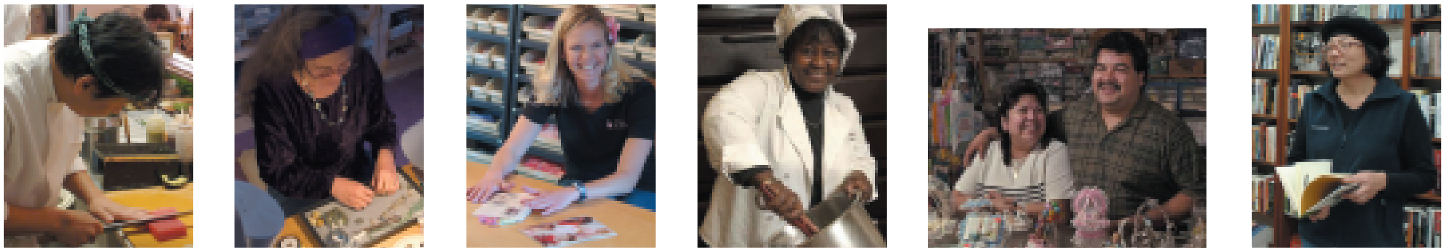
FIELD Funder Guide



Issue 6 | May 2006

Scaling Up, Achieving More

By any measure, there is a market in the U.S. for microenterprise services that programs offering credit and/or training are failing to serve. Among the more than 23 million microentrepreneurs operating today, an estimated 10 million are in markets that traditionally have experienced barriers to credit and other business development services. Add to that an untold number of entrepreneurs who are working in the informal economy, and that the microenterprise industry only reaches between 175,000 and 250,000 annually, and it is easy to see that the market for business development services is far from tapped out. Certainly some of those entrepreneurs are accessing services outside the microenterprise industry, but it is also quite likely that many are simply going without.[1]

For both the industry – and those funders interested in encouraging entrepreneurship and revitalizing local economies – this unserved segment represents a missed opportunity to foster business growth and job creation. While the number of individuals reached yearly by the microenterprise industry has grown over time, the gap remains wide. Why? And what can be done about it? This guide describes scale, some promising strategies for achieving it and how funders can help.

What is scale?

While no single definition prevails, at its core, scale describes the goal of serving large numbers of individuals – a viewpoint shared by 74 percent of 135 practitioners participating in a recent survey. Moreover, in 1998, the Association for Enterprise Opportunity established the goal of "one million low-income individuals in the U.S. achieving self-sufficiency through self-employment." But apart from sheer numbers, reaching scale also connotes market penetration, that is: reaching a significant portion of those who could benefit from services in a given area. Further, it involves achieving economies in service delivery, which in turn can lead to greater organizational sustainability and deepened social impact. We want to reach many more, delivering greater numbers of products and services, with greater efficiency, ultimately to achieve greater good.

Key Scale Numbers

- **175,000 – 250,000 individuals served annually**
- **20 largest lenders made half of all outstanding microloans – 7,405 in FY2003**
- **7 largest training and technical assistance providers offered these services to more than 600 clients each**
- **The largest microlender disbursed 1,091 loans in 2003**
- **The largest training and technical assistance provider served 1,109 clients in 2004**

What is the experience of scale in the U.S.?

Like other industries, the U.S. microenterprise field currently comprises hundreds of modest-sized programs – with an average of four to five staff each – and a small number of high volume producers. These high producers serve more than 1,000 clients each year while the other programs serve in the hundreds, averaging 230 a year.[2] This is not surprising given the field's grassroots origins, and its fairly strong dependence on philanthropic resources. Despite the many accomplishments of these small programs, their size and independent operation have left them challenged to incorporate technologies to increase efficiencies, to engage in

[1]Other research suggests that financial institutions are moving downstream into this market; some may also access business assistance through centers aimed at more mainstream small businesses. Even if one were to estimate that the field should achieve market penetration of 10 to 20 percent, that would mean reaching four to eight times the current number of individuals assisted in a given year.

[2]"Highlights from 2005 Data Collection Project," http://fieldus.org/Publications/Highlights2005.pdf

market research and product development, and to purchase the skills and expertise needed to support institutional growth. The experiences of those that have made progress in this area offer a set of lessons for others, and point to some real opportunities for further advancement in the future.

Scale doesn't happen by accident. Organizations that grow to reach significant scale have a clear and consistent focus on it. Both executive leadership and boards are committed to it, set ambitious targets, and monitor their progress against them relentlessly.

Market knowledge is key. Scale requires identifying and understanding market gaps on a continuous basis as the market for microenterprise services is not a static one. Some traditional customers now find banking services more open to them, for example. At the same time, changing demographics, such as increased immigration, may open up new opportunities for programs that know how to respond to them. Marketing is also critical as U.S. programs have found that many potential customers may either be completely unaware that their services exist or fairly skeptical that a lender (or business development service provider) would be interested in their business.

