Savings and Credit for U.S. Microenterprises

Individual Development Accounts and Loans for Microenterprise

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Abstract: This paper provides a framework for the integration of two asset-building instruments, Individual Development Accounts (IDAs) and loans for microenterprise. Initially, it provides an overview of the emergence of the asset-based approach to poverty alleviation in the U.S. context and the evolution of IDAs and microenterprise development (MED). Then, it evaluates the potential role of IDAs in reducing risk using conventional lending criteria. The paper summarizes the findings of initial research on integrated programs and highlights four case studies. Finally, the paper provides some preliminary observations regarding potential benefits and challenges of the integrated approach and proposes an agenda for future research that will test these hypotheses.

American policymakers have traditionally focused on methods of poverty alleviation that maintain or replace the incomes of poor individuals. Poverty is generally defined by relative levels of income. Although public policy in the U.S. has subsidized asset accumulation for the nonpoor for some time, it is only within the last decade that policymakers have begun to support the accumulation of assets as a viable approach to alleviating poverty. U.S. policy, through the deduction of mortgage interest expenses and the support of 401(k) retirement plans, has subsidized both savings and debt instruments for the accumulation of assets by members of the middle and upper classes. This paper will explore the integration of two important vehicles for asset development and accumulation among the poor: Individual Development Accounts (IDAs), which are matched savings instruments for low-income individuals; and credit for microenterprise, which are loans to support low-income entrepreneurs.

Individual Development Accounts were first proposed by Michael Sherraden (1991) in his pioneering work, *Assets and the Poor*. All IDA programs include financial literacy and asset-specific training. IDAs subsidize savings accumulation for increased homeownership, post-secondary education, and business ownership for low- to moderate-income (LMI) households. Similar to 401(k) retirement accounts, they reward the monthly savings of LMI families through the use of matching funds from a variety of public and private sources.

Microenterprise development (MED) programs have been operating in the U.S. primarily since the mid-1980s. These programs have traditionally provided LMI entrepreneurs with some combination of training, technical assistance, and small loans.

The Rationale for Integration

IDAs and microenterprise-based strategies share common goals and methodologies. They support the accumulation of human and financial assets by the poor. IDA programs promote responsible savings behavior and MED programs promote responsible

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credit management, the two complementary sides of the asset-building coin. Establishing the ability and predilection to save can increase both credit-readiness and credit-worthiness. Microenterprise is one of three primary permitted uses of IDAs under current public and private IDA demonstration programs. Currently, there are microenterprise development programs that offer IDAs and IDA programs that provide MED services. Asset-specific training for microenterprise savers often resembles MED training for microenterprise borrowers in both content and design. Despite many synergies, relatively little has been done to link the two strategies explicitly. Even less has been done to develop integrated IDA-MED programs that facilitate seamless transition of participants from one to the other, share training and program staff, seek out joint funding and advocacy opportunities, and promote IDA savings behavior and capital as necessary credit enhancements.

Organizations that operate both IDA and MED programs as independent, stand-alone entities may not only be missing the opportunity to maximize synergies, but they are likely to be duplicating effort, incurring unnecessary program costs and subjecting clients to unnecessary requirements and time commitments. Areas of duplication may include enrollment or intake, eligibility assessments, training, and counseling or one-one-one technical assistance. By designing and implementing integrated IDA-MED programs, managers may minimize costs, increase client retention, and reduce credit risk.

This paper reviews current practice in integrating IDA and microenterprise development strategies, proposes a conceptual framework for weighting IDA participation in credit analysis, and recommends areas for further research.

Increasing Deployment of Loan Capital

Although microentrepreneurs in the United States have expressed a desire to access credit, the levels of demand for and the deployment of microenterprise loan capital have been much lower than anticipated. Low deployment has serious consequences for the sustainability of microenterprise finance, because, in the long run, programs must depend on interest and fee income from loan portfolios to cover operating costs. According to the Aspen Institute's Microenterprise Fund for Innovation, Effectiveness, Learning, and Innovation (FIELD), the following are the primary reasons for low rates of deployment (Clark & Kays, 1999):

- Client aversion to debt
- Poor or no credit history
- Access to other sources of credit
- Lack of equity capital

In integrating IDA and MED products and services, programs may ensure that clients have access to financial literacy education, credit repair opportunities, and IDA equity capital, all of which may be valued as credit enhancements during consideration for microenterprise loans. In this way, integration has the potential to address several barriers to low demand and deployment, including debt aversion, credit history, and equity gaps.

Promoting Healthy Capital Structures and Mitigating Lender Risk

Historically, microenterprise institutions, both in the U.S. and abroad, have focused on providing loans to capitalize microenterprises. Low-income microentrepreneurs rarely have access to the equity capital that mainstream financial institutions require to reduce the risk of a small business loan. To compensate for this increased risk, microenterprise lenders provide training and technical assistance to support borrowers and their businesses, and boost the capacity to operate the business and repay the loan. However, by supporting capital structures that may be up to 100% debt-based, microenterprise lenders may be restricting opportunities for the growth, experimentation, and coverage that fledgling businesses require in order to prosper. By integrating the IDA savings process into microenterprise lending, organizations can help a microentrepreneur to develop a healthy capital structure that balances debt with equity, reduces the lender's exposure to risk, and enhances a growing business's chances of survival.

