

Providing Loans to Small Business Owners

A REAL Solutions® White Paper



Providing Loans to Small Business Owners – A REAL Solutions® White Paper is a 2010 publication of the National Credit Union Foundation's REAL Solutions® program.

About the National Credit Union Foundation (NCUF)

The National Credit Union Foundation (NCUF) raises charitable funds, runs innovative programs, and makes impactful grants for America's credit union movement. NCUF's mission is to "promote and improve consumers' financial independence through credit unions." Among the NCUF programs achieving this mission:

REAL Solutions® — Helping millions of consumers gain access to affordable financial services, achieve financial literacy, grow savings, build assets, and buy homes.

Development Education — Leading training on cooperative principles in the modern consumer marketplace to overcome what credit unions identify as the greatest threat to their future: "the eroding of credit union philosophy."

Social Impact Management — Meeting a "triple bottom line" that benefits credit unions, members, and communities.

About REAL Solutions®

REAL Solutions® is the signature program of the National Credit Union Foundation. REAL — "Relevant, Effective, Asset-building, Loyalty-producing"— Solutions® works to help credit unions offer a wide range of products and services that have proven successful in serving working families with low wealth and modest means. Using product/business models created and tested by credit unions, REAL Solutions® disseminates information to credit unions through special meetings, an [online impact center at realsolutions.coop](#), and state and national conferences. As NCUF's signature program over the past three years, REAL Solutions® has been adopted in 37 states and is saving members tens of millions of dollars. It has now become a documented business strategy for credit unions to grow their memberships by serving the underserved.

About the Author

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Jerving has lectured at the University of Wisconsin-Madison School of Journalism, where he earned his M.A. After completing his B.A. in Political Science at the UW-Madison, he lived and worked in Switzerland, France, Spain, Holland and Germany. In addition, he has traveled to more than 20 countries to write reports and photograph international development projects.

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Introduction

During the past two years, a series of events have come together to provide opportunities for credit unions to lend to small businesses and microenterprises (i.e., those with five or fewer employees and seed capital of not more than \$35,000). Banks are pulling back on credit to small business owners as more entrepreneurs enter the economy from companies that are shedding jobs because of the recession. Even what has become the small business owner's last source of working capital—the credit card—is showing signs of being restricted.

Credit unions are filling some of the credit void for start-up capital and other financial services for small businesses today as in the past. These loans are often granted as signature or home equity loans and not recorded as small business loans. But these loans are a continuing service to the small business community, as it's predicted that credit scarcity will continue in 2010 and possibly into 2011.

Credit unions are helping small businesses with start-up capital when banks consider the loan amount too small to be profitable, or if the business lacks a sufficient track record. They also help small businesses with other financial services as well as education and expertise—accounting, marketing, business planning, pricing—to become their primary financial institution.

Cooperative Federal Credit Union (\$15 million assets; Syracuse, New York), specializes in small business loans of \$50,000 or less, unless secured by real estate. Many of their business loans are for \$10,000 or less, which may fund business vehicles, equipment, and trucks, as well as business mortgages.


A start-up capital loan to a Mexican restaurant in Camillus, on the outskirts of Syracuse, shows how credit unions can help small businesses thrive and provide jobs for the community.

Start-up Capital for a Mexican Restaurant

Tom and Lupe Bryan made a loan application for \$62,000 at three local banks in Syracuse and were turned down. They were looking for funds to open a Mexican restaurant and live in the building. They developed a detailed business plan. They had five years of experience showcasing their food at a stand at the New York State Fair. Ron Ehrenreich, Treasurer/CEO of Cooperative FCU was impressed with their business plan.

“We liked the analysis and the plan,” he says. “They analyzed the competition and found few restaurants in the area. Their competition was from McDonald's, and they offered low-cost family meals, fresh and homemade, not corporate, but authentic.”

The restaurant would be open from April to November, and then Tom and Lupe would go back to Mexico for the winter. The building they proposed to buy has living quarters on the second level. It was located about one-half mile from a community college. The credit union granted the loan, which they paid off early.



