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A Newly Crowded Marketplace:
How For-profit Lenders Are Serving Microentrepreneurs

Authors:
Luz Gomez
Elaine L. Edgcomb

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THE ASPEN INSTITUTE
1 Dupont Circle, NW, Suite 700
Washington, DC 20036
Website: www.fieldus.org

The landscape of financial access for microenterprises in the U. S. has changed dramatically in the aftermath of the financial crisis. Gone are the days when many microentrepreneurs were easily able to tap home equity lines and personal and business credit cards, as access to both of these sources was pulled back considerably in the midst of falling home values and more conservative bank underwriting.

Recently, a number of for-profit organizations working in the retail financial services arena have begun to fill this void by offering microloans to microbusinesses and consumers alike — positioning themselves quite differently from traditional financial institutions and alternative financial (retail) providers, such as check cashing outlets or personal finance companies. While traditional personal finance companies offered access to credit, many did so without offering additional developmental benefits like building credit, which several of these newer companies aim to do. Some of these newer companies have scaled significantly in a short period of time. Progreso Financiero, for example, has disbursed over 100,000 small-dollar loans in low-income communities since its launch in 2005. Using a very different consumer model, online peer-to-peer (P2P) lenders, such as Lending Club or Prosper, have together lent over $400 million since their respective foundings in 2006 and 2007. While Progreso and these P2P lenders largely work in the consumer finance realm, a portion of their sizable (and growing) portfolios is comprised of small and microbusinesses that receive personal loans specifically for business purposes.

Other for-profit lenders focus explicitly on the microbusiness segment. OUR Microlending and Financiera Confianza, for example, target the low-to-moderate income microenterprise market exclusively and have grown aggressively (compared to nonprofit microlending peers) in a three-to-four year period. Other, more traditional companies, such as merchant cash advance providers and factoring companies, have reemerged as bigger players amid the credit crunch. And, even large retailers, such as Sam's Club, have thrown their hats in the ring. Sam's has begun offering SBA-guaranteed small business loans under $25,000 in partnership with California-based Superior Financial Group — not an insignificant move given its substantial small business customer base.

It is important to understand what this changing marketplace might hold. What are the implications of this new landscape of providers for microentrepreneurs and the nonprofit microlending industry? What might nonprofit microlenders learn from the experiences of the for-profit lenders in scaling their services? And, what opportunities might exist for collaboration?

Methodology

To begin to answer some of these questions, FIELD conducted a review of recently available literature on alternative financing for small businesses and conducted phone interviews with several providers. Although the term 'small business' can cover a large spectrum of enterprises, the research focused particular attention on lenders that offered loans less than $35,000, which has typically been the maximum loan size offered by most nonprofit microlenders. The research also included site visits to two for-profit microlenders working exclusively with low-to-moderate income entrepreneurs — OUR Microlending, based in Miami, Florida, and Financiera

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Confianza, based in Los Angeles, California — with the goal of understanding the operational underpinnings of these two companies as well as their positioning and targeting of the microenterprise market.

Box 1:

Defining Microenterprise: the microenterprise development industry has typically defined a microenterprise as a business with five or fewer employees that requires $35,000 or less in start-up capital and that does not have access to the traditional commercial banking sector. From FIELD's perspective, we have often used an additional qualifier or lens for the field, focusing on business owners who are low-income. While many entrepreneurs who lack access to commercial credit may be poor or struggling economically, not all are. Indeed, in the aftermath of the financial crisis, microlenders have indicated that more moderate-income entrepreneurs have found themselves without access to the capital needed to start or grow their businesses.

FIELD's Census of the field: In 2009, FIELD conducted the U.S. Microenterprise Census, collecting data for fiscal year 2008 on providers of microfinancing and training. Of the 696 organizations identified in the Census, 263 provided microloans. FIELD considered any loan less than or equal to $35,000 a microloan. Since the Census was conducted, the Small Business Administration has increased the size of loans that can be made under its Microloan program to $50,000 and it is likely that this figure will become the delimiter of microloans in the U.S.

The Changing Marketplace: A Widening Gap in Delivery

As FIELD documents in its publication, *Surviving the Recession: How Microlenders Are Coping with Changing Demand, Risk And Funding*, in the years leading up to the recession (2002 - early 2008), the microenterprise field experienced gradual growth as measured by increased lending activity. However, data collected on microlenders by the Opportunity Finance Network (OFN) illustrates that from late 2008 through the third quarter of 2010, although applications were increasing, originations were lagging, in some quarters quite far behind (see Table 1).[1] A survey conducted by FIELD in the first quarter of 2010 found similar results: 66 percent of 72 responding microlenders indicated they experienced increased demand from potential applicants in 2009 (compared to 2008). However, trends in originations were mixed among those surveyed, with only 39 percent citing an increase in originations, 32 percent citing a decline and 28 percent remaining flat over the same period.[2]

[1] Opportunity Finance Network. *CDFI Market Conditions Report Third Quarter 2010, Report II: Detailed Tables* (Philadelphia: Opportunity Finance Network, January 2011); available from http://www.opportunityfinance.net/store/downloads/CDFI_Market_Conditions_Q310_Report_II.pdf; Internet.
[2] *Trends in Demand, Risk and Funding: Market Conditions for Microlending*, http://fieldus.org/Webinars/TrendLines/lib/playback.html (accessed – February 1, 2011).

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Table 1: Applications, Originations and Expected Demand
Quarter 4 2008 through Quarter 3 2010

Increasing:	Q4 2008 (n=22)	Q1 2009 (n=11)	Q2 2009 (n=20)	Q3 2009 (n=13)	Q4 2009 (n=16)	Q1 2010 (n=18)	Q2 2010 (n=17)	Q3 2010 (n=23)
Applications	77%	73%	80%	69%	44%	61%	65%	61%
Originations	67% (n=21)	42% (n=12)	50%	62%	31%	50%	59%	65%
Expected Demand for Financing	78%	85%	71%	77%	50% (n=14)	62% (n=13)	65%	61%

Source: Opportunity Finance Network, CDFI Market Conditions Report Third Quarter 2010

Other responses to the OFN survey illustrate some of the story behind the data. Microlenders noted difficulties processing a growing number of applications (due to internal capacity issues), and that they had diverted resources from underwriting to collections because of declining portfolio quality and the effort involved in arranging work-outs.[3]

While these data were reported specifically by microlenders, other research provides context for their experience of increasing demand. A recent publication by the Federal Reserve documents that the contraction in bank small business lending in low-to-moderate income (LMI) communities was greater than non-LMI areas from 2008 to 2009. Its research found that, in 2009, LMI neighborhoods had only one loan for every 28.4 small businesses, compared to one loan for every 22.6 small businesses in middle and upper income neighborhoods. Moreover, during the peak of the recession, from 2007 to 2009, the number of small business loans from large banks dropped from 395,000 to 144,000, meaning that approximately $7.6 billion fewer dollars were going into these communities.[4] Many banks have cited dampened demand for loans among strong commercial applicants as the primary factor for the significant drop in commercial lending.[5] Whatever the case may be, drastic declines, such as these in LMI communities, would also seem to indicate the emergence of a large vacuum that enabled alternative lenders, such as those described here, to grow and scale relatively rapidly during this same period.

The "New" Players

The types of financial institutions that have emerged in recent years, and whose scale has grown in response to the changed context, are outlined below. Although it is difficult to identify the detailed market segments that some alternative financial providers specifically serve, this research focused on two groups: those working directly with clients that nonprofit microlenders have typically served — clients that are LMI, have had difficulty accessing business credit, and have capital needs of less than $35,000 — and emerging or fast-growing companies that have

[3]FIELD, *Surviving the Recession: How Microlenders are Coping with Changing Demand, Risk and Funding* (Washington D.C.: The Aspen Institute, July 2010), 4.