A variety of financial institutions, including credit unions, mainstream commercial lenders, and microfinance institutions working outside the U.S. have explored the integration of savings and credit instruments, particularly in the case of new clients. In evaluating business loan candidates, commercial lenders, including banks, traditionally turn to the Five Cs of credit analysis—character, capacity, capital, collateral, and coverage (Hunt, Williams, & Donaldson, 1976). Lenders look favorably on a candidate's savings, which demonstrate capacity to repay the loan, as well as serve as equity in a capital structure that protects the lender's exposure to risk. Banks will encourage small business loan candidates to open a Certificate of Deposit (CD) in their business's name, either to secure the loan or to provide additional coverage in the case of emergency.

Credit unions operate in countries around the world to fulfill member needs for savings and credit. Membership in a credit union is defined by a "common bond," a partnership of savers and borrowers, grounded in a community, organizational, or religious affiliation or an "employee-based relationship" (Branch & Evans, 1999, p. 2). Credit unions are authorized to mobilize both member and nonmember savings and loan out these internally generated funds to members. Although many organizations that specialize in microenterprise and microfinance have incorporated savings elements, credit unions are the only institutions that see savings as an equal partner to credit when promoting asset development in lower-income communities (Otero & Rhyne, 1994).

The Importance of Assets

Asset-based approaches to poverty alleviation assume that without assets, poor families will remain poor. In the United States, the distribution of assets, or wealth, is much less equal than the distribution of income. The top 1% of households control 90% of all assets, while 31% of American households have no or negative investable assets (Oliver & Shapiro, 1995). Nearly 61% of African American households have no or negative net financial assets, as compared to 25.3% of white households (1995). Sherraden (1991) points out that the U.S. already spends over $200 billion dollars annually on asset development by providing tax incentives for accumulating assets, specifically in accounts for housing and retirement-related expenses (Sherraden, 1991). However, 90% of these tax expenditures go to households earning over $50,000 per year, principally because the income and tax liabilities of LMI households are so low that tax deductions or deferments provide few incentives to save and acquire assets (Sherraden, 2000b).

Sherraden (1991), Oliver and Shapiro (1995), and others note that asset ownership helps households to set goals, realize dreams, stabilize families and neighborhoods, and improve their children's lives. Moser (1998) highlights the importance of helping lower-income households build diversified portfolios of assets that insure them against "income shocks," such as illness and termination of employment (1998). The lower a family's income, the more devastating such a shock can become. Assets, in the form of savings, housing, equipment, or education, can serve as alternate income streams in times of need. Similarly, IDAs define assets in terms of human capital (skills, knowledge, and experience) and financial capital (property and financial holdings).

Individual Development Accounts

IDAs vary in structure, but are generally defined as savings accounts with proceeds restricted to the acquisition of high-return assets, such as housing, postsecondary education, and business. The savings are matched at some rate, generally at $1 to $4 for every dollar saved. Participation is voluntary, but is restricted to LMI individuals through means and asset testing. Most programs include two training components: financial literacy education and training specific to the particular asset.

In 1997 the Corporation for Enterprise Development (CFED) partnered with the Center for Social Development (CSD) at Washington University in St. Louis to create the American Dream Demonstration (ADD), an extensive evaluation of 13 IDA programs across the United States. Support came from foundations, private companies, individuals, and state, local, and federal governments to leverage over $15 million in public and private funds (Corporation for Enterprise Development, 2001).

In 1998 the Assets for Independence Act (AFIA) passed under Title IV of the Community Opportunities, Accountability, and Training and Educational Services Act of 1998 (P.L. 105-285). AFIA authorizes IDA demonstration projects administered by the U.S. Department of Health and Human Services (HHS) at $125 million. The AFIA legislation asserts that "income-based domestic policy should be complemented with asset-based policy because, while income-based policies ensure that consumption needs (including food, child care, rent, clothing, and health care) are met, asset based policies provide the means to achieve greater independence and economic well being" (Assets for Independence Act, P.L. 105-285, 1998). Congress will consider reauthorization of the AFIA legislation in 2003.

A recent survey counted 511 IDA programs in operation in 49 states and the District of Columbia. Nationwide, at least 20,634 people are actively saving in IDAs and at least 5,177 people have graduated from an IDA program. Twenty-nine states have passed IDA-related legislation, and 40 states include the use of IDAs in Temporary Assistance to Needy Families (TANF) legislation (Corporation for Enterprise Development, 2002). American Dream Demonstration (ADD) data reveal that, as of December 31, 2001, 2,364 families in the 13 ADD sites alone had saved $1,248,678 and leveraged another $2,399,470 in matching funds (Schreiner, Clancy, & Sherraden 2002). Twenty-eight percent of matched withdrawals were for home purchase, 23% for microenterprise, 21% for postsecondary education, 18% for home repair, and 10% for other purposes, such as retirement, and the balance for job training (2002).

The most recent CSD report suggests a profile of the IDA participants in ADD (2002). Participants are primarily working, female (80%), African American (47%) high school graduates (85%). The average monthly net deposit was $25.42 and the average account holder made a deposit seven out of every twelve months. The average participant accumulated approximately $900 per year in IDAs when deposits and matches are counted.