“They now have more money saved in the credit union than the original loan,” says Ehrenreich. “They employ young people from the community college, which has a food service program.”

Cooperative FCU takes on more risk than a conventional bank, but they still rely on the basics of business lending. “We still look at the character of the member, the capacity to pay and the credit report,” he says. “The capacity to pay; that’s where you take a stretch when you are looking at a new business; you need to take a conservative view. Will they be able to repay the loan and still support themselves?”

Other questions the lender needs to ask the business owner-member, according to Ehrenreich: What is the appraised value of the collateral; can it cover the debt if things go wrong? Does the business owner-member have a realistic view of the competition and marketing?”

A business loan is different from a consumer loan. An auto loan varies little from loan to loan. It consists of 48 or so payments and that’s it, and each loan looks much the same. Each business loan is unique; the credit union business lender needs to get to know the business and the owner. Offering educational courses and expertise to member business owners is essential for a credit union to be successful in business lending. Cooperative FCU has speakers that come to the credit union to give seminars on business bookkeeping, retailing, marketing and other courses.

“We do a lot of one-on-one counseling, and we give people feedback on their business plans,” said Ehrenreich. “I teach a class on how to write a business plan. A lot of people have a skill, or a talent, but need help in starting a business.”


Apollo Towing Reaches Potential with Credit Union Loan

The story of Apollo Towing in Corpus Christi, Texas, shows how a small business starting in modest circumstances can reach its potential with a credit union loan. Three brothers started the business in 1996 at a used car lot in a 10 x 10 foot wooden building, detailing cars and earning \$75 for each car they detailed. According to Wayne Vann, CEO of NavyArmy Federal Credit Union (\$903 million in assets; Corpus Christi, Texas), the origins of the business were humble:

“They didn’t have anything; they were living day to day,” he says. “The wrecker business was different then. They didn’t use flat beds; they actually towed the cars. Today they use flatbeds for a lot of the wrecking business.”

In 1998, the brothers bought their first wrecker and started Apollo Towing. At that time, Laredo National Bank handled their financing. Vann’s relationship started with one of the brothers earlier; NavyArmy FCU financed his first home in 1997. Navy Army FCU refinanced Apollo’s first wrecker loan of about \$100,000 to get a better rate. Soon after, the Credit Union provided financing for a major business expansion.

“They needed financing for 12 to 15 wreckers; so, we went into the wrecker business,” says Vann. “Eighteen-wheelers carry a lot of scrap metal; you need more than one truck. They needed 12 trucks with big flatbeds and triple axles.”



With its growth, Apollo has acquired many government contracts, including one with the Drug Enforcement Agency for South Texas. “We’ve financed the brothers’ business, close to \$1.5 million in loans,” he says. “Of that, \$500,000 is in real estate. With all of that equipment they needed land to store it.”

“They come from simple poverty and 13 years later they are a success story,” says Vann. “They have good revenues and are very profitable. Their equipment and trucks are state of the art.”

There are lessons to be learned from Apollo Towing, according to Vann. Credit unions have to make sure that their member business owners have “skin in the game,” he says. In other words, they are investing some of their own money to ensure the owner’s commitment.

“Many people will leverage you to death,” he says. “With member business lending you have to understand that you are in business with the member, the person. Credit unions have a place in member business lending, provided they have the expertise on staff.”

“Of course, it is crucial to review the business plan and how the plan fits its intended market,” advises Vann. “And, it’s critical to determine if they have an exit strategy. You want to make sure that if the business fails to reach revenue targets, the owners have a plan for dismantling. That’s just smart lending.”

Alternatives FCU Offers Small Business IDA

Alternatives Federal Credit Union (\$64 million assets, Ithaca, New York), deserves special mention for the wealth of programs it offers the community, including small business Individual Development Accounts (IDAs), and women’s and minority subsidized business loans.


Alternatives FCU offers three IDAs: for education, housing and small business. The small business IDA works like a traditional IDA with a two-to-one savings match. If the member saves \$1,000 over 10 to 24 months, the credit union will match that savings with \$2,000, so the member will receive a total of \$3,000.

