Date: *Monday, April 16, 2012*

Hearing: *An Examination of the Challenges Facing Community Financial Institutions in Ohio*

Hearing Host: *The Subcommittee on Financial Institutions and Consumer Credit*

Planned Testimony: *Steven H.O. Fireman, President and General Counsel of the Economic and Community Development Institute*

On behalf of the Board of Directors and staff of the Economic and Community Development Institute, welcome to Ohio. Thank you for hosting this conversation regarding the challenges faced by Ohio's community-based financial institutions.

The Economic and Community Development Institute (ECDI) is a 501(c)3 nonprofit economic development organization, a U.S. Small Business Administration intermediary microlender, and U.S. Treasury designated Community Development Financial Institution (CDFI). **Since 2004, ECDI has made $10.5 million in loans to around 550 local, small businesses in Central and Southwest Ohio, creating or retaining 1650 jobs.** Because of its success in Central and Southwest Ohio, ECDI was recently approached by funders and stakeholders in Cleveland, and asked to expand its microenterprise development services to Northeast Ohio. The organization will open a branch office in Cleveland in July 2012. In addition to filling a gap in the credit industry by offering loans ranging from $500 to $100,000 to small local businesses through its revolving loan fund program, ECDI addresses the needs of very small business owners in the creation and expansion of small businesses. Our programs provide valuable services to entrepreneurs, including small business development training, one-on-one technical assistance, and industry specific training and access to markets through the Growing Entrepreneurs Initiative business incubation program. Every business and job created or retained equates to state and local tax dollars. In addition, ECDI has brought millions of federal dollars into the local economy in the form of loans and grants, and has helped keep those dollars circulating locally through small business capitalization.

Challenge #1: Keeping up with Demand for Capital

In the United States, small businesses "employ just over half of all private sector employees, pay 44% of total U.S. private payroll, and have generated 64% of net new jobs over the last 15 years."[1] In Ohio, as of 2008, the microenterprise sector, a subset of the small business sector defined as employing 5 or less employees, made up 87.95% of all businesses and accounted for 21.1% of all total nonfarm private employment. [2] This sector has been and will continue to be integral to the country's economic recovery.

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[1] http://www.lendio.com/blog/visual-funding-infographic/; accessed on 10/24/11
[2] http://aeoworks.org/images/uploads/pages/US-MEBS-2008%20rev.pdf, http://aeoworks.org/images/uploads/pages/US-MEES-2008%20rev.pdf; accessed on 10/25/11

While there is room to increase the number of microenterprises and to ultimately create new jobs and tax revenue in Ohio, there is a financing gap that few local community economic development organizations have the capital or capacity to address. According to a recent report titled *Cuyahoga County Microcredit Supply and Demand Analysis,* in Cuyahoga County MSA alone, “there is an estimated $38 million of unmet loan demand in the County that isn’t being provided by commercial banks.”
This financing gap for small businesses is a national problem, visually articulated in an Infographic article *A Visual Look at Funding – Comparing Equity vs. Debt Financing,* which says that 62% of small businesses would be unable to qualify for a bank loan right now.” Since the economic downturn in 2008, the small business sector has found it difficult to obtain financing from traditional sources. Banks have tightened their credit standards and have become less likely to lend in amounts under $250,000. To make matters even more difficult, alternatives to small business lending such as home equity or lines of credit are no longer viable options due to the collapse of home values.

As one of the few microlending organizations in Ohio, these factors have lead to an increased demand for ECDI’s small business loans. As a young and dynamic organization, ECDI is committed to scaling up to meet the increasing demand it is facing for its financial products. Since FY 2009, ECDI has demonstrated consistent and dramatic growth the amount of loan capital disbursed and businesses served. ECDI funded $1,456,578 in loans to 97 clients in FY 2009, and $1,760,719 to 86 clients in FY 2010. In FY11, ECDI disbursed $2,409,118.16 in loans to 85 clients, showing consistent year-to-year growth. In addition to seeing increased demand in our Central Ohio market, ECDI has expanded its service area from 7 counties at the beginning of 2009 to 49 counties currently at the request of stakeholders including the SBA, Ohio Department of Development, and The Cleveland Foundation.