In order to expand the scale of IDAs, CFED convened a coalition of policymakers, financial institutions, academics, and community-based organizations to advocate for the Savings for Working Families Act (SWFA), which, if passed, would offer depository financial institutions tax credits to administer IDAs and contribute matching funds. If passed, the SWFA would distribute $450 million in tax credits, and create approximately 300,000 new accounts (Charity, Aid, Recovery, and Empowerment (CARE) Act, H.R. 7, as amended).

IDAs are now a decade old. They have been analyzed from a variety of perspectives (Beverly, Moore, & Schreiner, 2001; Beverly & Sherraden, 1999; Boshara & Friedman, 1997; Clones, Friedman, Grossman, & Wilson, 1995; Edwards, 1997; Page-Adams & Sherraden, 1997; Sherraden, 1998). These studies consistently demonstrate that poor people can and will save. One study addresses the financial impact of ADD participation on net savings and assets (Stegman, Faris, & Urdapilleta Gonzalez, 2001). The authors find that IDAs have a small, yet significant, positive impact on net savings. The analysis indicates $117 more in savings for the median participant and $285 more in mean savings effect compared to what would have been saved without ADD.

IDAs for Microenterprise

IDAs have three primary uses: homeownership, education, and self-employment (microenterprise). Additional allowable uses are program or funder specific. As mentioned, microenterprise is one of the most common IDA uses chosen by participants. Microenterprise IDAs are intended for use in the capitalization of small businesses and may be restricted to the purchase of tangible assets. Account holders typically participate in core financial literacy training and some form of entrepreneurial training. IDA account holders are usually constrained to capitalizing very low entry costs and, presumably, low income potential businesses due to IDA savings limits. Many of the same community-based organizations that offer IDAs run microenterprise development programs, providing loans, training, and technical assistance to low-income entrepreneurs. Target populations include women, minorities, refugees, immigrants, and residents of lower-income communities and public housing developments.

Microenterprise Development in the United States

In the United States, microenterprise development is a relatively new field that traces back to the mid- and late 1980s. The main focus of MED is disadvantaged individuals who either operate or are considering staring microenterprise. MED programs arose at the confluence of several challenges in the U.S. society and its economy. These include a search for new methods of poverty alleviation; the need for nontraditional economic development strategies to rebuild impoverished communities; growth of the feminist movement and the roles of women in the work force and as business owners; a desire to resolve inequities in access to credit; and the need to assist pockets of high unemployment and displaced workers (Servon, 1999). MED has emerged as one strategy to assist in asset accumulation, poverty alleviation, community and economic development, empowerment of disadvantaged populations, and improved access to credit.

The 1999 Directory of U.S. Microenterprise Programs includes 341 U.S. microenterprise programs in 46 states and the District of Columbia (Langer, Orwick, & Kays, 1999). There are 283 practitioner programs listed providing direct service to over 57,000 individuals in 1997 and a cumulative total of approximately 250,000 participants. Of the programs reporting establishment dates, 78% were formed between 1991 and 1999 (Langer, Orwick, & Kays, 1999). The MED field in the U.S. has grown considerably in a short period of time.

U.S. MED programs are strikingly diverse. They differ in their goals, strategies, target populations, size, and sources of funding. Microenterprise development programs are variously perceived as programs for poverty alleviation, economic development, community development, self-employment support, personal development, or access to credit. Institutions tend to fall into one of two categories: "credit-led" institutions that concentrate on enterprise financing, and "training-led" institutions that focus on providing micro-entrepreneurs with training and technical assistance. Target populations encompass low-income populations, women, racial/ethic groups, recipients of public assistance, refugees and immigrants, public housing residents, people in targeted geographic areas, unemployed individuals, people in certain age groups, special populations, and credit constrained individuals and communities. Host programs have included community action agencies, women's economic development organizations, and newly created organizations.

Microenterprise development programs also differ substantially in size, financial capacity, and structure. Capital funds for MED programs range in size from $5,000 to $12 million, with an average size of $738,626 (Langer, Orwick, & Kays, 1999). The average operating budget was $268,102 in 1997, with a range of $3,000 to over $1 million. The funding for these MED programs comes from a wide variety of sources including private donors, religious sources, foundations, governments, financial institutions, and corporations. Although the sources of funding are diverse, when compared with spending on other social and economic development strategies, the $70 to $100 million per year spent on MED is small (Else & Gallagher, 2001).

The emphasis of the research on microenterprise development to date has been the documentation of programs and the evaluation of their contribution to the alleviation of poverty. One of the few evaluations of MED programs that use control group methodology studied the impact of MED services on Unemployment Insurance (UI) claimants. This study, sponsored by the Department of Labor, found MED to be a cost-effective intervention, in that social benefits, increases in total earnings due to self, and wage employment over a 32-month period exceeded social costs (Benus et al, 1995). The Aspen Institute's five-year longitudinal study of microentrepreneurs, the Self-Employment Learning Project (SELP), included the following findings regarding the impact of MED programs on the subset of very low-income clients (Clark & Kays, 1999, pp. vii & viii):

- 72% increased their household income over five years by an average of $8,484 or from $14,889 to $22,374
- Average household assets increased by $15,909 over five years
- Over half—53%—moved above the poverty line; and
- Dependence on public assistance decreased by 61%.

