Strategies for State-supported

Microenterprise Development Systems

Practitioner's Role

May, 1994

The Center for Rural Affairs Rural Enterprise Assistance Project (REAP) has entered into a contract with the Department of Economic Development for the State of Nebraska to explore methods for using Community Development Block Grant funds to support operating costs for practitioners serving the needs of microenterprises in the state. The following information sets out how this relationship started and the current status of the experiment.

1. REAP - Background

The Rural Enterprise Assistance Project (a project of the Center for Rural Affairs,a private non-profit) began in 1990 to meet the needs of self-employed individuals in the rural areas of the Midwest. Economic development strategies during the 1980's centered on finding a factory to come to town. Studies done by the Center showed that over 50% of people in the rural area were self-employed and staff decided that a program to assist this sector would make a good economic development strategy.

REAP fills three gaps for microenterprises: lending, education and networking. Associations of microentrepreneurs are formed in rural communities. The local community raises money for a loan loss reserve and for REAP fees. Members of the association have access to loan capital ten times the amount of the loan loss reserve (up to $25,000) through a group lending model. A step-up process is used in determining the size of loan ($100 to $10,000), with all loans below $4,000 being character based. (See attachment A)

REAP operating costs are covered by grants from the Ford Foundation and C.S. Mott Foundation. A special grant from the Aspen Institute has covered costs in exploring the role of state government in microenterprise development. REAP is an intermediary lender in the Small Business Administration's microenterprise lending program and uses SBA money, in conjunction with foundation money, for loans and technical assistance.

The stars that appear on Attachment B represent locations of REAP associations. The greatest driving time to an association from the Walthill REAP office at this time is 6 1/2 hours. Dealing with geographic distances has been a major concern for the project. Linkages have been made with existing service

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providers (Co-operative Extension, Development Company, and Community Colleges) to provide the basic training program.

The Rural Development Commission, housed in the Department of Economic Development, has been very supportive of the REAP concept from it's beginning. In October of 1993, the Center entered into a contract with the Department of Economic Development (DED). REAP's role in this contract includes the following:

* Providing outreach to projects approved for CDBG funding in 1993

* Develop, design, and conduct training for microenterprise programs in conjunction with the Corporation for Enterprise Development

* Assist in the selection and development of a consortia for CDBG assisted microlending programs

To date, REAP has provided assistance the CDBG recipients at two locations by establishing a member association in one community and providing micro program information to another community.

The training of microenterprise programs took place in March and May of 1994. The material covered design and implementation of a micro program. Participants represented rural, urban, public, private organizations.

The third area of the contract involves selection and development of a consortia for CDBG assisted programs. DED first made block grant money available for micro programing use in the summer of 1993 (see Microenterprise Development 5-14-94 page 17). In 1994, under a special projects category, DED is accepting Letters Intent for CDBG funding (maximum $100,000 per project matched 1:1). This is an open cycle application process with the first letters being accepted March, 1994.

In January, 1994, REAP conducted a facilitator training (attended by out-of-state projects interested in starting a REAP type project, local development employees interested in starting a REAP association in their community, and interested individuals who would like to belong to an association in their home community) in Southeast Nebraska. Participants came from 11 communities, with the majority based in the southeast corner of the state. Training covered organizing and maintaining associations. As a result of this training, several communities were interested in moving forward to establish associations.

REAP staff visited with Jenne Rodriguez of DED and decided to begin building a consortia in this area of the state. The area Development District and Resource Development Council (see Attachment B) had representatives at the training and it became apparent that the potential existed for establishing a partnership.

2. Partners

The following organizations are partners in the proposed consortia:

Rural Enterprise Assistance Project (REAP). REAP has designed and demonstrated a successful microenterprise project for use in rural areas of the Midwest. Through their project, local communities receive assistance in forming associations of microenterprise operators to provide lending, training and networking opportunities to the self-employed in the community.

Southeast Nebraska Development District (SENDD). This organization serves eight counties in southeast Nebraska. Their staff also support the activities of the Nebraska Economic Development Corporation. The district does business and industrial loan packaging in other CDBG programs and has established relationships with a majority of communities in the southeast corner of the state.

Five Rivers Resource Conservation and Development Council (RC &D). The RC & D is engaged in activities in eight southeast counties. The support tourism, marketing of cottage industries and expansion of existing business resources and services. The RC & D has made application for program funding from USDA.

3. Activities

Following REAP's February, 1994 facilitator training, a meeting was held to discuss the possibility of forming a consortia to access CDBG money and serve the microenterprises in southeast Nebraska. It was decided that SENDD staff would write a Letter of Intent to be delivered to DED by March 1, 1994.

The Letter of Intent set out that an employee would be hired in this area of the state for the purpose of forming associations under a REAP type model. It was proposed that six associations would be formed with $15,000 available to each for lending during the two year period. This capital would be provided by REAP and would represent the match necessary under the project guidelines.

Nebraska City (a community of 7,000 people) was selected as the recipient of the CDBG funds and will reallocate the money to other communities for use in forming associations. Nebraska City will be responsible for monitoring the program. This community was selected because of it's reputation for working with these types of money and a willingness to agree to work with the consortia.

To date, this Letter of Intent is the only one that has been received by DED. A work plan for the position has been written. REAP's experience in micro lending and their position as part of a larger program (extended support from the Center for Rural Affairs), brought members to consider them as the employer of the new position.

Representatives of REAP and SENDD attended the June 20th City Council meeting in Nebraska City to give testimony at the public hearing on Nebraska City's involvement in this project. The Council unanimously passed a resolution to serve as the applicant (Attachment C). The necessary documentation has been forwarded to the Department of Economic Development for approval.

4. Lessons Learned

A very important part of the consortia has been keeping an active role for all partners. At this time, as stated above, REAP is the probable choice for employing the new position. There is a role for SENDD in working with Nebraska City to monitor the funds. SENDD and the RC & D will work with the new employee to assist in making community connections and as trained facilitators of the REAP process can offer advice, etc. A location for this employee has not been determined at this time. Both SENDD and the RC & D have offered space if necessary.

The haste in filing the initial Letter of Intent is being corrected at this time. Detailing up front what each partner has to offer and the role they see for themselves in the activity is important.

5. State Government Role

Representatives of DED attended one of the planning meetings and provided guidance and neutral input on the project. They expressed a desire for this consortia to work and emphasized the involvement of all partners. State government involvement in the early stages was helpful for this reason. Everyone realized that this was not something they could do alone.

The fact that state representatives were not involved in subsequent meetings was good. Consortia members knew the guidelines and could go ahead and plan on the strengths of one another. Including state representatives in later negotiations also placed them in a difficult position of assisting with the design of a project that they would fund in the future.

A major role for state government lies in accessing resources that can be used for these efforts in the future. In Nebraska we have found that capital money for lending is available but it is difficult to cover operating costs.

Serving the needs of microenterprises has received much attention in recent years. Service providers who did not meet these needs in the past are developing programs to do so in the future. State government could play an important role in organizing the delivery of services in the state so that small businesses at any level would know who might assist in meeting their needs. Attachment D is a sample grid of how these services might be presented to micro businesses. Every effort should be made to use existing service providers to fill these needs. If new projects are developed to fill gaps, these should be looked upon as filling short term needs with future service responsibility being transferred to existing service providers.

There has been a great desire on the part of all consortia members to make this effort work in Nebraska. Part of the work plan for the new employee includes documenting activity for replication of this effort in other areas of the state. DED has given REAP permission to begin organizing a second consortia in the Panhandle area of Nebraska. The commitment of all partners to the effort plays a key role in its success.

How to Get Involved:

Small local businesses are at the core of economic activity in rural communities, and support for these businesses should be a part of the development plan of every small community. REAP is designed to be a partner in that plan. REAP not only enhances local business formation, it's an investment in local people, and in the future of the local community.

To become involved, a community, small business or individual should:

* Contact REAP or a local affiliate (see name in box) to find out if REAP is available in your area.
* Get a copy of REAP's introductory videotape and circulate it to potentially interested groups and individuals.
* Determine if there is sufficient local interest (10-20 potential members).
* Raise the start-up cost of $1000.

REAP resources are limited and its procedures subject to change. Communities should contact REAP before undertaking any organizing activities.

A number of trained REAP affiliates are available in different parts of Nebraska to assist in organizing REAP associations. Your local affiliate:

What People are Saying:

The part I like best about the association is the way we learn to keep records, the financial end of it...we really learned a lot.

Mary Pritchard, Spalding, Pritchard's Kitchen

As a chamber representative of the community and working in a financial institution I see a lot of people trying to get started but they just don't have the right resources. This is a good start for them, a way to get started.

Linda Fusselman First Federal Lincoln - Albion

If you have no way of putting money into a small town, it's definitely going to die. And that's where I think REAP is a big advantage.

Larry Buechter, Cedar Rapids, Corner Tire and Lube

I would be more than glad to tell them that it is one of the best things that they could do for their town.

Dixie Schilousky, Albion, Rags to Rugs

A video tape along with updated material explaining REAP associations and procedures is available from REAP or a local affiliate (see box on left panel).

Rural Enterprise Assistance Project
Center for Rural Affairs
P.O. Box 406
Walthill, NE 68067

Rural Enterprise Assistance Project (REAP)

REAP is a business development strategy that builds and supports small-scale self-employed businesses in the rural Midwest.

