Findings from the
Scale Academy

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Dollars for Dreams

Scaling Microlending in the United States

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MOTT FOUNDATION

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ACKNOWLEDGMENTS

This publication is built on the willingness of leading microfinance practitioners to share their experience. Members of the Scale Academy for Microenterprise Development — focused on growing their microfinance services in the United States — met in person and virtually over the course of a year to describe and reflect on their strategies, tactics and technologies. Their aim was to learn from each other and to document their learning for others in the field. The result is a document rich with examples of practice and with lessons for practitioners and funders.

We want to thank the following contributors to this process: Leslie Hoffman, Anne Haines Yatskowitz, Lynn Trojahn and Greg Henderson, ACCION New Mexico•Arizona•Colorado; Erika Eurkus, Luz Gomez, Gina Harman and Paul Quintero, ACCION USA; Robert Boyle, Sheri Flanigan-Vazquez, Galen Gondolfi, and Dan Montrey, Justine Petersen; Shaw Canale, Matt Hutcherson, and Fred Waldkoetter, Mountain BizWorks; and Ellie Bistricky, Anthony Chang and Eric Weaver, Opportunity Fund. Each has given generously of his or her time and experience.

We also thank the funders of the Scale Academy for their deep interest in, and support for, this work. The Charles Stewart Mott Foundation and the Citi Foundation have provided substantial funding to support the programs of grantee organizations that participate in the Academy, and to underwrite the peer learning and documentation initiatives that accompany the grantees' work. We acknowledge with gratitude the personal engagement of Jack Litzenberg of the Mott Foundation, and Amy Feldman of the Citi Foundation, who have offered their insights and helpful comments throughout the Academy's existence.

We hope that we have captured well the current state of the practice in the United States with respect to scaling microfinance. To the extent that we have, it is due to the valuable perceptions provided by those listed above. Any errors, of course, are our own.

Elaine Edgcomb
Joyce Klein
Luz Gomez

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Executive Summary

For years, U.S. microenterprise practitioners have identified scale as one of the field's principal challenges. The Scale Academy for Microenterprise Development, managed by the Aspen Institute's Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination (FIELD) in partnership with the Association for Enterprise Opportunity, is designed to address this challenge by offering organizational development grants, technical assistance and peer learning to leaders in the field. The initiative, funded by the Citi Foundation and the Charles Stewart Mott Foundation, also incorporates careful documentation of the experiences and lessons learned so that others can benefit. Launched in 2007 with support for eight grantees, the Academy has now grown to include five additional organizations that have joined the peer learning process.[1]

This document summarizes the experience and lessons of five grantees whose primary focus in the Academy has been on scaling their microlending. Representatives of these organizations have engaged in a year-long peer process, exchanging their experiences and reflecting on the lessons that emerged. During the course of the three years that they have participated in the Academy – from 2007 to the present – each has experienced both success and challenges. The goals they set at the start of the Academy have been tested in the fires of the financial and economic crises that have confronted the United States since late 2007. Their progress, and their lessons, must be read in that light.

Scale Academy Grantee Microlenders

ACCION New Mexico•Arizona•Colorado — Albuquerque, N.M.
ACCION USA — New York, N.Y.
Justine Petersen — St. Louis, Mo.
Mountain BizWorks — Asheville, N.C.
Opportunity Fund — San Jose, Calif.

For Academy founders, and its members, scale describes the goal of serving large numbers of individuals. In addition, it incorporates the concepts of increased market penetration and of achieving economies in service delivery, which, in turn, can lead to greater sustainability and social impact. Scale should be about transformative rather than incremental growth, involving a significant leap forward in an organization's way of doing business. To that end, at the time of their selection Academy grantees were judged to have already made significant progress in increasing their scale and to be pursuing strategies with the potential to yield further significant advances.

Institutional Performance

All of the microlenders demonstrated positive growth in total loans outstanding from 2006 to 2009 and remain among the largest in the industry. Four of the five institutions also achieved positive growth in the number of loans disbursed, ranging between 26 percent and 302 percent. At the same time, loan activity over the period illustrates the toll that the slowing economy has taken. Three lenders experienced either a flattening or decline in their microlending in the past two years. This slowing has been a source of disappointment for these institutions, but they see it as a considered response to the difficult context. Given several examples – both in the U.S.

[1] Grantee members include:, ACCION New Mexico•Arizona•Colorado, ACCION USA, ACEnet, Justine Petersen, Mountain BizWorks, Opportunity Fund, and WESST Corp. Learning Group members include: ACCION Chicago, Appalachian Community Enterprise, Mercy Corps Northwest, Mercy Corps/MicroMentor, and Renaissance Entrepreneurship Center. Microbusiness Development Corporation of Colorado was funded in the first year of the Academy, but has since ceased operations. More on these organizations can be found at: http://fieldus.org/Projects/ScaleAcademy.html; Internet.

and overseas – of organizations that experienced crises after explosive growth, the lenders are focused on maintaining portfolio quality and balancing scale with sustainability.

Experience and Lessons

As Academy microlenders have endeavored to increase their lending, they have worked on a number of areas that span organizational development and strategy. Their experience has demonstrated lessons for practitioners and funders.

Market Research and Marketing

As the five lenders have grown, they have reached plateaus in their markets, exhausting the easiest-to-reach entrepreneurs. Going beyond those numbers requires that programs become even more demand-driven, and that they find ways to communicate effectively with a market that is complex, fragmented, dynamic and, often, difficult to access.

As a result, the Scale Academy microlenders have invested considerable resources in market research and marketing. Their experiences underscore the need to understand specific market segments and channels, engage in continuous market research, and connect market research to pilot testing of promising strategies. The process must be iterative. Further, microlenders should expect to use both staff and external resources to develop effective research and marketing strategies and to implement new media approaches along with traditional ones. Funders interested in scale should consider how they might support these key investments. Collaborative efforts among microlenders could also extend the use of scarce resources.

Loan Products and Pricing

Scale Academy lenders have depended largely on a few core loan products to scale up, growing their volume by increasing the market penetration of those products and/or by deploying those products in new geographic markets. In fact, about 80 percent of the loans made by these lenders in 2008 were their core microloan products (mostly term loans and some lines of credit).[2]

That scaling lenders are driving growth through their core products makes sense, as focusing on a few products allows for standardization that can increase efficiency. However, the focus on core products does not mean that the Scale Academy lenders have not engaged in new product development. During the three years of the Academy, they have created at least 12 new loan products. This product development has been driven by both the interests of funders and by the changing market conditions that emerged in 2008.

Although funder-driven products can bring new supporters to the table and offer opportunities to meet important social objectives, they necessitate developing new capacities – new marketing strategies, partnerships, underwriting and risk management skills, as well as increased data tracking and reporting – that bring added costs. The added complexity can also detract from the standardization that can lead to greater efficiency. Market-driven product development also increases complexity, but offers the possibility of broader market uptake. For example, Scale Academy lenders have added or increased their offering of credit-builder loans to respond to the deterioration of credit quality among their target markets. Their experience suggests that, although product development can be important in the scale process, lenders need to be clear about their reasons for launching new products and understand the costs and benefits involved.

Loan pricing has been highly challenging. The central issues lie in four areas: pricing constraints imposed by funders; a lack of good market data on customer responses to varying

[2] Several also fueled portfolio growth by increasing their loan limits (sometimes to include small business loans up to $150,000 to $200,000) and thereby their average loan size. While this strategy does not necessarily involve creating a new product, it often requires building the capacity to underwrite more complex loans.

interest rates; limited information about the costs of individual loan products; and varying values as to the extent to which microloans should be subsidized. Academy lenders believe that moving to scale would be facilitated by charging prices that are more reflective of the full costs of lending, and that cost-accounting systems that enable them to "unpack" the costs of lending would support more informed decisions on pricing. Better cost data could also help lenders to influence the price sensitivity of their clients, funders, and even staff whose strong empathies with clients may color their orientation to pricing. Funders in particular need to understand the implications of placing limits on the interest rates and fees charged by lenders.

Underwriting and Decisioning

All of the Scale Academy lenders have made changes in their underwriting as they have sought to respond to and capture increased demand. The changes are driven by three important goals: increasing efficiency, improving quality, and responding to their customers' desires for loan processes that are smoother and provide greater upfront clarity regarding expectations.

Toward those ends, the lenders have reduced the number of staff or changed the roles of those who participate in underwriting and decisioning; developed tools that offer an early signal to applicants regarding their prospects for loan approval; and sought to standardize analysis based on a careful understanding of credit behavior and past portfolio performance. Several organizations now use a statistical scorecard. These more transactional approaches to underwriting do not mean that Scale Academy microlenders have abandoned a "high-touch" approach with their customers. Rather, they seek other opportunities where touch might produce greater value – helping struggling applicants complete loan applications, counseling those with financial education needs and working with them post-loan on business issues.

Risk Management

Risk management is the process of analyzing exposure to risk and determining how best to handle such exposure. The experience of Academy lenders illustrates that vigilance is ever important in periods of rapid growth, as portfolio expansion can often mask emerging delinquency. Challenging economic circumstances also can exacerbate underlying weaknesses in an organization's risk management infrastructure. As such, how organizations respond during times of crisis is critical to the impact on the loan portfolio. Scale Academy lenders have reinforced their risk management capacity by:

- Revising lending policies and procedures to ensure that lending decisions are made on the basis of appropriate risk and build on an organization's past performance.
- Implementing or improving the quality control structures and capacities applied in the loan review process and in monitoring the portfolio.
- Training and incentivizing lending and collections staff to intervene early with risky clients.

Recognizing that their relationship with the client is crucial to managing risk, Scale Academy lenders have built client connections through training and coaching services and interviewing techniques. Each of these approaches is high-touch and carries costs, so lenders need to assess carefully their costs and benefits in terms of both risk mitigation and organizational sustainability.

Customer Service

As Scale Academy microlenders have sought to enhance their customers' experience while moving to greater standardization, they have found that the solution may lie, at least in part, in becoming more customer-centric – in other words, in identifying more ways to understand and meet the needs of their customers. This requires creating new ways to solicit customer feedback, so that processes, products and services can be built around expressed needs rather than long-held perceptions about what customers may want. Becoming more customer-focused also involves developing more systematic approaches for monitoring and improving the customer experience.

Scale lenders report that committed employees give better customer service, so processes aimed at improving employee satisfaction should also be a focus. And, although technology and standardization may seem to be poor substitutes for direct client contact, used properly, they can enhance the customer experience by reducing response time, providing greater clarity and increasing the number of "customer touches."

Strategies for Expansion

Scale Academy lenders have grown primarily through two strategies – adding financial education and credit-building services to their product mix and expanding to new geographies. Those using the first strategy offer education and counseling, often combined with a financing product such as an Individual Development Account (IDA) or credit-building loan. But Scale Academy microlenders also have learned that these initiatives do not necessarily produce more microenterprise loans – unless they are explicitly designed to attract aspiring entrepreneurs or create a clear pipeline to their microloan services. To achieve a tighter link between credit building and microlending, Scale Academy lenders have tailored their financial education curriculum to the specific needs of entrepreneurs, offered credit-builder loans designed as step products to business loans, and created clear bridges to microlending staff and services.

Scale Academy microlenders have expanded their geographies by moving into new counties or states and, in one case, by national expansion via the Internet. As they have expanded to new geographic markets, they have learned that objective assessments of market need are not the same as assessments of likely demand. Although initial research into market conditions may enable organizations to launch services, greater penetration requires deeper market understanding, testing of marketing strategies and hard work. Recognizing this fact prepares the organization for the potential costliness of the endeavor. Finally, one obvious consideration is that geographic expansion requires investment in infrastructure. In all cases, a key seems to be to leverage the organization's core resources through a combination of streamlined staff and technology.

Capitalizing the Loan Fund

Scale Academy lenders have had varying needs to attract new capital. Their total capitalization for microlending activities ranges from $2 million to more than $10 million.

During the three years of the Academy's work, the microlenders increasingly have turned to public financing to build their lending capital. This move to public capital is not surprising, as the availability of bank capital has declined and Federal funds increased with stimulus financing. In addition, the Scale Academy lenders have engaged in several creative efforts to build their capital bases. These have included the launch of a (equity) capital campaign; the formation of a limited liability company to reduce the impact of outstanding debt liabilities; and participation in Kiva, the Internet program that matches individual lenders with microentrepreneurs across the globe. Each of these capitalization efforts has supported the overall brand-building of the organization in their respective geographies, ultimately increasing their ability to attract further investors.

As the lenders have grown their capitalization, all have faced challenges in managing the increasing diversity of capital sources, because of the specific, and varying, requirements imposed by funders and investors. In some cases, progress toward scale has been slowed by the work entailed in being accountable to these requirements. Scale Academy microlenders believe that the time is ripe for more sophisticated, long-term investment vehicles. Scaling could occur more quickly if they could tap a single, appropriate and significant source of capital, thereby reducing their costs of reporting and relationship management, and releasing more resources for product development, marketing and market research.

Structure and Staffing

As organizations scale, their structures evolve, and all of the microlenders have changed their structures over the course of their participation in the Scale Academy. Their experience suggests that there is no one "right" structure for greater scale, but rather that an effective structure must achieve a set of goals. Among the most important goals are: to reflect and support organizational values; to enable the organization to manage greater volume; and to incorporate greater capacity in areas that enhance outreach and visibility, development, and quality.

Critical to achieving these goals is getting the right people in the right positions, and providing them with professional development and incentives to perform well. The incorporation of systems that increase efficiency and support geographic expansion is also critical. The solution to this challenge lies in figuring out how best to assign marketing, sales and underwriting functions. Although the Scale Academy microlenders have taken different approaches to deploying staff in these areas, there is an overall trend toward greater specialization in functions.

Finally, the Scale Academy lenders have learned that the path toward scale that is sustainable must emphasize quality as much as production. To that end, they have increased attention to monitoring and compliance, customer service and collections – steps they would recommend to all microlenders that are pursuing growth.

Conclusion

For U.S. microenterprise development, the path to scale during these economically tumultuous times is marked by shifting contexts and strewn with challenges. Yet, the experience of the Scale Academy microlenders suggests that an organization's ability to successfully scale up operations is not entirely dependent on the context. Despite often enormous challenges, these lenders have shown the capacity not only to persevere, but also to innovate. Their example underscores that if microenterprise organizations are to scale their operations, even amidst difficult situations, they need to be both disciplined and, entrepreneurial – disciplined in their work on improving systems and practices focused on quality and entrepreneurial in capitalizing on opportunities that the context presents. Yet, innovation requires investment in the areas of product development, market research, marketing, underwriting and risk management. These types of investment, along with core operational support, are often hard to come by.

The work of scale in some ways is at a critical juncture. The easy work has generally been done. Reaching more of the market means offering products and services that match the needs of entrepreneurs in a struggling economy. Yet, as this text suggests, there are opportunities for new leaps forward. New types of clients – shut off from traditional financial institutions – have shown up at the door. Advances in systems provide ways to work together to increase efficiency and quality. And, there are important opportunities for joint work in market research and market outreach, in data sharing and analysis, and in product innovation and testing. This is the work not only of the five institutions studied here, but also of the industry as a whole, if it expects to remain a critical provider of capital for low- to moderate-income entrepreneurs nationwide.

Introduction

Scaling microlending in the United States has never been easy. For years, the industry has identified scale as one of its principal challenges. Estimates made by the Aspen Institute's FIELD program (the Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination) suggest that 10 million entrepreneurs and potential entrepreneurs face barriers to accessing mainstream capital and other business development services.[3] How many actually need capital is harder to determine, but most observers believe that the number is greater than the thousands who currently receive loans from microenterprise programs yearly.

Throughout the years, there have been a number of efforts undertaken by individual microenterprise development organizations (MDOs), and by institutions working collaboratively, to work on this challenge. The Scale Academy for Microenterprise Development, managed by FIELD in partnership with the Association for Enterprise Opportunity, is designed to build on the lessons from these efforts, and advance scale through a combination of operational grants targeted toward organizational capacity, technical assistance and peer learning. The initiative, funded by the Citi Foundation and the Charles Stewart Mott Foundation, also incorporates careful documentation of the experiences and lessons learned so that others can benefit. Launched in 2007 with support for eight grantees, the Academy has now grown to include an additional five organizations, which have joined the peer learning process.[4]

This document summarizes the experience and lessons of five Academy members — those grantees that have focused on scaling their microlending. Representatives of these organizations have engaged in a year-long peer process exchanging their experiences and reflecting on the lessons that emerged. Over the course of the three years that they have participated in the Academy, each has experienced some success, and each has experienced challenges. Research and planning for the Academy began in 2005. The first applications for participation in the Academy were written in 2007, and grantees selected in the middle of that year. The goals and numeric targets that institutions made in that period have been tested in the fires of the financial and economic crises that have confronted the United States since late 2007. Their progress, and their lessons, must be read in that light.

Scale Academy Grantee Microlenders

ACCION New Mexico•Arizona•Colorado — Albuquerque, N.M.
ACCION USA — New York, N.Y.
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Opportunity Fund — San Jose, Calif.

Defining Scale

Any conversation about scale in the microenterprise industry invariably leads to the question: "What do you mean by scale?" The research and literature review conducted in preparation for the Scale Academy identified multiple definitions used by the industry.[5] For the purposes of the Scale Academy, scale describes the goal of serving large numbers of individuals. In addition, it incorporates

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[3] Elaine L. Edgcomb and Joyce A. Klein, *Opening Opportunities, Building Ownership: Fulfilling the Promise of Microenterprise in the United States.* (Washington, D.C.: The Aspen Institute/FIELD, February 2005), 16.

