate their use of loan funds, borrowers surveyed in this study most often responded they would purchase additional equipment (17 or 47 percent) or additional supplies (13 or 36 percent). While some of these purchases were undoubtedly made outside the region, studies have shown for every $100 spent on local procurement, 33 percent remained within the local economy (Rodriguez and Houston, 2007).

Loan Payment Responsibility

Business owners receiving the loan made the primary decisions on how the funds would be spent and how the loan would be repaid. All of the borrowers in the study were sole proprietors. Table 12 provides more information on the role of the business owner. Though the respondents decided how loan funds were spent more than 50 percent of the time, when the decision was made jointly, it was the business owner’s spouse who was most likely to be involved in the decision-making. Though the borrower provided the funds for loan repayment more than 80 percent of the time, his or her spouse was involved in four cases (11 percent). The main source of loan repayment funds was the business owner’s salary (34 or 94 percent).

Effect on Business Finances After Loan Received

The effect on business finances was mostly positive since the loan had been received. More than 80 percent of businesses (30) said their dollar sales had increased since receiving the loan. Only four respondents (11 percent) said their dollar sales had decreased. With the increase in dollar sales, costs also increased for 27 firms (75 percent). However, the increase in dollar sales overall was greater than the increase in costs for at least 22 respondents (61 percent), who also reported an increase in profits. The borrowers who reported a decrease in their dollar sales also reported a decrease in their profits (See Table 13 on Page 20).

Borrowers were also asked to assess the changes in local and state taxes on their businesses after their loans were received. The majority who responded had seen an increase in their local (17) and state business taxes (20). The latter included both the payroll tax and the state sales tax. Thus local and state governments had received additional monies. Those responses complemented the above questions on busi-

<table>
<thead>
<tr>
<th>Response</th>
<th>Number* and Percentage Responding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who Decided How Loan Funds Spent</td>
<td></td>
</tr>
<tr>
<td>Business Owner</td>
<td>19 (53 %)</td>
</tr>
<tr>
<td>Decision Made Jointly</td>
<td>11 (31 %)</td>
</tr>
<tr>
<td>Provider of Loan Repayment Funds</td>
<td></td>
</tr>
<tr>
<td>Business Owner</td>
<td>30 (83 %)</td>
</tr>
<tr>
<td>Owner and 1 Other Household Member</td>
<td>4 (11 %)</td>
</tr>
<tr>
<td>Main Source of Loan Repayment Funds</td>
<td></td>
</tr>
<tr>
<td>Business Owner Salary</td>
<td>34 (94 %)</td>
</tr>
</tbody>
</table>


34. This study does not claim any causality between receipt of a microloan and changes in business finances because there was no comparison group of non-borrowers. The research does show evidence that microloan borrowers found participation in the microfinancing program to be positive. If it is assumed that they were able to use the services (including the microloan) in running their businesses, then some of the changes reported here may be attributed to those services received.
ness finances as businesses that increased their dollar sales, and increased their profits, were more likely to increase their state taxes as they hired additional people and/or increased purchases and sales.

**Positives and Negatives of Owning a Business**

Business owners were asked whether there had been positive results of owning their own business, and, if so, to list the top two reasons. Thirty-two respondents (89 percent) said there had been positive results of owning their own business. As each respondent could list up to two responses, 61 total responses were recorded. The two responses most often selected were “lifestyle” (22 responses or 36 percent) and “sense of accomplishment” (20 responses or 33 percent). “Lifestyle” was further explained by many respondents as the opportunity to be your own boss, set your own hours, and determine the types of services/goods that would be offered to your customers. “Sense of accomplishment” was related to the “lifestyle” response in that any positive changes to the business were a reflection of actual decisions made by the business owner.

A follow-up question on negative results of owning your own business elicited 49 responses with seven respondents indicating there were no negatives. Again, business owners could list up to two responses. “Stress” and “changes in business income” (16 responses each or 33 percent) received the same number of responses.

**Strategies for Increasing Business Income**

Finally, business owners were asked whether they had strategies for increasing their income from their current business. Thirty-two respondents (89 percent) indicated they had such strategies. The most popular of the 60 strategies recorded were “diversifying the business” (34 responses or 57 percent) and “increasing advertising” (10 responses or 17 percent).