Center for Rural Affairs
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Walthill, NE 68067
402-846-5428

Attachment A

REAP's Small Business Assistance Model has Five Elements:

The Rural Enterprise Assistance Project (REAP) offers business management training and modest credit assistance for all types of small businesses, including start-up and established, home-based and store front, full-time and part-time, farm-based or town-based. It has five basic elements:

1. The Association/Networking.

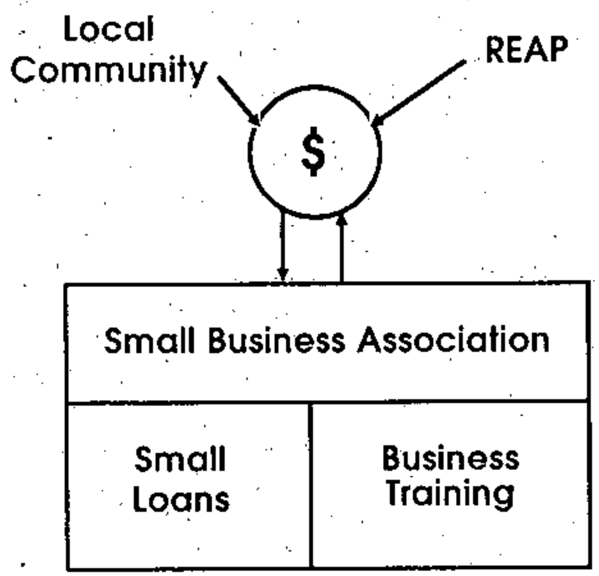
The local community forms an association of between 5 and 20 members. They meet monthly with staff from REAP or REAP affiliates to have business training, discuss business ideas and problems, provide mutual support and networking, review any loan applications, and receive monthly loan payments from association borrowers.

The association is responsible for maintaining the local Loan Loss Reserve. To continue access to REAP services after the first 12 months, the association will pay an annual fee of $150. This fee gives the association members access to REAP's video library, newsletter, annual conference, and business consulting service.

2. Revolving Loan Fund Access.

REAP's Revolving Loan Fund is used to make small loans ($100-$10,000) to small rural business owners who become members of a local REAP association. Local communities achieve leveraged 1 to 10 access to this fund by creating a Local Loss Reserve of $500 to $2,500.

Maximum capital access of $25,000 results from a $2,500 Local Loss Reserve. In the unlikely event of loan demand in excess of the REAP Loan Fund, access will be available on a first-come, first-serve basis.



3. Unique Lending Process.

The REAP project uses special lending techniques which respond to the needs of small start-up businesses while controling loan losses. These include step up borrowing and group borrowing:

* **Step up borrowing** limits a first-time borrower to a small loan (no more than $1,000) before stepping up to larger loans. Each loan can be double the previous loan up to $10,000 with a good repayment/attendance record.
* **In group borrowing** association members participate in reviewing each other's loan applications.

Interest rates for the first two "start-up" loans are prime plus 1%. Subsequent loans are prime plus 4%.

4. Business Training/TechnicalAssistance

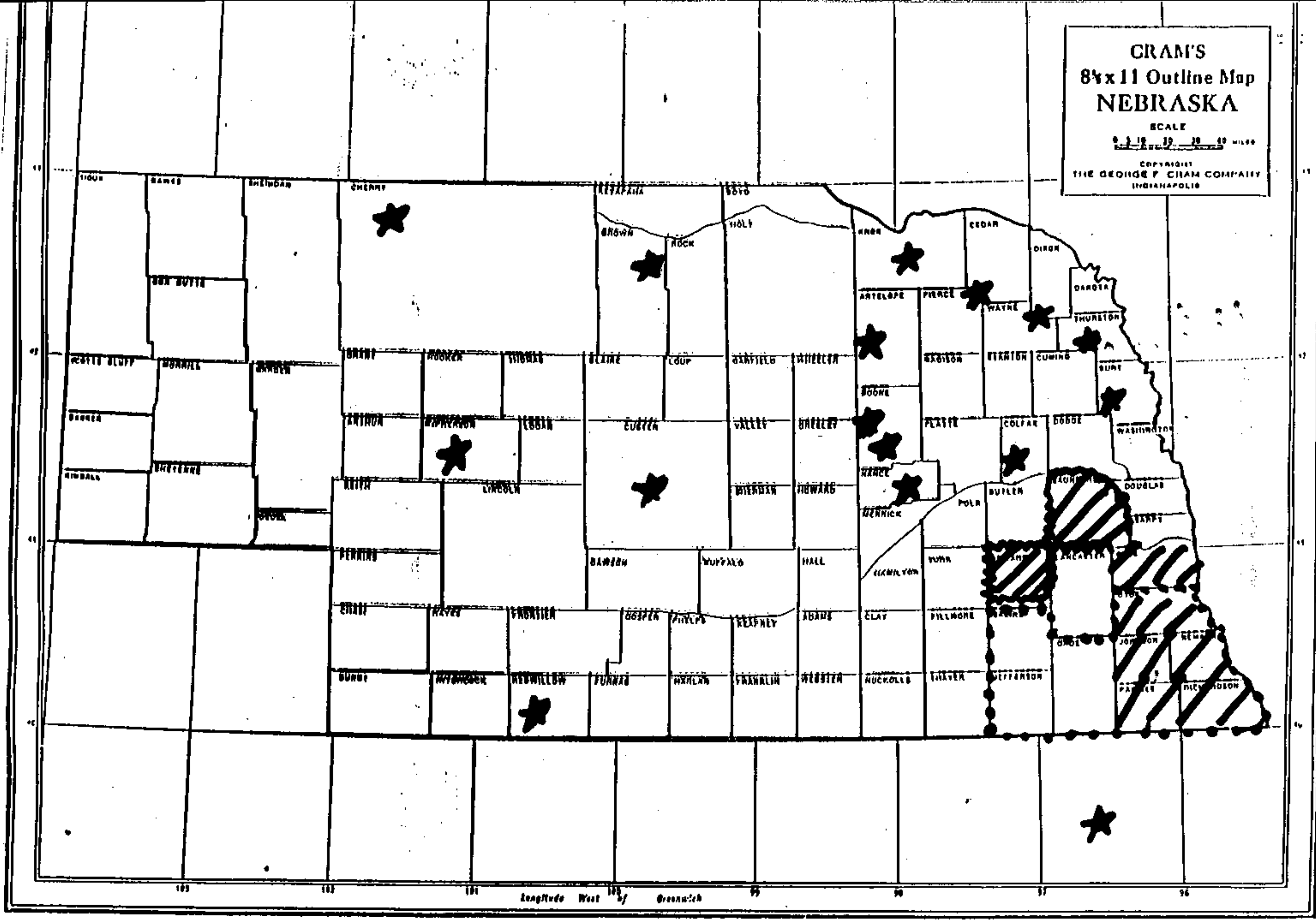
Staff from REAP or its affiliates provide a basic business management curriculum relating the instruction to the needs of individual businesses. This training improves members' business skills, repayment capacity and strengthens the local community's economic base. It is open to the public, and topics include marketing, customer relations, financial management, promotion and advertising, and goal setting. It results in a completed business plan.

All REAP association members have access to technical service from REAP staff to solve problems within their businesses. In addition, all members receive the *REAP Business Update* which provides important business tips and important networking information. There is a one-time start-up fee of $500 for the basic training and *Update* subscriptions for all who attend the training sessions.

5. Local Partnership.

The local community is responsible for identifying interested members and raising funds for the minimum association start-up cost of $1000. This includes $500 for a minimum local Loan Loss Reserve and a one-time $500 start-up fee for the basic business training program, the monthly *Business Update* and other start-up costs. Local donations for these funds can come from any source including community and business clubs, raffles, businesses, churches, and local individuals including prospective association members.

A "partnership agreement" between REAP and local donors formalizes access to REAP's Loan Fund and provides for the return of the funds to local donors if they are not needed.