[4]Elizabeth Laderman and Carolina Reid, "The Community Reinvestment Act and Small Business Lending in Low-and-Moderate Income Areas during the Financial Crisis," Working Paper 2010-05 (San Francisco: Federal Reserve Bank of San Francisco, October 12, 2010), 6.

[5]"Poor Loan Demand Damps Bank Profits," *Wall Street Journal*, 22 July 2010.

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broader client bases. While clients of this second group are likely comprised of more moderate-income small businesses, these businesses are still likely to be relatively small-scale given that their typical capital needs are less than $35,000 (see definition from Box 1).

Lenders Targeting LMI Microenterprises

Small-Dollar Consumer Lenders: While consumer finance companies are not a new phenomenon, one fast growing player largely serving the Latino market in California and Texas is Progreso Financiero. Launched in 2005 and located in retail sales points like Latino supermarkets, Progreso has positioned itself as a social enterprise committed to providing an alternative to payday lending among the unbanked Latino population. Using a credit-scoring model coupled with face-to-face client interaction the company's small-dollar loans somewhat mirror those found in international microfinance. With an average loan size of $900 and a loan limit of $2,500, Progreso processes roughly 8,000 loans per month.[6] In addition to charging a much lower Annual Percentage Rate (APR) than the payday lender average of 400 percent,[7] Progreso also reports its clients' payment histories to the credit bureaus, and the company cites that roughly fifty percent of its clients do not have a formal credit history. Despite its consumer-finance focus, the organization does serve more informal microentrepreneurs (such as Mary Kay or swap meet vendors); its data show that ten percent of its clients are using the small loans to invest in their own businesses.[8] The company processes and disburses loans via its own prepaid card in fewer than three days. With 37 retail sales points, the company is growing rapidly and is planning to add other products in the future as its relationships with unbanked customers grow.

For-Profit Commercial Microlenders: Both Financiera Confianza and OUR Microlending focus explicitly on lending to the microbusiness market. Both companies draw heavily on their founders' extensive experience with microfinance in Latin America. Their models are based on a grassroots relationship-based lending approach common to the U.S. microfinance industry, in which loan officers cover a geographic territory and handle the outreach, lending and collections in their area. While many nonprofit microlenders have grown incrementally over time, in some ways Confianza and OUR have leapfrogged much of the nonprofit industry, as can be seen in their infrastructure development, portfolio growth and portfolio performance (see more detailed discussion below). Both companies have higher pricing structures than their nonprofit counterparts, and both rely on qualitative, high-touch underwriting models[9] (versus scoring models). Efficiency levels–as measured by turnaround time from application to disbursement — are reported to be between one and five working days.

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[6]Gustavo Lasala, interview by author, 2 November 2010, via telephone.

[7] "How Quick Cash Leads to Financial Quicksand." Center for Responsible Lending, http://www.responsiblelending.org/payday-lending/ (accessed February 1, 2011).

[8]Materials from Progreso Financiero presentation at the 2010 Opportunity Finance Network Conference. Panelist at session titled "Small Dollar Lending: Accessibility, Responsibility, and Economic Viability," (San Francisco November 2010).

[9] FIELD defines "relationship-based" underwriting as incorporating more qualitative judgment and higher levels of client interaction in decision-making. In contrast, "transactional underwriting" uses statistics — or quantified learning —to evaluate risk and is exemplified by the use of scoring grids or scorecards to arrive at a lending decision. For a discussion on this topic, see Elaine L. Edgcomb and others, *Dollars for Dreams: Scaling Microlending in the United States* (Washington D.C.: The Aspen Institute, 2010), 24-27.

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Lenders Targeting Broader Client Bases with Capital Needs Less than $35,000

Peer-to-Peer Lenders (P2P): Prosper and Lending Club represent a new line of lending, which recent literature would put under the banner of "collaborative consumption". Collaborative consumption is broadly defined as people engaging directly with each other.[10] In this case, a lender finances a particular person or small business directly (note that this is different from platforms such as Kiva, where microfinance institutions (MFIs) act as intermediaries between lenders and borrowers). While these sites primarily focus on personal loans less than $25,000, both sites also cater to small business owners by facilitating personal loans for business purposes. It is not fully clear how many dollars in small business loans these lenders have facilitated; however, both have scaled dramatically. And, Prosper.com, which has funded $212 million in loans via its platform since launching in 2006, reported in November 2010 that 12 percent of its loans had been used for business purposes.[11]

These P2P platforms seem to be a viable option for business owners on the top end of the credit quality spectrum (credit scores for new borrowers on Prosper and Lending Club are set at a 640 and 660 minimum, respectively). For an internet-savvy customer with a solid credit score, this option is seemingly attractive — they get the sites' best rates and are a low-risk investment to an individual lender. Conversely, business owners with lower credit quality, who have likely been declined by other financing sources might represent the highest risk on these sites, but would also generate the highest returns for the investors since they are given the highest interest rates. Despite initial incentives offered by Prosper, the site has been less successful in moving lenders to less-qualified, riskier borrowers.[12] In addition, Prosper has been reducing its exposure to lower credit quality borrowers by establishing minimum credit thresholds. Although many microlenders would not necessarily cite these online lenders as direct competition (the sites were not designed to focus primarily on microenterprise or community development), they may be an attractive option for clients who might not qualify for a loan from an microenterprise development organization (MDO) (for example, because they lack sufficient documentation), or for "stronger" clients who have a more immediate need than a microlender can satisfy. On both sites, loans are listed for a maximum of 14 days, and many offerings are fully or partially funded in less than a week.

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[10] The term "collaborative consumption" is used to describe the cultural and economic force away from 'hyper-consumption' to re-invented economic models of sharing, swapping, bartering, trading or renting that have been enabled by advances in social media and peer-to-peer online platforms. Rachel Botsman and Roo Rogers, *What's Mine is Yours: The Rise of Collaborative Consumption* (New York: HarperCollins Publishers, 2010). The new website www.kickstarter.com can be considered within this P2P vein as well. The site is an online platform where creative projects are funded by individuals.

[11] Prosper (2010). Prosper Discovers Black Friday is not only for Shopping [Press Release]. Retrieved from http://www.prosper.com/about/media_press_releases.aspx?t=Prosper_Discovers_Black_Friday_Is_Not_Only_for_Shopping. A brief review of the available business listings on Prosper.com illustrates loan offerings by borrowers of less than $10,000.

[12] Tillman Bruett, "Cows, Kiva, and Prosper.com: How Disintermediation and the Internet are Changing Microfinance." *Community Development Investment Review* Vol.3, Issue 2 (December 2007): 3.

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Large Retailers: The Sam's Club small business loan program, in partnership with Superior Financial Group, is part of the Small Business Administration (SBA) 7(a) Express program[13] that offers term loans between $5,000 and $25,000. The benefits of adding this service are clear — Sam's Club provides its current small business clients with value-added services, allowing the company to nurture a deeper client relationship and potentially fostering greater sales volume at the store as the businesses grow. The loans carry an SBA guarantee (of up to 85 percent) and require that the borrower receive a minimal level of technical assistance.[14] Rates are competitive in comparison to traditional commercial bank loans and the turnaround is quick — with immediate prequalification and funding within a week of submission of a complete application.[15] The Sam's Club Web site also offers On Deck Capital's financing assessment (see below for details). Other large retailers have been offering financing programs for some time; for example, the Whole Foods Local Producer Program lends directly to the local producers with whom Whole Foods works. However, the Sam's Club pilot program appears to have a greater opportunity to scale given the sheer size of the retailer's client base and its direct access to its customers for cross-marketing opportunities.