Following up the strategy question, business owners were asked to detail the activities they were pursuing to accomplish these strategies. Respondents offered a total of 59 responses as they could indicate up to two responses each. The most common activities mentioned were “specific marketing plans” (14 responses or 24 percent) and “increasing research” (10 responses or 17 percent). “Specific marketing plans” included improved signage, designing and coordinating mail links, improving websites, and expanding service areas. “Research” responses included checking national registry criteria, checking competitors’ pricing, looking for skilled employees, and researching alternative methods of providing services. Other follow-up activities mentioned included hiring additional employees, improving interactions with other businesses to increase sales, renovating business, adding equipment to expand services or increase efficiencies, and obtaining required state licenses and/or certificates.

**Barriers to and Opportunities for Microfinancing**

An assessment of the barriers to and opportunities for commercial lending institutions to provide microfinancing services cannot be provided without first understanding the role of the Community Reinvestment Act (CRA). Created as part of the broader Housing and Community Development Act of 1977, the CRA mandates that all banks receiving Federal Deposit Insurance Corporation (FDIC) insurance meet the credit needs of the communities in which they operate. Banks are evaluated every 3 years to ensure they are in compliance. Bank evaluations are taken into account when banks apply for new branches, relocate an existing branch, apply for a merger or acquisition, and other corporate activities (Office of the Comptroller of the Currency, 2011). In 1993, new regulations encouraged banks to cooperate with and provide support to microfinance institutions as a way to meet their CRA obligations. Microfinancing programs and the CRA both strive to accomplish the same objective: provide low-income individuals and small businesses with access to banking services otherwise denied them (Berkman, 2006). Subsequent research has shown that the CRA has resulted in higher levels of lending to small businesses. The

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**Table 13. Effect on Business Finances After Loan Received**

<table>
<thead>
<tr>
<th>Response</th>
<th>Yes (%)</th>
<th>No (%)</th>
<th>No Response (%)</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dollar Sales Increased</td>
<td>30 (83%)</td>
<td>4 (11%)</td>
<td>2 (6 %)</td>
<td>36 (100%)</td>
</tr>
<tr>
<td>Dollar Sales Decreased</td>
<td>4 (11%)</td>
<td>30 (83%)</td>
<td>2 (6 %)</td>
<td>36 (100%)</td>
</tr>
<tr>
<td>Costs Increased</td>
<td>27 (75%)</td>
<td>6 (17%)</td>
<td>3 (8 %)</td>
<td>36 (100%)</td>
</tr>
<tr>
<td>Costs Decreased</td>
<td>4 (11%)</td>
<td>29 (81%)</td>
<td>3 (8 %)</td>
<td>36 (100%)</td>
</tr>
<tr>
<td>Profits Increased</td>
<td>22 (61%)</td>
<td>8 (22%)</td>
<td>6 (17 %)</td>
<td>36 (100%)</td>
</tr>
<tr>
<td>Profits Decreased</td>
<td>4 (11%)</td>
<td>26 (72%)</td>
<td>6 (17 %)</td>
<td>36 (100%)</td>
</tr>
</tbody>
</table>

Source: Field Work, 2011.

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35. Banks must meet CRA requirements where their offices are located. Bank policies can also dictate that CRA requirements must be met where bank customers are located, but this is not mandatory.
national mean size of CRA-linked small business loans was $36,200 in 2004 (Berkman 2006, Zinman, 2002)\(^\text{36}\).

Within existing requirements of the CRA, banks are concluding that they can benefit from an increased involvement with microlending activities. One reason is due to the collapse of the housing market in which commercial banks had traditionally fulfilled CRA obligations. A second reason is the idea of keeping good borrowers “in house” rather than providing loanable funds to an intermediary microloan program, which then lends the funds to creditworthy businesses. (A borrower who “graduates” from a microloan program may or may not bring his/her business to the commercial bank that had originally provided the funds to the microloan program.) Third, commercial banks will collect the interest and other loan fees if they are the lender. And fourth, microlending is a relatively new market with potential growth in a competitive financial industry.

Bankers from seven banks were interviewed to discuss the barriers and opportunities of providing microfinancing services. The list of banks is provided in Table 14.