[4] Grantee members include:, ACCION New Mexico•Arizona•Colorado, ACCION USA, ACEnet, Justine Petersen, Mountain BizWorks, Opportunity Fund, and WESST Corp. Learning Group members include: ACCION Chicago, Appalachian Community Enterprise, Mercy Corps Northwest, Mercy Corps/MicroMentor and Renaissance Entrepreneurship Center. Microbusiness Development Corporation of Colorado was funded in the first year of the Academy, but has since ceased operations. More on these organizations can be found at: http://fieldus.org/Projects/ScaleAcademy.html; Internet.

[5] "FIELD-AEO Scale Survey Findings," (Washington, D.C.: The Aspen Institute/FIELD, 2006), 3. A survey of 135 microenterprise practitioners found that, while a majority defines scale as the number of clients served in a given fiscal year (73.9 percent), many also define it as market penetration, cost-efficiency, loans outstanding, organizational size as defined by budget and in other ways.

the concepts of increased market penetration, and of achieving economies in service delivery, which, in turn, can lead to greater organizational sustainability and deepened social impact. Academy founders and participants also envisioned that scale is about transformative rather than incremental growth, and that it involves a significant departure or leap forward in an organization's way of doing business. The grantees selected were judged to have already made significant progress in increasing their scale and to be pursuing strategies with the potential to yield further significant advances.

The Context for Scale

One important lesson from the first years of the Scale Academy is that an organization's ability to reach scale will be deeply affected and conditioned by the context in which it operates. One of the significant changes that occurred since the launch of the Scale Academy is the eruption of the twin crises in the financial markets and in the U.S. economy. Interestingly, some initial warning signs of these emerging problems surfaced in early discussions among the Scale Academy grantees, perhaps a year before the crisis hit. Even then, Academy microlenders were beginning to see increasing numbers of clients burdened by heavy levels of consumer and, in some cases, mortgage debt. While these lenders were accustomed to taking on risk that traditional lenders might not, the levels of debt were significant enough to raise questions about whether — or what level of — debt would be appropriate for these entrepreneurs. Lenders were also seeing existing loan clients who were struggling to meet mortgage payments that had escalated.

As the crises have worn on, lenders have experienced shifts in demand that are challenging. In some instances, demand from traditional constituencies has waned as entrepreneurs, who earlier might have been planning for growth, are now seeking strategies to survive the recession. Others chose not to start or continue their businesses in reaction to news about the economy. On the other hand, microlenders saw increased inquiries and applications from two sources: entrepreneurs who previously might have been able to secure bank financing, and individuals who had lost their jobs or were looking to create a secondary source of income. Although demand from these sources increased, some of these applicants suffered from deteriorating business cash-flows because of economic conditions or presented credit reports that showed patterns of risky consumer credit management. The effect on Academy microlenders has been that they have had to work harder to make good loans. Although inquiries are up, and applications increasing, finding new clients who can manage debt successfully has been a challenge. At the same time, lenders have been forced to spend more time working to maintain the quality of their existing portfolios. The effect on existing portfolios has been apparent. As this document will discuss, most Scale microlenders have experienced increased portfolio at risk and loan losses over the time of their participation in the Scale Academy. And, while 2009 results improved over those of 2008, the rates remain higher than pre-crisis levels.

These dramatic changes in context impose constraints on programs, but they also create opportunities. While lenders are wary of providing their existing business loan products to customers who may lack the wherewithal to repay, there are efforts to provide financial literacy, and credit-building and repair products that can help these customers position themselves to be stronger loan customers in the future. Several of the lenders have increased their focus in this area. Of course, responding to these opportunities requires that lenders not only switch strategies, but also raise or redeploy resources to cover the marketing, product development, capital and other expenses associated with these additional products and services. And, in some instances, lenders found that funding commitments and opportunities were delayed or disappeared as corporate or philanthropic donors were forced to cut back because of declining earnings or endowments.

Looking to the future, the Scale Academy lenders remain optimistically, but realistically, focused on growth. A few have been able to take advantage of opportunities presented by geographic expansion or by new products to continue to grow. Others are moving forward more deliberately as they seek to contain their risk, working to build organizational capacity so that, as the economy improves, they are positioned for more aggressive growth.

The Progress Made

The microlenders entered the Scale Academy in mid-year 2007. The table below documents their scale in terms of loans made at "baseline" (the end of FY 2006), and their subsequent accomplishments in FY 2007, FY 2008, and FY 2009. As the data show, the five microlenders made 1,658 loans in FY 2009.[6] During the four-year period, the aggregate change was a positive 25 percent growth in number of loans made and 61 percent growth in total dollars outstanding.

All of the microlenders showed positive growth in the total dollars outstanding from 2006 to 2009, and four of the five institutions achieved positive growth in the number of loans disbursed. The fifth, ACCION USA, experienced a decline in the number of loans from its starting point in FY 2006 and from its subsequent peak in FY 2007. Its lower results stem from two primary factors: the intensity with which the financial and economic crisis affected several of its target markets and the work entailed in merging ACCION USA with ACCION New York.[7]

The percentage growth in the number of loans made by the other four lenders ranged from 26 percent to 302 percent. These figures include all loan products provided by the microlenders, including credit-builder loans and small business loans greater than $35,000. Credit-builder loans have become an important part of the portfolio of several organizations, most notably Justine Petersen, which made 219 of these in FY 2009. This indicates the extent to which the organization has expanded its product mix in response to client demand and to its own assessment of which type of financing would most benefit clients.

Table 1: Loans Disbursed and Outstanding By Microlender

		FY 2006	FY 2007	Percent Change (2006-07)	FY 2008	Percent Change (2006-08)	FY 2009	Percent Change (2006-09)
ACCION New Mexico•Arizona•Colorado	Loans	92	134	46%	196	113%	370	302%
	Outstanding Portfolio (M)	$6	$3.3	-45%	$3.1	-48%	$6.7	12%
ACCION USA	Loans	915	1,086	19%	739	-19%	629	-31%
	Outstanding Portfolio (M)	$5.4	$7.8	44%	$6.6	22%	$10.6	96%
Justine Petersen	Loans	171	230	35%	295	73%	457	167%
	Outstanding Portfolio (M)	$1.2	$1.5	25%	$2.1	75%	$2.3	92%
Mountain BizWorks	Loans	31	67	116%	67	116%	51	65%
	Outstanding Portfolio (M)	$0.6	$1.0	67%	$1.6	167%	$1.8	200%
Opportunity Fund	Loans	120	179	49%	148	23%	151	26%
	Outstanding Portfolio (M)	$1.3	$2.6	100%	$2.1	62%	$1.9	46%
	Total Loans Disbursed:	1,329	1,696	28%	1,445	9%	1,658	25%
	Total Outstanding (M)	$14.5	$16.2	12%	$15.5	7%	$23.3	61%

[6] The data in this table for FY 2008 have been amended from that reported in *Findings from the Scale Academy - Forging Ahead: Early Lessons* (Washington, D.C.: The Aspen Institute, 2009) based on additional cleaning of the numbers of loans made. The number of loans made by ACCION USA has been changed from 811 in the early report to 739. See http://fieldus.org/Publications/ScaleApril09.pdf; Internet.

[7] ACCION USA merged with ACCION New York in June 2008. The organization grew its overall portfolio size from $6.6 million to $10.6 million, but slowed its new lending considerably as a combined organization through the latter part of 2008 and most of 2009.

Among the Scale Academy lenders, ACCION New Mexico•Arizona•Colorado and Justine Petersen achieved the largest, and most dramatic increases in loans. ACCION New Mexico[8] experienced the largest percentage increase in the number of loans — growing by over 300 percent — because of two factors:

- A low baseline for the organization: in 2006, the institution was just emerging from a slowdown in lending resulting from an institutional decision to take a strategic pause in its operations,[9] and
- A subsequent expansion into neighboring Arizona and Colorado.

Justine Petersen reported the greatest absolute increase in the number of loans made on an annual basis and the second largest increase in percentage terms. The organization has grown both its microenterprise lending and credit-building portfolios consistently during the course of the past four years.

The largest increase in the value of the total portfolio was experienced by ACCION USA — the result of the merger of two portfolios, as well as a large active lending program throughout many years. And, although the institution has reduced the number of loans made during the past two years, its annual production remains the highest among the Academy lenders and is 38 percent higher than the next highest producer.

Despite this longitudinal progress, the numbers also illustrate the toll that the slowing economy has taken on three of the lenders, which have experienced either a flattening or decline in their microlending in the past two years. This slowing has been a source of disappointment for these institutions, but all see it as a considered response to the difficult context. And, given several examples — both in the U.S. and overseas — of microenterprise organizations that have experienced crises after explosive growth, the grantees are consciously focusing on maintaining quality in their portfolio and program services and achieving a balance between sustainability and scale.

A second way to assess the results of the Scale Academy microlenders is to compare them to those of the industry as a whole. Although comparative data on non-Academy lenders is not available for 2009, a recent survey captured information on the 2008 performance of 164 other microlenders across the country. These data demonstrate the size of Academy members relative to others in the field. The table below reports the median number, and dollar value, of loans disbursed, and the median dollars outstanding for the Scale Academy microlenders and for the other lenders. As can be seen, the differences are stark. The median number of loans made by the Scale Academy lenders is 16 times that of survey respondents; the median dollars disbursed is nine times that of the respondents; and the median total outstanding loans is almost seven times that of the respondents. Strikingly, while the 134 non-Academy lenders that reported on loans disbursed collectively made 4,142 loans in FY 2008, the five Scale microlenders alone made 1,455 loans — equal to a third of the total produced by the non-Academy lenders.[10]

Table 2: Loans in FY 2008 (Median Values)

	Loans Disbursed	Dollars Disbursed	Total Outstanding
Scale Academy (n = 5)	196	$1,665,472	$2,100,000
Other Microlenders	12	$178,471	$310,064
(number microlenders reporting)	n = 134	n = 131	n = 164

[8] For simplicity, ACCION New Mexico•Arizona•Colorado will be identified as ACCION New Mexico after its first introduction in each chapter.

[9] For a full discussion of this strategic pause and what ACCION New Mexico achieved as a result of it, see *FIELD Forum* No. 23, "The Organizational Foundations of Sustainability," (Washington, D.C.: The Aspen Institute, 2009); available from http://fieldus.org/Publications/FieldForum23.pdf; Internet.

[10] Data collected by FIELD as part of a field-wide survey on microenterprise development organizations in late 2009. The survey collected descriptive and performance statistics on the industry based on 2008 performance. A total of 369 organizations are documented in the survey, of which 250 are lenders. Of those, 134 provided at least some data on the size of their lending. Complete data findings are forthcoming.

Although trend data for the years 2006 to 2008 are not available for the overall field, MicroTest does have longitudinal data for 20 other microlenders for this time period.[11] During the three years, the five Academy microlenders increased the aggregate number of loans disbursed by 9 percent,[12] while the 20 others tracked through MicroTest experienced an aggregate increase of 2 percent. On the other hand, the aggregate value of outstanding loans for the MicroTest organizations increased 20 percent, while the Academy microlenders' aggregate portfolio increased by only 7 percent. Although four of the five Scale organizations experienced growth in their portfolios, ACCION New Mexico's portfolio declined by almost half because of its intentional slowdown in lending, discussed above.

Median data from MicroTest also illustrate that during the period from 2006 through 2008, non-Academy programs were much smaller and generally had flat performance compared to Academy lenders. The charts below compare the change in medians over those years for the two groups of organizations. They illustrate the higher base at which the Scale microlenders started and the more substantial growth in that group. Although challenges have prevented Academy members from meeting their own expectations, they still have demonstrated a scale, and pace of growth, that few others can match.

Chart 1: Median Number of Loans Disbursed

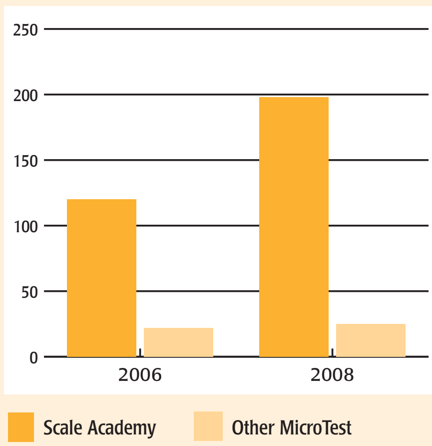
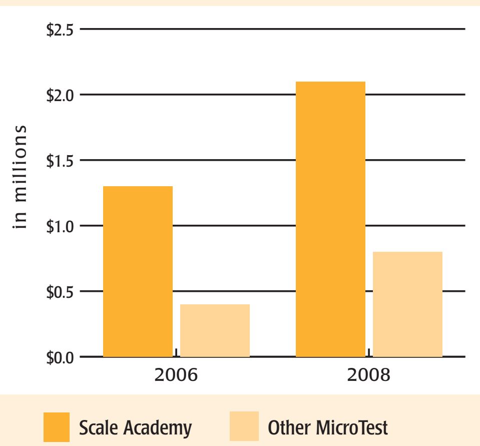


Chart 2: Median Dollar Value of Loans Outstanding



The following pages summarize the experience of the Scale Academy microlenders during the past three years and offer lessons for practitioners and funders based on that experience. Discussions focus on the microlenders' efforts to understand and reach out to new markets, develop new products and services, improve their underwriting, manage risk, capitalize their programs and structure themselves for scale. Although these institutions would argue that they still have much to learn about the path to scale in the United States, their experiences offer guideposts to others that have not advanced as far along on the journey.

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[11] MicroTest, an initiative of FIELD, is a management tool that empowers microenterprise practitioners to gauge and improve the performance of their programs and the outcomes of their clients.

[12] By the end of 2009, as discussed above, aggregate loan production had increased 25 percent from the baseline year of 2006. This was largely attributable to the efforts of two of the microlenders, ACCION New Mexico and Justine Petersen.

Market Research and Marketing

The microenterprise field in the United States emerged in response to several influences — the women's movement, which raised awareness of the barriers women faced in becoming business owners; the international microfinance industry, which demonstrated the power of small loans to assist informal entrepreneurs; and experimental and demonstration work designed to find new approaches to helping the unemployed and those on welfare. Early practitioners believed strongly in the need for innovative strategies that would empower individuals to leave poverty and achieve self-sufficiency through self-employment, and that there were many, many individuals who would eagerly seek financing, training and technical assistance to follow this path.

Early efforts to quantify the potential market for microenterprise services suggested that these practitioners were right. Research suggested that there were 10 million individuals who met the profile of those who could benefit from services: people lacking access to commercial credit, living on low incomes, or facing other challenges in the labor market due to their ethnic or racial status, gender or other factors.[13]

But, as programs opened and matured across the country, it became clear that this conceptual understanding of the market was inadequate for helping practitioners scale to serve more than modest numbers of entrepreneurs. As microlenders have grown, they have generally reached a plateau in their individual markets, either exhausting the easiest-to-reach entrepreneurs who may be geographically close, or who become aware of their services through proven outreach strategies (such as referral partnerships with local technical assistance organizations or local banks). Going beyond those numbers requires that programs truly become demand-driven, that is, driven less by a general understanding of what programs believe aspiring entrepreneurs need, and more by a very specific understanding of what these entrepreneurs think they *need, want, and are willing to pay for* to advance their businesses. It also requires finding ways to communicate effectively with a market that is complex, fragmented, dynamic and often difficult to access.

As a result, microlenders interested in scaling have invested considerable resources in market research and marketing. The experience of Scale Academy microlenders shows the value of doing this, as well as the challenges. These microlenders have invested in a variety of strategies, which illustrate the range of approaches that can be used and the need for an iterative approach. Their efforts demonstrate the need to continuously employ nuanced market research strategies and invest in pilot initiatives that test marketing approaches.

Researching the Market & Testing Strategies

The Scale Academy microlenders have used five key market research strategies. Each has resulted in actionable insights, but none has provided the complete answer on how to reach the market. Their experience underscores a critical fact that practitioners must recognize: that the microenterprise market is a segmented market, and distinct segments may require different products, services or outreach strategies.

Sectoral Analysis

Opportunity Fund has implemented several types of market research. In the organization's first effort, staff members identified several sectors that appeared to be dominated by microentrepreneurs and, in their experience, were likely to benefit from Opportunity Fund's services. The sectors included day-care providers, massage therapists, landscaping firms and small-scale contractors. Studying these sectors, it was hoped, would allow the organization to

[13] Edgcomb and Klein, *Opening Opportunities,* 14-16.

identify specific outreach strategies and market channels, and to create focused messaging and refined products for each. The research identified the greatest opportunities with day-care providers and massage therapists. In both cases, market channels were few and clear (e.g., state day-care licensing entities), and product adaptations were easy to design. In contrast, research and pilot outreach revealed that landscapers and small contractors would be difficult to reach, because these sectors are more diffuse and the channels much less clear.

Behavioral Analysis

Opportunity Fund also employed behavioral analysis with the goal of achieving more depth in current markets. Working in partnership with San Jose State University, the organization used ethnographic research on a sample of successful clients to identify the "Ideal Client Profile." The research identified a few key ingredients for success among this cohort: a deep willingness to learn and the presence of a precipitating event that motivated an individual (such as job loss or birth of a child). These factors often impelled clients to focus intently on growing their businesses and challenged them to be less risk averse.