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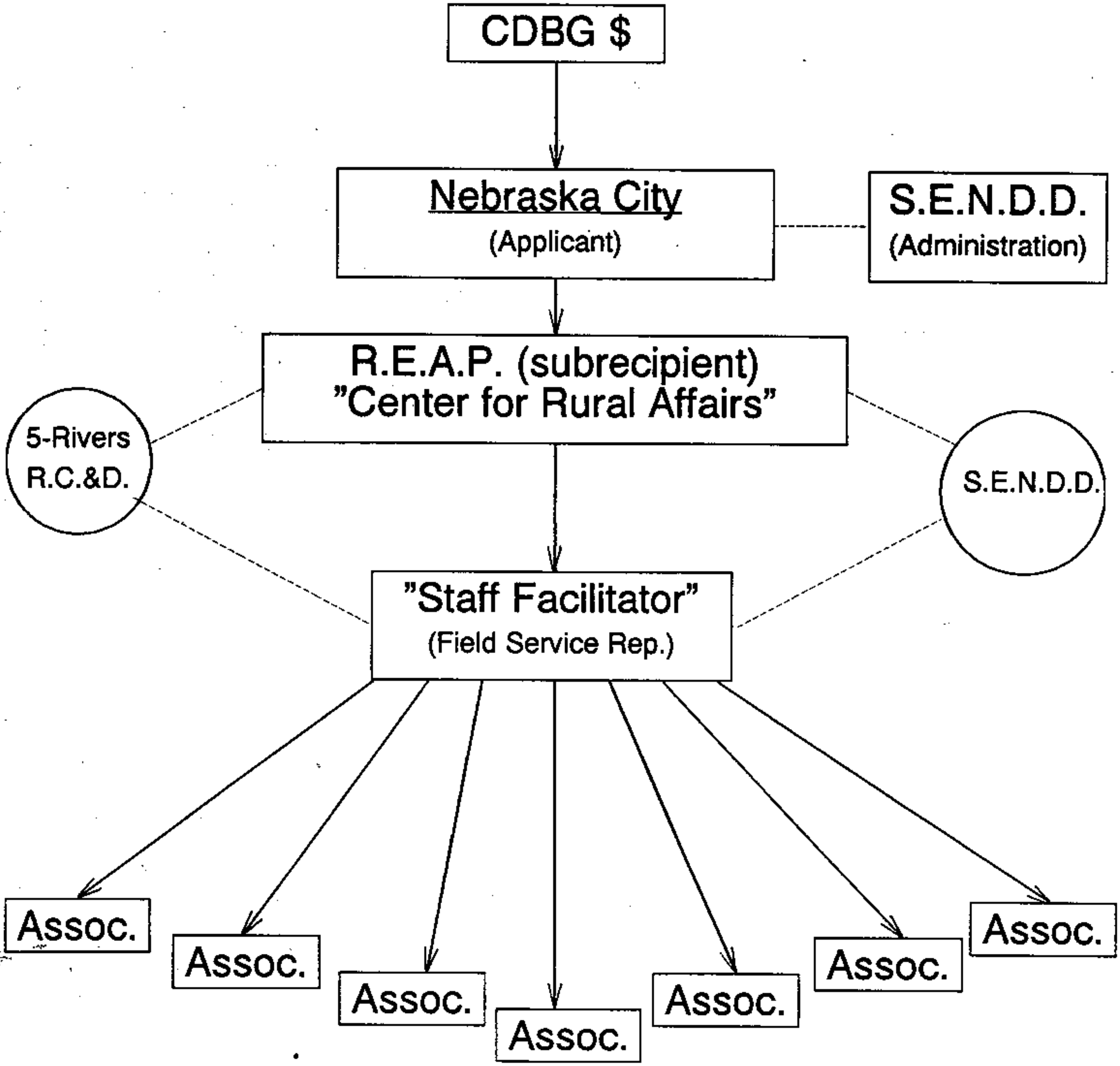
Attachment B - 1

Attachment C

Nebraska City, Nebr. 1994 CDBG Applilcation-Flowchart



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MICROENTERPRISE SERVICES

BUSINESS SIZE	LOAN APPROVAL	LENDING	TRAINING	NETWORKING	PROGRAM SUPPORT
Cash and Self-Employed	Group	REAP 0 - $10,000 Bank Hastings Com. Col. Lincoln Wom. Fund	Com. Col. REAP staff HBBA Conf. Private Train Co-op Extension Getting Down to Business	Group Monthly Mtg. (REAP, HBBA, etc.)	REAP Budget Private Found. CDBG NIFA NE Micro Initiative Loan Income REAP SBA Grant Community Match Utility Company Com. College
Small Business	Individual/ Group	Dev. Dist. RC & D CAP Agency REAP?? ($10,000-$25,000)	Fast Trac NBDC HBBA Conf. Private Train. Co-op Extension REAP Staff	Group (attend 4 yr.) (REAP, HBBA, etc.)	Loan Income Local Bank REAP SBA Grant IRP - FmHA SBA Tech. Assist. Grant Individual Bus. Fees US West RLF Utility Company Community College CDBG
Growth Business	Individual	$25,000 - $100,000 Dev. Dist. CAP RC & D	Fast Trac NBDC Loan provider Private Train. Co-op Extension	Individual attend yearly as resource for group (REAP, HBBA, Etc.)	Loan Income Bank Dev. Dist. TA/Loans NBDC (free) Individual Bus. Fees RLF Utility Company Community College Block Grant Program

REAP:4/94

Attachment D

Microenterprise Development
and
The Role of State Government

May 14, 1994
(corrected version- July 1,1994)

This paper has been prepared as part of a project supported by a grant from the Aspen Institute to the Center for Rural Affairs; P.O. Box 406; Walthill, NE 68067; 402-846-5428. This paper was prepared by:

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Microenterprise Development
and
The Role of State Government

A. Microenterprise Development and State Government: Two Moving Targets.

This paper deals with two converging and dynamic events: the rapid growth of microenterprise as a development strategy and the new interest in state government for finding ways to support this strategy. These two events are both moving targets, and in order to design appropriate and effective roles for state government, we must understand both the challenges facing the microenterprise field as well as the opportunities and limitations of state government involvement.

The purpose of this paper is to explore both conceptually and practically how state government can support microenterprise development. The paper focuses primarily on three states (Montana, North Carolina, and Vermont), which have carved out a comprehensive role for their states, and takes a close look at how the lessons learned from those experiences are being used to develop a comprehensive program in Nebraska. The paper is part of a learning experience that began in the summer of 1993 and will continue at a group session of interested state government officials and practitioners at the annual meeting of the Association for Enterprise Opportunity (AEO) in Tucson on May 18, 1994.

Status of microenterprise development: The interest in microenterprise and self-employment as strategies for both human and economic development has grown dramatically over the last several years. The handful of U. S. microenterprise lending programs in 1989 has grown to over 200 by 1994.[1] As the local level delivery capacity for microenterprise programming has spread (some would say exploded), the fast evolving field faces a number of interrelated concerns and challenges, including:

- brand new programs coming on line before their capacity, or even commitment, is firmly established,
- pressures on older programs to expand faster than may be prudent,
- slow development of a consensus on what constitutes "best practices,"
- limited understanding of the field's outcomes and impacts,[2]

1 A reflection of this growth is the establishment of the Association for Enterprise Opportunity (AEO) which serves as the national trade association of microenterprise programs and provides the new field with a policy voice and a forum for training and information.

2 The Self-Employment Learning Project (SELP) is developing evaluation tools and standards for microenterprise programs. For more information, contact SELP at 1333 New Hampshire Ave., NW, Suite 1070; Washington, DC 20036.

- unrealistic expectations created by some media accounts, public officials, funders, and new practitioners,
- the field's status as a "demonstration,"
- a still evolving array of support structures and arrangements, including various kinds of "intermediary" support organizations, technical assistance providers, and commercial lender linkages, and
- the uncertainty and fragmentation of funding needed to stabilize the operations of an expanding local program base.

In short, the microenterprise field is experiencing intense growing pains as it moves from a demonstration mode into an expansion mode.

State government issues: In addition to standard public policy concerns and the interplay of political opportunities, new dynamics are involved as states determine ways to support microenterprise. Strategic discussions on welfare reform, creation of enterprise zones, unemployment reform, redesign of some block grant approaches,[3] as well as notions of re-inventing government all have an impact on microenterprise development. While many of these strategic discussions are being initiated at the federal level, they all directly involve state governments which are having their own state-level versions of these strategic discussions.

As state governments consider adopting microenterprise and self-employment approaches as long-term strategies for their respective states, they face several critical issues, including:

- What is the appropriate public policy basis for adopting microenterprise strategies? Economic development? Jobs creation? Welfare reform? Unemployment or dislocation reduction? Community or neighborhood revitalization? Creating economic opportunities for minorities, women or socially disadvantaged groups? Other?
- How does microenterprise development fit with other conventional development strategies (like business recruitment) supported by the state?
- What is the most appropriate intervention approach for state government? Pro-active support for creating a comprehensive statewide delivery system? Or, moderate support for a more focused approach?
- Is state legislation needed or appropriate?
- Can or should current resources be re-directed to microenterprise development?
- Should a particular state agency take or play the lead? Which agency -- economic development, commerce, social services, labor, agriculture?
- How should state government interface with the largely private, non-profit organizations which have emerged as the experienced local practitioners?

3 For example, HUD's Community Development Block Grant (CDBG) program is being significantly changed to allow CDBG administrators to fund the full-range of microenterprise support services. See below at Section D.3.

- How does state government assure full statewide coverage and access?
- Where does the state funding come from? Can or should it leverage private funding?
- What special funding partners or resources can be leveraged as a result of state government involvement? What are the pro's and con's of these arrangements?
- How do commercial lenders fit in? Should state government encourage or insist on commercial lender involvement?
- What kind of organizational and structural arrangements should be considered to optimize operational effectiveness, flexibility, funding opportunities and long-term sustainability of the programming?
- If public-private partnerships are involved, how does the state assure appropriate public accountability without getting in the way of effective private delivery organizations?

Convergence: At this juncture (May 1994), the microenterprise movement and state government interest are converging, and committed state governments are clearly in a position to play a critical role in the development of the microenterprise field. Local microenterprise programs have been nurtured for over five years by national foundations and, more recently by injections of an assortment of federal support that began during the Bush Administration and are being expanded by the Clinton Administration.

However, national foundations cannot support the new expansion stage to the same degree they have supported the demonstration stage. And, new federal support, so far, flows through many different agencies serving important, but fragmented public purposes. A well-designed state-backed initiative could help provide the missing flexible support and become the mortar to stimulate, stabilize and rationalize the emerging amalgam of program efforts and funding sources.

This paper is an attempt to explore state government strategies and options in the context of the current condition of the microenterprise field. There are two sides to this equation -- the status of a state's microenterprise programming and the state's public policy and political environment. Both sides of the equation will be different in every state, and the results on one side influence the calculation on the other.

