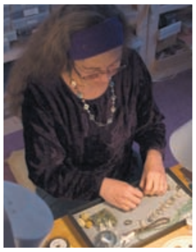
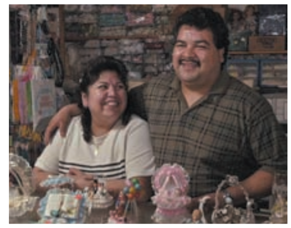
FIELD Funder Guide


Issue 10 | June 2007

Microenterprise Programs as Asset Builders

Money can't buy you love – but handled wisely, it can buy financial security. The latter is a relative, and sometimes intangible, concept incorporating very tangible components such as income, savings, retirement accounts, insurance and home ownership. Financial security requires both income and assets – those investments that appreciate over time. While income pays the costs of daily living, assets are needed to: protect family income in the event of unexpected emergencies, invest in children's education, and plan for the future. With assets, poor families have a chance to break the generational transfer of poverty; without them, financial insecurity often reigns.

Accumulating assets to secure one's financial present and future is definitional to middle class America. Through the tax code, the federal government helps families build wealth by subsidizing home ownership and savings, both for retirement and children's education. However, those who do not own homes or do not earn enough to have tax liabilities are excluded from these benefits. In fact, 90 percent of the estimated $335 billion in annual federal tax credits are provided to households earning more than $50,000.[1]

Low-income families are asset poor in other significant ways too. They make up the bulk of the uninsured and do not have savings for retirement. Only 10 percent of the bottom quintile of income earners have retirement accounts. Due to both the ever-widening gap in income and intergenerational wealth transfers, the disparity in assets is even greater than that of income. The top 20 percent of wage earners account for 43 percent of earned income, but 86 percent of net financial assets. Today, fully one-quarter of American families are asset poor; they do not have enough assets to sustain themselves at or above the poverty line for more than three months.[2]

Microenterprise programs in the United States have risen to the challenge posed by their clients' scarcity of assets. Indeed, building assets in the form of business equity is part of their core mission. Several studies of asset accumulation among low-income entrepreneurs – the Self-Employment Investment Demonstration (SEID), the Welfare to Work demonstration study (WTW) and the Self-Employment Learning Project (SELP) – have indeed found that business ownership has a positive impact on assets and net worth (See box).[3]

The Positive Effect of Business Ownership on Asset Growth

Business Assets
SEID*: Welfare recipients with businesses held an average of $10,501 in business assets after 2.6 years.

WTW: Welfare recipients had $4,800 in business assets after 2 years.

Business Net Worth
SEID: Business owners had $4,867 in business net worth after 2.6 years.

WTW: Participants had an average business net worth of $4,000 after 2 years.

Personal and Household Assets
SELP: Participants had median household assets of $13,140 after 5 years.

WTW: Home ownership increased from 14% to 22%.

Source: Edgcomb and Klein
*Abbreviation key: SEID = Self-Employment Investment Demonstration; WTW = Welfare to Work demonstration; SELP = Self-Employment Learning Project

[1] Lillian G. Woo, F. William Schweke and David E. Buchholz, "Hidden in Plain Sight: A Look at the $335 Billion Federal Asset-Building Budget," *Assets Newsletter* (Washington, D.C.: CFED, Spring 2004).
[2] Woo and others.
[3] Elaine L. Edgcomb, Joyce A. Klein, *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States* (Washington, D.C.:The Aspen Institute/FIELD, February 2005), 70.

Microenterprise development programs are also active participants in a growing movement to focus program services, products and public policy on creating opportunities for low-income families to acquire assets and build wealth. They have joined forces with corporations, financial institutions, government and a rich array of community development organizations to promote matched savings accounts, financial literacy, improved access to credit, and tax benefits for low-income families. With these mechanisms, microenterprise programs are both diversifying their services and bringing their clients closer to the financial mainstream. This guide describes these exciting, inter-related initiatives.

Individual Development Accounts (IDAs) offer low-income families a way to multiply their savings with matching contributions from public or private sources. Administered by microenterprise programs and other institutions, IDA account holders make regular contributions (up to a maximum of $2,000) that are matched at a predetermined rate, usually 1:1 or 2:1. Nationally, an estimated 500 IDA programs have generated 20,000 accounts.

Savings in IDAs can only be used for specific purposes, which vary by funding source and/or program rules, but the most common allowable goals are: business investment, home purchase and post-secondary education. The American Dream Demonstration, the first large-scale study of 14 IDA programs that took place between 1997 and 2001, showed that nearly 20 percent of account holders opted to save for a business. Further, researchers found that the poorer IDA account holders were more likely to save for a business compared to other allowable savings options, highlighting savings as a funding strategy for the poor who seek self-employment.[4] Lenders for Community Development in San Jose, Calif., estimates that 15 percent of its 495 active IDA clients are saving for a business; and when offered a loan product on favorable terms, most opted not to borrow, preferring to finance their business with savings.