Opportunity Fund is now working to aggregate the information from both types of research and to segment clients according to a number of factors — sector, income level, ethnographic type and geographic location (commercial hub focus) — with a view to devising specific outreach strategies around those segments.

Product Development Research

ACCION New Mexico•Arizona•Colorado conducted qualitative interviews and focus group research with clients and loan applicants to develop and pilot an "empowerment loan" designed to change credit behaviors.[14] The organization has also looked for inspiration to products offered by another Academy member, Justine Petersen. ACCION USA contracted a market research company to conduct focus groups with underbanked Hispanics. The aim was to test financial education curricula for building credit. The focus groups also informed the messaging for the advertising campaign when the curriculum and loan product were launched.

ACCION USA marketing staff also conducted its own desk research and some informal focus groups to develop the concepts for a green loan product, women-focused programming and 'alternative financial products' programming for launch in 2010 and 2011. Additionally, ACCION USA tapped a self-governing, all-volunteer group of young, New York professionals, called the "The Microfinance Council," to conduct more in-depth research in these particular areas.

Partner Research and Pilots

ACCION USA's market research also explored potential market channels to reach more borrowers. The goal was to identify for-profit and nonprofit entities that could serve as marketing channels or delivery agents for ACCION USA loans by tapping into its on-line platform. The organization used the following criteria to identify potential partners: an organization's 'embeddedness' in the local community, the potential for volume given local demographics, and a similar or aligned vision for reaching the small business community. The research led to three pilots, conducted more or less simultaneously from 2006 to 2008. ACCION USA launched a co-branded loan product with a large Puerto Rican bank, Banco Popular, worked with for-profit commercial loan brokers, and tested off-balance sheet partnerships with several different types of institutions.

Working through Banco Popular's branch network of 200 locations accessible to a large underbanked population and using bank employees as the local face of the program, ACCION USA disbursed $1.3 million to 175 entrepreneurs. But, the long-term continuance of the

[14] ACCION New Mexico no longer offers this product as its test demonstrated that the number of clients willing to meet program requirements was limited.

partnership is challenged. Changes in program leadership at the bank because of several bank restructures — and a steep recession, which hit prior to the one stateside — have impacted the quality and quantity of referrals. Furthermore, ACCION USA has not been able to replicate this model with other banks or credit unions at the same level on the mainland, and has concluded that strong buy-in by bank leadership is necessary to develop this type of programming.

The market research also identified for-profit commercial loan brokers as potential channels, and ACCION USA's pilot with this group has been more successful. Commercial brokers find financing and perform other business consulting services for their local small business clients. ACCION USA sought to screen, recruit and build a network of brokers who charged their clients fair fees and offered good customer service. In 2008 and 2009, referrals from loan brokers accounted for one-third of ACCION USA's approved Internet loans. In the organization's experience, commercial loan brokers have tended to move fast, be nimble (easily trained on new requirements), accept risk-based pricing (which has not been the case with some nonprofit partners), have their own on-line presence (to serve clients nationally or regionally), and be embedded in their local business communities. Based on this initial experience, ACCION USA is now working with a smaller set of brokers with the potential for higher volume, and is providing training on how to market and prescreen potential clients. Because this strategy depends on maintaining strong relationships with the brokers, ACCION USA is also developing a new MIS technology platform that can assist its loan officers to manage these relationships efficiently.

Finally, ACCION USA's research identified the potential of offering its underwriting services to institutions that made their own loans and kept them on their own books. ACCION USA saw this strategy as a way to learn about new markets, while earning some revenue. ACCION USA is paid a fee for its services and does not bear the risk of loss. Two such agreements — one with a community development credit union in New Orleans and the other with the Port Authority of New Jersey through a program with the Environmental Protection Agency — have allowed ACCION USA to work in specific local geographies (the Gulf region) and more deeply within a sector (short-haul truckers in New Jersey/New York). Although it remains to be seen how these partnerships will contribute to scale, the pilots have furthered ACCION USA's understanding of different segments of the microenterprise market and could be a revenue generation model benefiting its bottom line.

ACCION USA concluded from these initiatives that success requires partners with a similar vision for scale and a deep level of local community engagement, leadership that is committed for the long term, and reasonable incentives and benefits that are advantageous to both parties.

Improving Marketing Messages and Increasing Public Awareness

To reach its goal of analyzing how best to reach more entrepreneurs and develop effective messaging, ACCION New Mexico created a 'visibility committee' comprised of clients, board members, donors, and community members with expertise in advertising, marketing and communications. Staff found clients most helpful in developing messaging and with useful advertising placement. Others on the committee helped develop billboard and placard campaigns and secure local television coverage.

Mountain BizWorks has decentralized its marketing, using its marketing manager to train each of the organization's regional managers to develop and implement local marketing plans. The manager also spends time in each regional office developing relationships and generating media attention, with the goal of increasing awareness and coverage in 11 counties in addition to the Asheville area.

Other microlenders have tapped external marketing and public relations expertise, with varying levels of success. Justine Petersen enlisted a Hispanic marketing firm to reach the low-income Hispanic market, but found that its connections were with a more educated, professional community than the organization's desired target. Conversely, ACCION USA enlisted an outside Hispanic public relations consultant, who has been successful in securing both local and national media exposure with Spanish media outlets that are very popular among its target market.

ACCION USA has also implemented Web 1.0 and 2.0 strategies[15] to build awareness at relatively low cost. Staff developed content-sharing partnerships with Univision.com and AOL Latino (both among the most popular Spanish language Web sites in the U.S.) to increase referrals and overall brand awareness as Internet use among Hispanics grows. Staff writes financial education articles and provides client story illustrations for the partner sites. Through this work, the organization has increased its Web traffic by 12 percent. In addition, a search engine optimization consultant advises the staff regularly on key word rankings and strategy, optimizes its Web content to ensure key word inclusion, and posts content on article directories. All of these efforts are consistently and incrementally helping to build more traffic on the Web site.

Opportunity Fund and ACCION USA are actively using social media strategies. Both have launched blogs using volunteers or multiple staff members to produce regular content. Both are also currently experimenting with YouTube, Facebook and Twitter accounts. ACCION USA has also developed a series of podcasts of client stories, and financial education segments geared toward both clients and donors.

Opportunity Fund and ACCION USA's new partnership with Kiva, an international on-line person-to-person microlending Web site, has also drawn potential clients and supporters. On launch day in June 2009, ACCION USA's Web site received more than 3,000 hits (as opposed to the normal 800) and received over 100 on-line loan applications. Opportunity Fund had a 500 percent increase in inquiries, 300 percent coming from its target counties. Only a handful of these applications or inquiries have, at this point, converted into loans. But, perhaps more significantly, the Kiva partnership is rapidly creating more general brand awareness for U.S. microenterprise. In less than six months, the site has already generated approximately 14,000 distinct Kiva lenders funding U.S. borrowers from these two organizations.

Finally, ACCION USA has also experimented with "cause marketing"[16] in its evolving relationship with Sam Adams (The Boston Brewing Co.). The two organizations created a co-branded marketing campaign, *Brewing the American Dream,* to target microentrepreneurs in the food and beverage industry. The strategy has shown potential in terms of both generating public relations and in converting new clients.

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[15] The term "Web 2.0" is commonly associated with Web applications that facilitate interactive information sharing, user-centered design and collaboration on the World Wide Web. Examples of Web 2.0 include Web-based communities, hosted services, Web applications, social-networking sites, video-sharing sites, wikis, and blogs.

[16] "Cause Marketing" refers to a type of marketing involving the cooperative efforts of a for-profit business and a nonprofit organization for mutual benefit. Cause marketing differs from general philanthropic corporate giving in that the latter generally involves a specific donation that is tax deductible, while cause marketing is a marketing relationship generally not based on a donation.

LESSONS FOR SCALE

These experiences suggest several lessons for microlenders and funders:

- General market research (on potential numbers of microentrepreneurs, for example) is too global to provide directional guidance to programs. Scaling programs need to understand specific market segments and specific market channels.

- Market research must be continuous. Each research effort will reveal insights or promising paths to test, and testing will identify some winning approaches and some that are not fruitful. Microlenders cannot expect that one research effort alone will produce the key to scale. So market research needs to be seen as a necessary, ongoing function within the organization.

- Market research needs to be done in tandem with pilot tests of the promising strategies. The process should be iterative: research, testing and implementation of positive results; then more research, testing, etc.

- Microlenders should expect to use both staff and external resources to develop effective research and marketing strategies. However, not all marketing professionals are alike. It is important that expertise tapped has a deep understanding and connection to the specific target markets the organization is trying to reach.

- The challenge with new media is keeping content current and fresh to build a following. Organizations looking to use Web 2.0 strategies need to make sure they have the necessary staff resources in place to do so. While some emerging best practices suggest a blog should have one viewpoint and writer posting one to two times per week, some microlenders use several bloggers to make it more feasible for their stretched organizations.

- Market research and marketing demand investments that are often difficult to fund. Yet, having these resources is essential to better understanding the microenterprise market, and to increasing penetration to those who can benefit from microloans and other services. There is a role for funders in supporting these key, infrastructural investments. There also may be an opportunity for microlenders to take better advantage of scarce resources through collaboration. Recent social media initiatives employed by Scale Academy lenders have helped raise awareness of the field and could prove promising. Microlenders could also collaborate in developing tools for market research or in joint research on market segments common across several geographies.

Loan Products and Pricing

A microlender's suite of loan products, and the prices it charges for those products, is obviously a critical component of the scale-up process. For many years, the U.S. microenterprise industry has talked about product differentiation and innovation as a key to scale. But, to what extent does a broad set of differentiated products drive or support scale? Furthermore, it has been assumed that as microlenders scale, the income earned from their lending activities can be used to support future growth. However, this depends on the extent to which prices cover, and even exceed, the costs of lending. What is the experience of the Scale Academy members with costs and pricing?

Loan Products

Table 3 identifies the loan products offered by the Scale Academy lenders in 2008 and 2009. It indicates that the Scale Academy grantees have depended largely on a few core loan products to scale up, growing their volume by increasing the market penetration of those products and/or by deploying those products in new geographic markets. In fact, about 80 percent of the loans made by these lenders in 2008 were their core microloan products (mostly term loans, some lines of credit). Several also fueled portfolio growth, by increasing their loan limits (sometimes to include small business loans up to $150,000 to $200,000) and thereby their average loan size. While this latter strategy does not necessarily involve creating a new product, it requires building the capacity to underwrite and manage more complex loans.

That scaling lenders are driving growth through a set of core products makes sense, as focusing on a few key products allows for standardization that can drive increasing efficiency. However, the fact that much of the growth in loan portfolios has come from core products does not mean that these scaling microlenders have not engaged in new product development. In fact, during the three years of the Scale Academy, the microlenders have created at least 12 new loan products. The development of these products has been driven by several factors, including the interests and requirements of funders and the extraordinary and changing market conditions that began to emerge in 2008.

The experience of the Scale Academy microlenders raises an important question regarding loan products: how do these organizations define their products, and, when is a product "new?" The answer varies across the group. Since many funders require that their funds be segregated or targeted in a specific manner, some lenders define their products according to funding source. The addition of a new source results in a new "product," even though the terms of the product may not vary significantly from the organization's existing products, and it may not be marketed to clients in a distinct way. Other lenders define or identify their products by target markets: as "green loans," or as loans targeted to a specific geographic market or demographic groups (again, these often might also be linked to a particular funding source). Finally, at least one lender defined a product as "new" if it involved different terms (for example, with respect to interest rate or underwriting criteria) from its existing products. The differences in how lenders define their products are evident in Table 3.

Table 3: Scale Academy Member Loan Products

PRODUCT NAME	PRODUCT DESCRIPTION	PRODUCT PRICING
ACCION New Mexico•Arizona•Colorado		
Unsecured Credit Step and Secured Credit Step	$200 unsecured and secured credit-building product	Unsecured: 18% interest rate; $35 fee rolled into loan, 6-month term
ACCION Connect Loan (unsecured)	Small $200 term loan targeted to a broader market (not only thin file clients) that currently do not meet scorecard requirements for a larger loan	Unsecured: 18% interest rate; $35 fee rolled into loan, 4-month term
Empowerment Loan	$600 secured product for those who have overspent and would like to correct credit behavior	Secured: 18% interest rate; $10 fee rolled into loan, 6-month term
Term Loans	$200-$150,000 range for standard loan products	10.5% - 18% interest rates; fee 2% - 9% of loan amount
Lines of Credit	$35,000- $150,000. Same as term loans, with interest-only payments for 12 months, can be fully revolving or pay-down	10.5% - 12.5% interest rates; fee 2% - 5% of loan amount
ACCION USA		
General Loans	Variety of loans that range in size from $700 – $50,000 for various purposes, including building credit, vehicle purchases, startups and general business financing	Fixed interest rates of 8% - 15%; closing fee of 3% - 5% (depending on loan size)
Secured Loans	Loans for which a third party provides 100% cash collateral on the loan	Fixed interest rate of 8% and 5% closing fee
Kiva Loans	Loans of $10,000 or less for which entrepreneur is willing to have his/her picture and profile posted on Kiva.org	Fixed interest rates of 8% - 15%; closing fee waived for now
Abilities Fund	Loans for entrepreneurs with physical or other disabilities	Fixed interest rate of 12.5% and 4% closing fee
UMEZ Loans (NY)	Loans for businesses or residents of the Upper Manhattan Empowerment Zone	Fixed interest rates of 6.99% - 9.99%; closing fee of 3% - 5% (depending on size)
BEZ Loans (NY)	Loans for businesses or residents of the Bronx Empowerment Zone	Fixed interest rates of 6.99% - 10.99%; closing fee of 3% - 5% (depending on size)
Green Cart (NY)	Loans for entrepreneurs seeking to finance their fresh fruit and vegetable cart	Fixed interest rates of 6.99% - 9.99%; closing fee of 3% - 5% (depending on size)
CAP Access (NY)	Loans for entrepreneurs willing to participate in City's CAP Access program; these loans carry a 35% guarantee	Fixed interest rate of 8%; closing fee of 2% and sliding scale guarantee fee of 1%
Justine Petersen		
SBA Microloan	Term loan with strict amortization, capped by SBA spread	Interest rates of 8.75% - 10.5%; $100 loan origination; $8.33/mo servicing
CDFI Microloan	Non-traditional amortization, often balloon	Interest rates of 10% - 12%; 2% origination; $8.33/mo servicing
Credit Builder Loan	$150 loan to establish or re-establish credit, repaid $15/mo for 12 months	$30 flat fee
Credit-building loans	Piloting unsecured CBL and business builder loans, which include $200 deposit on secured credit card. Financed Credit-building Services included	Interest rate of 10.75%
JOLI	Low-income borrower, TANF/Ex-offender. Goal of job creation	Interest rate of 8.75%; $100 loan origination; $8.33/mo servicing

PRODUCT NAME	PRODUCT DESCRIPTION	PRODUCT PRICING
Justine Petersen *(continued)*		
Green Loan	Socially- or environmentally-friendly business	Interest rate of 10%; $100 loan origination; $8.33/mo servicing
SWIDA	Located in Madison or St. Clair County; store-front operations (not home-based businesses)	Interest rate of 10%; $100 loan origination; $8.33/mo servicing
Mountain BizWorks		
Term Loan	Up to five-year term, interest-only periods geared to seasonal cash flow of business or at front end of loan to start-up business	Interest rates of 8% - 12.25%
Line of Credit	12-month facility with interest only payments until maturity	Interest rates of 8% - 12.25%
Line of Credit (Borrowing Base)	Borrowing base geared to a percentage of eligible accounts receivable, base may include percentage of finished goods inventory	Interest rates of 8% - 12.25%
Short term loan	Terms set at maximum of 12 months	Interest rate of 8%
Opportunity Fund		
Credit Builder Loans	$1,000 or $2,000 with loans up to $5,000 for specific industries like flea market; no TA/meeting with Business Advisor; many loans to people with part-time businesses and outside income	Interest rate of 8%; loan fee $50 - 150
Microloan	Standard loan product $1,000-10,000; TA/meeting with Business Advisor required	Interest rates of 6.25% - 8.25%; Loan fee $50-250
Small Business Loan	Loan product from $10,000 up to $200,000; TA/meeting with Business Advisor required; approved by loan committee	Interest rates of 6.25% - 8.25%; Loan fee 3%
Day-Care Loans	Loan product with special rates and tailored TA for child-care providers	Interest rate of 5%

Funder-Driven Product Development

Product development by the Scale Academy lenders has sometimes been driven by funders interested in reaching a particular target population, often with specific product features or policy goals in mind. For example, ACCION USA has created several products targeted at specific sectors or neighborhoods in its New York market, driven by funders interested in a particular policy goal. These include loan products for residents or businesses located in the Upper Manhattan and Bronx Empowerment Zones, each of which carries a reduced interest rate; its "Green Cart" loan targeted at fresh fruit and vegetable vendors in the City of New York; and its participation in the "Truck Replacement Program" aimed at short-haul truckers working at the New York and New Jersey Port Authority sites.

