Access to Capital:
Issues for Micro-Entrepreneurs in Halton

Discussion Paper, July 2001

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Executive Summary

Data indicates that the most significant source of new jobs in the 1990s has been the rapid growth of self employment or micro-entrepreneurship. Between 1982 and 1995 the number of self employed Canadians between the ages of 25 and 54 increased by 70%, compared to a 45% increase in paid employment (Kuhn, 1999, 1). Job growth in Halton also reflects these patterns. Halton Region has recorded a 141% increase in home-based business for the 1986-1996 period.

The main issue affecting micro-entrepreneurs is access to small amounts of capital necessary to begin a micro-enterprise. Access to capital is particularly difficult for groups with specific needs, which include youth, women, the poor and new Canadians. Anyone with bad or insufficient credit ratings, lack of savings or other forms of collateral, will find business loans are inaccessible.

Over the last decade numerous public and private sector services have emerged to assist entrepreneurs to be successful in their self employment and to enable poor or unemployed persons to effectively participate in the new economy. Section 3 of the document provides an overview of the types of programs or services that are available. It is not an all-inclusive inventory.

However, despite the various public and private lending programs, the lack of access to capital still remains the main barrier to micro-entrepreneurs thus perpetuating the cycle of dependency, lost productivity, lost opportunity for economic and social benefits, and increased social costs. Consequently, local communities have begun experimenting with a range of different credit delivery models and community initiatives. The document highlights some of these models and examines the following:

i) International micro financing organizations with local initiatives which include the Grammen Foundation, ACCION and Calmeadow

ii) Community based micro financing initiatives which include revolving loan funds, loan guarantee funds, equity or venture funds

iii) Government legislated programs which includes the Community Reinvestment Act, United States of America

The results of these programs illustrate clearly that with the appropriate supports and services the poor, working poor and unemployed have the capacity to become self sufficient through self employment. The challenge is to devise a new framework, within the structure of Canadian financial institutions and in keeping with good business practices, which will enable access to micro financing options for poor, working poor, unemployed, and vulnerable Canadians.

In regard to this, research points to several policy options and programs that could be pursued at the Canadian federal and provincial government levels, as well as at the local community level to increase access to capital for micro-entrepreneurs. This discussion paper has recommended several options, they are:

1. Enact federal legislation that requires financial institutions to invest in their community.

2. Promote strategies to permit social assistance recipients to build savings and assets.

3. Establish a multi-sectoral partnership among community, local government, and financial institutions.

Each element is important in a strategy to best support the needs of entrepreneurs, with the key being the linking of public and private resources, strategically organized on a local, provincial and federal level.

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1. Introduction

The Halton Social Planning Council's research and community development work with low income groups has led us to identify a lack, or apparent lack, of available and accessible micro financing, particularly for the poor, working poor, and unemployed, who are striving to become self-sufficient through self employment.

There is little possibility for these individuals to obtain the necessary capital through traditional financial institutions. Banks loan money but in order to make loans certain conditions of guarantee are necessary. Most micro-entrepreneurs, especially the poor, cannot meet these conditions. Venture capital historically does not support micro-enterprises simply because the return on investment is not sufficient. Government programs often target specific larger enterprises such as small and medium sized businesses. Thus, the need for access to capital for micro-entrepreneurs continues.

This discussion paper investigates the difficulties of micro-entrepreneurs in Halton obtaining small amounts of capital to develop or sustain a small business.

1.1 Defining Micro-Entrepreneurs and Small Businesses

Although there is no universally accepted or standard definition of micro-entrepreneurs they usually have similar characteristics. Self Employment Development Initiatives[1] defines micro-entrepreneurs by the following:

[1] SEDI has grown to become a leading Canadian authority on self employment programs and advocacy. SEDI is an OECD designated expert in Canadian self employment programming and a member of the world summit on Micro Credit Advocacy Council.

- They are owner operated and managed;
- They are often home based;
- They usually have less than three employees; and
- They usually require a total initial capitalization of less than $25,000

(Self Employment Development Initiative, 1997, 3)

Similarly there is no standard definition for small business. Although small businesses are generally recognized as being larger than micro-enterprises, in terms of assets or employees for example, some programs and organizations do not provide a distinction between small and micro-enterprise. Different financial institutions, government and local community programs are guided by their own definitions and some are flexible.

The Canada Small Business Financing Act, Chapter S-36, for example, defines small business as follows:

> “a business carried on or about to be carried on in Canada for gain or profit with an estimated gross annual revenue
>
> > (*a*) not exceeding $5 million or any prescribed lesser amount for the fiscal year of the business during which a loan is approved by a lender in respect of the business; or
> >
> > (*b*) in the case of a business about to be carried on, not expected at the time a loan is approved by a lender in respect of the business to exceed $5 million or any prescribed lesser amount for its first fiscal year that is of not less than fifty-two weeks duration.
>
> It does not include the business of farming or a business having as its principal object the furtherance of a charitable or religious purpose”.

Some organizations also define the size of business by number of employees. For example the Canadian Federation of Independent Businesses uses the following criteria to define size of business:

- Small businesses – <50 employees
- Medium sized businesses – 50–499 employees
- Large businesses – 500+ employees

1.2 Issues Facing Micro-Entrepreneurs

The main issue affecting micro-entrepreneurs is access to small amounts of capital necessary to begin a micro-enterprise. At the 1995 OECD–US Department of Labour sponsored conference on “Self Employment Programmes for the Unemployed”, it was concluded that the unemployed were more likely to be successful in becoming self employed when they had appropriate access to:

- Business Training
- Business Counselling
- Business Capital

Of these requirements, business capital is the most difficult to obtain for the working poor, the poor and the unemployed (Self Employment Development Initiative, 1997, 6).