Other Alternative Commercial Lenders: While merchant cash advances (MCAs), factoring and purchase order financing[16] have been around for several decades, these lines of businesses received a bump in business with the economic downturn.[17] Alternative financing vehicles like MCAs are not structured as traditional loans, but rather are cash advances based on future credit card sales (allowing offerors to circumvent interest rate ceilings on commercial loans). MCAs take a percentage of daily sales; as such, the payment amount will rise or fall based on the sales of a particular day and continues until the cash advance is paid off. Typical fees can be the equivalent of 30 to 50 annual percentage rates, with rates up to 100 percent not uncommon. Average cash advances to largely high credit card volume retailer and service companies are $20,000 to $25,000 and, by some estimates, the industry represents $500 to $700 million in outstanding "advances."[18]

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[13] On December 15, 2010, the SBA announced an expansion of the 7(a) program to target underserved communities, acknowledging that minorities were disproportionately affected by the tightening of credit during the recession. The new Advantage program will expand its Preferred Lender Program to include Community Development Financial Institutions (CDFIs) and nonprofit microlending programs and increase the loan limits under the 7(a) program to $250,000. The Community Express will be replaced by April 30, 2011.

[14] Technical assistance is provided through business training providers like Small Business Development Centers (SBDCs) or in the form of templates provided by the company for start-up businesses.

[15] A brief look at the loan pilot success stories on the Sam's Club Web site (http://www.samsclub.com/sams/pagedetails/content.jsp?pageName=sbaLoanProgram) shows loans approved of less than $10,000.

[16] Factoring is the selling of a company's account receivables, at a discount, to a factor who then assumes the credit risk and the accounts' debtors. The factor then receives cash as the debtors settle their accounts. Purchase order financing refers to the assignment of purchase orders to a third party, who then assumes the obligation of billing and collecting.

[17] See "The Places They Go When Banks Say No," *New York Times*, 1 February 2010; "When Small Biz Can't Get a Loan," *Bloomberg Businessweek*, 8 May 2008; and "Look Who's Making Coin Off the Credit Crisis," *Forbes.com*, 31 January 2008.

[18] Marc Abbey and others, "The Green Sheet: Sizing Up Merchant Cash Advance" (Baltimore, MD: First Annapolis Consulting, January 28, 2008). http://www.greensheet.com/gs_online.php?story_id=542 (accessed February 1, 2011).

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On Deck Capital, a relative newcomer to commercial financing, launched four years ago. While not an MCA provider — the company defines itself as an alternative commercial lender providing capital to healthy Main Street businesses — some of the technology it employs is inspired by the MCA model. On Deck Capital extends loans of less than $30,000[19] based primarily on an in-depth cash flow determined by online banking statements and volume of credit card sales. Thus, underwriting focuses less on the business owners' personal credit score, although the company does report payments to the credit bureaus. On Deck's evolving proprietary model also analyzes variables such as business credit, tax data and social indicators.

Like MCAs, On Deck takes daily payments ("micropayments") directly from its clients' bank accounts. Unlike MCAs, the payments do not rise and fall according to incoming sales; rather, there are fixed daily payments. These daily micropayments not only help to ensure repayment, but also give the client a degree of flexibility in managing their cash flow and large monthly payment commitments (i.e. rent). Since its launch in 2007, On Deck has worked primarily with small retail and service establishments, disbursing roughly $110 million to more than 3,000 entrepreneurs. The company is typically able to service customers with what banks would consider weaker personal credit histories (credit scores generally in the 600 and above range),[20] but who can demonstrate a high volume of small-ticket electronic transactions. This opens the door to many small businesses (restaurants and small retailers in particular) that have difficulty accessing bank financing when based on a review of only recent tax return documentation. The company appears well-capitalized, with $60 million available through hedge funds and private equity firms.[21] It also recently launched the On Deck Credit Director,[22] a free service allowing business owners to input their personal and business data to find the lowest-cost financing option based on their profile. The service also provides feedback on what lenders are looking for and where business owners can improve. This brokerage-type model that helps to connect small businesses to other financing opportunities would also, in theory, provide another revenue source to the organization as it enables a broader array of business owners to access financing from a range of financial institutions.

[19] On Deck Capital very recently started offering loans up to $100,000 as well. Until late in the fourth quarter of 2010, however, the maximum loan size advertised on its site was $30,000.

[20] On Deck Capital noted being able to serve clients with scores as low as 500. Gordon Brott, interview by author, 20 December 2011, via telephone.

[21] "On Deck Capital Targets Businesses Banks Won't Touch," *Bloomberg Businessweek* 7 September 2010, http://www.businessweek.com/smallbiz/content/sep2010/sb2010097_939602.htm (accessed February 1, 2011).

[22] This service includes a soft credit pull and asks for basic information like a tax ID number. An analysis of bank statement activity, for example, will be provided if the client submits additional information for analysis by On Deck.

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Chart 1: A Snapshot of Providers: What Companies are Serving Microentrepreneurs?						
	Products	**Process**	**Mission**	**Rates (APR)/Fees**	**Positioning/ Value Proposition**	**Main Target/Segments Served**
Progreso Financiero	**-Fully amortizing installment loans up to $2,500. -Average $900 over nine months.**	**Scoring model with face-to-face interaction (initial application, disbursement and payment).**	**"…to help our customers build credit in the United States and gain access to better lives and mainstream financial services."[23]**	**-36% APR, (includes origination fee and interest). -lower rates on subsequent loans.[24]**	**-To deliver financial freedom by building credit.**	**-Unbanked LMI Hispanic population. -Largely consumer focused. -10% of portfolio very small scale micro-entrepreneurs.[25]**
OUR Microlending	**-Term loans from $1,500 to $20,000**	**Predicated on relationship-based underwriting model.**	**"…to offer efficient microfinance services that support and promote the economic and social development of microentrepreneurs".[26]**	**-18% APR, plus 5% origination fee on approved loans.[27] -Includes mandatory 10% cash collateral financed into loan and returned to client after repayment.**	**Quick turnaround, transparency, honest/solid reputation.**	**-Existing LMI microenterprises (in operation at least 1 year) -Typical revenues of $50,000-$60,000/year.**
Confianza	**-MiCredito Microloans: $2,500-$10,000 -EasyPay Loans: $2,500-$25,000 -Opportunity Loan: $5,000 to $25,000**	**Predicated on relationship-based underwriting model.**	**"To support low/moderate income Latino microentrepreneurs with their family's financial stability and growth, while achieving and maintaining our profitability…"[28]**	**-MiCredito and EasyPay: 50-80% APR, which includes a 5% admin fee; 12-month term.[29] -Opportunity Loan: 18% APR plus 5% admin fee; term is up to 30 months.**	**"Fast and hassle-free credit."[30]**	**-Existing LMI microenterprises (in operation at least 1 year) -Typical revenues of $60,000 to $96,000/year, Opportunity Loan recipients tend to have 50% higher revenues.**

[23]From corporate website: http://www.progressfin.com/en/about/ (accessed December 15, 2011).
[24]Materials from Progreso Financiero presentation at the 2010 Opportunity Finance Network Conference. Panelist at session titled "Small Dollar Lending: Accessibility, Responsibility, and Economic Viability," (San Francisco, November 2010).
[25] Progreso Financiero presentation, 2010 Opportunity Finance Network Conference.
[26]From mission statement posted in the client lobby of the OUR Microlending main office, Miami, Florida.
[27] There is an interest rate cap of 18 percent APR in the state of Florida for commercial loans.
[28]Confianza's full mission statement is: To support low/moderate income Latino microentrepreneurs with their family's financial stability and growth, while achieving and maintaining our profitability by: 1) Providing fast and hassle free access to small working capital loans; 2) Adjusting our rates as a function of our sustainability; 3) Setting correct incentives to improve credit worthiness and marketability; and 4) Giving access to a business network that can contribute to their success.
[29] The state of California has caps on interest rates for loans under $2,500 (which are considered personal loans). Confianza has chosen to focus on commercial loans above that threshold.
[30]Marco Lucioni, interview by author, 20 October 2010, via telephone.