To provide real nuts and bolts to this paper, it draws heavily from earlier research on three state-backed systems -- North Carolina, Montana, and Vermont.[4] A narrative and chart comparing these programs is appended as Attachment 1.[5] In addition to these three, recent experiences in Nebraska have been added. As is true of any moving target, there have been some recent state experiences which have not been studied as part of this project. References to these states, primarily Ohio and California, are occasionally included for purposes of providing a more comprehensive analytical framework.

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4 This paper is part of a larger process which included a draft version which was critiqued by a group of reviewers in Omaha in September 1993. This group included the directors of these three state programs. Both the earlier draft and this paper is part of learning process which will be continued at a special session at the Association for Enterprise Opportunity (AEO) in Tuscson on May 18, 1994.

5 A more comprehensive, multi-paged chart is available from the author.

Hopefully, this paper provides a blend of conceptual analysis and real experiences that will be useful to other states' policy makers and microenterprise practitioners and delivery organizations.

B. A Comprehensive Statewide Strategy.

One of the first questions that a state must grapple with is determining its basic strategy and scope of objectives. While there is a continuum of strategies to support microenterprise development, there are also some fundamental choices. This paper focuses primarily on a comprehensive, statewide approach -- the choice of the three states researched as part of this project, as well as of Nebraska.

This comprehensive statewide strategy has three characteristics -- one programmatic, one procedural, and one structural:

- Broad program objectives:
  - Statewide coverage,
  - Service to the full microenterprise sector,
  - Integration of lending with business training;
- State-level, multi-partied planning process; and
- Two-tiered delivery structure.

All three of these will be discussed in turn below, but the last -- two-tiered delivery structure -- will also be expanded in the following section *(Section C)*.

1. ***Broad program objectives:*** The breadth of these objectives -- statewide coverage, full sector service, and integrated lending plus training -- can be compared with less comprehensive approaches which tend to focus on: a single, more restrictive state funding source; a single state agency with its own specific mission; or earmarking for a single delivery organization which targets a specific set of microbusinesses. The results under this more limited state involvement can, of course, be very impressive, and may be appropriate in many circumstances. It can also be a step in a process that leads to more comprehensive objectives.

The point here is that there are strategic programmatic choices to be made in planning state involvement in microenterprise development. The less comprehensive approach does not typically strive for full statewide coverage or systematic coordination of microlending and training; and the population served is more likely to be a set of specific target groups (for example, welfare recipients, the unemployed, or a specific ethnic group or gender) rather than the full sector of self-employed and micro businesses.

By contrast, the four comprehensive programs studied here can be distinguished because they adopt plans which actively seek full statewide coverage, integration of lending with business training, and service to the full spectrum of micro businesses, with the only targeting mechanism being typically some type of income test.

*2. **State-level, multi-partied forum:*** Another characteristic of this comprehensive statewide strategy is an open, broad-based deliberative process through which the state system is planned and eventually adopted. The nature of this process varied in each state, but formal establishment of each of the comprehensive systems was preceded by a lengthy planning process involving multiple parties.

These planning processes were both horizontal, involving different state level entities and the legislature, and vertical, involving discussions between state-level entities and the sub-state delivery organizations and local practitioners that were to become a critical part of a proposed two-tiered delivery system (next section). Based on the four states focused on here, the critical forum which precipitated these discussions was either legislative or administrative in nature. In addition, information from at least two other states, California and Ohio, suggests that a coalition of delivery organizations is serving as the precipitating forum for state-level discussions in those states. Regardless of the forum, this planning process is time-consuming and frequently frustrating; however, each round of discussion should build understanding of microenterprise, develop alliances, help identify both funding and operational partners, and in the long run contribute to a more sustainable delivery system. Each of these planning forums will be discussed below.

a. Legislative process: In Montana, North Carolina, and Vermont, the legislature served as the precipitating forum for planning these states' respective systems. In Montana, it took two sessions to get that state's comprehensive system passed, and in all states the legislature has revisited and refined the legislation. In North Carolina, the law creating the statewide system has been amended and expanded nearly annually by the North Carolina General Assembly. In the spring of 1994, at least two additional state legislatures, South Dakota and Iowa, have adopted state microenterprise systems.

b. Administrative process: In the evolving case of Nebraska, the state's Department of Economic Development (DED) has played this precipitating role rather than the state legislature although some modest legislative action is expected in a future session. DED hired an interim consultant who provided a focus and prepared and circulated a series of working papers which advanced the discussion.

In some cases, an "administrative" process is really part of an eventual "legislative" process, but the distinction provided by the Nebraska scenario is an administrative process where a state agency makes a commitment not only to designing a state system but to making it operational without legislative funding.

c. Coalition process: In Ohio and California, practitioner coalitions are the precipitating forum for planning statewide microenterprise systems. In Ohio, an existing group, the Ohio Community Development Corporation Coalition played this role. In California, a new organization, the California Association for Micro Enterprise Opportunities plays this role. Both of these membership-based non-profit organizations are professionally staffed and include as part of their objectives securing state support for the delivery organizations which are members of their organization.

There is no attempt, here, to claim that one approach is better than another. The lesson, if any, simply stands for the basic notion of seizing or making opportunities as they present themselves, and then using that opportunity to advance a broader policy agenda and design the very best system one can to match that state's circumstances. The choice of a legislative forum in North Carolina and Montana reflected an opportunity to access new state funding. The choice of an administrative forum in Nebraska was the combination of the commitment of key agency staff and the need to comply with an informal moratorium on new legislative appropriations. Finally, my understanding is that the formation of a coalition forum in California signifies the lack of strong support in either the legislature or state agencies.

It should be noted that there is overlap among these three planning forums. For example, in Montana there was no formal practitioner coalition as in Ohio or California, but informally, the state's delivery organizations were involved collectively in planning and securing legislation. And even though the main Montana forum was its legislature, the state's Department of Commerce was extremely active in the planning process.

3. Two-tiered delivery structure: In all four of the researched states' planning processes an early assumption or conclusion was the decision to build on the current base of pre-existing delivery organizations. So far as I know, this was an easy decision in all four cases: these delivery organizations had the capacity and, one way or another, were active participants in precipitating the broader statewide interest. They were key partners from the beginning and the whole point was to build on and build up their efforts.

As obvious as that conclusion might be, it comes with an implied complexity -- the requirement of a mechanism to link state government with the largely private, nonprofit microenterprise practitioners. As part of a comprehensive statewide system, the planning process must create or designate a statewide entity that would implement the system and provide coherence to the overall statewide delivery capacity. The addition of this statewide entity, in effect, creates a two-tiered "system" comprised of a network of several local delivery organizations and a statewide organization that provides support for this network of practitioners.

There are a number of different models for this two-tiered structure *(Section C.3)*, but, at this point it is appropriate to spend some time analyzing more generally the potential role and function of support organizations in a two-tiered system.

C. Intermediary Support Structures.

Of all the characteristics of the three comprehensive systems studied as part of this project, the two-tiered delivery structure with its state-level entity is probably the most distinguishing feature. The functions which are assigned or assumed by the state-level entity will significantly influence the overall system. One of the main difference among the three programs is the scope of functions of the state support organization.

Before we get to specific state choices (*Section C.4*), we should observe that microenterprise intermediary support organizations are not entirely new.[6] While the

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6 The term "support organization," as used in this paper, describes an entity which provides a set of critical

three state programs reviewed here are important examples of these emerging intermediary structures, a full sampling would include other types as well. Some are totally private, some public; some self-appointed, some endorsed by representative mechanisms; some with bank linkages, some without. While many may focus on statewide coverage, other intermediary organizations may focus on smaller sub-state areas. Some provide support in multi-state regions *(see Section C.3)*.

The emergence of these support organizations is very significant. They imply a new restructuring that is quite different from earlier "stand-alone" programs which had little choice but to assume the full range of microlending capacities. State government's interest in supporting microenterprise delivery systems has developed at a time when learning from and utilizing these other support structures makes perfect sense.

1. Rationale and advantages of support organizations: The rationale for the development of support structures comes from the improved efficiencies gained through consolidating selected critical functions. While the functions assumed by a support organization can vary, a support organization which efficiently consolidates functions can provide local delivery organizations a number of advantages:

1. Facilitating a local delivery organization's start-up process;
2. Providing an on-going forum for learning about improved practices and services;
3. Attracting new funding sources through the support organization's expanded fiduciary capacity, larger scale, and enhanced contacts;
4. Stabilizing local delivery services through strategic grant making;
5. Developing a more cost-effective delivery system by capturing economies of scale in the allocation of support and delivery functions;
6. Facilitating "full spectrum" microenterprise assistance through important new linkages with marketing and technical assistance providers and other public and private lenders;
7. Standardizing and assisting necessary program evaluation, reporting, and accountability;
8. Supporting steady, orderly program expansion;
9. Creating broader and more equitable access to microlending services for all micro business owners;
10. Facilitating specific and more effective statewide marketing of microlending assistance.

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functions to a local organization in order to enhance that local organization's ability to deliver microenterprise assistance to local micro businesses. The addition of the word "intermediary" is used here to describe a subset of support organizations which employs a long-term, typically contract-based relationship between itself and several affiliated delivery organizations. Usually, this relationship includes mobilization of loan capital as one of the support functions.

The advantages for support organizations are especially compelling for start-up organizations. Starting a new microlending program from scratch is slow and daunting process, and support organizations can expedite the start-up process and replication of successful models.

More experienced organizations can also benefit from support structures. A well-functioning support organization can help improve delivery efficiencies through more efficient division of labor and aggregation of appropriate critical functions. These experienced organizations can also gain from improved access to information and ideas on complicated issues and opportunities like: the use of the federal Community Reinvestment Act as a way to negotiate with commercial lenders; participation in new federal demonstrations; developing and negotiating formal arrangements with commercial lenders; negotiating with business training providers to develop more integrated assistance; and developing unified evaluation and reporting systems.

All programs, new and experienced, will benefit from new funding made available through the support organization and from having a learning network to share experiences and lessons learned. They will also all gain by having a stronger voice for self-employment policies.

2. Consolidation of selected critical functions: The process of creating a viable two-tiered delivery system requires careful allocation of critical microlending functions and responsibilities between the statewide intermediary and the local delivery organizations. Based on my experiences, the list of critical functions needed for a fully operational, independent program includes:

- **Fund raising** (for operating costs): Raising funds for operating costs is quite different than raising or mobilizing loan capital, and the two should be treated differently. One of the realities of microlending programs (under $10,000) is that, unlike more conventional community-based lending, the need for loan capital is much less because micro loans generate so little volume. The real funding challenge is raising <u>operating</u> funds for these programs. Another permutation in funding (both operating and loan capital) is that there are different opportunities at many different levels. Accordingly, there needs to be fund raising strategies at all levels: local community, sub-state, state, multi-state regional, and finally the national level.
- **Mobilizing loan capital:** Capital mobilization can include raising equity capital, taking out program loans for re-lending to micro businesses (this is how the SBA Microloan Demonstration Program works and the Montana state program), or arranging for capital linkages with local commercial lenders.
- **Staff development:** Staffing of microloan programs is critical to their success. Staff can move up the learning curve quickly by being part of a learning network that includes regular contact with local colleagues and access to training on the field's best practices.

Should be done at the local delivery level (minimum activities):

- Fund raising for operating costs (at local, sub-state, national level)
- Mobilizing loan capital (local and national level)
- Local organizing and borrower recruitment
- Problem loan servicing
- Business training delivery

* See Addendum page 20

Can be consolidated at the statewide-level:

- Fund raising for operating costs (state-level, national level)
- Mobilizing loan capital (state level)
- Staff development
- Program design & refinement
- Evaluation & fiduciary accountability
- Portfolio management
- Program marketing
- Research, development & demonstration.

As mentioned above, this consolidation is especially important for new programs since it relieves them of the painstaking process of putting in place the full range of top-to-bottom functions. The support organization, by consolidating functions, allows the local delivery organization to concentrate on those functions which only it can do. Overall efficiency is improved and achievement of objectives like statewide coverage, integrated lending and training, and full spectrum coverage is enhanced.

3. Different models of support organizations -- public and private: As mentioned above there are many kinds of support organizations within the field of microenterprise. This includes national trade associations like the Association for Enterprise Opportunity (AEO), and intensive staff training programs similar to one recently started by the Corporation for Enterprise Development.

There are also a few private, non-profit support organizations which establish long-term contract-based relationships with local delivery programs. The support organization then trains and provides access to specific lending systems which the support organization has already developed. The partnership-like relationship between the two organizations is long-term, contract-based, and usually involves capital linkage. Working together, the support organization and several delivery organizations form a two-tiered delivery system. The term "intermediary" is used to describe this type of relationship. Some examples of these latter support organizations include: First Nations Development Institute which provides a broad range of support for reservation-based Native American microenterprise programs; ACCION-USA, which provides support for urban microenterprise programs serving Hispanic-speaking populations; and Working Capital, a New England based program which develops long-term contractual delivery relationships with a number of community organizations and agencies.

Table 1 shows how several programs have allocated the critical functions between support and delivery organizations. The table includes the three states studied as part of this project, as well as some private, non-profit and other analogous systems which will be discussed in Section E *(The Funding Dimension)*. The functions listed in the chart differ slightly from the above list in order to adequately reflect shared responsibilities or configurations that differ from the theoretical approach. Accordingly,

Table 1: Allocation of critical functions in sample microlending systems: ----

	Vermont Job Start (state)	Montana (state)	Ohio (CDBG)	SBA Demo (federal)	San Francisco (CDBG)	North Carolina (state)	Working Capital (private)
Support Organization roles:							
Fund raising-oper. (state,nat'l)		✓	✓	✓		✓	✓
Mobilizing loan capital	✓	✓		✓	✓	✓	✓
Staff trng & program netwkg		✓	✓	✓		✓	✓
Program delivery design	✓				✓	✓	✓
Microloan underwriting risk	✓				✓		
Evaluation & fiduciary accntblty	✓	✓		✓	✓	✓	✓
Portfolio management	✓				✓	✓	✓
Problem loan servicing	✓						
Program marketing	✓	✓		✓	✓	✓	✓
Research, devlpmt, & demo						✓	✓
Delivery Organization roles:							
Fund raising-oper. (local, nat'l)		✓	✓	✓	✓	✓	
Mobilizing loan capital		✓	✓	✓		✓	
Local organizing & recruitment	✓	✓	✓	✓	✓	✓	✓
Program delivery design		✓	✓	✓			
Microloan underwriting risk		✓	✓	✓		✓	✓
Porfolio management		✓	✓	✓			
Problem loan servicing		✓	✓	✓		✓	✓
Business training delivery	✓			✓	✓	✓	✓

some functions appear both as support roles and delivery roles. The individual checkmark-entries are simplifications and less important that the patterns which they reveal. For example, looking at the number of checkmarks within a program-column reflects the balance of responsibilities. For example, the Vermont Job Start lending system is highly centralized. By contrast, the Montana, Ohio, and SBA examples require strong local delivery organizations. The table is arranged to reflect more fully partnered support organizations from left to right.

*4. **State government choices:*** If there are logical comparative advantages that shape the relationship between support and local delivery organizations, then over time, the geographic scope of partnerships should take its own course. On its merits, the question is: at what geographic level should critical functions be aggregated -- sub-state, state, or multi-state? On the merits, answers will vary from state to state.

Once state government support is involved, however, this calculus changes since no state government will want its support going to benefit a neighboring state. But the fact is, states are an obvious level of consolidation. States, at least as compared to the sub-state or multi-state levels, are units of government which have resources and a political reason to be involved. State government can also assure more efficient systems through integration of microenterprise development with other related state services and public lenders. None of this means, by the way, that state government could not choose to channel state support through sub-state support organizations.

Another reason states are a logical unit is the simple fact that many federal resources for microenterprise will be funneled through the states in one way or another. The state that develops its support organization capacity will be in a much better position to utilize this federal support and assist its state's microenterprises.

The addition of state government into these support partnership opens new possibilities. State government involvement can sanction the development of full statewide coverage; open up and facilitate critical new partnerships; mobilize and diversify financial support; achieve more effective evaluation and accountability systems. These roles should help stabilize the emerging delivery system and make it more sustainable.

In the context of Nebraska at least, the vision of a state filled with dozens of independent, stand-alone programs is probably not tenable or efficient. There are many examples of how microlending programs can cooperate and consolidate to achieve greater impact without losing their local integrity or unique advantages. It makes little sense for a program to re-invent procedures or experience the downside of some lesson already learned by others. There is little point in each organization spending scarce funds on loan tracking software, for example, where a single software application has capacity for the entire state. Why should every organization go through the expense and delay of developing its own separate business training materials when one or two curricula could serve several programs? Consolidation of support efforts can achieve greater efficiency and broader impact, and, if done properly, is not inconsistent with a vision of dozens of locally empowered delivery partners that disseminate microlending services to every town and neighborhood in the state.

D. The Funding Dimension.

Funding for these state systems is a complex subject and the stakes are high. In reviewing the three state programs researched as part of this project, the connections among program structure, funding and ultimately program stability is obvious. Microenterprise development is a long-term strategy and the structure needs to be developed to reflect that fact.

1. Funding and structure: In both Montana and Vermont, the legislatures delegated the intermediary support functions to a state agency. In Vermont the agency was a human services agency; in Montana, an economic development agency. In both cases, this structure has had significant influence on funding and program stability.

In Vermont, the Vermont Job Start program has had its up's and down's from the beginning. Appropriations were piecemeal rather than strategic and, as part of a state agency, supplemental fundraising by Job Start was limited primarily to federal sources. The result was a cycle of feast and famine. Staffing of the intermediary fluctuated, and inadequate staffing apparently contributed to high loan loss rates which, in turn, may have undermined support for the program. In the spring of 1993, a third-party evaluation recommended that the program be financially stabilized by relocating it in a state-wide non-profit organization thereby allowing Job Start to raise funds from private sources. However, the Vermont legislature instead relocated the program at the Vermont Economic Development Authority (VEDA), a quasi-public bonding entity. It remains to be seen if this action will reinvigorate the program.

In Montana, the Montana Microbusiness Finance Program was delegated to the state's Department of Commerce. There was initially two views of the role of the department as a support organization. One view held that the role was primarily at the front-end. According to this view, once the local delivery organizations were up and running, the department would fall back into a basic administrative posture, performing few, if any, of the support functions described above *(Section C.2)*. The other, and prevailing, view saw the department actively fulfilling many of those support functions.