Access to capital is particularly difficult for groups with specific needs, which include youth, women, the poor and new Canadians. Anyone with bad or insufficient credit ratings[2], lack of savings or other forms of collateral, will find business loans are inaccessible.

[2] Credit Bureau’s rate peoples credit R1 to R9. An R9 credit rating, frequently termed bad credit, relates to a bankruptcy, collection item or failure to make payment of a credit card for 90 days. Insufficient credit means there no credit history or nothing to borrow or use collateral against.

A 1996 survey conducted by Self Employment Development Initiative with Bain and Company examined the capital requirements of micro-enterprises in Metro Toronto. The survey determined that:

- 30% of the self employed cited trouble in finding financing;
- 12% of *Self Employment Assistance* clients (an Employment Insurance claimant self employment program) have actively demonstrated a need for additional capital, but were unable to obtain it from commercial sources;
- on average, Metro self employed entrepreneurs required $3,100 of additional capital, which translates into a total requirement for Metro Toronto of an estimated additional $680 million in capital;
- funding available from existing “lenders of last resort” (i.e. government, Business Development Bureaus, private organizations such as Calmeadow, Downtown Economic Enterprises Development, Canadian Youth Business Foundation etc.) is estimated to be only $28 million over the next five years;
- to bring financing of “lenders of last resort” up to the national average would require an additional $140 million over the next five years.

The conclusion is that there is a lending “gap” of anywhere between $140 million and $680 million required by self employed entrepreneurs in Metro Toronto alone over the next five years (Self Employment Development Initiative, 1997, 7).

Despite various public and private lending programs, the lack of access to capital still remains the main barrier to micro-entrepreneurs thus perpetuating the cycle of dependency, lost productivity, lost opportunity for economic and social benefits, and increased social costs.

1.3 Purpose

The purpose of this document is to consider the types of programs or services that provide capital to micro-entrepreneurs in Halton, within a federal, provincial and regional framework; best practices which enable access to micro financing options for the poor in other communities; and then to suggest directions for program development.

Therefore, this document will examine three areas:

i) An overview of the types of financial credit and support programs for micro-entrepreneurs in Halton;

ii) Initiatives and best practices in Canada and U.S.; and

iii) Conclusions and recommendations

The Council hopes that this discussion paper will contribute to development of access to capital programs for micro-entrepreneurs through the Halton Business Development Centre and other economic development groups in the Halton community such as the Chamber of Commerce.

2. Context

2.1 The Changing Nature of Work in Canada

Data indicates that the strongest area of job creation in the 1980s was part-time work, while the most significant source of new jobs in the 1990s has been the rapid growth of self employment or micro-entrepreneurship.

Statistics Canada recently reported that self employment was the fastest growing segment of the Canadian Economy, accounting for 15% of employment and, over the last decade, 75% of the net new job growth. The majority (80%) of self employment initiatives in Canada are within the micro-enterprise sector of the economy (Self Employment Development Initiatives, 1997, 3)

Between 1982 and 1995 the number of self employed Canadians between the ages of 25 and 54 increased by 70%, compared to a 45% increase in paid employment (Kuhn, 1999, 1). This trend has gone hand-in-hand with the downsizing of institutions and the outsourcing of work. Job growth in Halton also reflects these patterns.

2.2 Profile of Halton's Small Business/Self Employed Sector

According to Statistics Canada data, employment in the labour force of persons 15 years of age and over in Halton Region increased from 172,095 in 1991 to 180,895 in 1996, representing a 5.1% increase. Of those employed, 13,050 or 7% reported working from home.

"Halton overwhelmingly leads the GTA and Hamilton-Wentworth as the primary area of growth for home based businesses. Halton Region has recorded a 141% increase in home-based business for the 1986-1996 period. This compared to an increase of only 39% in the overall GTA area. Within Halton, Oakville exhibited the largest growth of home based businesses with a 151% increase. Burlington followed close behind with a 114% increase; while Milton and Halton Hills showed a 70% and 49% increase respectively" (Regional Municipality of Halton, 1998, 2).

This growth of home based business activity in the 1990's reflects the following trends: (i) to accommodate people's personal needs, (ii) corporate downsizing and (iii) contracting out work as opposed to new hiring.

In 1998, the Halton Business Development Centre conducted a survey of their small business clients. Approximately 2,000 of the Centre's clients were contacted through a mail survey. The return rate was approximately 10%. The survey requested information on age, gender, how the business is registered, type of business, capital required for business start-up, from where the business is operated, if the business is a full or part-time endeavour, and the challenges they face in operating a business.

The Halton Business Development Centre's survey demonstrates that:

- the average client is between the age of 30 and 49,
- they are starting a business as a sole proprietor from their home,
- they required less than $10,000 capital for start-up, and
- the type of business is most likely to be a consulting business in one of three fields: health/safety/wellness, technical/computer or general business.

According to the respondents their biggest challenges are time management, marketing and sales. For those people who indicated that they did not start their business, lack of financing was the biggest reason. The amount of financing required to start their business was under $10,000.