New loan products that vary significantly from a lender's core offerings pose interesting questions and challenges for microlenders interested in scale. On the one hand, these new products can attract new funders, or help to retain a donor interested in a new twist on its giving to the organization. In ACCION USA's case, several of its new loan products brought new funders to the table at a time when the organization had exhausted its capital available for lending in the New York market; these new products provided capital that enabled it to continue to grow its portfolio. Funder-driven products can also offer the opportunity to meet other important social objectives, such as supporting environmental goals or reaching a particular group in need.

On the other hand, any distinctly different product will necessitate the development of new capacities in the organization — be they new marketing strategies and efforts, new partnerships to reach new markets, perhaps new underwriting and risk management skills and policies, and of course new reporting requirements. Building these capacities involves costs. The management and administrative complexity that new products bring may detract from the standardization that leads to greater efficiency, a key ingredient to achieving greater scale. In part for these reasons, ACCION New Mexico•Arizona•Colorado's scale strategy has always focused primarily on geographic expansion rather than new product development.

Market-Driven Product Development

Product development among the Scale Academy lenders has been driven by the market — or customers — as well as by funders. The most significant evolution in this area has been in the development of credit-building loan products. Both market research and the economic recession revealed the fact that many potential loan clients had poor, deteriorating or no credit profiles. This trend suggested to lenders the need to add products that could help build or re-build credit, and that include financial education and other support for behavior change. To date, four of the Scale Academy lenders offer some type of credit-builder or credit-step loan. One lender in particular has seen significant uptake of its credit-builder loans, which are building its overall microfinancing portfolio. And, although for the most part these are not business (but rather consumer) loans, as is described in the section on financial literacy and credit building, these lenders are looking to connect these products more explicitly to their business loans.

Loan Pricing

Businesses typically base their prices on a combination of factors that include costs, competition, and positioning. Pricing has been a highly challenging issue for microlenders in general; this challenge holds true for the Scale Academy microlenders as well. The central issues lie in four areas: pricing constraints imposed by funders; a lack of good market data on customer responses to varying interest rates; limited information about the costs of their individual loan products; and varying values as to the extent to which microloans should be subsidized.

As Table 3 indicates, the interest rates charged by the lenders range from 5 percent to 18 percent. Closing fees vary; some charge flat fees that range from $35 to $250 (typically based on the size and nature of the loan); others charge a percentage fee that ranges from 2 percent to 7 percent. One of the lenders also charges a monthly servicing fee of $8.33; this relates to the particular terms of its primary source of loan capital. Each of these lenders would agree that these rates and fees reflect a pricing scheme that does not reflect their actual risks and costs of lending. In 2008 the level of cost recovery for their microlending operations — which reflects their operational costs, their cost of capital, and net loan losses — ranged from 13 percent to 31 percent across the five lenders. And, in fact, these lenders have seen cost recovery either decline or remain flat over the three years of participation in the Academy. This is due to a range of factors, including growing loan losses brought on by the economic recession and increased costs associated with expansion strategies. However, as described below, pricing is also a key factor affecting the level of cost recovery.

Funding Streams and Pricing

Funding sources play a critical role in loan pricing, just as they do in the development of loan products. The most influential funder in this light is the U.S. Small Business Administration's Microloan Program (MLP). Although the Microloan Program has provided important capital (and financial support for technical assistance) to many of the Scale Academy lenders, at least one lender has voiced the concern that it is impossible to scale an organization by relying on Microloan capital. This is because the margin between the costs of running the program and the revenues generated is simply too large, and, therefore, as the portfolio grows, so does the amount of subsidy that the organization must raise annually.[17] Under Microloan program guidelines, lenders can charge an interest rate not more than 8 percent greater than the cost at which they borrowed the funds. They are also limited in the fees that they can charge to borrowers. Interestingly, because of these program requirements and others, until late in 2009, only two of the five Scale Academy lenders had elected to participate in the Microloan program. Two more have since elected to take part, due, in part, to the fact that the recession led to constraints in other sources of loan fund capital and because the rates to borrow from the Microloan program had dropped to almost zero. However, as a group, the lenders remain concerned about the extent to which participation in the program will support their goal of scale.

Although — given its national scope — the MLP may be the most influential funder in regard to pricing, other funders also influence the price of loans. Often local funders will provide capital that is structured to "buy down" the interest rate charged to a targeted group of borrowers. ACCION USA's Empowerment Zone products fit this model, as does Opportunity Fund's Child-Care Loan. In some cases the lower interest rates offered on these loans reflect the particular dimensions of the targeted sector (i.e., the low margins in the child-care industry); in others, the funders are hoping to incentivize behaviors in which the entrepreneur might not otherwise engage.

Staff and Borrower Perceptions about Pricing

Beliefs about borrower and local market perceptions also influence pricing. Most of the Academy lenders acknowledge, however, that these beliefs are not necessarily validated by or based on market research, which, as discussed in the earlier section on market research, is often limited by funding constraints. Rather, staff members often bring their own perceptions that customers will resist certain interest rates. Several lenders note that staff members are often apologetic when describing their rates and fees to potential clients — even though they are well below that charged by other lenders to whom those individuals might have access (credit cards, payday lenders, etc.). One lender noted, "When we are considering a new product, often one of the first questions raised by staff is 'Can we find a funder to buy down the interest rate?'" Another lender noted that although they have made an explicit attempt to educate staff about the need to move toward prices that are more reflective of their costs and risks, as staff turns over, the lender often finds the need to revisit the issue, so it becomes an ongoing dialogue within the organization.

All of the Academy lenders acknowledge the need to better understand, and, in some cases, to influence, their potential borrowers' attitudes towards pricing. ACCION New Mexico noted that the recent public discussions about predatory lending have cut two ways: on the one hand, potential borrowers are more aware of the damage that working with those lenders can cause; on the other, they are much more focused on interest rates charged by any lender. When its market research revealed that potential customers were more sensitive to interest rate than the total cost of borrowing, the organization moved to cover more of its costs through lending fees rather than the interest rate. Mountain BizWorks uses its training programs to provide its clients with a much more grounded understanding of the costs of capital.

Costs and Pricing

Prices should be linked to lending costs. Yet, here again there are challenges. Although most lenders have a good handle on their total lending costs, they typically lack detailed information, both on the costs associated with individual loan products, and with specific components of their lending process. The former problem stems in part from their accounting systems: it takes time and resources to create good cost-accounting systems, while also meeting funder requirements to account for expenditures by source of funding. But, such information is essential not only for

[17] According to these lenders, two other factors have also limited the utility of the MLP to organizations seeking to scale. These are the dollar limit on the amount that can be borrowed under the program (although this limit was raised in 2009) and the fact that an organization must raise a 15-percent cash loan loss reserve for each dollar lent.

pricing, but also for making informed decisions about whether new products are a net benefit or a net drain to the organization. Lenders would also benefit from knowing the costs associated with specific elements of their lending processes — such as the costs of marketing, underwriting, collections, and so forth. As one Scale Academy lender put it:

> *"In every business that I know about, knowing what it costs to acquire a customer is a fundamental piece of information; but we don't know what it costs to acquire them, [nor] what the benefit is to keep them; whether it costs us a lot or a little, whether the longer we keep them, the better off we are."*

Several Scale Academy lenders have moved to outsource parts of their lending process using ACCION Texas' Microloan Management Services (MMS™).[18] This move will enable them to have a more explicit sense of the costs of those elements of their lending process.

Although a better understanding of costs would help lenders to improve their pricing — and, perhaps, lead many to raise their prices, if possible — most would agree that this understanding would also support greater efficiency. Lenders do not want to pass inefficiencies on to the borrowers, but rather want to develop as efficient an operation as possible. For example, as ACCION USA worked to unpack the costs of its lending process, staff learned that reducing delinquencies was more beneficial to the bottom line than making more loans, and that the organization would earn more by improving the efficiency of its lending. This experience reinforces the important point that achieving scale is not only about making more loans. The organization found that in its overwhelming drive to make more loans, loan officers were spending hour after hour trying to make a loan, negotiating loan amounts with the underwriters, assessing the right pricing — and then losing the loan. Since then, ACCION USA has revised its statistical scorecard to have clearer underwriting guidelines, and required greater adherence to the scorecard. This, in turn, has reduced those time expenditures and costs. Better knowledge about costs has allowed ACCION USA to move toward an organizational structure in which the prices it charges may come closer to the costs incurred in making loans.

Pricing and Subsidy

Conversations about loan pricing among the Scale Academy lenders also reveal the importance of organizational values and perspectives regarding subsidy to decisions about pricing. Here "subsidy" reflects the extent to which the costs of lending are borne by funders — either private or public — versus the borrowers. Because none of these lenders is achieving break-even in their lending operations, all require some level of subsidy. However, as they think about how to approach setting prices, their values regarding the role of subsidy in microlending emerge.

In this conversation, all agreed that it is important to drive inefficiency out of the lending process — that neither borrowers nor funders should bear those costs. On the other hand, there were differences in thinking about whether, as inefficiencies are eliminated, programs should be striving to become self-sufficient. Rates and fees that fully cover the costs of lending would be higher than those paid by borrowers accessing traditional sources of capital, and some lenders questioned whether it is fair for microenterprise loan clients, given their lower incomes, to pay higher prices than those who are more affluent. While some believed that some subsidy should be provided, others noted that the argument for subsidy is less clear if one acknowledges that most subsidy is financed by the taxpayers; that clients and funders also pay taxes; and also that, in some programs, clients also become donors. Even those disposed to more use of subsidy note that it is important not to let the availability of subsidy lead to laziness in attacking potential inefficiencies in the system.

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[18] The ACCION Texas Microloan Management Services uses credit scoring to underwrite loans and is based on analysis of the loan performance of thousands of borrowers. For more information visit http://www.acciontexas.org/mms.php; Internet.

Furthermore, raising subsidy requires the investment of resources by the lender.[19] One Academy lender noted that while fundraising activities were important in creating connections to the local community, if they were able to divert resources invested in fundraising to marketing, they might be able to substantially increase their volume — if the increase in prices required to forego fundraising would not negatively impact demand. This discussion reinforces the earlier point that better information about borrower sensitivity to pricing is essential to charting the course to greater scale.

LESSONS FOR SCALE

The experiences of the Scale Academy lenders suggest the following lessons:

- Advances in scale appear to result more from reaching new geographic markets or greater market penetration with core loan products, rather than through the development of new products.
- However, product development can be both important and necessary in the scale process — for meeting the needs of some new markets, for addressing the growing need for credit-building products, and for responding to donor needs (which can, in turn, open new markets and create new funders). Lenders engaging in product development need to be clear about their reasons for launching new products and understand the costs and benefits involved.
- The operations of lenders seeking to scale are significantly influenced by the multiple requirements of the myriad funding sources they must access to build lending capital. To meet these requirements, they often must develop "new" products, meet numerous accounting and reporting requirements, and set specified prices.
- Charging prices that more reflect the full costs of lending would facilitate the movement to scale. To adjust their prices in this way, lenders must "unpack" their costs of lending and also better understand and influence the price sensitivity of their clients and funders. They should also understand how their pricing relates to their own values regarding the use of subsidy. In addition, it would help if funders better understood the implications of placing limits on the interest rates and fees charged by lenders.
- Better cost-accounting systems would enable lenders both to improve pricing and to make more informed decisions about the value of new loan products. This is another area where a collective effort among lenders — in this case to develop cost accounting systems — could be useful.

[19] Clara Miller of the Nonprofit Finance Fund notes that nonprofit organizations typically engage in two lines of business: their core business of delivering the products and services related to their mission and their "subsidy business," which is the set of activities related to raising the funds required to sustain their operations. See Clara Miller, "The Looking Glass World of Nonprofit Money: Managing in For-Profits' Shadow Universe." *Nonprofit Quarterly* 12, No. 1 (Spring 2005), available from http://www.nonprofitfinancefund.org/docs/Looking%20Glass,%20NPQ%20website.pdf; Internet.

Underwriting and Decisioning

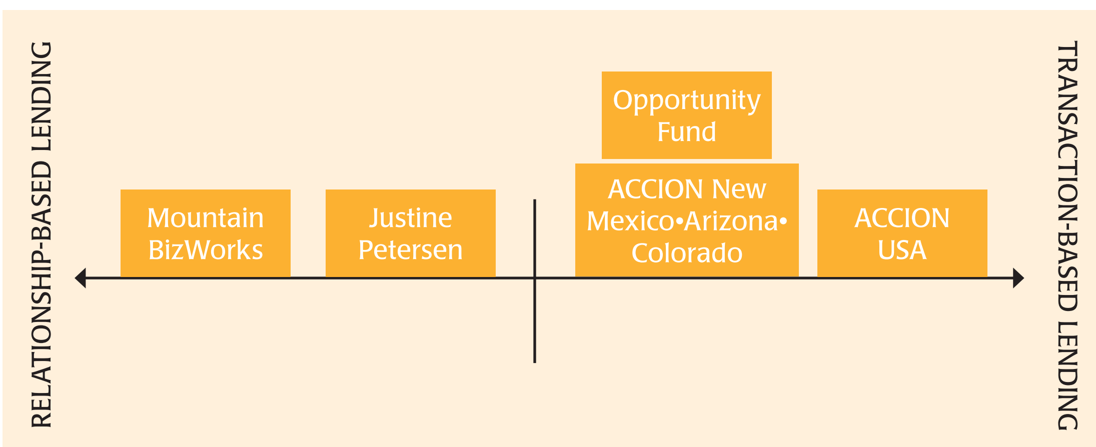
As Scale Academy lenders have grown their portfolios, they have also adapted their underwriting processes. What are the implications of these changes? The underwriting approaches used by the Scale Academy microlenders are diverse and range along a continuum from 'relationship-based' to 'transaction-based' evaluation, with none falling on either extreme end of the spectrum.

Relationship-based underwriting tends to incorporate more qualitative judgment and higher levels of client interaction in decision-making. Transactional underwriting, on the other hand, uses statistics — or quantified learning — to evaluate risk and is exemplified by the use of scoring grids or scorecards to arrive at the lending decision.

As microlenders have moved to incorporate elements of transactional analysis, they have expressed concern with having to 'give up' a portion of their client-centric process. However, is the move toward a transactional approach strictly zero-sum? If an organization is more heavily relationship-based, does it mean it cannot increase its volume of clients? Conversely, if an organization is more transaction-based, does it lose its ability to serve low-income entrepreneurs effectively? The discussion below explores the adjustments to the underwriting process made by Scale Academy lenders and how these have affected efficiency and the customer experience.[20]

Where are Scale Academy Lenders on the Spectrum?

The underwriting processes used by Scale Academy lenders fall on a continuum from completely relationship-based to wholly transactional (see graphic below). Three lenders that use statistical credit scorecards, which aim to be predictive of client risk, fall to the right of center, while the two lenders that have yet to incorporate such automated processes, lie to various degrees on the left.[21]



Drivers of Change: What Causes Modifications to the Decision-making Process?

Responses to Increased Demand

Microlenders that experience increased demand find that their customary approaches do not work. The financial crisis and ensuing credit crunch increased Mountain BizWorks' pipeline of

[20] The effects on delinquency will be discussed in the section on risk management, which follows.

[21] Opportunity Fund has recently contracted with ACCION Texas to use the Microloan Management Services and begun the shift to more transactional underwriting.

applicants substantially. In response, the organization began to differentiate functions among sales, pre-screening[22], and application development, as well as underwriting and lending. Business developers, assisted by resource specialists in each regional office, are charged with responding to inquiries, working with customers to understand their capital needs and informing them of the organization's loan requirements, and doing an initial "culling" to identify strong candidates. This separation of responsibilities has allowed the loan officers to focus their analytic skills on applications that have a higher likelihood of being funded. This approach, in which multiple staff members are involved with a client, supports Mountain BizWorks' philosophy that the entire organization, not just the loan officer, should have responsibility for the loan. Staff believes the approach also strengthens the relationship with the borrower.

Up until that time, the organization's loan officers (or business developers) had done not only sales, but also a large portion of the underwriting process. Now that the organization is seeing more applications, and applications from owners of larger businesses, who were previously "banked," management has begun to differentiate functions between their client-facing staff and others, who now are taking the substantial role in underwriting.

ACCION New Mexico•Arizona•Colorado anticipated an increase in demand in 2008 as the organization expanded its geographic service area to include Colorado and Arizona. The previous two years were spent restructuring the organization to include the rigorous use of the Microloan Management Services'[23] credit scorecard for pre-evaluation and underwriting. This system not only provided a more quantified analysis of loan applications, but also offered an on-line loan application that would support remote staff. Yet, while the scorecard offers a more transactional approach to loan analysis, over the whole of its lending process, ACCION New Mexico maintains a high-touch, hands-on approach to its engagement with customers. Loan officers do a "pre-underwriting" evaluation — including a site visit — that is an important part of the lending process. Loan officers also make quarterly site visits or calls to all clients with outstanding loans. Because the long-term performance of the client is viewed as the responsibility of the loan officer, his or her compensation is tied to the loan's performance over time.[24]

As Justine Petersen's portfolio grew, and with higher scale goals in sight, the organization adjusted its underwriting process to increase efficiency and eliminate duplicate work across several staff people. Prior to February 2009, all loan applications were manually underwritten by a committee of eight and then followed by a site visit by two underwriters (one being a senior underwriter). In the new process, a single underwriter is responsible for collecting loan documents, analyzing the loan, and making the site visit. Loan documents are then provided to the compliance manager, a new position charged with ensuring that all aspects of the underwriting process have been followed and that all documentation is complete. Subject to this check by the compliance manager, loans of up to $35,000 can be underwritten by the loan officer. Although there were challenges as staff has adapted to this new underwriting model, it has reduced turn-around time on loans by about two weeks. In addition, staff hopes that the introduction of the compliance manager will also improve portfolio quality.

Along with reorganizing staff responsibilities, the organization also created a lending grid that uses a point system to assess the strength of a loan, with the goal of reducing subjectivity in the underwriting process. Finally, Justine Petersen has also created a separate 'credit-building' division, which enables the microlending staff to move applicants with personal finance issues quickly into credit-building services (which tend to be more relationship-based). With this change, staff has noted

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[22] Pre-screening is defined here as the interaction with the client to determine preliminary eligibility, often before the formal application process.

[23] As discussed above, Microloan Management Services (MMS™) is a service offered by ACCION Texas. For more information, visit http://www.acciontexas.org/mms.php; Internet.

[24] ACCION New Mexico•Arizona•Colorado complements their use of MMS™ with a separate underwriting process for their larger loans (greater than $35,000).

cost savings and increased efficiency on the microloan side; at the same time, the use of a fee-for-service model for credit-building services has allowed for revenue generation in the new department.

Responses to Client Feedback

In client surveys conducted by ACCION USA, clients reported that a smoother loan process — with less back and forth and more up-front messaging around what to expect — was more important to their satisfaction than other factors, such as pricing. The organization has used a credit scorecard-based underwriting process to respond to that need. Similar to ACCION New Mexico, ACCION USA still requires a certain level of upfront analysis by the loan officer. However, the scorecard has eliminated ambiguity around the amount of the loan that applicants qualify for and also more quickly screens out clients who are not credit-ready. Earlier understanding of the allowable scope of the loan has eliminated much of the back-and-forth "negotiation" between loan officers and underwriters that produced a negative impact on the client experience.

Justine Petersen's changes in underwriting also have helped to speed up and provide more clarity in the lending process, from a consumer point-of-view. Similarly, Mountain BizWorks created an initial screening process for its sales staff with little lending experience, informally called the "Go-No Go" process. The technique is designed to enable staff to interact professionally with the customer, not frustrate the prospective borrower and stop the process early if a loan is not possible. Prior to implementation of this screening process, prospective borrowers completed loan packages that would not result in a loan. With coaching on how to conduct a good initial conversation and collect a few key items of information, staff members now better relay borrowers' prospects and the organization has minimized the number of unsuccessful applications.

An Evolving Market: What is Lost or Gained in the Move toward Transaction-Based Lending?

As microlenders have encountered more formerly "banked" clients among their applicants, the question of client demand for relationship-based services has confronted microlenders. For example, a senior lending officer at ACCION USA noted that these new clients did not need as much handholding as other applicants and were more interested in a clear and quick process to get the funding they needed. The organization has been able to use its scorecard-based underwriting to approve and disburse loans for strong candidates within five days.

The move to statistical scorecards has directly confronted two important tenets or beliefs within the microenterprise industry. One of these assumptions is that solid relationships between the microlender and the borrower strengthen the payment history. If that is the case, it follows that if a portion of a relationship is eliminated, portfolio quality may suffer. As lenders move toward more transactional underwriting practices, does this open up their portfolios to inherently more risk?

Both ACCION USA and ACCION New Mexico adopted a transactional underwriting model with the understanding that the statistical scorecard is based upon the accumulated knowledge of relationship-based microlending, and that the scorecard leverages that long-term knowledge to achieve a certain level of predictability. The organizations are systematically building on past experience to achieve greater efficiency. Credit grids — whether statistical scoring tools like those used by ACCION USA, ACCION New Mexico and Opportunity Fund, or rating systems like that developed by Justine Petersen — allow decisions to be applied systematically, regardless of which staff member is involved. This allows a level of consistency in decision-making despite turnover in staff.

It must be noted that the use of a scorecard does not mean that the focus on relationships has been abandoned. ACCION New Mexico has recently adopted policies that require all loan officers to touch base with their borrowers at least quarterly by phone, in the case of smaller loans, and through site visits, in the case of larger loans. The goal is to not only maintain portfolio quality, but also to increase client retention. And, as the section of this report on customer service indicates, ACCION

USA is currently examining a number of methods for connecting with its clients in all phases of the lending process.

Similarly, scorecards can be used in ways that enable organizations to take on the level of risk with which they are comfortable, while hopefully better predicting and controlling that risk. ACCION USA has set its scorecard such that the decisions it recommends are consistent with an overall level of risk that has been set by the board of directors and reflected in the organization's annual budgeting. In using the Microloan Management Services scorecard, ACCION New Mexico has made two adaptations to its lending process in order to ensure that it continues to serve the target market consistent with its mission. First, staff members have created new loan products aimed specifically at applicants whose credit positions preclude them from qualifying for its standard business loans.[25] Second, as staff found that loans under $2,000 routinely "fell out" of the MMS™ scorecard, these loans are now fully underwritten by its loan officers.

In the end, the question is not whether an organization uses relationship lending versus transactional lending. Rather, as microlenders scale their operations, they must find ways to make sound underwriting decisions more efficiently and apply their resources to those applicants with the greatest chance of success. As the Scale Academy microlenders move forward, they will continue to adjust their underwriting processes and consider when and where high-touch produces the best results. Can organizations straddle being both relational and transactional? The answer seems to be "yes," as these organizations seek their identity somewhere between that of a "boutique" bank and a credit card processor.

LESSONS FOR SCALE

The experiences of the Scale Academy lenders suggest the following lessons:

- As they pursue scale, programs need to recognize that their traditional approach to underwriting may not support their growth goals. Changes may be required to increase organizational efficiency to address the demands of volume, as well as to increase client satisfaction with the process.

- Given the mounting stresses in a growing portfolio, incorporating some transactional practices into underwriting seems to be a necessary part of the scale-up process. The experiences of the lenders that have adopted these practices suggest that the changes have contributed to increased customer satisfaction, some gains in efficiency and the cost savings inherent in portfolio health.

- The move to more transactional underwriting practices does not mean that the relationship-based lending, which many in the field see as a core asset of the industry, has to disappear. Scale Academy lenders have been weighing the costs and benefits involved in adapting their processes, with a view to maintaining high-touch, relationship-based processes where they produce the most value. This may be in early interactions with those borrowers needing the greatest assistance in completing loan applications. It may be in pre-screening, and, it may be once the loan has been made.

[25] These products are described in the section of this report on Credit Building and Financial Literacy.

Risk Management

In the three years since the launch of the Scale Academy, the economic environment changed from being relatively stable to tremendously volatile. Some lenders were operating in areas that were the ground zero of the housing crisis; still others were in places hit hard by unemployment and notably sharp declines in business revenue. Although microlenders have traditionally operated in difficult situations and often in local communities with intractable poverty, the macroeconomic environment, and the ensuing uncertainty in financial markets, had a ripple effect on many organizations' current and projected portfolios.

The challenges that emerged at the end of 2008 have yet to recede. Strains felt among target populations, with ballooning debt levels and mortgage payments, are still evident. For lenders with aggressive lending goals, the challenges are twofold. Despite increases in loan applications, most Academy microlenders have difficulty finding clients who can, and should, take on new debt. They also must divert staff resources from originations in order to maintain the quality of their existing portfolios.

Portfolio quality issues may be related not only to the current economic crisis. For some, the focus on growth that preceded this period may have resulted in a greater emphasis on production and willingness to take risk than might have been warranted. The thinking, as one lender expressed it, was, "If we are completely inflexible on one end of the spectrum, are we leaving deals on the table?" Maintaining the correct balance between growth and risk demands vigilance and constant recalibration. The current environment has exacerbated the dangers of an overemphasis on scale, and precipitated a more rigorous approach to balancing growth and risk management.

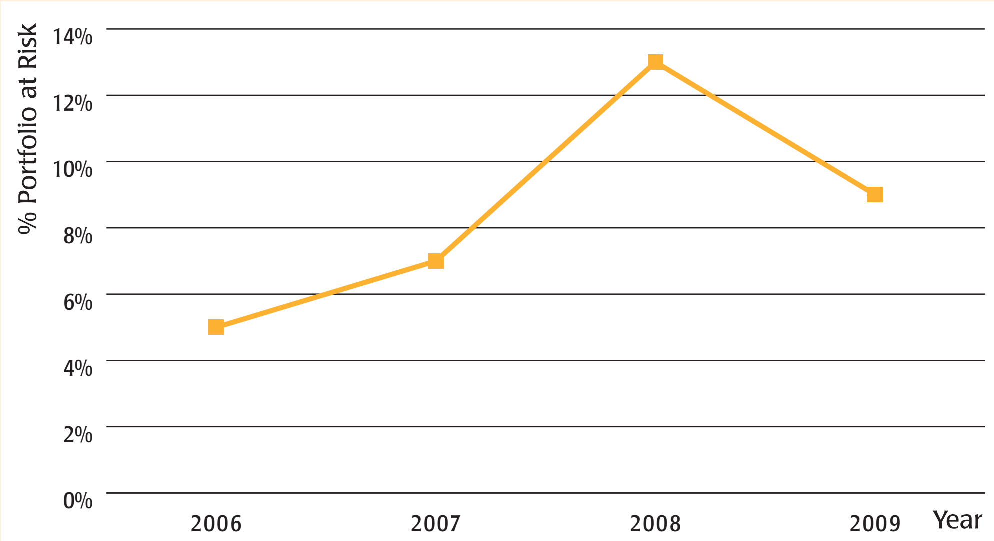
A Look at the Trends

At its core, finance is about managing risk. Risk management is defined here as the process of analyzing exposure to risk and determining how best to handle such exposure. Institutional responses to risk include the establishment of specific structures (such as compliance and collections functions), policies and procedures, and staff capacity to address risks throughout the lending process.

One marker of the level of risk in a lending institution is its portfolio at risk, that is, the dollar amount of the principal outstanding on all loans more than 30 days past due compared to the total principal outstanding. The chart below illustrates the progression of portfolio at risk (greater than 30 days) since the Scale Academy's inception. The trend line presents a weighted average[26] of the reported portfolio at risk for these five lenders at the end of their fiscal years from 2006 to 2009. Although the weighted portfolio at risk decreased from year-end 2008 to year-end 2009, three of the five lenders had higher rates of portfolio at risk at year-end 2009 compared to the previous year. In addition, three lenders had significant spikes in delinquency in 2008, and the weighted portfolio at risk was higher at year-end 2009 than at the starting point in 2006.

[26] This illustration, using a weighted average, takes into account the proportional relevance of each organization's total outstanding portfolio (in dollars), rather than the simple average of each organization's percentage of portfolio at risk.

Chart 3: Scale Academy Lenders Average Portfolio at Risk >30 Days: Year-End 2006-09



The chart above illustrates a weighted average of portfolio at risk by outstanding portfolio balance at each year's end.[27]

Other measures of risk indicate that the terrain ahead remains difficult. As of year-end 2009, four of the five lenders also reported increases in their loan loss rates, and three reported increases in the value of restructured loans, which they are monitoring closely. ACCION USA, for example, instituted a "Hardship Program" targeting clients with specific circumstances, such as documented decreases in sales activity and mortgage problems, for restructures. Whether this intervention will stabilize those risky loans remains to be seen.

Establishing Internal Processes and Controls in Preparation for Growth

The experiences of Scale Academy members during the past five years illustrate a commonality — that significant growth during a more intensive scale-up phase has been followed by portfolio challenges, and a period of retrenchment focused on risk management and infrastructure investment. Despite this common pattern, the Scale Academy lenders have had diverse experiences in the current economic environment, due in part to differences in *when* they experienced rapid growth and when they refocused their efforts in infrastructure development.

ACCION New Mexico•Arizona•Colorado's period of intense growth was from 2002 to 2005 — a period in which its outstanding portfolio nearly quadrupled to $8.5 million, and before the national economy embarked on its downward spiral. At the peak of its growth, the organization experienced declining portfolio quality and, as a result, chose to retrench lending to carefully evaluate infrastructure and capacity to support future growth. In restructuring, staff developed meticulous internal controls and collections measures, and refocused the job descriptions of the entire lending staff. They describe the reorganization as a "return to basics mentality" with a focus on, for example, early intervention and making many fewer, but solid loans. From 2006 to 2007, with these new measures in place, the organization turned over its entire lending staff; instituted training for newly recruited lenders to bolster its new procedures (see the example of motivational interviewing technique described below); shifted to the Microloan Management Services platform to support underwriting; and increased the rigor of its

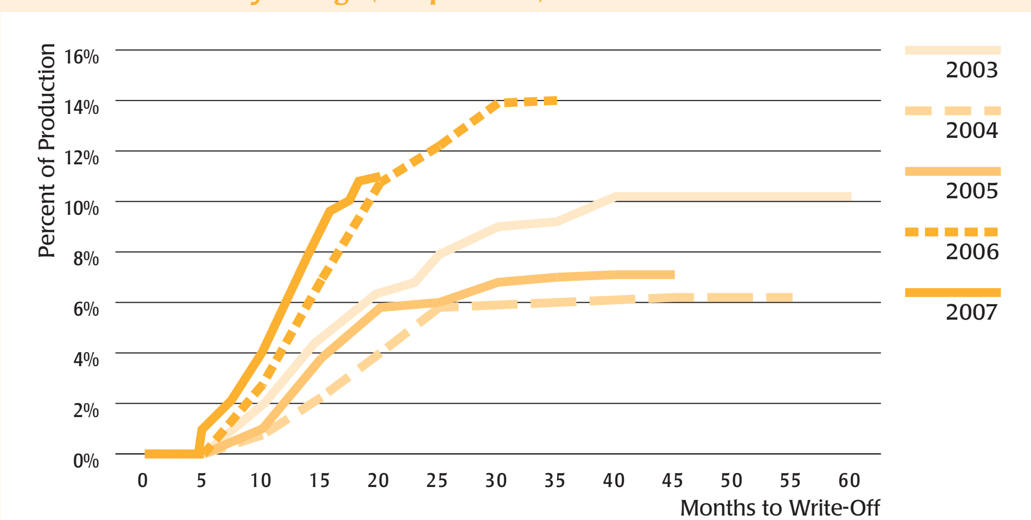
[27] Note that for 2009 year-end data, loans over $35,000 are included in the outstanding portfolio figures for four of five Scale Academy lenders.

portfolio analysis. The organization also reinstituted its historically rigorous focus on collections, with the collections process starting at day one in arrears. As ACCION New Mexico began to scale once again in 2008 through its geographic expansion to Arizona and Colorado, it seemed to be prepared to face the more challenging economic environment that lay ahead. Indeed, portfolio at risk remained steady in the 5 percent to 6 percent range from 2006 to 2009, even with significant growth in outstanding portfolio in 2008 and 2009.

In contrast, ACCION USA grew rapidly in 2006 and 2007, experiencing its fastest growth in markets like Atlanta and Miami. Growth in these markets happened during a time of tremendous uptick in easy consumer credit, and it was in these areas that the recession and housing crisis ultimately hit hard. In 2006 and 2007, ACCION USA's investment was focused primarily on growth, and not sufficiently on the types of risk management procedures *and* staffing that might have positioned the organization to stay on top of the challenges created by the crises. To make things more complex, the organization underwent a merger in mid-2008 (ACCION USA merged with ACCION New York), and it has taken time for the organization to align its risk management procedures and staffing. In 2008 and 2009, the organization executed a rigorous refocus on collection procedures and appropriate staffing, and introduced an improved credit scorecard with a risk level threshold set by its board of directors.[28] It is now beginning to see the fruits of these changes in the form of improved levels of risk.

Both organizations remain ever-vigilant even with these strong measures in place, especially with relatively newly disbursed segments of their loan portfolios. Although their efforts to refocus on risk management happened at different times, these two organizations employed some common approaches. Both have strengthened their portfolio analysis by creating tools that provide an accurate and much more detailed snapshot of risk. ACCION New Mexico uses a Loan Risk Rating Report, based on variables such as payment activity and client contact, to categorize loans according to four levels of risk. ACCION USA has created Vintage Charts that graphically illustrate the performance of the loan portfolio by the year in which the loans were made. Both tools help the organization to anticipate future performance and deploy collection efforts at points of maximum impact and also provide a clear basis for calculating loan loss allowances.

Chart 4: Write-Offs by Vintage (Sample Chart)



This sample vintage chart is for illustration purposes only and does not contain any organization's portfolio data. The above example illustrates write-offs by month, broken out by year originated, as a percentage of portfolio written-off. The steeper the curve, the faster loans originated in that year were written-off. Similar vintage charts could also be broken out by, for example, delinquency level, industry and geography.

[28] The scoring model allows ACCION USA to set its risk threshold (or the level of portfolio at risk), thereby making it more or less stringent in its screening of potential customers.

Similarly, as described in the previous section, both organizations have used credit scorecards — one developed by the organization, one contracted from an external source — that bring increased statistical rigor to their underwriting processes. Although these scorecards are not the sole basis for underwriting decisions, they tell an organization how similar loans have performed in the past. To date, both organizations are pleased with how use of the scorecard has supported portfolio performance.

In refocusing on risk management, ACCION New Mexico also implemented new controls in its lending process, using an approach similar to one used by Justine Petersen. Both organizations have controllers or external auditors who review their loan documentation to ensure its completeness and compliance with their underwriting standards. These controls support risk management even as the portfolio grows.