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Chart 1: A Snapshot of Providers: What Companies are Serving Microentrepreneurs? (cont)						
	Products	**Process**	**Mission**	**Rates (APR)/Fees**	**Positioning/ Value Proposition**	**Main Target/Segments Served**
Prosper.com (P2P lender)	**-Unsecured, Term loans between $1,000 and $25,000. -Prosper handles the origination and servicing function of the transaction for a fee.**	**Platform matching investors with borrowers. Both individuals and institutional investors can participate in funding all or part of a specific loan.**	**"Prosper allows people to invest in each other in a way that is financially and socially rewarding."[31]**	**-Average of all funded loans 20-21% APR. Range of 8-33% APR as of 11/2010.[32] Determined by risk grading of borrowers. -1-2% charged by Prosper for servicing.**	**-Easy, straightforward process: "personal loans without the big bank attitude."**	**-Largely moderate-income, consumer focused personal loans. -14% use loans for business purposes.[33]**
Sam's Club	**SBA 7(a) Express loans $5,000-$25,000**	**Apply remotely. Two week process to disbursement of funds. Some limited TA required as part of the 7(a) program.**	**"Sam's Club offers exceptional values on merchandise and services for small business owners and consumers."[34]**	**-7.5% to 9.17% plus a packaging fee from $350 to $450. -Up to 10 year terms.**	**"Low affordable interest rates with simple easy terms. No collateral required."[35]**	**-Existing Sam's Club business customers. -Typical household income of Sam's Club member is $72,000.[36]**
On Deck Capital	**-Typically loans less than $30,000 -On Deck Credit Director**	**Online application, evaluation of online banking and merchant information as part of proprietary model. -Use of daily micropayments. -Use online marketing and partners for distribution.**	**"…to be the connection between small business and capital…provide capital for growth to healthy Main St. businesses."[37]**	**-From 18-30% APR with terms from 6-12 months. -One-time fee of $500 and up for consulting/advisory services.**	**"Quick assessments, involves less work for business owner." "Flexible, accommodating, designed with your business in mind."[38]**	**-Existing business for at least a year. -Typical business has revenues from $250,000 to $2.5 million.**

[31]From corporate website: http://www.prosper.com/about/.
[32] Prosper. (2010). Prosper Reports 17% Increase in Loans in November [Press Release]. Retrieved from http://www.prosper.com/about/media_press_releases.aspx?t=Prosper_Reports_17%25_Increase_in_Loans_in_November.
[33] Prosper. (2010).
[34]Sam's Club. Corporate Fact Sheet. Retrieved from http://www3.samsclub.com/NewsRoom/AboutUs/Facts.
[35]Sam's Club. Retrieved from http://www.samsclub.com/sams/pagedetails/content.jsp?pageName=sbaLoanProgram&?searchCategoryId=all&searchTerm=loans&_requestid=27023.
[36]Sam's Club largely focuses on its small business clients (versus its parent company, Walmart) and has a higher household income than Walmart ($72,000 versus $45,000). "Support System: Guess Who's Got His Back?" *New York Times*, 1 May 2006.
[37]Gordon Brott, interview by author, 20 December 2010, via telephone.
[38]On Deck Capital. Retrieved from http://www.ondeckcapital.com/our-loans/overview.

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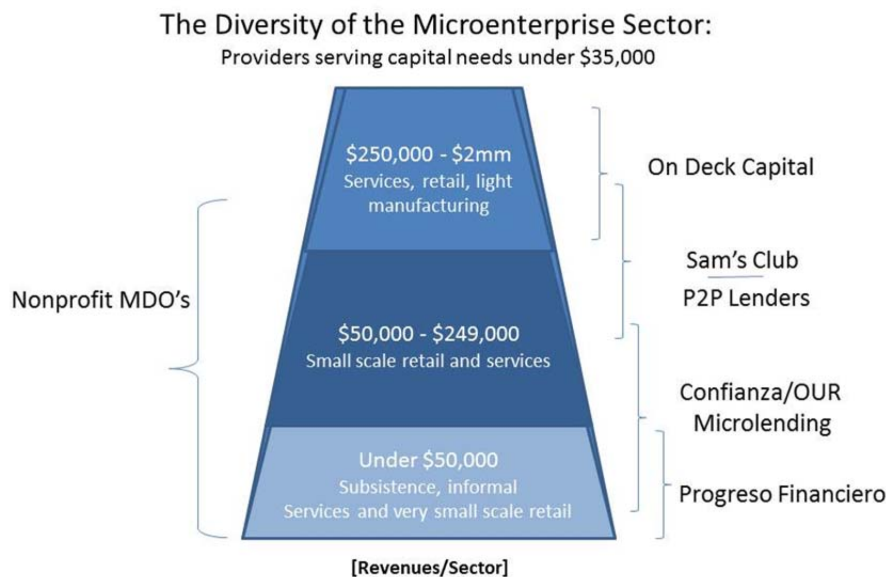
Target Markets: An Overlapping Market

Even within the microenterprise sector, the range of assisted businesses is wide. It varies from very small subsistence enterprises owned by low-income entrepreneurs, who may rely on other sources of income to meet their living needs, to larger microenterprises that are still modestly sized but growing in revenues, owner's draw and employees, and are owned by more moderate-income individuals. The sector also encompasses a diversity of industries/sectors and revenue sizes. The range of financing products offered by lenders targeting the microenterprise sector reflects the range of the clients served — with some of the larger-scale nonprofit microlenders offering small business loans larger than $50,000.[39] FIELD's paper, *At the Five Year Mark: Outcomes Reported by U.S. Microenterprise Clients*, offers a snapshot of the diversity of business owners served by MDOs. Among existing businesses (non start-ups) at intake (or initial interaction with the organization) median revenues were $64,000 per year and the mean $170,000.[40]

A comparison of the target markets served by MDOs with those of alternative financial institutions suggests that there is overlap. The graphic below illustrates where these target markets potentially coincide. Ultimately, if there is some degree of overlap, it is important to understand the difference in the value propositions and pricing offered by the nonprofits versus for-profits. How is each competing in this changing marketplace? After exploring these issues in more detail, we will also take an in-depth look at the most direct competitors to nonprofit microlenders.

Graphic 1: Overlapping Markets



[39]William Girardo and Elaine L. Edgcomb, *Key Data on the Scale of Microlending in the U.S.* (Washington D.C.: The Aspen Institute/FIELD, March 2010), 3.

[40]Tamra Thetford and Elaine Edgcomb, *At the Five Year Mark: Outcomes Reported by U.S. Microenterprise Clients* (Washington D.C.: The Aspen Institute/FIELD, March 2010), 7-8.

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Comparing Pricing Models

With the exception of the Sam's Club program, for-profit pricing is markedly higher than that of nonprofit microlenders. Factors influencing their rates include:

- The focus on profitability;
- Loan purpose (whether it is defined as business loan or consumer loan);
- The lender's assessment of the target market's pricing sensitivity;
- State limitations on interest rates; and
- Cost of capital.

The range, therefore, is wide. Progreso, which offers a consumer loan product (but one used by some clients for business purposes), charges a fixed 36 percent APR. The P2P lender, Prosper, reports average annual percentage rates of 20 to 21 percent. Among the strictly business lenders, pricing ranges from 7.5 percent to 9.15 percent at Sam's Club, 18 percent at OUR, between 18 and 30 percent at On Deck, and 50 to 80 percent at Confianza. The Sam's Club offering is unique among these examples because its loans are made through its partner, Superior Financial Group. As Superior is an SBA lender in the Community Express and Patriot Express programs, it faces limitations with regard to the price (see Chart 1 for further detail).

In contrast, FIELD has found that leading nonprofit microlenders charge interest rates between 5 and 18 percent and, that while they share some factors in common with for-profits (cost of capital and interest rate caps), other factors influencing their rates differ from those of the for-profits.[41] They include:

- A focus on "fair" pricing. The interpretation of "fair" varies from organization to organization, and with nonprofit lenders holding different views as to whether fair pricing requires some level of subsidy. For some that means not charging more than more "advantaged" business owners pay; for others it means charging more in relationship to costs and risk.
- Pricing pressures or constraints imposed by funders;
- A lack of good market data on customer responses to varying interest rates; and
- Limited information about the costs associated with their individual loan products.[42]

The pricing models that nonprofit lenders maintain create certain trade-offs. For one, at present the vast majority (if not all) of nonprofit lenders[43] require subsidy as their revenues are not sufficient to cover their total costs (reflecting their operational costs, their cost of capital, and net loan losses). By limiting revenue generation, current pricing schemes also hinder nonprofit lenders' ability to invest in infrastructure. At the same time, however, the generally lower rates and longer terms that nonprofits typically offer support their borrowers' ability to invest for longer-term growth, thereby allowing the nonprofits to focus on business development goals in combination with capital access. In contrast, Confianza's pricing scheme, for example, would seem untenable at longer terms and at loan amounts over $5,000 or $10,000 for many

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[41] Edgcomb and others, *Dollars for Dreams,* 20.

[42] Edgcomb and others, *Dollars for Dreams,* 17-23.

[43] It is important to note that the profitability of the for-profits is not known in most of the cases discussed here. Whether they are yet profitable or not, their pricing is driven by their intent to become so.

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microenterprises. There is undoubtedly a dynamic imposed by a for-profit model — the pressure inherent in getting to profitability quickly — that has the potential to leave business development progress second rather than at the forefront.

Quoting Interest Rates: the Nominal APR, Effective APR (EAR)

The Truth in Lending Act mandates that all companies provide clients with the total finance charges and the APR (annual percentage rate). Many companies, however, often only quote simple or *nominal* APRs, finance charges expressed as an annual rate, in their marketing materials. The *effective* APR (EAR) varies by state, but depends on the type of fees included, such as participation fees, loan origination fees, monthly service charges or late fees. Because the specifics of loans can vary, an *effective* APR can impact the total cost of a loan depending on whether the up-front fees, such as origination or participation fees, are added to the entire amount, or treated as a short-term loan due in the first payment. The effective rate will also be impacted by the term of the loan; the effective APR will be higher if the term is less than one year.

With the exception of Progreso Financiero, all rates quoted for both for-profit and nonprofit financial institutions are the nominal APRs and do not include varying origination fees. See Chart 1 for more detail on the pricing, including additional fees charged, and the loan terms for the for-profit companies highlighted here. Origination fees charged by leading nonprofits are similarly varied, ranging from flat one-time fees or fees from two to seven percent.[44]

Positioning and Value Propositions

"In the financial services industry today, the ease and convenience of service is a major component of success. Low-income communities also demand convenience."[45] *~Ratliff and Moy*

As will be discussed in more detail below, the case studies reveal a number of similarities between the for-profit microlenders and the largest scale nonprofit microlenders in the U.S.[46] There are parallels in core products, technology systems, certain outreach methods, and in some cases, the use of relationship-based underwriting. Besides the differences in pricing, an additional dissimilarity lies in how the for-profit lenders are positioned in the marketplace and the value proposition they offer to their target market. Positioning is what sets a company apart from its competition; it underscores characteristics that make product stand out. By extension, the value proposition describes the benefits directly related to the product or service.[47] How are for-profit microlenders setting themselves apart in terms of these two critical factors?

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[44]Edgcomb and others, *Dollars for Dreams*, 20.
[45]Gregory A. Ratliff and Kirsten S. Moy, "New Pathways to Scale for Community Development Finance," *Profitwise News and Views* (December 2004): 19.
[46]Edgcomb and others, *Dollars for Dreams.*
[47]*Competitive Positioning,* Marketing [M.O.]; available from http://www.marketingmo.com/strategic-planning/competitive-positioning/.

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Site visits to the for-profit microlenders revealed that the common sales pitch (or value proposition) used by loan officers during sales calls emphasizes a fairly hassle-free application process with a quick turnaround and a high level of personalized customer service. These for-profit microlenders do not attempt to compete with their nonprofit counterparts on price; in fact, as noted above, the pricing at for-profit companies can be significantly higher. At least anecdotally, the for-profit lenders perceive relatively less concern with price among their potential client base. And, as their growth rates indicate, rapid and streamlined access to credit appears to be a value proposition that these companies' target markets are responding to — at least for loans of less than $10,000. (The exception to this may be among businesses seeking larger amounts of financing. Confianza's partnership with Opportunity Fund (see partnership description on page 20) was precisely designed to respond to this need, allowing them to offer a product that was much lower-priced than their other products, while still strongly emphasizing turnaround and ease-of-process.)

The value proposition that nonprofit microlenders have traditionally offered is access to credit for the underserved. This access is typically also coupled with an emphasis on developing longer-term relationships and business development assistance (in the form of business counseling and/or coaching around credit). Affordable pricing is also implicit in the value proposition. However, although many larger-scale nonprofit lenders have recently moved to improve the efficiency of their lending processes, few if any can offer the very rapid turn-around times offered by the for-profit firms. Looking at the recent growth trajectory that some of the for-profit lenders have experienced, the question arises as to whether speed and ease of access to credit is of greater importance to some clients than access to other services or lower pricing – at least in the current credit environment. If this is indeed the case, it raises the question of whether nonprofit lenders should reassess the value proposition they are offering to microentrepreneurs.

Case Studies of For-Profit Microenterprise Lenders: Confianza and OUR Microlending

As previously noted, both Financiera Confianza and OUR Microlending (OUR) have operational models taken from a deep involvement in Latin American microfinance. The founder and CEO of OUR, for example, helped found the Banco de Desarrollo del Microempresario (BDM) in Venezuela, a for-profit banking institution with a primary focus on microfinance. Similarly, the founder and CEO of Confianza gained experience through a family-owned consumer finance operation in Peru.

Products

The core products offered by both companies are term loans up to $20,000 and $25,000, with some minor differences in product structures. OUR loan products require an additional ten percent cash collateral financed into the loan proceeds, which is reimbursed to the client after successful repayment of the loan.

In addition to its small MiCredito term loans, Confianza offers the EasyPay Loan, in which payments look more like a merchant cash advance (MCA) product, but for credit reporting purposes are structured like a term loan. EasyPay loans are evaluated according to a clients' previous credit history and the business' volume of credit card transactions. Daily payments (a

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preset percentage based on previous credit card transactions) are made via a partner merchant provider. With this structure, the dollar amount of these "micropayments" rises and falls with the clients' daily cash flow. Confianza has also launched its Opportunity Loan, term loans up to $25,000, in collaboration with nonprofit lender Opportunity Fund Northern California.

Performance

Chart 2 illustrates the performance of Confianza and OUR Microlending relative to two cohorts of nonprofit lenders reporting to MicroTest: a set of programs that mirror the two for-profits in terms of their age and target market, and a set of the largest-scale microlenders that report to MicroTest.