“Of those surveyed, 66% indicated that they required capital between $5,000 to $10,000. Approximately 4 out of 5 businesses are started from the home. Less than half (43%) of the businesses are started on a part-time basis” (Regional Municipality of Halton, 1998, 2).

3. Overview of the Types of Programs and Financing Options for Micro-Entrepreneurs

Over the last decade numerous public and private sector services have emerged to assist entrepreneurs to be successful in their self employment and to enable poor or unemployed persons to effectively participate in the new economy. This section is intended to provide an overview of some of the types of programs or services that are available. It is not an all-inclusive inventory. More information about these and other programs can be found on the appropriate website described with the program in the following sections or by contacting the relevant federal, provincial or regional offices.

3.1 'One-Stop' Resource Centres

Regional or local business centers exist designed to provide 'one-stop' shopping to people seeking information on starting a small business. These centers can be sources of information and provide services to assist entrepreneurs. An example of this would be Halton Region Business Development Centre. The Centre provides comprehensive information and counselling services on starting a small business in Halton. Services include:

- consultations on business plans, marketing and financing,
- *"Starting a Small Business"* information sessions,
- public use of computers with Internet access,
- access to resource materials,
- workshops and seminars and
- a free small business start-up kit.

Like the services of the Halton Region Business Development Centre, Small Business Enterprise Centres provide a single access point for information on federal and provincial government programs, services and regulations.

Information on the activities of some private sector organizations that are involved in the business community is also available.

3.2 Federal and Provincial Financial Programs

i) Canada Small Business Financing Program

The *Canada Small Business Financing Program*, under the *Canada Small Business Financing Act,* can assist a business in obtaining term loans of up to $250,000 to help finance fixed assets, including;

- The purchase or improvement of real property or movables;
- The purchase of leasehold improvements or improvements to leased property; and
- The purchase or improvement of new or used equipment necessary for the operation of the business

The program is a joint initiative between the Government of Canada and private sector lenders. The loans are made directly by approved lenders, such as banks, to businesses (excluding farming) operating for profit. For further information contact a participating major bank, trust or loan company or visit the Canada-Ontario Business Service Centre Web site at: www.cbsc.org/ontario, document No.1029

ii) Business Development Bank of Canada

The Business Development Bank of Canada is Canada's bank for small and medium-sized enterprise, delivering financial and management services, with particular focus on emerging and exporting sectors of the economy. One of the Bank's loan services is the *Micro Business Program*, which provides training, counselling and financing to support the early growth needs of some of the smallest businesses. Under this program, loans of up to $25,000 are available to new business. For further information on the *Micro Business Program* please see the Bank's Web site at: www.bdc.ca or contact the Burlington/Halton branch office at (905) 315-9590.

iii) Industry Canada

Industry Canada's *Community Investment Plan* is a seven-year program designed to improve access to risk capital by growth-oriented small and medium enterprises. In 1996, Canadian communities far from financial centres were invited to participate in a national competition by submitting feasible and innovative proposals to facilitate access to risk capital by linking entrepreneurs and investors. The panel selected 22 community-based economic development groups across the country to showcase innovative strategies to facilitate investment in local fast-growth firms. The 22 pilot projects receive up to $600,000 each over a five-year period and act as intermediaries between local businesses and local, regional and national sources of risk capital. One of the purposes of the program is to identify successful investment facilitation approaches, and to develop policies that foster access to equity financing by growth-oriented entrepreneurs.

Ventures Burlington is one of the Community Investment Plan pilot sites. The Burlington Economic Development Corporation has assumed responsibility for the operations of this local site. This site focuses on two primary services. The first provides the counselling and preparatory work required to make small businesses ready to attract investment capital. The second assists with the sourcing of venture capital through setting up groups consisting of institutions, structured investment funds and private investors, more commonly known as "angels." *Ventures Burlington* assists businesses through a process of intermediation, which involves identifying and mentoring growth-oriented businesses seeking access to risk capital, maintaining a database of risk capital sources and introducing companies with potential to sources of risk capital as well as to opportunities for strategic alliances. For further information visit their websites at: www.advantageburlington.com or www.entredirect.com or Industry Canada's website at: www.ic.gc.ca.

3.3 Banks

As well as federal and provincial government financing programs for entrepreneurs, private financing sources are available to individuals starting or operating small businesses. The most common private source of financing for small business is the chartered bank.

Most banks offer services to small business entrepreneurs. Banks can provide a number of financing options, such as short-term loans, long-term mortgage loans, loans against inventory or accounts receivable, lines of credit and credit cards. The most recent statistics show that the seven major banks are authorizing $71.2 billion in debt financing to over 799,000 small and medium enterprise customers in Canada. That's an increase of almost $5 billion in capital, and a 12% increase in the number of customers since 1996.

Banks are not only competing aggressively with each other for market share; they are also being challenged by a growing array of competitors. The Canadian Bankers Association reports in May 2001:

- Half of all small and medium-sized businesses in Canada rely on financial institutions to provide them with business debt financing.