These fundamentally different views were directly related to the funding structure of the support entity. Financing for the state intermediary role was mixed with general department funding, and others had concluded that microenterprise programs funds could be better used for other department purposes or cutting the budget.

In North Carolina, state support is funneled through a private non-profit organization which serves as the system intermediary support organization. From the beginning, there was an expectation that the non-profit would leverage state funding with federal and private foundation support. This has, in fact, been the case, and the legislature has responded to this non-state fund raising by increasing state appropriations on a regular basis. Interestingly, the non-profit's link to the legislature by-passes any state agency, and the non-profit reports directly to a joint committee of the legislature. The North Carolina program has thrived, and its unique public-private partnership relationship has helped make that possible.

2. The three states' funding formulas: The funding needs of a comprehensive statewide microenterprise development system can be divided into three types:

1. *system loan capital*
2. *state organization operations, and*
3. *delivery organizations' operations.*

To be most effective, the deployment of funds must match these three needs. Funding sources that are out of balance and inflexibly linked to one of the three uses, cannot be used efficiently. The challenge for system planners and the support organization is to optimize the funding balance and create flexibility to mix and match funding sources with these three needs. Since funding for local delivery operations (number 3) is the scarcest, any system needs to play particular attention to raising funds for this category.

In the experience of most microenterprise programs, raising loan capital is much easier than raising operating funds. This experience is paralleled in state government. In many state legislative settings, it is politically easier to consider system loan capital because it is a one-time investment into a revolving fund. Operating funds, whether

- **Program design & refinement:** Microlending is not easy. Both the lending and integrated business training systems (below) should be carefully designed and take advantage of lessons being continuously learned from the field.
- **Portfolio management:** Every program director will tell you how important it is to have policies and procedures that both (1) identify problem loans as early as possible and (2) provide quick, on-the-spot ways of dealing with delinquent loans. Portfolio management is the first of these two components, and in the best programs, it involves professional computerized management of the loan portfolio with built-in loan tracking procedures that lead to individual loan servicing (below).
- **Problem loan servicing:** Proper portfolio tracking identifies problems loans, but it must be followed by direct and timely borrower contact in order to maximize correcting the problem.
- **Business training delivery:** Part of the sound program design is the integration of basic business training into the lending program. There are many ways to do this, and many involve developing partnerships with pre-existing service providers.
- **Program marketing:** All microenterprise programs involve the development of an outreach capacity that introduces the program and its purposes to the public and helps set the stage for local organizing.
- **Local organizing & borrower recruitment:** Closely related to program marketing is the recruitment of prospective borrowers who then enter the programs formal loan application process.
- **Evaluation and fiduciary accountability:** Community-based microlending programs involve many long-term partnership and legal relationships that must be managed carefully. Proper evaluation, analysis, and reporting of program results is part of this responsibility and will enhance a program's ability to raised and leverage funds. This function also includes overall management of the program's loan fund.
- **Research, development & demonstration:** Closely connected with proper evaluation is the ability to quickly understand program shortcomings and develop adjustments and new products which correct problems and expand coverage. Public affairs and policy education are an important part of this function.

Under a two-tiered system these functions are performed more cost-effectively by re-allocating functions according to the level, local or consolidated, which can perform the tasks more efficiently. Determining this efficiency is not always obvious, and in the case of some functions, like fund raising, overall efficiency is improved by sharing the responsibility. Based on my own experiences and the research done as part of this project, I allocate the above critical functions as follows:

targeted to a statewide intermediary or local delivery organizations, are consumed and require continual, annual injections.

In Vermont and Montana, the legislature focused primarily on providing system loan capital (number 1). They presumed state-level operational support (number 2) by housing the support organization in a state agency, and paid less attention to the operational needs of the local delivery organizations (number 3). In Vermont, the delivery organizations, were all communuity action agencies which had developed their own way of accessing legislative financing independent of the statewide intermediary, Job Start, and the systems loan capital. As result, that relationship of the three sums of funding was uncoordinated, and the overall system experienced repeated imbalances.

In the case of Montana, there was considerably more coordination and better understanding of the relationship among the three types of funds. There were still imbalances, however. The legislatively controlled coal severance fund provided a ready and off-budget source for system revolving loan capital, but appropriating operating funds on an annual basis was much less feasible and not seriously considered. The issue of funding delivery operations was, however, partially addressed by allowing an advanced deployment of $250,000 of loan capital to each local organization. This is in the form of a low-interest "development loan," and by the successful re-lending and management of idle funds, a local organization could capture interest payments to cover part of their operating costs. Theoretically, the size of this local fund deployment could create a signficant annual income, but falling interest rates have reduced the spread between what can be the annual cost of money and what can be earned from idle and re-loaned funds. The resulting income earned cannot support the operating efforts, but it puts in place a mechanism that could perhaps be adjusted in the future. It also creates pressures to convert idle funds to microloans as quickly as possible. This can motivate performance, but it also creates pressure to make fewer, larger loans which can reduce the number of total micro businesses served.

Fortunately, the Montana state agency was successful in raising three year's local operating money from a regional foundation, and this funding was passed through to each program based on a three-year declining formula. It is not clear what will happen as these three years come to an end, but, the state agency-intermediary is responding by both helping local delivery organizations raise their own operating funds and raising moneys itself which it can pass through for local operations. This shows the important mixing and matching role that an active support organization can play. Fortunately, this view of the Montana statewide entity prevailed *(see Section D.1)*.

In North Carolina, the funding formulas varied from year to year, but one way or another the legislature has either provided all three types of funding or allowed the non-profit intermediary to make adjustments in the funding. In addition, the statewide organization has raised substantial amounts of funds from private and other sources which have given the state intermediary substantial flexibility to mix sources with needs. At a meeting of the three states' directors in Omaha in *(see Footnote 5)*, there was a consensus that the non-profit status of the North Carolina statewide intermediary provided it with unique fund raising and mixing and matching advantages resulting in a more sustainable system over the long run.

*3. **CDBG options:*** A number of states and practitioners view the federal Community Development Block Grant (CDBG) program as a regular funding source which can help stabilize microenterprise support structures. The CDBG program makes federal block grant money available directly to urban governments ("entitlement" cities) and to the rest of a state usually through the state's economic development agency ("small cities" progam). CDBG funding is both a regular annual income flow and a very flexible source of funding for economic development projects which create or retain jobs primarily for low or moderate income individuals. Recent proposed regulations would greatly facilitate the use of CDBG funds for use in supporting comprehensive microenterprise systems.

A number of CDBG-based support models are already available. In San Francisco, city goverment developed a cordinated city-wide delivery system called the SEED program which includes four separate non-profit microenterprise training programs, which serve different target populations, as well as a city-wide entity to provide coordination. The city itself runs the microenterprise lending operation for businesses which complete the training programs run by one of SEED local delivery organizations.

In Ohio, Nebraska, and Vermont state governments are developing models for using small cities CDBG funds for coordinated activities. While the Vermont effort, interestingly, does not seem to be coordinated with the pre-existing Job Start program, in Nebraska, the CDBG-based effort is part of an overall partnership approach which strives to provide statewide coordination for all microenterprise activities in the state including different federal sources and private sources *(see Section E.4)*.

While the use of small cities CDBG funds is limited to the areas of a state not covered by urban entitlement programs, in mostly rural states, the small cities program can serve the bulk of the population and serve as an important base, or at least beginning point, of a statewide system. Given the non-partisan history and urban-rural applicability of microenterprise development, CDBG funding could open the door to unique partnering efforts among entitlement and small cities programs. This is, in fact, happening in Nebraska *(see Secton E)*.

One of the challenges faced in the CDBG small cities program is working through local governments. Since the small cities program involves granting CDBG funds to a local political jurisdiction which may in turn re-grant to a local delivery organization, it will be important to develop procedures and possibly packaged approaches that avoid fragmenting microenterprise programs and losing the support benefits which a statewide intermediary can provide. Presumably, statewide intermediaries should be very involved in designing CDBG application procedures.

One additonal extremely important point about CDBG funds is their flexibility. The recently proposed regulations increase this flexibility and enhance the use of CDBG funds as a badly needed tool for mixing and matching funding sources with system needs. The ability to use CDBG funds for local operating costs is of special significance since this is the area where funding is scarcest. The strategic ability to mix and match fund sources with system needs is critical to a statewide intermediary, and the ability to work with state-level CDBG staff is important to provide overall statewide coordination.

E. A Close Look At One State's Experiences: Nebraska

The Nebraska Microenterprise Partnership is the result of a series of events which are described in the background section below. Following a description of the partnership's four components, there is commentary on which lessons and experiences were adopted from other states and why.

1. Background: In the fall of 1992, the Nebraska Department of Economic Development (DED) received a grant from HUD to provide technical assistance to non-entitlement CDBG communities to develop microenterprise programming. The grant provided for partnerships with the Corporation for Enterprise Development (CfED) and the Rural Enterprise Assistance Project (REAP) of the Center for Rural Affairs of Walthill. In 1989-90, REAP had developed a group-based microenterprise support program which had 12 sites with micro business members from 20 rural communities by 1993. Currently REAP has 16 sites, including one in northeast Kansas.

