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New Line on Credit

Popularized in the Developing World, Microloans Help Finance Budding Businesses

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A woman in a rural South Asian village receives a loan of about \$250 to buy a dairy cow. She milks the cow, sells the milk and improves her standard of living while repaying the loan. In much of the world, this is microfinance.

In the United States, microfinance is an entirely different animal. An aspiring entrepreneur typically needs thousands, not hundreds, of dollars to build a business that has a chance of turning a profit. That's the kind of person Tsehay Teferra is trying to help.

Teferra is the founder of Arlington-based ECDC Enterprise Development Group, an affiliate of the Ethiopian Community Development Council specializing in small loans to refugees, immigrants and others with business ambitions but little access to traditional sources of capital.

Microfinance became a hot topic this fall with the announcement that the Nobel Peace Prize would go to Bangladeshi economist Muhammad Yunus, whose Grameen Bank and its small, collateral-free loans are credited with lifting millions around the world out of poverty. The award was given in Oslo yesterday.

The Enterprise Development Group, Teferra said, seeks to implement the bank's global principles on a local scale. "People are frustrated going through this cycle of employment that is not really moving them up," said Teferra, who came here from Ethiopia in 1972 to attend Georgetown University. "This serves as a tool to help people build self-sufficiency."

In the 14 years of its existence, he said, the group has made about 500 microloans, totaling \$7.8 million. The average microloan is less than \$16,000, an amount so small that most banks don't think it is worth the paperwork and the risk.

EDG is a nonprofit organization and its staff members say expanding economic opportunity is its mission, but it's not a charity. Like other U.S. microlenders, its interest rates usually range from 11 to 14 percent, depending on a client's credit history, business plan, interview and sometimes a visit to the client's start-up. That interest rate seems high, but it is lower than rates in the developing world, where they are routinely 20 percent or higher. And compared with rates as high as 400 percent charged by so-called payday lenders in poor U.S. neighborhoods, microfinance is a bargain.

"What often happens in the U.S. is people go to predatory lending," said Amy McKenna Luz, chief executive of the 700-member Association for Enterprise Opportunity, a District-based national organization of U.S. microlenders. When the borrowers have trouble making payments, they borrow more, she said, and "it's a cycle they never break free of."

Microfinance is an attempt to halt that cycle. The U.S. movement "is in its infancy in many ways -- in terms of the number of people reached, in terms of awareness by corporate leaders and legislators," Luz said.

While some of the lenders in her association have offered microloans since the 1980s, it wasn't until 1991 that the Small Business Administration launched a program providing a pool of money for nonprofit groups to lend to small start-ups. The SBA loans cannot be more than \$35,000 and must have terms of six years or less.

EDG offers loans up to \$50,000, using money it gets from the SBA, the federal Office of Refugee Resettlement, the Calvert Foundation and some banks. Under federal regulations, EDG cannot lend money to illegal immigrants.

Many of its clients are refugees who left behind successful careers -- a former Burundi congressman, a Sudanese accountant -- but found that their skills don't translate into well-paying jobs in the United States. And without credit histories, starting a business is nearly out of reach.

A number of clients have used EDG's small loans to buy taxis. One started a moving company. In some cases, the loan recipients have already launched businesses and need loans to expand. Most of the loans help people who may need a leg up but bring talent, ambition and energy to the table.

"Microfinance is not a proven tool for poverty alleviation in the U.S., but it can help the people it serves," said Jonathan Morduch, a professor of public policy and economics at New York University. "Ultimately, a lot of people want jobs. They don't necessarily want to be self-employed."

About 10.5 percent of EDG clients are more than 30 days late on their loans, the industry's measure for loans at risk of delinquency. That's more than double the rate at microfinance institutions in other parts of the world, according to the Consultative Group to Assist the Poorest, a group that sets industry standards for microfinanciers. EDG is working to get more of its clients to make their payments on time.

In some parts of the world, repayment rates are bolstered by a communal ethic; loans are given out collectively to groups. Members hold one another accountable for making payments because if one person falls behind, the entire group is disqualified from further loans.

Such strategies are less effective in the United States, so EDG seeks other ways to ensure that its clients repay. Andrew Tulchin, EDG's director, recounted the story of a Latino immigrant who borrowed \$35,000 to purchase a dump truck. He won a hauling contract from a larger company, hired a second driver and paid upfront costs, such as fuel. After two weeks of work, he had not been paid by the contractor and was behind on his loan payments. EDG offered to help track down the contractor and found a lawyer for the truck owner. Now the driver is up to date on his payments.

Traditionally, microfinance has been funded by donors and philanthropy. But there is a growing movement among some interested parties -- including eBay founder Pierre Omidyar -- to commercialize the institutions, essentially creating profit-making, sustainable banks for the poor. But analysts and microfinancers said that might be a difficult goal in this country. The costs of staffing and operating a microfinance institution in the United States are much higher than in the developing world.

Michael Barr, a law professor at the University of Michigan who studies financial services for low- and moderate-income households, said U.S. microfinance is still facing a lot of challenges.

"There are examples of successful programs around the country, and all are looking for ways to professionalize, to grow their loan portfolios and to lower their costs," Barr said.

EDG plans to remain nonprofit but is moving to become more like a commercial bank in the way it reviews clients' credit histories and analyzes their business plans. But it also considers good character a qualification and will use nontraditional collateral to secure a loan.

"We are a nonprofit and our mission is to provide affordable financial services to the community," said Tulchin, who worked with the Grameen Foundation USA -- a District-based promoter of the global microfinance movement -- until joining EDG six months ago. "It's important we do that in a professional and business-like fashion so that we can continue to do this work."

The ultimate success, though, he said, is not gaining clients but losing them: "We lose clients because they don't need us anymore. They can go to a bank."

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