This surge in demand for small business loans as well as the geographic expansion has caused two challenges for ECDI. The first challenge we have faced is keeping up with a demand for capital. At the end of 2010, ECDI’s loan funds were nearly 100% deployed. We knew that if we were going to keep up with the demand for loan dollars, we not only needed to maintain our current sources of federal, local and private capital, we would also have to find new dollars to lend. ECDI faced this challenge head-on by creating an investment instrument approved by the Ohio Securities Commission called Invest Local Ohio. Invest Local Ohio gives community members the opportunity to invest in small businesses by investing in ECDI. Every dollar invested in the Invest Local Ohio fund is loaned to an Ohio small business and leveraged with at least two more dollars from other existing ECDI loan funds. ECDI investors receive a 2% return on their investment if they sign a 3 year note and a 3% return on a 5 year note.

Challenge #2: Keeping up with Demand on Capacity

The second challenge caused by increased demand for small business loans relates to capacity. In addition to outreach, assessment, training, underwriting, processing and servicing loans, ECDI’s model differs from banks in that we commit to provide ongoing technical assistance to our portfolio clients beginning with loan application and continuing throughout the life of the loan. This is critical in building successful business and, therefore, proactively working with clients to keep a healthy portfolio. This is also costly. As an SBA intermediary microlender, ECDI receives a yearly allocation of technical assistance funds to spend time with clients on building strong businesses. This is valuable, but 75% of the funding is restricted to working with clients only after the loan is closed. Not only is there a huge compliance-related burden associated with allocating and tracking staff time, very little of the SBA technical assistance allocation is able to be used to work with a potential loan client before the loan is closed and none of the funding is able to be used for general loan administration such as underwriting, processing, servicing, and collections.

Challenge #3: Unpredictability of Federal Funding

The demand for capital has surged, and ECDI's portfolio has consistently grown. Because we have a track record of impact in the form of business and job creation, we have been fortunate to remain competitive on a national level and, therefore, maintain federal support from the SBA, U.S. Treasury, and several Health and Human Services-funded programs. Because of the competitive nature of this funding, ECDI is forced to reapply for federal dollars on a regular basis. U.S. Treasury CDFI funding, in particular, requires a yearly reapplication process. While we understand the importance of competition in ensuring that federal dollars are being used effectively and efficiently, we want you to understand that the unpredictability of this funding makes it difficult to budget, plan, and scale our operations.

On a local level, since its inception, ECDI has experienced tremendous and consistent local support through City and County Economic Development departments, funded by federal CDBG dollars. Since 2009, this funding has been reduced in an effort to balance the federal budget. To date, our track record has been strong enough to maintain local support, but we know that we cannot count on this support to continue if the CDBG budget continues to experience significant cuts.

Challenge #4: Traditional Philanthropy Does Not Understand the Importance of Supporting Small Business Development

Philanthropic communities are not wired to think about small business development as a viable target for their dollars. According to a report from the Foundation Center entitled "Spotlight on Economic Development Grantmaking in Ohio," although the amount of dollars granted for economic development initiatives by foundations in Ohio increased by 152% between 2005 and 2008, grants specifically targeted toward Small Business Development decreased by a third. The vast majority of funding was directed toward employment and training services. The Cleveland Foundation has taken a lead in both advocating for and funding microenterprise development initiatives in Northeast Ohio, and Invest Local Ohio is serving a dual purpose of raising awareness about the importance of supporting local small businesses, but there is still work to do in this area.

Challenge #5: Limited Support from State Economic Development Initiatives

Just as traditional philanthropy is not wired to understand the importance of small business development, the majority of Ohio-sponsored economic development initiatives aren't wired to understand the importance of microenterprise development. Instead, they focus time and money on traditional economic development, such as attracting and retaining large corporations. The start-up initiatives that the State does put money into, such as Ohio's Third Frontier program, benefit the high-growth technology sector. While this type of economic development is valuable, it neglects a large portion of Ohio's potential employers – small businesses that employ 5 or less employees. In recent years, businesses employing 20 employees or less have been responsible for 100% of net-new job creation. According to "The Small Business Economy: A Report to the President":

> "During these two past recessions [1990-1991 and 2001], firms with fewer than 20 employees were the only ones with positive net job growth; the larger category of small businesses with fewer than 500 employees, as well as large firms with 500 or more employees both experienced net employment losses"[3]

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[3] "The Small Business Economy: A Report to the President," Small Business Administration, see http://archive.sba.gov/advo/research/sb_econ2009.pdf; accessed on 4/12/12

Without continued federal support and education on the state level, microenterprises will not have the opportunity to create the jobs that they have the potential to create.

As you can see, with each challenge, ECDI has looked for creative ways to continue to meet the capital demands of Ohio's entrepreneurs. Thank you for the opportunity to communicate the challenges we face in serving small businesses. I hope that this testimony is useful as you return to Washington and continue to do the work of shaping legislation that drives the economic recovery.