Although other Scale Academy lenders have not undergone the intensive restructuring of their risk management processes undertaken by ACCION USA and ACCION New Mexico, each has also become more proactive in analyzing and managing risk. Opportunity Fund is using Vintage Charts to track the performance of its portfolio and has adjusted its underwriting criteria to mitigate risk in several areas. It has also just moved onto the ACCION Texas Microloan Management Services underwriting platform. On the collections side, the organization has instituted a high-touch "call night" to get ahead of the curve with problem loans. Mountain BizWorks uses a risk rating system (ranging from 1 to 5) to determine the amount of loss reserves required for each loan; a quarterly review of concentration risk in specific industries; and a Loan Collateral Report to manage collateral positions and enhance its loan monitoring process. And, based on analysis of its loan portfolio, Justine Petersen has intensified its targeting to smaller loans, which have performed better in recent times, and has increased collateralization of larger loans, as these have been more problematic.

Client Services as a Risk Management Strategy

Another strategy Scale Academy microlenders have employed has been to offer additional client services, particularly in the form of mentorships and increased one-on-one counseling. However, with growing portfolios comes tension around the mounting costs of keeping those services.

ACCION New Mexico links clients with volunteer mentors as a form of delinquency management. The organization has many volunteers with particular expertise, such as receivables management, who have worked intensively with clients to bring them up to date. In addition to the recovery of dollars, many of these cases also involve saving the client relationship. Staff expects that the goodwill built between the organization and the client will have a long-term impact on the health of the portfolio.

Similarly, Mountain BizWorks has used paid coaches and trainers who work intensively with clients. As the organization has grown, so have the costs of this approach, and staff is now assessing the overall sustainability of the paid services model. Although its approach is similarly intensive, ACCION New Mexico has been able to reduce costs through the inclusion of volunteers.

Building Staff Capacity in Risk Management

ACCION New Mexico's very hands-on approach to risk management includes motivational interviewing with clients and a counseling approach drawn from the field of psychotherapy that is designed to elicit behavioral change in clients by drawing on their own intrinsic values and goals.[29] The interviewing technique is used with clients who have shown early signs of delinquency, and the idea is to bolster the relationship through heavy early interaction. As part

[29] For more on motivational interviewing, see Stephen Rollnick and William R. Miller, *What is MI?* at Motivational Interviewing: Resources for Clinicians, Researchers, and Trainers; available from http://www.motivationalinterview.org/clinical/whatismi.html; accessed February 16, 2010.

of the collections process, staff members — who have been trained in this technique — also offer individualized credit evaluations; coach clients on how to collect receivables; and even provide advice on how to approach difficult business situations, such as a dispute with a partner or family member, if this issue is germane to the business' success.

To complement this staff training, ACCION New Mexico developed an incentive system for loan officers that values both production and loan quality. A loan officer's total pay depends on her ability to achieve monthly lending targets and to make good quality loans. This comprehensive system has served to create a sales culture within the lending staff that focuses strongly on the maintenance of client relationships.

Like many small- and medium-size lenders, Mountain BizWorks' lending staff has traditionally focused on risk management. As the organization's portfolio has grown, it now is looking to hire an additional staff member with more specific training in collections to strengthen its overall operations.

LESSONS FOR SCALE

The experiences of the Scale Academy lenders suggest the following key lessons in risk management:

- Clear, consistently applied policies, and skilled lending and collections staff, create the infrastructure needed to weather some of the most challenging economic environments and to position organizations for healthy growth.
- Key elements of this infrastructure include:
  - Policies, tools and procedures that ensure that lending decisions are made on the basis of appropriate risk and that build on an organization's learning from past portfolio performance.
  - The structure and capacity to instill quality control during the loan review process, and effectively monitor the portfolio (using tools or controls that recognize early indicators of risk).
  - Lending and collections staff with training and incentives that support early intervention with risky clients.
- Vigilance is ever important in periods of rapid advances in scale, as growth can often mask emerging delinquency issues. Trying economic circumstances also exacerbate underlying weaknesses in an organization's risk management infrastructure. As one lender noted, "Our borrowers have no shock absorbers." How organizations respond during times of crisis is critical to the impact on the loan portfolio.
- The relationship between the client and the program is crucial to managing risk in the long term. Scale Academy lenders developed and sustained this relationship in a variety of ways — through training, coaching and interviewing techniques — all of which are high-touch and carry costs. Programs need to assess carefully the costs and benefits of such strategies in terms of risk mitigation and their other goals in order to build a sustainable model.

Customer Service and the Customer Experience

How do customer service and an understanding of the customer experience support the move to scale? As previous sections of this report have discussed, reaching larger scale requires that organizations achieve greater standardization and efficiency, in some cases by moving to a more transaction-based underwriting model. At the same time, client referrals and returning borrowers are two of the most cost-effective means of building a portfolio, and strong client relationships support portfolio quality, so building a strong customer experience is critical to achieving the right balance between growth and risk.

As Scale Academy microlenders have sought to enhance the customer experience while moving to greater standardization, they have found that the solution may lie, at least in part, in becoming more customer-centric — in other words, in identifying new ways to understand and meet the needs of their customers. This often requires creating new opportunities to interact with customers to solicit input and feedback, so that processes, products and services can be built around their real, expressed needs rather than around long-held perceptions about what they may want. It also involves developing more systematic approaches for monitoring and improving the customer experience, and using technology to support additional quality "touches" to the customer.

Standardization and Customer Service

One of the central questions faced by microlenders seeking to scale is when and how to alter their relationship-based lending model in the drive to serve more customers. For most community-based lenders, the move to a more standardized, transaction-based model is fraught with emotion, as it seems to fly at the core of their mission: to provide access to capital in a manner that truly supports the individual entrepreneur and his/her business.

Yet interestingly, some Scale Academy lenders have found that streamlining and standardizing the loan transaction can actually improve the customer's experience. As discussed in the section on underwriting, customer surveys conducted by ACCION USA found that in their lending process, customers valued a smoother process and better information up front about what kind of loan they could expect more than they valued price. The addition of a scoring tool that provides more analysis up front helps to provide that clarity to the customer.

In fact, both ACCION New Mexico•Arizona•Colorado and ACCION USA have found that implementing a credit-scoring model has increased satisfaction, because it has reduced turnaround time to a certain extent (especially in the initial phase of an application) and resulted in a more straightforward process. Both organizations say this clarity also improves their relationships with partners who receive clearer information as to whether their clients will qualify for and receive a loan. Greater clarity helps support internal staff relations as well, as individuals in different departments can have consistent understanding and expectations regarding loan policies and decisions.

Building Information and "Customer Touches"

Often in microenterprise organizations, discussion around client needs tends toward the anecdotal. However, as in the areas of underwriting and marketing, the key is to move from intuition and anecdote to rigor by taking steps to solicit direct feedback from clients. A number of Scale Academy lenders have moved in this direction. Specifically:

- ACCION USA has implemented bi-monthly surveys of those who withdraw from the loan process and those to whom loans are disbursed. The surveys gather information on the clients' experience with the loan process and have informed the messaging on ACCION USA's Web site, its printed materials and the rationale behind its scorecard.

- ACCION New Mexico•Arizona•Colorado surveyed 1,220 of its former clients with the goal of gleaning information that could lead to greater client retention. The organization also instituted, in 2010, new staff measures for customer care and contact.
- Opportunity Fund seeks feedback on its loan process through on-line surveys conducted midway in the application process. However, response to these surveys has been relatively low, particularly among those who fell out of the process. The organization also surveys customers at loan disbursement and has received a stronger response rate for this effort.

The creation of "purposeful touches" is another essential element of the customer relationship, and, as organizations scale, they must rethink how to achieve these touches in a widespread manner. Mountain BizWorks, with a small portfolio relative to the other Scale Academy lenders, uses site visits to keep in touch with its borrowers. In an effort to ensure that the visits were meaningful interactions, the organization implemented additional staff training on client site visits. On a larger scale, Mountain BizWorks' membership program — which is open to all its clients and is required among all current borrowers — is specifically structured to provide eight different potential client touches, each designed to provide relevant content to members. ACCION New Mexico also requires regular contact with borrowers. Because of the relatively large number of clients carried by its loan officers, the organization requires quarterly visits to all larger loan customers and quarterly calls to borrowers with smaller loans.

One of the primary precepts behind good customer service is that committed and satisfied employees will provide higher-quality service to customers. Opportunity Fund's approach to customer service begins with a strong focus on hiring only individuals committed to its targeted customer base. However, as its portfolio has grown, the organization has learned that it must find ways to "touch" customers that do not depend on one-to-one contact. It has now moved to use technology to massify touches by, for example, sending text messages to support its billing and collections efforts. ACCION USA is taking a similar technology-based approach as it revamps its on-line application. Its goal is to ensure that customers who fall out of the scoring model due to credit challenges automatically receive feedback and more information about the reasons for their decline, as well as tailored financial literacy content that can assist them to improve their credit position and move toward a successful future application.

In an effort to deal with a significantly increased volume of inquiries, generated in part as a result of its participation with Kiva, ACCION USA has also moved to an interactive voice recognition system (IVR) to handle initial customer inquiries. The system has the advantage of ensuring that customers receive some initial loan product information at the time of their inquiry, without having to wait for a staff member to return their call. However, the organization is aware that there is a potential downside to having a voice recording be the customer's first interaction with the organization. At present, it is collecting and analyzing customer response data to determine whether and how to continue with the system.

A Deliberate and Systematic Approach

An underlying theme of the Scale Academy lenders' work is that moving to scale requires a more deliberate and systematic approach to customer service. The previous section of this report discussed how lenders have altered their structure and staffing to support greater volume. But, as organizations take on more staff, there is more opportunity for ambiguity and lack of clarity both among staff and between staff and clients. This then drives the need to focus on the customer.

As the largest of the Scale Academy lenders, it is perhaps not surprising that ACCION USA has taken the most deliberate and comprehensive approach to the issue of customer service and customer experience. In the past year, ACCION USA has launched a comprehensive review and initiative, with the goal of becoming a more customer-centric organization. This effort includes a number of components, such as:

- Creating a cross-department staff team charged with leading and monitoring the initiative;
- Holding a day-long, all-staff training and retreat on customer service, led by an external consultant;
- Using the retreat to develop department-by-department workplans for improving customer service;
- Creating new tools for monitoring customer experiences, including new survey tools and a formal complaint log;
- Ensuring that each employee's annual goals include at least one goal related to customer service; and
- Identifying ways to add value to all customer interactions, such as by incorporating its financial education content into billing notices.

These steps are all part of a concerted, year-long initiative. Ultimately, however, management recognizes that moving to a more customer-centric approach requires a culture shift that will emerge and must be supported over the long term.

As one of the fastest growing lenders in the Scale Academy, ACCION New Mexico has also recognized the importance of customer service. In past years, the organization has used monthly team meetings to analyze how well it is meeting customer needs and how processes and practices can be improved. Management has also used the process of participating in New Mexico's "Best Places to Work" competition to take a deliberate look at employee satisfaction, which they believe has, in turn, strengthened the customer experience. ACCION New Mexico's leadership also notes that, as its operations and portfolio continue to grow, they will need to systematize further its process of monitoring and improving its customers' experiences. As such, in 2010, the organization will place a strong emphasis on the customer experience, taking an approach similar to that being implemented by ACCION USA. This process began in February of 2010 with an all-staff retreat focused on customer service.

LESSONS FOR SCALE

These experiences with customer service suggest the following lessons:

- As microlenders look to increase their scale, they must take a more rigorous and systematic approach to understanding and building a strong customer experience.
- Tools such as periodic customer surveys (both on-line and telephone) and complaint logs can generate data to supplement anecdotal information gleaned from direct client interactions and staff intuition.
- Committed employees give better customer service, so processes aimed at improving employee satisfaction should be part of a focused customer-service process.
- Although technology and standardization may seem to be poor substitutes for direct client contact, used properly they can enhance the customer experience by reducing response time, providing greater clarity and increasing the number of "customer touches." The key is to monitor customer response to these new approaches.

Connecting Lending to Financial Education and Credit Building

Financial education and credit-building services have been a somewhat unexpected area of focus among the Scale Academy lenders. Four of the five Scale Academy microlenders offer some form of these services, although the members view them differently. At one end of the continuum are organizations that see these services as central to their institutional mission; at the other are those who offer them as components of a particular product or service. And, the extent to which these products and services are integrated with an organization's core lending products has varied, although several are working to make the link more intentional. In developing financial education products, some lenders have developed their own content, while others have used pieces of readily available curricula. All seek to better understand the costs and benefits of these services and assume that the benefits will accrue both to their clients, in terms of improved credit scores and overall financial skills, and to their lending efforts, in terms of stronger loan applicants and, ultimately, more loans. But, is that reasoning correct? What does the experience of these lenders say about the link between financial education, credit building and scale in microlending? This section describes the products offered by the Scale Academy lenders and the answers to the above questions.

Products and Services

The table below illustrates the varied approaches to financial literacy and the loan products offered to support credit building.

Table 4: Credit-Building and Financial Literacy Products and Services

Product/Service Name	Product/Service Description	Still Offering/ Marketing? (Y/N)	# of Participants or Loans YE 2009
ACCION New Mexico•Arizona•Colorado			
Empowerment Loan Product	Small term loan for those with challenged credit histories, but motivation to repair and succeed; includes small amount of credit for six to nine months, a mentor, and a requirement for two classes in financial literacy or credit counseling based on the client; mentors trained in change behavior – Motivational Interviewing Techniques – meet with client monthly	No	26
Workshops on Financial Well-Being	Monthly workshops on various areas of business – understanding credit, customer service, cash flow management, understanding financing options	Yes	Offered monthly; average participation 6-10 people
Mentorship program	One-on-one mentorship with either a general mentor or a specialist that meets with the client on a regular basis to discuss their business;there is a mentorship coordinator	Yes	10-12 currently open; 43 completed, does not include mentored empowerment loan above
ACCION Connect and ACCION Credit Step loans	Small $200 term loans to clients with thin credit files or those who show potential but do not meet current scorecard requirements; requires minimum documentation	Yes	14

Product/Service Name	Product/Service Description	Still Offering/ Marketing? (Y/N)	# of Participants or Loans YE 2009
ACCION USA			
On-line Financial Education resources	-Webinars: On-line workshops featuring Business Survival Strategies Curriculum - Financial Education Section on Web site includes tips, podcasts, workshop calendar, directory of other training providers	Yes	Webinars: 237 participants; Web site: 66,000 page views for financial education section
Financial Education Workshops and Individual Training Sessions	Organized in tandem with community partners, featuring a variety of topics and offered in multiple languages	Yes	2,569 workshop participants; 302 individual sessions
Credit Builder Loan	Small loan offered to no hit/zero score clients	Yes	35 loans disbursed
Justine Petersen			
Credit-building consulting and planning	One-on-one review of personal credit report and creation of credit action plan to address credit barriers to affordable financing and build good credit	Yes	1,058
Credit Builder Loan	$150 loan to establish or re-establish credit, repaid $15/mo for 12 months	Yes	151
Secured Credit Cards (offered via Citibank/ Banamex USA)	Minimum $200 deposit up to $25,000 credit limit; deposit held in interest-bearing savings account (4% APY)	Yes	145
Credit-building loans	Piloting unsecured CBL and business builder loans, which include $200 deposit on secured credit card	Yes	31
Financial Education classes	Offer FDIC Money Smart curriculum on monthly basis; began four Webinar modules in Nov 2009	Yes	113
Individual Development Accounts (IDA)	Matched savings for home purchase and microenterprise	Yes	41 new accounts in 2009 related to small business
Newsletter	Have Credit-building Club as cause on Facebook; distribute weekly tips on maintaining and building good credit	Yes	76
Opportunity Fund			
Individual Development Accounts	Separate program at Opportunity Fund that offers financial literacy education (6 weeks of class) & matched savings over a 1-2 year period (typically 2:1 savings match); program offers a variety of savings goals, including education, homeownership and starting/growing a small business	Yes	54 new IDA savers for small business in 2009
Small credit-building loans	$1,000 - $2,000 loan designed as first-step loan for business owners who have no credit to help them build credit with a more streamlined application process (no TA); in implementation, has served business owners who staff believes cannot take on more than $2,000 in debt, and TA has been reintegrated into the product	Yes	23 loans

As the table indicates, Academy microlenders have developed educational and counseling products, and in many instances, combined them with financial products (an IDA, a "personal empowerment loan," or a credit-building loan). These products and services have expanded target markets by reaching those needing basic financial literacy or help in building and/or repairing credit; built their skills and improved their credit; tested the performance of some borrowers; and recruited individuals who might be future microenterprise loan borrowers. Microlenders have found value in adding these services, because they meet a critical need among their clients and among a much larger, unbanked and underbanked market, which includes business owners and non-owners alike.

Expanding markets

Lenders have used both education and financing products to reach new markets. For example, in 2008, ACCION USA launched a "Build Your Credit" campaign comprised of community seminars, one-on-one technical assistance and small personal loans for credit-building purposes that attracted a wider, especially immigrant-based clientele. The organization has also incorporated financial literacy content into its Web strategy, and the number of hits and on-line visibility increased as a result.