IDAs offer clients an opportunity to transform their tiny savings into a significant lump sum that can supplement or replace loan capital. Regular account deposits and accumulated savings may enhance clients' credit status, while business equity increases business stability and may mitigate risk to the lender.

Financial education, also known as financial literacy, provides basic knowledge about managing money. Content varies from budgeting and saving, to more complex information related to managing debt and investing. Financial education is a foundation for other asset-building strategies. Equally important is the way in which financial education helps participants understand their personal discourse with money and make the commitment to save.

In microenterprise programs, financial literacy is a precursor to business education, helping clients prepare their personal finances for starting a business. Clients learn about their options and identify the actions they must take to realize them. At the Maine Centers for Women, Work & Community, a statewide economic development organization that helps women start businesses, build assets and make career transitions, a 15-hour course called “Financing Your Future” is required for IDA account holders. However, robust demand for this financial literacy training extends well beyond these savers; at least 600 people have taken it since 1999. Participants finish the class with an action plan to pay off their debts, increase savings or repair their credit – all necessary steps to start a business. To develop this program, multiyear grants from two local foundations – the Maine Women's Fund and the River Rock Foundation – were very beneficial, allowing staff to concentrate on getting the program going and getting it right.

Enhancing access to credit through credit education and repair is an increasingly important asset-building strategy because one's credit history and score are so significant in securing loans, credit cards, housing and even jobs. Yet, an estimated 40 percent of the population has either no credit score or one that falls below the minimum required to access formal credit. In addition to opening more doors for entrepreneurs, home buyers and jobseekers, a better credit score will save a borrower hundreds of dollars on interest and fees that they can invest in other assets. Microenterprise programs have begun to address this need through financial education and credit repair. New “credit builder” loans – small and short-term - help clients improve their credit score relatively quickly with positive payment on an open account.
However, credit scores are largely controlled by the nation's three major credit bureaus that have found it difficult to vet the small loan portfolios of individual microlenders. The latter, in turn, can't help clients improve their credit score when they are unable to report their loan data. In response, industry leaders have formed the new Credit Builders Alliance as a one-stop shop through which community lenders can report loan repayment data to the credit bureaus

[4] Fred M. Ssewamala, Margaret Lombe and Jami C. Curley, “Using Individual Development Accounts for Microenterprise Development” (St. Louis, Mo.: Center for Social Development, Washington University, Working Paper, May 2006).

and receive client data from them. By bundling portfolios and analyzing portfolio data, the Credit Builders Alliance will legitimize and vouch for small lenders, who in turn will be in a better position to help "un" and "under" banked families build positive credit histories and access the formal financial system.

This groundbreaking effort is possible with support from the Ford Foundation, through the Center for Financial Services Innovation at Shorebank. It is the collaborative work of a dozen community lenders, housing agencies and microenterprise development organizations. The Annie E. Casey Foundation is supporting the development of a toolkit to teach the industry about credit education and repair.

The Earned Income Tax Credit (EITC) is a federal tax reduction and wage supplement program for low-income working families, and increasingly microenterprise programs are helping their clients access it. Varying with household earned income and number of children, the EITC is a "refundable" credit – if the family's credit is larger than its income tax bill, the family receives the difference as a refund. This feature enables low-income working families to take full advantage of the credit despite minimal tax liabilities. In 2002, the federal government made EITC payments to more than 21.6 million workers, 20 percent of whom were self-employed; the average payment was $1,700. Building on the success of the federal program, by 2006 18 states and the District of Columbia had enacted EITCs. When used as loan collateral, as a deposit in a matched savings account that can double or triple its value, or as a business investment to increase productivity, the EITC is a powerful asset-building tool.[5]

Despite the reach of the program to date, an estimated 25 percent of eligible families do not claim their credit.[6] Microentrepreneurs, patching together multiple sources of income, often operate in the informal economy. Those who do seek assistance filing tax returns may fall outside the purview of IRS-sponsored, free tax preparation centers that are set up specifically to assist the claims of wage earners. In response, microenterprise programs are stepping in to help their self-employed clients file and claim the tax credits due them. For example, in California, West Company helped welfare recipients determine the value of their widespread bartering of goods and services to establish themselves as legitimate income earners before the IRS and to qualify for the EITC. The Maine Centers for Women, Work & Community offers free tax preparation assistance to clients in a partnership with other community agencies, the IRS and the University of Maine. Microenterprise programs are well-positioned to link clients' EITC refunds with other asset-building tools to improve their financial security.

Clearly these asset-building tools are linked and overlapping. Financial education will enhance the effectiveness of each of them. Each has the potential to bring the "under" banked closer to the financial mainstream, which is a positive step toward asset accumulation. That each can help a microentrepreneur build and stabilize his/her business makes all of them relevant tools for microenterprise programs.

What funders can do

The asset-building field is dynamic, offering ample opportunity for donors to participate, including:

Support matched savings programs with a flexible approach to requirements for matching funds, allowable savings goals and income eligibility limits. The federal government, through the Assets for Independence Act, is a main source of funds IDA programs can access to match account holders' savings. That recipients must raise a 100 percent match for these funds from private sources has two obvious implications: the need for private match funds is huge and programs spend scarce resources raising them. The low federal income limits governing participation exclude many working poor; private match funds with broader eligibility guidelines can extend this opportunity to more needy families, including entrepreneurs.