Supply of Microfinancing Services

Microfinancing services provided by banks include: provision of loans to small businesses, lending funds to CDFIs for them in turn to lend to clients, and acting as a certified lender for SBA. Additionally, financial institutions provide lines of credit and loans to specific community populations, such as the lending programs Marquette has established with the Amish community in Erie and Crawford counties. Loans are available to Amish borrowers for working capital, new equipment, and business expansion. As the Amish traditionally do not use credit cards, the bank accepts credit history letters from feed stores, grocery stores etc. Marquette frequently waives the private mortgage insurance usually required for buildings because of the Amish community tradition of rebuilding after destruction.

Similar to PNC and First Columbia, First National, Northwest Savings and Mercer provide conventional loans directly to small businesses as part of their own lending portfolio, provide loans using federal or state monies and partner with area commissions and/or community development financial institutions to lend indirectly to qualified borrowers. Frequently, the microloan organizations agree to lend 50 percent of the loan amount and the banks agree to lend the remaining 50 percent. In this way, banks do not assume all of the lending risk, and the other institutions generally assume responsibility for training, loan repayment, and delinquent follow-ups.

All of the bankers interviewed mentioned the continued availability of loan funds for small businesses, especially since 2010. Several mentioned the existence of two different sets of borrowers: historical customers who had decreased their borrowing, and new customers who had moved from a larger bank to their smaller bank and had increased their borrowing. A decision by some big banks in 2011 and 2012 to call-in a customer’s line of credit before it was due (which the bank can legally request at any time, particularly in certain industries such as construction) motivated borrowers to move their accounts to other banks.

Reasons given for unused loan funds by the above banks because of borrower characteristics included: low FICO scores, unwillingness to go into debt due to slow economic recovery on “Main Street,” no longer able to use self-employment assistance funds, substitution of credit cards for smaller loans, inexperience in running a business and/or understanding business financials, and projects considered too risky by lenders. All bankers stressed the need for a detailed busi-

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\(^{36}\) The median loan provided by the three organizations examined in-depth in this research was $35,000. All three organizations are supported by funds from commercial banks as part of their CRA requirements.
ness plan as well as a high-collateral-to-loan-amount ratio, equivalent to 70-75 percent.

Reasons given for unused loan funds by these bankers because of banking institution characteristics were grounded in meeting two objectives: reducing risk and continuing to meet CRA requirements. Reasons included: smaller business loans referred to CDFIs, small business borrowers without personal bank history referred elsewhere as bank policy, banks not interested in lending to start-ups (especially restaurants and retail shops), and increased collateral requirements by private and federal lenders made it difficult for borrowers to successfully apply for a loan. Additionally, many loan applications continued to stress the need for capital goods as business collateral. This practice reflected a past era when small businesses were traditionally involved in small-scale manufacturing with tools that could be used as business collateral. A firm providing staffing solutions or developing electronic products for its customers may only need a laptop, printer, and Internet access to provide its service. Thus personal collateral would replace business collateral in those loans. All the bankers interviewed stressed that the CRA requirements had strengthened their relationship with small borrowers and microfinancing programs. In larger banks, lending decisions for microloans could be made at the branch level due to an increased knowledge about local borrowers and evaluation of training requirements.

The bankers interviewed were also seeing less graduation from CDFIs to commercial lenders since 2007 due to slower business growth and the inability of businesses to maintain momentum. Thus, if these bankers were to satisfy their CRA requirements, they would need to directly interact with microfinancing programs. These interactions could be monetary (providing loanable funds to these programs), and/or nonmonetary (bank personnel sitting on program lending committees/program boards or assisting in setting up loan policies and organization structure). None of the bankers felt they were competing with the microfinancing programs for creditworthy clients. It was more often the case that the small business owners would not have received a loan from the commercial bank in the first place. The business owner, once having received the loan from the microfinancing program, could then attempt to leverage that program loan with a bank loan, but the initial loan from the program was the linchpin.

For larger commercial banks, the partnering with microfinancing programs was seen as a recent innovation encouraged by relatively new regulations, such as the 1993 amendment to CRA regulations, and the 2010 Dodd-Frank Act. Those new regulations encouraged commercial banks to diversify their risks and simultaneously meet the demands of regulators to provide financial services to small businesses. This was one reason why some banks were downsizing and providing smaller loans.

The increase in small business lending by alternative lenders grew in 2011 (Arora, 2012). Using his Biz2 Credit Small Business Lending Index, Arora compared the small business approval percentage of big and small banks, and alternative lenders from January 2011 through December 2011 (See Table 15).

Nationwide, alternative lenders have become more aggressive in the small business lending market as the role of big banks in this market stalled (Arora, 2012). Big banks continue to require more stringent lending criteria including documentation of business operation for more than 2 years, which effectively eliminates small business start-up financing. The borrowers who received loans in this study had frequently requested financing initially from area banks, but their applications had been turned down. They then applied to an alternative lender on their own, or they were referred to an alternative lender for

Table 15. Percentage of Small Business Loans Provided Nationally by Type of Lender According to the Biz2 Credit Small Business Lending Index

<table>
<thead>
<tr>
<th>Lender</th>
<th>% Small Business Loans Approved January 2011</th>
<th>% Small Business Loans Approved July 2011</th>
<th>% Small Business Loans Approved December 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big Banks (&gt; $10b assets)</td>
<td>12.8 %</td>
<td>9.8 %</td>
<td>9.7 %</td>
</tr>
<tr>
<td>Small Banks (&lt; $10b assets)</td>
<td>43.5 %</td>
<td>44.9 %</td>
<td>47.1 %</td>
</tr>
<tr>
<td>Other Alternative Lenders</td>
<td>49.3 %</td>
<td>52.2 %</td>
<td>62.2 %</td>
</tr>
</tbody>
</table>


37. A provision in the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 provided incentives to promote banking among low- and medium-income individuals. CDFIs and banks that were FDIC-insured were specifically encouraged and provided incentives to make financial services more available to these two groups.
financing. At small banks referenced in this research, loans of ≤$50,000 are a larger part of the lending portfolio than at big banks and can represent as high as 60 or 70 percent of all loans. Notwithstanding this high percentage, these loans frequently accounted for less than 30 percent (and in some cases less than 15 percent) of the total value of the lending portfolio at small banks. The majority of these small business loans were used for equipment purchases or working capital.

All bankers interviewed agreed that they will be more likely to lend to small businesses if the financial and personal information requested could be standardized among alternate lenders, as well as between the banks and federal lending agencies. They lauded the SBA Express Loan Program, which required the completion of only two to three pages of paperwork, and allowed the bank to keep other borrower information on file in a bank-friendly format.

**Demand for Microfinancing Services**

According to the “Economic Outlook for Small and Middle-Market Business Owners,” published by PNC in April 2012, there was little interest in requesting a loan or line of credit by small businesses in Pennsylvania (PNC Economic Outlook April, 2012)\(^{39}\). Seventy-five percent of small business owners responded they would probably or definitely not apply for an additional loan or line of credit. While 13 percent said credit was easier to obtain now than 3 months prior, 22 percent said credit was more difficult to obtain. The main reason cited by these businesses for not requesting a loan was the undesirability of taking on additional debt in an economy that was recovering slowly from the most recent recession. Small business owners perceived a continuing weak economy based on their experience with erratic sales, low consumer confidence levels, and the undesirability of hiring additional employees. Another reason for not applying for a loan was the difficulty in accessing credit. The end result has been the largest drop in credit demand the PNC small business survey recorded.

Loan demand by small business owners is a function of debt risk aversion, deteriorating business financial conditions, access to less complicated lines of credit (e.g., personal and business credit cards), price and availability of loanable funds, and expectations about the economy. In May 2012 the Small Business Owners’ Confidence Index (Index) held steady at 92.4 from the previous two months\(^{40}\). Published by the National Federation of Independent Business, this monthly index gauges the outlook of small businesses. Though the index rebounded to 96 in June 2010, it was showing a steady decline for three main reasons: increase in gasoline prices, decrease in sales paralleled by an increase in costs, and declining access to credit (Dunkelberg and Wade, 2012). Small businesses face distinctive hurdles compared with larger businesses due to tighter profit margins, less ability to recover from financial missteps and diminished access to credit markets (Bernstein, 2011).

An illustration of the potential partnership between an alternative lender and a commercial bank was the following scenario as told to the researcher by a potential client of an alternative lender. A plumber’s assistant in a rural county desired to buy-out a retiring plumbing business owner and hire one additional employee. The loan for this buyout totaled $80,000. The loan would be considered too risky if using traditional commercial bank lending criteria due to the lack of entrepreneur experience and insufficient collateral on the part of the plumber’s assistant. An alternative lender (assuming the plumber’s assistant submitted a detailed business plan, provided all requested financial information, and had the capacity to run his own business) would be likely to lend $40,000 to $50,000 to the plumber’s assistant who could then use this loan as leverage with the commercial bank for the additional money. Thus the microfinancing program in partnership with the commercial bank would have sustained a rural business and increased rural employment.

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38. The SBA Express Loan Program is an expedited lending program targeted to specific groups (e.g., veterans, borrowers from distressed communities). It offers lower interest rates, a streamlined application, and a 36 hour turnaround time. Loans range from $10,000 to $250,000 and are available from SBA-certified lenders throughout Pennsylvania and the U.S.

39. Information in this paragraph is taken from PNC’s biannual “Economic Outlook” surveys in 2011-2012. Since 2003, the PNC Research Division has gathered data based on telephone surveys of small and middle-market business owners. Of the 1,000 to 2,000 interviews conducted nationally, approximately 150 interviews are conducted with Pennsylvania business owners.

40. The Small Business Owners’ Confidence Index is a monthly survey of small business owners’ plans and opinions. The respondents are drawn from the membership database of the National Federation of Independent Businesses. Subjects queried in the survey include: plans to increase employment and inventories, opinions on improvement in the economy and in sales, and expected credit conditions. Using 1986 = 100 as the base year, survey responses are compared to 1986 responses. The lowest recorded value for the Index was 80 in 2009.
The Progress Fund personnel stated more than 75 percent of their loans were made to businesses that initially had been turned down by commercial bankers. Bridgeway Capital personnel mentioned commercial lenders frequently requested a primary and/or secondary lender to decrease the risk of extending a loan to a small business owner, especially a start-up loan.

Nationally, microfinancing had a market penetration of 1 percent among very small business borrowers (Burrus, 2005). This was based on comparing the potential need for financial services by very small business owners who had not received credit with the number of outstanding loans. Of the estimated 20 million microentrepreneurs in the U.S., 50 percent of them were located in a target market area of a microfinancing program. However, only 10 percent or 1 million of them desired or sought services from those programs (Burrus, 2005).

CONCLUSIONS AND POLICY CONSIDERATIONS

The five major conclusions from this study are:

• microloan borrowers sustain, and at times increase, the economic growth of a rural area/town;
• the provision of microloans to small businesses in rural counties is a viable economic development strategy for specific rural areas with established economic growth potential but is not sufficient to jump-start or sustain growth in an area that is languishing economically;
• continued constraints on the Pennsylvania state budget mean funding of small business lending will increasingly originate with the federal government and the private sector;
• alternate lenders play a pivotal role in providing loanable funds of ≤$50,000 to small businesses that employ fewer than 100 employees; and
• the economic downturn beginning in 2008 has increased the movement of borrowers between big banks, small banks, and alternate lenders.

The researcher grouped the policy considerations into four categories as follows: institution strengthening, loan processing, information provision, and microfinancing program viability.

Institution Strengthening

Given continued constraints in the Pennsylvania state budget, it appears that lending programs for rural small borrowers will continue to be concentrated with alternate lenders and small commercial banks.

DCED uses revolving loan funds that it channels through alternate lenders to provide funding to the majority of small businesses that receive state lending monies. Additionally, federal monies from the U.S. Treasury, USDA and SBA are used by state agencies, alternate lenders, and banks to provide loanable funds to rural borrowers. Using the state as both an originator (in the case of the revolving loan funds) and an intermediary (e.g., State Small Business Credit Initiative) for loanable funds distribution appears to be working. However, there has been no attempt to compare and contrast the effectiveness of funds delivery (originator versus intermediary style). Such a comparison is timely since Pennsylvania budget constraints will probably preclude the use of additional state monies for small borrower lending, but additional federal and private sector funds will continue to be made available to state agencies for use in small business loans.

Given the important role of alternate lenders in providing loans to rural businesses, DCED should consider convening a one-day conference where “best practices” of alternate lenders is disseminated. The conference could also provide a forum for the discussion of the costs and benefits of providing financial and training services to rural borrowers.

The aggressiveness of alternate lenders in providing small business loans is likely to continue. DCED should also consider sponsoring a workshop that brings together alternate lenders and small commercial banks (banks with $10 billion or less total assets) to discuss various ways in which they could partner to expedite the provision of financial services and business training to small business owners. Topics discussed could include the standardization of requested information, and the standardization of reporting forms.

Loan Processing

There are a variety of reporting forms used by banks and alternate lenders to obtain financial information from potential borrowers. Standardizing these intake forms would expedite the lending process and reduce both borrower and lender transaction costs. Borrower costs might also be reduced because increased familiarity with standardized forms could result in more accurate reporting of requested financial information, and subsequent loan requests could be less onerous for borrowers. Lender costs could be
reduced with standardization since bank personnel training would need to be done for one set of forms only, and questions related to form interpretation could be addressed once. Standardization might also encourage additional partnerships between small commercial banks and alternate lenders.

Information Provision

The large geographic area served by alternate lenders and commercial banks in this research demands an interactive information technology that is accessible in rural areas. Site visits and meetings both between clients, and between clients and lenders, are more likely to occur in urban areas where borrower density makes such activities cost-effective. In rural areas clients and lenders need to drive many miles for such events to take place and electronic communication is problematic. Thus site visits, training sessions, and meetings are more expensive in rural areas. Rural borrowers and lenders need to be able to exchange documents and information electronically. Training can be provided electronically as well. Broadband provision, however, is intermittent in many rural areas. Interviewed borrowers complained of sporadic cell phone service as well as problems accessing the Internet. The Pennsylvania legislature should address this issue and provide benchmarks for service inclusion by telecommunications firms.

SBDCs appear to be doing a good job of assisting potential borrowers with the completion of business applications. Additional training for borrowers, however, remains infrequent and erratic. Assessing the ability of borrowers to provide and interpret business financial information after a loan is approved should be ongoing by the lender. This can be done through lender perusal of periodic financial statements, referral of outside business consultants to meet with borrowers, and even site visitations. There is an opportunity for the state to increase its funding for such ongoing training through the Partnership for Regional Economic Performance. This research has shown that the overall economic development effects of lending to small businesses are critical for rural counties and small towns where these businesses are located. Additional state dollars committed to improving the ability of small businesses to repay these loans through additional training dollars is money well spent. Lenders who have pioneered such training efforts should be publicly commended and financially rewarded for their efforts.

Microfinancing Program Viability in Rural Counties

Microfinancing is a viable program in rural counties because these relatively small loans have an economic impact in sparsely settled areas related to their ability to positively impact area employment, area economic activity, community sustainability and uniqueness, and state revenues. Given the role of microfinancing programs and the aggressiveness with which alternate lenders are becoming involved in lending to small businesses, it is imperative that current information on the potential and ongoing partnerships between major stakeholders in this field is provided in a timely and cost-effective manner. The major stakeholders currently include: alternate lenders, private sector firms, foundations, federal agencies, commercial banks and small business owners. Though DCED may continue to be affected by budget constraints, it can play a pivotal role in providing this information through a subscription-based newsletter and periodic gatherings of stakeholders in various regions of the state. (Expenses related to these gatherings can be shared with stakeholders and other interested participants such as large banks.)

Issues that could be discussed in newsletters and at stakeholder meetings would include: the different forms bankers are required to complete to participate with alternate lenders, a common monitoring and evaluation instrument for borrowers and organizations to document the socio-economic impact of microfinancing programs in Pennsylvania, and recognition of innovations in the field that should be disseminated to all stakeholders. As FIELD already has such an evaluation instrument in place, it would only be necessary to adapt the FIELD instrument, and not develop a new set of measurements. With its unique position within the lending matrix, DCED should consider assuming the role of catalyst in inaugurating this type of information flow.
REFERENCES


FIELD. 2011. “Key Data on the Scale of Microlending in the U.S.”


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