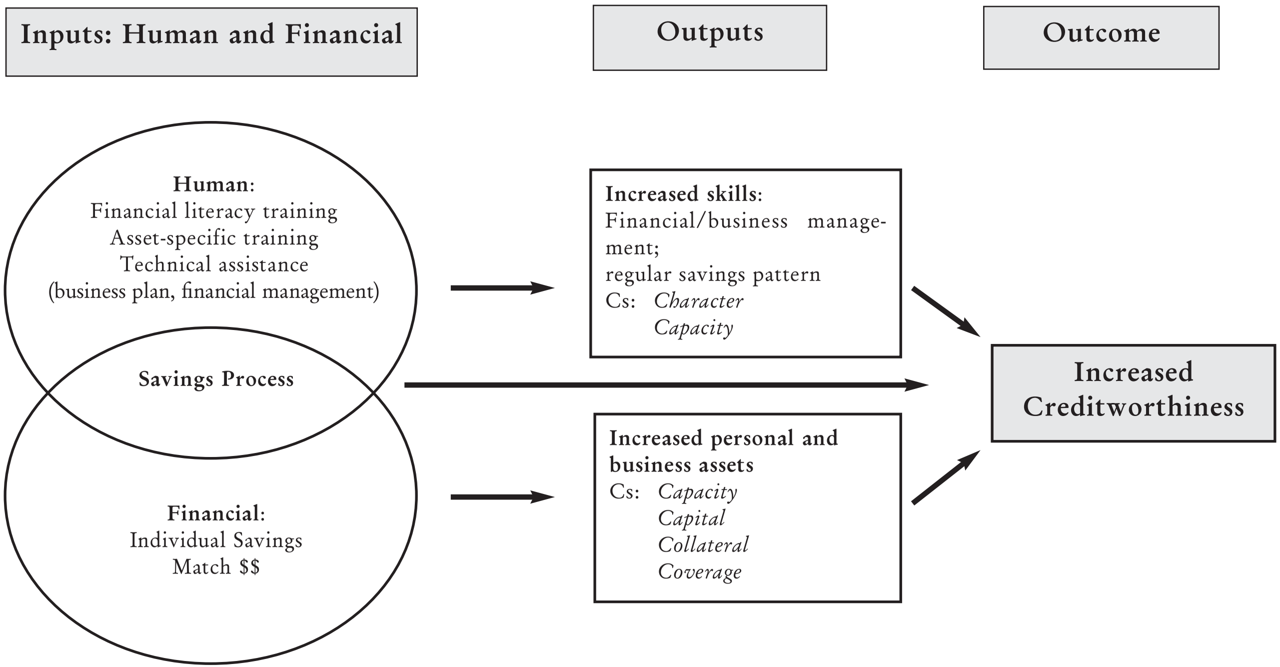
Although microenterprise has been largely endorsed as filling an important gap in services for low-income people, a consensus has emerged that beneficiaries are a fairly small segment of the LMI population in the United States. As Mark Schreiner asserts, "Microenterprise does work for a few extraordinary low-income people, but wage employment, additional education, and job training are still the most common paths out of poverty" (Schreiner, 2000a, p. 2). Other social scientists and practitioners have expressed their own concerns about microenterprise (Bates & Servon, 1996; Bhatt, Painter, & Tang, 1999; Else & Gallagher, 2001; Rogaly, 1996; Schreiner, 2000a; Servon & Bates, 1998).

The integration of IDA and MED services represents an opportunity to expand the scope and clientele of MED programs in the United States. By laying the groundwork and methodology for a systematic consideration of IDA savings in credit analysis, practitioners may be able to reach new, poorer clients and begin to explore a larger spectrum of financial services for low- to moderate-income households.

The Opportunity: Leveraging the IDA in Microcredit Analysis

Individual Development Accounts and microenterprise development are synergistic strategies for asset development. Participation in an IDA program involves a commitment to regular savings, to education in financial literacy, credit improvement and repair, and, in the case of microenterprise IDAs, to training in business planning and management. The IDA experience is one of "savings with education," which increases both financial and human capital. As such, participation in an IDA program can improve a participant's standing in light of the conventional 5 Cs of credit analysis: character, capacity, capital structure, collateral, and coverage. As illustrated in Figure 1, IDA participation holds explicit value from a credit perspective. Participation in financial literacy classes, credit education, and credit repair can endorse character through ultimate improvement in credit status. IDA training may improve the capacity of participants to operate a business and regular savings deposits demonstrate their capacity to repay business loans; IDA participation improves the capital structure of a business by providing increased equity in the form of participant savings and match funds; although largely unexplored, IDA savings could serve as collateral for a microloan (or any equipment purchased with the IDA could serve as collateral); and finally IDA savings could provide

Figure 1: Integrating IDAs and Loans for Microenterprise: IDAs as a Credit Enhancement



coverage or insurance for repayment in the event of an emergency. As suggested by Figure 1, participation in an IDA program results in improved creditworthiness for the individual and the business, as well as in the increased levels of household assets and self-sufficiency that all IDA programs promise.

Figure 1 provides a general logic model for integrating IDAs and loans for microenterprise, so that the savings process guided by IDA programs, and the increased human and financial capital produced, are valued in microcredit analysis. Table 1 illustrates this logic model by translating the elements of IDA programs into potential human and financial capital benefits from the perspective of credit analysis.