These data reveal that Confianza and OUR both outpace their direct peers — programs less than five years old that are urban-based — in most indicators of portfolio performance. Moreover, when contrasted to the cohort of larger-scale microlenders (organizations making over 100 loans per year) the two for-profit companies approach the median figures for outstanding portfolio, dollars disbursed and operating budget size, and surpassed the median for number of loans disbursed. The comparison also indicates that the operational cost rate – which indicates the costs involved in managing $1 in the organization's loan portfolio — is fairly similar for all of these lenders, ranging from $.40 to $.52.

Chart 2: Performance at a Glance

Confianza and OUR Statistics as of December 31, 2010. Data for nonprofit comparisons are from 2008 and 2009.

	Financiera Confianza	OUR Microlending	MT Young Urban Programs[48] Median values	Large-Scale Microlenders (>100 loans disbursed)[49] Median values
Age	4 years	3 years	**2005 N=9**	**Urban; started before 1998**
Total Operating Budget	~$900,000	~$850,000	**$233,358 N=9**	**$974,897**
# of Full-time Employees (FTE)	12	7 FTE/9 Independent Contractors	**2 N=5**	**8.9**
Loan Ranges	$2,500-$35,000	$1,500-$20,000	**$500-$25,000 N=7**	**$214-$35,000**
# of Loans Disbursed	495	299	**23 N=6**	**178**
Dollars Disbursed	$2.7 M	$1.66 M	**$204,750 N=6**	**$1,571,979**

[48]Data for programs reporting to MicroTest in 2009 that were defined as young (under 5 years old) and primarily serving an urban population.

[49] Data from a group of 10 large scale microlenders reporting to the U.S. Microenterprise Census and MicroTest 2009 (FY2008 data).

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Chart 2: Performance at a Glance (cont) *Confianza and OUR Statistics as of December 31, 2010. Data for nonprofit comparisons are from 2008 and 2009.*				
	Financiera Confianza	**OUR Microlending**	**MT Young Urban Programs[50] Median values**	**Large-Scale Microlenders (>100 loans disbursed)[51] Median values**
Average Loan Size	Cfza: $4,250 OF: $12,500[52]	$6,262	**$12,722 N=6**	**$6,819**
Outstanding Portfolio ($)	$1.73 M	$2.112 M	**$259,945 N=6**	**$1,750,006**
Operational Cost Rate	$.52	$.40	**$.47 N=5**	**$.45 N=7**
Portfolio at Risk (PAR) (>30 days)	5%	Not available[53]	**0.0%[54] N=6**	**11.5%**
Loan Loss Rate (LLR)	~10%	0%	**2.6%[55] N=6**	**9.8% N=5**

Although the pace of growth achieved by the for-profit lenders shows potential for continued scale and strong performance, it is important to recognize the short period of time that both companies have been in operation. Balancing portfolio quality amid rising growth (and external macroeconomic factors) is a critical challenge for all lenders, and one that many of the large-scale nonprofits understand given their longer-term experience. The extent to which these younger for-profits will be able to sustain their growth and maintain portfolio quality will depend upon having the appropriate infrastructure in place, as long-term nonprofits have learned.

The following section describes the operational lending model of these for-profit microlenders. In many respects, it bears similarity to the practices of a few of the larger-scale nonprofit microlenders. In addition, as FIELD has documented, several microlenders that are working to scale their lending have also adopted similar practices, particularly with regard to sales/marketing, and underwriting and risk management. At the same time, there are some key differences in strategy, which will be highlighted.

Operational Lending Model

Despite being well aware of the advances of credit scoring technology in Latin America — OUR senior lenders visited Colombia to observe institutions using scoring tools — both organizations have built their underwriting methodology on a strong relationship-based model

[50] Data for programs reporting to MicroTest in 2009 that were defined as young (under 5 years old), and primarily serving an urban population.

[51] Data from a group of 10 large scale microlenders reporting to the U.S. Microenterprise Census and MicroTest 2009 (FY2008 data).

[52] Averages for Confianza loans and those done in partnership with Opportunity Fund.

[53] OUR has not written off any delinquent loans in its portfolio since inception, making comparison to other programs that regularly write off loans difficult. Moreover, the company is just recently tracking all loans according to the PAR >30 industry benchmark so accurate data for comparisons is unavailable for 2010.

[54] Four of the six organizations comprising this group had PAR of 0 percent; the other two had a PAR of 8.3 percent. The average for the group is 2.8 percent.

[55] Four of the six organizations comprising this group had LLR of 0 percent; the other two had LLR of 9.9 percent and 5.5 percent. The average for the group was 6 percent.

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dependent on loan officer assessments of entrepreneurs with whom they interact in their geographic target markets (loan officers are assigned to areas with high concentrations of microentrepreneurs). This hands-on model is a potentially challenging model to scale as the COO at OUR noted: "[To grow] we would likely continue to build our lending staff — it's essentially our core business." Its CEO, Emilio Santandreu, remarked that, although OUR's model is more expensive than implementing a scoring model, he views the lending associates to be vital evaluators in the underwriting process. Yet, Santandreu is also cognizant of balancing the costs that come with growth. OUR is exploring other possible staffing strategies as it looks to cover the state of Florida (and move to other states as well). These options include developing a hybrid workforce that would combine independent contractors (which OUR uses at present) with independent brokers to help bring down the overall cost of replication/expansion.

OUR's nine loan officers were initially trained by consultants who previously worked with an ACCION International affiliate. Working with many cash-based clients who often have little formal documentation (such as bank statements or tax returns), the loan officer builds a detailed cash flow analysis using a visual evaluation of the location in terms of inventory turnover, and a detailed review of margins/profitability on the business' main products. This data is, in turn, checked against a combination of one or all of the following: vendor purchases, register receipts and bank statements. Depending on the work rhythm of the loan officer, much of the analysis and client interview is performed on-site. Once the loan officer prepares the package, it is passed to a staffer who plays an auditor function at the organization. The auditor double checks the entire application for completeness, ensuring the profit and loss statement makes sense with the backup documentation provided, and checks for liens on collateral, etc. The application is then reviewed closely by a weekly credit committee.

OUR Microlending does not review a client's personal credit history for loans under $10,000. This practice opens up the market for them considerably given the many challenges that the South Florida region has faced during the recession. Despite the strong background and training of its lending team, the CEO of OUR frankly stated that it took some early losses to develop their current underwriting and collection procedures, and to have a good comfort level with them.

Confianza's model relies on a deep understanding of the U.S. Latino immigrant market and a degree of trial-and-error with industries that were initially unfamiliar to them. Over the past four years, the organization has developed a base of knowledge that enables them to benchmark sales for certain industries common among microentrepreneurs in the Los Angeles area. Confianza's sole underwriter worked for more than 20 years as a senior underwriter with a large consumer finance company (Central Financial) in the Los Angeles area and has a deep knowledge of low-to-moderate income Hispanic consumer finance. On small loans less than $5,000 (the MiCredito product), evaluation of the loan is based on review of any previous credit history, and a site visit and detailed profit-and-loss statement created by the loan officer. High-resolution photos of the business collected at the time of application and of the loan documentation (e.g., business license, etc.) facilitate a completely paperless process. The detailed photos allow the underwriter to get a visual feel for the business — a virtual kicking of the tires — and to pass what the underwriter calls a "reasonableness" test. For their smaller loans especially, the company relies as much on experience and gut as on verified documentation. All five of Confianza's loan officers have direct experience, some extensive, working in microfinance operations in their

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Latin American home countries; this experience translates well to direct client-to-client marketing and sales, and to the collection of financial data from the client.

Confianza's customer service function, filled by two hourly employees, plays as audit function as well. They make sure the application is complete, double-check the information from the profit-and-loss with a call to the client, check personal and business references and collect any final outstanding documentation from the client. Larger loans (the EasyPay and Opportunity Loan products) require some additional documentation, such as bank or merchant statements, to verify the volume of sales revenue and that the potential borrower has not had excessive fees for non-sufficient funds. With each of these three products, Confianza is able to schedule weekly or monthly automatic payments for customers with bank accounts, accept cash or direct walk-in bank payments (at two large banks) to facilitate timely repayment. The company also instituted technology that allows it to record phone authorization for automatic payments and an auto-dialer to remind clients about their payment obligations.

Both OUR and Confianza also rely on collateral (usually fully-paid autos in combination with Universal Commercial Code (UCC) filings) to back smaller loans. Confianza, in particular, requires substantial collateral on larger loans it has done in partnership with Opportunity Fund, requiring up to a 40 percent contribution from the client on mobile food truck financing, for example. Both lenders have experienced better performance overall when some type of guarantee is applied.

Collections

Both Confianza and OUR Microlending also have strong loan officer-based collections efforts tied directly to incentives and overall compensation levels. At Confianza, the loan officer's responsibility for maintaining portfolio quality is supported by a strong collections unit that actively collects, repossesses or take clients to small claims court to recoup any potential losses. Confianza has recruited two additional collections staff with deep consumer finance experience, particularly among the Hispanic community. Both staff previously worked in collections for furniture and jewelry store credit programs, the more senior having more than 13 years of experience.

This collection infrastructure has borne fruit. After experiencing spikes in delinquency to 10 percent in 2009, Confianza demonstrated strong performance throughout 2010 with PAR (> 30 days) of 5 percent and Loan Loss Rates below 10 percent.

OUR, on the other hand, has developed what it considers a strong loan officer model for collections, and has not yet developed a dedicated collections team as has Confianza or some nonprofit microlenders like ACCION New Mexico•Arizona•Colorado.[56] OUR's loan officers begin making their collections calls at day one of delinquency and incentives are calculated based on even one day of payment lateness in their individual portfolios.

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[56]For a description of ACCION NM-AZ-CO operational model, see: FIELD, *The Organizational Foundations of Sustainability* (Washington D.C.: The Aspen Institute, 2009).

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The site visits revealed that loan officers at both organizations possess strong sales skills and experience, coupled with the motivation to earn their monthly incentive pay. The incentive pay and compensation levels at both companies require both a healthy portfolio and new, and renewal, loan applications. Given that loan compensation is determined monthly, loan officers are motivated to turn loan applications around quickly and stay on top of delinquency rates on a daily basis. Because both companies' financial models are predicated on renewal customers — through at least two to three loan cycles — a high level of customer service was apparent not only from loan officers, but also from other employees who continually follow up with customer needs.

Turnover at Confianza has been remarkably low, with only two loan officers from the entire staff of 12 let go for underperformance. OUR has experimented with different compensation models for its loan officers, variously weighting the collections piece and size of the portfolio. After some initial turnover in its first two years, OUR's current model appears to be producing desired results, and the loan officer shadowed for this research believed the current compensation model to be fair and within reach for a sales motivated employee.

Infrastructure, Marketing and Outreach

Both Confizana and OUR Microlending are using management information systems (MIS) designed for larger lenders, with robust capacities that allow their companies to scale. Confianza uses the Nortridge system (one of the first microlending organizations to do so) and keeps no paper files, choosing to use back-up servers to support their client archive. The paperless system also allows all remote lending staff to easily input client data from Netbooks and cameras with high-resolution capability. Their system also allows access and read-only status with its partner, Opportunity Fund, so that its staff can review and approve the loans they do collaboratively.

OUR initially built its own Web-based MIS to house all applications, client data and payment information. Although OUR is not at present ready to move beyond its relationship-based underwriting model, the data collected to date on industry and payment performance will provide the organization with the capability to benchmark and better understand risk as it grows. The organization has recently invested in upgrading to a more robust banking MIS platform, IBS-DataPro.

Both organizations engage in outreach activities that many nonprofit microlenders also employ. Direct block-walking, advertising in local community newspapers, client referrals, and other business development activities related to particular industries (trucking, mobile food trucks, for example) drive most referrals. The CEOs of both companies also engage in public relations activities either at events, conferences or as spokespersons in local newspapers. One difference from the practices of nonprofit lenders is that Confianza and OUR have not used bank and nonprofit partner referral programs (several banks have seemingly been less willing to establish active or formal referral programs with these companies). As noted above, staff at both organizations has been hired in part for its very strong sales and outreach skills with the target market.

In sum, the growth trajectory accomplished by both organizations in a relatively short period of

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time has been notable, bucking the trend of slower originations that the nonprofit field has generally experienced over the past several years. This rapid growth is likely due to a number of factors, including robust and large target markets, staff with key sales (and in the case of Confianza, collection) capacities, and significant upfront investment in lending infrastructure (such as MIS).

Opportunity for Collaboration?

"An industry of small, vertically integrated institutions with limited resources cannot be expected to scale up solely through the growth of individual organizations."[57] *~Ratliff and Moy*

At first glance, the collaboration between Opportunity Fund and Confianza may look like an odd marriage, but, in reality, the two share common interests that illustrate the potential for collaboration in the field. First, nonprofit practitioners have long heralded the need for more awareness of the field domestically — and this was also a need frankly discussed by the two leaders of the for-profit lenders with whom we met. Second, there may be some instances where the for-profits' needs for loan capital meshes with microlenders' interest in expanding the target market for their capital. Given that both OUR and Confianza have grown so quickly, limited liquidity has recently (Q4 2010) stifled some of their growth. At the same time, some nonprofit microlenders have raised more capital (with presumably favorable rates) — in some instances outpacing the rate of new originations. Both OUR and Confianza are addressing their capital constraints in different ways — OUR by submitting a Regulation A filing to the SEC to raise debt or equity from individual investors in five states, and Confianza testing nonprofit partnerships as way of diversifying its microenterprise clientele and generating revenue by using the liquidity of its collaborator.

As we briefly noted above, Confianza's most recently introduced product (launched in May 2010) is its Opportunity Loan, done in partnership with Opportunity Fund Northern California. Through the partnership, Confianza offers larger loans than it is able to offer with its other two products at significantly reduced interest rates. Confianza sources and processes the applicant, and then uses Opportunity Fund capital to fund the loan. The loan is serviced by Confianza but stays on Opportunity Fund's books. Confianza is paid a fee for its services, yet the risk is shared between the organizations in that fees are paid out towards the latter part of the loan being successfully repaid. While Confianza gains an opportunity to diversify its client base and earn revenue, Opportunity Fund has found a means to scale its operation in other parts of California, and to benefit from an organization that could more quickly process and disburse quality loans. At the same time, Opportunity Fund has been able to deploy low-cost capital to which it had access. Since the launch of their partnership in May 2010, 43 loans totaling roughly $500,000 have been disbursed through the collaboration. This represents roughly 20 percent of Opportunity Fund's current outstanding portfolio. Opportunity Fund's CEO noted that Confianza's commitment to transparency in pricing, as well as ethical sales and collections practices, were important elements in initially evaluating the partnership's potential.

[57] Ratliff and Moy, "New Pathways to Scale," 16.

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Implications and Questions for Nonprofit Microlenders

The emergence of a wider spectrum of alternative financing options, some of which are targeting the markets served by nonprofit microlenders, poses some key questions for the microlending field. What should nonprofit microlenders consider as they move forward and assess their competitive environment? Areas to consider include:

- **Target markets:** The recession and business credit crunch created increased demand for the products offered by nonprofit microlenders. However, new for-profit entrants have demonstrated the ability to tap into parts of that market – with firms like Sam's Club and On Deck Capital serving larger firms, peer-to-peer lenders meeting the needs of some entrepreneurs with stronger credit, and lenders such as OUR Microlending, Confianza and Progreso Financiero tapping into urban, Latino borrowers needing relatively small amounts of credit. In this context, nonprofit microlenders may need to re-evaluate their target markets to assess whether and how they have shifted during the course of the last few years, and also how they may shift again in the future. Who is the organization seeking to target? To what extent is there overlap with the markets that these newly emerging/re-emerging lenders are targeting? To what extent might the market shift again as the economy continues to recover? Developing a deep understanding of where the organization can truly compete will be pivotal in the years ahead.

- **Value Proposition/Positioning:** As nonprofit microlenders look to define their target market in a changing context, they also need to understand how the products and the benefits they offer to clients are positioned relative to other lenders. Nonprofit lenders will need to develop tools for gaining customer insights. The critical questions they must confront include: What does the *customer* value most highly? How can the organization balance consumer demand with the overall mission objectives of the organization? How hard is it to get customers who need or want money now to recognize the longer-term value of what nonprofit lenders offer? Is there a difference in approach when dealing with a client who has long-term growth plans versus short-term business needs? Who are the organization's direct (and indirect) competitors and how do their value propositions differ? Given that nonprofit lenders have differing goals and operate in different markets, it is likely that they will not all come to the same conclusions as they reassess their value propositions.

- **Process:** If it is the case that many potential borrowers value a rapid decision process, are there elements of the organization's loan process that are causing unnecessary bottlenecks in the delivery of its microloan services? What changes might improve turnaround time and efficiency in service delivery?

- **Infrastructure:** The for-profit lenders featured here have used technology to support outreach and efficiency. This includes the Internet platforms used by the P2P lenders, and the scalable MIS, communications technologies, and even cameras used by the for-profit microlenders. Some nonprofit lenders are also using technology to increase efficiency; for example, FIELD's publication, *Increasing Sustainability through*

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Improved Efficiency, highlights Opportunity Fund's investments in technology.[58] Other nonprofit lenders have implemented ACCION Texas' lending platform, MMS™, to streamline their loan decision processes. Can investment in these and other technologies support greater scale and efficiency on the part of other nonprofit lenders?

- **Underwriting models:** The for-profit lenders examined in this research used a mix of underwriting models. The two for-profit microlenders (OUR and Confianza) use relationship-based underwriting – although at least one (Confianza) notes that this approach may limit some of its growth in the future. The much higher-volume lenders, such as Progreso and On Deck, have already integrated scoring models into their processes (which also include varying levels of client interaction). Some nonprofit lenders have also made the move to integrate scoring models into their underwriting processes with the goal of creating efficiencies that support greater scale (as well as improving portfolio quality). As they have moved to use a more transactional underwriting approach, these nonprofit lenders have looked for other ways to build and support their relationships with their clients. These experiences raise the question of whether (and perhaps at what point in the growth process), it makes sense for nonprofit lenders to integrate a more transactional (scoring) based approach to underwriting in order to make gains in efficiency and customer satisfaction.[59]

- **Price:** This research illuminates some significant differences in the pricing models employed by for-profit versus nonprofit lenders – particularly at the smallest loans sizes. On the one hand, their missions would prevent nonprofit lenders from charging rates anywhere near what several of the for-profit lenders are charging. On the other hand, the prices currently charged by nonprofit lenders do inhibit their ability to generate funds to support expansion and/or to move toward greater sustainability. Given that at least some customers appear to value access more than low pricing, nonprofit lenders may want to revisit whether adjustments to the interest rates charged for some products might support the growth and sustainability of at least some of their products. Furthermore, given that the rates charged by nonprofit lenders are often dictated as much by donor requirements as customer demand, funders and investors may want to consider whether changes to their requirements might better support the growth and sustainability of the microlenders they are supporting.

- **Marketing and Sales:** The for-profit microlenders visited for this research are both located in large, urban and heavily-ethnic markets. Both are finding that direct client and business-to-business marketing are highly successful ways of reaching large numbers of customers. Although nonprofit lenders typically employ marketing techniques aimed directly at clients, most also often invest in cultivating sources of indirect client referrals from banks or other nonprofit partners. Is working through these referral sources an efficient way to reach customers? The answer to this likely depends, in part, on the nature of the local market (block-walking will work best in certain urban settings, for example). Moreover, the sales training and incentive models practiced by the for-profits

[58]Tamra Thetford, *Increasing Sustainability through Improved Efficiency* (Washington D.C.: The Aspen Institute/FIELD, 2009).
[59]Edgcomb and others, *Dollars for Dreams,* 24-27.

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(as well as some larger-scale nonprofit lenders) also seem to be an important means to drive greater scale. Other nonprofit lenders interested in scaling their lending may want to consider incorporating some of these sales and marketing approaches.

- **Capitalization:** Several of the larger for-profit lenders (Progreso, On Deck and the P2P lenders in particular) have received significant levels of private investment. In contrast, many nonprofits grow their infrastructure and capital base slowly over time, as they secure yearly donor dollars or government contracts. Making the case to donors regarding investments in strategic, long-term infrastructure could help provide the needed boost to support greater scale in the nonprofit microlending sector. At the same time, it is important to recognize that the pressure to achieve greater scale (coming either from investors seeking to achieve profitability, or donors and investors wanting to see greater reach) can divert an organization's attention away from a focus on making quality loans with development impact. Balancing the two always has to be an important consideration for nonprofits as they pursue their work.

- **Collaboration:** Although some of the for-profit microlenders featured here are currently operating in limited markets, several have plans for growth to other regions. Others, like On Deck or the P2P models have the technological platforms to move beyond placed-based constraints. As is described in this paper, nonprofit lender Opportunity Fund has created a partnership with Confianza that has allowed it to enter the Los Angeles market cost-effectively, offering a loan product at rates well below those for Confianza's other products. At the same time, this has enabled Opportunity Fund to learn about Confianza's sales and marketing techniques, and apply them to its operations in the Bay Area. Are there opportunities for other nonprofit microlenders to collaborate with for-profit lenders in ways that could improve the products and services offered to microentrepreneurs? Should nonprofits be thinking about competing head-on with these for-profit companies? Or rather, are there ways of working together where not only providers "win," but where the client benefits? And can the nonprofit partners provide a beneficial effect on the provision of financial services from for-profit actors as well?

Conclusion

With the debate raging on the international side around the role of for-profit MFIs, it is timely to examine what for-profit companies are already doing domestically. Clearly, the market for microloans has shifted over the course of the last three to five years as credit access from traditional sources has changed in fundamental ways. Organizations, some new and some old, have jumped into the microloan market — overlapping in some instances with entrepreneurs targeted by nonprofit MFIs. As new organizations surface, some with technologies and infrastructure to scale operations significantly, some show potential to be market leaders. Yet, it is important to note, many are not yet profitable, so the question of whether investors will stay engaged, and at what price, is still an open one.

As discussed throughout, however, their presence should provoke nonprofits to re-examine their position in the marketplace and consider carefully who they can best serve and why. At the same time, the approach that for-profits have taken with respect to methodologies, the use of

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technology, product and pricing features may offer some models for nonprofits to consider as they always seek to improve their services to those with the greatest barriers to credit access. Finally, the example of Opportunity Fund and Confianza raises the possibility that partnerships can help increase the aggregate number of entrepreneurs being served. It is our hope that these lessons and the framing of these market changes allow the industry to stay competitive in an ever changing environment.

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