ACCION New Mexico•Arizona•Colorado launched a small "Empowerment Loan" product for applicants with challenged credit histories who would not qualify for the organization's regular microloan. The loans were designed for those who were motivated to make substantive behavioral changes in their approach to credit. In addition to providing a small amount of capital, ACCION New Mexico assigned mentors who used "motivational interviewing techniques" and provided credit counseling to the participants. The organization saw the product as a way to fill a critical community need, given the sharp decline in credit quality observed among applicants. However, after experiencing repayment and ongoing participation challenges among the clients, ACCION New Mexico determined that it was too difficult to work with this market. It is now focusing on individuals with thin credit files, using a newly launched $200 Credit Step loan to help improve their credit scores and prepare them for microloans.

Building Skills and Scores

Justine Petersen directly offers three different credit-building products that combine education and microfinancing. Staff considers credit building to be at the heart of the organization's mission and, therefore, assesses and educates all clients about their credit status and matches them with financing tools that can most quickly improve their score and increase their eligibility for business loans. In 2009, the organization's credit-building loan portfolio grew significantly, demonstrating both the importance of this service in Justine Petersen's program and its value to its clients.

In addition, in mid-2009, the organization introduced a fourth product — a secured credit card, offered in partnership with Citi/Banamex — that enables users to improve their credit score and graduate to a regular credit card in one year, after participating in tailored credit education with Justine Petersen and demonstrating good repayment performance with Citi/Banamex. The secured credit card assists not only those without a credit history, but also those needing to re-establish credit because of past blemishes. Introduction of the card seems timely given that the availability of secured credit cards at a reasonable rate, for the underbanked market, has been curtailed with the tight credit markets. The organization has seen that the card is the most competitive product of its type in the St. Louis market, and it also generates modest fee income from the bank. The card is paired, in most cases, with one or more of Justine Petersen's credit-building term loans, which allows participants to more quickly build or rebuild a credit score. As of this writing, the organization has helped distribute more than 145 cards and 219 credit-builder loans.

Generating New Microloan Borrowers

Although these products and services have broadened markets (and in some cases, mission) and expanded the range of microfinance products offered, Scale Academy microlenders have learned that financial literacy and credit-building products do not necessarily produce more microloans — unless they are designed to explicitly attract aspiring entrepreneurs, or a clear pipeline is developed to their microloan products.

ACCION USA, for example, found that, although there was some degree of crossover between its "Build Your Credit" campaign and its microloan program, the curricula was more oriented to personal finance and personal credit issues. The organization made the decision to focus specifically on financial education for small businesses. Staff re-engineered outreach efforts to focus on attracting more businesses and adjusted training content to focus more heavily on business credit challenges and management issues (i.e., business survival strategies). ACCION USA now sees this effort as providing 'value-added' services for its small business clients.

Both Justine Petersen and Opportunity Fund also offer Individual Development Account programs that combine matched savings and financial education to savers, whose goals include education, home ownership and business ownership.[30] However, in contrast to Justine Petersen, Opportunity Fund found little crossover between the participants in its IDA business saver program and its loan program. The organization has recently added a 'business advisor' position to support the IDA program and is screening potential business participants more closely. Staff hopes that these changes will build more synergies with, and movement into, the microloan program. Finally, both ACCION New Mexico and Justine Petersen have recently launched their respective "ACCION Credit Step Loan" and "Business Builder Loan," each of which blend personal credit counseling with a very small loan as the first step to building a business.

Assessing Costs and Benefits

Just as the approaches the Scale Academy microlenders take to financial education and credit building differ, so too do their assessments of the costs and benefits of these services. As discussed above, Justine Petersen values these services in their own right, and their resonance with Justine Petersen's market is demonstrated by the demand the organization has experienced this past year.

ACCION USA has identified other benefits. Financial education programs have engaged new funders that were solely interested in the financial education component of its program. Staff has also seen waning funders re-engage with the ongoing development of financial education content and illustrations of impact from the program. Both ACCION USA and ACCION New Mexico believe that these services strengthen the connection with clients, generate referrals, retain borrowers, and improve portfolio quality.

ACCION USA has documented that 250 of the microloans it has disbursed since 2007 can be directly attributed to its financial education efforts. The organization has also seen explosive growth in views of, and traffic to, the educational section of its Web site, which, in turn, contributes to its overall brand-building. But, what is the value of the increasing recognition? The organization sees the need to track metrics that can quantify more rigorously the improvements in "client connection" (retention and client referrals), brand-building and public relations that result from these efforts. These data would allow the institution to more completely assess the overall value and contribution to scale of these services.

These services also generate costs, and some of the Scale Academy microlenders have raised the question whether the opportunity costs of focusing heavily in this area detract from focusing

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[30] Justine Petersen provides IDAs for home ownership or business. Opportunity Fund provides IDAs for these purposes and education.

on growing a small business portfolio. While ACCION New Mexico has attempted to minimize the cost of these services through the use of volunteers, Justine Petersen has managed to substantially cover its costs through fees charged for its educational and counseling services and loans. The organization has also realized additional cost savings by separating the credit building out from other microlending services, so that staff can more efficiently focus on their charge, whether it is personal finance or microlending. Although the Scale Academy lenders have not resolved the issue of how the benefits of financial literacy and credit-building services relate to their costs, what is clear is that their value to the organizations is not measured solely through direct revenue.

LESSONS FOR SCALE

These experiences with financial education and credit building suggest the following lessons:

- Financial education and credit-building initiatives can expand an organization's suite of services and microfinance products and meet the demand of many disadvantaged individuals for financial education and credit-building information, skills and assistance. Microlenders' traditional capacities fit nicely with those needed to deliver these services. If scale is envisioned as an increase in customers served, these services can lead to volume.

- Microlenders that want to use financial education and credit-building services to increase their microloan volume need to develop explicit links between these services and their target market of microentrepreneurs. Approaches include tailoring curriculum to the specific needs of entrepreneurs, offering credit builder loans designed explicitly as step products to business loans, and creating clear bridges to microlending staff and services.

- Financial education and credit-building products produce an array of benefits for organizations. Although the precise benefits will depend on the structure of the program and how it is marketed, they can include revenue generation, new funders, greater visibility in local markets and enhanced client relationships. To ensure that these services are achieving their aims, organizations need to be clear about the benefits they are trying to achieve and integrate methods to measure the results.

Geographic Expansion

Each of the Scale Academy lenders has scaled, in part, by expanding their geographic target markets. Opportunity Fund, Justine Petersen, and Mountain BizWorks have reached out to adjacent counties. ACCION New Mexico•Arizona•Colorado has, as the name implies, added two states to its target market. And, ACCION USA has developed a physical presence in some markets (Miami, Atlanta, Boston, New York) and also expanded nationally, using an Internet-based loan application, to reach microentrepreneurs across the country.

Clearly, a larger geographic market opens up a wealth of new market prospects. Accessing those prospects successfully demands an understanding of the local market and the development of a cost-effective infrastructure. As the experience of these microlenders shows, and as the earlier chapter on market research discussed, market knowledge needs to deepen over time to gain the full benefit of geographic expansion. And, the need to penetrate new markets with as lean an infrastructure as possible demands both creative strategies and an effective use of technology.

Table 5: Geographic Markets

Scale Academy Member	Coverage Area	Office Locations
ACCION New Mexico•Arizona•Colorado	New Mexico, Arizona, and Colorado	Albuquerque, Phoenix, Tucson, Denver
ACCION USA	Nationally via on-line system except within ACCION licensee lending areas[31]	Atlanta, Boston, Miami, New York
Justine Petersen	Throughout the St. Louis MSA, which includes St. Claire, Madison, Jersey and Clinton counties in Illinois	St. Louis; East St. Louis
Mountain BizWorks	12-county area, including Buncombe, Clay, Cherokee, Graham, Haywood, Henderson, Jackson, Macon, Madison, Polk, Swain, and Transylvania	Asheville, Sylva, Hendersonville
Opportunity Fund	Alameda, San Francisco, San Mateo and Santa Clara counties	San Jose, San Francisco

Converting Need to Market Demand

All of the Scale Academy microlenders conducted feasibility studies of their expansion areas that identified gaps in services to microentreprenuers. But, each also has found that "need" doesn't automatically translate into widespread "demand" for its services (a theme also explored in the section of this report on market research and marketing).

For many, the pattern has been an initial penetration of the market at some level, after which the work becomes harder. As one lender commented, *"Getting beyond one hundred loans in a new market is a huge step; there is something about moving beyond low-hanging fruit we don't yet understand."* These early borrowers may be the most agile, those who are open to new opportunities or who have businesses with the greatest potential to use new capital. Or, they may simply be entrepreneurs who are connected to the initial communications channels used by the microlenders. Opportunity Fund, for example, has seen that even within one particular county, Alameda, there are many different pockets of populations to potentially serve. Some may be more like previous clients and respond to standard marketing strategies. Others may require different approaches.

Justine Petersen has experienced this dynamic in its expansion to counties adjacent to its main area of client concentration. The organization straddles two states, Missouri and Illinois. Most of its client

[31] ACCION USA does not lend in New Mexico, Arizona, Colorado, Texas, Lousiana, San Diego or Chicago.

base has traditionally been in St. Louis, St. Claire and Madison counties. The organization encountered challenges when moving to lending in East St. Louis (just across the Mississippi River), even though the population is similar in many respects to its traditional target market. To build trust in the face of an historically strong distrust of outsiders, Justine Petersen found it necessary to establish a full-service office and business center near a key transit line to break into the community. The organization recognized that gaining depth in a market often requires a sustained effort — even in an adjacent county.

ACCION USA has found, not surprisingly, that while its Internet loan platform has generated borrowers in 48 states, achieving greater penetration or density requires additional outreach strategies. To that end, it has experimented with partnership models, corporate sponsors and Hispanic on-line media outlets to reach a wider small business network.[32] Over time, it has learned that the organization needs to target geographies with demographics and market characteristics with which it has been most successful (such as immigrant entrepreneurs) and be flexible enough to pursue new strategies as they meet with some success (for example, focusing on Internet-savvy Brazilian immigrants in key geographies). Thus, its on-line system has served as an entry point to develop a portfolio of clients in particular areas, giving the organization legitimacy as it recruits on-the-ground partners that are key to further depth.

Taking a Measured Approach

One advantage of slower growth in new markets is that it allows organizations to test their products and gain better knowledge of the context before increasing their visibility and investment. ACCION New Mexico, for example, decided on a "soft entry" into both Arizona and Colorado, states with different population densities and profiles than New Mexico. The organization purposefully kept costs low by deploying only a few staff, took the time to get to know the market, and made its first loans carefully to ensure they were of high quality. Staff also resisted the pull to take advantage of some early opportunities (for example, municipalities that approached the organization to run small local loan funds) and depended on existing funders for its first expenses, rather than seeking new funders that might bring new expectations and deliverables. In 2009, the expansion markets have been ACCION New Mexico's most productive in terms of loan volume. Whether this means that the organization has reached beyond the "low-hanging fruit" remains to be seen, but staff believes that this measured approach has, at least, given them time to integrate themselves into their local market, develop a portfolio that will perform solidly, and create the case for local financial support. At this writing, the organization has launched development activities in both states.

Building Infrastructure

Whether a geographic expansion means expanding to a new county or to another state, lenders have had to adjust their internal processes and staffing. Opportunity Fund, Justine Petersen and ACCION New Mexico have placed staff in each new location, some full-time and some part-time. Although the distances in urban expansions are not as great as in state-to-state expansions, reducing travel times and increasing visibility are reasons for establishing a physical presence.

Technology is an important tool in geographic expansion — for supporting and unifying operations and keeping staff connected to each other. Opportunity Fund, for example, upgraded its management information system to allow access from any computer and simultaneous updates by multiple users and invested in a new server and Voice over Internet Protocol (VoIP) phone system. Its Outlook server allows staff to see each other's calendars to ease group scheduling and to receive e-mail at any location. The phone system can "find" staff rather than requiring clients to have to track them down at different locations.

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[32] See section on marketing strategy for discussion.

ACCION New Mexico has used ACCION Texas' Microloan Management Services to support operations at its headquarters and its remote sites. The system provides an Internet-based loan application that can be completed at any location and submitted for underwriting. The data can also be accessed by users at all locations, enabling ACCION New Mexico to deploy a few "client-facing" staff in each expansion state, with other functions provided by its headquarters team. ACCION New Mexico staff members cite going "paperless" through the use of MMS™ and other Web-based technology as a pivotal step in expanding their programs, while maintaining a tightly-knit team.

ACCION USA's expansion plans involved two elements: extending the reach of its staff in Miami, Atlanta and Boston across those respective states, and reaching clients in other states where they had no physical presence. The organization created two units: a Boston-based lending team to interact with clients located in states without an office, and a centralized processing center to underwrite and support applications from all locations. The lending team can work with applicants who find ACCION USA on their own, as well as those referred by the various partners that the organization has incorporated into its delivery system. In all cases, the paperless, on-line platform has been essential to the effectiveness of these strategies.

One of the biggest challenges to ACCION USA's nationwide expansion has been handling the inquiry process well during periods of high volume. In 2008, the organization reached 16,500 new inquiries for the year. Rather than add more full-time employees, the organization has chosen to deploy an IVR (Interactive Voice Recognition) phone system to manage these peak periods. However, it is still experimenting and evaluating the potential costs and benefits to this new structure as it is a fundamental shift in that initial client-staff contact.

LESSONS FOR SCALE

The Scale Academy lenders' experiences in pursuit of geographic expansion suggest the following:

- Geographic expansion has made a strong contribution to growth in loan volume among the Scale Academy lenders. However, it is still not clear whether the Scale Academy lenders have reached below the "low-hanging fruit" in their expansion geographies.
- Microlenders must not assume that objective assessments of market characteristics and need are the same as assessments of likely demand. Initial research into market conditions may enable organizations to launch services and generate some early uptake of their loan products. But, deeper penetration will require deeper market understanding, testing of marketing strategies, pilot experimentation, and hard work. Recognizing this fact prepares the organization for both the sustained work, and potentially costs, of the endeavor.
- Lenders looking to scale should consider the infrastructure that must be developed in order to expand geographically. The experience of the Scale Academy lenders suggests that one key approach is to combine a streamlined staff structure with technology in order to leverage the organization's current resources in the expansion areas.

Capitalizing the Loan Fund

A growing loan program requires sufficient capital, and so capitalization must be part of any discussion of the scale-up process. During the three years of their participation in the Scale Academy, the lenders have had varying needs to attract new capital. Although some lenders have continued to experience growth in their portfolios, others have focused more on portfolio quality than on growth. But, even those that have been less focused on acquiring new capital are wrestling with often complex capital structures and funding streams that impose restrictions and, therefore, limit their cost recovery. And, all of the lenders have begun to look forward to a day when an improved macroeconomic climate will allow them to further expand their lending efforts and, therefore, are thinking about their future capital needs.

The total capitalization for the Scale Academy lenders' microlending activities ranges from $2 million to more than $10 million. Given that lenders were required to have achieved a significant level of scale in order to be selected for the Academy, it is not surprising that their capitalization is large relative to others in the industry. For example, among the non-Scale Academy microlenders reporting to FIELD's MicroTest program in FY 2008, the median capitalization was $427,500, while the mean capitalization was $1.5 million.

The Scale Academy lenders had built their loan funds on different capital bases. Three received a portion of their capital from foundations and the federal government's Community Development Financial Institutions (CDFI) Fund (which had provided both equity and debt) and then leveraged that capital with debt provided by banks. The other two lenders had used smaller amounts of private and CDFI Fund capital to leverage debt through the SBA Microloan program, which provided the bulk of their loan capital.

At the time they entered the Scale Academy in 2007, two of the five lenders were experiencing capital constraints, with around 90 percent of their loan capital deployed in loans to entrepreneurs. The remaining three lenders had sufficient capital to expand lending, with deployment rates between 50 percent and 60 percent.

Diverse Capital Strategies and Opportunities

During the three years of the Academy's work, the microlenders increasingly have turned to public financing to build their lending capital. Each has received at least one award from the CDFI Fund (although in one case, the bulk of the capital received was dedicated to financing activities other than microlending). And, two new organizations have elected to become intermediaries under the SBA Microloan program. This move to public capital is not surprising, as the availability of bank capital has declined and Federal funds increased with the financial and economic crisis and subsequent stimulus funding.

In addition to these more traditional capitalization strategies, the Scale Academy lenders have engaged in several creative efforts to build their capital bases:

- Justine Petersen *launched a (equity) capital campaign,* aimed at providing funds, both for core capital and for loan loss reserves, that it could use to support additional lending through the SBA Microloan program. Justine Petersen was one of the lenders that came into the Academy with significant capital constraints. It began its efforts to build its capital base with a rebranding, communications and public awareness campaign aimed at attracting a more diversified funding base.[33] As of early 2009, the organization had received funding commitments from several new bank funders, but each of these was put on hold as the financial crisis and recession took hold. Conversations resumed later in 2009, and by the end

[33] For more detail on Justine Petersen's capital structure and campaign, and its rebranding and public awareness initiative, see *FIELD Forum* No. 20, "Capital Structure: Getting it Right to Ensure Sustainability." (Washington D.C.: The Aspen Institute, April 2008).

of the year, the organization had received grants from three new financial institutions and was in conversation with others.