Some of the small businesses that have taken advantage of this IDA include a yoga instructor, massage therapist, and chiropractor, as well as crafts people. They’ve bought tools or computers, or taken classes with the matched savings plan. The account has an income level maximum, which is 200 percent of the poverty level.

There is also a financial education component for each participant in this program. Alternatives FCU has an IDA coordinator who works with the aspiring small business owner to help set up a savings plan for a weekly or monthly deposit.

Leslie Ackerman, Director of Business CENTS (Community Enterprise Networking and Training Services), helps small business members develop business plans in partnership with the Credit Union.

“I meet with new clients, but before I do that, I send out a business questionnaire to get a sense of where they are in the process of setting up their business,” she says. “The real objective of a business



plan is not a document, but a planning tool of where you are going. You need a marketing strategy, promotion and operational pieces.”

Alternatives FCU provides a variety of small business loans in the community and many of these loans are under \$25,000, according to Bob Anderson, business loan officer.

“We have a reputation for small business loans and good service, education and training; that’s our niche,” he says. “With our reputation and our loan program, they don’t even go to the banks first.”

The maximum loan amount for a non-real estate business loan is \$50,000; for a real estate business loan, it’s \$400,000. One loan of \$22,000 provided the start-up capital for a vegan restaurant in Ithaca. According to Anderson, the restaurant is doing well.

The credit union offers Small Business Administration (SBA) loans, including microloans, which are loans up to \$35,000 for working capital, purchase of inventory, supplies, furniture, fixtures, machinery or equipment.

Underserved Sometimes More Entrepreneurial than Affluent

Business people in underserved markets are, in some cases, more entrepreneurial than those in more affluent markets. That’s been the experience of William Bynum, CEO of Hope Community Credit Union (\$121 million in assets; Jackson, Mississippi).

“They are more entrepreneurial, in some cases, than those in more prosperous areas because they have fewer resources to work with,” he says. “The population is smaller, there is more geography to cover, and they overcome these odds to succeed.”


Hope Community CU has been providing credit to small business owners that have a broad range of needs since Hurricane Katrina hit the Mississippi Delta. Compounding the situation for small business owners is a lack of financial institutions on the Delta.

“There aren’t a large number of major national banks on the Delta; it’s an underserved region,” he says. “People often go to higher cost options—pawn shops, payday lenders and cash for titles.”

Many traditional lenders fail to see the underserved community as viable markets. “You can provide credit to underserved markets prudently,” he says. “It takes commitment, innovation and a willingness to stay the course.”

Hope Community CU has loan losses that are 0.05%, which compares well with its peers, especially during these recessionary times. What do you attribute the low loan losses to?

“We have an experienced staff that understands small businesses and their local economies,” says Bynum. “We hire people who know how to underwrite risk and have the willingness to work in areas and sectors that traditional lenders might ignore.”



The Credit Union also provides referrals to training and technical assistance in areas such as accounting, pricing, and business planning. “We developed a strong referral network of experts that we can refer business members to.”

One of the continuing needs on the Gulf Coast is affordable housing, particularly rentals. “It’s more difficult to find housing because prices and insurance premiums have increased,” says Bynum. “In response, we worked with public agencies and nonprofits to establish a housing counseling network.”

Some of the small business loans granted by Hope Community CU include: \$12,000 for a pet grooming business; \$10,452 for a management consulting and pet grooming hall; \$30,000 for a small crafts business in New Orleans; and \$12,000 for a computer business.

Helping Military Members

Credit unions and the military have a long and well-known history of working together. Given young recruits are sometimes exploited by non-traditional lenders, credit unions like Langley Federal Credit Union (\$1.6 billion in assets; Newport News, Virginia), has offered financial education classes and payday lending alternatives. The Credit Union also helps their retired military members ease the transition into civilian life for those who choose to start a small business.

Retired military personnel have both advantages and challenges when starting a new business. Advantages include a steady income if sufficient time was served and often transferable skills. The challenge becomes apparent when a retiree, for example, wants to start a restaurant and has no experience in a highly risky venture.