- Other sources of financing include:
  Retained earnings (51%)
  Supplier credit (48%)
  Personal savings (45%)
  Personal lines of credit (37%)

Personal credit card (36%)

Leasing (28%)

Personal loans (25%)

Business credit cards (22%)

Government lending agencies / grants (13%)

Loans from employees, friends and relatives (13%)

Public equity (2%) and

Venture capital (2%)

In order to compete, banks' individual strategies are becoming more innovative and banks are working collectively on a number of small business skill-based initiatives such as:

- *Getting Started in Small Business* – a free booklet published by the Canadian Bankers Association (CBA) emphasizes the importance of up-front planning, developing a market strategy, building a balanced capital structure, the value of a business plan. It also provides sources of where to go for more information.

- CBA's *There's Something about Money* is a national high school seminar program designed to help Canada's youth develop good money management skills - a key component of running a successful business and planning for personal financial goals.

- Sessions of *Preparing Your Business for the E-Commerce Age* seminar to improve small business owners understanding of electronic commerce have been held across the country benefiting nearly 6,500 small business owners.

See the CBA's web site at www.cba.ca to learn more these initiatives and other bank-led initiatives in support of small businesses.

3.4 Credit Unions

Credit Unions are community-based and community focused. They play an integral role in their communities by investing in community projects, sponsoring local activities and promoting community development. Credit unions are financial service co-operatives owned and controlled by their members. Over the years, credit unions have taken the lead in developing and introducing innovative financial service products. There are 419 Credit unions and Caisses Popularies throughout Ontario.

Credit unions provide a variety of services to small and medium sized businesses and often work with underserved populations such as individuals on low incomes. Services include business advising and consulting, financial services and various types of loans. Credit unions work in partnership with governments, community organizations and other financial institutions to assist entrepreneurs. Credit unions, may be useful sources of financing for small businesses for people with little collateral since some are involved in loan circles and peer lending programs with community groups and low income populations.

ACCE$$ Riverdale Business Loans is an example of a micro credit lending program run in partnership with the Metro Credit Union. The partnership provides loans to start-up and expend businesses in the community of Riverdale, Toronto. Money is lent based on the potential of the business, not on the individual’s collateral. Credit is provided by a step-lending approach, which is a series of loans that increases as the size of business increases. *ACCE$$ Riverdale* also provides free business support services and has created more than 1,500 new jobs and sustained more than 5,400 jobs in the past five years.

For further information about Credit Unions visit the Association of Credit Unions of Ontario Website at: www.ontcu.com or contact your local credit union.

3.5 Programs for the Unemployed

i) Self Employment Assistance

The *Self Employment Assistance Program* funded by Human Resources Development Canada provides eligible individuals (applicants must be qualified Employment Insurance claimants) with income support, training and technical assistance to enable them to become self-employed. Participation in the program is subject to the availability of resources at the local level. Applicants must be approved as a Self Employment client by Human Resources Development Canada. Applicants must not have participated in a self employment assistance program within the past five years and must be legally entitled to work in Canada. You may receive financial assistance, support in business planning and ongoing coaching for a period of up to 52 weeks. For further information on the Self Employment Program, see the Canada-Ontario Business Service Centre Web site at: www.cbsc.org/ontario, document No.1088 or contact your local Human Resources Centre.

ii) Social Assistance

There are self employment components to both Government of Ontario social assistance programs: *Ontario Works* and the *Ontario Disability Support Program*. Not all types of businesses will be eligible. For example, Ontario Works will not consider business ideas such as selling a specific product for commission sales or starting a franchise company.

Once you have registered with a self employment agency (such as the Halton Business Development Centre), you will have eight weeks to develop a business plan. A business plan describes in detail what your business will do and how you plan to make it a success. Once the business plan is approved, you will have another eight weeks to show that your business is starting to make money.

You may be registered in the program for up to 60 weeks (or about 14 months). Under the program, you will be allowed a "business asset exemption" of about $10,000, depending on the business you're interested in starting. If you borrow any money to start the business, it may be exempted from your income and assets for the purpose of calculating the amount of welfare that you will receive.

In Halton social assistance recipients are referred to the Halton Business Development Centre. Supports provided to participants by the Centre include:

- Assistance with the development of a comprehensive business start-up plan
- Support in new business launch
- Training in basic accounting
- Access to program counsellors, computer technology, international and local enterprise networks, mentoring and information about new business trends and systems
- Monitor progress and evaluation

(Regional Municipality of Halton, 2001, 12)

In 2000, the Halton Business Development Centre had 25 clients registered in the *Ontario Works Self Employment Program* from an average monthly Ontario Works caseload of 1,548. For further information, contact your local social assistance office.

3.6 Programs for Women

Women and Rural Economic Development

Women and Rural Economic Development is a federally incorporated, not-for-profit organization dedicated to enhancing the sustainability of rural Ontario communities. Their goal is to promote economic opportunity through equitable local control and ownership by providing programs which enhance business development, life skills and networking. Emphasis is placed on providing access to capital, information and markets and on developing an awareness of rural community economic development.

The organization has successfully provided business development assistance to 482 women with estimated gross sales of more than $8 million since 1993. There are now more than 262 new businesses operating in rural Ontario because of this initiative. *Women and Rural Economic Development* also offer ongoing support through a variety of integrated initiatives such as access to capital through the Rural Enterprise Loan Fund, Business Women's Networks, Mentorship programs, Business Alliance programs. For further information visit their website at www.sentex.net/~wred or contact their office at (519) 273-5017.

3.7 Programs for Youth

i) Business Development Bank of Canada

One of the Business Development Bank of Canada's products is the *Young Entrepreneur Financing Program*. This program is aimed at giving start-up entrepreneurs between the ages of 18 and 34 a solid foundation to build a new business. Term financing of up to $25,000 and 50 hours of business management support help to ensure that entrepreneurs with commercially-viable business proposals get their business off the ground. For further information on the *Young Entrepreneur Financing Program* please visit the Bank's Web site at www.bdc.ca or contact the Burlington/Halton local branch office at (905) 315-9590.

ii) My Company

The *My Company program* is offered by the Government of Ontario in partnership with the Royal Bank. *My Company* is a new initiative from the Ministry of Economic Development and Trade and is replacing the *Young Entrepreneurs Program*, which was discontinued in March of 2001. The *My Company* program combines hands-on business training and the availability of loans of up to $15,000 to help enterprising young people start and run their own business. Small Business Enterprise Centres and Business Self-Help Offices across the province will provide business training and on-going business support. For more information on the *My Company* program, visit the Ministry of Economic Development and Trade Website or contact the Canada-Ontario Business Service Centre at (416) 954-4636 or 1-800-567-2345.

iii) Summer Company

The *Summer Company* program is a new initiative from the Ministry of Economic Development and Trade and is replacing the Student Venture Program, which was discontinued in 2001.The *Summer Company* program provides hands-on business training and mentoring, and awards of up to $3,000, to help enterprising young people start up and run their own summer businesses. For more information on the *Summer Company* program, visit the Canada-Ontario Business Service Centre Web site at: www.cbsc.org/ontario, document No.8120, visit the Ministry of Economic Development and Trade Website or contact the Canada-Ontario Business Service Centre at (416) 954-4636 or 1-800-567-2345.

iv) Canadian Youth Business Foundation

The *Canadian Youth Business Foundation* provides loans to young entrepreneurs (aged 18 to 29) that are unemployed or underemployed, eligible to work in Canada and not able to raise the necessary finances to start their own small business from other sources. The Foundation is sponsored by private sector businesses and was founded in 1996 by the CIBC, the Royal Bank, and the Canadian Youth Foundation. The Foundation provides loans of up to $10,000 to cover the start-up costs of small businesses. The loan repayments are extended to lengths of three or five years to enable small repayments. As of March 1998, the Foundation's loan program has started 199 new businesses and created 326 new jobs. The foundation currently offers loans in the greater Toronto Area and the Niagara Region.

v) Self Employment Development Initiatives

Since 1986, Self Employment Development Initiatives (SEDI), a charitable non-profit organization, has been promoting self employment as a self sufficiency option for poor and working poor Canadians. Over the past eleven years SEDI has been involved in self employment research, policy and program design, and service delivery, management and evaluation. As well as managing such programs as the *Self Employment Assistance* program for Employment Insurance Claimants (see Section 4.3) across Metro Toronto; SEDI has designed, implemented, monitored and evaluated various federal, provincial, local, and private sector funded youth entrepreneurship and self-employment initiatives. SEDI is currently in the process of implementing two national youth self-sufficiency projects, the *"A" Game* and *youth.comm.*

The goal of *"A" Game* is to broaden the focus on entrepreneurship to using entrepreneurial skills to assist youth in planning for and achieving self-sufficiency. The *"A" Game* builds on the issues, concerns and feedback that SEDI has received from both young people who are struggling and the organizations that serve them in 35 communities across Canada.

youth.comm is a national initiative made possible through the Business Action Program of the National Crime Prevention Centre, and will be delivered in 12 Canadian communities over the next three years**.** *youth.comm* will involve local youth facilitators, participants from local business and local community bankers to build the capacity of local organizations to deliver program planning for youth including a mentorship strategy, on-line support and youth awareness sessions.

For further information please contact SEDI at (416) 665-2828 or visit their website at: www.sedi.org

4. Initiatives and Best Practices in Other Communities

As outlined in section 3, there are many types of services and programs to assist micro-entrepreneurs in accessing capital to start small businesses, however, there are still barriers to capital for particular groups such as the poor and working poor. "Traditional financial institutions have not been active players in responding to the micro-enterprise financing needs of the growing legion of self employed Canadians, particularly low-income Canadians" (Self Employment Development Initiatives, 1998, 1). Consequently, local communities have begun experimenting with a range of different credit delivery models and community initiatives.

4.1 International Micro Financing Organizations with Local Initiatives

Those that are somewhat familiar with the world of micro finance will be familiar with the success stories of micro credit lending institutions in Bolivia, Bangladesh and elsewhere, which have not only lent successfully to large numbers of poor micro-entrepreneurs, but have done so sustainably. In the last decade, a number of these institutions have also been experimenting with lending in developed countries, such as the United States and Canada.

i) Grameen Foundation

Grameen Banking has become almost synonymous with micro credit for poverty reduction. The *Grameen Bank* was started in Bangladesh in 1976 as an experiment in micro credit lending which affected the lives of the rural poor. It has since loaned more than 2 billion dollars to millions of people. The *Grameen Bank Approach* has become both an ideology and a methodology. As an ideology, it believes that every human being is endowed with skills and creativity that can be harnessed to benefit himself/herself and society at large. It believes that poverty is a human creation, and that human creativity can eliminate poverty. It believes that micro credit, when properly designed and implemented, can be a powerful tool for reducing poverty.