The balance of this paper offers a discussion of findings from our research and explores current and potential program and product models.

Research Methodology

The First State Community Loan Fund (FSCLF), with the support of CFED, used multiple methods to assess the current status of the integration of IDAs and microenterprise loans in organizations across the U.S., and to identify future opportunities for integration. First, a literature review was completed to enhance understanding of both microenterprise and asset-based strategies. Second, a written survey was sent to IDA and microenterprise programs. Third, programs that were self-identified as "linking" the two strategies were interviewed. Finally, three focus groups were held to gain insights from microenterprise program staff, IDA program staff, and microenterprise IDA account holders.

The written survey was distributed to 106 IDA and microenterprise program directors across the U.S. All IDA grantees under AFIA, ORR, and ADD as of September 1, 2001, received the survey. In addition, members of the IDA Network Listserv who self-identified as linking IDAs and microloans and one microloan program known to the investigators were surveyed. Program directors were asked questions about the

Table 1. The Value of IDAs from the Microcredit Perspective

IDA Aspect	Five Cs	Capital Type	Benefits from Microcredit Perspective
Regular savings over a 6-month to a 3-year period to reach a goal	Capacity	Human Capital	• Demonstrates capacity to manage finances consistently • Time spent in IDA equal to time in business at preset proportion • Shows character and discipline • Increaces capacity for more timely payments
Savings $$	Capacity Capital Structure	Financial Capital	• Provides owner's equity • Reduces debt requirements • Decreases liquidity constraints
Match $	Capital Structure	Financial Capital	• Provides owner's equity • Leverages scarce resources
Financial literacy training	Capacity	Human Capital	• Creates and enhances understanding of how money works • Increases capacity to manage business resources.
Credit counseling	Character	Human Capital	• Strengthens credit record • Encourages progress on repairing credit problems
Entrepreneurship training/ technical assistance	Capacity	Human Capital	• Decreases need for training technical assistance within microloan program
Business plan development	Capacity	Human Capital	• Improves preparation and atriculation of business concepts, plans, and needs
Support groups	Capacity	Human Capital	• Build social capital and trust • May provide a strong substitute for peer groups • Foster additional character and capacity for repayment
IDA at an insured financial institution	Character Coverage Collateral	Financial Capital	• Develops a banking relationship and overcomes privacy issues and fear of formal institutions • Opens potential credit repair opportunities to reduce risk

design, content, requirements, and funding of their programs. Those programs that offered both IDA and MED services were asked if they linked the services in any way, including giving special consideration to IDA participants seeking loans. A total of 71 usable responses (67%) were received and analyzed.

Sixteen programs that self-identified as pursing connections between IDA and MED were interviewed between May and August of 2002 by FSCLF staff. Profiles of these programs were developed for separate dissemination.

Finally, in order to delve more deeply into the benefits and challenges of integrated program and product design, CFED staff conducted three focus groups in Wilmington, Delaware, during July of 2002. The focus groups included IDA and MED program staff and microenterprise IDA account holders. The first group included five professional staff from the Capital Works™ microenterprise program, a statewide program that, since its inception in 1995, has issued over 550 loans and served in excess of 2,000 customers through training, technical assistance, and access to markets. The staff members were drawn from Capital Works™ program partners, the FSCLF, and the YWCA of New Castle County. The second focus group was composed of five program managers and staff from the sites involved in Delawareans Save!, the statewide IDA collaborative, a 2001 AFIA grantee. Delawareans Save! sites include a social services agency, a housing counseling agency, a community action agency, and a faith-based CDC. The final group included seven microenterprise IDA account-holders from Delawareans Save!

Multiple research methods ensured increasing depth of understanding and triangulation of results. However, it is important to note that the sampling approach focused on year 2000 IDA grantees under the three major funding sources that exist (AFIA, ORR, and ADD). Organizations that received IDA grants from these three sources since 2000 and organizations with other sources of IDA funding were not included in this study. As we mention below, more comprehensive research is needed to produce recommendations.

Findings: National Results and Program Activities

While a number of interesting findings emerged from the national survey of program managers, the most remarkable result was that while 89% of respondents report providing both IDAs and MED services, only 22.5% of survey respondents report making any form of explicit connection between IDA and microenterprise strategies. Although the majority of IDA programs offer homeownership IDAs that result in home mortgage loans, very few respondents have explored providing increased access to business loans for participants with microenterprise IDAs. Unlike the case of homeownership, microenterprises do not always require relatively large infusions of up-front capital. However, with IDA savings and matching funds capped at a maximum of $5,500 among respondents, one would think that the demand for additional enterprise capital among microenterprise savers might have produced more explicit connections with credit facilities, especially among facilities in the same organization.

According to the Aspen Institute's forthcoming 2002 Directory of U.S. Microenterprise Programs, 67 out of 308 programs (21.8%) offer IDAs (Walker and Blair, 2002). Due to this survey's response rate (60.6% of known programs) and incomplete responses, these results may represent a significant undercounting of MED programs offering IDAs. What these data do demonstrate is that microenterprise programs have begun to offer IDAs, and that they may be linking their savings and credit facilities at some level. Further research on such relationships is needed.