- ACCION New Mexico•Arizona•Colorado *formed a limited liability company (ACCION LLC)* to reduce the impact of outstanding debt liabilities on its balance sheet. An EQ2 investment from one bank partner makes up the capital of the LLC, in which ACCION New Mexico has a controlling interest. When the financials are consolidated, these funds are booked as contributions from the LLC to the institution's net assets, allowing the organization to leverage more debt financing as needed. In addition, during the year, ACCION New Mexico can borrow funds from the LLC, if needed, for lending. The structure is an innovative strategy in that banks that invest can satisfy the lending, investment or innovation CRA test. It also provides banks a second option to contribute to ACCION New Mexico. In addition to any debt financing provided directly to the organization, the bank can make EQ2 investments in the LLC.[34]
- Opportunity Fund and ACCION USA *became the first U.S. microenterprise organizations to participate in Kiva.* The loan capital is structured as a recoverable grant that they repay as principal is repaid. The agreements are such that organizations can pass losses along — Kiva lenders assume the risk, which is helpful, because it offsets the necessary reserve levels that organizations must maintain. Although there is no interest due on this capital, and that is a net benefit to the organization, there are associated costs, including monthly reporting to Kiva and the lenders, as well as the creation of marketing collateral (stories, videos) to keep the site fresh. It is unclear how much further this source will grow. At present, the maximum amount that the organizations can tap is limited and comprises a small portion of their total capital base — $250,000 and $550,000, respectively.

One of the important outcomes of these capitalization efforts is that each has supported the overall brand-building and recognition of the organization in their respective geographies and, in some cases, on the national stage as well. Ultimately, these additional benefits strengthen the organizations' overall ability to attract new investors and donors into their loan funds.

Capitalization Issues Moving Forward

One commonality among the lenders is the increasingly complex loan pools they have put together to keep pace with growth. As is discussed in greater detail, this increasing complexity has implications for scale, due to the time spent in managing multiple sources of capital and the product development and pricing requirements that funders sometimes impose. The questions that lenders are now confronting include: What are the implications of having an increasingly complex loan pool? Do these pools impose other opportunity costs to the organization? Do they increase management costs and drive product development, thereby potentially limiting cost-recovery and self-sufficiency?

As the Scale Academy lenders have reflected on these questions, they have concluded that the move to scale would be significantly strengthened if leading lenders had access to a large pool of attractively-priced loan capital that offered consistent terms and management requirements. This is another area where collaborative efforts among leading practitioners, in partnership with donors, could yield important benefits.

[34] For more detail on the LLC and its role in ACCION New Mexico's overall financial structure, see *FIELD Forum* No. 23, "The Organizational Foundations of Sustainability." (Washington, D.C.: The Aspen Institute, July 2009).

LESSONS REGARDING CAPITALIZATION

The experiences of the Scale Academy lenders with respect to capitalization suggest the following:

- New capitalization strategies can be a means of strengthening an organization's funding as well as its brand and public awareness — critical not only to individual lenders, but also to the microenterprise field as it moves toward this next level of scale and development.

- The formation of limited liability companies and the advent of peer-to-peer lending in the U.S. pose innovative and potentially transformative approaches to the capitalization of microlending efforts in the U.S.

- Both lenders who are seeking capital, and the investors and funders who provide it, must be cognizant of the costs specific funding requirements can impose — and the fact that, in some cases, these costs slow progress toward scale.

- The time is becoming ripe for more sophisticated, long-term investment vehicles aimed at scaling lenders. Lenders could scale more quickly if there were a single appropriate and significant source of capital they could tap, enabling them to cut costs associated with reporting and managing myriad funders and redirect resources to currently-underfunded areas such as product development, marketing and market research.

Structure and Staffing

As organizations scale, their structures must evolve, and all of the microlenders have restructured over the course of their participation in the Scale Academy. Their experience suggests that there is not one "right" structure for greater scale, but rather that effective structures must achieve a set of goals. The most important goals include:

- To reflect and support organizational values;
- To enable the organization to manage greater volume;
- To build and support greater capacity in areas that enhance outreach and visibility, fund development, and quality; and
- To extend capacity through strategic use of volunteers.

Critical to achieving these goals is getting the right people in the right positions and providing them with professional development and incentives to perform well. Implementing systems that increase efficiency and support staff operating at greater distances (as described in the section of this report on geographic expansion) is also critical. This section discusses how the Academy lenders have approached these challenges.

Reflecting and Supporting Organizational Values

The case of ACCION New Mexico•Arizona•Colorado perhaps best illustrates how an organization works toward a structure that reflects and supports its organizational values. The organization's statement of values emphasizes passion, pioneering spirit, integrity, excellence and accountability.[35] Beginning in 2005, an increase in delinquency provoked concerns that there was a disconnect between the organization's focus on growth and its emphasis on excellence. After a close review of operations, the organization made a variety of structural and functional changes that would allow it to continue to push for scale *and* maintain its value focus. Among the most important changes, the organization:

- Revised the loan officer position to make sales and originations, rather than underwriting, the focus of this staff's work. Simultaneously, the organization introduced a loan officer incentive system that rewarded portfolio quality as well as production. The intent was to highlight individual responsibility for achieving the institution's goals.
- Strengthened and standardized underwriting by adopting Microloan Management Services for underwriting microloans and creating a separate in-house underwriting process for larger loans.
- Increased monitoring and quality review by adding a quarterly safety and soundness review conducted by an external auditor to its existing internal monitoring and compliance function.
- Revised its loan officer hiring process to place a higher value on compatible values, openness to learning and teamwork and sales experience, rather than banking experience.
- Implemented staff retreats and used technology to support staff cohesion. Quarterly retreats of staff from all states facilitate staff cohesion. The move to the Microloan Management Services platform supported the work of remote staff. In addition, ACCION New Mexico's new building will have video conferencing facilities that can further enhance communication among team members (as well as provide a tool for client training).

Other ways that lenders have worked to strengthen values include:

- ACCION USA has made customer service a key value, and built staff understanding and support for it through a staff retreat and integrating customer service goals into all staff work plans; and
- Justine Petersen views credit-building as the foundation of its mission and has strengthened its focus by adding staff positions dedicated strictly to this function.

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[35] For more on these values, see *FIELD Forum* No. 23. "The Organizational Foundations of Sustainability." (Washington, D.C.: The Aspen Institute, July 2009), 3.

Restructuring to Manage Greater Volume

In building a structure to support greater scale, the issue is how best to organize the lending process to expand outreach, deliver more high quality originations, speed approval time, and enhance the customer experience. In part, the solution to this challenge is figuring out how best to assign and implement the marketing, sales and underwriting functions. Some Scale Academy lenders are still wrestling with finding the best configuration. Others have defined their approaches and are more focused on fine-tuning and improving the process.

Two of the lenders, ACCION New Mexico and ACCION USA, have restructured to focus their loan officers on sales and developed separate underwriting (also called risk management) departments to centralize that function. Both organizations also separate general marketing from sales and have other positions in the organization that focus on increasing overall visibility to the target markets. Of course, nothing is absolute and each organization finds ways to build appropriate flexibility into their models. As the CEO of ACCION USA said, "If there are 12 factors [in a process], eight can be standardized but four can be flexible and depend upon the teams." One example of that flexibility is in its services to the Brazilian market in New England. The loan officer for that community has strong community connections, the right cultural skills and solid lending skills. In that instance, ACCION USA allows him to take on a broader range of lending tasks (from marketing and intake to disbursement) than other loan officers.

The three other lenders have kept underwriting central to their loan officers' job descriptions, while seeking other ways to increase the overall efficiency of the process to support more production. Opportunity Fund has added business development officers charged with marketing to specific geographies or target markets; their role is to build relationships with referral sources, manage client intake, screen out unpromising inquiries and support the application process. The loan officers focus on interaction with the most promising applicants, underwrite loans (now with assistance from Microloan Management Services) and provide some technical assistance.

Justine Petersen's microlending staff has grown from 4.75 FTEs (with 197 loans outstanding) to 7 FTEs (with 444 loans outstanding). It increased the production of its more senior loan officers by adding a junior staff position designed to handle intake and other administrative functions. In addition, its new credit-building department allows clients who need greater assistance with credit building to receive assistance from specialized staff, further increasing the ability of its loan officers to focus on microenterprise loan production. As noted in the section on underwriting, Justine Petersen re-organized its underwriting and approval process from a committee process to one managed by its senior loan officers in conjunction with its compliance officer.

And, as Mountain BizWorks' has grown its loan program to play a more prominent role in its overall microenterprise program, it has had to increase the sophistication of its lending structure. In 2005, its total outstanding portfolio was $200,000, composed of loans in the $2,000 to $4,000 range. By 2007, the portfolio had grown to $1 million with an average loan size of $13,000, and by the end of 2009, the portfolio had doubled to $2 million with a maximum loan amount of $50,000. The organization added a senior position to manage the loan fund, and is now focusing on restructuring the roles of regional and central office staff to smooth and strengthen the loan process.

Increasing Capacities

FIELD's first report on the Scale Academy, *Forging Ahead: Early Lessons* discussed the importance of organizational capacity to scale and identified the components and key dimensions of the capacities that Academy members believed to be essential to sound, transformational growth. Leadership, development and fundraising, human resources, capitalization, technology, branding and communications, data collection and evaluation, and fiscal management and controls were all critical, and the lenders have worked to strengthen their staffing and structures in many of these areas.[36]

Most commonly, the lenders have added the following components to their structures as they have scaled:

- Compliance and monitoring: Several lenders have added these positions, or enlarged the team addressing these issues. The intent is to increase quality control throughout the lending process, ensuring that all procedures are followed, that all documentation is reviewed and filed, that underwriting guidelines are applied consistently, and that appropriate financial management controls are in place.
- Collections: At least two lenders have added collections staff. Several have strengthened this function by increasing and clarifying the roles of various staff in the collections process (including loan officers) and providing training to improve staff confidence, and skills, in collections.
- Underwriting: As discussed above, ACCION New Mexico and ACCION USA have developed separate underwriting/risk management positions to increase standardization and rigor in their lending process.
- Loan servicing: ACCION USA also has created a separate department to manage loan closing documentation and ongoing servicing of loans (i.e., billing and perfecting liens). Opportunity Fund outsources much of this function to a local bank. Others may choose to follow one of these paths as loan volume increases.
- Marketing: ACCION USA has a separate marketing department focused on new business development, product development and communications. Opportunity Fund has created new business development positions. Justine Petersen has increased its communications staffing to increase visibility to its target markets as well as to prospective supporters.
- Development: Justine Petersen has strengthened its staffing in this area. Three others — Opportunity Fund, ACCION New Mexico and ACCION USA — all have strong development departments that they view as critical to their ability to scale and sustain their operations.

Because these organizations differ in size, the number of staff and level of investment in each department varies. Yet, the direction is clear: as these institutions have grown, they have seen the need to specialize staff functions, hire talent that brings new competencies and adopt more standardization throughout the entire loan process. In addition to increasing capacities, one of the intents is to increase the amount of loan officer staff time that is client-facing in an effort to generate more production. To the extent that other functions can be transferred to other positions, loan officers can focus on client outreach and service.

Efforts to structure and staff these lenders for scale have also been about clarifying of roles and responsibilities, and developing staff who are clear about how their efforts contribute to institutional goals, and their roles in assuring portfolio quality and customer satisfaction. The organizations have employed incentives, messaging and culture-building initiatives as they have worked to develop staff in these areas.

Leveraging Volunteers

As organizations expand, they generally experience a strain to existing resources. Yet, lenders are carefully adding FTEs in an attempt to keep their organizations lean. To that end, most have leveraged volunteers to extend their capacities. Opportunity Fund, for example, has an all-volunteer fundraising council. ACCION USA has a part-time volunteer coordinator to manage myriad volunteer requests, in addition to a New York-based “Microfinance Council” of young

[36] For more, see *Findings from the Scale Academy – Forging Ahead: Early Lessons.* (Washington, D.C.: The Aspen Institute, No. 1, April 2009), 7-8.

professionals who work on short-term consulting projects for the organization. As noted earlier, ACCION New Mexico has developed a substantial mentoring program that they see as a long-term risk management and client relationship-building strategy. In order to maintain quality, manage expansion in different directions and still maintain lean structures, volunteers have almost become a necessary component of organizational structures.

LESSONS FOR SCALE

These experiences with staffing and structure suggest the following lessons:

- There is no one right organizational structure to support scale. Lenders looking to scale must rather work to build a structure that reflects their values, increases their efficiency, and adds capacities that allow them to achieve greater production.

- Effective lending processes allow organizations to increase outreach, deliver more high-quality originations, speed approval time and enhance the customer experience. The key, in part, is figuring out how best to assign and implement the marketing, sales and underwriting functions. Although the Scale Academy microlenders have taken different approaches to deploying staff in these areas, there is an overall trend toward greater specialization in functions.

- Scaling organizations need to emphasize quality as much as production in order to assure sustainable growth. To that end, increased attention to monitoring and compliance, customer service and collections must also be strengthened as the organization scales.

Conclusion

For U.S. microenterprise development, the path to scale during these economically tumultuous times is marked by shifting contexts and strewn with challenges. Yet, the experience of the Scale Academy microlenders suggests that an organization's ability to successfully scale up operations is not *entirely* dependent on the context. Despite often enormous challenges, these lenders have shown the capacity not only to persevere, but also to innovate. While it is easy to blame an unprecedented crisis for underperformance, the five participating organizations have shown that their own agency — their actions and strategies — is pivotal to organizational performance and survival.

This lesson is borne out in a variety of examples. ACCION New Mexico•Arizona•Colorado's strategic restructuring, especially around risk management, positioned the organization to maintain a strong handle on its portfolio, even as the economy began to decline. Justine Petersen and Opportunity Fund are now using this time to strengthen their loan underwriting processes. Justine Petersen and ACCION USA introduced stronger credit-building and financial education components to their product mix as the credit landscape in their markets changed. Their next step is to link their credit-building portfolio more closely to their overall microenterprise strategies. And, Mountain BizWorks incorporated a coaching strategy to help its borrowers strengthen their businesses in challenging times.

These and other examples underscore that if microenterprise organizations are to scale their operations, even amidst difficult situations, they need to be both disciplined and entrepreneurial — disciplined in their work on improving systems and practices focused on quality and entrepreneurial in capitalizing on opportunities presented by the changing context. Yet, innovation requires investment in the areas of product development, market research, marketing, underwriting and risk management. These types of investment, along with core operational support, are often hard to come by.

All the Scale Academy microlenders articulate the challenge of adequately evaluating and "unpacking" the real costs (and corollary benefits) of different aspects of their lending operations. Questions remain regarding: How much does it cost to acquire a client? What does it cost to retain a current client? Is it more cost-effective to maintain loan quality or generate new business? How do investments in financial education and credit building "pay off" in terms of revenues and future loans? How does pricing influence loan acquisition, and what are the trade-offs at various price points? Currently managers make decisions on product mix, loan officer objectives and program strategy with limited data. The industry needs this type of detailed analysis to move forward.

In the journey toward scale, the Scale Academy lenders have confronted the fact that they must strive for new efficiencies and adopt transactional practices, as many older processes simply do not work with a burgeoning client portfolio. Many of the lenders have also expressed concern about losing touch with clients and the personalized approach for which the industry is known. Yet the experience of the Academy microlenders is that organizations need not choose one path over the other. Rather, Academy members have blended relationship- *and* transaction-based lending, incorporating crucial practices of both into key parts of the lending process. Illustrations of this balance are clear in how some have approached customer service, underwriting and the allocation of staff time.

Finally, the experience of Academy members underscores the need to ensure that the end user of products and services remains at the center of the work. In a competitive and changing marketplace, lenders must be driven by consumer demand. The great diversity among microentrepreneurs requires that lenders build a deep understanding of different market segments. That means developing products and services tailored to meet varying needs, creating underwriting and decision processes that respond to client feedback, and recognizing the need to incorporate best practices in customer service as a portfolio grows. Renewed focus in these areas will keep microlenders competitive and relevant.

The work of scale is in some ways at a critical juncture. The easy work has generally been done, and, to make matters more complicated, at present, reaching more of the market means offering products and services that match the needs of entrepreneurs operating in a struggling economy. Yet, as this text suggests, there are opportunities for new leaps forward. New types of clients — shut off from traditional financial institutions — have shown up at the door. Advances in systems, such as ACCION Texas' underwriting and servicing platform, provide ways to increase efficiency and quality. And, there are important opportunities for joint work — in market research and market outreach, in data sharing and analysis, and in product innovations and testing. This is the work not only of the five institutions outlined here, but also of the industry as a whole — if it expects to remain a critical provider of capital for low- to moderate-income entrepreneurs nationwide.

FOR MORE INFORMATION

To learn more about the Scale Academy for Microenterprise Development, please see: http://fieldus.org/Projects/ScaleAcademy.html

For more resources on Scale, published by FIELD and others, please see the resource list at: http://fieldus.org/Projects/direction3.html

Additional publications on Scale Academy grantees featured in this study include:

- *FIELD forum* Issue 19: *Blazing a Trail to Sustainability through Social Enterprise: A Case Example* (2008) on Mountain BizWorks, http://fieldus.org/Publications/FieldForum19.pdf
- *FIELD forum* Issue 20: *Capital Structure: Getting it Right to Increase Sustainability* (2008) on Justine Petersen, http://fieldus.org/Publications/FieldForum20.pdf
- *FIELD forum* Issue 22: *Increasing Sustainability through Improved Efficiency* (2009) on Opportunity Fund, http://fieldus.org/Publications/FieldForum22.pdf
- *FIELD forum* Issue 23: *The Organizational Foundations of Sustainability* (2009) on ACCION New Mexico.Arizona.Colorado, http://fieldus.org/Publications/FieldForum23.pdf

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