Grameen Foundation USA was founded to advance the philosophy and work of Grameen in the Americas. *Grameen Foundation USA* works in partnership with the Grameen Bank by implementing such programs as *Project Enterprise*, which provides business loans, training, and peer support to hopeful entrepreneurs in New York City who are at or below the poverty level. *Project Enterprise* has attempted to remove traditional barriers to capital by offering access to capital without the restrictions of credit and background checks, collateral requirements, and prior business planning by using a peer lending group model.

Project Enterprise peer group lending members are responsible for reviewing each other’s loans and supporting each other to be successful. Each member of a Group is eligible for a first 5-Month Loan of $750 or less or a 12-Month Loan of $1,500 or less. Upon each successful repayment of a loan, the member can move to the next loan ceiling: $1,500, $3,000, $6000, and $12,000. Interest on all loans is 12% and a processing fee of $25 is charged on all loans but the first. Five percent of each loan is deposited into the client’s Group Fund, which the Group can use for the purpose of helping a member in need, investing in a member's business, or investing in a joint Group venture. The Group Fund serves as an introduction to commercial banking and encourages asset development. *Project Enterprise* has grown from serving 10 clients and disbursing six loans totalling $3,000, to serving 53 clients and disbursing 39 loans totalling $76,700.

ii) ACCION

Concerned about growing income inequality and unemployment in the United States *ACCION International* is one of the world's leading micro finance organizations that fights poverty through micro lending. *ACCION International* brought its experience in Latin American micro lending home, starting a program in Brooklyn, New York in 1991. *ACCION USA* works with low and moderate income people, who are economically marginalized and have no access to commercial business loans, such as single mothers on social assistance. Since 1991, *ACCION USA* has grown, reaching over 3,700 low income business owners with more than $23 million in business credit. As of December 31, 2000, ACCION had 2,142 active clients in the United States, with an average loan size of $5,154.

iii) Calmeadow

The Calmeadow Foundation is a Canadian based non-profit organization with over sixteen years of direct experience in supporting micro finance initiatives in Latin America and Africa. Calmeadow was one of the first institutions to test the peer group-lending model in Canada and for years was the largest micro lending institution in Canada. Between 1987 and 1999, it disbursed more than $4.6 million in 2,558 loans to micro-entrepreneurs across the country.

Calmeadow has now spun off, sold or closed all of its Canadian micro loan funds. In 2000, its largest and most prominent Canadian initiative, *MetroFund*, in Toronto, was transferred to a local credit union. The transfer of *MetroFund*'s portfolio was significant because it effectively ended Calmeadow's fourteen-year experiment with micro finance in Canada. It was believed micro loans, such as the funding model of *MetroFund*, needed additional program support such as government legislation. Calmeadow decided the *MetroFund* model, "could not stand alone as a viable method for micro lending in the current Canadian context" (Frankiewicz, 2001, 1).

The Calmeadow Foundation identifies several issues with sustainability of Canadian micro lending compared to its international experience. They include:

- Canada does not have a visible critical mass of potential micro enterprise borrowers
- The complexities of the Canadian social welfare system compete or deter the pursuit of self employment by recipients
- The dramatically higher operating costs and initial high start up costs in Canada

(Self Employment Development Initiative, 1995, 9).

4.2 Community Based Micro Financing Initiatives

Community based micro credit initiatives are community economic development strategies in response to credit gaps which conventional financial institutions cannot or will not fill. These initiatives are developed to meet the unique social, economic, cultural and capital needs of particular communities. As a result almost every strategy, to some extent, is different from the next.

i) Revolving Loan Funds

Revolving loan funds extend capital to entrepreneurs in a way similar to banks and credit unions. The fund has a capital base that is used to give loans to clients. Clients repay the loan in regular installments with interest, as they would a bank. Repaid capital is then lent out to other entrepreneurs – hence the name ‘revolving’ fund. Many revolving loan funds are self–financing through profitable lending, although investor capital is needed initially.

The *Calville Investment Corporation* was set up as a revolving loan fund to help enterprises in Nanaimo, British Columbia. “In its twelve years of existence, the *Calville Investment Corporation* has provided loans to help hundreds of enterprises… The $3 million loaned to these small firms has created more than 1,000 full and part-time jobs… Because Calville took the initial risk to extend these loans, additional loans have been leveraged from conventional financial institutions. What's more, the loan loss ratio has been remarkably low: only one firm in 147 has defaulted and gone into receivership" (Social Investment Organization, 1994, 17). This reflects the pattern, whether national or international, of community based micro financing initiatives.

ii) Loan Guarantee Funds

Loan guarantee funds use capital to secure or 'guarantee' loans made to entrepreneurs by traditional financial institutions such as banks and credit unions. The security offered by the fund is similar to that given by a loan co-signatory. In the case of default on the loan, the fund, not the investor, assumes responsibility and makes repayments to the financial institution. Loan guarantee funds provide capital as collateral for loans from financial institutions. The fund pools investor capital and makes conservative investments in Treasury Bills or corporate bonds. Accumulated interest is used to pay dividends to investors and to cover any defaulted loans. The loan guarantee model can help lever capital from financial institutions, which would not normally extend loans to, 'risky', low income entrepreneurs.