Invest in product and service delivery enhancements by which microenterprise programs can expand program offerings and strengthen their asset-building capacity. As natural sponsors of asset-building strategies, microenterprise programs are searching for ways to improve their products. EARN advocates segmenting the IDA market and tailoring services accordingly – offering financial education in immigrants' languages or intensifying case management for more disadvantaged groups. Lenders for Community Development is considering how best to offer its IDA account holders

[5] Center on Budget and Policy Priorities, *A Hand Up: How State EITCs Help Working Families Escape Poverty in 2006* (Washington, D.C.: Center on Budget and Policy Priorities, March 2006); available from www.cbpp.org/3-8-06sfp.pdf; Internet.

[6] *FIELD Forum* Issue 16: *EITC and Microentrepreneurs: One Program's Experience* (Washington, D.C.: The Aspen Institute/FIELD, September 2005).

technical assistance specific to savings goals (e.g., buying a house) in order to maximize the outcomes of their saving effort. To better address clients' access to credit, microenterprise programs may need to learn more about credit education and repair. Tax preparation for the self-employed offers interesting potential for microenterprise programs: It can expand their customer base; substantially contribute to clients' asset growth through tax credits and refunds they may not have otherwise accessed; and help clients keep more of their income by avoiding the costly refund anticipation loans often associated with commercial tax preparers. However, this new product implies building staff capacity (staff need to upgrade and maintain their skills to stay current with the tax code) and/or cultivating new partners.

Support microenterprise program participation in collaborative efforts, networks and partnerships that enable diverse but complementary forces to enhance service delivery. Helping asset-poor Americans build net worth is in the best interest of a wide range of financial institutions, corporations, banks, government and nonprofit entities. The largest IDA programs in the country are partnerships in which members take on specific roles in outreach, case management or account administration. In California, the "Earn it! Keep It! Save It!" campaign provides free tax assistance and asset-building information through a coalition of more than 200 community organizations, government agencies and financial institutions that served 13,500 families in 2005.

Support policy initiatives that create benefits for self-employed microentrepreneurs. The Self Employed Tax Initiative (SETI), a project of CFED, is exploring ways to use the tax code to create cash benefits for microbusiness owners. Such benefits serve as incentives for filing a Schedule C, an important step toward formalization. SETI advocates for a new Entrepreneur Tax Credit targeted to Schedule C filers with an adjusted gross income of less than $75,000; the proposed credit would provide a declining refundable tax credit for three years to help support business start-up costs. Another component of this policy initiative is tax literacy for the self-employed, making the tax code their ally. SETI is funded by the Annie E. Casey, Citigroup, eBay, and Charles Stewart Mott foundations.

A Full-Service Business Center Combines Savings and Credit to Build Assets

At the New York Association for New Americans (NYANA), the Business Center for refugees supports 300-400 businesses each year with training, technical assistance, microloans and IDAs. Since 1998 it has made more than 500 loans, lending about $1 million each year. It also operates the largest IDA program in New York state. From 2000-2005, NYANA opened 799 accounts; of those savers, 708 have successfully graduated from the program. Saving for a business was the most common savings goal, the choice of 26 percent of the account holders. The trend has grown stronger in Phase II of its IDA program that began in early 2006; of the 103 savers to date, 73 are saving for a business. The popularity of business as a savings goal for refugees can be explained by both their enthusiasm to operate their own enterprise and the fact that home ownership is a distant goal for NYANA's refugee clients, given the price of New York real estate. Interestingly, a significant number of these new IDA savers are also borrowers in the microloan program (45 of 103), taking full advantage of their opportunities to build assets. Yanki Tshering, vice president at the Business Center, says borrowers who are refugees, and thus eligible to open an IDA, need very little extra encouragement to do so.

Since its inception, NYANA's IDA program has been funded by the Office of Refugee Resettlement (ORR), a donor that Tshering commends for its long-term funding and flexibility. Its first five-year grant combined funding for both operations and the savings match, making it possible to build a program. Equally helpful was the fact that ORR did not require its grantees to raise matching funds. And, originally, it allowed more savings goals for IDA account holders than most funders, adding purchases of vehicles or technology and home repair to the "big three" – business, post-secondary education and home purchase.

For more information

See *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States*, available at: http://www.fieldus.org/publications/FulfillingthePromise.pdf. For information on asset building, see www.cfed.org. Visit the Asset Policy Initiative of California (APIC) at http://www.assetpolicy-ca.org/.

FIELD Funder Guides are produced by the Aspen Institute's FIELD program, dedicated to promoting best practice and policy for microenterprise development in the United States. Series funding is provided by the Charles Stewart Mott Foundation.

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Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination

The Aspen Institute | One Dupont Circle, NW | Suite 700 | Washington, DC 20036
www.fieldus.org