Skills learned in the military are often highly valued in the civilian economy. Some retired military members form consulting businesses in systems development, software design and aeronautical systems.

Military members are familiar with the planning process and have learned discipline and structure all of which are valuable business skills, according to Millie Wilkerson, VP business services, Langley FCU. Wilkerson is a graduate of the U.S. Naval Academy, served as a Marine for 10 years, and worked in the banking industry for 16 years before coming to Langley FCU.

“Credit unions can help retired military with their business needs by offering solutions and options as well as by serving as a resource,” says Wilkerson. “The business owner may not know what type of business deposits, services and loan products are available. For example, we offer business deposits in addition to loan products.”

Wilkerson offers a list of recommended vendors. “We want to be a resource for our business members,” she says. “We want them to think of us for solutions when they have financial needs.”

Langley FCU made a strategic decision to focus on small business loans ranging from \$5,000 to \$5 million. It offers business credit cards, real estate loans, lines of credit, equipment loans, and vehicle loans. It also offers educational programs for new business owners in its Member Educational Center.



Langley FCU offers a variety of SBA loans, with one that is especially relevant for the credit union – which has more than 40 percent military as members – called the Patriot Express loan. This is a loan for veterans, reservists, National Guard members, and their spouses. The loan doesn't require as much paperwork as the traditional SBA 7(a) loan program and it provides the financial institution with a higher loan guarantee than the regular SBA Express loan. The maximum Patriot Express loan is \$500,000.

Small businesses, of course have a high failure rate. What can credit unions do to help small businesses succeed? Can they play a watchdog role?

“You have to say no to some people and you have to have good lending guidelines,” says Wilkerson. “There are a lot of factors needed for a new business to succeed in addition to having an entrepreneurial heart and the brains to put it all together. Most businesses fail because they are overleveraged and undercapitalized.”

Partnering with SBA

Most of the small business lenders interviewed for this report agree that it makes sense to partner with the SBA. In a workable scenario, the SBA and credit union form a working partnership that benefits both parties.

“We get value from the SBA, from their knowledge of products, and we return value,” says Bill Myers, senior fellow, Aspen Institute, Washington, D.C., former credit union CEO and Real Solutions field coach. “The SBA field office would come to our credit union and review loans and later on they would guarantee loans with us.”

When starting out as a business lender though, it's wise for credit unions to tread carefully, says Myers. Start with car loans and go to truck loans when you build up the experience. One mistaken approach is “the bigger the loan, the better the deal.” The thinking is that you've already done the work, so why not go for the bigger loan? So a \$50,000 loan is the same work as a \$10 million loan. Not so, says Myers.

A \$50,000 loan is like a car loan where there is a second source of repayment – the borrower's income – if the business goes south. With a larger loan of \$10 million in the event of a default, you lack the luxury of a second source of income. And with the larger loan, there is more competition on rates.

A loan officer also has to empathize with an applicant to understand the business proposition. He/she has to “buy into” the idea and establish rapport. However, at the same time, a loan officer has to be critical and skeptical. A new loan officer who is bowled over by a persuasive business owner later regrets not following the fundamentals, says Myers.

Small business lending involves hand-holding, he says. “We're trying to evaluate creditworthiness at the same time we're encouraging best practices and delivering technical assistance.”



Concluding Thoughts

Credit unions have been granting business loans to their members for over a century in North America, but haven't called them business loans. They've helped many entrepreneurs start their businesses when other financial institutions passed on their loan applications and their business.

The timing is right for credit unions to help member business owners who are unable to get credit from other sources in the community. There are a growing number of people who are laid off from jobs or unable to find work that need their credit unions to take a chance on these new businesses. Most important, small business owners need their credit unions to take a chance on them. Credit unions can offer member business owners a full menu of services and become their primary financial institution.

Small business is the backbone of both the community and the economy. Credit unions have a vital interest in funding small business loans. The payback will be a stronger and more vibrant community and economy as well as opportunities for credit union membership and balance sheet growth.