Microlending – Is It Worthwhile?

small business   lending   business customers

Summary: The Small Business Administration provided $85MM in microloans to 5,890 people in 2020. Many community financial institutions assisted in that business as intermediaries. These loans help startups and smaller businesses that might not be eligible for traditional loans. Are they worthwhile for your institution? We explore this lending sector.

Microlending started in 1976 in Bangladesh, when an economics professor, Mohammed Yunus, saw startups struggle. The only loans available kept a hefty portion of the proceeds, keeping entrepreneurs from flourishing. His first loan was $27 to a women-led, bamboo stool business. Not only were the women able to pay off the loan, but they could also buy materials that allowed them to expand their business and thrive.

Microloans may not be on top of mind for community financial institutions (CFIs). However, those wanting to help startups get off the ground or nurture certain small businesses needing extra support might want to consider lending these small amounts of capital.

Are microloans a good idea?

These products could expand your customer base and further support your community. These offerings are geared toward entrepreneurs who might not be eligible for traditional financing, particularly in underserved areas. Providing microloans can be a good alternative for businesses that might otherwise need to turn to riskier loan providers, such as payday loan vendors that offer high interest rates. Microloans typically have lower interest rates and longer terms, even up to 6Ys. Successful microloan borrowers can then transition to a more traditional form of credit and more sophisticated financial products and services.

Globally, the microlending sector is strong, with an expected CAGR of 12.6% from 2020 to 2027. The worldwide market is expected to hit $343.84B in 2027. Historically, repayment rates are high for microloans too — 98% pre-pandemic. Across the world, women entrepreneurs make up the vast majority of borrowers and the majority live in rural areas, where financial resources can be limited. But microloans aren't just for entrepreneurs in developing countries — more and more are being lent in the US.

Three ways CFIs can offer microloans

1. **Using the SBA's microloan program.** In 1992, the US Small Business Administration (SBA) introduced a microloan program and since then the product has steadily grown in popularity. In 2020, the SBA via intermediaries like CFIs granted $85MM in microloans to 5,890 people. While SBA microloans can reach $50K, the average loan size was $14,434 with an average interest rate of 6.5%.

Entrepreneurs and other small businesses use SBA microloans for a number of purposes, including working capital, inventory, supplies, furniture, fixtures, machinery, and equipment. However, borrowers cannot use the microloan to pay existing debts or to purchase real estate.

A CFI in the Southwest has been approved by the SBA to make the agency's microloans, typically granting around $13K to borrowers, as well as other types of SBA loans.

"*No matter what type of loan brings you in the door, we'll ensure you consider the right choices based on your individual needs," the CFI writes on its website. It adds that borrowers can trust the institution "to learn your goals and explain borrowing options, so you can make an educated, smart decision about the future of your business.*"

2. **Partnering with community development financial institutions.** A Pacific Northwest CFI partnered with a Community Development Financial Institution (CDFI) to create a microlending fund, contributing $150K of the CFI's income from the Paycheck Protection Program loans granted during the pandemic.

"*The goal is to get these businesses to become viable and eventually develop relationships with banks that can be lifelong," says one of the CFI's market presidents, adding that the partnership is now developing a revolving microloan program. "We would like for this program to live in perpetuity, and we believe that it's our responsibility as a community bank to help that group of small businesses.*"

3. **Participating in CFI consortiums.** Six CFIs in the Northeast banded together to create a microloan recovery program, granting low-interest loans from $3K to $25K to small businesses adversely impacted by the pandemic. These types of groups are likely to continue after the pandemic, as they see value in lifting up small businesses through these microloans.

Your institution may not have considered microlending. Yet, there are opportunities to be found in this area. Explore the various microlending options to see if there is one that works for your institution to help budding entrepreneurs and small businesses.

LOOKING TO GROW YOUR LOAN PORTFOLIO?

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ECONOMY & RATES

Rates As Of: 04/07/2022 05:43AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.67	0.15	0.61
6M	1.15	0.09	0.96
1Y	1.76	0.14	1.38
2Y	2.46	0.12	1.72
5Y	2.69	0.22	1.42
10Y	2.62	0.28	1.10
30Y	2.64	0.19	0.74

FF Market	FF Disc	IORB
0.33	0.50	0.40
SOFR	**Prime**	**OBFR**
0.30	3.50	0.32