The *First People's Loan Guarantee Funds* and Borrowers Circle, as the name implies, guarantees loans to Native Canadians for micro-enterprise development. The *First Peoples Fund*, started in 1990, is a private sector initiative designed by the Calmeadow Foundations to assist first nations across Canada to establish and operate their own micro-entrepreneur loan funds. "Loans are offered at commercial interest rates and range from $300 to $3,000. Loans are extended to self-employed individuals within borrowers' circles of four to seven people. No collateral or equity contributions are required. Instead, members of the borrowers circle approve and guarantee each others' loans" (Social Investment Organization, 1994, 19).

iii) Equity or Venture Funds

The equity or venture fund model is considered to be more complex than the revolving or guarantee fund model. The equity fund model has investors buy shares in an investment fund, which in turn invests money in enterprises. Through ownership in the fund, investors 'own' a share of the profit or losses of the companies in which the fund has invested. This model is somewhat like a mutual fund.

The *Canadian Alternative Investment Co-operative* is an example of a venture fund. Established in the early 1980's by a consortium of religious organizations, their goal has been to take a portion of the religious communities' endowment fund (normally held in treasury bills or investment certificates) and place it in socially valuable micro-entrepreneur projects, which also produce investment revenues. "The *Canadian Alternative Investment Co-operative's* venture investment fund makes loans, either secured or unsecured, and buys equity in cooperatives and non-profit associations. It now embodies about 45 groups with $4.5 million in investment capital" (Social Investment Organization, 1994, 21).

4.3 Government Legislated Programs

The Community Reinvestment Act, United States of America

In 1977 the U.S. Congress enacted the *Community Reinvestment Act* to require U.S. banks and other lenders to make capital available in low and moderate income neighbourhoods. The *Act* and associated regulations requires detailed disclosure of financial institutions' lending, investment and service record branch by branch, neighbourhood by neighbourhood across the country. The *Act* requires almost all of the 10,000 U.S. banks and other financial institutions and companies to disclose how many people apply for mortgage, small business and small farm loans, how many are approved and how many are rejected. This information is all categorized by the race, gender, income level and census tract of the borrower.

Each financial institution's records are reviewed and graded regularly by government agencies. Institutions are required to take corrective action if they have a failing grade. Even their applications to expand, especially by merging with or taking over financial institutions can be denied if their lending record is below expectations. Therefore, the banks have a commercial incentive to investment in their community.

"As a result of the U.S. *Community Reinvestment Act* and related measures, more than $1 trillion has been committed by financial institutions for targeted loans, investments, and service programs in low and moderate income and, visible minority neighbourhoods and communities – commitments that would not have been made if these laws were not in force" (Canadian Community Reinvestment Coalition, 2000, 4).

5. Conclusions and Recommendations

Several studies have evaluated the success of many of the existing micro credit services and programs that are available to micro-entrepreneurs. Their results are instructive in demonstrating the efficacy of self employment as a self sufficiency strategy for the poor and unemployed.

In 1996, Human Resources Development Canada evaluated the *Self Employment Assistance* program (see section 3.5 for details) with the following results:

- Approximately 12,000 individuals participate in the program at an additional direct cost of $12,975 per participant

- The survival rate for participant sponsored businesses was 83% two years after starting the program

- Of the sponsored businesses, 37% were found to have hired paid employees, on average 1.5 full-time and 1.8 part-time employees.

The evaluation concluded that the Self Employment Assistance program generates a positive rate of return to society within a reasonable period of time (Self Employment Development Initiative, 1997, 4).

Between 1993 and 1996, the province of Ontario funded *JobsOntario Self Employment Program* as a component of its larger *JobsOntario* employment strategy. This program was primarily targeted to people on social assistance who were interested in self sufficiency through self employment. The program offered training and counselling in business, regulatory waivers and access to micro financing through the establishment of Community Loan Funds.

Outcomes of the *JobsOntario Self Employment Program* included:

- A total number of 4,218 participants
- A total number of 3,066 were receiving welfare
- A total number of 2,417 started a business
- A total number of 879 left welfare as a result of starting a business

(Self Employment Development Initiative, 1997, 6)

The results of these programs serve as proof that the poor, working poor and unemployed have the capacity to become self sufficient through self employment. *Regulatory Barriers to Self Employment for Social Assistance Recipients* published by Self Employment Development Initiatives reports: “The training programs and the trainers are excellent and of enormous value to the trainee. However, there is a real lack of start up capital from financial institutions. In some instances bankers discriminate against social assistance recipients. For example: There is a coding system used by the banks to identify welfare recipients. This practise makes it very difficult to obtain bank loans to start up businesses.”

In a Survey of 30 Canadian and 86 U.S. entrepreneurial, small business counselling and financing organizations they indicated that “access to capital was a key problem for the poor trying to start a business… institutional lenders are frequently unwilling to make loans to welfare recipients, the unemployed, minorities and residents of poor communities” (The Corporation for Enterprise Development, 1990, 13).

Access to capital has been noted as a principal barrier to micro-entrepreneurs and self employment. The lack of access to appropriate micro financing by the poor, working poor, or unemployed, is a barrier to building self reliance and economic growth. Traditionally, many of these individuals, who could be contributors to the Canadian economy, instead are a social expenditure due to their dependency.

The challenge is to devise a new framework, within the structure of Canadian financial institutions and in keeping with good business practices, which will enable access to micro financing options for poor, working poor, unemployed, and vulnerable Canadians who have the capacity and who seek the opportunity to increase their economic independence through self employment.