Program and Product Integration

There is a range of opportunities to integrate IDA and microenterprise strategies, at both the levels of program and product design. The goals, target populations, and funders of the two strategies overlap considerably, indicating a strong potential for programmatic synergy. The data shows that there are IDA programs that offer MED services and MED programs that offer IDAs, and the interest in each is growing. Survey respondents assert that integration can benefit both IDA and MED program participants. Microsavers can leverage savings to access additional capital in the form of credit, and microborrowers can improve financial literacy and access to equity infusions and other resources.

This study's results demonstrate that there is an "integration spectrum," which ranges from "low integration," which generally consists of basic coordination, the referral of participants from one program to the other; to "medium integration," the integration of programs, whose very design, training, and staff resources maximize synergies and participant transition; to "high integration," which complements an integrated program design with the integration of IDA and microcredit products, such that IDA participation (financial and human capital) is explicitly valued in the underwriting of a microenterprise loan. This spectrum is often, but not always, cumulative, so that programs move from low to high degrees of integration. "High integration" is not for everyone and depends very much on the individual needs of a target market and organizational core competencies. The next section provides examples from the study that illustrate the various points along this integration spectrum.

Illustrating the "Integration Spectrum"

The study followed up the national survey with in-depth interviews of those 16 organizations that reported some "connection" between IDA and MED programs. Eleven of these organizations provide MED training and lending services and microenterprise IDAs using in-house staff and resources. The other five organizations offer some combination of IDA and MED training, technical assistance, and financing through collaboration with partners. The 16 organizations differ in programmatic mission, target population, legal structure, and funding sources. They include microlenders, community development financial institutions (CDFIs), 6 refugee service agencies, social service agencies, a community development credit union,[7] and an international relief organization. Using the data gathered during in-depth interviews with the 16 "linking" programs, Table 2 describes these organizations in terms of internal and external provision of the various IDA and MED program components. "Internal services" refers to those services that organizations provide in-house with their own staff or resources. "External services" refers to those services provided through collaboration with partner organizations. The table also documents the degree to which IDA savings and microcredit products are integrated, and the nature of the value, if any, assigned to IDA participation. In terms of the value or "reward" for IDA participation, responses fell into one of the following categories:

- None: no value
- Automatic qualification for a loan equal to the amount saved
- Equity requirements fully to partially satisfied by IDA savings
- Collateral requirements fully to partially satisfied by IDA savings
- Increased eligibility: IDA participants are more likely to qualify for a loan. In those programs where IDA participants automatically qualify for loans equal to the amount saved, "increased eligibility" refers to the increased probability that they will qualify for larger loans
- Loan terms: IDA participants received more favorable loan terms, such as reduced interest rates or longer loan terms.

Table 2 highlights a number of interesting characteristics of current integration practice. There does not seem to be a

Table 2. IDA and MED Service Provision

	External Services			Internal Services			Reward for IDA Participation					
	Financial Literacy	MED Training	Lending	Financial Literacy	MED Training	Lending	None	Automatic Qualification	Equity	Collateral	Increased Eligibility	Loan Terms
ACCION Texas (San Antonio, TX)				X	X	X			X	X		X
Advocap (Oshkosh, WI)				X	X	X	X					
Alternatives FCU (Ithaca, NY)				X	X	X	X					
CAP Services (Menosha, WI)		X	X	X			X					
Catholic Charities (San Jose, CA)		X	X	X	X						X	
Ethiopian Community Development (Arlington, VA)			X	X	X			X	X			X
First State Community Loan Fund (Wilmington, DE)				X	X	X		X	X	X	X	
Institute for Social & Economic Development (Des Moines, IA)			X	X	X						X	

Table 2. Cont'd

	External Services			Internal Services			Reward for IDA Participation					
	Financial Literacy	MED Training	Lending	Financial Literacy	MED Training	Lending	None	Automatic Qualification	Equity	Collateral	Increased Eligibility	Loan Terms
Jewish Family Services (Columbus, OH)			X	X	X	X					X	
Justine Peterson Housing & Re-investment Corp (St. Louis, MO)				X	X	X			X		X	X
Mercy Corps (Portland, OR)				X	X	X					X	
Mountain Micro-enterprise Fund (Asheville, NC)				X	X	X	X					
New York Assoc. for New Americans (New York, NY)			X	X	X	X	X					
WECO (Cleveland, OH)				X	X	X					X	X
West Company (Ukiah, CA)				X	X	X	X					
Women's Initiative for Self-employment (San Francisco, CA)	X				X	X	X					

particularly high degree of association between internal provision of MED and IDA services and “rewarding” IDA participation in credit analysis. For example, organizations with strong partnerships with credit facilities may have equal success in implementing such credit enhancements as those that administer loans themselves. This issue warrants further exploration.

The most common “reward” given to IDA participants during the credit analysis or underwriting process is increased eligibility for a microenterprise loan. Participants with IDA experience are more likely to be approved for microenterprise loans. Requirements may be reduced or waived and loan applications are given “special” consideration. The next most common rewards for IDA participation are: decreased equity requirements, in that IDA savings and match funds contribute towards that requirement; automatic qualification for a microenterprise loan equal to the amount saved; and more favorable loan terms (such as reduced interest rates or extended terms). Organizations seem much less likely to treat IDA savings as collateral. Only one MED program, ACCION-Texas, treats IDAs as sources of collateral. However, this organization only admits into their program individuals who have previously qualified for microenterprise loans.