In June 1993, as part of the HUD effort, DED launched the first round of its CDBG-based "Business Development Initiative." This funding round included grants totaling just under $300,000 for four microloan grantees. Each was matched 1:1 with local sources for a total investment in microlending programs of $600,000. One of the sites is linked with REAP, the others intend to start independent programs in conjunction with a local non-profit. Two of the grantees are towns, two are on Indian reservations, the remaining three cover four counties. All would use some type of non-profit delivery organization although half of these programs appear to have little if any experience with microlending. Accordingly, DED arranged that CfED, REAP, and the newly formed Nebraska Microenterprise Initiative (below) would provide an intensive 8-day training workshop for newly developing microenterprise programs. These workshops were completed on May 13, 1994.

At nearly the same time, Nebraska's two CDBG entitlement cities (Omaha and Lincoln) became interested in supporting microenterprise programming in their jurisdictions. Two CDBG-based Omaha programs are completing final paper work for a joint grant of $60,000.

In July 1993, DED launched the Nebraska Microenterprise Initiative to provide a state clearinghouse of information about micro enterprise and, in the long term, to design and develop a permanent statewide support system. With DED serving as the sponsor of both the HUD/CDBG small cities microlending project and this Initiative, there has been an assumption that DED's small cities efforts would become an active part of this broader statewide partnership. In April 1994, the Initiative was re-organized as the Nebraska Microenterprise Partnership.

2. Four components and stages: The Nebraska Microenterprise Partnership is a flexible organization unit *(see Section E.3)* and includes four major components:

1. <u>*Clearinghouse & program technical assistance*</u>: This component would create a learning network which allows delivery programs to received the best and latest information about program linkages, funding opportunities,

training events, and new program practices. The Partnership would help build staff capacity and foster inter-program learning. This would allow new programs to move quickly up the learning curve and become operational sooner. This component is already operational. See Addendum p. 21.

2. *Strategic support for local services:* Local programs are the core of a statewide delivery system. Under this component, the Partnership would stabilize quality programs across the state through modest but strategic support (through matching) for local client services and local micro loan funds. Through larger statewide scale and enhanced fiduciary capacity, the Partnership plans to attract new funding which would otherwise be unavailable for local programs. DED's small cities CDBG program currently earmarks upto $750,000 for microenterprise support annually, and linkage between DED and Partnership staff allows this funding to be strategically coordinate as part of the overall partnership deployment. The Partnership has also facilitate coordination among the states two entitlement cities (Omaha and Lincoln) and the small cities programm, thereby assuring program development and partnership support in both urban and rural. Additional funds mobilized outside the CDBG area provide additional statewide flexibility in support local program operations. See Addendum p. 21.
3. *Direct programs:* When appropriate, the Partnership will play a more active role, usually in collaboration with other programs, to fill special microenterprise service gaps (geographic or programmatic) or utilize its statewide scale to encourage consolidated and more cost-effective delivery. In addition, for some national programs, direct statewide programming and staffing could enhance the competitiveness of a state proposal. See Addendum p. 21.
4. *Development & evaluation:* Microlending methods are new and evolving, and there is much to learn. Under this component, the Partnership would identify and develop new programming appropriate to Nebraska.

These four components also represent stages in which the Partnership can be implemented over time depending on the availability of funding. At this point in time, the clearinghouse component is already implemented, and proposals are pending which would fund all of the local support component and significant parts of the remaining two. These four components give the Partnership a broad scope of operations, and in this respect, if resembles the North Carolina model more than the other states studied.

3. Organizational structure: The Partnership is a joint project of the Nebraska Investment Finance Authority (NIFA), DED, and the Nebraska Community Foundation, a tax-exempt nonprofit corporation organized under Section 501(c)(3) of the IRS Code. NIFA is a quasi-public, tax-exempt entity organized by the Nebraska Legislature to issue tax-exempt bonds for specified certain public purposes, including stimulating basic economic activity, expansion of the tax base, and creation of jobs. Its board of directors include, by statute, certain state agency heads. In addition, the Governor appoints private citizens for staggered terms. The director of DED serves as chairperson of the board.

The Partnership's structure as a joint project of these three entities provides fund raising flexibility and has helped build broad ownership of the Partnership and its mission to provide micro business assistance to every community and neighborhood in the state. Just as important, the Partnership has deliberately create inter-program staff linkages that facilitate broad strategic coordination of microenterprise development. The architecture of the Partnership is open to other organizations and anticipates other state agencies, like Social Services, Labor, and Agriculture joining into coordinated activities in the future. NIFA and the Nebraska Community Foundation help assure that the Partnership remains non-partisan. As the Partnership matures, its organizational structure will be reviewed and revised as appropriate.

4. Lessons learned from other states: The design of this Partnership reflects lessons and experiences from the other three states studied in this project in a number of ways.

- Modified two-tiered structure: Like the other states studied, the Nebraska Partnership has adopted the basic two-tiered delivery structure. However, through its direct programming (component 3), it can act proactively, and if necessary, as a direct provider of microenterprise services which are not available through locally based delivery organizations. This flexibility enhances the Partnership's capacity to facilitate statewide coverage and innovative programming and increases the system's scale and ability to access competitive federal and national funding.
- Mixed local delivery system: Unlike Montana's or Vermont's programs, there is no predetermined geographic formulas for covering the state. While this could result in overlapping coverage in some places and coverage gaps in others, the strategic assumption is that local programs will be more effective in the long run if they are free to expand or remain focused based on their own mission and capacity. It also prevented the problem of granting large geographic monopolies in rural areas to local programs which might never succeed in serving the entire area. This mixed system implicitly puts in place a performance-driven standard which allows successful programs to expand based on their track record. This approach both allows local programs with different target populations to co-exist geographically. It also allows programs to compete with each other. The Partnership can guide this process strategically through its use of its flexible matching (below).
- Flexible matching: The matching formulas for providing local support (component 2 above) is designed to be used flexibly to achieve the goal of reaching as many Nebraska micro businesses as possible. The matching will be scaled to allow for special consideration of programs with unusual costs arising from such things as special disadvantages of a unique target population or high logistical costs because of rural geography. The state programs studied as part of this project mostly use a uniform matching ratio

that doesn't provide incentives for programmatic, performance or geographic differences that require special consideration or reinforcement.

- Operating support: One of the realities of the microenterprise field is that it cannot support its administrative and overhead costs through income earned from its lending operations. The loan volume is too small and the technical assistance needs of its customers too great to expect the programs to become self-sufficient on program income. Accordingly, the flow-through support made available through matching (component 2) will be heavily weighted toward providing operating costs. By contrast, the Montana legislature's program provided for a substantial deployment of loan capital without fully providing for local operation costs *(see Section D.3)*.
- Unique funding partners: Since operating funds, unlike loan funds, do not revolve, the Nebraska Partnership's focus on providing local operating support (see above) means that the Partnership will need to identify regular annual income streams which it can mobilize and then re-deploy to support local operations. This will be a continuing challenge for the Partnership, but the current funding partners provide a very good starting point for matching this need. NIFA, a quasi-public agency, has earn annual yields from its bond issues in excess of its operating expenses and could become a viable long-term funding source. DED, a state agency, provides important funding linkages through its CDBG programming and links to the legislature *(see Section E.3)*. The Nebraska Community Foundation, a 501(c)(3) tax-exempt entity, provides linkage to private foundations (local, state, regional and national) and to long-term Nebraska donors interested in the economic well-being of the state. The Montana, and especially the Vermont program, have suffered from an inadequate fund raising base. In Vermont the program experienced periods of dormancy because of the mismatch between funding sources and system needs. Access to private non-profit status which allows tax deductible contributions and private foundation support was one of the emphasized recommendations of a third-party evaluation to the Job Start program.

Center For Rural Affairs Addendum to Microenterprise Development and The Role of State Government

July, 1994

The following comments are added by Center staff and refer to sections in the previous text.

Pages 11 and 12:

In a program designed exclusively for providing microenterprise services and for those that existed prior to the

Partnership the following tasks would also be conducted on the local level:

* Staff development
* Evaluation & fiduciary accountability
* Program marketing
* Portfolio management
* Research, development & demonstration
* Program design and refinement

These programs are already conducting many of these tasks and would most likely continue their operations as in the past.

Page 18

1. Practitioner organizations in the state are currently working to form a practitioner association for information exchange and policy work. Although the systems are not in place at this time, this practitioner organization would be valuable to the Partnership in providing input on design and implementation of the Partnership's activities. This practitioner level input increases the odds for long term success just as grassroots level input enhances the success of micro programs.

2. Current micro programs in the state repeatedly comment that raising operating money is their number one concern. Making this a number one goal of the Partnership and concentrate a majority of their time in this area would best serve the needs of local delivery organizations.

3. Direct programs:

REAP has been very successful in making linkages with existing service providers in the state to assist in providing services to microenterprises. These linkages have evolved over the course of the project from little interest in year one to requests from service providers wanting to help in year four. For this reason, it is important that the Partnership not provide direct programming but allow existing service providers to fill gaps. Other community and economic development projects being proposed for the state are based on forming regional consortia of several service providers. The Partnership could play a key role in assisting in the organizing of consortia.

The banking community in Nebraska is also taking far more interest in the microenterprise activity in the state and the potential for more linkages between programs and banks exists.