One size doesn't fit all. Because the microenterprise market is a market of niches, having a product mix is important. It allows a program to meet the needs of many and help them as their businesses grow. A diversified product line also offers the opportunity for cost recovery, as some revenue-producing products can subsidize others targeted to clients of lesser means.

Staff capacity is built in anticipation of demand. Smart organizations hire smart people, with the full array of skills and experience needed to meet customer needs, and they hire them before instituting aggressive marketing and outreach initiatives.

Performance counts. Organizations that manage by results, using performance measurement to guide decision-making, move more quickly to scale. Monitoring performance increases the targeting of scarce resources, supports the search for efficiencies, and keeps staff accountable to the growth goals of the organization.

Geographic expansion fuels growth. Programs that tap new geographic markets are more able to reach new clients and to achieve a level of transactions that enable them to generate economies of scale. Obviously, then, organizations with a national reach have a greater opportunity than others to reach large numbers of clients.

A National Strategy to Scale-Up Microlending

In 1991, ACCION International launched a pilot program in Brooklyn, N.Y., to serve low- to moderate-income microentrepreneurs without access to traditional sources of financing. Over the next decade, with the strong support of the C. S. Mott Foundation, Citigroup Foundation, JP Morgan Chase and Deutsche Bank, ACCION helped launch four additional "licensee" microlending organizations serving borrowers in Chicago, Texas, New Mexico and San Diego. It also established ACCION USA as a subsidiary organization to oversee all of its microlending efforts in the United States. Collectively, ACCION USA and five licensees had loaned out nearly $150 million to more than 15,000 microbusinesses by the end of 2005.

To reach even greater numbers, ACCION USA developed an outreach strategy based on on-line lending, marketed directly and through partnerships, and using credit-scoring to increase efficiency. The Knight Foundation, new to microenterprise, found the on-line expansion fit well with its interest in supporting innovative leadership, and in organizations and ideas that can contribute to systemic change and can provide a valuable service to communities where Knight has a presence. The Foundation made a three-year grant through its National Venture Fund to enable ACCION USA to expand into these target communities through both on-line lending and the establishment of two new offices.

After completing the pilot phase during which 22 Internet loans valued at $125,000 were made, ACCION USA rolled out the program nationally in September 2005, and launched a marketing blitz in April 2006. Partner organizations, many of which are banks, market ACCION's on-line lending application to their clients, helping them apply through ACCION-provided computer kiosks in the banks. Florida partners, such as Banco Popular, Washington Mutual, Bank of America, HSBC and Wachovia, have provided the majority of client referrals to date. ACCION's expansion strategy now includes Puerto Rico and Katrina-affected areas – for which it received additional support from the Google Foundation.

Significant investments in infrastructure – systems and technology – as well as standardization, are critical precursors. Technology is a means to expand outreach, add new products and reduce costs. Standardization in data collection, loan products, curricula, underwriting, risk mitigation procedures and other activities aids the use of technology, increases efficiency and makes institutions more transparent and attractive to funders and investors.

Organizational scale-up takes time and money. Developing the institutional capacity for significant growth is not a quick process, and some researchers have noted that "reaching scale can take a long time, a period possibly measured in decades rather than in years."[3] Further, it takes a lot of funding, and smart organizations are aware that underfunded growth can threaten an organization's sustainability rather than support it. For this reason, they've learned that it's important to diversify funding streams and build an appropriate capital structure, incorporating a mix of grants, fees for services, other earned revenues, and loans. And it's necessary to understand the real costs of operations and how each line of work contributes to both costs and revenues.

Strategic restructuring is often the launch pad for much more substantial growth. Mergers and acquisitions, strategic alliances and partnerships, and other forms of horizontal integration, hold the opportunity for achieving greater efficiency, for gaining access to additional products and services, and to skills and expertise. Replication models may also hold some promise, but this approach is difficult and those that have succeeded have done so because of their ability to achieve high clarity in structure and roles, methodology and business model, as well as high quality management, and substantial standardization.

The legal or regulatory environment also drives growth and capacity. The availability of public money can provide the resources for both expansion and long-term sustainability. Funding vehicles such as the Small Business Administration's PRIME and Microloan Programs have provided operating capital and loan funds used by many microenterprise programs to deliver training, technical assistance and financing to many entrepreneurs across the country. Policies such as the Community Reinvestment Act set the stage for engagement between microenterprise organizations and mainstream financial institutions. Looking forward, other new policy initiatives could spur the industry's growth or create mechanisms to serve aspiring entrepreneurs directly.