In regard to this, research points to several policy options and programs that could be pursued at the Canadian federal and provincial government levels, as well as at the local community level to increase access to capital for micro-entrepreneurs. They are:

1. Enact Federal Legislation that requires financial institutions to invest in their community.

Some proponents of micro-enterprise, such as the Canadian Community Reinvestment Coalition, believe that the only way financial institutions will become involved in unsecured micro loans is if they are required to do so by law. Enacting Federal Legislation that requires financial institutions to invest a portion of their after tax revenues in community reinvestments, such as micro loan funds for the poor is one such option. The *Community Reinvestment Act* in the United States is an example of how this type of legislation can work to support micro lending.

Self Employment Development Initiatives identifies specific roles for the successful implementation of such a recommendation. They are as follows:

The role of **government** is:

- To draft and implement legislation including specification of eligible investments:
- To ensure compliance by the financial services sector; and.
- To evaluate results.

The roles of **financial institutions** are:

- To develop a roster of “eligible community investment options” (e.g. micro loan fund); and,
- To develop a management information system to meet government compliance requirements.

2. Promote strategies to permit social assistance recipients to build savings and assets.

Access to capital is not just a debt financing issue. For some people, using savings to finance their business is a more desirable approach. However, current provincial welfare regulations do not permit social assistance recipients to keep savings or assets and there are currently no policies in place to assist the poor and working poor to save for investment in their future.

One type of option the provincial government could explore is the development of Individual Development Accounts (IDAs), similar to an RRSP. IDAs are restricted savings accounts established as early as birth by poor and working poor individuals, families or groups. The accounts can be matched at a locally determined ratio (e.g. 3:1) with tax deductible funds donated by charities, businesses, service clubs, individuals, etc. Funds can only be withdrawn without penalty for designated purposes. IDA funds could also be used to finance a business directly or as collateral to obtain a micro loan.

Self Employment Development Initiatives identifies specific roles for the successful implementation of such a recommendation. They are as follows:

The role of **government** is:

- To undertake a demonstration project to test the efficacy of IDAs as savings and asset tools for the poor and the working poor;

- To monitor for policy purposes the results of IDA investments in achieving savings and asset building objectives;

- To provide short term grants in partnership with other funders (i.e. foundations, corporations) to community groups to assist them to develop local IDA pilot projects; and,

The roles of the **financial institutions** are:

- To manage IDA deposits, possibly at preferred rates of interest and with waived fees.

Although research supports the principle of IDA's it has been the experience of the Council, that existing social assistance legislation is prohibiting to self employment options to the poor. To qualify for social assistance you must have minimal financial assets or savings. In 1998, the provincial government reduced the allowable total value of assets that existed previously for all social assistance recipients except those receiving *Ontario Disability Support*.

In some cases families have had an 80% reduction in their allowable assets. For a single mother with one child, for example, there has been an allowable asset reduction from $5,000 to $1,020. In addition, regulations state that a recipient must dispose of all assets above the new level within the first year of collecting social assistance. The assets that must be disposed of can only be spent on items that are categorized as necessary by the recipient's case worker. Under the new 1998 law a person on social assistance is also not allowed to own a car that is worth more than $5,000 (this was lowered from the previous level of $10,000). However, a recipient is allowed to keep the car for six months while looking for a job. If a recipient does not find employment within the six months, they must sell their car and collect the money to support themselves (Halton Social Planning Council, 1998, 1).

These types of social assistance regulations affect the very types of assets that are necessary to support micro-entrepreneurship. Therefore, the Council recommends that it is these types of prohibiting regulations that must be addressed if self employment is to be a feasible option for the poor.

3. Establish a multi-sectoral partnership among community, local government, and financial institutions.

As this document and other research has shown, traditional financial institutions have not been active players in responding to the micro-enterprise needs of the growing sector of self employed, particularly low income entrepreneurs. Consequently, local communities have begun to experiment with a range of different credit delivery models such as loan guarantee funds. Such a local community driven credit model could take the form of a revolving fund program.

Self Employment Development Initiatives identifies specific roles for the successful implementation of such a recommendation. They are as follows:

The roles of the **financial institutions** are:

- To provide wholesale credit at a discounted rate (e.g. prime less one half per cent) to local micro finance retailers or to a central capital pool

The role of **government** is:

- To support the capacity building of local micro finance retailers and the marketing of the new micro finance products;

- To establish codes and standards of operation for the micro finance retailers; and

- to provide loan loss guarantees based on a limited percentage of the loan.

The role of **community** is:

- To identify and recruit stakeholders and partners in the community;

- To attract local dollars;

- To promote the program within the community.

In conclusion, this discussion paper has recommended several options, the federal requirement of financial institutions to invest in their local communities, the reform of provincial welfare regulations to permit social assistance recipients to retain and build savings, and the support of local public/private sector credit lending programs. Each element is important in a strategy to best support the needs of entrepreneurs, with the key being the linking of public and private resources, strategically organized on a local, provincial and federal level.

Research has shown us that there are successful models of lending for micro credit developed by international and local organizations that demonstrate the need for accessible micro credit. However, as organizations such as Calmeadow have concluded, these organizations cannot fill the need alone.

Local government, financial services, economic development organizations, public and private, should come together at the community level to see how each can play complementary and synergic roles in providing the services and capital necessary to make self employment for the disadvantaged a viable route to self sufficiency.

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