The following section includes profiles of three organizations that represent the various phases of the integration spectrum.

Low Integration

The New York Association for New Americans, Inc., (NYANA) in New York City offers programs to aid refugees in their efforts to achieve financial independence. Programs in NYANA’s Business Center provide microloans, financial literacy training, and IDAs. They also provide referrals to other microlenders and financial institutions. NYANA’s MED program serves all foreign born individuals. However, only refugees, those with asylum, and Haitian and Cuban entrants may enroll in the IDA program. IDA savings may be used for microenterprise, homeownership, postsecondary education, home repair, or computer purchase.

NYANA requires microenterprise clients in its IDA program to attend eighteen hours of Management Training workshops, which include instruction on how to write a business plan and six hours of training on money and assets, all of which are conducted by NYANA staff. Clients also receive business counseling and complete a two-page business plan and financial projections. No special underwriting considerations are given for IDA savers in the microloan program. However, some microloan customers have enrolled in IDAs subsequent to enrolling in the MED program.

NYANA receives funding from the Office of Refuge Resettlement (ORR).

Medium Integration

In keeping with the Jewish tradition to help one's community, Jewish Family Services (JFS) of Columbus, Ohio, provides social services to individuals and families of all backgrounds. JFS offers MED, IDA, and financial literacy training programs for both low-income and refugee populations in the Greater Columbus Metropolitan area and assists participants in building relationships with local banks. IDA savings may be used for microenterprise, homeownership, postsecondary education, home repair, transportation, or computer purchase.

Participants in the IDA program must attend four two-hour training sessions, and microenterprise clients must complete and submit a business plan before receiving matching funds. The microenterprise IDA program at JFS is linked to a microloan program. IDAs are treated as credit enhancements, and IDA clients receive technical assistance. Microenterprise clients are encouraged to save in IDA accounts.

JFS is funded by various institutions, including the ORR and several banks.

High Integration

IDA-EDG, housed at the Ethiopian Community Development Council, Inc., in Arlington, Virginia, focuses primarily on asset building for refugees. IDA-EDG provides IDAs, financial literacy, and MED training in-house and partners with other organizations for the provision of microloans. IDA-EDG savers may use IDA savings for microenterprise, homeownership, postsecondary education, home repair, transportation, or computer purchase.

IDA clients of IDA-EDG must attend five two-hour classes in financial literacy and asset building. IDA savers automatically qualify for microloans. These loans are available to IDA participants at a reduced interest rate. IDA funds may also be used to fulfill equity requirements for microloans.

This program is funded through the ORR.

The mission of the Justine Petersen Housing & Reinvestment Corporation (JPHRC) of St. Louis, Missouri, is to match institutional resources to the needs of LMI families. JPHRC is an SBA intermediary lender that specializes in asset development and housing programs. JPHRC provides financial literacy training, MED training, and microloans in-house. JPHRC offers IDAs for the purposes of microenterprise, homeownership, transportation, home repairs, or postsecondary education.

JPHRC offers two tracks of training for MED and IDA programs, both of which focus on "loan readiness." Clients in the "Fast Track" program prepare business plans with minimal assistance from a loan counselor. In the "Technical Assistance Track," JPHRC counselors assist clients to complete a business plan questionnaire, market analysis, and cash flow projections. At JPHRC, participation in the IDA program is correlated with approval of a microloan application. For savers with a low level of readiness, the IDA program creates and reinforces savings habits to ensure a buffer for cash flow issues. IDAs provide an initial equity capital injection of $600 to $900 after six months, including savings and match funds, into businesses, and help JPHRC establish relationships with potential borrowers. After six months, IDA participants with a moderate level of readiness qualify for a Step loan of $500 to $2,500. A "Next Step" loan of $2,501 to $5,000 is available, based upon the borrower's ability to repay the first loan and to save in the IDA program. For those with a high level of readiness, IDAs are paired with microloans and borrowers receive matching funds without restrictions.

JPHRC receives funding from the United Way of St. Louis, HHS, AFIA, and Missouri State Tax Credits.

Table 3. Four Representative Organizations

	NYANA	JFS	IDA-EDG	JPHRC
IDA Income Eligibility	At or below 200% of poverty	At or below 200% of peverty	At or below 200% of poverty	At or below 200% of poverty or 80% area median
IDA Match Rate	2:1	2:1	2:1	2:1 (general) 1:1 (median)
Maximum Match $	$2,000/ Individual $4,000/ Household	$4,000	$2,000/ Individual $4,000/ Household	$600 Annually
Cumulative Microenterprise IDA Accounts	41	183	11	75
Cumulative IDA Savers with Microloans	9	15	1	Approx. 30%
IDA Program Start Date	Oct. 1999	1999	Oct. 2000	Aug. 199

Preliminary Observations

Given that the integration of IDAs and microenterprise is nascent, it is difficult to offer conclusions or recommendations with confidence at this point. We have merely introduced the concept, a framework for valuing IDAs in microcredit analysis, and the state of current practice. We recommend further research. Recognizing the small sample size and preliminary nature of the data, we make some initial observations and tentative recommendations:

- A number of organizations have made the link. Nine out of the sixteen organizations that were interviewed have taken explicit steps to reward IDA participants with increased creditworthiness. In some cases, managers indicated a desire or intent to make a more explicit connection.
- Integration is not for everyone. Depending on an organization's target market, microentrepreneurs served may prefer to save for their businesses rather than accumulate additional debt. Some program managers cited the need to give everyone an "equal opportunity" to access a loan, and rejected the idea of "privileging" IDA account-holders. Still others cited funding requirements as a barrier to integration.
- One size does not fit all. Some program managers assert that IDA participation should be mandatory for potential microborrowers. Others merely think that aspiring borrowers should be rewarded for creditworthy behavior at the end of the day. Still others cited the IDA savings process and integration itself as a way to level the "borrowing playing field." Depending on the risk tolerance of the organization, a microloan may be provided up front or only after successful completion of the IDA program. IDA participation may fulfill or decrease loan requirements. Or it may have no effect.
- Integration goes both ways. Although we have focused on bridging the gap between IDAs and microloans for IDA savers, there is some evidence that microborrowers also benefit from entering IDA programs, which can improve both human and financial capacity; the human capacity to

operate the business and the financial capacity to repay the loan. Microborrowers can access the equity missing from their businesses' largely debt-dependent structures. Lenders benefit by decreasing their own exposure to risk.

Conclusion

It has become increasingly clear that low-income entrepreneurs, like their higher-income counterparts, need a variety of financial and nonfinancial services to support and enhance their businesses. Like mainstream financial institutions, organizations providing IDAs and microenterprise services are beginning to test the benefits of integrating savings and credit instruments. There appear to be institutional benefits that come in the form of decreased exposure to risk and, potentially, increased loan volume with minimal underwriting costs. There are a variety of potential customer benefits, including increased credit-worthiness, decreased transaction costs, and healthier capital structures for enterprises.

In order to fully test these potential benefits, further research must be done to measure a number of institutional and individual indicators. We recommend that studies be undertaken to measure the impact of integration on,

- Recruitment and retention of participants
- Participant transaction costs
- Targeting of lower-income populations
- Performance of microenterprise loans
- Loan volume
- Program costs per outcome (business started, loan deployed)
- Business sustainability and performance
- Household self-sufficiency and asset holdings

Barriers to integration should also be examined in more detail.

By quantifying the impact of the various IDA components on variables such as loan performance, this research will inform a growing discussion of systematic risk assessment in microfinance. Some microenterprise lenders have begun to implement credit-scoring models that help to predict the risk profile of a loan applicant based on certain traits that are associated with repayment of a loan (asset ownership, employment, and so forth). If it is determined that participation in IDA training and saving is correlated with higher loan repayment rates, these components can be explicitly incorporated into risk profile definitions through positive scoring, possibly enabling applicants to compensate for poor credit histories.

Microenterprise development is a maturing field in the United States. MED programs are exploring the range of asset development services that serve the needs of lower-income clients. By diversifying and integrating products and services such as IDAs and microloans, MED organizations can grow to become operations that more accurately reflect the realities of the people they serve and thus expand the reach and impact of this industry in the United States.

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Notes

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1. Microenterprise development in the U.S. is defined as financing, training, mentoring, counseling, and other kinds of technical assistance provided to individuals starting or operating a business that generally employs less than five people, or that can use a loan less than $35,000.

2. Loans for microenterprise are generally designed for investment in working capital or equipment. We will also refer to microenterprise loans as “microloans.”

3. IDA programs may serve households receiving TANF benefits; Earned Income Tax Credit (EITC) eligible households; households below 80% of Area Median Income (AMI), 200% of the federal poverty line, and others. Sometimes these income guidelines are paired with asset limits, so that participants qualify on the basis of income and assets at the time they begin asset accumulation. Programs also have other explicit and implicit target markets based on mission, community needs, and funding parameters.

4. Note that ADD limits the amount of match to $500 per year per individual.

5. Not unlike the "credit with education" model endorsed by microfinance organizations, such as Freedom From Hunger, around the world.

6. CDFIs are specialized financial institutions that work in market niches that have not been adequately served by traditional financial institutions. These CDFIs provide a wide range of financial products and services, including mortgage financing for first-time home-buyers, financing for needed community facilities, commercial loans and investments to start or expand small businesses, loans to rehabilitate rental housing, and financial services needed by low-income households and local businesses. In addition, these institutions provide services that will help ensure that credit is used efffectively, such as technical assistance to small businesses and credit counseling to consumers. CDFIs include community development banks, credit unions, loan funds, venture capital funds, and microenterprise loan funds, among others, (CDFI Fund: http://www.dcfifund.gov/overview/index.asp)

7. Community development credit unions (CDCUs) are credit unions with a mission of serving low income people. Like all credit unions, they are nonprofit financial cooperatives, owned and operated by and for their members. CDCUs also have a strong commitment to serving the broader community. They demonstrate that commitment through community outreach, through participation in government programs, through partnerships with the private-sector in community revitalization efforts, and by their collaberation nationally with other members of NFCDCU (National Federation of Community Development Credit Unions: http://www.natfed.org).