Review of Three Comprehensive Statewide Support Systems for Microenterprise Development *(1-21-94)*

Three state-sponsored microenterprise support systems were examined as part of this project. Each of the three states -- Montana, North Carolina, and Vermont -- has adopted a comprehensive approach which provides full statewide coverage to the full population of the state's micro businesses. The accompanying chart compares these systems on a number of features. While the methods, origins, and potential of these three systems differ, they share a number of important beginning points:

1. Two-tiered partnership: All three states use a two-tiered public-private partnership approach with a designated state-level entity performing a select number of critical functions.

2. Local-level credit delivery: All three systems use local organizations to deliver microenterprise assistance to the state's self-employed sector. The structure and capacities of these local organizations are quite different. They are typically local or multi-county nonprofits and occasionally governmental units. Some are quite independent and may have been experienced with microlending prior to the establishment of the state support organization; others owe their existence to the support organization and are very dependent, at least initially, on services and support (including funding) provided by the support organization.

3. State-level capacity building: In all three systems, the state-level entity is designed to complement and facilitate, and if necessary, build the delivery capacity of the local-level partners. In Montana, the state-level entity is a state agency; in North Carolina, a private nonprofit; in Vermont, a quasi-public financing authority. The most important distinction between the three support organizations is in the number of "critical functions" performed by each, and the implied degree of on-going mutual dependence between each support organization and its respective delivery organizations.

4. Performance-based: In two states (MT, NC), the state-local partnership is contract-based and the performance of both is subject to annual review.

** The state entity is expected to provide: leveraging of both capital and operational funding; start-up and on-going "best practices" training for individual programs; program networking; fund raising assistance advice for individual program ; matched access to loan capital and operating funds for individual programs.

** The local organization is expected to provide or maintain: reasonable coverage of microlending and/or business training assistance to an agreed upon target population; reasonable default rates; regular reporting on use of funds; and local matching funds to secure the state entity's contribution.

5. Integrated training and lending: All three approaches require that the local delivery organizations integrate business training with micro lending assistance. However, the three states differ on how they incorporate this assistance:

** In Montana, the local organization is responsible for the micro lending component and can either perform the training component itself or contract it out.
** In North Carolina, the state entity assists in forming local delivery partnerships between the lending organization and a regional training organizations (community colleges and small business development centers).
** In Vermont, the local partners are primarily technical assistance providers and are involved in microloan delivery only indirectly.

6. Full statewide coverage: All three systems provide mechanisms to assure full statewide coverage -- urban and rural. The support structures in North Carolina and Montana, in particular, have resulted in the broad geographic coverage and comprehensive support systems.

Statewide Micro Lending Delivery Systems: Three States' Approaches (10/21/93)

	Montana:	**North Carolina:**	**Vermont:**
STATEWIDE SYSTEM:			
Geography:	841,700 pop /45,000sq.mi.= 6 per sq mile.	6,386,000 pop /49,000sq.mi = 130 per sq.mi.	544,000 pop /9000 sqmi. = 60 per sq.mi.
Capitalization:	$3.25 million from state coal severance fund. Local agents provide 1:6 local match from private or fed. sources.	$4 million. About half public (general funds and half private foundation low-interest loans).	$500,000 from surplus general funds. Currently undercapitalized; has suspended all lending.
Targeting:	A "qualified microbusiness" must have fewer than 10 employees and under $500K in gross revenues. No specific low-income requirement.	State partner's regranting authority limited to nonprofit organizations controlled by low-income constituents.	Original state partner targets to businesses with household incomes no more than 70% of HUD median income.
STATE PARTNER:	Department of Commerce (state agency)	No. Car. Micro Loan Program (independent private non-profit)	Vermont Economic Development Auth. (quasi-public authority). Originally, the state Office of Econ. Opp'ty.
Responsibilities:			
· *Selection of local orgzt'ns:*	Competitive one-time RFP process to receive a $250,000 Dev.Loan.	Competitive RFP process; competitive annual re-granting process for partial operating expenses.	Selected by legislature. Local organizations have geog. monopoly and direct line item in state budget.
· *Local capacity building:*	Start-up training provided for local organizations with no lending experience. On-going consultation on annual basis.	State partner has extensive capacity bldg role. Provides on-going training in one of two "turn-key" models.	State partner has limited capacity building role. In Vermont model, local partners have limited lending role.
· *Monitoring :*	Quarterly reporting requirements. Can declare Local partner's loan in default and seek recovery for any deficiency.	Reviews local organization's performance through annual re-granting process and portfolio reviews.	No role.
· *Leveraging role:*	Received US WEST grant ; passed through to local organization for operating expenses.	Leveraged large amounts of national foundation and federal funds. Secured participation of Com'ty Coll & SBDCs.	Leveraged federal and low-interest private foundation loan for capital.

	Montana:	North Carolina:	Vermont:
LOCAL PARTNER:	Development Dists, CAAs, RC&Ds, Dev.Corps.	Independent non-profits and Com'ty Dev. Corps, some "stand-alones" some "add-ons."	Community action agencies (only).
Responsibilities:			
· ***Geog. scope:***	8-10 very large counties. (12 dists/state).	Approximately 4 counties.	Five CAAs cover entire state.
· ***Lending:***	State partner makes secured $250,000 loan to local partner which in turn re-lends to micro borrowers. Local partner is the direct lender and designs own lending system.	Local partner must choose one of 2 "turn-key" lending systems designed by state partner. State partner is direct lender to micro borrowers; local partner puts up loss reserve.	Local partner merely screens loan applications; has little role and no risk in system lending.
·***Business trng & tech.asst:***	Local partner provides borrower training or can contract out.	Local partner provides limited training. Also refers to com'ty colleges or SBDCs through links est'd by state partner.	Local partner's primary responsibility is to provide technical assistance.

Strategies for State-Supported Microenterprise Development Systems

Models and Options

May 18, 1994

I. Why Should States Support Microenterprise Development?

Two reasons:

- **Economic Development -- Role of self-employment in job and business creation; existence of a "capital gap."**

- **Economic Self-Sufficiency -- Means of job and income creation for targeted groups of individuals -- welfare recipients, dislocated and unemployed workers, public housing residents, the disabled.**

II. How Can States Support Microenterprise Development?

Three policy interventions:

- **Funding support:**
  - **Operating funds and loan fund capital**
  - **State support fairly limited to date**
  - **Range of potential funding sources**

II. How Can States Support Microenterprise Development (continued)?

- **Policy change to support program operations:**
  - **Reinterpret AFDC regulations**
  - **Apply to provide self-employment allowances to U.I. recipients**
  - **State CRA -- encourage private sector support**
  - **Provide next level of business finance**

II. How Can States Support Microenterprise Development (continued)?

- Comprehensive State System

  - Broader commitment to microenterprise development as a policy goal/strategy (statewide coverage, service to full sector, integration of training and lending).

  - Two-tiered delivery system/structure

  - Invest in institutional structures and supports in addition to simply providing funding

III. Key Issues from the State Policymaker's Perspective

1. Link between Problem Definintion and Program Design

- How is the problem defined -- economic development or economic self-sufficiency?

- Can both goals be met within one program/system?

- Who is served and how is a function of:

  - Program funding and financing structure

  - Policy barriers facing specific clients

  - Mission of sponsoring agency/local delivery agents

III. Key Issues from the State Policymaker's Perspective (continued)

2. Selecting a Delivery System

- Are there existing microenterprise providers in the state?
- Are there institutions with the capacities required of microenterprise programs?
- How do their missions relate to the goals of the state's effort?
- Consortia model versus stand-alone providers.

III. Key Issues from the State Policymaker's Perspective (continued)

3. Building Delivery Capacity

- Are there existing microenterprise providers in the state?
- Are they serving the groups the state wants to serve?
- At what level of scale are they currently functioning?
- What will it take to build the required capacity -- funding and source of expertise?

III. Key Issues from the State Policymaker's Perspective (continued)

4. Statewide Coverage

- Problem definition
- Political considerations
- Level of existing capacity
- Costs

III. Key Issues from the State Policymaker's Perspective (continued)

5. Program Costs

- How much will it cost? Function of model, scale, ability to leverage.
- Are the costs reasonable?
- What are the trade-offs?

III. Key Issues from the State Policymaker's Perspective (continued)

6. Financing Structure and Types

- What will the state provide funding for? What structuring will the funding take?
- Critical need for operating funding.
- Tendency to lend rather than grant.

III. Key Issues from the State Policymaker's Perspective (continued)

7. Where Does the Money Come From?

- Specific to state circumstances.
- Opportunities to leverage Federal (or private) funds is a key selling point.
- To what extent will program design be tailored to the funding source?

III. Key Issues from the State Policymaker's Perspective (continued)

8. Evaluation

- Outcomes will depend on problem definition, program design
- Need for a multi-dimensional framework
- Evaluation is costly, need to invest in capacity
- Make it a learning experience

III. Key Issues from the State Policymaker's Perspective (continued)

9. Role of Intermediary Structures

- **Building capacity**
- **Centralizing functions to capture economies of scale:**
  - **Servicing**
  - **Centralized loan portfolio**
  - **Fundraising**
- **Key issue -- can a state-level intermediary accomodate different local designs?**

IV. Key Considerations from the Practitioner's Perspective

1. More constant, long-term source of support -- although can be affected by change in administrations.

2. Heightened legitimacy with other funders.

3. Push to tailor program design to requirements of funding stream.

4. Stronger state role in monitoring, accountability.

5. State involvement may build, broaden over time.

6. Location of state program/funding stream.

   - Strong/flexible relationship

   - Similarity of mission

7. Introduction of other providers