Organizational Growth Fueled by More than Funding from Local Foundations

MicroBusiness Development Corporation, a microenterprise organization based in Denver, Colo., has experienced significant growth over the past four years. From an organization that in 1999 served about 500 clients and made a handful of loans, MBD served more than 1,600 clients and made 171 loans totaling more than $1 million in 2004. Support from several local donors, in the form of funds and other assistance, has been critical to this expansion. MBD's growth was first catalyzed by the merger of two pre-existent microenterprise programs – PACE and Colorado MicroCredit (CMC). The JFM Foundation, a supporter of PACE, saw great promise in the merger – not only in terms of efficiencies, but also in terms of PACE's ability to better reach communities that were served by CMC. The foundation provided a general support grant to fund costs associated with the merger – marketing, the name change, legal work and other expenses. The Rose Community Foundation, another existing funder, also funded a new branding and marketing campaign, so that MBD could quickly position itself.

As the organization continued to grow, funders have helped it increase its organizational capacities. The Rose Community Foundation provided funding to strengthen MDB's financial management capacity, and to reach out to the Latino communities in Denver and Boulder. The Anschutz Family Foundation offered one of its staff members to mentor MBD's director for a year, providing her with key advice on board development, personnel and financial issues. And the Piton Foundation, as well as other local funders, introduced MBD to other foundations and local partners who have joined with it to expand services throughout the region. From MBD's perspective, this latter role – in which funders help to bring them into new relationships and partnerships – has been especially critical to its ability to expand geographically, and to deepen its reach into existing markets.

[3] Greg Ratliff and Kirsten Moy, New Pathways to Scale for Community Development Finance, *Profitwise News and Views*, Chicago Federal Reserve, December 2004, http://chicagofed.org/community_development/files/12_2004_pnv_new_pathways_to_scale.pdf

What funders can do

Funders are beset with challenges when trying to decide how best to allocate scarce resources. Those interested in supporting scale might consider the following:

Invest in the "winners" for the long term.

A program with a good track record and the potential for growth merits long-term support. If scale-up takes time, then funding needs to be there for the long term as well. This doesn't mean funders shouldn't expect these programs to push toward greater self-sufficiency at the same time. Subsidy and revenue generation need to go hand in hand.

Invest in the building blocks of scale.

Organizations need funding for more than direct program services. They also need funding for market research, product development, management information systems and other technology, and staff and board development. Support for business planning and the development of a financing structure that matches the institution's vision is critical, too. Recognize that innovation is present not just in the initial concept, but in thinking through product delivery and implementing a full-scale rollout of a useful product.

Support structural change in the industry.

Mergers and acquisitions already have fueled growth for a few institutions, leading to broader product lines, new geographic regions, and increased efficiencies. Strategic alliances and functional or geographic partnerships also have the potential to help smaller institutions increase their product line, efficiency and quality. For example, partnering with MicroMentor – an Internet service that matches aspiring entrepreneurs with mentors – allows an organization to offer a service that would require more resources if done independently. Similar partnerships around loan products have the potential to reach more credit seekers without replicating expensive infrastructure. Funders can encourage grantees to take a hard look at such approaches, support board education and engagement around these issues, and even identify potential partners.

Consider "out-of-the-box" approaches to achieving mass impact.

Some practitioners are asking: Are there other ways to benefit thousands, and potentially millions, of aspiring entrepreneurs besides direct service delivery? What about changes in health insurance that can increase its affordability to small business owners, and possibly increase the likelihood that workers gain coverage as well? Would tax credits for early stage businesses make formalization more attractive, and feasible, and enhance their long-term growth prospects? Currently, microentrepreneurs are "invisible" in most EITC campaigns, their tax filing requirements outside the purview of many free tax preparation services. Strategies for mass outreach to these business owners could increase their incomes, and potentially infuse their businesses with much needed cash. While there has been small-scale experimentation at building bridges between the EITC and microenterprise worlds, a larger solution waits to be designed. Achieving greater scale and impact in the U.S., then, may come not only from expanding direct service delivery, but also from enhancing the prospects for entrepreneurial activity through changes like these.

For more information

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. See especially pages 34-36, 81-83 and 90-92. Available from: http://www.fieldus.org/publications/FulfillingthePromise.pdf.

Elaine L. Edgcomb. *Scaling up Microenterprise Services*. Washington, D.C.: The Aspen Institute/FIELD, May 2002. This summarizes the experience of eight organizations with lessons learned. Available from http://www.fieldus.org/publications/ScalingUp.pdf

FIELD Funder Guides are produced by the Aspen Institute's FIELD program, dedicated to promoting best practice and policy for microenterprise development in the United States. Series funding is provided by the Charles Stewart Mott Foundation.

The Aspen Institute | One Dupont Circle, NW | Suite 700 | Washington, DC 20036

www.fieldus.org

FIELD
Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination